Stock Market Review

Tumas Group achieves strong results from Portomaso

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In the introduction to last week's article, I touched upon the importance for investors to also track developments across bond issuers to understand whether such companies are performing positively and are in a position to honour their financial obligations. Following the report detailing developments at Premier Capital plc, I met up with the Ray Sladden, finance director of Tumas Group, to gain a better understanding of the recent financial performance of Spinola Development Company Limited, one of the larger subsidiaries forming part of the Tumas Group.

The Tumas Group's exposure to the bond market is via the finance arm Tumas Investments plc. However, it is important for investors to understand that since the bonds issued by Tumas Investments plc are guaranteed by Spinola Development Company Ltd, the financial statements of the guarantor are the ones that need to be analysed to gauge the fundamental strength and ability of the issuer to ultimately pay bondholders' the annual interest payments and capital on redemption date.

Spinola Development Co Ltd (SDC) is the owner and operator of the landmark Portomaso project and also owns the Halland site in Tal-Ibragg. The Halland was operated as an aparthotel until 2009 when it ceased operations ahead of an eventual redevelopment of the land into a residential estate.

Portomaso is a mixed-use development encompassing a wide array of activities comprising the Hilton Malta hotel and conventional centre, a large number of upmarket residential apartments (most of which have been sold), the business tower, and other commercial properties including the casino, retail catering outlets, extensive underground parking facilities as well as the yacht marina with 120 berths. The temporary emphyteusis of the vast parcel of land comprising Portomaso was redeemed by SDC in December 2005.

In recent years the Hilton Malta consistently ranked among the best performing hotels on the island. The financial statements of SDC show a 6.1 per cent increase in revenue from hotel and ancillary operations to a record level of €28.6 million. At the start of the interview, Mr Sladden confirmed that the Hilton Malta achieved a remarkable increase in the room rate in 2012 with occupancy levels similar to 2011. This helped the hotel to outperform the average 5-star sector according to the regular data published by the Malta Hotels and Restaurants Association.

The finance director attributed much of the improved performance to the higher airline capacity which helped the overall tourism market during 2012 but he also remarked that there was a very good improvement in food and beverage sales which was above that originally forecasted and which contributed to the record performance. This was also due to the improvement in conference business is gradually improving, although this has to be seen in the light of the current economic turmoil plaguing many of Malta's source markets.

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Mr Sladden also revealed that, according to a number of key performance indicators used in the hotel industry and hotel surveys undertaken by Hilton International, the Hilton Malta is among the top performing Hilton hotels across Europe. When discussing the comparison to Hilton International, it occurred to me that in the prospectus published by Tumas Investments plc at the time of the most recent two bond issues in 2009 and 2010, it had been stated that the current management agreement with Hilton has a possible initial expiry date in 2015 although it is renewable for further periods.

Mr Sladden was quick to point out that the Tumas Group is in advanced discussions for an update and extension of the agreement. Following recent discussions the group's chairman George Fenech has had with Hilton a positive outcome is expected in the coming weeks. Mr Sladden also explained that apart from location and the facilities available to guests, the success behind the Hilton Malta is also attributable to the continuous investment undertaken to maintain quality and brand standards as well as overall customer service. The finance director confirmed that in 2014 and 2015 the hotel will undergo a major refurbishment programme of all rooms and public areas (with the exception of the new wing completed in 2008).

Spinola Development Co Ltd (Group)	2010 - €000	2011 - €000	2012 - €000
Revenue	33,315	42,903	44,454
EBITDA	9,535	11,714	13,591
Profit before tax	533	2,742	4,234
Profit after tax	237	1,677	2,660
Shareholders' Funds	39,268	37,736	49,281
Net Finance Costs	(3,909)	(4,064)	(4,252)
Interest Cover - times	2.44	2.88	3.20
Net Debt	62,434	65,517	63,606
Gearing Ratio (net debt/sh. funds) - times	1.59	1.74	1.29
Gearing Ratio (total debt/total capital employed)	64.2%	65.0%	58.9%

Another major part of the business operations of SDC over the years was the development and sale of the apartments forming part of this residential and commercial complex. Revenue from apartment sales during 2012 was 3.8 per cent lower at €10 million. Mr Sladden confirmed that during 2011 and 2012 the vast majority of the last batch of apartments added to the residential estate were completed and delivered to owners. As with all property developments, sales are dependent on the stock available and the delivery times, thereby rendering a company's performance dependent on this line item volatile.

In fact, SDC had generated much less revenue from its property development activities in 2009 and 2010 as little stock was available then, and the company was still in the process of finishing the units for sale. In the light of the recent general slowdown in property sales it is encouraging to note that only a few apartments are still held as stock and available for sale. This continues to vindicate claims by certain developers of high-end properties that this sector of the market continued to generate sustained demand from both local as well as foreign buyers despite the subdued economic conditions. The demand for upmarket residential properties is also evident in the re-sale of apartments units also within Portomaso which according to Mr Sladden is proof of the success of the real estate development over the years.

While revenue from property development is a volatile area of SDC's operations, the income generated from the rental of office space within the Business Tower together with the other commercial outlets generate a very stable revenue stream for the company. In addition to a number of floors within the Business Tower, the supermarket and the other retail units as well as the various restaurants forming part of the complex, SDC also recently managed to add some other areas for lease as commercial premises and Mr Sladden confirmed that lease contracts have recently been signed for a large part of the new areas. SDC have a total of over 15,000 sqm of rentable area which are practically fully occupied at premium rates.

The recent financial performance of SDC since 2010 was also positively impacted by the higher incidence of apartment sales in the past two years. While such revenue cannot be considered as recurring revenue due to the finite amount of stock of apartments and the few units which remain unsold, the company benefited from a strong performance of the Hilton Malta in line with the record number of tourist arrivals. SDC also benefited from the stability of the income generated from rental of its commercial properties both office and leisure areas.

As such, bondholders can be comforted that the interest cover ratio remained well above two times in each of the last three years. Another financial indicator which ought to be of interest to bondholders of Tumas Investments plc is the level of gearing, i.e. the amount of capital and reserves compared to the overall borrowings. The leverage improved in 2012 partly due to the year's profitability but largely on account of the higher level of reserves.

This in turn was mainly brought about by the property revaluation carried out in 2012 based on future earnings projections from the hotel as opposed to a customary uplift in value attributed to a parcel of land. Since the hotel is not classified as investment property as it is deemed an operational asset of SDC and therefore not for sale, the uplift in value was reflected only in the level of reserves and this did not impact the profitability during the year.

The Portomaso complex can be considered a mature development as a large majority of apartments have been sold and the hotel and other operations are functioning in full capacity. I therefore asked Mr Sladden about the future plans for the company. He indicated that "possibilities still exist for development of other areas in future years although physical limitations are obvious" and he also pointed out that the company owns the Halland site. The company intends to redevelop this into a new estate to accommodate circa 9,000 square metres of residential area.

The finance director also spoke about the outlook for 2013 and he indicated that the hotel performance is expected to be similar to the record levels achieved in 2012. Although 2013 is proving to be more challenging given the strong performance in 2012, Mr Sladden indicated that Q1 was relatively positive and therefore the company is cautiously optimistic on achieving its financial forecasts for this year. SDC is also expected to generate a higher level of rental income due to the additional area that is coming on stream in the next few months. However, he noted that revenue from property development will inevitably decline in view of the lower number of apartments to be delivered.

Mr Sladden also reiterated the resilience of a mixed-use top quality property development like Portomaso with its different yet complementary areas of operation. He also confirmed that Spinola Development Co Ltd will always retain a certain level of debt in order to maximise long-term return to shareholders, while simultaneously safeguarding our other stakeholders' interests. In fact, he indicated that the company's executives are regularly assessing the situation across the capital market with a view to maintaining an optimal financing model for the company.