CREDIT RESEARCH | Bortex Group Finance p.l.c.

10th December 2020

Executive Summary

As from FY19, the Group's performance started to recover following the initiation of Hotel1926, which improved its EBITDA considerably. The COVID-19 pandemic has presented several challenges to the Group, however actual results for FY20 should be better than that previously forecasted. In fact, Management confirmed that actual sales both in the retail and hospitality segments outperformed expectations.

In view of this, coupled with the excess liquidity generated from the sale of the TEN Apartments and the locked MDB loan, we believe that the Group should generate sufficient liquidity to meet all of its near term financial obligations. Therefore, notwithstanding the current distressed environment, the positive traits noted above merits a **Neutral** credit opinion on the Issuer.

BX27: This bond is currently yielding 3.6%, while its peers are currently trading at an averaged YTM of 3.9%. Despite the possible downside risks, the recent positive developments of the Group might warrant the tighter spreads when compared to its peers. Consequently, we are issuing a **Hold** recommendation on BX27.

Business Overview

The Group's operations are, and have been for a number of years, divided into two principal segments, garment manufacturing and retailing on the one hand and property development and hotel operations on the other.

Debt securities issued by the Group

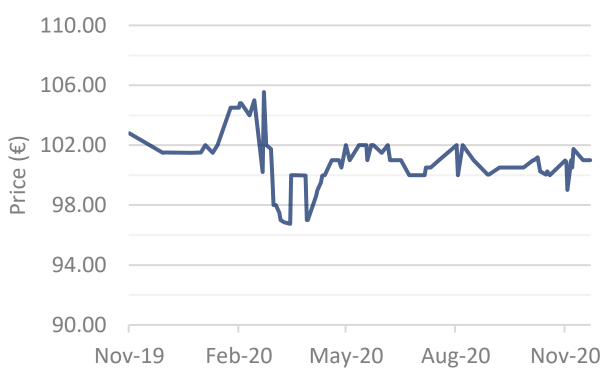
In 2017, the Group, through its financing vehicle Bortex Group Finance plc (the "**Issuer**" or "**BX**"), issued a €12.75m unsecured bond, with a coupon of 3.75%, which matures in 2027. The bond is guaranteed by Bortex Group Holdings Company Ltd, which acts as the holding company of the Bortex Group.

Credit Opinion	**Neutral**
Country	Malta
Sector	Manufacturing/Retail and Hospitality

3.75% BRX 2027

Security	Unsecured
Nominal	€12.75mln
Ticker	BX27
Price (09.12.20)	€101.00
Recommendation	**Hold**
Yield to Maturity	3.6%
Exchange	Malta Stock Exchange (MSE)
52-week range	€96.75 - €105.55

1-Year Price Movement



Source: Malta Stock Exchange

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Group's developments

By end of Q1 2020, the Group has successfully completed its property development project, named the 'TEN Apartments'. The sale of the units is on-track and by June 2020, the Group secured the sale of circa 90% of its units by way of promise of sale.

Trading update: COVID-19 and outlook

Inevitably, due to the nature of its business models, the Group was severely impacted by the pandemic. Consequently, the Group expects a significant downturn in its financial performance for 2020, which might also be prolonged into the initial months of FY21 (Group has an October year-end).

The latest news from the vaccine front augurs well for the economic recovery proposition, with an improved more benign economic sentiment envisaged to kick-off in early 2021, while more tangible recovery predicted once the full-scale COVID-19 vaccination process kicks-in. The latter is expected to occur in Q2 of 2021. Therefore, the upcoming winter months will continue to be challenging both for the tourist industry, but also from a consumer spending perspective.

For FY20, the Group is forecasting a drop in revenue and EBITDA of 23% and 97%, respectively. Notwithstanding this remarkable impact, upon recent discussions with management, it is expected that the actual results for FY20 will be better than those forecasted in the June 2020 Financial Analysis Summary (FAS). Management explained that manufacturing and retail sales up to September 2020, have exceeded the forecasts presented in the FAS. Similarly, hospitality revenue also exceeded prior expectations with Hotel 1926 registering strong average occupancy levels of 85% between the summer months July to September.

Additionally, management explained that throughout this unprecedented period it managed to successfully carry out a restructuring exercise which drastically reduced the operating costs of the manufacturing and retail division. The Group has secured a loan under the Malta Development Bank (MDB) scheme, with favourable terms, as per the Government's initiative to assist businesses during this distressed period. The Group has also benefitted from the wage supplements on both of its divisions given that these were classified as 'industries most hit by the pandemic'.

In addition to the above, the Group's financial position has been further improved through the development of the TEN Apartments. As reported by the Group the construction of this development was limitedly impacted by the pandemic, with a favourable momentum in terms of sales and POS (as at today: 80% sold and 10% subject to POS). Management confirmed that the Group has repaid all loans related to this project, with the remaining proceeds strengthening its working capital.

In view of these positive developments, coupled with better visibility from the general economic recovery front, we are of the opinion that the Group should generate sufficient liquidity to meet all of its financial obligations, including the next coupon payment (which falls due on 1 December 2021).

SWOT analysis

Strengths

- ✓ The Group operates in two segments, which are independent from each other.
- ✓ No near term bond maturities.
- ✓ The Group has responded well to the digital transformation and established its own website, including its exclusive Gagliardi brand.
- ✓ The sale of the TEN Apartments during this year has generated excess liquidity which was essential during this distressed environment.
- ✓ Specialisation in manufacturing of high-end garment.

Weaknesses

- × Revenue from garment manufacturing which represents a considerable contribution to the Group's revenue has been on a downward trend.
- × The expansion of the Gagliardi brand has been delayed as a result of COVID-19. Additionally, some of the new stores did not yield the expected return, which resulted in the Group taking the strategic decision to close down 3 stores.
- × The pandemic has significantly impacted both segments of the Group and it is not yet clear when the Group expects to recover back to pre-pandemic levels.

Opportunities

- Once the current situation stabilises, the Group is expected to recognise the full benefit of Hotel 1926, which should further diversify away from the Group's main business, being the manufacturing and retail operations.
- Despite the headwinds faced in the manufacturing business, the Group through its history and specialisation may secure new private label agreements.

Threats

- Although post COVID-19 recovery is more visible, the extent of the impact on the Group from the pandemic is not yet fully known.
- Increased competition within both segments the Group operates in.
- The retail industry is going through a radical transformation, with online shopping continuing to experience strong growth.
- The previous growth forecasted from the expansion of the Gagliardi brand may not come to fruition.

Financial summary

Bortex Group Holdings Company Ltd - €'mn (unless otherwise indicated)	FY17A	FY18A	FY19A	FY20F
Income statement				
Revenue	19.9	18.0	20.4	15.7
Cost of Sales	(13.1)	(11.2)	(12.1)	(13.4)
Gross Profit	6.9	6.8	8.3	2.3
Net operating expenses	(6.3)	(6.1)	(6.0)	(2.2)
EBITDA	0.6	0.7	2.3	0.1
Profit from property development	-	-	-	3.4
Depreciation and amortisation	(0.8)	(0.8)	(1.1)	(1.3)
EBIT	(0.2)	(0.1)	1.2	2.2
Net investment income	0.0	0.1	0.0	-
Net finance costs	(0.2)	(0.2)	(0.6)	(0.8)
Profit before tax	(0.4)	(0.2)	0.7	1.4
Taxation	1.5	(0.1)	(0.1)	(0.6)
Profit after tax	1.1	(0.2)	0.5	0.8
Cash flow				
Net cash from operations (CFO)	1.7	(2.2)	3.5	0.9
Capex	(2.0)	(9.1)	(6.5)	(0.2)
Free cash flows (CFO – Capex)	(0.3)	(11.3)	(3.0)	0.7
Balance sheet				
Cash and cash equivalents	1.5	1.4	1.1	1.0
Current assets	21.0	24.0	25.8	23.1
Non-current assets	21.0	28.6	34.5	33.2
Total assets	42.0	52.6	60.3	56.3
Current liabilities	9.3	7.3	12.5	8.5
Non-current liabilities	3.6	17.5	19.9	19.1
Total liabilities	12.9	24.7	32.4	27.6
Total Financial debt	8.6	19.7	22.4	21.9
Net debt	7.0	18.3	21.3	20.8
Total equity	29.1	27.9	27.9	28.7

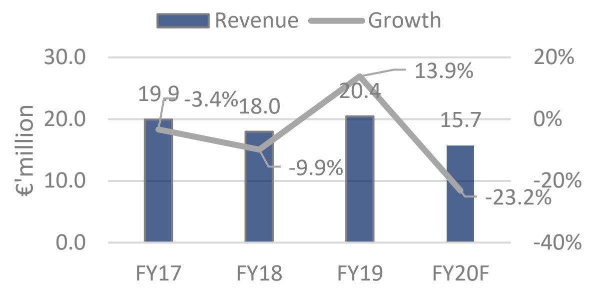
Bortex Group Holdings Company Ltd - €'mn (unless otherwise indicated)	FY17A	FY18A	FY19A	FY20F
Financial ratios				
Growth in Total Revenue (YoY Revenue Growth)	-3.4%	-9.9%	13.9%	-23.2%
Gross profit margin (Gross profit / Revenue)	34.4%	37.7%	40.6%	14.6%
EBITDA margin (EBITDA / Revenue)	3.0%	3.9%	11.4%	0.4%
Operating (EBIT) margin (EBIT / Revenue)	-1.0%	-0.4%	6.0%	13.9%
Net margin (Net income / Revenue)	5.6%	-1.3%	2.7%	5.3%
Return on common equity (Net Income / Total Equity)	3.9%	-0.8%	2.0%	2.9%
Return on assets (Net Income / Total Assets)	2.7%	-0.5%	1.0%	1.4%
Current ratio (Current assets / Current Liabilities)	2.3x	3.3x	2.1x	2.7x
Interest coverage ratio (EBITDA /Cash interest paid)	2.3x	4.3x	2.6x	0.1x
Gearing level 1 (Net debt / Net Debt and Total Equity)	24.2%	65.6%	76.3%	72.5%
Gearing level 2 (Total Liabilities / Total Assets)	30.7%	47.0%	53.7%	49.0%
Net debt / EBITDA	11.8x	26.0x	9.1x	325.7x
Cash from Operations / EBIT	(8.6)x	30.8x	2.9x	0.4x

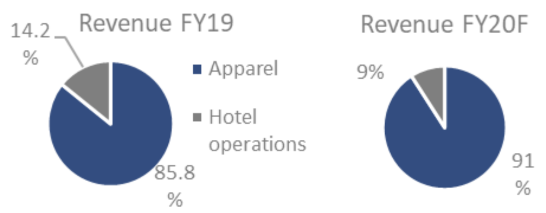
Source: BX's Audited Financial Statements

Investment considerations

- **Revenue**: The Group's revenue is derived from two streams being apparel and hospitality. Prior to FY19 revenue was on a downward trend due to a decrease in private label activity. This trend was reversed in FY19, where the Group generated €20.4m meaning a growth of 13.9%. It is important to highlight that this was a result of the initiation of Hotel1926 (reached full occupancy in August 2019), which generated €2.9m in revenue. In fact, apparel revenue still decreased by 1.4% as Brexit continued to impact the manufacturing business.

  As can be analysed, the main contributor to revenue is the apparel segment (FY19: 85.8%). It is worthy to note that FY19 does not capture the full year operations of Hotel1926 given this was opened gradually during 2019. As per FAS, the Group forecasted a revenue of €15.7m for FY20, with the main impact being from hotel operations given the lack of tourists for this year. As noted earlier, management indicated that actual results up to September 2020 exceed this forecast, as sales both from the hotel and retail operations beaten expectations.

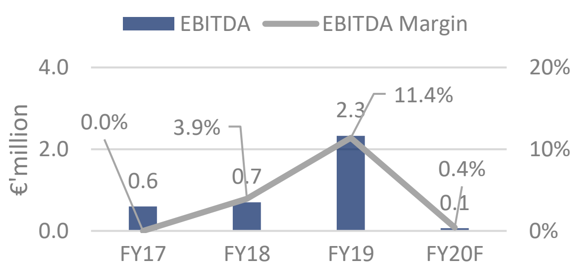


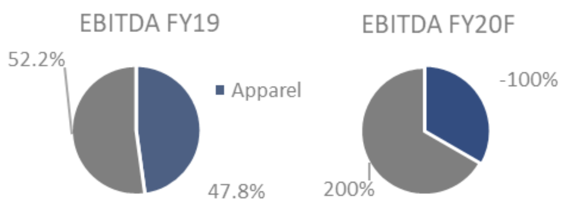


Source: BX's Audited Financial Statements

- **EBITDA:** As can be analysed, the EBITDA margin of the hotel operations is significantly better than that of the apparel segment. In fact, the hotel operations generated 52.2% of total the EBITDA despite this only contributing 14.2% to the total revenue. As a result, the Group's EBITDA improved significantly in FY19 to €2.3m (EBITDA margin: 11.4%).

  As per the FAS, the Group was forecasting to breakeven operations in FY20, however as discussed with management actual results should be better following stronger than expected sales, coupled with better than anticipated costs reduction. The Group also confirmed that both segments should return positive EBITDA in FY20.





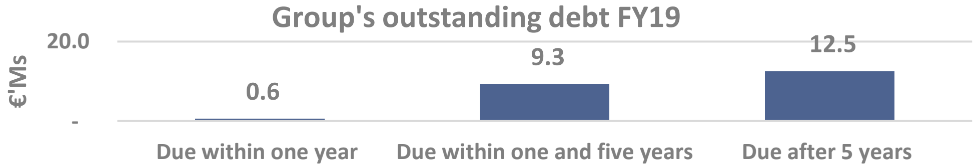
Source: BX's Audited Financial Statements

- **Finance costs:** Finance costs consist of interest incurred on the Group's bond currently in issue and bank borrowings. In FY19, the Group incurred €0.6m in financing expenses, an increase of €0.4m over FY18. This excludes capitalised interest of €0.2m in FY19, which if included results in adjusted financing expense of €0.8m.

- **Interest cover:** In FY19, the Group's interest coverage ratio stood at 2.6x. Given that as per FAS the Group was expected to breakeven in FY20, the interest coverage ratio is reflecting the severe impact the business faced due to the pandemic. However, in line with the management's presumption that actual results have exceeded forecasts, interest coverage is expected to improve.

- **Capital Expenditure -** During FY19, the Group invested €6.5m in capital assets which mainly represents the refurbishment of Hotel1926 and the TEN Apartments project. Given the significant impact of the pandemic, the Group ceased all expansionary capex during FY20 and only expects to maintain recurrent capex of circa €0.2m.

Debt maturity profile



Maturity Ladder: FY19 (€mn)	Within 1 year	Between 1 - 5 years	More than 5 years	Total
Debt Securities in issue	-	-	12.5	**12.5**
Bank loans and overdrafts[1]	0.6	9.1	-	**9.7**
Loans from ultimate shareholders	-	0.2	-	**0.2**
	0.6	**9.3**	**12.5**	**22.4**

Source: BX's Audited Financial Statements

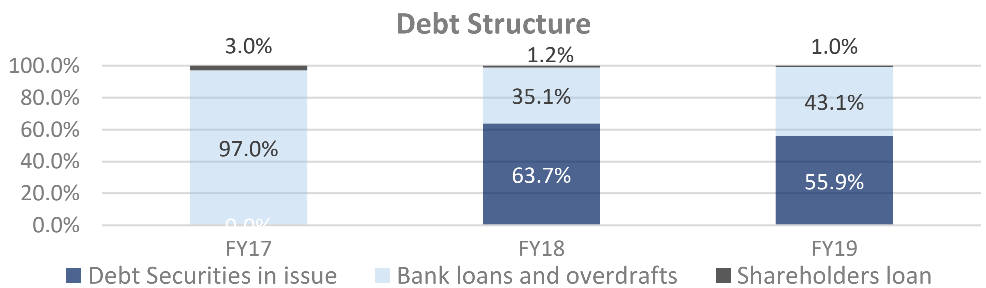
As can be noted from above, the majority of the Group's financial debt is due after 5 years, which mainly reflects the Issuer's €12.75m unsecured bonds maturing in December 2027.

Bank loans: These facilities are secured by special and general hypothecs over the assets and properties of the Group, together with pledges over insurance policies covering hypothecated property. The Group's bank loan facilities stood at €13.3m in FY19, with overdrafts and loans bearing an effective interest rate of 3.2% and 4.6%, respectively.

Developments not reflected in the above maturity Ladder:

- Following recent discussions with management it was confirmed that, **as at today the Group has an overdraft facility of circa €5.6m, of which circa 50% is being utilised.**
- **Additionally, the Group benefitted from a €2.85m MDB loan, bringing the total loans as at today to circa €8m, which excludes the above mentioned overdraft of about €2.6m.**

Loans from ultimate shareholders: The loan is unsecured, interest free and repayable on demand, however, upon being payable the Group has the option to defer such repayment for a maximum period of 12 months. Given that these are repayable on demand with the option to extend by 1-year, we classified this loan as due between 1-5 years.



[1] The bank overdraft was classified as due within 1 year in the audited financial statements, however following discussions with the Group, this overdraft is for an indefinite term and therefore we classified it as due between 1-5 years.

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Analysis of outstanding issues

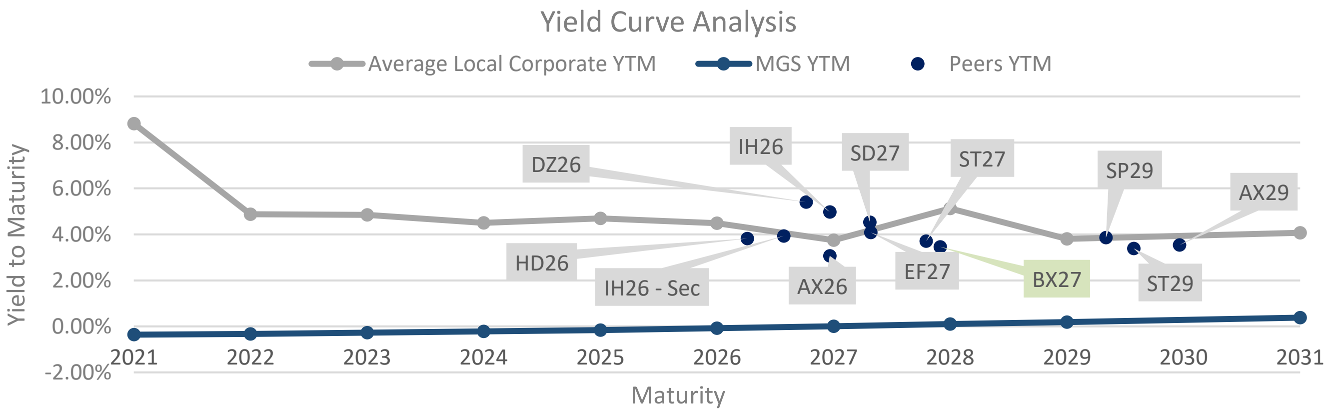
Security	Nom Value	Yield to Maturity	Interest coverage (EBITDA)	Total Assets	Total Equity	Total Liabilities / Total Assets	Net Debt / Total Equity	Net Debt / EBITDA	Current Ratio	Return on Common Equity	Net Margin	Revenue Growth (YoY)	Last Closing Price *
	€000's	(%)	(times)	(€'millions)	(€'millions)	(%)	(%)	(times)	(times)	(%)	(%)	(%)	
4.35% Hudson Malta plc Unsecured € 2026	12,000	3.82%	5.0x	56.6	9.4	83.4%	255.4%	5.0x	1.4x	0.0%	0.9%	22.8%	102.50
4% International Hotel Investments plc Secured € 2026	55,000	3.70%	3.2x	1,617.9	877.6	45.8%	58.7%	7.6x	1.1x	1.0%	3.3%	5.7%	101.49
5% Dizz Finance plc Unsecured € 2026	8,000	5.20%	8.8x	316.6	132.6	58.1%	47.0%	3.0x	1.0x	10.9%	19.1%	11.7%	99.00
4% International Hotel Investments plc Unsecured € 2026	60,000	4.19%	3.2x	1,617.9	877.6	45.8%	58.7%	7.6x	1.1x	1.0%	3.3%	5.7%	99.00
3.25% AX Group plc Unsec Bds 2026 Series I	15,000	3.07%	5.5x	342.4	226.1	34.0%	23.2%	3.2x	0.9x	2.2%	9.4%	-8.1%	100.97
4.35% SD Finance plc Unsecured € 2027	65,000	4.35%	6.1x	229.9	63.8	72.3%	101.1%	3.1x	0.7x	11.7%	15.1%	7.8%	99.98
4% Eden Finance plc Unsecured € 2027	40,000	4.01%	6.6x	199.3	113.1	43.2%	40.9%	3.4x	1.1x	11.7%	28.1%	9.7%	99.95
4% Stivala Group Finance plc Secured € 2027	45,000	3.91%	4.0x	225.3	123.1	45.4%	68.3%	7.4x	0.7x	5.0%	26.0%	19.5%	100.52
3.75% Bortex Group Finance plc Unsecured € 2027	12,750	3.59%	2.6x	60.3	27.9	53.7%	76.3%	9.1x	2.1x	2.0%	2.7%	13.9%	101.00
4% SP Finance plc Secured EUR Bonds 2029	12,000	3.86%	6.4x	20.9	16.0	23.6%	15.0%	2.7x	0.5x	2.5%	28.0%	6.9%	100.99
3.65% Stivala Group Finance plc Secured € 2029	15,000	3.39%	4.0x	225.3	123.1	45.4%	68.3%	7.4x	0.7x	5.0%	26.0%	19.5%	101.90
3.75% AX Group plc Unsec Bds 2029 Series II	10,000	3.54%	5.5x	342.4	226.1	34.0%	23.2%	3.2x	0.9x	2.2%	9.4%	-8.1%	101.60
Average		**3.91%**											

* Last price as at 09/12/2020

Source: Latest available audited financial statements

Investment rationale

We have compared the securities of Bortex Group Finance plc against similar issuers in the local market. Comparable companies were specifically identified on the basis of the industry in which they operate, more specifically their service offerings. The credit profile of the comparable companies was analysed in terms of leverage and the ability to meet debt obligations.



Source: Malta Stock Exchange, Central Bank of Malta, and Calamatta Cuschieri Investment Management

The above graph illustrates the average yearly yield of all local issuers as well as the corresponding yield of MGSs (Y-axis) vs the maturity of both Issuers and MGSs (X-axis), in their respective maturity bucket, to which the spread premiums can be noted. The graph illustrates on a stand-alone basis, the yield of comparable issuers having a maturity between 6-9 years (Peers YTM).

The Group's performance was declining prior to the COVID-19 outbreak as it was shifting from the high volume manufacture of garments to private labels towards the manufacture and retailing of Gagliardi garments through the Group's retail outlets. This trend started to reverse in FY19, as the Group initiated the operations of Hotel1926, which improved its EBITDA considerably.

Unfortunately, the Group's performance during FY20 was significantly impacted by the onslaught of the COVID-19 pandemic, which affected both operating segments of the Group. Albeit, management confirmed that actual trading results for FY20 should be better than that previously forecasted during the midst of the pandemic. In fact, actual sales both in the retail and hospitality segments outperformed expectations.

Even though we are cognisant of the current distressed environment, we believe that the recent positive vaccine news will improve consumer confidence and demand in the near future. This, combined with the better than expected results for FY20, coupled with acceptable liquidity levels generated from the sale of the TEN Apartments, in addition to the locked MDB loan (including the continued wage support from the Government), indicate that the Group should generate sufficient liquidity to meet all of its near term financial obligations. Therefore, we are of the opinion that a **Neutral** credit opinion is warranted on this Issuer.

BX27

BX's bond is currently trading at €101.75, translating into a YTM of 3.6%. The identified peers are currently yielding an averaged YTM of 3.9%, thus trading at wider spreads. Despite the positive traits noted above, the Group is still subject to possible downside risks. That said, we are of the view that the current liquidity levels, in addition to the more favourable outcome, namely from the TEN apartment project, might warrant the tighter spreads when compared to its peers. Therefore, we are issuing a **Hold** recommendation on BX27.

Glossary and definitions

Income Statement	
Revenue	Total revenue generated by the Group/Company from its principal business activities during the financial year.
EBITDA	EBITDA is an abbreviation for earnings before interest, tax, depreciation and amortisation. It reflects the Group's/Company's earnings purely from operations.
Operating Profit (EBIT)	EBIT is an abbreviation for earnings before interest and tax.
Depreciation and Amortisation	An accounting charge to compensate for the decrease in the monetary value of an asset over time and the eventual cost to replace the asset once fully depreciated.
Net Finance Costs	The interest accrued on debt obligations less any interest earned on cash bank balances and from intra-group companies on any loan advances.
Net Income	The profit made by the Group/Company during the financial year net of any income taxes incurred.
Profitability Ratios	
EBITDA Margin	EBITDA as a percentage of total revenue.
Operating (EBIT) Margin	Operating margin is the EBIT as a percentage of total revenue.
Net Margin	Net income expressed as a percentage of total revenue.
Return on Common Equity	Return on common equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing the net income by the average common equity (average equity of two years financial performance).
Return on Assets	Return on assets (ROA) is computed by dividing net income by the average total assets (average assets of two years financial performance).
Cash Flow Statement	
Free Cash Flows (FCF)	The amount of cash the Group/Company has after it has met its financial obligations. It is calculated by taking Cash Flow from Operating Activities less the Capex of the same financial year.
Balance Sheet	
Total Debt	All interest bearing debt obligations inclusive of long and short-term debt.
Net Debt	Total debt of a Group/Company less any cash and cash equivalents.
Financial Strength Ratios	
Current Ratio	The Current ratio (also known as the Liquidity Ratio) is a financial ratio that measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares current assets to current liabilities.
Quick Ratio (Acid Test Ratio)	The quick ratio measures a Group's/Company's ability to meet its short-term obligations with its most liquid assets. It compares current assets (less inventory) to current liabilities.
Interest Coverage Ratio	The interest coverage ratio is calculated by dividing EBITDA of one period by cash interest paid of the same period.
Gearing Ratio Gearing Ratio Level 1 Gearing Ratio Level 2	The gearing ratio indicates the relative proportion of shareholders' equity and debt used to finance total assets. Is calculated by dividing Net Debt by Net Debt and Total Equity. Is calculated by dividing Total Liabilities by Total Assets.
Net Debt / EBITDA	The Net Debt / EBITDA ratio measures the ability of the Group/Company to refinance its debt by looking at the EBITDA.
Cash from Operations / EBIT	This ratio measures the ability of the Group/Company to convert its earnings into cash.
Other Definitions	
Yield to Maturity (YTM)	YTM is the rate of return expected on a bond which is held till maturity. It is essentially the internal rate of return on a bond and it equates the present value of bond future cash flows to its current market price.

Glossary and definitions

Credit Opinion

- **Positive** indicates expectations of a general improvement of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.
- **Neutral** indicates expectations of a general stable trend of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.
- **Negative** indicates expectations of a general deterioration of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Issue specific recommendations

The recommendations below are with respect to existing debt securities issued on the Malta Stock Exchange.

- **Buy** indicates our favourable view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.
- **Hold** indicates our neutral view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.
- **Sell** indicates our negative view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

N.B: Newly issued research recommendations supersede previously published research.

Disclaimer