Criteria | Corporates | Industrials:

Key Credit Factors For The Leisure And Sports Industry

Primary Credit Analysts:
Emile J Courtney, CFA, New York (1) 212-438-7824; emile.courtney@standardandpoors.com
Stefan Kirschner, Frankfurt (49) 69-33-999-281; stefan.kirschner@standardandpoors.com
Melissa A Long, New York (1) 212-438-3886; melissa.long@standardandpoors.com
Joe Poon, Hong Kong (852) 2533-3507; joe.poon@standardandpoors.com
Adom J Rosengarten, New York (1) 212-438-7382; adom.roengarten@standardandpoors.com
Ariel Silverberg, New York (1) 212-438-1807; ariel.silverberg@standardandpoors.com

Secondary Contact:
Ranjith Nair, Mumbai (91) 22-4047-2676; ranjith.nair@standardandpoors.com

Criteria Officer:
Gregoire Buet, New York (1) 212-438-4122; gregoire.buet@standardandpoors.com
Peter Kernan, London (44) 20-7176-3618; peter.kernan@standardandpoors.com
Mark Puccia, New York (1) 212-438-7233; mark.puccia@standardandpoors.com

Table Of Contents

SCOPE OF THE CRITERIA
SUMMARY OF THE CRITERIA
IMPACT ON OUTSTANDING RATINGS
EFFECTIVE DATE AND TRANSITION
METHODOLOGY
Part I: Business Risk Analysis
A. Industry Risk
B. Country Risk
Table Of Contents (cont.)

C. Competitive Position (Including Profitability)

Part II: Financial Risk Analysis

D. Accounting And Analytical Adjustments

E. Cash Flow/Leverage Analysis

Part III: Rating Modifiers

F. Diversification/Portfolio Effect

G. Capital Structure

H. Liquidity

I. Financial Policy

J. Management And Governance

K. Comparable Ratings Analysis

L. Other Considerations

RELATED CRITERIA
Criteria | Corporates | Industrials:

Key Credit Factors For The Leisure And Sports Industry

1. Standard & Poor's Ratings Services is refining and adapting its methodology and assumptions for rating companies in the leisure and sports industry. We are publishing this article to help market participants better understand the key credit factors in this industry. This article is related to our corporate criteria (see "Corporate Methodology," published Nov. 19, 2013) and to our criteria article "Principles Of Credit Ratings," published Feb. 16, 2011.


SCOPE OF THE CRITERIA

3. These criteria apply globally to issuers we rate in the leisure and sports industry, which includes issuers that derive a majority of their revenues from gaming, lodging, and hospitality companies, timeshare operators, cruise lines, sports teams and sports related companies, fitness club operators, theme parks and other visitor attractions, and toy companies and other leisure goods manufacturers.

SUMMARY OF THE CRITERIA

4. Standard & Poor's is updating its criteria for analyzing leisure and sports companies, applying its corporate criteria.

5. We view leisure and sports as an "intermediate" risk industry under our criteria, given its "moderately high" cyclical risk and "intermediate" degree of competitive risk and growth. In assessing the competitive position of a leisure and sports company, we put particular emphasis on market position, brand or asset diversity, and operating efficiency. In our assessment of the financial risk profile, we take into account the fixed and working capital intensity of the company. Some subsectors, including toy companies and other leisure product manufacturers, have working capital requirements that fluctuate seasonally and over the course of the business cycle. Others, such as lodging, gaming, or cruise lines, are more fixed capital intensive. As such, we focus on supplemental ratios, such as free operating cash flow (FOCF) to debt and cash flow from operations (CFO) to debt, to capture those characteristics.

IMPACT ON OUTSTANDING RATINGS

6. We do not expect these criteria, in and of themselves, to result in any rating changes. The effect of the new corporate criteria is described in the article "Corporate Methodology," published Nov. 19, 2013.
EFFECTIVE DATE AND TRANSITION

7. These criteria are effective immediately upon publication.

METHODOLOGY

Part I: Business Risk Analysis

A. Industry Risk

8. Within the framework of Standard & Poor's corporate criteria for assessing industry risk, we view leisure and sports as an "intermediate" risk industry (category 3). We derive our industry risk assessment for leisure and sports from our view of the segment's "moderately high" risk (4) cyclicality assessment, and our assessment that the industry warrants an "intermediate" (3) competitive risk and growth assessment.

9. Key drivers of cyclicality broadly across the leisure industry include GDP; consumer spending; consumer confidence; and employment growth. In the lodging segment, changes in business investment and corporate operating profit also contribute to cyclicality. In segments where consumer product costs are relatively high and consumers often borrow to finance at least a portion of the cost, including timeshare, motorcycles and boats, interest rates and the availability of consumer credit can drive cyclicality. Cyclicality also varies by segment: lodging owners and managers can experience higher than industry average peak-to-trough (PTT) declines in revenue and EBITDA, as a result of significant variability in hotel occupancies and average daily rate (ADR) over the cycle. Conversely, toy companies typically experience lower than industry average PTT declines in revenue and EBITDA, as a result of the tendency of consumers to reliably purchase toys during the holiday season.

10. Pricing competition in the leisure industry can be significant during periods when supply exceeds demand, typically during economic downturns because of the generally discretionary nature of leisure products. Specifically, the lodging industry has a long history of discounting room rates when occupancy levels are low. Cruise companies often discount ticket prices in order to fill ships during hard economic times and following significant ship accidents. Fitness companies and theme parks use meaningful discounting strategies when new members and attendees become scarce. Casinos significantly increase marketing promotions--such as free play and inexpensive hotel rooms--to attract players, and toy companies can discount heavily to eliminate excess inventory.

1. Cyclicality

11. We assess cyclicality for the leisure and sports industry as "moderately high" risk (4). The industry has demonstrated moderate cyclicality--relative to other industries--in revenue, and moderately high cyclicality in profitability, which are two key measures we use to derive an industry's cyclicality assessment (see "Methodology: Industry Risk," published Nov. 19, 2013). Based on our analysis of global Compustat data, leisure and sports companies experienced an average peak-to-trough (PTT) decline in revenues in the mid-single digits during recessionary periods since 1972. In the last
recession (2007-2009) revenue declined 7%. Leisure and sports companies experienced an average PTT decline in EBITDA margin of 15% during recessionary periods, with PTT EBITDA margin declines materially exceeding the average in two of six periods. The largest PTT drop in EBITDA margin was 30% during the 1968-1971 downturn.

12. With an average drop in revenues in the mid-single digits and an average profitability decline of 15%, leisure and sports' cyclicality assessment calibrates to (4) "moderately high" risk. We generally consider that the higher the level of cyclicality in an industry, the higher the credit risk of entities operating in that industry. However, an industry's competitive and growth environment may mitigate or exacerbate the overall effect of cyclicality on an industry's risk profile.

2. Competitive risk and growth

13. We view leisure and sports as warranting an "intermediate" (3) competitive risk and growth assessment. To assess competitive risk and growth, we assess four sub-factors as low, medium, or high risk. These sub-factors are:

- Effectiveness of industry barriers to entry;
- Level and trend of industry profit margins;
- Risk of secular change and substitution by products, services, and technologies; and
- Risk in growth trends.

a) Effectiveness of leisure and sports industry's barriers to entry--medium risk

14. Barriers to entry in the leisure and sports industry are moderate across the industry, although barriers in specific segments vary. For example, barriers to entry are very low in the fitness club segment, given that a viable competitor can set up shop renting commercial space and purchasing gym equipment with a relatively small investment. The large midscale and economy lodging segments have greater exposure to suburban and roadside markets, with generally lower barriers to entry because more land is available for new construction, with less onerous zoning restrictions. Barriers tend to be high in upscale and luxury lodging segments, resulting from their urban and resort locations, higher construction costs, complex zoning laws, and fewer developable sites. Barriers are moderate-to-high across gaming, given licensing requirements. Barriers are high in the cruise segment, given the size, cost, and length of time required to build an ocean cruise ship.

b) Level and trend of leisure and sports industry profit margins--medium risk

15. Profit volatility in the leisure industry is moderately high, reflecting discretionary leisure demand that is subject to a moderately high degree of volatility over the economic cycle. In addition, safety, weather, political, and terrorism related event risk can impair margin, sometimes significantly, but generally for a moderate period of time. Increases in materials, commodities, and labor costs may pressure margin. Discretionary consumer spending is subject to changes in discretionary income, which is predominately influenced by wages, taxes, and inflationary changes in the cost of gas, food, and housing. However, many of these factors tend to be temporary or cyclical. Companies that rein in overhead and other costs can weather a protracted downturn. Leisure industry margins tend to be periodically impaired from these negative factors, but rarely, if ever, fall to zero or below.

c) Risk of secular change and substitution by products, services, and technologies--medium risk

16. Overall, we view the risk of secular change and substitution for the leisure and sports industry as medium. With anticipated increasing wealth and population trends, leisure activities are not generally at risk of secular change.
However, discretionary leisure activities can often be subject to a high level of substitution primarily from other discretionary leisure activities competing for discretionary spending dollars. Technological displacement is not typically a risk factor, given leisure activities are centered on experiences, although competition is significant inside the industry to use technology to enhance leisure experiences. One exception is the advent of online gaming, particularly in the U.S., which could moderately displace casino volumes and the ancillary spending connected to the guests' physical presence at the casino. However, the aggregate level of spending in the gaming segment is unlikely to decline as a result.

**d) Risk in industry growth trends--medium risk**

17. While cyclical, leisure activity is well established and aspirational for most people. Demographic and growing wealth trends are supportive of long-term demand for leisure activity. However, economic stagnation or recession can inhibit positive growth trends in the leisure and sports industry, as spending on nearly all leisure and sports activities is discretionary. We expect aggregate revenue growth related to leisure activity to generally exceed GDP during positive economic growth periods and to contract more than GDP during recessions.

18. Factors that are generally supportive of long-term demand for leisure activities include increasing wealth and population trends, as well as aging population trends in advanced nations. We expect increasing wealth to cause an increase in travel and leisure spending over time, and aging populations in general tend to have more time to pursue leisure. However, to the extent slower overall levels of economic growth and higher unemployment levels hinder growth in discretionary income and consumer confidence, secular growth in long-term demand for leisure activities could moderate.

**B. Country Risk**

19. Country risk plays a critical role in determining all ratings on companies in a given country. Country-related risk factors can have a substantial effect on company creditworthiness, both directly and indirectly. In assessing country risk for a leisure and sports company, our analysis uses the same methodology as with other corporate issuers (see corporate criteria). A key factor in our business risk analysis for corporate issuers is the country risk assessment, which includes the broad range of economic, institutional, financial market, and legal risks that arise from doing business in a specific country.

20. We generally determine exposure to country risk using revenues, as this information is consistently available. However this may not capture country risks beyond those affecting demand potential. Therefore, if country exposure by EBITDA or assets is available and indicative of a materially different country exposure profile, we may use EBITDA or assets instead. This could be the case, for instance, if a toy or other leisure goods manufacturer's production footprint is in countries with a higher risk profile than where it derives its revenue, and if those assets are not easily movable.

**C. Competitive Position (Including Profitability)**

21. Under our corporate criteria, a company's competitive position is assessed as (1) excellent, (2) strong, (3) satisfactory, (4) fair, (5) weak, or (6) vulnerable. In assessing the competitive position for leisure and sports issuers, we review the
following factors of an individual company:

- Competitive advantage;
- Scale, scope and diversity;
- Operating efficiency; and
- Profitability.

22. We assess independently the first three components as either (1) strong, (2) strong/adequate, (3) adequate, (4) adequate/weak, or (5) weak. We assess profitability through the combination of two components—the level of profitability and the volatility of profitability.

23. After evaluating separately competitive advantage; scale, scope, and diversity; and operating efficiency, we determine the preliminary competitive position assessment by ascribing a specific weight to each component. The applicable weightings will depend on the company's Competitive Position Group Profile (CPGP). The CPGP assigned to leisure and sports issuers that we rate is "Services or Product Focus," whereby we weight the first three components of competitive position as follows: competitive advantage (45%); scale, scope, and diversity (30%); and operating efficiency (25%). Many leisure and sports companies have a highly identifiable brand, or set of brands, and competitive standing in their market segment, or generate a significant portion of sales from service revenues. Although hotel, casino, and cruise companies—to name a few leisure segments—require significant capital investments in real estate and shipbuilding to develop and grow their market positions, sustaining them over the long term is more reliant on the quality of branded reputation and service operations. This makes competitive advantage of leisure companies' products and services the most significant determinant of competitiveness.

24. In assessing competitive advantage; scale, scope, and diversity; and operating efficiency of leisure and sports companies, we acknowledge various segments of the industry have differing risk characteristics. As a result, we are separately outlining supplementary assessment criteria that should be used in conjunction with our global corporate criteria for the following: gaming, lodging, and hospitality companies, cruise lines, sports teams and other sports issuers, theme parks and other visitor attractions, toy companies and other leisure goods manufacturers, fitness club operators, and timeshare operators.

1. **Competitive advantage**

25. In assessing competitive advantage for a leisure and sports company, we put particular emphasis on its:

- Degree of brand recognition or franchise strength;
- Relative attractiveness and competitiveness of the market; and
- Asset and/or service quality.

More specifically, we consider how the above factors manifest themselves across the various subsectors of leisure and sports as follows:

a) **Gaming**

26. A gaming company with a "strong" or "strong/adequate" competitive advantage assessment is characterized by a combination of:

- Locations in favorable markets with a high population or visitation base with a high propensity to game, or where
Criteria | Corporates | Industrials: Key Credit Factors For The Leisure And Sports Industry

gaming supply is relatively low compared with demand and unlikely to significantly increase;
• Operations in markets with high barriers to entry, typically evidenced by a fixed number of gaming licenses;
• High asset quality and the ability to reinvest sufficiently to sustain asset quality across the portfolio. (Typically, investment beyond normal maintenance spending is required to periodically reinvigorate a property, especially in more competitive markets);
• Gaming revenue share frequently exceeds the casino's share of slot machines and table game seats;
• The ability to create a superior, all-encompassing visitor experience in gaming, entertainment, lodging, dining, and shopping; and
• Strong brand recognition and the ability to create value through customer loyalty programs.

27. A gaming company with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

• Locations in less favorable markets with low population or visitation base with a low propensity to game, or where gaming supply is relatively high;
• Operations in markets with high degrees of competition or unlimited gaming license jurisdictions;
• Poor asset quality or limited ability to reinvest in maintaining assets;
• Gaming revenue share is frequently less than the casino's share of slot machines and table game seats;
• Limited additional amenities to drive ancillary spend or increase the length of stay; and
• Weak brand recognition or an inability to create customer loyalty through marketing programs.

b) Lodging and hospitality

28. A lodging and hospitality company with a "strong" or "strong/adequate" competitive advantage assessment is characterized by a combination of:

• Broad and consistently favorable brand recognition, combined with successful and growing loyalty programs and shared marketing and reservation services;
• A track record of sustaining successful long-term franchise and management contracts with hotel owners that typically survive a change in hotel ownership;
• Ability to market and distribute lodging brands through attracting third-party development capital over multiple economic cycles that typically increases the net number of rooms in the system annually, regardless of the health of the economy;
• For hotel owners, highly desirable real estate in markets with high barriers to entry; and
• A significant and sustainable market position in a deep travel market.

29. A lodging and hospitality company with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

• Less than adequate brand recognition, or an inconsistent or periodically unfavorable brand reputation;
• A track record of turnover in franchise and management contracts with hotel owners;
• Below average asset quality;
• Operations in markets with low barriers to entry, typically in large midscale and economy lodging segments because they have greater exposure to suburban and roadside markets where land is more readily available for new construction, with less onerous zoning restrictions.
c) Cruise lines

30. A cruise line with a "strong" or "strong/adequate" competitive advantage assessment is characterized by a combination of:

- Strong brand recognition combined with a value proposition that is consistently viewed favorably over time;
- Superior track record of ship building and launch success, as evidenced by the ability to deliver a superior guest experience that translates into yield premiums compared with the existing fleet and competitors;
- High asset quality in terms of providing consistently desirable ship amenities for the target market; and
- High levels of customer satisfaction and retention support ability to maintain and improve market share.

31. A cruise line with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

- Weak or less than adequate brand recognition;
- Adequate to less than adequate track record of ship building and launch success;
- Frequent service level mishaps or service underperformance over a long period of time that threatens market share or leads to significant and sustained price discounting exceeding that of peers.

d) Sports team or other sports issuers

32. A sports team or other sports issuer with a "strong" or "strong/adequate" competitive advantage assessment is characterized by a combination of:

- Strong franchise and enthusiastic and sizable fan base that translates into predictable attendance at events;
- Strong and sustainable sponsorships and demand for media rights leading to multiyear and highly profitable sponsorship and media contracts; and
- Strong market share, or in the case of sports leagues, near-monopolistic position.

33. A sports team or other sports issuer with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

- Weak franchise;
- Volatile attendance at sporting events and weak relative demand for media rights; and
- Weak market share.

e) Theme park and other visitor attractions

34. A theme park or other visitor attractions issuer with a "strong" or "strong/adequate" competitive advantage assessment is characterized by a combination of:

- Strong brand recognition that draws reliably high attendance at a premium ticket price compared with industry competitors;
- Sustained market position as a premier destination attracting a loyal visitor base;
- High asset and service quality and a strong safety record;
- Operations in markets with high barriers to entry; and
- Successful track record of investing in refreshed or new rides and attractions.

35. A theme park or other visitor attractions issuer with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:
• Limited brand differentiation leads to frequent strategic discounting;
• Highly seasonal attendance compared with industry peers;
• Operations in markets where the ticket purchase decision can be easily postponed because of bad weather, generally associated with drive-to destinations compared with premier destinations where the consumer generally incurs the fixed cost of multiple airline tickets; and
• Operations in markets with low barriers to entry and high degrees of competition.

f) Toy companies and other leisure goods manufacturers

36. A toy company or other leisure goods manufacturer with a "strong" or "strong/adequate" competitive advantage assessment is characterized by a combination of:

• Established brand awareness and longevity;
• Resilient demand and a track record of limited inventory obsolescence;
• Track record of successfully coping with a limited number of supply chain disruptions and product recalls; and
• Ability to retain, expand, and profitably monetize licensing agreements and entertainment properties.

37. A toy company or other leisure goods manufacturer with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

• Limited brand awareness;
• Limited brand longevity and frequent inventory obsolescence; and
• Supply chain disruptions and product recalls often negatively affect inventory distribution.

g) Fitness club operators

38. Fitness club operators are not typically assigned a "strong" or "strong/adequate" competitive advantage assessment because fitness clubs compare unfavorably to other leisure segments due to very low barriers to entry and the resultant high levels of competition and customer attrition.

39. A fitness club operator with an "adequate" competitive advantage assessment is characterized by a combination of:

• High level of ancillary revenue, principally personal training revenue, since relationships with trainers tend to lead to greater customer retention;
• Customer loyalty as evidenced by relatively low attrition rates;
• High quality real estate located in population centers that are easily accessible; and
• Widely held reputation for club cleanliness and good service levels.

40. A fitness club operator with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

• Uneven track record of personal training services retaining members;
• High relative customer attrition rates; and
• Less desirable real estate in less attractive locations.

h) Timeshare operators

41. Timeshare operators are not typically assigned a "strong" or "strong/adequate" competitive advantage assessment, primarily because the timeshare industry faces high levels of competition for discretionary leisure spending on vacations and because of the high degree of sales execution risk. While marketed as a value-oriented vacation
alternative, timeshare is a relatively high-ticket investment for the unfamiliar consumer compared with a vacation that may include the one-time cost of travel and a hotel stay, or a cruise. As a result, the consumer's decision to purchase faces a higher barrier that frequently requires financing to overcome. In addition, a timeshare purchase involves buying ownership in an interest in real estate and a right to use it for a period of time each year. Consequently, new customer acquisition costs are high to fund a significant sales effort to promote understanding of the product and to overcome consumer caution.

42. A timeshare operator with an "adequate" competitive advantage assessment is characterized by a combination of:

- Successful track record of sales execution that increases the base of timeshare owners in the system regardless of the economy;
- Sales operation is moderately reliant upon external borrowing to finance consumer loans, generally characterized as less than 50% of total timeshare sales;
- Strong branding and loyalty program affiliation, typically with a widely recognized high quality hotel brand;
- A network of high-quality real estate located in popular resort locations; and
- Widely held reputation as a good value by existing owner base.

43. A timeshare operator with a "weak" or "adequate/weak" assessment of its competitive advantage typically is characterized by any one of the following:

- Sales operation highly susceptible to a significant loss of external financing for consumer loans during periods of financial stress;
- Uneven track record selling to new timeshare owners and a heavy reliance on selling additional timeshare product to existing owners, even during good economic times;
- Relatively weak branding; and
- Less desirable real estate in less attractive resort locations.

2. Scale, scope, and diversity

44. In assessing scale, scope, and diversity for a leisure and sports company, we put particular emphasis on its:

- Degree of diversity by geographic markets;
- Degree of brand, asset, or segment concentration; and
- Scale and related ability to fund large capital expenditures where applicable.

More specifically for the following subsectors:

a) Gaming

45. A gaming company with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

- Broad geographic diversity, operating across a number of different gaming markets or platforms; and
- High level of revenue diversity across gaming and non-gaming amenities, including revenue from slot machines and table games, and from entertainment, lodging, dining, and retail.

46. A gaming company with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:
• Limited geographic diversity in a portfolio of properties;
• Concentration in a single asset; and
• Limited revenue diversity.

b) Lodging and hospitality

47. A lodging and hospitality company with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

• Wide distribution of multiple successful brands;
• Room base targeting luxury, upscale, midscale, and economy hotel price segments; and
• Broad geographic diversity.

48. A lodging and hospitality company with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:

• Brand concentration;
• Price segment concentration; and
• Limited geographic diversity.

c) Cruise lines

49. A cruise line with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

• Demonstrated successful track record of wide distribution across global itineraries of multiple brands;
• Scale sufficient to translate into ability to invest in expensive ship building with internally generated cash flow; and
• Cruise ships targeting luxury, premium, and contemporary price segments.

50. A cruise line with a "weak" or "adequate/weak" assessment of scale, scope, and diversity is typically characterized by any one of the following:

• Brand concentration;
• Price segment concentration; and
• Limited scale insufficient to fund the significant investment required to build a ship, and as a result, capacity growth reliant on external financing.

d) Sports team or other sports issuers

51. A sports team or other sports issuer with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

• High event or facilities diversity;
• Event, attendance, sponsorship, media, and ancillary revenue diversity; and
• Broad event and product distribution and global sales diversification.

52. A sports team or other sports issuer with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:

• Limited diversity of events and/or facilities;
• Revenue concentration in one or a few events; and
• Limited distribution.

e) Theme park and other visitor attractions

53. A theme park or other visitor attractions issuer with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

• Distribution of multiple successful brands targeting multiple price points and demographic groups; and
• Broad geographic and site diversity in terms of number of locations and operating properties, including both indoor and outdoor attractions, which can reliably mitigate weather and other seasonal risk factors.

54. A theme park or other visitor attractions issuer with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:

• Limited distribution of brands; and
• Limited geographic and site diversity.

f) Toy companies and other leisure goods manufacturers

55. A toy company or other leisure goods manufacturer with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

• High product diversity across multiple age and demographic groups;
• Broad product distribution and global sales diversification; and
• Broad geographic diversity of manufacturing locations and relationships.

56. A toy company or other leisure goods manufacturer with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:

• Limited product diversity and distribution; and
• Concentration of manufacturing capabilities.

g) Fitness club operators

57. A fitness club operator with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:

• Geographic diversity across markets;
• Good revenue diversification among member dues and ancillary products and services; and
• Club clusters near customer concentrations.

58. A fitness club operator with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:

• Limited geographic diversity;
• Limited revenue diversity; and
• Limited club clustering.

h) Timeshare operators

59. A timeshare operator with a "strong" or "strong/adequate" assessment of scale, scope, and diversity is characterized by a combination of:
• Significant resort distribution across multiple desirable markets that translates into an attractive vacation network for the owner base;
• Large and growing owner base; and
• Good revenue diversification among timeshare sales, home ownership association (HOA) management fees, and financing revenue.

60. A timeshare operator with a "weak" or "adequate/weak" assessment of scale, scope, and diversity typically is characterized by any one of the following:

• Limited geographic and resort diversity, translating into a limited vacation network;
• Small relative owner base; and
• Limited revenue diversity.

3. Operating efficiency

61. In assessing operating efficiency for a leisure and sports company, we put particular emphasis on its:

• Asset utilization and efficiency metrics (such as revenue per unit where applicable);
• Relative success at managing fixed and variable costs in a downturn compared with peers; and
• Track record at managing large capital investment programs where applicable.

More specifically for the following subsectors:

a) Gaming

62. "Strong" or "strong/adequate" operating efficiency for gaming is characterized by a combination of:

• Casino operations with relatively high revenue win per slot and table unit;
• Operations in markets with relatively low gaming tax rates;
• Consistent ability to adjust casino or resort labor costs in a down cycle or to limit labor cost inflation; and
• Ability to effectively manage promotional allowances and other marketing spending, regardless of the revenue environment.

63. "Weak" or "adequate/weak" operating efficiency for gaming is characterized by any one of the following:

• Operations in highly competitive gaming markets frequently requiring high levels of promotional spending;
• Limited ability to adjust casino or resort labor costs in a down cycle or to limit labor cost inflation; and
• Operations in markets with relatively high gaming tax rates.

b) Lodging and hospitality

64. "Strong" or "strong/adequate" operating efficiency for lodging is characterized by a combination of:

• Frequently achieving a premium compared with market peers in revenue per available room (RevPAR) across multiple brands and segments; and
• Relatively low capital investment requirements and relatively flexible cost structure, typically a lodging franchisor or manager rather than a hotel owner.

65. "Weak" or "adequate/weak" operating efficiency for lodging is characterized by any one of the following:

• Limited success managing fixed and variable costs during economic downturns compared with the leisure and sport industry; and
High capital investment requirements.

c) Cruise lines

66. "Strong" or "strong/adequate" operating efficiency for a cruise line is characterized by a combination of:

- Frequently achieving a net revenue yield premium or superior comparable year-over-year yield performance fleet wide, compared with peers, regardless of the economic environment;
- Price discounting is limited to customary marketing programs and is generally not severe or the result of frequent service underperformance; and
- Dry dock, fuel, corporate, and other expenses are consistently managed to support profitability, regardless of the economic environment.

67. "Weak" or "adequate/weak" operating efficiency for a cruise line is characterized by any one of the following:

- Net revenue yield consistently underperforms peers;
- Price discounting is frequently severe and the result of frequent service underperformance; and
- Cost overruns are frequent and detrimental to profitability.

d) Sports team or other sports issuers

68. "Strong" or "strong/adequate" operating efficiency for sports teams or sports-related issuers is characterized by a combination of:

- Inflation in commissions, payroll, corporate, and other expenses are consistently managed to support profitability;
- High visibility in sponsorship, media, and ancillary revenue is consistently supportive of improved profitability; and
- Strong and consistent event attendance consistently translates into ticket price premiums and other event revenue.

69. "Weak" or "adequate/weak" operating efficiency for sports teams or sports-related issuers is characterized by any one of the following:

- Inflation in commissions, payroll, corporate, and other expenses frequently rise at a higher rate than revenue; and
- Poor or declining attendance translates into weak ticket and other ancillary revenue.

e) Theme park and other visitor attractions

70. "Strong" or "strong/adequate" operating efficiency for theme parks is characterized by a combination of:

- Price discounting is consistently and successfully used to optimize park attendance regardless of the economic environment; and
- Maintenance, labor, and other park operating costs are successfully managed over the economic cycle.

71. "Weak" or "adequate/weak" operating efficiency for theme parks is characterized by any one of the following:

- A track record of significant and sustained price discounting due to park service underperformance; and
- Maintenance, labor, and other park operating costs frequently are inefficiently managed compared with revenue generation.

f) Toy companies and other leisure goods manufacturers

72. "Strong" or "strong/adequate" operating efficiency for toy companies and other leisure goods manufacturers is characterized by a combination of:
• Limited price discounting due to relatively infrequent inventory obsolescence;
• Commodity, labor, and other manufacturing input costs are effectively managed to produce minimal gross margin variability; and
• Revenue mix is weighted toward evergreen products and other long-lived brands compared with entertainment-based products.

73. "Weak" or "adequate/weak" operating efficiency for toy companies and other leisure goods manufacturers is characterized by any one of the following:

• Frequent price discounting due to inventory obsolescence; and
• Gross margin is volatile due to highly variable commodity, labor, and other input costs.

g) Fitness club operators

74. "Strong" or "strong/adequate" operating efficiency for fitness clubs is characterized by a combination of:

• Relatively high portion of revenue derived from high-margin ancillary services, largely personal training;
• Ability to successfully manage frequent price discounting and the high fixed cost structure due to leasing arrangements and a fixed facility platform to support profitability; and
• A measured approach to club growth that limits the negative EBITDA margin impact of new clubs that have not yet ramped up and built the member base to absorb all fixed costs.

75. "Weak" or "adequate/weak" operating efficiency for fitness clubs is characterized by any one of the following:

• Minimal portion of revenue derived from high-margin ancillary services, largely personal training;
• Frequent and sustained use of price discounting to attract members, producing an EBITDA margin that is consistently below average compared with the leisure and sport industry; and
• Aggressive club growth that results in a meaningful decline in EBITDA margin over multiple years.

h) Timeshare operators

76. "Strong" or "strong/adequate" operating efficiency for timeshare operators is characterized by a combination of:

• During periods of economic stress, a demonstrated ability to significantly reduce sales levels in response to limited financing availability and decreased consumer demand and rapidly reduce costs to partially offset sales declines in order to preserve cash flow;
• A majority of timeshare sales derived from sales of high margin commission-based third-party inventory; and
• A significant portion of total sales is derived from high margin and less volatile HOA management fees.

77. "Weak" or "adequate/weak" operating efficiency for timeshare operators is characterized by any one of the following:

• Minimal portion of revenue derived from high margin commission-based third-party inventory;
• Minimal HOA management fee revenue; and
• Difficulty successfully reducing cost base in response to periods of economic stress.

4. Profitability

78. The profitability assessment can confirm or modify the preliminary competitive position assessment. The profitability assessment consists of two components: (1) the level of profitability and (2) the volatility of profitability. We combine the two components into the final profitability assessment using a matrix (see corporate criteria).
a) Level of profitability

79. We assess the level of profitability on a three point scale: "above average," "average," and "below average."

80. We use EBITDA margin as the primary indicator of a leisure and sports company's level of profitability, based on thresholds (see table 1). We may use return on capital (ROC) as a supplementary indicator to refine our assessment when EBITDA margin is close to the thresholds for "below average" or "above average" (see table 2). For instance, if a company's EBITDA margin is at the high end of the defined range for "average," but its return on capital is comfortably in the "above average" range, we may assess its level of profitability as "above average." In accordance with the corporate criteria, for this assessment we typically calculate the five-year average EBITDA margin and ROC using the last two years of historical EBITDA, and our EBITDA forecast for the current year and for the subsequent two years. We may put more emphasis on forecast years if historical data is not deemed representative, or take into account deteriorating or improving profiles where prospective ratios meaningfully differ from average ratios.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>EBITDA Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Below average</td>
</tr>
<tr>
<td>All companies</td>
<td>&lt;20%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 2</th>
<th>Return On Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Below average</td>
</tr>
<tr>
<td>All companies</td>
<td>&lt;6%</td>
</tr>
</tbody>
</table>

b) Volatility of Profitability

81. We assess the volatility of profitability on a six point scale, from: "1" (lowest volatility) to "6" (highest volatility).

82. In accordance with our corporate criteria, we generally calculate the volatility of profitability assessment using the standard error of regression (SER), subject to having at least seven years of historical annual data. We generally use nominal EBITDA as the metric to calculate the SER for leisure and sports companies, although we may also use EBITDA margin or ROC. In accordance with the corporate criteria, we may--subject to certain conditions being met--adjust the SER assessment by up to two categories worse (more volatile) or better (less volatile). If we do not have sufficient historical information to calculate the SER, we follow the corporate criteria guidelines to determine the volatility of profitability assessment.

Part II: Financial Risk Analysis

D. Accounting And Analytical Adjustments

83. In assessing the accounting characteristics of leisure and sports companies, the analysis uses the same methodology as with other corporate issuers. Our analysis of a company's financial statements begins with a review of the accounting to determine whether the statements accurately measure a company's performance and position relative to its peers and the larger universe of corporate entities. To allow for globally consistent and comparable financial analyses, our
rating analysis may include quantitative adjustments to a company's reported results. These adjustments also enable better alignment of a company's reported figures with our view of underlying economic conditions. Moreover, they allow a more accurate portrayal of a company's ongoing business. Adjustments that pertain broadly to all corporate sectors, including this sector, are discussed in "Corporate Methodology: Ratios And Adjustments," published Nov. 19, 2013.

E. Cash Flow/Leverage Analysis

84. In assessing the cash flow adequacy of a leisure and sports issuer, our analysis uses the same methodology as with other corporate issuers (see corporate criteria). Cash flow/leverage is assessed on a six point scale—ranging from (1) minimal to (6) highly leveraged—by aggregating the assessments of a range of credit ratios, predominantly cash flow based, which complement each other by focusing attention on the different levels of a company's cash flow in relation to its obligations.

1. Core ratios
85. For each company, we calculate in accordance with Standard & Poor's ratios and adjustments criteria, two core debt payback ratios: FFO/debt and debt/EBITDA.

2. Supplemental ratios
86. In addition to our analysis of a company's core ratios, we also consider supplemental ratios in order to develop a fuller understanding of a company's credit risk profile and refine our cash flow analysis in accordance with the corporate criteria. We generally use for leisure and sports companies EBITDA/interest expense as the primary supplemental ratio, especially when the cash flow and leverage score, indicated by the core ratios is significant or weaker. We use additional supplemental ratios for various subsectors to refine our cash flow/leverage assessment, especially when the cash flow and leverage score indicated by the core ratios are intermediate or stronger. These typically include:

- Gaming: FOCF/debt, given periodic development capital spending and maintenance capital spending requirements; DCF/debt for dividend paying companies, particularly tribal gaming entities.
- Lodging and hospitality: FOCF/debt in most cases, given hotel renovation and other investment spending; DCF/debt for dividend paying companies.
- Cruise lines: FOCF/debt, given capital spending on shipbuilding; DCF/debt for dividend paying companies.
- Toy companies and other leisure goods manufacturers: CFO/debt, given heavy working capital requirements.
- Sports teams and other sport issuers: CFO/debt, given high payroll costs and limited capital spending needs.
- Theme parks and other visitor attractions: FOCF/debt, given relatively high maintenance capital spending on attractions.
- Fitness club operators: FOCF/debt, given the tendency to grow through investing in opening new clubs.
- Timeshare operators: CFO/debt, given working capital required to fund inventory and receivables.

Part III: Rating Modifiers
F. Diversification/Portfolio Effect

87. In assessing the diversification/portfolio effect on a leisure and sports company, our analysis uses the same methodology as with other corporate issuers (see corporate criteria).

G. Capital Structure

88. In assessing a leisure and sports company's capital structure, our analysis uses the same general methodology as with other corporate issuers (see corporate criteria).

H. Liquidity

89. In assessing the liquidity of a leisure and sports company, our analysis uses the same general methodology as with other corporate issuers (see corporate criteria and "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers," published Jan. 2, 2014).

I. Financial Policy

90. In assessing the financial policy of a leisure and sports company, our analysis uses the same methodology as with other corporate issuers (see corporate criteria).

91. Specifically, when assessing financial policy of Native American gaming entities, we take into account the governing Tribe's financial policy:

- We typically do not assess financial discipline as "positive" because we do not believe that Native American related entities would prioritize debt repayment over distributions. Generally speaking, we observe that reductions in distributions are implemented in response to weaker-than-expected operating performance, rather than as a credit enhancing measure to reduce leverage.
- We may assess financial discipline as "neutral" if we believe that distributions as a percentage of free operating cash flow are likely to be relatively predictable because there is a sufficient level of flexibility within distributions and the Tribe would be able and willing to lower them in times of operating stress. Getting to this conclusion regarding flexibility requires transparency into the Tribe's financial position and financial policy, including the receipt of Tribal financial statements and discussions of Tribal budgets with elected Tribal officials, particularly as it relates to the level of flexibility within the Tribal budgets. We also factor historical track record into our analysis of flexibility.
- We may assess financial discipline as "negative" for Native American related entities, particularly as it relates to shareholder remuneration policies if we believe distributions as a percentage of free operating cash flow are likely to be unpredictable over time because we have limited ability to assess the flexibility of distributions or the Tribal government budget.
J. Management And Governance

92. In assessing management and governance of a leisure and sports company, our analysis uses the same methodology as with other corporate issuers (see corporate criteria).

K. Comparable Ratings Analysis

93. In assessing the comparable ratings analysis for a leisure and sports company, our analysis uses the same methodology as with other corporate issuers (see corporate criteria).

L. Other Considerations

94. In assessing issue-level ratings for Native American gaming entities, we do not assign recovery ratings because of significant uncertainties surrounding the exercise of creditor rights against a sovereign nation. These include whether the relevant bankruptcy code would apply, whether a relevant court would ultimately be the appropriate venue to settle such a matter, and to what extent a creditor would be able to enforce any judgment against the sovereign nation. The notching of our issue-level ratings from our issuer credit rating on a given Native American issuer reflects the relative position of each security in the capital structure, incorporating the amount of higher ranking debt ahead of each issue. For additional information about determining issue ratings when we cannot confidently model absolute recovery because of jurisdictional issues, see "2008 Corporate Criteria: Rating Each Issue," published April 15, 2008.

RELATED CRITERIA

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011

These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.