Otthon Centrum Holding Kft.
Hungary, Business Services

BB- NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	22x	net cash interest	net cash interest	net cash interest
Scope-adjusted debt/EBITDA	2.0x	0.7x	2.6x	3.1x
Scope-adjusted funds from operations/debt	46%	125%	43%	36%
Scope-adjusted free operating cash flow/debt	40%	69%	25%	-1%

Rating rationale

The Negative Outlook mainly reflects increasing pressure on profitability, underpinned by high costs for integration, marketing, training and IT planned in H2 2023 and 2024 to onboard the newly acquired Polish entities. It also results from the risk that loan demand will only slowly recover.

Otthon Centrum's rating is driven by its leading market position in its home market as a real estate and financial brokerage. The business risk profile suffers from the absence of geographical diversification, which exposes the company to the macroeconomic trends of one market only. This is expected to change with the successful integration of the two acquired Polish entities, but results will only be visible in the long term. The business risk profile benefits from: i) a granular customer base from Otthon Centrum's focus on the retail segment with very limited repeat business; and ii) a relatively diverse line of products.

Otthon Centrum's financial risk profile is expected to weaken due to the decline in profitability, driving leverage above its historically low levels. Nonetheless, we do not expect the metric to increase above 3.5x, as no new debt issuance is planned and HUF 1.8bn are still available on the issued bonds. We expect Otthon Centrum's favourable interest rate on its HUF bank deposit to generate positive interest income. Liquidity is adequate given the absence of substantial short-term debt and bond repayment starting in 2024 at a 5% amortisation rate.

Outlook and rating-change drivers

The Outlook is Negative and reflects our expectation that the recent acquisitions of two entities in Poland will carry high integration costs in H2 2023 and 2024, pressuring operating profitability, cash flows and leverage in the medium term. The risk is further exacerbated by the uncertainty on the Hungarian loan market, where weaker-than-expected demand, driven by government incentives not materialising or inflation and interest rates rising again, could easily bring leverage above our rating case.

A positive rating action including a revision of the Outlook back to Stable, would require Scope-adjusted debt/EBITDA to remain around or below 3x for a sustained period. This could be supported by the successful integration of the two Polish real estate brokers, including a positive EBITDA contribution in 2024.

A negative rating action could be warranted if financial leverage (Scope-adjusted debt/EBITDA) increased to significantly above 3x on a sustained basis. This could be caused by margin pressure due to higher-than-expected challenges in the integration of acquired businesses. growing competition from banks, online retailers or other larger organisations with greater financial muscle.

Ratings & Outlook

Issuer	BB-/Negative
Senior unsecured debt	BB-

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Related Methodology

Corporate Rating Methodology; October 2023

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
16 Nov 2023	Outlook change	BB-/Negative
15 Nov 2022	Affirmation	BB-/Stable
21 Dec 2021	No action	BB-/Stable

Rating and rating-change drivers

Positive rating drivers

- Strong debt protection and robust liquidity
- Asset light business model, hence little financial debt and moderate financial leverage
- Strong market position in Hungarian real estate and loan brokerage market
- Diversified among several real estate related services; high customer granularity

Negative rating drivers

- International expansion via M&A carries execution and integration risks
- Strong dependency on general transaction volumes in the Hungarian real estate and loan markets with limited recurring revenue
- Strong competition in the online real estate brokerage market

Positive rating-change drivers

- Scope-adjusted debt/EBITDA around or below 3x on a sustained basis.

Negative rating-change drivers

- Financial leverage (Scope-adjusted debt/EBITDA) significantly above 3x on a sustained basis

Corporate profile

Otthon Centrum Holding Kft. (Otthon Centrum) was founded in 2000 and runs a leading real estate agency network, providing credit intermediation and other real estate transaction-related services in Hungary. It operates an integrated platform consisting of an online real estate marketplace together with a national network of both self-operated and franchised physical offices.

The company issued a HUF 2.9bn bond to fund the international expansion of the real estate and mortgage agency network in April 2021.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	net cash interest	22x	net cash interest	net cash interest	net cash interest	net cash interest
Scope-adjusted debt/EBITDA	net cash	2.0x	0.7x	2.6x	3.1x	2.2x
Scope-adjusted funds from operations/debt	net cash	46%	125%	43%	36%	43%
Scope-adjusted free operating cash flow/debt	net cash	40%	69%	25%	-1%	-12%
Scope-adjusted EBITDA in HUF m						
EBITDA	784	1,236	1,509	588	453	623
Other items	-	-	-	-	-	-
Scope-adjusted EBITDA	784	1,236	1,509	588	453	623
Funds from operations in HUF m						
Scope-adjusted EBITDA	784	1,236	1,509	588	453	623
less: (net) cash interest paid	2	-56	59	233	107	41
less: cash tax paid per cash flow statement	-71	-63	-188	-164	-63	-84
Funds from operations (FFO)	**715**	**1,117**	**1,380**	**657**	**497**	**580**
Free operating cash flow in HUF m						
Funds from operations	715	1,117	1,380	657	497	580
Change in working capital	77	283	-297	108	-115	-349
less: capital expenditure (net)	-645	-319	-183	-245	-245	-245
less: lease amortisation	-78	-113	-139	-139	-147	-148
Free operating cash flow (FOCF)	**69**	**968**	**761**	**381**	**-10**	**-162**
Net cash interest paid in HUF m						
Interest paid	8	65	98	81	94	116
add: interest received	-10	-9	-157	-314	-201	-157
Net cash interest paid	**-2**	**56**	**-59**	**-233**	**-107**	**-41**
Scope-adjusted debt in HUF m						
Reported gross financial debt	417	3,441	3,303	3,251	3,057	2,912
less: cash and cash equivalents[1]	-635	-1,000	-2,202	-1,740	-1,674	-1,573
Scope-adjusted debt	**net cash**	**2,441**	**1,101**	**1,511**	**1,383**	**1,339**

[1] 50% of available cash netted only, as considered permanent.

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Environmental, social and governance (ESG) profile[2]

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

ESG considerations

No material ESG risks identified.

As a real estate agency, the major ESG risks Otthon Centrum is exposed to are typically regulatory and reputational, as well as governance risk factors. Environmental risks are not significant given the asset light business model. We believe there is a need to address potential risks coming from:

1) product (loan) mis-selling identified as a potential social risk factor;

2) lack of independent oversight of the board as a potential governance risk factor, but not dissimilar to other privately owned businesses.

In relation to the product mis-selling risk, Otthon Centrum reports having a very rigorous process, supported by a high-quality IT system. In the financial intermediation segment, the company is subject to Hungarian Central Bank supervision and has established an internal team that performs regular audits and investigates customer complaints.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B+

Industry risk profile: BBB

We classify Otthon Centrum as a business services provider with an asset-light balance sheet and mainly specialised workforce, reflecting a medium cyclicality, medium entry barriers and medium substitution risk. Business performance is closely tied to transaction volumes in the Hungarian real estate and loan markets with limited recurring revenues. The ability to attract and retain franchisees and agents very much depends on the company's good reputation, its ability to keep up with technological advances, innovation, execution, and customer service quality.

Top market position in Hungary

Otthon Centrum is one of the two leading retail-focused real estate and credit brokerage firms in Hungary and with the recent acquisition of Open House (about 30 offices), the company further consolidated its market position in Hungary. The main competitor is Duna House, which has continued to grow outside of Hungary (mainly Italy) and remains significantly larger.

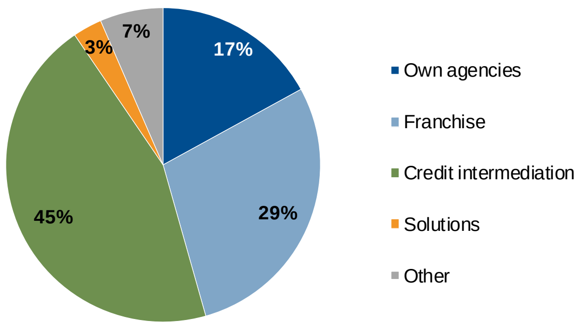
Geographical diversification set to improve

With geographical focus on Hungary, lack of diversification is a negative rating driver for Otthon Centrum, especially in comparison to Duna House, which has a significant presence also in Italy, Poland and to a minor extent in the Czech Republic. This is however likely to change after the acquisition of Freedom N sp.Zoo, in April 2023, and Investor N. sp.Zoo, in September 2023, two Polish broker franchises totalling 120 offices. Following the acquisition, Otthon Centrum will rank among the two largest brokers in Poland in terms of offices. Nonetheless, the revenue contribution is expected to be below 10% in the first three years, as the issuer will focus on successful integration of the Polish offices, rather than growth.

There is some diversification in the product offering, with around half of revenue coming from real estate brokerage (franchises and own agencies) and half coming from credit intermediation. About half of credit intermediation relates to real estate loans and the other half to personal and corporate loans, credit cards and loyalty programmes. We consider these different revenue streams as credit positive as they provide some cash flow stability.

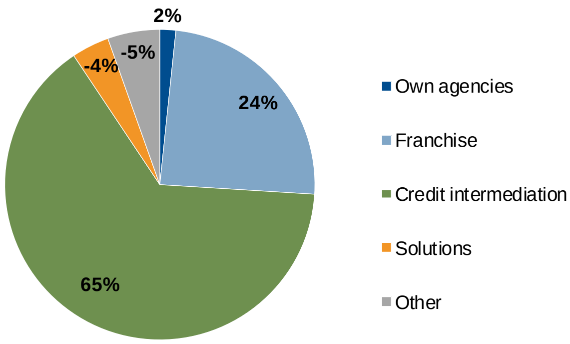
Customer granularity is very high given the focus on retail customers.

Figure 1: Revenue by segment (2023 issuer's forecast)



Sources: Otthon Centrum, Scope estimates

Figure 2: EBITDA by segment (2023 issuer's forecast)

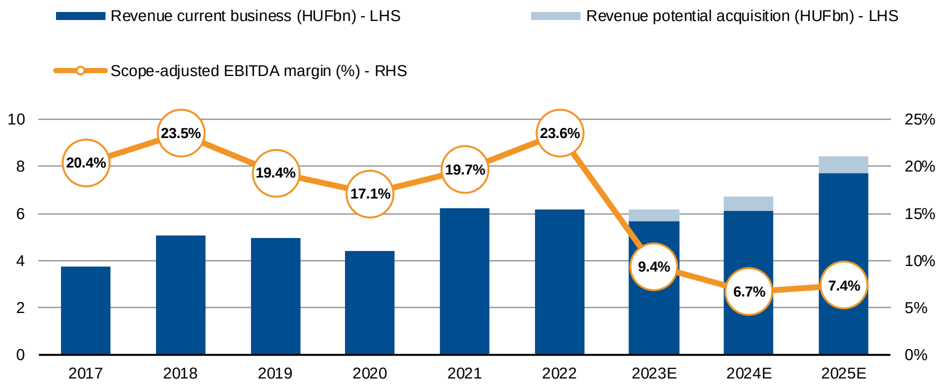


Sources: Otthon Centrum, Scope estimates

Profit margin to trend downwards

Over the years, Otthon Centrum has shown solid profitability with Scope-adjusted EBITDA margin ranging between 16% and 24%; while in H1 2023 the lower volume drove the margin down to 14.4% (from 23.8% in H1 2022). We expect margins to weaken more in the coming years due to the newly acquired entities, which will require restructuring and integration expenses, hurting profitability. We hint at the uncertainty which is still impacting the real estate and loan markets in Hungary and Poland and that a lower-than-expected improvement or a further market decline could put further pressure on profitability and leverage. The variable nature of most costs at Otthon Centrum (COGS and part of services costs are variable), gives some comfort that the issuer can quickly adapt its structure if needed.

Figure 3: Scope-adjusted EBITDA margin



Sources: Otthon Centrum, Scope estimates

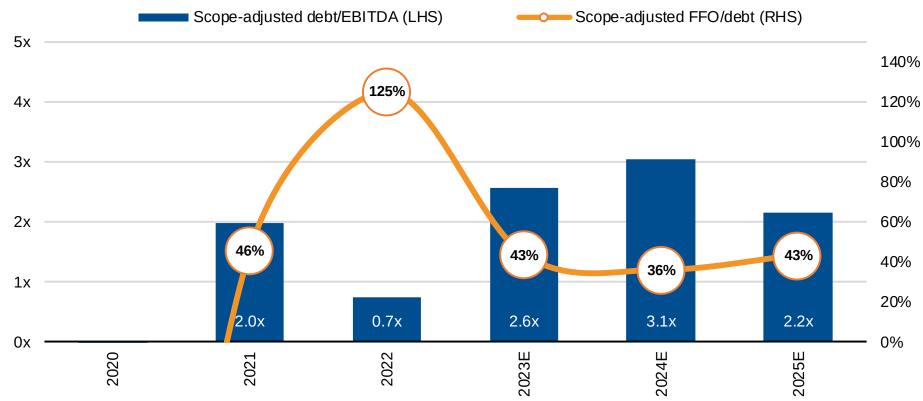
Financial risk profile: BB+

We assess the financial risk profile at BB+ (two notches down compared to our previous assessment).

Leverage threatened by the profitability downtrend

While Otthon Centrum had historically benefitted from low leverage, measured by Scope-adjusted debt/EBITDA, the ratio increased as a result of the weakening Scope-adjusted EBITDA in H1 2023. We anticipate increasing leverage going forward due to the high costs planned to integrate the newly acquired entities, which will put additional pressure on profitability. We believe a decrease in leverage is unlikely before 2025, as the market in Hungary is expected to show timid growth in 2024 and the Polish business will initially contribute marginally to revenue.

Figure 4: Leverage



Sources: Otthon Centrum, Scope estimates

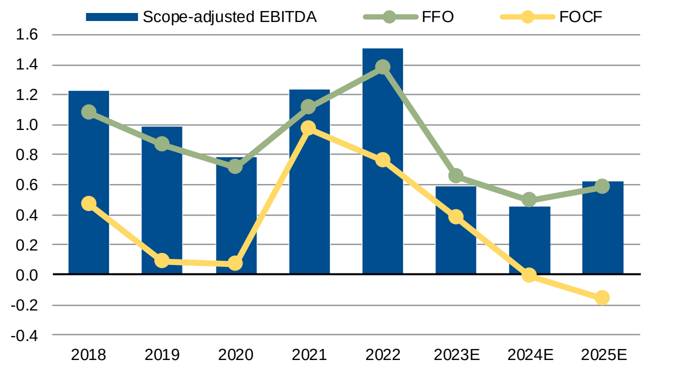
Strong interest coverage

Otthon Centrum's financial risk profile is supported by its strong interest coverage, measured by the Scope-adjusted EBITDA interest coverage, thanks to its asset-light and debt-light business model. In the coming years, we expect the company to benefit from net interest income. This is due to the low coupon on the bond (3%), stable indebtedness and the high interest that Otthon Centrum will earn on its HUF deposits.

Cash flow coverage to downtrend

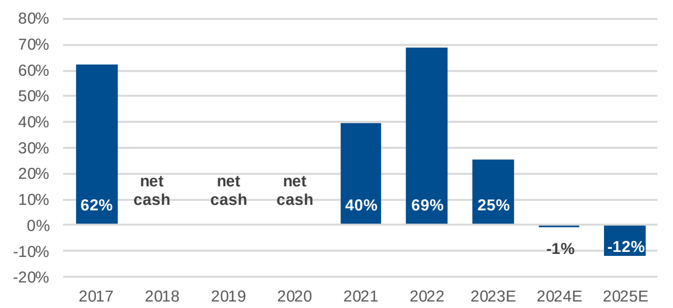
While in the past the company has been consistently cash flow positive, even in 2020 when it underwent a major IT upgrade, we now expect cash flow to trend downward due to the decline in profit and higher capex following the acquisitions on Poland.

Figure 5: Cash flows (HUF bn)



Sources: Otthon Centrum, Scope estimates

Figure 6: Scope-adjusted FOCF/debt (%)



Sources: Otthon Centrum, Scope estimates

Adequate liquidity

Liquidity is considered adequate.

The HUF 2.9bn bond start amortising in 2024 (5% p.a. in 2024-2027, 10% in 2028-2030 and 50% in 2031). Other short-term debts repayments are also negligible.

Balance in HUF m	2022	2023E	2024E
Unrestricted cash (t-1)	3,734	4,404	3,479
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	761	381	-10
Short-term debt (t-1)	15	15	193
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

We have previously applied a negative one-notch adjustment to Otthon Centrum's standalone credit assessment based on peer context to recognize the smaller size and weaker diversification compared to Duna House. The adjusted standalone credit assessment and Otthon Centrum's improved geographic reach and position as market leader in Hungary, after the acquisitions completed in 2023, no longer justify the negative one notch adjustment. It has therefore been removed.

Long-term debt rating

Senior unsecured debt rating: BB-

Otthon Centrum has HUF 2.9bn of senior unsecured capital market debt outstanding (ISIN: HU0000360391) issued in April 2021 through the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond proceeds were used for the acquisition of Open House, Freedom N sp. Zoo, and Investor N. sp. Zoo, and HUF 1,809m is still available. The bond has a tenor of 10 years and a fixed coupon of 3%. Bond repayment is in eight tranches starting from 2024, with 5% of the face value payable yearly from 2024 to 2027, 10% of the face value payable from 2028 to 2030, and a 50% balloon payment at maturity. We note that Otthon Centrum's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clause requires Otthon Centrum to repay the nominal amount in case of a rating deterioration (two-year cure period for a B/B- rating; repayment within 60 days after the bond rating falls below B-, which could have default implications). Other bond covenants in addition to the rating deterioration covenant include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, and dividend.

We base the rating on the going concern method, since the company has relatively few hard assets. We affirmed the BB- rating of the issuer's senior unsecured debt, reflecting limited prior ranking liabilities (leasing obligations) in the capital structure. We see material uncertainty regarding the group's asset values in a hypothetical default scenario, which would likely be driven by increased competition and/or a confidence loss in the business/brand and a departure of many licensees and agents.

Appendix: Peer comparison (as at last reporting date)

	Otthon Centrum Kft.	Duna House Holding Nyrt	Pannon Work Zrt.	Mobilbox Kft.	Progress Étteremhálózat Kft.
	BB-/Negative	BB/Stable	B+/Stable	BB/Stable	BB/Stable
Last reporting date	31 December 2022	31 December 2022	31 December 2021	31 December 2020	31 December 2022
Business risk profile					
Service offered	Loan brokerage, real estate brokerage and other financial and management services	Loan brokerage, real estate brokerage and other financial and management services	Human resource services	Rental and sales of office, storage and special containers	Franchisor of McDonalds restaurants in Hungary
Scope-adjusted EBITDA (EUR m)	3.9	9.1	2.4	17.4	20.6
Scope-adjusted EBITDA margin	7-13%	9-13%	5-7%	40-43%	13-18%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	net cash interest	net cash interest	11.6x	24.8x	13x
Scope-adjusted debt/EBITDA	0.7x	3.3x	4.5x	0.5x	3.2x
Scope-adjusted funds from operations/debt	125%	24%	14%	173%	28%
Scope-adjusted free operating cash flow/debt	69%	73%	-7%	70%	-14%

Sources: Public information, Scope

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