Otthon Centrum Holding Kft.
Hungary, Business Services

SCOPE BB- STABLE

Corporate profile

Otthon Centrum Holding Kft. (Otthon Centrum) was founded in 2000. The company runs a leading real estate agency network and provides 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 raised HUF 2.9bn through a bond issuance in 2021, with the primary goal of using the funds for the international expansion of its real estate and mortgage agency network.

Key metrics

			Scope estimates	
Scope-adjusted credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover	944x	-457x	21x	15x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	0.3x	0.5x	2.5x	2.3x
Scope-adjusted funds from operations/SaD	290%	171%	33%	35%
Free operating cash flow/SaD	61%	35%	36%	28%

Rating rationale

The ratings on Otthon Centrum Holding Kft. are based on the expectation that the company will pursue a debt-funded, acquisition-led growth strategy with moderate financial leverage.

Otthon Centrum's business risk profile is supported by: i) the company's position as one of the two leading real estate and loan brokerage firms in its home market of Hungary, the other one being Duna House Holding Nyrt. (BB-/Stable); and ii) its above-average profitability in the industry. Otthon Centrum operates an integrated real estate and loan brokerage business consisting of a network of physical offices supported by an online platform. Some diversification arises from operating profits being generated via several segments, the most important of which are the real estate brokerage franchise, credit intermediation services, the own physical agency network, and real estate-related consultancy services. Client base granularity is very high since the company is focused on the retail segment, which entails a high number of small transactions.

Otthon Centrum's business risk profile is constrained by the small absolute size of its business, the relatively fragmented markets in which it operates and a lack of geographic diversity. The company raised HUF 2.9bn through a bond issuance in April 2021 to fund the geographical expansion of its business. The funds are yet to be deployed and are likely to be the company's first major inorganic growth initiative outside its home market, which entails risk.

Otthon Centrum's financial risk profile is driven by its low financial leverage, as measured by the Scope-adjusted debt/EBITDA ratio, and our expectation that this will not exceed 3.5x (H1 2021: 2.4x) on a sustained basis following the planned acquisitions. The company has managed the effects of the pandemic well, with strong a recovery in revenue since mid-2020. Otthon Centrum recorded year-on-year revenue growth of 47% and a solid EBITDA margin of 23.2% in H1 2021.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured debt rating	BB-

Analyst

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Related Methodology

Corporate Rating Methodology, 6 July 2021

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Liquidity remains adequate, with over HUF 4bn of cash and equivalents at 30 June 2021, minimal short-term debt and cash outflows under our base case which are largely discretionary in nature (i.e. growth capex and dividends).

The overall rating outcome of BB- incorporates a one-notch downward adjustment based on our peer comparison, notably vis-a-vis the larger and more geographically diversified Duna House.

Outlook and rating-change drivers

The Outlook is Stable and incorporates our view on the relative stability of Otthon Centrum's core business of real estate and loan brokerage and its ability to generate positive free operating cash flow, also under stressed conditions in 2020 and 2021. Moreover, the Stable Outlook reflects our expectation that the issuer will use the proposed bond proceeds to acquire property agencies with a positive EBITDA contribution.

A positive rating action is remote at this point and would require Otthon Centrum to significantly expand in size and diversity while maintaining financial metrics in line with our expectations.

A negative rating action could be warranted if financial leverage increased to above 3.5x on a sustained basis. This could be caused by margin pressure due to growing competition from banks, online retailers or other larger organisations with greater financial muscle, adverse regulatory developments, or challenges in the integration of acquired businesses.

Rating drivers

Positive rating drivers	Negative rating drivers
• High visibility as one of the two largest real estate and loan brokerage franchisors in Hungary • Above-average profitability in the industry • High customer granularity • Asset-light business model with limited historical financial debt and low leverage • Cap on dividend at 50% of net profits under the bond indenture	• Strong dependency on general transaction volumes in the Hungarian real estate and loan markets with limited recurring revenue • Growing competition in (online) real estate and loan brokerage • Execution and integration risks posed by international expansion via M&A

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Significant expansion in size and diversity while maintaining financial leverage (SaD/EBITDA) below 2x	• Financial leverage (SaD/EBITDA) of above 3.5x on a sustained basis

Financial overview

			Scope estimates		
Scope-adjusted credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	944x	-457x	21x	15x	18x
Scope-adjusted debt (SaD)/SaEBITDA	0.3x	0.5x	2.5x	2.3x	1.9x
Scope-adjusted funds from operations/SaD	290%	171%	33%	35%	44%
Free operating cash flow/SaD	28%	16%	33%	25%	35%
Scope-adjusted EBITDA (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	985	784	1,317	1,410	1,689
Gains/losses on sale of assets	5	0	0	0	0
Scope-adjusted EBITDA	**990**	**784**	**1,317**	**1,410**	**1,689**
Scope-adjusted funds from operations (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	985	784	1,317	1,410	1,689
less: cash interest as per cash flow statement	-1	2	-63	-96	-95
less: cash tax paid as per cash flow statement	-124	-70	-173	-181	-215
Gains/losses on sale of assets	5	0	0	0	0
Scope-adjusted funds from operations	**864**	**715**	**1,081**	**1,133**	**1,379**
Free operating cash flow (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted funds from operations	864	715	1,081	1,133	1,379
Working capital change	-535	77	291	0	0
Non-operating cash flow	-15	0	0	0	0
Amortization of leasing obligations	-97	-78	-113	-90	-81
less: capital expenditure (net)	-128	-645	-195	-246	-195
Scope-adjusted free operating cash flow	**85**	**69**	**1,073**	**797**	**1,103**
Scope-adjusted debt (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	298	417	3,260	3,211	3,161
Scope-adjusted debt	**298**	**417**	**3,260**	**3,211**	**3,161**
Cash and equivalents	525	635	4,292	1,819	2,410

Business risk profile: B+

Industry risk of BBB based on medium cyclicality, barriers to entry and substitution risk

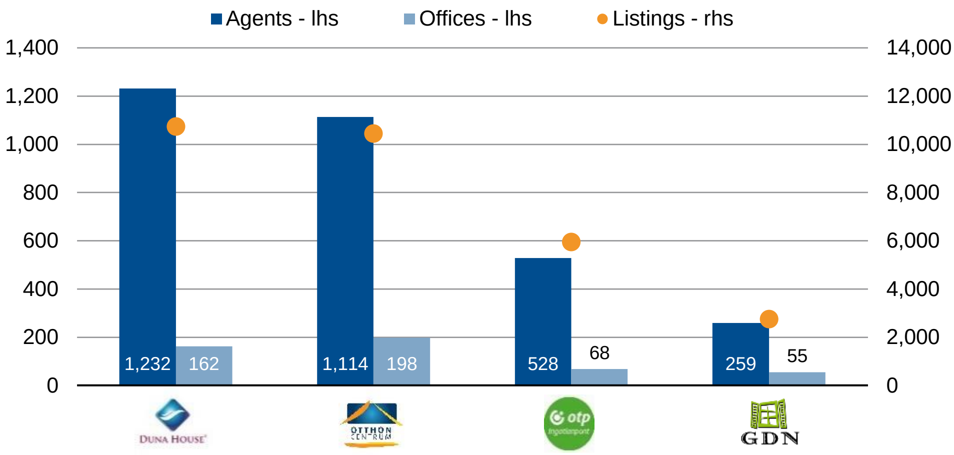
We classify Otthon Centrum as a business services provider, an industry we assess at BBB based on medium levels of cyclicality, substitution risk and entry barriers.

Business performance is closely linked to transaction volumes in the Hungarian real estate and loan markets, with limited recurring revenues. The ability to attract and retain franchisees and agents is very much dependent on a company's good reputation, its ability to keep up with technological advances, innovation, execution and its level of customer service. Regulation is another risk factor that can impact the credit intermediation business, as was evident by the cap on commission rates imposed in 2016.

Leading market position in Hungary

Otthon Centrum is one of the two leading real estate brokerage platforms in Hungary; the other is competitor Duna House, whose size is similar in terms of listings, offices and agents. We estimate Otthon Centrum's market share in the high single digits, both in real estate and loan brokerage (retail). The relative fragmentation of the markets implies little pricing power but also allows for a potential increase in market share going forward if the real estate brokerage sector continues its consolidation.

Figure 1: Hungarian residential real estate brokerage landscape, YE 2021



Sources: Otthon Centrum, public sources, Scope

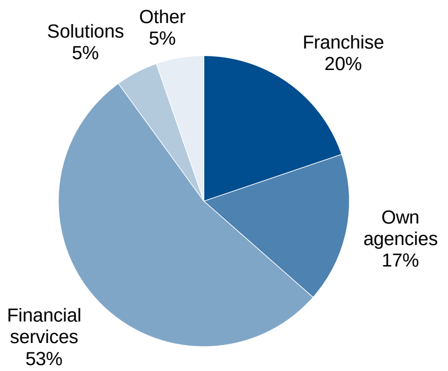
Profitability above industry average

Otthon Centrum has above-average profitability for its industry, with a Scope-adjusted EBITDA margin and return on capital above 20% in H1 2021 despite the pandemic. However, we see margins trending downwards in the coming years since near-term revenue growth is likely to focus less on higher-margin franchising and more on lower-margin agency acquisitions, which may require significant restructuring and integration expenses. Rising interest rates may also dampen demand for new loans. We see the possibility for margin pressures owing to the growing competition in (online) real estate and loan brokerage but recognise that Otthon Centrum appears to be gaining market share, notably in loan brokerage. As one of the two market leaders, the company also has the opportunity to further strengthen its market share through industry consolidation, which may mitigate price pressure. We expect Otthon Centrum to continue to grow its domestic business, both in its core and new complementary business areas.

Execution and integration risks associated with M&A

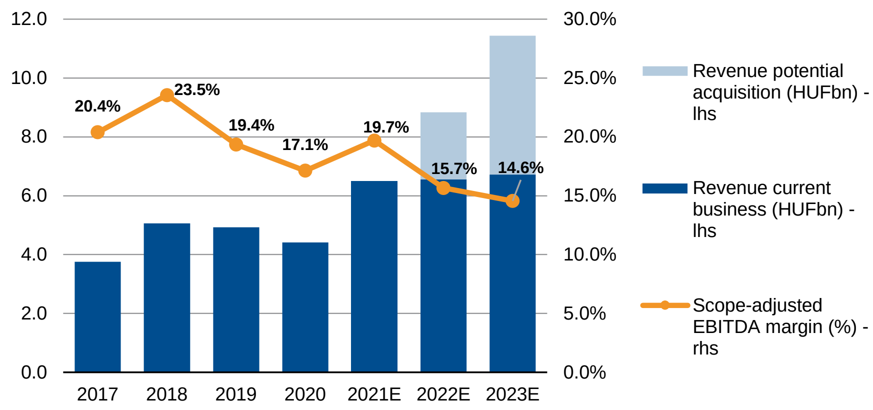
Concentration on a single geographic market is a weakness, although the focus on retail means client granularity is high. We see the benefits of the complementary service offering consisting of real estate brokerage, credit and insurance intermediation and other real estate-related services such as valuations, energy certificates and consultancy services. The planned acquisitions are likely to add geographic diversity to the company, but will also involve execution and integration risks, particularly since these transactions will be the first time the company is pursuing major inorganic growth in international markets.

Figure 2: Divisional revenue, 2020



Sources: Otthon Centrum, Scope

Figure 3: Turnover and Scope-adjusted EBITDA margin



Sources: Otthon Centrum, Scope

Very strong growth in 2021 fueled by rising house prices

Otthon Centrum fared well in 2021, with a strong recovery in real estate transaction volumes (+8.4% year-on-year) helped by a rebound in house prices and massive growth in loan volumes (+56.4% year-on-year). Commission levels have declined somewhat during the pandemic, however. The company recorded year-on-year revenue growth of 47% and a solid EBITDA margin of 23.2% in H1 2021

Looking forward, we expect growth to decelerate due to rising inflation, higher interest rates and consequently weaker purchasing power. Otthon Centrum has so far not experienced significant credit losses or customer defaults.

We believe investment in IT and digital services will be a key success factor for the industry going forward, and this has been a focus area for Otthon Centrum's capital spending in 2020. The company appears to have benefitted from this strategy, with strong growth in its credit intermediation business during the pandemic. The key risk is that banks, online retailers and other larger organisations with greater financial muscle will enter the marketplace.

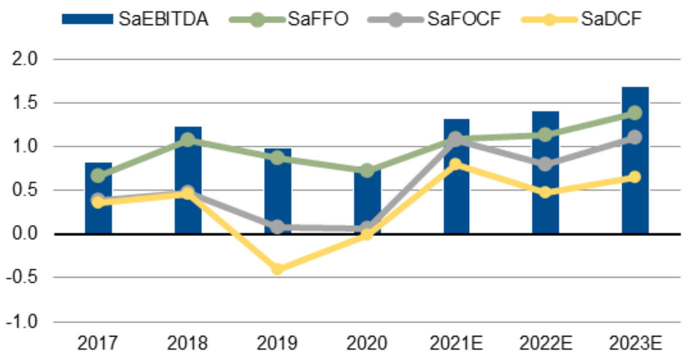
Financial risk profile: BBB-

Asset-light business model with limited historical debt and low financial leverage

Otthon Centrum's financial risk profile reflects an asset-light business model with limited historical debt and low financial leverage, as measured by the Scope-adjusted debt/EBITDA ratio, which we do not expect to exceed 3.5x (H1 2021: 2.4x) on a sustained basis.

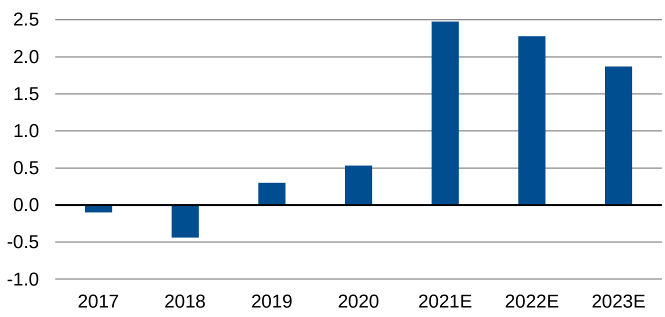
Otthon Centrum raised HUF 2.9bn through a bond issuance in April 2021 to fund inorganic expansion. The 10-year bond was priced at a low yield to maturity of 2.6% (coupon of 3%) with no amortisation until 2024. We have not applied cash netting for the purpose of our leverage assessment since the bond proceeds are earmarked for acquisitions. We assume that Otthon Centrum will primarily use the proceeds to acquire companies in the same field of operation, but with complementary geographic coverage. This may cause an initial spike in leverage, which will decrease over time as the acquired companies are integrated into Otthon Centrum and start to contribute to earnings.

Figure 4: Scope-adjusted cash flow (HUF bn)



Sources: Otthon Centrum, Scope

Figure 5: Scope-adjusted debt/EBITDA



Sources: Otthon Centrum, Scope

Cap on dividends protects business from negative ownership intervention

The bond caps dividend payouts at 50% of net profits. This reduces the risk of material cash flow leakage to the wider Biggeorge Holding group, the controlling shareholder of Otthon Centrum. Biggeorge Holding, which also has interests in real estate fund services and construction, is owned by Tibor Nagygyörgy.

Absence of short-term debt provides adequate liquidity position

Liquidity is adequate, with minimal short-term debt, healthy operating cash flow and major cash outflows expected under our base case to be largely discretionary in nature (i.e. acquisitions and dividends). Otthon Centrum has not traditionally experienced large swings in working capital and did not see cash balances drop below HUF 300m at the low point during the first half of 2020.

Figure 6: Liquidity

in HUF m	2021E	2022E
Cash and marketable securities $_{(t-1)}$	635	4,292
Committed unused bank facilities $_{(t-1)}$	0	0
Short-term debt $_{(t-1)}$	113	90
Free operating cash flow $_{(t)}$	1,073	797
Coverage	**1,517%**	**5,654%**

Source: Otthon Centrum, Scope

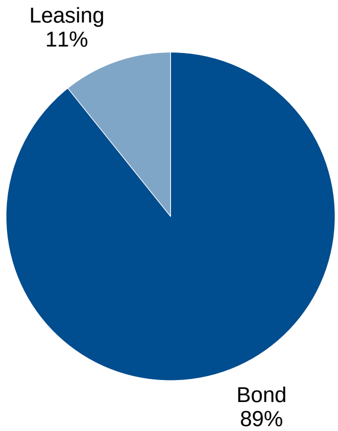
Long-term debt rating

Limited prior ranking liabilities in the capital structure

Average recovery expected for senior unsecured debt holders

We have assigned a debt class rating of BB- to senior unsecured debt, reflecting limited prior-ranking liabilities (leasing obligations) in the capital structure. We base our recovery assessment on a going concern enterprise valuation and expect an average recovery (30%-50%) for bond holders. We did not rate the debt higher due to Otthon Centrum's asset-light business model and the material uncertainty regarding its asset values in a hypothetical default scenario, which may be driven by increasing competition and/or a loss of confidence in the business and resulting departure of licensees and agents.

Figure 7: Funding sources, H1 2021



Source:: Otthon Centrum, Scope

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