Otthon Centrum Holding Kft. Hungary, Business Services

BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2022	2023	2024E	2025E
Scope-adjusted EBITDA/interest cover	net cash interest		net cash interest	
Scope-adjusted debt/EBITDA	0.7x	1.7x	2.4x	1.5x
Scope-adjusted funds from operations/debt	141%	83%	56%	65%
Scope-adjusted free operating cash flow/debt	69%	-2%	5%	22%

Rating rationale

The Outlook revision reflects that financial metrics remain within our rating case, although profitability weakens in 2023 and 2024 due to high integration and marketing costs. We expect leverage to rise only temporarily above 2x in 2024 and to return to between 1x and 2x in the long term due to an upturn in profitability and the absence of new debt issuance.

Otthon Centrum's rating is driven by its leading market position in its home market as a real estate agency and financial brokerage provider. The company's business risk profile suffers from the absence of geographical diversification, which exposes it to the macroeconomic trends of one market only. This is expected to change with the successful integration of the two acquired Polish entities, but the results will only be visible in the long term. Otthon Centrum's business risk profile is also constrained by low service strength, as the services it provides typically generate one-off transactions, thus limiting recurring revenues.

Otthon Centrum's financial risk profile is expected to weaken due to the decline in profitability, driving leverage above its historically low levels. However, we do not expect the ratio to rise above 3x, as there are no plans to issue new debt and HUF 1.7bn of outstanding bonds remain.

Outlook and rating-change drivers

The Stable Outlook, revised from Negative reflects the assumption that, although our expectation of declining EBITDA due to the integration of the new business has materialised and is expected to continue into 2024, the impact on leverage and cash flows has been less than expected. We now expect leverage to rise only temporarily above 2.0x, but to remain still largely within the rating case, and to return to between 1x and 2x in the long term.

A positive rating action is remote and would require Otthon Centrum to significantly increase its size and diversification while maintaining financial metrics in line with our expectations, i.e. Scope-adjusted debt/EBITDA below 2x for a sustained period.

A negative rating action would occur if financial leverage (Scope-adjusted debt/EBITDA) were to rise significantly above 3.0x on a sustained basis. This could be caused by margin pressure due to increased competition from banks, online retailers or other larger organisations with greater financial strength, adverse regulatory developments or challenges in integrating acquired businesses.

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodology

European Business and Consumer Services Rating Methodology, January 2024

General Corporate Rating Methodology; October 2023

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
17 Jun 2024	Outlook change	BB-/Stable
16 Nov 2023	Outlook change	BB-/Negative
15 Nov 2022	Affirmation	BB-/Stable

Rating and rating-change drivers

Positive rating drivers	Negative 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 across several real estate-related services; high customer granularity	• 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	Negative rating-change drivers
• Significant increase in size while maintaining Scope-adjusted debt/EBITDA below 2x	• Scope-adjusted debt/EBITDA significantly above 3.0x on a sustained basis

Corporate profile

Otthon Centrum Holding Kft. 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.

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

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	22.0x	Net cash interest	Net cash interest	Net cash interest	Net cash interest	24.6x
Scope-adjusted debt/EBITDA	2.0x	0.7x	1.7x	2.4x	1.5x	1.0x
Scope-adjusted funds from operations/debt	46%	141%	83%	56%	65%	91%
Scope-adjusted free operating cash flow/debt	40%	69%	-2%	5%	22%	35%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,236	1,509	781	547	794	1,064
Other items	-	-	-	-	-	-
Scope-adjusted EBITDA	**1,236**	**1,509**	**781**	**547**	**794**	**1,064**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,236	1,509	781	547	794	1,064
less: (net) cash interest paid	(56)	59	355	212	4	(43)
less: cash tax paid per cash flow statement	(63)	(187)	(224)	(4)	(4)	(6)
Other non-operating charges before FFO[1]	-	177	220	56	69	81
Funds from operations (FFO)	**1,117**	**1,558**	**1,132**	**755**	**794**	**1,015**
Free operating cash flow in HUF m						
Funds from operations	1,117	1,558	1,132	755	794	1,015
Change in working capital	283	(297)	(614)	(280)	(135)	(232)
less: capital expenditure (net)	(319)	(183)	(194)	(268)	(254)	(254)
less: lease amortisation	(113)	(139)	(137)	(137)	(137)	(137)
Other items	-	(178)	(220)	1	-	-
Free operating cash flow (FOCF)	**968**	**761**	**(33)**	**71**	**268**	**392**
Net cash interest paid in HUF m						
Interest paid	65	99	81	76	72	68
add: interest received	(9)	(158)	(436)	(288)	(76)	(25)
Net cash interest paid	**56**	**(59)**	**(355)**	**(212)**	**(4)**	**43**
Scope-adjusted debt in HUF m						
Reported gross financial debt	3,441	3,303	3,049	2,900	2,750	2,601
less: cash and cash equivalents[2]	-1000	-2,202	-1,692	-1,562	-1,522	-1,491
Scope-adjusted debt	**2,441**	**1,101**	**1,357**	**1,338**	**1,229**	**1,110**

[1] Other financial charges

[2] From 2022 50% of available cash netted only, as we consider it permanent.

Table of Content

Environmental, social and governance (ESG) profile[3]

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)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

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 have been identified.

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

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

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

Otthon Centrum has stated that it has a very rigorous process in place to avoid product mis-selling risk, 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.

[3] 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 a mainly specialised workforce, reflecting 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. With the recent acquisition of Open House (about 30 offices), the company further consolidated its market position in Hungary. Its main competitor is Duna House, which has continued to grow outside of Hungary (mainly Italy) and remains significantly larger.

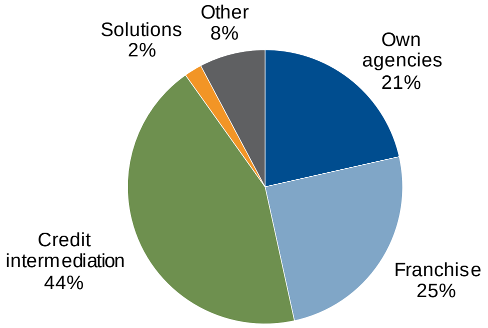
Geographical diversification set to improve

The geographical focus on Hungary makes poor diversification a negative rating driver for Otthon Centrum, especially in comparison to Duna House, which also has a significant presence in Italy, Poland and, to a minor extent, the Czech Republic. This is, however, likely to change after the acquisition of two Polish broker franchises totalling 120 offices in 2023. 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 around 10% in the first three years, as the issuer focuses on the successful integration of the Polish offices rather than growth.

There is some diversification in Otthon Centrum's product offering, with around half of revenue coming from real estate brokerage (franchises and own agencies) and half 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 to be credit-positive as they provide some cash flow stability.

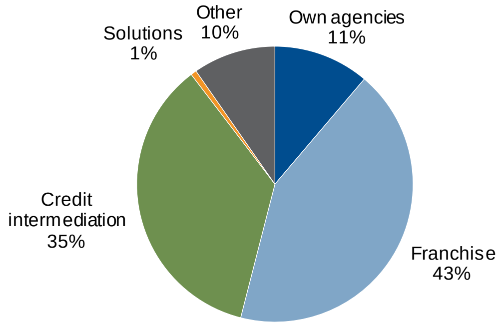
Customer granularity is very high given the focus on retail customers. However, the nature of the service, which typically involves one-off transactions, is also a negative factor, as it limits the opportunities to build recurring revenues. Otthon Centrum is trying to mitigate this risk by focusing on increasing cross-selling while improving penetration in the insurance segment, a product that offers long-term contracts.

Figure 1: Revenue by segment (2024 issuer's forecast)



Sources: Otthon Centrum, Scope

Figure 2: EBITDA by segment (2024 issuer's forecast)



Sources: Otthon Centrum, Scope

Profit margin trending downwards…

While profitability has been solid in the past, with a Scope-adjusted EBITDA margin of around 20% (higher than its main competitor Duna House), the margin declined to 13.6%

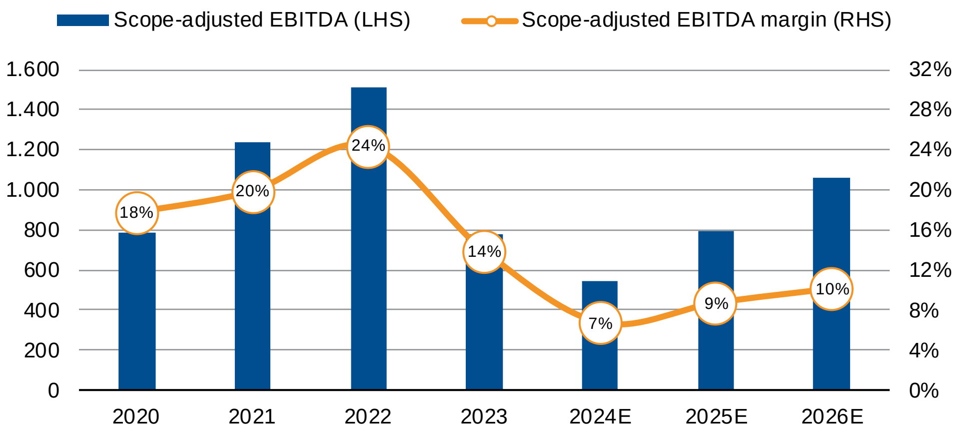
in 2023, due to lower revenues and higher costs related to the Polish acquisitions. This decline was anticipated by the company last year and margins are expected to decline further to around 8% in 2024 due to:

- The lower margin initially expected from the Polish franchises, which still require high restructuring and integration costs, while the revenue contribution is expected to remain limited. The issuer plans to spend HUF 60m in 2024 to integrate all branches into the Freedom franchise and to launch a marketing campaign to open as many branches as possible in order to achieve the expected revenues.
- Increasing costs in Hungary, driven by the implementation of a new sales strategy, including the development of a new sales team that will focus more on cross-selling, especially insurance, in order to benefit from more recurring revenues in the long term. The main rise in costs will be related to personnel and credit intermediation.
- A cost increase in 2024 due to the establishment of a new FinTech, which will also provide administrative applications and software for Otthon Centrum and the market.

…but will recover from 2025 on

We expect margins to increase from 2025 and to reach around 10% in 2026 as the restructuring ends and the Polish business starts to contribute revenue and EBITDA. Our assumption is supported by a good start in 2024, as all segments' EBITDA in Q1 2024 was above plan.

Figure 3: Scope-adjusted EBITDA (HUF m) and Scope-adjusted EBITDA margin



Sources: Otthon Centrum, Scope estimates

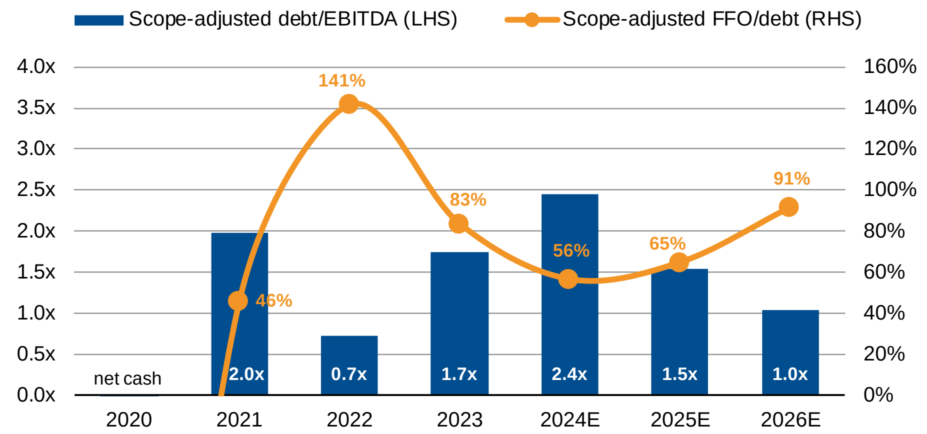
Financial risk profile: BB+

We assess Otthon Centrum's financial risk profile at BB+.

Leverage threatened by the profitability downtrend

Otthon Centrum has historically benefited from low leverage, measured by Scope-adjusted debt/EBITDA, of less than 2x. We expect leverage to temporarily increase as a result of declining profitability, ranging between 2x and 3x in the short term, as the company incurs additional costs to integrate the new business. We expect the increase to be temporary. Leverage should recover on the back of the increasing EBITDA contribution from 2025 onwards, returning to below 2x. This expectation is further supported by the assumption that Otthon Centrum will not need additional debt financing in the forecast period, as HUF 1.7bn of the issued bond is still available.

Figure 4: Leverage



Sources: Otthon Centrum, Scope estimates

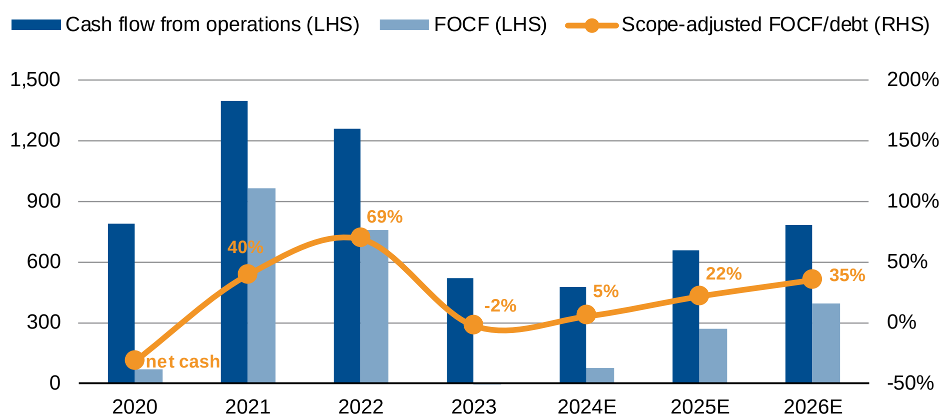
Strong interest coverage

Otthon Centrum benefits from positive interest income. This is due to the low coupon (3%) on the bond, and the high interest the company currently earns on its HUF deposits with local banks (although Otthon Centrum expects this to fall sharply). Even if debt protection is likely to decrease, we anticipate that the ratio will stay largely above 10x, as no acquisitions are expected in the short term and almost all debt is fixed rate.

Cash flow coverage reduced

Otthon Centrum has historically had positive FOCF, including in 2020 when it underwent a major IT upgrade. However, cash flow cover turned negative in 2023 due to the declining profitability and negative net working capital. We anticipate that FOCF will again become positive or break even from 2024. This is despite the decline in EBITDA in the first forecast year, as we expect net working capital changes to be less consistent and to return to the historical average.

Figure 5: Scope-adjusted FOCF/debt (%)



Sources: Otthon Centrum, Scope estimates

Adequate liquidity

Liquidity remains adequate, with over HUF 3bn of cash and equivalents at 31 December 2023, minimal short-term debt and cash outflows, which are largely discretionary (i.e. growth capex and dividends) under our base case. Otthon Centrum has not traditionally experienced large swings in working capital and did not see cash balances drop below HUF 300m even at their low point, which was H1 2020. The senior unsecured bond will start amortising in 2024 (HUF 149m annually) and other bank debt is negligible.

We highlight that Otthon Centrum's senior unsecured bonds issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 2.9bn) if the debt rating of the bonds stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 120 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is 1 notch. We therefore see no significant risk of the rating-related covenant being triggered.

Other bond covenants in addition to the rating deterioration covenant include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, and dividend.

Balance in HUF m	2023	2024E	2025E
Unrestricted cash (t-1)	4,404	3,385	3,123
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	-33	71	268
Short-term debt (t-1)	15	164	164
Coverage	**>200%**	**>200%**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB-

Otthon Centrum issued a HUF 2,981m senior unsecured bond (ISIN: HU0000360391) 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, while HUF 1,699m 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 yearly from 2028 to 2030, and a 50% balloon payment at maturity.

We have rated senior unsecured debt at BB-, the same level as the issuer rating, reflecting limited prior-ranking liabilities (leasing obligations) in the capital structure. Our recovery assessment is based on a going concern enterprise valuation and we expect an average recovery (30%-50%) for bondholders. We do not rate the debt higher due to Otthon Centrum's asset-light business model and material uncertainty regarding its asset value in a hypothetical default scenario, which may be driven by increasing competition and/or a loss of confidence in the business and the resulting departure of 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-/Stable	BB-/Stable	B+/Stable	BB/Stable	BB/Stable
Last reporting date	31 December 2023	31 December 2023	31 December 2022	31 December 2022	31 December 2023
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)	1.9	6.1	2.8	29.6	33
Scope-adjusted EBITDA margin	7-13%	9-13%	5-7%	40-45%	13-18%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	net cash interest	net cash interest	12.3x	115.3x	24.6x
Scope-adjusted debt/EBITDA	1.7x	4.8x	4.7x	0.7x	3.0x
Scope-adjusted funds from operations/debt	83%	17%	18%	127%	33%
Scope-adjusted free operating cash flow/debt	-2%	21%	5%	23%	22%

* Not published yet

Sources: Public information, Scope

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