26 September 2022

Corporates

Alfa Equity Holding Kft. Hungary, Real Estate

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021P**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	5.0x	2.3x	2.8x	1.9x
Scope-adjusted debt/EBITDA	15.6x	9.9x	9.5x	14.7x
Scope-adjusted loan/value ratio (LTV)	66%	44%	38%	50%

Rating rationale

Alfa Equity Holding Kft. (AEH)'s business risk profile (assessed at B+) reflects the company's relatively small size and market share, with total assets of EUR 149m at end-December 2021 (preliminary), a relatively short weighted-average unexpired lease term (WAULT) of 3.3 years in June 2022, and a significant development pipeline of over EUR 300m of gross development value over the coming five years (of which EUR 32m committed and funded). Development risk is partially mitigated through a pre-sale (20-40%) and pre-let (50-60%) strategy and fixed price turn-key construction contracts. Operating margins for the rental assets improved in 2021 to more than 50% on higher occupancy but remain below average. AEH managed the Covid-19 crisis relatively well, with lower occupancy mainly in the office segment and some government-imposed concessions in favour of tenants in the retail segment. The company's diverse portfolio by asset type, focused mainly on commercial real estate (retail, logistics and office), and a development pipeline with an emphasis on residential property, as well as good tenant diversity provide support for the rating. The company's assets are in Budapest (Hungary) and Bratislava (Slovakia), classified as B-locations, but providing an element of geographic diversity. Finally, occupancy stood at 94% at June 2022, reflecting good asset quality, particularly in the logistics segment.

The financial risk profile (assessed at BB) reflects moderate leverage, as measured by the Scope-adjusted loan/value (LTV) ratio of 44% at YE 2021 (prelim.). The LTV ratio improved in 2021 due to conversion of part of outstanding shareholder loans to equity as well as some uplift to asset values on favourable planning outcomes. We do not expect the company to pay excessive dividends given funding needed for its full development pipeline and commitment to maintaining the LTV below 60%. We expect an increase in revenue and EBITDA in 2022 with 7871 sq m of additional net leasable area at Alfa Hub Business 11 and the handover of 2913 Uptown Homes, to some extent offset by higher energy costs, some of which cannot contractually be passed on to tenants. Revenue and EBITDA are set for another boost in 2023 when phase 1 of the Haller residential development (gross value EUR 32m) in Budapest is scheduled for handover. Forex risk is managed by matching the currency of debt and revenue, while the cost of debt is set to rise as around 60% is floating (mostly denominated in EUR). Rising interest costs, together with a significant increase in developments in progress, will put pressure on debt protection in 2023 and 2024. The extent of pressure will be a function of the pace of execution of the large development pipeline, movements in interest rates and trends in real estate rents and sale prices. Scope-adjusted EBITDA interest cover should remain above 2x (2021 prelim.: 2.3x) over the long term.

The overall rating is lowered by one notch based on our peer comparison and AEH's small size compared to rated peers.

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

Analyst

Tommy Träsk
+49 69 33689 36
t.traesk@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; 15 July 2022

European Real Estate Methodology; 25 January 2022

ESG considerations for the credit ratings of real estate corporates; 23 April 2021

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Outlook and rating-change drivers

The Outlook is Stable reflecting a high pre-let ratio of 75% at the Alfa Hub 11 expansion and strong demand for AEH’s residential real estate developments with current price expectations above budget. We expect the EBITDA margin for rental operation to remain above 50% in 2022 and 2023 based on good occupancy. The rating and Outlook assume that contracted asset swaps (Haller development) with related parties are confirmed by the banks and the relevant authorities.

A positive rating action would require AEH to achieve a larger size and Scope-adjusted EBITDA interest cover sustainably above 3x. This larger size could be accomplished through successful execution of its development pipeline.

A negative rating action would be possible if the LTV increased sustainably above 60% or interest cover fell below 2x, both on a sustained basis, or liquidity worsened materially. Leverage could increase if the value of portfolio properties dropped due to wider yields, weaker rental cash flow, or excessive growth through speculative development. Liquidity could worsen if, for example, the company suffered project delays or cost overruns, tenant payment delays, or subsidiary profits were trapped because of covenant breaches at the bank borrowing entity level.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
26 Sep 2022	Affirmation	B+/Stable
21 Oct 2021	New	B+/Stable

Positive rating drivers	Negative rating drivers
• Diverse portfolio by asset type (mainly retail, logistics, and office) located in Slovakia and Hungary with relatively low tenant concentration • Relatively modern assets with an average age of around seven years • Exposure to B location investment markets, but with asset quality reflected in high occupancy of 94% at June 2022 • Moderate leverage with LTV of 44% at YE 2021 • Natural currency hedge	• Small company with net leasable area of 107,000 sq m (eight assets) and total assets of EUR 149m at YE 2021 • Relatively short WAULT of 3.3 years at June 2022, leaving the company exposed to market volatility • Significant development exposure, with gross development value of over EUR 300m over the coming five years • Scope-adjusted EBITDA margin of 54% for 2021, at the lower end of the peer group • Exposure to higher interest rates with about 60% of debt at floating rates and an average debt maturity of about 3.5 years • All income-producing assets encumbered in favour of secured lenders

Positive rating-change drivers	Negative rating-change drivers
• Larger size and Scope-adjusted EBITDA/interest cover sustainably above 3x	• Scope-adjusted EBITDA/interest cover of sustainably below 2x or LTV above 60% • Materially worsened liquidity

Corporate profile

AEH is the holding company of a group of Hungarian and Slovakian property companies indirectly owned by Mr. Ohad Epschtein. The company is active in real estate rentals, property management and development. It has a portfolio of predominantly retail, logistics and office real estate rental assets valued at about EUR 109m and a development pipeline of over EUR 300m. AEH develops assets both for property sales and for its own rental portfolio. The company has been operating in Hungary for over 20 years and in Slovakia for over 10 years.

Financial overview

				Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021P**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	4.8x	5.0x	2.3x	2.8x	1.9x
Scope-adjusted debt/EBITDA	16.4x	15.6x	9.9x	9.5x	14.7x
Scope-adjusted loan/value ratio (LTV)	71%	66%	44%	38%	50%
Scope-adjusted EBITDA in EUR m					
EBITDA	6,428	5,684	6,351	8,558	13,923
Less: earnings from development activities	0	0	0	-1,948	-6,885
Scope-adjusted EBITDA	**6,428**	**5,684**	**6,351**	**6,610**	**7,038**
Funds from operations in EUR m					
Scope-adjusted EBITDA	6,428	5,684	6,351	6,610	7,038
less: (net) cash interest paid	-1,340	-1,126	-2,745	-2,347	-3,613
less: cash tax paid per cash flow statement	-163	-174	-1,172	-312	-928
Change in provisions	11	23	79	-24	0
Funds from operations (FFO)	**4,936**	**4,407**	**2,513**	**3,928**	**2,497**
Scope-adjusted total assets in EUR m					
Reported total assets	155,501	139,414	149,082	171,950	219,481
Less: cash and equivalents	-6,734	-4,900	-4,372	-5,196	-14,908
Scope-adjusted total assets	**148,767**	**134,514**	**144,710**	**166,753**	**204,573**
Net cash interest paid in EUR m					
Net cash interest per cash flow statement	-1,340	-1,126	-2,745	-2,347	-3,613
Net cash interest paid	**-1,340**	**-1,126**	**-2,745**	**-2,347**	**-3,613**
Scope-adjusted debt in EUR m					
Reported gross financial debt	105,592	88,567	62,965	62,723	103,056
add: provisions	11	34	113	89	89
Scope-adjusted debt	**105,603**	**88,601**	**63,079**	**62,812**	**103,146**

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Environmental, social and governance (ESG) profile[1]

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)

Sustainability is an important part of the company's strategy

AEH targets for all its assets to be within the 15% most energy efficient of the relevant segment. To achieve this, it has installed solar panels on many roofs and fitted water pumps for energy-efficient heating and cooling.

The company is indirectly owned by a private individual. It had over EUR 30m of related party receivables outstanding at YE 2021, some of which are to be exchanged for real estate development land held by the same owner outside of the rated entity. Our base case assumes the exchange will happen in 2022 as outlined by the company. Scope-adjusted debt included about EUR 18m of shareholder and related-party loans at YE 2021, some of which are pass-throughs of bank loans at the related parties. The related party transactions add some complexity and uncertainty to the financial analysis and slows down the audit process, which has not been finalised for 2021.

Financial policy is clear, and we do not expect significant shareholder distributions in the foreseeable future.

[1] 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+

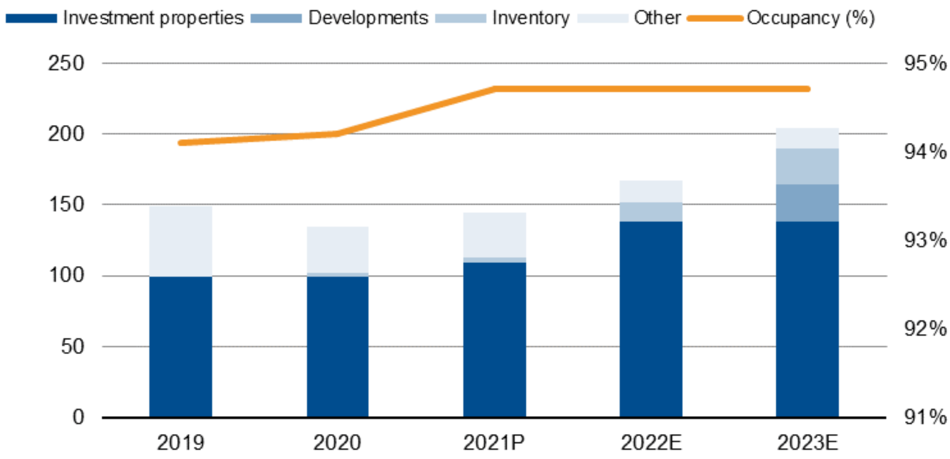
Industry risk profile: BB

AEH's activities comprise the leasing and management of primarily commercial real estate and the development of primarily residential real estate assets for sale and rental. The assigned industry risk of BB is a blend of commercial real estate rentals (industry risk of BB) and residential real estate development (industry risk of BB). Both industries have medium barriers to entry and risk of substitution. Commercial rentals are subject to medium cyclicality, whereas residential development is highly cyclical.

Development risk mitigated through pre-sale/letting and fixed-price, turnkey construction

AEH has a very large development pipeline of over EUR 300m, primarily focused on residential real estate development in Budapest, partly for its own rental portfolio but mostly for property sales. Development risk is partially mitigated through a pre-sale (20-40%) and pre-let (50-60%) strategy and fixed-price turnkey construction contracts. Developments undertaken over the past year have been severely delayed due to shortages of building materials but were delivered on budget. The only committed and funded development is a major residential development in Budapest, Haller, of which phase 1 is 53% pre-sold.

Figure 1: Asset breakdown (EUR m) and occupancy rate (%)

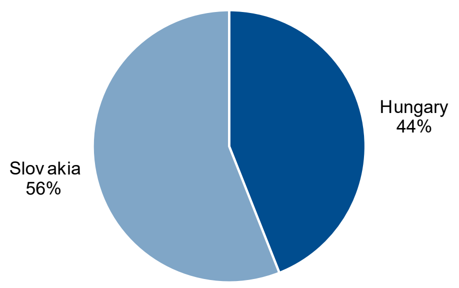


Sources: AEH, Scope (estimates)

One of the smallest companies in the peer group, but with a sizeable development pipeline

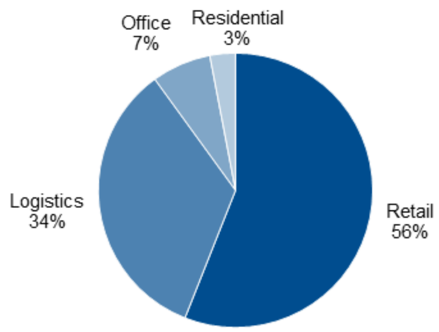
AEH is relatively small, with eight assets providing a net leasable area of 107,000 sq m and total assets of EUR 149m (Figure 1). This limited size is a negative rating driver since it implies enhanced sensitivity to unforeseen shocks, limited economies of scale and high key person risk. AEH has an ambitious five-year development pipeline with a gross investment value of over EUR 300m. Over time, this will increase the company's size and diversity. AEH is, however, one of the smaller companies in the rated peer group, with low market shares within its locations and asset classes. AEH operates mainly in Budapest and Bratislava, two cities classified as 'B locations' according to our European Real Estate Rating Methodology, implying that these markets are average in terms of size, growth potential and asset liquidity (Figure 2).

Figure 2: Asset breakdown by value (Dec 2021)



Sources: AEH, Scope

Figure 3: Asset breakdown by value (Dec 2021)

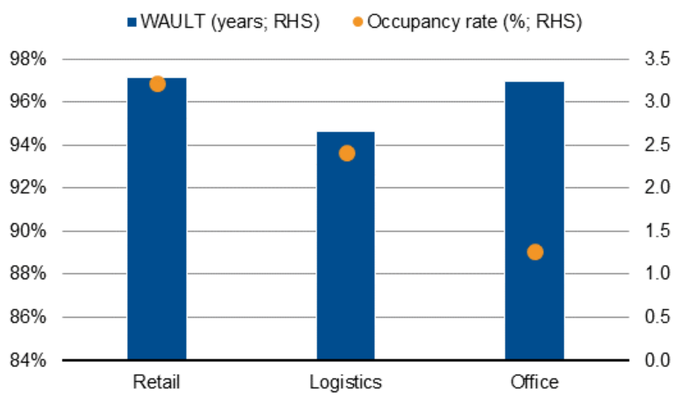


Sources: AEH, Scope

AEH has a diverse portfolio by asset type and unusually good tenant diversity for a company of its size. Although retail comprised 56% of assets at December 2021 (Figure 3), underway and planned investments are mostly in residential and logistics assets, which will further increase asset class diversity. The company's presence across multiple asset classes constituted a strength during the Covid-19 pandemic, considering the weaker demand for office and retail assets and stronger demand for logistics assets.

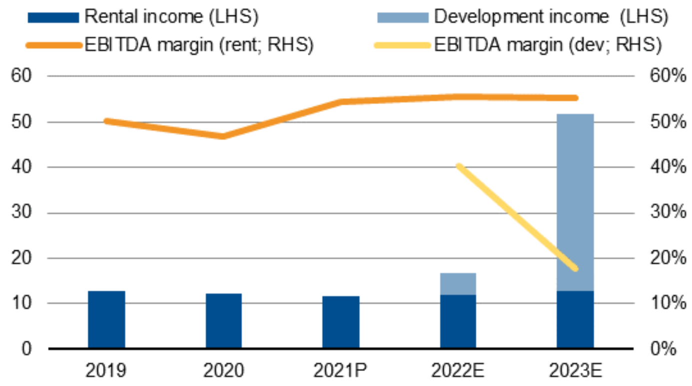
AEH's portfolio occupancy rate stood at 94% at June 2022 (95% at December 2021), signalling good overall asset quality, with a notable strength in the logistics segment. The assets are also relatively new or recently modernised with an average age of six to seven years. Conversely, WAULT stood at only 3.3 years at June 2022 (3.1x at December 2021). This relatively low number exposes the company to reletting risk and potential cash flow volatility (Figure 4).

Figure 4: WAULT and occupancy rate (Dec 2021)



Sources: AEH, Scope

Figure 5: Revenue and EBITDA margin (EUR m)



Sources: AEH, Scope (estimates)

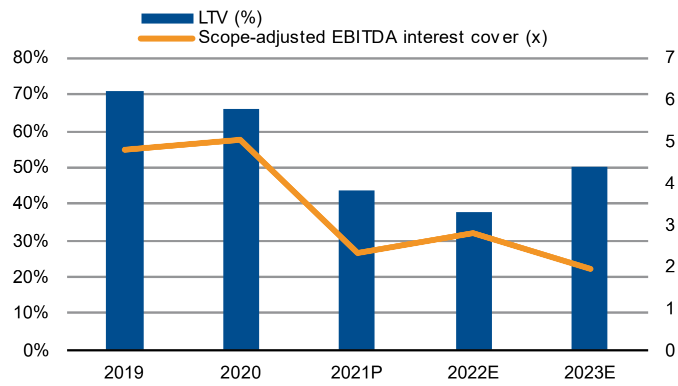
AEH's profitability, as measured by its Scope-adjusted EBITDA margin, was 54% in 2021 (Figure 5), at the lower end of the peer group. Overall margins are likely to decrease in H2 2022 and 2023 given that the company will recognise significantly lower margin earnings from real estate development in these periods. We nevertheless expect margins from the rental business to remain above 50% on sustained high occupancy.

Financial risk profile: BB

Moderate leverage with LTV at 44% at December 2021

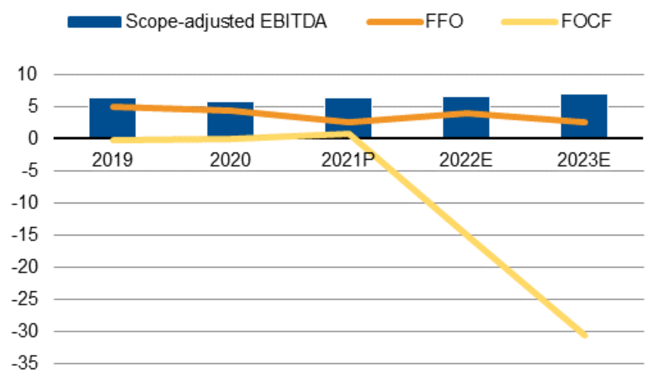
The financial risk profile reflects moderate leverage, as measured by an LTV ratio of 44% at YE 2021 (prelim.). The LTV ratio improved in 2021 due to the conversion of some outstanding shareholder loans into equity as well as an uplift to asset values on favourable planning outcomes. We do not expect the company to pay excessive dividends to enable funding of its very large development pipeline, whilst maintaining the LTV below 60%. We expect an increase in revenue and Scope-adjusted EBITDA in 2022 with 7,871 sq m of additional net leasable area at Alfa Hub Business 11 and the handover of 2913 Uptown, to some extent offset by higher energy costs, some of which cannot contractually be passed on to tenants. Revenue and EBITDA are set for another boost in 2023 when phase 1 of the Haller residential development (gross value: EUR 32m) in Budapest is scheduled for handover.

Figure 6: LTV and interest cover



Sources: AEH, Scope (estimates)

Figure 7: Scope-adjusted EBITDA and cash flow (EUR m)

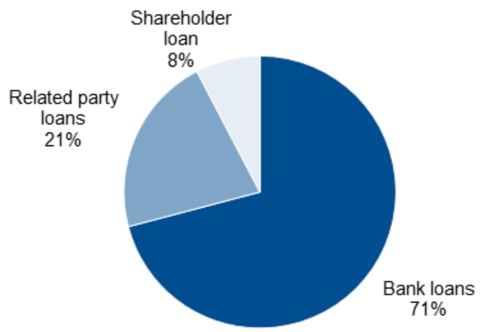


Sources: AEH, Scope (estimates)

Debt service to be pressured in 2023 and 2024, but to remain above 2x over the long term

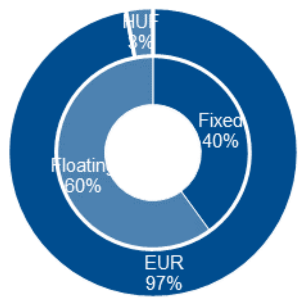
Forex risk is managed by matching the currency of debt and revenue, whilst cost of debt is set to rise in 2022 onwards as around 60% of debt is floating (Figure 9). This, together with a significant increase in developments in progress, is expected to put pressure on debt protection in 2023 and 2024. The extent of pressure will be a function of the pace of execution of the large development pipeline, movement of interest rates and the evolution of real estate rents and sale prices. We nevertheless expect Scope-adjusted EBITDA/interest cover to remain above 2x (2021 prelim.: 2.3x) in the long term.

Figure 8: Sources of financing (Dec 2021)



Sources: AEH, Scope

Figure 9: Debt overview (Jun 2022)



Sources: AEH, Scope

Adequate liquidity

We consider AEH's liquidity as adequate. The company had EUR 4.4m in cash and EUR 4.5m of short-term debt as at December 2021 and has since secured a HUF 7.59bn

(EUR 15.4m) credit facility due in December 2023 to fund the ongoing Haller phase 1 residential development. Financing has not yet been secured for the remainder of the development pipeline (we expect execution only once financing is in place). The company is in the process of refinancing (pooling) all its asset-based financing with one syndicated bank loan facility secured on its income-producing assets. The weighted average remaining term of the bank loans is three to four years. We understand covenant headroom is adequate under all loans.

Balance in EUR m	2022E	2023E
Unrestricted cash (t-1)	4,372	5,196
Open committed credit lines (t-1)	15,400	0
Free operating cash flow	-15,097	-30,622
Short-term debt (t-1)	4,515	2,859
Coverage	**104%**	**-889%**

Supplementary rating drivers: - 1 notch

The overall rating is lowered by one notch based on peer comparison and AEH's relatively small size compared to rated peers. The company lacks economies of scale and does not have the same access to capital market funding as its larger peers.

The company also has a more ambitious growth strategy than most of its peers.

Long-term debt ratings

Income-producing assets encumbered in favour of secured lenders

All of AEH's income-producing assets are encumbered in favour of its secured lender. Nevertheless, we expect an 'average' recovery for senior unsecured debt in a hypothetical default scenario and therefore rate it in line with the issuer rating of B+.

Appendix: Peer comparison

	Alfa Equity Holding Kft.	Summus Capital OU	Wingholding Zrt.	Jaka Trade Kft.
	B+/Stable	BB/Stable	B+/Stable	B-/Stable
Last reporting date	31 December 2021 (prelim.)	31 June 2022	31 December 2021	30 September 2021
Business risk profile				
Scope-adjusted total assets (EUR m)	145	416	1,500	15[2]
Portfolio yield	na	7%	6.8%	10%
GLA (thousand sq m)	107	218	600	75
Countries active in	2	3	3	1
Top 3 tenants (%)	12%	19%	10%	32%
Top 10 tenants (%)	24%	38%	17%	60%
Office (share NRI)	7%	18%	69%	na
Retail (share NRI)	56%	60%	7%	na
Residential (share NRI)	3%	0%	0%	na
Hotel (share NRI)	0%	0%	3%	na
Logistics (share NRI)	34%	12%	21%	na
Others (share NRI)	0%	10%	0%	na
Property location	'B'	'B'	'B'	'B'
EPRA occupancy rate (%)	94%	97%	86%	73%
WAULT (years)	3.1	5.0	6.0	1.6
Scope-adjusted EBITDA margin	54%	63%	29%	47%
Financial risk profile				
Scope-adjusted EBITDA/interest cover	2.3	2.0	4.3	1.9[3]
Scope-adjusted debt/EBITDA	9.9	9.7	9.0	34.8[4]
Scope-adjusted loan/value ratio	44%	54%	71%	54%[5]
Weighted average cost of debt	4.4%	2.8%	4.2%	3.6%
Unencumbered asset ratio	0%	301%	>100%	na
Weighted average maturity (years)	3.5	3.7	na	4.6

Sources: Public information, Scope

[2] Based on our estimates.
[3] Proforma for 9 months to end-September 2021
[4] Average between 2021 and 2023E.
[5] Average between 2021 and 2023E.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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