Jaka Trade Kft.
Hungary, Real Estate

SCOPE B- STABLE

Corporate profile

Jaka Trade Kft. was established in 2010. The company is engaged in the utilisation (warehousing) and development of its own real estate portfolio of 51,624 sq m of commercial real estate as well as the utilisation (sub-lease) of a 23,200 sq m industrial park owned by a third party. Jaka has purchased almost all its properties from liquidation proceedings. Jaka's assets are in the greater Budapest area.

Key metrics

		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	net interest income	4.2x	1.0x	0.3x
Scope-adjusted debt (SaD)/EBITDA	5.2x	8.5x	22.2x	73.5x
Scope-adjusted loan/value ratio	47%	55%	47%	59%

Rating rationale

Scope assigns first time B-/Stable issuer rating to Jaka Trade Kft.

The rating is driven by the company's small size, which results in a concentrated portfolio carrying the risk of volatile cash flow. Further, the company's debt-driven growth will significantly weaken its credit metrics, at least in the investment phase.

Jaka Trade's business risk profile suffers from the company's small size, its associated key person risk, and volatile cash flow from a highly concentrated portfolio. The company's portfolio, while benefitting from relatively good property locations, is somewhat aged, resulting in weak key performance indicators limiting cash flow visibility, below peer profitability with Scope-adjusted EBITDA margins, and increased capex needs.

While planned capex will certainly have a positive impact on asset quality, it comes at the expense of an increase in leverage caused by negative free operating cash flow that will be debt funded. As capex-related top line growth is expected to kick in with an 18 to 24-month delay, Jaka Trade will suffer from below-par (<1x) interest coverage during the first part of the upcoming investment phase (2022 to 2023). Furthermore, Jaka Trade's liquidity is seen as weak since cash uses are not fully covered by cash sources, pointing to a continued dependence on external financing, at least during the upcoming investment phase.

Outlook and rating change drivers

The Outlook for Jaka Trade is Stable and reflects our expectations that the company will execute the development of the first phase of the workers' hostel (to be delivered between 2023-26) - financed with secured investment loans - as well as the housing project (2024). The Outlook further reflects a substantial increase in leverage triggered by the debt funded development activity, with a Scope-adjusted loan/value ratio of between 50% and 60% and Scope-adjusted debt/Scope-adjusted EBITDA significantly above 10x during the first phase of the investment phase.

A positive action is remote and would require the company to grow significantly, which could occur after the planned investment phase, while keeping Scope-adjusted loan/value ratio sustainably below 60%, paired with adequate liquidity.

Ratings & Outlook

Corporate rating: B-/Stable

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Related Methodologies

Corporate Rating Methodology: July 2021

Rating Methodology: European Real Estate Corporates January 2022

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A negative rating action is possible if liquidity weakens further, and the company loses access to external financing, on which the development projects rely.

Rating drivers

Positive rating drivers	Negative rating drivers
• Relatively good property locations • Planned capex with positive impact on asset quality	• Small real estate company with highly concentrated portfolio (# of properties, top tenants) • Aged portfolio with weak KPI's • Increase in leverage caused by negative free operating cash flow as a consequence of ambitious growth • Weak liquidity • Key person risk [negative ESG factor]

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Significant growth in size, while keeping Scope-adjusted loan/value below 60% paired with adequate liquidity	• Weakening liquidity

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**9M 2021[1]**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	net interest income	3.1x	4.2x	1.0x	0.3x
Scope-adjusted debt (SaD)/EBITDA	5.2x	4.6x	8.5x	22.2x	73.5x
Scope-adjusted loan/value ratio	47%	50%	55%	47%	59%
Scope-adjusted EBITDA in HUF m	**2020**	**9M 2021[1]**	**2021E**	**2022E**	**2023E**
EBITDA	39	24	34	125	320
Operating lease payments in respective year	66	49	66	68	70
Others[2]	0	0	0	-109	-345
Scope-adjusted EBITDA	**104**	**73**	**100**	**83**	**44**
Scope-adjusted funds from operations in HUF m	**2020**	**9M 2021[1]**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	104	73	100	83	44
less: (net) cash interest as per cash flow statement	112	0	0	-57	-103
less: interest component operating leases	-24	-24	-24	-24	-25
less: cash tax paid as per cash flow statement	-1	0	-2	-2	-8
Scope-adjusted funds from operations	**192**	**49**	**74**	**1**	**-92**
Scope-adjusted debt in HUF m	**2020**	**9M 2021[1]**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	0	128	303	1,292	2,675
add: operating lease obligations	543	543	543	559	576
Scope-adjusted debt	**543**	**671**	**846**	**1,851**	**3,251**
Cash balance in HUF m	**2020**	**9M 2021[1]**	**2021E**	**2022E**	**2023E**
Cash balance[3]	24	8	5	237	255

[1] Pro-forma 9M results based on the company's general ledger
[2] Net effect of housing project: revenues less costs recognised under percentage of completion method. We assumed services employed for the standing portfolio in the period 2021-2023 to be HUF 88m per year
[3] Netting of cash: generally, only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible

Business risk profile: B-

Industry risk: B+

Jaka Trade is a real estate investor and developer, thus exposed to two sub-segments (commercial real estate: BB; and development: B) of the real estate industry. Based on gross asset value contribution during the forecast period (up until 2024), development properties contribute a share of around 60%, leading to a blended industry risk of B+.

Figure 1: Industry risk assessment: European real estate

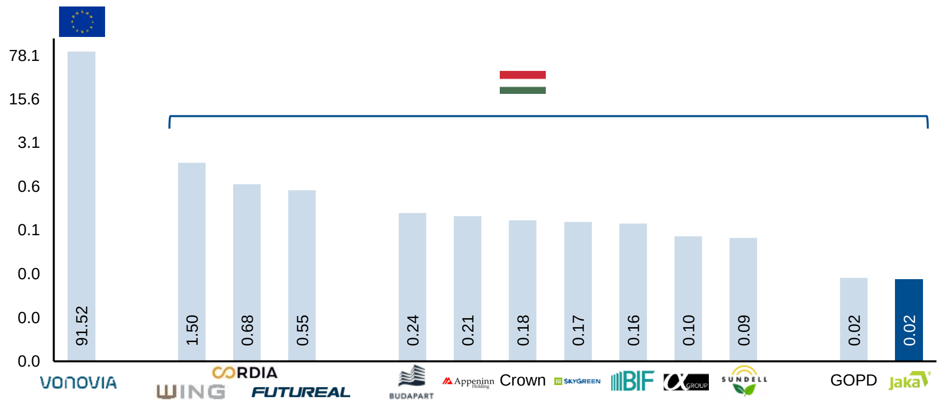
Cyclicality \ Barriers to entry	Low	Medium	High
High	CCC/B	**B**/BB	BB/BBB
Medium	B/BB	**BB**/BBB	BBB/A
Low	BB/BBB	BBB/A	AA/AAA

Source: Scope

Small real estate company with unclear focus

Jaka Trade Kft. is a small player in Hungarian real estate with Scope-adjusted total assets of EUR 4m as at end-September 2021[4]. Its small size is due to Jaka's growth strategy that has focused on acquiring properties from liquidation proceedings using no debt financing, thus only allowing for slow growth. The company's own portfolio comprises a gross lettable area of 51,624 sq m. To add some outreach the company entered into a lease agreement of an industrial park comprising 23,242 sq m in gross lettable area while sub-letting it to third parties. The small portfolio spreads across different property types and locations, leading to little visibility on letting and investment markets. As such, Jaka's small size constitutes a negative rating driver, because it implies a greater sensitivity to unforeseen shocks, greater cash flow volatility and a higher key person risk.

Figure 2: Jaka Trade and peers by Scope-adjusted total assets (EUR bn), log scale



Sources: Jaka Trade Kft., public information on peers, Scope estimates

The company plans to enter into a debt-financed expansion phase including i) the refurbishment of three buildings to create a 1,090-bed workers' hostel (with the first building to be delivered by September 2023) followed by an extension with 1,513 beds in three new buildings (development to start 2024/25); ii) the development of a four and a three-star hotel complex in Visegrád (to be delivered in 2025 with 33,263 sq m gross lettable area and 470 rooms) as well as iii) the development of 15 to 20 new apartments. Targeted growth is expected to lift Scope-adjusted total assets to about EUR 15m[5] and gross lettable area to around 82,000 sq m by YE 2026 (from EUR 75,000 sq m at YE

[4] Based on book values + hidden reserves according to valuation reports
[5] Includes mark-to-market valuation estimate based on average yield of 10% for the company's portfolio including its operational lease (industrial park)

2021), with a limited impact on the company's market position. Only the newly built workers' hostel with about 2,500 beds will likely benefit from low competition, thus ensuring relatively high visibility and attractiveness in its proximity, having only one comparable competitor within 5km of the site.

Weak diversification across geographies…

Jaka Trade's limited size has also taken a toll on portfolio diversification by tenant and geography. The whole portfolio consists of four properties and one development site all located in the greater Budapest area (incl. Budapest, Budaörs, Visegrád and Bicske). The company intends to maintain its geographical outreach within the greater Budapest area in the foreseeable future. Thus, performance will largely hinge on the macroeconomic environment of the Hungarian capital.

…and high tenant concentration

Jaka Trade suffers from a high tenant concentration with the top three tenants contributing 32% of net rental income as at end-September 2021 and the top 10 contributing 60%. High tenant concentration exposes the company to a heightened risk of deterioration in cash flows if a tenant defaults or delays payment, especially considering the underlying tenants' credit quality, believed to be modest at best. Consequently, Jaka Trade will likely suffer from pressure on contractual rental cash flow if the economy weakens, especially given its geographical concentration.

Tenant concentration will increase further following the development of the workers' hostel and the three and four-star hotels in Visegrád. The company's main clients for the former will be corporates: mainly industrial, construction companies with a large share of blue-collar workers (B2B sales). The latter will be operated through a management contract.

A more diversified portfolio would allow the company to spread future investments over a longer period, thus reducing the risk of weaker demand for most of the portfolio and the associated consequences as mentioned above.

Mixed asset quality with good locations …

The asset quality of the company's portfolio is mixed. Locations are good considering each property type under operation:

- light industrial: part of a larger agglomeration of retail and industrial parks in Budaörs;
- retail: centre of the small town of Bicske. The retail park north of Bicske however represents strong competition;
- hotel (holiday apartments): city centre of Budapest;
- hostel (workers' hostel): nearby access to central bus station (Néglipet), tram and railway stations and the M35 motorway all in relative proximity to the city centre.

These locations ensure stable tenant/customer demand in the current market environment. Jaka Trade's sole portfolio location is the greater Budapest area, a second-tier investment market. Even if the Budapest market gained more momentum, portfolio liquidity would remain relatively limited. In times of a cooling economy and/or rising interest rates, (international) investors are likely to focus on tier-one markets and safe havens like London, Paris or the seven major German cities. This could eventually lead to substantial downward pressure on property value, an increase in leverage, a reduced availability of external financing, and limited recovery expectations for debt investors.

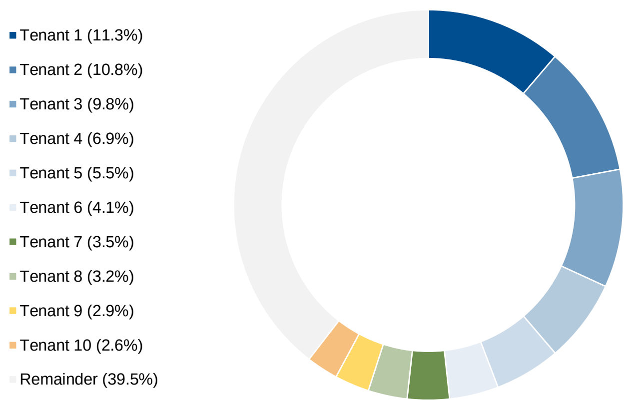
… but weak portfolio KPIs driven by aged building structures

The company not only shows mediocre occupancy rates as at end-September 2021 (73%) but also a short weighted-average unexpired lease term of only 1.6 years. The latter exemplifies the relatively high share of indefinite lease contracts (about a third as at end-September 2021) that could be cancelled any time with a maximum of three months' notice. This exposes cash flow stability and visibility to a continued re-letting risk amplified by the relatively high average economic age of the operational portfolio (exceptions are the four holiday apartments recently refurbished).

Planned capex with positive impact on asset quality

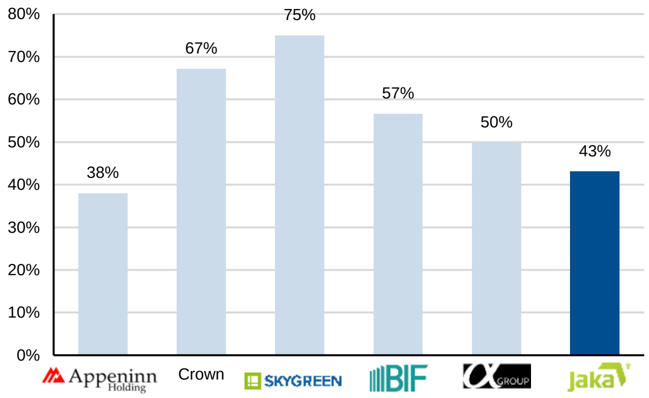
The refurbishment of the industrial site in Budapest (to become a worker's hostel), however, will not only improve the economic age/attractiveness of the portfolio but also occupancy given the good demand for that kind of accommodation (average utilisation of competitors stood at 92% on a long-term contractual basis in September 2021). It remains to be seen whether this demand prevails up until the delivery of the first stage in Q4 2023. Concerns arise from i) the targeted price point (upper end – however, justified by the good location) and ii) the government's recent pre-election (April 2022) austerity measures, which lead to high uncertainty in the execution of public procurement projects beyond those already started. Furthermore, a changing political landscape could lead to limited availability of EU funding, leading to the cancellation of large government-funded projects in the greater Budapest area, ultimately reducing the need for worker accommodation.

Figure 3: Tenant diversification by net rental income Q3 2021



Sources: Jaka Trade Kft., Scope

Figure 4: SaEBITDA margin vs peers (average 2020-2022)



Sa: Scope-adjusted; Sources: Jaka Trade Kft, public information, Scope estimates

Profitability below that of peers held back by concentrated business and increased opex

Jaka Trade showed a somewhat volatile profitability with Scope-adjusted EBITDA margin (adjusted for operating lease payments and estimated service charge pre-payments) between 40-60%. Profitability is likely to deteriorate during the investment phase ahead, while recovering to around 50% afterwards. However, profitability will be subject to volatility driven by a top line that is exposed to a concentrated tenant portfolio of at best modest credit quality.

Furthermore, we believe that the cost of services to operate the workers' hostel will limit the achievable level of profitability.

Financial risk profile: B

Negative free operating cash flow because of ambitious growth targeted

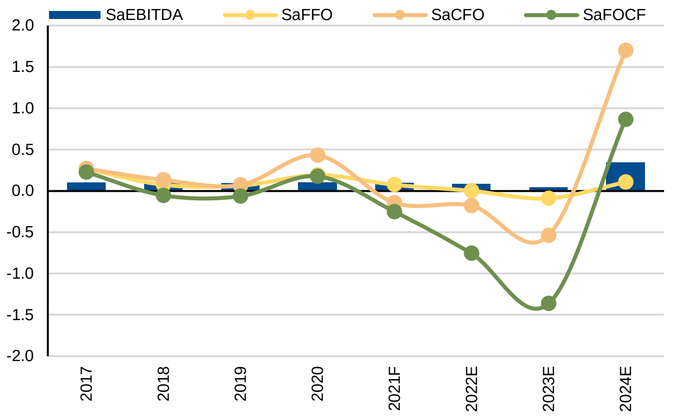
Operating cash flow has been around break-even in the last couple of years with limited need for external financing. However, Jaka Trade plans to enter an important investment phase with a total of HUF 15.4bn to 15.8bn in planned capex for a workers' hostel in Budapest (HUF 14.2bn), a housing project in Budapest (HUF 1.2bn to 1.6bn) and the Visegrád hotel development (total investment costs not known yet). These developments need to be financed externally, given the limited cash generation of the current portfolio. Jaka Trade plans to issue secured financing (investment loans) to finance the first phase of the workers' hostel development (HUF 3.7bn)[6]. We anticipate that additional, external financing will be needed for the housing project even with a pre-financing by customers of

[6] The company plans to refurbish the existing buildings step by step, starting with Building A followed by Building F as soon as the workers' hostel in Building A begins its activities and so on.

between HUF 400m and 520m (20%[7] of assumed sales proceeds of between HUF 2.0bn and 2.6bn).

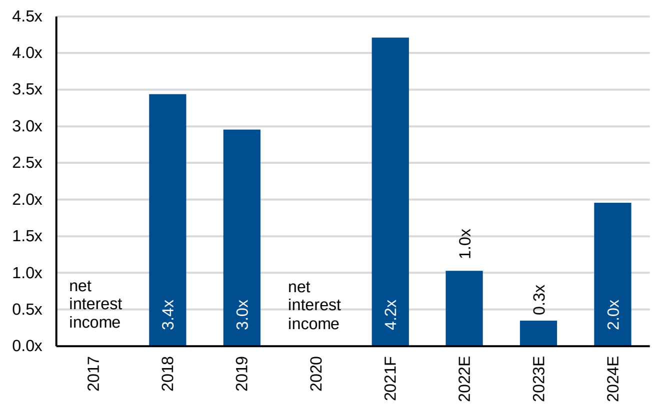
Developments to be entered into bear heightened execution risks with regards to on-time and in-cost delivery considering workforce scarcity as well as ever increasing construction costs in Hungary (+15.8% YoY in November 2021). According to Jaka, risk is mitigated by a fixed-priced contract with the engineering, procurement and construction contractor (Bieder Bau Kft.), that is however a small and regional player.

Figure 5: Cash flow in HUF m



Sa: Scope-adjusted; Sources: Jaka Trade Kft., Scope estimates

Figure 6: Interest cover



Sources: Jaka Trade Kft, Scope estimates

Interest cover below par during development phase

The assumed increase in interest-bearing indebtedness to about HUF 2.7bn by YE 2023 from HUF 0.1bn as at end-September 2021 will take its toll on interest cover, especially as capex-related top line growth is expected to kick in with an 18 to 24-month delay. Thus, we anticipate Scope-adjusted interest cover to be below par (<1x) in 2022 and 2023 before recovering to above 1x in 2024, subject to the successful delivery of the first phase of the workers' hostel by YE 2023, with adequate utilisation as well as a repayment of the bridge financing needed for the housing project from anticipated sales proceeds.

SaD/EBITDA peaking in 2022/2023

Jaka Trade was debt free up until YE 2020 only having HUF 0.5bn in operating lease obligations for its headquarters and the Kamaraerdei industrial park. The planned issuance of investment loans to finance the workers' hostel as well as the additional financing needs of around HUF 0.3bn to ensure full cost coverage and sufficient liquidity will impair Jaka's leverage with Scope-adjusted debt (SaD) to Scope-adjusted EBITDA skyrocketing in 2022 and 2023 but returning to below 10x once the first building of the workers' hostel is fully operational. However, capex planned in addition will keep leverage volatile, a direct consequence of the company's limited size and concentrated cash flow sources.

Relatively high Scope-adjusted loan/value caused by debt-financed growth

Leverage as measured by the company's Scope-adjusted loan/value ratio stood at 50% as at end-September 2021 (including disclosed hidden reserves of c. HUF 140m for the Bicske and Visegrád property). To account for the difference between book value (all properties acquired out of liquidation proceedings) and the market value of properties (including the industrial park that is held under a lease contract), we discounted the company's annualised net rental income of HUF 230m-260m by 10% that reflects a market adequate discount rate for Jaka Trade's portfolio, resulting in hidden reserves of between HUF 1.4bn and 1.6bn. However, the Scope-adjusted loan/value ratio is still set to increase to between 50% and 60% following the debt-financed expansion programme.

[7] 20% represents the needed equity share of a retail client with banks only financing up to 80% loan-to-value. Furthermore, MNB has introduced a new programme to secure mortgage financing at fixed rates for 25 years. However, it can only be used to purchase finished apartments in Hungary (minimum BB energy rating and a maximum primary energy consumption of 90kWh/m2/year). A prefinancing of more than 20% during the construction phase is therefore unlikely.

Generally, we believe Jaka Trade will be able to show significantly lower Scope-adjusted loan/value ratio once the well-located workers' hostel is operational, providing additional headroom to source external financing if needed. The company has a limited track record with development activity and execution and the associated operational risk. It remains to be seen whether Jaka Trade can deliver the project as expected.

Weak liquidity

Jaka Trade's liquidity is weak as cash uses are not fully covered by cash sources, pointing to a continued dependence on external financing, at least during the first part of the upcoming investment phase (2022-2023). In detail:

Position	2022E		2023E	
Unrestricted cash (t-1)	HUF	5m	HUF	237m
Open committed credit lines (t-1)	HUF	0m	HUF	0m
Free operating cash flow	HUF	-223m	HUF	-1,168m
Short-term debt (t-1)	HUF	11m	HUF	17m
Coverage		**negative**		**negative**

However, liquidity is seen a manageable risk as the company's properties are mostly unencumbered (except for the retail property in Bicske).

Supplementary rating drivers: +/- 0 notches

Given its size, the company has no supervisory board and there is no regulatory requirement for this. The two shareholders directly influence day-to-day business as the company's CEO and COO. However, almost all decisions are at the discretion of the majority shareholder Balázs Gáspár who owns 76% in shares and commands the needed quorum to decide on all issues subject the Act V of the 2013 Civil Code of Hungary (liquidation, change of deed of foundation, etc.). We see some key person risk given Jaka Trade's heavy dependence on Mr. Gáspár (negative ESG factor).

Jaka Trade has no dedicated framework that deals with the environmental or social aspects of its operations. However, we see limited risk on the company's cash generation beyond those already flagged in the business and financial risk assessment (e.g. concentrated portfolio, execution risk with regards to developments).

Appendix: Peer comparison (as at last reporting date)

	Jaka Trade Kft.	Alfa Equity Holding Kft.	Appenin Holding Nyrt.	Crown Holding Kft.	Wingholding Zrt
	B-/Stable	B+/Stable	B/Stable	not rated[8]	B+/Stable
Last reporting date	30 September 2021	31 December 2020	31 December 2020	31 December 2020	31 December 2020
Business risk profile					
Scope-adjusted total assets (EUR m)	15[9]	139	150	181	2,083
Portfolio yield	10%	na	na	na	na
Gross lettable area (thsd. sq m)	75	100	86	100	
No. of residential units	na	na	na	na	na
No. of countries active in	1	2	1	1	2
Top 3 tenants (%)	32%	12%	46%	30%	34%
Top 10 tenants (%)	60%	24%	65%	50%	44%
Office (share by net rental income)	na	na	na	22%	na
Retail (share by NRI)	na	na	na	67%	na
Residential (share by NRI)	na	na	na	na	na
Hotels (share by NRI)	na	na	na	11%	na
Logistics (share by NRI)	na	na	na	na	na
Others (share by NRI)	na	na	na	na	na
Property location	'B' locations	'B' locations	'B' locations	'B' and 'C' locations	'B' locations
EPRA occupancy rate (%)	73%	90%	88%	90%	86%
WAULT (years)	1.6 years	2.6 years	3.0 years	5.5 years	6.0 years
Tenant sales growth (%)	na	na	na	na	na
Like-for-like rent growth (%)	na	na	na	na	na
Occupancy cost ratio (%)	na	na	na	na	na
SaEBITDA margin	47%[10]	30%	61%	71%	10%
EPRA cost ratio (incl. vacancy)	na	na	na	na	na
EPRA cost ratio (excl. vacancy)	na	na	na	na	na
Financial risk profile					
SaEBITDA interest cover (x)	1.9x[11]	5.0x	1.8x	7.7x	0.8x
Scope-adjusted loan/value ratio (%)	54%[10]	63%	39%	25%	65%
SaD/SaEBITDA (x)	34.8x[10]	14.9x	17.0x	5.3x	34.5x
Weighted average cost of debt (%)	3.6%	na	3.1%	2.1%	na
Unencumbered asset ratio (%)	na	117%	211%	na	>100%
Weighted average maturity (years)	4.6 years	na	na	na	na

Sources: Public information, Scope

[8] Ratings have been withdrawn 23 February 2022
[9] Based on our estimates
[10] Pro forma for the nine months to end-September 2021
[11] Average between 2021 and 2023

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