Summus Capital OÜ
Estonia, Real Estate

SCOPE **BB** STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	2.3x	2.4x	2.3x	2.2x
Scope-adjusted debt/EBITDA	9.1x	8.0x	7.5x	8.4x
Scope-adjusted loan/value ratio	52.9%	51.1%	49.6%	57.0%

Rating rationale

The rating affirmation reflects the issuer's high-quality portfolio of assets in Baltic capital cities, second-tier investment markets with stable tenant demand. Summus buy-and-hold investment approach provides stable rental cash flows. The quality of the assets is evidenced by the high and stable occupancy rate of 97% as of June 2024. The rating remains constrained by the company's limited size and market shares, as Summus remains small in the European context and exposed to the retail segment.

Summus' financial risk profile is driven by its moderate credit metrics. Debt protection, as measured by EBITDA interest cover[1], stood at 2.4x in December 2023. The loan/value ratio has stabilised in the range of 50%-55% in the last few years. We forecast that the loan/value ratio will increase to above 55% in 2025, as the company plans to borrow around EUR 60m in loans needed to finance its business plan, but we expect the ratio to stabilize at around 55% over the next few years.

Outlook and rating-change drivers

The Outlook remains Stable and incorporates our expectation that rental growth will strengthen cash generation, as well as: i) the successful execution of Summus' intended acquisitions; ii) the extension of Riga Plaza, and iii) the portfolio's average occupancy rate remaining above 97%. The rating case assumes that the loan/value ratio* will temporarily increase after the acquisitions but stabilize at around 55%.

The upside scenario for the ratings and Outlook is:

1) Scope-adjusted loan/value ratio decreased to around 50% while the company significantly grew in size, thereby decreasing portfolio concentration. This could be achieved through new acquisitions financed with a higher share of equity relative to debt.

The downside scenario for the ratings and Outlook is (individually):

1) EBITDA interest cover decreased to below 2.0x;
2) Leverage increased, indicated by a loan/value ratio of above 60% on a sustained basis. Leverage could rise if property values in the portfolio dropped considerably due to a shock in the Baltic real estate market, particularly regarding shopping centres, or if new properties are acquired via external financing with higher leverage than in our rating base case

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
4 Sep 2024	Affirmation	BB/Stable
5 Sep 2023	Affirmation	BB/Stable

[1] All credit metrics refer to Scope-adjusted figures

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

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Related Methodologies/ Research

General Corporate Rating Methodology; October 2023

European Real Estate Rating Methodology; March 2024

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Positive rating drivers	Negative rating drivers
• Good diversification across the Baltic countries, with exposure to second-tier investment markets with healthy demand from tenants • High and stable occupancy rate of above 97% as at end-June 2023 • Stable EBITDA margin of above 80% in the last few years • Moderate WAULT of about four years to first break option • Moderate Scope-adjusted EBITDA/interest cover of 2.4x in 2023; expected to remain above 2x	• Small player in the European context, with small market shares amid increasing competition • Significant exposure to retail (about 50%), a segment under increasing pressure from e-commerce, particularly the fashion industry • Modest tenant diversification (main tenant represents 7% of total rental income; top 10, 34%) • High leverage, with Scope-adjusted loan/value ratio expect to rise at above 55% due to planned portfolio expansion, which will be partly debt-financed • Negative discretionary cash flow due to portfolio expansion in the next few years

Positive rating-change drivers	Negative rating-change drivers
• Decrease in Scope-adjusted loan/value ratio to below 50% while company significantly grows in size	• Decrease in debt protection to below 2x and/or increase in Scope-adjusted loan/value ratio to above 60%

Corporate profile

Summus Capital OÜ, headquartered in Estonia, is a family-owned real estate investment holding company active in the Baltic countries. The company pursues a buy-and-hold investment strategy, and its income-generating portfolio includes commercial properties (retail, offices, logistics and medical premises). Summus was founded in 2013 and holds a portfolio with a total market value of about EUR 400m.

Financial overview

			Scope estimates		
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	2.3x	2.4x	2.3x	2.2x	2.1x
Scope-adjusted debt/EBITDA	9.1x	8.0x	7.5x	8.4x	7.8x
Scope-adjusted loan/value ratio	52.9%	51.1%	49.6%	57.0%	54.7%
Scope-adjusted EBITDA in EUR m					
EBITDA	18.0	21.9	27.6	35.8	37.2
Operating lease payments	0.0	0.0	0.0	0.0	0.0
Other items (provisions, impairments)	5.9	4.4	-	-	-
Scope-adjusted EBITDA	24.0	26.3	27.6	35.8	37.2
Scope-adjusted funds from operations in EUR m					
Scope-adjusted EBITDA	24.0	26.3	27.6	35.8	37.2
less: (net) cash interest as per cash flow statement	(10.6)	(11.1)	(12.0)	(16.4)	(17.3)
less: cash tax paid as per cash flow statement	-	-	(2.1)	(1.7)	(1.9)
Others items	5.9	4.4	-	-	-
Scope-adjusted funds from operations	19.3	19.6	13.4	17.7	17.9
Free operating cash flow in EUR m					
Funds from operations	19.3	19.6	13.4	17.7	17.9
Change in working capital change	5.6	4.3	0.2	0.4	0.1
Non-operating cash flow	-	-	-	-	-
less: capital expenditure (net)	-	-	(2.9)	(3.6)	(4.8)
Free operating cash flow	24.9	23.9	10.7	14.5	13.2
Net cash interest paid in EUR m					
Net cash interest as per cash flow statement	11.9	11.6	12.8	17.2	18.0
add: interest component on operating leases	0.0	0.0	0.0	0.0	0.0
add: interest component, operating leases	(1.3)	(0.5)	(0.8)	(0.8)	(0.8)
Net cash interest paid	10.6	11.1	12.0	16.4	17.3
Scope-adjusted debt in EUR m					
Reported gross financial debt	252.2	236.0	257.7	316.6	311.3
less: cash, cash equivalents	(16.4)	(15.9)	(44.6)	(11.7)	(15.8)
add: restricted cash	-	0.4	5.4	5.4	5.4
Shareholder loan – equity credit	(17.5)	(10.8)	(10.8)	(10.8)	(10.8)
Other financial loans	-	-	-	-	-
Scope-adjusted debt	218.3	209.6	207.7	299.5	290.0

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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)	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 analysis is credit neutral

As at June 2024, about 86% of the portfolio's gross asset value is BREEAM-certified. The company aims to increase the proportion of environmentally certified properties in its portfolio and is in the process of certifying three further assets. Summus' medium-term goal is to have 95% of the portfolio BREAAM/LEED-certified. Summus also aims to optimise energy consumption in its buildings and to generate 90% (84% in 2023) of energy from renewables. In addition, the Group aims to boost energy efficiency and reduce CO2 emissions, targeting a 50% reduction by 2030, compared to 2019 levels.

These initiatives are expected to enhance the portfolio's attractiveness and company profitability as: i) work to attain certification improves energy efficiency and increases portfolio efficiency; and ii) environmentally friendly landlords are attractive since high-quality prospective tenants are increasingly concerned with sustainability.

[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: BB

Industry risk profile: BB

Summus' activities encompass the acquisition and management of commercial real estate, mainly offices, shopping centres and logistics buildings in the Baltic region. The portfolio consists of 14 properties, including shopping centres (about 64% of total rental income), office buildings and medical services premises (23%) and industrial buildings (10%).

Stable performance backed by recurring income-generating portfolio

Summus buy-and-hold investment approach provides stable rental cash flows. The portfolio generated EUR 30m in net annual rental income in 2023, up 8% YoY.

With higher capital costs and fewer opportunities in core markets, most market participants have taken a wait-and-see approach to property sales in recent years. Summus made no additions to its portfolio in 2023, and its Scope-adjusted total assets remained broadly stable at EUR 410m (down 0,7% YoY) at the end of 2023. However, the company intends to invest around EUR 100m to expand its portfolio over the next twelve months, with potential acquisitions being outside its traditional key markets.

Small in a European context

Despite these investments, we expect Summus to remain a small property company in the European context. This relatively small scale implies a greater sensitivity to unforeseen shocks, greater cash flow volatility and higher key person risk. In this light, we view Summus' competitive position as weaker than its larger peers.

Small market shares with some visibility through its shopping centres

Summus' market shares are modest in the fragmented Baltic commercial real estate market. As the company's portfolio is spread across multiple asset classes and locations (mainly Vilnius, Tallin and Riga) it does not have substantial power or visibility in its markets.

As regards retail (62% of the portfolio's net leasable area), the company has increased its presence in Latvia through acquisition of large assets in recent years, including the Riga Plaza, Damme Riga, and Depo DIY, totalling approximately 84,400 sq m.

Foothold in the Baltic countries

Summus' portfolio is well diversified but remains focused on the Baltic region: Estonia (18% of total property value), Lithuania (42%) and Latvia (40%), second-tier investment markets in terms of size and demand from international investors. Although the Baltic countries form a closely integrated economic area, there are still asymmetries among them. Estonia is the most exposed to international fluctuations, whereas Lithuania (the most populated of the three) is more resilient. Summus benefits from the slightly different demand patterns, influenced by the different industries in its markets.

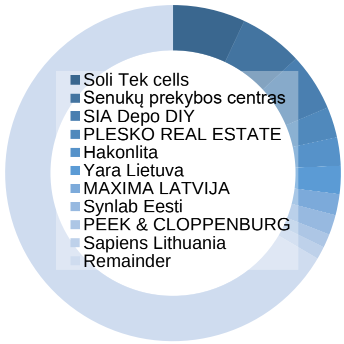
Summus intends to further expand its portfolio in coming years and is constantly looking for new investment opportunities in the Baltics and neighbouring countries. The company is currently assessing potential acquisitions outside its traditional core markets, with a total investment of around EUR 100m to expand its income-generating portfolio. The transactions are still subject to execution risk, but if successfully completed, the newly integrated assets would contribute around 15% of the company's rental income. While the acquisitions would slightly improve diversification, in our view, the company's geographical foothold will remain focused on its core markets for the next few years.

Modest tenant diversification, partially mitigated by moderate tenant quality

Tenant diversification is still modest despite more than 350 tenants in the portfolio, with the top 10 accounting for about 34% of rental income as of June 2024. The tenant mix includes medium and small tenants, mainly in the retail segment (more than 50% of net rental income), which exposes the company to major changes in consumer habits accelerated by the pandemic such as the shift to e-commerce. The largest tenant, Soli Tek cells, accounted for 7% of rental income as of June 24.

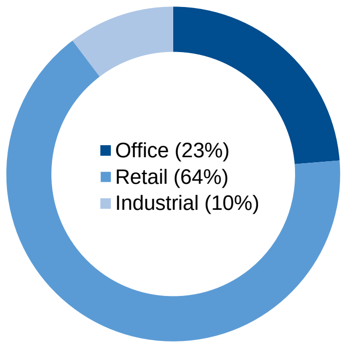
Of the top 10 tenants, only few have a credit rating. Even so, the tenant mix has had a negligible bad-debt rate of less than 1% since 2016. The presence of bank guarantees or cash deposits as well as the high and stable occupancy of the portfolio partially mitigates the risk of a single tenant default and its impact on rental cash flow.

Figure 1: Tenant diversification by rental income



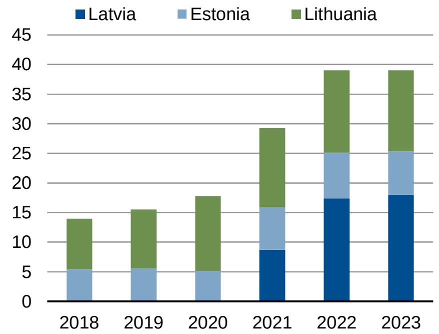
Sources: Summus, Scope

Figure 2: Property type diversification by rental income



Sources: Summus, Scope

Figure 3: Geographical diversification by rental income



Sources: Summus, Scope

High and stable occupancy rate and medium-term WAULT provide cash visibility

The portfolio's high occupancy rate in the last few years (97% as of June 2024) has helped to keep net rental income stable.

Although demand for office space is uncertain due to the massive shift to hybrid working models, we expect Summus office portfolio to continue to benefit from robust demand. Average occupancy benefits from the office and industrial assets, which are fully let, but is also influenced by the shopping centres, which have some minor vacancies. The company's efforts have resulted in significant improvements in the occupancy rate of the largest asset in the portfolio, Riga Plaza, which has a vacancy rate of only 2%, 6pp lower than last year. We expect occupancy to remain above 95%, based on healthy demand in the tenant market and Summus' proven ability to maintain high levels of occupancy in the buildings.

The company's estimated medium-term WAULT to first break of around four years as of June 2024 provides some visibility on future cash flows. Near-term re-letting risk in the short term is limited, with only 4% of leases expiring in H2 2024.

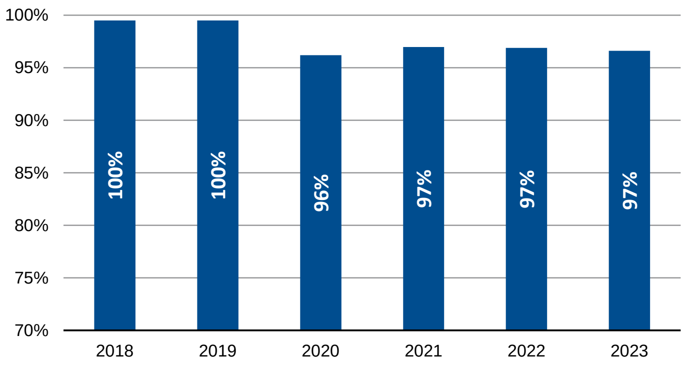
High quality assets with 86% BREEM or LEED-certified

As at June 2024, about 86% of the portfolio's gross asset value is LEED or BREEAM-certified. Summus' medium-term goal is 95%. We expect tenants' preference towards best-in-class, energy-efficient space in prime locations will support demand, and all of Summus' office buildings have LEED or BREEAM certifications.

Relatively modern property portfolio

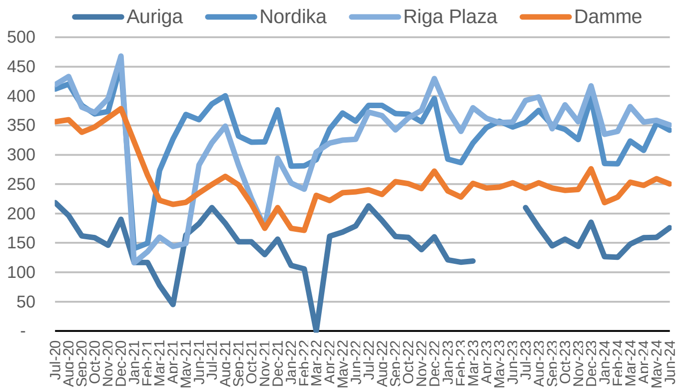
The average portfolio age is of around 10 years. The portfolio ranges from newer properties such as the two medical centres (Veerenni 1, in operation since 2017; Veerenni 2, since 2020) and Depo DIY (since 2021) and older ones such as De la Garde (2000). The assets benefit from either a central location, a resilient neighbourhood catchment or strategic locations to tenants.

Figure 4: Historical occupancy rate



Sources: Summus, Scope

Figure 5: Retail assets footfall (thousands)



Sources: Summus, Scope

Stable profitability ratios

Profitability, as measured by the EBITDA margin, remained stable at over 85% at the end of June 2024, in line with other buy-and-hold peers.

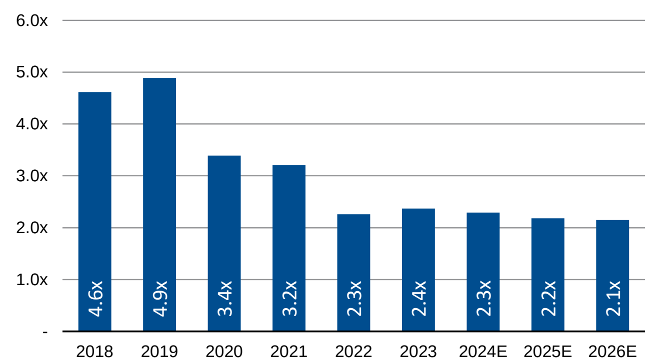
In 2023, the company's energy efficiency initiatives in recent years, combined with lower energy costs, resulted in a 9% reduction in net service costs. Summus is able to pass on around 60% of utility costs through leases, and most tenants on fixed-rate contracts pay for electricity consumption as measured by counters. We foresee the EBITDA margin to remain above 85% for the next few years as inflationary cost increases are largely offset by corresponding rental increases, as approximately 95% of the leases have an indexation clause.

Financial risk profile: BB

Increasing debt costs to impact debt protection

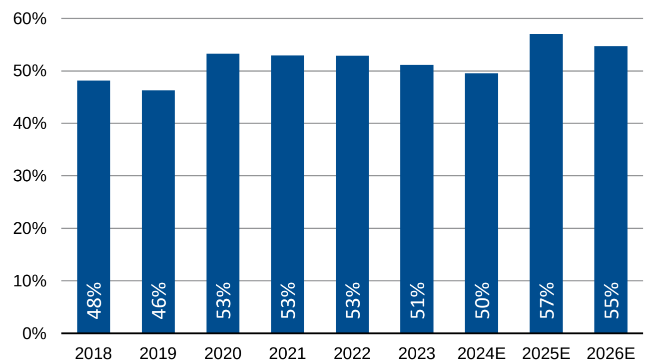
Debt protection, as measured by EBITDA interest cover, was 2.4x at December 2023 (2.2x for the 12 months to June 2024). We expect debt protection to remain above 2x due to stable operating cash flows and a relatively low average cost of bank financing (2.9% at end-June 2024, excluding Euribor). Summus is exposed to interest rate risk as its bank loans are at floating rates (2.7%-3.3% + Euribor). This risk is partially mitigated by the company's policy of using interest rate swaps on at least 50% of its loans (52% until Q2 2024). We expect higher financial expenses in the coming years, as Summus' planned portfolio expansion is partly debt-financed. Nevertheless, we expect EBITDA interest cover to remain above 2x, supported by the issuer's inflation-linked revenue base and positive cash flow contribution from planned acquisitions.

Figure 6: Scope-adjusted EBITDA interest cover (x)



Sources: Summus, Scope estimates

Figure 7: Scope-adjusted loan/value ratio



Sources: Summus, Scope estimates

Stable and positive cash flow generation, with investments being of discretionary character

Summus has generated positive SaFOCF in the past years. This cash flow has mainly been absorbed by investments in the acquisition of investment properties. For the next few years, we anticipate positive internal cash flow (Scope-adjusted EBITDA, Scope-adjusted FFO and Scope-adjusted Free Operating cash flows), due to Summus's solid recurring rental income and based on the further acquisition of income-generating assets Discretionary cash flow will remain negative, driven by approximately EUR 100m of planned acquisitions in 2025. These acquisitions will be partly financed by external bank debt, resulting in higher on-balance sheet leverage.

Adequate leverage, but vulnerable to downside market-related volatility

Leverage, as measured by the loan-to-value ratio, was 51% at December 2023, excluding outstanding subordinated loans from the majority shareholder (EUR 10m at June 2024). Summus portfolio is exposed to market pressure that could lead to yield compression. However, we expect the portfolio value to remain resilient (slightly positive fair value adjustment of EUR 1.9m in 2023), with only minor adjustments of around 1%-2% by end-2024. Like-for-like rental growth over the next few years - as the market remains supportive - should offset any potential yield expansion. We expect leverage to rise to over 55% in the coming years (57% in 2025). Our view is driven by Summus's intention to increase its bank debt by around EUR 60m to partially finance the company's business plan and the assumption of a loan-to-value ratio of around 60% for its planned acquisitions.

Adequate liquidity

Summus' liquidity is adequate, supported by high cash balance (EUR 41m as at end-June 2024, thereof EUR 5.4m restricted cash) and positive operating cash flow that covers short-term debt of about EUR 8m as at June 2024. Free operating cash flow will remain positive in the next few years, as capex is mostly discretionary and will be financed by available internal resources and financial debt.

Balance in EUR	2023	2024E	2025E
Unrestricted cash (t-1)	16.4	15.6	39.3
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	23.9	10.7	14.5
Short-term debt (t-1)	8.4	17.8	7.6
Coverage	**>200%**	**148%**	**>200%**

The financial covenants set forth in Bond Terms were met as of June 2024. Financial covenants include:

i) equity to total assets ratio of at least 30% - 40% as at June 2024, and

ii) DSCR of at least 1.2x – 1.38x in the last twelve months to June 2024.

Scope assumes that financial covenants are in compliance at all times.

Long-term and short-term debt ratings

Senior unsecured debt rating: BB

Summus has a EUR 15m senior unsecured corporate bond in the capital market debt outstanding as at end-June 2024. The bond's tenor is three years with a fixed coupon of 9.5% and payments made four times per year. Proceeds are earmarked for refinancing prior bond and the acquisition of revenue-generating properties.

Our recovery analysis is based on a hypothetical default scenario in FY 2025 with a company liquidation value of EUR 394m. This value is based on a haircut of 25% to reflect liquidation costs and reasonable discounts to the company's asset base as well as 10% for insolvency proceedings. We expect an 'above average' recovery for Summus' senior unsecured debt (EUR 15m) but still note the high sensibility the sensibility analysis regarding the portfolio of property's advance rate and therefore assigns the debt class a rating of BB, in line with the issuer rating.

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