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 is seeking to raise HUF 2.9bn, with the primary goal of using the funds for international expansion of its real estate and mortgage agency network.

Key metrics

		Scope estimates		
Scope credit ratios	**2019**	**2020E**	**2021E**	**2022E**
EBITDA/interest cover (x)	944x	76x	8x	10x
Scope-adjusted debt (SaD)/EBITDA (x)	Net cash	Net cash	3.0x	1.5x
Funds from operations/SaD (%)	Net cash	Net cash	26%	54%
Free operating cash flow/SaD (%)	Net cash	Net cash	22%	24%

Rating rationale

Scope Ratings has today assigned a first-time issuer rating of BB-/Stable to Hungarian real estate and loan brokerage company Otthon Centrum Holding Kft. Senior unsecured debt has been rated BB-.

The business risk profile (assessed at B+) is supported by i) the group'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. The group 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 group is focused on the retail segment, which entails a high number of small transactions.

The issuer's business risk profile is constrained by the small absolute size of its business, the relatively fragmented markets in which it operates and lack of geographic diversity. The company is seeking to raise HUF 2.9bn through a bond issuance to fund international expansion. This is the company's first major inorganic growth initiative into new geographic markets, which entails risk. We expect also margins to trend downwards, driven by i) the higher likelihood that near-term revenue growth will be more focused on lower-margin agency acquisitions than higher-margin franchising; ii) the growing competition in (online) real estate and loan brokerage; and iii) uncertainties caused by the Covid-19 pandemic.

The financial risk profile (assessed at BBB-) is driven by the issuer's low financial leverage as measured by the Scope-adjusted debt (SaD)/EBITDA ratio. We expect this leverage ratio to fall to below 2x in 2022 after a temporary peak of 3x in 2021, due to the full impact of the bond issuance and planned acquisitions but only a couple of months' contributions from acquired assets. The company has managed the effects of the pandemic relatively well, with a strong recovery in the second half of 2020, growth in credit intermediation offsetting weakness in real estate transactions, and minimal credit losses. Liquidity is adequate, with minimal short-term debt and cash outflows as expected under our base case being largely discretionary in nature (i.e. growth capex and dividends).

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	BB-

Analyst

Tommy Träsk
+49 69 6677389 36
t.traesk@scoperatings.com

Related Methodology

Corporate Rating Methodology, 26 Feb 2020

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

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 the issuer'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. Moreover, the Stable Outlook reflects our expectation that the issuer will use the proposed bond proceeds to acquire property agencies with positive EBITDA contribution and that financial leverage will return below 2.0x after an anticipated temporary spike in 2021 caused by the debt-funded acquisitions.

A positive rating action is remote at this point and would require the issuer to significantly expand in size and diversity while maintaining financial metrics along 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 credit ratios	**2019**	**2020E**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	944x	76x	8x	10x
Scope-adjusted debt (SaD)/EBITDA (x)	Net cash	Net cash	3.0x	1.5x
Funds from operations/SaD (%)	Net cash	Net cash	26%	54%
Free operating cash flow/SaD (%)	Net cash	Net cash	22%	24%
Scope-adjusted EBITDA (HUF m)	**2019**	**2020E**	**2021E**	**2022E**
EBITDA	985	755	778	1,249
Operating lease payments in respective year	0	0	0	0
Gains/losses on sale of assets	5	0	0	0
Scope-adjusted EBITDA	**990**	**755**	**778**	**1,249**
Scope-adjusted funds from operations (HUF m)	**2019**	**2020E**	**2021E**	**2022E**
EBITDA	985	755	778	1,249
less: cash interest as per cash flow statement	-1	-10	-92	-123
less: cash tax paid as per cash flow statement	-124	-105	-72	-126
Gains/losses on sale of assets	5	0	0	0
Scope-adjusted funds from operations	**864**	**640**	**614**	**1,209**
Scope-adjusted debt (HUF m)	**2019**	**2020E**	**2021E**	**2022E**
Reported gross financial debt	298	188	3,063	3,063
less: cash, cash equivalents	-525	-463	-962	1,205
add: restricted cash (bond proceeds earmarked for capex)	0	0	250	0
Scope-adjusted debt	**-227**	**-275**	**2,351**	**1,858**

Business risk profile: B+

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

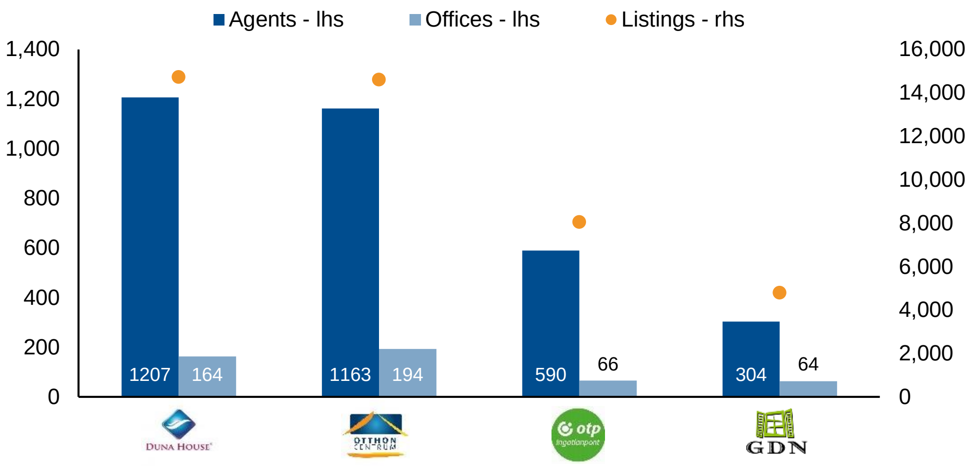
We classify Otthon Centrum as a business services provider, an industry we rate BBB based on the medium levels of cyclicality, substitution risk, and entry barriers.

The 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 is very much dependent on the company's good reputation, its ability to keep up with technological advances, innovation, execution, and 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

The company 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



Sources: Reálmonitor, Otthon Centrum, public sources, Scope

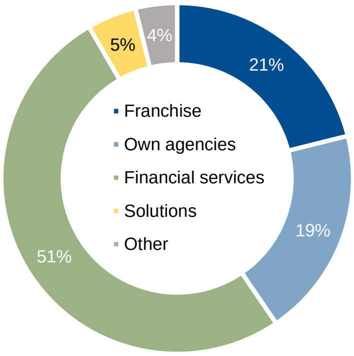
Profitability at above industry average

Otthon Centrum displays above-average profitability in its industry, with the EBITDA margin and return on capital comfortably above 15% and 20% respectively in 2020, a year hampered by the pandemic. We do, however, 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. We also see additional margin pressures owing to the growing competition in (online) real estate and loan brokerage as well as uncertainties caused by the Covid-19 pandemic. The relatively high return on capital suggests the company is seen as a good investment by its shareholders and gives it the option to issue new equity as an alternative source of funding, if needed.

Execution and integration risks associated with M&A

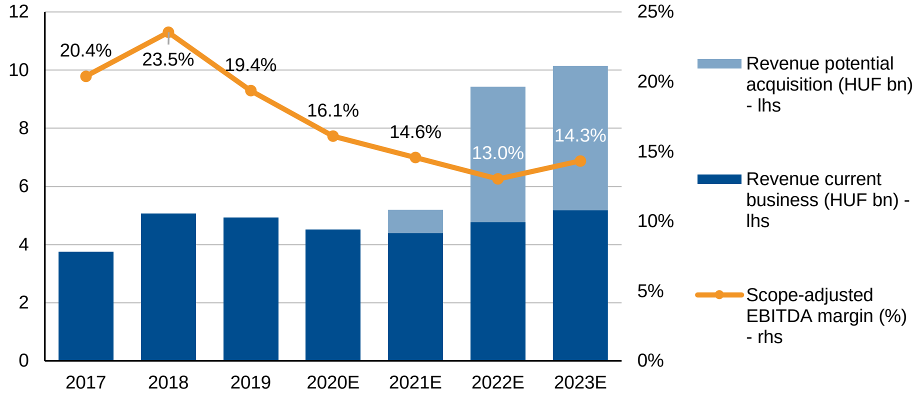
Concentration on a single geographic market is a weakness, although the focus on retail means client granularity is high. We see the benefits of the complementary service offering consisting of real estate brokerage, credit and insurance intermediation and other real estate-related services such as valuations, energy certificates and consultancy services. The planned acquisitions are likely to add geographic diversity to the group, 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



Sources: Otthon Centrum, Scope

Figure 3: Turnover and EBITDA margin



Sources: Otthon Centrum, Scope

Positive aspects going forward include the opportunity for the issuer, as one of the two market leaders, to further strengthen its market share through industry consolidation, which may mitigate price pressure in the medium term. We expect the company to continue to grow its domestic business, both in core and new complementary business areas.

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 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.

The company has fared relatively well in 2020, with a strong recovery in real estate transaction volumes in the second half of the year, on par with levels in 2019, and year-on-year growth in loan volumes. Commission levels have held up well during the pandemic, and residential real estate values have also remained resilient, after a wobble in the first half of the year. The company has so far not experienced significant credit losses or customer defaults.

Financial risk profile: BBB-

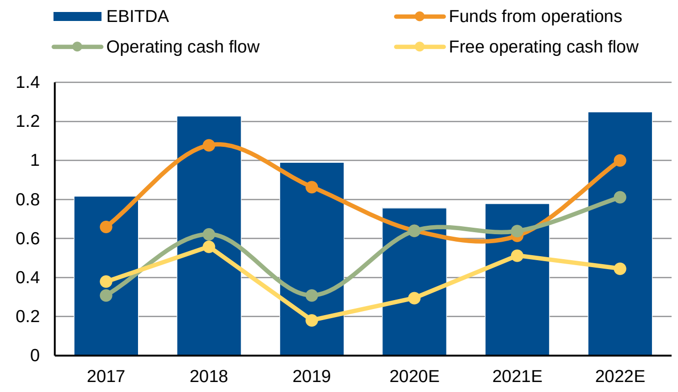
Asset-light business model with limited historical debt and low financial leverage

The financial risk profile (assessed at BBB-) reflects an asset-light business model with limited historical debt and low financial leverage. Our rating scenario assumes the company will successfully place a HUF 2.9bn 10-year bond in the first half of 2021 and use the proceeds to finance acquisitions and associated restructuring and integration expenditures in the second half of the year. This scenario sees a spike in leverage at the end of 2021, when bond proceeds have been deployed, but associated incremental earnings will be recognised only for a couple of months. We expect leverage to return to below 2x by the end of 2022, with a full-year contribution from the acquired assets.

Cap on dividends protects business from negative ownership intervention

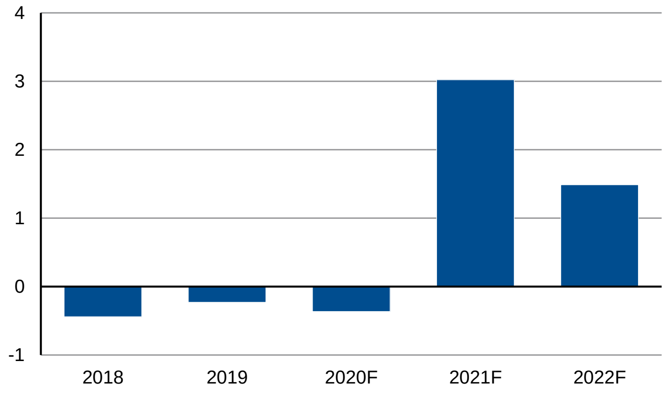
The bond will cap dividend payouts at 50% of net profits. This removes any concerns of material cash flow leakage to the wider Biggeorge Holding group, the controlling shareholder of Otthon Centrum. Biggeorge Holding, also with interests in real estate development, construction and telecom services, is owned by Tibor Nagygyörgy.

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



Sources: Otthon Centrum, Scope

Figure 5: Scope-adjusted debt/EBITDA



Sources: Otthon Centrum, Scope

Absence of short-term debt provides adequate liquidity position

Liquidity is adequate, with minimal short-term debt and cash outflows as expected under our base case being largely discretionary in nature (i.e. growth capex and dividends). The company 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 HUFm	2019	2020E	2021E
Cash and marketable securities (t-1)	933	525	463
Committed unused bank facilities (t-1)	0	0	0
Short-term debt (t-1)	126	110	0
Free operating cash flow (t)	181	295	512
Liquidity (%) – internal	**882%**	**745%**	**No short-term debt**
Liquidity (%) – internal + external	**882%**	**745%**	**No short-term debt**

Source: Otthon Centrum, Scope

Senior unsecured debt: BB-

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

Our base case financial forecast assumes the successful placement in Q2 2021 of a HUF 2.9bn senior unsecured bond with a fixed annual coupon under the Hungarian National Bank's Bond Funding for Growth Scheme. We expect the bond to have a 10-year tenor, with 5% amortization in 2024-2027, 10% in 2028-2030 and 50% in 2031. The terms of the bond will cap dividends at 50% of net profits. Bond proceeds are earmarked for M&A, primarily to fund international expansion of the group's real estate and mortgage agency network. In case a transaction cannot be concluded within a reasonable timeframe at a reasonable price, bond proceeds will be used to acquire either domestic targets with significant potential synergies or – as a fallback option – an income-producing rental property.

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

111 Buckingham Palace Road
UK-London SW1W 0SR

info@scoperatings.com
www.scoperatings.com

Disclaimer