Summus Capital OÜ
Estonia, Real Estate

BB Stable

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.4x	2.8x	2.3x	2.4x
Scope-adjusted debt /EBITDA	15.5x	9.7x	10.1x	9.8x
Scope-adjusted loan/value (%)	53%	51%	54%	54%
Scope-adjusted loan/value (%) including shareholder loan	83%	58%	61%	61%

Rating rationale

The rating affirmation reflects our unchanged view on Summus' business profile, which benefits from its core portfolio of income-generating properties in Baltic capital cities, which are second-tier investment markets with stable tenant demand. Summus maintained growth during the LTM to June 2022 with the addition of two assets (about EUR 50m), resulting in Scope-adjusted total assets rising to EUR 416m at June 2022 (+16% YoY). Asset quality is evidenced by the high and stable occupancy rate (97% as of June 2022). Although over 50% of rental income is derived from retail tenants, properties proved resilient during the pandemic, with no significant impact on rent collections.

Summus' financial risk profile is driven by its moderate credit metrics. The Scope-adjusted loan/value ratio stabilised in the range of 50%-55%. Debt protection, as measured by Scope-adjusted EBITDA interest cover, stood at 3.6x for the LTM to end-June 2022. It benefits from a relatively low average cost of debt (2.8% in average). However, we note Summus' exposure to interest rate risk as its bank loans pay variable interest rates (EURIBOR + 1.8%-2.5%), which is partially mitigated by the policy to keep at least 50% of the loan portfolio hedged by interest rate swaps (60% to Q2 2022).

Outlook and rating-change drivers

The Outlook remains Stable and incorporates: i) the successful execution in the next few years of Summus' business plan, including acquisitions; ii) the extension of Riga Plaza; and iii) the portfolio's average occupancy rate remaining above 97%. Our rating case assumes that the Scope-adjusted loan/value ratio will stay around 55% going forward.

A positive action is possible if the Scope-adjusted loan/value ratio (leverage) decreased to around 50% while the company grew in size, thereby decreasing portfolio concentration. This could be achieved by new acquisitions financed with a higher share of equity relative to debt.

A negative rating action is possible if the Scope-adjusted EBITDA interest cover decreased below 2.0x and/or leverage increased, indicated by a Scope-adjusted loan/value ratio of above 60%. Leverage could rise if property values in the portfolio drop considerably due to a sudden 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
5 September 2022	Affirmation	BB/Stable
3 September 2021	Initial	BB/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

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Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Rating Methodology European Real Estate Corporates January 2022

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Bloomberg: RESP SCOP

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 2022 • Stable EBITDA margin of above 60% in the last few years • Moderate WAULT of about five years to first break option • Moderate Scope-adjusted EBITDA/interest cover of 3.6x for the LTM to end-June 2022; expected to remain slightly 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 retail fashion • Modest tenant diversification (main tenant represents 7.7% of total rental income, while top 10 represent 38.2%) • High leverage, with Scope-adjusted loan/value ratio of 53% in 2021 • 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 grows in size	• Decrease in debt protection to below 2x and/or increase in Scope-adjusted loan/value ratio to above 60% • Worsened liquidity

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	**2020**	**2021**	**LTM 2022[1]**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	2.4x	2.8x	3.6x	2.3x	2.4x	2.4x
Scope-adjusted debt/EBITDA	15.5x	9.7x	9.3x	10.1x	9.8x	9.8x
Scope-adjusted loan/value ratio (%)	53%	51%	52%	54%	54%	54%
Scope-adjusted loan/value ratio (%) including shareholder loan	83%	58%	59%	61%	61%	60%
Scope-adjusted EBITDA in EUR m						
EBITDA	11.4	20.7	23.2	22.4	24.9	26.1
Operating lease payment	0.0	0.0	0.0	0.0	0.0	0.0
Other items	0.0	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	11.4	20.7	23.2	22.4	24.9	26.1
Scope-adjusted funds from operations in EUR m						
Scope-adjusted EBITDA	11.4	20.7	23.2	22.4	24.9	26.1
less: (net) cash interest as per cash flow statement	-3.4	-7.4	-6.5	-9.9	-10.4	-10.8
less: cash tax paid as per cash flow statement	0.0	0.0	0.0	-0.3	-0.3	-0.4
Others (provisions, impairments)	0.0	-3.0	-3.0	0.0	0.0	0.0
Scope-adjusted funds from operations	8.1	10.3	13.7	12.1	14.2	15.0
Free operating cash flow in EUR m						
Funds from operations	8.1	10.3	13.7	12.1	14.2	15.0
Change in working capital change	-0.3	1.8	1.1	3.2	0.3	0.6
Non-operating cash flow	0.0	0.0	0.0	0.0	0.0	0.0
less: capital expenditure (net)	-0.4	-2.2	6.1	-2.8	-0.9	-1.0
Free operating cash flow	7.3	9.9	20.9	12.6	13.6	14.6
Net cash interest paid in EUR m						
Net cash interest as per cash flow statement	-3.4	-7.4	-6.5	-9.9	-10.4	-10.8
add: interest component, operating leases	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Net cash interest paid	-3.4	-7.4	-6.5	-9.9	-10.4	-10.8
Scope-adjusted debt in EUR m						
Reported gross financial debt	274.4	236.1	251.3	254.6	271.1	284.2
Shareholder loan – equity credit[2]	-98.6	-27.6	-28.1	-28.1	-28.1	-28.1
Other financial loans	13.6	4.7	4.7	2.4	2.4	2.4
Leasing	0.0	2.6	2.3	2.3	2.3	2.3
less: cash, cash equivalents	-11.5	-15.1	-13.8	-5.8	-3.1	-4.7
Scope-adjusted debt	177.9	200.7	216.3	225.5	244.6	256.1

[1] Last 12 months to end-June 2022 for cash flow-related metrics
[2] Includes subordinated majority and minority shareholder loans.

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

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Grey leaf	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

As at June 2022, about 35% of portfolio GAV is BREEAM-certified, including office buildings Park Town West and Park Town East and shopping centre Nordika. The company aims to increase the proportion of environmentally certified properties in its portfolio and is in the process of certifying five assets, which will increase the certified share of portfolio to 89% by the end of 2022. 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 65% of energy from renewables.

This initiative is 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.

[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: 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.

Portfolio robust performance in LTM to end-June 2022…

Summus maintained growth in the LTM to end-June 2022. Scope-adjusted total assets rose to EUR 416m (+16% YoY) and gross lettable area increased by 19%, partially enabled by positive funds from operations and the first tapping of capital markets (EUR 10m bond issued in 2021). Portfolio performance was robust in the LTM to June 2022, with rental revenues reaching above 37% like-for-like in H1 2022 (revenues for LTM to end-June 2022 were EUR 26.9m). The rental increase was mainly due to portfolio additions, including Depo DIY and Damme Riga (around 3.5m of additional rental income). Further acquisitions and the planned expansion of the Riga Plaza (planned total investment of about EUR 65m until 2024) will support the company's current standing as the shopping mall operator in the Baltics.

… but still small in a European context

Nonetheless, Summus is still 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 markets. Since the company's portfolio is split across multiple asset classes and locations (mainly Vilnius, Tallin and Riga) it does not have substantial market power in the very fragmented Baltic markets. However, we acknowledge Summus visibility in the markets in which it operates, specially through its shopping centres.

As regards retail (about 58% of the portfolio's net lettable area), the company has increased its presence in Latvia via the acquisition of two new assets: i) Damme Riga, a leading shopping centre in Riga (16,000 sq m); and ii) Depo DIY (19,400 sq m).

Good geographical diversification, with assets spread across the Baltic region

Summus' portfolio is well diversified but remains focused on the Baltic region: Estonia (20% of total property value), Lithuania (41%) and Latvia (39%). While 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. As such, Summus can benefit from slightly different demand patterns, influenced by the different industries in its markets.

Modest tenant diversification, partially mitigated by moderate tenant quality

Tenant diversification is still modest despite more than 390 tenants in the portfolio, with the top 10 accounting for about 40% of rental income. The largest tenant, BOD Group (main industrially recorded CD, DVD and Blue-Ray manufacturer in the Baltic States), provides 7.7% of rental income as of June 2022. The tenant mix also includes medium and small tenants, mainly in the retail segment (more than 50% of NRI) and exposed to potential major changes in consumer habits accelerated by the pandemic such as the shift to e-commerce.

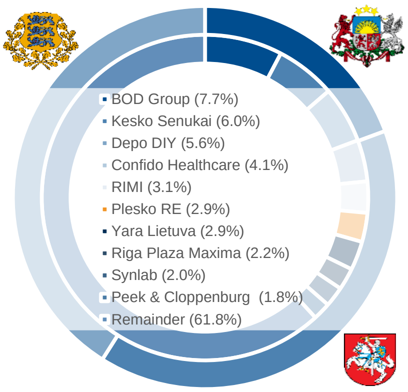
Of the top 10 tenants, only two have a credit rating, one being investment grade. Even so, the tenant mix has had very low bad-debt rates during the last five years (below 0.5% since 2016).

Although demand for the assets is stable, worsening macroeconomic conditions and unforeseen shocks remain a risk. A slowdown in the economy could directly translate into softer demand and the closure of some branches, particularly in the retail segment. The presence of bank guarantees or cash deposits partially mitigates the risk of a single tenant default, which could impair rental cash flow.

Presence in second-tier investment market in Europe

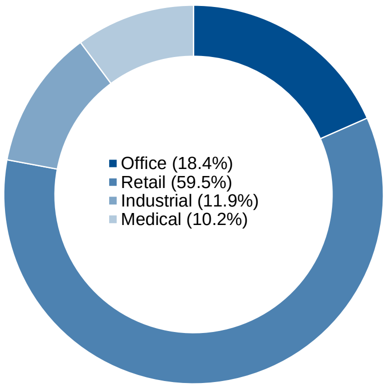
The portfolio consists of 15 properties, including shopping centres (about 60% of total rental income), office buildings (18%), medical services premises (10%) and industrial buildings (12%). The properties are in either Latvia, Lithuania or Estonia, i.e. in second-tier investment markets in terms of size and demand from international investor. The investor base in the Baltic markets has a rather local focus. If the economy cools and/or interest rates rise, this could lead to substantial downward pressure on property values, an increase in leverage, the reduced availability of external financing, and limited recovery expectations for debt investors.

Figure 1: Geographical (outer ribbon) and tenant diversification (inner ribbon) by NRI[4]



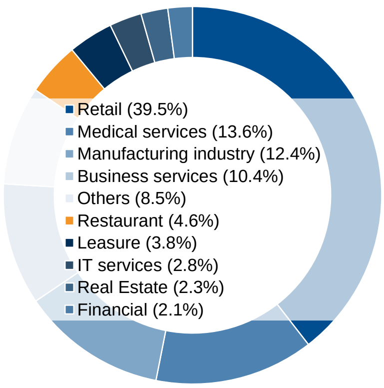
Sources: Summus, Scope

Figure 2: Property type diversification by NRI



Sources: Summus, Scope

Figure 3: Tenants by industry



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 2022) has helped to keep net rental income stable. Average occupancy benefits from the office and industrial assets, which are fully let, but is also influenced by the shopping centres, which have some vacancies. The largest asset in the portfolio, Riga Plaza, has still an 8% vacancy rate as of June 2022 (12% in the prior year). We expect occupancy to remain above 95% based on healthy demand among tenants and Summus' ability to keep occupancy high.

The company's estimated medium-term WAULT to first break of around five years as of June 2022 provides some visibility on future cash flows. Re-letting risk in the short term mostly concerns the retail properties, which are particularly under threat from the rise of e-commerce and fluctuating demand.

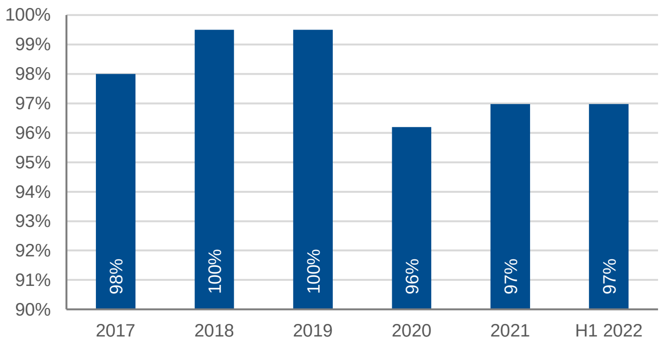
Relatively modern property portfolio

The average portfolio age is 7.9 years. The portfolio ranges from newer properties such as the two medical centres (Veerenni 1 in operation since 2017; Veerenni 2 in 2020) and the recently built Depo DIY (completed in 2021) and older ones such as De la Garde, built in 2000. The assets benefit from either a central location, a resilient neighbourhood catchment or strategic locations to tenants.

The recovery in retail asset footfall following the easing of pandemic restrictions will enhance demand for the shopping centres' products and services. Summus budgets about 2%-3% of revenue for regular property maintenance. More recently, it started energy audits for all Estonian properties to map current energy consumption (technical systems, sensors, lights, ventilation, heating, cooling, outside lights, BMS etc.) and define improvement areas.

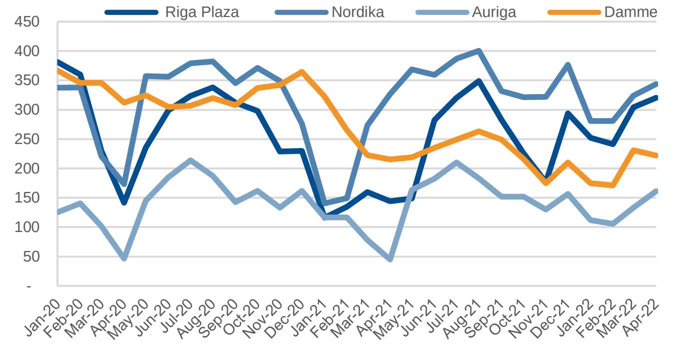
[4] NRI = net rental income

Figure 4: Historical occupancy rate



Sources: Summus, Scope

Figure 5: Retail assets footfall (thousands)



Sources: Summus, Scope

Stable profitability ratios

Summus' profitability, as measured by its EBITDA margin, stood at 64% as at end-June 2022, still below that of other buy-and-hold peers, some of which have above 80%. The company's asset occupancy rate has remained high and the impact of Covid-19 has been negligible. In 2021, the company received a EUR 1.6m grant from the Latvian Investment and Development Agency to compensate for rent discounts in the Riga Plaza.

We foresee the EBITDA margin to remain above 60% in the next few years. Although increasing energy costs could put pressing on operating costs, Summus can pass on utilities costs in around 62% of lease agreements, while large industrial tenants have triple-net conditions. Most tenants with fixed-rate agreements pay their own premises' electricity costs. In addition, we expect that cost pressures from spiking inflation will be balanced by corresponding rental growth (around 95% of lease contracts have an indexation clause).

Financial risk profile: BB

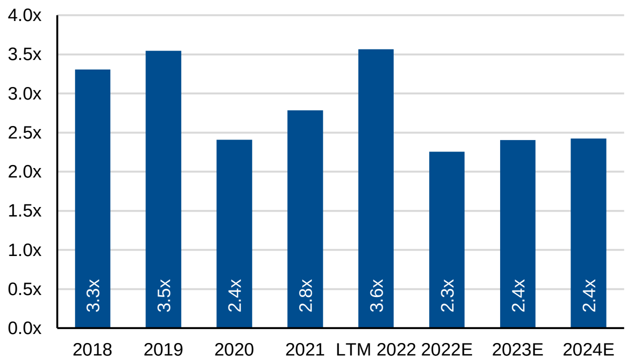
Adequate debt protection supported by positive operating cash flows

Debt protection, as measured by Scope-adjusted EBITDA interest cover, stood at 2.8x in December 2021 (3.6x for LTM to June 2022). We expect debt protection to remain above 2x from 2022 on the back of i) stable operational cash flow; ii) the addition of income-producing assets; and iii) the relatively low average cost of bank financing (2.8% as at end-June 2022). There is interest rate risk, however, as bank loans pay variable interest rates (EURIBOR + 1.8%-2.5%), although this is mitigated by the policy to keep at least 50% of the loan portfolio hedged by interest rate swaps (60% to Q2 2022). Although we expect portfolio growth to lead to higher indebtedness, we believe debt protection will remain above 2x, driven by the cash flow contribution from planned acquisitions.

Targeted portfolio expansion to squeeze free operating cash flows

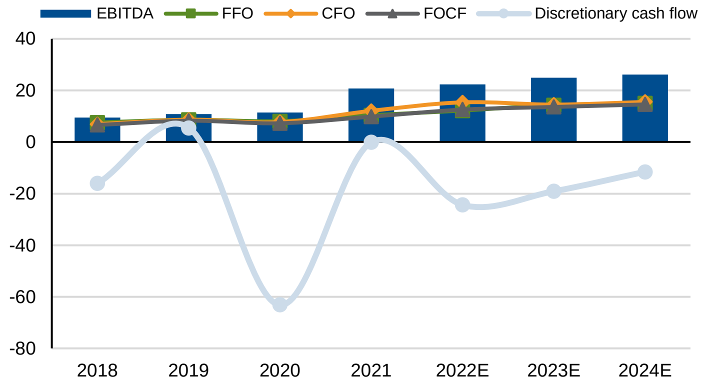
Scope-adjusted free operating cash flow has been positive in the past years, which was mainly used to acquire investment properties. For the next few years, we expect positive internal cash flow (Scope-adjusted EBITDA, Scope-adjusted funds from operations and Scope-adjusted free operating cash flows) thanks to solid recurring rental income and further acquisitions of income-generating assets. Discretionary cash flow will remain negative, driven by about EUR 65m of acquisitions in 2022-24. These acquisitions will be partly financed by external bank debt, leading to higher on-balance-sheet leverage.

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



Sources: Summus, Scope estimates

Figure 7: Cash flows (EUR m)

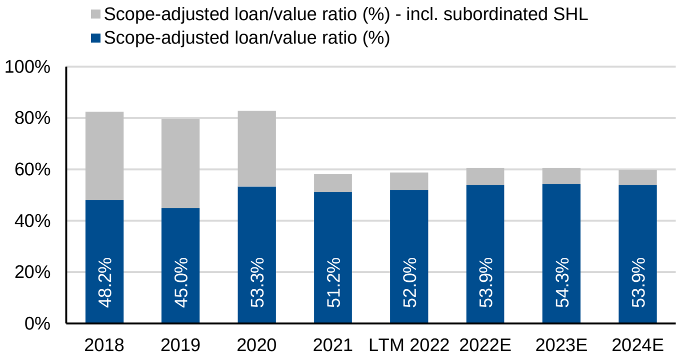


Sources: Summus, Scope estimates

Adequate leverage, but vulnerable to downside market-related volatility

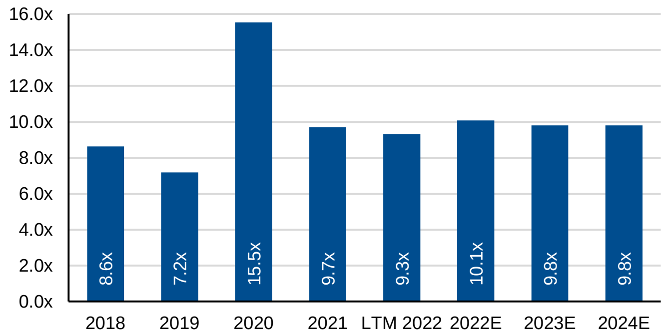
Leverage, as measured by the Scope-adjusted loan/value ratio, stabilised in a range of 50%-55% (end-June 2022: 53.8%), which excludes outstanding subordinated loans from the shareholders (EUR 28.1m). The Scope-adjusted loan/value ratio is forecast to increase above 55% in the coming years. This is based on the around EUR 60m in additional loans needed to finance the business plan and the assumption of a 60%-65% loan/value ratio financing structure for the intended acquisitions. In addition, Summus' portfolio is exposed to market pressure that could lead to yield expansion, especially regarding the shopping centres.

Figure 8: Scope-adjusted LTV ratio



Sources: Summus, Scope estimates

Figure 9: SaD/EBITDA



Sources: Summus, Scope estimates

Adequate liquidity

Summus' liquidity is adequate, supported by unrestricted cash of EUR 13.8 m as at end-June 2022 (EUR 15.1m as at December 2021) and positive operational cash flow that covers short-term debt of about EUR 5m. Even if free operating cash flow turns negative due to investments in the next few years, capex is mostly discretionary and will be financed by a combination of available internal resources and financial debt.

Balance in EUR	2021	2022E	2023E
Unrestricted cash (t-1)	11.5	15.1	5.8
Open committed credit lines (t-1)	0.0	0.0	0.0
Free operating cash flow	9.9	12.6	13.6
Short-term debt (t-1)	-10.5	-42.4	-9.8
Coverage	**2.0x**	**0.7x**	**2.0x**

Long-term and short-term debt ratings

Senior unsecured debt rating: BB

Summus has a EUR 10m senior unsecured corporate bond in terms of capital market debt at end-June 2022. The bond's tenor is three years with a fixed coupon of 6.75% and payments made four times a year.

Our recovery analysis is based on a hypothetical default scenario in FY 2023 with a company liquidation value of EUR 337m. 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 10m) but note the high sensitivity of the portfolio to property advance rates. Therefore, we have assigned the debt class a rating of BB, in line with the issuer rating.

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Appendix: Peer comparison (as at last reporting date)

	Summus Capital OÜ	NEPI Rockcastle Plc	Fastpartner AB	Globe Trade Centre S.A.	Deutsche Konsum REIT AG
	BB/Stable	-- / --	BBB-/Stable	BBB-/Stable	BB+/Stable
Last reporting date	30/06/2022	31/12/2021	30/06/2022	31/12/2021	31/12/2021
Business risk profile					
Scope-adjusted total assets (EUR m)	416	6,099	3,702	2,745	1,040
Portfolio yield	7%	6.8%	4.80%	6.9%	5.4%
GLA (thousand sq m)	218	2,014	1,573	854	1,023
No. of residential units	na	na	na	na	na
Countries active in	3	9	1	6	1
Top 3 tenants (%)	19%	12%	9.2%	9%	33%
Top 10 tenants (%)	38%	24%	19.1%	22%	48%
Office (share NRI)	18%	1%	46%	69%	na
Retail (share NRI)	60%	98%	12%	31%	100%
Residential (share NRI)	0%	na	0%	na	na
Hotel (share NRI)	0%	na	4%	na	na
Logistics (share NRI)	12%	na	24%	na	na
Others (share NRI)	10%	0%	14%	na	na
Property location	B	'B'	'A' and 'B'	'B'	'B'
EPRA occupancy rate (%)	97%	96%	92%	90%	95.1%
WAULT (years)	5.0	3.6	4.6	3.6	5.4
Tenant sales growth (%)	na	23.9%	na	na	na
Like-for-like rent growth (%)	na	na	na	na	1.7%
Occupancy cost ratio (%)	na	13.0%	na	na	na
Scope-adjusted EBITDA margin	63%	81%	68%	86%	66%
EPRA cost ratio (incl. vacancy)	na	8.3%	na	na	36.0%
EPRA cost ratio (excl. vacancy)	na	8.2%	na	na	32.5%
Financial risk profile					
Scope-adjusted EBITDA interest cover (x)	3.6x	5.8x	5.1x	3.4x	4.4x
Scope-adjusted loan/value ratio (%)	54%	30%	44%	52%	54%
SaD/Scope-adjusted EBITDA (x)	9.6x	5.7x	13.5x	12.7x	11.7x
Weighted average cost of debt (%)	2.8%	2.4%	1.50%	2.2%	1.9%
Unencumbered asset ratio (%)	301%	278%	230%	155%	147%
Weighted average maturity (years)	3.7	3.7	3.7	5.2	3.3

* Subscription ratings available on ScopeOne

Sources: Public information, Scope

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