Otthon Centrum Holding Kft.
Hungary, Business Services

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	net cash interest	22x	net cash interest	net cash interest
Scope-adjusted debt/EBITDA	net cash	2.0x	2.0x	2.9x
Scope-adjusted funds from operations/debt	net cash	46%	47%	34%
Scope-adjusted free operating cash flow/debt	net cash	40%	33%	21%

Rating rationale

Otthon Centrum's rating is driven by the leading market position in its home market as a real estate and financial brokerage. The business risk profile suffers from the absence of geographical diversification, which exposes the company to the macroeconomic trends of one market only. Margins are expected to weaken in 2023 based on rising interest rates that are affecting loan and house demand in Hungary. The business risk profile benefits from i) a granular customer base, being Otthon Centrum focus on the retail segment with very limited repeated business; ii) a relatively diverse line of products.

Otthon Centrum rating continues to reflect a strong financial risk profile, with debt protection, measured by the Scope-adjusted EBITDA interest cover, historically largely above 10x. We expect Otthon Centrum's favourable interest rate (above 10%) on its HUF bank deposit to generate positive interest income. Leverage will likely remain below 3x, even when considering the additional costs of two possible acquisitions to be closed in 2022. Liquidity is adequate given the absence of short-term debt and the current HUF 2.9bn bond not repayable before 2024.

Outlook and rating-change drivers

The Outlook is Stable and reflects the company's ability to generate positive free operating cash flow and the current net cash position. We expect significantly weaker demand and lower profitability in 2023, but credit metrics should remain in line with expectations for the given rating. Moreover, the Stable Outlook reflects our expectation that the issuer will use the bond proceeds to acquire property agencies with a positive EBITDA contribution.

A positive rating action would require Otthon Centrum to significantly extend its size and diversity while maintaining financial metrics in line with our expectations, i.e. Scope-adjusted debt/EBITDA of below 2x for a sustained period.

A negative rating action could be warranted if financial leverage (Scope-adjusted debt/EBITDA) 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 history

Date	Rating action/monitoring review	Issuer rating & Outlook
15 Nov 2022	Affirmation	BB-/Stable
17 Dec 2021	No action	BB-/Stable
20 Jan 2021	New	BB-/Stable

Ratings & Outlook

Issuer BB-/Stable

Senior unsecured debt BB-

Analyst

Claudia Aquino
+49 30 27891599
c.aquino@scoperatings.com

Related Methodology

General Corporate Rating Methodology;
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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

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong market position in Hungarian real estate and loan brokerage market • High organic revenue growth • Asset-light business model, hence little financial debt and moderate financial leverage • Diversified among several real estate related services, high customer granularity • Robust liquidity	• Strong dependency on general transaction volumes in the Hungarian real estate and loan markets • Strong competition in the online real estate brokerage market • International expansion via M&A bearing execution and integration risks

Positive rating-change drivers	Negative rating-change drivers
• Significant expansion in size and diversity, and financial leverage (Scope-adjusted debt/EBITDA) maintained below 2x	• Financial leverage sustained over 3.5x

Corporate profile

Otthon Centrum Holding Kft. (Otthon Centrum) was founded in 2000 and runs a leading real estate agency network, providing 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 issued a HUF 2.9bn bond to fund the international expansion of the real estate and mortgage agency network in April 2021.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	944x	net cash interest	22x	net cash interest		
Scope-adjusted debt/EBITDA	net cash	net cash	2.0x	2.0x	2.9x	2.5x
Scope-adjusted funds from operations/debt	net cash	net cash	46%	47%	34%	41%
Scope-adjusted free operating cash flow/debt	net cash	net cash	40%	33%	21%	27%
Scope-adjusted EBITDA in HUF m						
EBITDA	985	784	1,236	1,220	834	931
Disposal gains of fixed assets	5	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**990**	**784**	**1,236**	**1,220**	**834**	**931**
Funds from operations in HUF m						
Scope-adjusted EBITDA	990	784	1,236	1,220	834	931
less: (net) cash interest paid	-1	1.5	-56	150	170	201
less: cash tax paid per cash flow statement	-124	-70	-63	-234	-163	-188
Funds from operations (FFO)	**865**	**715**	**1,117**	**1,136**	**841**	**944**
Free operating cash flow in HUF m						
Funds from operations	865	715	1,117	1,136	841	944
Change in working capital	-535	77	283	-3	16	0
Non-operating cash flow	-15	0	0	0	0	0
less: capital expenditure (net)	-128	-645	-319	-200	-200	-200
less: lease amortisation	-97	-78	-113	-134	-134	-134
Free operating cash flow (FOCF)	**90**	**69**	**968**	**799**	**523**	**610**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-1	1.5	-56	150	170	201
Net cash interest paid	**-1**	**1.5**	**-56**	**150**	**170**	**201**
Scope-adjusted debt in HUF m						
Reported gross financial debt	298	417	3,441	3,441	3,441	3,296
less: cash and cash equivalents	-525	-635	-1,000	-1,000	-1,000	-1,000
add: non-accessible cash	0	0	0	0	0	0
Scope-adjusted debt (SaD)	**-227**	**-218**	**2,441**	**2,441**	**2,441**	**2,296**

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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)	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

No material ESG risk identified.

As a real estate agency, the major ESG risks Otthon Centrum is exposed to are typically regulatory and reputational, alongside governance risk factors. Environmental risks are not significant given the asset-light business model. Otthon Centrum needs to address potential risks coming from:

1) product (loan) mis-selling identified as a potential social risk factor;

2) lack of independent oversight of the board as potential governance risk factor, but not dissimilar to other privately owned businesses.

In relation to the product mis-selling risk, Otthon Centrum reports having a very rigorous process, supported by a high-quality IT system. In the financial intermediation segment, the company is subject to Hungarian Central Bank supervision and has established an internal team that perform regular audits and investigate customer complaints.

[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: BBB

We classify Otthon Centrum as a business services provider, an industry we rate BBB based on medium cyclicality, medium risk of substitution and medium barriers to entry. 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 very much depends on the company's good reputation, its ability to keep up with technological advances, innovation, execution, and customer service quality.

Top market position in Hungary…

Otthon Centrum is one of the two leading retail-focused real estate and credit brokerage firms in Hungary with an estimated market share of around 6% for real estate transactions and 8% for mortgage loans. With the recent acquisition of Open House (about 30 offices), the company further consolidated its market position in Hungary. The main competitor is Duna House, which has continued to grow outside of Hungary (mainly Italy) and remains significantly larger.

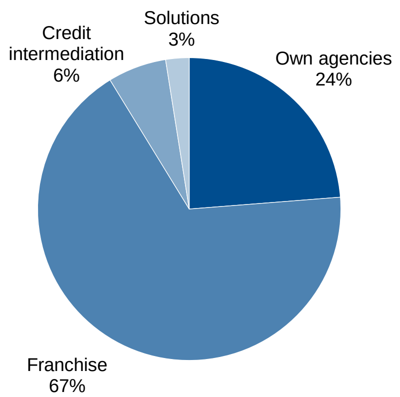
…but lack of geographical diversification

The business risk profile is however constrained by the lack of geographical diversification, given that Otthon Centrum only operates in the Hungarian market. Otthon Centrum is, however, working to improve its geographical diversity as it is considering acquisitions outside of Hungary, two of which are expected to close in 2022. The company's current focus on Hungary is credit negative as business is strongly dependent on the macroeconomic and interest rate trends of one market.

There is some diversification in the product offer, with around half of EBITDA coming from real estate brokerage (franchises and own agencies) and half coming from credit intermediation. About half of credit intermediation relates to real estate loans and the other half to personal and corporate loans, credit cards and loyalty programmes. We consider these different revenue stream as credit positive as providing some cash flow stability.

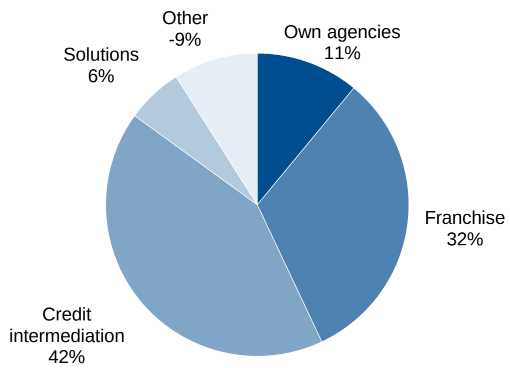
Customer granularity is very high given the focus on retail customers.

Figure 1: Revenues by segment (2022E)



Sources: Otthon Centrum, Scope

Figure 2: EBITDA by segment (2022E)



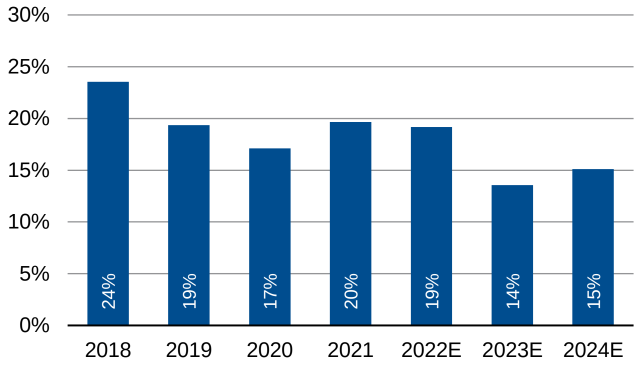
Sources: Otthon Centrum, Scope

Historical solid profitability but margin to trend downwards

Otthon Centrum's EBITDA margin has been above 15% over the last few years. We expect margins to weaken in the coming years due to lower revenues, as rising interest rates are affecting the demand for residential real estate and loans. Furthermore, the newly acquired entities will likely require restructuring and integration expenses, driving down profitability. For a global perspective, we have compared the top three real estate service providers with Otthon Centrum and its competitor Duna House in terms of EBITDA margins (Figure 4). The main difference between the top three providers versus

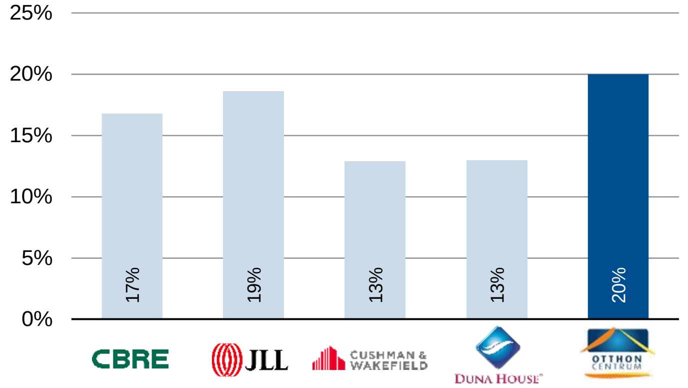
Otthon Centrum and Duna House is that the global players are primarily focused on commercial real estate; however, they all show similar margins.

Figure 3: Scope-adjusted EBITDA margin



Sources: Otthon Centrum, Scope estimates

Figure 4: Scope-adjusted EBITDA margin versus peers 2021



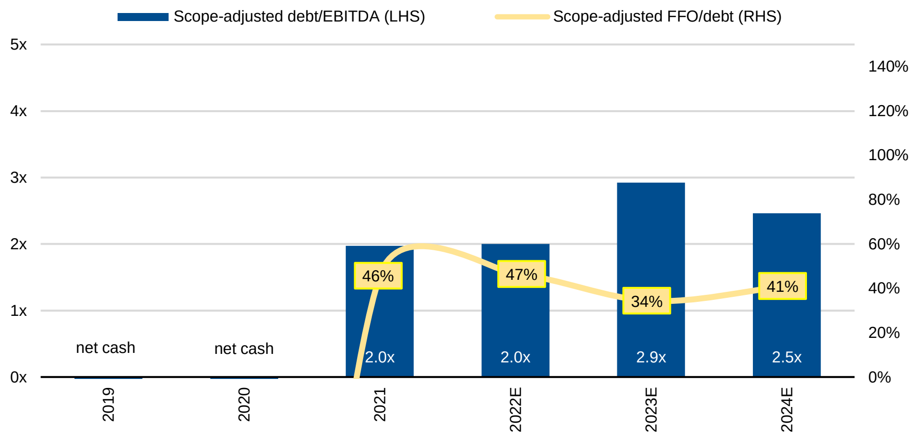
Sources: Otthon Centrum, Scope, public information

Financial risk profile: BBB

Leverage to remain within current range

Otthon Centrum's financial risk profile is supported by its low leverage measured by Scope-adjusted debt/EBITDA. We expect the ratio to remain below 3x as the company is not expected to pursue further acquisitions except the three new pending that are included in our base case forecast (one acquisition has been closed and two potential acquisitions are pending).

Figure 5: Leverage



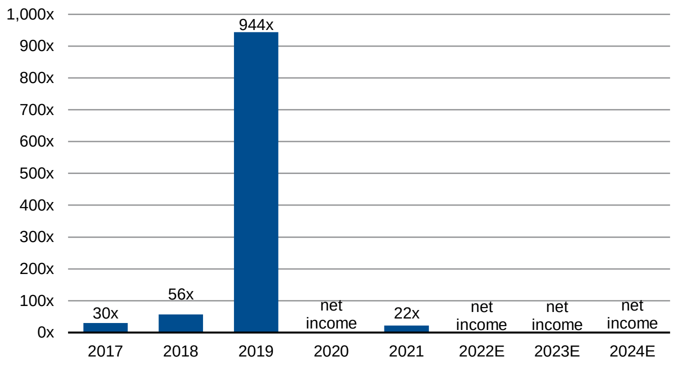
Sources: Otthon Centrum, Scope estimates

Strong interest coverage

Over the years, Otthon Centrum has shown strong interest cover thanks to its asset-light and debt-light business model. In the coming years, we expect the company to benefit from net interest income. This is due to the low coupon (3%) on the bond and the high interest (over 10%) that Otthon Centrum currently earns on its HUF deposits.

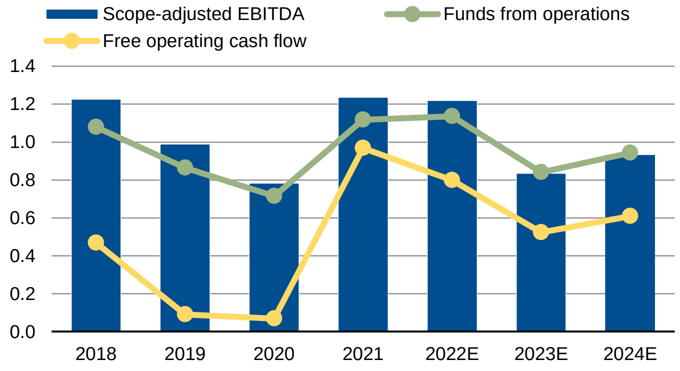
The company has been consistently cash flow positive, even in 2020 when it underwent a major IT upgrade.

Figure 6: Scope-adjusted EBITDA interest cover



Sources: Otthon Centrum, Scope estimates

Figure 7: Cash flows (HUF bn)



Sources: Otthon Centrum, Scope estimates

Adequate liquidity

Liquidity is robust given that the HUF 2.9bn bond proceeds are yet to be deployed. The bond will not be repayable before 2024 (5% per year in 2024-2027, 10% in 2028-2030 and 50% in 2031). Otthon Centrum reported HUF 4bn of cash and equivalents as at end-June 2022. We are aware that in H2 2022, Otthon Centrum invested a large part of its cash in local real estate funds, but we expect these investments to be realised before end-2022 and the proceeds to be deposited at local banks. According to Otthon Centrum, these funds can be withdrawn at any time and without any loss in value.

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	635	3,734	2,781
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	968	799	523
Short-term debt (t-1)	0	15	15
Coverage	**No debt**	**>200%**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB-

Otthon Centrum has HUF 2.9bn of senior unsecured capital market debt outstanding.

We base the outcome on the going concern method, since the company has relatively few hard assets. We assign an instrument rating of BB- to the issuer's senior unsecured debt, reflecting limited prior ranking liabilities (leasing obligations) in the capital structure. We see material uncertainty regarding the group's asset values in a hypothetical default scenario, which would likely be driven by increased competition and/or a confidence loss in the business/brand and a departure of many licensees and agents.

Appendix: Peer comparison (as at last reporting date)

	Otthon Centrum Kft.	Duna House Holding Nyrt.	Pannon Work Zrt.	Mobilbox Kft.	Progress Étteremhálózat Kft.
	BB-/Stable	BB-/Stable	B+/Stable	BB/Stable	BB/Stable
Last reporting date	31 December 2021	31 December 2021	31 December 2020	31 December 2021	31 December 2021
Business risk profile					
Services offered	Loan brokerage, real estate brokerage and other financial and management services	Loan brokerage, real estate brokerage and other financial and management services	Human resource services	Rental and sales of office, storage and special containers	Franchisor of McDonalds restaurants in Hungary
Scope-adjusted EBITDA (EUR m)	3.0	8.6	2.3	16.4	26.8
Scope-adjusted EBITDA margin	15-20%	7-13%	5%	40-43%	17%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	22x	94x	11.6x	24.8x	15.2x
Scope-adjusted debt/EBITDA	2x	3.1x	4.5x	0.5x	2.5x
Scope-adjusted/debt	46%	34%	14%	173%	36%
Scope-adjusted free operating cash flow/debt	40%	17%	-7%	70%	0%

Sources: Public information, Scope

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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