Hili Finance Company p.l.c.

Executive Summary:

"Notwithstanding the distressed economic environment and weaker fundamentals, Hili Group still forecasts healthy profitability margins for FY20, with an EBITDA margin of 12.3% (FY19: 13.2%). In view of this, the Group expects a positive interest coverage of 4.0x (FY19: 4.1x), with a leverage ratio of 6.6x.

We believe that Premier Capital remains a core operation for the Group. The latter's reliance on Premier might pose risks for the Group, however we view that the strong franchise and regional operations are Premier's key success in translating better margins within the restaurant segment. That said, we also acknowledge the fact that over the years management has pursued a strategy in sector diversification. Overall, we believe that the Group is well positioned despite setbacks brought about by Covid-19. Based on this, combined with the Group's strong credit metrics and a substantial cash position of €66.2m as at FY19, justify a **Positive** credit opinion on HLF.

HF28 – This security is currently trading at a discount and yielding a YTM of 3.9%. We believe that based on our Positive view on the Issuer and the current yield, investors should take this opportunity to capitalise on this security and therefore we are issuing a Buy recommendation on HF28

HF29 - This bond is also trading at a discount and yielding 3.9%. Given that the characteristics of this security are very similar to HF28, coupled with our positive view on HLF, we are also issuing a Buy recommendation on HF29."

Debt securities issued by the Group:

The Group currently has five unsecured bonds in issue, three of which issued by its subsidiaries, with the remaining two issued by the Group through Hili Finance Company plc (the "**Issuer**" or "**HLF**"), as a special purpose vehicle. The latter two bonds are guaranteed by Hili Ventures Ltd, which also acts as the holding company of the Group.

Business Overview:

The Hili Group is engaged in multi-sited activities with McDonald's and Apple, logistics, marine & engineering, technology, oil & gas, property, hospitality and leasing. The Group has presence in 10 countries, with a team of 9,500 people.

Group's Developments:

In July 2019, HLF issued a 10-year €80m 3.8% unsecured bond. Out of this, €59m was earmarked to acquire Comino Hotel and Bungalows, €10m to part-finance the acquisition of new containers by Cobalt and €10m retained for potential Group-wide investment opportunities.

In April 2020, the Group through 1923, successfully acquired STS Marine Solutions from Teekay Tankers Limited (cost of deal: $26m), which provides ship-to-ship support services operations.

Credit Opinion Positive

Country	Malta
Industry	Real Estate, Logistics, Restaurants, Retail, Marine, Hospitality and Technology

3.85% HLF 2028

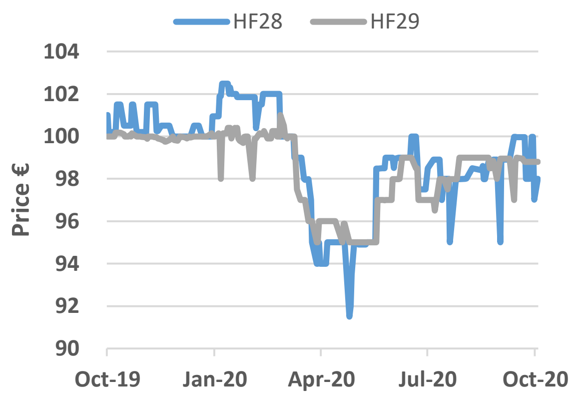
Security	Unsecured
Nominal	€40m
Ticker	HF28
Price (as at 21/10/20)	€99.95
Recommendation	**Buy**
Yield to Maturity (YTM)	3.9%

3.8% HLF 2029

Security	Unsecured
Nominal	€80m
Ticker	HF29
Price (as at 21/10/20)	€98.95
Recommendation	**Buy**
Yield to Maturity (YTM)	3.9%

Exchange	Malta Stock Exchange (MSE)
52-week range (HF28)	€91.50 - €102.49
52-week range (HF29)	€95.00 - €101.00

1-Year Price Movement



Source: Malta Stock Exchange

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COVID-19 implications on the Group's operations

In view of the wide-reaching impact of the COVID-19 pandemic, the majority of the Group's operations have been affected by the negative repercussions of this outbreak. More specifically to Premier Capital, all restaurants either closed or shifted their service to take away, McDrive and McDelivery. iSpot retail stores in malls had to abide by closure protocols, while difficulties faced by third party tenants posed strains to rental income on investment property effecting Hili Properties.

In response to this unprecedented event, the Group reported that all uncommitted investments and capital expenditure were put on hold, in addition to implementing several costs mitigating measures. Despite the significant impact of the pandemic, the Group still expects to generate the same level of liquidity as originally planned and also expects to still operate at satisfactory profitability levels.

Revenue from restaurant operations (70% of total revenue as at FY19) is expected to decline by 3.8% or €12.9m in FY20 due to the business lost following the outbreak. However, the Group expects strong growth both from the 'IT Solutions & Security' (+47.8% or €8.1m) and 'Logistics & Transport' (+62.9% or €10.9m) operations. The former represent the revenue generated by Harvest Technology plc which to date has exceeded its IPO forecasts. The latter's growth in revenue will be generated following the acquisition of STS Marine Solutions. Given the improved contribution of these two segments the Group's overall revenue is expected to improve by 2.7% or €13.2m in FY20.

Prior to the COVID-19 outbreak, the Group had plans to initiate a container leasing operation through Cobalt Leasing Ltd. Capital funding for this project were earmarked through €10m from the proceeds of the recently issued €80m bond and an additional €10m in bank borrowings. The business operation is within the shipping industry through the acquisition of new containers for leasing to container shipping lines on a long term basis. However, due to the significant uncertainty in the market, the Group will not proceed with this investment until there the COVID-19 situation stabilises.

Despite the adverse impact of the pandemic on the Group's operations, we are of the opinion that the Group's cash reserves (FY19: €66.2m), coupled with the profitable performance projected for FY20 should ensure that HLF will meet all of its financial commitments including the interest on its bonds.

SWOT Analysis

Strengths

- ✓ A strong diversified Group, both in terms of business operations and geographical positioning
- ✓ Strong cash reserves prior to the outbreak
- ✓ The Group has an established history, with a track record of profitability and constant improvement in financial performance
- ✓ The Group has a strong asset base
- ✓ Despite the considerable impact of COVID-19, the Group expects to remain profitable in FY20

Weaknesses

- × The Group's gearing is relatively high, which consequently results in significant finance costs
- × The Group is exposed to exchange rate movements
- × The outbreak may delay the Group's strategic plans, hindering the growth expected from recently invested capital, such as the circa €60m investment in Comino Hotel. This might depress profitability margins in the short to medium term

Opportunities

- ○ Given the strength of the Group's financial position, it can capitalise on new opportunities which may arise subsequent to the pandemic
- ○ Hili's diversified line of businesses across several geographies might present the Group with additional investment opportunities.

Threats

- ! The extent of the impact from COVID-19 is not yet fully known, thus there might be potential downturn if the situation deteriorates further
- ! Prolonged economic recession ensuing from the pandemic

Financial Summary

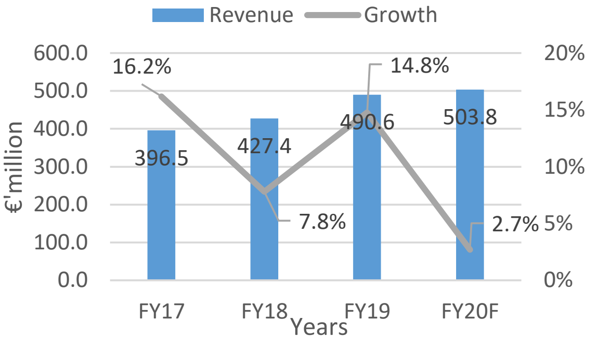
Hili Ventures Limited - €'m (unless otherwise indicated)	FY17A	FY18A	FY19A	FY20F Pro forma[1]
Income statement				
Revenue	396.5	427.4	490.6	503.8
Cost of Sales	(320.3)	(343.4)	(384.4)	(384.3)
Gross Profit	76.1	84.0	106.1	119.5
Net operating expenses	(37.4)	(41.1)	(41.5)	(57.6)
EBITDA	38.8	42.9	64.6	61.8
Depreciation and amortisation	(14.1)	(15.7)	(27.2)	(33.6)
EBIT	24.6	27.1	37.4	28.3
Net investment income/(loss)	(3.1)	0.6	5.8	0.8
Net finance costs	(12.1)	(12.0)	(16.7)	(15.6)
Profit before tax	9.4	15.8	26.5	13.5
Taxation	(2.5)	(4.0)	(3.9)	(3.3)
Profit after tax	6.9	11.8	22.6	10.2
Cash flow				
Net cash from operations (CFO)	10.9	36.3	48.6	29.8
Capex	(24.0)	(28.7)	(87.6)	(53.1)
Free cash flows (CFO – Capex)	(13.1)	7.5	(38.9)	(23.3)
Balance sheet				
Cash and cash equivalents	27.3	40.4	66.2	38.6
Current assets	77.7	96.7	135.2	112.6
Non-current assets	330.5	358.4	493.7	513.7
Total assets	408.2	455.1	628.9	626.3
Current liabilities	91.0	94.4	112.4	107.1
Non-current liabilities	234.4	274.3	406.4	414.4
Total liabilities	325.3	368.7	518.8	521.6
Total Financial debt	255.9	286.0	437.1	449.8
Net debt	228.6	245.6	370.9	411.2
Total equity	82.9	86.4	110.1	104.7
Ratios				
Growth in Total Revenue (YoY Revenue Growth)	16.2%	7.8%	14.8%	2.7%
Gross profit margin (Gross profit / Revenue)	19.2%	19.6%	21.6%	23.7%
EBITDA margin (EBITDA / Revenue)	9.8%	10.0%	13.2%	12.3%
Operating (EBIT) margin (EBIT / Revenue)	6.2%	6.3%	7.6%	5.6%
Net margin (Net income / Revenue)	1.7%	2.8%	4.6%	2.0%
Return on common equity (Net Income / Total Equity)	8.9%	14.0%	23.0%	9.5%
Return on assets (Net Income / Total Assets)	1.7%	2.7%	4.2%	1.6%
Current ratio (Current assets / Current Liabilities)	0.9x	1.0x	1.2x	1.1x
Interest coverage ratio (EBITDA /Cash interest paid)	3.3x	4.0x	4.1x	4.0x
Gearing level 1 (Net debt / Net Debt and Total Equity)	73.4%	74.0%	77.1%	79.7%
Gearing level 2 (Total Liabilities / Total Assets)	79.7%	81.0%	82.5%	83.8%
Net debt / EBITDA	5.9x	5.7x	5.7x	6.6x
Cash from Operations / EBIT	0.4x	1.3x	1.3x	1.1x

Source: HLF's Group Audited Financial Statements and FY20 Financial Analysis Summary

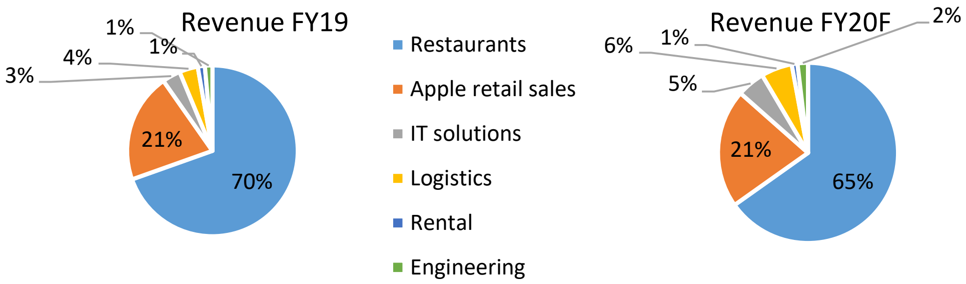
[1] As per company announcement dated 02/10/2020, Premier Capital has withdrawn its application for the issue of €20m 3.75% unsecured bonds 2026. In view of this, we are showing pro forma figures for HLF's Group for FY20, excluding such bond. Based on the announcement and discussions with management, Premier still intends to acquire the Romanian minority shareholder and continue with its CAPEX plan. Therefore, amongst other adjustments, we reduced the cash position and financial debt in FY20 by €20m to reflect these developments.

Investment Considerations

- **Revenue** – The Group's revenue is segregated in 6 main operations, with the largest contributor being the 'Restaurant Operations'. In FY19, the Group's total revenue stood at €490.6m, meaning an improvement of 14.8% over FY18 (€427.4m). As per FY19, restaurant operations contributed 70% to total revenue, followed by apple retail sales (21%) and logistics (4%).

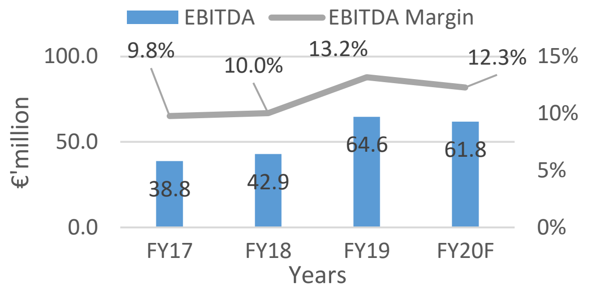


In view of the downturn brought about by the pandemic, including closure/restrictions of sit-down restaurants the Group expects revenue from restaurant operations to taper down to €328.4m (FY19: €341.3m) in FY20, translating into a decrease of 3.8%. In view of this, the contribution of restaurants to total revenue is expected to fall to 65%. The Group expects positive performance from both its IT solutions & security and logistics & transport business, where in FY20 these are forecasted to grow by 47.8% and 62.9%, respectively. Consequently, the contribution of these revenue streams to aggregated revenue is expected to increase to 5% and 6%, respectively.



Source: HLF's Financial Statements and FY20 FAS

- **EBITDA –** In FY19, EBITDA jumped to €64.6m (FY18: €42.9m). Circa half of this increase was due to the implementation of IFRS 16, which if excluded results in an adjusted EBITDA of €54.2m, meaning an increase of 26.5%. In view of these developments, the EBITDA margin also improved to 13.2% in FY19, 11.0% excluding IFRS 16 (FY18: 10.0%).



Source: HLF's Financial Statements and FY20 FAS

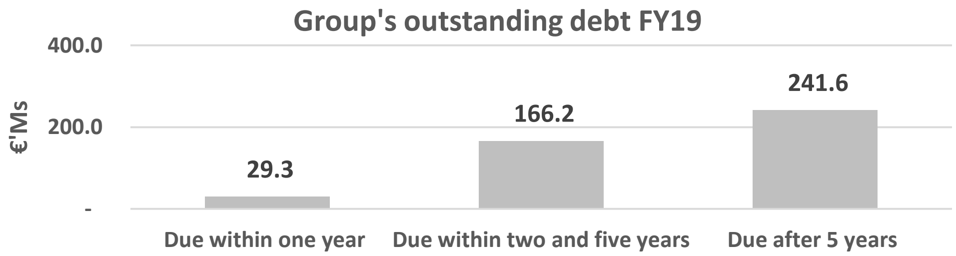
The Group does not provide a segregated EBITDA by each segment, however it does disclose that Premier Capital's (Premier's) EBITDA ('Restaurant Operations') contributes to circa 90% of the aggregated EBITDA (FY19: 87%). Given this high correlation to Premier Capital it is forecasted that the Group's EBITDA will fall to €61.8m (-4.3% or €2.8m over FY19), despite the forecasted revenue growth of 2.7% for FY20. Although both the IT Solutions & Security and Logistics & Transport businesses are expected to positively impact the Group's EBITDA, in fact Premier's EBITDA (on a standalone basis) is forecasted to drop by 17.3% or €9.7m in FY20. It is pertinent to note that Premier expects a substantial recovery in FY21 with its EBITDA growing by 17.0% or €7.9m over FY20. Naturally, this should positively impact the Group in FY21. Following conversations with management, Premier is still expected to continue on its CAPEX plans, therefore the recovery in FY21 should still be sustained even though it has withdrawn its €20m bond application (as per above).

- **Finance costs** – Finance costs mainly consist of interest incurred on the Group's bonds currently in issue, in addition to finance costs on bank borrowings and finance lease liabilities (IFRS 16). In FY19, the Group incurred €16.7m in financing expenses, an increase of €4.7m over FY18. This was mainly as a result of the implementation of IFRS16, coupled with new debt, mainly the €80m bond issue. In FY20, net finance costs are expected to amount to €15.8m.

- **Interest cover –** In FY19, the Group's interest coverage stood at 4.1x. In view of the limited deterioration expected in EBITDA for FY20, the interest cover is expected to marginally decrease to 4.0x.

- **Capital Expenditure -** During FY19, the Group invested €87.6m in the acquisition of properties and capital expenditure, including €55m for Comino Hotel and €20.2m capex of Premier Capital. The Group ceased all of its uncommitted CAPEX for FY20, however it still expects to invest €53.1m, which includes the acquisition of STS Marine Solutions and the remaining 10% shareholding in Premier Capital SRL (McDonald's Romania).

Debt Maturity Profile



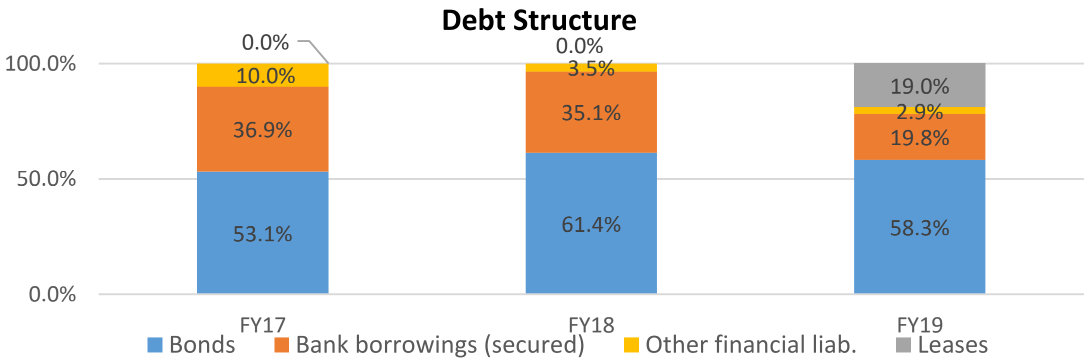
Maturity Ladder: FY19 (€'Ms)	Within 1 year	Between 1 - 5 years	More than 5 years	Total
Debt Securities in issue	-	72.2	182.8	254.9
Bank loans and overdrafts[2]	11.7	59.5	15.5	86.7
Lease liabilities	9.7	30.0	43.4	83.1
Other financial liabilities	7.9	4.5	-	12.5
	29.3	166.2	241.6	437.1

Source: HLF's Audited Financial Statements

- As can be noted from above, the majority of the Group's financial debt is due after 5 years, which mainly reflects the two bonds of Hili Finance and the €65m 2026 bond of Premier Capital.
- The bonds of Hili Group are unsecured and those of Hili Finance are guaranteed by Hili Ventures Ltd.

Bank loans and overdrafts – These facilities are secured by hypothecs over the assets of the Group and guarantees provided by the Group and related parties

- Premier Capital has (i) a bank loan in Romanian leu equivalent to €10.5m maturing in 2022 bearing an interest rate of 3-mnth ROBOR+2.75% (ii) a loan facility of €10m maturing in 2023 bearing an interest rate of 1-month EURIBOR+2.5% and (iii) an unutilised facility of €1m currently bearing an interest rate of 2.35%.
- Hili properties as at FY19 had bank borrowings facilities amounting to €45.4m.
- 1923 Investments plc has overdraft facilities in Malta and Poland, bearing a variable interest rate of 5.14% and 3.13%, respectively.
- Motherwell Bridge Industries (MBI) has a bank overdraft which bears interest at 3.25% - 5.65%. Additionally, as at FY19 it has bank borrowings facilities amounting to €1.5m. MBI did not have any bank loans at the end of FY19.



[2] As per financials bank overdrafts are included as due within 1 year, however given that the Group's overdrafts have no date of repayment, we classified this debt as due between 1-5 years.

Analysis of outstanding issues

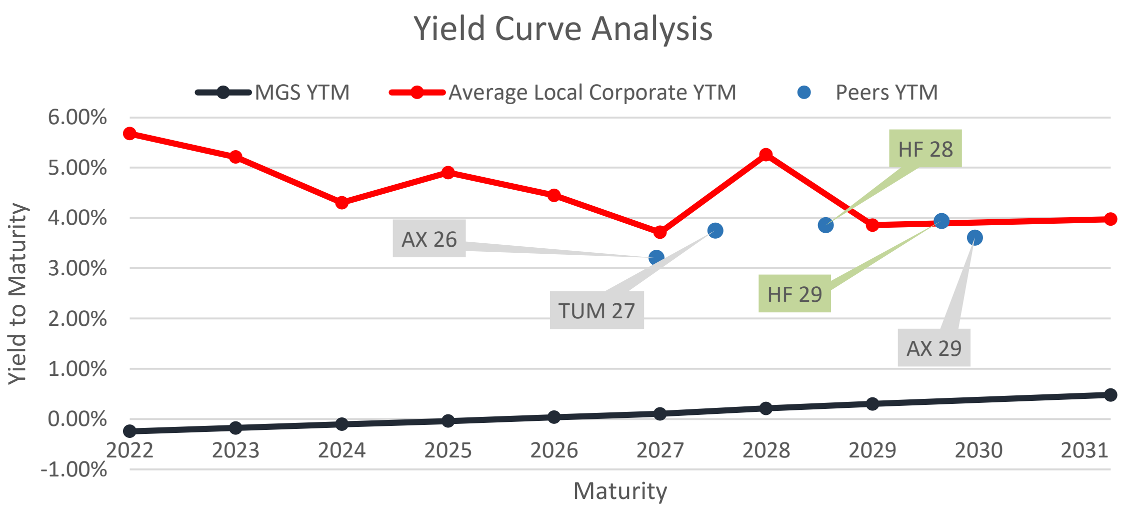
Security	Nom Value	Yield to Maturity	Interest coverage (EBITDA)	Total Assets	Total Equity	Total Liabilities / Total Assets	Net Debt / Net Debt and Total Equity	Net Debt / EBITDA	Current Ratio	Return on Common Equity	Net Margin	Revenue Growth (YoY)	Last Closing Price *
	€000's	(%)	(times)	(€'millions)	(€'millions)	(%)	(%)	(times)	(times)	(%)	(%)	(%)	
3.25% AX Group plc Unsec Bds 2026 Series I	15,000	3.2%	5.5x	342.4	226.1	34.0%	18.9%	3.2x	0.9x	2.2%	9.4%	-8.1%	100.25
3.75% Tumas Investments plc Unsecured € 2027	25,000	3.7%	9.1x	244.6	131.5	46.2%	16.5%	1.0x	2.2x	8.6%	20.6%	-52.6%	100.01
3.85% Hili Finance Company plc Unsecured € 2028 (xd)	40,000	3.9%	4.1x	628.9	110.1	82.5%	77.1%	5.7x	1.2x	23.0%	4.6%	14.8%	99.95
3.8% Hili Finance Company plc Unsecured € 2029	80,000	3.9%	4.1x	628.9	110.1	82.5%	77.1%	5.7x	1.2x	23.0%	4.6%	14.8%	98.95
3.75% AX Group plc Unsec Bds 2029 Series II	10,000	3.6%	5.5x	342.4	226.1	34.0%	18.9%	3.2x	0.9x	2.2%	9.4%	-8.1%	101.10

* Last price as at 21/10/2020

Source: FY19 audited financial statements

Investment Rationale

We have compared the securities of Hili Finance Company plc against similar issuers in the local market. **Comparable companies were identified based on the size of the Group, more specifically having a diversified revenue stream.** The credit profile of the comparable companies was analysed in terms of leverage and the ability to meet debt obligations.



Source: Malta Stock Exchange, Central Bank of Malta and Calamatta Cuschieri Workings

The above graph illustrates the average yearly yield of all local issuers as well as the corresponding yield of MGSs (Y-axis) vs the maturity of both Issuers and MGSs (X-axis), in their respective maturity bucket, to which the spread premiums can be noted. The graph illustrates on a stand-alone basis, the yield of comparable issuers having a maturity between 6-9 years (Peers YTM).

As can be witnessed, Hili Group is larger than both of its identified peers in terms of assets size. It also has a higher leverage (net debt/EBITDA) standing at 5.7x with Tumas Investments standing at 1.0x and AX Group standing at 3.2x. It pertinent to note that these metrics do not capture the impact of COVID-19, in fact Hili Group is forecasting leverage to increase to 6.6x. Meanwhile, AX Group which reported significant impact from the pandemic estimates its gearing to surge to 23.4x, while Tumas Investments expects its gearing to increase to 4.1x. Naturally, given the higher leverage of the Group, its interest coverage ratio is lower than that of its peers.

Notwithstanding the distressed economic environment and weaker fundamentals, Hili Group still forecasts healthy profitability margins for FY20, with an EBITDA margin of 12.3% (FY19: 13.2%). In view of this, the Group expects a positive interest coverage of 4.0x (FY19: 4.1x), with a leverage ratio of 6.6x. These strong credit metrics, combined with a substantial expected consolidated cash reserve of €38.6m for FY20 (FY19: €66.2m), justify a **Positive** credit opinion on HLF.

We believe that Premier Capital remains a core operation for the Group. The latter's reliance on Premier might pose risks for the Group, however we view that the strong franchise and regional operations are Premier's key success in translating better margins within the restaurant segment. That said, we also acknowledge the fact that over the years management has pursued a strategy in sector diversification. Overall, we believe that the Group is well positioned despite setbacks brought about by COVID-19. The latter is in line with our positive credit opinion.

HF28

The best comparable securities to HF28 are AX Group 2026 and Tumas Investment 2027, which are currently returning a YTM of 3.2% and 3.7%, respectively. HF28 is trading at a discount and yielding a YTM of 3.9%. We believe that based on our Positive view on the Issuer and the current yield, investors should take this opportunity to capitalise on this security and therefore we are issuing a **Buy** recommendation on HF28.

HF29

HF29 is also trading at a discount and currently yielding a YTM of 3.9%. The best comparable is AX Group 2029, which is yielding a YTM of 3.6%. Given that the bond characteristics of this security are very similar to that of HF28, coupled with our positive opinion on the issuer, we are also issuing a **Buy** recommendation on HF29.

Glossary and Definitions

Income Statement	
Revenue	Total revenue generated by the Group/Company from its principal business activities during the financial year.
EBITDA	EBITDA is an abbreviation for earnings before interest, tax, depreciation and amortisation. It reflects the Group's/Company's earnings purely from operations.
Operating Profit (EBIT)	EBIT is an abbreviation for earnings before interest and tax.
Depreciation and Amortisation	An accounting charge to compensate for the decrease in the monetary value of an asset over time and the eventual cost to replace the asset once fully depreciated.
Net Finance Costs	The interest accrued on debt obligations less any interest earned on cash bank balances and from intra-group companies on any loan advances.
Net Income	The profit made by the Group/Company during the financial year net of any income taxes incurred.
Profitability Ratios	
EBITDA Margin	EBITDA as a percentage of total revenue.
Operating (EBIT) Margin	Operating margin is the EBIT as a percentage of total revenue.
Net Margin	Net income expressed as a percentage of total revenue.
Return on Common Equity	Return on common equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing the net income by the average common equity (average equity of two years financial performance).
Return on Assets	Return on assets (ROA) is computed by dividing net income by the average total assets (average assets of two years financial performance).
Cash Flow Statement	
Free Cash Flows (FCF)	The amount of cash the Group/Company has after it has met its financial obligations. It is calculated by taking Cash Flow from Operating Activities less the Capex of the same financial year.
Balance Sheet	
Total Debt	All interest bearing debt obligations inclusive of long and short-term debt.
Net Debt	Total debt of a Group/Company less any cash and cash equivalents.
Financial Strength Ratios	
Current Ratio	The Current ratio (also known as the Liquidity Ratio) is a financial ratio that measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares current assets to current liabilities.
Quick Ratio (Acid Test Ratio)	The quick ratio measures a Group's/Company's ability to meet its short-term obligations with its most liquid assets. It compares current assets (less inventory) to current liabilities.
Interest Coverage Ratio	The interest coverage ratio is calculated by dividing EBITDA of one period by cash interest paid of the same period.
Gearing Ratio Gearing Ratio Level 1 Gearing Ratio Level 2	The gearing ratio indicates the relative proportion of shareholders' equity and debt used to finance total assets. Is calculated by dividing Net Debt by Net Debt and Total Equity. Is calculated by dividing Total Liabilities by Total Assets.
Net Debt / EBITDA	The Net Debt / EBITDA ratio measures the ability of the Group/Company to refinance its debt by looking at the EBITDA.
Cash from Operations / EBIT	This ratio measures the ability of the Group/Company to convert its earnings into cash.
Other Definitions	
Yield to Maturity (YTM)	YTM is the rate of return expected on a bond which is held till maturity. It is essentially the internal rate of return on a bond and it equates the present value of bond future cash flows to its current market price.

Explanation of Ratings

Credit Opinion

Positive indicates expectations of a general improvement of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Neutral indicates expectations of a general stable trend of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Negative indicates expectations of a general deterioration of the fundamentals / market sector / asset class / credit rating over the next 6 to 12 months.

Issue specific recommendations

The recommendations below are with respect to existing debt securities issued on the Malta Stock Exchange.

Buy indicates our favourable view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

Hold indicates our neutral view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

Sell indicates our negative view from a total return perspective with respect to the credit considering yield-to-maturity / fundamentals / maturity bucket / credit rating over the next 6 to 12 months.

Newly issued research recommendations supersede previously published research.

Disclaimer