14th September 2020

Mercury Projects Finance p.l.c.

Executive Summary:

"The Group's Project was limitedly impacted by the pandemic and to date, MCY has sold 96% of the units it expects to sell during this year. Therefore, we are of the opinion that the Issuer's financial position will improve during FY20 and it will have sufficient resources at its disposal to honour all of its financial obligations. In fact, the Group is forecasting its leverage to fall to 3.6x in FY20 (FY19: 82.9x), with an interest coverage ratio of 6.2x (FY19: 0.4x).

Nonetheless, we are still cognisant of the fact that the Issuer expects to enter in the luxury hospitality industry in the near future. The recovery process for the local luxury hospitality, is still uncertain and highly dependable on developments linked to the pandemic. On this basis we are issuing a **Neutral** credit opinion on this Issuer.

MY27: This bond is currently yielding 3.4%, which we deem as unattractive in the current stressed scenario. Based on this, coupled with our neutral opinion on the Issuer, we rate MY27 as a **Hold**.

MY31: Taking into account the uncertainty surrounding the hospitality industry, together with the longer maturity of this bond, we believe that at this price level investors will not be adequately rewarded and therefore we are issuing a **Hold** recommendation.

Debt securities issued by the Group:

The Group, through its financing vehicle Mercury Projects Finance plc (the "**Issuer**" or "**MCY**"), issued two secured bond series of €11.5m and €11.0m in 2019. Out of this issue, €5.7m were earmarked for bank loans refinancing, while the remaining proceeds of €16.4m were utilised for investments within the Group's real estate development.

Business Overview:

The Issuer was set up as a financing vehicle, consequently it does not carry out significant operations, apart from that of providing financing to its subsidiaries. Mercury Towers Ltd acts as the **Guarantor** of the bonds and is also the '**Parent**' company of the '**Mercury Group**'. The Group is involved in the purchase and sale of property within the '**Mercury Tower Project**' in St Julian's.

The Group owns the land measuring circa 7,702sqm, which is currently being developed into a mixed use development project comprising, amongst others, a tower (incl. apartments), a boutique hotel, retail and commercial activity, as well as an underlying car park. The finished complex will include a mix of historical and ultra-modern edifices on its site. At its heart there is 'Mercury House', which will be flanked by a 31-storey Tower hosting 279 branded serviced apartments, as well as 2 underground storeys with a boutique hotel situated in its podium and in parts of the said Tower, and will also be serviced by an underlying 4-storey car parking facility.

Credit Opinion — Neutral

Country	Malta
Industry	Real Estate Development

3.75% MCY 2027

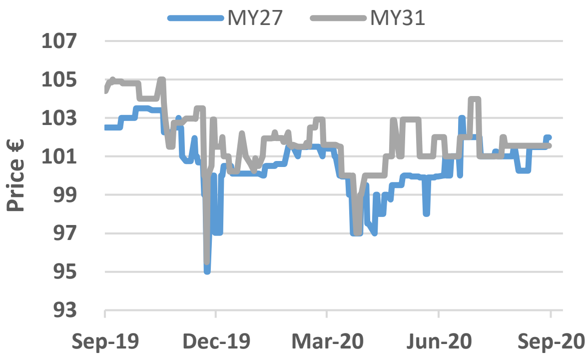
Security	Secured
Nominal	€11.5m
Ticker	MY27
Price (as at 10/09/20)	€101.99
Recommendation	**Hold**
Yield to Maturity (YTM)	3.40%

4.25% MCY 2031

Security	Secured
Nominal	€11.0m
Ticker	MY31
Price (as at 10/09/20)	€101.56
Recommendation	**Hold**
Yield to Maturity (YTM)	4.06%

Exchange	Malta Stock Exchange (MSE)
52-week range (MY27)	€95.00 - €103.50
52-week range (MY31)	€95.50 - €105.00

1-Year Price Movement



Source: Malta Stock Exchange

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COVID-19 implications on the Group's operations

The pandemic, which is a rapidly evolving situation, has adversely impacted global and local commercial activities. Recently, both locally and other European countries have experienced a surge in COVID-19 cases. This uncertainty precludes any prediction of the pandemic's ultimate impact, which may have a continued adverse effect on economic and market conditions and heighten the current global and local economic slowdown.

Nonetheless, the Group (as reported in the FAS dated 31/08/2020) continued to operate without disruptions, even during the more challenging months of the pandemic. Construction has been limitedly impacted, if at all, and at this point in time, given that the Government loosened the strict COVID-19 related restrictions experienced during the first half of the year, management is confident that the Group can continue to manage the situation without any significant impact.

Notwithstanding the above, it is worth noting that currently certain works pertaining to the cladding of the Mercury Tower are being negatively impacted by restrictions on the availability of imported skilled workforce for specialised work. Additionally, the Group reported that the completion of the Project may also be affected if local and overseas suppliers and contractors would not be in a position to provide the material and personnel when due. These developments may result in the Group experiencing a delay in terms of the Project's completion date.

The Group reported that based on conservative forecasts, it should generate sufficient cash and be in a position to meet all of its financial commitments, including the next bond interest due on 27 March 2021.

SWOT Analysis

Strengths

- ✓ The Group owns sizeable land in St Julian's, being one of the most sought after areas in Malta
- ✓ 89.5% of the apartments within the Project have been sold, with the remaining units subject to a promise of sale (POS) agreement or are still available for sale
- ✓ The Group's hotel is currently being constructed, consequently the current pandemic has not impacted its operations. Additionally, during this period the Group will still be earning cash flows from the sale of the airspace on its apartments within the Mercury Tower

Weaknesses

- × No geographical diversification. The Group is only exposed to the local real estate industry, with intentions to go in the hospitality industry in the near future
- × During recent years, Malta experienced a significant increase in tourist accommodation. Thus making the market more competitive and less attractive

Opportunities

- The Group has applied for a permit for the construction of a 9-storey block, linked to the existing Tower via a podium (Phase II). Should the permit be approved, the main Tower will also increase by an additional 8 metres, which will host an amenity floor at level 32, and a bar and swimming pool at roof level. This might further boost the financial performance of the Group
- The Government acknowledged that tourism is essential for Malta and seems to be determined to assist in its recovery both during and post COVID-19

Threats

- ! Further escalation of the COVID-19 outbreak might result in further delays in terms of the Project's completion date
- ! Highly competitive real estate industry in Malta
- ! A major element of the Group's Project will be a 5-star branded hotel. The extent of the impact from COVID-19 on the hospitality industry is not fully known, which might result in the Group not reaching previously expected profitability margins
- ! The future performance of the local luxury accommodation sector is uncertain, with all hotel operators reporting lower occupancies and concern about the lower tourist expenditure per capita

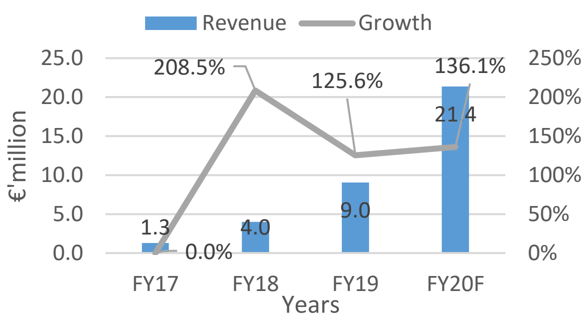
Financial Summary

Mercury Towers Ltd	FY17A €'000s	FY18A €'000s	FY19A €'000s	FY20F €'000s
Income statement				
Revenue	1,300	4,011	9,047	21,362
Cost of Sales	(1,300)	(2,904)	(7,428)	(13,185)
Gross Profit	-	1,107	1,619	8,177
Other operating income	8	-	5	-
Operating costs	(51)	(349)	(1,228)	(2,027)
EBITDA	(43)	758	396	6,150
Depreciation	-	-	-	-
EBIT	(43)	758	396	6,150
Net finance costs	(115)	(174)	(1,096)	(1,000)
Profit before tax	(158)	584	(700)	5,150
Tax expense	-	(265)	(741)	(1,782)
Net income	(158)	319	(1,441)	3,368
Cash flow				
Net cash from operations (CFO)	1,913	7,611	(19,344)	18,329
Capex	-	(7,220)	(6,101)	(7,785)
Free cash flows (CFO – Capex)	1,913	391	(25,445)	10,544
Balance sheet				
Cash and cash equivalents	69	222	267	244
Inventories	21,114	20,839	18,023	7,669
Current assets	22,715	22,508	38,670	8,702
Non-current assets	9,374	16,947	23,549	30,625
Total assets	32,089	39,455	62,219	39,327
Current liabilities	25,847	37,463	40,327	14,067
Non-current liabilities	5,900	1,159	22,500	22,500
Total liabilities	31,747	38,622	62,827	36,567
Total Financial debt	7,144	6,225	33,066	22,500
Net debt	7,075	6,003	32,799	22,256
Total equity	342	833	(608)	2,760
Ratios				
Growth in Total Revenue (YoY Revenue Growth)	n/a	208.5%	125.6%	136.1%
Gross profit margin (Gross profit / Revenue)	0.0%	27.6%	17.9%	38.3%
EBITDA margin (EBITDA / Revenue)	-3.3%	18.9%	4.4%	28.8%
Operating (EBIT) margin (EBIT / Revenue)	-3.3%	18.9%	4.4%	28.8%
Net margin (Net income / Revenue)	-12.2%	8.0%	-15.9%	15.8%
Return on common equity	-46.2%	54.3%	237.0%	313.0%
Return on assets	-0.5%	0.9%	-2.3%	6.6%
Current ratio (Current assets / Current Liabilities)	0.9x	0.6x	1.0x	0.6x
Quick ratio (Current assets - Inventory / Current Liabilities)	0.1x	0.0x	0.5x	0.1x
Interest coverage ratio (EBITDA /Cash interest paid)	(0.4)x	4.4x	0.4x	6.2x
Gearing level 1 (Net debt / Net Debt and Total Equity)	95.4%	87.8%	101.9%	89.0%
Gearing level 2 (Total Liabilities / Total Assets)	98.9%	97.9%	101.0%	93.0%
Net debt / EBITDA	(164.5)x	7.9x	82.8x	3.6x
Cash from Operations / EBIT	(44.5)x	10.0x	(48.8)x	3.0x

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

Investment Considerations

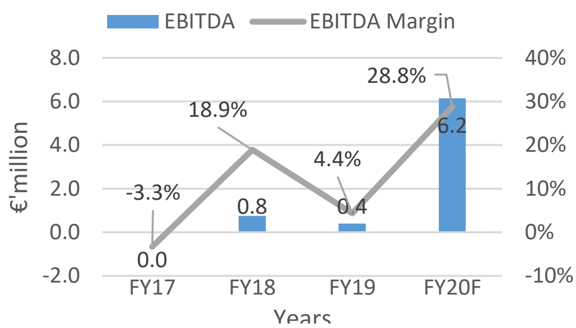
- **Revenue** – The Group's operations in FY17 were minimal, as it carried out only one transaction. In FY18 and FY19, the Group started to recognise revenue from the sale of its airspace on the units within the Tower. By the end of FY19, the Group sold in total 106 units, which resulted in a revenue generation of €4.0m and €9.0m in FY18 and FY19, respectively.



Source: MCY's Financial Statements and FY20 FAS

  In FY20, the Group is forecasting the sale of a further 134 units. More specifically, following discussions with management, 129 units out of 134 have been sold to date. This translates into a revenue of €21.4m, representing a growth of 136.1% over FY19. The Group has a total of 267 apartments available for sale, with the remaining 12 apartments intended to be retained by the Guarantor (279 total of apartments). The Group plans to convert these 12 units at the uppermost level into a lesser number of apartments, which are intended to be used as part of the hotel 5-star serviced accommodation

- **EBITDA –** Cost of sales directly relate to the number of units sold, since this represents the portion of land costs and development costs related to these particular units. In FY19, costs of sales stood at €7.4m, while in FY20 this is expected to increase to €13.2m given the higher number of units forecasted to be sold during this financial year. In view of this, the gross profit is expected to increase to €8.2m in FY20 (FY19: €1.6m).



Source: MCY's Financial Statements and FY20 FAS

  The operating costs are not material to the Group and stood at €1.1m in FY19. Apart from the day-to-day expenses, this includes a one-off cost amounting to €0.5m, which relates to a fee paid on the cancellation of a POS by a potential client of Phase II of the Project. In FY20, total operating costs are expected to amount to €2.0m, with the majority of this (circa €1.5m) being the selling fees incurred in selling the units.

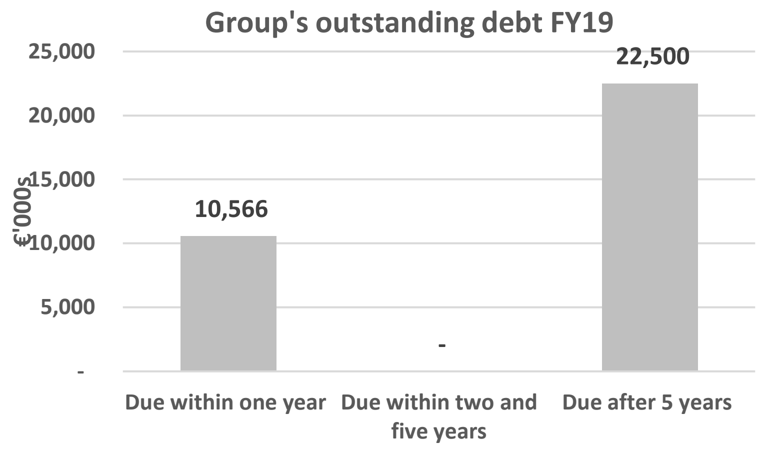
  Based on the above, the Group expects to generate an EBITDA of €6.2m in FY20, with an EBITDA margin of 28.8%. This is an improvement over FY19, where the Group generated an EBITDA of €0.4m, translating into an EBITDA margin of 4.4%.

- **Finance costs –** Financing costs amounted to €1.1m in FY19, out of which €0.7m represent the interest due on the Issuer's bonds. In FY20, finance costs are expected to amount to €1.0m, whereby €0.9m relates to the bonds' interest payments, given that FY20 captures a full-year of operations. While the rest, reflects interest that has been incurred on a bridge loan taken by the Guarantor, which is expected to be paid by end of FY20.

- **Interest cover –** In FY19, the Group generated a low EBITDA, which resulted in an interest coverage of 0.4x. In view of the anticipated improvement of the Group's financial performance for FY20, the interest cover is expected to improve to 6.2x in FY20.

- **Capital Expenditure -** During FY19, the Group invested €6.1m in the Project and in FY20 the Group expects to spend another €7.8m.

Debt Maturity Profile



Maturity Ladder: FY19 (€'000s)	Within 1 year	Between 2 - 5 years	More than 5 years	Total
Debt Securities in issue	-	-	22,500	22,500
Bank loan	10,000	-	-	10,000
Other loan	566	-	-	566
	10,566	**-**	**22,500**	**33,066**

Source: MCY's Audited Financial Statements

- As can be noted form above, the majority of the Group's financial debt is due after 5 years, which reflects the €11.5m bond maturing in 2027 (3.75%) and the €11.0m bond maturing in 2031 (4.25%).
- In October 2019, the Guarantor obtained a bridge loan of €10m, which was revolved in July 2020. Following discussions with senior management, it was confirmed that this loan is secured by a special hypothec over property within the project that do not form part of the below mentioned bonds' security assets. This loan is expected to be settled during the remaining part of this year from the anticipated cash that will be generated from the sale of airspace on units within the Mercury Tower.
- The Group's bonds are secured by a first ranking special hypothec over:
  - The airspace over the 12 apartments that will be retained by the Guarantor;
  - The restaurant (including lounge area) located at level 1 of the tower;
  - Conference area and meeting rooms and ancillary facilities located at level 2 in the tower;
  - The airspace wherein there will be developed the planned indoor pool, spa, lounge bar and amenities within level 11 of the tower, and;
  - The old building known as 'Mercury House' within the Project.
- The Secured Bonds constitute the general, direct and unconditional obligations of the Issuer and shall at all times rank pari passu, without any priority or preference among themselves. The Secured Bonds of both Series shall be guaranteed in respect of both the interest due and the principal amount under said Secured Bonds by the Guarantor in terms of the Guarantee, as further explained in the bonds' prospectus.

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)	(%)	(%)	(%)	
6% Pendergardens Developments plc Secured € 2022 Series II	26,781	3.21%	3.7x	81.5	28.3	65.2%	54.3%	5.3x	1.5x	0.1x	0.0x	1.0x	105.00
6% AX Investments Plc € 2024	40,000	3.81%	5.5x	342.4	226.1	34.0%	18.9%	3.2x	0.9x	2.2%	9.4%	-8.1%	107.00
4.4% Von der Heyden Group Finance plc Unsecured € 2024	25,000	4.24%	1.1x	147.8	44.3	70.1%	66.4%	36.6x	0.7x	-4.9%	-8.5%	8.6%	100.50
4.5% Hili Properties plc Unsecured € 2025	37,000	4.28%	1.8x	150.5	57.6	61.7%	57.7%	12.7x	1.1x	9.9%	62.4%	20.0%	101.00
4% MIDI plc Secured € 2026	50,000	3.27%	6.1x	234.6	104.0	55.7%	33.0%	4.2x	3.0x	8.2%	29.6%	-47.2%	103.84
3.25% AX Group plc Unsec Bds 2026 Series I	15,000	3.25%	5.5x	342.4	226.1	34.0%	18.9%	3.2x	0.9x	2.2%	9.4%	-8.1%	100.00
3.75% Mercury Projects Finance plc Secured € 2027	11,500	3.40%	0.4x	62.2	(.6)	101.0%	101.9%	82.9x	1.0x	236.9%	-15.9%	125.6%	101.99
3.75% AX Group plc Unsec Bds 2029 Series II	10,000	3.00%	5.5x	342.4	226.1	34.0%	18.9%	3.2x	0.9x	2.2%	9.4%	-8.1%	106.00
4.25% Mercury Projects Finance plc Secured € 2031	11,000	**4.06%**	0.4x	62.2	(.6)	101.0%	101.9%	82.9x	1.0x	236.9%	-15.9%	125.6%	101.56
Average**		**3.58%**	**4.2x**	**234.5**	**130.4**	**50.7%**	**38.3%**	**9.8x**	**1.3x**	**4.2%**	**16.0%**	**8.3%**	

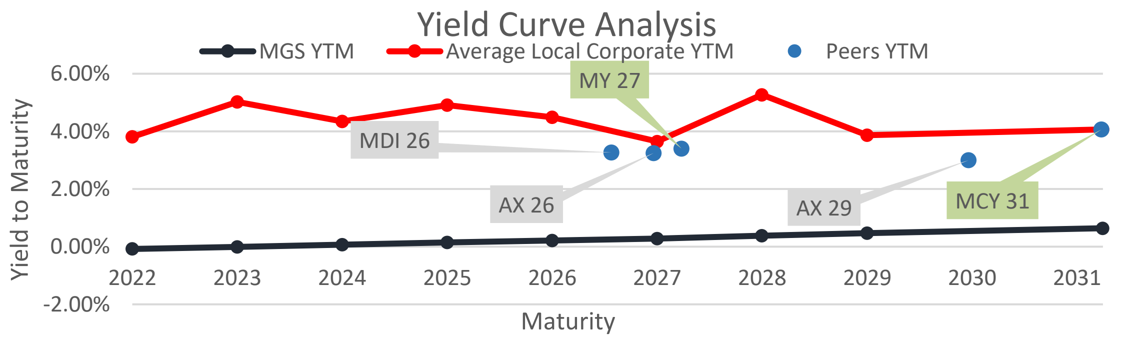
* Last price as at 28/08/2020

Source: Latest available audited financial statements

** Average figures do not capture the financial analysis of the Group

Investment Rationale

We have compared the securities of Mercury Projects Finance plc against similar issuers in the local market. Comparable companies were specifically identified on the basis of the industry in which they operate, more specifically their service offerings. 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 plots the entire MGS yield curve, thus taking into consideration the yield of comparable issuers. The graph illustrates on a stand-alone basis, the yield of comparable issuers having a maturity between 6-8 years and 9-11 years, respectively (Peers YTM).

As can be witnessed in the comparative analysis, the Group's leverage is above the average of its comparable issuers on the Malta Stock Exchange at a gearing (net debt / EBITDA) standing as at 82.9x in FY19 compared to the average of 9.8x. It is worthy to note that the Group has been recently incorporated and the Project is currently under construction, hence the high leverage. In fact, in FY20 the Group is forecasting net debt / EBITDA to fall to 3.6x (FY19: 82.9x). Similarly, the interest coverage ratio stood at 0.4x in FY19, but is expected to improve to 6.2x in FY20.

As demonstrated by the Group's performance, whereby 96% of the units expected to be sold during FY20 has been sold to date, we believe that there has been a limited impact by the pandemic on Mercury's Project. In view of this, we are of the opinion that the Issuer's financial position will improve during 2020 and it will have sufficient resources at its disposal to honour all of its financial obligations, including its bond interest payment obligations. Nonetheless, we are still cognisant of the fact that the Issuer expects to enter in the luxury hospitality industry in the foreseeable future. The recovery process for the accommodation sector, especially the local luxury hospitality, is still uncertain and highly dependable on developments linked to the pandemic. On this basis we are issuing a **Neutral** credit opinion on this Issuer.

MY27

Best comparable issuers to MCY's 2027 bond are, AX 2026 and MIDI 2026 bonds. Both of these are currently trading at a marginally lower yield. In view of our neutral opinion on the Issuer and the relatively unattractive yield of 3.4%, we believe that a **Hold** recommendation on MY27 is justified.

MY31

MY31 is currently trading at a YTM of 4.06%, which is higher than the YTM of AX 2029 bond (3.0%). Taking into account the uncertainty surrounding the hospitality industry and our neutral opinion on the Issuer, coupled with the longer maturity of this bond, we believe that at this price level investors will not be adequately rewarded and therefore we are issuing a **Hold** recommendation on MY31.

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