CREDIT RESEARCH | Hili Properties p.l.c.

26th November 2020

Executive Summary

"Throughout the years the Group has experienced a steady growth with revenue increasing at a CAGR of 21.8%, while maintaining a stable EBITDA margin of 70%. This growth was sustained through considerable high leverage with gearing averaging at 16.4x during this period.

Inevitably, in line with the current unprecedented scenario credit metrics have deteriorated, whereby HP expects its interest coverage ratio to fall to 1.5x in FY20 (FY19: 1.8x) and the gearing to increase to 15.9x (FY19: 12.7x). Notwithstanding the deterioration in credit metrics, the Group is still forecasting to generate positive cash flows from its operations during FY20. In view of this, while also taking into account that the full extent of the COVID-19 pandemic in not yet fully known, we are issuing a **Neutral** credit opinion.

HP25: This security is currently yielding a YTM of 4.3%, which is in line with the average of comparable issuers. We are of the opinion that the current distressed situation has been exacerbated by the strong probability of further lockdowns and restriction of movement throughout Europe, which we believe merits a **Hold** recommendation on HP25."

Business Overview

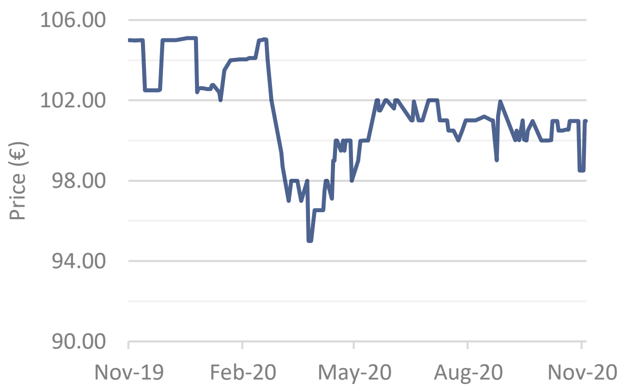
Hili Properties holds and manages strategic commercial real estate for lease around Europe. Its portfolio includes dedicated business blocks and office space, retail complexes and properties housing McDonald's restaurants in key commercial districts within these territories. HP represents the real estate division of Hili Ventures.

Debt securities issued by the group

In 2015, Hili Properties plc (the "**Issuer**" or "**HP**"), which holds a portfolio of real estate companies issued a €37m 4.5% bond with a 10-year term maturity. HP's bond is unsecured, however it is guaranteed by two other companies being Hili Estates and Harbour (APM) Investments. As per the prospectus, the Guarantors bound themselves that they shall collectively ensure that their aggregate NAV will amount to not less than €37m on each reporting date (Jun & Dec).

Credit Opinion	Neutral
Country	Malta
Sector	Real Estate
4.50% HIL 2025	
Security	Unsecured
Nominal	€37mln
Ticker	HP25
Price (25.11.20)	€100.98
Recommendation	**Hold**
Yield to Maturity	4.3%
Exchange	Malta Stock Exchange (MSE)
52-week range	€95.00 - €105.10

1-Year Price Movement



Source: Malta Stock Exchange

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Group's developments

On 20 December 2019, the Group disposed of its shareholding in Hili Properties (Swatar) Limited for the consideration of €7.1m. The Group sold the said company, which owns a property, known as Tower Business Centre, located within a prime commercial and office area in Swatar. The Group also sold another two properties in Latvia for €4m.

On 18 January 2019, the Group acquired a plot measuring 10,680sqm in Riga, Latvia for a consideration of €2.3m. This property was subsequently sold in FY20 for €3.9m.

Covid-19 implications on the Group's operations

The COVID-19 pandemic has presented a very challenging environment to global markets and naturally it has also negatively impacted the property market. Management reported that the outbreak has significantly impacted the economies in which the Group operates. Consequently, this may lead to a number of tenants facing distressed financial conditions, which ultimately will also impact the profitability and cash flow of HP.

The forecasts for FY20 presented in the recently issued Financial Analysis Summary, are based on the underlying assumption that the spread of COVID-19 will be under control in the course of the year, with the situation in the respective economies assumed to remain positive in general.

Unfortunately, the winter months has presented Europe with a surge in the number of COVID-19 cases, with several countries re-imposing lockdowns and containment measures. This situation will present further difficulties to tenants especially if such measures are maintained throughout the Christmas season, where usually retail malls register strong activity and traditionally it's a seasonal period that generates excess liquidity to cover the quieter shoulder months.

Notwithstanding the above, based on the Group's pessimistic forecasts, which factor in significant strain on rental rates and occupancy, the directors consider the going concern assumption in the preparation of the financial statements as appropriate. Additionally, the directors also noted their intentions to adopt a conservative approach with regards to development opportunities, as their primary focus is on cash flow preservation and active asset management. In implementing this strategy, the indicative aggregate borrowing as a percentage of gross asset value of the Group is not expected to exceed 70%.

SWOT analysis

Strengths

- ✓ The Group's properties are located within different countries, providing geographical diversification.
- ✓ Potential support from the wider Hili Group, should the fundamentals of HP deteriorate.
- ✓ Despite the considerable impact of COVID-19, the Group expects to remain profitable in FY20.
- ✓ The sale of a number of properties during FY19 provided the Group with excess liquidity prior to the outbreak.
- ✓ The main tenant in several properties owned by the Group is the anchor client McDonald's on behalf of Premier Capital plc (a fellow subsidiary of the wider Hili Group).

Weaknesses

- × The Group is exposed to exchange rate movements
- × Highly capital-intensive industry, resulting in relatively high leverage.
- × The recent re-imposition of lockdowns throughout Europe will present further challenges to HP, as was witnessed in H1 2020.

Opportunities

- o The downturn brought about by the pandemic may present interesting investment opportunities which the Group may capitalise on, given its relatively strong position.

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.

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Financial summary

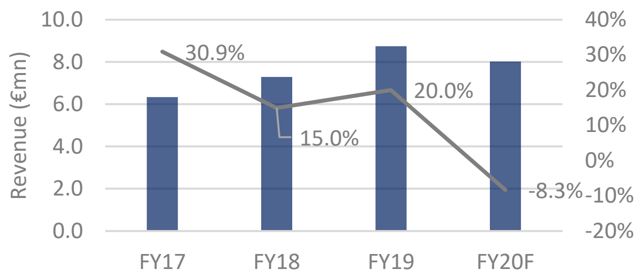
Hili Properties plc - €'mn (unless otherwise indicated)	FY17A	FY18A	FY19A	FY20F
Income statement				
Revenue	6.3	7.3	8.7	8.0
Cost of Sales	(0.4)	(0.4)	(0.6)	n/a
Gross Profit	5.9	6.9	8.1	
Net operating expenses	(1.9)	(1.9)	(2.5)	(3.1)
EBITDA	4.5	5.4	6.2	5.0
Depreciation and amortisation	(0.1)	(0.1)	(0.2)	(0.2)
EBIT	4.4	5.3	6.0	4.8
Net investment income	1.3	0.7	3.9	1.5
Net finance costs	(3.7)	(3.5)	(3.8)	(3.4)
Profit before tax	2.0	2.5	6.2	2.9
Taxation	1.4	(0.4)	(0.8)	(0.6)
Profit after tax	3.4	2.1	5.5	2.3
Cash flow				
Net cash from operations (CFO)	1.0	2.1	0.2	0.7
Capex	(2.0)	(5.6)	(3.7)	(1.7)
Free cash flows (CFO – Capex)	(1.0)	(3.5)	(3.5)	(1.0)
Balance sheet				
Cash and cash equivalents	0.9	2.9	7.1	2.8
Current assets	4.0	5.7	9.2	4.4
Non-current assets	131.9	149.0	141.3	144.5
Total assets	135.9	154.7	150.5	148.9
Current liabilities	8.1	12.8	8.1	7.9
Non-current liabilities	89.4	89.7	84.7	79.8
Total liabilities	97.5	102.5	92.8	87.7
Total Financial debt	90.1	93.1	85.9	81.4
Net debt	89.3	90.2	78.7	78.6
Total equity	38.4	52.2	57.6	61.2
Financial ratios				
Growth in Total Revenue (YoY Revenue Growth)	30.9%	15.0%	20.0%	-8.3%
Gross profit margin (Gross profit / Revenue)	93.8%	94.6%	93.2%	n/a
EBITDA margin (EBITDA / Revenue)	70.7%	74.5%	70.9%	61.8%
Operating (EBIT) margin (EBIT / Revenue)	69.0%	73.0%	69.2%	59.5%
Net margin (Net income / Revenue)	53.1%	29.0%	62.4%	29.0%
Return on common equity (Net Income / Total Equity)	10.1%	4.7%	9.9%	3.9%
Return on assets (Net Income / Total Assets)	2.9%	1.5%	3.6%	1.6%
Current ratio (Current assets / Current Liabilities)	0.5x	0.4x	1.1x	0.6x
Interest coverage ratio (EBITDA /Cash interest paid)	1.5x	1.6x	1.8x	1.5x
Gearing level 1 (Net debt / Net Debt and Total Equity)	69.9%	63.3%	57.7%	56.2%
Gearing level 2 (Total Liabilities / Total Assets)	71.8%	66.2%	61.7%	58.9%
Net debt / EBITDA	19.9x	16.6x	12.7x	15.9x
Cash from Operations / EBIT	0.2x	0.4x	0.0x	0.1x

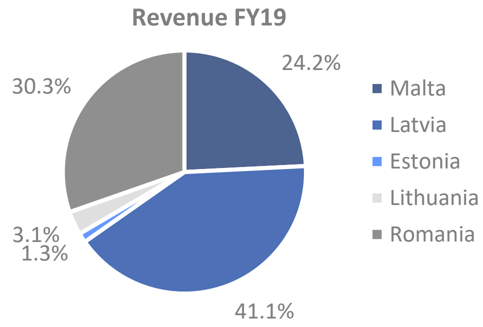
Source: HP's Audited Financial Statements

Investment considerations

- **Revenue**: The Group's revenue is derived from the leasing of commercial properties within 5 locations being Malta, Latvia, Estonia, Lithuania and Romania. In FY19, revenue increased by 20% or €1.4m, predominantly due to newly acquired supermarket & retail centre in Latvia (later part of FY18) and 2 newly acquired McDonald's restaurants in Romania. As can be analysed, Latvia contributes the largest portion to total revenue (41.1%), followed by Romania (30.3%) and Malta (24.2%).

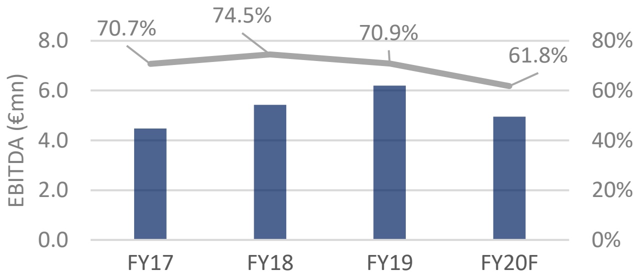
  In FY20, revenue is forecasted to fall to €8.0m, translating into a decrease of 8.3% over FY19. As noted earlier, at the end of FY19 the Group disposed of the Swatar property, which naturally reflects the expected decrease in revenue for FY20. Management noted that HP shall consider acquiring other properties in replacement of the Swatar property only when the current economic instability caused by the pandemic stabilizes

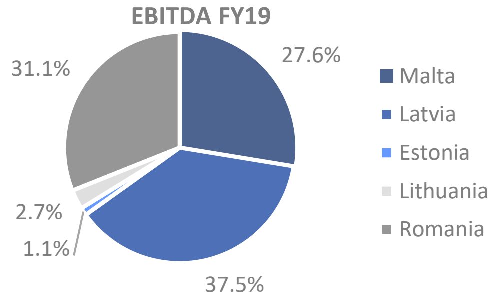




- **EBITDA:** In view of the improvement in revenue during FY19, EBITDA improved to €6.2m from €5.4m in FY18. However, following an increase of €0.7m in operating expenses the EBITDA margin decreased to 70.9% in FY19 (FY18: 74.5%).

  Similar to revenue, Latvia represents the largest share of total EBITDA at 37.5%, followed by Romania (31.1%) and Malta (27.6%). Going forward, normalised EBITDA is expected to be in line with forecasted FY20 figures, in view of the recent Swatar property sale. In addition, operating expenses are envisaged to increase by €0.5m, which is captured in the above normalised EBITDA. In view of these developments, the EBITDA margin is expected to fall to 61.8% in FY20.





Source: HP's Audited Financial Statements

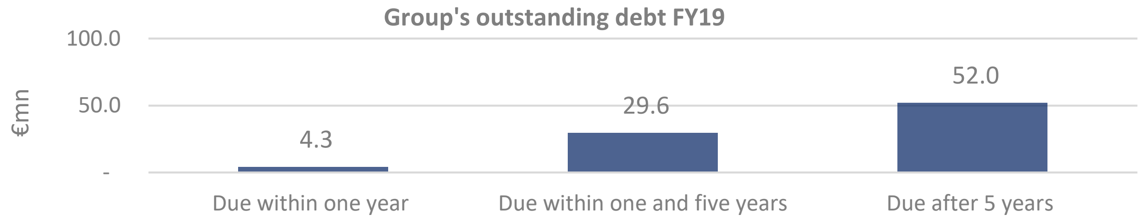
- **Finance costs:** Finance costs mainly consist of interest incurred on the Group's bank borrowings and the bond currently in issue. In FY19, the Group incurred €4.0m in financing expenses, an increase of €0.4m over FY18. This was mainly as a result of an increase on interest on bank borrowings, together with a one-off loss on a derivative.

- **Interest cover:** In FY19, the Group's interest coverage stood at 1.8x. In view of the fall in EBITDA in FY20, the interest coverage is forecasted to fall to 1.5x. Such fall in EBITDA will be partially mitigated by a forecasted de-leveraging following the proceeds of the Swatar property, which will lead to circa €0.1m savings in finance interest cost.

- **Capital Expenditure -** During FY19, the Group invested €3.7m in investment property. In FY20, the Group is forecasting a capex investment of circa €1.7m.

- **Collective NAV of the Guarantors –** The Guarantors bound themselves that they shall collectively have a net asset value (NAV) of not less than €37m, should this be breached, it will classify as an event of default. As at FY19, the aggregate NAV stood at €38.6m and is forecasted to increase to €40.2m in FY20. **Given that the tenants of the Guarantors are related parties and that the Group has strong liquidity profile (i.e. it can provide inter-group financing), we are of the opinion that there is a low risk that this covenant will be breached**.

Debt maturity profile



Maturity Ladder: FY19 (€mn)	Within 1 year	Between 1 - 5 years	More than 5 years	Total
Debt Securities in issue	-	-	36.6	36.6
Bank loans	3.7	26.2	15.5	45.4
Lease liabilities	0.0	0.0	-	0.0
Other financial liabilities	0.6	3.4	-	3.9
	4.3	29.6	52.0	85.9

Source: HP's Audited Financial Statements

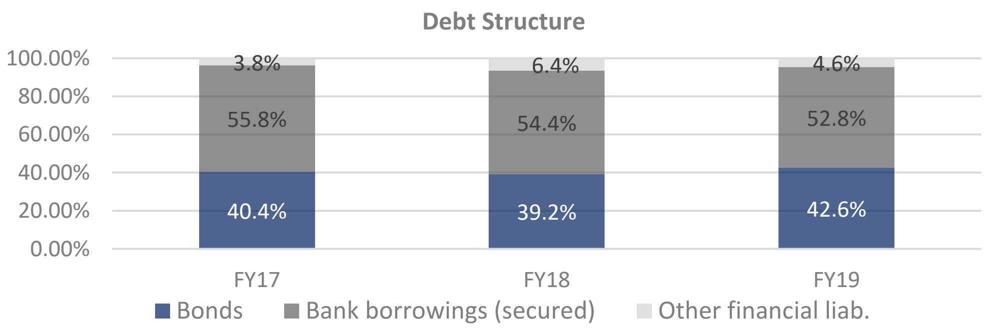
As can be noted from above, the majority of the Group's financial debt is due after 5 years, which mainly reflects the Issuer's €37m unsecured bonds maturing in October 2025. As at end of FY19, the Group had €7.1m in cash reserves which was boosted by the sale of the Swatar property. This cash will be utilised to settle the above mentioned €4.3m payable during FY20, with cash reserves forecasted at €2.8m for end of FY20.

Bank loans: These facilities are secured by special hypothecs over the investment property of the group, a general hypothec over the assets of the group, guarantees provided by other related party and a pledge over rent receivable from the company's tenants.

- The Group's bank loans facilities stood at €45.4m in FY19 and bear an effective interest rates ranging from 3.25% to 4.85% per annum.

Other financial liabilities: These mainly represent loans from parent and other related companies, which bear an interest rate ranging from 4.5% to 5%.

- An amount of €1.7m is repayable in full by 31/12/2022 and €1.2m is due by 31/12/2024. The remaining amounts are payable on demand, which we elected to classify as payable between 1-5 years.
- On 05/11/2020, HP announced that an amount of €1.2m due to the parent company (Hili Ventures) has been capitalised in the form of ordinary shares, therefore in FY20 financial debt should further decrease by this amount.



Source: HP's Audited Financial Statements

Analysis of outstanding issues

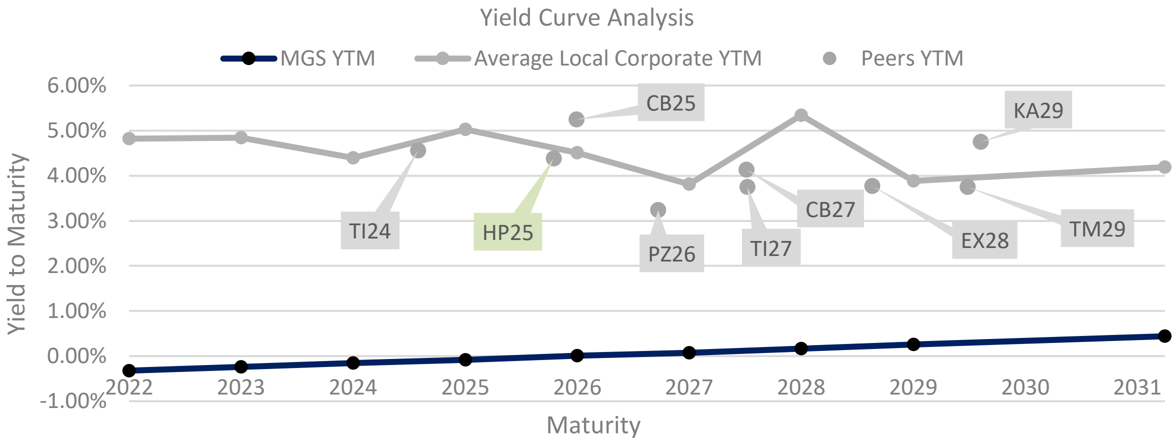
Security	Nom Value	Yield to Maturity	Interest coverage (EBITDA)	Total Assets	Total Equity	Total Liabilities / Total Assets	Net Debt / Net Debt and Total Equity	Net Debt / EBITDA	Current Ratio	Return on Common Equity	Net Margin	Revenue Growth (YoY)	Last Closing Price *
	€000's	(%)	(times)	(€'millions)	(€'millions)	(%)	(%)	(times)	(times)	(%)	(%)	(%)	
5% Tumas Investments plc Unsecured € 2024	25,000	5.0%	9.1x	244.6	131.5	46.2%	16.5%	1.0x	2.2x	8.6%	20.6%	-52.6%	100.01
4.5% Hili Properties plc Unsecured € 2025	37,000	4.3%	1.8x	150.5	57.6	61.7%	57.7%	12.7x	1.1x	9.9%	62.4%	20.0%	100.98
5.25% Central Business Centres plc Unsecured € 2025 S2T1	3,000	5.2%	1.9x	29.5	16.6	44.0%	41.4%	13.2x	0.5x	3.0%	45.6%	205.0%	100.01
3.9% Plaza Centres plc Unsecured € 2026	7,820	3.2%	5.2x	48.8	31.5	35.5%	26.3%	3.9x	7.7x	4.6%	38.3%	8.6%	103.50
4.4% Central Business Centres plc Unsecured € 2027 S1/17 T1	6,000	4.1%	1.9x	29.5	16.6	44.0%	41.4%	13.2x	0.5x	3.0%	45.6%	205.0%	101.50
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%	100.50
4% Exalco Finance plc Secured € 2028	15,000	3.8%	3.9x	68.2	39.7	41.7%	32.0%	5.7x	1.0x	5.0%	44.7%	13.9%	101.50
3.75% TUM Finance plc Secured € 2029	20,000	3.7%	2.1x	60.1	32.1	46.6%	53.0%	11.1x	4.5x	41.9%	773.6%	n/a	100.00
4.75% KA Finance plc Secured Callable Bonds 2026-2029	6,000	4.7%	4.9x	23.1	11.1	52.0%	34.3%	9.7x	1.8x	31.9%	548.7%	7.0%	100.00
Average (does not capture the yield of HP)		**4.2%**											

* Last price as at 25/11/2020

Source: Latest available audited financial statements

Investment rationale

We have compared the securities of Hili Properties 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 Investment Management

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 4-7 years (Peers YTM).

The Group's performance has constantly improved throughout the years, with revenue and EBITDA during the period FY16 to FY19 experiencing a compound annual growth rate (CAGR) of 21.8% and 25.6%, respectively. During this period, the EBITDA margin has also averaged at a stable level of circa 70%. In view of the capital–intensive business of the Group, this growth was sustained through considerable high leverage with total financial debt increasing at a CAGR of 11.7% during the said period, with the gearing (net debt to EBITDA) averaging at 16.4x.

The Group's leverage is higher than the average of the above selected peers, with this standing at 7.4x. Given the higher leverage, HP's interest coverage ratio (FY19: 1.8x) is also one of the lowest when compared with its local peers. Additionally, in view of the sale of the Swatar property, coupled with the onslaught of the COVID-19 pandemic, the interest coverage ratio is expected to fall to 1.5x, with the gearing increasing to 15.9x (FY19: 12.7x).

Notwithstanding the deterioration in credit metrics, the Group is still forecasting to generate positive cash flows from its operations during FY20, therefore HP should be in a position to meet its financial obligations, including the interest due on its bonds. Additional, no material debt obligations are expected to fall due within the short-term, which also provides further comfort on the Group's liquidity position. In view of this, we are issuing a **Neutral** credit opinion on this Issuer.

HP25

HP's bond is currently trading at €100.98, translating into a YTM of 4.3%. The average yield for the identified peers above maturing between 4 to 7 years is 4.3%, while the average yield for local listed securities maturing in 2025 is 5.0%. We are of the opinion that the uncertainty surrounding the COVID-19 pandemic, which has been exacerbated by the strong probability of further lockdowns and restriction of movement throughout Europe, merits a **Hold** recommendation on HP25.

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	The gearing ratio indicates the relative proportion of shareholders' equity and debt used to finance total assets.
Gearing Ratio Level 1	Is calculated by dividing Net Debt by Net Debt and Total Equity.
Gearing Ratio Level 2	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.

Glossary and definitions

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.

N.B: Newly issued research recommendations supersede previously published research.

Disclaimer