

KA Finance p.l.c.

Prospects MTF Bond Issue: 4.75% Secured Guaranteed 2026-2029

Credit Research

Issuer Profile

KA Finance plc (“the Issuer” or “KAF”) will be issuing a bond amounting to €6 million with a coupon of 4.75% maturing in 2029 (“the Bond”) with the option of early redemption starting from 7th August 2026. KAF is a wholly owned subsidiary of KA Holdings Limited (“the Guarantor” or “KAH”), the parent company of the Issuer. KAH and KAF will be collectively referred to as the Group.

KAH, which is owned by Mr. Kurt Abela, is projecting to expand its operations via additional investments in immovable property as part of its core activities in addition to partly diversifying its business.

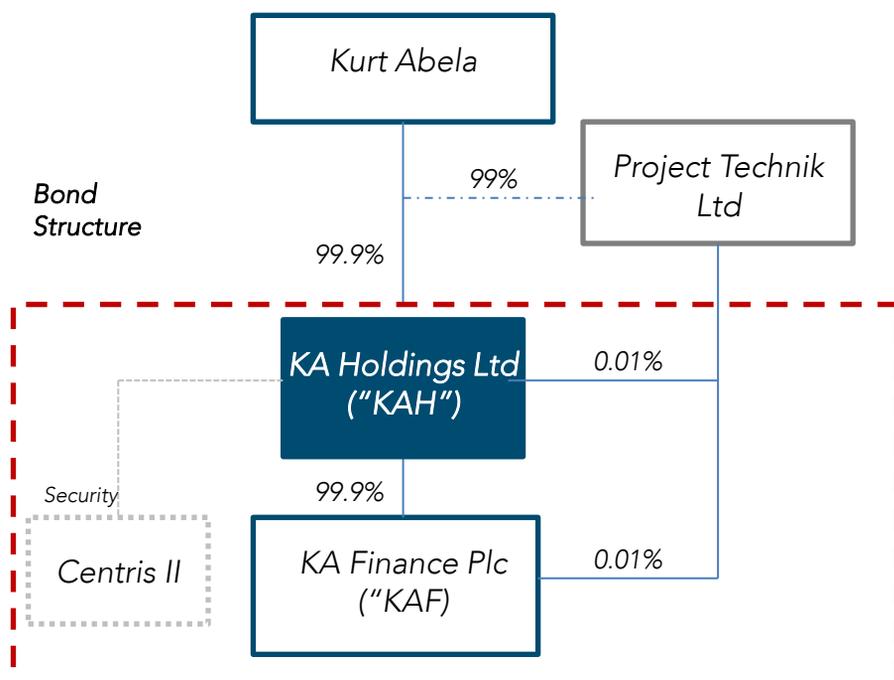
Project Technik Limited (“PTL”), which is also owned by Mr. Kurt Abela but does not form part of the KAH structure, is an innovative and experienced contractor which specialises in ceiling, drywall, plastering and interior finishing works. Over the past 12 years, PTL has established itself as a significant player in the market, having worked on high-profile projects such as the Life Sciences Park, Vodafone Skyparks and Toly factory.

KAF was set up as the financing entity of KAH with the aim of financing the Group’s further expansion. The Guarantor was set up in 2012 and is fully owned by Mr. Kurt Abela.

Bond Details

| | |
|------------------------|---|
| Issuer | KA Finance plc |
| Guarantor | KA Holdings Ltd |
| Maturity Date | 7 th August 2029 |
| Early Redemption Dates | [7 th August] 2026 until maturity date |
| Coupon | 4.75% |
| Coupon Frequency | Annual |
| Rank | Secured |
| Amount Issued | €6 million |
| Listing Venue | Prospects MTF |
| Minimum Subscription | €2,000 |
| Security | Property : Centris II |
| Type | Complex |

Organisational Structure



Business Overview and Upcoming Projects

KAH was incorporated on the 19th of April 2012 and its primary business objective is that of investing in real estate assets with the intention to either sell the property or earn income through rental agreements entered into with tenants. Following its incorporation, KAH acquired a plot of land with an area of 1,250 m² in Mrieħel which was developed into an eight storey building with three levels of underground parking and five floors of open plan office space. The building, Centris I, was completed in the first quarter of 2016.

• Centris I

In 2012, the Group acquired 1,250 m² of land in a prime site in Mrieħel with the objective of developing an office building named Centris Business Gateway. Two years later, an adjacent plot of land of equivalent size was acquired by PTL. The development was projected to be completed in two phases, with the first phase being referred to as "Centris I". Construction of the building commenced towards the end of 2013 and was completed in Q1 2016.

Centris 1 is an eight storey building consisting of five floors of open-plan office space and having a 3 floor car underground park. By the end of 2017, Centris I was essentially fully rented out to eight blue chip tenants operating in different industries including the banking and financial sectors, medical aesthetics and creative marketing.

The contracts that the Group has agreed to with its tenants stipulate a 2% yearly increase in the rent payable by the tenants. Expenses pertaining to general repairs and maintenance on equipment will be borne by the tenants rather than KAH.

• Centris II

This property, which is adjacent to the existing Centris I property, will offer 5,500 m² of office space and underground parking. The property on which Centris II will be built is currently owned by PTL and will be transferred to KAH for €2.0 million. The land upon which the building will be built was purchased in 2014 for the sum of €1.4 million. Following the land purchase, PTL incurred a further €0.6 million for excavation works. KAH will spend a further €1.9 million on construction and finishings on Centris II bringing the total project expenditure to €4.9 million.

Centris II will be completed in the second quarter of 2020 and is expected to generate revenues just shy of €0.9 million by 2021. Following the completion of the building, Centris II is expected to be valued at €14.0 million.

• Apartment Complex

In 2018, a plot in Swieqi was purchased for almost €0.5 million with the intention to develop the property into an apartment complex ("the Apartment Complex") comprising of fifteen apartments and a communal pool. The development is expected to cost €0.8 million and once complete, the Apartment Complex will be offered on a short-term lease basis. In its finished state, the property is estimated to be worth €2.7 million and is forecasted to generate almost €0.4 million in its first year of operation as its expected to open its doors to tenants in 2020.

• Boutique Hotel

A property located in Gżira will be converted to an eight room boutique hotel ("Boutique Hotel") and was purchased in August 2018 for €0.3 million. In its first full year of operation, which is projected to commence in 2021, the Boutique Hotel's total revenue will be that of €0.1 million as the average expected occupancy is that of 60% and the weighted average room rate will be that of €72 per night. The development of the Boutique Hotel is expected to be completed by the third quarter of 2020 and the building will be valued at just below €0.5 million once complete.

Proposed Bond

Use of Proceeds

The proceeds from the Bond, which net of expenses are expected to amount to approximately €5.9 million, will be on-lent to the Guarantor and will be used for the following purposes:

- €2.0 million to purchase the land on which Centris II will be built upon
- €2.9 million for the construction and finishing works of Centris II
- €0.8 million for the development of the Apartment Complex
- €0.2 million for the development of the Boutique Hotel

Security

The bond will be secured as follows :-

- (i) A special hypothec on Centris II
- (ii) A general hypothec on all of the Guarantor's present and future assets

Sinking Fund

The Issuer will be creating a sinking fund for four years starting from 2025 whereby it will be contributing €0.75 million in each of the four years. The total value of the sinking fund, which will be that of €3.0 million, will be 50% of the bond issue. The funds allocated to the sinking fund will be used to repay the Bond upon repayment date.

Covenants

The Issuer and the Guarantor shall not be allowed to declare dividend payments and make any repayments towards any outstanding related party loan ("Restricted Payments") until after 31st December 2020. Also, after 31st December 2020 and for as long as any principal or interest under the Bond remain outstanding, the Guarantor shall not be allowed to make any Restricted Payments unless :-

- The interest coverage ratio is greater than 2.0x and;
- The Debt-To-Total Capital Ratio is below 60%

Furthermore, for as long as any principal or interest due to bondholders remains outstanding, neither the Issuer nor the Guarantor shall undertake any liability or financial indebtedness which is secured by the Bond's collateral (i.e. Centris II).

Early Redemption

As from 7th August 2026, the Issuer has the option to redeem the Issue in whole by providing at least sixty days notice in writing. The redemption prices together with the redemption dates are stipulated below :-

- From 7th August 2026 to 6th August 2027 at a price of €103.00
- From 7th August 2027 to 6th August 2028 at a price of €102.00
- From 7th August 2028 to 7th August 2029 at a price of €100.00

Should the Issuer exercise its option to redeem the Bond during the dates stipulated above, bondholders will still be eligible to any accrued and unpaid interest on their holdings.

Performance and Financial Position of the Issuer

Since its incorporation in 2012, KAH's main source of revenue has been the rental income from Centris I. From 2020 onwards, the Group's revenue stream is expected to also include rental income from Centris II, the Apartment Complex and also the income generated by the Boutique Hotel.

According to the Group's management projections, revenue will increase from €0.5 million in 2017 to €0.7 million in 2018 and €0.8 million in 2019. Following the issuance of the Bond, revenue is projected to increase to €1.4 million in 2020 and reach €2.4 million by 2023. Operating Profit will also increase substantially once the three projects currently under development are complete as it is expected that in 2023 Operating Profit will be that of €1.8 million compared to €0.6 million in 2019.

Net Income will follow a similar pattern to both total revenue and operating profit whereby it is being forecasted that by 2023 this figure will reach €1.0 million in 2023 compared to the expected revenue of €0.4 million in 2019.

Since its inception, KAH's asset base has consisted mainly of Centris I which was valued at €12.0 million in 2018. Following the acquisition, development and revaluation of Centris II, the Apartment Complex and the Boutique Hotel, the Group's total assets is expected to be that of €29.5 million in 2020.

KAH's total borrowings are expected to increase significantly due to the Bond Issue as total borrowings amounted to €2.0 million in 2018 and are expected to increase to €8.2 million by 2019. Borrowings are expected to decrease by 2023 as the total amount of outstanding debt is forecasted to be that of €7.7 million.

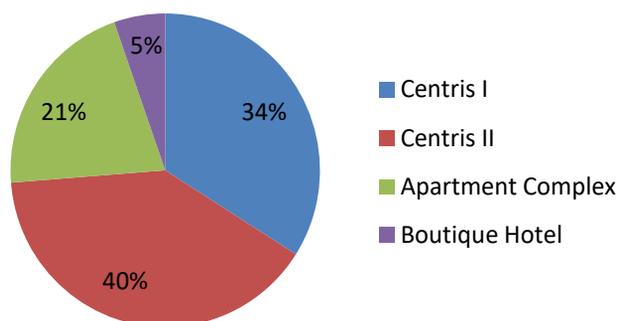
Table 1 – KAH Financial Highlights

| Year / Period | 2017 Actual | 2018 Actual | 2019 Projected | 2020 Projected | 2021 Projected | 2022 Projected | 2023 Projected |
|-------------------------|----------------|----------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Revenue (€000) | 484 | 686 | 749 | 1,434 | 2,219 | 2,371 | 2,437 |
| Operating Profit (€000) | 433 | 600 | 617 | 1,058 | 1,708 | 1,757 | 1,797 |
| Net Profit (€000) | 277 | 380 | 396 | 599 | 959 | 1,004 | 1,044 |
| Total Assets (€000) | 11,103 | 13,260 | 24,826 | 29,530 | 30,582 | 31,316 | 32,082 |
| Total Borrowings (€000) | 2,052 | 1,983 | 8,217 | 8,098 | 7,972 | 7,838 | 7,677 |
| Total Equity (€000) | 6,195 | 7,550 | 11,779 | 16,779 | 17,739 | 18,743 | 19,787 |

Source : KA Holdings plc Management Accounts; KA Holdings plc Financial Statements; KA Holdings plc Management Information

The table below shows the revenue that each property is forecasted to contribute to the Group in 2021 (which is the first year in which all of the four properties held by KH will be fully operational for an entire financial year). Centris I and Centris II will earn the majority of the Group's total revenue as they are expected to contribute 74% to KAH's topline. On the other hand, the Apartment Complex will contribute 21% with the Boutique Hotel's total revenue of €0.1 million making up 5% of KAH's revenue.

Table 2 – Forecasted Revenue Breakdown in FY 2021



Source: KA Holdings plc Management Information

Table 3 – KAH Financial Ratios

| Year / Period | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------------|--------|--------|-----------|-----------|-----------|-----------|-----------|
| | Actual | Actual | Projected | Projected | Projected | Projected | Projected |
| Current Ratio | 0.2x | 0.2x | 2.2x | 0.7x | 1.3x | 1.8x | 2.3x |
| Total-Debt-To-Total Assets | 0.2x | 0.2x | 0.3x | 0.3x | 0.3x | 0.3x | 0.2x |
| Gearing | 25% | 21% | 41% | 33% | 31% | 29% | 28% |
| Interest Coverage | 4.8x | 4.6x | 5.3x | 4.1x | 4.3x | 4.5x | 4.7x |
| Net Debt-to-EBITDA | 4.6x | 3.3x | 8.7x | 5.5x | 3.9x | 3.3x | 2.7x |

Source : KA Holdings plc Management Accounts; KA Holdings plc Financial Statements; KA Holdings plc Management Information

Conclusion

The experience gained by the management team in the development, construction and rental of the Centris I building will prove useful in the development and management of Centris II, even though the Group's ventures in the Apartment Complex and Boutique Hotel may present the management team with certain challenges due to the move into the hospitality industry. However, the diversity in the tenants housed in Centris I and the shift away from the office rental space segment and into the hospitality industry will help in diversifying the Group's revenue streams.

The Guarantor's gearing is expected to increase slightly in 2019 but should improve in the subsequent years as the three projects come to fruition. Also, according to management's expectations, the Group's bottom line is expected to increase once the projects that are currently under development are complete.

The key risks facing KAH, given that the majority of its revenue will be based on both Centris I and Centris II, is the reliance on its tenant base, the prospects of the office space rental market as a whole and the risk of not completing the three projects as scheduled. The investments undertaken in the Apartment Complex and the Boutique Hotel do mitigate these risks. The nature of the Group's businesses, i.e. the rental income earned on office space, provides a certain level of predictability and stability for the Group.

Investors should keep in mind that this bond will trade on the Prospects MTF market, where so far volumes have generally been lower than in the main market. This potentially results in lower liquidity.

In conclusion, the Bond is viewed to offer a good return for the risk it provides, specifically for income focused investors.

Expected Timetable

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|--|--|
| Application Forms available | 19 th July 2019 |
| Issue Period | 22 nd July to 2 nd August 2019 |
| Announcement of basis of acceptance | 5 th August 2019 |
| Expected dispatch of allotment advices & refunds of unallocated monies, if any | 6 th August 2019 |
| Issuance of Bonds | 7 th August 2019 |
| Commencement of interest | 7 th August 2019 |
| Expected date of admission to Prospects MTF List | 8 th August 2019 |
| Expected date of commencement of trading | 9 th August 2019 |

Disclaimer

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