

Scope Hamburg downgrades issuer rating of German KGAL GmbH & Co. KG to BB/Stable from BBB-/under review for changes in methodologies following methodology change

The downgrade mainly reflects a change in Scope Hamburg's assessment under the methodology introduced on 2 May 2022. Simultaneously, Scope Hamburg has assigned a S-3 short-term debt rating and a senior unsecured debt category rating of BB+.

Rating action

Scope Hamburg GmbH (Scope Hamburg) has downgraded the issuer rating of KGAL GmbH & Co. KG to BB / Stable from BBB- / under review for changes in methodologies. The downgrade follows a review of the issuer rating after the introduction of changed rating methodologies at Scope Hamburg on 2 May 2022. Simultaneously, Scope Hamburg has assigned a S-3 short-term debt rating and a senior unsecured debt category rating of BB+.

Rating rationale

KGAL's business risk profile is assessed at BB. Supportive factors for the business risk profile are i) the good visibility in recurring and contracted fees for fundraised real assets under management (AuM), cash flows from co-investments (AuA), and ii) the diversified range of products for open and closed-end public and special funds covering assets types of real estate, renewable energy generation and aviation. Good access to investors to fund investments into accelerated energy transition (positive ESG factor) support the expectation for recurring management fees to continue.

The business risk assessment also captures the currently increased recession and performance risks, increased price pressure, and substitution risks through low cost Exchange-traded (ETF) and hedgefunds.

We assess as negative i) the limited geographical diversification in core European markets (mainly Federal Republic of Germany and Austria), ii) the high dependency on commercial real estate and aviation markets, and iii) the increased project risks for investments into renewable energy. The growth potential is driven by an increased investors' appetite for sustainable environmental transition investments.

Scope-adjusted EBITDA margin may deteriorate significantly to around 15% until 2024E from 53% in 2021. This is the result of limited gains from equity instruments from 2023E onwards, significant cost increases, stricter regulation of alternative investment funds (AIFs) in Germany, and increased competition. Currently recurring fees represent 86% of KGAL group's revenues. Scope Hamburg believes that KGAL could achieve total cost cover (sustainable asset management fee revenues related to total costs excluding dividend payments) in a range of 0.9x-1.0x within the forecast period.

KGAL's financial risk profile is assessed at BB. We expect KGAL's leverage (SaD/EBITDA) to increase significantly towards 3.3x until 2024E. The yearly forecasted annual net investments of around EUR 33m will likely lead to significantly negative discretionary cash flow in the period 2023-2024E. Subsequent to 2022E, we expect a rise in fundraising and real asset investments at around EUR 17m-28m per year as result of the expected economic upswing, the accelerated energy transition and changes in KGAL's investment strategy.

KGAL group's liquidity is adequate. The group had available EUR 51m unrestricted cash and EUR 30m of undrawn committed credit lines as at 31 August 2022. Operating cashflow is used for capex and the dividend payment, leading to an expected very narrow discretionary cashflow in 2022E. Financial maturities in 2023E consist of the intra-group borrowings related to physibile GmbH's bullet bond (EUR 30m). The bond is expected to be covered with the guarantor's (KGAL) projected unrestricted cash. The projected increased capex for a new office campus and investments is no major concern thanks to well-established relationships with banks and funding arranged for these real estate investments.

KGAL's financial policy is focused on preserving good credit quality as laid out in the financing covenants of physibile GmbH's issued bond.

One driver in this credit rating action is considered as ESG-related factor but this factor mentioned has no substantial impact on the overall assessment on credit risk.

Outlook and rating-change drivers

The stable outlook reflects Scope Hamburg's expectation that KGAL maintains its credit metrics at levels projected by 2024E, as expressed by leverage (SaD/EBITDA) of around 3.3x, FOCF/SaD negative and a total cost cover of below 1.0x (currently around 0.9x).

A positive rating action is tied to an improved financial risk profile based on credit metrics such as SaD/EBITDA sustainably below 2.0x and total cost coverage ratio above 1.5x on a sustained basis.

A negative rating action could be warranted if KGAL's leverage (SaD/EBITDA) sustainably deteriorates to levels above 4.0x as this would trigger a lowering financial risk profile assessment. A negative rating action may likewise be warranted if KGAL's total recurring cost cover sustainably weakens to below 0.7x. A negative rating action may also be warranted, if the risk appetite of the shareholders was to change materially.

Long-term and short-term debt ratings

In 2018 KGAL's 100% subsidiary physibile GmbH has issued a senior unsecured bullet bond ("Inhaber-Teilschuldverschreibungen" of EUR 30m; ISIN DE000A2LQST9) due on October 15, 2023. The net proceeds were used to expand in real assets and investment fundraising (AIF) of real estate, renewable energy infrastructure and aviation to secure growth of management fees.

We performed a recovery assessment for the senior unsecured debt issued by physible GmbH, reflecting KGAL's unconditional and irrevocable guarantee issued 17 July 2018 in favor of physible GmbH. For this assessment, we assumed a hypothetical default scenario and calculated a liquidation value for the hypothetical default situation allocated to the waterfall of debt obligations. The calculated simulated default scenario leads to recovery rate of 'above average' (50-70%) for the senior unsecured debt issued by physible GmbH. As a result, we upgrade by one notch the debt instrument rating for the EUR 30m senior unsecured bond to BB+.

The assigned S-3 short-term rating reflects the expected operational cash flow generation and access to external funding through capital markets and bank debt and a committed credit line at present.

Stress testing & cash flow analysis

No stress testing was performed. Scope Hamburg performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlook, (General Corporate Rating Methodology (15 July 2022), Rating Methodology: European Real Estate Corporates (25 January 2022), Corporates – Rating Methodology: European Utilities: Renewable Energy Corporates Rating Methodology (17 January 2022), are available on <https://scoperatings.com/governance-and-policies/rating-governance/methodologies>.

Scope Ratings GmbH, Scope Ratings UK Limited and Scope Hamburg GmbH apply the same methodologies/models and key rating assumptions for their credit rating services.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Basic Principles for Assigning Credit Ratings and Other Services 8 June 2022', published on https://scopehamburg.com/seiten/SH_Basic_Principles_July_2022.pdf. Historical default rates of the entities rated by Scope Hamburg can be viewed in the 'Credit Rating Transition and Default Study July 2022' at https://scopehamburg.com/seiten/Default_Study_2022_Scope_Hamburg.pdf.

Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. A comprehensive clarification of Scope Hamburg's definitions of default and Credit Rating notations can be found at https://scopehamburg.com/seiten/SH_Basic_Principles_July_2022.pdf. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on <https://scoperatings.com/governance-and-policies/rating-governance/methodologies>.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, and Scope Hamburg's internal sources.

Scope Hamburg considers the quality of information available to Scope Hamburg on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Hamburg considers to be

reliable and accurate. Scope Hamburg does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Hamburg GmbH, Ferdinandstraße 29-33, D-20095 Hamburg, Tel +49 40 524724-170.

Lead analyst: Karl Holger Möller, Senior Analyst

Person responsible for approval of the Credit Ratings: Werner Stäblein, Managing Director

The Credit Ratings/Outlook were first released by Scope Hamburg or its predecessor on 25 July 2018. The Credit Ratings/Outlook were last up-dated on 2 May 2022.

Potential conflicts

See www.scooperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

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About Scope Group

With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope

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Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several Europe-an countries. More on www.scopegroup.com

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