

Cairo, 22nd of August 2024

Press Release: Palm Hills Development S.A.E. (PHD)

MERIS (Middle East Rating & Investors Service) Maintained the National Scale Rating (NSR) of Palm Hills Development S.A.E. (PHD) at "BBB+", with a "Stable Outlook" For the Entity and "BBB-" for the First Musharka Sukuk backed by Badya Project, with a Stable Outlook, Issued by Sarwa Sukuk Company (Third Issue)

MERIS has maintained the senior unsecured local currency rating of "BBB+" to the entity "Palm Hills Developments (PHD)", and a "BBB-" for the Musharka Sukuk issue, with a **Stable Outlook** for both ratings. The rating is considered an investment grade on the National Rating Scale. "BBB" rated issuers or issues are considered **Average in Creditworthiness** relative to other domestic issuers or issues. The (+/-) signs denote relative status within each rating category.

Year 2023, witnessed a high inflationary environment, coupled by the devaluation of the Egyptian pound which have significantly affected the real estate developer's business fundamentals, especially the construction costs. This issue is more intensified for an on off-plan business approach, which eliminates the developers cost passing ability for the already sold units. In 2022, management strategy was attending towards accelerating the construction pace, going forward, in 2023 they reverted back to normal construction schedule. The said strategy has tightened the cost overrun to 28%, compared to initial Sukuk model assumptions, while the delay in construction schedule was only 6% as per the "Independent Engineer (IE)" report issued in March 24. According to the said report and the reviewed business model, the remaining investment cost for the Sukuk phase is EGP 4.6bn, while the remaining unsold units worth around EGP 7bn out of which EGP 5bn relates to the commercial section, while the remaining are mainly apartments. The commercial and admin section is considered the gateway for the Sukuk cashflows, before depending on PHD cash recourse. Worth to note that the sales activity for the commercial complex was initially planned to start Jan.23, however management decided to postpone the process several times till the raw material cost stabilizes, which is supposedly to be started construction early 2025, while sales is projected to start this year and the year after (20% and 80%, respectively).

Currently, the Sukuk expected cash outflows is approx. EGP 12.6bn, including Sukuk amortization as well as EGP 1bn as an admin and management fees; in addition to the remaining construction costs, amounting to EGP 5.2bn (including 5% contingency); whereas EGP 1.7 bn will be financed from PHD own sources, to cover the cost overrun. The aggregate expected return through the sukuk lifetime will record EGP 3.4bn (assuming the interest rate remains unchanged till sukuk amortization). While the cash inflows are represented in the current Post-Dated Cheques (PDCs) for sold residential units in the range of EGP 6bn; in addition to EGP 2bn relates to future sales for the residential units, mainly apartments along with the projected commercial sales worth EGP 5bn. As highlighted the Sukuk business model is highly depended on the success of the commercial portion of the project, as well as the full support of PHD to meet any financial deficit.

PHD tapped the capital market with the first Musharka Sukuk in Egypt amounting to EGP 3.25bn issued through "Sarwa Sukuk Company S.A.E. (Sarwa Sukuk)". The Sukuk proceeds used to finance any shortfalls in the development and construction costs associated with Badya Project, in addition to any deficit in land obligations. The 10 years Sukuk carries a variable coupon rate assigned on date of disbursement and paid on a monthly basis. The proceeds in booked in an escrow account (Project Account), the disbursement from which is subject to a pre-agreed on criteria to be approved by the ECG and reviewed by the Sukuk Company. The Sukuk structure allows for an Availability Period of four years from the date of issuance (till April 2026), during which PHD can withdraw funds from the Project account to finance the project's construction costs and land. As of March 24, PHD has withdrawn around EGP 1.6bn from the Sukuk Fund.

It is worth mentioning that the Sukuk issue follows a pass-through amortization structure. Although, this feature gives more flexibility to the issuer and relieves pressure on the transaction's cash flows, **MERIS** believes it is creating an element of uncertainty to the Sukuk holders, which along with the ten-year tenor, places them in a

structurally subordinated position to PHD's existing and future lenders. The Sukuk originally was planned to be booked as an off-balance sheet liability with a conditional recourse on PHD; however, based on the PHD auditor recommendation the Sukuk was booked as an on-balance sheet exposure, taking into consideration the significant financial and operational exposure PHD entails. As per the issuance contract, the primary source of Sukuk repayment will be the sales proceeds for the real estate units, while the secondary source of payment will be the repossession of unsold units. Furthermore, the essential role PHD assumes under its capacity as the Project Manager is considered another main factor in the key rating consideration, as they undertake the development and operation roles for Badya project, while carrying any cost overruns that may arise as per the Sukuk legal agreements.

PHD launched its first city Badya located in new October city in west Cairo of 3000 acres. The group's flagship project represents a stark departure from PHD usual business concept, which was mainly based on small to medium scale compounds targeting high net worth individuals. Badya is a fully integrated city targeting different socio-economic segments. Launched in 2018, the project started to deliver units and is planned to fully deliver the residential sector in phase one in the next four years and has the ambition to create a completely new living destination in a relatively remote area. Since inception Badya faced several internal, as well as external challenges, mainly government commitments to provide the adequate infrastructure in terms of accessibility and utilities which negatively affected its position in the market, however these challenges have found a way for resolving. As of Dec. 23, the Sukuk receivables balance reached EGP 6bn and has achieved a construction progress of almost 40%. The sukuk is being utilized gradually to fill the financial gap between sales collection and construction costs and reached EGP 1.6bn as March 24 compared to EGP 900mn as of March 23. The area associated to the Sukuk instruments is 270 acres that can be translated to 1.1mn sqm with a BUA (Build Up Area) of 554k sqm for residential area containing a mix of Villas, town houses, twin houses and apartments in addition to 66k sqm of mix used commercial-admin complex.

PHD's rating reflects the company's leading position in the real estate sector with solid track record of more than 20 years in the Egyptian market, with a portfolio developed/under development of around 34 small and medium size residential projects and 30 commercial projects. Geographically, PHD has a balanced presence across Egypt, although it is most prominent in West Cairo and the North Coast. The company is active in both the first and second home markets and caters predominantly for the upper income client bracket. Additionally, the group has access to a solid landbank of around 32.3mn sqm. The company has an ample room for growth, given that only two thirds of its land bank is currently developed or under development, and the other third is not developed yet. The rating also takes into consideration the strong brand equity of PHD, as well as the solid shareholders' profile, and the long track record of support to the business over the economic cycles.

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