Scope assigns first-time issuer rating of B+ to Proform Ingatlanbefektetesi Zrt., Outlook Stable

The issuer rating is driven by the company's relatively strong credit metrics but constrained by the complex structure and its limited size.

Rating action

Scope Ratings has assigned a first-time issuer rating of B+ to Proform Ingatlanbefektetesi Zrt. ('Proform'). Senior unsecured debt is rated at BB-. The Outlook is Stable.

Rating rationale

Proform's B+ issuer rating benefits from its exposure to the commercial property market of Budapest, strong debt protection and cash flow metrics, and track record in the development and management of its property portfolio.

The rating is constrained by the company's limited size and geographical diversification as well as potential cash flow volatility caused by its underlying development activities. Moreover, the holding structure that finances non-consolidated subsidiaries via shareholder loans implicates structural subordination of holding-level creditors vis-à-vis the creditors on operating subsidiary level.

Our rating scenario assumes the following:

- *Successful placement of a HUF 5.0bn senior unsecured corporate bond with a 10-year tenor and 4% coupon*
- *Investment of c. HUF 4.3bn into two new large development projects, F99 and T4*
- *Full repayment of the remaining bank liabilities on holding level within Q4 2019*
- *Funding of the relevant project subsidiaries in 2019 (75%) and 2020 (25%)*
- *Inflation of cost positions at c. 1%-4% above the issuer's internal planning levels*
- *7% tax rate (vs the 5.5% five-year historical average)*
- *Cash dividend payment of maximum HUF 150m for 2019 and maximum HUF 200m annually going forward*

Business risk profile

We deem Proform's industry risk profile at B due to its activities in commercial real estate development.

Proform today is a company of limited size with about EUR 0.2bn of total assets (mostly held/financed indirectly via shareholder loans and unconsolidated) and has less than EUR 2m in funds from operations as of year-end 2018. According to management there will be significant additions to the development portfolio in the near future. The two main projects are T-4 and F-99, two office development projects in Budapest, for which bank financing has been already secured and plots have been purchased.

The company's small size constitutes a negative rating driver because it implies a greater sensitivity to unforeseen shocks, greater volatility in the cash flows as well as a higher key person risk.

Looking at diversification, we see a mixed picture. The portfolio consists of 18 properties, with the vast majority located in Budapest. The company does not intend to alter its geographical focus away from Budapest in the foreseeable future; thus, its future performance will hinge on the macroeconomic environment of the Hungarian capital. The limited number of properties within Proform's portfolio as well as the focus on office space in one is, however, mitigated by a moderate tenant concentration, with the top-three tenants representing only 6% of rental income as of year-end 2018. This compares fairly well to peers with less than EUR 1 bn of commercial assets.

Proform's property portfolio is predominantly located in the city of Budapest, a second-tier investment market. The company benefits from high occupancy (>95%) and also has an above-average WALT of 9.6 years as at August 2019, pointing to a fairly good visibility of cash flows.

However, the company has a partially aged portfolio, with some properties finished before 2000. We estimate an average economic age of more than 10 years as at YE 2018.

With regards to profitability, EBITDA margin has ranged between 40% and 50% in the last five business years. However, due to plans to expand development activities in the next years starting from late 2019, we forecast this operating margin to deteriorate if the company will not realise additional profits through profitable asset sales. Our analysis has not incorporated additional profits from property sales but, in the event of this, we would anticipate higher EBITDA margins.

Our overall business risk profile for Proform is deemed 'B'.

Financial risk profile

Proform has shown moderate leverage, as measured by SaD/EBITDA, on holding level but bears additional leverage within its non-consolidated subsidiaries. SaD/EBITDA is expected to increase from c. 1.5x during the past three business years to a range of 2.4x to 3.6x for 2020 and 2021, respectively. However, we expect a sharp temporary increase to 15x-20x at YE 2019 shortly after the bond issuance and the company to pass on most of the proceeds to project subsidiaries.

We highlight the elevated potential volatility of earnings because Proform's operating profitability depends on development projects and/or asset sales.

We do not regard the operating leverage metric to be crucial in assessing Proform's creditworthiness as neither the portfolio's total rental cash flow nor its total underlying financial debt is visible on the level of the rated entity.

Driven by the aforementioned planned portfolio expansion, we forecast EBITDA interest cover in a range of 2.2x to 3.0x and a loan/value ratio at between 50% and 60% for 2020E and 2021E, respectively, both on a look-through basis (portfolio subsidiaries and holding leverage combined). The 2019E numbers, however, will show temporarily greater leverage due to the bond issuance. Operating leverage is expected to increase from 2019 to 2021, due to the planned new projects. Those will be funded by the bond issuance and the company will pass on most of the proceeds to project subsidiaries.

We hence assess a financial risk profile of 'BB' for Proform.

Liquidity

Proform's liquidity is judged to be adequate thanks to recurring revenues and no short-term financial debt as of year-end 2019. We assume only the planned HUF 5bn 10-year bond on the holding level (issuing entity) as part of the MNB programme. Nevertheless, the HUF 5bn bond, if issued as planned in Q4 2019, would expose the company to 'maturity wall' in 2029.

Consequently, we deem Proform's issuer rating at B+, assuming the 10-year HUF 5.0bn bond is successfully placed in Q4 2019.

Senior unsecured debt

Our recovery analysis for the company's senior unsecured debt indicates an above-average potential recovery based on the company's loan/value ratio (look-through including subsidiary debt). This allows for an uplift for the senior unsecured debt compared to the issuer rating. Due to unsecured holding debt being structurally subordinated below all subsidiary debt (secured and unsecured), we nevertheless limit the improvement to +1 notch.

Consequently, we assign a debt class rating of BB- for senior unsecured debt.

Recovery is based on a hypothetical default scenario in FY 2020 with a company liquidation value of HUF 5.5m. This value is based on a haircut applied to the assets of roughly 35%, reflecting a market value decline of 14% as well as liquidation costs of around 15% for the assets and 10% for insolvency proceedings. In addition, the analysis also accounts for the leverage on both subsidiary and holding level. This compares to senior unsecured debt of HUF 5bn (bond) on the level of the rated entity.

Outlook

The Outlook for Proform is Stable and incorporates a successful placement of the HUF 5.0bn bond as well as the launch of the two main new development projects, T4 and F99.

Rating-change drivers

A positive action would require the company to grow its rental portfolio in size, leading to less reliance on project development profits and a (look-through) loan/value ratio sustained at below 50%.

A negative rating action is possible if leverage notably increased, indicated by a (look-through) loan/value ratio of more than 60%.

Stress testing

No stress testing was performed.

Cash flow analysis

Scope performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for this rating and/or rating outlook (Corporate Rating Methodology; Rating Methodology: European Real Estate Corporates) are available on www.scoperatings.com.

Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definitions of default and rating notations can be found at https://www.scoperatings.com/#governance-and-policies/rating-scale.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The rated entity and/or its agents participated in the rating process. The rated entity did not request the issuer rating.

The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, third parties and Scope internal sources.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the rating or outlook action, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.

Lead analyst: Denis Kuhn, Associate Director

Person responsible for approval of the rating: Olaf Tölke, Managing Director

The ratings/outlooks were first released by Scope on 02.09.2019.

Potential conflicts

Please see www.scoperatings.com. for a list of potential conflicts of interest related to the issuance of credit ratings.

Conditions of use / exclusion of liability

Scope Ratings GmbH, Lennéstraße 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Directors: Torsten Hinrichs and Guillaume Jolivet.