30 Oct 2020 - Scope Ratings GmbH

Scope assigns B/Stable issuer rating for Hungarian real estate developer SunDell Estate Nyrt.

The ratings are primarily driven by the company's moderate leverage but constrained by a lack of recurring revenues and a concentrated project pipeline.

The latest information on the rating, including rating reports and related methodologies, is available on this **LINK**.

Rating action

Scope assigns SunDell Estate Nyrt. an issuer rating at B/Stable and a debt category rating on senior unsecured debt of B+.

Rating rationale

The rating reflects the SunDell's limited size, resulting in cluster risks, albeit mitigated by moderate financial leverage going forward. Most importantly, the ratings are based on the assumption of a successful placement of a HUF 10bn senior unsecured bond in Q4 2020, leading to the complete refinancing of all other financial debt with part of the bond proceeds.

With regard to SunDell's business risk profile, rated B-, and in particular its market position, the company is currently a small real estate developer with Scope-adjusted assets of around EUR 60m and an exclusive geographical focus on the Budapest residential development market. SunDell nevertheless has moderate local market shares and visibility in its core market, also thanks to a track record of HUF 12bn (EUR 35m) of projects developed and sold in the past five years. Diversification is weak due to a limited number of projects and the concentration on one asset class in one local market, namely residential development in Budapest. While Scope expects the company to increase its market share in this segment, diversification is expected to remain a constraint on SunDell's business risk profile for the next 18 months at least. Although plans to increase recurring income streams by building up a permanent rental portfolio are credit-positive, they remain largely un-executed at this point in time. Asset quality is credit-positive for the company's business risk profile. SunDell is focussed on medium-priced residential projects in Budapest. These projects enjoy relatively robust demand thanks to their affordability, which is also supported by several government incentives to promote home ownership, especially among families. Moreover, the post-bond issuance financing structure, with no financial debt except the senior unsecured bond at a moderate Scope-adjusted loan/value ratio (LTV) of below 40% (based on Scope-adjusted debt/Scope-adjusted assets) would allow SunDell to better withstand potential market value declines and/or generate revenues by renting out unsold stock if necessary. Profitability is expected to stay volatile due to the clustered project pipeline, but at above-average levels compared to peers, with an approx. 20% internal rate of return and approx. 25% Scope-adjusted EBITDA margin going forward, depending on the timing of project completions. However, Scope expects profitability to remain at a lower level, with an Scope-adjusted EBITDA margin of around 13% for 2021 due to the smaller volume of completions, before returning to the 25% range from 2022 onwards.

SunDell's financial risk profile, rated BB, benefits from an Scope-adjusted EBITDA interest coverage significantly exceeding 1x going forward, as well as an expected gradual reduction of volatility in cash profits via the larger and thus more granular project portfolio as well as the ramp-up of recurring revenue from leased properties. It is also supported by moderate leverage with a LTV below 40% based on Scope-adjusted debt/Scope-adjusted assets for the next two business years. The high volatility of cash flows caused by the clustered project pipeline and a lack of recurring revenues at this point is credit-negative for SunDell's financial risk profile.

Liquidity is adequate in Scope's financial base case. The company will not have any short-term financial debt maturing until the first 30% amortisation tranche of the 10-year, HUF 10bn bond, which is planned to come due in 2025, according to the management's planning and Scope's financial base case.

Outlook and rating-change drivers

The Outlook for SunDell is Stable and incorporates the assumption of a LTV below 40% and Scope-adjusted interest cover of over 1.7x together with the successful execution of sales at expected prices from its growing project pipeline. Furthermore, the Outlook incorporates a successful placement of a 10-year, fixed interest HUF 10bn senior unsecured bond in 2020.

A positive rating action would require SunDell to keep credit metrics in line with Scope's base case on a sustained basis while substantially improving its business risk profile, e.g. by increasing its recurring revenue streams.

A negative rating action could be warranted if SunDell's LTV moves above 60% or Scope-adjusted interest cover drops to less than 1.7x on a sustained basis. This could be caused by the underperformance of development projects, e.g. as a result of lower prices for residential real estate in its core market of Budapest.

Long and short-term debt instrument ratings

Scope expects SunDell to successfully issue the planned HUF 10bn senior unsecured bond in 2020 and to refinance all other outstanding bank debt in a volume of around HUF 2.6bn. The amortisation schedule of the 10-year, fixed interest instrument assumes repayment in three tranches of 30%, 30% and 40% at the end of the years 2025, 2027 and 2030, respectively. The proceeds are earmarked for the refinancing of financial debt (HUF 2.6bn) and investments in new development projects (HUF 7.4bn). Scope's base case financial forecast assumes that the company will not incur any additional senior secured or unsecured financing within the next two years, implying that the HUF 10bn senior unsecured corporate bond represents the entire financial debt of the company going forward.

Scope assumed a hypothetical default scenario for the year 2022 and applied reasonable discounts to the company's asset base. The agency expects an excellent recovery rate for senior unsecured creditors in this liquidation scenario, thus allowing for an uplift of up to two notches on the company's issuer rating. However, Scope decided for a one-notch uplift due to the remaining risks of potential changes in the financing structure, i.e. introduction of secured debt ranking senior to the unsecured financial debt and the high sensitivity of the expected recovery rate to the assumed advance rates on completed and uncompleted developments.

This translates into a B+ debt class rating for senior unsecured debt.

Stress testing & cash flow analysis
No stress testing was performed. Scope performed its standard cash flow forecasting for the company.

Methodology
The methodologies used for this rating(s) and/or rating outlook(s) (Corporate Rating Methodology, 26 February 2020; European Real Estate Corporates, 17 Jan 2020) are available on https://www.scoperatings.com/#!methodology/list.
Information on the meaning of each rating category, including definitions of default and recoveries can be viewed in the "Rating Definitions - Credit Ratings and Ancillary Services" published on https://www.scoperatings.com/#!governance-and-policies/rating-scale. 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. Guidance and information on how Environmental, Social or Governance factors (ESG factor) are incorporated into the rating can be found in the respective sections of the methodologies or guidance documents provided on https://www.scoperatings.com/#!methodology/list.
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 rating was not requested by the rated entity or its agents. The rating process was conducted:
With Rated Entity or Related Third Party Participation YES
With Access to Internal Documents YES
With Access to Management YES
The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, the rated entities' agents and Scope internal sources.
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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, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0.
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Potential conflicts
Please see www.scoperatings.com for a list of potential conflicts of interest related to the issuance of credit ratings.

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