TUESDAY, 25/10/2022 - Scope Ratings GmbH

Scope affirms B/Stable issuer rating on Hungarian real estate developer GOPD Nyrt.

The ratings are primarily driven by the dependence on subsidiary SunDell Estate Nyrt. The moderate leverage benefits the rating while the lack of recurring revenues and the concentrated project pipeline are constraints.

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

Rating action

Scope Ratings GmbH (Scope) has affirmed the issuer rating of B/Stable on GOPD Nyrt. along with the B senior unsecured debt rating and B+ senior unsecured rating on the bond guaranteed 80% by MFB Hungarian Development Bank (ISIN HU0000361076).

Rating rationale

The rating reflects GOPD's strong dependence on its subsidiary, SunDell Estate Nyrt. (rated B/Stable), as well as GOPD's limited size that results in cluster risks, albeit mitigated by its moderate financial leverage going forward.

GOPD successfully issued a senior unsecured bond of HUF 5.5bn, guaranteed 80% by MFB, and gained the majority of and control over SunDell, in line with Scope's rating case. While the fixed yearly finance cost of 6.75% seemed high last year (other bonds were issued at around 3%-4%), it has become beneficial after the base rate in Hungary increased steeply to 13% in September 2022.

In line with the rating case from 2021, bond proceeds were used to purchase HUF 4.4bn in SunDell shares to gain a controlling stake (62.76%) as well as a HUF 1.1bn plot in the metropolitan area of Budapest. The SunDell transaction contains significant risk as the share purchase was financed by debt and company cash flows; hence, the debt service of GOPD bonds will be based on SunDell dividends. GOPD bondholders are structurally a level above SunDell bondholders, further from cash flow production, making GOPD bonds more risky than the bonds of SunDell. GOPD's remaining activity of plot incubation also depends on SunDell as GOPD has historically sold its plots exclusively to SunDell (though this may change in the long term).

In addition to the rating case, a capital raise was performed by MFB Invest and Hiventures (investment companies of the MFB Hungarian Development Bank) in SunDell of HUF 9bn (EUR 21.5m) for the purpose of growth, half of which was already used to acquire a landbank. The size is significant for SunDell. GOPD's stake in SunDell changed to 52.37%, keeping majority ownership and control. The expected yield for equity investors is 8.5% a year, which consists of dividend received from SunDell and an option fee payable by GOPD. Should the SunDell dividend be high enough to cover the yield, the option fee could be zero.

GOPD develops real estate and owns shares in real estate development companies, leading to an industry risk of BB for homebuilders. Scope rates GOPD's business risk profile at B, in particular for its rather weak market position and low diversification.

The company is relatively new and most of its business is performed at subsidiary level. Its most important subsidiary is SunDell, for which it develops plots. SunDell operates exclusively in Budapest's fragmented residential development market, in which it has a low market share, with Scope-adjusted assets of around EUR 150m. Nevertheless, SunDell has moderate visibility in its core market, also thanks to the HUF 12bn (EUR 35m) of projects it has developed and sold in the past five years.

GOPD's diversification is weak. Cash flow is expected from a limited number of projects (2-3 plot developments a year for SunDell) and dividend upstream from SunDell (behind which are 6-7 residential project developments). As a real estate investment trust, SunDell enjoys tax exemptions and is expected to have significant dividend upstream. The underlying business comes with a backlog until the end of 2023, meaning cash flows and cash conversion for GOPD will be visible until late 2024.

Asset quality is credit-positive for the company's business risk profile. GOPD is focused on medium-priced residential projects in Budapest to be sold to SunDell in the pre-construction phase. These projects relate to affordable housing and therefore enjoy relatively robust demand, which is further supported by government incentives to promote home ownership and energy-efficient housing, especially among families.

GOPD's profitability is highly dependent on SunDell's profitability. This leads to high concentration risk and volatility, which is same for SunDell. Scope therefore expects profitability to stay volatile, with the Scope-adjusted EBITDA margin at above 30% going forward, depending on the timing of project completions.

GOPD's financial risk profile, rated at BB, assumes a Scope-adjusted debt/Scope-adjusted EBITDA ratio of 5x-7x in the coming two years, although volatility may be high. GOPD benefits from its Scope-adjusted EBITDA interest coverage, expected at more than 4x going forward, and no upcoming debt repayments in the coming years. Scope also expects the company to benefit from the gradual reduction in cash flow volatility via SunDell's larger and thus more granular project portfolio and the ramp-up of recurring revenue from SunDell's leased properties, albeit only from 2025. The high volatility of cash flows caused by the clustered project pipeline and lack of recurring revenues at this point are credit-negative for GOPD's and SunDell's financial risk profiles.

Liquidity is adequate in Scope's financial base case. The company has no short-term debt outstanding and the GOPD 2031/A bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme will only start amortising from 2026, while the first amortisation for SunDell will be in 2025. SunDell allocates liquidity reserves of HUF 1.25bn a year from 2022 for debt service, which serves as debt protection.

Outlook and rating-change drivers

The Outlook for GOPD is Stable and assumes a Scope-adjusted loan/value ratio of below 50%, a Scope-adjusted interest cover of more than 4x and the majority ownership and control in SunDell being maintained.

A positive rating action would require financial metrics to be sustained in line with the Stable Outlook while the business risk profile improved substantially, e.g. via more projects, a stronger backlog, more recurring-revenue streams and/or less dependence on SunDell.

A negative rating action might be warranted if the Scope-adjusted debt/EBITDA reached more than 8x or financial metrics deteriorated below the rating base case or in case of liquidity issues. This could be caused by an underperformance of the company's own development projects, or less dividend received than expected from SunDell, e.g. as a result of lower prices for residential real estate in its core market of Budapest or increasing input or labour costs.

Long-term and short-term debt ratings

Scope assumed no senior secured debt on GOPD level, no corporate guarantees or suretyships offered by GOPD and no pledge on the SunDell shares owned by GOPD (except for MFBI and Hiventures).

Scope assumed a hypothetical default in 2024 and applied reasonable discounts on the company's asset base. While the liquidation scenario may point towards an 'above-average' recovery, Scope did not grant a rating uplift due to the structuring of the financing. This translates into a B debt class rating for senior unsecured debt, in line with the issuer rating.

The HUF 5.5bn senior unsecured bond is guaranteed 80% by MFB (**rated by Scope at BBB+/Negative**), based on which Scope affirms the senior unsecured guaranteed debt. Scope expects in this case an 'above-average' recovery for outstanding senior unsecured guaranteed debt in a hypothetical default scenario based on a distressed liquidation value, resulting in one notch of uplift above the issuer rating.

Stress testing & cash flow analysis

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

Methodology

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

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. 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 Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. 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 and/or its Related Third Parties 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 Ratings' internal sources.

Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings 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 Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.

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The Credit Ratings/Outlook were first released by Scope Ratings on 3 November 2021.

Potential conflicts

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