Rating Action Release 03 DEC 2021

Scope affirms BB/Stable issuer rating of Futureal Development Holding Kft.

Scope affirms issuer and debt class ratings for Futureal after updated business plan that incorporates additional bond taps of up to HUF 32.3bn until year-end

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 BB/Stable for issuing entity Futureal Development Holding Kft. as well as the issuer rating of BB/Stable for the holding company and guarantor of outstanding senior unsecured bonds, Futureal Holding B.V. Scope has also affirmed its long-term debt class rating on senior unsecured debt of BB for both entities after receiving updated business planning from the issuer including an additional planned tap bond placement

Rating rationale

Scope's assessment of the issuer's business risk remains at BB. This consists of a blended industry risk of B+ that reflects the issuer's core activity of real estate development and a growing portfolio of commercial investment properties that generates recurring revenues. Credit-positive factors for the issuer's competitive positioning are its strong market position and track record as Hungary's largest commercial real estate developer and the high visibility resulting from that status. The absolute size of its commercial portfolio is limited at this time, given that the vast majority of previous development projects have been sold. However, the issuer aims to create a roughly EUR 1.0-1.5bn commercial portfolio via its own develop-to-hold projects and selective acquisitions within the next two to three years. While the company has properties/projects in several regions of Hungary and some properties in the UK, Scope still sees diversification as a rating constraint. This is because the lion's share of anticipated rental revenue will come from commercial real estate (mostly office space) and a geographically concentrated area around Budapest, Hungary. Thus, the issuer's performance hinges on the macroeconomic environment of Budapest. The planned add-on acquisitions of existing cash generating properties are expected to take place predominantly in Hungary and Central and Eastern Europe and should therefore only have a limited impact on business diversification.

Profitability is expected to increase to a Scope-adjusted EBITDA margin of 45%-60% over the next two to three years (2020: -1%) as higher recurring rental revenues are expected to lift profitability when more projects are finished. However, the transition from a typical developer operating margin to a higher-margin commercial property owner is still subject to execution risks in the develop-to-hold project portfolio.

The financial risk profile remains unchanged at BB-. This is because the most relevant financial metrics for the rating case, particularly the Scope-adjusted loan/value ratio (LTV), are still expected to develop within Scope's previous financial base case. Scope expects the issuer to increase its LTV to a range of 50%-60% (YE 2020: 25%) with a trend towards 60% for at least the next two years due to its dynamic, mostly debt-funded expansion programme. However, the agency does not believe the issuer will break the 60% threshold based on the latest business plans provided by the issuer. However, if the issuer should decide to spend more cash than currently incorporated in Scope's base case, e.g. due to higher investments in standing assets, LTV might increase faster than anticipated as a result of a lower cash position. Scope expects free operating cash flow to remain negative for several business years to come as a result of current expansion. For 2020, Scope-adjusted EBITDA interest coverage was below par and is expected to stay below 1.0x for the current year caused by the gradual ramp-up of rental income from current developments. Scope expects EBITDA interest coverage to return to above par at 1.2x for 2022 and 1.6x for 2023 after additional project completions such as Etele Plaza (retail) in 2021 and further stages of BudapestOne (office) in 2022.

With regard to anticipated free operating cash flows, Scope nevertheless hints at the fact that a considerable part of capex is of a discretionary nature, since projects may be postponed, renegotiated or cancelled in case of a severe market downturn. Scope expects the issuer to maintain a high level of pre-lets (no speculative developments) as well as turnkey contracts with construction companies/contractors to limit the risk of severe cost overruns.

Futureal's liquidity situation is expected to temporarily drop into negative territory in 2021 due to its substantial capex volumes and resulting negative free operating cash flow. Yet it is expected to return to double-digit ratios for 2022-23 given high expected cash levels. Scope did not incorporate any open committed credit lines as the issuer does not have any committed lines with a maturity of over one year. Scope believes the company will be able to refinance its financial debt in the next 12-24. This follows Scope's view, that at least completed projects (subject to an LTV of below 60% and sufficient cash rental income) should allow for secured refinancing with banks.

Outlook and rating-change drivers

The Outlook is Stable and reflects Scope's view that Futureal will be able to grow its recurring revenue base by successfully completing develop-to-hold projects on time and on budget. Consequently, Scope assumes higher LTV that stays between 50%-60% and Scope-adjusted EBITDA interest cover to return to more than 1.0x from recurring revenues after 2021E, not taking potential asset sales into account.

A positive action is remote at this point. It would require the company to reduce leverage, as measured by LTV, to below 50% on a sustained basis while achieving Scope-adjusted interest coverage from recurring rental income of around 2.0x.

A negative rating action is possible if Futureal's LTV approached 60% or if Scope-adjusted interest coverage stayed below par beyond FY 2021E. This could be triggered by a slump in market prices/rents or delayed up-letting of new properties.

Long-term debt instrument ratings

Futureal contemplates an issue or tap issue of senior unsecured bonds within the Hungarian National Bank's Bond Funding for Growth Program in the maximum amount of HUF 32.3bn (after the successful HUF 33.7bn bond issue as of November 16, 2021) and have a tenure of up to 15 years with a fixed coupon, paid annually. The contemplated issues may include the tap issue of Futureal's 15 years term amortizing bond (amortization schedule: from year eight on, annually 5.00% are amortized every year and has a final bullet of 65%) and/or the tap issue of Futureal's 10 years term amortizing bond (amortization schedule: from year seven on, annually 10.00% are amortized every year and a has final bullet of 70%) or new, fixed coupon bonds with similar amortization schedules for identical use of proceeds and with Issuer's mother company guarantee.

Scope now incorporated a successful placement of the above-mentioned tap issuances in a volume of maximum HUF 32.3bn into its financial base case for the monitored rating. This sum consists of HUF 6.3bn remaining unutilized from the previous tap issuance already incorporated in our previous base case and an additional HUF 26.0bn that the issuer is planning to issue according to its latest business plan.

Scope's recovery analysis is based on a hypothetical default scenario at year-end 2023E and shows a high sensitivity to attainable prices in a distressed sales scenario as well as a very high sensitivity to the volume of senior secured bank debt at the time of a hypothetical default. For those reasons, especially given the structural subordination of senior unsecured creditors of the rated entity below current and future secured debt at property SPV level in Scope's default scenario, Scope assesses senior unsecured debt at the same level as the issuer rating.

This translates into a BB debt class rating for senior unsecured debt.

Stress testing

- No stress testing was performed.

Cash flow analysis

- Scope performed its standard cash flow forecasting for the company.

Methodology

The methodology/ies used for this rating(s) and/or rating outlook(s): Corporate Rating Methodology 6 July 2021; European Real Estate Corporates 15 Jan 2021 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 rated entity and/or its agents participated in the rating process.

The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity 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, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0

The credit rating and/or outlook is UK endorsed.

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Potential conflicts

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