

Proform Ingatlanbefektetési Zrt. Hungary, Real Estate



STABLE
B+

Corporate profile

Proform Ingatlanbefektetési Zrt. was founded in 1989 and its main activities include the construction, development, distribution and maintenance of office buildings, hotel projects, and residential and commercial real estate. To date, it has built more than 300,000 m² of commercial real estate mainly in Budapest, worth around EUR 220m by market value as of year-end 2018. Apart from previously developed office buildings, the PARK INN hotel and commercial real estate in Budapest, other developments are also in the pipeline.

Key metrics

Scope credit ratios	2017	2018	Scope estimates	
			2019F	2020F
EBITDA/interest cover (x)	neg.	neg.	2.9x	7.8x
Scope-adjusted debt (SaD)/EBITDA	1.6x	1.4x	18.7x	2.4x
Scope-adjusted FFO/SaD	52%	107%	3%	34%
Loan/value ratio (%)	55%	51%	66%	59%

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

Ratings & Outlook

Corporate issuer rating B+/Stable

Senior unsecured rating BB-

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Related Methodologies

Corporate Rating Methodology,
January 2019

Real Estate Rating Methodology,
February 2019

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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 city (75% of current rental income from office space) 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%.



Rating drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none">• Exposed to second-tier investment market with healthy demand from tenants• Strong occupancy (95% as at August 2019) and good tenant diversification with top 10 tenants accounting for 16%• 20+ year track record in the Budapest commercial real estate market (development and management)	<ul style="list-style-type: none">• Small property company exposed to greater sensitivity to unforeseen shocks and volatility in cash flows• Small market shares in an increasingly competitive environment• Weak diversification across geographies

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none">• Further improvement of business risk profile while achieving a loan/value ratio of less than 50%	<ul style="list-style-type: none">• An increase in loan/value to more than 60%



Financial overview

			Scope estimates	
Scope credit ratios	2017	2018	2019F	2020F
EBITDA/interest cover (x)	neg.	neg.	2.9x	7.8x
Scope-adjusted debt (SaD)/EBITDA	1.6x	1.4x	18.7x	2.4x
Scope-adjusted FFO/SaD	52%	107%	3%	34%
Loan/value ratio (%)	55%	51%	66%	59%
Scope-adjusted EBITDA in HUF '000	2017	2018	2019F	2020F
EBITDA	596,689.0	494,289.0	249,136.0	1,571,600.1
Operating lease payments in respective year	0.0	0.0	0.0	0.0
Other items	0.0	1.0	2.0	3.0
Scope-adjusted EBITDA	596,689.0	494,289.0	249,136.0	1,571,600.1
Scope-adjusted funds from operations in EUR m	2017	2018	2019F	2020F
EBITDA	596,689.0	494,289.0	249,136.0	1,571,600.1
less: (net) cash interest as per cash flow statement	15,554.0	10,648.0	-84,541.8	-201,890.0
less: cash tax paid as per cash flow statement	-32,439.0	-47,229.0	-10,139.3	-96,035.7
add: dividends received from shareholdings	-94,995.0	292,197.0	0.0	0.0
Scope-adjusted funds from operations	484,809.0	749,905.0	154,454.9	1,273,674.4
Scope-adjusted debt in EUR m	2017	2018	2019F	2020F
Reported gross financial debt	1,161,316.0	781,972.0	5,038,800.0	5,038,800.0
less: cash, cash equivalents	-229,072.0	-83,818.0	-387,918.7	-1,302,679.8
add: cash not accessible	0.0	0.0	0.0	0.0
Scope-adjusted debt	932,244.0	698,154.0	4,650,881.3	3,736,120.2



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