Crown Holding Kft.
Hungary, Real Estate

B STABLE

Corporate profile

Crown Holding Kft. is a Hungarian limited liability company that is active in the real estate sectors of Hungary and Romania. The company pursues an opportunistic investment strategy, looking for undervalued assets and development opportunities with which it can expand its income-generating portfolio. Its portfolio includes commercial properties (shopping malls, offices buildings and hotels).

Key metrics

		Scope estimates		
Scope credit ratios	2019	2020E	2021E	2022E
Scope-adjusted EBITDA/Scope-adjusted interest cover (x)	3.1x	7.7x	4.0x	3.4x
Scope-adjusted debt (SaD)/ Scope-adjusted EBITDA	6.5x	5.3x	12.6x	10.3x
Scope-adjusted loan/value ratio (%)	24%	25%	45%	46%

Rating rationale

Scope Ratings GmbH (Scope) has affirmed the B/Stable issuer rating on Crown Holding Kft.

The affirmation of the B issuer rating is driven by Crown's adequate credit metrics. Crown's leverage, as measured by the Scope-adjusted loan/value (LTV) ratio, stood at 24% as at YE 2019 -based on pro-forma consolidated figures- and 25% as at YE 2020, based on preliminary pro-forma consolidated figures. While we foresee a significant increase in the company's leverage due to the investment phase planned for the next years, Scope-adjusted LTV is expected to remain at close to 50%. Crown's current expansion strategy is to fully finance its planned acquisitions – negotiations are ongoing- and developments with debt including a EUR 60m bond in 2021 and bank debt of around EUR 10m. Crown's key performance indicators on its property portfolio remained strong in 2020. The average occupancy rate was 90% as of February 2021 and total revenues were EUR 12.2m in 2020 (-18% YoY), based on 2020 preliminary pro-forma consolidated figures. The Covid-19 crisis did not have a material impact on rent collections from the office properties but did affect the retail and hospitality exposures. Crown has granted EUR 1.6m in rent relief in 2020 (around 13% of total rent). While the occupancy rate for the retail assets have remained high, the renting-out of the newly refurbished OSC property has been slower than expected (currently 46%). EUR 0.6m of rents are overdue as of February 2021 but management expects to recover them in the next six months.

The rating continues to be constrained by the company's small size and market shares, with total assets of around EUR 180m as of December 2020. The resulting lack of economies of scale leads to greater sensitivity to unforeseen shocks and volatile cash flow, as experienced during the current crisis. In terms of diversification, Crown plans to acquire properties and develop a hotel in Budapest, as well as extend and upgrade existing properties on its portfolio (total capex of around EUR 80m). Despite this, we expect Crown to remain small and largely exposed to the retail segment, which itself exposed to major changes in consumer habits exacerbated by the pandemic, such as the shift to e-commerce. This is somewhat mitigated by the portfolio weighted average unexpired lease term (WAULT) of 5.5 years. Weak geographical and tenant diversification further constrain the rating.

Ratings & Outlook

Corporate rating	B/Stable
Senior unsecured rating	B+

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Related Methodologies

Corporate Rating Methodology, February 2020

Rating Methodology European Real Estate Corporates January 2021

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Bloomberg: RESP SCOP

Outlook and rating-change drivers

The Outlook is Stable and incorporates: i) the successful execution of the Radisson project in Budapest and its commencement of operations in 2022; and ii) the successful placement of a EUR 60m bond in H1 2021 to finance the acquisition of revenue-generating properties in Q2 2021 via a joint-venture structure. Our rating case embeds an increase in Scope-adjusted LTV to around 50%.

The Outlook also incorporates our view that Crown subsidiaries outside the scope of the bond issuance will maintain debt at current levels. Furthermore, we expect the issuer to receive all of its subsidiaries' profits in cash, ensuring it can pay its obligations on time such as debt service and operating expenditure. In addition, we assume cash proceeds from the bond will be transferred to SPVs via equity and shareholder loans, which will enable property acquisitions without recourse to additional bank debt or other senior-ranked financing. The same would apply if the issuer were to directly acquire and hold the properties. Finally, Crown does not prepare consolidated accounts, which are not a regulatory necessity due to its small size. However, according to Crown's management, from FY 2020 it will produce consolidated financial statements that include all of its holdings.

A positive rating action is seen to be remote but would require a significant improvement in Crown's business risk profile. This could be achieved by the company growing in size and strengthening its market position, increased geographical and tenant diversification of the portfolio, and more cash flow visibility through longer weighted average unexpired lease terms while sustaining an LTV below 50%.

A negative rating action would be possible if Scope-adjusted loan/value increased above 60% or if liquidity worsened. Leverage could increase if the value of portfolio properties dropped due to widening of yields or weakening rental cash flow from uncertainty around the permanence of the pandemic driven change of consumer habits. Liquidity could worsen if, for example, i) subsidiary profits are not transferred to the parent, leading to delayed payments on the issuer's obligations; or ii) tenants delay payments significantly.

Rating drivers

Positive rating drivers	Negative rating drivers
• Exposure to second-tier investment markets with healthy demand from tenants • Moderate average occupancy rate (90% as at February 2021); above 98% for core asset Lotus Center, which has had similar levels in the last five years • Stable Scope-adjusted EBITDA margin of above 60% • Adequate credit metrics, with Scope-adjusted loan/value ratio of approx. 24% in 2019 (pro-forma consolidated) and 25% in 2020 (preliminary pro-forma consolidated).	• Small player with greater sensitivity to unforeseen shocks and cash flow volatility • Small market shares amid increasing competition • Exposure to real estate development leading to volatile cash flow, partially mitigated by stable recurring rental income • Weak diversification across geographies • Limited tenant diversification (main tenant representing around 19% of total rental income, while top three represent 30% as of February 2021) and exposure to retail tenants • Modest WAULT of 5.5 years providing limited cash flow visibility after 2025 • Key person risk: founder/CEO crucial to the company • Forecasted negative free operating cash flow due to portfolio expansion in 2021 and 2022 leading to weaker credit metrics

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improved business risk profile, including significant growth in size and diversification, while reducing Scope-adjusted loan/value ratio below 50%	• Increase in Scope-adjusted loan/value ratio to more than 60% • Worsened liquidity

Financial overview

		Scope estimates		
Scope credit ratios	**2019**	**2020P**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	3.1x	7.7x	4.0x	3.4x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	6.5x	5.3x	12.6x	10.3x
Scope-adjusted loan/value	24%	25%	45%	46%
Scope-adjusted EBITDA in EUR m	**2019**	**2020P**	**2021E**	**2022E**
EBITDA	6.9	8.6	9.2	11.7
Operating lease payments in respective year	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**6.9**	**8.6**	**9.2**	**11.7**
Scope-adjusted funds from operations in EUR m	**2019**	**2020P**	**2021E**	**2022E**
Scope-adjusted EBITDA	6.9	8.6	9.2	11.7
less: (net) cash interest as per cash flow statement	-2.3	-1.1	-2.3	-3.4
less: cash tax paid as per cash flow statement	-0.7	-0.8	-0.6	-0.6
add: depreciation component, operating leases	0.0	0.0	0.0	0.0
Scope-adjusted funds from operations	**4.0**	**6.7**	**6.3**	**7.7**
Scope-adjusted debt in EUR m	**2019**	**2020P**	**2021E**	**2022E**
Reported gross financial debt	55.0	54.8	121.5	126.4
less: shareholder loan (50% equity credit)	-8.0	-7.2	-7.2	-7.2
less: cash and cash equivalents	-6.9	-6.9	-4.5	-4.4
add: other off-balance sheet debt	5.2	5.2	5.2	5.2
Scope-adjusted debt	**45.3**	**45.9**	**115.0**	**120.0**

Business risk profile: B

Industry risk: BB

Industry risk remains unchanged. Crown's activities comprise the leasing and management of commercial real estate buildings, as well as the development of hotel projects. This exposes the company not only to the highly cyclical real estate industry, especially regarding its development activities, which tend to increase cash flow volatility, but also the retail segment, an already-challenged property market affected by e-commerce penetration and Covid-19 lockdowns in 2020. Industry risk for Crown is therefore modest.

Small property company exposed to sudden shocks and the real estate cycle

Crown's limited size, with about EUR 180m of total assets as of December 2020 on a pro-forma basis, is a negative rating driver since it implies enhanced sensitivity to unforeseen shocks (as seen during the current crisis), greater cash flow volatility, limited economies of scale and high key person risk. Crown is targeting growth through the acquisition of around EUR 60m in assets, investments of EUR 12m to develop a hotel in central Budapest and EUR 11m to extend and upgrade existing properties on its portfolio. Despite this, we expect Crown to remain small in a European context.

Negligible market shares with some visibility through retail assets

Crown's market shares are negligible. Since the company's small portfolio is split across multiple asset classes and locations (mainly Debrecen, Budapest and Oradea) it does not have substantial market power or visibility in the markets in which it operates. In an increasingly competitive environment, this makes it vulnerable to larger players.

Retail comprises more than 70% of the portfolio's gross leasable area. In the small market of Oradea (10th largest city in Romania), the company has a small cluster of assets: three shopping centres, including the first and largest in the city, the Lotus Center (40,000 sq m), located in the city's prime shopping destination, as well as the OSC (35,000 sq m), which was recently refurbished. Nevertheless, this does not significantly impact our assessment of Crown's market positioning or market shares.

Limited geographical diversification, with properties located in two secondary markets

The company holds properties in two countries, Hungary (around 25% of the total property value) and Romania (75%). Thus, its performance hinges on the macroeconomic environment of the Hungarian capital and other small secondary markets in Hungary and Romania. Those markets have lower liquidity than in other European locations. If the economy cools and/or interest rates rise, investors are likely to focus on tier-one markets and safe havens like London, Paris or the seven major German cities. This could eventually lead to substantial downward pressure on property values, an increase in leverage, the reduced availability of external financing, and limited recovery expectations for debt investors.

Limited tenant diversification and exposure to retail companies, partially mitigated by credit quality of main tenant

The company continues to have high tenant concentration. There is a considerable net rental income contribution (19%) from its main tenant, ITHS, which is a subsidiary of T-Systems and Deutsche Telekom in Hungary. Further, the top 10 tenants represent 50% of total rental income and are mostly retailers.

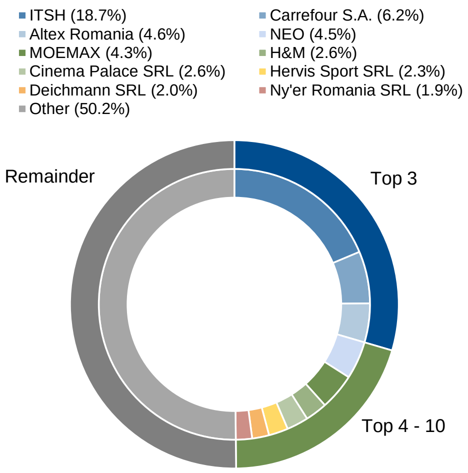
However, worsening macroeconomic conditions and unforeseen shocks are expected to directly translate into softer demand and the possible closure of some branches. The presence of bank guarantees or cash deposits for at least 90% of the leases partially mitigates the risk of a single tenant's default, which could impair rental cash flow. On average, guarantees amount to an equivalent of three months' rent.

We do not expect the planned additions in Crown's portfolio to have a significant impact on our diversification assessment.

Exposure to cyclical segments: retail and hospitality

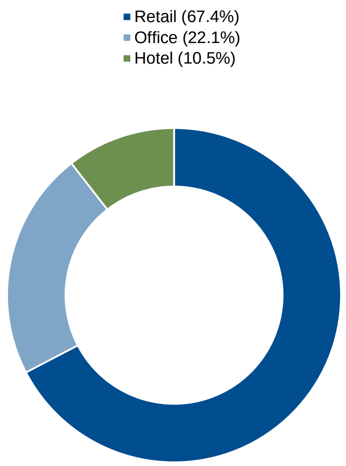
Crown's portfolio has a high exposure to the real estate sub-segments that were hardest hit by the pandemic – retail and hospitality (78% of the total 2020 revenues). The effects are especially pronounced for the retail segment, which is undergoing major changes including the rise in e-commerce and shift in consumer habits exacerbated by the pandemic. This could challenge Crown's operational performance and have a negative impact on credit metrics if economic activity recovers slower than expected.

Figure 1: Tenant diversification (share of rent) as at February 2021



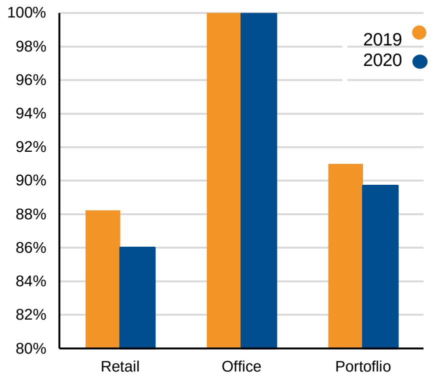
Source: Crown, Scope

Figure 2: Distribution of rental income by type of use as at February 2021



Source: Crown, Scope

Figure 3: Occupancy rate by property type



Source: Crown, Scope

Moderate occupancy rate and exposure to re-letting risk in the medium term

Crown's average occupancy rate is strong at 90% as of February 2021. This benefits from the office assets that are fully let and is influenced by the recently refurbished asset, OSC, which had a slower-than-expected renting-out (currently 46%). The hotel segment has been affected by the Covid-19 shock given its sensitivity to tourism, which has been largely restricted globally to contain the virus. The hotel's occupancy rate was below 40% (64% in 2019), which translated into a 37% drop in the hotel's revenues for 2020. We expect occupancy to gradually recover and stabilise at around 60% from 2022 once tourism and business travellers return to the cities.

The medium-term WAULT of 5.5 years as of December 2020 provides some visibility on future cash flows but exposes the properties to re-letting risk after 2025. This is more concerning for the retail properties, whose tenants are increasingly threatened by the rise of e-commerce. In addition, some cluster risk could arise from the office building in Debrecen, currently fully let to a single tenant. This is partially mitigated by the lease terms (until the end of 2025) and the fact that the tenant has occupied the premises since the asset's completion in 2009.

Stable profitability ratios but limited visibility beyond 2024

Crown's profitability, as measured by its Scope-adjusted EBITDA margin, stood at 60% in 2020. This reflects the company's businesses, which include development activities. (Pure developers usually have lower EBITDA margins than buy-and-hold companies, some of which have margins above 80%.) The company has kept its asset occupancy rate high and, like most retail property landlords, has granted rent relief (EUR 1.6m in 2020, 13% of total rents) to tenants affected by the lockdown measures. Regarding rent collections, EUR 0.6m is overdue as of February 2021. Management expects to recover these receivables in the next six months, aided by the Romanian government's programme to provide retailers with up to EUR 150,000 for outstanding bills.

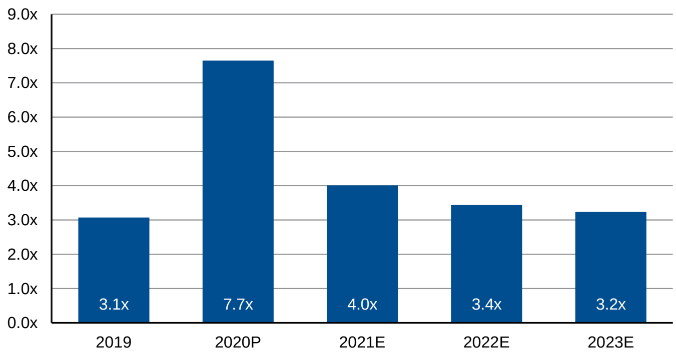
We expect Crown's Scope-adjusted EBITDA margin to remain above 60%, with limited potential for improvements. While the planned acquisition has a triple-net lease, implying less property and management costs for the landlord and thus higher margins, benefits will be offset by Crown's exposure to development and refurbishment activities with their lower margins.

Financial risk profile: BB-

Interest cover with stronger support from recurring EBITDA

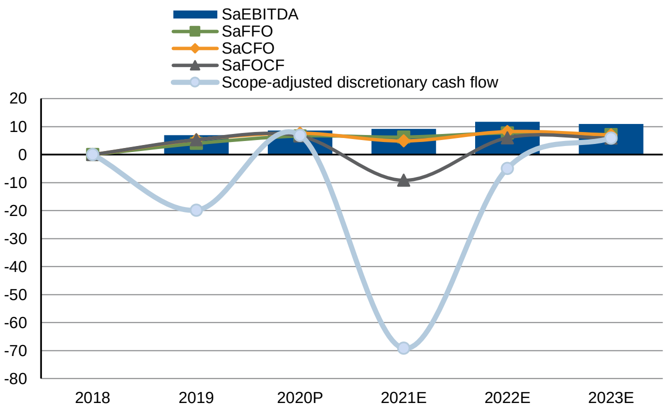
The company's debt protection, as measured by the Scope-adjusted EBITDA interest cover, stood at 7.7x, based on preliminary pro-forma figures for 2020. We anticipate some pressure on debt protection as a result of the higher balance sheet leverage after the bond placement in 2021. However, we forecast that Scope-adjusted EBITDA interest cover will remain above 3x in the next few years, benefitting mainly from i) the addition of income-producing assets that will provide more certainty on recurring cash flows; ii) the start of operations of the Radisson hotel in Budapest in 2022; and iii) the issuer's low cost of financing (average of 2.1% as at February 2021).

Figure 4: Scope-adjusted EBITDA interest cover (x)



Source: Crown, Scope estimates

Figure 5: Cash flows (EUR m)



Source: Crown, Scope estimates
Sa = Scope-adjusted

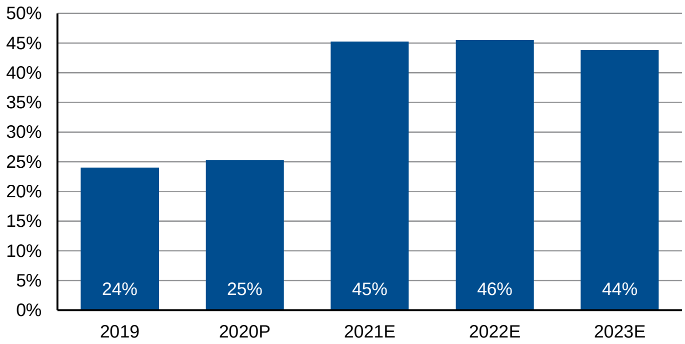
Negative free operating cash flow driven by investment planned for 2021-22

We forecast relatively stable and positive funds from operations (Scope-adjusted FFO) and cash flow from operations (Scope-adjusted CFO) in the next few years, due to Crown's solid recurring rental income, subject to some lease terminations in the short run. Scope-adjusted free operating cash flow (SaFOCF) will be more volatile, and we expect it to turn negative, driven by the portfolio expansion planned for 2021-22, which is anticipated to bear fruit from 2022. Negative Scope-adjusted FOCF will be financed by external debt, leading to higher balance sheet leverage.

Growth strategy at the expense of strong increase in leverage

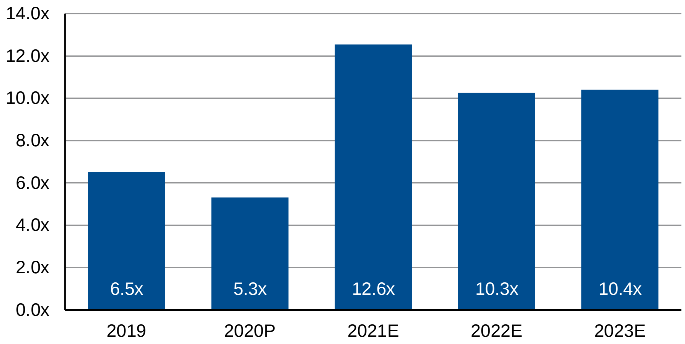
Crown's leverage has been low, with a Scope-adjusted LTV of 24% at YE 2019 and 25% at YE 2020, based on preliminary pro-forma consolidated figures. However, we expect the leverage to increase, driven by a significant debt-finance capex programme in 2021-2022. Currently, debt consist of EUR 40.3m bank loans at YE 2020 and our base case also includes a bond placement in 2021 (EUR 60m) and new bank debt totalling around EUR 10m. The company's current strategy to fully finance its potential acquisitions with debt applies pressure on the rating, but we expect leverage to remain below 50% in the next few years.

Figure 6: Scope-adjusted LTV ratio (%)



Source: Crown Scope estimates

Figure 7: SaD/EBITDA (x)



Source: Crown, Scope estimates

Adequate liquidity

Crown's liquidity is adequate. Unrestricted cash (EUR 6.9m) exceeds short-term debt (EUR 4.3m). Even if FOCF remains negative due to planned investments (mostly discretionary capex), the company has additional open credit lines of more than EUR 30m provided by OTP Bank (as at end-February 2021). However, these credit lines are tied to particular purposes, among them, the Radisson Hotel development, the Lotus Center and the Nymphaea Resort, thus not fully considered within our liquidity calculation.

Figure 8: Liquidity

in EUR m	2020P	2021E
Short-term debt (t-1)	2.5	4.3
Unrestricted cash (t-1)	6.9	6.9
Open committed credit lines (t-1)[1]	0.0	10.5
Scope-adjusted Free operating cash flow (t) [2]	6.6	-9.2
Coverage	**5.4x**	**1.9x**

Source: Scope estimates

Corporate governance & structure

Crown's management has extensive industry knowledge, both for real estate and its sectors (e.g. hospitality). However, owner and CEO Sandor Mudura poses key person risk. In our opinion, the company heavily depends on Mr Mudura's ability and market competence in both the Romanian and Hungarian real estate markets, factors that will shape the company's future development.

The company has no independent board that provides oversight functions.

Financial transparency

Crown does not prepare consolidated accounts; this is not a regulatory necessity due to its small size. However, according to Crown's management, from FY 2020 it will produce consolidated financial statements that include all of its holdings.

Long-term and short-term debt ratings

Senior unsecured debt: B+

Crown plans to issue a EUR 60m senior unsecured corporate bond (around HUF21.8bn). The bond's tenor is 10 years with 10% of its face value subject to amortisation starting in the fourth year after its issuance until the ninth year and 40% in the 10th year. The coupon will be fixed and payable annually. Proceeds are earmarked for the acquisition of revenue-generating properties.

[1] We include the share of available credit lines that will be drawn to finance the company's development activities, namely the Radisson hotel development.
[2] We exclude discretionary expansion capex from our liquidity calculation, as such investments are only made if external financing is available.

Our recovery analysis is based on a hypothetical default scenario in FY 2022 with a company liquidation value of EUR 183m. This value is based on a haircut of 21% to reflect liquidation costs and reasonable discounts to the company's asset base as well as 10% for insolvency proceedings. This compares to secured financing of a forecasted EUR 52m, and senior unsecured debt of EUR 60m.

We expect an 'above average' recovery for Crown's senior unsecured debt (EUR 60m), allowing a one-notch uplift on the company's issuer rating. We therefore affirm the debt class rating of B+.

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