Duna House Holding Nyrt.
Hungary, Business Services

SCOPE BB- STABLE

Corporate profile

Publicly listed Duna House Holding Nyrt. was founded in 1998 in Hungary and offers real estate and loan brokerage as well as other real estate transaction-related services. It operates an integrated platform consisting of an online real estate marketplace together with a national network of both self-operated and franchised physical offices. The group is also active in residential property developments and has – in addition to its own property investments – established Hungary's first public, open-end residential property asset management fund.

Key metrics

		Scope estimates		
Scope credit ratios	**2019**	**2020E**	**2021E**	**2022E**
EBITDA/interest cover (x)	23.1x	8.0x	7.2x	7.5x
Scope-adjusted debt (SaD)/EBITDA	3.2x	5.5x	1.2x	1.0x
Free operating cash flow/SaD	-30%	-5%	199%	61%
Scope-adjusted free funds from operations/SaD	25%	22%	67%	73%

Rating rationale

Scope Ratings has today assigned a first-time issuer rating of BB-/Stable to Hungarian real estate and loan brokerage provider Duna House Holding Nyrt. All senior unsecured debt including the planned HUF 6.6bn bond has been assigned a debt instrument rating of BB-.

The business risk profile (assessed at BB-) is mainly driven by the group's position as one of the leading real estate and loan brokerage firms in its home market of Hungary as well as in Poland. The group operates an integrated real estate and loan brokerage business consisting of a network of physical offices supported by an online platform. Some diversification arises from operating profits being generated via four different segments: real estate and loan brokerage, franchise fees, own real estate developments, and asset management fees. Moreover, the group is active in three different markets in Central and Eastern Europe (CEE) and we expect further expansion in this region. Client base granularity is very high since the group operates in retail, which entails few recurring transactions from individual clients.

The issuer's business risk profile is constrained by the small absolute size of its business and the relatively fragmented markets in which it operates. We also expect EBITDA margins to weaken to roughly between 12% and 14% in our base case forecast due to the fierce competition in (online) real estate brokerage as well as uncertainties caused by the Covid-19 pandemic.

The financial risk profile (assessed as BB) is driven by the issuer's strong interest coverage of more than 7.0x on a sustained basis, both historically and going forward, as well as the relatively low financial leverage (Scope-adjusted debt/EBITDA), expected to stay at around between 1.0x and 1.2x after hitting a temporary peak during 2019-2020. However, the financial risk profile is constrained by the currently high cash flow volatility caused by the issuer's real estate development activities and its high dependency on real estate transactions in the CEE market. Liquidity is adequate as a large portion of cash outflows expected under our base case is discretionary.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	BB-

Analyst

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Related Methodology

Corporate Rating Methodology
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Outlook and rating-change drivers

The Outlook is Stable and incorporates our view on the stability of the issuer's core business of real estate and loan brokerage and its ability to generate cash. Moreover, the Stable Outlook reflects our expectation that the issuer will be able to return its financial leverage to below 2.0x after the anticipated temporary spike in 2019 and 2020 caused by the Forest Hill development.

A positive rating action is a remote scenario at this point and would require the issuer to significantly expand in terms of size, market shares and geographical outreach while maintaining financial metrics along our expectations.

A negative rating action could be warranted if financial leverage increased to around 4.0x on a sustained basis. This could be caused by a slump in revenues due to the weakness in the overall transaction market.

Long-term debt ratings

We have assigned an instrument rating of BB- to all of the issuer's senior unsecured debt, reflecting the debt's subordinate ranking to secured bank financing. While we have computed a 'superior recovery' (70%-90%) for the issuer's outstanding senior unsecured debt in a hypothetical default scenario as of year-end 2022E based on a distressed liquidation value, we have not adjusted the debt instrument rating on this basis due to the material uncertainty regarding the group's asset values upon a hypothetical liquidation. As a result, senior unsecured debt is rated at the same level as the issuer rating.

Our base case financial forecast also incorporates the successful placement in Q3 2020 of a HUF 6.6bn senior unsecured bond under the Hungarian National Bank's Bond Funding for Growth Scheme. We expect the bond to have a 10-year tenor, a 3.5% coupon, 0% amortisation from 2020 to 2025, and 20% amortisation each year from 2026 to 2030. The proceeds are earmarked for the acquisition of companies in a volume of around HUF 3bn in its core segment in the CEE region as well as for the repayment of existing financial debt.

Rating drivers

Positive rating drivers	Negative rating drivers
• Strong market position in CEE real estate and loan brokerage (first in Hungary and Poland) • High organic revenue growth • Asset-light business model; hence limited financial debt and moderate financial leverage • Diversified among several real estate-related services and countries; high customer granularity	• Strong dependency on general transaction dynamics in the CEE real estate markets with limited non-transaction-based recurring revenue • Fierce competition in (online) real estate brokerage • Execution and integration risks posed by international expansion via M&A

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Significant expansion in terms of size and market shares while maintaining financial metrics along with Scope’s expectations	• Financial leverage of around 4.0x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020E**	**2021E**
Scope-adjusted EBITDA/interest cover (x)	46.6x	23.1x	8.0x	7.2x
Scope-adjusted debt (SaD)/EBITDA (x)	1.0x	3.2x	5.5x	1.2x
Free operating cash flow/SaD	22%	-30%	-5%	199%
Funds from operations/SaD	90%	25%	22%	67%
Scope-adjusted EBITDA in HUF ‘000	**2018**	**2019**	**2020E**	**2021E**
EBITDA	2,188,367	1,466,236	1,026,395	1,838,650
Operating lease payments in respective year	140,000	0	0	0
Scope-adjusted EBITDA	**2,328,367**	**1,466,236**	**1,026,395**	**1,838,650**
Scope-adjusted funds from operations in HUF ‘000	**2018**	**2019**	**2020E**	**2021E**
Scope-adjusted EBITDA	2,328,367	1,466,236	1,026,395	1,838,650
less: cash interest as per cash flow statement	-49,965	-63,497	-128,917	-253,969
less: cash tax paid as per cash flow statement	-310,541	-250,425	-224,988	-288,566
add: dividends received from shareholdings	37,278	51,543	554,097	149,650
Scope-adjusted funds from operations	**2,005,139**	**1,203,857**	**1,226,588**	**1,445,766**
Scope-adjusted debt in HUF ‘000	**2018**	**2019**	**2020E**	**2021E**
Reported gross financial debt	2,982,259	6,380,810	7,880,867	6,838,451
less: cash, cash equivalents	-1,509,613	-2,525,673	-2,823,265	-4,980,826
add: restricted cash	752,694	897,947	600,000	300,000
Scope-adjusted debt	**2,225,340**	**4,753,084**	**5,657,602**	**2,157,625**

Business risk profile: BB

Industry risk of BB+, driven by core services and additional development risks

In recent years, two-thirds of EBITDA were generated via various business services, mainly through real estate and loan brokerage fees as well as franchise fees. Hence, we apply a blended industry risk approach with a 66% weighting of the industry risk for business services. The remaining third of EBITDA was generated via real estate developments, thus allowing for a 33% weighted industry risk of B for that segment.

Competitive position

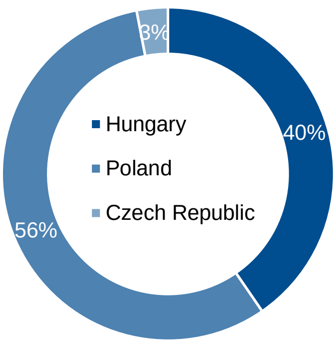
Leading market positions in Hungary and Poland

The issuer's market position is credit-positive. The group has the largest platform in Poland and one of the two leading real estate brokerage platforms in Hungary together with competitor Otthon Centrum, whose size is similar to the issuer's in terms of listings, offices and salespeople. The issuer's relative market shares peaked during a weak phase in the real estate market during 2011-2015. Its current market share in its home market of Hungary ranges from 5% to 8%, both in real estate and loan brokerage. Market shares in real estate development and asset management are negligible in our view.

Consolidation might benefit larger players in the medium term

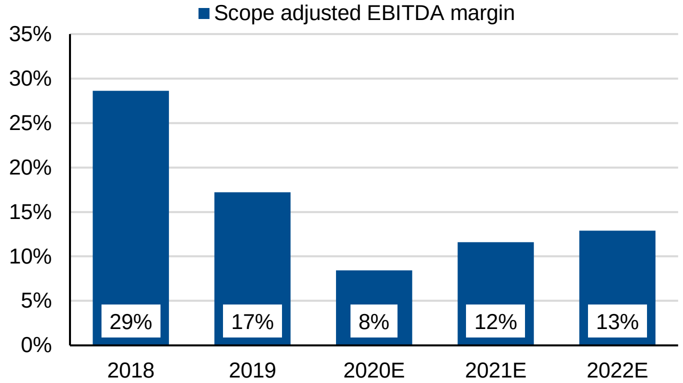
The issuer's single-digit market shares despite its market leadership shows the relative fragmentation of its markets. This implies little pricing power but also allows for a potential increase in market share going forward if the real estate brokerage sector continues its consolidation. With the issuer's strategy to support its leading network of physical offices with strong online integration and a web-based platform, we deem it likely that the issuer as well as competitor Otthon Centrum will gain further market share in the future.

Figure 1: Geographical diversification



Sources: Duna House Holding, Scope

Figure 2: Profitability



Sources: Duna House Holding, Scope

The lion's share of the issuer's revenues is generated in Hungary and Poland. A single-digit share of external revenue is from the Czech market and management is planning to grow via acquisitions in the CEE real estate and loan brokerage markets. Geographical diversification is thus spread across but limited to the CEE region.

Customer granularity is very high with the issuer targeting retail brokerage clients and real estate buyers.

In terms of segments, we consider revenues and operating income to be diversified thanks to the different revenue streams from:

1. Real estate brokerage (physical presence and online platform)
2. Loan brokerage
3. Franchise fees
4. Own real estate developments (to be terminated after 2021)
5. Asset management (small EUR 12m real estate fund at this point)

Group operating profitability has ranged from around 15% to 30% in recent years, with fluctuations caused mainly by changes in the segment revenue mix. The group's EBITDA margin has averaged 25%-30% on past real estate developments but is lower on its core brokerage business at 15%-20%. The fast-growing share of loan brokerage fees had the highest EBITDA margins of more than 30% recently (Q1 2020).

We expect at least a temporary drop in profitability due to the Covid-19-induced slowdown in transaction volumes in the first half of 2020E and margins to be somewhat lower going forward than in the past. Our opinion is based on:

1. Increasing and sustained price competition in (online/physical) real estate brokerage
2. Integration costs of the new businesses to be acquired
3. The planned withdrawal from the relatively high-margin development business

Positive aspects going forward include the opportunity for the issuer, as one of the two market leaders, to further strengthen its market share if industry consolidation accelerates, which would mitigate price pressure in the medium term.

While we expect the core brokerage business to continue to grow organically and to increase in market share in Hungary and Poland for the coming years, thanks to ongoing industry consolidation, we also expect a reduction in the group's share of own real estate developments after the sales for its current project are completed in 2021. This will weigh on profitability and diversification but most likely lead to improvements in its industry risk and the volatility of revenues and cash flows, as development project profits were usually clustered around their respective completion date.

Financial risk profile: BB

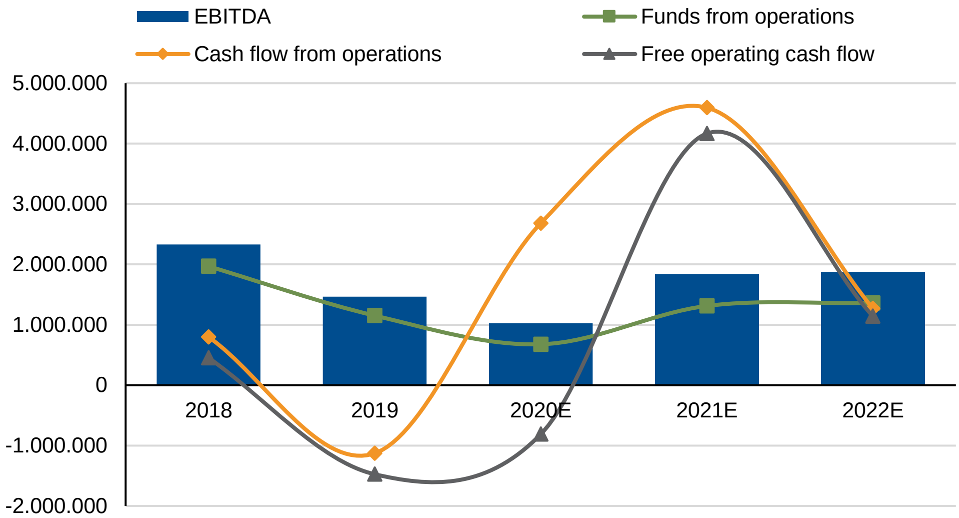
Our rating scenario assumes the following:

1. External revenue growth at below the levels in the issuer's latest business plan as of July 2020 (-10% for 2020E and -5% for 2021E)
2. Increase in all operating costs (cost of goods sold, personnel and other expenses) by 3% each year, above the levels in the issuer's business plan for 2020E, 2021E and 2022E
3. Average cost of financial debt of 3.7%, versus 3.5% as per the issuer's planning
4. Successful placement of a HUF 6.6bn senior unsecured bond with a 3.5% coupon in Q3 2020; we expect the bond to have 0% amortisation from 2020 to 2025 and 20% of amortisation payments per year during 2026-2030
5. Cash outflows of around HUF 3bn-4bn in 2020E for strategic M&A transactions within the core segments of real estate and/or loan brokerage and HUF 4bn-5bn for the repayment of existing financial debt
6. Complete sale and hand-over of all remaining units of real estate development project Forest Hill in 2020 and 2021 at unchanged sales prices and the complete repayment of all related project financing
7. No additional development projects apart from Forest Hill after 2021

Free operating cash flow expected to be smoother after completion of current development project

Financial leverage spiked in 2019 and 2020E, due to the issuer's investment into a real estate development (2019-2021E) and the planned debt-financed acquisition of 1-2 targets within its core segment of real estate and loan brokerage. Going forward, we anticipate a return to a moderate leverage of around 1.0x, even on the basis of lower operating profitability.

Figure 3: Cash flow overview (HUF '000), Scope-adjusted figures

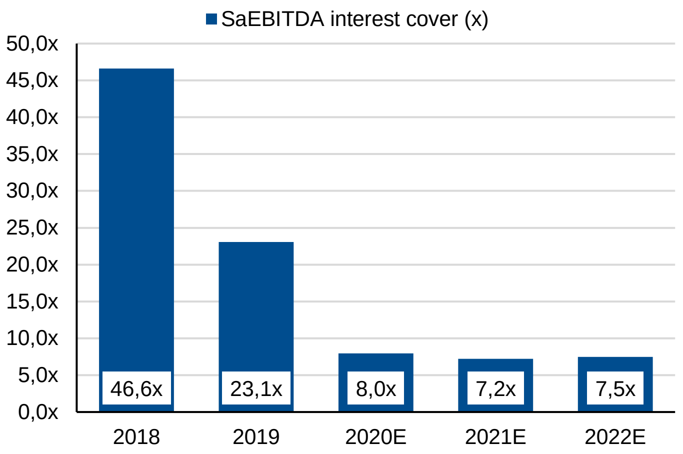


Sources: Duna House Holding, Scope

While EBITDA and free funds from operations have been relatively stable, the volatility of free operating cash flows has been elevated due to the group's real estate development activities. Most recently, the start of the Forest Hill development in 2019 resulted in large cash outflows and we expect more significant cash outflows for the acquisition planned for 2020. However, we expect large cash inflows in 2021 from the sale of all units under the Forest Hill project.

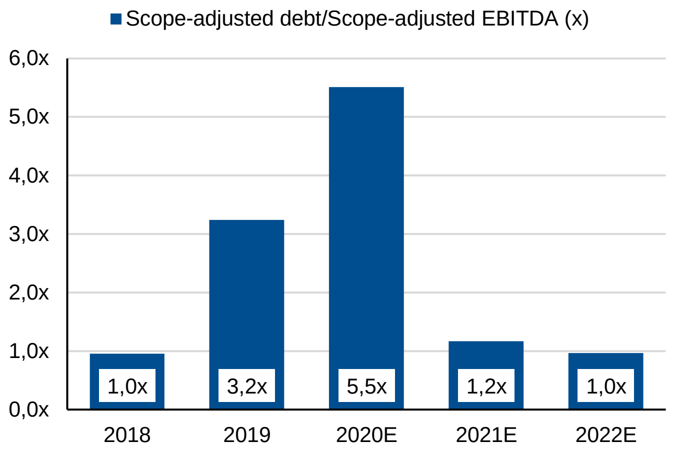
Our current financial base case does not include further real estate development activities after 2021, meaning cash flow is expected become more smooth going forward. We nevertheless point out that the group has a remaining land bank, which creates the potential for further future developments.

Figure 4: Scope-adjusted EBITDA interest cover



Sources: Duna House Holding, Scope estimates

Figure 5: Leverage (SaD/EBITDA)



Sources: Duna House Holding, Scope estimates

Interest cover has been at very comfortable levels and is expected to stay robust thanks to the issuer's asset- and debt-light business model.

Robust interest coverage

Liquidity is adequate. The company's unrestricted cash balance and free operating cash flows excluding discretionary spending cover short-term debt repayment needs by well over 110% going forward.

Liquidity: adequate

Figure 6: Liquidity

in HUF m	2019	2020E	2021E
Short-term debt (t-1)	-3,038,537	-361,338	-361,338
Unrestricted cash (t-1)	1,509,613	2,525,673	2,823,265
Free operating cash flow excl. discretionary spending (t)	-1,199,058	2,531,988	4,642,697
Liquidity (internal)	0.1x	14.0x	20.7x
Open committed credit lines (t)	1,378,000	1,338,000	1,338,000
Liquidity (internal and external)	**0.6x**	**17.7x**	**24.4x**

Source: Scope estimates

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