Wingholding Zrt.
Hungary, Real Estate

SCOPE B+ STABLE

Corporate profile

Wingholding Zrt. (Wing) is one of the largest privately owned real estate groups in Hungary. It has investment activities, subsidiaries specialising in real estate services, and a development pipeline. Wing is one of Hungary's leading developers of office space, residential and logistics properties, with previous projects including industrial properties, hotels and special-use properties. In 2019, the company acquired a majority stake in Polish office and residential real estate developer ECHO Development S.A. and owned 66% of the company as of May 2020. The group also offers integrated real estate services through its subsidiaries: NEO Property Services Zrt. provides the group's property and facility management; Aspectus Architect plans, designs and organises permits for the group's developments; and Gladiator manages Hungarian real estate funds.

Key metrics

			Scope estimates	
Scope credit ratios	2018	2019	2020F	2021F
EBITDA/interest cover (x)	6.4x	4.6x	1.9x	2.0x
Scope-adjusted debt (SaD)/EBITDA (x)	4.8x	13.9x	7.7x	12.3x
Loan-to-value (%)	46%	63%	69%	71%
Free operating cash flow/SaD (%)	(-) FOCF	(-) FOCF	19%	(-) FOCF

Rating rationale

Scope Ratings has today downgraded the issuer rating of Hungarian real estate group Wingholding Zrt. to B+/Stable from BB/Stable. This follows the recent partly debt-financed acquisition of Polish real estate company ECHO Development S.A. and a revised financial forecast in the light of further expansion plans in a challenging market environment. Senior unsecured debt was downgraded to BB- from BBB-.

The downgrade is mainly driven by the substantial increase in indebtedness compared to our previous assessment. The increase was due to the partly debt-financed acquisition of publicly listed Polish real estate developer ECHO Development S.A. in H2 2019 and the anticipated further expansion of the property portfolio in H1 2020E. The latter would be financed by the planned HUF 60bn senior unsecured bond issue under the Bond Funding for Growth Scheme of the Hungarian National Bank (MNB).

Our assessment of the business risk profile remains at BB. Our view of the issuer's market position and asset quality also has not changed. The improved geographical diversification as well as the increasing granularity of clients are credit-positive; however, the positive effects will be offset by the lower profitability that accompanies a higher development volume, as this typically weighs on EBITDA margins due to the associated increase in revenue.

Looking at the financial risk profile, we have lowered our assessment to B+ from BB+ as a result of substantially increased leverage. Our new base case includes a higher loan-to-value (LTV) ratio of above 60% for the next two business years. This follows the LTV of below 50% until year-end 2018 (based on property market values) and c. 63% as of year-end 2019.

Ratings & Outlook

Corporate ratings	B+/Stable
Short-term rating	-
Senior unsecured rating	BB-

Analysts

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Related Methodologies

Corporate Rating Methodology, January 2020

Rating Methodology European Real Estate Corporates February 2020

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Outlook and rating-change drivers

The Stable Outlook is based on our revised forecast, which assumes the continued expansion of the issuer's investment property and development portfolios. This should result in negative free operating cash flows and increased debt, which, however, should be balanced by even higher recurring cash flows from rents and improved diversification. Leverage as measured by LTV is anticipated to stay above 60% for the next two business years.

A negative rating action may be warranted if LTV reached around 80% on a sustained basis and/or the business risk profile weakened. An increase in LTV could be triggered by market value declines owing to lower rental income or weaker sentiment in Hungary's real estate market.

A positive rating action is possible if the issuer managed to return the LTV ratio to below 60% on a sustained basis while keeping sufficient levels of interest coverage from recurring EBITDA.

Long-term and short-term debt ratings

Our base case assumes the successful placement of a HUF 60bn senior unsecured corporate bond, with a seven-year bullet maturity and an interest rate of c. 4%, under the MNB Bond Funding for Growth Scheme.

Based on our revised financial forecast, which considers 2019 preliminary results and the anticipated further portfolio expansion financed by debt, we have calculated a lower, but still above-average, recovery rate for senior unsecured debt holders in a hypothetical liquidation scenario in 2022E. Senior unsecured creditors benefit from an above-average unencumbered asset ratio of more than 2.5x going forward. We therefore rate senior unsecured debt at BB-, one notch above the issuer rating.

Rating drivers

Positive rating drivers	Negative rating drivers
• Mixed commercial portfolio with good tenant quality, mostly in Budapest • Leading market position in Hungary with experienced management and long track record of more than 20 years • Good diversification by asset classes and tenants	• High leverage after ECHO Development S.A. acquisition and debt-financed portfolio expansion in 2019/20E • Hungarian office property market less liquid and more volatile than western European core office markets • Added risks from expansion of development business • Limited scale compared to western European peers

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• LTV of less than 60% on a sustained basis while keeping sufficient levels of interest coverage from recurring EBITDA	• LTV of more than 80% on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019P**	**2020F**	**2021F**
EBITDA/interest cover (x)	6.4x	4.6x	1.9x	2.0x
Scope-adjusted debt (SaD)/EBITDA	4.8x	13.9x	7.7x	12.3x
LTV (%)	46%	63%	69%	71%
Free operating cash flow/SaD	(-) FOCF	(-) FOCF	19%	(-) FOCF
Scope-adjusted EBITDA in EUR m	2018	**2019P**	2020F	2021F
EBITDA	21,611	21,745	41,570	33,477
Operating lease payments in respective year	188	326	698	643
Other	0	0	0	0
Scope-adjusted EBITDA	21,799	22,071	42,268	34,120
Scope-adjusted funds from operations in EUR m	2018	**2019P**	2020F	2021F
Scope-adjusted EBITDA	21,799	22,071	42,268	34,120
less: (net) cash interest as per cash flow statement	-3,395	-4,790	-22,269	-17,411
less: cash tax paid as per cash flow statement	-537	-1,149	-2,845	-6,023
add: dividends received from shareholdings	565	7,150	3,659	1,206
Scope-adjusted funds from operations	18,432	34,465	20,812	11,893
Scope-adjusted debt in EUR m	2018	**2019P**	2020F	2021F
Reported gross financial debt	137,036	387,806	462,092	494,392
less: cash and cash equivalents	38,594	87,233	141,929	82,239
Add: guarantees	6,506	6,506	6,506	6,506
Scope-adjusted debt	105,594	307,726	327,316	419,306

Business risk profile

Industry risk profile

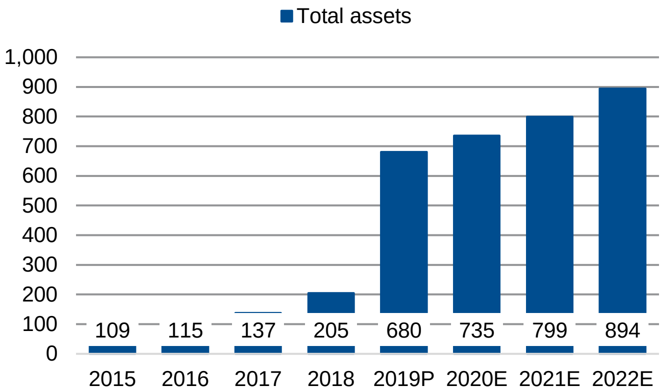
Industry risk profile remains at BB-

The company's industry risk is primarily driven by its commercial rental portfolio, which is its largest source of recurring operating income. In addition, the group's industry risk profile includes an exposure to development projects. Since 2018, the group has added residential projects to its development pipeline, which will contribute an increasing share of revenues going forward. The recent acquisition of Poland-based ECHO Development S.A. has also added to the absolute volume of development business. However, the buy-to-hold investment portfolio is also being expanded at the same time, which will lead to comparable segment split going forward. We have therefore maintained the industry risk profile at BB-.

Competitive position

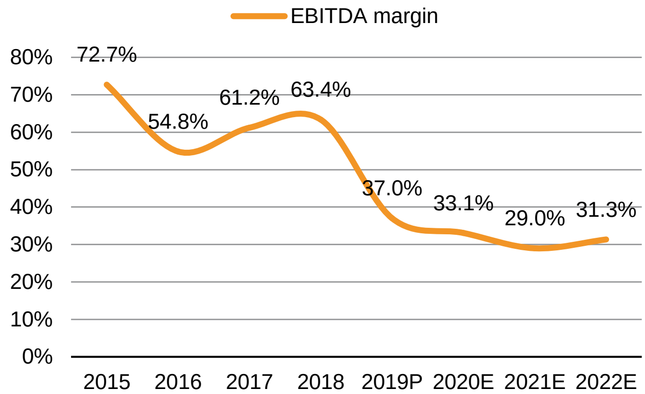
With around EUR 1.5bn in assets, Wing has a leading market position in Hungary, but is small compared with western European peers. Asset quality and the main characteristics of the property portfolio remain the same.

Figure 1: Total assets (HUF bn)



Source: Scope estimates

Figure 2: EBITDA margin (%)



Source: Scope estimates

Increasing development activities will weigh on EBITDA margin

The improved geographical diversification and increasing granularity of clients are credit positive. However, the positive effects will be offset by the lower profitability that accompanies a higher development volume, as this typically weighs on EBITDA margins due to the associated increase in revenue.

All in all, the issuer's business risk profile remains at BB.

Financial risk profile

Free operating cash flow expected to stay negative due for the time being as expansion is ongoing

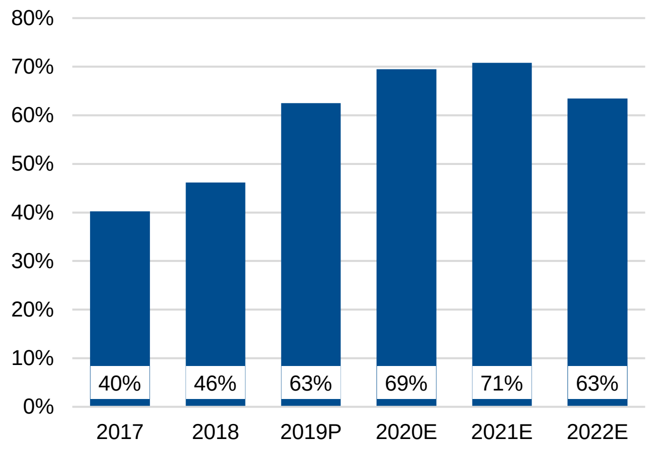
The massive expansion plans will lead to ongoing negative free operating cash flow, except for in 2020E, during which cash flows from the ongoing expansion will be offset by those from a large asset disposal. Nevertheless, we point out this capex is mostly discretionary as the company will only build larger built-to-suit commercial projects if a long-term, creditworthy tenant is interested *and* financing for the project is available. Residential developments only start once the pre-sale/reservation ratio is sufficient, at c. 40% in the past.

Moreover, the group uses its land bank to manage capex. Hence, in the event of a slowdown in operating cash flows or a deterioration in business prospects, the company can still realise further projects without having to acquire land.

Liquidity deemed adequate, also taking discretionary capex into account

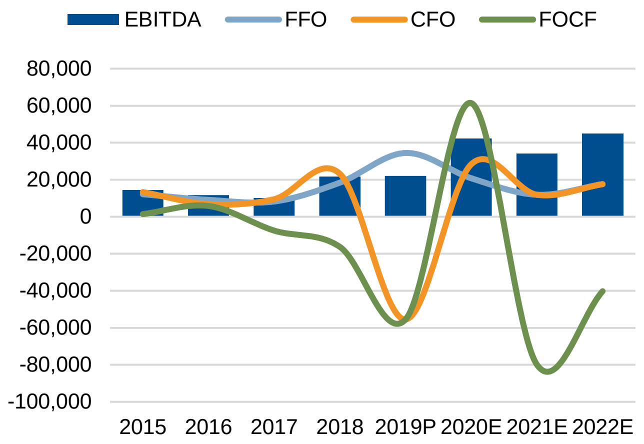
In our view, this gives part of the planned capex a discretionary character and leads to an assessment of adequate liquidity.

Figure 3: Loan-to-value ratio



Source: Scope estimates

Figure 4: Cash flow overview



Source: Scope

LTV increased substantially after the acquisition of ECHO Development S.A., effective as of 2019, and we expect the level to remain above 60% for some time.

LTV expected to stay above 60% on a sustained basis

Under conservative assumptions, we forecast EBITDA/interest coverage to drop to c. 2.0x over the next two business years if the anticipated asset purchases and the HUF 60bn corporate bond issue are successfully executed. This translates into a B+ financial risk profile.

Outlook

The Stable Outlook is based on our revised forecast, which assumes the continued expansion of the issuer’s investment property and development portfolios. This should result in negative free operating cash flows and increased debt, which, however, should be balanced by even higher recurring cash flows from rents and improved diversification. Leverage as measured by LTV is anticipated to stay above 60% for the next two business years.

A negative rating action may be warranted if LTV reached around 80% on a sustained basis and/or the business risk profile weakened. An increase in LTV could be triggered by market value declines owing to lower rental income or weaker sentiment in Hungary’s real estate market.

A positive rating action is possible if the issuer managed to return the LTV ratio to below 60% on a sustained basis while keeping sufficient levels of interest coverage from recurring EBITDA.

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