SunDell Estate Nyrt.
Hungary, Real Estate

SCOPE | B STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	2.6x	4.4x	5.5x	4.2x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	20.9x	5.6x	4.8x	5.9x
Scope-adjusted loan/value ratio (LTV)	28%	31%	31%	37%

Rating rationale

SunDell has developed more than HUF 50bn (EUR 130m) in residential projects in the past five years in Hungary. The company grew significantly while keeping a moderate leverage with a Scope-adjusted loan/value (LTV) ratio of about 30% and no secured debt.

Currently, the issuer has a high exposure to the cyclicality of the Budapest residential real estate market, with most of its revenues directly dependent on its development activities, i.e. sales of units.

The company is planning gradual build-up of recurring revenues from the rental portfolio, which will smooth out future cash flows, albeit still rather slowly. Recent equity investment of MFB Invest and Hiventures of HUF 9bn boost new development projects.

The small size of SunDell is leading to more volatile cash flows and limited economies of scale. The development pipeline with eight active projects is rather concentrated and has some cluster risk within Budapest.

Increasing construction prices and interest rates have been putting pressure on development margins and on demand. Pre-sale ratios will fall behind historical values.

Outlook and rating-change drivers

The Outlook for SunDell is Stable and incorporates the assumption of SaD/Scope-adjusted EBITDA of 4x-6x, Scope-adjusted EBITDA/interest cover of more than 4x, and the execution of sales at the expected prices on the growing project pipeline.

A positive rating action would require increased visibility of sales to beyond one year (likely expressed by a backlog of above 1x) or a substantial share of recurring EBITDA while credit metrics stay in line with our rating case.

A negative rating action might be warranted were the issuer to show Scope-adjusted interest cover moving towards 1.0x, SaD/Scope-adjusted EBITDA moving towards 15x or weaker liquidity. This could be caused by underperformance of its development projects, e.g. as a result of increasing input prices or demand shocks due to soaring inflation rates.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
24 Jun 2022	Affirmation	B/Stable
28 Jun 2021	Affirmation	B/Stable
18 May 2020	Initial rating	B/Stable

Ratings & Outlook

Issuer	B
Senior unsecured debt	B+

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Related Methodologies and Related Research

Corporate Rating Methodology; July 2021

European Real Estate Methodology; January 2022

Second party opinion – Green Bond Framework

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Track record of more than HUF 50bn (EUR 130m) in residential projects in the past 5 years in Hungary • Moderate leverage with a Scope-adjusted LTV of about 30% going forward • Gradual build-up of recurring revenues from rental portfolio smoothing future cash flows • Recent equity investment of MFB Invest and Hiventures of HUF 9bn for new development projects	• Small-sized company in a fragmented market leading to more volatile cash flows and limited economies of scale • Concentrated development pipeline (currently 8 active projects) with geographical cluster risk in Budapest • Currently high exposure to the cyclicality of the Budapest residential real estate market with most of revenues directly dependent on the company's development activities, i.e. sales of units • Increasing construction prices and interest rates put pressure on development margins and on demand

Positive rating-change drivers	Negative rating-change drivers
• Increased visibility of sales to beyond one year (likely expressed by a backlog of above 1x) • Substantial share of recurring EBITDA while credit metrics stay in line with rating case	• SaD/Scope-adjusted EBITDA moving to 15x • Scope-adjusted EBITDA interest cover deteriorating to 1.0x • Weakening liquidity

Corporate profile

SunDell is a Budapest-focused residential real estate developer with mainly mid-priced properties built for sale and for leasing purposes. During 2015-2019, two large projects totalling 274 apartments were developed in Levendula Park and Nerium Park, located in the Zugló district of Budapest. Between 2018-2022, SunDell has been continuing development in the Zugló district in Budapest, with 150+ flats completed in the Paskal Rose project and started development in Budapest District XIII in Csata utca with168 flats completed.

With two bond issuances the company started ambitious developments in Zugló with 450+ flats in Paskál Garden (over 85% completion rate) and 141 flats in Paskál Rose II (start of development).

The company has started development across Budapest in the affordable housing and premium housing segments (Zugló, Kodály Körönd, Hárshegy, etc), has building permits for several other locations in Budapest and is looking to diversify its operations across Hungary opportunistically.

Furthermore, SunDell acquired and leased out Mystery Hotel (5 stars, 82 rooms) and started commercial real estate leasing through its subsidiary Dessewffy Investments Kft.

SunDell is a stock-exchange listed real estate investment trust (REIT). The company's largest shareholder is the Piukovics family through several holding companies (ca. 43%). MFB Invest and Hiventures (two financial investor entities of the Hungarian Development Bank) invested HUF 9bn in 2022 in SunDell to boost its development activity and gained a 11.59% shareholding and a 4.97% shareholding, respectively.

Strategic partners of SunDell belonging to the Piukovics family's holding companies are GOPD Nyrt (main shareholder of SunDell developing projects until permitting and then selling to SunDell), Phoen Architect Ltd (design) and Dakota Építő Kft (general contractor).

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	2.6x	4.4x	5.5x	4.2x	7.1x
SaD/Scope-adjusted EBITDA	20.9x	5.6x	4.8x	5.9x	3.2x
LTV	28%	31%	31%	37%	32%
Scope-adjusted EBITDA in HUF m					
EBITDA	443	2,553	3,240	2,440	4,168
Scope-adjusted EBITDA	**443**	**2,553**	**3,240**	**2,440**	**4,168**
Funds from operations in HUF m					
Scope-adjusted EBITDA	443	2,553	3,240	2,440	4,168
less: (net) cash interest paid[1]	-169	-576	-585	-585	-585
less: cash tax paid per cash flow statement[2]	0	0	0	0	0
Funds from operations	**274**	**1,977**	**2,655**	**1,855**	**3,583**
Free operating cash flow in HUF m					
Funds from operations	274	1,977	2,655	1,855	3,583
Change in working capital	-5,723	-15,718	-3,369	11,230	-1,442
Non-operating cash flow[3]	1,986	12,207	-5,586	-8,005	201
less: capital expenditure (net)	-5,100	-834	-250	-500	-500
Free operating cash flow	**-8,564**	**-2,368**	**-6,550**	**4,580**	**1,842**
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-169	-576	-585	-585	-585
Net cash interest paid	**-169**	**-576**	**-585**	**-585**	**-585**
Net cash interest paid in HUF m					
Total Assets	35,093	48,676	52,261	43,605	44,384
less: cash and equivalents	-1,844	-2,502	-2,458	-5,038	-3,579
Scope-adjusted assets	**33,248**	**46,174**	**49,803**	**38,569**	**40,806**
Scope-adjusted debt in HUF m					
Reported gross financial debt	11,083	16,716	16,716	16,716	16,716
less: subordinated (hybrid) debt	0	0	0	0	0
less: cash and cash equivalents	-1,844	-2,502	-2,458	-5,038	-3,579
add: non-accessible cash	0	0	1,258	2,638	0
Scope-adjusted debt	**9,239**	**14,214**	**15,516**	**14,316**	**13,137**

[1] Company records interest as inventory cost, which was reclassed to this line.
[2] Tax exempt REIT
[3] Changes relate mainly to advances received until 2021 are gradually downsized due to lower expected pre-sale rates and buildup of investment portfolio for lease.

Table of Contents

Environmental, social and governance (ESG) profile[4]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Leaf system

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Commitment to energy-efficient housing development

In Hungary, the government focuses on energy-efficient housing and incentivises it by preferential interest rates for mortgage loans. The latest residential green housing mortgage loan programme (*Zöld Otthon Program*) closed in Q2 2022, with a 2.5% fixed interest rate for up to 25 years. While there are no new programmes in sight, the market expects this area to be incentivised in the future as well.

SunDell is an early complier for developing environmentally-conscious and sustainable residential buildings with low energy consumption, low water usage and high green area. When SunDell constructs new buildings, it is guaranteed that these properties achieve at least the Energy Performance Certificate (EPC) category 'BB' implemented in the Hungarian law, which is considered as a nearly zero energy building (nZEB).

The company has obtained a green bond second party opinion for its latest issued bond.

[4] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B

Industry risk profile: BB

As a residential real estate developer, SunDell is exposed to the highly cyclical real estate industry with medium barriers to entry and low substitution risk. Revenues and EBITDA arising from letting out properties are limited to below 10% of SunDell's activities.

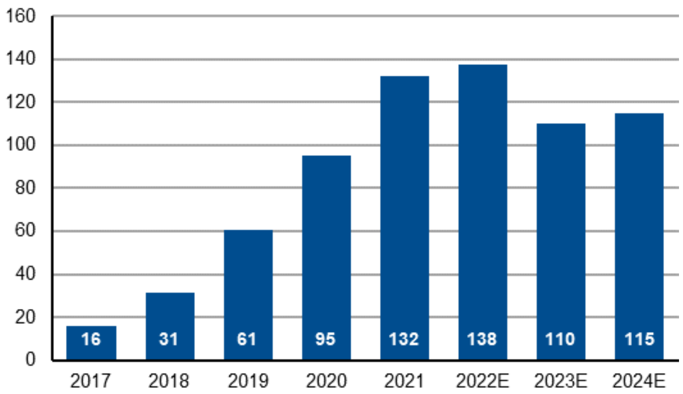
We view real estate development as the riskiest sub-segment in real estate and assign an industry risk of BB for homebuilder companies, giving credit for housing being a basic need.

Emerging company in a highly fragmented market

With a total asset value of c. EUR 60m at its initial rating in 2019 and doubling to EUR 132m by the end of 2021, SunDell is an emerging real estate developer in a highly fragmented market. With its large developments in Zugló, Budapest, the company grew significantly in the number of residential apartments developed, followed by expansion to several areas of Budapest. The company has a good track record of EUR 130m of sold apartments in the past 5 years, which shows a large improvement compared to EUR 35m from 2015-2019. We still see the company as small from a European context. Furthermore, cluster risk remains rather high with a handful of new projects, many of them in initial phase.

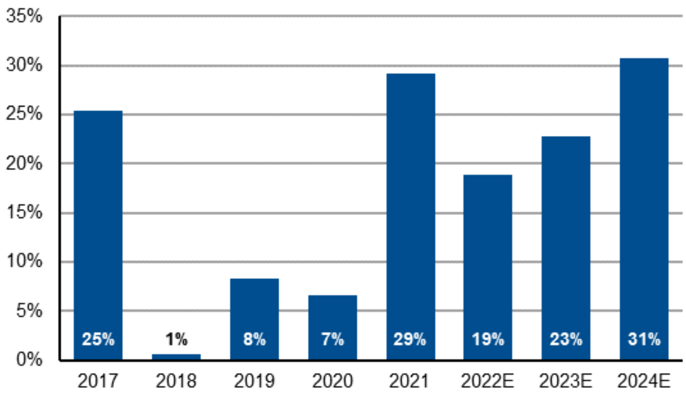
SunDell's main focus remains mid-priced residential real estate units in Budapest and opportunistic premium projects such as the Kodály Köröndi and Hárshegy developments.

Figure 1: Scope-adjusted total assets (HUF bn)



Sources: SunDell, Scope estimates

Figure 2: Scope-adjusted EBITDA margin



Sources: SunDell, Scope (estimates)

Clustered pipeline with strong Budapest exposure

Geographical distribution of the company's revenues remains rather weak, given the issuer's main focus on the Budapest residential market, however it improved in the past two years.

The price segment has been diversified from affordable housing to mid and premium segments and locations within Budapest have also been diversified. Expansion to other cities has started opportunistically.

Historically, pre-sales were high in the case of mass-market residential condos. This was boosted by the cheap retail financing in early 2022. Future pre-sales will be limited at early stages of construction and are expected to ramp up in the second half of the construction phase. This entails some risk as new developments will be more speculative compared to previous projects. However, this is mitigated by the fact that SunDell will be able to price the new condos based on actual costs, but these are hard to forecast in the existing volatile construction price environment.

The lease portfolio (hotel and offices) accounted for 18% of assets in 2021. SunDell intends to keep half of one project as rented out properties, as a start of a 100+

apartment lease portfolio after 2024. The economic age of the lease portfolio is very good as the hotel underwent a full reconstruction just a couple of years back. The hotel is leased for 5 years with an extension option. The existing lease portfolio is rather small and diversification will come only in a couple of years.

SunDell went into a period of high expansion during 2018-2020 with volatile EBITDA margin. SunDell went under a three-way merger, stock listing and REIT conversion during this period.

We expect EBITDA margins to stabilize in the range of 20% to 30% depending on housing completions. The lower end already entails the increased construction material prices by end of last year, which we assume will remain volatile in the next two years, with stabilisation from 2024 onwards.

As the number of projects has increased significantly and deliveries have sped up, we see increased albeit still rather low operating profitability with medium volatility in the projected period. Good double-digit internal rates of return support the profitability assessment.

Financial risk profile: BB+

Assumptions

- Strong revenues and EBITDA contribution from flats sold in 2022 (from Jan-May) with cheap green retail mortgage financing for the Paskál Garden project (strong demand due to end of incentivised mortgage loan programme).
- Delays in handover (3-6 months) results in delayed EBITDA and cash flows. SunDell realises revenue on sold apartments when possession is transferred to the buyer via the handover of the apartment.
- No advance payments collected from customers results in lower operating cash flow and lower pre-sale rates going forward.
- Equity investments of HUF 9bn included as they are underwritten.
- No short-term debt. Long-term debt consists of the two issued bonds (HUF 11.0bn and HUF 5.5bn) at 3.25% and 3.65% p.a. fixed coupon, respectively.
- No new significant interest-bearing debt and no significant off-balance sheet obligations (except for minor guarantees and obligations).
- High dividend distribution with up to 100% payout ratio of yearly profit after tax
- Netting of cash was applied only for the funds put on escrow for debt service

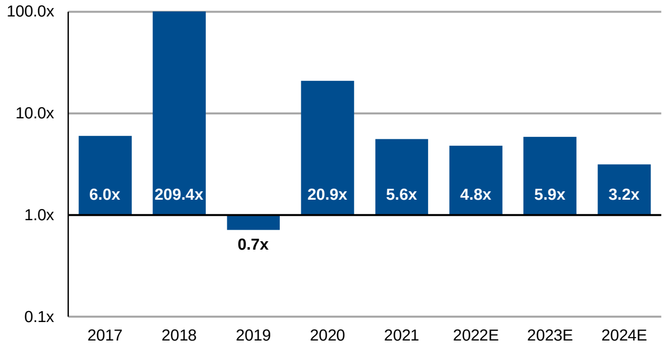
Improved, low leverage for a developer

At the end of 2021, the company's LTV stood at 31% while SaD/Scope-adjusted EBITDA was at 5.6x. Going forward, the LTV ratio is forecasted to increase to a range of 30% to 40% as the investment portfolio for leases develops and SaD/Scope-adjusted EBITDA to between 5x and 6x, which is rather conservative for a developer and leaves enough headroom for the company to either lease properties at sufficient cap rates to cover financing costs and tackle a moderate downturn of the properties' fair values, or tap external financing sources to cover construction costs if needed.

SunDell plans to tackle rising construction costs with somewhat slower pre-sale activity, which makes investments more speculative. This is mitigated by the construction of energy-efficient housing, which had been subsidised on both the construction and the demand side. We expect incentives in the future as well (ESG credit-positive factor).

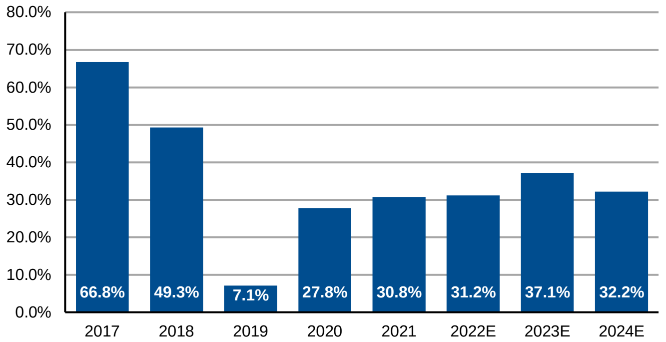
Recent equity investments help keep leverage at low levels while boosting the project pipeline of properties for sale and for the investment portfolio.

Figure 3: SaD/Scope-adjusted EBITDA



Sources: SunDell, Scope estimates

Figure 4: Scope-adjusted loan/value ratio

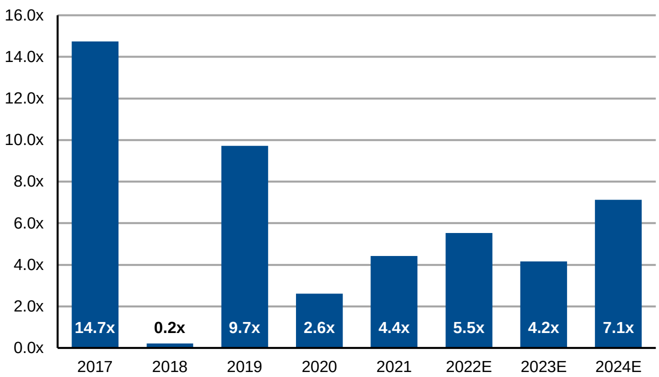


Sources: SunDell, Scope estimates

Strong interest cover expected to remain

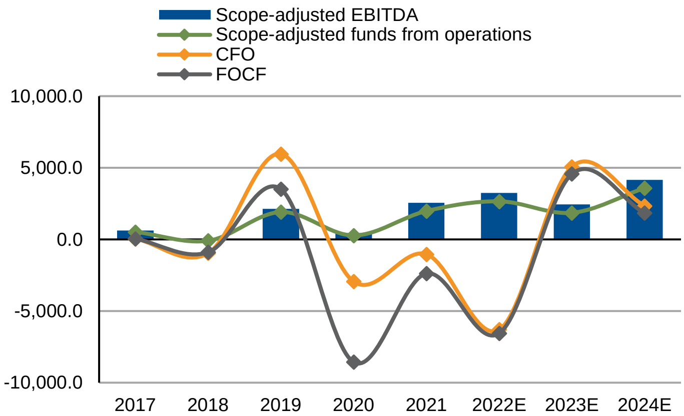
Scope-adjusted EBITDA interest cover is strong with 4.4x at YE 2021 as shown in Figure 5, and we expect it to stay at above 4x due to the strong cash flow generation. The contracted fixed interest rate debt protects cash flows in the current environment in Hungary where interest rates are rising strongly.

Figure 5: Scope-adjusted EBITDA/interest cover



Sources: SunDell, Scope estimates

Figure 6: Cash flows (HUF m)



Sources: SunDell, Scope estimates

Adequate liquidity

SunDell has no short-term debt. Liquidity is adequate based on high cash amounts on the balance sheet, the recent equity injection and expected cash flows.

Balance in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	2,502	2,458	5,038
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	-6,550	4,580	1,842
Short-term debt (t-1)	-	-	-
Coverage	**n/a**	**n/a**	**n/a**

Supplementary rating drivers: +/- 0 notches

Financial policy is neutral. We take note of the existing high dividend distribution plans as a REIT, which is mitigated by the low leverage and recent decision to start certain new equity-financed projects.

There are no guarantees issued towards the rated entity and we do not have visibility on the ability of the ultimate beneficiary owners to support the company. Recent equity injection was done by third parties, which are financial institutions from whom we do not assume further support. We therefore do not incorporate any adjustment for parent support.

SunDell fully owns all project SPVs, and all legal entities are incorporated in Hungary.

Auditor was changed in 2021 to PwC (from a tier 3 auditor) and the real estate valuer to Colliers (from a tier 3 valuer).

No notching is given on peer group.

Long-term debt ratings

Senior unsecured debt rating: B+

SunDell has issued two senior unsecured bonds totalling HUF 16.5bn, which will start amortising in 2025 and 2026, respectively, and refinanced all other outstanding bank debt. We assumed a hypothetical default scenario for the year 2023 and applied reasonable discounts on the company's asset base, resulting in an 'above-average' recovery expectation.

This translates into a B+ debt class rating for senior unsecured debt, one notch above the issuer rating.

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