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Research Update:

Neinor Homes S.A. Upgraded To 'B+' On Lower Leverage; Outlook Stable

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Rating Action Overview

- Following the successful integration of Quabit, residential homebuilder Neinor Homes S.A. delivered 3,038 units in 2021 and generated S&P Global Ratings-adjusted EBITDA of €139.2 million and about €206 million in free operating cash flow, reducing its adjusted gross debt to EBITDA to less than 5x, below our previous expectations.
- We understand Neinor has already presold 80% of its 2022 deliveries, supporting cash flow visibility, and we expect the company will sustain adjusted debt to EBITDA below 5.0x going forward.
- We raised the issuer credit rating on Neinor to 'B+' from 'B' and the issue rating on the senior secured notes to 'BB-' from 'B+'.
- The stable outlook reflects our expectation that Neinor will continue to benefit from sustained demand for residential housing in Spain and could withstand any potential impact from the current inflationary environment.

Rating Action Rationale

Neinor's leverage decreased beyond our previous forecasts in 2021 and we expect the company to maintain it at this level. Our rating action reflects the company's reduction in adjusted debt to EBITDA to less than 5x in 2021 while maintaining solid EBITDA interest coverage of above 5.0x. The company sold 3,038 units in 2021 versus 1,603 units in 2020 (representing a 90% increase), boosting its EBITDA and cash flow base. We understand the company has already presold 80% of its total 2022 deliveries and 37% of 2023 deliveries are secured, further increasing future cash flow visibility and predictability. In addition, the company invested about €550 million in land, bringing its total landbank potential to 17,000 units, including 9,000 units under active development (build-to-sell [BTS] and build-to-rent [BTR]). This supports visibility over future deliveries. We have updated our forecasts and now expect the company to maintain adjusted gross debt to EBITDA below 5.0x and an EBITDA interest coverage of well above 4.0x over the next 12-24 months, commensurate with the 'B+' rating threshold. Furthermore, we do not deduct cash on the balance sheet from our debt calculation, in line with our criteria for the rating assessment.

However, we note sufficient unrestricted cash on Neinor's balance sheet of €270 million at year-end 2021.

We expect Neinor will continue to deliver robust operating performance in 2022 and 2023. Neinor delivered 3,038 units in 2021, resulting in €882 million of revenue and achieving its run rate objective of about 3,000 units delivered per year. We understand the sales price has increased by about 3% last year. The company plans to deliver about 3,000 units per year, including both BTS and BTR units. We note that the relative contribution of BTS units will decrease as Neinor grows its rental platform and increases the pace of BTR deliveries. We expect BTR deliveries to increase to 213 units in 2022 and more than 1,000 units in 2023, with the rest of the units feeding its BTS pipeline. We therefore expect Neinor's development activities will continue to generate sizable cash flows, contributing to the funding of its rental platform and limiting the recourse to debt financing. We expect Neinor to continue benefiting from the Spanish residential market's sound fundamentals. Supportive demographic trends are driving demand for new housing in the large metropolitan areas of Spain largest cities, and there is a low supply of new housing units in these areas. Although we expect tightening credit conditions and current economic uncertainty will weigh on price growth, we continue to expect housing prices will increase in 2022 due to the structural supply-demand imbalance in the Spanish market.

Cost inflation and supply chain issues remain a key issue for the industry. In this context, we expect additional pressure on developers' margins. We expect inflation in Spain to be about 6% in 2022, affecting the costs of 2023 and 2024 deliveries, while having less of an effect on 2022 deliveries, which are already close to completion. That said, we think Neinor will be able to partly offset the cost increase via housing price increases, also supported by an ongoing undersupply for Neinor products in its operating markets. We also understand the company builds sufficient contingencies in its budgeting process and has a long track record of underutilization of such contingencies, which could absorb part of the price increase.

The company will likely ramp up its rental platform operations, in line with its strategy, which should increasingly support stable cashflows. Neinor pursued the ramping up of its rental platform operations in 2021, closing the year with 542 units under operation, representing a total portfolio value of €102 million. Furthermore, the company has launched an additional 671 units, while 1,300 more are under construction. The company plans to develop and operate about 4,600 units generating about €48 million in rental income in the long term. We view the revenue diversification strategy as credit positive because we view residential assets for rent as a defensive asset class that provides resilient and predictable cash flow, offsetting the more inherently volatile nature of development activities. In addition, the Spanish rental market has supportive fundamentals in terms of demand and limited supply of good quality residential units for rent on a large scale. This has resulted in increasing institutional investor interest in the Spanish residential asset class, with 2021 investments totaling €2.1 billion and more than €1 billion in the year to date according to JLL. We understand that the rental platform will represent about 20% of total EBITDA in the long term. That said, we have not reflected the company's long-term plans in our current rating assessment, given the immateriality of this business line over the next 12-24 months.

Outlook

The stable outlook reflects our view that Neinor will continue to generate positive free operating cash flow from its development business, supported by the high level of presales and sustained demand for newly built residential units in the main metropolitan areas of Spain. The stable outlook also reflects our view that Neinor will continue to benefit from sustained demand for residential housing in Spain and could withstand any potential impact from the current inflationary environment.

We estimate Neinor will maintain S&P Global Ratings adjusted debt to EBITDA below 5x over the next 12 months, with EBITDA interest coverage well above 4x and sustained positive FOCF.

Downside scenario

We could lower our rating if Neinor's operating performance deteriorated owing to a market downturn with a significant decline in demand or prices in Neinors' units, or large debt-funded acquisitions, resulting in:

- Debt to EBITDA trending toward 5x;
- EBITDA interest coverage falling below 2x; and
- Sustained negative FOCF.

A material deterioration of Neinor's liquidity cushion would also result in a negative rating action.

Upside scenario

We consider an upgrade as unlikely in the short term, given Neinor's diversification strategy focusing on capital-intensive rental platform growth. That said, a positive rating action would stem from Neinor maintaining adjusted debt to EBITDA below 4.0x and EBITDA interest coverage in line with our base case while increasing its EBITDA contribution from rental operations to further improve its cash flow visibility and resilience.

Company Description

Neinor is a publicly listed Spanish residential real estate developer. It is among the largest homebuilders and developers in Spain in terms of gross asset value (€1.9 billion) as of year-end 2021 and a total gross development value of about €4.3 billion. Neinor delivered 3,038 units in 2021, 2,892 of which came from the BTS division, its main business (about 97% of revenue in 2021), with 146 units coming from its rental platform. We understand the company intends to diversify its revenue base over the medium term via its rental platform by developing, owning, and leasing residential units.

The company is listed, and its shares trade on the Spanish stock exchange. Its main shareholders are Orion Capital Managers, Stoneshield Capital and Adar Capital Partners, representing 28%, 23%, and 15% of total capital, respectively. The remaining 34% of shares are free float.

Our Base-Case Scenario

Assumptions

- Sustained real GDP recovery momentum in Spain of 6.1% in 2022 and 4.2% in 2023 following a 5.0% increase in 2021. We estimate consumer price inflation of about 5.8% in 2022 and 2.3% in 2023 on the back of supply chain issues and energy price inflation.
- Total annual revenue of about €850 million in 2022 and €750 million-€800 million in 2023, supported by stable deliveries of about 2,500-3,000 units annually (both BTS and BTR) and high pre-sale levels. The decrease in revenue in 2023 stems from the growing relative weight of BTR deliveries (1,000 units expected in 2023 versus about 200 units in 2022).
- Adjusted EBITDA margins stabilize at below average levels to about 15%-16% in 2022, with home price appreciation inflation partly offsetting cost inflation in building materials.
- Positive net working capital outflows in 2022 on the back of high deliveries and high presale levels, turning negative in 2023, with BTR capital expenditure investments and the company's land acquisition strategy (yearly land acquisitions of €200 million coupled with lower BTS deliveries) resulting in lower cash flow generation.
- Annual shareholder returns (including dividends and share buybacks) of about €100 million in 2022 based on robust performance in 2021 and a solid start to 2022.
- Average cost of debt to remain stable at 2.5%.

Key metrics

- Adjusted gross debt to EBITDA of 4.2x-4.5x in 2022 and about 4.4x-4.7x in 2023;
- EBITDA interest coverage to remain well above 4.0x for the next 12-24 months; and
- Adjusted FOCF to debt to remain positive over the forecasted horizon.

Liquidity

We anticipate Neinor's liquidity sources will likely cover liquidity uses by 1.5x in the 12 months from Jan. 1, 2022. Neinor's cash flows are stable and predictable thanks to its high level of presales and visibility on development works, large cash balances, and available committed lines, which enhances the company's liquidity profile. In addition, Neinor's long track record of solid relationship with banks supports its liquidity position.

We expect principal liquidity sources for the 12 months from Jan. 1, 2022, will include:

- €270 million in available unrestricted cash;
- €50 million of undrawn backup facilities with a maturity of more than 12 months; and
- Funds from operations of about €100 million.

We expect principal liquidity uses for the same period will include:

- About €180 million of contractual debt amortization payments and the repayment of outstanding credit lines; and

- A planned distribution of about €100 million.

Covenants

The revolving credit facility (RCF) carries a springing covenant applicable when more than 40% of the line is used at any one time. The applicable financial covenant is set at a maximum loan-to-value of 45%. As of year-end 2021, the RCF was fully undrawn.

The senior secured bond has incurrence covenants related to a senior secured leverage ratio of 3.0x and a fixed-charge coverage ratio of at least 2.0x.

We understand the company will make reasonable efforts to maintain sufficient headroom (greater than 10%) under all its covenants.

Environmental, Social, And Governance

ESG credit indicators: E-3, S-2, G-2

Environmental factors are a moderately negative consideration in our credit rating analysis of Neinor, mainly because increasing industry-wide requirements to comply with environmental regulations, such as restrictions on land usage and carbon emissions, may weigh on margins. To mitigate the secular change in industry norms, the company places meaningful attention on its sustainability efforts as a response to increasing demand for sustainable buildings from clients, certifying the majority of its developments, with close to 71% of total deliveries BREEAM certified since the company was founded.

Issue Ratings - Recovery Analysis

Key analytical factors

- We raised our issue rating on Neinor's senior secured bond to 'BB-' from 'B+', which is one notch higher than our issuer credit rating on the company. The recovery rating is unchanged at '2', reflecting our expectations of substantial recovery (70%-90%; rounded estimate: 85%). The large, unencumbered asset base supports the recovery rating.
- That said, we view the security package as relatively weak, which constrains recovery expectations, since it comprises only a pledge over the share capital of the issuer and any structural intercompany receivables.
- Similarly, the risk of further collateralization of unencumbered assets on future indebtedness constrains the recovery prospects in the event of a default.
- Our hypothetical default scenario assumes an adverse real estate market downturn and drying credit supply, as well as increased competition.
- We value the business as a going concern in view of its leading position in the Spanish residential real estate development market. We use a distressed asset valuation for the homes business, in line with peers.

Simulated default assumptions

- Year of default: 2025
- Jurisdiction: Spain

Simplified waterfall

- Gross recovery value: about €750 million
- Net recovery value for waterfall after administrative expenses (5%): about €713 million
- Super senior claims: €44 million
- Value available to secured debt: €669 million
- Estimated priority debt (mortgage-based liabilities with priority over secured assets and corporate debt): About €275 million
- Value available to subordinated debt: About €395 million
- Total de facto unsecured debt: €303 million
- Recovery range: capped at 70%-90% (rounded estimate: 85%)

Note: All debt amounts include six months' prepetition interest. RCF is assumed to be 85% drawn at default.

Ratings Score Snapshot

Ratings Score Snapshot -- Neinor Homes

Issuer Credit Rating	B+/Stable/--
Business risk	Weak
Country risk	Intermediate
Industry risk	Moderately high
Competitive position	Weak
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	b+
Modifiers	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; Outlook Action

	To	From
Neinor Homes S.A.		
Issuer Credit Rating	B+/Stable/--	B/Positive/--
Senior Secured	BB-	B+
Recovery Rating	2(85%)	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914