Kopaszi Gát Kft.
Hungary, Real Estate

B+ STABLE

Corporate profile

Kopaszi Gát Kft. (Kopaszi) is a Budapest-focused residential and commercial real estate developer that builds properties to sell or lease. Its activities cover the entire development process from site evaluation and project planning to implementation and marketing. The company is currently fully focused on the BudaPart project, a site acquired in 2015 (market value of about EUR 80m as at YE 2020).

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	4.4x	9.1x	2.1x	1.9x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	20.6x	3.3x	7.2x	10.4x
Scope-adjusted loan/value ratio (%)	64%	31%	48%	58%

Rating rationale

Scope Ratings has assigned a first-time issuer rating of B+ to Kopaszi Gát Kft.

The business risk profile (assessed at B+) reflects the company's industry risk as a real estate developer with limited recurring income and strong focus on homebuilding. Credit-positive is the diversified customer base due to the retail residential core business as well as asset quality, with newly built premium and standard residential units deemed to have above-average liquidity within the real estate market. We expect Scope-adjusted EBITDA margins in a range of 20% to 30% from residential and commercial development.

A rating constraint is Kopaszi's small size in both the European and the fragmented real estate market in Hungary, with total Scope-adjusted assets of about EUR 235m as of December 2020. This implies greater sensitivity to unforeseen shocks, greater volatility in cash flows and a heightened sensitivity to the performance of single projects due to existing cluster risks. The limited size is also evident in i) the concentrated development pipeline; and ii) the full geographical concentration on Budapest. The decent pre-sale ratios of between 30% to 90% for projects under development partially mitigate the risk of a liquidity shortfall posed by the high working capital allocated to these projects. The Hungarian state's introduction of incentives to promote private home ownership in the country should also support demand

The financial risk profile (assessed at B+) reflects the expectation of continuous growth, which will keep free operating cash flows negative and Kopaszi dependent on external financing. Scope-adjusted debt (SaD) is expected to rise from around EUR 73m in 2020 to EUR 174m by the end of 2023, due to the planned bond placement of HUF 32bn (equivalent to around EUR 87.7m) in Q1 2022 and EUR 94m in additional development loans until 2023. This will result in a SaD/EBITDA ratio of close to 10x in 2022 in the rating case and a Scope-adjusted EBITDA interest coverage of around 1.9x in 2022 and 2023.

Ratings & Outlook

Corporate rating B+

Senior unsecured rating B+

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Related Methodologies

Corporate Rating Methodology: July 2021

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 the completion and disposal of one office building in 2022 and two residential buildings in 2023. It also incorporates the redemption of current first-ranked bank loans and the shareholder loan in 2022 but an increase in debt due to the additional development loans and the bond placement (HUF 32bn in Q1 2022). We anticipate SaD/EBITDA to increase to around 10x, adequate interest cover in the next few years and ongoing adequate access to external financing to finance the negative Scope-adjusted free operating cash flow in the next few years.

A positive rating action is remote but may be warranted if the company grew significantly in size, as measured by its development pipeline, leading to greater diversification and more stable cash flows, while leverage as measured by SaD/EBITDA stabilised below 8x on a sustained basis.

A negative rating action is possible if SaD/EBITDA were to reach well above 10x or if liquidity weakened, for example, due to weaker access to bank financing.

Rating drivers

Positive rating drivers	Negative rating drivers
• Focused on real estate development, mainly residences and offices, with strong demand in Hungary • High quality development portfolio, with buildings that meet recognized standards – namely LEED (gold or above and Hungarian EPC level BB). • Gradual build-up of recurring revenues from rental portfolio and retail areas, smoothing future cash flows	• Small company in a fragmented market, leading to more volatile cash flows and limited economies of scale • Geographical cluster risk on Budapest combined with a concentrated development pipeline (BudaPart comprising 26 buildings: five ongoing, seven completed and the remainder to be completed by 2028) • Exposure to development activities leading volatile cash flow, partially mitigated by stable recurring rental income and activities in home-building, which is less volatile than commercial development

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improving business risk profile, while SaD/EBITDA stabilises below 8x on a sustained basis	• Significantly increasing leverage, indicated by a SaD/EBITDA of more than 10x on a sustained basis

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover (x)	4.4x	9.1x	2.1x	1.9x	1.7x
Scope-adjusted debt (SaD)/EBITDA	20.6x	3.3x	7.2x	10.4x	10.5x
Scope-adjusted loan/value ratio (%)	64%	31%	48%	58%	61%
Scope-adjusted EBITDA in EUR '000s	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	6,401.0	15,659.0	12,524.1	1,686.0	7,777.6
Operating lease payments in respective year	0.0	0.0	0.0	0.0	0.0
Gain from sale of subsidiaries	0.0	6,157.3	648.6	12,453.6	8,883.7
Scope-adjusted EBITDA	**6,401.0**	**21,816.3**	**13,172.7**	**14,139.6**	**16,661.3**
Scope-adjusted funds from operations in EUR '000s	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	6,401.0	21,816.3	13,172.7	14,139.6	16,661.3
less: (net) cash interest as per cash flow statement	-1,442.0	-2,399.0	-6,237.8	-7,625.8	-9,632.3
less: cash tax paid as per cash flow statement	0.0	0.0	-5,071.0	-840.9	-1,227.2
Others (provisions, impairments)	0.0	0.0	0.0	0.0	0.0
Scope-adjusted funds from operations	**4,959.0**	**19,417.3**	**1,864.0**	**5,672.9**	**5,801.7**
Scope-adjusted debt in EUR '000s	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	140,131.8	90,574.0	111,232.0	160,460.5	215,977.8
add: finance lease	0.0	0.0	0.0	0.0	0.0
less: cash, cash equivalents	-28,453.4	-29,591.3	-19,346.1	-21,047.8	-53,466.3
add: restricted cash	20,472.8	11,806.0	2,533.0	7,852.0	11,727.3
Scope-adjusted debt	**132,151.2**	**72,788.7**	**94,418.9**	**147,264.7**	**174,238.8**

Business risk profile: B+

Industry risk: B+

Kopaszi is a Budapest-focused developer of residential and office premises built for sale or leasing (mainly ground floor shops in residential buildings).

To reflect the company's business model, we calculated a blended industry risk, considering the contribution of each business line to revenues, which led to a weighted average industry risk of B+.

Business line	Activities	Estimated average operating profit contribution (2019-21)	Industry risk
Development	Commercial – offices	30%	B
	Homebuilding	59%	B
Rental	Commercial – retail	11%	BB
Weighted average industry risk			**B+**

Small property company in a highly fragmented market

Kopaszi is a small property company in both a European context and the fragmented Hungarian real estate market, with total Scope-adjusted assets of about EUR 235m as of December 2020. The small size is a negative rating driver, because it implies a greater sensitivity to unforeseen shocks, greater volatility in cash flows and a heightened sensitivity to the performance of single projects due to existing cluster risks (five projects currently). The company's pipeline for the next few years includes more than 800 residential units as well three commercial buildings (around 50,000 sq m) to be developed until 2024. Nonetheless, we expect the company to remain small.

Small market shares, but some visibility through BudaPart

In 2015, Kopaszi acquired the site for the mixed-use project BudaPart, with a market value of EUR 80m as of December 2020. BudaPart is one of the largest real estate developments in Budapest, consisting of 26 buildings including residences (about 2,800 apartments), offices (about 215,000 sq m) and a hotel (198 rooms). The development has a progress rate of 23%, with seven buildings (134,000 sq m) already completed as of December 2021. The project is expected to be completed by 2028.

Geographical focus on Budapest

Kopaszi focuses on investing in real estate in Budapest. The company does not plan to increase its geographical outreach beyond this as it is fully focused on the development of the BudaPart project. Whilst the project offers further development potential, it also fully exposes Kopaszi to the macroeconomic environment and demand from one market.

Project concentration mitigated by diversified customer base

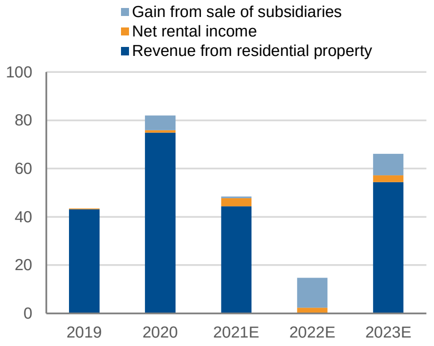
Kopaszi has a concentrated development pipeline with five projects in development and 13 in the pipeline until 2028. This may negatively affect future cash flow in the event of project delays or cost overruns. It is worth noting that the BudaPart project is divided into phases and the development of single buildings is an independent process.

The company's project pipeline is diversified across residential and office buildings, and, to a minor extent, hotel and retail spaces. Credit-positive is the highly diversified customer base due to the retail residential core business, whose demand should remain strong based on asset quality, with newly built residential units deemed to have an above-average liquidity within the real estate market.

Tenant portfolio with exposure to small to medium-sized companies

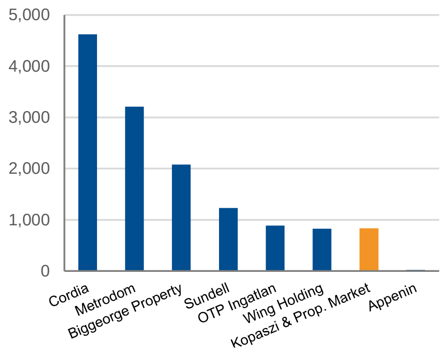
The company holds a small tenant portfolio stemming from retail spaces located on the ground floors of its residential buildings and the completed office building (BOE, expected disposal in 2022). Excluding tenants in the office building, the top three and top 10 tenants represent about 14% and 35% respectively. Tenant quality is moderate as the tenant mix comprises mostly supermarkets, food stores and restaurants.

Figure 1: Revenue breakdown by segments (EUR m)



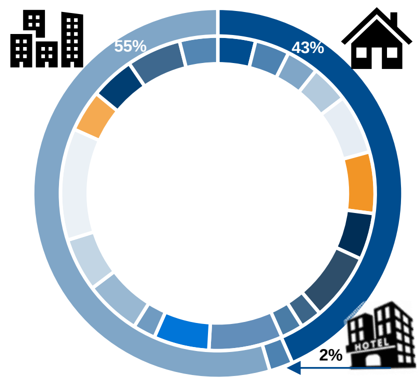
Sources: Kopaszi, Scope

Figure 2: Top residential developer in Hungary by number of units sold since 2015



Sources: Kopaszi, Scope

Figure 3: Distribution of gross lettable area by segment (outer ribbon) and buildings (inner ribbon)



Sources: Kopaszi, Scope

High asset quality to support portfolio liquidity

Developments are solely in Budapest, considered a 'B' location with population growth of 2.3% over the last 10 years (2011-21).

Asset quality is credit-positive, as Kopaszi's development portfolio comprises high-quality buildings that meet recognized standards – namely LEED (gold or above) and Hungarian EPC level BB). In our view, newly built – premium and mid-priced residential units – will benefit from high liquidity. The incentives introduced by the Hungarian government to further promote private home ownership in Hungary should also support demand for this kind of asset. Besides the significant adjustment of VAT on new homes to 5% from 27%, further incentives are in discussion, including a cash refund on the remaining 5% VAT for families buying their first home and all-time-low fixed funding for environmentally efficient new housing. Financing conditions for private homeowners will most likely also remain supportive as the Hungarian Central Bank has incentivised commercial lenders to finance private home ownership.

The company also benefits from decent pre-sale ratios for current residential development buildings (35%-90%), while the preliminary process of the sales and reservations of other assets is yet to start. In general, we expect the liquidity of Kopaszi's properties to benefit from resilient demand and the supportive government policy, which would lower potential price haircuts in a distressed sales scenario.

Office buildings to be built under the BudaPart project are Grade A and LEED/BREEAM certified and will contain modern, flexible office spaces. We believe that demand for newly built, energy-efficient offices will remain more robust than more obsolete supply, especially in the context of Covid-19. In addition, many high-quality tenants focus on sustainability and therefore seek environmentally friendly properties.

Above-average profitability and stable on single project basis

Profitability, as measured by the Scope-adjusted EBITDA margin, stood at 27% as at December 2020, outperforming development peers' (15%-20%). We expect the margin to remain above 25% going forward, supported by the high-quality projects in the pipeline with targeted margins of between 20% and 30%.

Due to the timing mismatch between cash outflows and inflows (expenses and revenues), we have also looked at profitability at project level (internal rate of return). Profitability from this perspective is relatively stable, providing certainty that it can be sustained (standard residential buildings average 9%; premium residential, 18%) at around 12% yearly and at a project-specific net profit margin of above 20%.

From the cost side, with raw material costs increasing, cost overruns have been partially mitigated by fixed-price agreements for the developments through turn-key contracts with the general contractor.

Financial risk profile: B+

Adequate debt protection although debt increase in 2022

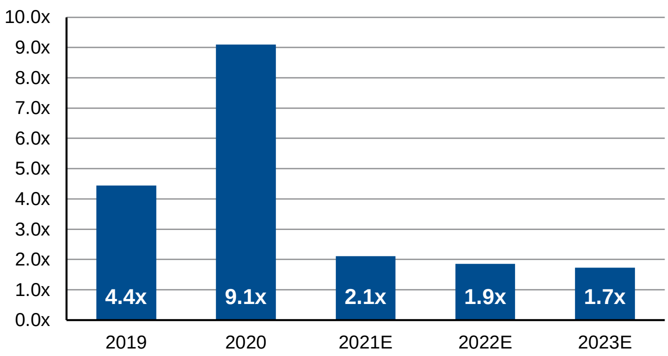
The Scope-adjusted EBITDA interest cover stood at 9.1x in 2020. We expect the ratio to fluctuate as cash flows strongly depend on the timely delivery and disposal of projects. If projects are delayed, Kopaszi may have to rely on cash reserves or external financing to cover interest payments. Kopaszi's development loans are also typically exposed to floating interest rates. In addition, if there was a risk of a significant rise in the Euribor rate, the company would use interest rate swaps to partially offset the increased financial costs.

We anticipate some pressure on debt protection from the higher balance sheet leverage after the planned bond placement but at a level appropriate for the rating. We assume that the bond will be priced with a fixed coupon of maximum 6%.

Targeted portfolio expansion will squeeze free operating cash flow

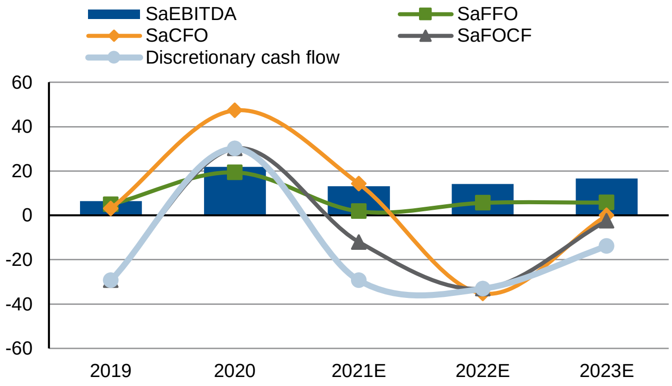
Cash flow has been volatile, with negative free operating cash flow driven by the development pipeline in 2019. We expect free operating cash flow to remain negative owing to the company's anticipated further growth, compounded by the mismatch of cash inflows and outflows inherent to the development sector.

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



Sources: Kopaszi, Scope estimates

Figure 5: Cash flows (EURm)

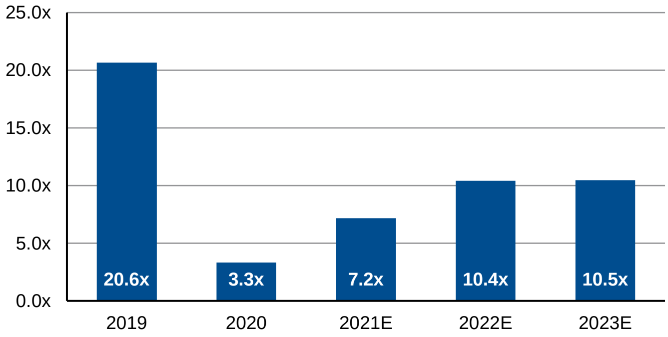


Sources: Kopaszi, Scope estimates; 'Sa' = Scope-adjusted

Leverage under pressure due to strong SaD increase

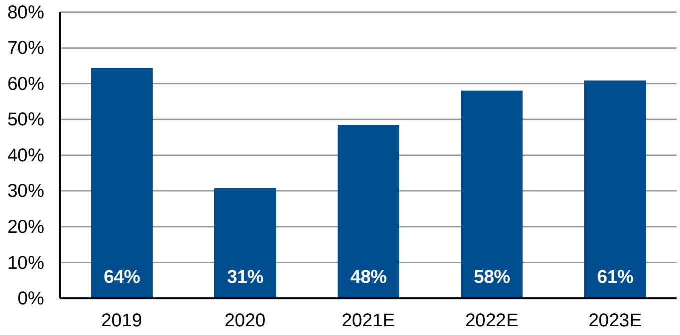
The company's leverage, as measured by the SaD/EBITDA stood at 3.3x in 2020. We foresee the ratio to remain under pressure in next few years, following the expected rise in net financial debt after 2021 due to the planned unsecured bond and the addition of senior secured development loans (EUR 94m until 2023). This will result in SaD rising from around EUR 73m in 2020 to an estimated EUR 174m by the end of 2023, thus resulting in higher leverage. We expect the ratio to continue to fluctuate as volatility is typical for a developer, with the completion of projects and financing taking place not in annual tranches but over the development period.

Figure 6: SaD/EBITDA



Sources: Kopazi, Scope estimates

Figure 7: Scope-adjusted loan/value ratio



Sources: Kopaszi, Scope

Adequate liquidity

Liquidity is adequate, supported by an unrestricted cash balance (around EUR 17.8m as of December 2020; EUR 17m estimated for 2021) that exceeds short-term debt (EUR 9.9m). Even if free operaing cash flow remained negative due to planned investments (net capex of EUR 60m until 2023) and working capital requirements (mainly EUR 50m in inventories), open credit lines (more than EUR 69.2m as of December 2021) would still be able to finance the specific developments.

in EUR k	2020	2021E
Short-term debt (t-1)	-35,548	-9,989
Unrestricted cash (t-1)	7,981	17,785
Open committed credit lines (t-1)	0	0
Free operating cash flow (t)	30,124	-12,023
Coverage	**1.1x**	**0.6x**

Long-term and short-term debt ratings

Senior unsecured debt: B+

The rated entity plans to issue a HUF 32bn senior unsecured corporate green bond under the Hungarian National Bank's Bond Funding for Growth Scheme. There is an amortising repayment of 10% yearly between the fifth and ninth anniversaries and a 50% balloon payment at maturity. Bond proceeds are earmarked for: i) ensuring financing of future developments (50% of total funding); ii) refinancing the actual outstanding amount at bond issuance of the first-ranking mortgage-backed loan provided by EXIM Bank; and iii) partially refinancing the second-ranking mortgage-backed shareholder loan (remaining proceeds). The remaining part of the shareholder loan will be repaid upon the sale of the office building BOE – BudaPart City – and a delayed sale will result in the shareholder loan being extended.

Our recovery analysis is based on a hypothetical default scenario at year-end 2023. This scenario shows an average recovery value on senior unsecured debt with a high sensitivity to attainable prices in a distressed sales scenario and factors in the structural subordination of the rated entity's senior unsecured creditors below future secured creditors at property SPV level (development loans). This translates into a B+ rating for senior unsecured debt, in line with the issuer rating.

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