EUROBODEN GmbH
Germany, Real Estate

B+ STABLE

Corporate profile

EUROBODEN GmbH is an owner-managed residential real estate developer with a focus on the high-quality segment. Its activities cover the entire development process, from site evaluation and project planning to implementation and marketing. The company develops architecturally valuable residential real estate properties and works with a pool of well-known architects such as David Chipperfield and Jürgen Mayer H.

Key metrics

			Scope estimates	
Scope credit ratios	**2017/18**	**2018/19**	**2019/20E**	**2020/21E**
Scope-adjusted EBITDA interest cover (x)	3.1x	9.7x	3.2x	2.8x
Scope-adjusted loan/value ratio (%)	44%	49%	53%	57%
Scope-adjusted debt (SaD)/SaEBITDA (x)	10.7x	4.2x	9.6x	8.8x

Rating rationale

Scope affirms the issuer rating of EUROBODEN GmbH at B+/Stable as well as the BB instrument rating on senior unsecured debt, reflecting the company's updated business plan.

The affirmation reflects our increased revenue and operating profit expectations after the company substantially expanded its development pipeline to more than EUR 1bn within the past 12 months (+83% YoY) and expectation of the successful placement of a EUR 75m senior unsecured bond in Q4 2020.

With regards to the business profile, rated B+, the company remains a relatively small real estate developer, with Scope-adjusted assets of around EUR 400m and geographical concentration around its two core markets of Munich (68% of estimated pipeline sales) and Berlin (28%). We nevertheless see improvements in the company's market shares and visibility in those two cities. Diversification has improved thanks to the enlarged project pipeline, which also implies a greater granularity of project risks. Asset quality remains a major credit-positive factor for the company's business risk profile, with a continuing focus on 'A' locations and thus relatively liquid real estate projects. The issuer's track record and brand name allow for off-market deals, which ensure the constant replenishment and further growth of the project pipeline, as demonstrated in the past business years. Going forward, profitability is expected to stay volatile but within a high range compared to peers' levels, at Scope-adjusted EBITDA margin of 15% to 30% depending on the timing of project completions. The financial risk profile, rated B+, benefits from our expectation of EBITDA interest coverage significantly exceeding 1x going forward and of a gradual reduction in the volatility of cash profits via the larger and thus more granular project portfolio. It is constrained by the increase in financial leverage, as measured by the Scope-adjusted loan/value (LTV) ratio, which we forecast at between 50% and 60% for the next two business years. Liquidity remains weak since the issuer will remain dependent on ongoing access to external financing to cover short-term financial liabilities and to simultaneously fund its envisaged operational growth. Nevertheless, we expect the company to be able to reliably refinance all short-term obligations going forward, which will also benefit from available undrawn committed credit lines and net proceeds from the expected bond placement in Q4 2020.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	BB

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Related Methodologies

Corporate Rating Methodology

Rating Methodology European Real Estate Corporates

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Outlook and rating-change drivers

The Outlook for EUROBODEN is Stable and incorporates the assumption of an LTV at the upper end of the range between 40% and 60% as well as sales executed at expected prices on the growing project pipeline. Moreover, we expect Scope-adjusted EBITDA interest cover of substantially above 1x and ongoing adequate access to capital markets and bank debt to finance short-term debt positions.

A positive rating action would require an improvement of the company's business risk profile with more stable cash generation via i.e. increasing recurring revenue streams, while LTV improves to below 40% on a sustained basis.

A negative rating action might be warranted if the issuer shows an LTV of more than 60% on a sustained basis and weakening access to bank financing. This could be caused by the underperformance of its development projects.

Rating drivers

Positive rating drivers	Negative rating drivers
• Lack of supply in EUROBODEN's core markets of Munich and Berlin as well as robust demand for residential real estate in group's core markets • Very good market knowledge and standing due to established brand, enabling off-market deals • EUROBODEN's 'A' located development portfolio that supports price stability and fungibility • EBITDA interest cover of sustained above 1.0x	• Relatively small company in a highly fragmented market, leading to more volatile cash flows and limited economies of scale • Predominant niche focus on high-priced residential real estate, keeping EUROBODEN exposed to more elastic demand margin volatility • Still concentrated but clearly improved development pipeline (EUR 1.1bn in August 2020; +83% YoY) with geographical cluster risks regarding Munich and Berlin • Full exposure to the cyclicality of the real estate market with almost all revenue directly linked to the company's development activity • Key person risk associated with the managing directors, which hold 100% of EUROBODEN's shares • Continued high refinancing risk with around EUR 40m of short-term debt, partially mitigated by available credit lines of EUR 31.5m as at September 2020

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement of the company's business risk profile with more stable/recurring cash generation • Significant deleveraging with LTV of below 40% on a sustained basis	• LTV of more than 60% on a sustained basis • Weakening access to external financing

Financial overview

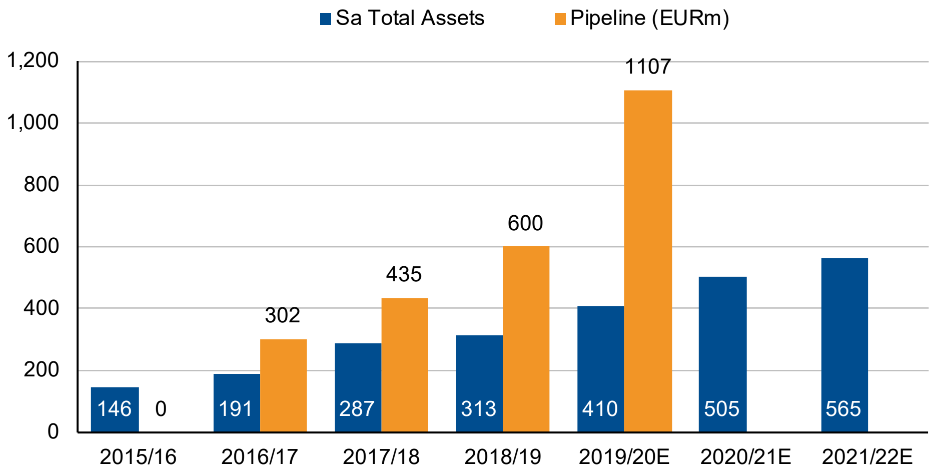
			Scope estimates	
Scope credit ratios	**2018/19**	**LTM H1 2019/20**	**2019/20E**	**2020/21E**
Scope-adjusted EBITDA/interest cover (x)	9.7x	2.2x	3.2x	2.8x
Scope-adjusted debt/Scope-adjusted EBITDA (x)	4.2x	18.1x	9.6x	8.8x
Scope-adjusted loan/value ratio (%)	49%	54%	53%	57%
Scope-adjusted EBITDA in EUR m	**2018/19**	**LTM H1 2019/20**	**2019/20E**	**2020/21E**
EBITDA	35.4	9.5	22.0	32.2
Operating lease payments in respective year	0.7	0.7	0.6	0.6
Scope-adjusted EBITDA	**36.1**	10.2	**22.5**	**32.8**
Scope funds from operations in EUR m	**2018/19**	**LTM H1 2019/20**	**2019/20E**	**2020/21E**
Scope-adjusted EBITDA	36.1	10.2	22.5	32.8
less: cash interest as per cashflow statement	-3.7	-4.6	-7.0	-11.7
less: interest component operating leases	-0.1	-0.1	-0.1	-0.1
less: cash tax paid as per cashflow statement	-1.0	-0.9	-4.4	-6.1
Δ Provisions	-2.5	-2.6	0.0	0.0
Scope funds from operations	**28.8**	**2.1**	**11.1**	**14.9**
Scope-adjusted debt in EUR m	**2018/19**	**LTM H1 2019/20**	**2019/20E**	**2020/21E**
Reported gross financial debt	154.3	188.2	246.4	306.5
less: cash, cash equivalents	-3.8	-4.5	-31.2	-20.7
Cash not accessible	0.5	0.5	0.5	0.5
add: operating lease obligation	1.2	1.2	1.2	1.6
Scope-adjusted debt	**152.2**	**185.4**	**216.9**	**287.9**

Business risk profile: B+

Industry risk: B

Industry risk for EUROBODEN is very high as it operates in the riskiest sub-segment (project development) of a highly cyclical industry (real estate).

Figure 1: EUROBODEN's Scope-adjusted total assets and project pipeline volume



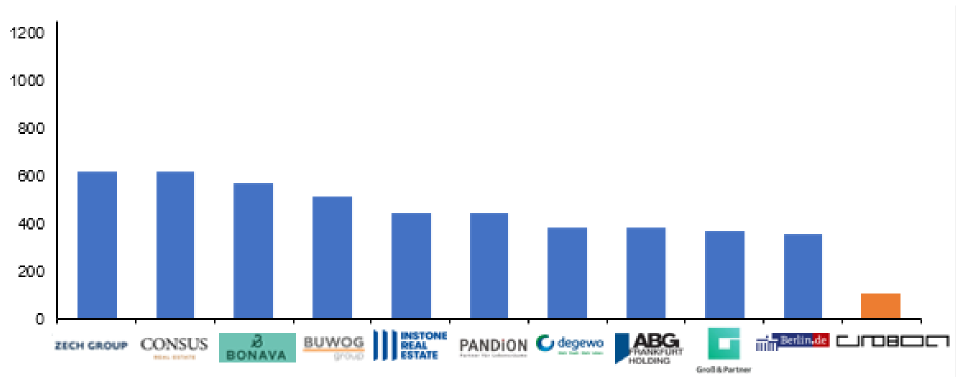
Sources: EUROBODEN, Scope

Issuer benefitting from increasing brand awareness and still robust demand for high-quality residential units

With total assets of EUR 410m (including significant hidden reserves), EUROBODEN is a relatively small property company in a highly fragmented market. Size is expected to further grow in the next two years based on the EUR 1.1bn (+83% YoY) project pipeline as of September 2020. The number of residential units under development has also almost doubled, from around 650 as of August 2019 to more than 1,100 as of September 2020. The company's market position is expected to improve further if it successfully executes i) its larger projects in Munich and Berlin; and ii) its geographical expansion (see also Diversification section). EUROBODEN is expected to maintain its niche focus of upscale and high-quality residential real estate, despite the increasing focus on larger projects along with additional locations.

The issuer's still relatively small size is a negative rating driver, because it implies a greater sensitivity to unforeseen shocks, greater volatility in cash flows and higher key person risk.

Figure 2: EUROBODEN's competitors (residential project pipeline in '000 sqm)



Sources: BulwienGesa, EUROBODEN, Scope

EUROBODEN sees itself as an 'architectural brand' supported by an established network of well-known architects. According to the company, its self-positioning and brandbuilding facilitate off-market deals, allowing it to avoid bidder competition for land and properties and to carry out its pricing policy.

Limited but improving geographical diversification with a focus on Munich and Berlin

The geographical distribution of revenues remains a credit risk, due to EUROBODEN's relatively small size and concentrated development pipeline exposed primarily to Munich and Berlin, two cities with very similar demand patterns. Thanks to the increasing number of new projects outside of the two core markets Munich and Berlin, we acknowledge a gradual decrease of this cluster risk.

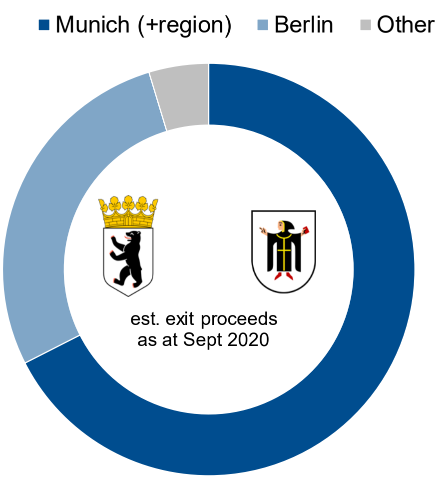
Heavily dependent on real estate development for the next few years

EUROBODEN generates the vast majority of its income (92% in 2017/18 and 85% in 2018/19) from development, with other revenue sources such as rental income or management fees directly linked to this core activity. This very modest diversification fully exposes the company to the cyclicality of the real estate market and is seen as a credit-negative. From 2015/16 on, selective investments in other asset classes, have provided some recurring income streams, which are expected to increase over the next business years as a result of the planned expansion of income-generating investment properties.

These recurring revenue streams are credit-positive as they partially mitigate the cash flow volatility of the development business.

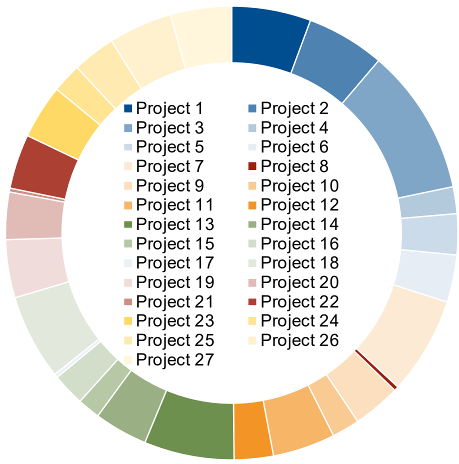
The issuer has recently also expanded its asset focus by adding office projects, but at this point we expect upscale residential developments to stay at the centre of operations. We therefore give no additional credit for this, which also takes into account that commercial projects usually pose higher development risks than residential projects, a factor that has become increasingly relevant in the context of the current Covid-19 crisis.

Figure 3: Geographical diversification of project pipeline as at September 2020



Sources: EUROBODEN, Scope

Figure 4: Expected project pipeline exit proceeds as at September 2020



Sources: EUROBODEN, Scope

EUROBODEN's development pipeline is concentrated, with 27 projects (around 1,100 apartments). The recent project portfolio growth has improved granularity significantly: the top three projects in 2019 accounted for 47% of planned costs (August 2018: 50%); this figure has improved to around 24% as of September 2020.

Improving but still concentrated development pipeline of now 27 projects

Nevertheless, substantial delays and/or cost overruns still have the potential to negatively affect future cash flow, although the company does benefit from apartment pre-sales.

Assets in EUROBODEN's development portfolio are situated in the mature and very liquid markets of Munich (68% of expected sales volume) and Berlin (28%). Furthermore, both cities benefit from favourable demand for residential real estate, even during the current economic slump in the wake of Covid-19. The company's activities focus on 'A' locations in these cities, which supports the fungibility of its properties and lowers potential price haircuts in a distressed sales scenario. With the newly added 'western region', including Frankfurt and Cologne areas, we expect no dilution of asset quality going forward.

With Scope-adjusted EBITDA margins in recent years of 15% (2015/16) to more than 30% (2018/19), EUROBODEN's profitability has been volatile but continues to increase. We expect Scope-adjusted EBITDA margins to remain within a range of 15% to 21% going forward.

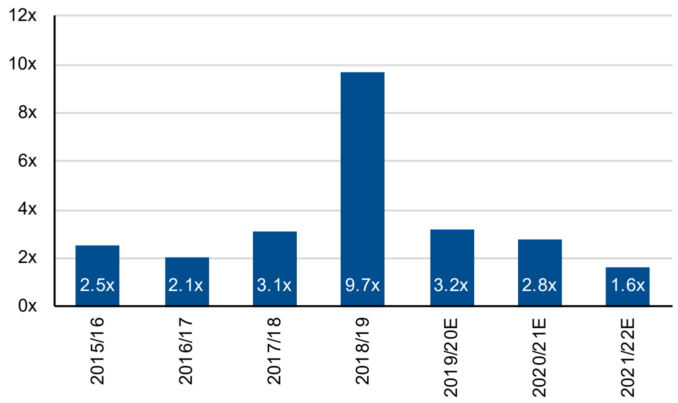
EUROBODEN has clearly benefitted from the strong demand for residential real estate development in Munich and Berlin and has been able to crystallise significant hidden reserves accumulated. However, strong demand also impacts the company's acquisition pipeline. Projects added more recently are expected to be less profitable in terms of net margins but still in line with or slightly above most peers' margins.

Financial risk profile: B+

Scope-adjusted EBITDA interest cover expected to stay substantially above 1.0x

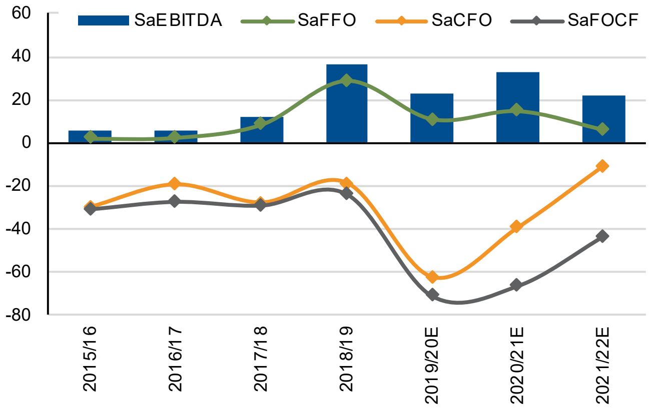
Scope-adjusted EBITDA interest cover is expected at 3.2x for the business year ending 30 September 2020 and to remain between 1.6x and 3.2x in our forecast period. However, this ratio will fluctuate depending on the timely delivery and disposal of projects. If projects are delayed, EUROBODEN may have to rely on external financing to cover interest payments. We believe external financing is readily available, thanks to: i) committed, undrawn credit lines totalling EUR 31.5m as at September 2020, which can be drawn upon without restrictions; and ii) hidden reserves, which allow existing credit lines to be increased.

Figure 5: Scope-adjusted EBITDA interest cover (x)



Sources: EUROBODEN, Scope estimates

Figure 6: Cash flows (EUR m)

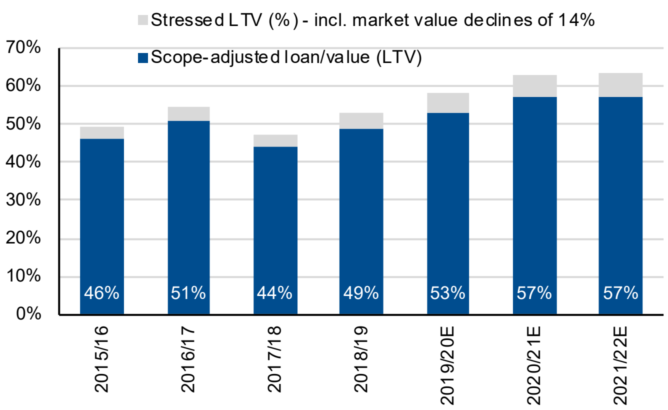


Sources: EUROBODEN, Scope estimates

Increasing LTV from 50% to 60% expected to remain at this level going forward

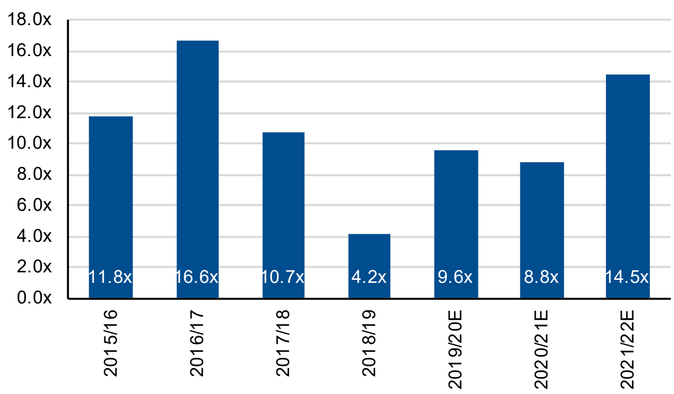
The company's cash flow has been volatile, with negative free operating cash flow driven by the expansion of the business over the last years (Figure 5). We expect free operating cash flow to remain negative, owing to anticipated further dynamic growth, as well as to the nature of real estate development. Accordingly, cash inflows and outflows are not necessarily matched during the lifetime of each project. Furthermore, EUROBODEN suffers from its still limited size, which creates a concentrated project pipeline that also amplifies the volatility inherent in EUROBODEN's business model.

Figure 7: Loan/value ratio (%)



Sources: EUROBODEN, Scope estimates

Figure 8: Scope-adjusted debt/EBITDA



Sources: EUROBODEN, Scope

We consider liquidity to be weak. In detail:

EUROBODEN's liquidity – subject to substantial fluctuations in the past – is expected to stay below 100% for the next two years.

Position (EURm)	2020/21E	2021/22E
Short-term debt (t-1)	22.0	42.7
Unrestricted cash (t-1)	30.7	39.0
Free operating cash flow (t)	-66.7	-43.7
Open committed credit lines (t-1)	31.4	35.3
Liquidity (internal and external)	**-0.2x**	**0.7x**

We do not believe the company can repay debt due in the next 13 months using only free operating cash flow and available cash. However, we hint at the fact that the large capital outflows leading to the negative free operating cash flows are to a large extent of a discretionary nature, i.e. investments in new projects could be stopped or postponed if deemed necessary by the management.

In detail, we expect the issuer to have around EUR 22m in short-term financial obligations until the end of the current business year as well as EUR 30.7m of unrestricted cash and c. EUR 31.5m of undrawn credit lines. Free operating cash flow is expected to be negative with c. EUR -66.7m due to the growing project pipeline. The company will therefore have to rely on external funding to redeem maturing debt. Taking the broadening pool of lenders as well as the increasing number and size of successful bond placements into account, the company enjoys improving access to external financing, in our view.

However, if EUROBODEN achieves operational success – i.e. pre-sales of above 50% (supported by the market environment), projects delivered on time and on budget, and disposals at targeted prices – the extension of credit facilities for project debt should be possible and EUROBODEN can manage the related refinancing risk. EUROBODEN has done this in the past and managed to extend all short-term secured financing credit facilities by at least one year prior to maturity.

Improved access to external financing via bonds

The successful placement of the new EUR 75m senior unsecured bond– as expected in our base case – would result in a substantially higher cash balance going forward. This additional liquidity would primarily be used to improve both the speed and access to new project acquisitions that can be refinanced with secured bank debt afterwards. However, if needed, these additional senior unsecured funds may also be used for upcoming short-term debt refinancing, thus also improving liquidity.

Long-term debt instrument ratings

BB senior unsecured debt rating affirmed, including new EUR 75m bond

As at September 2020, EUROBODEN has EUR 65m of capital market debt outstanding. According to our methodology and reasonable discounts on the company's asset base, we expect a 'superior' recovery of more than 71%, allowing a two-notch uplift on the issuer rating.

In addition, EUROBODEN plans to issue a new five-year senior unsecured bond (up to EUR 75m) in Q4 2020. The bond's rating will be in line with the rating on the senior unsecured debt class, benefitting from the same recovery expectations as the outstanding senior unsecured bond.

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