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 famous architects, such as David Chipperfield and Jürgen Mayer H.

Key metrics

			Scope estimates	
Scope credit ratios	**2015/16**	**2016/17**	**2017/18E**	**2018/19E**
EBITDA/interest cover (x)	2.5x	2.1x	2.9x	7.0x
Scope-adjusted debt (SaD)/EBITDA	11.8x	16.6x	10.2x	3.0x
Scope-adjusted FFO/SaD	3%	3%	5%	20%
Loan/value ratio	46%	51%	49%	46%

Rating rationale

Scope upgrades EUROBODEN GmbH's issuer rating to B+ from B. Outlook Stable

The main driver for the upgrade is a result of the successfully refinancing of unsecured debt in 2018 and a broadening lender universe substantiating an improved access to external financing as well as more conviction on Scope's side that the company maintains LTV levels commensurate with the higher ratings.

The B+ issuer rating on EUROBODEN, a real estate developer with a focus on the high-quality segment, is supported by the company's: i) 'A' location, highly liquid properties; ii) good growth prospects in its core markets of Munich and Berlin; iii) profound market knowledge; iv) high profitability compared with the industry average; and v) strong brand recognition allowing it to make off-market deals.

The issuer rating is negatively affected by EUROBODEN's position as a small niche player in high-quality residential property development as well as its volatile cash flows. Full exposure to the cyclical real estate market and dependence on external financing are also credit negative. In addition, we believe that key person risk still exists due to the contribution of the managing directors who together own the company. However, EUROBODEN has taken measures, such as the enlargement of its secondary management level, to reduce operational dependence on these two individuals.

The BB rating for EUROBODEN's unsecured corporate bond reflects our view that the recoupment of this investment is highly probable, thanks to the company's disclosure of hidden reserves and the excellent locations of the properties in its development portfolio.

Outlook

The Outlook for EUROBODEN is Stable and incorporates a further but more muted growth of the company's topline and development portfolio without impairing its credit metrics. Specifically, Scope anticipates an LTV remaining around 50% and ongoing adequate access to capital markets and bank debt to finance short-term debt positions.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	BB

Analysts

Philipp Wass
+49 30 27891 253
p.wass@scoperatings.com

Related methodology

Corporate Rating Methodology, January 2018

Rating Methodology: European Real Estate Corporates January 2018

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Tel. + 49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

A positive action would require the company to grow significantly in size, as measured by its development pipeline, leading to greater diversification and more stable cash flows, while leverage as measured by the company's LTV would have to decrease to below 40% on a sustained basis. Both of these possibilities are judged to be remote at present. A negative rating action is possible if the company's LTV were to exceed substantially 50%, or if the company's access to bank financing weakened.

Rating drivers

Positive rating drivers	Negative rating drivers
• Lack of supply in EUROBODEN's core markets of Munich and Berlin as well as a strong German economy support stable demand over the next few years. • Excellent market knowledge and standing, due to established brand and achieved size, enable off-market deals. • EUROBODEN's 'A' located development portfolio supports price stability and fungibility. • Volatile EBITDA margin in line with that of peers. However, project-related net profit margin expected to remain around 20% and is stronger than that of peers. • EBITDA interest cover expected to remain substantially above 1.0x (last twelve months [LTM] to H1 2017/18 1.5x). • Moderate LTV of below 50% expected to remain at this level going forward.	• Small-sized company in a highly fragmented market leading to more volatile cash flows and limited economies of scale. • Focus on niche market of high-quality, high price residential real estate in munich keeps EUROBODEN exposed to more elastic demand and potential margin deterioration. • Still concentrated but improving development pipeline (EUR 480m in September 2018 +7% YoY) with limited geographical diversification focusing on Munich and Berlin • Full exposure to the cyclicality of the real estate market with almost all sources of revenue directly linked to the company's development activity. • Key person risk associated with the managing directors holding 100% of EUROBODEN's shares. • Continued high refinancing risk with 59% of total debt falling due in the next 12 months. However, this is partially off-balanced by available credit lines of EUR 26m as at 31/08/2018, cash inflows from the sale of two assets in Munich and adequate access to external financing.

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Significant deleveraging with LTV of below 40% on a sustainable basis. • Significant growth of the company's project pipeline leading to higher diversification and more stable cash flows.	• LTV substantially greater than 50%. • Weakening access to external financing.

Financial overview

			Scope estimates	
Scope credit ratios	**2015/16**	**2016/17**	**2017/18E**	**2018/19E**
EBITDA/interest cover (x)	2.5x	2.1x	2.9x	7.0x
SaD/EBITDA	11.8x	16.6x	10.2x	3.0x
Scope-adjusted FFO/SaD	3%	3%	5%	20%
Loan/value ratio	46%	51%	49%	46%
Scope-adjusted EBITDA in EUR m	**2015/16**	**2016/17**	**2017/18E**	**2018/19E**
EBITDA	5.2	5.2	12.0	35.2
Operating lease payment in respective year	0.5	0.7	0.7	0.7
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**5.7**	**5.8**	**12.7**	**35.8**
Scope funds from operations in EUR m	**2015/16**	**2016/17**	**2017/18E**	**2018/19E**
Scope-adjusted EBITDA	5.7	5.8	12.7	35.8
less: (net) cash interest as per cash flow statement	-2.2	-2.8	-4.3	-5.1
less: cash tax paid as per cash flow statement	-0.9	0.0	-2.3	-9.2
less: interest component operating leases	0.0	0.0	0.0	0.0
Change in provisions	-0.4	-0.4	0.0	0.0
Scope funds from operations	**2.1**	**2.6**	**6.0**	**21.6**
Scope-adjusted debt in EUR m	**2015/16**	**2016/17**	**2017/18E**	**2018/19E**
Reported gross financial debt	67.9	106.8	159.5	109.2
less: cash, cash equivalents	-1.3	-11.6	-31.9	-5.0
Cash not accessible	0.4	0.8	0.8	0.8
add: pension adjustments	0.0	0.0	0.0	0.0
add: operating lease obligations	0.4	0.7	0.7	0.7
Scope-adjusted debt	**67.3**	**96.7**	**129.2**	**105.7**

Business risk profile

Industry risk: B

'Developer' corporates face the highest cyclicality, as demand is linked to economic growth. In addition, these companies mostly have a high time-to-delivery, as three to four years are needed to develop a new property from scratch. If demand declines during this time because of an economic downturn or competition from existing or newly-built stock, risks associated with letting and disposal could increase tremendously.

We believe that the real estate industry generally has low barriers to entry. On the one hand, significant investment is needed to buy, maintain or develop properties. Thus, a company needs either significant internal resources or good access to third-party capital. On the other hand, there is a high level of fragmentation in the real estate industry and good general access to credit due to collateral-eligible assets. Both are indicators of relatively low barriers to entry.

Substitution risk is generally low as the properties (mainly for residential spaces) represent one of the basic human needs. Substitution risk for developers depends on the property type. The skills and reputation of a developer are essential to the successful development of made-to-measure projects. As these are not easily replicable, substitution risk is deemed to be medium. However, generic property design and development could be easily substituted by any existing competitor, or by new players entering the market from other industries, due to potential benefits gained from new infrastructure and/or more efficient processes.

Figure 3: Industry risk assessment: European commercial real estate corporates

Cyclicality \ Barriers to entry	Low	Medium	High
High	CCC/B	B/BB	BB/BBB
Medium	B/BB	BB/BBB	BBB/A
Low	BB/BBB	BBB/A	AA/AAA

Source: Scope

Stable sector outlook

Scope's 2018 outlook for the real estate sector is stable. Our view is based on still-lively investor and tenant demand which has a positive influence on business risk profiles. In addition, companies have been able to make use of the ECB's ongoing ultra-loose monetary policy (with an all-time high of capital market debt issuance at very low interest rates) to enhance their financial risk profiles. However, our assessment emphasises the further heightening of sensitivity to changes in politics, economic conditions and interest rates.

For more information please refer to Scope's 2018 Corporate Outlook (click here).

Small-sized company in a highly fragmented market

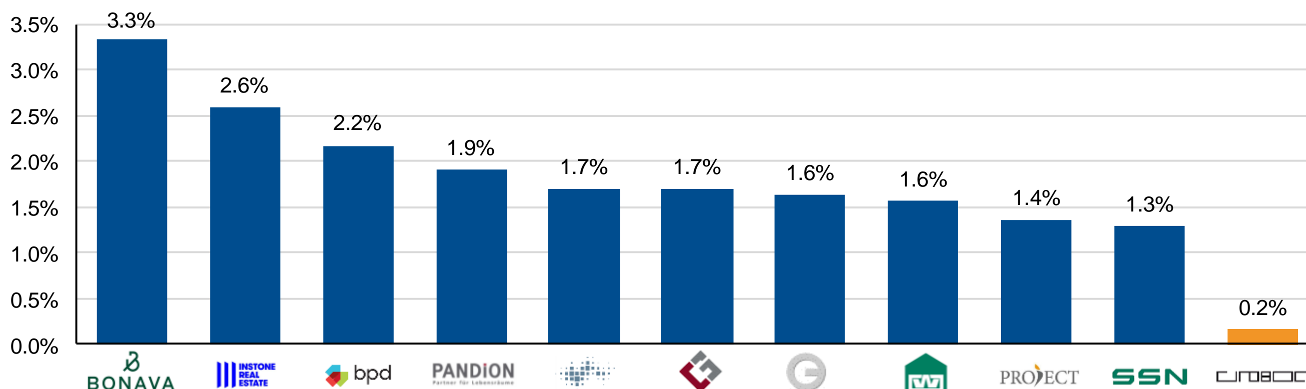
EUROBODEN is a small property company in a highly fragmented market. It has a total asset value of below EUR 500m and funds from operations of EUR 2m for LTM to end-March 2018 (Figure 4). EUROBODEN's size is expected to grow in the next two years based on the EUR 480m (+EUR 30m YoY) project pipeline as of September 2018. Market positioning is expected to improve further, if the company successful accomplishes a) its larger projects in Munich as well as b) its geographical expansion (see also Diversification). Despite the increasing concentration on larger projects and additional locations, EUROBODEN is expected to maintain its focus on its specific niche market of luxury residential real estate.

Small size is a negative rating driver, because it implies heightened sensitivity to unforeseen shocks, greater cash flow volatility and higher key person risk.

Niche market player in the high-quality segment benefitting from increasing brand awareness and a solid economic environment…

As a niche market player, EUROBODEN has a small market share of below 1% in Germany as well as comparably small market shares in its core markets of Munich (c. 3%) and Berlin (c. 2%). A strong economy, the low interest rate environment and a lack of supply will support stable demand over the next few years. However, in the event of an economic downturn or a slump in demand, competition is likely to wipe out the majority of market participants.

Figure 4: EUROBODEN and its competitors (market share of trading development based on sq m)



Source: public information, Scope estimates

EUROBODEN conceives of itself as an ‘architectural brand’ supported by an established network of well-known architects. According to the company, self-positioning and brand building support its activities by facilitating off-market deals, avoiding bidder competition when sourcing land and property and allowing EUROBODEN to carry out its pricing policy.

… however, exposed to more elastic demand.

However, we believe that EUROBODEN’s positioning in Munich, with a focus on the high-quality, high-price niche market segment – as opposed to Berlin (upper price segment), greatly exposes the company to adverse market movements. This opinion is based on more elastic demand and price levels in the luxury property segment, with higher peak-to-trough declines during a crisis compared to price movements for the total stock, according to Knight Frank Residential Research[1].

Limited geographical diversification with a focus on Munich and Berlin

The geographical distribution of the company’s revenues is highly volatile – driven by EUROBODEN’s small size and ‘chunky’ development pipeline – and currently limited to the two cities of Munich and Berlin. We judge this localised geographical diversification to be a credit risk, given the very similar demand patterns of both markets. Our assessment of EUROBODEN’s geographical diversification has improved slightly due to the purchase of a ski lodge including a 60-bed hotel (‘Resterhöhe’) in Kitzbühel (Austria) in November 2016, as this region, and tourism itself, has a different demand pattern.

In 2016/17 EUROBODEN expanded its geographical reach further to Frankfurt am Main. However, new projects are not in the development pipeline yet. Improving reach has therefore not impacted the company’s business risk profile so far.

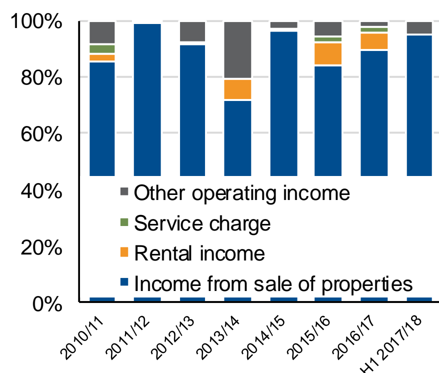
Heavily dependent on residential real estate development for the next few years

EUROBODEN generates the majority (2016/17: 90% I 2015/16: 84% I 2014/15: 96%) of its income from its development activities (Figure 5). Other revenue sources such as rental income or managing fees contribute to a lesser extent. However, the latter is also directly linked to the company’s development activities. This very modest diversification of revenue sources fully exposes the company to the cyclicality of the real estate market and is seen as credit negative. Income from other businesses, particularly hotel

[1] Comparison of volatility between Global House Price Index and Prime Global Cities Index.

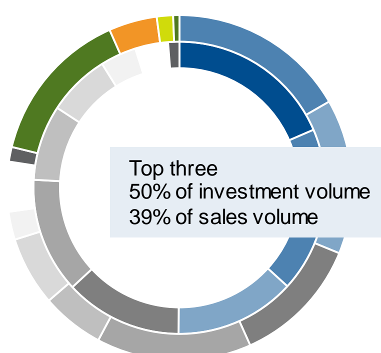
operations and letting, is expected to provide a more visible income stream of EUR 1m from 2017/18 on. This will partially mitigate the volatility of the development business. According to the company, the office building in Aschheim will be build-to-hold, further increasing the recurring income stream by an estimated EUR 2.5m from 2022/23 on.

Figure 5: Income source diversification



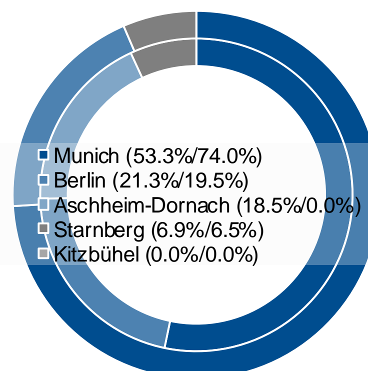
Source: EUROBODEN, Scope

Figure 6: Concentration of development pipeline by expected costs and exit proceeds



Source: EUROBODEN, Scope

Figure 7: Geographical diversification of development pipeline by expected costs and exit proceeds



Source: EUROBODEN, Scope

Improving but still concentrated development pipeline of 15 projects

EUROBODEN has a very concentrated development pipeline with 15 projects in its portfolio at present (c. 360 apartments). This represents a widening diversification with the addition of five new projects to the development pipeline. However, the top three projects still account for 50% of planned costs (September 2017: 51%). This may negatively affect the company's future cash flow generation, if projects are delayed or suffer from a cost overrun. It is credit positive that the company benefits from: i) decent pre-sale ratios for some of its largest development schemes including Erhardstraße 10 (60%), Kolbergerstraße 5 (15%) and Lützowstraße (77%[2]) all of which represent 39% of total committed investment volume; and ii) invoicing according to the German real estate agent and commercial construction regulation (MaBV). We believe this should reduce the risk of high working capital allocation to these specific projects, which could lead to a shortfall of liquidity.

'A' located development portfolio supports price stability and fungibility

EUROBODEN's development portfolio is situated in the mature and very liquid markets of Munich (83% of expected sales volume including Aschheim and Starnberg) and Berlin (17%). The company focusses its activities on 'A' locations in these cities, supporting the fungibility of its properties and lowering potential price haircuts in a distressed sales scenario. As Frankfurt am Main is the next targeted market, we expect no dilution of asset quality going forward.

Volatile EBITDA margin in line with that of peers. However, project-related net profit margin expected to remain around 20% stronger than that of peers.

With an EBITDA margin of 17% for 2016/17, EUROBODEN's profitability has increased for the fourth consecutive year (2015/16: 15% [restated] I 2014/15: 9% I 2013/14: 7%). We expect the margin to remain at a level above 10% going forward, supported by the high-quality project pipeline with gross margins aimed between 30% and 40%. Due to the timing mismatch between cash outflows and inflows (expenses and revenues), we have also looked at profitability on a single project basis. EUROBODEN's profitability from this perspective is relatively stable, providing us with certainty that profitability is at a sustainable level. We expect an EBITDA margin above 10% on an annual basis and project-specific net profit margins of around 20%. Margins will thus be in line with or slightly above those of most of EUROBODEN's peers.

[2] Including the sale of the existing buildings.

Financial risk profile

Scope's rating scenario assumes the following:

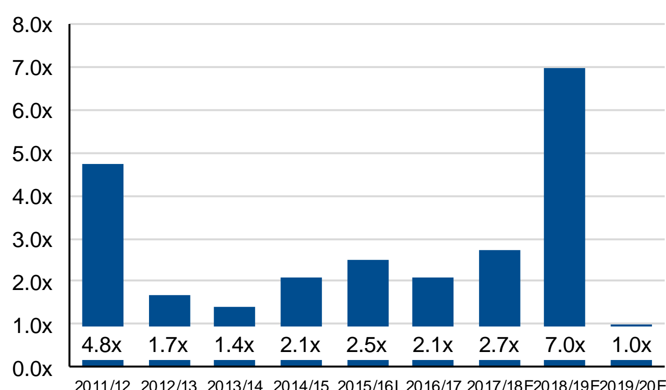
- Decrease in market prices of up to 10.0% by FY 2019/20
- Increase in material costs of up to 12.5% by FY 2019/20
- Increase in operational expenses of 2% per annum
- Drawdown of new debt with a weighted average tenor of 18 months
- Interest rate for new and floating debt to increase by 50 bp per year
- Dividend payout of the lower of the following: 20% of net profit or EUR 2m
- Capex in 2017/18: EUR 2m I 2018/19: EUR 16m I 2019/2020: EUR 55m

EBITDA interest cover expected to remain substantially above 1.0x (LTM H1 2017/18 1.5x)

EUROBODEN's EBITDA interest cover stood at a sufficient 1.5x for the LTM to end-March 2018 and is expected to remain above 1x. 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 of EUR 48.5m as at March 2018 which can be drawn upon without restrictions; and ii) hidden reserves which allow existing credit lines to be increased.

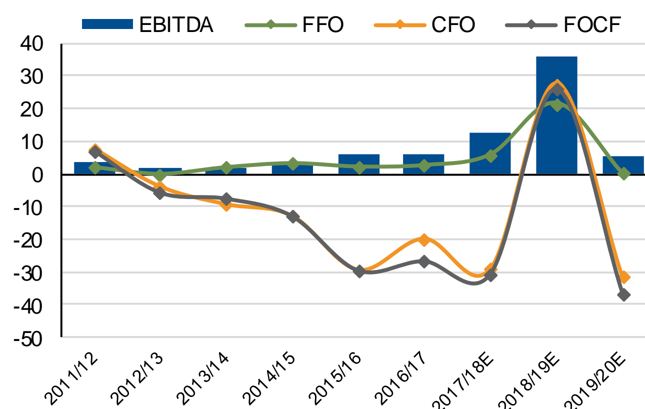
The company's cash flow generation has been volatile, with negative free operating cash flow driven by the expansion of business over the last five years. We expect free operating cash flow to remain negative, owing to anticipated further growth, as well as to the nature of real estate development, the company's core activity. Accordingly, cash inflows and outflows are not necessarily matched during the lifetime of each project. Furthermore, EUROBODEN suffers from its small size, which creates a 'chunky' project pipeline. The latter amplifies the volatility inherent in EUROBODEN's business model.

Figure 8: EBITDA interest cover



Source: EUROBODEN, Scope

Figure 9: Cash flows



Source: EUROBODEN, Scope estimates

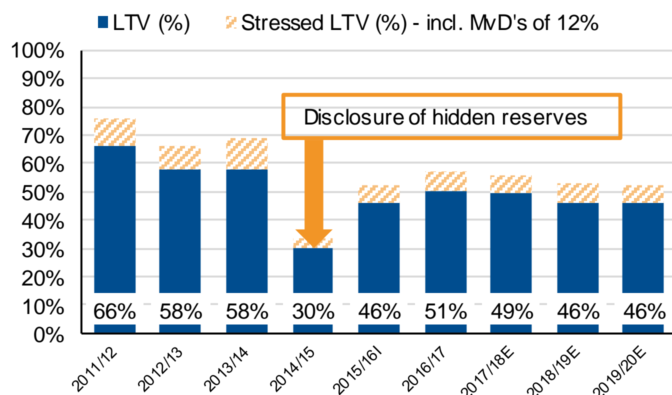
Moderate LTV of below 50% expected to remain at this level going forward

At the end of March 2018, the company's LTV stood at below 50%. As a consequence of the rise in the company's indebtedness, Scope-adjusted debt (SaD) has increased by EUR 55m since end-September 2015 to EUR 122m, driven by the acquisition of new properties and the financing of existing project development. This is in line with our expectations. With the sale of two projects in Munich, to be executed in the coming months, SaD is expected to decrease to around EUR 100m and, subsequently, LTV to fall to the mid 40% range. LTV is projected to remain below 50% going forward, which is adequate for a developer of this size and leaves enough headroom for the company to increase leverage to cover construction costs or to buffer a moderate decrease in the properties' fair values. Consequently, we would not necessarily change our view on the

company's leverage if market value declines of 12% – reflecting circa one standard deviation in the German house price index – occur. Given the company's ambitious growth plans, we do not believe that EUROBODEN will be able to significantly reduce its leverage over the next few years.

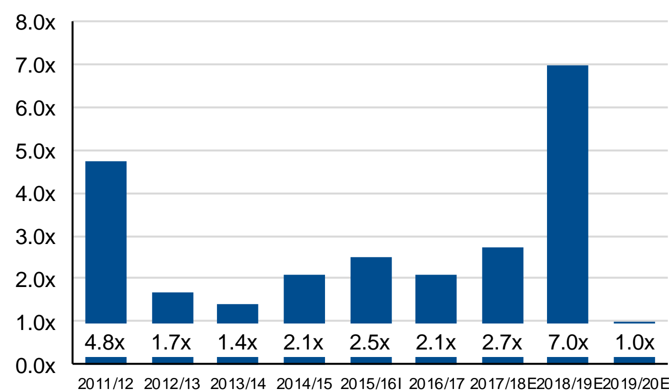
The company's SaD/EBITDA of 28x (end-March 2018) implies a level commensurate with a B financial risk profile. The ratio will continue to fluctuate. However, we judge this volatility to be typical for a developer, with projects not considered and financed in annual tranches but over the whole development period.

Figure 10: Loan/value



Source: EUROBODEN, Scope estimates

Figure 11: SaD/EBITDA



Source: EUROBODEN, Scope estimates

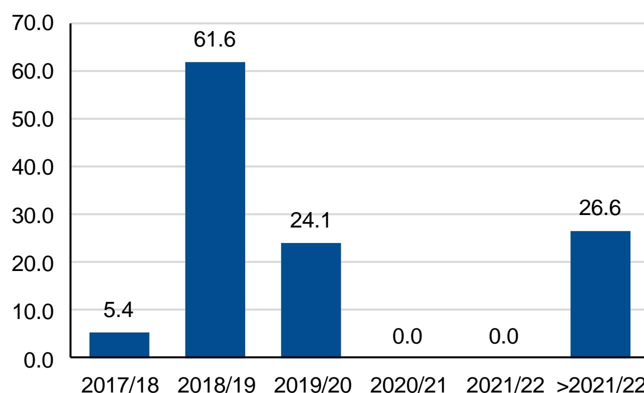
Adequate liquidity

EUROBODEN's liquidity is judged to be weak. In detail:

Position	FY 2017/18E
• Unrestricted cash	EUR 32m
• Open committed credit lines	EUR 19m
• Free operating cash flow (t+1)	EUR 26m
• Short-term debt (t+1)	EUR 85m
Coverage	**0.9x**

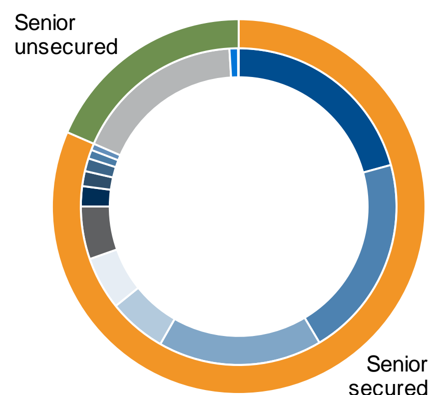
EUROBODEN's liquidity – subject to substantial fluctuations in the past – is expected to stay below 100% for the next two years. We do not believe that the company will be able to repay debt due in the next 13 months using free operating cash flow and available cash. A forecasted EUR 85m of debt is due in 2018/19, which is not covered by a forecasted EUR 32m of cash available at end-September 2018 and EUR 19m of undrawn credit lines (since 31 August an additional EUR 7m are available). The company will therefore have to rely on external funding to redeem maturing debt. However, if EUROBODEN achieves operational success, by attaining pre-sale rates above 50% – supported by the market environment – and by delivering on time and on cost, as well as by making disposals at targeted prices, it should be possible to extend credit facilities for project debt and EUROBODEN will be able to manage related refinancing risk. This is evidenced by the company's ability to refinance almost 100% of its EUR 15m (2013/18) bond eight months before its maturity in July 2018. In addition, EUROBODEN managed to extend secured financing at least one year prior to maturity. With a broadening pool of lenders, we believe the company enjoys moderate access to external financing.

Figure 11: Debt maturity profile



Source: EUROBODEN, Scope

Figure 12: Financing sources



Source: EUROBODEN, Scope estimates

Senior unsecured debt: BB

In November 2017 EUROBODEN issued a EUR 25m bond with a five-year tenor (ISIN DE000A2GSL68). Scope's recovery analysis indicates an 'excellent recovery' which translates into an instrument rating of BB. Recovery is based on a hypothetical default scenario in FY 2018/19 including a 34% haircut applied to EUROBODEN's assets, reflecting a market value decline representing one standard deviation in the German property price index as well as liquidation costs of c. 26% for the assets and 10% for insolvency proceedings.

Outlook

Outlook: Stable

The Outlook for EUROBODEN is Stable and incorporates a further but more muted growth of the company's topline and development portfolio without impairing its credit metrics. Specifically, we anticipate LTV remaining around 50% and ongoing adequate access to capital markets and bank debt to finance short-term debt positions.

A positive action would require the company to significantly grow in size as measured by its development pipeline, leading to higher diversification and more stable cash flows, while leverage, as measured by the company's LTV, would have to decrease to below 40% on a sustained basis. Both of these possibilities are judged to be remote at present.

A negative rating action is possible if the company's LTV were to exceed substantially 50%, or if the company's access to bank financing weakened.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Paris

33 rue La Fayette
F-75009 Paris

Phone +33 1 82885557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer

© 2018 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Analysis GmbH, Scope Investor Services GmbH and Scope Risk Solutions GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.

Scope Ratings GmbH, Lennéstrasse 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Torsten Hinrichs.