Cordia International Zrt.
Hungary, Real Estate

SCOPE BB NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	3.6x	5.2x	5.6x	3.2x
Scope-adjusted debt/EBITDA	5.0x	5.3x	7.8x	8.5x
Scope-adjusted loan/value ratio	31%	31%	33%	37%

Rating rationale

The affirmation reflects credit metrics that have remained well within our rating guidance, thanks largely to strong profitability that has allowed the company to withstand the weak market conditions. Cordia's operational performance will remain volatile, highly sensitive to high interest rates hindering affordability for households seeking a flat. Nevertheless, we find comfort in the company's sound liquidity position and steady pre-sale levels for 2023, although we expect additional sales contracts to remain low compared to historic levels.

Outlook and rating-change drivers

The Outlook remains Negative and reflects the increased risk of apartment sales remaining low amid high interest and inflation rates. These adverse conditions will put a strain on Cordia's credit metrics, which are particularly sensitive to downside revenue movement. While we expect that the company will prudently execute its development pipeline, earnings volatility could lead to significant swings in leverage and interest cover, which could impair the rating.

A positive rating action (i.e. Outlook back to Stable) could be warranted if the Scope-adjusted EBITDA/interest cover stabilised at above 2.5x. Further upside is remote but could be warranted if the business risk profile materially improved. This could be achieved if the company increased its size and improved diversification while growing its share of recurring revenue and keeping credit metrics at current levels.

A downgrade could be warranted if the Scope-adjusted EBITDA/interest cover fell to below 2.5x or Scope-adjusted debt/EBITDA consistently exceeded 10x. This could be triggered by a prolonged and sharp decline in sales volumes, cost overruns or delays in the pipeline execution.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
26 May 2023	Affirmation	BB/Negative
02 June 2022	Outlook change	BB/Negative
06 June 2021	Affirmation	BB/Stable

Ratings & Outlook

Issuer	BB/Negative
Senior unsecured debt	BB

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Related Methodologies and Research

General Corporate Rating Methodology; July 2022

European Real Estate Rating Methodology; January 2023

ESG considerations for the credit ratings of real estate corporates; April 2021

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Solid reputation and strong brand recognition in the eastern European property development market, with leading position in Hungary (Budapest) • Sizeable and well-balanced project pipeline across different markets, ensuring favourable growth prospects • Robust operating profitability supported by low land-acquisition cost and supportive market sale prices • Moderate leverage and adequate debt protection despite rising cost of debt	• Small-to-medium residential developer compared to European peers, suggesting high vulnerability to shifting demand and cash flow volatility • High exposure to volatility induced by the cyclical nature of real estate development and weak prospects surrounding the demand for newly built apartments, exacerbated by elevated interest and inflation rates • Despite diversification efforts, development activities remain largely concentrated in two core-markets (Budapest, Poland) • Debt protection constrained by exposure to floating rate debt (22% of total debt) • Lack of recurring revenue sources and high cash flow volatility

Positive rating-change drivers	Negative rating-change drivers
• Remote scenario but a substantial improvement of business risk profile through increase in size, diversification and/or share of recurring revenues, while keeping credit metrics at current levels	• Scope-adjusted EBITDA interest cover of below 2.5x or Scope-adjusted debt/EBITDA of above 10x on a sustained basis

Corporate profile

Cordia engages in the development and sale of residential properties to individual customers (primarily apartments in multi-family residential buildings), with a geographic focus on Hungary, Poland, Romania, Spain and the United Kingdom. The company holds a 14.7% stake in Argo Properties N.V., a German owner and manager of residential and commercial properties.

Cordia was spun out of Futureal and established as its own company in 2016, although both companies have operated for over two decades. Over the last 20 years, including during its time under Futureal, Cordia has developed more than 9,500 apartments in Hungary, Poland and Romania.

Financial overview

				Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	2.1x	3.6x	5.2x	5.6x	3.2x
Scope-adjusted debt/EBITDA	12.8x	5.0x	5.3x	7.8x	8.5x
Scope-adjusted loan/value ratio	37%	31%	31%	33%	37%
Scope-adjusted EBITDA in HUF m					
EBITDA	7,261	15,464	8,621	10,954	12,279
Operating lease payments	0	0	0	0	0
Other items[1]	0	0	5,789	0	0
Scope-adjusted EBITDA	**7,261**	**15,464**	**14,410**	**10,954**	**12,279**
Funds from operations in HUF m					
Scope-adjusted EBITDA	7,261	15,464	14,410	10,954	12,279
less: (net) cash interest paid	-3,460	-4,271	-2,792	-1,971	-3,860
less: cash tax paid per cash flow statement	-278	-174	-1,121	-373	-392
add: dividends from associates	0	0	5,048	0	0
Change in provisions	-465	2,572	-622	0	0
Other items[2]	-661	-1,900	-477	-1,879	-3,405
Funds from operations (FFO)	**2,397**	**11,691**	**14,446**	**6,731**	**4,622**
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-3,460	-4,271	-2,792	-1,971	-3,860
Change in other items	0	0	0	0	0
Net cash interest paid	**-3,460**	**-4,271**	**-2,792**	**-1,971**	**-3,860**
Scope-adjusted total assets in HUF m					
Total assets (reported)	299,212	281,276	296,300	295,651	309,859
less: cash and cash equivalents	-66,535	-53,590	-64,888	-58,628	-45,099
IFRS fair value adjustments	15,221	20,090	20,135	20,135	20,135
Scope-adjusted total assets	**247,898**	**247,776**	**251,547**	**257,157**	**284,895**
Scope-adjusted debt in HUF m					
Reported gross financial debt	148,711	123,957	134,121	136,021	141,402
less: subordinated (hybrid) debt	0	0	0	0	0
less: cash and cash equivalents	-66,535	-53,590	-64,888	-58,628	-45,099
add: non-accessible cash	10,725	6,310	7,805	7,805	7,805
add: pension adjustment	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0
Other items	0	0	0	0	0
Scope-adjusted debt	**92,902**	**76,677**	**77,038**	**85,198**	**104,108**

[1] Includes non-cash item adjustment (i.e. write-down of long-term receivables)
[2] Includes capitalised interest

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Environmental, social and governance (ESG) profile[3]

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)	

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Cordia so far has not prepared extra financial performance reports or set defined targets or key performance indicators in relation to ESG considerations. Given the extensive environmental footprint of the real estate industry, we believe the issuer would greatly benefit from the disclosure of greenhouse gas emissions and the implementation of actions and strategies to mitigate climate-related risks, for instance, in line with the Paris agreement.

It is worth noting that Cordia is working on a detailed ESG strategy but has been following standard practices thus far.

[3] 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: BB-

Industry risk profile: BB

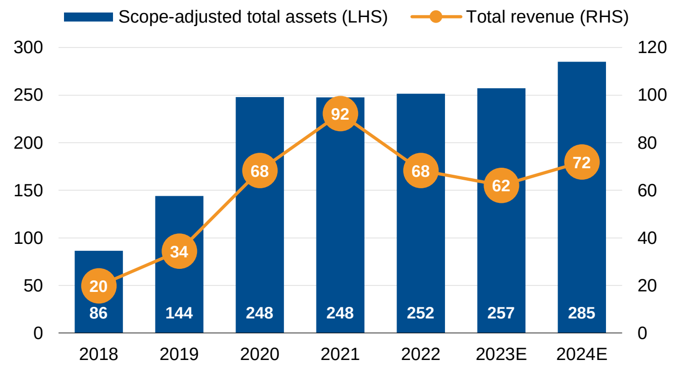
Cordia's activities are centred around the development and sale of residential properties, which translates into an industry risk assessment of BB (homebuilders).

Market leading residential developer in Budapest

With Scope-adjusted total assets of HUF 252bn and total revenue of HUF 68.3bn as of end-2022, Cordia is one of the leading residential developers in Central and Eastern Europe. However, it remains small in a European context. During 2022, the company handed over 1,112 units (of which three-fourths were in Hungary), sold 851 units (down 49% YoY) and launched five projects (with 934 apartments in total).

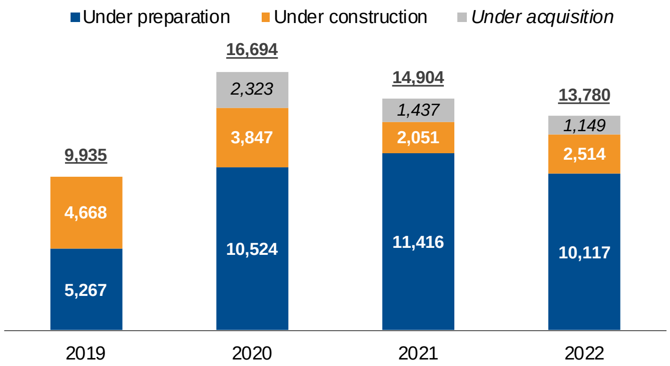
Following the opportunistic acquisition of Polnord in 2020, the company is set on stepwise, organic growth for the foreseeable future, driven by the execution of the current project pipeline (13,780 units as of end-2022, including 1,149 units under acquisition).

Figure 1: Scope-adjusted total assets and total revenue in HUF bn



Sources: Cordia, Scope estimates

Figure 2: Cordia's land bank – number of units



Sources: Cordia, Scope

Strong market shares in Budapest…

In terms of market shares, Cordia is the leading developer of residential property in its home market of Budapest. The company has nine active projects as of end-2022. Based on units sold throughout Budapest during 2022 (4,950), Cordia's market share stood at just below 10% and its offering (764 units open for sale) represented about 12% of the total in Budapest. Noting that Cordia is positioned in the mid-market segment, which accounts for about two-thirds of new-build flat transactions, its segment market share stands at 12%-15% (stable).

… but still negligible in other markets

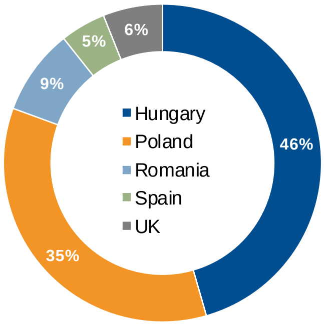
Among residential developers in Poland, Cordia remains small, having sold 858 units in 2021-2022 and offering about 530 units as at end-2022. For reference, the five largest in Poland each sold more than 1,500 units in 2022 alone. As such, Cordia's market share stood at around 1% and should remain at similar levels based on its project pipeline. Cordia's market shares in Romania, Spain and the United Kingdom remain negligible, with only a handful of active projects.

Moderate geographical concentration

Cordia's residential projects are spread across five countries and eight metropoles, although we note a large concentration in Budapest, which hosts 50% of the company's total offering. The company's geographical reach benefitted from the increased activity in Poland, now its second-largest market, especially after the 2020 acquisition of Polnord. Aside from its two core markets, the minor exposure gained in Romania (Bucharest), Spain (Costa del Sol) and the United Kingdom (Birmingham) also alleviate the geographic concentration, as these markets benefit from slightly different demand patterns and market specificities (e.g. buyer profiles, mortgage lending models and regulations). Therefore, adverse market developments in one country can be balanced out by more resilient sales activity in another, which, for instance, could be supported by local government schemes such as subsidised loans or reduced value-added tax.

Figure 3: Pipeline geographical diversification (by number of units under construction)

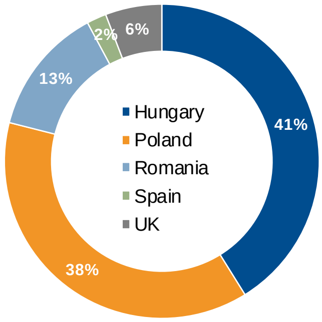
[As of end- 2022]



Sources: Cordia, Scope

Figure 4: Cordia's secured land bank geographical diversification (by planned number of units)

[As of end-2022]



Sources: Cordia, Scope

Exposure to development risks partly mitigated by a balanced and calibrated project pipeline

As of end-2022, Cordia's secured project pipeline contained a potential of 12,631 units, of which 2,514 were under construction, spread across 56 projects. The average project size of 217 units helps to limit development risks and the necessity to deploy substantial capital resources on a single project, given that large-scale developments are carried out in phases. Furthermore, each project is operated and financed through a dedicated SPV and only starts once the development budget is fully funded.

Exposure to various real estate regulations

The markets in which Cordia operates have different sales regulations and project financing modes, spreading out the regulatory risks while partly mitigating disposal risks. As such, project-equity and pre-sales requirements from local bank financing vary from one country to another, but usually request 20%-30% of equity of the total development costs and 20%-40% of pre-sales for a given project. Also, we note the different rules encompassing sales contracts or payment phases, as buyers' initial deposits (e.g. up to 25% of the purchase price in Hungary) are non-refundable or penalised if withdrawn, which limits the risk of walk-aways. Furthermore, customer advances can be used to draw down respective project loans. All in all, these various specificities provide the company with some flexibility in the risk management of its projects.

Diversified customer base thanks to B2C sale model

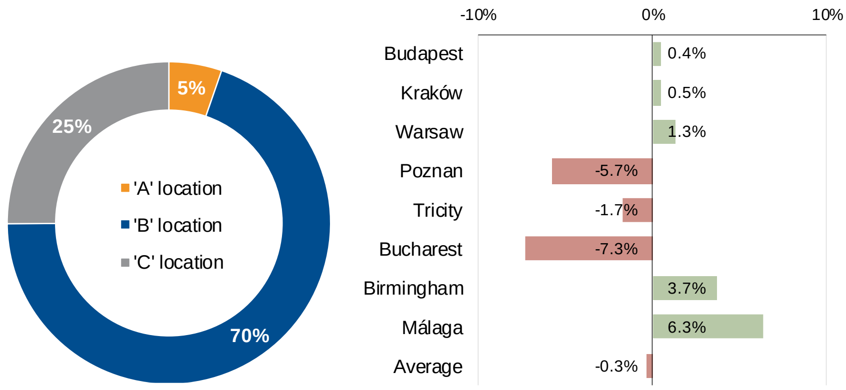
Buyer concentration is low due to the large exposure to private homebuyers purchasing a single unit (first-time buyer/primary residency) and to a lesser extent, investors buying 10-15 units. As such, we consider customer concentration and the exposure to buyers' default to be very limited. The latter is largely mitigated by contract terms allowing the company to withhold initial deposits or charge penalties in the event of a buyer's withdrawal, whilst having the ability to resell the unit afterwards. Besides this, we note the large proportion of cash buyers in eastern European markets, which helps maintain sales amid the current rise in mortgage loan costs that is pricing out many applicants or making them ineligible, especially with the tightening prudential rules for calculating creditworthiness.

While unlikely in the short to medium term (gradually from 2024), buyer concentration could increase for build-to-rent projects, which are tailored for investors and residential landlords willing to take on more than 100 units. This model carries a higher risk due to its more speculative nature, but the risk is partly mitigated by the strong interest from institutional investors for this asset class and options for developers to de-risk early on through forward purchase agreements.

Solid reputation in the Hungarian residential development market

With over two decades of experience, Cordia has gained a solid reputation in the residential development market in Central and Eastern Europe (especially in Budapest) and built a strong brand, having successfully conducted multi-award-wining projects and large-scale urban redevelopment (e.g. Corvin promenade). This good standing is evidenced by the trust gained from local and international buyers (sale model primarily focused on B2C). The company's development projects are positioned in the mid-market segment, which sees the highest volume of transactions. The average selling price for Cordia's units remains broadly in line with market prices as of end-2022 (5% below in Budapest for instance). We note that prices rose sharply in the premium segment.

Figure 5: Categorisation of Cordia's project locations[4] and population growth 2020-2030E



Sources: Cordia, Scope, Eurostat

Unfavourable demographics on project locations mitigated by sound demand for modern flats

Cordia's project portfolio is predominantly located in its home market of Budapest but also spans several Polish cities, the Romanian city of Bucharest, the UK city of Birmingham and the Spanish region of Costa del Sol. The company focuses on markets where at least 5,000 newly built flats are sold a year, with appropriate micro locations for the mid-scale segment.

While demographics trends are unfavourable on Cordia's project locations (mostly 'B' locations as assessed by Scope), these cities remain nationally important and benefit from sound demand for newly built apartments as the existing stock largely comprises old and energy-intensive properties.

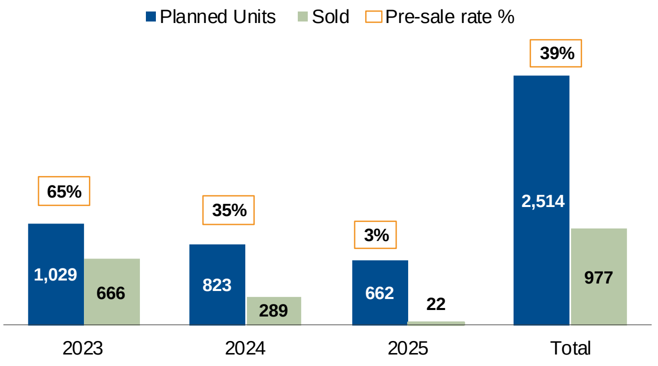
Noting the high cyclicality of development activities, the demand is closely linked to economic growth. Cordia's markets have good prospects, with GDP growth forecast at or above that of the euro area. However, these markets are particularly sensitive to a downturn and therefore subject to sharp movements of interest rates, inflation (currently above the euro area average) and currency exchange rates.

Good pre-sale rates in completed and ongoing projects support cash flow visibility

Pre-sale rates in Cordia's completed projects stood at 93% as at end-2022 (11 completed including one under a 50/50 joint venture), but the Gothic 1 project in Birmingham has the lowest with 28%.

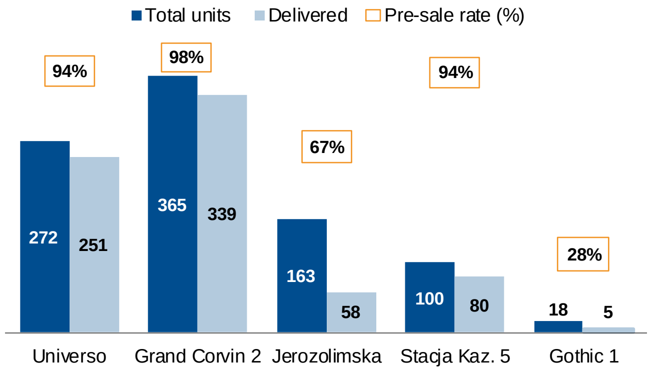
[4] Classification of locations as defined by Scope.

Figure 6: Pre-sale rates in ongoing projects by planned year of completion



Sources: Cordia, Scope

Figure 7: Pre-sale rates in projects completed during 2022



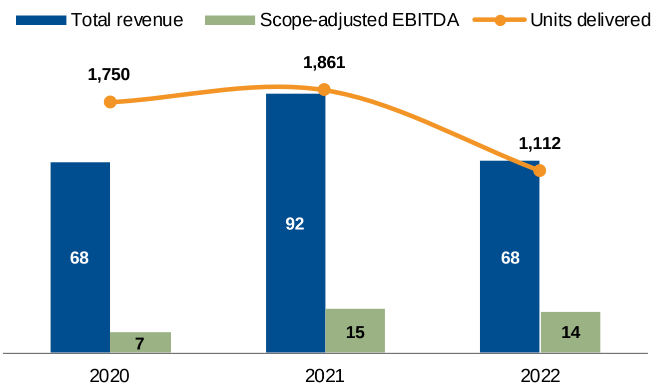
Sources: Cordia, Scope

Regarding the 18 projects under construction as of end-2022 (of which one is under a 50/50 joint venture), the pre-sale rate stood at 39%. In detail, five projects have just started, with pre-sales of 0%-10% (early commercialisation phase).

Profitability supported by low cost of land and growing sales price

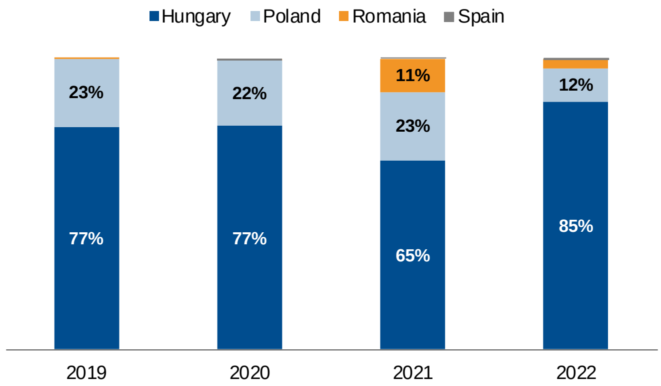
Despite the revenue drop in 2022 (-26% YoY) driven by the sharp decline in handovers (down 40% YoY), Cordia recorded a stable gross profit of HUF 25.4bn (gross profit margin of 37% – up 10.2 pp YoY) thanks to the recognition of more profitable projects in Hungary. This was supported by the cheap landbank coupled with an expanding sales price, as well as the positive scissor effect from a reduced cost of sales (contracting works were settled at fixed prices before construction costs increased further in 2022).

Figure 8: Revenue and Scope-adjusted EBITDA (HUF bn) vs number of units delivered



Sources: Cordia, Scope

Figure 9: Gross profit contribution by geographies



Sources: Cordia, Scope

As such, profitability as measured by the Scope-adjusted EBITDA margin rose to 21% in 2022 (up 4.3 pp YoY), which adjusts for the non-cash, one-off cost related to a HUF 5.8bn write-down of long-term receivables for legal claims. We expect profitability to remain above 15%, supported by the low cost of land in current projects and the fairly stable development costs, which should translate into a margin by project of above 20%.

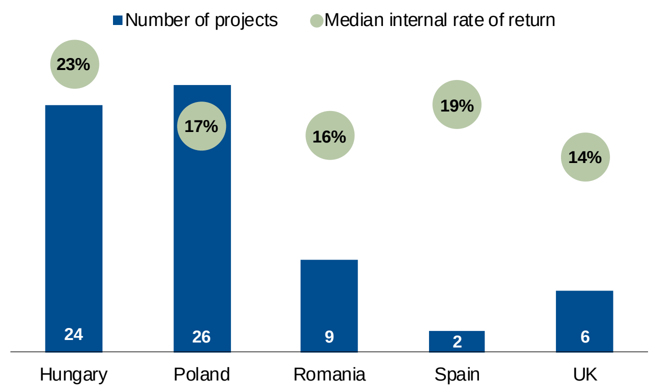
Robust project-based profitability in Cordia's core markets

Cordia emphasises profitability rather than volume, targeting a minimum 20% internal rate of return, 25% gross margin and 1.8x return on invested capital. To this end, Cordia has a restrictive land acquisition policy, as proven by the company's average land cost being 54% below Budapest market prices for ongoing projects as at end-2022.

The weighted average internal rate of return stands at 24% for completed projects and 21% for ongoing projects. Projects conducted in Hungary show the highest internal rate of return, expected to be further supported by shorter construction periods (by up to one-quarter in Budapest), contractors' capacity release due to lower order intakes, and a stabilisation of construction costs.

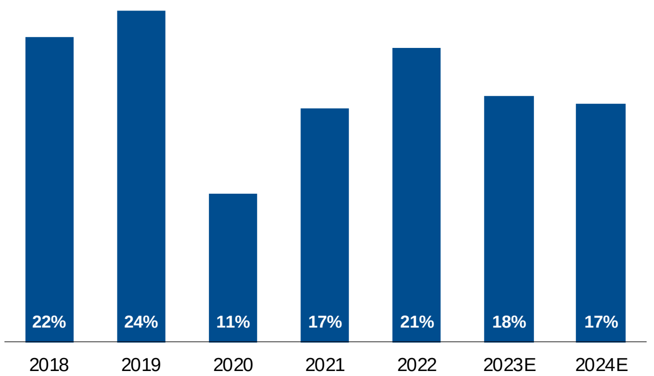
Figure 10: Projects' internal rates of return by geography

Including projects completed, ongoing and under preparation



Sources: Cordia, Scope estimates

Figure 11: Scope-adjusted EBITDA margin



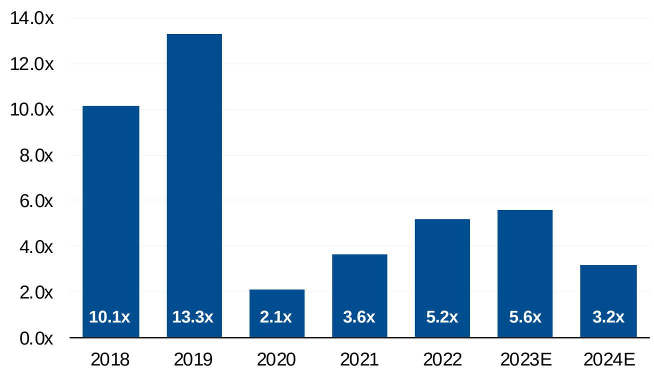
Sources: Cordia, Scope estimates

Financial risk profile: BB

Adequate debt protection to serve interest payments…

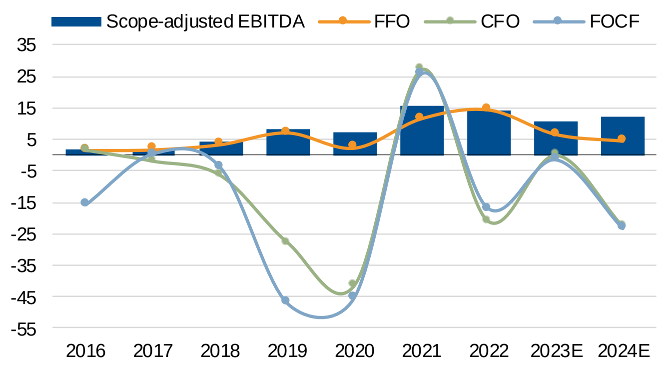
Cordia's debt protection is adequate, with Scope-adjusted EBITDA interest cover standing at 5.2x in 2022 (2021: 3.6x), largely supported by the significant profitability improvement. Interest cover level is sufficient to serve current and future interest payments while leaving some headroom against the potential cash flow volatility common in real estate development.

Figure 12: Scope-adjusted EBITDA/interest cover



Sources: Cordia, Scope estimates

Figure 13: Cash flow (HUF bn)



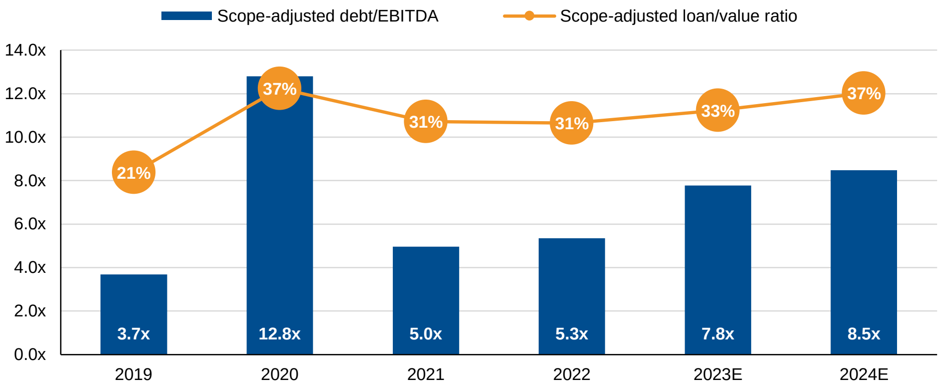
Sources: Cordia, Scope estimates

…although constrained by high interest rates and exposure to floating-rate debt

Nonetheless, Cordia is exposed to interest rate risk, as most of its projects are financed through floating-rate construction loans (HUF 23.8bn as of end-2022 – 18% of total debt). In addition, the vast majority of these loans are contracted in either Hungary (Bubor plus a margin) or Poland (Wibor plus a margin), which translate into effective rates of about 17% and 9% respectively. Cordia also issued a bond in Poland of HUF 5.9bn equivalent at a floating interest rate (six-month Wibor plus 4.25%). On the other hand, the interest rate risk is largely mitigated by timely drawdowns and scheduled repayments of construction loans in line with the projects' phases. The bulk of the company's debt is also at a fixed rate (3%-4%), made up of a bond series issued (HUF 84bn) under the MNB programme, thereby lowering the overall cost of debt.

We expect interest cover to be sustained at above 3.0x. This includes the higher interest burden from construction loan drawdowns, which will be mostly counterbalanced by interest received from cash deposits (around 14% on forint deposits as at end-March 2023). Altogether, this will maintain a strong interest cover in 2023, though the ratio could be under pressure from 2024 should deposit rates decrease.

Figure 14: Leverage



Sources: Cordia, Scope estimates

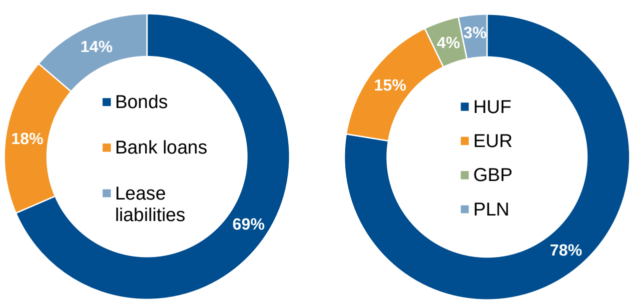
Leverage could peak through volatility in earnings and cash flow

Leverage as measured by Scope-adjusted debt/EBITDA slightly rose to 5.3x as of end-2022 (2021: 5.0x), which remains well below its 2020 peak following the bond issues. Leverage remains satisfactory for a residential developer, especially in the current context of rising interest rates and inflationary pressure, as it provides some headroom against a potential drop in market prices or a prolonged period of slack demand.

Indebtedness remained stable in 2022 with Scope-adjusted debt standing at HUF 77bn (up HUF 2.3bn YoY). Noting that all ongoing projects have already secured financing and no major debt issuance is expected in the foreseeable future (no refinancing needs), Cordia's debt will be mainly driven by movements in construction loans (aligned with development activities). As such, we expect that gross debt will stand between HUF 135bn and 145bn in 2023-2024, which should contain leverage below 10x, notwithstanding potential volatility in cash flow and earnings.

Figure 15: Debt composition and currency denomination

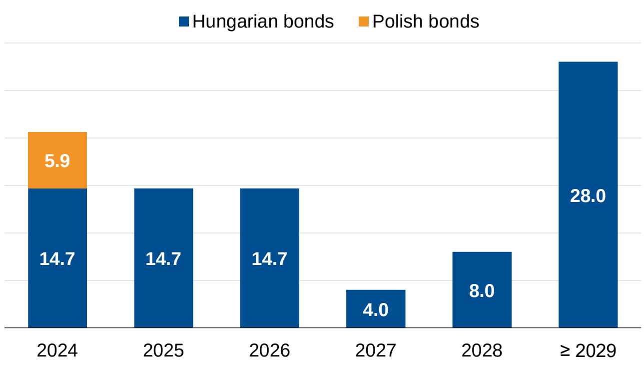
[As of end-2022]



Sources: Cordia, Scope

Figure 16: Bonds redemption schedule (HUF bn)

[As of end-2022]



Sources: Cordia, Scope

Adequate liquidity

Cordia's liquidity is adequate, with cash sources (unrestricted cash of HUF 57bn as of end-2022) fully covering short-term debt of HUF 18.1bn due in the 12 months to end-December 2023 and forecasted free operating cash flow of negative HUF 1.5bn. We believe the company can comfortably repay debt in the next 12-24 months, as all short-term debt relates to construction projects that are repaid along the project lifecycle. Construction loans are drawn as needed and repaid as soon as advances from customers come in. The company had HUF 57bn of approved credit financing as of end-2022, which are tied to project constructions; cross-subsidies are not possible.

Balance in HUF m	2022	2023E	2024E
Unrestricted cash (t-1)	47,280	57,083	50,823
Open committed credit lines (t-1)	57,388	57,000	0
Free operating cash flow	-17,076	-1,539	-23,315
Short-term debt (t-1)	16,483	18,102	18,102
Coverage	**> 200%**	**> 200%**	**152%**

The first bond maturities are not due before 2024 and Cordia has set a 1.5-year cash reserve for bond redemptions. We also find comfort in the issuer's liquidity management policy to keep a minimum cash position of EUR 50m (HUF 18.5bn) at all times.

Long-term debt rating

Senior unsecured debt rating: BB

We have affirmed the BB debt rating on senior unsecured debt issued by Cordia International Zrt. We expect an 'average' recovery for outstanding senior unsecured debt in a hypothetical default scenario in 2024 based on the company's liquidation value. With an unencumbered asset ratio of above 100%, senior unsecured debt holders could also benefit from a large pool of assets not pledged as collateral.

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