Euroboden GmbH
Germany, Real Estate

SCOPE B+ STABLE

Corporate profile

Euroboden GmbH is an owner-managed residential real estate developer with a focus on the high-quality segment, predominantly in Munich and Berlin. 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	2018/19	2019/20E	2020/21E	2021/22E
Scope-adjusted EBITDA interest cover (x)	9.9x	3.4x	3.0x	2.3x
Scope-adjusted loan/value ratio (%)	49%	54%	54%	54%
Scope-adjusted debt (SaD)/SaEBITDA (x)	4.1x	9.8x	8.6x	10.9x

Rating rationale

Scope has affirmed the issuer rating on Euroboden GmbH at B+/Stable as well as the BB rating on the senior unsecured debt class after the H1 2020/21 report.

The affirmation reflects the operating profits reported for 2019/20 and H1 2020/21 as well as the continued expansion of the issuer's development pipeline to around EUR 1.5bn within the past 12 months (+25% YoY), fully in line with our existing financial base case.

With regards to the business profile, assessed B+, the company remains a relatively small real estate developer. Further, its geographical exposure is concentrated around its two core markets of Munich (76% of estimated pipeline sales) and Berlin (18%), which again shifted to Munich this year as a result of asset sales in Berlin. We nevertheless deem the company's market shares and visibility in those two cities as robust, also in light of the continued robust demand for high-quality residential real estate throughout and after the Covid-19 pandemic. 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 as measured by the Scope-adjusted EBITDA margin is expected to stay between 15% and 20%, depending on the timing of project completions.

The financial risk profile, assessed B+, benefits from our expectation of Scope-adjusted 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 still forecast at between 50% and 60% for the next two business years. Furthermore, leverage as measured by Scope-adjusted debt (SaD)/Scope-adjusted EBITDA is expected in a range of 10x to 11x for the next two years in our financial base case. The liquidity assessment of the issuer has improved to adequate from weak.

Ratings & Outlook

Corporate rating B+/Stable

Senior unsecured rating BB

Analyst

Denis Kuhn
+49 69 6677389 83
d.kuhn@scoperatings.com

Related Methodologies

Corporate Rating Methodology

Rating Methodology European Real Estate Corporates

Scope Ratings GmbH

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

Tel. +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

While liquidity still suffers from the ongoing expansion through the substantial short-term debt and negative free operating cash flows, it benefits from an increased volume of undrawn committed credit lines as well as the fact that a substantial portion of expansion capex is discretionary.

In the case of a weaker-than-expected liquidity situation, project acquisitions as well as constructions starts could be postponed or cancelled. We therefore expect the issuer to be able to meet all its financial obligations in a reliable manner.

Outlook and rating-change drivers

The Outlook for Euroboden is Stable and incorporates the assumption of an LTV at the upper end of the 40%-60% range as well as sales executed at expected prices on the growing project pipeline. Moreover, we expect a 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 financial risk profile with an LTV of 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 or 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 and 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 • Track record of identifying and developing plots incl. zoning, obtaining building permits etc. • Euroboden’s ‘A’ located development portfolio supports price stability and liquidity of assets • Euroboden enjoys a dual track sales channel. Hence, projects can be either sold to other developers after pre-development on a “ready for construction” basis or to end users or investors after construction	• 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 1.5bn in September 2021) with persisting 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 significant short-term debt, mitigated by available credit lines and cash on hand

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• 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

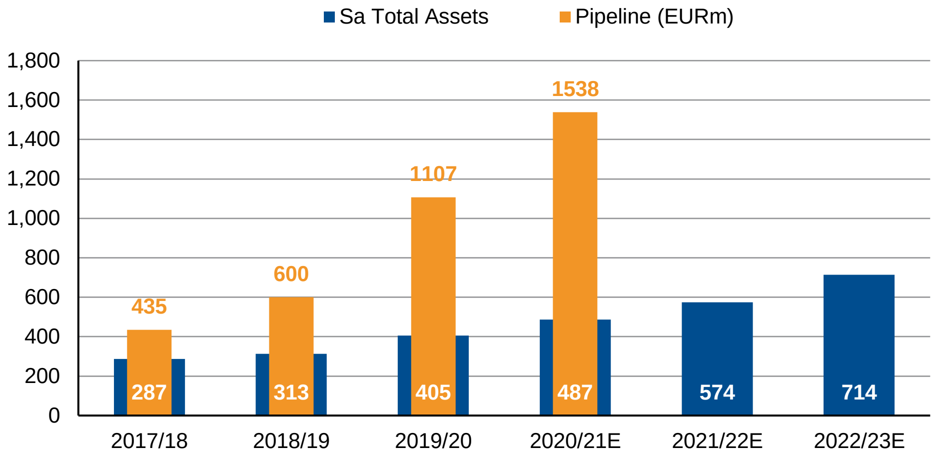
			Scope estimates	
Scope credit ratios	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
Scope-adjusted EBITDA/interest cover (x)	9.9x	3.4x	3.0x	2.3x
Scope-adjusted debt/Scope-adjusted EBITDA (x)	4.1x	9.8x	8.6x	10.9x
Scope-adjusted loan/value ratio (%)	49%	54%	54%	54%
Scope-adjusted EBITDA in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
EBITDA	36.1	21.6	30.0	27.7
Operating lease payments in respective year	0.7	0.6	0.6	0.6
Scope-adjusted EBITDA	**36.8**	**22.2**	**30.6**	**28.3**
Scope funds from operations in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
Scope-adjusted EBITDA	36.8	22.2	30.6	28.3
less: cash interest as per cash flow statement	-3.7	-6.4	-10.0	-12.4
Less: interest component, operating leases	-0.1	-0.1	-0.1	-0.1
less: cash tax paid as per cash flow statement	-1.0	-2.7	-5.9	-4.5
Change in provisions	-2.5	-0.2	-0.2	-0.2
Scope-adjusted funds from operations	**29.5**	**12.8**	**14.4**	**11.2**
Scope-adjusted debt in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
Reported gross financial debt	154.3	219.8	301.0	346.0
less: cash, cash equivalents	-3.8	-3.2	-40.9	-40.5
Cash not accessible	0.5	0.5	0.5	0.5
add: operating lease obligations	1.2	1.2	1.6	1.6
Scope-adjusted debt	**152.2**	**218.3**	**262.2**	**307.6**

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

Benefits from established brand and robust demand for high-quality living space

With Scope-adjusted total assets of almost EUR 500m (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 1.5bn project pipeline as of September 2021. The number of residential units under development also still stands at more than 1,000 as of September 2021, implying that the company's high market visibility continues in its core markets. Market position is expected to improve further upon the successful execution of i) larger projects in Munich and Berlin; and ii) geographical expansion (more detail below). 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. It implies a greater sensitivity to unforeseen shocks, greater volatility in cash flows and higher key person risk. Euroboden sees itself as an 'architectural brand' with an established network of well-known architects. According to the company, its self-positioning and brand-building facilitate off-market deals, allowing it to avoid bidder competition for land and properties and to carry out its pricing policy.

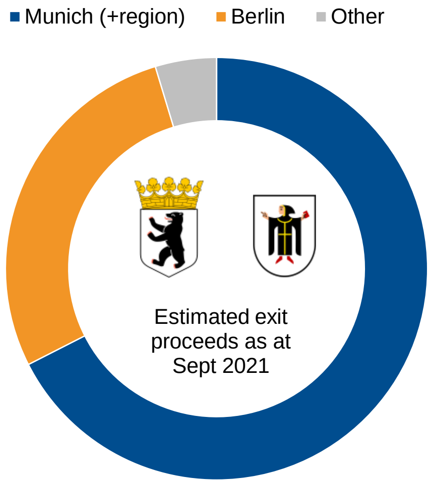
Limited geographical diversification with cluster risks on Munich and Berlin

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.

Euroboden generates the vast majority of its income (around 90% on average over the past three business years) from development, with other revenue sources such as rental income and 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 therefore credit-negative. Since 2015/16, selective investments in other asset classes have provided some recurring income streams, which are expected to increase over the next business years.

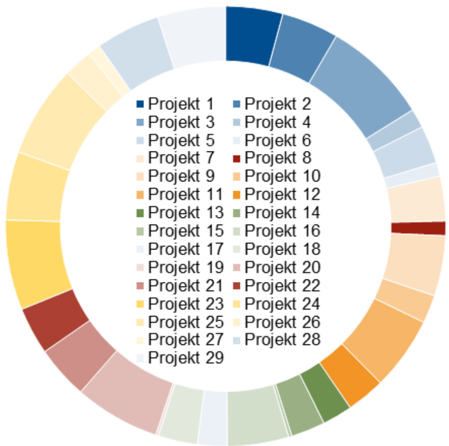
These recurring revenue streams are credit-positive as they partially mitigate the cash flow volatility of the development business. The issuer has also expanded its asset focus by adding office projects within the past two to three years, but at this point we expect upscale residential developments 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 2: Geographical diversification of project pipeline as of September 2021



Sources: Euroboden, Scope

Figure 3: Expected project pipeline exit proceeds as of September 2021



Sources: Euroboden, Scope

Euroboden's development pipeline has improved regarding concentration and contains 29 individual projects as of September 2021.

Improving granularity of development pipeline with 29 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 (76% of expected sales volume) and Berlin (18%). Furthermore, both cities benefit from favourable demand for residential real estate, even during the recent economic slump triggered by the Covid-19 pandemic. 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.

Dual track sales approach increases cash management flexibility

Euroboden has a strong focus and expertise in identifying and developing plots of land into "ready for construction project sites". Thus Euroboden enjoys a dual track sales channel. Projects can be either sold to other developers on a "ready for construction" basis or to end users or investors after completion of construction (including pre-sales). This dual track sales approach increases the issuer's cash management flexibility and enables Euroboden to substantially reduce the funding time of individual projects.

With Scope-adjusted EBITDA margins in recent years of 15% (2015/16) to more than 30% (2018/19), profitability has been volatile but continues to increase. We expect Scope-adjusted EBITDA margins to remain within a range of 15% to 20% going forward.

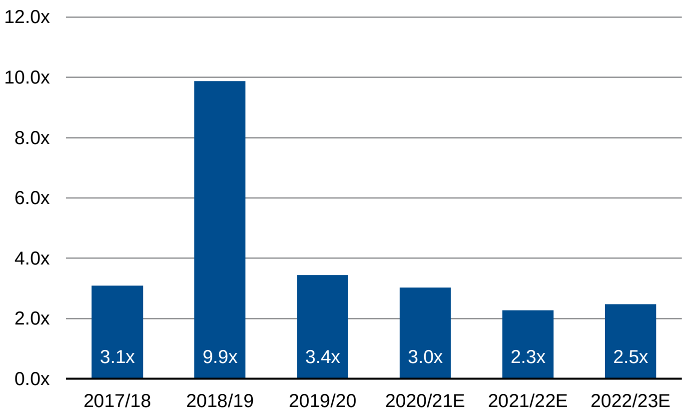
Euroboden has clearly benefitted from the strong demand for residential real estate development in Munich and Berlin. However, strong demand also impacts the company's acquisition pipeline. Projects added more recently are expected to be less profitable in terms of net margins but still in line with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

Financial risk profile: B+

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

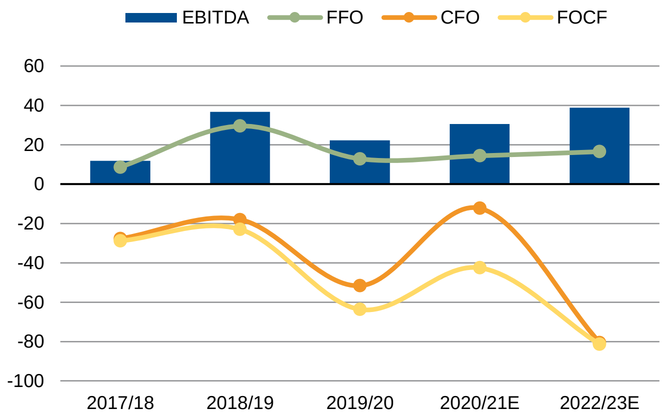
Scope-adjusted EBITDA interest cover is expected at 3.0x for the business year ending 30 September 2021 and to remain above 2.2x in our forecast period. However, this ratio will fluctuate depending on the timely delivery and disposal of projects. If projects are delayed, Euroboden may have to rely on external financing to cover interest payments. We believe external financing is readily available, thanks to: i) committed, undrawn credit lines totalling EUR 45.8m as at August 2021, which can be drawn upon without restrictions; and ii) hidden reserves, which allow existing credit lines to be increased.

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



Sources: Euroboden, Scope estimates

Figure 5: Cash flows (EUR m)

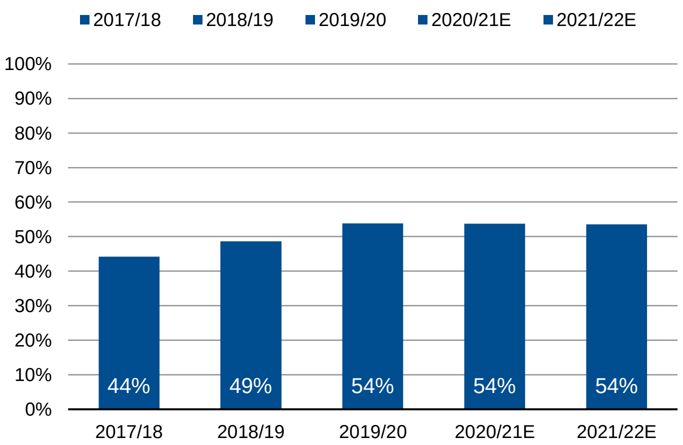


Sources: Euroboden, Scope estimates

LTV expected to remain at between 50% and 60%

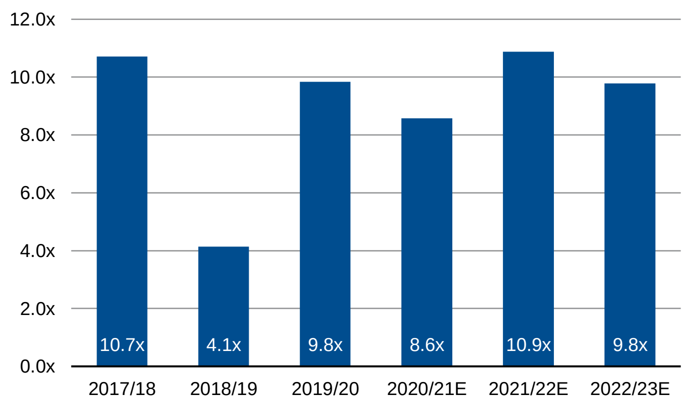
The company's cash flow has been volatile, with negative free operating cash flow driven by the expansion of the business over the last years (Figure 5). We expect free operating cash flow to remain negative, owing to anticipated further dynamic growth, as well as to the nature of real estate development.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

Figure 6: Loan/value ratio (%)



Sources: Euroboden, Scope estimates

Figure 7: Scope-adjusted debt/EBITDA



Sources: Euroboden, Scope

We consider liquidity to be adequate. In detail, subject to substantial fluctuations in the past, liquidity is expected to develop as follows:

Position (EUR m)	2020/21E	2021/22E
Short-term debt (t-1)	45.8	42.7
Unrestricted cash (t-1)	2.7	40.4
Free operating cash flow (t)	-42.6	-53.7
Open committed credit lines (t-1)	45.8	45.8
Liquidity (internal and external)	**0.1x**	**0.8x**

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 largely discretionary, relating to investments in new projects that could be stopped or postponed if deemed necessary by management.

Sufficient access to external financing via bonds and bank debt

Free operating cash flow is expected to be negative by around EUR 43m 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 sufficient access to external financing, in our view.

BB rating on senior unsecured debt affirmed

Long and short-term debt instrument ratings

As at September 2021, around EUR 85m of senior unsecured capital market debt was outstanding. According to our methodology and reasonable discounts on the company's asset base, we expect an 'above-average' recovery of more than 71%, thus allowing for a two-notch uplift on the issuer rating. This translates into an affirmation of the BB rating for senior unsecured debt.

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

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

Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer