Credit Rating Announcement

29 May 2017

Scope affirms EUROBODEN's B issuer rating and BB- unsecured bond rating, both with Stable Outlook

Rating affirmation supported by company's 2016 financial results matching its business plan.

The B issuer rating for EUROBODEN, a real estate developer with a focus on the high-quality segment, is supported by the company's: i) 'A'-located and highly liquid properties in its development portfolio; ii) positive 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 that enables off-market deals.

The issuer rating is negatively affected by EUROBODEN's position as a small niche player in high-quality residential property development and its volatile cash flows. The full exposure to the cyclical real estate market and dependence on external financing are also credit-negative. In addition, key person risk exists due to the still-vital contribution of the CEO, who is also the company's owner and founder.

Business risk profile

Industry risk for EUROBODEN is assessed to be very modest, as the company is exposed to the highly cyclical real estate industry. Its core activity consists of developing residential real estate. Scope's short-term credit view for the industry is positive but accompanied by increasing sensitivity against changes in politics, economic conditions and interest rates.

With total assets of EUR 82m at end-September 2016 (+55% YoY) and funds from operations (FFO) of EUR 2m for the year to September 2016 (+100%), EUROBODEN is a small company, but exhibits strong growth in the highly fragmented market of German real estate developers. Size is expected to grow further in the next two years thanks to the larger project pipeline, which grew to EUR 435m as of May 2017 from EUR 302m at YE 2015. EURBODEN's activities focus on niche, high-quality residential real estate development, a market characterised by elastic demand and generally volatile prices. The company's limited size and market position also indicate a heightened sensitivity to unforeseen shocks and stronger volatility in cash flows, particularly as EUROBODEN is highly exposed to inherent cyclicality in the real estate market, with 84% of its revenues linked to development activity, which Scope judges as credit-negative.

EUROBODEN's cash flow volatility is exacerbated by its concentrated pipeline of 10 development projects, the largest of which represents 26% of expected future turnover. This very modest diversification might affect future cash flows if projects suffer delays or cost overruns. However, Scope believes asset prices and demand in EUROBODEN's core markets, Munich and Berlin, will keep growing after average prices in both markets rose by 75% from 2011. This trend looks set to continue, however at a slower pace (Deutscher Wohnimmobilienmarkt: Ende des Booms - aber kein Crash), owing to the lack of new apartments and the strong growth expected for both cities. These factors could strengthen the company's business model in the coming years In addition, the development portfolio's assets are situated predominately in the 'A'-rated locations of Munich and Berlin. Scope believes this supports the fungibility and liquidity of its properties and lowers potential price haircuts in a distressed sales scenario.

EUROBODEN's profitability has remained stable: EBITDA margin rose to 16% in 2016 from 8% in 2015. Scope believes this margin will generally remain above 10%, supported by the 20% EBITDA margin for the last 10 projects, along with the high-quality development pipeline. The company's project-related EBITDA margin of 20% is higher than many of its peers'. Scope anticipates a stable project-related EBITDA margin of around 20%, which is supported by the firm's profound market knowledge and brand recognition that enables off-market deals.

Financial risk profile

EUROBODEN's EBITDA interest cover stood at a sufficient 2.5x at end-September 2016. This is expected to remain above 1x. However, this ratio will fluctuate, depending on the on-time delivery and disposal of projects. If projects are delayed, EUROBODEN may have to rely on external financing to cover interest payments. Scope believes external financing is readily available, thanks to i) the committed, undrawn credit lines which can be drawn on without restrictions and ii) the hidden reserves, which allow the further step-up of existing credit lines.

The company's cash flow generation was volatile, with negative free operating cash flow (FOCF) driven by the expansion of business over the last four years. Scope expects FOCF to continue to be negative, owing to the expectation of further growth, as well as to the nature of real estate development, the company's core activity. Thus cash in- 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 to EUROBODEN's business model.

The company's loan/value ratio (LTV) increased to 45% (incl. Scope adjusted hidden reserves of EUR 64m) at the end of September 2016, a consequence of the upscaling of the company's indebtedness. Scope-adjusted debt (SaD) increased by EUR 35m to EUR 66m, driven by the acquisition of new properties and the financing of the development of existing projects. However, 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. Scope does not believe that the company will be able to significantly reduce its leverage over the next few years.

The company's SaD/EBITDA of 12x (2016) implies a level commensurate with a B financial risk profile. The ratio was and will continue to be volatile. However, Scope judges this volatility to be typical for a developer, with projects not looked at and financed in annual tranches but over the whole development period.

Liquidity

EUROBODEN's liquidity – subject to high volatility in the past – is expected to stay below 100% for the next two years. As such Scope does not believe that the company can repay the EUR 48m of debt due in the next 24 months using operational cash flow and available cash. Thus the company will have to rely on external funding to redeem maturing debt. However, if EUROBODEN proves its operational success, with pre-sale rates of greater 50% – supported by the market environment – by delivering on time and on cost, as well as making disposals at targeted prices, extension of credit facilities for project debt should be possible and EUROBODEN will be able to manage refinancing risk. This is evidenced by the company's ability to either refinance or repay almost 100% (EUR 12m) of debt due in 2016-17 by 31 March 2017.

Nonetheless, Scope expects EUROBODEN to be exposed to substantial refinancing risk in 2018 related to its corporate bond, potentially triggered by delays in project delivery. Scope expects that EUROBODEN will have an executable refinancing concept by the end of this year.

Bond 2013/18 – 7.375% (ISIN DE000A1RE8B0)

As the bond is unsecured, its credit quality is tightly linked with EUROBODEN's credit quality and performance. However, as EUROBODEN has disclosed hidden reserves, and has a development portfolio with very well-located assets, Scope believes the bond's potential recovery is well above market average, lifting the bond's rating two notches above the issuer rating.

Outlook

The rating Outlook is Stable, supported by EUROBODEN's high-quality development pipeline in the still-booming core markets of Munich and Berlin. The Stable Outlook incorporates Scope's expectation that the EBITDA interest cover remains sustainably above 1.0x, that project-related profitability will remain at EBITDA margins of between 15% and 20%, and that the EUR 435m project pipeline will be successfully executed in the next few years.

A negative rating action is possible if the company's LTV exceeded 60%, if EBITDA interest cover did not remain substantially above 1.0x on a sustained basis, or if the company's access to bank financing weakened.

Scope could consider a positive rating action if EUROBODEN managed to maintain its LTV below 50% and if its unsecured debt is refinanced in 2018.

Regulatory disclosures

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund.

The rating analysis has been prepared by Philipp Wass, Lead Analyst
Responsible for approving the rating: Olaf Tölke, Committee Chair

Rating history - EUROBODEN GmbH

(Date | Rating action | Rating)
27 May 2016 I Affirmation I B I Stable
28 May 2015 I Initial Rating I B I Stable

Rating history - EUROBODEN GmbH - Bond 2013/18 – 7.375% (ISIN DE000A1RE8B0)

(Date | Rating action | Rating)
27 May 2016 I Affirmation I BB- I Stable
28 May 2015 I Initial Rating I BB- I Stable

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

Information on interests and conflicts of interest

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• Prospectus
• Website of the rated entity
• Annual financial statements
• Annual reports/semi-annual reports of the rated entity
• Information provided on request
• Data provided by external data providers
• Valuation reports
• External market reports
• Press reports / other public information
• Interview with the rated entity

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Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodologies applicable for this rating (Corporate Rating Methodology, Rating Methodology - European Real Estate Corporates) are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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