2 June 2022

Corporates

Cordia International Zrt.
Hungary, Real Estate

BB NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.1x	3.6x	2.8x	1.5x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	12.7x	4.8x	6.5x	17.1x
LTV	37%	30%	27%	45%

Rating rationale

The Outlook change to Negative reflects our view of Cordia's ongoing business expansion, despite the weaker anticipated economic environment, which if pursued will be putting strain on the company's financial risk profile. Cordia's financial risk profile improved significantly in 2021, with Scope-adjusted loan/value decreasing to 30% from 37%, Scope-adjusted debt (SaD)/EBITDA falling to 4.8x from 12.7x and interest coverage increasing to 3.6x from 2.1x. However, factoring in our expectation of Cordia's ambitious expansion plan will increase loan/value to 45%, SaD/EBITDA to 17x and reduce interest cover to a mere 1.5x in 2023E. The Negative Outlook is also driven by the greater uncertainty in the overall market environment, resulting in a potential squeeze on profit margins due to a slowdown of sales, while inflationary pressure, supply chain disruptions and increasing interest rates weigh on the cost side. Cordia's planned expansion includes a new build-to-rent development business segment in the UK together with further growth in its core markets in Hungary, Poland and Romania.

Outlook and rating-change drivers

The Outlook for Cordia is Negative reflecting our view of a high probability of leverage, as measured by SaD/EBITDA, averaging 10x for the next three years and interest cover, as measured by EBITDA/interest, below 2.5x on a sustained basis amid lower visibility on business fundamentals i.e. a weaker economic environment and inflationary pressure. Our base case incorporates the following assumptions: i) Cordia will continue to successfully execute its growth plans and integrate acquired entities; ii) a loan/value ratio of below 50% based on SaD/Scope-adjusted total assets; and iii) volatile EBITDA interest coverage with short-term dips due to project loans and the nature of the business.

A positive rating action, with a return to a Stable Outlook, could be warranted by interest cover of above 2.5x on a sustained basis. This could, for instance, be achieved via significant recurring rental income, a different funding structure for Cordia's ambitious expansion resulting in less floating rate construction loans and/or a more conservative growth strategy.

A negative rating action, i.e. a downgrade, might be warranted by EBITDA interest cover below 2.5x on a sustained basis. This could be triggered by a deterioration in market conditions, accelerated interest rate growth and a related margin squeeze widening the gap between required EBITDA and interest to be covered.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
20 May 2022	Outlook change	BB/Negative
21 June 2021	Rating unchanged	BB/Stable
23 June 2020	Affirmation	BB/Stable

Ratings & Outlook

Issuer	BB/Negative
Senior unsecured debt	BB

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Related Methodology(ies) and Related Research

Corporate Rating Methodology; July 2021

European Real Estate Methodology; January 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Moderate leverage with loan/value ratio of around 30%-45% despite a significant growth programme • Well-established market position in residential real estate in Budapest and increasing market share in Poland after Polnord acquisition • Well-diversified project pipeline and good asset quality across four different economies	• Small to medium sized property developer (compared to Western peers), resulting in high sensitivity to unforeseen shocks and volatile cash flows, and limited recurring income (rental/other) • Negative free operating cash flow driven by continuous portfolio expansion, partially funded via debt markets • Historically strong cluster risk around Budapest

Positive rating-change drivers	Negative rating-change drivers
• Return to a Stable Outlook could be warranted by interest cover above 2.5x on sustained basis	• Downgrade might be warranted by EBITDA interest cover below 2.5x on a sustained basis

Corporate profile

Cordia International Zrt. is a privately owned Hungarian residential real estate developer predominantly active in the business-to-customer for-sale market. The company focuses on major cities in Hungary, Poland and Romania with a small exposure to Spain and the UK. It also has exposure to Germany through its investment in listed residential real estate corporate Argo Properties N.V. Cordia’s developments are mainly aimed at middle/upper-middle-class customers and, to a smaller degree, investors. Cordia as a brand has existed since 2005 and was spun out of Futureal as an independent company in 2016. The 2020 acquisition of Polnord, a Poland-based listed real estate developer, has expanded Cordia’s footprint in the country.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	2.1x	3.6x	2.8x	1.5x	2.2x
SaD/Scope-adjusted EBITDA	12.7x	4.8x	6.5x	17.1x	7.0x
Loan/value	37%	30%	27%	45%	45%
Scope-adjusted EBITDA in HUF m					
EBITDA	7,261	15,464	11,147	9,518	24,845
Operating lease payments	0	0	0	0	0
Other items	0	0	0	0	0
Scope-adjusted EBITDA	7,261	15,464	11,147	9,518	24,845
Funds from operations in Scope-adjusted EBITDA in					
Scope-adjusted EBITDA	7,261	15,464	11,147	9,518	24,845
less: (net) cash interest paid	-3,460	-4,271	-4,023	-6,524	-11,130
less: cash tax paid per cash flow statement	-278	-174	-391	-841	-1,226
less: capitalised interest	-661	-1,900	-1,270	-615	-1,459
Change in provisions	-465	2,572	0	0	0
Funds from operations	2,397	11,692	5,464	1,539	11,031
Free operating cash flow in Scope-adjusted EBITDA in					
Funds from operations	2,397	11,692	5,464	1,539	11,031
Change in working capital	-43,988	15,633	-20,895	-93,869	-22,061
Non-operating cash flow	10,689	8,637	0	0	0
less: capital expenditure (net)	0	0	0	0	0
less: operating lease payments	0	0	0	0	0
Free operating cash flow	**-41,591**	**27,325**	**-15,431**	**-92,330**	**-11,030**
Net cash interest paid in Scope-adjusted EBITDA in					
Net cash interest per cash flow statement	3,460	4,271	4,023	6,524	11,130
Change in other items	0	0	0	0	0
Net cash interest paid	**3,460**	**4,271**	**4,023**	**6,524**	**11,130**
Scope-adjusted debt in Scope-adjusted EBITDA in					
Reported gross financial debt	148,711	123,957	107,474	195,991	204,508
less: hybrid bonds	0	0	0	0	0
less: cash and cash equivalents	67,089	56,690	40,925	36,928	35,075
add: non-accessible cash	-10,725	-6,310	-6,310	-6,310	-6,310
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	**92,347**	**73,577**	**72,860**	**165,374**	**175,744**

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Environmental, social and governance (ESG) profile[1]

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)	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)

een leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

ESG strategy

As a major CEE real estate developer, Cordia is willing and able to significantly contribute to the goals of the EU's Green Deal to decrease the greenhouse gas emission of buildings in the region. The company also endorses all 17 sustainable development goals as defined by the UN. Cordia's ambitions regarding green buildings and energy efficiency benefit customers and the company alike, allowing buyers to take out subsidised green mortgages and opening up the potential to issue green bonds at favourable conditions for the latter.

[1] 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

As a residential real estate developer, Cordia is exposed to the highly cyclical real estate industry with low barriers to entry and low substitution risk. We view real estate development as the riskiest sub-segment in real estate and assign an industry risk of BB to companies active within it.

Leading residential real estate developer in Budapest, small in a European context

With a total asset value of HUF 245bn (EUR 660m including hidden reserves of HUF 20bn at YE 2021), Cordia is a fairly small property company in a European context. Its size is expected to grow significantly over the next two years, with its project pipeline taking it to HUF 390bn in Scope-adjusted-assets and HUF 9.5bn-HUF 25bn in EBITDA annually, if management pursues all its growth plans.

In terms of market share, Cordia is one of the leading residential real estate developers in Hungary. In the last four years, Cordia (and its predecessor Futureal) has been responsible for over 12% of newbuilds in Budapest. The company focusses on the mid-market segment, which represents 60%-70% of the market, resulting in a 20%-25% market share in its target markets (defined by segment and location) in Hungary.

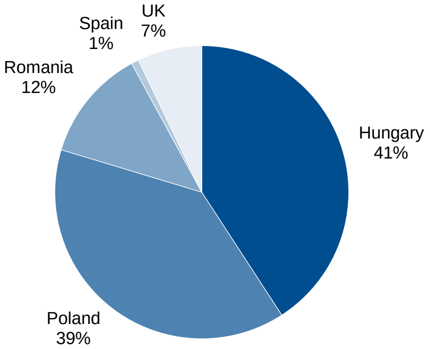
In Poland, the market is more fragmented than in Hungary and Cordia's overall market share is around 1%. In Bucharest, Cordia has a market share of about 1.5% of newbuilds. Its market share in the UK and Spain is negligible.

Cordia's development portfolio is located predominantly in Budapest, with an increasing share of developments in Warsaw, Cracow, Tricity, Bucharest and Birmingham. The company is focussing on urban areas, zeroing in on the most mature, liquid and growing markets in each respective country. In addition, there is a great need for the renewal of housing stocks in Eastern Europe.

Relatively low and volatile pre-sale ratio weighs on rating

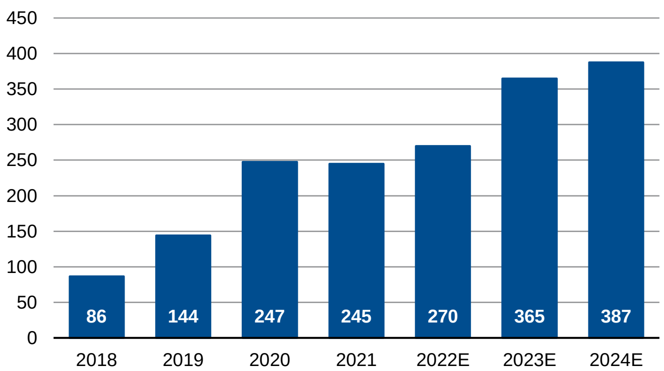
At year-end 2021, the average pre-sale rate for ongoing projects was at 48% of total value (translating into around 70% as per our cost coverage calculation), which is a deterioration compared to previous years. If we look at the projects to be finished in 2022, the rate increases to 60% (around 84% based on our cost coverage calculation), which is in line with previous years. However, the volatility of this ratio weighs on the rating. Also, in light of the uncertain geopolitical environment, inflationary pressure and weaker expected economic growth, a low pre-sale rate poses the risk of a slowdown in sales, which would drag on cash flows.

Figure 1: Geographical project diversification



Sources: Cordia International, Scope

Figure 2: Total Scope-adjusted assets (HUF bn)



Sources: Cordia International, Scope

Improved geographical diversification

Geographical diversification has improved recently due to the direct and indirect acquisitions of new projects in Poland (via the Polnord company acquisition in 2020), Spain and the UK as well as a minority stake in rental/lease company Argo Properties B.V., active in Germany. With exposure to more than 60 projects, both ongoing and in preparation, project risk concentration is moderate. Cordia uses different general contractors for its projects based outside of Hungary. For residential real estate developments in Hungary, Cordia has its preferred partner Pedrano, a residential general contractor working exclusively for Cordia and Futureal at present.

The company's customer base is highly diversified, mostly consisting of single-flat buyers for own use and a small group of investors (mainly families investing in real estate) purchasing several apartments. Going forward, Cordia wants to develop more build-to-rent properties (starting in the UK), which might be more attractive to larger investors with the capacity to absorb over 100 units, but so far these projects have not started.

Dip in profitability due to Covid-19 and Polnord acquisition

Cordia's historical dataset shows that its EBITDA margin is rather volatile: from 2017-2019 it was 22%-29% before dropping to 11% in 2020. This drop was due to: i) a Covid-19-related fall in sales; and ii) the acquisition of Polnord, a Polish real estate developer, whose margin was 3.7% at the time of purchase. Cordia restructured Polnord and increased its gross margins to 20% over 2021, resulting in a recovery of the group's EBITDA margin to 16%. Going forward we expect the margin to be stable at current levels in 2022E and 2023E, before an increase to 21% in 2024 with the handover of the first build-to-rent properties in the UK.

On a project basis, Cordia only underwrites projects with an internally calculated profit of at least 20% and a gross margin of over 25%. Looking at Cordia's history on a project by project basis, the company has achieved an average gross margin (defined as sales/cost of goods sold) of 27% for the last 15 project handovers until May 2022. We calculate that this translates into an internal rate of return of 11.5%.

Financial risk profile: BB

Geopolitical climate and strong expansion negatively affect credit metrics

Our rating base case assumes a slowdown in sales due to the current economic geopolitical climate, resulting in postponed revenues in 2022-2024. Cordia's ambitious build-to-rent property development plans in the UK, starting in 2023 if pursued by management, will heavily affect cash flows, increase debt and will only start generating rental revenues for the portion Cordia is keeping on balance sheet from 2025.

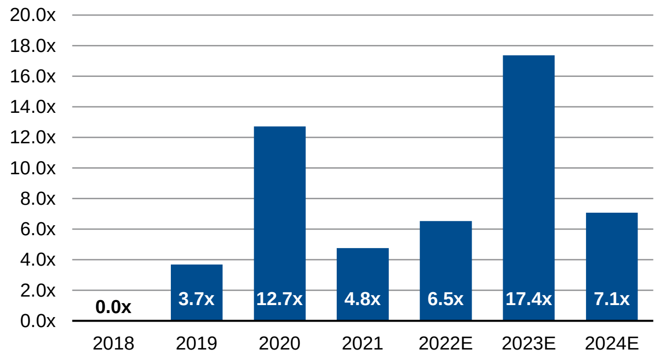
Volatile leverage, driven by aggressive expansion plan

Up until 2018, Cordia only had a negative loan/value ratio due to a net cash position (without any adjustments for hidden reserves). The loan/value ratio increased to 37% in 2020 due to the issuance of bonds. In 2021 the company managed to delever somewhat, coming in at 30% (compared to our expectation of 36%), a level we also expect for 2022E. Thereafter, our base case assumes a significant growth plan with large development investments in the UK and in Cordia's home markets, lifting loan/value to 45% in 2023E and keeping it at these elevated levels thereafter.

Leverage, as measured by SaD/EBITDA, increased significantly due to the bond issuances under the MNB programme and peaked at 12.7x in 2020. Last year, we expected this ratio to stabilise at high levels, but Cordia was able to bring it down to 4.8x. This was thanks to deleveraging, predominantly as regards SPV project debt, and much stronger EBITDA in 2021 than anticipated (faster turnaround of the Polnord acquisition).

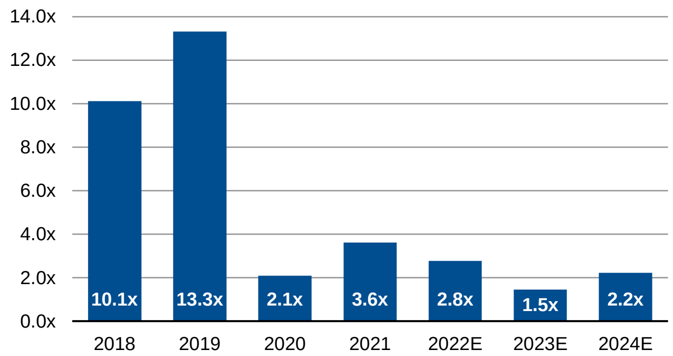
We forecast that SaD/EBITDA will again increase somewhat to 6.5x in 2022 due to a slowdown in business and less handovers this year. In 2023 we foresee a significant need for external financing to support the anticipated growth if pursued by management, taking SaD/EBITDA up to 17x on our forecast, followed by deleveraging again to 7.0x in 2024E as we expect the handovers to afford strong positive EBITDA contributions.

Figure 3: Leverage (SaD/Scope-adjusted EBITDA)



Sources: Cordia, Scope (estimates)

Figure 4: Scope-adjusted EBITDA/interest cover



Sources: Cordia, Scope (estimates)

Interest cover negatively affected by expansion plans and rising interest environment

Cordia started its operations with equity financing in 2016 and has since attracted investments via its investment fund, which are treated as equity under IFRS. The company only draws on construction loans as it builds. Therefore, interest payments have historically been very modest, resulting in a high historic EBITDA interest coverage of 10-20x in 2017-2019. Interest cover dropped to 2.1x in 2020 following the issuance of bonds under the MNB funding for growth scheme in 2020. It improved to 3.6x in 2021 on the back of numerous handovers that year, benefitting EBITDA. Cordia also reduced its project loans by two thirds during the year.

The majority of Cordia's bonds are denominated in HUF under the MNB's bond programme. The first bond is at a fixed rate of 4% and the last two have a fixed rate of 3%. This fixed exposure will be favourable in a rising interest rate environment. In mid-2021 Cordia issued its first small bond in Poland (equivalent to HUF 5.7bn), where floaters are the norm, at 6m Wibor +4.25%. Since then, 6m Wibor has moved from 0.25% to 6.6%, demonstrating the rapidly changing interest environment.

Going forward we expect lower interest cover of 2.0x to 2.8x as a result of the sharp rise in the cost of debt on Cordia's project loans. 2023E will be particularly hit hard as the forecasted investments are large (HUF 90bn) and EBITDA will follow with a lag, taking interest cover down to 1.5x based on our estimates.

Furthermore, all of Cordia's construction loans are floating rate, (although they are in local currency, which dispenses with forex risk). This means that a delay in the construction, delivery or sale of units could result in prolonged interest payments at higher rates

Adequate liquidity

We expect Cordia's liquidity to stay adequate for the next three years despite highly negative cash flows in 2023 turning the ratio negative. We believe the company will be comfortably able to repay debt in the next 12-24 months as all short-term debt is tied to construction projects and is thus only repaid upon project completion.

Balance in Scope-adjusted EBITDA in	2022E	2023E
Unrestricted cash (t-1)	50,380	34,614
Open committed credit lines (t-1)	57,388	57,388
Free operating cash flow	-6,481	-93,130
Short-term debt (t-1)	16,483	16,483
Coverage	**614%**	**-7%**

Long-term and short-term debt ratings

Senior unsecured debt rating: BB

Cordia currently has four senior unsecured bonds outstanding, three in HUF (fixed coupon) and one in PLN (floating rate).

We rate senior unsecured debt at the same level as the issuer rating based on: i) our recovery analysis, with a hypothetical default scenario at year-end 2024, which shows a high sensitivity to attainable prices in a distressed sales scenario; ii) the structural subordination of Cordia's senior unsecured creditors to construction loans on SPV level; and iii) current and future secured debt at property SPV level, which consists of fully drawn construction loans at the hypothetical point of default. This translates into a BB rating for senior unsecured debt.

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