15 December 2022

Corporates

Kopaszi Gát Zrt.
Hungary, Real Estate

SCOPE

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA interest cover	10.0x	5.8x	0.2x	3.5x
Scope-adjusted debt/EBITDA	4.2x	9.3x	242.2x	6.2x
Scope-adjusted loan/value	38%	49%	82%	64%

Rating rationale

Kopaszi Gát Zrt.'s (Kopaszi) business risk profile reflects its industry risk as a real estate developer with limited recurring income and a strong focus on homebuilding. Credit-positive aspects are the diversified customer base due to the retail residential core business and the issuer's asset quality due to the focus on medium- to high-end residential projects, which enjoy robust demand, reflected in a high pre-sale ratio. A predominant exposure to the weakening Hungarian economy and high cluster risk around Budapest holds back the business risk profile. Small size, with Scope-adjusted assets of below EUR 300m as of June 2022, implies greater sensitivity to unforeseen shocks, greater volatility in cash flows and a heightened sensitivity to the performance of single projects. Limited size is evident in: i) the concentrated development pipeline; and ii) the full geographical concentration on Budapest.

The financial risk profile reflects our expectation that credit metrics will return to a level commensurate with the rating category in 2023, after an expected weakening in 2022 due to the company's planned shift of the BOE office building disposal. We note the heightened execution risk associated with that strategy, as potential buyers are understandably more cautious and hesitant to make decisions, preferring a wait-and-see approach in the current economic climate. Nevertheless, the building scores high on quality and energy efficiency with a LEED Gold certification, partially mitigating this risk; more than five international investors having signed the NDA and are interested in acquiring the building.

Outlook and rating-change drivers

The Outlook is Stable and incorporates the disposal of the BOE office building and two residential buildings in 2023. While we expect weakened credit metrics in 2022, metrics will return to adequate levels for the rating category from 2023 onwards. Scope-adjusted debt/EBITDA will approach 11x by 2024 and Scope-adjusted EBITDA interest cover is expected to remain above 2.0x on average in the period from 2022 to 2024. We also assume ongoing adequate access to external financing to finance the company's business plan.

A positive rating action is remote but may be warranted if the company grew significantly in size, as measured by its development pipeline, leading to greater diversification and more stable cash flows, while leverage as measured by Scope-adjusted debt/EBITDA stabilised below 8x on a sustained basis. A negative rating action is possible if Scope-adjusted debt/EBITDA were to reach well above 12x or if liquidity weakened, for example, due to weaker access to bank financing.

Furthermore, senior unsecured bonds issued by Kopaszi include a debt acceleration clause triggering early repayment if the rating falls below B+ and is not restored within two years or if the rating falls below B- the debt acceleration becomes immediate (60 days).

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
15 Dec 2022	Affirmation	B+/Stable
19 Jan 2022	Initial	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

Analyst

Rigel Patricia Scheller
+49 30 27891 319
r.scheller@scoperatings.com

Related Methodologies

Corporate Rating Methodology; July 2022

Rating Methodology European Real Estate Corporates January 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Focused on real estate development, mainly residential and offices with strong demand in the Hungarian market • High quality development portfolio, with buildings that meet recognised standards – namely LEED (gold or above and the Hungarian EPC level BB) • Gradual build-up of recurring revenues from rental portfolio, retail areas, smoothing future cash flows • Strong pre-sales ratio of 75% as at November 2022	• Small company in a fragmented market leading to more volatile cash flows and limited economies of scale • Geographical cluster risk on Budapest combined with a concentrated development pipeline of projects (BudaPart comprising 26 buildings: five under construction, seven completed; remainder to be completed by 2032) • Exposure to development activities leading to volatile cash flow pattern, partially mitigated by stable recurring rental income and activities in home-building which is less volatile than other commercial development • Highly leveraged company, partially mitigated by longer debt maturities

Positive rating-change drivers	Negative rating-change drivers
• Improving business risk profile, growing significantly in size, less concentrated portfolio, while stabilising Scope-adjusted debt/EBITDA below 8x	• Leverage increases significantly, indicated by a Scope-adjusted debt/EBITDA of more than 12x on a sustained basis • Liquidity weakened

Corporate profile

Kopaszi Gát Zrt. (Kopaszi) is a Budapest-focused residential and commercial real estate developer that builds properties to sell or lease. Its activities cover the entire development process from site evaluation and project planning to implementation and marketing. The company is currently fully focused on the BudaPart project, a site acquired in 2015, that comprises more than 2,500 apartments, 12 office buildings, a hotel and more than 15,000 sqm retail space (market value of about EUR 80m). Ongoing development projects progressed at an uninterrupted pace, reaching a 33% completion rate.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**H1 2022[1]**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover (x)	10.0x	5.8x	86.3x	0.2x	3.5x	2.4x
Scope-adjusted debt/EBITDA	4.2x	9.3x	13.8x	242.2x	6.2x	11.4x
Scope-adjusted loan/value ratio (%)	38%	49%	67%	82%	64%	65%
Scope-adjusted EBITDA in EUR '000s						
EBITDA	15,659	10,202	9,829	-353	12,896	20,785
add: gain from sale of subsidiaries[2]	6,157	765	0	0	15,297	0
Others (provisions, impairments)[3]	0	0	1,237	1,237	0	0
Scope-adjusted EBITDA	21,817	10,967	11,066	884	28,194	20,785
Funds from operations in EUR '000s						
Scope-adjusted EBITDA	21,817	10,967	11,066	884	28,194	20,785
less: (net) cash interest paid	-2,188	-1,903	-128	-3,906	-8,124	-8,579
less: cash tax paid as per cash flow statement	-1,219	-2,534	-1,508	1,318	-3,996	-2,423
Others	0	0	0	0	0	0
Funds from operations (FFO)	18,410	6,529	9,429	-1,704	16,074	9,783
Total assets in EUR '000s						
Total assets	265,526	238,527	304,423	337,472	316,823	389,573
less: cash and cash equivalents	-29,591	-27,452	-76,939	-75,859	-42,947	-22,908
Scope-adjusted assets	235,935	211,076	227,484	261,613	273,876	366,665
Net cash interest paid in EUR '000s						
Net cash interest per cash flow statement	-2,188	-1,903	-128	-3,906	-8,124	-8,579
Net cash interest paid	-2,188	-1,903	-128	-3,906	-8,124	-8,579
Scope-adjusted debt in EUR '000s						
Reported gross financial debt	90,574	102,490	152,377	214,091	175,374	237,890
Scope-adjusted debt	90,574	102,490	152,377	214,091	175,374	237,890
Cash balance in EUR '000s						
Cash and equivalents[4]	29,591	27,452	76,939	75,859	42,947	22,908

[1] Year ending June 2022 for cash flow metrics.
[2] Sale of BOE office building in 2023.
[3] Corresponds to a write-off in infrastructure cost due to a road crossing has been given to the municipality without compensation.
[4] Unlike in the previous rating case, the calculation does not apply netting of cash. Net cash is generally applicable when the rating is BB category or higher and cash is permanent and accessible. As such, Scope-adjusted debt/EBITDA differs from that in previous rating report.

Table of contents

Environmental, social and governance (ESG) profile[5]

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)

ESG considerations

All completed office buildings at BudaPart have the LEED Gold certification, and Kopaszi aims to obtain the highest possible energy performance certificate (EPC) standard in all future office developments. Residential buildings all conform to the EPC BB energy rating. New residential buildings plan to introduce a geothermal heat pump system, making the building essentially energy-independent.

The company also strives towards efficiency during the development phases. Kopaszi estimates to save between 10-30 tonnes of CO_2 emission per year, by interior landscaping and limiting transportation needs by utilising a local concrete plant.

All initiatives are expected to enhance the portfolio's attractiveness and company profitability because: i) work to attain certification improves energy efficiency and increases portfolio efficiency; and ii) environmentally friendly buildings are attractive since high-quality prospective tenants are increasingly concerned with sustainability, but also attract prospective investors.

The company does not plan to distribute dividends in the next years. But we note that it will repay the remaining shareholder loan (about EUR 31.6m) upon sale of BOE office building.

[5] 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: B+

Industry risk profile: BB-

Kopaszi is a Budapest-focused real estate developer. Its activities comprise the development of properties built for sale – residential and office premises - and for leasing, mainly ground floor shops in residential buildings.

Industry risk for Kopaszi is high as it operates in the riskiest sub-segment of real estate, development. However, Kopaszi's activities in the residential development/homebuilding partially mitigate the associated risk as homebuilders address a basic human need. To reflect the company's business model, we calculated a blended industry risk, considering the contribution of each business line to revenues, which led to a weighted average industry risk of BB-.

Business line	Activities	Estimated average operating profit contribution (2021-23)	Industry risk
Development	Commercial – offices	8%	B
	Homebuilding	74%	BB
Rental	Commercial – retail	16%	BB
Weighted average industry risk			**BB-**

Development of BudaPart shows strong performance …

Kopaszi's development portfolio had a robust performance in the LTM to end-June 2022. Scope-adjusted total assets rose to EUR 227m (+8% compared to December 2021). Ongoing development projects progressed at an uninterrupted pace, reaching a 33% completion rate. Revenues in H1 2022 increased 6% YoY due to higher net rents from retail, office leases in the BOE building, but also residential unit sales have continued to perform, rising 1% YoY.

… but company is still small in a European context

Nonetheless, Kopaszi is still a small property company in a European context. Limited size implies greater sensitivity to unforeseen shocks, greater volatility in cash flows and a heightened sensitivity to the performance of single projects due to existing cluster risks.

Limited geographical and revenue stream diversification

The company's geographical diversification is limited by its small size and concentrated development pipeline in the Budapest real estate market. The company does not plan to increase its geographical outreach beyond Budapest as it is fully focused on the development of the BudaPart project. Whilst the project offers further development potential, it also fully exposes Kopaszi to the macroeconomic environment and demand from one market. We judge the limited geographical diversification as a credit risk, however partially mitigated by the market strength and robust demand for residential projects.

Project concentration mitigated by diversified customer base

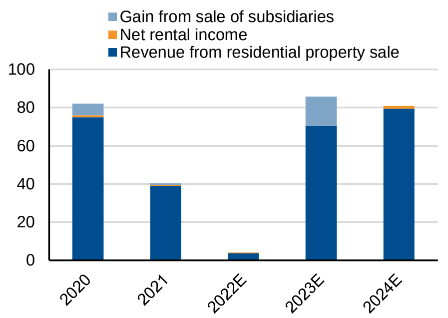
Kopaszi has a concentrated development pipeline with five projects under construction. This may negatively affect future cash flow in the event of project delays or cost overruns. However, it is worth noting that the BudaPart project is divided into phases and the development of each building is an independent process. Also, the company's project pipeline is diversified across residential and office buildings, and, to a minor extent, hotel and retail spaces.

The highly diversified customer base (B2C residential core business) is credit positive due to the limited impact on cash flow resulting from delays in payments of single clients.

Tenant portfolio with exposure to small-to-medium size companies

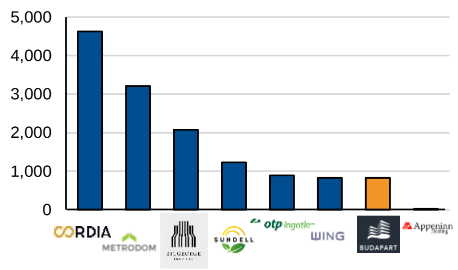
The company holds a small tenant portfolio, consisting of retail and shop spaces located in the residential building's ground floor and the completed BOE office building. Tenant diversification is weak, as top 3 and top 10 tenants represent about 50% and 90%, respectively. Tenant quality is judged to be moderate, as it comprises mostly supermarkets, food stores and restaurants.

Figure 1: Revenue breakdown by segments (EUR m)



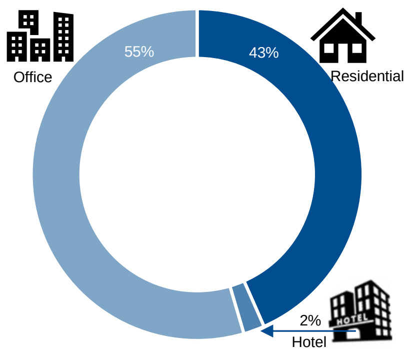
Sources: Kopaszi, Scope estimates

Figure 2: Top residential developers in Hungary by number of units sold since 2015



Sources: Public information, Scope

Figure 3: Distribution of gross lettable area by segment



Sources: Kopaszi, Scope

High asset quality to support portfolio liquidity

Credit-positive is the high asset quality portfolio of developments due to the focus on medium- to high-end residential projects, which enjoy robust demand reflected in the high pre-sale ratio of around 75%.

Demand remains strong for Kopaszi's residential buildings, although increasing interest rates and rapidly rising living costs in Hungary (the consumer price index increased more than 20% YoY in September 2022) are making housing significantly less affordable. We acknowledge that the premium and standard residential units being developed are energy-efficient and deem them to have above-average liquidity in the real estate market.

Office buildings built under the BudaPart project are Grade A and LEED/BREEAM-certified and will contain modern, flexible office spaces. We believe that demand for newly built, energy-efficient offices will remain robust, compared to more obsolete supply, as outdated buildings independent of their respective locations are vulnerable to deteriorating tenant demand and will experience more downward pressure on rents. In addition, many high-quality tenants focus on sustainability and therefore seek environmentally friendly properties.

Above-average profitability expected to stabilise at around 20%

Profitability as measured by the Scope-adjusted EBITDA margin stood at 28% in 2021. We anticipate that Scope-adjusted EBITDA margin, along with levered IRR, to decline in FY 2022 and going forward due to cost inflation (construction, financing) and potential sales delays. However, we acknowledge that materials price pressure has recently eased, and projects have not shown significant budget overruns in previous months. At the single project level, profitability has remained relatively stable, providing certainty that profitability is sustainable at around 20%.

Further, due to the timing mismatch between cash outflows and inflows, we have assessed profitability on a single project basis. Kopaszi's profitability, as measured by the levered IRR, is relatively stable, providing us with certainty that profitability is at a sustainable level (standard residential buildings average 9%, premium residential 18%) at around 10% on an annual basis.

Financial risk profile: B+

Weaking credit metrics in 2022 expected to recover from 2023 onwards

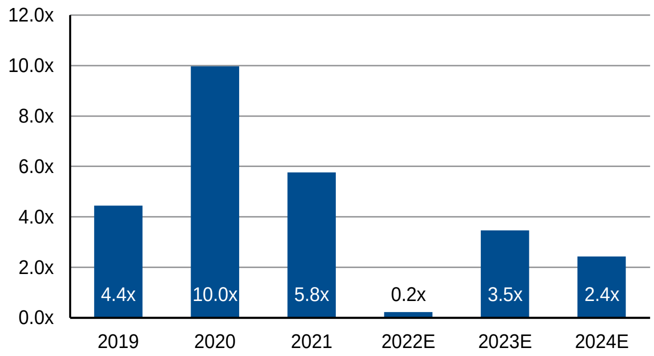
The financial risk profile reflects Scope's expectation that credit metrics will return to a level commensurate with the rating in 2023, after an expected weakening in 2022 due to the delay in the disposal of the BOE office building as Kopaszi expects better returns by waiting until 2023 considering the unsupportive macroeconomic environment. We note the heightened execution risk associated with that strategy, as buyers are understandably more cautious and hesitant to make decisions, preferring a wait-and-see approach in the current economic climate. Nevertheless, the building scores high on quality and energy efficiency with a LEED Gold certification, partially mitigating this risk; more than five international investors having signed the NDA and are interested in acquiring the building.

EBITDA interest cover will be squeezed by the sharp decrease in EBITDA in 2022

Scope-adjusted EBITDA interest cover will be squeezed by the sharp decrease in EBITDA, declining to 0.2x in 2022 from 5.8x in 2021.

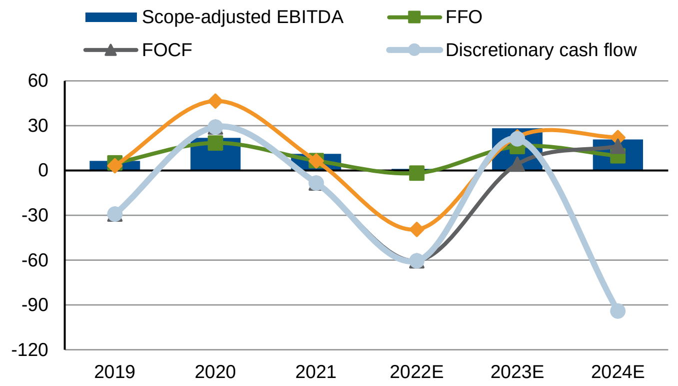
While we expect the ratio to continue fluctuating, depending on the timely delivery and disposal of projects, debt protection will remain solid over the next two years at an average of above 2x, as shown in Figure 4. In 2023, the cash flow will benefit from the handover of two residential buildings. We anticipate some pressure on debt protection because of increasing indebtedness higher (additional debt of EUR 75-100m until 2024) limiting headroom against cash flow volatility. On the other hand, debt protection benefits from the low share of variable-rate debt (only 15% as at November 2022) in an environment of rising interest rates.

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



Sources: Kopaszi, Scope estimates

Figure 5: Cash flows (EUR m)

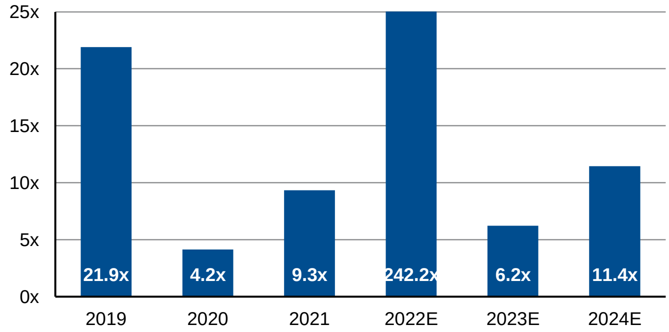


Sources: Kopaszi, Scope estimates

Leverage under pressure due to strong Scope-adjusted debt increase

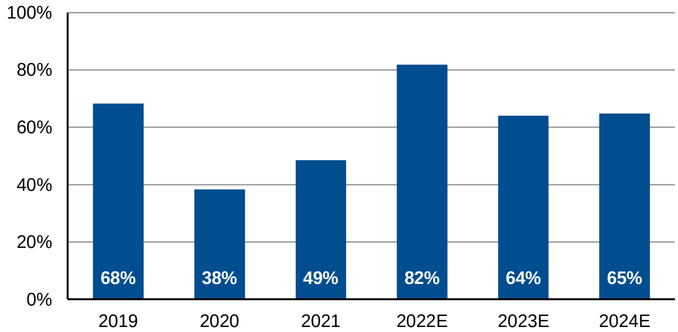
Scope-adjusted debt is forecasted to exceed EUR 175m by YE 2023 (H1 2022: EUR 152.4m) and Scope-adjusted debt/EBITDA to approach 11x by 2024. The company's net financial debt increased after the unsecured bond placement that was partly used to redeem existing loans (about EUR 51m). We assume the company will repay the remaining shareholder loan of about EUR 31.6m upon the BOE disposal and we assume additional debt of about EUR 86m in the period to 2024. Whilst we foresee some fluctuation, as volatility is typical for a developer, we expect the ratio to remain at a level commensurate with the assigned rating. The shift in the EBITDA will significantly weaken the Scope-adjusted debt/EBITDA ratio in 2022. However, we foresee that the leverage will return to a level commensurate with a financial risk profile of B.

Figure 6: Scope-adjusted debt/EBITDA



Sources: Kopaszi, Scope estimates

Figure 7: Scope-adjusted loan/value ratio



Sources: Kopaszi, Scope estimates

Adequate liquidity

Kopaszi's liquidity is adequate, supported by unrestricted cash of EUR 77m as at end-June 2022 and a back-loaded debt maturity profile, with no significant amount due in the next few years. Given the long maturity of the HUF 34.5bn bond, upcoming short-term maturities will be manageable. We also expect the company to maintain its low short-term debt levels and ensure that these are covered by available liquidity. Even if FOCF turns negative due to investments in the next few years, capex will be mostly discretionary and financed by a combination of available internal resources and open credit lines (more than EUR 89m as of November 2022) available for financing specific developments.

Balance in EUR '000s	2022E	2023E	2024E
Short-term debt (t-1)	-51,074	-46	-46
Unrestricted cash (t-1)*	24,919	69,530	42,273
Open committed credit lines (t-1)	0	0	0
FOCF	-60,483	4,182	16,211
Coverage	**-0.7x**	**>2x**	**>2x**

* Net of restricted cash

Long-term debt ratings

Senior unsecured debt: B+

Our recovery analysis is based on a hypothetical default scenario at year-end 2024. We estimate the recovery for all senior secured debt to be average driven by the high sensitivity to attainable prices in a distressed sales scenario and the structural subordination of the rated entity's senior unsecured creditors below future secured creditors at the property SPV level (development loans), justifying a debt class rating equal to that of the issuer (B+).

Appendix: Peer comparison (as at last reporting date)

	Kopaszi Gat Zrt.	Wingholding Zrt.	Euroboden GmbH	SunDell Estate Nyrt.
	B+/Stable	B+/Stable	B+/Negative	B/Stable
Last reporting date	30 June 2022	31 December 2021	30 March 2022	31 December 2021
Business risk profile				
Scope-adjusted total assets (EUR m)	228	1,500	600	130
Portfolio yield	na	6.8%	na	na
GLA (thousand sq m)	439	600	na	na
Countries active in	1	3	2	1
Top 3 tenants (%)	50%	10%	na	na
Top 10 tenants (%)	90%	17%	na	na
Office (share NRI)	55%	69%	na	na
Retail (share NRI)	0%	7%	na	18%
Residential (share NRI)	43%	0%	na	82%
Hotel (share NRI)	2%	3%	na	na
Logistics (share NRI)	0%	21%	na	na
Others (share NRI)	0%	0%	na	na
Property location	'B'	'B'	'A'	'B'
EPRA occupancy rate	na	86%	na	na
WAULT (years)	na	6.0	na	na
Scope-adjusted EBITDA margin	28%	29%	21%	25%
Financial risk profile				
Scope-adjusted EBITDA/interest cover	86.3x	4.3x	1.4x	4.4x
Scope-adjusted debt/EBITDA	13.8x	9.0x	20.8x	25%
Scope-adjusted loan/value ratio	67%	71%	50%	5.6x
Weighted average cost of debt	5.7%	4.2%	2.1%	3.5%
Unencumbered asset ratio	ca. 100%	>100%	145%	255%

Sources: public information, Scope

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

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