12 December 2023

Corporates

Kopaszi Gát Zrt.
Hungary, Real Estate

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2021	2022	2023E	2024E
Scope-adjusted EBITDA interest cover	5.8x	net cash interest	1.2x	2.8x
Scope-adjusted debt/EBITDA	9.3x	-214.0x	33.9x	8.0x
Scope-adjusted loan/value	36%	26%	26%	22%

Rating rationale

Kopaszi Gát Zrt.'s (Kopaszi) business risk profile reflects its industry risk as a real estate developer. Credit-positive aspects are the asset quality due to the focus on medium- to high-end residential projects, which enjoy robust demand, reflected in a high pre-sale ratio of about 90%, despite the high interest rates and rapidly rising living costs in Hungary. In June 2023 the company announced the forward-sale preliminary agreement to develop a portfolio of several office buildings, which reinforces the company's pipeline of projects and provides it with a solid revenue medium-term outlook. Small size and predominant exposure to the weakening Hungarian economy and high cluster risk around Budapest holds back the business risk profile. Limited size is evident in: i) the concentrated development and customer pipeline; and ii) geographical concentration on Budapest.

The financial risk profile (assessed at B) reflects our expectation that credit metrics will remain volatile. Although the company intends to keep a small office portfolio to benefit from the stable income in the next few years, the majority of revenues and EBITDA generation remain strongly depend on project completions. Revenues from the new forward-sale project will not be reflected in the company's topline and EBITDA until completion in 2026.

Outlook and rating-change drivers

The Outlook is Stable and incorporates the completion and handover of two residential buildings in 2024. We expect the leverage to remain high in 2023 before returning to adequate levels for the rating category in 2024. We foresee that Scope-adjusted debt/EBITDA will remain volatile in the next few years and Scope-adjusted EBITDA interest cover is expected to remain at around 3.5x on average in the period from 2023 to 2026. The Outlook also assumes ongoing adequate access to external financing to finance the company's business plan.

A positive rating action is remote but could 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 on a sustained basis that is not being counterbalanced by high pre-sale rate of above 90%. A negative rating action is also possible if liquidity weakened, for example, due to weaker access to bank financing or higher-than-anticipated cash absorption from the execution on Kopaszi development pipeline.

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 repayment becomes immediate (60 days).

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
12 Dec 2023	Affirmation	B+/Stable
15 Dec 2022	Affirmation	B+/Stable
19 Jan 2022	Initial	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

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Related Methodologies and Related Research

General Corporate Rating Methodology; October 2023

European Real Estate Methodology; January 2023

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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 90% as at November 2023 • Strong backlog (that includes the development of a portfolio of office buildings for a local customer	• 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 • Exposure to development activities leading to volatile cash flow pattern, partially mitigated by stable recurring rental income and activities in home-building which are 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, that is not being counterbalanced by high pre-sale rate of above 90% • 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).

Financial overview

			Scope estimates			
Scope credit ratios	**2022**	**H1 2023[1]**	**2023E**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover (x)	Net Cash	0.9x	1.2x	2.8x	0.9x	10.4x
Scope-adjusted debt/EBITDA	-214.0x	18.0x	33.9x	8.0x	26.0x	1.8x
Scope-adjusted loan/value ratio (%)	26%	35%	26%	22%	11%	15%
Scope-adjusted EBITDA in EUR '000s						
EBITDA	-760	9,112	6,794	25,058	7,369	89,907
add: gain from sale of subsidiaries	0	0	0	0	0	0
Others (provisions, impairments)[2]	0	1,237	0	0	0	0
Scope-adjusted EBITDA	**-760**	**10,349**	**6,794**	**25,058**	**7,369**	**89,907**
Funds from operations in EUR '000s						
Scope-adjusted EBITDA	-760	10,349	6,794	25,058	7,369	89,907
less: (net) cash interest paid	2,268	-11,057	-5,582	-9,020	-8,629	-8,629
less: cash tax paid as per cash flow statement	-1,118	-645	-2,041	-3,063	396	-16,112
Others	0	0	0	0	0	0
Funds from operations (FFO)	**390**	**-1,353**	**-829**	**12,974**	**-864**	**65,167**
Total assets in EUR '000s						
Total assets	375,669	386,175	526,379	584,742	837,059	421,369
less: cash and cash equivalents	-86,580	-77,301	-127,471	-90,429	-111,963	-116,788
Scope-adjusted assets	**289,089**	**308,874**	**398,908**	**494,313**	**725,095**	**304,582**
Net cash interest paid in EUR '000s						
Net cash interest per cash flow statement	2,268	-11,057	-5,582	-9,020	-8,629	-8,629
Net cash interest paid	**2,268**	**-11,057**	**-5,582**	**-9,020**	**-8,629**	**-8,629**
Scope-adjusted debt in EUR '000s						
Reported gross financial debt	162,733	186,492	230,070	200,070	191,720	161,096
Scope-adjusted debt	**162,733**	**186,492**	**230,070**	**200,070**	**191,720**	**161,096**
Cash balance in EUR '000s						
Cash and equivalents[3]	86,580	77,301	127,471	90,429	111,963	116,788

[1] Year ending June 2023 for cash flow metrics.
[2] Corresponds to a write-off in infrastructure cost due to a road crossing that has been given to the municipality without compensation.
[3] 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 the previous rating report.

Table of Content

Environmental, social and governance (ESG) profile[4]

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 buildings 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 about sustainability, but also attract prospective investors.

[4] 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. Kopaszi intends to keep two office buildings and a hotel building on its balance sheet and benefit from recurring rental income.

Nevertheless, the company's core business remains in the development activities (commercial development and homebuilding). Kopaszi's activities in homebuilding, which address a basic human need, partially mitigate the risk associated with commercial development activity. 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-.

Small in a European context

With Scope-adjusted total assets of EUR 309m as at end-June 2023 (+6.8% compared to December 2022), Kopaszi is a relatively small property company in Europe and in the fragmented real estate market in Hungary. The company's size is expected to slightly grow in the next years based on its existing project pipeline, which increased significantly over the course of 2023.

In June 2023 the company announced the forward-sale preliminary agreement to develop a portfolio of several office buildings with completion planned for 2026.

The construction has already started and Kopaszi has received the first advance payment. The agreement reinforces the company's pipeline of projects and provides it with a solid medium-term revenue outlook. This is a credit positive as: i) there is a slight improvement in scale (Scope-adjusted total assets will increase to around EUR 500m, compared to EUR 309m as at June 2023); ii) it supports cash flow visibility, as the company will receive pre-defined advances payments based on project milestones, and; iii) the current pipeline of projects (two residential buildings and portfolio of office buildings) has no speculative component and is not subject to sale or letting risk.

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 it is partially mitigated by the robust demand for residential projects with pre-sales rates of about 90%.

Concentrated pipeline of projects

Kopaszi has a concentrated development pipeline with eight buildings (residential and office) under construction. This concentration 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.

Residential project benefit from diversified customer base

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.

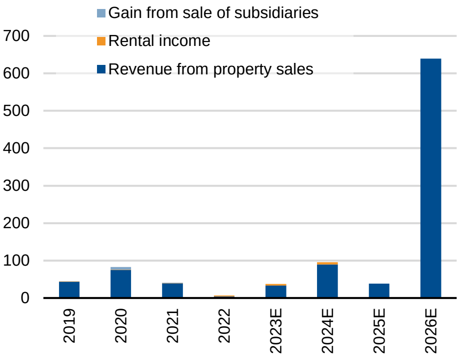
Cluster risk emerges

The newly signed contract on the one hand improved the diversification in the pipeline (between residential and commercial), but on the other hand, it also introduces cluster risk from one significant customer. This is partially mitigated by the customer credit quality, which is investment grade. In case of a termination attributable to the purchaser, Kopaszi is entitled to compensation.

Tenant portfolio comprises large companies as well as small retailers

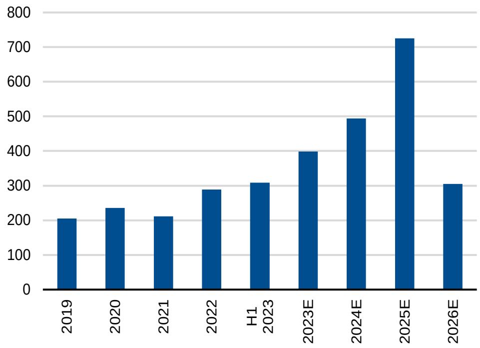
Due to its core business, the company has a low share of recurring revenue. However, Kopaszi intends to keep one office building (BOE, delivered in Q1 2021) and one office/hotel building (BOG, delivered in Q2 2023) on its balance sheet in the medium-term. The tenant portfolio includes large companies (Bayer, Merck, McKinsey, Mol, among others) but also retail and shop spaces located in the residential and office building ground floors. Tenant diversification is weak, as the top 3/top 10 tenants represent about 47% and 80%, respectively. Tenant quality is judged to be moderate, as it combines international companies as well as supermarkets, food stores and restaurants.

Figure 1: Revenue breakdown by segments (EUR m)



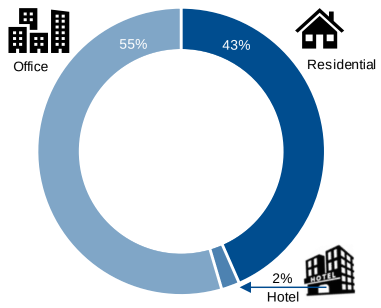
Sources: Kopaszi, Scope estimates

Figure 2: Scope-adjusted assets of Kopaszi (EUR m)



Sources: Public information, Scope

Figure 3: Breakdown of Kopaszi's development by segment as at November 2023 (by GLA)



Sources: Kopaszi, Scope

High asset quality to support portfolio liquidity

Asset quality is credit positive. In both main asset classes, residential and offices, we see significantly higher liquidity for newly built premises, premium and mid-priced residential units in the city of Budapest (Kopaszi Dam district) than for retail and older office assets.

High-quality office and residential developments support the high pre-sale rate of 90% for current residential developments and 100% for the office portfolio. It is worth noting that BudaPart is divided into phases and the development of each building is an independent process and initiating new residential projects will be determined by market tendencies.

Increasing occupancy rate

Office buildings built under the BudaPart project are Grade A and LEED/BREEAM-certified and will contain modern, flexible office spaces. BOE had a significant improvement in the occupancy rate, that increased to 93% in November 2023 from 74% in November 2022, while BOG's occupancy rate stood at 36% (0% in previous year). The buildings score high on quality and energy efficiency with a LEED Gold certification. 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

Profitability as measured by the Scope-adjusted EBITDA margin was negative in 2022 as the company had no significant disposals of commercial buildings, and only a low number of handovers of residential units. We anticipate that the Scope-adjusted EBITDA margin will remain volatile and depending on projection completion, while in terms of levered IRR at the single project level, the company expects a yearly return to range from 15% to 30% in the residential portfolio.

Backlog of projects providing some visibility on future cash flows

The newly signed forward-sale for a portfolio of office buildings reinforces the company's pipeline of projects and provides it with a solid revenue medium-term outlook.

The transaction will have not an impact on revenues and profitability in the short term. However, there is a cash inflow from advance payments during the project development. The execution risk is partially mitigated by the custom1er's credit quality and because Kopaszi has already signed a fixed price agreement for the construction work with Market Építő Zrt. (BB-/Stable). A potential delay penalty for the construction is born by Market Építő.

We note the potential execution risk as the projects will be developed over the next three years and its completion depends on the construction company's performance, timely availability of building materials and the government strategy in the medium term.

Financial risk profile: B+

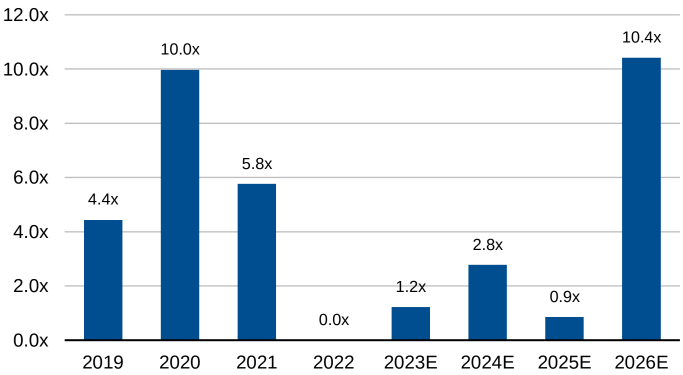
Volatile credit metrics depend on project completion

The financial risk profile reflects our expectation that credit metrics will remain volatile. This is however mitigated by the high pre-sale rate of 90%. Although the company intends to keep the office portfolio to benefit from the stable income in the next few years, revenues and EBITDA generation remain strongly dependent on project completions. Revenues corresponding to the new forward-sale project will not be reflected in the company's topline and EBITDA until completion in 2026.

Weak EBITDA interest cover

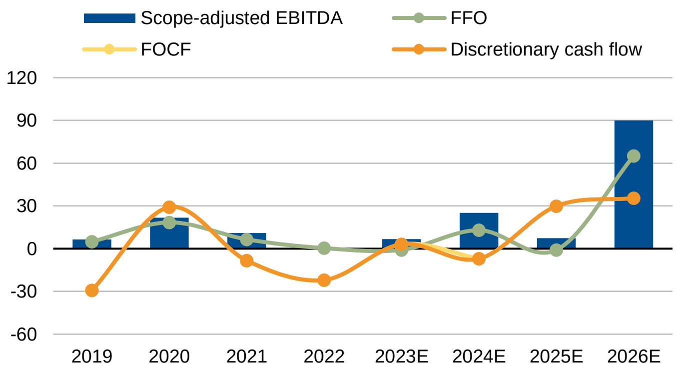
Debt protection in 2022 benefited from net interest income that year. In 2023, financial expenses are expected to increase significantly due to the higher amount of gross debt (about EUR 40m in borrowings to finance current residential developments and additional debt following the refinancing of BOE office building in Q4 2023) and due to the higher interest rate (with 20% of debt subject to a variable interest rate as at November 2023, 40% from May 2024). The expected significant increase in the interest burden will put pressure on interest cover limiting headroom against potential cash flow volatility. We foresee interest cover at an average of around 3.5x for the period 2023-2026.

Figure 4: Scope-adjusted EBITDA interest cover



Sources: Kopaszi, Scope estimates

Figure 5: Cash flows (EUR m)

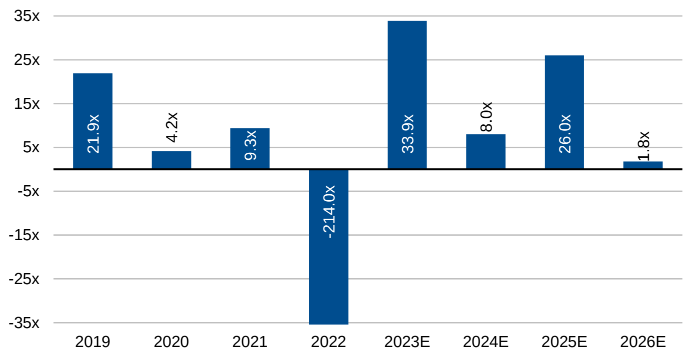


Sources: Kopaszi, Scope estimates

Leverage under pressure due to strong Scope-adjusted debt increase

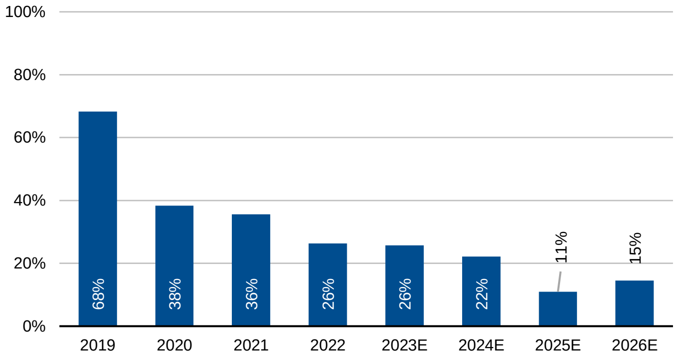
As expected, Scope-adjusted debt/EBITDA was negative in 2022 impacted by the low EBITDA that year. We expect leverage to remain volatile as revenue and EBITDA generation strongly depend on project completions. Scope-adjusted debt is forecasted to exceed EUR 230m by YE 2023 (H1 2023: EUR 186.5m). In H2 2023, the company repaid EUR 13m of the shareholder loan (EUR 20m remains in the balance sheet) upon refinancing of the BOE office building. We foresee high fluctuations in leverage, as volatility is typical for a developer, this is reflected in a high Scope-adjusted debt, averaging 17x in 2023-2026.

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 financial risk profile is supplemented by a supportive liquidity position, including cash (EUR 77.3m as at end June 2023), available credit lines (EUR 67.8m) and a back-loaded debt maturity profile. Given the long maturity of the issued bond, upcoming short-term maturities will be manageable. Even if free operating cash flow turns negative due to working capital requirements in the next few years, committed investment will be financed by a combination of available internal resources and open credit lines available for financing specific developments.

Balance in EUR '000s	2023E	2024E	2025E
Short-term debt (t-1)	38,682	0	30,000
Unrestricted cash (t-1)	86,580	127,471	90,429
Open committed credit lines (t-1)	0	0	0
Free operating cash flow (t)	3,114	-7,042	29,883
Coverage	**>200%**	**>200%**	**>200%**

Long-term debt rating

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

	Kopaszi Gat Zrt.	Cordia International Zrt.	Futureal Development Holding Kft.	SunDell Estate Nyrt.
	B+/Stable	BB-/Negative	BB-/Negative	B/Stable
Last reporting date	30 June 2023	30 June 2023	30 June 2023	30 June 2023
Business risk profile				
Scope-adjusted total assets (EUR m)	309	683	1,269	200
Portfolio yield	na	na	6.7%	na
GLA (thousand sq m)	160	na	493	na
Countries active in	1	5	3	1
Top 3 tenants (%)	47%	na	11%	na
Top 10 tenants (%)	80%	na	23%	na
Office (share NRI)	55%	na	31%	na
Retail (share NRI)	0%	na	38%	10%
Residential (share NRI)	43%	na	na	90%
Hotel (share NRI)	2%	na	na	na
Logistics (share NRI)	0%	na	31%	na
Others (share NRI)	0%	na	na	na
Property location	'B'	'B'	'B'	'B'
Financial risk profile[5]				
Scope-adjusted EBITDA/interest cover	0.9x	2.3x	1.6x	3.9x
Scope-adjusted debt/EBITDA	18.0x	13.5x	25.0x	8.4x
Scope-adjusted loan/value ratio	35%	34%	54%	26%

Sources: public information, Scope

[5] Year ending June 2023 for cash flow metrics.

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