# Cordia International Zrt.
# Hungary, Real Estate

STABLE
BB

## 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, Romania and Spain. Its developments are aimed mainly 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. With the recent acquisition of a 93% majority stake in Polnord, a Poland-based listed real estate developer, Cordia has expanded its footprint in the country.

## Key metrics

| | | Scope estimates | | |
|---|---|---|---|---|
| Scope credit ratios | 2019 | 2020E | 2021E | 2022E |
| EBITDA/interest cover (x) | 13.0x | 2.3x | 2.1x | 2.5x |
| Scope-adjusted debt/EBITDA | 2.4x | 9.2x | 10.6x | 11.7x |
| LTV (%) | 13% | 28% | 38% | 48% |

## Rating rationale

**Scope Ratings still rates the issuer rating of Cordia International Zrt. as BB/Stable as well as the instrument rating on all senior unsecured debt as BB.**

The rating reflects Cordia's ongoing business expansion (including an assumed HUF 40bn total corporate bond issue volume after the planned HUF 4bn tap issuance; see debt instruments ratings section for details) and its impact on the company's business and financial risk. The rating also reflects greater uncertainty in the overall market environment. Cordia's expansion includes the acquisition of projects in Hungary and Poland, the acquisition of a 93% majority stake in Poland-based real estate developer Polnord as well as a stake of around 20% in Argo Properties N.V., a company exposed to the German residential real estate market. These transactions have led to weaker credit metrics, weighing on the company's financial risk profile, which we now rate at BB, one notch lower than before.

The impact of the recent business expansion on Cordia's business risk profile is mixed. Geographical diversification has improved, with a higher volume of development projects in Poland as well as newly added activities in Germany and an improving market position via the substantial increase in company size.

However, we expect the impact on profitability to be negative, at least in the short to medium term, since the acquired Polnord business had historically lower operating margins than Cordia's development business in its home market of Hungary. We rate the company's business risk profile at BB-, the same level as before.

In addition, we had lowered our profitability forecasts for Cordia and the sector as a whole due to the negative impact of the Covid-19 pandemic on economic growth globally.

### Ratings & Outlook

| | |
|---|---|
| Corporate ratings | BB/Stable |
| Senior unsecured rating | BB |


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### Related Methodologies

Corporate Rating Methodology 26 Feb 2020

European Real Estate Rating Methodology 17 Jan 2020


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## Outlook and rating-change drivers

The Outlook for Cordia is Stable and incorporates the following assumptions: i) the company successfully executing its growth plans; ii) a loan/value ratio (LTV) of below 50% based on Scope-adjusted-debt/Scope-adjusted total assets iii) interest cover to sustainably stay above 2.2x after assumed temporary Covid-19 related weakness.

A positive rating action is seen as remote and would require a significant improvement in Cordia's business risk profile, through a much higher share of recurring cash flows independent of continued asset sales. This could, for instance, be achieved through significant recurring rental income.

A negative rating action may be warranted if Cordia's EBITDA interest coverage drops to below 2.2x on a sustained basis beyond 2021E. This could be triggered by a significant slump in sales volumes caused by a serious deterioration in real estate conditions in Cordia's core markets.

## Long and short-term debt instrument ratings

Cordia is considering to tap the existing HUF 36bn 10-year senior unsecured bond by an additional HUF 4bn, taking its total volume to HUF 40bn with the amortisation of six repayments of 10% each plus a final 'bullet' repayment of the remaining 40% of principal. Repayments will be made on a semi-annual basis starting in 2027 with a coupon of 3%. The intended use of proceeds will be financing of investments into real estate development and investment projects and developments, acquisitions (lands, portfolios of lands, business shares and immaterial goods etc.) working capital and potentially the refinancing of outstanding loans financing the above purposes (including senior loans, shareholder loans etc.) We have incorporated a successful placement of the additional intended HUF 4bn corporate bond tap in our base case financial forecast.

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 2022, which shows a high sensitivity to attainable prices in a distressed sales scenario; ii) the structural subordination of Cordia's senior unsecured creditors; 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.

## Rating drivers

| Positive rating drivers | Negative rating drivers |
| --- | --- |
| • Moderate leverage with around 30% LTV despite a significant growth programme<br>• Well-established market position in residential real estate in Budapest and increasing market share in Poland after Polnord acquisition<br>• 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)<br>• Negative free operating cash flow driven by continuous portfolio expansion and partially funded through debt markets<br>• Historically strong cluster risk on Budapest |

## Rating-change drivers

| Positive rating-change drivers | Negative rating-change drivers |
| --- | --- |
| • Remote. Significant business risk profile improvement through a higher share of recurring cash flows independent of continued asset sales | • EBITDA interest coverage of below 2.2x on a sustained basis. |

## Financial overview

| | | | Scope estimates | |
|---|---|---|---|---|
| **Scope credit ratios** | **2018** | **2019** | **2020E** | **2021E** |
| Scope-adjusted EBITDA/interest cover (x) | 9.8x | 13.0x | 2.3x | 2.1x |
| Scope-adjusted debt (SaD)/EBITDA (x) | net cash | 2.4x | 9.2x | 10.6x |
| Loan/value ratio | -11% | 13% | 28% | 38% |
| **Scope-adjusted EBITDA in HUF m** | **2018** | **2019** | **2020E** | **2021E** |
| EBITDA | 4,181.5 | 7,979.5 | 6,229.8 | 8,422.0 |
| Operating lease payments in respective year | 0.0 | 0.0 | 0.0 | 0.0 |
| **Scope-adjusted EBITDA (SaEBITDA)** | **4,181.5** | **7,979.5** | **6,229.8** | **8,422.0** |
| **Scope-adjusted debt in HUF m** | **2018** | **2019** | **2020E** | **2021E** |
| Reported gross financial debt | 10,069.3 | 70,104.9 | 133,029.2 | 133,029.2 |
| less: cash, cash equivalents | 19,440.3 | 51,070.2 | 75,872.0 | 43,876.4 |
| **Scope-adjusted debt (SaD)** | **-9,371.0** | **19,034.8** | **57,157.2** | **89,152.8** |

## Business risk profile: BB-

As a 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 B to companies active within it.

**Industry risk of B, driven by development risks**

### Competitive position

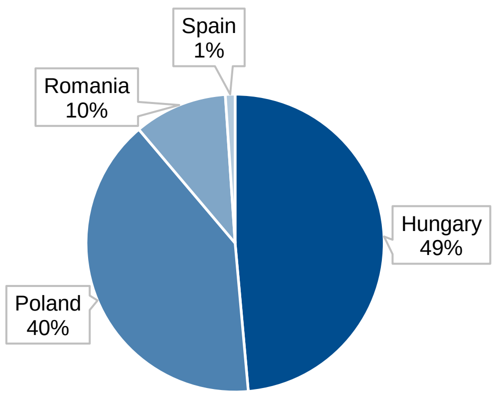
With a total asset value of HUF 144bn (including hidden reserves of HUF 13bn at YE 2019), Cordia is a fairly small property company in a European context. Its size is expected to grow significantly over the next two years, with its project pipeline taking it to HUF 200bn-HUF 270bn in Scope-adjusted-assets and HUF 6bn-HUF 11bn in EBITDA annually.

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 10% of newbuilds in Budapest (2-4000 units per year). 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.

The market in Poland is more fragmented than in Hungary. Cordia's overall market share was around 1% until the recent acquisition of listed competitor Polnord, which will substantially increase the company's market position in the country. In addition, Cordia has development projects in Romania and Spain, where we assume a negligible market position.

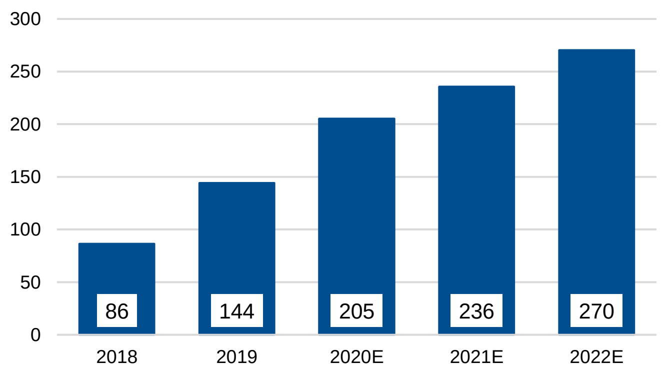
Cordia's development portfolio is located predominantly in Budapest, with an increasing share of developments in Warsaw, Krakow, Tricity and Bucharest. The company is focussing on urban areas, zeroing in on the most mature, liquid and growing markets in each respective country. In addition, there is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

**Figure 1: Geographical project diversification**




Sources: Cordia International, Scope

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




Sources: Cordia International, Scope

Geographical diversification has improved recently via direct and indirect acquisitions of new projects in Poland (via the Polnord company acquisition) as well as in Spain and a minority stake in rental lease company Argo Properties B.V., active in Germany. With exposure to more than 70 projects, both ongoing and in preparation, project risk concentration is moderate and the company uses different general contractors for its projects based outside of Hungary. For residential real estate developments in Hungary, Cordia has built up its preferred partner Pedrano as a residential general contractor, which is exclusively working for Cordia and Futureal at present.

Given Cordia's short historical dataset it is not surprising that its margin is rather volatile: at 43% in 2016, 29% in 2017 and 21% in 2018 and 2019. 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 (limited) history on a project-by-project basis, the company achieved an average gross margin (defined as sales minus the cost of goods sold) of 29% until 2019, with the 'worst' project still making more than 20% gross profit. We nevertheless project a temporary slump in operating margins in 2020E and 2021E in our conservative financial base case, due to two major reasons:

i) the Covid-19 crisis and resulting anticipated decline in GDP in all of Cordia's major markets adds uncertainty to demand patterns and hence prices, also considering the high share of international buyers in recent years.

**Profitability dependent on timely completions and price development**

ii) the newly acquired Polnord business, which now represents a significant share of the business with over 40% of planned unit sales, has had much weaker historical operating margins in a range of 6% to 9%. While we expect Cordia to be able to improve these margins gradually via professional project management and sales, we still expect this to take some time in the current environment. We also note the fact that the Polnord projects have been acquired at substantial discounts on market values, which should allow for higher profitability figures going forward after the acquisition by Cordia.

## Financial risk profile: BB

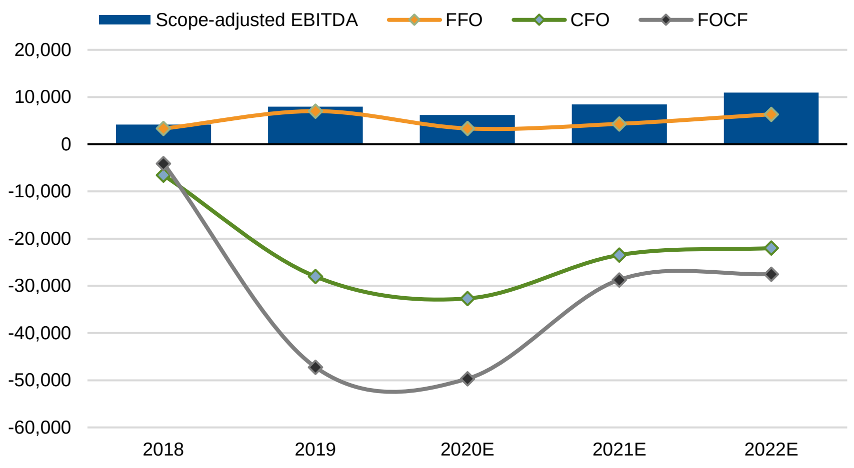
Our rating scenario assumes the following:

- 5%-15% lower revenue than expected by the company for the coming years
- Operating cost growth at 3.1% above company forecast
- Average cost of financial debt of 3%
- Planned capex/acquisition of new projects (investment in land plus business acquisitions) in our base case stands at annual total net capex of HUF 41bn for 2020E, 33bn for 2021E and 34bn for 2022E. A significant portion of these capex volumes is of a discretionary nature, as projects are only started and/or land bank is only expanded if market conditions are suitable.

Cordia started its operations with equity financing in 2016 and has since attracted investments via its investment fund, which is accounted for as equity under IFRS, drawing only on construction loans as they build. Consequently, interest payments were very modest up to 2017. In 2018 and 2019 Cordia drew more strongly on secured construction loans.

Going forward, we expect Cordia's interest cover to fall sharply, ranging from 2.2x to 2.7x, based on much higher financial debt and our conservative Scope-adjusted EBITDA assumptions.

**Figure 3: Cash flow overview (HUF m)**

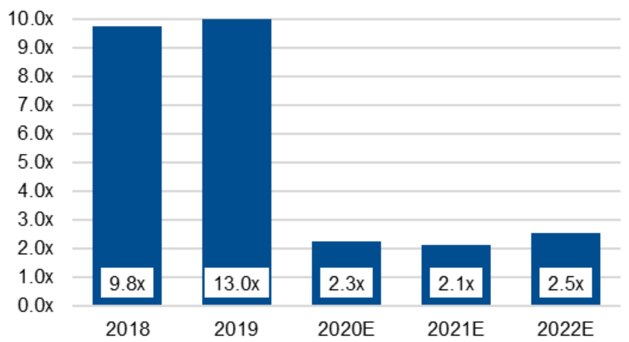



Sources: Cordia International, Scope

Up until 2018, Cordia had only a negative LTV due to a net cash position (without any adjustments for hidden reserves). With strong future debt-funded expansion, we forecast that Cordia's LTV will increase to 28% in 2020E and around 30% to 50% in the medium term. The increase in leverage is mitigated by the repeated cash equity injections of the owners, most recently with a HUF 12bn capital increase in Q1 2020.

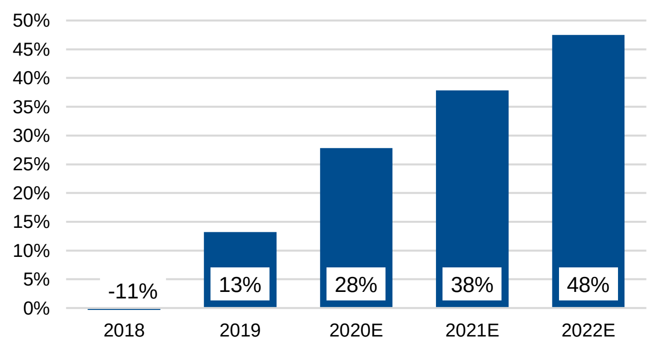
Our calculation is on the conservative side, as we have not given the company any further increased hidden reserve levels from year-end 2019 figures. Moreover, the HUF 13.6bn hidden reserves position includes only the hidden reserves on inventories in Hungary. All projects in other countries are only accounted at cost within inventories.

**Figure 4: Scope-adjusted interest cover**




Sources: Cordia International, Scope estimates,

**Figure 5: Leverage (LTV)**




Sources: Cordia International, Scope estimates

As regards short-term financial liabilities, we expect liquidity to stay above 1.0x (internal and external) for the next two years. We believe Cordia will be able to comfortably repay debt in the next 12-24 months. This is because all maturing debt is tied to construction projects and only needs to be repaid upon project completion.

**Liquidity: adequate**

**Figure 6: Liquidity**

| in HUF m | 2019 | 2020F | 2021F |
|---|---|---|---|
| Short-term debt (t-1) | 5,239.7 | 11,575.8 | 11,575.8 |
| Unrestricted cash (t-1) | 19,440.3 | 51,070.2 | 75,872.0 |
| Free operating cash flow (t) | -47,227.1 | -49,822.4 | -31,695.6 |
| Liquidity (internal) | -530% | 11% | 382% |
| Open committed credit lines (t) | 37,457.3 | 37,457.3 | 37,457.3 |
| **Liquidity (internal and external)** | **185%** | **334%** | **705%** |

Source: Scope estimates

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