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Research Update:

Romania-Based Impact Developer & Contractor SA Assigned 'B-' Rating; Outlook Stable

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Rating Action Overview

- Romania-based residential real estate developer Impact Developer & Contractor (Impact) is a publicly listed real estate company that primarily develops large community-based residential apartments in Bucharest.
- The company's high project and geographic concentration and relatively small scale are somewhat mitigated by an established track record in large project developments.
- We are assigning our 'B-' long-term issuer credit rating to Impact.
- The stable outlook reflects our view that Romania's growing economy and disposable incomes are likely to support good demand for Impact's real estate projects at least for the next 12 months. This should translate into S&P Global Ratings-adjusted debt to EBITDA above 5.0x and EBITDA interest coverage of above 3x over the next 12-24 months.

Rating Action Rationale

Our rating on Impact takes into account the high cyclicality and capital intensity of Romania's real estate development industry and the highly fragmented market. We believe that homebuilding activity in general is highly volatile and vulnerable to a country's economy, mortgage lending availability and terms, and the cost of construction. In 2009-2014 Romania's real estate market suffered a particularly severe recession. Sales at Impact's projects almost came to a halt and home prices sharply declined (by about 40% on average according to Imoniliare.ro). We note that the current sales price has not reached to the peak of pre-recession era (before 2008-09) and Romania's wage growth has been moderate in last few years.

Romania has no regulations on speculative development, but we understand that banks require a certain level of pre-sales while funding project loans to control speculative development to some extent. The risk of this is that supply can more quickly outweigh market demand--unlike in France, for instance, where construction is limited legally by required minimum pre-sales levels.

Impact is a relatively small operation and its EBITDA base is limited. We forecast its 2019 EBITDA at only Romanian leu (RON) 40 million-RON50 million (€8.5 million-€10.5 million). Its high project and geographic concentrations constrain our business risk assessment.

In our view, the company's revenue concentration on two projects, Greenfield and Luxuria, representing more than 90% of total expected revenue for 2019 and 2020, offers limited mitigation against operating challenges despite some recent diversification efforts. The company has launched three other projects, which will start contributing to revenue only in 2021 because of the construction timeline (about two years). On the other hand, the lack of project diversity is partially mitigated by the different phases of Greenfield's commercialization process, given that its construction is spread over several independent stages.

Impact's pre-sale transactions have gained momentum recently, with pre-sales representing more than 45% of total sales in the last 24 months. In our opinion, Impact will continue to strengthen its pre-sales through its good brand name from existing projects. As of Sept. 30, 2019, the company has a sizable, well-located, low-cost land bank, which is sufficient for at least six to eight years of development. We also see some degree of product and customer diversity as the Greenfield project consists of midprice dwellings targeting higher-middle-class Romanians, while the high-end Luxuira project targets upper class families and a few professional investors.

On the financial side, Impact's debt should remain high in 2020, in our view, given high working capital requirements related to property development and project constructions at RON280 million-RON300 million (€60 million-€64 million). This should result in adjusted debt to EBITDA of 5.0x-5.5x over the next 12 months.

We believe increasing deliveries of the Greenfield and Luxuria projects will support Impact's interest-servicing capacity, such that the company's EBITDA interest coverage should exceed 3.5x over the next two years.

We see inventory as temporarily high relative to sales, and revenue is only recognized at the project's completion. This puts pressure on Impact's free cash flow generation. We note, however, that almost half of Impact's inventory consists of land plots under construction and the company will start delivering dwellings from the fourth quarter of this year.

The rating incorporates a one-notch downward adjustment for our comparable rating analysis. This reflects the company's relative positioning within its business risk category. In particular, there is some volatility in the cash flow base, linked to often-unpredictable quarter-on-quarter fluctuations in demand in Impact's main markets. We also view the company's absolute EBITDA base as small; we forecast 2019 EBITDA at about RON40 million-RON50 million (€8.5 million-€10.5 million). We think this provides only a limited cushion to absorb the impact of any unexpected events, such as a temporary spike in working capital.

Outlook

The stable outlook reflects our expectation that Romanian's growing economy and disposable income will support good demand for Impact's real estate development projects. This should result in a progressive increase in revenue and the absolute EBITDA base. Furthermore, we expect Impact's current pre-sales rate will support revenue and translate into EBITDA interest coverage remaining above 3x, and debt to EBITDA remain above 5x at least for next 12-24 months.

Downside scenario

We may lower the rating if Impact's liquidity cushion materially deteriorates from the current level. We would also take a negative rating action if Impact's debt-funded expansion becomes larger than we currently expect or if its apartment sales in the next two years are substantially below our expectations, translating into EBITDA interest coverage lower than 2x.

Upside scenario

We could take a positive rating action most likely as a result of a significantly larger and more stable EBITDA base. Alternatively, we may raise the rating if the company runs its business with a more disciplined financial policy, such that debt to EBITDA is well below 4x on a sustainable basis.

Company Description

Founded in 1991, Impact Developer & Contractor is one of the oldest established residential real estate developers in Bucharest. Since its founding, Impact has completed 17 small and midsize projects, comprising over 3,500 residences and over 13,000 square meters of office and trade premises. On Dec. 31, 2018, Impact has ongoing residential developments in four Romanian cities; the main project is Greenfield Residence Baneasa, located in Bucharest.

The company is listed on the Bucharest Stock Exchange since 1996 and as of November 2019 has a market capitalization of RON367 million. The biggest shareholder is Mr. Gheorghe Iaciu, with an approximately 56.75% shareholding as of Sept. 30, 2019, followed by Adrian Andrici with 15.43%, and Swiss Capital and affiliates with about 12%.

Our Base-Case Scenario

- Romania's GDP to grow 3.9% in 2019, 3.5% in 2020, and 2.9% in 2021.
- The country's property market to remain stable, with 2%-3% annual growth over the period.
- Impact's continued reliance on sales from two large projects (Greenfield and Luxuria) over the next two years.
- We expect the company's revenue to be RON140 million-RON150 million in 2019 and RON260 million-RON280 million in 2020, supported by delivery of apartments in Greenfield phase III and Luxuria phase I and II.
- EBITDA margin to improve to 28%-30% in 2019 largely supported by economies of scale (fixed cost structure) and the low-cost land bank. However, we expect EBITDA margin to decline to 19%-20% in 2020 due to the delivery of Luxuria, which we understand contributes less margin compared with Greenfield and other projects.
- We expect working capital outflow to support the initial phase of construction to the tune of RON100 million-RON120 million in the next 12 months.
- No large capital expenditure, as Impact has already acquired a large enough land bank to support growth for the next six-to-eight years.

Based on these assumptions, we arrive at the following credit measures:

- EBITDA margin of 28%-30% for 2019 and 19%-20% for 2020.
- S&P Global Ratings-adjusted ratio of gross debt to EBITDA of about 5.0-5.3x in 2019 and around 5.1x-5.4x in 2020; and
- EBITDA interest coverage of close to 3.5x for the next 12.

Liquidity

We assess Impact's liquidity as less than adequate. We anticipate that the company will have sufficient sources of liquidity to cover its working capital needs in the next 12 months.

Principal liquidity sources are:

- Unrestricted cash and cash equivalent of about RON29.8 million, including cash at the level of Impact and its subsidiaries as of Sept. 30, 2019;
- Our forecast of cash funds from operations of RON35 million-RON40 million for the next 12 months; and
- Undrawn project loans of about RON90 million–RON 100 million to fund the working capital needs (project construction).

Principal liquidity uses are:

- Short-term debt maturities of around RON65 million-RON70 million, including Impact's bank loans and partial repayment on WC facility; and
- Working capital requirements of about RON90 million-RON100 million for the next 12 months, to fund the construction of new developments.

We link the undrawn project construction loans to working capital needs as the company would only draw down the facility to use for project construction. Therefore we only consider the undrawn amount of RON90 million-RON100 million, out of the RON134 million available as of Sept 30, 2019, for working capital needs. The company has no undrawn revolving credit facility or other corporate general facility in place.

Covenants

The company has several financial covenants under its project-financed debt and outstanding bonds, mostly related to loan-to-value, interest coverage, current ratio, and sales of apartments. We understand that it has adequate headroom (more than 10%) under the covenants and aims to maintain more than 10% headroom in next 12 months.

Ratings Score Snapshot

Issuer Credit Rating: B-/Stable/--

Business risk: Weak

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Highly Leveraged

- Cash flow/Leverage: Highly Leveraged

Anchor: b

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating; CreditWatch/Outlook Action	
Impact Developer & Contractor SA	
Issuer Credit Rating	B-/Stable/--