Masterplast Nyrt.
Hungary, Construction Materials

SCOPE B+ POSITIVE

Corporate profile

Masterplast Nyrt. was founded in 1997 as a distributor of building materials, mainly roofing foils, glass mesh nets and additional construction products. In 2005, Masterplast started manufacturing its own construction materials and now operates four manufacturing plants. The company benefits from a direct presence in eight Eastern European countries (Hungary, Romania, Serbia, Ukraine, Poland, Slovakia, Croatia and Macedonia) through its 11 subsidiaries. Its total geographical outreach comprises 41 countries including the company's export activity.

Key metrics

			Scope estimates	
Scope credit ratios	2018	2019	2020E	2021E
Scope-adjusted EBITDA interest cover (x)	13.0x	15.4x	13.6x	10.3x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA (x)	3.7x	3.3x	2.9x	2.9x
Scope-adjusted FFO/SaD	24%	27%	29%	27%
FOCF/SaD	-25%	2%	-1%	22%

Rating rationale

Scope revised Outlook on B+ issuer rating of Masterplast Nyrt. to Positive

The Outlook change is driven by the anticipated improvement in credit metrics that lever on a growing operational cash flow following investments into the company's production capacities and product availability in the past and going forward.

The B+ issuer rating is driven by Masterplast's comparatively strong credit metrics, which benefit from a relatively high Scope-adjusted EBITDA interest cover ratio as well as modest leverage. The rating is also supported by the company's high exposure to the maintenance end market, which is less cyclical than the construction materials market, leading to more stable cash flows and less volatile margins.

The rating is mainly constrained by the company's small overall scale, which lessens its ability to benefit from economies of scale or to offset the impact of economic cycles. The rating is also limited by relatively low but stable profitability. We judge diversification to be poor because Masterplast generates most of its revenues in one region (Europe) and is exposed mostly to one segment (construction materials).

Outlook and rating-change drivers

The Outlook is Positive and reflects our view that credit metrics will improve further, with an ongoing strong Scope-adjusted EBITDA interest cover and a Scope-adjusted debt (SaD) to Scope-adjusted EBITDA ratio below 3.5x thanks to a stable business performance with investments made in the last 18 months starting to pay off and a limited impact of Covid-19 on the company's operations. The Outlook also incorporates further improving liquidity with lower working capital built-up anticipated in the future compared to 2020.

Ratings & Outlook

Corporate ratings	B+/Positive
Senior unsecured rating	B+

Analysts

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Related Methodology

Corporate Rating Methodology, February 2020

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A positive rating action may be warranted if the company can reduce its leverage to a SaD to Scope-adjusted EBITDA ratio significantly below 3.5x on a sustained basis. This could be driven by the successful integration and expansion of the higher margin business of special fleece and multilayer membranes production for the healthcare industry.

A negative rating action could occur if the SaD to Scope-adjusted EBITDA ratio remained around or exceeded 3.5x on a sustained basis. This could be triggered by a continuous, strong build-up in working capital and/or expansion capex beyond current expectations, leading to ongoing negative Scope-adjusted free operating cash flow.

Rating drivers

Positive rating drivers	Negative rating drivers
• Relatively strong credit metrics • Stable cash flows and profitability due to high exposure to the maintenance end market and granular customer structure • Adequate liquidity following the targeted restructuring of liabilities	• Small scale and weak market position • Low profitability • Weak diversification across geographies • Exposed to cyclical industry

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/SaEBITDA significantly below 3.5x on a sustained basis	• SaD/SaEBITDA around or greater than 3.5x on a sustained basis.

Financial overview

				Scope estimates	
Scope credit ratios	**2018**	**2019**	**H1 2020[1]**	**2020E**	**2021E**
Scope-adjusted EBITDA interest cover (x)	13.0x	15.4x	18.5x	13.6x	10.3x
Scope-adjusted debt/Scope-adjusted EBITDA (x)	3.7x	3.3x	3.8x	2.9x	2.9x
Scope-adjusted funds from operations/SaD	24%	27%	25%	29%	27%
Scope-adjusted free operating cash flow/SaD	-25%	2%	-5%	-1%	22%
Scope-adjusted EBITDA in EUR m	**2018**	**2019**	**H1 2020**	**2020E**	**2021E**
EBITDA	6.2	7.3	7.9	10.2	12.2
Operating lease payments in respective year	0.0	0.0	0.0	0.0	0.0
Other[2]	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**6.2**	**7.3**	**7.9**	**10.2**	**12.2**
Scope-adjusted funds from operations in EUR m	**2018**	**2019**	**H1 2020**	**2020E**	**2021E**
Scope-adjusted EBITDA	6.2	7.3	7.9	10.2	12.2
less: cash interest as per cash flow statement	-0.5	-0.5	-0.4	-0.8	-1.2
less: cash tax paid as per cash flow statement	-0.2	-0.2	-0.2	-1.1	-1.5
Change in provisions	0.0	0.0	0.0	0.0	0.0
Scope-adjusted funds from operations (SaFFO)	**5.6**	**6.7**	**7.3**	**8.4**	**9.5**
Scope-adjusted debt in EUR m	**2018**	**2019**	**H1 2020**	**2020E**	**2021E**
Interest-bearing debt	25.3	28.8	33.0	46.0	40.7
add: derivatives (net)	0.0	0.1	2.0	2.0	2.0
less: cash	-2.1	-4.5	-5.4	-18.5	-7.8
add: restricted cash	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt (SaD)	**23.2**	**24.4**	**29.6**	**29.5**	**34.9**

[1] Year ending June 2020 for cash flow metrics
[2] Disposal gains from fixed assets included in EBITDA

Business risk profile: B

Industry risk: B

Masterplast generates most of its EBITDA within the construction material industry, an industry we consider to be highly cyclical overall with medium barriers to entry and a low/medium substitution risk.

Industry Outlook: Stable

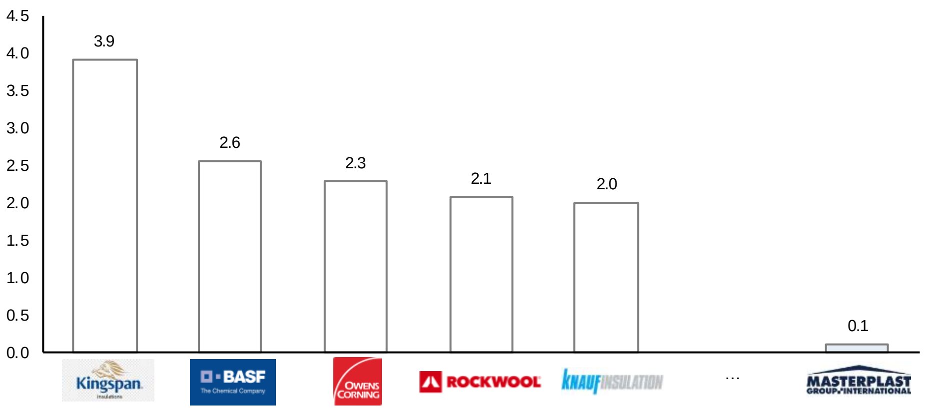
The credit profile for the European building products sector remains stable in the third quarter of 2020. Major players benefitted from good financials entering the Covid-19 related setback in construction output that is anticipated to lead to a strong decline in top lines and EBITDA. Both will impair building product companies' credit metrics in 2020. However, we believe industry players will be at the forefront of the recovery as they are expected to benefit from any future stimulus measures.

For more information, refer to our corporate outlook for real estate (click here).

Small company but relatively strong market position in a fragmented market

Masterplast is a relatively small player in the construction materials industry with a revenue of around EUR 107m and Scope-adjusted EBITDA of EUR 7m, both for 2019. The company's small size limits its ability to benefit from economies of scale or to offset the impact of economic cycles. However, the company's market position is supported by i) its strong standing in Eastern Europe, the rather fragmented market structure in its main segment (insulation systems) and strong customer loyalty as well as ii) its dedicated growth strategy, underpinned by total capex of EUR 32m in the last four years, which was mainly used to acquire new production facilities.

Figure 1: Peers in insulation segment by revenue in 2019 (EUR bn)*



*BASF construction chemicals segment as a whole

Sources: Public information, Scope

A relatively high capital expenditure has translated into some growth in terms of revenue (+30% since 2015 to last twelve months to end-June 2020) and Scope-adjusted EBITDA (+49%). In 2020, Masterplast acquired a 50% share in a production facility in Germany (Aschersleben)[3] for a total consideration of EUR 4m that is expected to contribute circa EUR 20m in revenues and around EUR 5m in Scope-adjusted EBITDA per year. However, we do not expect Masterplast to reach a critical size, which would enable it to defend its foothold if larger competitors, such as BASF, Knauf Insulation or ROCKWOOL International enter the niche markets in which it operates[4].

[3] Masterplast Nonwoven GmbH (50/50 joint-venture between Masterplast and previous owner – buyout (call/put) option until Q2 2023), production of special fleece and multilayer membranes for the healthcare and construction industry.

[4] These are: facade insulation systems (49% of last twelve months to end-June 2020 revenues), roofing foils and roofing elements (13%), dry construction systems (11%), heat insulation, soundproofing and waterproofing materials (12%), construction industry accessory products (5%) and products for industrial use (10%).

During the Covid-19 pandemic-induced reduction of construction output across Europe in Q1/Q2 2020[5], Masterplast was able to gain market share, benefitting from its relatively high inventories, negligibly impacted supply chains, regional production facilities and its own distribution/logistics capabilities. As a result, Masterplast replaced competitors with starkly reduced product availabilities. Positive development is evidenced by group sales in 2020 exceeding last year's sales every month up to July, with the exception of months hit hardest by Covid-19 (April: -22% YoY; May: -4% YoY).

Masterplast is expected to invest further into its production capacities and product availability in 2020 and 2021 with regard to breathable membranes and fiberglass mesh as well as warehouse extensions and logistics equipment. All of these supporting its market positioning going forward especially in comparison to regional peers.

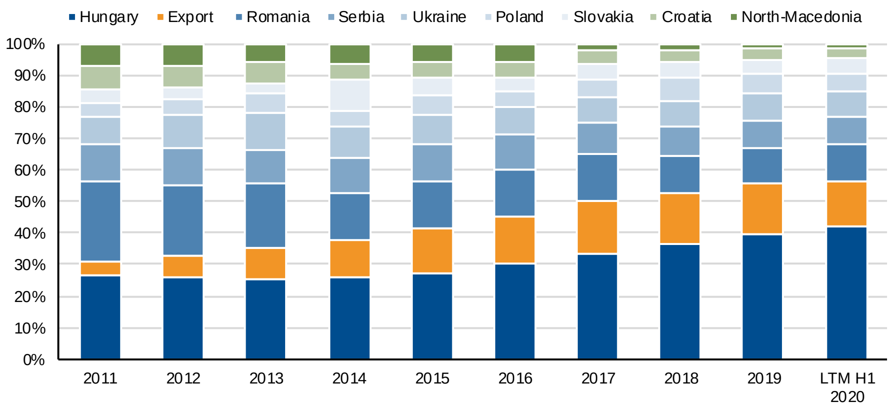
Limited diversification bears the risk of a sharp decline in revenue if demand weakens

Masterplast's geographical diversification is rather poor, since the company generates most of its revenues in one region, Europe (with a strong focus on Central Eastern Europe).

A low geographical diversification bears the risk of exposure to the construction cycle of one region. In a cyclical industry such as construction materials, revenues and earnings are likely to come under pressure if there is a downturn in one region. Conversely, a wide spread of activities across various geographical regions with different demand patterns or cyclicality exposures tends to reduce cash flow volatility.

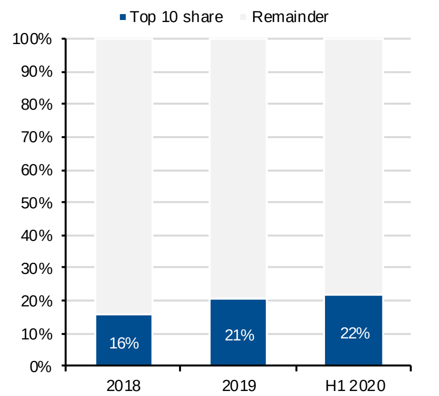
However, the company is diversified within Europe, with an exposure to several countries in that region. This supports our assessment of diversification because we expect demand patterns to differ at least a little between the countries to which the issuer is exposed. We acknowledge that Masterplast has a pan-European footprint, benefitting from its export activities (around 14% of last twelve months to end-June 2020 revenues). We believe diversification will benefit from the acquired production facility in Germany, lifting the share of revenue from outside Central Eastern Europe to around 25% from H2 2020 on.

Figure 2: Geographical diversification of revenue



Sources: Masterplast, Scope

Figure 3: Share of top 10 customers (by revenue)



Sources: Masterplast, Scope

Segment diversification is anticipated to improve slightly with the addition of healthcare equipment to that of construction materials via the Aschersleben plant acquisition in July 2020. Future segment contribution of healthcare equipment is estimated at above 5% in revenue and above 20% in EBITDA. The increased business of healthcare equipment

[5] Circa 10% decline from YE 2020 to May/June 2020 on a weighted average base depending on sales contribution of individual countries compared to a sales decline of 2% for Masterplast during the same period.

from the Aschersleben plant was a result of an increase in domestic (German) demand given the Covid-19 crisis. According to the company, there is some visibility of stable sales under that banner via forward sales for the next two to three years. However, the contribution from this segment is not seen as sustained for the time being, leaving a weak segment diversification. This weak segment diversification is partially mitigated by the different end markets the issuer serves (including the less cyclical end market of real estate maintenance and healthcare business) as well as its the relatively broad range of products[4] with limited dependence on single customers. The largest customer contributed a mere 3% of total revenues in H1 2020 (top 10: 22%).

Improving, but relatively low profitability

In comparison to its peers, Masterplast had a relatively low profitability with a Scope-adjusted EBITDA margin of between 6% to 7% (last twelve months to end-June 2020: 7.2%). However, the company benefits from its significant exposure to the maintenance end market, which leads to more stable cash flows and less volatile margins. We forecast the Scope-adjusted EBITDA margin to improve to over 8% on a sustained basis driven by higher existing and further investments into the extension of production capacities, product ranges and product availability. The strongest drivers of future profitability are i) the higher margin production of special fleece and multilayer membranes (EBITDA margins of above 20%) and ii) lower raw material prices. The latter is a consequence of Masterplast being able to negotiate lower prices with its suppliers as a result of the oil price plunge following Covid-19 outbreak as well as the internalisation of supplier margin via the acquisition of the Aschersleben production facility.

Relatively low profitability and small scale would make it difficult to defend market shares if competition increases

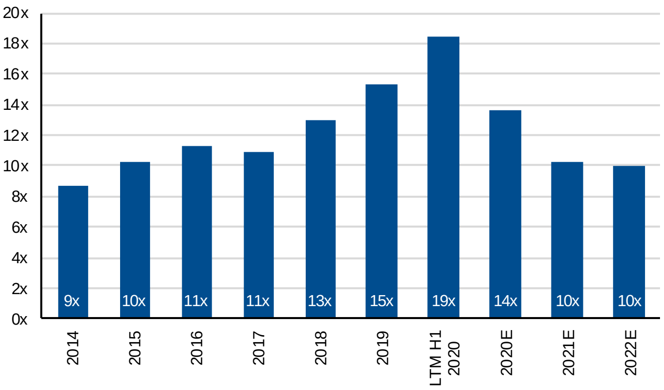
Relatively low profitability, in conjunction with small scale, entails the risk of Masterplast not being able to protect its market shares if larger peers try to establish a foothold in the company's markets by initiating a fierce price war.

Financial risk profile: BB

Strong debt protection thanks to low-yielding debt

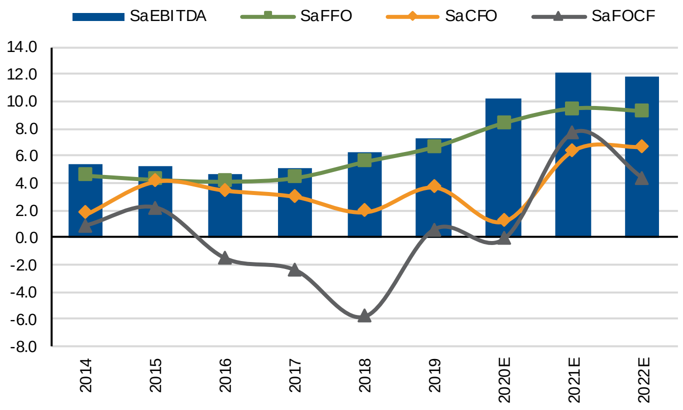
Masterplast has a strong debt protection with a Scope-adjusted EBITDA interest cover well over 10x in the last few years (last twelve months to end-June 2020: 19x). The company has benefitted from the low interest rate environment, which helped to reduce the weighted average cost of debt to 2.0% as at end-June 2020, from 3.6% as at YE 2015, because almost half of its debt is exposed to floating interest rates.

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



Sources: Masterplast, Scope estimates; 'Sa' = Scope-adjusted

Figure 5: Cash flows (EUR m)



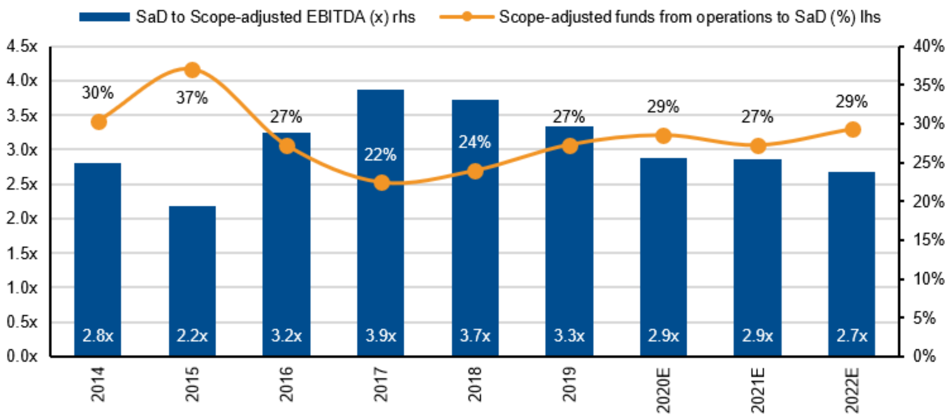
Sources: Masterplast, Scope estimates; 'Sa' = Scope-adjusted

Given the company's exposure to floating interest rates as well as the anticipated increase in total indebtedness we forecast the Scope-adjusted EBITDA interest coverage ratio to decline to around 10x going forward.

Further investments into production capacities and product availability dependent on external financing

Over the last few years, Masterplast has increased its capital expenditure significantly at the cost of Scope-adjusted free operating cash flows, which turned negative from 2016 on, and led to a significant increase in SaD to EUR 29.6m as at end-June 2020, from EUR 11.4m as at YE 2015. Spending has mainly focused on the acquisition of production facilities. Masterplast plans to spend around EUR 10m[6] in capex in 2020 (EUR 5m spent in the seven months to end-July 2020 including EUR 4m for a 50% stake in the Aschersleben production facility) and EUR 12m[6] in 2021. Expansion capex are focused on investments into the issuers production capacities and product availability in 2020 and 2021 with regard to breathable membranes and fiberglass mesh as well as warehouse extensions and logistics equipment. These investments are dependent on availability of external financing, as Scope-adjusted cash flow from operations, which is forecasted to take a hit in 2020 given the anticipated strong build-up of inventories to ensure raw material and product availability, does not cover these expansion capex.

Figure 6: Leverage



Sources: Masterplast, Scope estimates

Improving leverage as investments into production capacities start to pay-off

Masterplast's leverage, as measured by its SaD to Scope-adjusted EBITDA ratio, stood at a relatively high 3.3x as at YE 2019 (last twelve months to end-June 2020: 3.8x). This follows a continuing decrease since YE 2017 with the growth strategy bearing fruit leading to a strong growth in Scope-adjusted EBITDA (+56% since 2017 to last twelve months to end-June 2020). Absolute indebtedness as measured by the company's SaD is anticipated to grow by EUR 11m (from end-June 2020) to EUR 35m as at YE 2021 as a consequence of further investments planned.

Despite the increase in absolute indebtedness, we forecast a further reduction of the SaD to Scope-adjusted EBITDA ratio to around 3x going forward, predominately driven by the expected strong EBITDA contribution of the Aschersleben production facility (EUR 5m per year). Further improvements of leverage depend on the successful execution of investments, while keeping utilisation rates stable.

Currently, Masterplast's Scope-adjusted funds from operations (SaFFO)/SaD (which exceeded 20% throughout the period considered) benefit from relatively low interest payments driven by the low weighted average cost of debt. This has helped to balance the twofold rise in the company's indebtedness since YE 2015. We expect SaFFO/SaD to remain stable, between 25 to 30% going forward (last twelve months to end-June 2020: 25%) despite the forecasted increase in the company's weighted average cost of debt, due to the planned second bond issuance. The risk of rising interest rates will be

[6] incl. maintenance capex of EUR 2.5m

significantly reduced, helping to stabilise the company's FFO as Masterplast plans to use parts of the proceeds to repay existing short-term debt.

Adequate liquidity

We assess Masterplast's liquidity to be adequate. In detail:

Position	2020E		2021E	
Unrestricted cash (t-1)	EUR	4.5m	EUR	18.5m
Open committed credit lines (t-1)	EUR	0.0m	EUR	0.0m
Free operating cash flow	EUR	-0.2m	EUR	7.7m
Short-term debt (t-1)	EUR	6.1m	EUR	8.7m
Coverage		**0.7x**		**3.0x**

Liquidity is adequate, even if sources (EUR 4.5m of cash available as at YE 2019) do not cover uses (EUR 6.1m in short-term debt as at YE 2019 and negative Scope-adjusted free operating cash flow of EUR 0.2m forecasted for 2020). This follows our understanding that build-up in working capital in H1 2020 (EUR 8m) to improve product availability during the Covid-19 crisis i) has been financed in full and ii) will be reversed to a great extent in H2 2020.

Aside from the repayment of short-term debt, we anticipate positive free operating cash flows from 2021 onward, thus further supporting future liquidity.

Covenants

We note that Masterplast has to meet several financial maintenance covenants for its interest-bearing liabilities. The headroom under these covenants is expected to be sufficient in our base case scenario.

Senior unsecured debt: B+

Masterplast issued a HUF 6bn senior unsecured bond in December 2019 under the Hungarian National Bank's Funding for Growth Scheme. Our recovery analysis is based on the enterprise value calculated on a going concern. A continuation of the business in a default scenario seems to be likelier than a liquidation, as Masterplast already has a distribution network in several European countries, which comprises subsidiaries in its core Eastern European countries as well as 'external' export partners, which are responsible for the distribution in Masterplast's export markets. This distribution network also has a value in itself, that would get lost in the case of a liquidation of the company. Recovery for all senior secured debt is estimated to be between 51 and 70% (above average recovery). However, we do not grant a possible one notch uplift on the issuer rating due to risk and possibility of senior secured debt to increase in the path to default (volatility of capital structure and share of senior unsecured debt).

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