Masterplast Nyrt.
Hungary, Construction Materials

BB- NEGATIVE

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	20.8x	14.2x	3.8x	7.7x
Scope-adjusted debt/EBITDA	2.5x	3.1x	7.2x	3.6x
Scope-adjusted debt/EBITDA (excluding cash)	3.2x	4.4x	9.3x	4.6x
Scope-adjusted funds from operations/debt	29%	18%	8%	18%
Scope-adjusted free operating cash flow/debt	-63%	-33%	8%	2%

Rating rationale

The Negative Outlook reflects significant credit deterioration projected for 2023 and continued uncertainty. Masterplast benefited from favourable industry trends in H1 2022, but the industry deteriorated significantly in the final quarter of 2022, as inflation and interest rates soared around the world.

Masterplast faces a challenging year as the construction sector has begun to slow down throughout Europe. Building material wholesalers have started reducing their stockpiles, which means building material manufacturers face even lower demand. This slowdown has put Masterplast's margins under pressure. The company has built up several strategic partnerships over the past few years. They have enabled it to generate significant growth, with revenues rising from EUR 123m in 2020, to EUR 191m in 2021 and EUR 202m in 2022. However, the company is expecting to operate at lower profitability in 2023, having already revised forecasts it issued in 2022, before an expected recovery in revenue and profitability margins in 2024.

The slowdown in the construction industry throughout Europe has meant Masterplast is no longer able to achieve full operational efficiency at its production plants, and it is not expected to operate at full capacity for the remainder of 2023. Masterplast has begun to take corrective measures to manage the downturn, including: i) pausing dividend payments for 2022 and 2023; ii) reducing its workforce by 200 people; and iii) reducing production output at a number of its plants.

Outlook and rating-change drivers

The Negative Outlook reflects the significant deterioration of key credit metrics expected for 2023 and related uncertainty as to the scope of recovery thereafter. The recovery in Scope-adjusted EBITDA will depend on the construction sector returning to normal supply and demand conditions. Unfavourable macro trends, rising energy prices, increasing inflation and the deterioration of the interest rate environment will all hinder Masterplast in 2023. A return to profitability in 2024 is also dependent on domestic and foreign home-renovation and energy-efficiency programmes being resurrected, most of which are on hold for 2023.

A downgrade could occur if Masterplast's Scope-adjusted debt/EBITDA ratio remains above 4x on a sustained basis. This could be triggered by a prolonged reduction in Scope-adjusted EBITDA and a further increase in Masterplast's bank facilities, which increased substantially in 2022.

A positive rating action as expressed by a return to a Stable Outlook could be warranted if Masterplast's Scope-adjusted debt/EBITDA ratio returns to below 4x on a sustained basis and business conditions stabilise. This could occur if Masterplast's Scope-adjusted EBITDA improved to the levels seen at YE 2022 and YE 2021. Further positive rating action deemed remote.

Ratings & Outlook

Issuer	BB-/Negative
Senior unsecured debt	BB-

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Related Methodologies/ Research

General Corporate Rating Methodology; July 2022

Construction and Construction Materials Rating Methodology; January 2023

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
13 Jun 2023	Affirmation with change in Outlook	BB-/Negative
15 Jul 2022	Affirmation	BB-/Stable
16 Aug 2021	Upgrade	BB-/Stable

Rating and rating-change drivers

Positive rating drivers

- Almost at the end of capex-heavy expansion phase (2020-23) that is expected to bear fruit in H2 2023
- Ability to reduce workforce without incurring high costs, particularly at the production facility in Serbia
- Europe's intensifying energy independence goals and high energy prices project a positive trend for the thermal insulation industry.
- Entering German and Italian markets will open up further growth opportunities.
- Development of recyclable insulation systems (ESG factor)

Negative rating drivers

- Small company but strong market position in a fragmented market
- Limited diversification bears the risk of a decline in revenues if demand weakens.
- Further investments in production capacity and product availability depend on external financing. 10-year Hungarian bond at 8.040% as at end May 2023
- Decrease in profitability margins due to reduced demand. Production facilities no longer operating at full operational efficiency
- Heavy exposure to home market (Hungary), which is experiencing inflationary pressures amid weaker policy predictability and currency weakness, weighing on the country's growth prospects
- Poor debt protection, which is expected to decline even further in 2023 due to a decline in EBITDA

Positive rating-change drivers

- Scope-adjusted debt/EBITDA ratio returns to below 4x on a sustained basis and business conditions stabilise

Negative rating-change drivers

- Scope-adjusted debt/EBITDA ratio remains above 4x on a sustained basis

Corporate profile

Masterplast Nyrt. was founded in 1997, and its main area of activity is the production and sale of building insulation materials and systems in the construction industry. This is complemented by the production and sale of healthcare textiles and hygiene products.

Masterplast started as a wholesale distributor of construction materials, but in 2005 it started to manufacture its own construction materials, and now it operates seven manufacturing plants. The company's share of self-manufactured products increased from 30% in 2017-19 to almost 60% by YE 2022. Given the amount of investment undertaken by the company in the last few years and the amount of new investment currently underway, this figure is expected to rise even further in the next few years. The company benefits from a direct presence in 10 European countries (Hungary, Romania, Serbia, Ukraine, Poland, Slovakia, Croatia, North Macedonia, Germany and Italy), where its seven production plants operate through 16 subsidiaries. Its total geographical reach comprises more than 40 countries.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**Q1 2023[1]**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	20.8x	14.2x	8.3x	3.8x	7.7x	8.8x
Scope-adjusted debt/EBITDA	2.5x	3.1x	6.0x	7.2x	3.6x	2.9x
Scope-adjusted debt/EBITDA (excluding cash)	3.2x	4.4x	7.0x	9.3x	4.6x	3.6x
Scope-adjusted funds from operations/debt	29%	18%	9%	8%	18%	23%
Scope-adjusted free operating cash flow/debt	-63%	-33%	-32%	8%	2%	10%
Scope-adjusted EBITDA in EUR m						
EBITDA	22.8	20.6	13.3	8.0	16.1	18.3
Other items	0.0	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**22.8**	**20.6**	**13.3**	**8.0**	**16.1**	**18.3**
Funds from operations in EUR m[2]						
Scope-adjusted EBITDA	22.8	20.6	13.3	8.0	16.1	18.3
less: (net) cash interest paid	-1.1	-1.5	-1.6	-2.1	-2.1	-2.1
less: cash tax paid per cash flow statement	-0.9	-2.8	-3.0	-0.1	-0.8	-1.0
Change in provisions	0.0	0.0	0.0	0.0	0.0	0.0
Funds from operations (FFO)	**20.8**	**16.4**	**8.7**	**5.8**	**13.2**	**15.2**
Free operating cash flow in EUR m						
Funds from operations	20.8	16.4	8.7	5.8	13.2	15.2
Change in working capital	-28.1	-22.6	-8.3	14.6	-1.0	-0.4
less: net effect of operating lease payments	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	-38.7	-24.9	-31.2	-14.8	-10.9	-8.0
Divestments	0.1	1.4	1.4	0.0	0.0	0.0
Free operating cash flow (FOCF)	**-45.9**	**-29.8**	**-29.5**	**5.6**	**1.3**	**6.8**
Net cash interest paid in EUR m[2]						
Net cash interest per cash flow statement	-1.1	-1.5	-1.6	-2.1	-2.1	-2.1
Change in other items	0.0	0.0	0.0	0.0	0.0	0.0
Net cash interest paid	**-1.1**	**-1.5**	**-1.6**	**-2.1**	**-2.1**	**-2.1**
Scope-adjusted debt in EUR m[2]						
Reported gross financial debt	68.0	84.9	88.3	68.7	68.7	61.2
add: derivatives	4.3	5.6	4.4	5.6	5.6	5.6
less: cash	-15.4	-25.9	-13.0	-16.8	-16.7	-14.2
add: restricted cash	15.4	25.9	13.0	16.8	16.7	14.2
add: other	0.0	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt	**72.3**	**90.5**	**92.8**	**74.2**	**74.2**	**66.7**

[1] 12 months ending March 2023 for cash flow metrics
[2] Editorial note: the currency has been added on 11 July 2023

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Environmental, social and governance (ESG) profile[3]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Green leaf	Labour management		Management and supervision (supervisory boards and key person risk)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend
Green leaf (ESG factor: credit-positive)
Red leaf (ESG factor: credit-negative)
Grey leaf (ESG factor: credit-neutral)

Regulatory tailwinds support growth

As a provider of insulation for buildings (thermal, facade and roof insulation), Masterplast participates in the reduction of carbon emissions in the real estate sector. In this context, Masterplast should benefit from good growth prospects, driven by solid demand for its products. This demand is supported by regulatory tailwinds, with most EU member states subsidising investments in properties to reduce energy consumption and carbon emissions[4].

Masterplast introduced a limited set of ESG targets in 2021: i) ‘greening’ the packaging of Masterplast products by 2023; ii) 10% green electricity use by 2025; and iii) use of 500 t of waste plastic to produce extruded polystyrene (XPS) sheets by 2026. In our view, the company should also prioritise the reduction of direct and indirect greenhouse gas emissions from its own operations, coming from manufacturing (large factory in Serbia), logistics and distribution.

Higher share of recycled materials lowers costs and dependence on raw materials

Masterplast has launched a circular business model called the Hungarocell Green Programme, which promotes waste recovery and recycling in Hungary. By spreading its programme across the Hungarian building materials industry through a network of collection points, this initiative has the potential to generate returns (e.g. reduced cost of material) while having a positive impact. This is because it will not only lead to a reduction in waste but also address regulatory requirements, thus creating cost savings for customers.

Overall, we believe Masterplast is on the right path to becoming a front-runner in sustainability best practices in Hungary, assuming the company gradually strengthens its commitment. This will mitigate ESG-related risks, such as regulatory changes and availability of raw materials.

[3] 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.
[4] The real estate industry is the largest energy-consuming sector in Europe, accounting for around 40% of total energy consumption and one third of carbon emissions.

Business risk profile: B+

Revenue surpasses EUR 200m for the first time

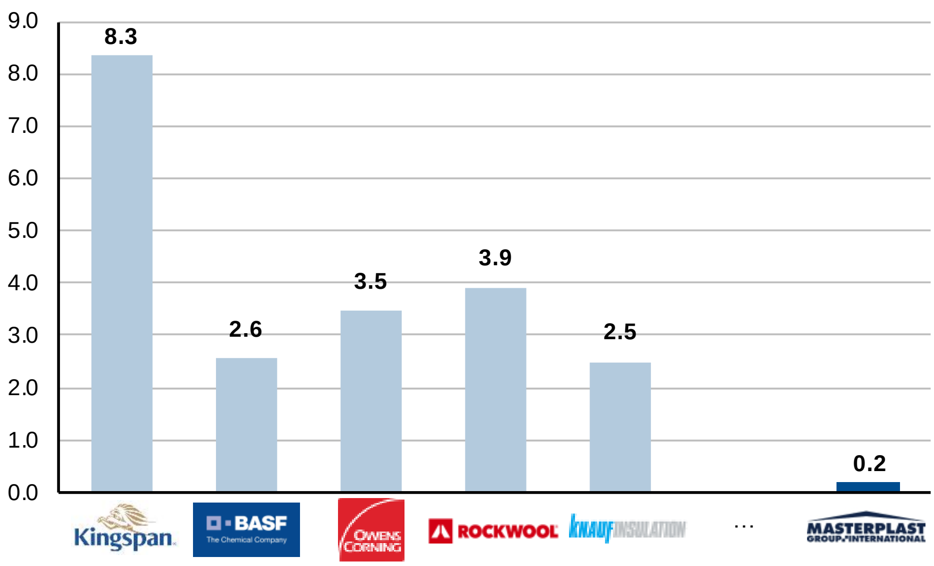
Masterplast is a relatively small player in the construction materials industry. The company has built up several strategic partnerships over the past few years. They have enabled it to generate significant growth, with revenue rising from EUR 123m in 2020 to EUR 191m in 2021 and EUR 202m in 2022. During that time the company's Scope-adjusted EBITDA increased from EUR 11.1m in 2020 to EUR 22.8m in 2021 and EUR 20.6m in 2022. Masterplast produces high-quality products, backed up by an efficient delivery system (largely thanks to its own logistics and distribution network) and a constant stock of goods (thanks to its warehousing capacity).

Challenging start to 2023

However, the company is facing a more challenging environment now, and it is expected to operate at lower profitability in 2023, having already revised forecasts it issued in 2022. Revenues have been declining since Q4 2022. In the 12 months to end-March 2023, revenues fell to EUR 188m and Scope-adjusted EBITDA fell to EUR 13.3m. Revenues are expected to decline even further to EUR 175m by YE 2023 before returning above EUR 200m in 2024. As a result, Scope-adjusted EBITDA is expected to decline to EUR 8m by YE 2023 before returning to EUR 16.1m in 2024.

The expected drop in revenues for 2023 is driven by a significant downturn in the construction industry. This has accelerated since Q4 2022 due to high inflation and soaring interest rates around the world. As a result, building material wholesalers started reducing their stocks, which meant building material manufacturers faced even lower demand. This slowdown has put Masterplast's margins under pressure. The company's small size limits its ability to benefit from economies of scale or offset the impact of economic cycles. However, its market position is supported by its strong standing in Eastern Europe, the rather fragmented market structure in its main segment (insulation systems) and strong customer loyalty.

Figure 1: Peers in insulation segment by revenue FY 2022 (EUR bn)



Sources: public information, Scope

We do not expect Masterplast to reach a critical size in the coming years, which would enable it to defend its foothold if larger competitors such as BASF, Knauf Insulation or ROCKWOOL International entered the niche markets in which it operates.

Significant investment over the past three years expected to bear fruit in H2 2023

Masterplast's growth over the past few years has been underpinned by capex of almost EUR 90m since 2020. This investment was mainly used to build and acquire new production facilities. This includes the investment in two EPS production facilities, one new production facility in Reggio Emilia, Italy, and one facility in Kál, Hungary, which is being repurposed from its current use. This was followed by additional investment in a new XPS production facility in Subocia, Serbia, where the company has operated since 2002. The Subotica facility officially opened in May 2023, and the two other facilities are expected to be operational in the second half of 2023.

The company is currently undertaking a EUR 49m project in Halmajugra, Hungary, which is a 50% partnership with Market Építő. This is the largest investment in the company's history. This facility is not expected to start production until H1 2025, and it will be for mineral wool production.

In January 2023 Masterplast announced its acquisition of PIMCO Ltd. PIMCO Ltd owns a 4.3-hectare industrial site in Szerences, Hungary, on which a new production facility is already at an advanced stage of investment. This includes EUR 14.4m of non-refundable state aid from the Hungarian Investment Promotion Agency (HIPA). The facility will be used to manufacture glass wool insulation, and production is expected to start in the first half of 2025 with the involvement of a co-investor. The total development is expected to cost EUR 47.5m.

EUR 22.4m raised in second public offering

The proceeds from the second public offering in October 2022 (EUR 22.4m) are being used to fund both the Halmajugra (glass wool) and Szerences (rock wool) facilities. After 2023 the company is not expected to have any additional spending requirements beyond maintenance-related investments.

42% decline in healthcare revenue

The healthcare sector proved to be very profitable for the company because of the Covid-19 pandemic, which saw the segment contribute EUR 44m in revenue in 2021 (23% of total revenue). However, as the pandemic started to dissipate, revenues from this segment declined by 42% to EUR 25m in 2022 (13% of total revenue).

This decline in revenue, coupled with higher manufacturing costs (especially for energy) also led to lower gross margins. However, the company managed to offset this decline in revenue with an increase in sales in its thermal insulation segment. These rose from EUR 77m in 2021 to EUR 107m in 2022, driven by growth in the renovation market throughout Europe. We expect the healthcare segment to contribute less than 10% of total revenue going forward. The company is currently in the investment phase of its modular homes business but does not expect to start mass production until at least 2024.

Beyond 2023, sales growth should benefit from supportive trends such as the EU's goal of becoming carbon-neutral by 2050. Consequently, the company's sales of insulation materials benefit from: i) regulatory tailwinds, with most EU member states subsidising investments in properties to reduce energy consumption and carbon emissions; and ii) the development of recyclable insulation systems (credit-positive ESG factor).

Successful entry into healthcare equipment market should stabilise cash flow

Segment diversification improved in 2020 when the company entered the healthcare equipment segment via the acquisition of a production facility in Germany (Aschersleben). This acquisition laid the groundwork for the company's expansion into the higher-margin medical equipment industry (personal protective equipment and finished products). The Aschersleben facility produces special fleece and multilayer membrane textiles for the healthcare sector. Additional production capacity was added in Q3 2021 at Masterplast's headquarters in Sárszentmihály, Hungary. The Aschersleben plant was originally used to produce construction materials for the roofing segment, but the technology was easily adapted for use in medical products during the Covid-19 pandemic. This segment led to significant growth in profitability in 2020 (EBITDA +51%) and 2021 (EBITDA +106%), due to the huge demand and higher margins for healthcare products during the pandemic.

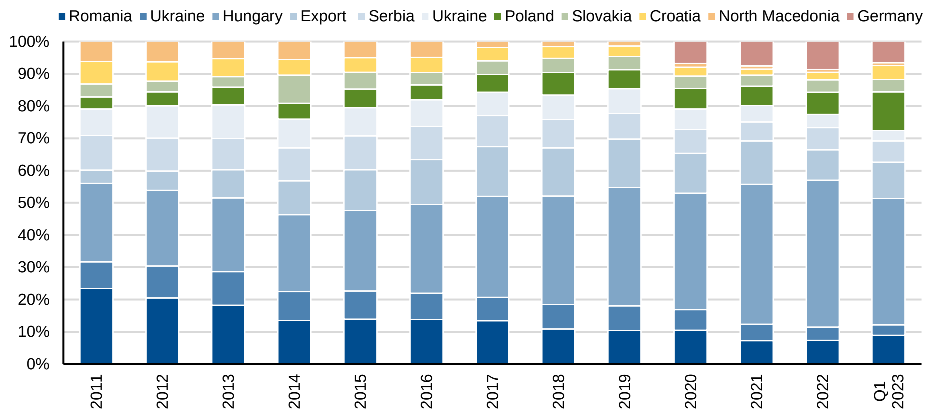
However, as the pandemic subsided in the first half of 2022, the production of healthcare materials declined and the factory was able to quickly return to producing construction materials at pre-pandemic levels.

Poor geographic diversification poses risk of 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 and Eastern Europe). In 2022 the company generated 44% of its revenue in Hungary (2021: 46%).

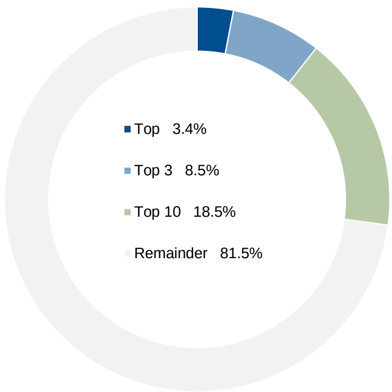
Low geographical diversification bears the risk of exposure to the construction cycle of one region. In a cyclical industry such as construction materials, revenues and earnings are likely to come under pressure if there is a downturn in one region. Conversely, a wide spread of activities across various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

Figure 2: Geographical diversification of revenue



Sources: Masterplast, Scope

Figure 3: Share of top 10 customers (by revenue) for Q1 2023



Sources: Masterplast, Scope

Masterplast is diversified within Europe, with exposure to several countries in that region. This provides some diversification because we expect demand patterns to differ at least a little across the countries to which the company is exposed. Masterplast's pan-European footprint also benefits from its export activities, in which sales outside of CEE account for EUR 44.1m or 23% of total revenue in the LTM Q1 2023, in line with previous years. We expect further diversification away from CEE with the start of EPS production in Calerno, Italy, which is expected in 2023.

Segment diversification and less cyclical end-markets provide near-term cash flow visibility

Healthcare products accounted for a very significant share of revenue growth during the Covid-19 pandemic. These products are traditionally less sensitive to the economic cycle and are sold at substantially higher prices than construction products. This enabled the company to double its EBITDA margin from EUR 11.1m (2020) to EUR 22.8m (2021). However, following European societies' improved capacity to cope with the pandemic, the special economic situation that boosted sales from the healthcare segment ended.

This year's contribution from healthcare equipment (PPE, medical capes, slings, isolation sheets, etc.) is expected to remain around 2022 levels, followed by steady growth of 10% in the coming years. Sales of medical products under the Masterplast Medical brand (produced at the company's Sárszentmihály facility) are expected to start in 2023, once the ongoing acquisition of the necessary health certificates is achieved. We do not expect the healthcare sector to contribute more than 10% of revenue going forward, and we continue to see thermal insulation products making up the majority of sales in the medium term, highlighting the company's dependency on a single segment.

Modular buildings

In 2023 Masterplast will begin production of modular buildings that will have a variety of uses, including residential, offices, medical clinics and changing rooms. This new segment will be supported by proprietary technologies developed by an in-house engineering team. In addition, Masterplast already possesses the required supplier and manufacturing background. The plant requires minimal investment, but it has higher labour needs, although costs are still lower compared to traditional construction. However, due to a shortage of skilled workers in the construction industry, the company aims to achieve a level of automation where certain operations can be carried out by skilled workers without the need for specialists. Thanks to new building materials and digital technologies, modular houses are higher quality than container houses, and they can be installed faster than traditional buildings, with lower costs and less need for live labour. This is why industry forecasts expect modular to have a larger role and weight within the construction industry, with dynamic growth potential.

Modular construction is common in the Nordic countries but it is still rather new in Masterplast's region. While the company is expected to start mass production in 2023, the product does not have market validation yet, so we see the segment having a limited impact on the company's financials in the short-to-medium term. The modular housing segment would represent higher added value, with higher margins than construction products (although somewhat lower than the healthcare segment).

Not dependent on any one customer

Masterplast's largest customer (the National Institute for Health Services) contributed 9% of total revenues in 2021 (top 10: 25%). However, in Q1 2023, as sales in the healthcare sector dropped, the largest customer 'Biemme Srl' contributed 3.4% of total revenues, with the top 3 contributing 8.5%, and the top 10 contributing 18.5%.

Margins to come under pressure in 2023

Profitability as measured by the company's Scope-adjusted EBITDA margin decreased to 10.2% (YE 2022) from a high of 11.9% (YE 2021). In the 12 months to end-March 2023, this figure weakened further to 7.1%, and by year-end 2023 we forecast it will decline to 4.6% before gradually recovering in 2024.

One of the main contributing factors to the drop in the Scope-adjusted EBITDA margin is the negative impact from raw materials that Masterplast purchased at high prices in order to build up its inventory. This inventory buildup, which is typical of Masterplast's business model, proved to be costly once the slowdown in the construction industry took hold in Q4 2022. The company will continue to experience a negative impact from purchasing raw materials at high prices until the end of Q2 2023. Furthermore, the inflation rate and key interest rate in Masterplast's home market of Hungary is the highest among EU countries. Hungarian businesses are further burdened by fluctuations in the Hungarian currency, which peaked in October 2022 (EUR 1=HUF 432.122).

Cutting workforce by 200 people in effort to reduce costs

The slowdown in the construction industry throughout Europe has meant Masterplast is no longer able to achieve full operational efficiency at its production plants, and it is not expected to operate at full capacity for the remainder of 2023. In response, the company has taken measures to reduce costs and has begun laying off about 200 people at the company level.

A return to profitability in 2024 is dependent on domestic and foreign home-renovation and energy-efficiency programmes, most of which are on hold for 2023. Unfavourable macro trends, rising energy prices, increasing inflation and the deterioration of the interest rate environment will all hinder Masterplast in 2023. As a result, a further decrease in sales related to the new building market is expected. At the same time, renovation and energy modernisation of buildings is essential to dealing with the energy crisis. The framework of the EU's REPowerEU programme plans for the emergence of powerful building energy support programmes in Europe. These could ensure growth in demand for insulation materials even in the face of a deteriorating economic environment and an impending recession.

Recovery in Hungarian construction sector dependent on EU funds

The strongest driver of medium-term profitability is dependent on the recovery of the Hungarian construction sector, and it depends on the release of funds from the EU to kickstart the sector, particularly the renovation sector. We believe this is a significant risk for Masterplast because the construction industry in its domestic market of Hungary – which accounted for 44% of revenue in 2022 – is relying on these funds to kickstart the sector in 2023. Yet there is also a risk that these funds might not be made available to Hungary in the near term. This is because the European Commission decided in November 2022 to suspend 65% of commitments for three operational programmes under cohesion policy, amounting to EUR 7.5bn. It did so due to Hungary's failure to implement significant reforms, including an independent judicial and effective anti-corruption system. The European Union also stated that these funds will only flow to Hungary once all the necessary milestones are met. We have no visibility on when these funds will be made available.

The higher-margin segment of healthcare will not be as prevalent going forward as it was in 2021, but we still expect it to provide stable revenue. If Hungary is able to meet its EU targets and the funds are released, revenues could grow to levels previously forecasted, and profitability margins could start to improve again to above 11% or 12% as the company will be able to benefit from better economies of scale and operate its production facilities more efficiently.

Financial risk profile: BB

Debt protection expected to come under pressure

Masterplast's financial risk profile previously benefited from very strong debt protection, with Scope-adjusted EBITDA historically well over 10x during the past few years. However, revenue is expected to decline by 13% to EUR 175m at YE 2023 (from EUR 202m at YE 2022) due to a material deterioration in the macro environment and the expiry of subsidies. As a result of this drop in revenue, Masterplast's Scope-adjusted EBITDA is expected to fall to EUR 8.0m (YE 2023) from EUR 20.6m (YE 2022).

In October 2022 the company raised an additional EUR 22.3m through a secondary public offering in order to finance its growth plans. With an increase in debt and equity of nearly EUR 40m in 2022, the company has limited financing needs in the short term.

Masterplast's interest-bearing debt increased to EUR 84.9m in 2022 from EUR 68.0m (YE 2021), largely due to an increase in bank debt. While the company's interest-bearing debt is not expected to increase significantly in 2023, its interest expense is expected to increase because of floating rate bank debt.

Masterplast issued three bonds under the Hungarian National Bank's Funding for Growth Scheme (in December 2019, December 2020 and August 2021) totalling EUR 52m, with an average fixed interest rate of 2.4%. The first repayment on the first bond facility is due in December 2023, totalling EUR 3.7m. In addition, the company has received substantial government grants to partially cover expansion capex.

Big increase in bank debt

Masterplast has a number of bank facilities primarily denominated in euros. These include investment loans, current asset loans and overdraft facilities. Total bank loans increased substantially to EUR 31.9m (YE 2022) from EUR 10.2m (YE 2021). The additional bank debt increases Masterplast's floating rate risk. The effects of the increase in floating rate bank debt could already be seen in Q1 2023, with a total interest expense of EUR 0.75m, up from EUR 0.48m in Q1 2022 (54% increase YoY). The average interest rate on the bank facilities was 3.9% (base rate plus margin) in 2022. However, the majority of Masterplast's bank facilities are based on the 3M Euribor (base rate), which is currently at 3.46% (end-May 2023) and is expected to remain between 3.6% and 3.9% until YE 2023. Therefore, the cost of bank financing alone is expected to rise to EUR 1.74m for 2023, up from EUR 1.24m (YE 2022). The 3M Euribor rate is also forecasted to remain above 3% throughout 2024.

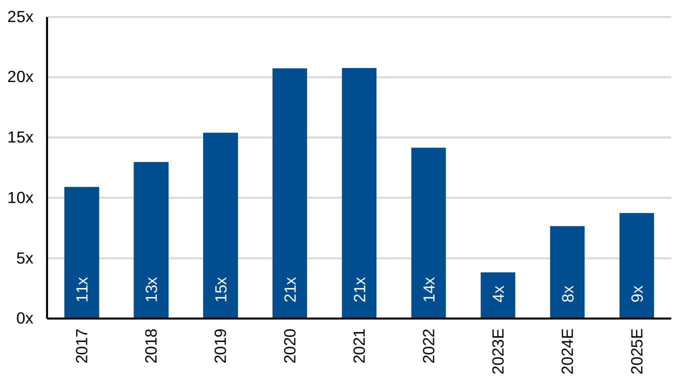
Increase in interest expense offset by high deposit rates

Masterplast total interest paid (from bonds and bank facilities) of EUR 2.51m in 2022, up from EUR 1.45m in 2021. While this increase of over EUR 1m is substantial, the amount of interest Masterplast received in 2022 also increased – to EUR 1.06m from EUR 0.35m in 2021. This results in a net increase of only EUR 0.35m. The increase in interest income is because the overnight deposit rate in Hungary is so high, currently at 17% (end-May 2023). Hence, the company's additional interest expense is somewhat offset by its high interest income. Its weighted average cost of debt as at Q1 2023 is an estimated 3.6%, up from 2.5% as at end-June 2022.

Interest cover to drop in 2023

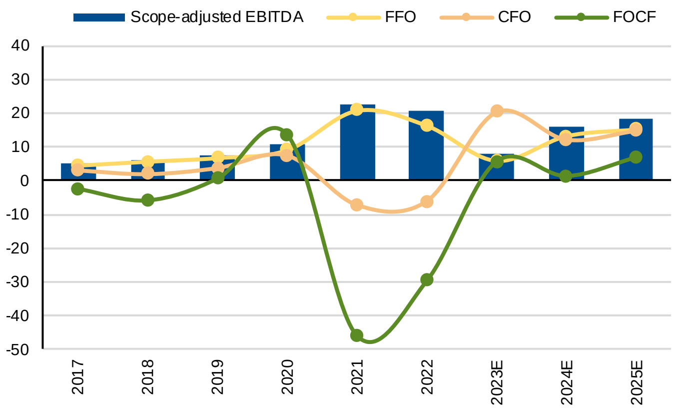
As a result, Scope-adjusted EBITDA interest cover dropped to 8.3x in LTM Q1 2023, and it is expected to drop to 3.8x by YE 2023. A recovery to above 7x is expected in 2024 when market conditions are expected to improve. New production facilities that are currently under development will come online and start contributing to Scope-adjusted EBITDA in 2024 too.

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



Sources: Masterplast, Scope estimates

Figure 5: Cash flow (EUR m)



Sources: Masterplast, Scope estimates

Further investments dependent on external financing

Over the last few years Masterplast has increased its capital expenditure significantly at the cost of FOCF. This metric turned negative from 2016 on and led to a significant increase in Scope-adjusted debt to EUR 92.8m as at end-March 2023, from EUR 11.4m as at YE 2015. Spending during the past few years has mainly focused on the acquisition of production facilities.

Masterplast spent around EUR 18m on capex in 2022, including EUR 8m on an XPS production site in Subotica, Serbia. The new facility was partially financed by a 50% non-refundable state subsidy provided under the HEPA programme of the Ministry of Foreign Affairs and Trade. The 50% subsidy limited the impact on FOCF.

New XPS production facility in Subotica is now operational

Masterplast plans to spend around EUR 14.7m on capex in 2023, followed by an additional EUR 10.8m in 2024 and a further EUR 8m in 2025. Of the EUR 14.7m earmarked for 2023, EUR 6.3m has been spent to date, including EUR 2.4m to finish the XPS production facility in Subotica (Serbia) that is now operational. The remaining capex for 2023 will primarily be spent to complete the two EPS production facilities (Kál, Hungary and Reggio Emilia, Italy) and invest in Masterplast's new modular house segment in partnership with the KÉSZ Group.

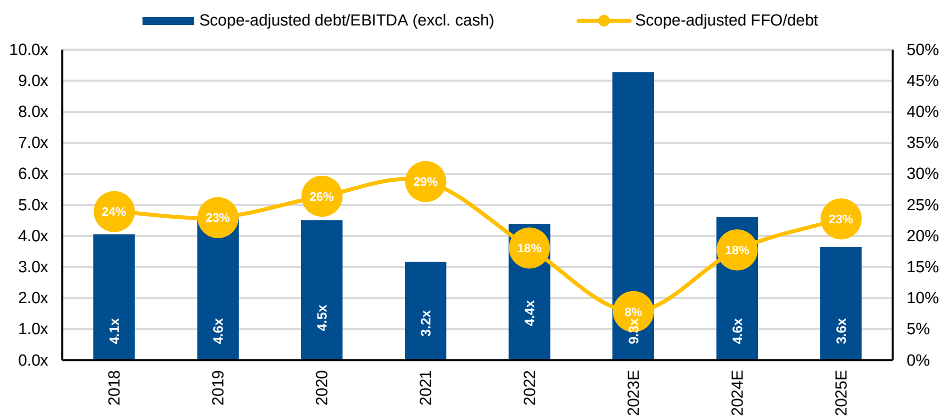
Substantial expansion of production capacity is anticipated to come to a halt in 2023, with the XPS facility in Subotica now operational and the two additional EPS facilities expected to be operational in H2 2023. Any further growth is subject to developments in the cost of capital (including debt and equity). Therefore, we forecast cash flow cover to break even at YE 2023, providing the necessary headroom to deal with the first bond amortisation payment (EUR 3.7m) in December 2023.

We see rather limited risk from price surges in raw materials, labour and energy as seen in 2022. Masterplast had to purchase raw materials at higher prices after the war in Ukraine started, and the effects of those purchases will continue to be felt until H2 2023. Although freight container costs have gone down significantly since Q2/Q3 2022, the company's costs for raw materials, energy, fuel and value of services remain higher than in Q1 2022. And while Masterplast has been able to pass on most of the increase in costs, gross margins have declined and are not expected to recover until 2024.

Leverage deteriorating due to reduction in Scope-adjusted EBITDA

Masterplast's leverage as measured by its Scope-adjusted debt/EBITDA ratio has historically been around 2.5x-3.5x, such as 3.1x as at YE 2022 and 2.5x as at YE 2021 (including cash). However, the past two quarters have proven very difficult for the entire construction sector. In Q1 2023 Masterplast's Scope-adjusted EBITDA posted a loss of EUR 2.0m and an after-tax loss of EUR 5.8m. Scope-adjusted EBITDA is expected to deteriorate to EUR 8m by YE 2023.

Figure 6: Leverage



Sources: Masterplast, Scope estimates

The Scope-adjusted debt/EBITDA ratio (excluding cash) increased significantly to 7.0x as at LTM Q1 2023 due to the decline in Scope-adjusted EBITDA to EUR 13.3m over the same period. We forecast that the Scope-adjusted debt/EBITDA ratio (excluding cash) will weaken to 9.3x by YE 2023 before an expected recovery to 4.6x by YE 2024.

Our forecast of deterioration in the Scope-adjusted debt/EBITDA ratio (excluding cash) is driven by: i) the increase in interest-bearing debt, which stood at EUR 92.8m as at LTM Q1 2023 and is expected to remain unchanged throughout 2023; and ii) the expected deterioration in Scope-adjusted EBITDA to EUR 8m by YE 2023 (EUR 20.6m at YE 2022; EUR 22.8m at YE 2021).

Masterplast's Scope-adjusted FFO/debt ratio is 9% (LTM Q1 2023), down from 18% (YE 2022) and 29% (YE 2021). This ratio is also suffering from the decline in Scope-adjusted EBITDA. We forecast that this figure will drop to 8% by YE 2023 before a recovery to 18% in 2024, which will be driven by the expected improvement in Scope-adjusted EBITDA.

The recovery in Scope-adjusted EBITDA will depend on the construction sector returning to normal supply and demand, while the growth strategy that Masterplast has embarked on over the past few years is expected to bear fruit in 2024 with increased production output and increased production efficiency.

Limited external financing needs will also ensure that the Scope-adjusted FFO/debt ratio remains above 30% going forward (last 12 months to end-March 2022: 32%).

Adequate liquidity

Masterplast's liquidity is adequate based on our expectation that sources of liquidity will cover uses by about 1.5x in the 12 months to YE 2023.

Balance in EUR m	2023E	2024E
Unrestricted cash (t-1)	25.9	16.8
Open committed credit lines (t-1)	0.0	0.0
FOCF (t)	5.6	1.3
Short-term debt (t-1)	21.2	7.5
Coverage	**148%**	**>200%**

Aside from the repayment of short-term debt, we anticipate positive FOCF from 2023 onward, once subsidised investments in the company's production facilities have been executed. This should further support future liquidity.

Supplementary rating drivers: +/- 0 notches

We note that Masterplast must 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.

Long-term debt rating

First bond amortisation due in December 2023

In December 2019, Masterplast issued a HUF 6bn senior unsecured bond (ISIN: HU0000359369) through the Hungarian Central Bank's Bond Funding for Growth Scheme. The proceeds of the bond was used to repay Masterplast's high portion of short-term debt. The bond has a tenor of 7 years and a fixed coupon of 2.00%. The bond repayments are in four equal tranches starting from December 2023, with 25.00% of the face value payable yearly.

In December 2020, Masterplast issued a second HUF 6bn senior unsecured bond (ISIN: HU0000360219), also through the Hungarian Central Bank's Bond Funding for Growth Scheme. The proceeds were used to refinance current debt and further capital expenditure, as well as business acquisitions. The bond has a tenor of 7 years and a fixed coupon of 2.10%. The bond repayments are in four equal tranches starting from December 2024, with 25.00% of the face value payable yearly.

In August 2021, Masterplast issued a HUF 9bn senior unsecured bond (ISIN: HU0000360748), again through the Hungarian Central Bank's Bond Funding for Growth Scheme. The proceeds were used for further capital expenditure and business acquisitions. The bond has a tenor of 10 years and a fixed coupon of 2.90%. The bond repayments start in August 2027, with 4 equal instalments of HUF 1.125bn (12.5% of the face value) each year until 2030, with a 50% balloon payment at maturity in August 2031.

Our recovery analysis is based on the enterprise value calculated as a going concern. A continuation of the business in a default scenario seems to be more likely than liquidation given that Masterplast already has a distribution network in several European countries. This network comprises subsidiaries in its core Eastern European countries as well as 'external' export partners that are responsible for distribution in Masterplast's export markets. This distribution network has its own inherent value, which would be lost if the company was liquidated. We estimate the recovery for all senior secured debt to be 'average', justifying a debt class rating equal to that of the issuer (BB-).

Senior unsecured debt rating: BB-

We note that Masterplast's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clause requires Masterplast to repay the nominal amount of all three bonds (total HUF 21bn) in case of rating deterioration (2-year cure period for a B/B- rating, repayment within 30 days after the bond rating falls below B-, which could have default implications).

Appendix: Peer comparison

	Masterplast Nyrt.	Holcim Ltd.
	BB-/Negative	--/--*
Last reporting date	31/03/2023[5]	30/06/2022
Business risk profile		
Total revenue (EUR m)	188	28,959
Scope-adjusted EBITDA (EUR m)	13	6,726
Regions in which active	Europe	Global
Segments in which active	Construction materials, medical equipment and devices	Construction materials
Scope-adjusted EBITDA margin	7.1%	23%
Financial risk profile		
Scope-adjusted EBITDA interest cover	8.3x	14.7x
Scope-adjusted debt/EBITDA	6.0x	2.3x
Scope-adjusted debt/EBITDA (excl. cash)	7.0x	n/a
Scope-adjusted FFO/debt	9%	37%
Scope-adjusted FOCF/debt	-32%	23%
Weighted average cost of debt	3.6%[6]	2.1%
Weighted average maturity (years)	n/a	7.0

*Subscription ratings available on ScopeOne
Sources: public information, Scope

[5] Last 12 months to end March 2023
[6] Estimated as at end-June 2022

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