KÉSZ Holding Zrt.
Hungary, Construction

SCOPE BB- STABLE

Key metrics

		Scope estimates		
Scope credit ratios	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	11.7x	6.2x	5.7x	5.2x
Scope-adjusted debt/EBITDA	2.8x	3.0x	3.9x	3.3x
Scope-adjusted FFO/debt	25%	16%	12%	14%
Scope-adjusted FOCF/debt	-9%	-13%	-40%	-16%

Rating rationale

The rating is supported by KÉSZ's position as the third largest construction company in Hungary. KÉSZ's subsidiaries operate in designing, manufacturing, and implementing new construction projects. The group's vertical integration makes it a one-stop shop to companies looking to implement new construction projects. While KÉSZ's main activity is construction (67% of revenue in FY 2022), the group has a number of other business lines providing segment diversification and revenue streams that are not dependent on the construction cycle. The spread of activities partially limits cash flow volatility and leads to relatively stable profitability.

The main constraint on the rating is the group's exposure to the high cyclicality of the construction sector, combined with limited geographic diversification, reflected in 93% revenue being generated in their domestic market, which weakens their ability to mitigate economic cycles. Additionally, the expected increase in leverage to finance the group's expansion, will put credit metrics under pressure for the next few years.

Outlook and rating-change drivers

The Outlook is Stable for KÉSZ and incorporates our view that the group will continue to generate positive operating cash flow based on their current backlog. It also reflects our expectation of a successful execution of current real estate projects as well as Scope-adjusted debt/EBITDA remaining below 4x and Scope-adjusted interest cover remaining above 5x. Our Outlook considers the group's commitment to a cautious financial approach, particularly regarding the distribution of dividends and investments for expansion.

A positive rating action is remote but may be warranted if the business risk profile improved, with size and diversification improving (by customer and project), combined with Scope-adjusted debt/EBITDA remaining below 3.0x on a sustained basis.

A downgrade could be required if KESZ's leverage significatively deteriorated to above 4.0x on a sustained basis or if their order backlog dropped below 1x. This could be caused by a deterioration in market conditions and fewer projects being added to the backlog.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
30 Mar 2023	New	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
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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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Long-established market position in domestic markets, ranking in the top three construction companies in Hungary • Solid contracted backlog exceeding 1.7x as at March 2023, with a highly reputable project portfolio and long record of delivering successful projects in its domestic market, and benefiting from recurring income's streams from the group's energy segment • Vertical integration strategy that benefits the group during tenders, due to the group's independence from external subcontractors, with a high degree of their own resources covering the construction and civil engineering supply chain • Large portion of fixed-rate debt issued as of December 2022 • Stable project executions indicated by fairly constant profitability margins, as measured by the Scope-adjusted EBITDA margin, over the last few years	• Relatively small-scale construction company in the European context exposing it to the cyclical and competitive construction industry (approximately 79% of income in 2022), somewhat mitigated by the groups' exposure to other business segments • Limited geographic diversification with 93% of revenue generated in Hungary and higher-risk Central and Eastern European countries, leaving cash flow vulnerable to an industry cooldown • Notable concentration among domestic customers in view of the contracted volumes in the construction segment (top 10 >80%; top 3 >60%) • Market-wide increasing costs for building materials and labour likely to stress profit margins • Increasing leverage following additional HUF 20bn of financial debt expected in 2023 in the current rising interest rate environment

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA of below 3.0x on a sustained basis • Higher geographic diversification with reduced reliance on domestic markets	• Backlog to fall below <1x • Scope-adjusted debt/EBITDA moving above 4.0x

Corporate profile

KÉSZ was first established in 1982 as a family-run business and is now one of the largest construction companies in Hungary. As an independent group of companies, KÉSZ aims to become one of the leading construction companies in Central and Eastern Europe through investments and project development in domestic and international markets. One of the leading domestic players in construction, KÉSZ has built numerous prominent industrial facilities, office buildings, shopping and logistics centres, sports venues, hotels and housing facilities (e.g. Kossuth Lajos Square, Mercedes-Benz factory, LEGO factory, Budapest Airport Sky Court, Sheraton Hotel, Duna Arena Swimming Complex).

KÉSZ Holding Zrt., the group's holding company, was formed in 2007 to provide a clearer company structure and to professionalise the investment and asset management activities in Hungary and abroad. To date, KÉSZ has implemented more than 3,100 projects and has 5 million m2 references in more than 12 countries. The group employs more than 2,000 people and reported a revenue of HUF 197bn for 2022E (2021: HUF 180bn).

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	9.1x	11.3x	11.7x	6.2x	5.7x	5.2x
Scope-adjusted debt/EBITDA	2.6x	1.1x	2.8x	3.0x	3.9x	3.3x
Scope-adjusted FFO/debt	31%	76%	25%	16%	12%	14%
Scope-adjusted FOCF/debt	-3%	25%	-9%	-13%	-40%	-16%
Scope-adjusted EBITDA in HUF m						
EBITDA	4,789	8,120	16,716	13,025	15,263	17,362
Other items[1]	128	594	-2,573	0	0	0
Scope-adjusted EBITDA	**4,918**	**8,714**	**14,143**	**13,025**	**15,263**	**17,362**
Funds from operations in HUF m						
Scope-adjusted EBITDA	4,789	8,120	14,143	13,025	15,263	17,362
less: (net) cash interest paid	-541	-773	-1,204	-2,092	-2,697	-3,341
less: cash tax paid per cash flow statement	-435	-714	-1,967	-1,118	-1,459	-1,641
less: profit for minority shareholdings	21	-260	-971	-3,565	-3,808	-4,203
Change in provisions	0	0	0	0	0	0
FFO	**3,835**	**6,373**	**10,001**	**6,250**	**7,300**	**8,177**
Free operating cash flow in HUF m						
Funds from operations	3,835	6,373	10,001	6,250	7,300	8,177
Change in working capital	2,839	4,488	-11,620	-3,370	-15,476	-3,273
Capital expenditure	-7,220	-9,197	-1,769	-8,191	-15,518	-14,219
Divestments	0	0	0	0	0	0
FOCF	**-546**	**1,663**	**-3,388**	**-5,311**	**-23,694**	**-9,315**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-541	-773	-1,204	-2,092	-2,697	-3,341
Change in other items	0	0	0	0	0	0
Net cash interest paid	**-541**	**-773**	**-1,204**	**-2,092**	**-2,697**	**-3,341**
Scope-adjusted debt in HUF m						
Reported gross financial debt	20,017	22,049	52,834	48,024	67,564	66,568
add: derivatives	0	0	0	0	0	0
less: cash	-7,249	-12,840	-45,680	-23,906	-25,414	-20,862
add: restricted cash	0	0	32,541	15,306	16,814	12,262
Scope-adjusted debt	**12,768**	**9,210**	**39,695**	**39,424**	**58,964**	**57,968**

[1] Relates to an exception gain in 2021 from the sale of properties and loss attributed to the Russia-Ukraine war.

Table of Content

Environmental, social and governance (ESG) profile[2]

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 neutral

The following ESG risks are the most relevant for companies in the segment: i) waste and sustainable building materials; ii) efficient technology; iii) employee health and safety; and iv) litigation, bribery and regulatory risk.[3]

We did not identify any ESG-related rating driver that would have a relevant impact on our overall assessment of credit risk.

Given the extensive environmental impact of the construction industry, medium-to-large companies, including KÉSZ Group, increasingly seek to reduce the use of energy and non-renewable materials as well as limit the environmental footprint of construction projects throughout the supply chain. This aligns with efforts to mitigate climate-related risks in line with the Paris Climate Agreement. The social aspect is also relevant, especially regarding practices that could severely impair the group's reputation and financial performance (e.g. corruption, stakeholder management). KÉSZ plans to publish their first ESG report by 2023 and has mandated KPMG as advisor during the strategy making process.

[2] 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.
[3] ESG consideration for construction companies, Scope Ratings December 2022.

Business risk profile: B+

Industry risk profile: B+

KÉSZ's activities are primarily exposed to construction activities that contributed around 80% of revenues in previous years. Additionally, KÉSZ has extended their capabilities in the last two decades into the fields of steel structure manufacturing, design, value engineering, energy performance certificate contracting, ship-building, hydraulic engineering, and renewable energy projects. The group has also launched a new, smaller division in business solutions (IT services, facility management, business and marketing consulting, fleet management, factoring, hotel operation, innovation HUB etc).

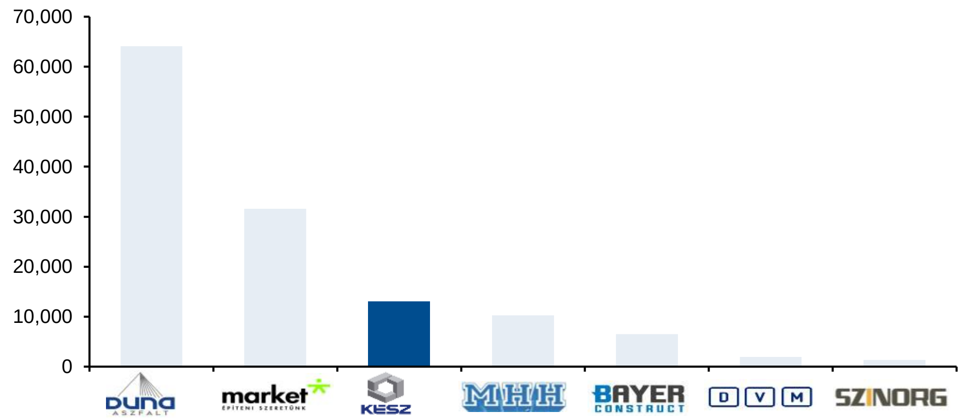
As KÉSZ is active in various segments within the construction sector and have a focus on large to medium sized projects subject to high entry barriers, together with the generally high cyclicality and low substitution risk of the construction industry, this leads to a blended industry risk assessment of B+.

Small in a European context but with stablished market position, ranked top 3 in Hungary

KÉSZ is a relatively small player in the construction industry in a European context but is the third largest construction company by turnover in Hungary with strong visibility on income over the next 3 years. The group is constantly growing with expected revenues of HUF 197bn in 2022 (HUF 180bn in 2021), with Scope-adjusted EBITDA of HUF 13bn in 2022, down from HUF 14bn in 2021. For 2023 and the years ahead, KÉSZ expects annual revenue to continue to grow incrementally and reach HUF 220bn by YE 2023, based on a robust contracted construction backlog of HUF 287bn, and recurring income of HUF 187bn over the next four years (mainly from their energy segment).

Small size in a European context limits the group's ability to benefit from economies of scale or to offset the impact of economic cycles as the group is largely exposed to their domestic market. However, the groups market position is supported by their strong standing in Hungary as it is a domestic leader in building construction, with a highly reputable project portfolio and an international presence in Central and Eastern Europe.

Figure 1: Hungarian peers by Scope-adjusted EBITDA (HUF m)



Sources: public information, Scope

The leading domestic peers include companies such as Market Építő, Duna Aszfalt and Strabag. KÉSZ's issuer rating is strongly supported by their long-established market position. We see several specific advantages in respect to the competitive landscape that supports the credit rating. The most important factor is KÉSZ's independence from external subcontractors thanks to a high degree of own resources within the group, able to cover most of construction and civil engineering process (e.g. steel structure manufacturing, facades, hydraulic or electrical engineering).

Vertical integration as a differentiating factor from their peers

This long-pursued vertical integration strategy provides barriers to entry for competitors and creates strategic benefits to access raw materials, new markets and large tenders. In addition, their dedicated growth strategy, underpinned by the issuance of two bonds, which were mainly used to build and acquire new production facilities, has allowed the group to grow significantly in the past three years, aided by the successful tendering of larger projects. Furthermore, KÉSZ's limited dependency on external subcontractors supports their market position by maintaining consistent quality across all products and services they provide. We believe both factors will support KÉSZ's business going forward, however, we note some downside risk of being a conglomerate, as this could result in limited room for maneuver their cost structure, which could lead to a prolonged period of deprived profitability.

Limited geographic and customer diversification…

Geographic diversification is weak, as 93% of revenue was generated in KÉSZ's domestic market in 2022. Hungary is experiencing a significant slowdown in its construction industry, with output down almost 4% in YoY 2022. This is due to record-high interest rates and the effects of the Russia-Ukraine war, which has disrupted global supply chains and caused a spike in the cost of materials (24.5%higher on average[4]). In addition, the volume of contracts awarded for construction projects in Hungary in January 2023 was down 10.6% YoY[5]. We expect the Hungarian construction sector to keep declining in 2023, coupled with a deterioration in Hungary's competitiveness caused by an ongoing lack of labour (amplified by the country's demographics), increased wages, and a strong increase in investment costs (cost of capital and inflation). KÉSZ's large exposure to Hungary – with an only marginal revenue generated outside of Hungary – poses a significant risk for the group. In addition, the company has a notable concentration among domestic customers in view of the contracted volumes in the construction segment (top 10 >80%; top 3 >60%), though this is partially mitigated by the robust credit quality and long-standing relations with their main clients.

Business profile driven by construction activities

The flagship subsidiary of the KÉSZ Group is KÉSZ Építő PLC, which accounted for 67% of total revenue in 2022. KÉSZ executes over 70 projects every year and currently has 12 projects individually worth at least EUR 10m lined up for 2023. KÉSZ has completed many large construction projects in the past, and their clients include LEGO, SK Innovation, Samsung, Toray, BMW, Mercedes and SMR.

Through their subsidiary, KÉSZ Ipari Gyártó, the group has a steel manufacturing facility in Kesckemét. The facility has a floor area of 25,000 m^2, and its production capacity exceeds 16,000 tonnes per year. Through their subsidiary KÉSZ Metalates, the group is primary engaged in the assembly of steel structures, in addition to producing, selling and installing aesthetic and industrial facades. The design team of KÉSZ consists of about 90 experts and an R&D team with about 20 engineers and developers. Collectively, through their steel operations, the KÉSZ Group is expected to generate HUF 25bn in 2023, which accounts for 12% of revenue. The group is able to benefit from synergies between these two companies, which complement their general construction business.

Segment diversification and limited cyclicality in end-markets provide near-term cash flow visibility

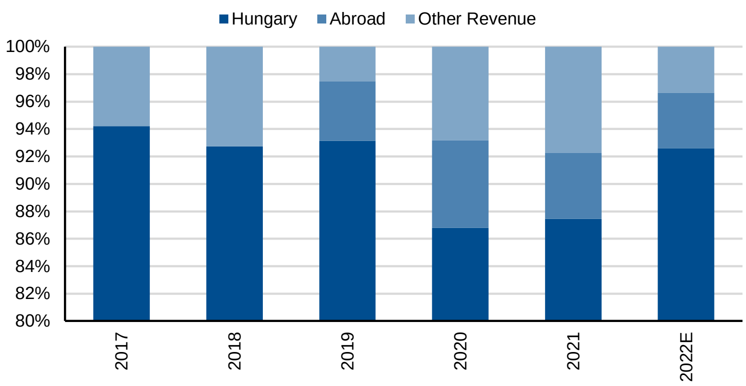
KÉSZ has a number of different business segments that provide diversified income, which partially mitigate their exposure to the construction industry. KÉSZ has a wide portfolio of business units and their activities overlap and complement one another. The group specialises not only in general construction but also provides complex and integrated solutions. From design through to implementation and operation, all the related tasks and services needed by their customers can be carried out by the group.

[4] Source: EVOSZ
[5] Idem.

With the acquisition of Greenergy in 2020, KÉSZ entered the energy market. Greenergy is a very small utility as it operates a generation portfolio of just about 45 MWe. An annual electricity generation of about 80 GWh covers just about 0.1% of electricity demand in Hungary (corresponding to an electricity demand of roughly 35,000 households assuming average household consumption of 2,200 kWh per year). The same is true for Greenergy's position in heat generation of about 80 GWh which covers 0.7% of the country's heat demand (for industry and residential).

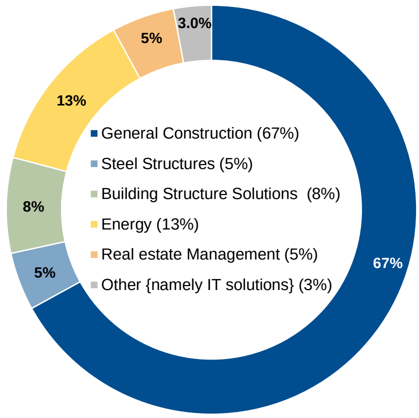
While we acknowledge KÉSZ achievements in reducing existing concentration risk, we expect the construction segment to continue to contribute to the largest portion of them groups revenues over the next number of years.

Figure 2: Geographical diversification of revenue



Sources: KÉSZ, Scope

Figure 3: Revenue breakdown 2022



Sources: KÉSZ, Scope

One-stop shop for clients

The group benefits from the vertical integration of its business and from being able to provide a one-stop solution for designing, manufacturing, and implementing new projects, making it an attractive partner for potential clients. Conversely, a wide spread of activities across various geographical regions with different demand patterns or cyclicality exposures tends to reduce cash flow volatility. However, with a large array of revenue sources, the group is somewhat protected from a dip in revenue in one of its segments. Furthermore, the relatively low share of government-related contracts (below 10% of the order backlog as at December 2022) protects KÉSZ from the decline in demand anticipated for central and local government projects. KÉSZ's ability to win large projects, as it has done in the past and continues to do, cements their place as one of the top companies in the Hungarian construction industry.

What makes KÉSZ unique compared to their competitors is that the group does not rely on external subcontractors. Additionally, the group can also carry hydraulic engineering projects, electrical engineering projects, and the undertaking of projects requiring the coordination and management of various technical fields. We do not expect further diversification in the short to medium term.

Profitability low but relatively stable

Profitability, as measured by the Scope-adjusted EBITDA margin, has stayed between 6.5% and 7.8% in the last two years (2022: 6.6%). Profitability is therefore relatively low but stable, in comparison to their Hungarian construction peers, which keep exceeding KÉSZ' profitability range, but also fluctuate greatly. KÉSZ's three-year average EBITDA margin is 7.3%.

We expect that mounting inflationary pressures, building material supply disruptions and the currently dampened macroeconomic mid-term outlook will contribute to shrink profit margins within the construction sector. Therefore, we forecast that the Scope-adjusted EBITDA margin will remain at a low range of 6.5%-7.7% (2023-2025).

Revenues rest on a solid contracted backlog and some recurring income streams

KÉSZ's future revenues rest on a solid contracted construction backlog and recurring income streams from other business lines. The total construction backlog over the next three years is HUF 287bn, which gives an order backlog of 1.7x (of three-year average revenue). The order backlog of contracted construction projects for 2023 is HUF 177bn, with an additional HUF 33bn in recurring revenue from other business lines - largely made up of the energy segment. The group is also aided by HUF 1,000bn in projects currently out for tender, providing good visibility over the next two years. As at March 2023, the total contracted revenue is HUF 473bn.

The backlog consists of many large projects, including projects worth HUF 58bn with BMW, HUF 45bn with LEGO and HUF 70bn with Mercedes-Benz. KÉSZ carried out a project for LEGO already in 2013, Mercedes-Benz in 2017, and therefore benefits from a strong relationship with big clients.

Financial risk profile: BB

Debt protection expected to decrease but to remain adequate for the rating category

KÉSZ had strong debt protection, with Scope-adjusted EBITDA interest cover well over 9x prior to 2022. However, with the issuance of two bonds in 2021, interest cover dropped to 6.2x in 2022, and is expected to drop further in 2023, as the company plans to issue a third bond and an additional development facility, both in Q2 2023.

The group benefitted from a low interest rate environment, with HUF 33bn in fixed-rate debt issuances in 2021. As such, for YE 2022, the group had 78% fixed debt at an average interest rate of 3.2%, and 22% variable debt at an average interest rate of 11%[6], with a combined weighted average cost of debt at a healthy 4.9%.

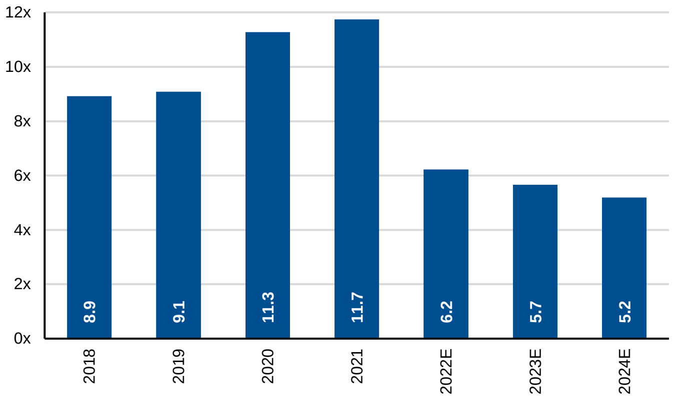
We anticipate declining interest cover in the years to come as balance sheet leverage is expected to rise to finance the group's expansion plan. The group's variable facilities (i.e. bank overdrafts) are priced at the overnight rate in Hungary, at a cost of 15%. At YE 2022, the group had drawn HUF 9.7bn from a credit facility. However, of the available credit lines, the group usually only draws HUF 2bn-3bn, as they have sufficient cash on hand. The group aims to optimise their financial cost structure with new debt planned to be denominated in EUR (we have assumed an interest rate of 7%). We forecast a Scope-adjusted EBITDA/interest cover to remain above 5x in the next few years.

Further investments dependent on external financing

Over the last few years, KÉSZ has increased their capital expenditure significantly at the cost of FOCF. To date, KÉSZ's capex programme has allowed it to invest into the modernisation of their construction technologies and (IT) infrastructure (e.g. automation, implementation of eco-friendly technologies) to expand their own construction capacities, and to invest into new specialised construction activities, e.g. fire protection, facades with the 2022 acquisition 90% of Frontal Holding, other industries (e.g. logistics, health, renewable energies with the project portfolio of Greenergy).

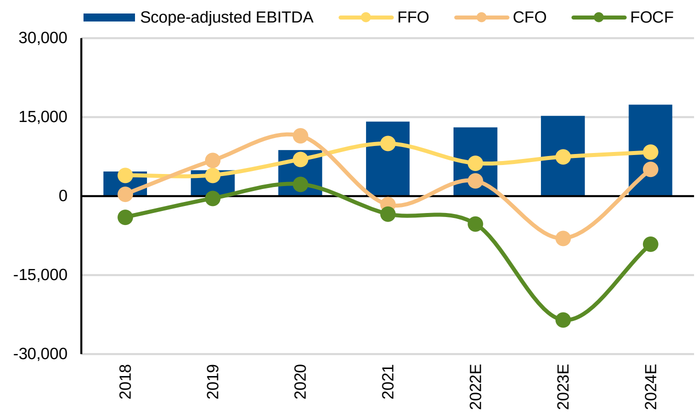
[6] Mainly driven by high BUBOR rates observed in the last-twelve months.

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



Sources: KÉSZ, Scope estimates

Figure 5: Cash flow (HUF m)



Sources: KÉSZ, Scope estimates

In 2022, KÉSZ acquired a 90% share in Frontal Holding plc, a Hungarian holding company which owns, among other companies, the Frontal GmbH. Frontal GmbH specialise in the development and construction of custom engineered and unitised facades, glass roofs as well as doors and windows made of aluminium and glass. The German company offers a wide range of services in a new market from project management, planning and production to assembly and logistics and allowed KÉSZ to increase their regional diversification.

KÉSZ plans to spend around HUF 15.4bn in capex in 2023, a further HUF 13.7bn in 2024, and HUF 9.3bn in 2025. Their capex strategy places emphasis on increasing diversification and includes spending HUF 10.5bn on their own real estate development projects in 2023, with the aim of selling upon completion. Furthermore, the acquisition of Greenergy has provided an alternative revenue stream away from the construction sector, and it is expected to contribute to a larger portion of the groups revenue over the next three years, backed by capex of HUF 3.6bn in 2023 alone.

FOCF will remain negative in 2023, before recovering to a normalised level in 2024 with the release of cash from the sale of finished construction projects. We expect that substantial expansion will come to a halt in 2023, with further growth being subject to the development of cost of capital (including debt and equity). Consequently, we forecast cash flow cover to remain negative in the medium term.

KÉSZ faces limited financing needs, with the exception of working capital, but due to changes in the tendering model in Hungary, has seen larger clients provide advance payment (interest free) to their contractors in the region of 10%-20% of the contract value, in order to ensure the contractors are fully resourced and to prevent project delays.

Capex strategy funded by more expensive debt

KÉSZ's main drivers of indebtedness are the corporate bonds issued under the Hungarian Central Bank's Bond Funding for Growth Scheme to partially finance their significant capex programme. Interest-bearing debt went from HUF 22bn in 2020 to HUF 48bn in 2022, due to the issuance of two bond facilities (HUF 22bn in June 2021 and HUF 11bn in November 2021) and one by the 51% KÉSZ's subsidiary, Greenergy[7] (HUF 5.7bn bond issued in September 2021) which is currently rated B+/Positive by Scope Ratings.

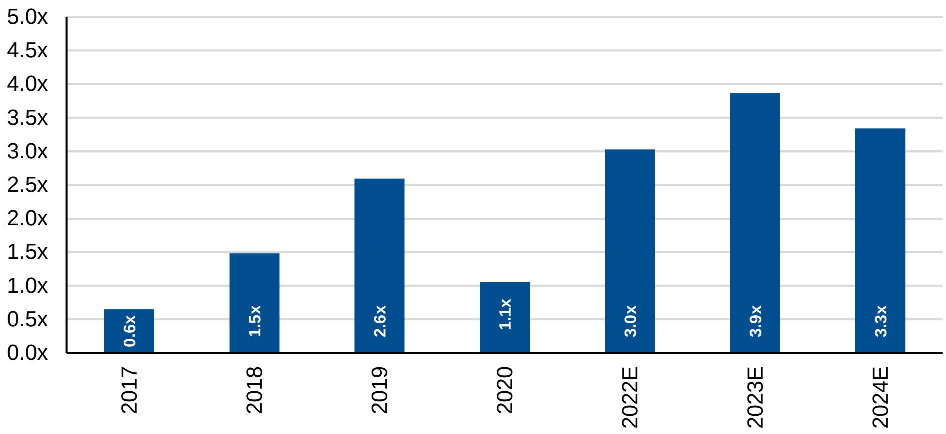
KÉSZ's leverage, as measured by its Scope-adjusted debt/EBITDA ratio, remained stable at 3.0x as at YE 2022 (YE 2021: 2.8x). However, with debt expected to rise by about HUF 20bn in 2023, we forecast that Scope-adjusted debt/EBITDA will rise to 3.9x. This is predominately driven by the group's capex plans, making the group take on more

[7] There is no guarantee by KÉSZ group for debt issued by Greenergy Holding and there's also no recourse of creditors for Greenergy to the final parent, i.e. the KÉSZ Group.

expensive debt to finance its operations and to invest in new projects. Further improvements in leverage will depend on the successful execution of investments, while keeping utilisation rates stable.

Currently, Scope-adjusted FFO/debt (16% YE 2022) benefits from relatively low interest payments driven by the low weighted average cost of debt. However, with debt expected to increase by HUF 20bn in Q2 2023, the weighted average cost of debt is expected to increase from the low 4.4% in 2022, 5.1% in 2023. The three-year average of FFO is 18%, mainly driven by rising interest rates.

Figure 6: Leverage (Scope-adjusted debt/EBITDA)



Sources: KÉSZ, Scope estimates

Adequate liquidity

Liquidity is adequate, as sources (HUF 24.9bn of cash available as at YE 2022, of which HUF 8.6bn is assumed to be unrestricted) cover uses (HUF 2.7bn in short-term debt as at YE 2022 and negative FOCF of HUF 23.7bn forecasted for 2023). Aside from the repayment of short-term debt, we anticipate positive FOCF from 2025 onward, once investment projects have been completed and sold, and a number of larger ticket projects have also been completed, thus further supporting future liquidity.

Balance HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	13,139	8,600	8,600
Open committed credit lines (t-1)[8]	0	3,500	3,500
Free operating cash flow (t)	-5,311	-23,694	-9,315
Short-term debt (t-1)	1,705	2,696	1,292
Coverage	**>200%**	**Negative**	**>200%**

Furthermore, as at YE 2022, KÉSZ had an additional undrawn credit lines HUF 7.8bn across a number of Hungarian banks, of which HUF 3.5bn is committed for over one year.

Negative liquidity in 2023 results from negative free operating cash flow, which is mainly driven by the group's capex and increasing working capital (due to inventories built up from real estate developments) that is expected to be partially financed by the upcoming bond issuance and bank facility.

[8] Considers only available credit lines committed for over one year.

Supplementary rating drivers: +/- 0 notches

We note that KÉSZ has only one financial covenant for their interest-bearing liabilities, which is for Scope-adjusted debt/EBITDA to remain under 4x. The headroom under these covenants is expected to be sufficient in our base case scenario.

Long-term and short-term debt ratings

Senior unsecured debt rating: BB

In June 2021, KÉSZ issued a HUF 22bn senior unsecured bond (ISIN: HU0000360466) through the Hungarian Central Bank's Bond Funding for Growth Scheme. This was followed by a 2nd issuance of HUF 11bn senior unsecured bond (ISIN: HU0000360870) in November 2021 under the same scheme. The proceeds of the bonds were used to support the group's working capital financing needs and to secure long-term funding for group-wide expansion plans. Both instruments have a tenor 10 years, with the HUF 22bn bond having a fixed coupon of 2.8% and the HUF 11bn bond having a fixed coupon of 4.10%. The repayments or both instruments are in five tranches starting from 2026, with 10% of the face value payable yearly, and 50% balloon payment at maturity.

We note that KÉSZ's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clauses require KÉSZ to repay the nominal amount (HUF 22bn & HUF 11bn) 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). In addition to the rating deterioration covenant, other covenants include (i) change of control, (ii) maximum dividend 50% PBT, and (iii) consolidated net debt/EBITDA above 4x.

Our recovery analysis is based on a hypothetical default in 2024, which assumes outstanding senior unsecured debt of HUF 49bn in addition to HUF 11.1bn in bank loans, payables of HUF 34.0bn and HUF 3.5bn, assuming the group draws on available overdrafts. The recovery assessment results in an 'above-average' recovery for senior unsecured debt and therefore we assigned a BB debt for KÉSZ's debt instruments in this category (one notch above the underlying issuer rating).

Appendix: Peer comparison

	KÉSZ Holding Zrt.	Market Építő Zrt.	Duna Aszfalt Kft.	Szinorg Universal Zrt.
	BB-/Stable	BB-/Stable	BB-/Stable	B/Negative
Last reporting date	31/12/2022E	31/12/2021	31/12/2021	31/12/2022E
Business risk profile				
Total revenue (EUR m)	494	808	822	53
Scope-adjusted EBITDA (EUR m)	33	105	182	2.2
Regions in which active	Hungary	Hungary	Hungary	Hungary
Segments in which active	Specialist construction	General construction	General construction	General construction
Scope-adjusted EBITDA margin	6.6%	14%	22%	4%
Financial risk profile				
Scope-adjusted EBITDA/interest cover	6.2x	29.5x	18.3x	Net cash interest
Scope-adjusted debt/EBITDA	3.0x	0.2x	2.8x	8.0x
Scope-adjusted FFO/debt	3.7x	4.2x	32%	10%
Scope-adjusted FOCF/debt	16%	164%	29%	-131%

Sources: Public information, Scope

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