Stavmat Építőanyag Kereskedelmi Zrt. Hungary, Wholesale

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022P	2023E
Scope-adjusted EBITDA/interest cover	131.5x	46.9x	40.3x	10.1x
Scope-adjusted debt/EBITDA	0.5x	2.1x	1.6x	2.6x
Scope-adjusted funds from operations/debt	177%	44%	58%	34%
Scope-adjusted free operating cash flow/debt	31%	-29%	-27%	-23%

Rating rationale

The business risk profile (B+) is driven by Stavmat's high profitability, despite the expected weakening in the Scope-adjusted EBITDA margin (to below 7% from 9% in 2022) and the Scope-adjusted EBITDA return on assets after the paving plant's completion. Constraints are Stavmat's limited size and low diversification in terms of both geography and distribution channels as well as the high dependency on its underlying market of construction, which impacts operating profitability as its wide range of products belong to this cyclical goods category.

Stavmat's financial policy remains aggressive based on its new business plan involving the debt-financed acquisition of three sites amid unfavourable market conditions. The HUF 3.2bn loan will cause leverage to deteriorate in 2023, but the financial risk profile (BB+, down from BBB-) will benefit from strong interest coverage, forecasted to recover towards 8.5x by 2025 after deteriorating due to the new loan, as all interest-bearing debt has favourable fixed interest rates. Cash flow coverage is the main constraint despite its expected recovery to 15% by 2025, as the long-term expansionary strategy means levels are unlikely to be sustained.

Outlook and rating-change drivers

Stavmat's Outlook has been revised to Stable and incorporates the still aggressive financial policy. The company's growth relies on a market that has been slowing since Q4 2022, which is expected to lead to reduced profitability from 2023. The Outlook also includes the HUF 3.2bn loan from 2023 to finance the acquisitions, which will drive up leverage (Scope-adjusted debt/EBITDA) before it recovers to 2.5x-3.0x.

A positive rating action is possible if Stavmat can show i) for an extended period Scope-adjusted debt/EBITDA of below 2.5x and a less aggressive financial policy, allowing the removal of the negative notch for financial policy and; ii) an improved business risk profile by expanding to neighbouring countries, though is less likely in the near future.

A negative rating action may occur through a Scope-adjusted debt/EBITDA sustained above 3.5x, for example, due to a major decline in the Hungarian construction industry.

Rating History

Date	Rating action/monitoring review	Issuer rating & Outlook
13 Apr 2023	Outlook change	B+/Stable
27 Apr 2022	Outlook change	B+/Positive
21 May 2021	New	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

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Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2022

ESG considerations for the credit ratings of retail corporates, November 2021

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Leading wholesaler of construction materials for professional customers in Hungary • Adequate profitability margins in the past years, supported by the positive business cycle, expected to be reinforced by the concrete paving stone production margins • Strong interest coverage due to fixed interest rate on the (HUF 5bn) NKP bond issued in 2021 (issued before high interest rate environment) paired with the low fixed interest rate on the new HUF 3.2bn loan • Adequate internal liquidity	• Limited revenue size • Concentration on small domestic market • Margins highly dependent on the construction industry cycle and cost of materials (over 90% of sales) • Weaker leverage after bond issuance in 2021 and additional loan of HUF 3.2bn planned in 2023 • Limited cash flow cover in medium term amid planned acquisition of several sites • Flagged financial policy due to distribution of reserves in 2020

Positive rating-change drivers	Negative rating-change drivers
• Track record of less aggressive financial policy while keeping Scope-adjusted debt/EBITDA well below 2.5x and material increase in size and geographical diversification	• Scope-adjusted debt/EBITDA sustained above 3.5x

Corporate profile

Stavmat Építőanyag Kereskedelmi Zrt. (Stavmat) is primarily a wholesaler of construction materials for professional use, with an approximate 10% leading position in the small Hungarian market and leadership in the industrial segment. Around 25% of sales are generated by retail consumers (private professionals). Stavmat owns 35 stores across Hungary and employs around 400 people. The company provides the full range of high-quality building materials and solutions for both outdoor and interior design work, renovation and house construction. In December 2016, Stavmat became part of IN Group, a Slovakian diversified construction group that trades building materials in Slovakia, the Czech Republic and Hungary.

Financial overview

			Scope estimates			
Scope credit ratios	**2020**	**2021**	**2022P**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	131.5x	46.9x	40.3x	10.1x	8.1x	8.4x
Scope-adjusted debt/EBITDA	0.5x	2.1x	1.6x	2.6x	2.6x	2.5x
Scope-adjusted funds from operations/debt	177%	44%	58%	34%	33%	35%
Scope-adjusted free operating cash flow/debt	31%	-29%	-27%	-23%	4%	15%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,619	2,240	3,233	2,709	2,791	2,860
Operating lease payments	401	446	473	613	471	388
Other items[1]	289	499	544	300	150	**0**
Scope-adjusted EBITDA	**2,309**	**3,185**	**4,250**	**3,621**	**3,411**	**3,248**
Funds from operations in HUF m						
Scope-adjusted EBITDA	2,309	3,185	4,250	3,621	3,411	3,248
less: (net) cash interest paid	-18	-68	-105	-360	-421	-388
less: cash tax paid per cash flow statement	-78	-113	-153	-92	-85	-82
Other items[2]	-7	-23	0	0	0	0
Funds from operations (FFO)	**2,206**	**2,981**	**3,992**	**3,169**	**2,906**	**2,778**
Free operating cash flow in HUF m						
Funds from operations	2,206	2,981	3,992	3,169	2,906	2,778
Change in working capital	-583	-1,831	-700	-663	-627	-143
less: capital expenditure (net)	-860	-2,666	-4,721	-4,100	-1,450	-1,100
less: lease amortisation	-381	-424	-449	-582	-447	-369
Free operating cash flow (FOCF)	**382**	**-1,940**	**-1,878**	**-2,176**	**381**	**1,166**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	3	-46	-82	-329	-397	-369
add: interest component, operating leases	-20	-22	-24	-31	-24	-19
Net cash interest paid	**-18**	**-68**	**-105**	**-360**	**-421**	**-388**
Scope-adjusted debt in HUF m						
Reported gross financial debt	0	5,000	5,000	8,200	7,720	7,080
less: cash and cash equivalents	-2,901	-4,560	-2,838	-3,362	-2,763	-2,789
add: non-accessible cash	2,901	4,560	2,838	3,362	2,763	2,789
add: operating lease obligations	1,246	1,578	1,901	1,045	972	894
Other items[3]	0	142	37	37	37	37
Scope-adjusted debt (SaD)	**1,246**	**6,720**	**6,937**	**9,281**	**8,728**	**8,011**

[1] Other items include disposal gains of fixed assets and cash discounts.
[2] Other items include other financial expenses and income excluding cash discounts.
[3] Other items include bank guarantees.

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Environmental, social and governance (ESG) profile[4]

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)

Stavmat's ESG efforts are positive but yet to have a significant effect on its credit quality.

In 2021, Stavmat issued a green bond as part of the National Bank of Hungary's Bond for Growth program to finance its pavement factory and established a green committee to monitor the company's progress in its ESG initiatives. The green bond commitments are primarily linked to the paving factory. With the completion of the factory, Stavmat has met the requirements outlined in the green bond. The company also has medium-term goals aligned with the UN Sustainable Development Goals, which it plans to accomplish by 2030, as well as the long-term goal to be carbon-neutral by 2050.

As a wholesaler, Stavmat is exposed to indirect reputational risk. For example, product or labour management that has a negative social impact may prompt buyer renegotiations due to consumer boycotts, affecting sales, margins and inventory value. Also, Stavmat's wide network of brick-and-mortar shops comes with an environmental footprint and will remain fundamental to its development. Like other wholesalers, Stavmat has to strike a balance between improving the energy efficiency of its large shops (comparable to hypermarkets) and increasing the flexibility of its space to incorporate additional distribution channels (e.g. click and collect).

The paving production plant, once operational, will expose Stavmat to the construction materials industry and its significant environmental footprint. Aside from the issues regarding the sustainability of raw materials, the production of construction materials regularly requires large amounts of energy and fuel, which often generate pollution and large amounts of waste (some of which is hazardous). These companies also face the risk that customers opt for more environment-friendly solutions and products.

[4] 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.

Business risk profile: B+

Industry risk profile: BB

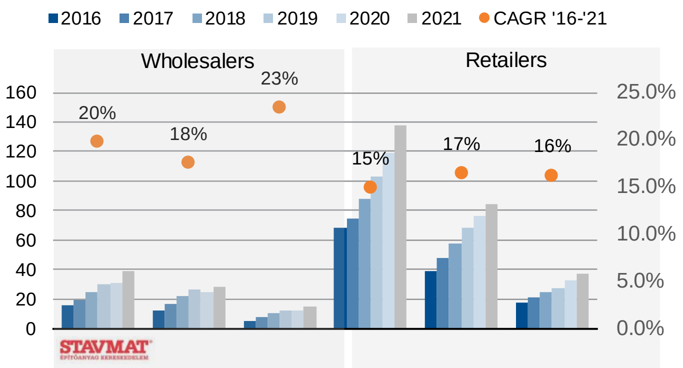
Stavmat operates in a discretionary retail market, which is characterised by medium cyclicality, low entry barriers and low substitution risk. We assess the industry risk profile for the retail and wholesale industry at BB. The company's business risk profile remains constrained by its limited size with EUR 130m in sales (2022) and low diversification in terms of geography and distribution channels, despite it being one of the leading wholesalers of construction materials for professional customers in Hungary. Furthermore, the company's high dependency on its underlying market, the construction industry and its cycles, also impacts its operating profitability as its wide range of products all belong to this cyclical goods category.

The construction industry in Hungary had one of the fastest growth rates in Europe between 2016 and 2022. This growth was mainly due to government-driven orders, rising household disposable incomes, and low interest rates. The Covid-19 pandemic slowed construction activity during 2020, but the industry promptly recovered by the end of the year. In 2022, the Hungarian government extended many of its subsidy schemes (e.g. the baby loan and 'CSOK' family subsidy scheme), continuing construction-friendly policies aimed at improving demographic trends within the country. However, by the end of 2022 the industry again started to slow in the wake of macroeconomic conditions prompted by the Russia-Ukraine war, high inflation and the energy crisis.

Leading market share as a wholesaler despite small size

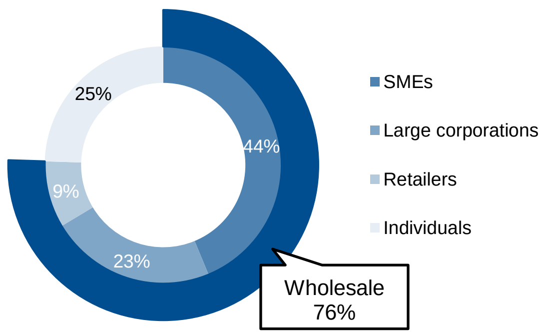
The Hungarian building materials trading industry is rather fragmented. Stavmat holds a leading 6% market share in the wholesaling of construction materials for professional use. The second largest competitor (Lambda) is close in terms of revenues but has almost 50% fewer stores. Stavmat also produces construction materials, which indicates that the real gap in terms of wholesale-only market shares is even wider. Stavmat's revenues are still small (EUR 130m in 2022) in an international context. However, even though Stavmat does not operate in a protected industry, we still assess the risk of new entrants in its market as only moderate in view of the high investment needs.

Figure 1: Revenue development versus peers (HUF bn)



Sources: Stavmat, Scope estimates

Figure 2: Revenue split by customer segment



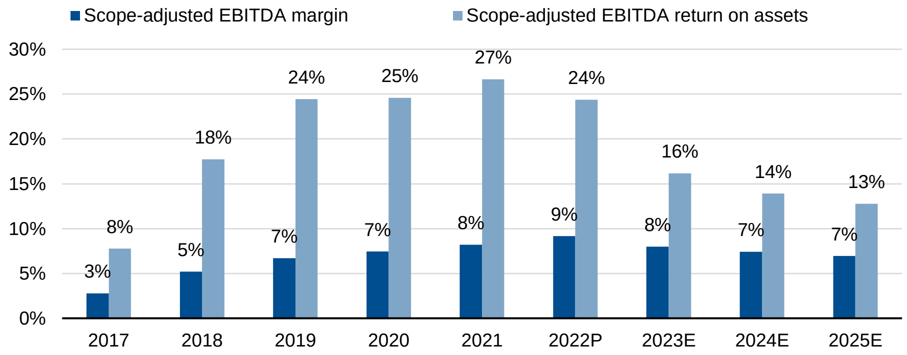
Sources: Stavmat, Scope

Based on preliminary 2022 figures, Stavmat will generate record profits for the year, with the Scope-adjusted EBITDA margin to increase 96 bp YoY to 9.2%. Reasons for the increase are i) high inflation in Hungary driving up revenues; ii) the ability to pass on price volatility to customers through the daily pricing implemented in H1 2022; and iii) the increased demand for insulation products after the Hungarian government decided to reduce utility price cuts.

Going forward, profitability is expected to benefit from the completed paving plant's higher margins for producing private label and premium products and from the reduced rental costs following the planned acquisitions of three sites. However, since the company's key business driver, the construction industry, is already slowing from Q4 2022, we forecast profitability to reduce to 8% in 2023. The Scope-adjusted EBITDA margin is expected to further decline as the more challenging market conditions are likely to impact Stavmat's ability to gain cash discounts by paying suppliers in advance (Scope-adjusted EBITDA includes these gains as part of operating profitability).

The Scope-adjusted EBITDA margin is expected to decrease to below 7% by 2025 and the Scope-adjusted EBITDA return on assets is also forecasted to significantly deteriorate due to the completion of the paving plant. However, because of their relatively high levels they remain the main drivers of the business risk profile. Stavmat expects demand to return in H2 2023, partially due to the expected launch of the energy modernisation programme.

Figure 3: Scope-adjusted EBITDA margin and Scope-adjusted EBITDA return on assets



Sources: Stavmat, Scope estimates

Cost of materials is a key profitability driver

Overall, Stavmat's profitability is dependent on the cost of materials, at more than 90% of its revenues in 2017-22. Additionally, Stavmat benefits from larger supplier bonuses than those of smaller peers as these are linked to order sizes, although the impact on overall profitability is moderate.

Financial risk profile: BB+

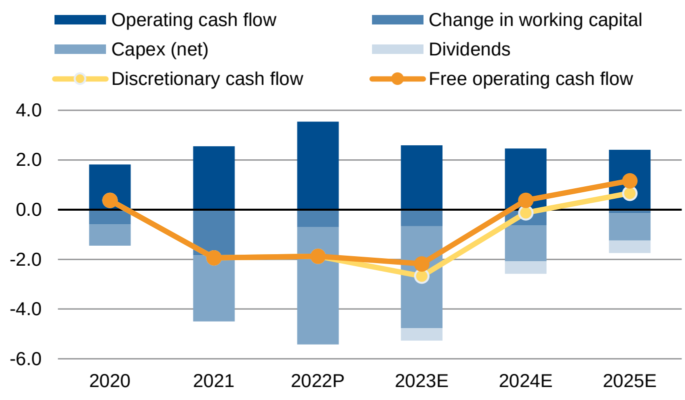
The financial risk profile was revised to BB+ from BBB- as credit metrics are forecasted to deteriorate in 2023. This will be due to the new loan to be issued combined with the worsening conditions in the underlying construction market. The strong interest coverage and leverage metrics remain supportive but the weakened cash flow cover due to the company's recently outlined investment plans is a major constraint.

Stavmat's HUF 5bn green bond issuance in 2021 pushed up the debt balance substantially; debt in previous years consisted only of operating leases. Most of the green bond proceeds went towards the construction of the paving production plant in Dabas.

After the completion of the plant (production is expected to start in Q2 2023 instead of previously delayed deadline of Q4 2022) Stavmat plans to acquire three properties for HUF 4.5bn in the following three years, specifically its headquarters and two existing stores. The purpose is to reduce its rental costs. The acquisitions will be financed through the HUF 3.2bn loan in 2023 under the Baross Gabor programme, which grants SMEs and some large corporations favourable fixed interest rates to mitigate the currently negative market conditions in Hungary. The six-year loan will be secured, linearly amortising and is planned to have a fixed interest rate of 7%.

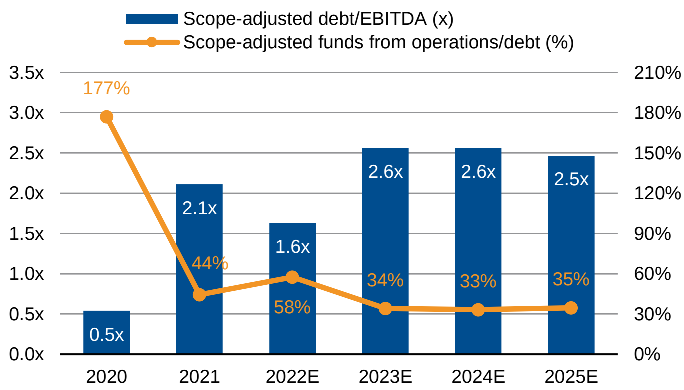
The financial risk profile benefitted from the overall improvement of credit metrics in 2022 due to the record-high Scope-adjusted EBITDA. In 2023, however, credit metrics are forecast to deteriorate due to the planned increase in interest-bearing debt and the unfavourable market conditions.

Figure 4: Cash flow generation (HUF bn)



Sources: Stavmat, Scope estimates

Figure 5: Scope leverage metrics



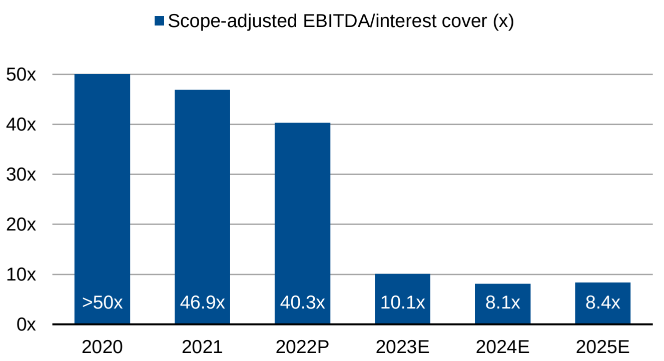
Sources: Stavmat, Scope estimates

Operating cash flow has been robust in the last few years. We forecast it to have peaked in 2022 at HUF 3bn then decrease until 2024, constrained by working capital changes (though the company generally has no issues with covering recurring maintenance capex). However, expansionary capex plans interrupted the ability to generate positive free operating cash flow in the last three years and we expect this to continue until the end of 2023.

In the medium term, we expect Scope-adjusted debt to decrease with the reduction in leasing adjustments after the three sites are acquired and as the HUF 3bn loan amortises and lessens interest-bearing debt. These effects are expected to outweigh the decline in Scope-adjusted EBITDA. Credit metrics will therefore improve, with Scope-adjusted debt/EBITDA decreasing to 2.5x by 2025, from its peak of 2.6x in 2023 due to the new loan. The financial risk profile also benefits from strong interest coverage, which is forecasted to increase towards 8.5x by 2025 after deteriorating with the new loan, as all interest-bearing debt has favourable fixed interest rates.

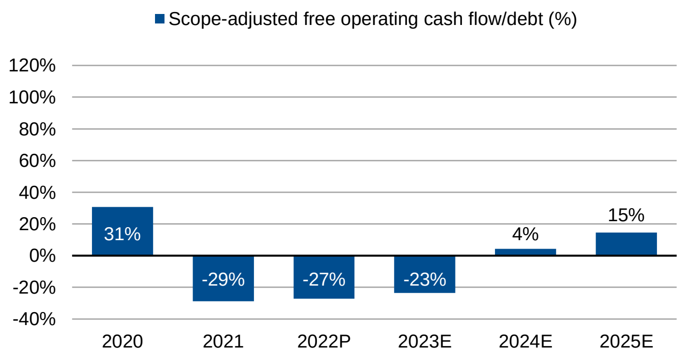
Due to the new business plan, cash flow coverage has deteriorated and is the main constraint of the financial risk profile. Despite a forecasted increase to 15% by 2025, management's long-term expansionary strategy means such levels are unlikely to be sustained.

Figure 6: Interest cover



Sources: Stavmat, Scope estimates

Figure 7: Cash flow cover



Sources: Stavmat, Scope estimates

Adequate liquidity

Liquidity is adequate, based on the current cash reserves (HUF 2.8bn as of end-December 2022) and communicated HUF 1bn cash at hand needed for day-to-day operations, in combination with the solid cash flow expected. Before the issuance of the new debt, the green bond was scheduled to amortise only in 2026. The new loan will start linearly amortising in 2024, in the amounts of HUF 580m in 2024 and HUF 640m in 2025.

Internal liquidity will be adequate to cover this as cash generation is more than 200% of the scheduled debt amortisation in 2024 and 2025.

Balance in HUF m	2021	2022P	2023E
Unrestricted cash (t-1)	2,201	3,560	1,838
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	-1,940	-1,878	-2,176
Short-term debt (t-1)	0	0	0
Coverage	**No short-term debt**	**No short-term debt**	**No short-term debt**

Supplementary rating drivers: -1 notch

Financial policy is credit-negative

We continue to apply one-notch down for supplementary rating drivers due to Stavmat's aggressive financial policy.

Stavmat previously had a low appetite for risk, operating without bank debt (only leases) and following a prudent approach, including owning most of its stores. This changed in 2020 on the back of the HUF 1.4bn in Covid-related government subsidies and plans to issue the HUF 5.0bn green bond, after which the company returned to shareholders HUF 1.8bn of committed reserves that the previous owners had granted to back past losses. A more prudent approach would have been to compensate shareholders after the completion of the large capex plan of building the paving plant.

On the positive side, no dividends have been paid since 2020 even though Stavmat has HUF 500m in dividend payouts in its forecasts, and we have no reason to believe management will deviate from this position. However, the execution risk that fell away with the completion of the paving plant has returned with the planned acquisitions. We would need to see a longer track record before considering the removal of the negative one-notch adjustment.

Parent support is neutral

Stavmat Zrt. is currently 100% directly owned by IN Group via the 100% ownership by Stavmat Stavebniny (Czech Republic). IN Group is a Slovakian investment holding company with diversified interests within the construction industries in Slovakia, the Czech Republic and Hungary. Its activities include the wholesaling and production of building materials, construction, and the development of real estate. The ultimate beneficial owner is Mr Pavol Kollar (67% share in IN Group). Stavmat Zrt. continues to operate independently from the group and we have therefore assessed it on a standalone basis. We expect the parent to have significant willingness to support Stavmat in case of need since Hungary is becoming an increasingly important market for the group. However, we assess parent support as neutral, also since we do not have visibility on the financial strength of IN Group.

In our view, the company compares negatively (with a standalone rating of BB-) against peers regarding its size, but the associated risk (i.e. volatile cash flow, weaker competitive power) does not exceed the risk expressed by the B+ rating.

Long-term debt rating

Senior unsecured debt rating: BB-

Stavmat's senior unsecured debt rating has been affirmed at BB-, one notch above the issuer rating. Our recovery assessment includes the planned secured loan of HUF 3.2bn in addition to the HUF 5bn senior unsecured bond (ISIN HU0000360714). We expect an 'excellent' recovery (91%-100%) for the outstanding senior unsecured debt in a hypothetical default scenario in 2025 based on a liquidation value method. This level of recovery would have allowed a two-notch-uplift, but we have taken a more conservative view due to the execution risk related to Stavmat's new business plan and limited the uplift to one notch.

In July 2021, Stavmat issued a HUF 5bn senior unsecured green bond (ISIN: HU0000360714) through the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond proceeds were used for the paving plant capex and for working capital financing. The bond has a tenor of 10 years and a fixed coupon of 3%. Bond repayment is in six tranches starting from 2026, with 10% of the face value payable yearly, and 50% balloon payment at maturity. We note that Stavmat's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clause requires Stavmat to repay the nominal amount (HUF 5bn) 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, bond covenants include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, change of control and additional indebtedness covenants.

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