Szinorg Universal Zrt.
Hungary, Construction

B NEGATIVE

Key metrics

			Scope estimates		
Scope credit ratios	2020	2021	2022E	2023E	2024E
Scope-adjusted EBITDA/interest cover	7.7x	14.2x	Net cash	4.4x	3.1x
Scope-adjusted debt/EBITDA	8.3x	3.3x	8.0x	6.9x	9.2x
Scope-adjusted funds from operations/debt	10%	25%	10%	11%	7%
Scope-adjusted free operating cash flow/debt	-4%	-20%	-131%	-26%	1%

Rating rationale

The issuer rating is supported by Szinorg's strong liquidity, healthy debt protection, balanced outreach to public and private customers, and long relations with main clients. Good position and regional market visibility in Debrecen, a region where foreign investment and private demand for construction is also credit-positive. The rating is limited by the group's small scale in a European context as it weakens the ability to mitigate economic cycles. Weak diversification is another constraint, with the strong focus on construction in Hungary and cluster risk with one contract representing more than 50% of the contracted backlog.

Outlook and rating-change drivers

The Negative Outlook is driven by the risk of a sharp rise in leverage, caused by the potential deterioration in future revenues, given a limited order book for 2024 amid multiple headwinds, including higher input prices and an unfavourable macroeconomic outlook. It also reflects Szinorg's limited room for maneuver its cost structure, which could lead to a prolonged period of deprived profitability with Scope-adjusted EBITDA margin of around 5%.

A positive rating action, i.e. a revision of the Outlook back to Stable may be warranted if Szinorg is able to provide a constant visibility of sales beyond 12 months, i.e. constant backlog of above 1x enabled by successful tenders for new mandates paired with a stabilization of EBITDA from their investment properties in order to support profitability with Scope-adjusted EBITDA margin reaching around 7% going forward.

A downgrade could occur if the backlog deteriorates to below 1x, or Szinorg only achieves a limited adjustment of cost structure leading to Scope-adjusted EBITDA margin remaining at around 5%. We note that Szinorg's senior unsecured bonds issued under the Hungarian Central Bank's bond scheme has several accelerated repayment clauses. The clauses require the issuer to repay the nominal amount (HUF 5.0bn) in case of rating deterioration (2-year cure period for B- rating, immediate repayment below B-) or change of control at the issuer level.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
01 Feb 2023	Outlook change	B/Negative
01 Feb 2022	Affirmation	B/Stable
02 Mar 2021	Affirmation	B/Stable

Ratings & Outlook

Issuer B/Negative
Senior unsecured debt B+

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Related Methodologies and Related Research

General Corporate Rating Methodology, July 2022

Construction and Construction Materials Rating Methodology, January 2023

European Real Estate Rating Methodology, January 2023

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Positive rating drivers	Negative rating drivers
• Good regional position translating into local visibility and moderate access to third-party financing sources and guarantees • Strong liquidity with about HUF 7.0bn in cash, supported by available undrawn overdrafts totalling HUF 1.8bn as at December 2022 • Healthy debt protection despite sharp anticipated increase in interest-bearing debt	• Small construction group in Europe and lack of geographic and segment diversification, somewhat mitigated by the strong position in a niche market • Concentrated contracted backlog (top three projects accounting for 78% of backlog revenues; top 10 for 99%) • Negative free operating cash flow, which translates into increased indebtness due to Szinorg's investment phase

Positive rating-change drivers	Negative rating-change drivers
• Backlog remained steadily above 1x paired with a stabilization of EBITDA from own investment properties supporting profitability and Scope-adjusted EBITDA margin reaching around 7% going forward.	• Backlog deteriorated to below 1x or limited adjustment of cost structure with profitability, as measured by the Scope-adjusted EBITDA margin, staying at around 5%.

Corporate profile

Szinorg Universal Zrt. (Szinorg), headquartered in Debrecen, is one of the largest construction groups in eastern Hungary. Its activities include the construction, development, and property and facility management of real estate assets. The group's three largest subsidiaries by revenues are Hunép Zrt. and HC Építő Kft., two construction companies, and Hajdu-Alu Zrt, a producer of curtains walls, doors and windows. The Szinorg group has nearly 200 employees.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	7.7x	14.2x	Net Cash	4.4x	3.1x
Scope-adjusted debt/EBITDA	8.3x	3.3x	8.0x	6.9x	9.2x
Scope-adjusted funds from operations/debt	10%	25%	10%	11%	7%
Scope-adjusted free operating cash flow/debt	-4%	-20%	-131%	-26%	1%
Scope-adjusted EBITDA in HUF m					
EBITDA	754	1,983	1,545	1,199	1,033
less: disposal gains from fixed assets included in EBITDA	0	0	-680	0	0
Scope-adjusted EBITDA	754	1,983	865	1,199	1,033
Scope funds from operations in HUF m					
Scope-adjusted EBITDA	754	1,983	865	1,199	1,033
Less: cash interest as per cash flow statement	-97	-140	10	-275	-328
less: cash tax paid as per cash flow statement	-44	-222	-170	-19	-3
Funds from operations (FFO)	613	1,621	705	905	702
Free operating cash flow in HUF m					
Funds from operations	613	1,621	705	905	702
Change in working capital	541	259	-739	-2,068	672
less: capital expenditure (net)	-1,402	-3,223	-8,988	-989	-1,297
Free operating cash flow (FOCF)	-248	-1,343	-9,022	-2,152	77
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-97	-140	10	-275	-328
Net cash interest paid	-97	-140	10	-275	-328
Scope-adjusted debt in HUF m					
Reported gross financial debt	5,000	5,304	5,635	6,990	8,250
add: subordinated liabilities	1,277	1,276	1,276	1,276	1,276
Scope-adjusted debt (SaD)	6,277	6,580	6,911	8,266	9,526
Cash balance in HUF m					
Cash balance[1]	10,416	11,078	4,771	3,783	3,071

[1] Netting of cash: generally, only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible.

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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 considerations

ESG factors are neutral for the rating. We acknowledge, however, the implemented sustainability measures. These include: i) energetic renovation for outdated buildings; ii) the selective collection of construction waste; iii) the segregation of hazardous waste; and iv) the avoidance of the use of single-use plastics. The group is also using solar systems at its headquarters and various projects, electric vehicles chargers and green energy. Its aim is to develop an energy transition concept. Szinorg's sustainability engagement was acknowledged by the City of Debrecen (its core market), which had launched the Sustainable Debrecen programme.

[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 and material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B-

Industry risk: B

Szinorg's activities remain primarily exposed to construction, real estate development and the facility management of some group properties. Construction accounts for most of the business: Hunép and HC Építő contributed more than 90% of revenues in 2022. Worth noting is that activities have increased in scope with the build-up of the real estate development portfolio in the last few years. As of today, revenues and EBITDA from the real estate business are negligible, but we expect them to start contributing in 2023.

Small player in both a European context and domestically

Szinorg is a small player in the European and Hungarian construction markets. This is a negative rating driver as it limits the group's ability to benefit from economies of scale and offset the impact of economic cycles. However, its focus on the geographic niche of eastern Hungary gives it good visibility in the regional market. As at end-December 2022, revenues stood at around HUF 21bn based on preliminary figures, which is down 6% YoY, but 12% above our previous rating case. This is because the group's core market of Debrecen benefits from strong foreign investment. For example, the establishment of a BMW automotive plant in Debrecen, including a battery factory, has provided some counterbalance for the delayed EU-funded government projects and government tenders, pushed back to 2024 at the earliest.

While we expect EBITDA to be around the targeted level based on preliminary figures, Scope-adjusted EBITDA is forecasted to drop by 50% YoY down to below HUF 1bn (adjusts for HUF 680m in disposal proceeds for a student hostel). This reduction is mainly for two reasons; i) higher than initially planned cost in the renovation of a listed monument, and ii) an issue with a supplier that could not perform due to increasing raw material costs, both resulting in some cost overruns for the group.

The group's business plan is to strengthen its pipeline by continue building up its real estate portfolio, that generates recurring income and sales proceeds. While this offers some diversification, this pipeline is subject to heightened risk, including lower demand for residential developments as well as potential delays to project execution and handovers.

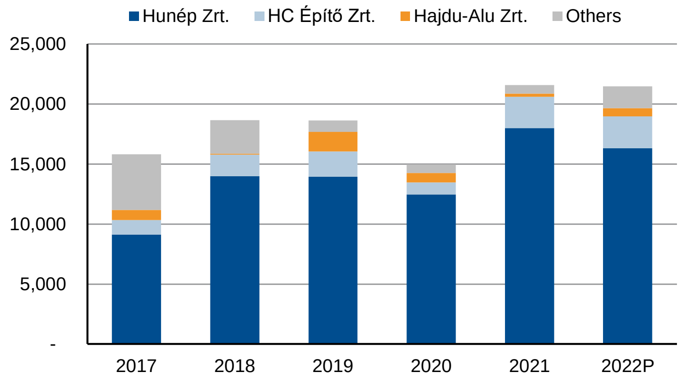
Weak geographical diversification with portfolio focused on Debrecen

Geographical diversification remains limited. Activities are concentrated in eastern Hungary, with more than 80% of revenues from projects in Debrecen and the surrounding areas. Szinorg intends to maintain this focus as it defines itself as a specialist and prefers to benefit from its good local knowledge and networks. While this seems prudent given Szinorg's small size, it fully exposes the group to the macroeconomy of one region.

Concentrated but balanced customer mix, including state institutions and municipalities

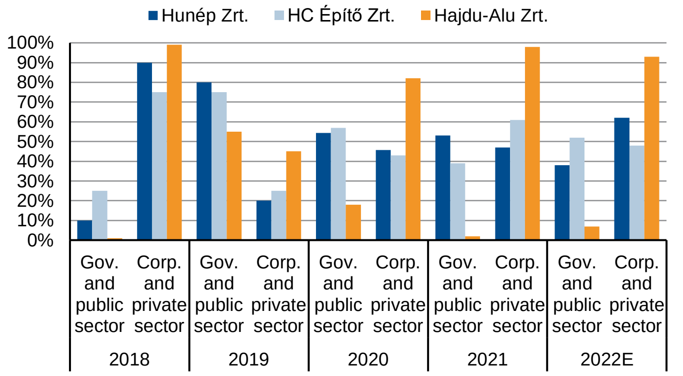
Szinorg's limited size results in high customer concentration as only a few projects can be executed simultaneously. This means both profitability and cash flow from operations can be greatly affected by the failure of one project. The balanced ratio of public to private customers reflects Szinorg's good record of developing private and public projects, with around 60% of revenues from private and 40% from public in 2022. While Szinorg depends less on government customers than peers, its revenues remain subject to government demand and policy.

Figure 1: Revenue breakdown by company (HUF m)



Sources: Szinorg, Scope

Figure 2: Revenue breakdown by type of customer (%)



Sources: Szinorg, Scope

Backlog still concentrated

The backlog remains concentrated, with the top three projects accounting for 78% of future contracted revenues. A major project was signed in December 2022 with an international company, which wants to expand its plant significantly in 2023. While this implies high cluster risk, the group has already signed on a supplier and subcontractors and the advance payments from customers will finance the initial project phase.

However, cluster risk is still present in the order backlog, with the one contract representing 52% of total contracted work. This concentration bears the risk of significant cash flow volatility if projects are delayed or cancelled.

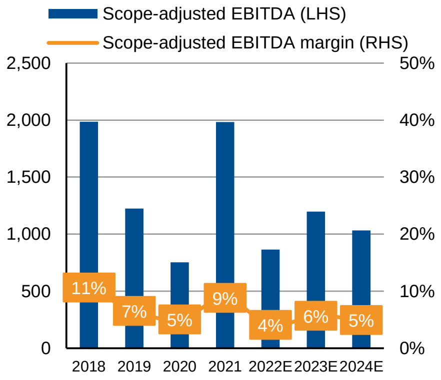
Real estate developments to secure project pipeline

This risk will be partially mitigated by the development of a real estate portfolio that will generate recurring income and sales proceeds. The current project pipeline involves around HUF 52bn (as at December 2022) of investment over the next few years and is well diversified by asset class and includes a hotel, residential developments and industrial premises.

The Bajcsy/Mercure Hotel, opened in August 2022, represented an investment of around HUF 8bn and was partially subsidised by the Hungarian state (around HUF 3.5bn). Other assets include industrial buildings (11,000 sqm industrial hall under development) and various residential projects, one of which is located in the Balaton Lake region.

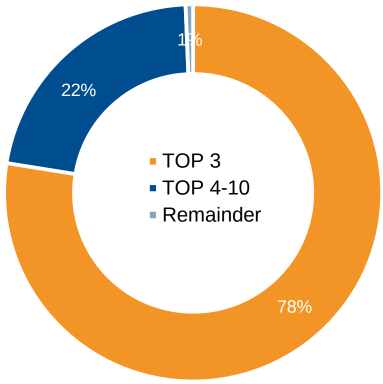
Although demand for newly built residential units has remained robust, amid supportive governmental incentives, higher cost of debt, delay in sales and lower investor demand and/or increasing raw materials price and labour mean a significant development risk for the group.

Figure 3: EBITDA and EBITDA margin



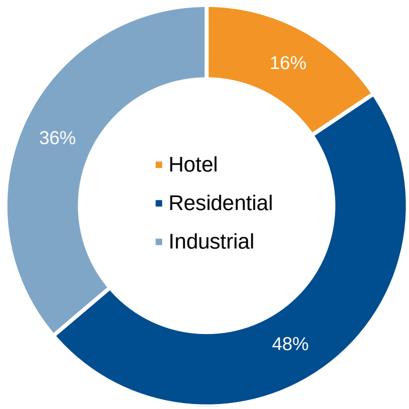
Sources: Szinorg, Scope

Figure 4: Top projects in construction backlog, 2023



Sources: Szinorg, Scope

Figure 5: Real estate project pipeline by segment



Sources: Szinorg, Scope

Profitability under pressure and still limited visibility on future cash flows

Profitability as measured by the Scope-adjusted EBITDA margin is expected to reach 4% for FY 2022 (3pp below our forecast). This was due to increasing raw materials prices and supply chain issues, factors which are expected to remain in place. However, the group's strategy to sign projects at a fixed price and based on the stage of work mitigates this to some extent.

Given the significant uncertainties in the Hungarian construction sector, most notably the inflated construction materials prices, profitability is expected to stay stagnant in the medium term. However, this will be counterbalanced by Szinorg's plan to optimise the group structure. The group intends to dampen the effect of inflation by reducing costs and merging its two large construction subsidiaries in 2023, which we expect will help to keep the overall margin slightly above 5% in the next few years.

The orderbook as of January 2023 amounts to HUF 27bn, resulting in a backlog of 1.3x, providing top line visibility only until the beginning of 2024.

Financial risk profile: B

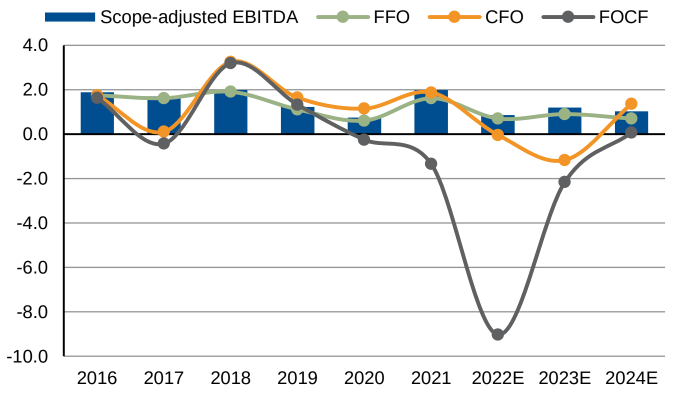
Adequate debt protection metrics despite debt increase in 2020

Debt protection benefits from positive cash flow generation that will support the EBITDA in 2023 as well as the group's low debt expense (HUF 5bn bond with 3% fixed-interest rate). We anticipate declining interest cover in the years to come as balance sheet leverage is expected to rise to finance the real estate projects. However, we forecast that EBITDA interest cover will remain above 3.0x in the next few years. The floating rates on the new loans (around 33% of the financial obligations would be subject to floating rates by end of 2023) will also expose the group to a significant rise in the Euribor rate.

Free operating cash flow impacted by development pipeline

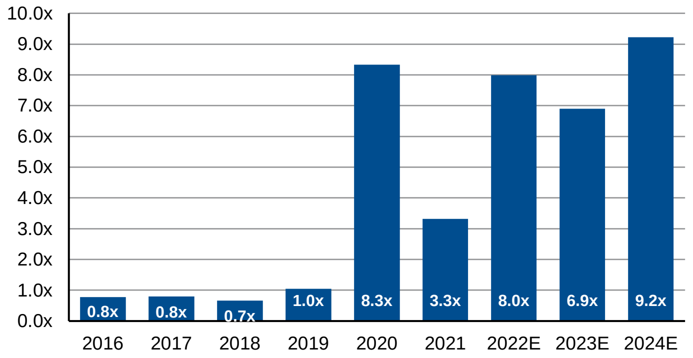
We expect stable and positive FFO in the next few years. This is based on Szinorg's backlog and our expectation that turnover will remain at the historical average. However, Scope-adjusted cash flow from operations (CFO) and FOCF will remain negative over the next years, driven by the build-up of the real estate development portfolio. Projects will be financed using current available funds (liquidity of above HUF 7bn as of January 2023) and potential customer advances. We expect the group's FOCF to remain negative, driven by real estate development in 2023.

Figure 6: Cash flows (HUF bn)



Sources: Szinorg, Scope estimates

Figure 7: Leverage (Scope-adjusted debt/EBITDA)



Sources: Szinorg, Scope estimates

Growth strategy at the expense of increased leverage

Szinorg has issued a HUF 5bn senior unsecured bond under the Hungarian National Bank's Bond Funding for Growth Scheme to finance part of its significant capex programme, with the rest to be financed with additional bank loans. However, in the view exceptionally high domestic interest rates, the group has revised the amount of additional bank debt, now expected at about HUF 2.7bn until 2024 from HUF 12bn budgeted in the previous year. Szinorg will also re-assess its real estate pipeline to follow a more cautious approach. This may include the requirement of a higher pre-sale rate for residential projects of 60% before a project can start, development in phases, gradual payment from buyers, and no bank financing.

Cash is higher than financial debt as of December 2022. We foresee some increase in leverage, as measured by Scope-adjusted debt/EBITDA, to above 9x by the end of 2024. This is due to risk related to future revenues with limited order book and weakening demand for real estate assets, which could lead to a prolonged period of lower Scope-adjusted EBITDA.

Adequate liquidity

Liquidity remains adequate, with over HUF 5bn of cash and equivalents as at December 2022, available overdrafts of HUF 1.8bn and a back-loaded debt maturity with a HUF 5bn bond maturing only in 2030 and no significant amount before then. Nonetheless, the group will remain dependent on external liquidity to finance capex and working capital.

Figure 8: Liquidity

in HUF m	2023E	2024E
Short-term debt (t-1)	10	120
Unrestricted cash (t-1) [3]	5,285	4,298
Open committed credit lines (t-1) [4]	0	0
FOCF (t)	-2,152	77
Coverage	**>200%**	**>200%**

Source: Scope estimates

Long-term debt rating

Senior unsecured debt: B+

The rated entity has issued a HUF 5bn senior unsecured corporate bond (ISIN HU0000359633) in H1 2020 under the Hungarian National Bank's Bond Funding for

[3] Considers cash and available money market instruments.
[4] Available overdrafts are excluded from our liquidity calculation as those are yearly rolling facilities. However, we acknowledge Szinorg long-term relationship with various financial institutions.

Growth Scheme. The amortisation schedule of the 10-year, fixed-interest instrument assumes 10% repayment at the eighth anniversary, 20% at ninth anniversary and 70% balloon payment at maturity.

Our recovery analysis is based on a hypothetical default in 2024, which assumes outstanding senior unsecured debt of HUF 5bn in addition to HUF 2.7bn in bank loans and HUF 1.8bn, assuming the group draws on available overdrafts. We expect an 'above-average' recovery for senior unsecured debt and therefore have affirmed the B+ rating for this debt category (one notch above the issuer rating).

Appendix: Peer comparison

	Szinorg Universal Zrt.	Duna Aszfalt Zrt.	Market Építő Zrt.	DVM Kft.	Bayer Construct Zrt.
	B/Negative	BB-/Stable	BB-/Stable	B/Stable	B+/Negative
Last reporting date	31 Dec 2022E	31 Dec 2021	31 Dec 2021	31 Dec 2021	31 Dec 2021
Business risk profile					
Scope-adjusted EBITDA (EUR m)	4	150	105	5	23
Backlog (years)	1.3	1.4	1.5	2.8	1.4
Scope-adjusted EBITDA margin	4%	22%	14%	8%	11%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	Net cash interest	73.2x	29.5x	7.7x	9.8x
Scope-adjusted debt/EBITDA	8.0x	1.0x	0.8x	4.3x	6.9x
Scope-adjusted FFO/debt	10%	90%	120%	22%	12%
Scope-adjusted FOCF/debt	-131%	18%	47%	6%	14%

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