Szinorg Universal Zrt.
Hungary, Construction

B STABLE

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 construction companies Hunép Zrt. and HC Építő Kft., as well as Hajdu-Alu Zrt, which produces curtains walls, doors and windows. Szinorg group has nearly 200 employees.

Key metrics

			Scope estimates		
Scope credit ratios	2019	2020	2021P	2022E	2023E
Scope-adjusted EBITDA/Scope- adjusted interest cover (x)	120.4x	7.7x	10.4x	7.4x	3.9x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	1.7x	9.6x	4.3x	7.0x	16.0x
Scope-adjusted funds from operations/SaD	55%	8%	20%	12%	5%
Scope-adjusted free operating cash flows/SaD	65%	-3%	-44%	-138%	-51%

Rating rationale

Scope affirms B/Stable issuer rating of Szinorg Universal Zrt.

The rating affirmation is driven by Szinorg's robust performance in 2021, after delays in public procurements and private tenders in 2020 weakened results. Revenues of HUF 23bn in 2021, based on preliminary figures, were more than 50% higher than in 2020 and 27% more than our forecast. Scope-adjusted EBITDA amounted to HUF 1.7bn and the Scope-adjusted EBITDA margin recovered slightly to around 7% in FY 2021 from 5% in FY 2020. Szinorg's backlog along with its plans to build up a real estate development portfolio will help to secure cash flow via recurring income and sales proceeds. Main projects include the Bajcsy Hotel as well as industrial and residential developments.

In H1 2020, Szinorg issued a senior unsecured bond for a total of HUF 5bn, to partially finance its business plan and secure the project pipeline. Given the significant size of the projects, external financing will still be required, with up to HUF 12.3bn in additional bank loans estimated until 2023

Szinorg's business risk profile (assessed at B) continues to benefit from its position and presence in its core regional market of Debrecen. Customer diversification, with good outreach in terms of private and public sector customers (the latter accounted for around 45% of total revenues in 2021) is also credit-positive. The rating remains constrained by the company's small scale in both a European and a Hungarian context, which lessens its ability to mitigate economic cycles. Weak geographical, segment and backlog diversification is a further constraint.

The financial risk profile (assessed at B) is constrained by the forecasted increase in leverage, as measured by the Scope-adjusted debt (SaD)/EBITDA, to above 15x in 2023 as external funds are needed to finance working capital and the ambitious investment plan. The ratio is expected to stabilise at an adequate level for the rating category once the planned real estate portfolio bears fruit.

Ratings & Outlook

Corporate rating	B/Stable
Senior unsecured rating	B+

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Related Methodologies

Corporate Rating Methodology: July 2021

Construction and Construction Materials Rating Methodology January 2022

European Real Estate Rating Methodology January 2022

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Outlook and rating-change drivers

The Outlook remains Stable and incorporates Scope's expectation of i) continued positive operating cash flows; ii) the successful execution of real estate developments to generate recurring income and sales proceeds; and iii) stable backlog. Some risk could arise regarding newer projects in light of the elections in Hungary (April 2022), as about 50% of the backlog relates to public procurements.

A positive rating action is remote but may be warranted if business risk profile improved, with the development pipeline substantially growing in size and diversification improving (by customer and project), while Scope-adjusted debt/EBITDA remained at around 5x.

A negative rating action could occur if real estate developments saw significant delays or cost overruns. It could also occur if liquidity worsened, for example, through significant delays in customer payments or non-recoverable cost overruns in projects.

Rating drivers

Positive rating drivers	Negative rating drivers
• Good regional market position translating into local market visibility as well as moderate access to third-party finance sources and guarantees • Strong liquidity (about HUF 11bn in cash in FY 2021) supported by available undrawn overdrafts totalling HUF 3.9bn as at December 2021 • Healthy debt protection despite sharp anticipated increase in interest-bearing debt	• Small construction company in a European context, with a lack of geographic and segment diversification, somewhat mitigated by the strong niche position • Concentrated contracted backlog (top three projects account for 64% of backlog revenues: top 10 for 95%) • Negative free operating cash flow, which also translates into negative Scope cash flow metrics, but this is typical during investment phases

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Remote but may be warranted if the business profile improved (development pipeline grew significantly and diversification improves) while SaD/EBITDA remained at around 5x	• Worsening liquidity due, for example, to delayed customer payments or cost overruns • Delays or cost overruns for real estate developments

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021P**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover (x)	120.4x	7.7x	10.4x	7.4x	3.9x
Scope-adjusted debt (SaD)/SaEBITDA (x)	1.7x	9.6x	4.3x	7.0x	16.0x
Scope-adjusted funds from operations/SaD (%)	55%	8%	20%	12%	5%
Scope-adjusted free operating cash flow/SaD (%)	65%	-3%	-44%	-138%	-51%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021P**	**2022E**	**2023E**
EBITDA	1,485.2	753.7	1,668.0	1,266.9	1,224.5
less: disposal gains from fixed assets included in EBITDA	-262.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	1,223.2	753.7	1,668.0	1,266.9	1,224.5
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021P**	**2022E**	**2023E**
Scope-adjusted EBITDA	1,223.2	753.7	1,668.0	1,266.9	1,224.5
less: cash interest as per cash flow statement	-10.2	-97.4	-160.0	-170.6	-316.1
less: cash tax paid as per cash flow statement	-98.7	-43.6	-87.8	-46.2	-23.5
add: dividends received from shareholdings	0.0	0.0	0.0	0.0	0.0
Scope funds from operations	1,114.3	612.7	1,420.3	1,050.1	884.9
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021P**	**2022E**	**2023E**
Interest-bearing debt	0.1	5,000.0	5,000.0	6,650.0	17,300.0
add: subordinated liabilities	1,277.4	1,277.4	1,277.4	1,277.4	1,277.4
add: other liabilities	754.0	975.5	975.5	975.5	975.5
add: off-balance sheet debt	0.0	0.0	0.0	0.0	0.0
Scope-adjusted debt	2,031.5	7,252.9	7,252.9	8,902.9	19,552.9
Cash balance in HUF m	**2019**	**2020**	**2021P**	**2022E**	**2023E**
Cash balance[1]	9,920.2	10,415.7	11,358.9	2,878.7	3,346.0

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

Business risk profile: B

Industry risk: B

Szinorg's activities include construction, real estate development and the facility management of some group properties (such as hotels and student accommodation). Construction accounts for most of the business: Hunép and HC Építő contributed more than 85% of revenues in 2021. 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 is negligible. We expect the contribution of those developments to be reflected from 2023 on.

Small market player, both in a European context and domestically

Performance in 2021 was robust after delays in public procurements and private tenders weakened results in 2020. Revenues in 2021 of HUF 23bn, based on preliminary figures, were higher by 50% than in 2020 and 27% more than our forecast. Scope-adjusted EBITDA was HUF 1.7bn (121% higher than in 2020). This performance was mainly supported by a recovery in external procurements and additional projects in the backlog, mainly from the group's main construction company, Hunép.

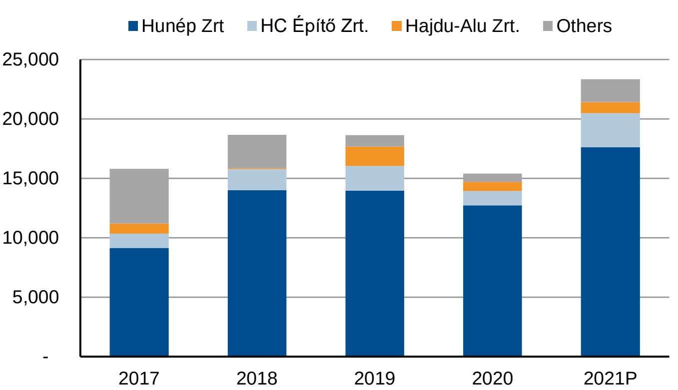
An ambitious business plan aims to secure the pipeline in the next few years, through the build-up of a real estate portfolio (including projects for about HUF 45bn as of January 2022) that can generate recurring income and sales proceeds. Two projects are subsidised partly by the Hungarian state with HUF 3.7bn. However, given the significant size of the projects, additional external financing will be needed. Main projects include the Bajcsy Hotel as well as industrial and residential developments.

Even with the potential for growth, we expect Szinorg to remain a small construction company both in a European context and in Hungary, a highly fragmented market. The small size is a negative rating driver as it limits the company's ability to benefit from economies of scale and offset the impact of economic cycles, as evidenced in 2020.

Weak geographical diversification with portfolio focused on Debrecen

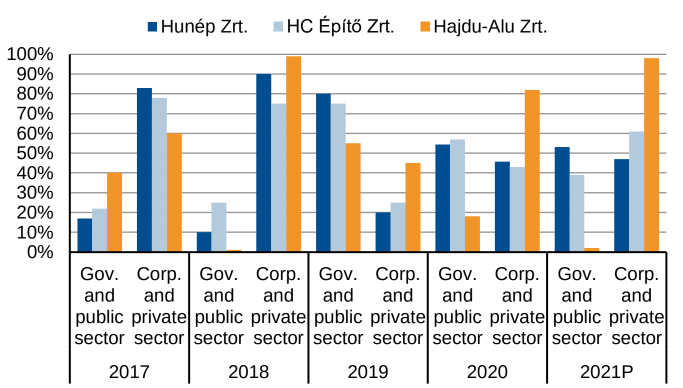
Geographical diversification is limited. Activities are concentrated in eastern Hungary, with more than 80% of revenues from projects in Debrecen and surrounding areas. Szinorg intends to maintain its focus on Debrecen as it defines itself as a market specialist and prefers to benefit from its good local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

Figure 1: Revenue breakdown by company (HUF m)



Source: Szinorg, Scope

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



Source: Szinorg, Scope

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 50% of revenues from private and 45% from public in 2021. While dependence on government customers is lower than peers, the group's revenue generation is still highly dependent on government demand and strategy.

Backlog still concentrated

The backlog is concentrated, with the top three projects accounting for 64% of future contracted revenues. The largest project, the reconstruction of the Csokonai Theatre in Debrecen, represents 27% of backlog revenues. The remainder is distributed across 19 other projects. This concentration bears the risk of significant cash flow volatility if projects are delayed or cancelled.

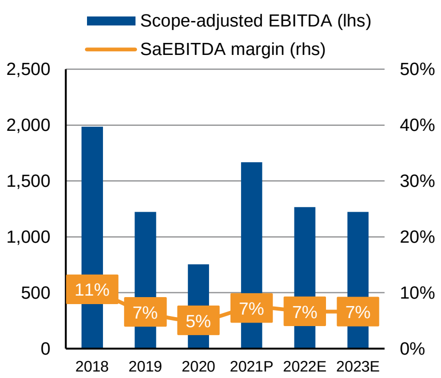
Real estate developments to secure project pipeline

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 45bn (as at January 2022) of investment in the next few years. The development pipeline is well diversified by asset class and includes a hotel, residential developments and industrial premises. Some projects have started, while others (one office building) will start depending on demand.

Slightly improved profitability for 2021, but still limited visibility on future cash flows

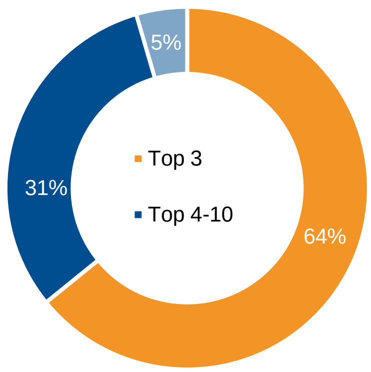
Profitability, as measured by the Scope-adjusted EBITDA margin, slightly recovered to around 7% in FY 2021 from 5% in FY 2020. Increasing prices for raw materials are expected to put some pressure on profitability, but this will be partially mitigated by the company's strategy to sign construction projects based on stages of works subject to fixed prices. The backlog as of February 2021 amounts to HUF 25bn (HUF 31bn for 2020), resulting in a backlog-to-sales ratio of 1.1x. The backlog partly benefits from the government's long-term investment plan for the Debrecen region.

Figure 3: EBITDA and EBITDA margin



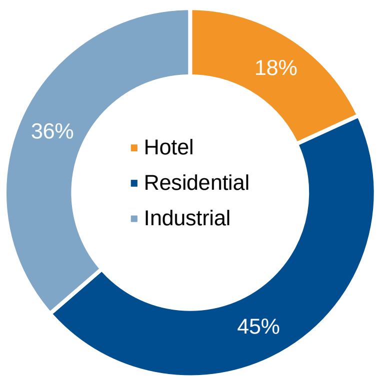
Sources: Szinorg, Scope

Figure 4: Top projects in backlog, 2022



Sources: Szinorg, Scope

Figure 5: Project pipeline by segment



Sources: Szinorg, Scope

Financial risk profile: B

Adequate debt protection metrics despite debt increase in 2020

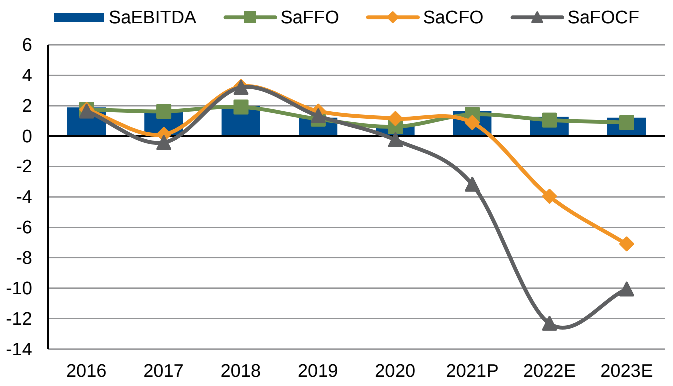
Szinorg previously had little financial debt and interest expenses were low, with debt protection strong before 2019. This changed with the HUF 5bn bond issued in 2020 (3% coupon), resulting in the Scope-adjusted EBITDA interest coverage ratio reaching 10.4x in FY 2021, based on preliminary figures. Scope anticipates declining debt protection in the years to come, as a result of the expected higher leverage component in the company's balance sheet. However, Scope forecasts that EBITDA interest cover will remain above 3.0x in the next few years. Floating rates on the loans also expose the company to the potential risk of a significant rise in the Euribor rate.

Free operating cash flow impacted by development pipeline

We expect stable and positive funds from operations in the next few years. This is based on Szinorg's backlog and our expectation that the company can maintain turnover at the average historical level. However, Scope-adjusted cash flow from operations (CFO) and free operating cash flow (FOCF) will remain negative over the next years, driven by the build-up of the real estate development portfolio.

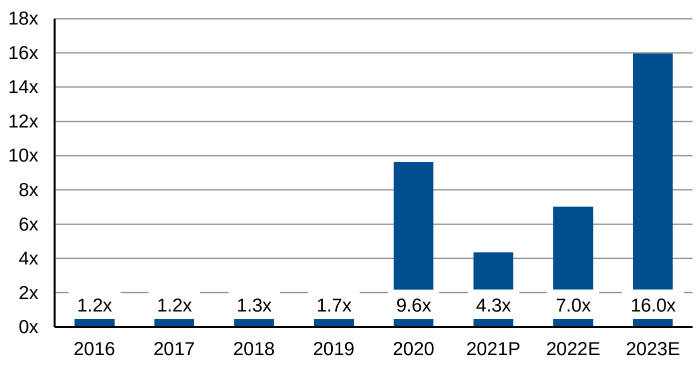
The projects will be financed using current available funds (liquidity of around HUF 11.3bn as of December 2021), also benefitting from the HUF 3.7bn in government subsidies. However, the company will still require additional external financing to cover working capital (mainly through increased inventories) and capital expenditure, which combined will require an estimated HUF 44bn until 2023.

Figure 6: Cash flows (HUF bn)



Source: Szinorg, Scope estimates; 'Sa' = Scope-adjusted

Figure 7: Leverage (SaD/EBITDA)



Source: Szinorg, Scope estimates; 'Sa' = Scope-adjusted

Growth strategy at the expense of increase in leverage

In 2020, the company issued a HUF 5bn senior unsecured bond under the Hungarian National Bank's Bond Funding for Growth Scheme to partially finance its significant capex programme. The company will still need additional bank financing to finance the programme, estimated at around HUF 12.3bn until 2023.

The higher leverage will put credit metrics under pressure for the next few years. From 2022, we foresee SaD/EBITDA leverage to increase above 15x in 2023 before stabilising at a level commensurate with the rating category once developments are complete and provide a boost to the top line.

Strong liquidity

Liquidity remains adequate, with over HUF 11.3bn of cash and equivalents as at December 2021, available overdrafts of HUF 3.9bn and a back-loaded debt maturity with a HUF 5bn bond maturing only in 2030 and no significant amount before then. Nonetheless, the company will remain dependent on external liquidity to finance free operating cash flow (capex and working capital).

Figure 8: Liquidity

in HUF m	2021P	2022E
Short-term debt (t-1)	0	0
Unrestricted cash (t-1)[2]	15,065	11,859
Open committed credit lines (t-1)	2,760	3,860
Free operating cash flow (t)[3]	-3,173	-12,308
Coverage	**5.6x**	**1.3x**

Source: Scope estimates

[2] It includes marketable securities (of about HUF 5bn FY 2020 and HUF 500m in 2021).
[3] We exclude discretionary expansion capex from our liquidity calculation, as such investments are only made if external financing is available.

Long-term and short-term debt ratings

Senior unsecured debt: B+

Szinorg issued a HUF 5bn senior unsecured bond (ISIN HU0000359633) in H1 2020 under the Bond Funding for Growth Scheme. The bond has a 3% coupon and a tenor until 2030.

Our recovery analysis is based on a hypothetical default scenario in 2023, which assumes outstanding senior unsecured debt of HUF 5bn in addition to HUF 16.2bn in bank loans (HUF 12.3bn to finance capex and HUF 3.9bn assuming the company draws on available overdrafts). We expect an 'above-average' recovery for senior unsecured debt and therefore affirm the B+ rating for this debt category (one notch above the issuer rating).

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