ENSI Kft.
Hungary, Construction

SCOPE B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	Net interest income	Net interest income	Net interest income	Net interest income
Scope-adjusted debt/EBITDA	3.7x	2.1x	2.5x	3.0x
Scope-adjusted funds from operations/debt	27%	59%	42%	34%
Scope-adjusted free operating cash flow/debt	22%	73%	70%	44%

Rating rationale

ENSI Kft.'s business risk profile (assessed at B) continues to be driven by the operating profitability, with a Scope-adjusted EBITDA margin around 7%. Despite the more adverse market conditions, we expect operating profitability to remain stable in the medium term. ENSI's order book for as of October 2024 remained strong (around HUF 28bn), close to historical averages. The business risk profile is constrained by ENSI's still limited absolute size in a European and global context. Additionally, the business risk profile is constrained by limited diversification in terms of activity, geographies and customer portfolio.

The financial risk profile (assessed at BBB+) is supported by good credit metrics. We assume leverage, measured by Scope-adjusted debt/EBITDA, to be between 3.0x and 4.0x in the coming years. ENSI is expected to generate net interest income, EBITDA interest cover benefitting from the high cash level and low coupon rate of the bond. Cash flow cover, measured by Scope-adjusted free operating cash flow/debt, is expected to be strong, above 40 % till 2026. Liquidity is adequate, with no short term debt till the first amortization of the bond (2027).

While the standalone credit assessment is deemed at BB-, the final rating is constrained at B+, thereby incorporating a negative one-notch adjustment for peer context.

Outlook and rating-change drivers

The Outlook is **Stable**. This incorporates our assumption that ENSI's credit metrics will remain mainly unaffected by the worsening performance of the construction segment, staying at their current level, with Scope-adjusted debt/EBITDA consistently below 4.0x, positive net interest, and Scope-adjusted free operating cash flow/debt above 40%. Our financial forecast includes two acquisitions, the first for HUF 2.0bn occurring in 2025 and the second for HUF 1.0bn in 2026.

The **upside scenarios** for the ratings and Outlook are (individually): i) Improving business risk profile, via an improved market position, diversification of stronger visibility on cash flows from a more substantial order backlog, paired with maintained credit metrics; ii) Removal of the negative rating adjustment for peer group wile at least maintaining its current financial risk profile. **The downside scenario** for the ratings and Outlook is: Scope-adjusted debt/EBITDA sustained above 4.0x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
11 Dec 2024	Affirmation	B+/Stable
19 Dec 2023	Monitoring review	B+/Stable
19 Jan 2023	Affirmation	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

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Related Methodologies:

General Corporate Rating Methodology; October 2023

Construction and Construction Materials Rating Methodology; January 2024

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Solid financial risk profile with robust interest coverage and good leverage • Solid order book • Market leader in niche segment, with a 20% market share in the field of mechanical engineering and a consistent EBITDA margin of around 7%	• Small-scale construction company in both the European and Hungarian contexts • Weak diversification, both in terms of geographical scope and customer portfolio • Softening demand in the segment, negatively influenced by lower investment volumes • Negative rating adjustment for peer group context

Positive rating-change drivers	Negative rating-change drivers
• Improving business risk profile, via an improved market position, diversification of stronger visibility on cash flows from a more substantial order backlog, paired with maintained credit metrics • Removal of the negative rating adjustment for peer group while at least maintaining its current financial risk profile	• Scope-adjusted debt/EBITDA sustained above 4.0x

Corporate profile

ENSI is a Hungarian construction company specialised in mechanical engineering (heating, cooling, ventilation, hot water, lighting) with over 25 years of experience in its domestic market. The company was established in 1994 and is owned by the Németh family: the founder and CEO László Németh and his three sons. The company's headquarters are in Budapest. On top of mechanical engineering implementation, which accounts for about 90% of total revenue, the company also engages in professional consulting, planning and maintenance activities through specialised members of the ENSI group.

Financial overview

				Scope estimates		
Scope credit ratios	**2021[1]**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	N/A	Net interest income	Net interest income	Net interest income	Net interest income	Net interest income
Scope-adjusted debt/EBITDA	N/A	3.7x	2.1x	2.5x	3.0x	3.5x
Scope-adjusted funds from operations/debt	N/A	27%	59%	42%	34%	29%
Scope-adjusted free operating cash flow/debt	N/A	22%	73%	70%	44%	44%
Scope-adjusted EBITDA in HUF m						
Reported EBITDA	903	1,362	2,594	2,209	1,821	1,544
Recurring associate dividend received	42	132	39	23	23	23
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**945**	**1,494**	**2,633**	**2,232**	**1,844**	**1,567**
Funds from operations in HUF m						
Scope-adjusted EBITDA	945	1,494	2,633	2,232	1,844	1,567
less: (net) cash interest paid	0	118	891	284	239	186
less: cash tax paid per cash flow statement	-97	-101	-279	-226	-185	-156
Funds from operations (FFO)	**848**	**1,511**	**3,245**	**2,290**	**1,898**	**1,597**
Free operating cash flow in HUF m						
Funds from operations	848	1,511	3,245	2,290	1,898	1,597
Change in working capital	-1,037	431	-1,526	1,568	548	828
Non-operating cash flow	900	-719	2,328	0	0	0
less: capital expenditure (net)	-19	-6	-17	-17	-17	-17
Free operating cash flow (FOCF)	**692**	**1,217**	**4,030**	**3,841**	**2,429**	**2,408**
Net cash interest paid in HUF m						
Interest paid	0	-263	-278	-261	-261	-261
Interest received	0	382	1,169	546	500	447
Change in other items	0	0	0	0	0	0
Net cash interest paid	**0**	**119**	**891**	**285**	**239**	**186**
Scope-adjusted debt in HUF m						
Reported gross financial debt	0	5,500	5,500	5,500	5,500	5,500
less: cash and cash equivalents[2]	N/A	N/A	N/A	N/A	N/A	N/A
Other items	0	0	0	0	0	0
Scope-adjusted debt (SaD)	**0**	**5,500**	**5,500**	**5,500**	**5,500**	**5,500**

[1] In FY 2021, ENSI operated with no financial debt.
[2] No cash netting applied.

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

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		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)

Credit-neutral ESG factors

No drivers of the credit rating are considered ESG-related factors with a substantial impact on the overall assessment of credit risk.

ENSI is a family-owned company, with László Németh as the majority shareholder and owner of the company. He is supported by a five-people management team of financial and engineering professionals, reducing the key person risk that is typical of family-owned companies. The company has no independent supervisory board.

In 2022, ENSI formulated a dedicated ESG Strategy, defining the following goals for the next 10 years:

i) Reduction of carbon footprint by 50 % by 2028

ii) Zero carbon emission by 2033

[3] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B (unchanged)

Industry risk profile: B

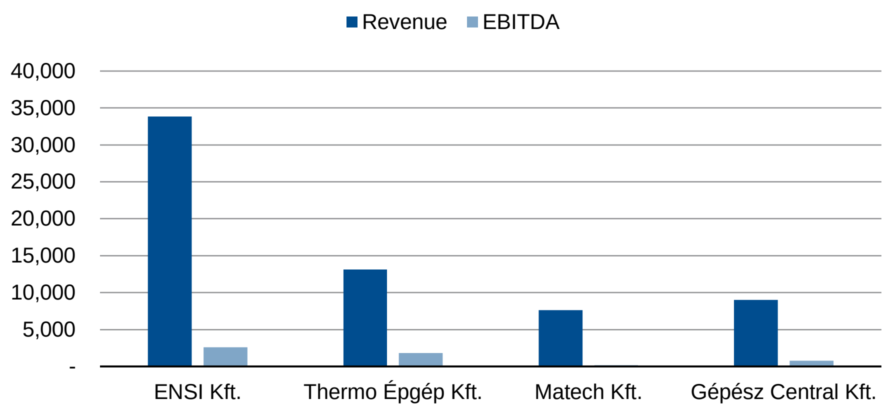
ENSI predominantly acts as a contractor specialised in mechanical engineering. We consider this activity as part of the buildings and small civil engineering projects subsector of the construction industry. This subsector is characterised by a low need for capital investment but a high need for specialised knowledge, competencies and references to ensure competitiveness. We assess the market entry barriers as low, together with the high cyclicality and low substitution risk of the construction industry, leading to an associated industry risk assessment of B.

The business risk profile of ENSI is supported by the stable operating profitability and a strong order book accounting for around HUF 28bn as of October 2024. The business risk profile remains constrained by the issuer’s small size by global standards, limited diversification in terms of activity, geographies and customers.

While revenues have shown dynamic increase in the past five years, ENSI remains a relatively small constructor in the contexts of the European and Hungarian construction markets. Small size leads to more volatile cash flow and higher exposure to external shocks. ENSI’s size is in part compensated for by its market leadership in Hungary in its niche of mechanical engineering. In previous years, ENSI’s revenue has displayed significant volatility, influenced by business cycles and investment volumes. While ENSI was subject to rapid revenue growth until 2021, revenue has decreased by about 9% in 2022 to HUF 18.7bn. In 2023 revenues grew by +84%, driven by the FDI inflow to Hungary in the previous years. Based on the interim management accounts for 2024 (9M 2024 revenue: HUF 20.2bn), we forecast a slight decrease in revenues for 2024.

ENSI’s size is limited compared to leading Hungarian construction companies, which are general contractors with a wide scope of activities and a strong focus on public procurement. However, ENSI is a market leader in its niche with an estimated market share of 20%. Its direct competitors include family-owned SMEs with strong focus either on a geographical region or on a particular project type. ENSI focuses on large projects (more than 20,000 sq m) that involve specialised knowledge and high added value. Despite its small relative size, the company has an impressive list of references from a wide range of public and private projects.

Figure 1: ENSI Kft. and direct peers by revenue in 2023 (HUF m)



Sources: Public information, Scope

Limited diversification in terms of activities and geographies

As the company is only active in Hungary, geographical diversification is weak. Its previous focus on the Budapest area has shifted, resulting in a more even distribution between the capital and other regions of the country (as of October 2024, 60% of its ongoing projects centre on the Budapest area, with the rest in rural areas). The company remains active in one segment of the construction industry based on the 2024 order book: buildings. This makes the company more vulnerable to shifts in demand and slowdown of sector growth. The weak segment diversification is partially mitigated by a wide range of projects undertaken within the buildings segment: apartments, offices, and industrial complexes.

In 2024, ENSI participated in 26 projects overall (2023: 21 projects), with the largest ones in terms in revenue being the BMW Assembly hall in Debrecen, the Nestlé pet food factory in Bük and the Budapart offices in Budapest. Based on the number of projects, the concentration within the order book is low, but there is significant exposure to different phases of the construction of the above mentioned projects.

Customer diversification is mainly unchanged compared to the previous review. Customer concentration is high, with revenue from Market Építő Zrt (rated BB-/Stable), the biggest customer of ENSI, accounting for around 50% of total revenue in 2023 (top five: 96 %). We expect the strong cooperation between ENSI and Market to continue beyond 2024 based on the issuer's current order book.

Stable operating profitability, with Scope-adjusted EBITDA margin around 7%

In 2023, the EBITDA margin remained consistent with the previous year's results, demonstrating resilience in the face of challenging market conditions. Based on interim financial information, the EBITDA margin for 2024 is forecasted to be in a similar range (7.2%). Going forward, we anticipate a gradual decline in profitability below 7%, based on: i) softening demand from the end-market side due to negative macroeconomic conditions; and ii) still strong inflationary pressure from the cost side. We highlight the limited medium-term visibility on cash generation, as the order book usually entails only the next year (project duration usually less than 12 months).

Financial risk profile: BBB+ (revised from BB+)

The financial risk profile continues to provide the most support to the rating, benefitting from a low level of financial debt, positive net interest, and strong free operating cash flow (FOCF) generation.

Good leverage metrics, with modest level of financial debt

Other than a HUF 5.5bn senior unsecured bond issued in January 2022, ENSI still operates without any short- or long-term debt. We assume leverage, measured by Scope-adjusted debt/EBITDA, to be between 3.0x-4.0x in upcoming years. As no additional debt intake is assumed in the medium term, and bond amortization does not start before 2027, the development of leverage is highly dependent on the profitability of ENSI. As we expect the EBITDA margin to gradually deteriorate, Scope-adjusted debt/EBITDA is expected to change in a similar manner.

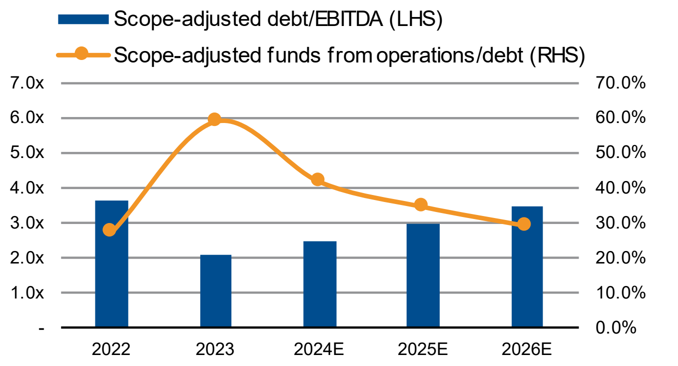
Scope-adjusted debt does not account for performance guarantees since they have never been drawn since the creation of the company. Restricted cash (related to the cash deposit required for the guarantees) is calculated in Scope-adjusted debt, but the effect has historically been minimal. We assume that will remain negligible.

Positive interest income due to short-term investing of unused bond proceeds

Due to the fact the company has historically operated without bank debt, ENSI used to have minimal interest expense. Since the bond issuance in 2022 with 4.75% coupon rate, the company's interest expense has increased to HUF 261m yearly. Additionally, the unused bond proceeds generate interest income, which has exceeded the interest payment in the previous years, benefitting from the favourable BUBOR interest rate. We forecast the issuer to generate net interest income in the medium term.

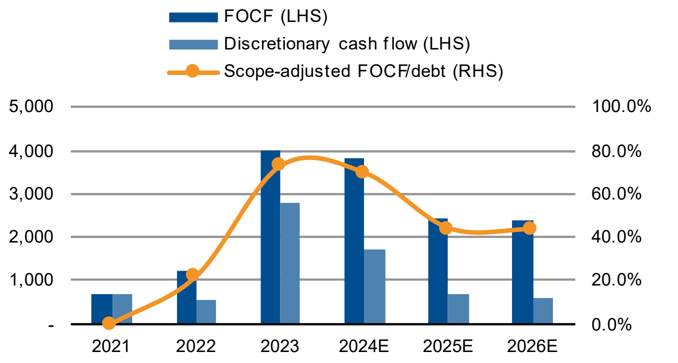
Taking into consideration the assumption that interest payments will remain stagnant (coupon rate of the bond fixed for the whole tenor), ENSI is expected to comfortably meet its interest payment obligations in the medium term.

Figure 2: Leverage metrics



Sources: ENSI, Scope (estimates)

Figure 3: Cash flows (HUF m) and cash flow coverage (%)



Sources: ENSI, Scope (estimates)

Strong cash flow cover

Scope-adjusted FOCF has historically been more volatile than EBITDA, which is mainly affected by the change in working capital needs. We forecast highly positive FOCF from 2024, within a range of HUF 2-3bn, benefitting from: i) stabile EBITDA generation; ii) positive net interest income; iii) minimal CAPEX spending; iv) decreasing working capital needs as per our financial forecast. Financial investments – most prominently the expected business acquisition in 2025-2026 – is included in the discretionary cash flow. Discretionary cash flow also includes expected dividend payments (based on the business plan of the company: in 2024 HUF 2.1bn, in 2025 HUF 1.7bn and in 2026 HUF 1.8bn).

Adequate liquidity

Liquidity is assessed as adequate as sources in our liquidity forecast for 2025 fully cover uses (the company has no short-term debt as at YE 2024). Sources comprise HUF 7.0bn of unrestricted cash available as at YE 2024 and FOCF of HUF 2.4bn forecasted for 2025. We believe a worsening of liquidity, e.g. due to delayed customer payments or cost overruns, is unlikely at this time thanks to the significant cash balance available to the company.

Balance in HUF m	2024E	2025E	2026E
Unrestricted cash (t-1)	5,297	6,994	7,680
Open committed credit lines (t-1)	0	0	0
Free operating cash flow (t)	3,841	2,429	2,408
Short-term debt (t-1)	0	0	0
Coverage	**No ST Debt**	**No ST Debt**	**No ST Debt**

We highlight that ENSI's senior unsecured bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 5.5bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 30 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is zero notches. We note that the company must at least maintain its current credit profile to avoid triggering the rating-related covenant. Considering the improved financial risk profile and good credit metrics, we regards the risk of breaching the rating-related covenant as limited.

Supplementary rating drivers: -1 notch

-1 notch adjustment for peer context

The B+ issuer rating incorporates a negative one-notch adjustment for peer context. The issuer's limited size and weak diversification in terms of activity, geographical outreach and customer portfolio hinders its credit quality compared to relevant peers in the BB category.

Long-term rating

Senior unsecured debt rating: B+

ENSI issued a HUF 5.5bn senior unsecured bond (ISIN: HU0000361258) in January 2022 through the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond proceeds are currently unused but earmarked for M&A, in line with the company's strategy to enter related segments and achieve synergies and economies of scale. The bond has a tenor of 10 years and a fixed coupon of 4.75%. Bond repayment is in six tranches; 10% of the face value is payable each year between 2027 and 2031, and 50% at maturity in 2032.

We have affirmed ENSI's senior unsecured debt rating at B+, the same level as the issuer rating. The recovery analysis is based on a hypothetical default scenario at YE 2026. We have decided to use the going concern scenario in the analysis due to the asset-light nature of the company and the assumption that its business activity generates its enterprise value. Recovery is 'average' for the holders of senior unsecured debt in this scenario.

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