THURSDAY, 08/08/2024 - Scope Ratings GmbH

Scope affirms B+/Stable issuer rating on Bayer Construct Zrt.

The affirmation reflects credit metrics that have remained strong in a challenging market of high inflation and interest rates, as well as the government investment freeze. This is supported by the company's robust yet concentrated order backlog.

The latest information on the rating, including rating reports and related methodologies, is available on this **LINK**.

Rating action

Scope Ratings GmbH (Scope) has affirmed the B+/Stable issuer rating on Bayer Construct Zrt. Scope has also affirmed the B+ rating on senior unsecured debt.

The full list of rating actions and rated entities is at the end of this rating action release.

Key rating drivers

Business risk profile: B+ (unchanged). The business risk profile reflects Bayer Construct's solid competitive position, underpinned by its high vertical integration, solid order backlog and relatively good profitability. The assessment remains constrained by its smaller size and the still high concentration of its order backlog.

Bayer Construct posted consolidated revenues of HUF 155bn (up 83% YoY) and Scope-adjusted EBITDA* of HUF 28bn (up 49% YoY) as of end-2023. The record-high order backlog (HUF 359bn as of end-March 2024; up 20% from end-2023) will continue to drive revenue growth in 2024-25. Despite the challenging market environment, Bayer Construct has managed to secure new contracts and grow its order backlog, which is equivalent to 3.4x the three-year average revenue until 2023. This will allow the company to at least maintain its market share (estimated at 1% 3%), while competition has intensified due to the shrinking pool of public contracts.

However, two factors continue to constrain the business risk profile assessment due to their potential effect on cash flow: the dominant exposure to Hungary (although Scope sees positively the growing exposure to Romania) and the high customer concentration. With regard to the latter, the agency acknowledges some improvements due to solid order intake and increased project counts. The top 10 customers accounted for 86% of the backlog at the end of March 2024 (down 12pp YoY) while 54% were contracts with affiliates (down 24pp YoY). The Zugló City Center project now accounts for 38% of outstanding works as of end March 2024 (end-March 2023: 66%).

The company's profitability, as measured by the Scope-adjusted EBITDA margin, reached 18% in 2023 (down 4.2pp YoY), driven by the sharp increase in material costs, which was not fully offset by a concurrent increase in market prices. Bayer Construct continues to benefit from its vertical integration, lean organisation and operational efficiency, which should safeguard profitability. Scope expects profitability to remain above 12%, taking into account some remaining pressure from building material and labour cost inflation.

Financial risk profile: BB- (revised from B+). The financial risk profile reflects Bayer Construct's solid credit metrics and moderate indebtedness. The main constraint is the cash flow volatility.

Debt protection as measured by the EBITDA/interest cover, at 17.5x in 2023 (2022: 15.7x), is very solid, largely supported by the growth in EBITDA while indebtedness reduced slightly (total debt down 6% YoY to HUF 52bn at end-2023). This provides sufficient headroom against potential cash flow volatility that is inherent to construction activities. Moreover, the interest burden on floating-rate debt (30% of total debt as of end-2023) is likely to decline in line with Hungary's easing monetary policy, and Scope expects interest cover to remain above 7x.

Leverage, as measured by debt/EBITDA, pursued its downward trend, falling to 1.9x at the end of 2023 (YE 2022: 3.0x). This level ensures access to external financing, on both a secured and unsecured basis, to offset potential volatility in cash flow or pre-financing of projects. Scope expects leverage to remain below 4x as no major debt issuance is anticipated and total debt is expected to remain below HUF 55bn. Following the completion of an intensive investment phase, capex is expected to normalise from 2024, thereby easing pressure on leverage and cash flow, while steady customer payments are likely to continue.

Liquidity: adequate. Bayer Construct's liquidity is adequate, with cash sources (unrestricted cash of HUF 8.4bn as of end-2023 and forecasted free operating cash flow of HUF 1.0bn in 2024) fully covering short-term debt of HUF 5.0bn due in the 12 months to end-December 2024. The liquidity assessment is further supported by the company's consistent track record of rolling over or repaying debt, the absence of significant debt maturities in the short term and the availability of undrawn loan limits (HUF 5.6bn unused at end-2023 that do not expire before the end of 2025). Liquidity and refinancing risks are therefore manageable.

Scope highlights that Bayer Construct Zrt.'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 30.1bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 15 days). Such development could adversely affect the company's liquidity profile. There is currently no rating headroom to entering the grace period. Given the limited headroom, the company must at least maintain its current credit profile to avoid triggering the rating-related covenant.

Supplementary rating drivers: credit-neutral. Supplementary rating drivers have no impact on the issuer rating.

Outlook and rating sensitivities

The **Outlook** is **Stable** and reflects Scope's view that Bayer Construct will successfully execute on its order backlog while keeping leverage under control with a debt/EBITDA of below 4x. The Stable Outlook also reflects the good visibility on revenues in 2024-25 stemming from the backlog execution.

The **upside scenario** for the rating and Outlook is:

1. Significant improvement in Bayer Construct's business risk profile, i.e. improved outreach, geographic diversification and reduced concentration in the order backlog, while maintaining moderate credit metrics

The **downside scenarios** for the ratings and Outlooks are (individually):

1. Debt/EBITDA exceeding 6x on a sustained basis

2. Worsening of liquidity (deemed remote for the time being)

Debt rating

Scope has affirmed the B+ rating on senior unsecured debt issued by Bayer Construct Zrt. Scope expects an 'average' recovery for outstanding senior unsecured debt in a hypothetical default scenario in 2025 based on the company's liquidation value.

Environmental, social and governance (ESG) factors

Overall, ESG factors have no impact on this credit rating action.

All rating actions and rated entities

Bayer Construct Zrt.

Issuer rating: B+/Stable, affirmation

Senior unsecured debt rating: B+, affirmation

**All credit metrics refer to Scope-adjusted figures.*

Stress testing & cash flow analysis

No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlook, (General Corporate Rating Methodology, 16 October 2023; Construction and Construction Materials Rating Methodology, 25 January 2024), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity and Scope Ratings' internal sources.

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Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings and/or Outlook were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.

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The Credit Ratings/Outlook were first released by Scope Ratings on 31 August 2021. The Credit Ratings/Outlook were last updated on 9 August 2023.

Potential conflicts

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ISSUERS 1

INSTRUMENTS 1