VIAVIN Epitoipari Zrt.
Hungary, Construction

B- STABLE

Corporate profile

VIAVIN Epitoipari Zrt. (VIAVIN) is a private, majority owner-managed construction company, focussed on the Hungarian market for road and railway construction. It was founded in 2015, has about 80 employees and generates around HUF 4.5bn of annual revenue, primarily as a first-line subcontractor in large civil engineering projects. The company is planning to expand and renew its fleet of operating machinery via a debt-financed capital expenditure programme.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA interest cover (x)	22.4x	34.1x	7.3x	6.5x
Scope-adjusted debt (SaD)/SaEBITDA (x)	1.2x	3.5x	4.9x	3.6x
Scope-adjusted FFO/SaD (%)	65%	18%	34%	21%
Free operating cash flow/SaD (%)	17%	-91%	-52%	4%

Rating rationale

Scope Ratings GmbH (Scope) has assigned a first-time private issuer rating of B-/Stable to VIAVIN Epitoipari Zrt. A first-time rating of B- has been assigned to the company's senior unsecured debt.

VIAVIN's business risk profile (assessed at B-) benefits from its robust operating profitability, with a Scope-adjusted EBITDA margin of around 10% from its core activities as a subcontractor in the construction industry. The company's market position is a credit weakness due to its limited overall size, reflected in around HUF 4.0-4.4bn (EUR 11m-12m) in total annual revenue in recent years. Moreover, the intense competition in the CEE construction market implies little to no pricing power for companies, especially as second-line contractors. Diversification is very limited with full exposure to one niche of the construction industry (road and railway) exclusively within Hungary. Client and project diversification is also weak as one first-line contractor for major projects poses cluster risk with more than 60% of external revenue in 2020. However, such cluster risk is partially mitigated by the different services offered in VIAVIN's portfolio together with good creditworthiness of major clients.

The company's financial risk profile (assessed at B+) is mainly supported by its debt protection, with Scope-adjusted interest cover between 7x-10x. This is a sufficient level to service interest payments and even provide some headroom to cover for potential cash flow volatility driven by high client concentration. Financial leverage has been very moderate in the past, but we expect it to grow due to the envisaged debt-financed capex programme. We anticipate that Scope-adjusted debt (SaD) will grow by around HUF 2bn subject to the planned senior unsecured bond issuance within Q4 2021. Leverage has increased in recent years, from SaD/Scope-adjusted EBITDA below 1.0x to 3.5x as of year-end 2020. This is a consequence of greater debt-financed capex in 2019 and especially 2020. The capex has been used to renew and expand VIAVIN's fleet of trucks and construction machinery in anticipation of increasing project volumes as well as to improve operating margins via efficiency gains.

Ratings & Outlook

Corporate ratings	B-/Stable
Senior unsecured rating	B-

Analyst

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Related Methodologies

Corporate Rating Methodology

Rating Methodology European Construction Corporates

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We expect leverage, based on SaD/Scope-adjusted EBITDA, to stay between 3.4x and 4.0x in 2021 and 2022 before improving back to levels below 3.0x after 2022, subject to a positive operating result development in line with our financial base case.

Liquidity is adequate since the planned investments in smart construction machinery are both discretionary and granular. We further assume that VIAVIN will have sufficient liquidity throughout the forecast period of our financial base case, given a successful placement of the planned HUF 2bn in senior unsecured debt within Q4 2021.

The current company structure leads to very high key person risk regarding founder, CEO and 75%-owner Mr. Béla Schmidt. Order flow (which is typically t+1 year for subcontractors) is largely generated by Mr. Schmidt thanks to his personal track record and industry network. The concentration of power and responsibilities on Mr. Schmidt as majority owner, founder, technical expert in civil engineering, CEO and relevant sales person poses substantial additional credit risk. We therefore apply a downward adjustment of one notch for governance and structure.

Outlook and rating-change drivers

The Outlook is Stable and reflects our view that leverage on a consolidated basis will remain at SaD/EBITDA of below 4x from 2022 onwards. However, credit metrics will stay volatile due to a concentrated backlog. The Stable Outlook also reflects a successful HUF 2bn bond issuance and the completion of the planned PPE renewal programme.

A positive rating action is remote but may be warranted if VIAVIN substantially improves visibility on revenues, i.e. improves the order backlog picture, while keeping SaD/Scope-adjusted EBITDA below 4x on a sustained basis.

A negative rating action could occur if liquidity were to worsen or SaD/EBITDA were to increase to more than 5x on a sustained basis. Liquidity may be negatively affected by a sudden drop in order intake and thus prepayments or if VIAVIN becomes exposed to non-recoverable cost overruns or fails to successfully refinance the envisaged capex programme.

Rating drivers

Positive rating drivers	Negative rating drivers
• Specialised Hungarian second-line contractor with relevant niche track record • Moderate diversification of services • Relatively moderate financial leverage	• Very small size with under HUF 5bn (EUR 15m) in total annual revenue • Weak geographical diversification with exclusive focus on Hungarian (infrastructure) construction industry, leaving cash flows vulnerable to any deterioration in sector demand • Substantial key person risk • High customer concentration, partially mitigated by robust credit quality of clients • Low medium-term visibility on cash flows due to order backlog only covering t+1 projects • Expected increase in leverage following the planned bond transaction

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Substantially improved visibility of revenues, i.e. improved order backlog picture, while keeping SaD/Scope-adjusted EBITDA below 4x on a sustained basis	• Deteriorating liquidity or SaD/EBITDA of more than 5x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA interest cover (x)	22.4x	34.1x	7.3x	6.5x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA (x)	1.2x	3.5x	4.9x	3.6x
Scope-adjusted FFO/SaD (%)	65%	18%	34%	21%
Free operating cash flow/SaD (%)	17%	-91%	-52%	4%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	484	349	634	789
Adjustments	0	0	0	0
Scope-adjusted EBITDA	**484**	**349**	**634**	**789**
Scope funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA	484	349	634	789
less: cash interest as per cash flow statement	-22	-10	-86	-121
less: cash tax paid as per cash flow statement	-9	-8	-30	-40
Δ Provisions	-78	-107	539	-40
Scope funds from operations	**375**	**224**	**1,057**	**588**
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	577	1,235	3,084	2,842
less: cash, cash equivalents	-284	-57	-466	-452
add: cash not accessible[1]	284	57	466	452
Scope-adjusted debt	**577**	**1,235**	**3,084**	**2,842**

[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

As construction services are forecasted to remain at more than 90% of VIAVIN's revenues and EBITDA, we have determined the company's industry risk using our construction methodology. While the industry's cyclicality is high, it also has low market entry barriers as initial investments are relatively low. Large-scale civil engineering projects have higher market entry barriers and often have multi-year visibility on revenues and counterparties with high credit quality, e.g. governments.

However, since VIAVIN does not profit from the crucial credit-supportive features of civil engineering as a first-line subcontractor, we have assigned it a blended industry risk of B, as for normal contractors. In particular, both the multi-year visibility of large-scale projects and the higher entry barriers are not directly applicable to VIAVIN as a subcontractor.

Strong demand for civil engineering in Hungary

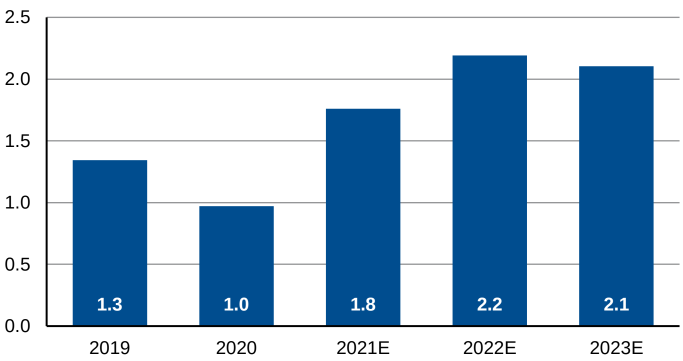
VIAVIN has benefitted from the strong rise in demand for road and railway building projects in Hungary, with annual revenue growing to over HUF 4bn in recent years. Nevertheless, the company is a very small player in the construction industry in both a European and national context. As a small company in a competitive, usually price-taking market, it does not have significant visibility or bargaining power, resulting in a credit-negative assessment of its market position.

Cluster risks regarding largest client, which represents over 60% of revenue

Geographical diversification is weak, as VIAVIN generates 100% of its revenue in Hungary, its domestic market. Low geographical diversification bears the risk of exposure to the construction cycle of one region. The company also has a relatively clustered client base with over 60% revenue exposure to several companies within the Colas group. In addition, around 14% of revenues are related to UNI-CITY Kft., which is majority-owned by Mr. Czirjak who is also a 25% owner in VIAVIN.

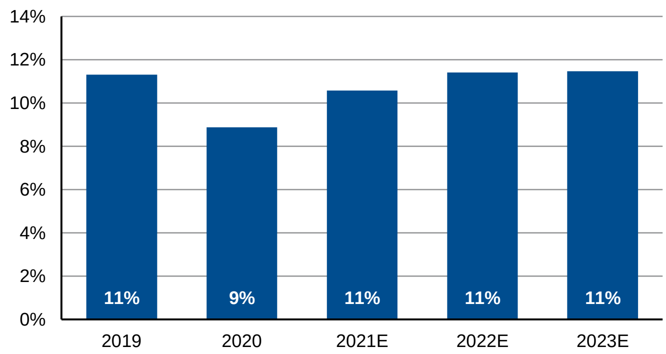
A mitigant to the credit risks associated with this lack of client diversification is the fact that Colas is part of the Bouygues SA group of companies, which is believed to have a very good level of creditworthiness.

Figure 1: Scope-adjusted EBITDA (EUR m)



Sources: VIAVIN Epitoipari, Scope

Figure 2: Scope-adjusted EBITDA margin (%)



Sources: VIAVIN Epitoipari, Scope

EBITDA margins of around 10% expected in the medium term

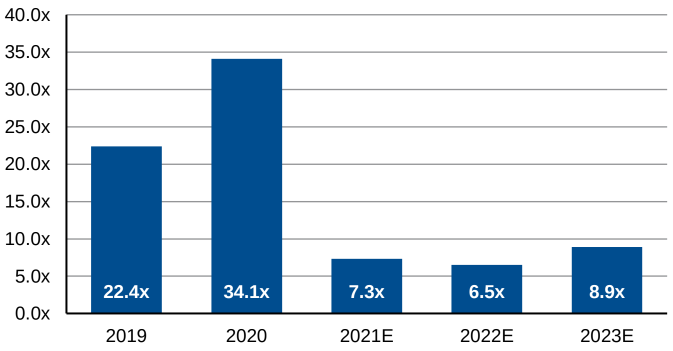
We expect Scope-adjusted EBITDA margins to remain at around 10% to 12%. Margins differ across business lines: whereas construction and logistics have achieved EBITDA margins of roughly 10%-13%, sub-contracted services and building materials have only generated an EBITDA margin of around 5%. Nevertheless, the operating margins on construction and logistics benefit VIAVIN's business risk profile. In addition, the company expects those operating margins (within the construction division) to further improve via the use of highly automated smart construction equipment as part of the envisaged capex programme.

Financial risk profile: B+

Scope-adjusted EBITDA interest cover expected to stay substantially above 4x

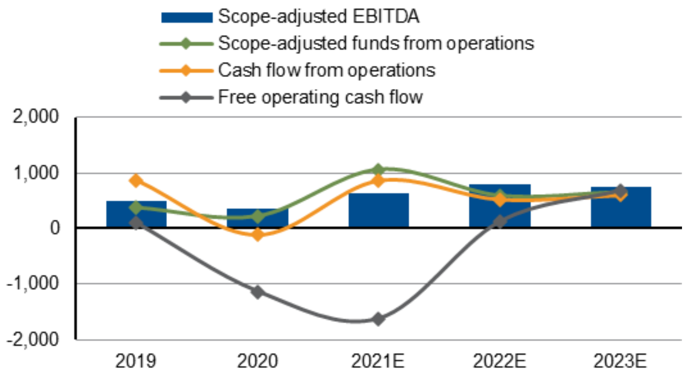
We expect Scope-adjusted EBITDA interest cover to stay at comfortable levels. Thanks to limited financial debt in the past, interest coverage has historically been clearly at double-digit levels. The placement of the HUF 2bn corporate bond and the investment programme will lead to Scope-adjusted interest coverage of 6.0x to 9.0x in our financial base case. We again note the very limited visibility of future revenues and thus Scope-adjusted EBITDA, which leads us to underweight interest cover in our overall assessment.

Figure 3: Scope-adjusted EBITDA interest cover (x)



Sources: VIAVIN Epitoipari, Scope estimates

Figure 4: Cash flows (HUF m)



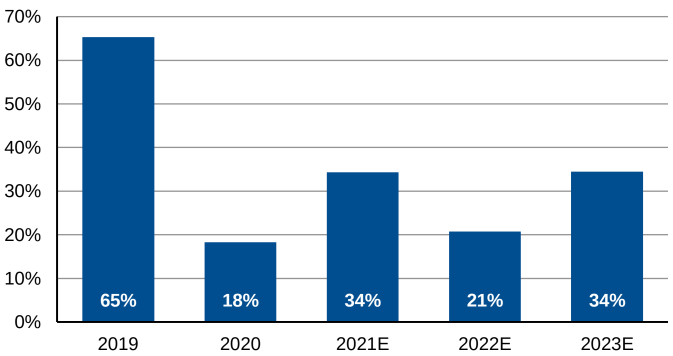
Sources: VIAVIN Epitoipari, Scope estimates

Scope-adjusted debt/EBITDA expected to increase due to capex programme

VIAVIN has achieved sufficient levels of Scope-adjusted funds from operations and free operating cash flow compared to its financial debt position in the past. We expect free operating cash flows to turn highly negative in 2020/21 due to increased capital expenditure.

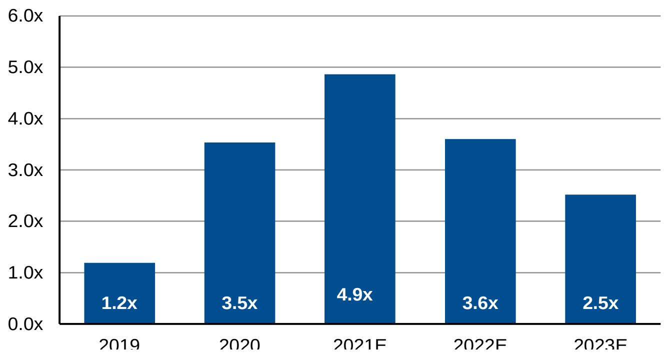
In the medium term (2022 and beyond) the additional machinery should enable VIAVIN to increase its total operating capacity and also improve margins in the construction segment via the use of smart/computer-aided state-of-the-art machinery.

Figure 5: Scope-adjusted funds from operations/SaD (%)



Sources: VIAVIN Epitoipari, Scope estimates

Figure 6: SaD/EBITDA



Sources: VIAVIN Epitoipari, Scope

The anticipated development of Scope-adjusted funds from operations/SaD mirrors the anticipated steady increase in revenues at stable margins (based on our assumptions and haircuts regarding the company's business plan). Financial debt will increase further following the planned bond placement in 2021.

Since the planned investments in smart construction machinery are both discretionary and granular, we assume that VIAVIN will have sufficient liquidity throughout the forecast period of our financial model given a successful placement of the planned HUF 2bn in senior unsecured debt within Q4 2021.

We consider liquidity to be adequate. In detail:

Position (HUFm)	2021E	2022E
Short-term debt (t-1)	445.9	546.7
Unrestricted cash (t-1)	56.6	465.7
Free operating cash flow (t)	-1,616.1	122.9
Open committed credit lines (t-1)	0.0	0.0
Liquidity (internal and external)	**-3.5x**	**1.1x**

Long-term debt instrument ratings

Senior unsecured debt rating: B-

VIAVIN plans to issue a HUF 2bn senior unsecured corporate bond. Proceeds from the bond are earmarked for the acquisition of new construction machinery. The bond's tenor is nine years, and it will amortise from year three to year eight in equal instalments of 10% annually with a 40% balloon at maturity. The coupon will be fixed and payable on an annual basis.

Our recovery analysis assumes a potential default at year-end 2023 and is based on VIAVIN's liquidation value, as we assume that the sum of the company's parts would have higher value than a going concern valuation. Based on the recovery analysis, we expect an 'average recovery' for the company's senior unsecured debt, also in light of a possible increase in senior secured debt prior to a potential default. This results in a B- rating for the senior unsecured debt class in line with the issuer rating.

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