# ENSI Kft.
# Hungary, Construction

SCOPE B+ STABLE

## Corporate profile

ENSI Kft. is a Hungarian construction company specialised in mechanical engineering in the areas of heating, cooling, ventilation and hot water. The company was established in 1994 and is owned by ENSI's founder and CEO, László Németh, along with his three sons. The company's headquarters are in Budapest and its geographical focus is on the Hungarian capital. On top of mechanical engineering implementation (around 90% of total revenue), the company also engages in consulting, planning and maintenance.

## Key metrics

| | | | Scope estimates | |
|---|---|---|---|---|
| **Scope credit ratios** | **2019** | **2020** | **2021E** | **2022E** |
| EBITDA/interest cover (x) | N/A[1] | N/A[1] | N/A[1] | 8.2x |
| Scope-adjusted debt (SaD)/EBITDA | N/A[1] | N/A[1] | N/A[1] | 1.9x |
| Scope-adjusted funds from operations/SaD | N/A[1] | N/A[1] | N/A[1] | 42% |
| Free operating cash flow/SaD | N/A[1] | N/A[1] | N/A[1] | 40% |

## Rating rationale

**Scope Ratings has assigned a first-time issuer rating of B+/Stable to ENSI Kft. and a B+ rating to its senior unsecured debt.**

The company's business risk profile reflects its market leadership in the niche construction segment of mechanical engineering, with a varied project portfolio and wide range of references (sports facilities, housing, offices, factories and warehouses). The rating benefits from the issuer's robust credit metrics through its ability to operate without external financing and its above-average Scope-adjusted EBITDA margin (2020: 13.6%). We expect operating profitability to remain close to historical averages.

The rating is constrained by ENSI's small scale both in a European and Hungarian context. The relatively small size makes the company more vulnerable to macroeconomic shocks and less able to mitigate economic cycles. The rating is further constrained by a lack of geographical diversification. ENSI is only active on the Hungarian market, with the vast majority of projects centred around the Budapest area. Moreover, the company's contracted backlog covers a fairly short timeframe (one year), providing limited visibility on future cash flows.

Liquidity is adequate, as sources (HUF 2.3bn of cash available as at YE 2021 and Scope-adjusted free operating cash flow of HUF 2.2bn forecasted for 2022) fully cover uses (the company has no short-term debt as at YE 2021).

## Outlook and rating-change drivers

The Outlook is Stable and incorporates our assumption that operating profitability will remain close to historical averages (Scope-adjusted EBITDA of around 14%) while Scope-adjusted debt/EBITDA remains around 3x. The Stable Outlook also reflects a successful HUF 5bn bond issuance under the Hungarian National Bank's Bond Funding for Growth Scheme in Q1 2022.

[1] no external debt

### Ratings & Outlook

| | |
|---|---|
| Corporate ratings | B+/Stable |
| Senior unsecured rating | B+ |


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### Related Methodologies

Corporate Rating Methodology: 6 July 2021

Rating Methodology: European Construction Corporates 15 January 2021


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A positive rating action is remote at this point but may be warranted if ENSI manages to improve its business risk profile – providing higher visibility on future cash flows and greater geographical diversification, while keeping Scope-adjusted EBITDA/Scope-adjusted debt at around 3.0x in the medium term.

A negative rating action might be warranted by Scope-adjusted debt/EBITDA of above 4.0x on a sustained basis, caused by worsening profitability or the need for additional external financing. Additionally, worsening of liquidity due to, for example, delayed customer payments or cost overruns might warrant a negative rating action.

## Rating drivers

| Positive rating drivers | Negative rating drivers |
|---|---|
| • Historically strong operational profitability (EBITDA margin averaging around 14%)<br>• Strong financial risk profile with no external debt before the expected bond issuance<br>• Market leader in niche construction segment of mechanical engineering, with 20% market share | • Small construction company in the context of both Europe and Hungary and lack of geographic diversification<br>• High customer concentration, with top five customers accounting for 80% of total revenues<br>• Backlog providing limited future insight, with 82% of current orders to be realised in 2022 |

## Rating-change drivers

| Positive rating-change drivers | Negative rating-change drivers |
|---|---|
| • Improving business risk profile while keeping SaD/EBITDA at around 3.0x | • SaD/EBITDA of above 4.0x on a sustained basis<br>• Worsening liquidity |

## Financial overview

| | | | Scope estimates | |
|---|---|---|---|---|
| **Scope credit ratios** | **2019** | **2020** | **2021E** | **2022E** |
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| Scope-adjusted debt (SaD)/EBITDA | N/A[1] | N/A[1] | N/A[1] | 1.9x |
| Scope-adjusted funds from operations/SaD | N/A[1] | N/A[1] | N/A[1] | 42% |
| Free operating cash flow/SaD | N/A[1] | N/A[1] | N/A[1] | 40% |
| **Scope-adjusted EBITDA in HUF ‘000s** | **2019** | **2020** | **2021E** | **2022E** |
| EBITDA | 1,802,757 | 1,820,919 | 2,574,814 | 2,676,025 |
| Operating lease payments in respective year | 0 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 |
| **Scope-adjusted EBITDA** | **1,802,757** | **1,820,919** | **2,574,814** | **2,676,025** |
| **Scope-adjusted funds from operations in HUF ‘000s** | **2019** | **2020** | **2021E** | **2022E** |
| EBITDA | 1,802,757 | 1,820,919 | 2,574,814 | 2,676,025 |
| less: (net) cash interest as per cash flow statement | -3,029 | -522 | -2,000 | -325,000 |
| less: cash tax paid as per cash flow statement | -170,935 | -183,725 | -246,082 | -224,391 |
| add: dividends received from shareholdings | 0 | 35,506 | 60,882 | 45,000 |
| **Scope-adjusted funds from operations** | **1,628,793** | **1,672,178** | **2,387,615** | **2,171,634** |
| **Scope-adjusted debt in HUF ‘000s** | **2019** | **2020** | **2021E** | **2022E** |
| Reported gross financial debt | 0 | 0 | 0 | 5,000,000 |
| less: hybrid bonds | 0 | 0 | 0 | 0 |
| less: cash and cash equivalents | 0 | 0 | 0 | 0 |
| add: cash not accessible | 0 | 0 | 0 | 0 |
| add: pension adjustment | 0 | 0 | 0 | 0 |
| add: operating lease obligations | 0 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 |
| **Scope-adjusted debt** | **0** | **0** | **0** | **5,000,000** |

## Business risk profile: B

**Industry risk: B**

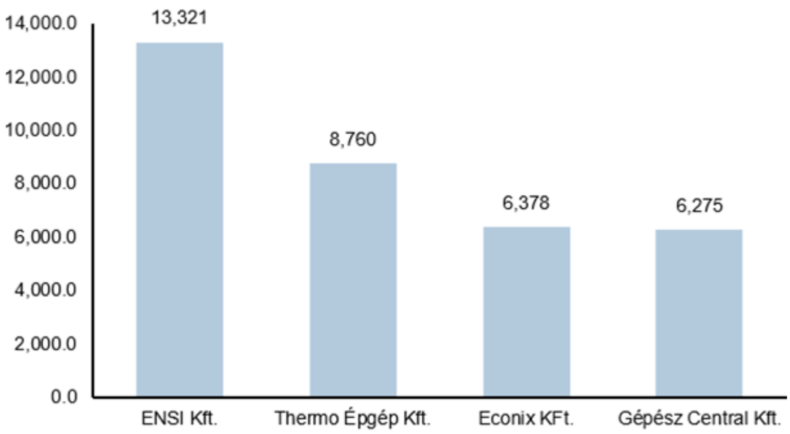
ENSI predominantly acts as a contractor specialized in mechanical engineering. This sub-sector of the construction industry is characterised by a low need for capital investment but a need for specialised knowledge, competencies and references to ensure competitiveness. We assess the market entry barriers to be low, together with the high cyclicality and low substitution risk of the construction industry, leading to an associated industry risk assessment of B.

**Small in European and Hungarian contexts, but market leader in niche**

ENSI is a small sized constructor in the context of the European and Hungarian construction markets. The small size leads to more volatile cash flows and higher exposure to external shocks. Small size is compensated for in part by its market leadership in Hungary in its niche of mechanical engineering. ENSI's revenue has grown rapidly in recent years, reaching HUF 13.3bn in 2020 and expected to grow 40% in 2021 to reach HUF 18.7bn. This growth is fuelled by the organic growth of the Hungarian construction sector.

ENSI's size is limited compared to the leading Hungarian construction companies, which are general contractors with a wide scope of activities and strong focus on public procurement. However, ENSI is market leader in its niche with 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 require specialised knowledge and higher added value.

**Figure 1: ENSI Kft. and direct peers by revenue in 2020 (HUF m)**




**Low geographical and segment diversification**

As the company is only active in Hungary, geographical diversification is weak. Around 65% of its ongoing projects centre on the Budapest area, with the rest in rural areas. The company is active in one segment of the construction industry based on the 2021 order book: buildings. This makes the company more vulnerable towards shifts in demand and slowdown of sector growth. The weak segment diversification is partially mitigated by wide range of projects undertaken within the buildings segment: sports facilities, offices, factories and industrial complexes.

**Stable, strong operational profitability**

The volatility of ENSI's profitability is low, with the EBITDA margin stable at 14%-15% in the past three years, driven by the continuously growing demand in the sector. We assume a slightly lower EBITDA margin (around 13%) in the upcoming years, mainly due to strong pressure from the rising raw material prices and domestic wages.

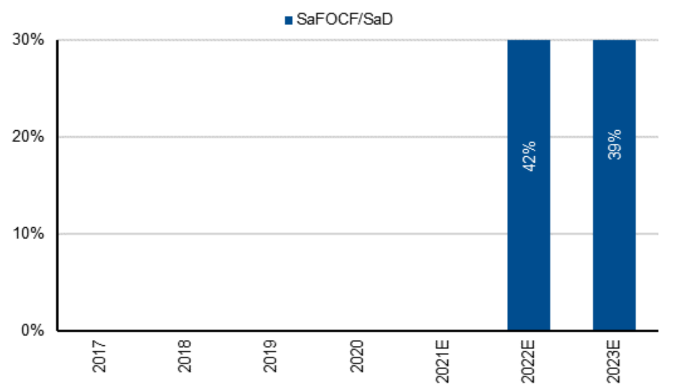
## Financial risk profile: BB+

**Debt-free operations have led to comfortable interest coverage and leverage**

The company has been operating without the use of bank debt, resulting in minimal interest expenses. The planned HUF 5bn bond issuance with an anticipated coupon of 6.5% is expected to increase interest expense to HUF 325m per year, resulting in an EBITDA interest coverage in excess of 5x.

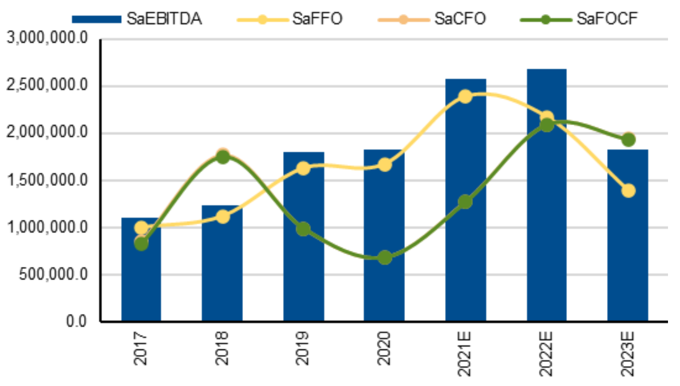
Given ENSI's strong EBITDA and assuming interest remains stable, interest payment obligations after the bond issuance are expected to be comfortably met.

**Figure 2: Cash flow cover**




Source: ENSI, Scope

**Figure 3: Cash flows (HUF '000s)**




Source: ENSI, Scope

Historical leverage ratios are not meaningful due to ENSI's lack of debt. The bond issuance in Q1 2022 is expected to push up leverage moderately in the coming years, to a SaD/EBITDA of 2x-3x and a funds from operations/SaD in between 25-45%.

We have excluded performance guarantees from SaD as they have never been drawn on. Restricted cash (cash deposit required for guarantees are calculated in SaD, but the effect is only minimal historically) has been around HUF 30m in past years but we assume it to increase to HUF 215m due to the higher level of cash deposit needed as security for performance guarantees.

**Stable cash generation in the medium term**

Operating cash flows have been positive (Scope-adjusted EBITDA and Scope-adjusted funds from operations) with slight fluctuations in Scope-adjusted free operating cash flow due to year-end spikes for working capital needs. In view of the current backlog, the strong cash generation is expected to continue in 2022 and to a lower extent in 2023 (due to the relatively short timeframe of the orderbook and limited visibility beyond 2022). We anticipate maintenance capex of HUF 8m per year, a level similar to the period in between 2018-2020. We expected dividend payments of HUF 1.8bn in 2022 and HUF 2.3bn in 2023 as well as HUF 5.0bn for M&A in 2022-2023 including the acquisition of engineering material wholesalers and retailers, in line with the company's strategy to enter the segment and achieve synergies and economies of scale.

**Adequate liquidity**

We assess ENSI's liquidity as adequate. In detail:

| Position | 2021E | | 2022E | |
|---|---|---|---|---|
| Unrestricted cash (t-1) | HUF | 1.70bn | HUF | 2.28bn |
| Open committed credit lines (t-1) | HUF | 0.00bn | HUF | 0.00bn |
| Free operating cash flow | HUF | 1.27bn | HUF | 2.09bn |
| Short-term debt (t-1) | HUF | 0.00bn | HUF | 0.00bn |
| **Coverage** | | **No short term debt** | | **No short term debt** |

Liquidity is adequate, as sources (HUF 2.3bn of cash available as at YE 2021 and Scope-adjusted free operating cash flow of HUF 2.2bn forecasted for 2022) fully cover uses (the company has no short-term debt as at YE 2021).

## Senior unsecured debt rating

**Senior unsecured debt rating: B+**

ENSI Kft. plans to issue a HUF 5bn bond under the Bond Funding for Growth Scheme of the Hungarian National Bank. Based on the indicative terms provided to us, the bond's tenor is 10 years with 10% of its face value subject to yearly amortisation from 2027 onwards, with the remaining 50 % due in 2032. The coupon, assumed at maximum 6.5%, will be fixed and payable on an annual basis. Proceeds are earmarked for M&A including the acquisition of engineering material wholesalers and retailers, in line with the company's strategy to enter the segment and achieve synergies and economies of scale. The preliminary bond prospectus includes a 70% cap on dividend payment during the tenor of the bond.

Our recovery analysis is based on a hypothetical default scenario in 2023. We expect an 'average' recovery of the company's unsecured debt, taking into consideration the possible volatility of the capital structure, resulting in B+ rating for this debt class (same as the issuer rating).

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