Metál Hungária Holding Zrt.
Hungary, Construction

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	27.6x	13.8x	14.0x	14.3x
Scope-adjusted debt/EBITDA	3.2x	2.8x	2.3x	2.2x
Scope-adjusted funds from operations (FFO)/debt	27%	30%	37%	39%
Scope-adjusted free operating cash flow (FOCF)/debt	31%	-35%	33%	35%

Rating rationale

The rating for MHH is driven by the company's leading position in Hungary as a contractor in façade cladding and roof covering, a construction subsegment we believe benefits from medium barriers to entry. Furthermore, MHH benefits from long-standing relationships with its main clients. Both should help to protect the company's market position in the medium term. In addition, MHH's adequate customer diversification limits the impact of a single customer's default or poor payment behaviour. Furthermore, the rating benefits from the strong improvement of credit metrics following the hike caused by debt financed capex programme and working capital built-up.

The rating is mainly constrained by the company's sole exposure to Hungarian construction, leaving cash flows vulnerable to the expected cooldown in the domestic industry. Especially as we believe current market growth in non-residential building is a short-term exception, driven by strong foreign direct investment (FDI) inflows. Coupled with generally short project durations (typical for the segment), this will burden credit metrics in case of declining FDI under the current setup of MHH. We note that the company's financial policy tolerates a certain exposure to foreign exchange rate risk.

Outlook and rating-change drivers

The Outlook is Stable and reflects our view that credit metrics will stay at current levels, with Scope-adjusted debt/EBITDA below 3x despite impending headwinds including higher input prices, an unsupportive macroeconomic outlook, relatively low order backlog and limited visibility on the resilience of FDI inflows currently boosting MHH's top line growth. Furthermore, we assume that dividend and dividend-like pay-outs to entities owned by MHH's shareholders will not exceed the company's FOCF on average.

A positive rating action is seen remote at present but may be warranted if the company improves its diversification in terms of construction segments and/or geographic regions to partially decouple its top line from FDI inflows that currently supports its business. At the same time, we expect credit ratios to remain at or below current levels, with MHH's leverage, as measured by Scope-adjusted debt/EBITDA, of below 3x on a sustained basis.

A negative rating action could occur if Scope-adjusted debt/EBITDA increases to above 3x. An increase in leverage could be triggered by either: i) an adverse operational development leading to reduced profitability and cash flows; or ii) higher dividend and dividend-like pay-outs in excess of FOCF.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
12 Sep 2022	Upgrade	BB-/Stable
4 Oct 2021	Outlook change	B+/Positive
30 Sep 2020	No action	B+/Stable

Rating & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

Analysts

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Related Methodologies

Corporate Rating Methodology; July 2022

Construction and Construction Materials Rating Methodology; January 2022

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Positive rating drivers	Negative rating drivers
• Market leader in its niche segment, with position protected for the medium term by medium entry barriers for specialty construction (façade cladding and roof covering) and long-standing relationships with clients • Adequate customer diversification and credit quality limits the impact of a single customer's default or poor payment behaviour • Strong debt protection benefitting from no immediate financing needs, fixed interest rates and positive fx-effects • Improved leverage thanks to strong cash generation enabling debt amortization/repayment • Relatively low fixed costs support positive FOCF throughout the construction cycle • Improved profitability driven by elimination of non-business-related grants to direct owners and cost savings enabled by investments into the company's PPE	• Small construction company, but market leader in its niche segment • Exposed to domestic construction industry, leaving cash flows vulnerable to the expected cooldown • Weak segment diversification as all activities serve the same domestic end-markets • Improved backlog but short project durations (typical for the segment) limit cash flow visibility

Positive rating-change drivers	Negative rating-change drivers
• Improved diversification regards segments and geographies while credit metrics remain at or below current levels	• Scope-adjusted debt/EBITDA above 3x

Corporate profile

Founded in 1996, Metál Hungária Holding Zrt. (MHH) is a construction firm focused solely on the niche market for roofing and cladding, including some activities in the design, manufacturing, assembly, and supply of steel products for its own construction sites. According to the company, MHH is an independent market leader in Hungary for façade cladding and roof covering. As such, it has been involved in all the country's major industrial, logistic, commercial and recreation development projects in recent years.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	29.2x	27.6x	13.8x	14.0x	14.3x	14.9x
Scope-adjusted debt/EBITDA	1.0x	3.2x	2.8x	2.3x	2.2x	2.0x
Scope-adjusted FFO/debt	105%	27%	30%	37%	39%	41%
Scope-adjusted FOCF/debt	40%	31%	-35%	33%	35%	37%
Scope-adjusted EBITDA in HUF m						
EBITDA	3,157	2,865	5,339	7,445	7,463	7,467
Operating lease payments	227	227	633	633	633	633
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**3,383**	**3,092**	**5,972**	**8,078**	**8,096**	**8,100**
FFO in HUF m						
Scope-adjusted EBITDA	3,383	3,092	5,972	8,078	8,096	8,100
less: cash interest as per cash flow statement	-35	-32	-208	-352	-342	-320
less: interest component operating leases	-80	-80	-225	-225	-225	-225
less: cash tax paid as per cash flow statement	161	-275	-469	-655	-771	-775
add: dividends received from shareholdings	0	0	0	0	0	0
FFO	**3,429**	**2,705**	**5,071**	**6,846**	**6,759**	**6,781**
FOCF in HUF m						
FFO	3,429	2,705	5,071	6,846	6,759	6,781
Change in working capital	-1,983	477	-10,456	-285	-74	-71
less: depreciation component operating leases	-146	-146	-408	-408	-408	-408
less: capital expenditure	0	0	0	-113	-118	-118
add: divestments	19	1	0	0	0	0
FOCF	**1,319**	**3,037**	**-5,794**	**6,039**	**6,160**	**6,184**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-35	-32	-208	-352	-342	-320
add: interest component, operating leases	-80	-80	-225	-225	-225	-225
Net cash interest paid	**-116**	**-112**	**-433**	**-577**	**-567**	**-545**
Scope-adjusted debt in HUF m						
Reported gross financial debt	1,748	10,544	14,500	14,000	13,094	12,188
less: cash and cash equivalents	-417	-7,214	-9,849	-12,071	-14,058	-15,515
add: non-accessible cash[1]	326	4,985	1,205	11,927	13,914	15,371
add: operating lease obligations	1,610	1,610	4,499	4,499	4,499	4,499
Scope-adjusted debt (SaD)	**3,266**	**9,924**	**10,355**	**18,355**	**17,449**	**16,543**

[1] Netting of cash: generally, only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible. Thus, cash not accessible represents cash and cash equivalents on balance sheet that is not netted, even if it is freely accessible as we lack visibility on the permanence of this item.

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Environmental, social and governance (ESG) profile[2]

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)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Improved corporate governance

The company is owned in equal shares by József Kreinbacher (CEO) and Josef Unger, with no independent board to provide oversight functions. The credit-negative procedure whereby MHH provides, on a recurring basis, non-business-related grants to Mr. Kreinbacher's other ventures (HUF 0.3bn to HUF 1.7bn accounted for as other expenses) has been eliminated in FY 2021. This is a consequence of a restructuring of ownership interests in the company that year. For tax and structural reasons, Mr. Kreinbacher has contributed all of his shares in MHH to the newly established Kreinbacher Invest Zrt. (a holding company for Mr. Kreinbacher's equity stakes in different undertakings, including MHH) as a payment in kind. As a consequence, earnings will solely be distributed to Kreinbacher Invest Zrt. via dividends and the holding company will finance Mr. Kreinbacher's other ventures. In addition, both owners have agreed on a significant reduction of Mr. Unger's interest in MHH. Over the course of six years, Mr. Kreinbacher will acquire a 30% equity interest in MHH from Mr. Unger, increasing his interest in MHH to 80%. Acquisition costs will be paid by Kreinbacher Invest Zrt.

The industry is focused on reducing the use of energy and non-renewable materials as well as limiting the environmental footprint of construction projects and global operations. The social aspect is also relevant, especially regarding practices that could severely impair reputation and financial performance (e.g. corruption, stakeholder management). Malpractice would also impair the company's ability to win new orders or execute own projects and therefore threaten cash flow.

The following ESG risks are the most relevant for construction companies: i) rising costs and sustainable building materials; ii) efficient technologies; iii) health and safety of employees; and iv) litigation and bribery.

[2] 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

Industry risk profile: BB

MHH predominately acts as a contractor specialised in roofing and façade cladding as well as speciality low-weight construction (cleanrooms). These areas require specialist knowledge in both engineering and manual labour. Thus, we judge market entry barriers for this subsegment to be medium. Together with the generally high cyclicality and low substitution risk of the construction industry, this leads to an associated industry risk assessment of BB.

Small construction company, but market leader in its niche

Revenues for 2021 jumped to HUF 50bn (EUR 134m, up 45% YoY) as the market MHH operates in recovered from the Covid-ravaged 2020, which saw many projects postponed or cancelled. MHH's market share in Hungarian construction improved on the back of strong growth in its sub-segment of non-residential construction that surpassed HUF 1,500bn in 2021 for the first time, being fuelled by FDI inflows. We expect revenues to surpass HUF 60bn in 2022 and 2023, based on MHH's H1 2022 performance (HUF 31bn in revenues) and the stable order backlog (HUF 42bn as at end-June 2022[3]; down 5% YoY) which provides good revenue visibility.

Figure 1: MHH and peers (total revenues in FY2021[4] in HUF bn)

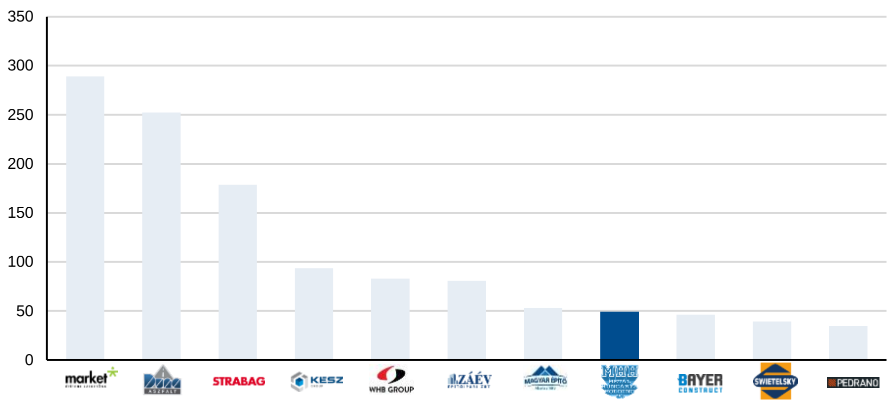
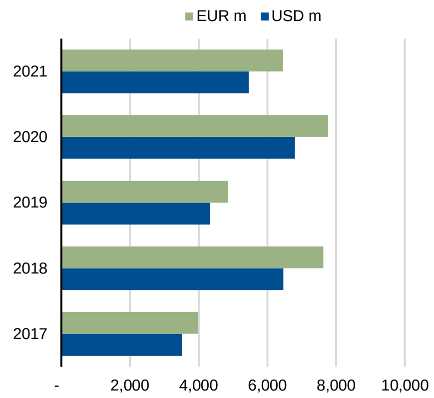


Figure 2: FDI inflows



Sources: MHH, Scope, public information

Growth will be driven by: i) MHH's improved access to large-scale projects such as battery factories for Samsung or SK Innovation; as well as ii) projects, especially from the automotive industry, which are currently up for tender following delays triggered by the Covid-19 pandemic.

- Improved access to large-scale projects is driven by the company's long-term relationships with key customers that proved advantageous, as did its ability to provide necessary capacities and a functioning supply chain for raw materials. This allowed it to deliver projects in time and quality, thus stabilising its market share. As a result, MHH won tenders for e.g., SK Innovation's second facility in Komáron in 2021, and the 3rd facility in Iváncsa, 50km southwest of Budapest, valued at HUF 8.6bn (EUR 22m). These projects make up a significant portion of MHH's backlog.
- The main project from the automotive industry - after a 2-year delay to the project - is BMW's new green automotive factory in Debrecen. The new facility comes after an investment of more than EUR 1bn by BMW and will see the factory produce the newest series production of purely electric vehicles in 2025.

[3] MHH has a total contracted order backlog of HUF 29.3bn for the rest of 2022, with an additional HUF 12.8bn for 2023
[4] Revenues of Swietelsky as of end-March 2021 and Pedrano as of end-December 2020; revenue of Bayer Construct (standalone)

In addition, we believe MHH will secure some of the larger projects currently up for tender with a total construction value of around HUF 100bn. This includes a HUF 28bn (EUR 70m) project with BMW and a HUF 24bn (EUR 60m) project with Mercedes. MHH is seen to be in a strong position to win these projects, as they have a long-standing relationship with both clients already and should be able to defend their market position. Thus, we expect the company's top line to remain stable throughout 2023.

We consider growth in the Hungarian construction market to be unsustainable, with previous sector growth directly and indirectly driven by fiscal stimulus or subsidies enabled by capital inflows of foreign direct investments and EU funds. However, political headwinds with the EU (a significant delay in the availability of EU funds) or a strong decline in FDI inflows might put pressure on sustained stimulus going forward. The latter might be triggered by weakened competitiveness of Hungary due to an ongoing lack of labour (amplified by the country's demographics) and a strong increase in investment costs (cost of capital, wages, inflation, etc.). As such we view MHH's strong link to the sub-segment of non-residential construction in Hungary with growth fuelled by FDI as a risk to the company's top line going forward.

Exposure to domestic construction industry makes cash flows vulnerable

Geographical diversification is weak, as MHH generates almost all of its revenue in the Hungarian construction industry. This is compounded by the fact that construction is a cyclical industry in which revenues and earnings tend to come under pressure in a downturn.

The recent growth in the Hungarian construction market is unsustainable. After a dynamic 2021 with HUF 5,389bn[5] in contracted volume (up 13% from 2020), perspectives are being limited by i) the impact of the Russia-Ukraine war; ii) rising materials costs; iii) labour and building materials shortages; and iv) rising interest rates. EVOSZ, the National Federation of Hungarian Building Contractors, expects government orders to decline significantly by around HUF 500bn and the volume of residential works to remain stagnant. A survey[6] conducted by EVOSZ also confirms the industry's negative sentiment/outlook: 83% of respondents indicated a lack of skilled workers and 77% mentioned procurement issues as their main obstacle. Regarding contract portfolios, 47% anticipate a decline and 27% a relatively stable business volume. From 2021 to 2022, labour costs are expected to rise by 15% on average and nearly 47% of respondents expect weaker profitability. However, the availability of raw and building materials has improved of late, with prices as of July 2022 already below January 2022 levels.

Construction activity, especially in the sub-segment MHH operates in, will be driven by high FDI inflows of above EUR 6bn (2021: EUR 5.9bn promoted from HIPA, the Hungarian Investment Promotion Agency) with some of the related projects extending until 2023. However, we believe this to be a short-term exception and we fail to see clear signs that these investments can be sustained at these levels. Especially as Hungary's competitiveness is likely to deteriorate due to an ongoing lack of labour (amplified by the country's demographics), increased wages, and a strong increase in investment costs (cost of capital, inflation, etc.).

As such, we expect MHH's sole exposure to Hungary – with an only marginal project-related side businesses – as a significant risk for the company.

[5] Source: EVOSZ
[6] Survey conducted by EVOSZ with 400 companies about their current market situation and expectations for 2022.

Weak segment diversification as all activities serve the same domestic end-markets

The company's segment diversification is also weak. MHH focuses on the construction and design of façade cladding and roof coverings, but also has minor operations in steel products as a supplier (trading activities) and producer (building materials). However, these activities are negligible for segment diversification as they serve the same end-markets (construction), exposing MHH to a small number of underlying demand patterns, and thus the industry's inherent cyclicality, leading to high cash flow volatility.

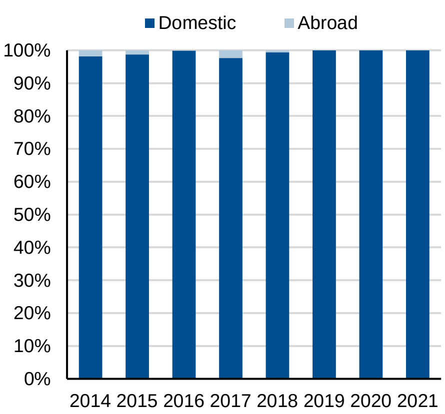
Enlarged, more diversified supplier network will support MHH's market positioning

We see the prices and the availability of basic materials as the main driver of successful project tenders in Hungarian construction. MHH has formed long-term relationships with suppliers[7] in the last 15 years and increased its outreach in the last 12 months to regional manufacturers from Belgium, the United Kingdom, Romania and Russia. We note that MHH no longer works with its Russian distributor and its share was negligible. Thus, we believe MHH is in a good position to gain market share going forward, with at least sufficient access to basic materials to cover the next 12 months in construction works.

Still adequate customer diversification

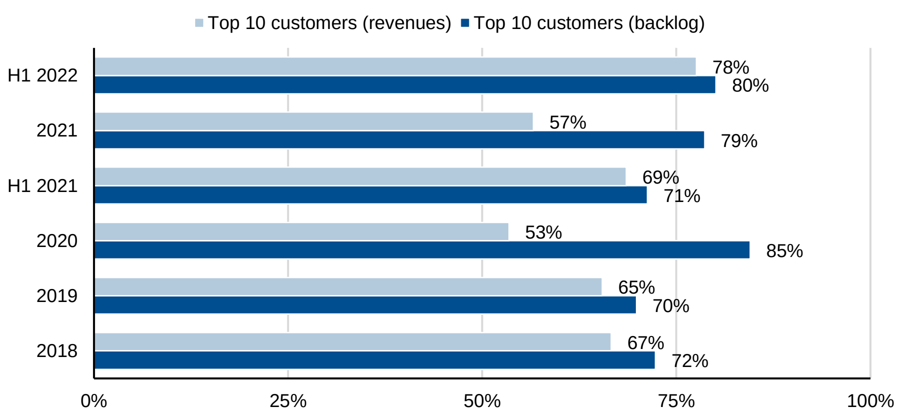
Customer diversification has weakened due to a sharper focus on large-scale projects: the top 10 customers accounted for 78% of end-June 2022's backlog (up 9pp YoY). The largest project (SK Innovation) is contributing approx. 20% of the backlog. The increased share of projects worth above HUF 1.5bn (about 65% of the company's backlog) for which MHH is a sub-contractor, loosens its dependency on the credit quality and payment behaviour of the general contractor or end-customer, as these projects are covered under a payment scheme[8] enforced by Hungarian law. We believe that risks associated with the remainder of the company's backlog are partially mitigated by the adequate credit quality of most of MHH's end-customers.

Figure 3: Geographical diversification by revenues



Sources: MHH, Scope

Figure 4: Customer concentration



Sources: MHH, Scope

MHH executes 60-90 projects with a volume of above HUF 10m yearly, pointing to a more granular customer base following the top 10. While these small projects are executed within 3-6 months, we also see higher revenue/intra-year customer diversification (top ten projects accounted for 57% of revenues in 2021), which will help to offset loss in revenue from delayed or cancelled projects, like in 2020. The relatively low share of government-related contracts (less than 2% of the order backlog as at end-June 2022) protects MHH from the decline in demand anticipated for central and local government projects.

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[7] Top 10 suppliers, including Arcelor Mittal, Kingspan, Rockwool, Knauf Insulation, provided around 50% of basic materials in 2021.

[8] To secure timely payment, customers are obliged to pay upfront the costs invoiced by the contractor for the next construction phase. The money is paid into an escrow account.

Improved profitability driven by elimination of non-business-related grants to direct owners

The volatility of MHH's profitability is medium, as measured by its Scope-adjusted EBITDA margin, which has fluctuated between 5% and 9% in the last few years before rising to 12% in 2021. The increase in profitability to above 10% should be sustained going forward, as the improvement is driven by the implementation of a new corporate structure in 2021. This structure eliminates non-business-related grants to other ventures of the direct owners of MHH (HUF 0.3bn to HUF 1.7bn annually in 2016-2020), accounted for as other expenses. Further support stems from cost savings enabled by investments made into own machinery, headquarters and a painting facility.

MHH's improved profitability provides the company with some headroom to protect market shares if larger peers initiate a fierce price war. However, the company's small scale sets a natural limit to the extent to which this is possible. This is especially the case as other contractors with a focus on façade cladding and roof covering, such as Lindner Group, Yuanda Europe or Porr AG, follow their customers to Hungary. We believe the associated risk is high as MHH's domestic customer base is weak, with more than two-thirds of its revenues stemming from foreign companies.

Stable backlog cash flow visibility to YE 2023

The company's backlog remained above 1x at YE 2021 (1.3x; up 0.1x YoY; 0.9x as at end-June 2022), thanks to a higher share of large-scale projects. We believe this is a short-term exception caused by strong FDI focusing on large-scale developments, which are driving non-residential building construction in Hungary at present. However, it is not clear whether these investments will continue going forward. We therefore expect MHH's backlog to decline below par in the medium term, however, which is typical for contractors focusing on façade cladding and roof covering, with project durations averaging 3-6 months[9]. As such, most contracts are executed within a year after they are signed. Thus, we deem the book-to-bill ratio to be more reliable regarding the company's ability to secure tenders and thereby ensure good future revenues. The book-to-bill ratio has been around 1x (2021: 0.9x) for the last couple of years, indicating fairly stable performance despite the volatility in Hungarian construction output in recent years.

Financial risk profile: BBB-

Low fixed costs support positive FOCF through the construction cycle

MHH has continuously generated positive, yet volatile, FOCF. Volatility will continue to be driven by changes in working capital, with construction work mostly pre-financed by the contractor. Risk for MHH associated with the continuous pre-financing of inventories is partially mitigated by a payment scheme enforced by law, which protects contractors from non-payment or late payments for projects larger than HUF 1.5bn (82% of MHH's backlog).

Contractors need to ensure the timely execution of work in order to gain a competitive advantage in bidding wars. This makes proven access to the necessary raw materials and blue-collar workers imperative. Previously, MHH mitigated working capital issues by offering advantageous payment terms for materials, generally 60 days after delivery, while ensuring raw material availability already 12 months in advance. Since late 2020, with the construction industry facing massive supply chain disruptions, vendors have started requesting a down payment when the order is placed.

In 2021, MHH used an additional HUF 10.5bn of working capital to finance their project pipeline. This led to a negative FOCF in 2021. However, this was a one-off effect, and FOCF is expected to be positive again in 2022, which should support cash flow cover with Scope-adjusted FOCF/debt expected to remain above 30%, but subject to volatility. Our view is based on MHH's low fixed annual cost base, at HUF 3.4bn for 2022-24,

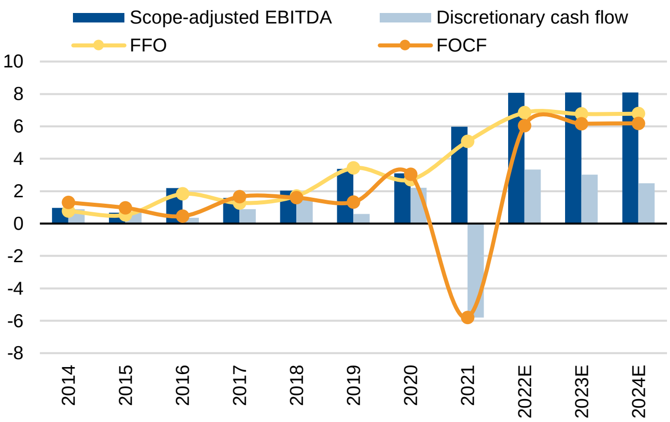
[9] Start of construction work up to delivery

including: HUF 2.8bn of operational expenditure; HUF 0.5bn of interest expense; and HUF 0.1bn of mandatory capital expenditure.

Increase in absolute indebtedness covered by return on investments

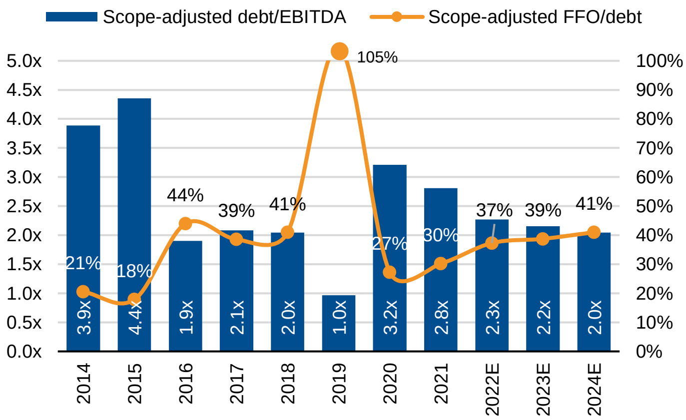
Leverage has been stable in recent years, with Scope-adjusted debt/EBITDA below 2x and Scope-adjusted FFO/debt of above 30%. However, with discretionary capital expenditure in 2020/21 as well as the build-up of inventories to maintain a competitive advantage over competitors financed with debt (total HUF 14.5bn in bonds), leverage increased significantly to around 3x (2021: 2.8x).

Figure 5: Cash flows (HUF bn)



Sources: MHH, Scope estimates

Figure 6: Leverage



Sources: MHH, Scope estimates

We believe the increase will be covered not only by the elimination of recurring non-recoverable grants paid in the past (up to 2020), but also by strong growth in the company's top line that benefits from its good standing in its niche market that thrives due to high FDI inflows as well as a sustained improvement in profitability (up to HUF 0.4bn per year). The latter will benefit from: i) the debt-financed investments into higher-margin real estate holdings; and ii) operational expense savings (acquisition of headquarters, a painting facility and machinery) enabled by bond proceeds. Therefore, Scope-adjusted EBITDA is forecasted to grow to around HUF 8bn in 2022 and beyond, keeping Scope-adjusted debt/EBITDA between 2-3x.

In addition, given the rising interest rate environment, we do not expect an additional bond issuance by MHH. We expect Scope-adjusted FFO/debt to remain at above 30% going forward (2021: 30%).

Stable interest cover because of decreasing indebtedness enabled by positive FOCF

MHH has strong debt protection with Scope-adjusted EBITDA interest cover well over 10x in the last few years (2021: 13.8x).

The proceeds of the 6.5bn HUF bond issued in November 2021 was partially used to repay the 'Dorottya loan facility' of HUF 2.3bn, which was due to expire in 2027 as well as overdrafts of HUF 0.2bn at CIB Bank. While this increased the company's average cost of debt to 3.20% as at end-December 2021 (up 45bp YoY), the company benefits from the longer maturity of both bonds compared toits existing bank financings. Given these repayments, interest-bearing debt only increased by HUF 4.0bn to HUF 14.5bn at YE 2021.

We forecast that interest cover will remain comfortably above 10x going forward benefitting from positive FOCF enabling debt repayments in line with the amortisation schedule for the issued bonds (2022: HUF 0.5bn; 2023: 0.9bn), thus a gradual decrease in interest-bearing debt, limited interest rate risk given the relatively large share of fixed rate debt as well as no external financing needs for the time being. In case MHH succeeds in its tenders for the next stage of the BMW project and the Mercedes Benz factory in Kecskemét, an additional inventory build-up of up to an estimated HUF 6.0bn needs to be financed. The early amortisations of the issued bonds under the MNB bond funding for growth scheme (2022: HUF 0.5bn; 2023: HUF 0.9bn) will support debt protection beyond 2023 when the development of the top line will become more uncertain given limited visibility on the future order backlog.

Adequate liquidity

Liquidity is expected to improve significantly in 2022 due to the issuance of the HUF 6.5bn bond, in which part of the proceeds were used to repay the Dorottya financing loan, and all working-capital credit facilities, which led to a continuously high portion of short-term debt in the past. As such, cash sources (available cash and cash equivalents of HUF 9.8bn as at YE 2021 and forecasted positive FOCF of HUF 6.0bn for 2021) cover cash uses (short-term debt of HUF 0.5bn as at YE 2021) in full.

Balance in HUF m	2022E	2023E	2024E
Unrestricted cash & equivalents (t-1)	9,849	12,071	14,058
Open committed credit lines (t-1)	0	0	0
Free operating cash flow (t)	6,039	6,160	6,184
Short-term debt (t-1)	500	906	906
Coverage	**> 200%**	**> 200%**	**> 200%**

Supplementary rating drivers: +/- 0 notches

Financial policy: neutral

We note that the company's financial policy tolerates a certain exposure to foreign exchange rate risk. On the one hand, most of MHH's contracts with suppliers and customers are denominated in euros, on the other hand, the company swapped its entire corporate financing structure to Hungarian forints following the successful second bond issuance. A strengthening of the Hungarian forint against the euro is therefore likely to increase leverage and weaken debt protection. However, this additional forex risk has not been addressed by the company so far and is seen to be remote at this stage.

Following the restructuring of the ownership structure, MHH introduced a new share class that is entitled to a preferred EUR 0.3m in dividend payments, as long as the company generates distributable profits. This is likely to burden the company's ability to deleverage in times of limited earnings capacity. The only shareholder of the new share class is the Unger family, which will reduce its share in MHH to 20% by YE 2027.

MHH also introduced a dedicated dividend policy allowing only dividend payments if net debt/EBITDA does not surpass 4x up until 2026 or 3x thereafter in line with financial covenants for the bonds issued under the framework of the MNB Bond Funding for Growth Scheme. Furthermore, net debt/equity shall not surpass 1x. MHH will only pay out dividends in excess of HUF 2bn if all of the above items are met and the credit rating will not be adversely impacted by such dividend contribution.

Long-term debt rating

Senior unsecured debt rating: BB-

MHH issued two bonds under the MNB Bond Funding for Growth Scheme with a combined issuance volume of HUF 14.5bn. Our recovery analysis assumes a potential default in 2024 and is based on MHH's going concern status. As the company is a specialist contractor (façade cladding and roof covering), its enterprise value is linked to 'soft' assets (access to long-term customers and technical knowledge in engineering and manual labour) rather than 'hard' assets.

The estimated EBITDA at default is HUF 1.5bn which leads to an implied enterprise value at default of HUF 5.1bn. Based on our recovery analysis, we expect an 'average recovery' for the company's senior unsecured debt (HUF 12.2bn in bonds as at default, HUF 0.3bn in guarantees), resulting in a BB- rating for this debt class (in line with that of the issuer).

Appendix: Peer comparison

	Metál Hungária Holding Zrt.	Duna Aszfalt Kft.	Market Építő Zrt.	Masterplast Nyrt.	Bayer Construct Zrt.
	BB-/Stable	BB-/Positive	BB-/Stable	BB-/Stable	B+/Negative
Last reporting date	31 Dec 2021	31 Dec 2020	31 Dec 2021	31 Dec 2021	31 Dec 2021
Business risk profile					
Scope-adjusted EBITDA (EUR m)	16	150	105	23	23
Backlog	1.3x	2.0x	1.5x	n/a	1.4x
Scope-adjusted EBITDA margin	12%	22%	14%	12%	11%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	13.8x	67.9x	29.5x	20.7x	9.8x
Scope-adjusted debt/EBITDA	2.8x	0.8x	0.8x	2.5x	6.9x
Scope-adjusted FFO/debt	30%	110%	120%	37%	12%
Scope-adjusted FOCF/debt	Negative FOCF	Negative FOCF	47%	Negative FOCF	14%

Sources: Public information, Scope

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