Masterplast Nyrt.
Hungary, Construction Materials

BB- STABLE

Corporate profile

Masterplast Nyrt. was founded in 1997 as a distributor of building materials, mainly roofing foils, glass mesh nets and additional construction products. In 2005 Masterplast started to manufacture its own construction materials and now operates seven manufacturing plants. The company benefits from a direct presence in eight eastern European countries (Hungary, Romania, Serbia, Ukraine, Poland, Slovakia, Croatia and Macedonia) as well as Germany through its 15 subsidiaries. Its total geographical outreach comprises 41 countries including the company's export activity.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA interest cover (x)	15.4x	20.4x	20.0x	13.2x
Scope-adjusted debt (SaD)/EBITDA	3.3x	3.1x	2.3x	2.0x
Scope-adjusted FFO/SaD	27%	30%	34%	38%
FOCF/SaD	2%	42%	-10%	14%

Rating rationale

Scope upgrades issuer rating of Masterplast Nyrt. to BB-/Stable

The upgrade of the ratings is driven by Masterplast's strong business performance in the last 18 months thanks to its broadened segmental setup (healthcare equipment) and a positive market environment (insulation materials) that will help to keep business afloat going forward. More importantly, corresponding investments in production capacities have been heavily subsidised (40%-80% of investment costs), maintaining credit metrics on track with gradual deleveraging.

Masterplast's rating is driven by its solid credit metrics, which benefit from a relatively high Scope-adjusted EBITDA interest cover ratio (last twelve months to end-March: 23x) as well as modest leverage (Scope-adjusted debt [SaD]/Scope-adjusted EBITDA of 2.7x for the twelve months to end-March 2021). The rating is also supported by the company's high exposure to the maintenance end market as well its expansion into the healthcare industry (medical fleece, multilayer membranes and personal protective equipment). Both are less cyclical than the construction materials market, leading to more stable cash flows and less volatile margins. Profitability has improved on the back of expansion into the healthcare industry (Scope-adjusted EBITDA margin for the last twelve months to end-March 2021: 10.3% +3.5pp YoY) and is expected to stay at these new levels going forward.

Despite further strong revenue growth (+24% YoY), the rating is mainly constrained by the company's small overall scale, which lessens its ability to benefit from economies of scale or to offset the impact of economic cycles. We judge diversification to be poor because Masterplast generates most of its revenues in one region (Europe) and is mainly exposed to one segment (construction materials). The rating is also limited by the continuous need for external financing to cover persistently negative free operating cash flow given the ongoing investment programme in production capacities and product availability.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	BB-

Analysts

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Related Methodology

Corporate Rating Methodology: July 2021

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Outlook and rating-change drivers

The Outlook is Stable and reflects our view that credit metrics will improve further, with an ongoing strong Scope-adjusted EBITDA interest cover and a SaD/Scope-adjusted EBITDA ratio of below 3.0x thanks to stable business performance with investments made in recent years starting to pay off. Investments in the healthcare industry made in the first six months of 2021 and anticipated in the coming months will aid cash flow stability and loosen dependence on the construction cycle and seasonality.

A positive rating action may be warranted if the company can reduce its leverage to a SaD/Scope-adjusted EBITDA ratio significantly below 2.5x on a sustained basis. This could be driven by a successful expansion of the higher-margin business in special fleece, personal protection equipment and multilayer membranes production for the healthcare industry.

A negative rating action could occur if the SaD/Scope-adjusted EBITDA ratio weakened towards 4.0x. This could be triggered by a continuous strong build-up in working capital and/or expansion capex beyond current expectations leading to ongoing negative, debt-financed Scope-adjusted free operating cash flow not compensated by corresponding growth in the company's EBITDA.

Rating drivers

Positive rating drivers	Negative rating drivers
• Stable cash flows and profitability due to high exposure to the maintenance end market and granular customer structure • Improving segment diversification (incl. a successful market entrance into healthcare equipment) and less cyclical end markets provide near-term stability and cash flow visibility • Improving profitability anticipated to stabilise at new levels closer to peers • Strong debt protection thanks to low-yielding debt • Improving leverage as investments in production capacities start to pay off	• Small company but strong market position in a fragmented market • Limited diversification bears the risk of a sharp decline in revenues if demand weakens • Further investments in production capacities and product availability dependent on external financing to cover for negative free operating cash flow

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/Scope-adjusted EBITDA of below 2.5x on a sustained basis	• SaD/Scope-adjusted EBITDA moving towards 4.0x

Financial overview

				Scope estimates	
Scope credit ratios	**2019**	**2020**	**Q1 2021[1]**	**2021E**	**2022E**
Scope-adjusted EBITDA interest cover (x)	15.4x	20.4x	23.4x	20.0x	13.2x
Scope-adjusted debt/Scope-adjusted EBITDA (x)	3.3x	3.1x	2.7x	2.3x	2.0x
Scope-adjusted funds from operations/SaD	27%	30%	35%	34%	38%
Scope-adjusted free operating cash flow/SaD	2%	42%	1%	-10%	14%
Scope-adjusted EBITDA in EUR m	**2019**	**2020**	**Q1 2021[1]**	**2021E**	**2022E**
EBITDA	7.3	10.8	14.1	20.6	22.6
Operating lease payments in respective year	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**7.3**	**10.8**	**14.1**	**20.6**	**22.6**
Scope-adjusted funds from operations in EUR m	**2019**	**2020**	**Q1 2021[1]**	**2021E**	**2022E**
Scope-adjusted EBITDA	7.3	10.8	14.1	20.6	22.6
less: cash interest as per cash flow statement	-0.5	-0.5	-0.6	-1.0	-1.7
less: cash tax paid as per cash flow statement	-0.2	-0.2	-0.2	-2.9	-3.7
Change in provisions	0.0	0.0	0.0	0.0	0.0
Scope-adjusted funds from operations	**6.7**	**10.1**	**13.3**	**16.6**	**17.2**
Scope-adjusted debt in EUR m	**2019**	**2020**	**Q1 2021[1]**	**2021E**	**2022E**
Interest-bearing debt	28.8	47.4	45.9	76.3	70.7
add: derivatives (net)	0.1	2.5	3.0	2.4	0.0
less: cash	-4.5	-33.3	-10.4	-30.7	-25.4
add: restricted cash[2]	0.0	17.4	0.0	0.0	0.0
Scope-adjusted debt (SaD)	**24.4**	**34.0**	**38.4**	**48.1**	**45.3**

[1] Year ending March 2021 for cash flow metrics
[2] Grants received in December 2021 to finance the construction of the medical fleece production facility in Sárszentmihály

Business risk profile: B+

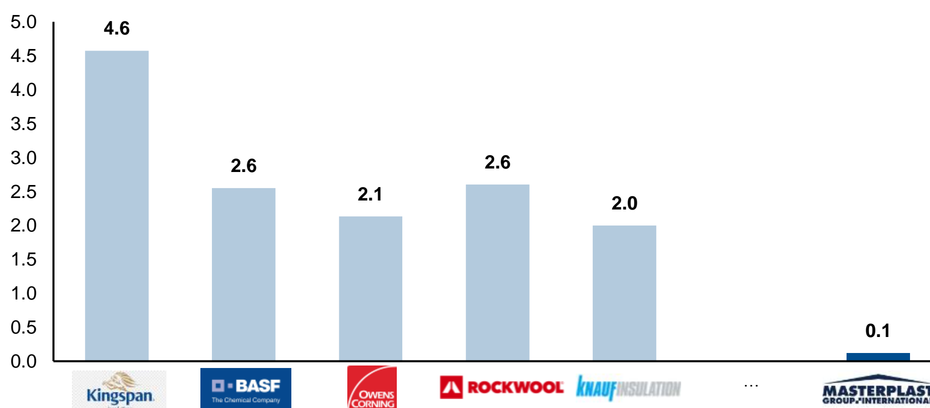
Industry risk: BB+

The acquisition (Aschersleben in Q2 2020), build-up (Sárszentmihály in H1 2021) and further investment (Sárszentmihály Q3 2021) in production capacities focussing on the healthcare industry (medical fleece, multilayer membranes and personal protective equipment) have slowly broadened the company's industry setup. We estimate that the EBITDA contribution from the healthcare devices industry (industry risk: A) will reach around 40% by 2023 (estimated at 22% for the period from 2019 to 2021).

Small company but relatively strong market position in a fragmented market

Masterplast is a relatively small player in the construction materials industry (87% of EBITDA in 2020). It is, however, constantly growing and achieved revenue of around EUR 123m and Scope-adjusted EBITDA of EUR 11m for 2020. The company's small size limits its ability to benefit from economies of scale or to offset the impact of economic cycles. However, its market position is supported by: i) its strong standing in Eastern Europe, the rather fragmented market structure in its main segment (insulation systems) and strong customer loyalty; as well as ii) its dedicated growth strategy, underpinned by total capex of EUR 44m in the last four years, which was mainly used to build and acquire new production facilities.

Figure 1: Peers in insulation segment by revenue in 2020 (EUR bn)*



* Knauf Ins. (2019), Bayer construction chemicals segment as a whole (2019), Sources: public information, Scope

Relatively high capital expenditure has translated into strong growth in terms of revenue (+62% from 2015 to the last twelve months to end-March 2021) and Scope-adjusted EBITDA (+167%). However, we do not expect Masterplast to reach a critical size in the coming years, which would enable it to defend its foothold if larger competitors, such as BASF, Knauf Insulation or ROCKWOOL International enter the niche markets in which it operates.

During the Covid-19 pandemic-induced reduction of construction output across Europe in Q1/Q2 2020[3], Masterplast was able to gain market share, benefitting from its relatively high inventories as well as the negligible impact on its supply chains, regional production facilities and its own distribution/logistics capabilities. As a result, Masterplast was able to replace competitors with starkly reduced product availabilities. This positive development is evidenced by group sales in the last 12 months to end-March 2021 boosted by 24% (YoY). Masterplast is going to invest further in its production capacities and product availability in 2021 and 2022 (a total of EUR 51m in capex spent or earmarked), with a

[3] Approx. 10% decline from YE 2019 to May/June 2020 on a weighted average base depending on individual countries' sales contribution, compared to a sales decline of 2% for Masterplast during the same period

focus on fiberglass mesh[4] and breathable membranes. This will support its market positioning going forward, especially in comparison to regional peers.

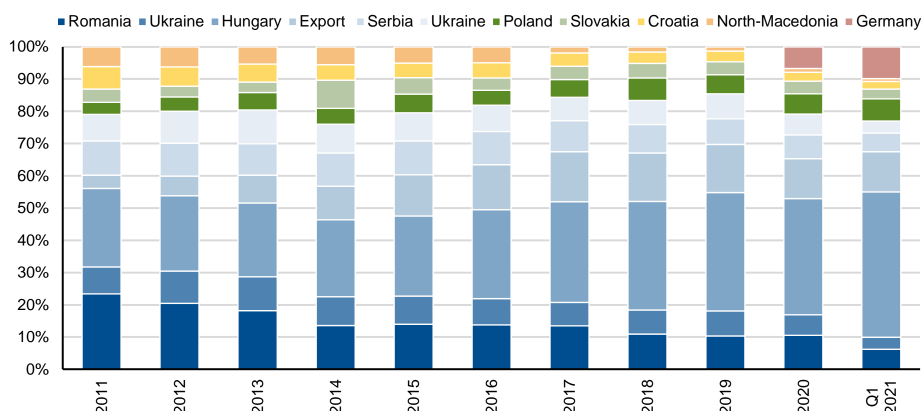
Successful market entrance into healthcare equipment should stabilise cash flow

The 2020 acquisition of a 50% share in a production facility in Germany (Aschersleben)[5] laid the groundwork for the company's expansion into the higher-margin medical equipment industry (personal protective equipment and finished products), which is expected to contribute around 40% of the company's EBITDA by 2023. The market entrance was kickstarted by the subsidised build-up of a modern production facility at the company's headquarters in Sárszentmihály as well as a contract with the National Institute for Health Services Hungary to supply protective overalls for the coronavirus epidemic in April 2021 (contract value of around EUR 13m). We believe in the short-medium term viability of this new business line, supported by: i) the government's focus on building up capacities that match national demand, with Masterplast being the preferred partner; and ii) the company's focus on personal protective equipment that is usable throughout the healthcare system. The new business line will help to loosen dependence on the construction cycle and its seasonality, stabilising intra- and year-on-year cash flow generation.

Poor geographic diversification poses risk of sharp decline in revenue if demand weakens

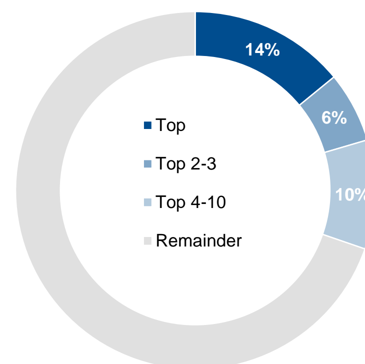
Masterplast's geographical diversification is rather poor, since the company generates most of its revenues in one region, Europe (with a strong focus on Central and Eastern Europe). Low geographical diversification bears the risk of exposure to the construction cycle of one region. In a cyclical industry such as construction materials, revenues and earnings are likely to come under pressure if there is a downturn in one region. Conversely, a wide spread of activities across various geographical regions with different demand patterns or cyclicality exposures tends to reduce cash flow volatility. Masterplast is diversified within Europe, with an exposure to several countries in that region. This provides some diversification because we expect demand patterns to differ at least a little between the countries to which the company is exposed. Masterplast's pan-European footprint also benefits from its export activities (sales outside CEE accounting for around 22% of revenues in the last twelve months to end-March 2021). This is a strong boost (+7pp YoY), supported by the expansion into Germany (Aschersleben).

Figure 2: Geographical diversification of revenue



Sources: Masterplast, Scope

Figure 3: Share of top 10 customers (by revenue) for H1 2021



Sources: Masterplast, Scope

Segment diversification and less cyclical end markets provide near-term cash flow visibility

Segment diversification is anticipated to improve with: i) the addition of healthcare equipment to that of construction materials via the Aschersleben plant acquisition in July

[4] Masterplast will become Europe's second largest producer of fiberglass mesh with a capacity of 125 million m²/year (+25% YoY) from early 2022 on
[5] Masterplast Nonwoven GmbH (50/50 joint-venture between Masterplast and the previous owner – buyout [call/put] option until Q2 2023), production of special fleece and multilayer membranes for the healthcare and construction industry

2020; ii) additional production capacities in Sárszentmihály (production started in Q3 2021); as well as iii) further investments planned (around EUR 29m of capex for 2021). The future segment contribution from healthcare equipment is estimated at around 10% of revenue and around 40% of EBITDA. According to the company, there is some visibility of stable sales via forward sales for the next two to three years, which will be further supported by high-profile hirings to keep and improve market access. Consequently, we believe the contribution from this segment will be sustained, supporting the company's segment diversification.

Segment diversification generally benefits from the different end markets Masterplast serves (including the less cyclical end market of real estate maintenance, packaging and healthcare equipment) as well as its relatively broad range of products (more than 2,000) with limited dependence on single customers. The largest customer (the National Institute for Health Services) contributed 15% of total revenues in H1 2021 (top 10: 33%) with its share expected to diminish going forward.

Improving profitability anticipated to stabilise at new levels closer to peers

Masterplast was able to increase its profitability as measured by its Scope-adjusted EBITDA margin (last twelve months to end-March 2021: 10%), catching up to larger peers thanks to the strategic expansion into the healthcare equipment industry. Furthermore, the company benefits from its significant exposure to the maintenance end market, which leads to more stable cash flows and less volatile margins. We forecast that the Scope-adjusted EBITDA margin will increase to around 12% on a sustained basis, driven by higher existing and further investments into the extension of production capacities, product ranges and product availability. The strongest drivers of future profitability will be: i) the higher-margin production of special fleece and multilayer membranes (EBITDA margins of above 20%); ii) increasing demand for insulation material due to tightening regulation and government stimulus as regards energy efficiency; as well as iii) lower raw material prices. The latter is a consequence of Masterplast's ability to increase its share of self-manufactured products (internalisation of supplier margin) up to 53% for FY 2020 with the strategic goal to reach over 65% by 2030. This could be achieved by, for instance, the acquisition of either existing suppliers or additional production capacities with a focus on insulation (EPS, XPS, thermobeton and PE foam).

Improved profitability partially mitigates Masterplast's small scale, providing some headroom to protect market shares if larger peers try to establish a foothold in the company's markets by initiating a fierce price war.

Financial risk profile: BB+

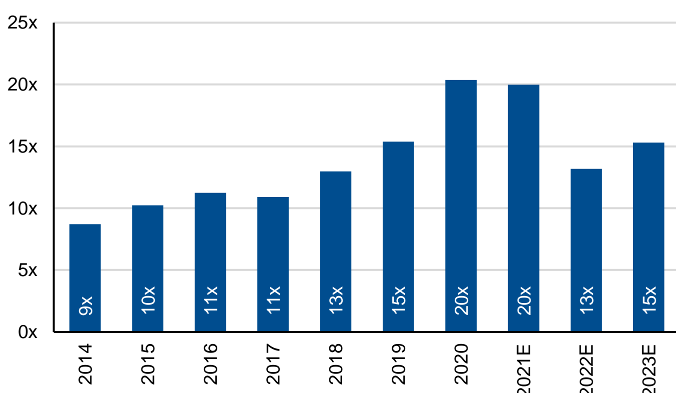
Strong debt protection thanks to low-yielding debt

Masterplast has strong debt protection with Scope-adjusted EBITDA interest cover well over 10x in the last few years (last twelve months to end-March 2021: 23x).

The company has benefitted from the low interest rate environment because almost one-third of its debt is exposed to floating interest rates. This has helped to reduce the weighted average cost of debt to 1.9% as at end-June 2021, from 3.6% as at YE 2015.

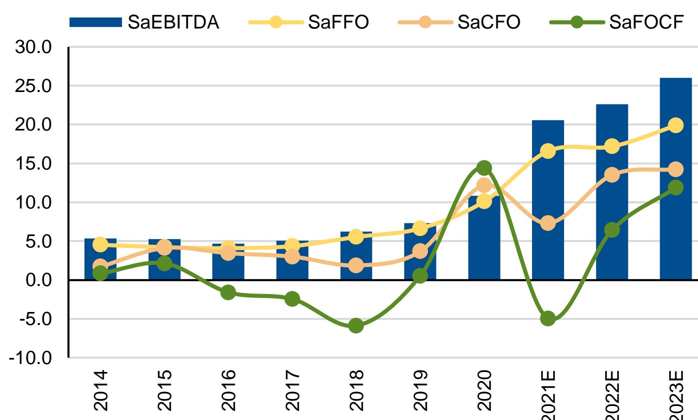
Masterplast plans to issue a third HUF 9bn (EUR 25m) bond under the Hungarian National Bank's Funding for Growth Scheme. This should further enhance liquidity, with proceeds used to temporarily repay short-term financial liabilities. It will also reduce Masterplast's floating rate risk but increase financing costs, as the interest rate for the new bond is expected to be above the company's weighted average cost of debt as at end-June 2021 (1.9%). We forecast a lower Scope-adjusted EBITDA interest coverage ratio down to 10x-15x. This is based on some negative carry for part of the bond proceeds, which will be used to increase Masterplast's firepower for further capex or acquisitions, as well as the continuing exposure to floating interest rates.

Figure 4: Scope-adjusted EBITDA interest cover (x)



Sources: Masterplast, Scope estimates

Figure 5: Cash flows (EUR m)



Sources: Masterplast, Scope estimates; 'Sa' = Scope-adjusted

Further investments dependent on external financing

Over the last few years, Masterplast has increased its capital expenditure significantly at the cost of Scope-adjusted free operating cash flows. This metric turned negative from 2016 on and led to a significant increase in SaD to EUR 38.4m as at end-March 2021, from EUR 11.4m as at YE 2015. In the past, spending has mainly focused on the acquisition of production facilities. Masterplast plans to spend around EUR 44m[6] in capex in 2021 (including EUR 22m for medical fleece production capacities at its headquarters, operational since July 2021) and EUR 12m[6] in 2022. Expansion capex will be focused on investment in the production capacities and product availability in 2021 and 2022 with regard to medical fleece, personal protection equipment, fiberglass mesh and XPS. Most related investments are subject to government grants covering 40%-80% of associated costs, thus limiting the impact on Scope-adjusted cash flow from operations. Furthermore, we do not consider expansion capex to be mandatory as long as government grants have not been received.

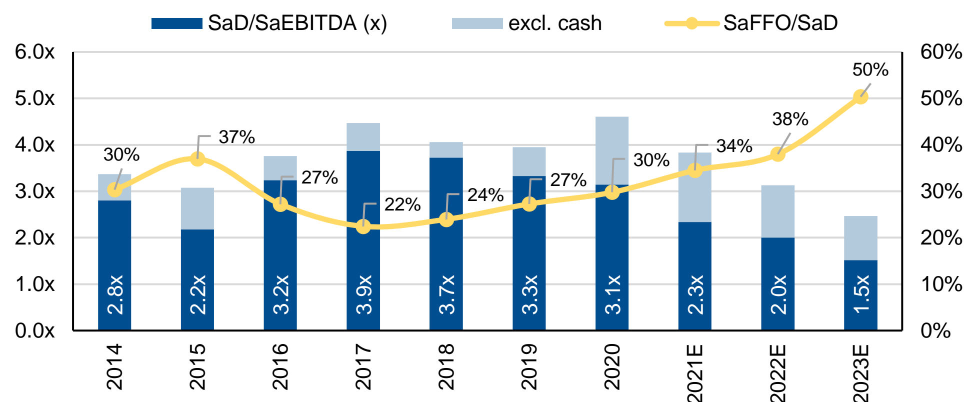
Improving leverage as investments in production capacities start to pay off

Masterplast's leverage, as measured by its SaD/Scope-adjusted EBITDA ratio, remained at a relatively high 3.1x as at YE 2020 (last twelve months to end-March 2021: 2.7x). However, this follows a continuing decrease since YE 2017 with the growth strategy bearing fruit and leading to a sharp rise in Scope-adjusted EBITDA (+179% since 2017 to

[6] Including maintenance capex of EUR 2.5m

last twelve months to end-March 2021). We anticipate that absolute indebtedness, as measured by the company's SaD, will increase to around EUR 50m by YE 2021 driven by investments earmarked for 2021 and remain broadly stable afterwards.

Figure 6: Leverage



Sources: Masterplast, Scope estimates; 'Sa' = Scope-adjusted

We forecast a further reduction in the SaD/Scope-adjusted EBITDA ratio to below 3x going forward. This should be predominately driven by the strong EBITDA contribution from investments in medical fleece production capacities (Aschersleben, Sárszentmihály production facilities) as well as the ramp-up of production capacities for personal protective equipment and finished products, all together contributing an estimated EUR 8m-9m per year. Further improvements in leverage will depend on the successful execution of investments, while keeping utilisation rates stable.

Currently, Scope-adjusted funds from operations/SaD (which exceeded 20% throughout the period considered) is benefitting from relatively low interest payments driven by the low weighted average cost of debt. This has helped to balance the threefold rise in the company's indebtedness since YE 2015. We expect Scope-adjusted funds from operations/SaD to remain stable, at around 30% going forward (last twelve months to end-March 2021: 35%) despite the forecasted increase in the company's weighted average cost of debt, due to the planned third bond issuance. The risk of rising interest rates will be significantly reduced, helping to stabilise the company's funds from operations as Masterplast plans to use part of the proceeds to repay existing short-term debt.

Adequate liquidity

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

Position	2021E		2022E	
Unrestricted cash (t-1)	EUR	15.9m	EUR	30.7m
Open committed credit lines (t-1)	EUR	0.0m	EUR	0.0m
Free operating cash flow	EUR	-4.9m	EUR	6.4m
Short-term debt (t-1)	EUR	6.2m	EUR	5.8m
Coverage		**1.8x**		**6.4x**

Liquidity is adequate, as sources (EUR 15.9m of cash available as at YE 2020) cover uses (EUR 6.2m in short-term debt as at YE 2020 and negative Scope-adjusted free operating cash flow of EUR 4.9m forecasted for 2021). Aside from the repayment of short-term debt, we anticipate positive free operating cash flows from 2022 onward, once subsidised investments in the company's production facilities have largely been made, thus further supporting future liquidity.

Covenants

We note that Masterplast has to meet several financial maintenance covenants for its interest-bearing liabilities. We expect the headroom under these covenants to be sufficient in our base case scenario.

Senior unsecured debt: BB-

Masterplast issued two HUF 6bn senior unsecured bonds under the Hungarian National Bank's Funding for Growth Scheme (one in December 2019 and one in December 2020). The company plans to issue another HUF 9bn senior unsecured corporate bond in Q3 2021 under the same programme. Proceeds are earmarked for further capital expenditure, acquisitions and to temporarily refinance short-term debt. The bond's tenor is ten years and it will amortise from year six to year nine in equal instalments with a 50% balloon at maturity. The coupon will be fixed and payable on an annual basis.

Our recovery analysis is based on the enterprise value calculated as a going concern. A continuation of the business in a default scenario seems to be likelier than a liquidation, as Masterplast already has a distribution network in several European countries, comprising subsidiaries in its core Eastern European countries as well as 'external' export partners, which are responsible for distribution in Masterplast's export markets. This distribution network also has a value in itself, which would be lost if the company is liquidated. We estimate the recovery for all senior secured debt to be average, justifying a debt class rating equal to that of the issuer rating (BB-).

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