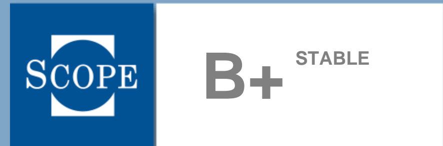
21 May 2021 Corporates

Stavmat Zrt.
Hungary, Wholesale



Corporate profile

Stavmat Építőanyag Kereskedelmi Zrt. (Stavmat) is primarily a wholesaler of construction materials for professional use, with a 10% leading position in the small Hungarian market and leadership in the industrial segment. Around 30% of sales are generated by retail consumers (private professionals). Stavmat owns 34 stores across Hungary and employs around 350 people. The company provides a full range of high-quality building materials and solutions for both outdoor and interior design work, renovation and house construction. In December 2016, Stavmat became part of IN Group, a Slovakia-based diversified construction group, which trades building materials in Slovakia, the Czech Republic and Hungary.

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover (x)	125.3x	115.0x	21.1x	13.7x
Scope-adjusted debt (SaD)/EBITDA	0.7x	0.6x	3.1x	2.7x
Scope-adjusted funds from operations/SaD	170%	178%	34%	38%
Free operating cash flow/SaD	92%	31%	-29%	3%

Rating rationale

Scope Ratings GmbH (Scope) has assigned a first-time issuer rating of B+/Stable to Stavmat Zrt., along with a senior unsecured debt rating of BB-.

The issuer rating reflects Stavmat's limited size, concentration on the domestic market of building materials, high dependency on construction industry cycles and volatile cost of materials (covering over 90% of sales). The rating also reflects the worsening of leverage metrics in view of the upcoming planned HUF 5.0bn bond issuance and limited cash flow cover in the near term, impacted by the higher capex required for the ongoing construction of a new paving production plant. In this context, the recent change in financial policy regarding the distribution of equity reserves and the future dividend plan is credit-negative. This risk is partly mitigated by Stavmat's leading position as wholesaler of construction materials for professional customers in Hungary, adequate liquidity with refinancing risk only in the long term, and strong interest cover. Profitability margins have been adequate in the last few years, which were, however, characterised by extremely favourable government policies for the construction industry.

Stavmat plans to issue a HUF 5bn (approximately EUR 14m) bond in mid-2021 under the Bond Funding for Growth Scheme of the Hungarian National Bank (MNB). The bond's tenor is 10 years with 10% of its face value subject to amortisation in 2026, 10% in 2027, 10% in 2028, 10% in 2029, 10% in 2030 and the remaining 50% in 2031. The coupon will be fixed and payable on an annual basis. Funds from the bond will be used for capex (HUF 4.3bn) as partial financing of the new investment in a paving production plant in Dabas, and related working capital needs (HUF 0.7bn). The bond will rank as senior unsecured, and the annual coupon is expected at 3% per year. There is no guarantee from the parent.

Ratings & Outlook

Corporate rating	B+/Stable
Senior unsecured rating	BB-

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Related Methodologies

Corporate Rating Methodology: February 2020

Rating Methodology: Retail and Wholesale Corporates March 2021

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Outlook and rating-change drivers

The Outlook for Stavmat is Stable and incorporates our view that business growth will benefit from recently introduced government policies that are favourable for the construction industry. They will support a continuation of the positive construction cycle and thus stable operational cash flow for Stavmat. The Outlook further includes a HUF 5bn bond issuance with proceeds used to construct a new paving production line, which is anticipated to become fully operational in 2022. Increased indebtedness will drive leverage up to a Scope-adjusted debt (SaD)/Scope-adjusted EBITDA of between 2.5-3.5x going forward.

Rating upside

A positive rating action could occur if Stavmat were to improve its business risk profile by significantly increasing its size and/or expanding geographically, which is less likely in the near future. Similarly, a positive action could be warranted by a leverage (SaD/Scope-adjusted EBITDA) of significantly below 2.5x on a sustained basis, affording the company the headroom to maintain its financial policy.

Rating downside

A negative rating action may occur in the case of a SaD/Scope-adjusted EBITDA of above 3.5x on a sustained basis. This could be triggered by a reversal of the current positive multi-year business cycle for the construction industry in Hungary, and more specifically by an interruption of current government subsidies, which would materially affect the demand for construction materials.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leading wholesaler of construction materials for professional customers in Hungary • Adequate profitability margins in recent years, supported by the positive business cycle, which we expect to be sustained by favourable government policies in the medium term • Strong interest cover despite the planned HUF 5.0bn bond issuance in 2021 • Adequate internal liquidity, with bond repayment risk only materialising in the long term	• Limited revenue size • Concentration on the small domestic market • Margins highly dependent on the construction industry cycle and volatile cost of materials (covering over 90% of sales) • Worsened leverage profile in view of bond issuance • Limited cash flow cover profile in medium term amid the ongoing construction of a paving production plant • Financial policy change, with distribution of reserves in 2020 and a plan to regularly distribute significant dividends from 2021 onwards • Lack of bank relationships or capital market standing in case of need

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Material increase in size and geographical diversification, unlikely in the near term • SaD/EBITDA of significantly below 2.5x on a sustained basis, affording headroom to maintain financial policy	• SaD/EBITDA of above 3.5x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	125.3x	115.0x	21.1x	13.7x
Scope-adjusted debt (SaD)/EBITDA	0.7x	0.6x	3.1x	2.7x
Scope-adjusted funds from operations/SaD	170%	178%	34%	38%
Free operating cash flow/SaD	92%	31%	-29%	3%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	1,437	1,619	1,583	1,898
Operating lease payments in respective year	281	401	446	468
Other	-2	-1	0	0
Scope-adjusted EBITDA	1,716	2,019	2,029	2,366
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	1,437	1,619	1,583	1,898
less: (net) cash interest as per cash flow statement	0	3	-74	-149
less: cash tax paid as per cash flow statement	-66	-78	-77	-85
add: depreciation component, operating leases	267	381	424	445
less: disposal gains, fixed assets	-2	-1	0	0
add: other financial income (cash discounts)	266	283	297	301
Scope-adjusted funds from operations	1,903	2,206	2,153	2,409
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	0	0	5,000	5,000
add: operating lease obligations	1,118	1,243	1,305	1,344
Scope-adjusted debt [1]	1,118	1,243	6,305	6,344

[1] Based on Scope's corporate rating methodology, netting of cash is generally only applicable to BB ratings or higher.

Business risk profile: B+

Key drivers for Stavmat's business risk profile (assessed B+) are its limited revenue size, concentration on the small domestic market, high dependency on construction industry cycles and volatile cost of materials (covering over 90% of sales). However, the rating also incorporates Stavmat's leading position as a wholesaler of construction materials for professional customers in Hungary.

Industry risk profile impacted by medium cyclicality

We assess the industry risk profile for the retail and wholesale industry at BB, as it is characterised by medium cyclicality and generally low market entry barriers. Substitution risk is considered low.

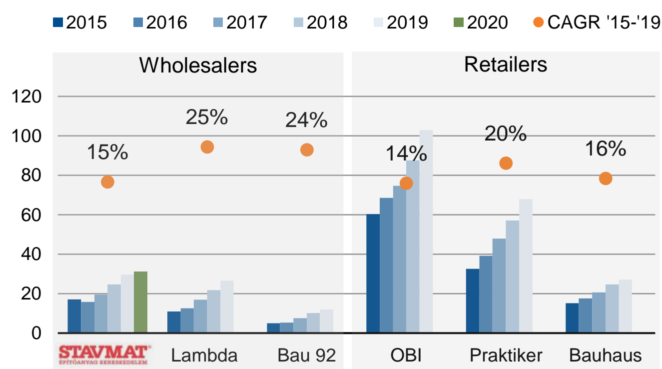
Business cycle benefits from the extension of favourable government policies

The construction industry in Hungary experienced robust and rapid growth between 2016 and 2020, amongst the fastest in Europe. This growth was mainly due to government-driven orders, increasing disposable income and low interest rates. 2020 saw a contraction in the market due Covid-19, but the industry promptly recovered by year-end. In 2021, the Hungarian government has extended and further strengthened the effects of the 'CSOK' scheme launched in 2015, continuing its construction-friendly policies aimed at improving the demographic trend within the country. State subsidies are expected to fuel the demand for construction materials in the near term. The only risk could be capacity constraints on the part of local construction companies.

Leading 10% market share as a wholesaler, amid small size

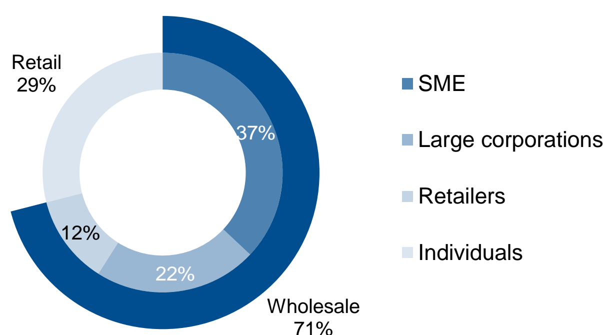
The Hungarian building material trading industry is rather fragmented. Stavmat holds a leading 10% market share in the wholesaling of construction materials for professional use. The second largest competitor (Lambda) is close in terms of revenues, but has almost 50% fewer stores than Stavmat. It is also involved in the production of construction materials, which indicates that the real gap in terms of wholesale-only market shares is larger. Stavmat's revenues are still small (HUF 31bn as of YE 2020) if compared on an international scale but, despite not operating in a protected industry, we still assess the risk of new entrants in its market as only moderate in view of the high level of investment needed.

Figure 1: Revenue development versus peers (HUF bn)



Source: Stavmat, Scope estimates

Figure 2: Revenue split by customer segment



Source: Stavmat Scope estimates

Sustained revenue growth across all peers

If we look at historical revenue development versus peers', Stavmat's direct peers have grown faster in recent years. According to Stavmat's management, this is partly due to their different business models, making them more sensitive to market developments. Overall, all the main players in the market have benefited from the extremely positive multi-year cycle, which we expect to continue in the medium term.

Limited geographical and business diversification

Stavmat's concentration on the Hungarian wholesale market for building materials makes it vulnerable to shifts in the local economy and the construction business cycle (including the impact of government policies). Stavmat operates entirely on the national market,

although its presence within the country is broad. Export sales are currently negligible, but they may increase in the future amid plans to enter export markets in neighbouring countries. In addition, sales are entirely via physical stores, with no online sales.

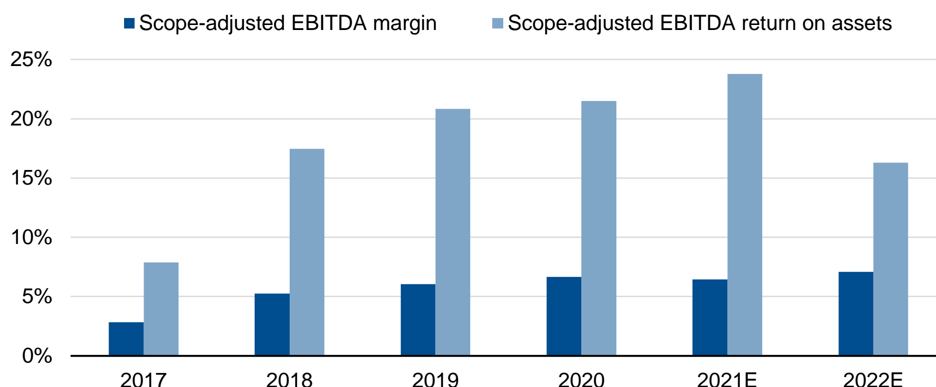
Varied product offering within the construction material category

The company offers a varied range of solutions for the construction industry, including over 57,000 different products covering the full range of classical heavy and light construction materials. However, we consider this to be part of one product category. There are no major dependencies on the supplier or customer side.

Margins have been volatile over the last decade

An analysis of EBITDA margin performance in 2018-20 provides an extremely positive view of profitability as the business benefited from government-driven demand. Looking back, the reported EBITDA margin fluctuated in the lower 1%-4% range in 2015-17. In the 10 years before 2015, the company posted negative EBITDA each year.

Figure 3: Scope-adjusted EBITDA margin and Scope-adjusted EBITDA return on assets



Source: Stavmat, Scope estimates

Cost of materials is a key driver of profitability

Overall, profitability is highly dependent on the cost of materials. This is the largest cost item for Stavmat, covering around 92% of revenues in 2017-19. For 2021E, in line with management projections, we see the cost of materials moderately increasing and then remaining broadly stable in 2022E in view of continued market demand.

Moderate impact from supplier bonuses and credit management

Stavmat benefits from larger supplier bonuses than those of smaller peers as these are linked to order sizes, although the impact on overall profitability is moderate. Stavmat has strict credit management practices, resulting in a less risky receivable portfolio, as proved by the limited credit losses of within 0.1% in the past few years.

Profitability to remain adequate in the medium term on the back of solid demand...

We believe the market will continue to grow for the next two years but at a more moderate pace of organic growth from 2022E onward, in the mid-single digit level. The construction of the paving production plant in Dabas is supposed to bring higher marginality from 2022, although the impact will be limited initially. We anticipate a Scope-adjusted EBITDA margin of close to 7% in 2021, broadly in line with the 2020 level. We expect the margin to exceed 7% once the impact of the production facility kicks in.

... but it can still be very volatile

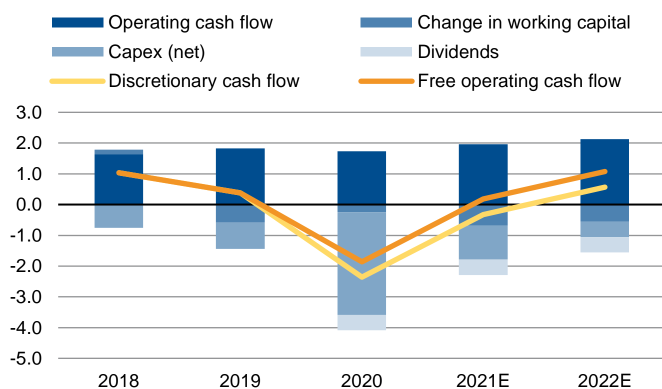
Our profitability assessment reflects the implied volatility the company faces in terms of demand and the cost of materials, which could cause margins to deteriorate rapidly due to the small revenue base. Nevertheless, since the establishment of new ownership in 2016, the EBITDA margin has been positive and on a growing trend.

Financial risk profile: BB+

Planned HUF 5bn bond issuance in mid-2021

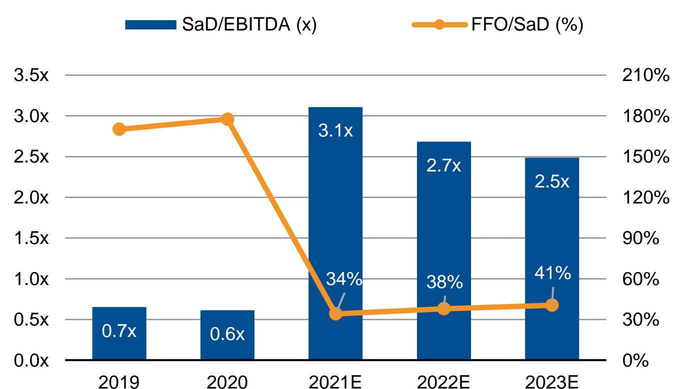
Stavmat plans to issue a HUF 5bn (approximately EUR 14m) bond in mid-2021 under the MNB Bond Funding for Growth Scheme. The bond's tenor is 10 years with 10% of its face value subject to amortisation in 2026, 10% in 2027, 10% in 2028, 10% in 2029, 10% in 2030 and the remaining 50% in 2031. The coupon will be fixed and payable on an annual basis. Funds from the bond will be used for capex (HUF 4.3bn) as partial financing of the new investment in a paving production plant in Dabas, and related working capital needs (HUF 0.7bn). The bond will rank as senior unsecured, and the annual coupon is expected at 3% per year. There is no guarantee from the parent.

Figure 4: Cash flow generation (HUF bn)



Source: Stavmat, Scope estimates

Figure 5: Scope leverage metrics



Source: Stavmat, Scope estimates

Operating cash flows cover expansionary capex planned in 2021/22

Stavmat has benefited from robust operating cash flow generation in the last three years, which peaked in 2019 at HUF 1.9bn and then decreased moderately in 2020 due to working capital changes. Going forward, we see working capital needs remaining a constraint on operating cash flow growth, but the company generally has no issues with covering recurring maintenance capex. However, the planned expansionary capex for the construction of the paving production plant (from 2021 until Q2 2022 based on the company's schedule) will interrupt the positive free operating cash flow generation of the last three years.

Deteriorating leverage upon bond issuance but still acceptable

Up to 2020, Stavmat had a sound leverage position as the only liabilities were represented by leases. Going forward, the bond issuance will cause financial metrics to deteriorate. We expect SaD/EBITDA to spike at around 3x in 2021E, and then gradually converge towards 2.5x in 2023E. This will be driven by gradually increasing EBITDA amid broadly stable debt. Funds from operations generation has been quite consistent for Stavmat, at 6%-7% of revenues over the last three years, benefiting from low financial expenses and taxes. We expect funds from operations/SaD to remain between 30% and 40% over the next couple of years.

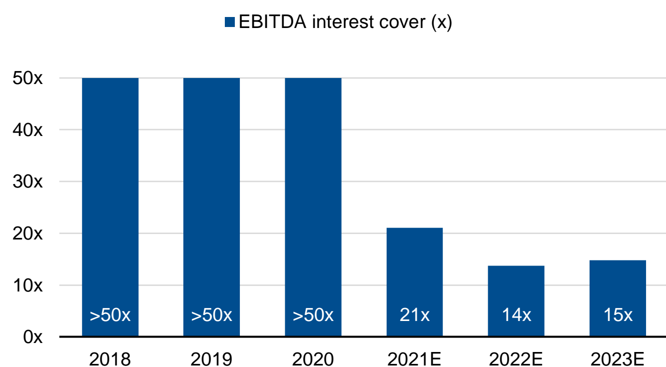
Strong debt interest cover of over 10x

The upcoming bond is expected to bear a 3% coupon, equal to HUF 150m of yearly interests. Despite this, EBITDA interest cover is projected to remain comfortably above 10x.

Cash flow cover constrained over the next 18 months

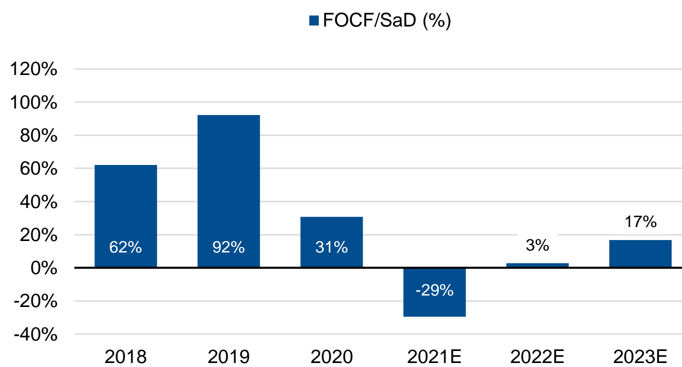
The cash flow cover metric for 2021 is an exception, given the high net capex of HUF 3.3bn. In 2022, capex is lower at HUF 1.0bn, but a large part of it still includes the expansionary investment in the production plant. Going forward, capex will reduce, mostly including maintenance capex. In the medium term, free operating cash flow/SaD will remain constrained below 5%. However, we believe a higher ratio of well above 15% is feasible in the long term.

Figure 6: Debt interest cover



Source: Stavmat, Scope estimates

Figure 7: Cash flow cover



Source: Stavmat, Scope estimates

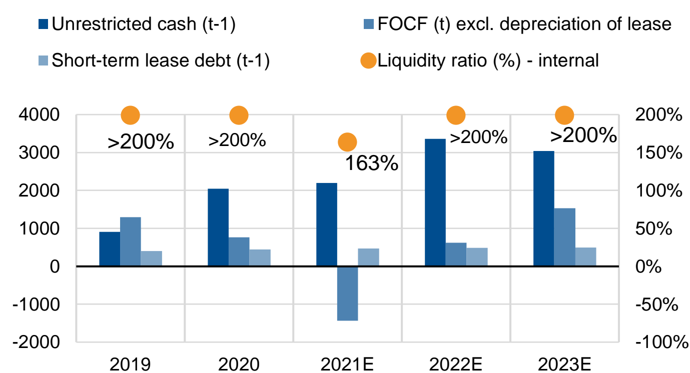
Adequate liquidity

We assess liquidity as adequate in the medium term. This is based on the current level of cash reserves in combination with expected robust cash flow generation. With the exception of 2021 due to expansionary capex, recurring cash flow generation should be sufficient to cover moderate short-term (off-balance-sheet) debt, entirely represented by operating leases (around HUF 450m in 2021). The planned HUF 5.0bn bond will not impact liquidity until 2026 (bond amortisation will be HUF 500m per year until 2030).

Adequate liquidity

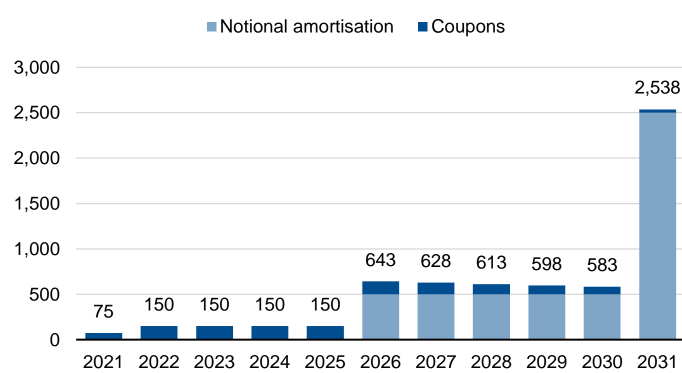
Stavmat has HUF 2.9bn of cash and equivalents as of YE 2020 (HUF 2.7bn at YE 2019). The company has no credit facilities but relies on a credit insurance agreement with Atradius on over 90% of its receivables. The liquidity ratio is above 110% over the entire forecasted period. The planned bond will further strengthen liquidity, with cash reserves forecasted to reach around HUF 4.0bn at YE 2021E.

Figure 8: Liquidity sources (HUF m) and liquidity ratio



Source: Stavmat, Scope estimates

Figure 9: Amortisation and coupon schedule of planned bond (HUF m)



Source: Stavmat, Scope estimates

Supplementary rating drivers

Financial policy is credit negative

Stavmat's risk appetite was limited until 2020. The company operated without bank debt (only leases) and followed a prudent approach, including the ownership of most of its stores.

In 2020, however, on the back of the HUF 1.4bn Covid-related government subsidies and the HUF 5bn planned bond issuance, the company decided to return to its shareholders HUF 1.8bn of committed reserves, which it had been granted in order to back past losses. A more prudent approach would have been to compensate shareholders after the completion of the large capex plan.

In addition, we see a change in financial policy from 2021: besides the increase in leverage, management is planning to distribute around HUF 500m per year in 2021-23 (there are no details for subsequent years), which translates into a dividend payout of around 30% of net profits. While this would be adequate for a larger business, we believe Stavmat would benefit from building more cash reserves over the coming years. This would ensure the timely servicing of the bond over the long term in view of potential negative swings in the business cycle as well as potential execution risk involved with the construction of the new paving production plant.

Parent support is neutral

Stavmat Zrt. is currently 100% indirectly owned by IN Group via the 100% ownership by Stavmat Stavebniny (Czech Republic). IN Group is an investment holding company based in Slovakia with diversified interests within the construction industry in Slovakia, the Czech Republic, and Hungary, including the wholesaling and production of building materials, construction, and real estate development. The ultimate beneficial owner is Mr Pavol Kollar (67% share in IN Group). Stavamat Zrt. has operated independently from the group until now and we have therefore assessed it on a standalone basis. We expect the parent to have significant willingness to support Stavmat in case of need, since Hungary is becoming an increasingly important market for the group. However, we assess parent support as neutral, also since we do not have visibility on the financial strength of IN Group.

Senior unsecured debt rating

Senior unsecured debt: BB-

We have assigned a BB- rating to the senior unsecured debt of Stavmat Zrt, one notch above the issuer rating. Our recovery assessment includes the planned HUF 5bn senior unsecured bond issuance. We expect an 'above average recovery' (50%-70%) for outstanding senior unsecured debt in a hypothetical default scenario based on a liquidation value method.

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