Reneszánsz Kőfaragó Zrt.
Hungary, Metals and Mining

B STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	3.5x	3.4x	2.9x	3.4x
Scope-adjusted debt/EBITDA	7.7x	7.4x	8.0x	7.1x
Scope-adjusted funds from operations/debt	9%	10%	11%	10%
Scope-adjusted free operating cash flow/debt	4%	-26%	-47%	-7%

Rating rationale

The business risk profile of Reneszánsz (assessed at B+) continues to be supported by i) the strong market position as the largest limestone dimension stone producer in Hungary; ii) the unique properties of the limestone at the Süttő quarry, which is also close to national heritage buildings in Budapest, a captive market; and iii) the mine's very long reserve life. While the mine itself (previously also owned by the shareholders of Reneszánsz) was sold to the Hungarian state in Q1 2022, the terms and conditions of the concession agreement are unchanged. In this context, Scope notes the regulatory risk related to the potential amendment of mining concession after the quarry and the limestone deposits moved into government ownership (ESG factor: credit-negative). The business profile is constrained by i) the company's small absolute size in both a domestic and a European context; ii) the low diversification of products and the order book; and iii) the deteriorating operating profitability due to increasing energy costs.

The financial risk profile (assessed at B) is driven by the issuer's high financial leverage (Scope-adjusted debt/EBITDA, including the capitalisation of future mine concession payments), expected to deteriorate to 8.0x in 2022 due to a worsening EBITDA margin. In the medium term, Scope expects leverage to stabilise to around 7.0x. Despite the lower profitability, debt protection (Scope-adjusted EBITDA/interest cover) is expected to remain strong at around 3.0x. Liquidity is adequate, with no short-term debt maturing other than the future amortisation of the bond and with capex to be funded with bond proceeds.

Outlook and rating-change drivers

The Stabile Outlook reflects the assumption the Reneszánsz will be able to upkeep the resilient interest coverage and positive FFO despite the lower profitability caused by energy prices placing additional pressure on margins. Scope's base case assumes EBITDA margins at below the historical average with gradual recovery on the medium term, and considers leverage metrics less meaningful due to its sensitivity to the debt composition (strongly influenced by the leasing adjustment).

A positive rating action is possible if Free operating cash flow/ Scope-adjusted Debt would improve towards 15%, through either improving operating profitability or decreasing outstanding Scope-adjusted debt. A negative rating action, i.e. a downgrade, might occur if interest cover deteriorated below 2.0x in the medium term or funds from operations/ Scope-adjusted Debt remained below 5 % beyond 2022. Scope notes that the senior unsecured bond issued by Reneszánsz under the Hungarian Central Bank's Bond Scheme has an accelerated repayment clause. The clause requires Reneszánsz to repay the nominal amount (HUF 2.4bn) within 30 days after the bond rating falls below a B-, which could have a default implication.

Ratings & Outlook

Issuer	B/Stable
Senior unsecured debt	B+

Analyst

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Related Methodology

Metals and Mining Rating Methodology, 27 October 2022

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Bloomberg: RESP SCOP

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
16 November 2022	Affirmation	B/Stable
17 December 2021	Monitoring review	B/Stable
29 January 2021	New	B/Stable

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Market leader in Hungary for limestone • Unique stone properties; mine in proximity to a captive market • Long mine reserve life • Much improved liquidity after HUF 5.7bn capital injection	• Single site operator with limited geographic and customer diversification. • High leverage after (mine) operating lease adjustment • Highly exposed to changes in energy prices • High capex requirements and negative free operating cash flow historically (after capex)

Positive rating-change drivers	Negative rating-change drivers
• Free operating cash flow /Scope-adjusted Debt towards 15%	• Funds from operations / Scope-adjusted Debt below 5% • EBITDA interest cover below 2x

Corporate profile

Reneszánsz operates Hungary's largest limestone quarry located in Süttő in northern Hungary, next to the Danube River about 65km from the city of Budapest. The 90-hectare mine has been exploited since ancient Roman times and still holds about 300 years of reserves. Reneszánsz holds a 70-year lease to operate and extract limestone from the quarry, agreed with the mine's owner, a state-owned entity formerly owned by a shareholders of Reneszánsz, Mészkőbánya Ltd. The limestone mined by the company has unique physical properties that makes it very durable and resistant to frost, salt and abrasion. The stone is processed in 11,000 sqm of industrial halls adjacent to the mine. The company employs 200 people including 70 stonemasons. Many national heritage buildings in Budapest are built with limestone from the Süttő quarry.

Reneszánsz has been majority owned by the Balogh family since 2014; the owner has worked in the business since 1970. The mine itself was sold in January 2022; the transaction has preserved the 70-year exclusive concession rights on the quarry, ensuring the continuous supply of raw material.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	4.7x	3.5x	3.5x	2.9x	3.4x	3.4x
Scope-adjusted debt/EBITDA	6.3x	7.7x	7.4x	8.0x	7.1x	7.1x
Scope-adjusted funds from operations/debt	13%	9%	10%	11%	10%	10%
Scope-adjusted free operating cash flow/debt	-9%	4%	-26%	-47%	-7%	3%
Scope-adjusted EBITDA in HUF m						
EBITDA	414,986	338,163	417,859	289,186	383,351	378,841
Operating lease payments	308,700	320,000	330,000	344,000	361,200	379,260
Disposal gain on fixed assets	33,800	0,00	0,00	0,00	0,00	0,00
Scope-adjusted EBITDA	757,486	658,163	747,859	633,186	744,551	758,101
Funds from operations in HUF m						
Scope-adjusted EBITDA	757,486	658,163	747,859	633,186	744,551	758,101
less: (net) cash interest paid	162,723	187,795	221,091	216,500	220,634	225,189
less: cash tax paid per cash flow statement	-0,200	-2,088	-16,741	0,00	0,00	0,00
add: other financial income	33,800	8,492	48,347	0,00	0,00	0.00
add: change in provisions	-40,600	-746,521	-70,880	0,00	0,00	0,00
Funds from operations (FFO)	599,863	476,772	558,374	416,686	523,918	532,912
Free operating cash flow in HUF m						
Funds from operations	599,863	476,772	558,374	416,686	523,918	532,912
Change in working capital	-203,100	868,142	-965,573	628,857	-262,464	320,178
Non-operating cash flow	0,00	0,00	-324,085	-369,113	67,624	-165,915
less: capital expenditure (net)	-580,600	-195,715	-465,168	-2,885,849	-500,000	-350,000
less: lease amortisation	-171,577	-162,906	-156,139	-148,769	-140,795	-132,400
Free operating cash flow (FOCF)	-429,814	227,585	-1,444,535	-2,393,795	-363,892	134,204
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	25,600	42,001	68,530	56,569	52,720	48,889
add: interest component, operating leases	137,123	145,794	152,561	159,931	167,905	176,300
Change in other items	0,00	0,00	0,00	0,00	0,00	0,00
Net cash interest paid	162,723	187,795	221,091	216,500	220,634	225,189
Scope-adjusted debt in HUF m						
Reported gross financial debt	1,931,664	2,111,339	2,408,844	2,404,422	2,404,422	2,284,000
less: cash and cash equivalents	0,00	0,00	0,00	-627,395	-536,422	-539,973
add: operating lease obligations	2,850,383	2,981,363	3,121,067	3,276,190	3,440,000	3,612,000
Other items	0,00	0,00	0,00	0,00	0,00	0,00
Scope-adjusted debt	4,782,047	5,092,702	5,529,911	5,053,218	5,308,000	5,356,027

Reneszánsz Kőfaragó Zrt.

Hungary, Metals and Mining

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Environmental, social and governance (ESG) profile[1]

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

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Improving production efficiencies after the end of the investment, but potential regulatory risk

Natural stone is an environmentally friendly building material according to LEED and BREEM standards. Natural stone rates well in terms of recyclability, heat storage/reflection and service life. It also emits no volatile organic compounds. The limestone at Süttő has uniquely physical properties: it is exceptionally resistant to frost, salt and abrasion. The stone is mined at surface level, reducing the expense and energy consumed in extraction, with the processing plant on site and the key market in Budapest only 65km away.

Scope notes the regulatory risk related to the potential amendment of mining concession after the quarry and the limestone deposits moved into government ownership.

Investments in 2021-22 improved the efficiency of mining and stoneworking. The procurement of new tools and the refurbishment of existing machinery made order fulfilment quicker and the production process smoother with fewer steps involved.

Reneszánsz will also invest in a solar park to reduce its electricity consumption and carbon footprint and make energy procurement more sustainable.

[1] 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

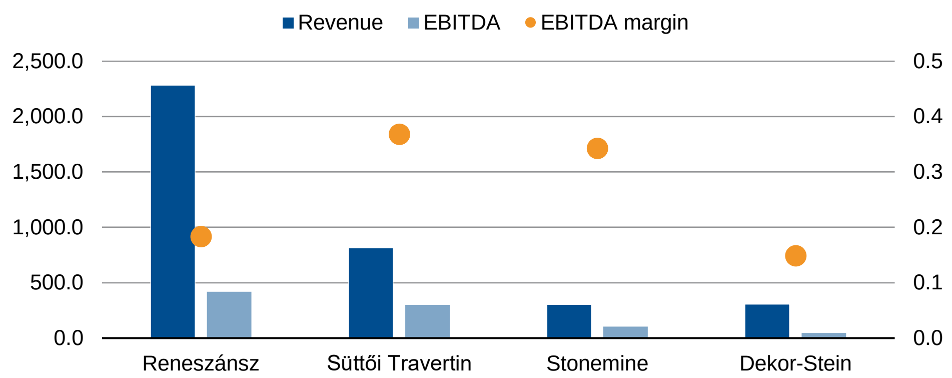
Reneszánsz operates in metals and mining, an industry we rate at BB based on its high cyclicality, medium substitution risk, and medium barriers to entry.

Limited diversification by products and customers; highly concentrated order book

The company's performance is closely tied to public spending as most of its products are used for the construction and renovation of government buildings in Budapest. The fact that many national heritage buildings in Budapest are constructed with limestone from the Süttő quarry provides a captive market for the company's products.

Customer concentration is high, with one entity accounting for about 32% of revenues in 2021. This is no surprise given the high concentration of the order book: large projects such as the renovation of the Buda Castle in Budapest absorb production capacities. Reneszánsz has a healthy order book of four years; however, given its high concentration, delays are likely and make the distribution of revenues difficult to forecast.

Figure 1: Hungarian limestone producers with own quarries (2021 data)

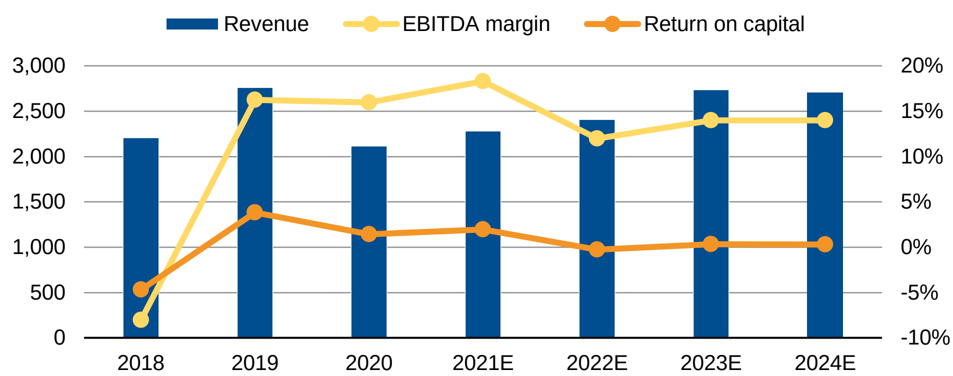


Sources: Reneszánsz , Scope

Leading market position in Hungary

The company is the largest limestone producer in Hungary (see Figure 1) with an estimated market share of 15%-18% for dimension stone. The market is fragmented with 75%-80% of supplies originating from outside of Hungary, mostly Turkey and Italy. This implies weak pricing power for the company, but also potential for increasing market share. Reneszánsz has competitive advantages over imported products in terms of its transport costs, the type and quality of its stone, and its skilled workforce (stonemasons)

Figure 2: Revenue and profitability (HUF m)



Sources: Reneszánsz , Scope

Operating profitability under heavy pressure from energy prices

Profitability has been limited, with significant volatility in both revenue and earnings (see Figure 2). The 2021 results improved on a year-on-year basis, as expected (18.5% EBITDA margin). From Q1 2022, margins have come under strong pressure from rising energy prices. Mining and stoneworking are inherently energy-intensive and the company is limited in its ability to mitigate energy price changes. In the medium term, the company plans to improve energy security by investing in a solar park, which would cover around 30% of the workshop's electricity needs.

Strong cost and reserve position

The limestone extracted from the Süttő quarry is uniquely durable. The surface mine has a reserve life that vastly exceeds the 70-year concession agreement. The cost of extracting the limestone is also relatively low.

Financial risk profile: B

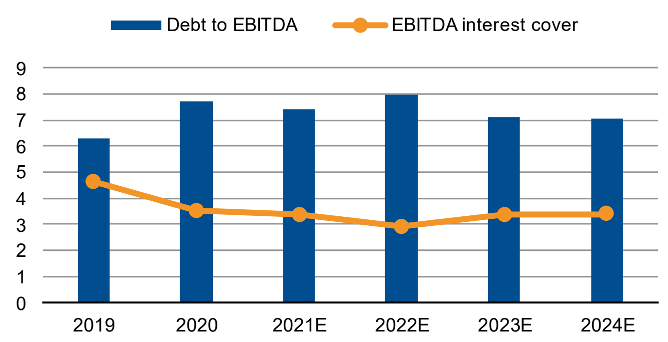
Increasing leverage due to lower profitability; debt protection and cash flow cover remain adequate

The financial risk profile (assessed at B) is driven by the issuer's high leverage as measured by Scope-adjusted debt/EBITDA, expected to increase to 8.0x in 2022, and remain at around 7.0x in the next 2-3 years. Scope-adjusted debt includes mine concession payables and the net present value of future mine concession commitments totalling HUF 3.3 bn. The Scope-adjusted debt also includes partial netting of the unrestricted cash, to reflect the positive effect of the capital injection in the leverage metrics. We forecast leverage to deteriorate due to the worsening margins caused by rising energy prices. In the medium term, we expect Scope-adjusted debt to improve as the bond amortises from 2024 with principal repayment of HUF 120m yearly.

Debt service protection, measured by Scope-adjusted EBITDA/interest cover, remains comfortably above 3x despite the worsening profitability thanks to a low cost of debt. The bond issuance in April 2021 secured funding and locked in borrowing costs for the next 10 years, with amortisation starting only in 2024.

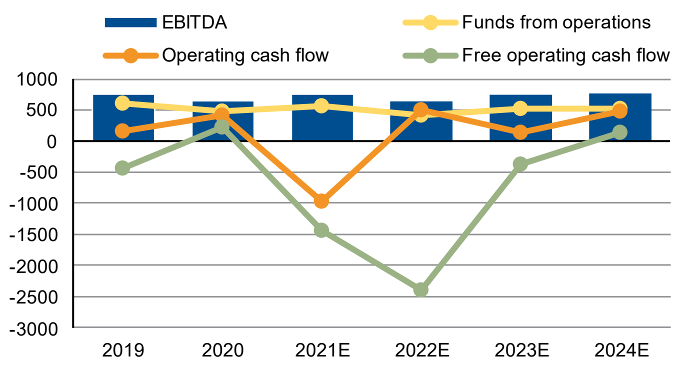
The significant capital investment phase from 2018 until July 2022 has left the company with negative free operating cash flow (see Figure 5.). With lower capital expenditure and no dividend payments expected beyond 2022, free operating cash flow is expected to turn positive in the medium term despite the weaker profitability.

Figure 3: **Scope-adjusted leverage and interest cover**



Sources: Reneszánsz, Scope (estimates)

Figure 4: Scope-adjusted cash flow



Sources: Company name, Reneszánsz (estimates)

Adequate liquidity, with additional buffer after the capital injection

Liquidity is adequate. The only short-term debt that will mature relates to bond amortisation, while the negative free operating cash flow (resulting from capital expenditure) will be funded with the green bond proceeds. Liquidity became the strong point of the financial risk profile following the HUF 5.7bn capital injection in Q1 2022. While these funds are earmarked for potential future investments, they are held in easily accessible, marketable assets, forming an additional liquidity buffer.

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	377,920	210,097	2,509,580
Open committed credit lines (t-1)	0,00	0,00	0,00
Free operating cash flow	-1,444,535	-2,393,795	-363,892
Short-term debt (t-1)	2,111,339	8,844	4,422
Coverage	**Negative**	**No ST Debt**	**No ST Debt**

Long-term debt ratings

Senior unsecured debt rating: B+

In April 2021, Reneszánsz issued a HUF 2.4bn senior unsecured bond (ISIN: HU0000360375) through the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond proceeds have been used for refinancing and capital investment, i.e. to procure new mining and stone working equipment and refurbish existing equipment. The bond's tenor is 10 years, with a fixed coupon of 3.2% and repayment in eight tranches: 5% of the face value in 2023 and 2025; 10% yearly between 2026 and 2030; 40% at maturity in 2031.

We have rated the senior unsecured debt issued by Reneszánsz at B+, one notch above the issuer rating. The recovery is 'above average' for senior unsecured debt holders in a liquidation scenario.

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