Reneszánsz Kőfaragó Zrt.
Hungary, Metals & Mining

B STABLE

Corporate profile

Reneszánsz Kőfaragó Zrt. (Reneszánsz) was founded in 1948 and operates Hungary's largest limestone quarry (in Süttő, on the Danube about 65km from Budapest). The company, which has been controlled by the Balogh family since 2014, has the right to mine, process and sell stone from the quarry under a 70-year exclusive concession agreement. The limestone at the Süttő quarry has unique properties and has been used to construct many important national heritage buildings in Budapest. The company is seeking to raise HUF 2.4bn through a bond issuance, half for refinancing and half for capital expenditure.

Key metrics

		Scope estimates		
Scope credit ratios	**2019**	**2020E**	**2021E**	**2022E**
EBITDA/interest cover (x)	4.8x	3.4x	4.0x	4.1x
Scope-adjusted debt (SaD)/EBITDA (x)	5.9x	6.8x	5.8x	5.5x
Funds from operations/SaD (%)	13%	10%	13%	16%
Free operating cash flow/SaD (%)	-10%	-2%	-14%	3%

Rating rationale

Scope Ratings has today assigned a first-time issuer rating of B/Stable to Hungarian limestone producer Reneszánsz Kőfaragó Zrt. Senior unsecured debt has been rated B+.

The business risk profile (assessed at B+) is supported by i) the group's 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 that serve as a captive market for the company; iii) the mine's low cost and very long reserve; and iv) opportunities to grow the business by investing in plant and equipment, which would increase both production and efficiency. The company operates Hungary's largest limestone quarry, which is in Süttő, situated on the Danube about 65km from Budapest. The company, controlled by the Balogh family since 2014, has the right to mine, process and sell stone from the quarry under a 70-year exclusive concession agreement.

The issuer's business risk profile is constrained by the small absolute size of its business, concentration on a single site, high customer concentration, and significant historical earnings volatility. The company is seeking to raise HUF 2.4bn through a bond issuance under the Hungarian National Bank's Bond Funding for Growth Scheme; half of the proceeds will be used for refinancing and the other half for capital expenditure. The investment in new plant and equipment has the potential to increase production, efficiency and profitability, which is currently below the industry average, with the return on capital in the low single-digits.

The financial risk profile (assessed at B) is driven by the issuer's high financial leverage (SaD/EBITDA), including the capitalisation of future mine concession payments, expected to remain above 5x for the coming 2-3 years. The company is in a capital investment-intensive period expected to last until the end of 2021, resulting in negative free operating cash flow (FOCF). With minimal capital expenditure and no dividend payments expected beyond 2021, as well as likely higher earnings as a result of the plant modernisation, we see potential for positive FOCF from 2022 onwards. Liquidity is considered adequate, with no short-term debt other than related-party liabilities and capex to be funded with bond proceeds.

Ratings & Outlook

Corporate ratings	B/Stable
Senior unsecured rating	B+

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Related Methodology

Corporate Rating Methodology, 26 Feb 2020

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Outlook and rating-change drivers

The Outlook is Stable and incorporates our view of the company's solid order backlog at the end of 2020, with firm orders in excess of one year of production, and the potential for improved FOCF from 2022 onwards on the back of the plant and equipment upgrade planned for 2021.

A positive rating action would require an improvement in FOCF generation, measured by FOCF/Scope-adjusted debt, to above 5% (2019: -10%), and leverage of around 4x (2019: 5.9x).

A negative rating action could be warranted if FOCF generation remains negative beyond 2021. This could be caused by a failure to improve efficiency and/or weaker-than-expected demand for the company's products.

Rating drivers

Positive rating drivers	Negative rating drivers
• High visibility as market leader in Hungary for limestone dimension stone • Unique stone properties; mine close to national heritage buildings in Budapest • Low-cost and long-life mine reserve • Opportunity to improve efficiency and displace imports of finished products (tiles, pavers and façade claddings) through investment in new mining and production equipment • No dividend payments anticipated	• Single site operator with limited geographic and customer diversification • High leverage after capitalisation of future mine concession obligations • High capex requirements and negative historical free FOCF generation (after capex)

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• FOCF/SaD of above 5% and SaD/EBITDA of about 4x on a sustained basis	• Negative FOCF beyond 2021 and SaD/EBITDA of above 6x

Financial overview

		Scope estimates		
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Free operating cash flow/SaD (%)	-10%	-2%	-14%	3%
Scope-adjusted EBITDA (HUFm)	**2019**	**2020E**	**2021E**	**2022E**
EBITDA	415	368	617	653
Operating lease payments in respective year	309	320	330	339
Gains/losses on sale of assets	34	0	0	0
Scope-adjusted EBITDA	**757**	**688**	**946**	**993**
Scope-adjusted funds from operations (HUF m)	**2019**	**2020E**	**2021E**	**2022E**
EBITDA	415	368	617	653
less: cash interest as per cash flow statement	-20	-66	-96	-96
less: cash tax paid as per cash flow statement	0	-7	-4	-25
Add: depreciation component, operating leases	177	182	188	193
Gains/losses on sale of assets	33	0	0	0
Scope-adjusted funds from operations	**604**	**477**	**704**	**725**
Scope-adjusted debt (HUF m)	**2019**	**2020E**	**2021E**	**2022E**
Reported gross financial debt*	1,932	2,012	3,036	2,936
less: cash, cash equivalents	-167	-143	-399	-483
Other debt-like obligations	2,716	2,799	2,883	2,970
Scope-adjusted debt	**4,480**	**4,668**	**5,521**	**5,423**

*Including past mine concession payables.

Business risk profile: B+

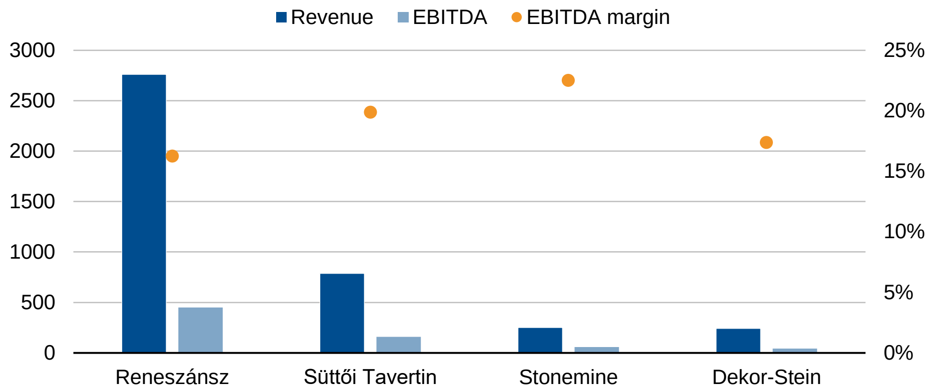
Industry risk of BB based on high cyclicality, and medium barriers to entry and substitution risk

We classify Reneszánsz as a metals and mining company, an industry we rate BB based on a high level of cyclicality, medium risk of substitution, and medium barriers to entry.

Leading market position in Hungary and captive clientele in Budapest national heritage buildings

With the majority of the company's products used for the construction and renovation of government buildings in Budapest, business performance is closely tied to the level of public spending on building and renovation projects in Hungary. 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 only a handful of customers accounting for the vast majority of revenues. However, with mostly public sector clients, and advances of 10%-30% of orders, we expect any credit losses to be manageable.

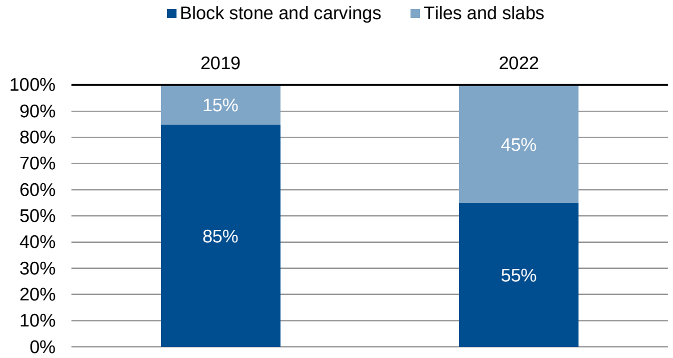
Figure 1: Hungarian limestone producers with own quarries (2019 data)



Sources: Reneszánsz, Scope

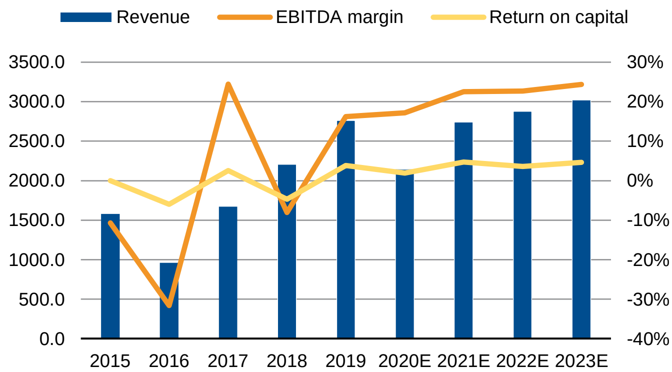
The company is the largest limestone producer in Hungary (see Figure 1) with an estimated market share of 15%-18% for dimension stone. The market is relatively fragmented with 75%-80% of supplies originating outside of Hungary, mostly from Turkey and Italy. This implies little pricing power for the company, but also potential for increased market share going forward. Reneszánsz has competitive advantages over imported products in terms of transportation costs, the type and quality of the stone, and a skilled workforce (stonemasons). With additional investment in plant and equipment, the company is looking to displace some of the imported products, by increasing production volume and efficiency, as well as broadening its product slate and producing more finished products (tiles and slabs). The aim is also to reduce dependency on a few large customers through the broader product offering.

Figure 2: Revenue breakdown by product



Sources: Reneszánsz, Scope

Figure 3: Revenue and profitability

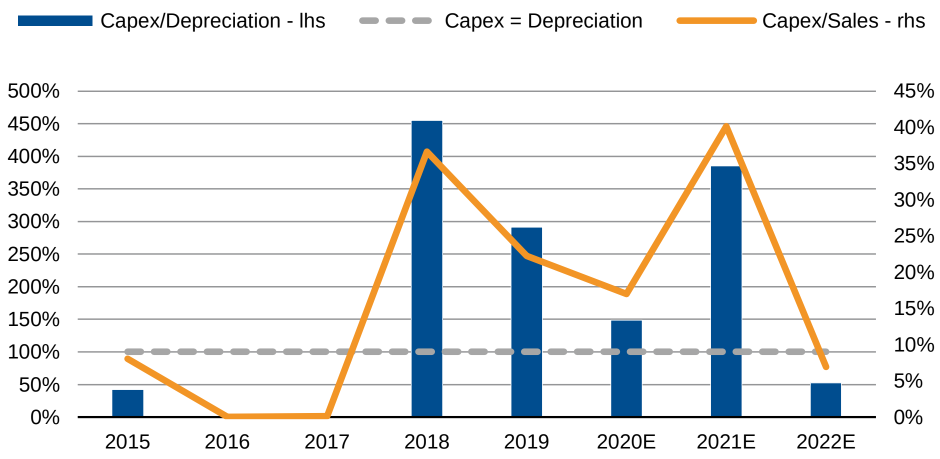


Sources: Reneszánsz, Scope

The limestone extracted from the Süttő quarry has unique physical properties that makes it exceptionally durable (resistant to frost, salt and abrasion). Reserves of the surface mine vastly exceed the 70-year concession life, and the cost of extraction is relatively low. However, the company pays an annual fee to related party Mészkőbánya Zrt. for the right to mine the quarry, which adds to the cost of goods sold.

The company has a relatively weak profitability track record, with significant volatility in both revenue and earnings (see Figure 3). This partly reflects the company's refocusing on core business (mining and processing of limestone) and exit from construction activities. We expect to see improved earnings in 2022 onwards, on the back of nearly HUF 3bn of actual and expected capital investments in 2018-2021 that should enable the company to increase production volumes and efficiency and result in an improved product mix (see Figure 2). The company has undergone major capital investment programmes every 8-12 years in the past, with the last cycle started in 2018 (see Figure 4).

Figure 4: Capex to turnover/depreciation



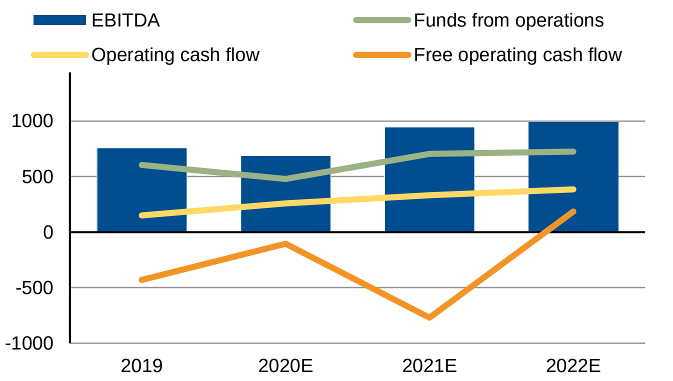
Financial risk profile: B

Sale of quarry in 2018 provided much needed funds for capex, but resulted in a sizeable annual mine lease commitment

The financial risk profile (assessed at B) is driven by the issuer's high financial leverage measured by SaD/EBITDA, expected to remain above 5x for the coming 2-3 years. The SaD calculation includes mine concession payables and the net present value of future mine concession commitments totalling HUF 2.8bn.

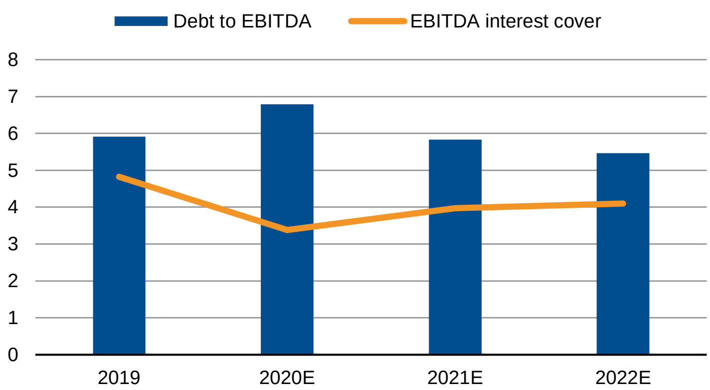
Debt service protection, measured by Scope-adjusted EBITDA interest cover, remains comfortably above 3 times, however, thanks to a relatively low cost of debt (see Figure 6). The proposed bond issuance will secure funding and lock in the borrowing cost for Reneszánsz for the next 10 years, with amortisation starring only in 2026.

Figure 5: Scope-adjusted cash flow (HUF bn)



Sources: Reneszánsz, Scope

Figure 6: SaD/EBITDA and interest cover



Sources: Reneszánsz, Scope

Absence of growth capex and dividends should help FOCF generation from 2022 onwards

The current significant capital investment phase, which commenced in 2018, is expected to continue until the end of 2021 and has resulted in negative FOCF. With minimal capital expenditures and no dividend payments expected beyond 2021, as well as higher earnings anticipated as a result of the plant modernisation, we see potential for positive FOCF from 2022 onwards (See Figure 5).

Liquidity supported by absence of third-party short-term debt and capex funded by the planned bond

Liquidity is currently considered adequate, given that all short-term debt comprises past mine concession expenses owed to Mészkőbánya Zrt., which is controlled by the same shareholder, and a large portion (HUF 1.1bn) of cash outflows comprising capex are to be funded by the planned bond (not captured by Scope's measure of liquidity in Figure 7 below). The two entities have agreed that the HUF 796m payable will be repaid over several years, starting with HUF 160m in 2021 and HUF 100m in both 2022 and 2023.

Figure 7: Liquidity

in HUFm	2019	2020E	2021E
Cash and marketable securities (t-1)	58	167	143
Committed unused bank facilities (t-1)	0	0	0
Short-term debt (t-1)	710	716	796
Free operating cash flow (t)	-430	-105	-769
Liquidity (%) – internal	**-52%**	**9%**	**-79%**
Liquidity (%) – internal + external	**-52%**	**9%**	**-79%**

Source: Reneszánsz, Scope

Debt notched up based on limited prior-ranking debt, modern equipment and large finished goods stocks

We have assigned a debt class rating of B+ to the issuer's senior unsecured debt, one notch higher than the issuer rating of B. This reflects the limited prior-ranking liabilities in the capital structure, relatively modern plant and equipment given the actual and planned capex of nearly HUF 3bn in 2018-2021, relatively large finished goods stock of HUF 1.6bn, and negative pledge provisions to be incorporated in the planned bond indenture. We estimate an above average recovery for senior unsecured debt holders in a default scenario.

Our base case financial forecast assumes the successful placement of the HUF 2.4bn senior unsecured bond with a fixed annual coupon under the Hungarian National Bank's Bond Funding for Growth Scheme. We expect the bond to have a 10-year tenor, with amortisation of 5% yearly in 2024-2025, 10% yearly in 2026-2030 and a 40% bullet maturity in 2031[1]. Bond proceeds are earmarked for refinancing and capital expenditures.

[1] This sentence was amended on 31 March 2021. The original sentence was: "We expect the bond to have a 10-year tenor, with amortisation of 10% yearly commencing in 2026 and a 50% bullet maturity in 2031 .

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