Reneszánsz Kőfaragó Zrt.
Hungary, Metals and Mining

B STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024 E**	**2025 E**
Scope-adjusted EBITDA/interest cover	4.3x	3.4x	4.0x	4.0x
Scope-adjusted debt/EBITDA	8.3x	7.1x	6.2x	6.1x
Scope-adjusted funds from operations/debt	13%	10%	12%	12%
Scope-adjusted free operating cash flow/debt	-52%	-15%	-2%	1%

Rating rationale

The business risk profile of Reneszánsz (assessed at B+) is supported by: i) the solid domestic market position; ii) a strong, although highly concentrated order book, with capacities fully utilized till 2026; iii) stable operating profitability, as reported EBITDA margin expected to stay close to 15%, benefitting from the significant machinery investments in the previous years; iv) the long reserve life of the mine. The business risk profile is constrained by the small absolute size in both a European and global context, and weak diversification in terms of activity, products, order book and geographies.

The financial risk profile, assessed at B, is driven by the issuer's high financial leverage. Debt protection (Scope-adjusted EBITDA/interest cover) is expected to remain comfortably around 4.0x. Cash flow cover, measured by Scope-adjusted free operating cash flow/debt, is expected to remain close to break even, mainly due to the increased working capital needs (higher inventory). Liquidity is adequate, as sources (HUF 696m cash available as of YE 2023) fully cover the negative FOCF of HUF 145m and HUF 120m maturing short term debt in 2024.

Outlook and rating-change drivers

The Stable Outlook reflects our assumption that Reneszánsz's credit metrics will develop in line with our financial forecasts, with the EBITDA margin remaining close to historical averages (24%-28%) and EBITDA interest coverage maintained at around 4.0x. The base case also assumes significantly lower capex from 2024 (marking the end of the current investment-heavy cycle), resulting in close to break-even free operating cash flow generation after 2023. The Outlook also reflects the expectation of continued adequate liquidity and improved revenue visibility beyond 2026 within the next few months, given the issuer's unique market positioning.

The upside scenarios for the ratings and Outlook are (collectively): (1) Significant growth in size (a scenario considered remote at present); and (2) improvement in Scope-adjusted free operating cash flow/debt towards 15%.

The downside scenarios for the ratings and Outlooks are (individually): (1) No material improvement in Scope-adjusted free operating cash flow, i.e. higher cash consumption from net working capital, with cash generation remaining insufficient to cover annual debt repayment instalments; or (2) no improved visibility on revenue development beyond 2026 until end of H1 2025; or (3) a deterioration in Scope-adjusted EBITDA interest cover to below 2.0x.

Ratings & Outlook

Issuer	B/Stable
Senior unsecured debt	B+

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Related Methodologies

General Corporate Rating Methodology; October 2023

Metals and Mining Rating Methodology; October 2023

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
30 September 2024	Affirmation	B/Stable
17 November 2023	Affirmation	B/Stable
16 November 2022	Affirmation	B/Stable

Rating and rating-change drivers

Positive rating drivers

- Market leader in Hungary for limestone
- Strong order book, with capacities utilised till 2026
- Unique stone properties in close proximity to historic national heritage buildings in Budapest
- Long-life mine reserve

Negative rating drivers

- Single site operator with limited geographic and customer diversification
- High leverage after (mine) operating lease adjustment
- Small absolute size in a European and global context
- Weak free operating cash flow generation
- Limited visibility on revenues beyond 2026

Positive rating-change drivers

- Significant growth in size (a scenario considered remote at present)
- Improvement in Scope-adjusted free operating cash flow/debt towards 15%

Negative rating-change drivers

- No material improvement in Scope-adjusted free operating cash flow, i.e. higher cash consumption from net working capital, with cash generation remaining insufficient to cover annual debt repayment instalments.
- No improved visibility on revenue development beyond 2026 until end of H1 2025
- A deterioration in Scope-adjusted EBITDA interest cover to below 2.0x

Corporate profile

Reneszánsz operates Hungary's largest limestone quarry located in Süttő in northern Hungary, next to the Danube River about 65 km 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 shareholder 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. 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 preserved the 70-year exclusive concession rights on the quarry, ensuring the continuous supply of raw material.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	3.4x	4.3x	3.4x	4.0x	4.0x	3.8x
Scope-adjusted debt/EBITDA	7.3x	8.3x	7.1x	6.2x	6.1x	5.9x
Scope-adjusted funds from operations/debt	9%	13%	10%	12%	12%	12%
Scope-adjusted free operating cash flow/debt	-25%	-52%	-15%	-2%	1%	-1%
Scope-adjusted EBITDA in HUF m						
Reported EBITDA	418	380	491	567	572	592
Operating lease payments	330	349	400	468	487	506
Recurring associate dividends received	48	0	0	0	0	0
Scope-adjusted EBITDA	**796**	**729**	**891**	**1,035**	**1,059**	**1,098**
Funds from operations in HUF m						
Scope-adjusted EBITDA	796	729	891	1,035	1,058	1,098
Scope-adjusted interest	(234)	(171)	(263)	(256)	(266)	(288)
less: cash tax paid per cash flow statement	(17)	(37)	(10)	(10)	(9)	(10)
Other non-operating charges	0	266	0	0	0	0
Funds from operations (FFO)	**545**	**786**	**618**	**769**	**783**	**800**
Free operating cash flow in HUF m						
Funds from operations	545	786	618	768	784	800
Change in working capital	(966)	(703)	(1,048)	(53)	(54)	(209)
Non-operating cash flow	(395)	(248)	713	0	0	0
less: capital expenditure (net)	(465)	(2,829)	(1,035)	(600)	(400)	(400)
less: lease amortization	(165)	(164)	(199)	(260)	(269)	(280)
Free operating cash flow (FOCF)	**(1,446)**	**(3,158)**	**(951)**	**(145)**	**61**	**(89)**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	68	(13)	62	48	48	62
add: interest component, operating leases	165	185	201	208	218	227
Net cash interest paid	**233**	**172**	**263**	**256**	**266**	**289**
Scope-adjusted debt in HUF m						
Reported gross financial debt	2,404	2,503	2,400	2,280	2,160	1,920
less: cash and cash equivalents[1]	0	(449)	(174)	(108)	(93)	(11)
add: operating lease obligations	3,385	3,998	4,059	4,271	4,442	4,619
Scope-adjusted debt	**5,789**	**6,052**	**6,285**	**6,443**	**6,509**	**6,528**

[1] 25% netting of cash on balance sheet applied from 2022 onwards, to reflect the positive effects of the capital injection

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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)	Grey leaf	Labour management		Management and supervision (supervisory boards and key person risk)	Grey leaf
Efficiencies (e.g. in production)	Grey leaf	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)

Improving production efficiency with the end on the current investment cycle

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 65 km away.

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.

[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

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.

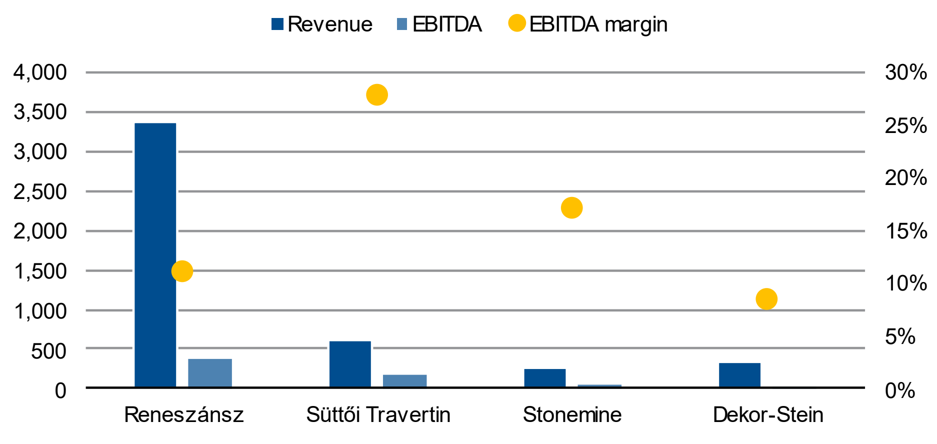
Strong domestic market position, with output benefitting from the recent investments

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 the potential for increased market share going forward. Reneszánsz has competitive advantages over imported products in terms of transportation cost, type and quality of the stone and a skilled workforce (stonemasons). With additional investment finished in 2023 in plant and equipment, the company is increasing production volume and efficiency, as well as broadening its product slate and producing more high value-added products.

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.

The limestone extracted from the Süttő quarry has unique physical properties that makes it exceptionally durable (resistant to frost, salt and abrasion). The surface mine has reserves that vastly exceed the 70-year concession life, and the cost of extraction is relatively low. In 2023 Reneszánsz paid HUF 400m to the owner of the quarry, Mészkőbánya Zrt., for the right to mine the quarry. This amount is expected to increase to HUF 464m in 2024.

Figure 1: Hungarian limestone producers (2023 data, HUF m)



Sources: Reneszánsz, Scope

Although Reneszánsz has a strong market position in a niche sector on the domestic market, the company's absolute size is still small, both in a domestic or European context. This makes the issuer more vulnerable to external shocks, and limits the issuers ability to mitigate the risk stemming from the market environment.

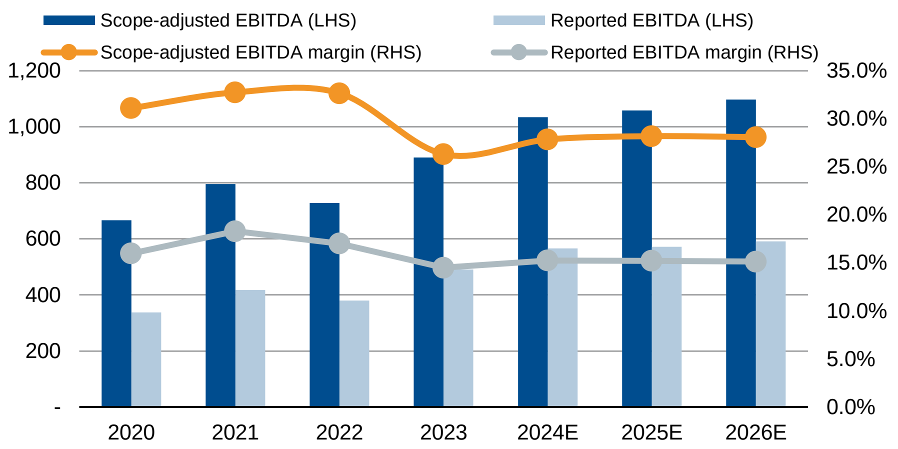
Still limited diversification and highly concentrated order book

Asset diversification remains low, as mining operation is happening at a single site, comprising quarry and adjacent production facilities. Rock is extracted from two separate locations at the quarry, and the production facilities are spread across separate buildings. The product suite is also concentrated to dimension stone and carvings, with no expected change over the medium term.

Customer concentration remains high, with a single entity accounting for about 42% of revenue in 2023. This is no surprise taking into consideration the highly concentrated nature of the order book. Large-scale projects, such as the renovation of the Buda Castle absorb the limited production capacities of Reneszánsz, and the general contractor in these projects is usually the most important customer.

Reneszánsz has a healthy order book of two years, but taking into account the highly concentrated nature, delays are highly probable. Please note that the Buda Castle project has not been affected by the cancellation of public procurement projects. The other significant project in the order book is the reconstruction of several historical buildings located on the Kossuth Square, Budapest. There are currently projects similar in size in negotiation, but we note that the overall the visibility on potential orders beyond 2026 is limited.

Figure 2: Development of reported and Scope-adjusted EBITDA (HUF m) and Scope-adjusted and reported EBITDA margin (%)



Sources: Reneszánsz, Scope

Operating profitability remains resilient despite more challenging business environment

The EBITDA margin of Reneszánsz has shown relatively low volatility historically, staying in the range of 15-18% in the past three years. In 2023 the reported EBITDA margin deteriorated to 14.5% (2022: 17%), mainly as a result of the increasing pressure from the input costs, most notably wages. The significant investments in the past years enabled Reneszánsz to improve not just capacity, but also efficiency (lower energy consumption and more efficient extraction processes, for example) benefitting not just the EBITDA margin, but also reducing the volatility. This is reflected by the more resilient gross margin, remaining largely unaffected by the adverse market conditions. In H1 2024 we see a slight improvement of the EBITDA margin (moving above 15%) in line with our forecast.

It is important to note that the development of the reported EBITDA margin is a more accurate indicator of Reneszánsz's business performance than the Scope-adjusted EBITDA. An examination of the evolution of the reported EBITDA over the previous two years reveals a modest decline (2022: 17.0%, 2023: 14.5%), while the decline in Scope-adjusted EBITDA is significantly higher (2022: 32.7%, 2023: 26.3%). This increased volatility is linked to the fact that operating lease payments (which account for almost half of Scope-adjusted EBITDA) are indexed to inflation and increased by only 20%, while revenues increased by 51.8%. This has an adverse effect on the Scope-adjusted EBITDA margin and results in increased volatility.

Going forward we expect profitability to remain relatively flat, reported EBITDA margin between 14 -15%, and Scope-adjusted EBITDA margin around 28%. We expect the issuer to be able to dominantly reflect the effects of external shocks (energy price or wage cost increases) in their selling prices, and due to the highly specialized nature of their products, this price taker nature of the market is expected to remain on the medium term.

Long quarry reserve life benefitting the business risk profile

Limestone has been mined since the roman times at the Süttő quarry, and the reserve is expected to last for the next several hundred years. The limestone mined here is suitable for both indoor and outdoor flooring, and has unique properties not just visually, but by being resistant to extreme temperatures. Additionally, the limestone is more environmentally friendly, by being reusable, and no hazardous material is created during the demolishing of limestone constructs.

Financial risk profile: B

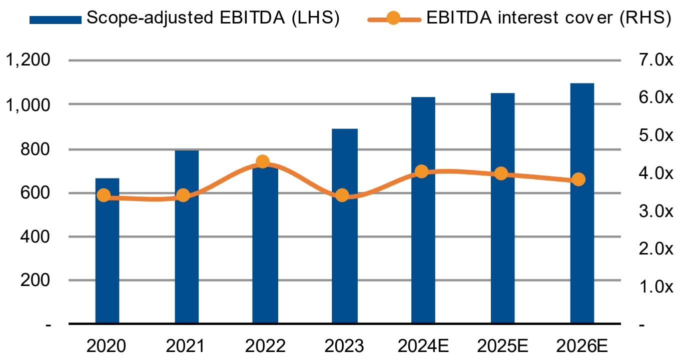
Financial risk profile constrained by leverage metrics and negative free operating cash flow, but supported by strong interest coverage

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 gradually improve towards 6.0x (2023: 7.1x), as the bond amortisation starts from 2024 with a yearly HUF 120m in principal repayment. In addition to the bond of HUF 2.4bn, we include mine lease payables in financial debt, and adjust this further by adding the net present value of future mine lease commitments totalling HUF 4.0bn to Scope-adjusted debt.

Debt protection (Scope-adjusted EBITDA interest cover) is expected to remain comfortably above 3.0x. This is due to the favourable coupon of the bond issued in 2021 which is fixed for the whole tenor (3.2%), and no plans or need by the issuer to seek for new interest-bearing debt. The Scope-adjusted interest expense also includes the interest component of operating lease payments, HUF 201m in 2023.

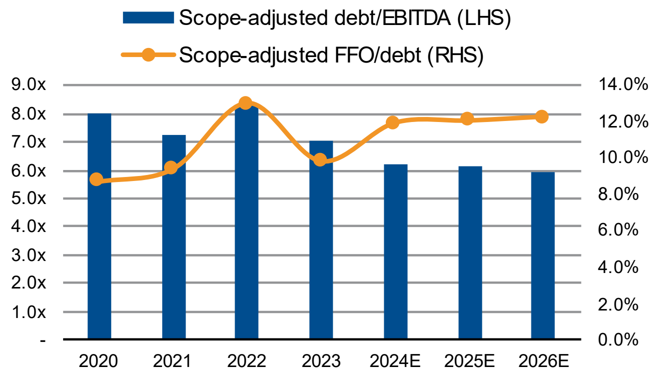
Cash flow cover, measured by Scope-adjusted FOCF/debt has been highly negative in the previous years, mainly as a result of the significant CAPEX undertaken. We expect FOCF generation to be close to break-even going forward, despite the lower capital expenditure, mainly due to the cash outflow related to the increasing inventory. Management voiced the strategy to keep inventory below HUF 5bn – while this is still high, this is due to the nature of the business (stone slabs are kept in the inventory of Reneszánsz till the whole stoneworking process, from mining till the end of the construction phase. The weak FOCF generation significantly limits the company's ability to deleverage (as debt repayments are expected to be covered by available free cash, not FOCF) and creates the need to further increase prices if capacity remains unchanged.

Figure 3: Scope-adjusted EBITDA (HUF m) and interest cover



Sources: Reneszánsz, Scope estimates

Figure 4: Scope-adjusted debt/EBITDA and Scope-adjusted FFO/debt



Sources: Reneszánsz, Scope estimates

Adequate liquidity

Liquidity is adequate, as sources (HUF 696 cash available as of YE 2023) fully cover the negative FOCF of HUF 145m and HUF 120m maturing short term debt in 2024. We note, however, the eroding of cash reserves due to the fact that the forecasted FOCF does not cover the prescribed bond amortization.

Balance in HUF m	2023	2024E	2025E
Unrestricted cash (t-1)	1,794	696	432
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	(952)	(145)	61
Short-term debt (t-1)	103	120	120
Coverage	**>200%**	**>200%**	**>200%**

We highlight that Reneszánsz's senior unsecured bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 2.3bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 30 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is zero notches. Given the limited rating headroom, the company must at least maintain its current credit profile to avoid triggering the rating-related covenant.

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 stoneworking 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 2024 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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