Kometa 99 Zrt.
Hungary, Consumer Products

SCOPE B+ STABLE

Key metrics

			Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	8.5x	35.5x	-5.4x	7.0x	4.0x
Scope-adjusted debt/EBITDA	3.2x	4.5x	4.4x	4.4x	4.8x
Scope-adjusted funds from operations/debt	29%	26%	27%	19%	15%
Scope-adjusted free operating cash flow/debt	4%	-1%	-1%	-17%	-16%

Rating rationale

The issuer rating reflects Kometa's high indebtedness and negative free cash flow amid expansionary capex, which will increase over the coming years. Other rating constraints include Kometa's still limited size, concentration on domestic sales, and a low-margin core business that is highly dependent on pork prices and under pressure from its large food retail customers. The rating benefits from Kometa's leading domestic position within pork products, resilient demand in its industry, the comfortable liquidity buffer supporting interest cover in the next 18 months and its operational efficiency from having all production processes in one facility.

Outlook and rating-change drivers

The Outlook is Stable and reflects our expectation that Scope-adjusted debt/EBITDA will remain below 5.0x and the company will benefit from high interest income and from a strong liquidity cushion for much of 2024 (leverage on a net debt basis should remain below 3.5x over the next 18 months). The Outlook assumes a gradual improvement in EBITDA thanks to normalising livestock prices after a steady increase until mid-2023. Scope's base scenario also assumes that Kometa will not quickly deplete its currently comfortable liquidity buffer before EBITDA reaches above HUF 4bn.

A positive rating action could derive from Scope-adjusted debt/EBITDA being consistently at 3.5x or lower, coupled with a positive Scope-adjusted FOCF/debt. This could result from higher EBITDA thanks to a quick ramp-up in capacity and/or increased market shares in export countries, especially in processed products.

A negative rating action could materialise if Scope-adjusted debt/EBITDA reached above 5.0x on a sustained basis and EBITDA interest cover deteriorated to below 4.0x. This could be driven by further large increases in livestock and energy prices not offset by selling-price adjustments, and/or the use of the liquidity buffer for expansionary capex without a significant improvement in EBITDA.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
13 Nov 2023	Affirmation	B+/Stable
15 Nov 2022	Affirmation	B+/Stable
21 Dec 2021	New	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

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Related Methodologies

General Corporate Rating Methodology; October 2023

Consumer Products Rating Methodology; November 2023

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Third largest pork meat processor in Hungary, with a stronger domestic position in selected categories, such as modified atmosphere packaging (MAP) meat and cold cuts • Resilience of the consumer food sector, as demonstrated during the Covid-19 pandemic • Comfortable liquidity cushion, supported by the prudent decision of postponing expansionary capex in 2022 and 2023 while parking a significant portion of recent bond proceeds into fixed-term deposits • Better ability than peers to generate operating cost savings thanks to all activities within one location • Extensive diversification across pork products • Increasing vertical integration by upcoming acquisition of affiliate livestock breeder Triagro • Minority shareholding from government-related entities	• High leverage and weak free operating cash flow in the medium term amid expansionary capex • Still small absolute size • Limited inherent profitability of core business (fresh meat), with only around 20% of quantities coming from the higher-value-added processed products segment • Historically volatile and price-dependent margins; EBITDA being pressured by extremely high energy and raw materials (including livestock) prices • Competitive industry despite good position in some meat categories; still limited bargaining power against large international food retailers, especially abroad • Limited diversification outside pork products (some turkey processed products); somewhat dependent on pig prices • Concentration on Hungary for almost 60% of volumes sold; reliance on a few export countries (Italy, Croatia, Slovenia) • While strategic partnership with livestock supplier Zito is supportive, dependency on Zito grew above 20% • Increasing dependency – yet still moderate - to customer Lidl for around 15% of sales in 2022 • Relatively weak brand value, as the core business is mostly based on private-label agreements (conversely, around 80% of processed products are branded Kometa) • Tail risk, with asset concentration in one plant

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA sustained at or below 3.5x and positive Scope-adjusted FOCF/debt	• Scope-adjusted debt/EBITDA sustained at above 5.0x and interest cover at below 4.0x

Corporate profile

Kometa 99 Zrt, established in 2000 and owned by the Pedranzini and Ruffini families, is one of Hungary's largest meat processing companies, ranking among the top three in pork processing. The company operates in Kaposvár, in one of the most modern and efficient processing plants in Central Europe. All production processes (slaughtering, butchering, meat-processing and packaging) occur under one roof, recently reinforced by the new by-product processing plant. In 2023, Kometa agreed to acquire the entirety of shares in Hungary-based affiliate Triagro, extending its activities into pig breeding. The transaction is expected to be finalised by end-2023.

Processing activities are divided into two segments: meat and processed products. The meat segment (roughly 80% of volumes sold) sells unprocessed meat including fresh, frozen, MAP meat and food service industry products. The processed product segment sells a variety of pork and poultry products, including cold cuts, ham, salami and sausages. Clients operate in food retail, hospitality and meat processing. Kometa exports to over 30 countries. Exports account for around 45% of sales. The company's main export markets in order of size are Italy, Croatia, Slovenia and Germany.

Financial overview

			Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	8.5x	35.5x	-5.4x	7.0x	4.0x
Scope-adjusted debt/EBITDA	3.2x	4.5x	4.4x	4.4x	4.8x
Scope-adjusted funds from operations/debt	29%	26%	27%	19%	15%
Scope-adjusted free operating cash flow/debt	4%	-1%	-1%	-17%	-16%
Scope-adjusted EBITDA in HUF m					
EBITDA	3,177	2,886	2,927	4,271	4,675
Operating lease payments	116	156	224	224	224
Other items	4	(13)	-	-	-
Scope-adjusted EBITDA	**3,296**	**3,029**	**3,151**	**4,495**	**4,899**
Funds from operations in HUF m					
Scope-adjusted EBITDA	3,296	3,029	3,151	4,495	4,899
less: (net) cash interest paid	(390)	(85)	583	(639)	(1,219)
less: cash tax paid per cash flow statement	(86)	(90)	(107)	(67)	(28)
add: dividends from associates	-	-	-	-	-
Other items (provisions, buyback option with minority shareholder MFB Invest)	263	654	96	(100)	(100)
Funds from operations	**3,083**	**3,508**	**3,723**	**3,690**	**3,553**
Free operating cash flow in HUF m					
Funds from operations	3,083	3,508	3,723	3,690	3,553
Change in working capital	(982)	(954)	(561)	318	(369)
Non-operating cash flow	-	-	-	-	-
less: capital expenditure (net)	(1,628)	(2,618)	(3,100)	(7,130)	(6,675)
less: operating lease payments	(96)	(132)	(184)	(184)	(184)
Free operating cash flow	**377**	**(197)**	**(122)**	**(3,307)**	**(3,675)**
Net cash interest paid in HUF m					
Interest expenses	(375)	(928)	(1,197)	(1,499)	(1,499)
Interest income	5	867	1,820	900	320
Interest component operating leases	(20)	(24)	(40)	(40)	(40)
Net cash interest paid	**(390)**	**(85)**	**583**	**(639)**	**(1,219)**
Scope-adjusted debt in HUF m					
Reported gross financial debt	10,019	19,115	22,052	27,052	22,802
Subordinated debt	-	-	-	-	-
less: cash and cash equivalents	(4,109)	(13,106)	(15,922)	(15,115)	(7,190)
add: non-accessible cash	4,109	7,106	7,000	7,000	7,190
add: pension adjustment	-	-	-	-	-
add: leasing adjustment	410	553	794	794	794
Other adjustments (contingencies)	55	28	-	-	-
Scope-adjusted debt	**10,484**	**13,696**	**13,925**	**19,732**	**23,597**

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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)

Limited ESG risks

While Kometa is exposed to several relevant ESG factors, those are credit-neutral for the time being. In general, the key environmental risks for a meat processor come from intensive energy and water consumption in the production process as well as carbon emissions, especially from livestock breeding. On the social side, the major risks are decreasing meat consumption and litigation and/or reputational risks from product safety and animal welfare (supply chain control).

Kometa's investment into sustainability

Kometa's environmental investments into a water treatment plant and a by-products plant support a better use of raw materials and circular economy, while also benefiting operating efficiency to a certain extent. On the social side, Kometa initiated the Honest Food/Honest Pig programme, consisting in certifications of animal welfare and a reduced use of antibiotics. The issuance of a green bond shows the company's sustainable path, which will involve further green investments, including the construction of more energy-efficient technologies and the installation of solar panels.

[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: BB-

Kometa's business risk profile is constrained by its limited size, concentration on domestic sales, and a low-margin core business that is highly dependent on pork prices and under pressure from its large food retail customers. Conversely, it benefits from Kometa's leading domestic position within pork products, the resilient demand of its industry, and its operational efficiency from having all production processes (except pig breeding) in one location.

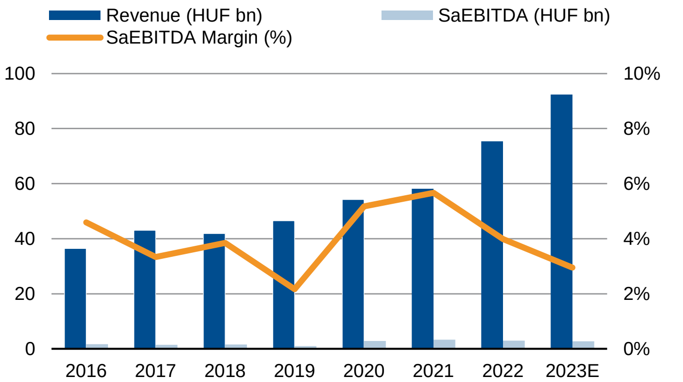
Blended industry risk profile: A-

Kometa acquires livestock and meat mostly from suppliers (which breed and feed the animals) and partly from soon-to-be acquired affiliate Triagro (pig breeder). The company then proceeds to slaughter, process and package the final product. In view of Kometa's business model and the upcoming acquisition of Triagro by end-2023, we have updated our assessment and applied a blended industry profile of non-discretionary consumer products and agriculture based on the EBITDA breakdown of the respective businesses. The industry risk profile of non-discretionary consumer products is rated A and is based on low cyclicality, medium market entry barriers and low substitution risk. The industry risk profile for agriculture is BBB and based on high cyclicality, high market entry barriers and low substitution risk.

Increasing capacity

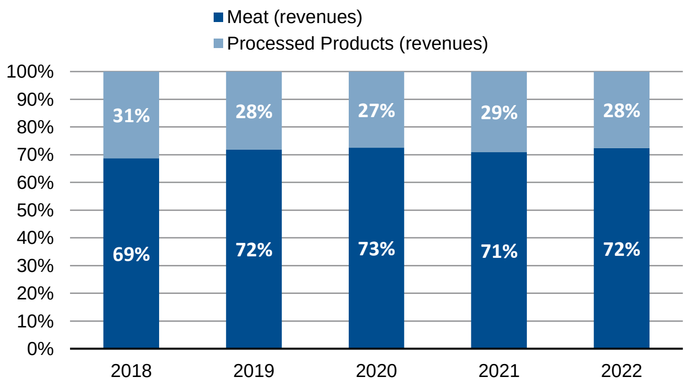
Kometa has a yearly production capacity of 1m pigs for slaughtering and processing (60% utilised in 2022). Its meat segment has a capacity of 80,000 tonnes/year (planned to increase by 50% in the long term), and its processed products segment has a capacity of 17,000 tonnes/year (planned to increase by 200%). With close to 800 employees and HUF 75bn of revenue in 2022 (around EUR 200m), Kometa is one of the largest employers in the Hungarian counties of Kaposvár and Somogy (reflected by the minority municipal shareholders), yet still small in an international context.

Figure 1: Key data



Sa: Scope-adjusted
Source: Kometa, Scope

Figure 2: Revenue split by segment



Source: Kometa

Top three pork processor in Hungary

Kometa has been growing faster than peers in recent years and now ranks third in Hungary in terms of volume of pork sold. Of the other top-three companies, Pick focuses on the processed products segment, where it dominates in the traditional Hungarian winter salami product category, while Hungary Meat operates in the fresh meat segment.

Leader in domestic MAP meat, weaker in processed products

Kometa's market shares are best assessed by considering specific product categories. Within the meat segment, Kometa dominates domestically in MAP meat, with around 70% of the Hungarian market. This category is still relatively underpenetrated, as it makes up only around 20% of total meat sales (in line with Kometa's other core export markets). For comparison, MAP products have significantly higher penetration in Scandinavia (above 90%), Germany and the UK (both above 60%). These figures point to the growth potential of this category in Hungary. It is worth noting that MAP (along with the food service industry) is one of the two highest-margin product categories in meat, together with Gastro (convenience products). Within processed products, Kometa is in several categories, but its overall position is weaker than in its core meat business. Kometa's highest domestic market share is in cold cuts (above 20%). Other product categories rank substantially lower.

Partial vertical integration benefits production flexibility

Partial vertical integration between meat and processed products, along with the company's concentration of production in one location, provides advantages over competitors in terms of flexibility, since it can switch production between different products to follow market demand. Owning the spice-mixing technology also allows switching between different types of production and reduces dependence on procurement since Kometa can source the raw spices directly.

Limited bargaining power compared to large retailers...

Kometa only has limited bargaining power, especially with its main customers, which are large international discounters and hypermarkets. Size matters to large customers as they require reliable suppliers to provide large quantities. Kometa is becoming an increasingly strategic partner for Lidl in the region, and it was able to gain permanent positions for Kometa-branded products with the discounter as well as with other discounters. The superior growth of discounters in Hungary compared to other retailers supported Kometa's market share increase in the past couple of years.

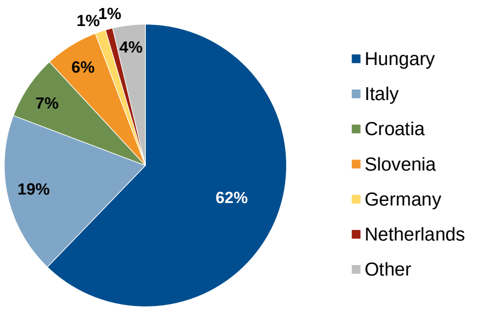
... but more flexible production

A local differentiation factor for Kometa is that, having all the processes in one location, the company can decide about the product destination of livestock entering the plant in the morning (e.g. meat versus processed products), adapting quickly to market trends. The fact that Kometa owns its own spice mixing technology also facilitates switching amongst different productions.

Around 60% reliance on domestic sales

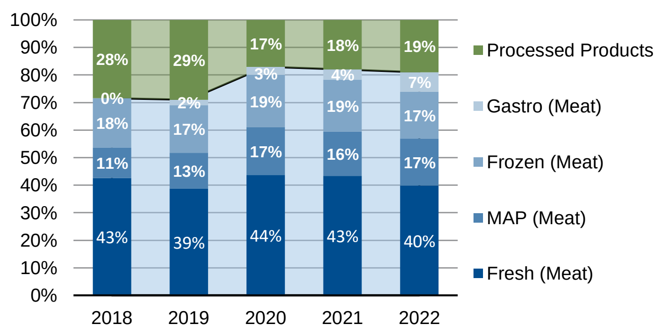
Exports made up around 40% of sales in 2022 (versus 25% in FY 2013). Although Kometa exports to over 40 countries, sales are concentrated in just a few, with Italy the largest (around 20% of total sales) followed by Croatia and Slovenia. Abroad, the issuer's overall market position is more limited, with some exceptions for specific products (for example, roasted turkey breast ham in Italy). Kometa plans to increase sales in Italy, expand in Germany (thanks to increasing production from affiliate Zito) and Spain, and increase MAP sales in Croatia and Slovenia.

Figure 3: Geographical split of sales (2022)



Source: Kometa, Scope

Figure 4: Volume split by product segment



Source: Kometa, Scope

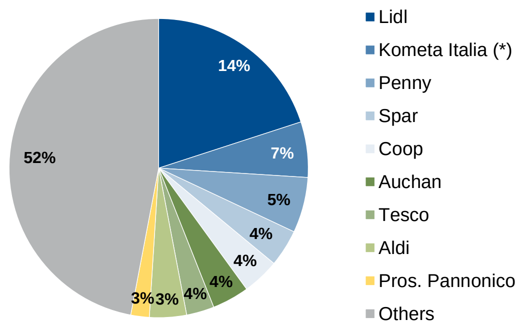
Size and pressure from large international discounters still constrain market position

The market share assessment factors in the company's small absolute size and the competitive nature of its business, including margin pressure from large food retailer customers. The company can improve its market position once it expands production and establishes itself as a reliable large-scale meat supplier in Hungary and abroad.

Key role of large international food retailers

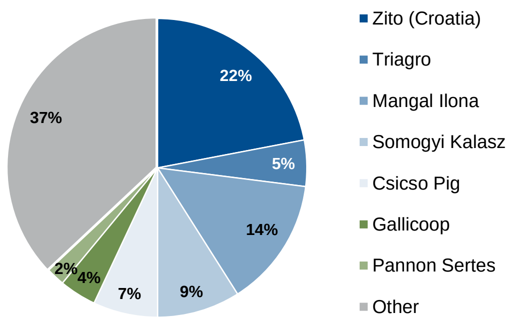
The customer base is moderately diversified and includes several hundred partners, but large international food retailers hold a key position. Other clients include small domestic retail chains, meat processors and wholesalers serving the hospitality industry. The top 10 customers account for around 40% of sales, with the largest being Lidl at 14%. In Hungary, customer concentration is noticeable in meat: Lidl (37%) and Penny (11%) together account for around 50% of sales and the top five account for almost 70%. Local processed products sales have a slightly more granular customer base, with the top three (Lidl, Coop, Tesco) accounting for around 40% of sales and the top five for around 50%. In exports, customer structure is more diversified, with Kometa Italia being the largest client, effectively acting as a distributor to the Italian market and covering over 200 clients, including small wholesalers and clients within the hotel, restaurant and catering industries.

Figure 5: Top customers (2022)



(*) Kometa Italia distributes to over 200 hospitality industry clients in Italy.
Source: Kometa, Scope

Figure 6: Top livestock suppliers (2022)



Source: Kometa, Scope

Moderate supplier concentration, partially integrated via Triagro

Livestock and meat are the key raw materials and pork prices are based on weekly market data from Germany (ZMP). Kometa has over 150 suppliers, with the top five accounting for around 55% of its total livestock supplies in 2022. By agreeing to acquire the totality of shares in pig breeder Triagro (so far participated at 24%), Kometa will vertically integrate across its value chain and provide for around 5% of its livestock needs. Auxiliary materials – including packaging – represent a much smaller portion (less than 10%) of livestock costs and show a more diversified distribution.

Strategic alliance with its largest livestock supplier Zito

The largest supplier is Croatia-based Zito with over 20% of livestock supplies in 2022. Zito is a leading agro-industrial food processor in Croatia. Kometa acquired 50% of Zito's meat processing companies in 2021, entering a 50/50 joint venture in each company, while Zito entered Kometa's shareholding with a 7.7% stake. Zito is expected to cover around 30% of Kometa's livestock supplies in the future, reducing price volatility. Zito's meat processing operations consists in three small local companies, COPADIO d.o.o. (dried meat products), Prosciutto Pannonico d.o.o. (premium raw ham) and Salami Aurea d.o.o. (durable sausages and salami products), whose product portfolio is complementary to that of Kometa. Kometa has a strategic partnership with Zito, based on which the export sales from these meat processors are channelled through Kometa (excluding ex-Yugoslavian territories). Additionally, the partnership allows Kometa to benefit from a secure source of livestock supply for its own production. Nevertheless, an unexpected termination of such strategic partnership, may have moderate negative short-term effects on production levels.

Highly diversified and flexible pork production in part complemented by poultry

Although most of its sales are pork, Kometa's major strengths compared to peers include its ability to produce a large variety of products from pork and use every part of the animal except its blood. Nails and fur, along with other meat waste, are processed in the by-products facility to produce meat powder and industrial lard, mostly for pet food. Less popular parts, such as head and legs, are destined to the Asian market. In addition to pork, Kometa sells processed poultry products, which are not slaughtered in house. The poultry category has been gradually increasing and Kometa expects it to reach nearly 10% of sales in the long term.

Fresh meat segment represents over 70% of sales

The company counts a dozen fresh meat product groups and even more within processed products. Within the meat segment, the volume of value-added products produced in 2022 included 17% for MAP products and 7% for Gastro products, while the remainder was lower-margin fresh or frozen meat. Within the processed products segment, the product portfolio is diversified and includes cold cuts, hams (including poultry meat), salami, sausages, Parisian ham and bacon, among others.

Distribution mostly via food retailers

Kometa's distribution channels are quite concentrated, with around two-thirds distributed to retailers. There is a wide variety among retailers, which include primarily large international discounters (especially for meat), hypermarkets and cash and carry (especially for processed products), but also local retail chains. The remainder comprises meat processors and distributors for the hospitality sector. Online sales are not available.

Assets concentrated in one location

Asset concentration in one plant somewhat constrains the overall diversification score. While running everything under one roof does save on costs, a catastrophic event in the Kaposvár plant could disrupt the business.

Profitability sensitive to livestock price volatility

Kometa's profitability remains volatile and susceptible to changes in raw materials price. The purchase of livestock makes up a large share of costs at around 55% of revenue in 2022 (aggregate cost of goods sold: around 85% of revenue). Prices are contracted weekly in meat but are negotiated three-to-four times a year in processed products, which is also explained by the shorter expiration period of meat products (days/weeks) compared to processed products (months). This means that margins in the processed products segments are more volatile in case of steep and persisting changes in livestock prices. Product segmentation, along with strategic relations with suppliers Zito and Triagro, helps reduce price volatility.

Acquisition of Triagro partly mitigates dependency on livestock prices

The acquisition of Triagro (which had an EBITDA margin of 15% in 2022) will contribute to stabilising margins, given the complementary nature of pig breeding and slaughtering activities (pig price movements generally impacts the profitability margins of these businesses in opposite ways). Based on communication with management, Kometa agreed to acquire the remaining 76% shares in addition to the 24% it already owns in affiliate Triagro (expected EBITDA of around HUF 1.8bn in 2023, up from HUF 0.7bn in 2022). The agreed acquisition price is EUR 6.5m (HUF 2.5bn), 80% of which will be funded via HUF-denominated debt, 20% via internal resources. Based on communication with management, the transaction is expected to be finalised by end-2023.

Meat segment has lower margins but is less volatile

The meat segment has lower margins than processed products but has been less volatile in recent years as it can adjust more quickly to livestock prices. However, it shows some seasonality, with the period between October and April being the strongest. In line with the general food industry, demand for Kometa's products is resilient, with processed products facing more competition as they are more exposed to export markets. Within meat, the segments with higher marginality are MAP and Gastro products, both of which have increased their contribution to the company's product mix in the past five years, with consequent improvements in the meat segment's profitability.

Limited FX risk

Kometa is mostly a price taker, with exposure to foreign exchange changes being mostly limited to euros. Foreign exchange gains or losses had a limited impact in the last few years, although this was moderately larger in 2022 amid the significant depreciation in the forint; imports in euro (mainly from Croatia) are generally higher than euro export sales (mainly to Italy).

EBITDA margin down to 4% in 2022 due to rising energy and livestock prices...

In 2021, raw material prices went down, benefiting profitability. In 2022, profitability was hindered by extreme cost inflation, with a delay between the increase of input prices and that of Kometa's retail prices. As a result, Scope-adjusted EBITDA slightly decreased to HUF 3.0bn from HUF 3.3bn, while the EBITDA margin dropped to 4.0% from 5.7%. In H1 2023, livestock prices increased further, but Kometa decided not to apply further price increases in the local market to gain market shares. This decision lowered the EBITDA margin to 3.2% for H1 2023. Even tough energy costs have decreased since their peak, they are still high, so Kometa started in June 2023 to hedge 50% of its energy needs until February 2025 via derivatives.

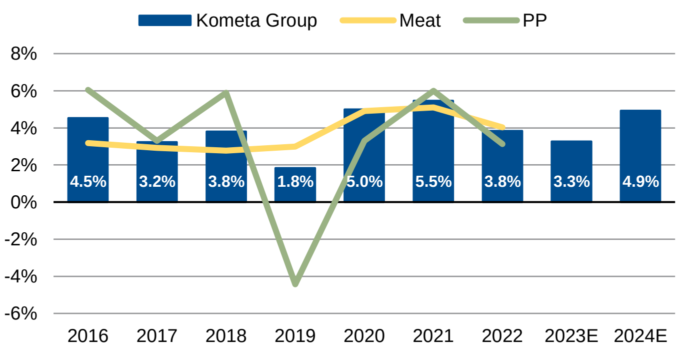
…to gradually recover to above 5% on normalisation of input cost and saving initiatives

For the full year 2023, we forecast Scope-adjusted EBITDA of HUF 3.2bn, with a margin of 3.5%. The margin improvement in H2 2023 is explained by the decline in livestock prices from July 2023 (selling prices should remain stable) combined with business seasonality. For 2024, we expect Scope-adjusted EBITDA of HUF 4.5bn, with profitability recovering to around 5% in the absence of major livestock price inflation and thanks to the consolidation of Triagro (which had a high EBITDA margin in 2022 at 15%, still rising in 2023). The acquisition of Triagro will contribute to stabilising margins given the complementary nature of pig breeding and slaughtering). Kometa has also made investments in energy-efficient technologies to lower costs.

Profitability margins are adequate based on product mix

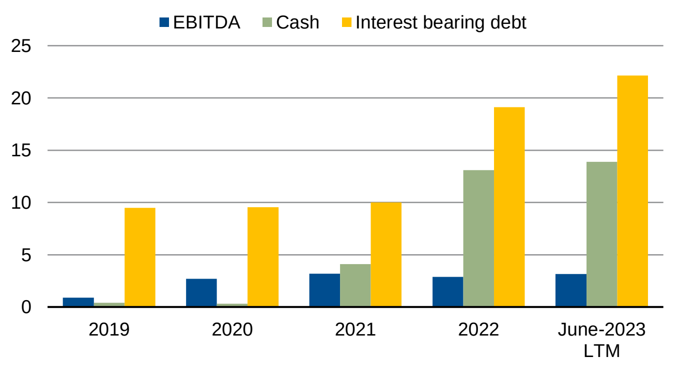
Overall, profitability is adequate based on the product mix, considering that slaughtering constitutes a drag on profitability. Kometa outperforms local peers within the meat segment, including Hungary Meat and Paipai, also thanks to its positioning in high-margin MAP meat. However, Kometa still has room to improve within processed products. It lags behind leader Pick (even after including its unconsolidated slaughterhouse), which benefits from a stronger brand and a higher-value-added product (longer maturation for main salami product). It is also behind local peers that do not have slaughterhouses and focus on a single product.

Figure 7: EBITDA margin by segment



PP: processed products
Source: Scope estimates

Figure 8: Reported EBITDA, cash, interest bearing debt (HUF bn)



Source: Kometa, Scope

Having everything under one roof brings operating cost savings

Whilst the differing business models among peers makes margins hard to compare, Kometa's single facility and newer technology provide operating cost savings. Its personnel and logistics costs are much lower and can be leveraged if production capacity increased as planned. Additionally, its by-product processing plant built in 2019 (running at less than 50% capacity) provides it with an edge as no other local meat peer has one and it is expected to generate HUF 600m-700m in surplus revenue yearly while eliminating external service costs of waste removal and disposal. However, the advantage in operating efficiency is partly offset by the company's broad product range, which constrains overall capacity utilisation more than if it focused on one standard process. Margins could reach near 10% if the company expanded capacity significantly and increased its product mix towards processed products and added-value meat products while strengthening its brand.

Emerging brand within the processed products segment

Kometa's brand is still emerging. Fresh meat is a business primarily based on private labels and brand recognition is limited for end-consumers. The processed products segment offers good value for money and tries to attract a younger group (compared to more traditional brands such as Pick) while focusing on sustainability. The brand is known in Hungary but less so in its export markets. Within processed products, Kometa-branded products make up around 80% of sales, with the company increasing advertising spending through the years (from 0.4% of revenue in 2014 to around 1.2% in 2022).

Financial risk profile: B+

The financial risk profile remains at B+, reflecting high leverage and weak cash flow cover. The weak cash flow cover has been partly offset by a good EBITDA interest cover, which has been particularly strong in 2023 thanks to the large interest income related to unutilised proceeds from the bond issued in 2022, parked into high-yielding fixed-term deposits (earning above borrowing rate). In fact, Kometa delayed a large part the expansionary capex it had planned for 2022-2023, now expected to occur from 2024.

Base scenario assumptions

Key assumptions in our base scenario include:

- Revenue growth around 20% in 2023; mid-single digit decline in 2024, up 5% in 2025;
- EBITDA improving from HUF 3.2bn in 2023 to HUF 4.9bn in 2025;
- Interest expense ranging from HUF 1.1bn in 2023 to 1.5bn annually;
- Interest income of around HUF 1.8bn in 2023, declining to HUF 0.3bn in 2023;
- Negative working capital in 2023; proportionate to sales development afterwards;
- Net capex of HUF 3.1bn in 2023, around HUF 7bn in 2024 and 2025; subsidy intensity assumed at 35% of gross capex
- Additional debt: HUF 3bn in 2023; HUF 5bn in 2024 (including: HUF 2bn investment loan for the acquisition of Triagro maturing in eight years and linear amortisation; HUF 3bn additional subsidised working capital lines;
- M&A: acquisition of Triagro for HUF 2.5bn beginning of 2024;
- No dividends paid.

Key adjustments of the rating case include:

- EBITDA adjusted for operating lease payments of HUF 224m per year;
- Capex considered net of received subsidies;
- Debt includes around HUF 7bn of restricted cash during 2022 to 2024 to reflect the portion of cash earmarked for investments (net of received subsidies). As a result, around 50% of cash is netted from debt during this period to reflect the large cash reserves invested in fixed-term deposits and preserved until 2024. No netting of cash is applied from 2025;
- Debt includes operating lease adjustments of around HUF 0.8bn per annum;
- Interests include HUF 40m of operating lease interests per annum;
- Funds from operation include changes in provision and around HUF 100m yearly paid for the buy-back option to minority shareholder MFBI.

HUF 12bn bond issued in 2022

Kometa issued a HUF 12bn green bond under Hungary's Bond Funding for Growth Scheme in February 2022. The bond has a tenor of 10 years with 10% of its face value subject to amortisation in 2027, 10% yearly in 2028-2031 and the remaining 50% in 2032. The coupon of 5% is fixed and payable yearly, which is beneficial in the current high interest rate environment in Hungary. Funds from the bond will be used mainly for investments to expand production capacity and replaces around HUF 2bn of existing long-term investment loans.

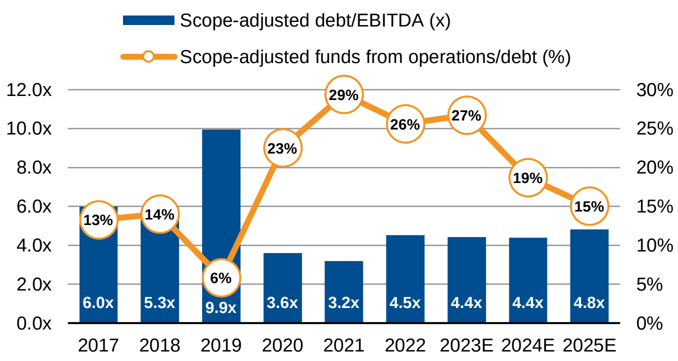
Debt to moderately increase on M&A and potential new working capital line

After Kometa issued a HUF 12bn green bond in Q1 2022 to refinance existing investment loans, gross debt jumped to around HUF 20bn in 2022. As of June 2023, around HUF 3.0bn in working capital lines were added. Further major debt increases in the forecast period relate to the planned HUF 2.0bn investment loan for the acquisition of Triagro in Q1 2024 and the potential addition of HUF 3.0bn of subsidised working capital lines in 2024. Besides this, we assume partial refinancing of existing working capital lines, with HUF 4.0bn of them maturing in 2025 and HUF 4.5bn in 2026.

High indebtedness partly offset by strong liquidity

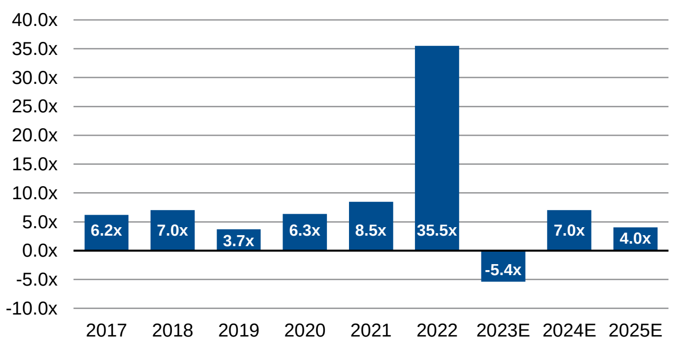
Scope-adjusted leverage increased to 4.5x in 2022 (2.2x if netting 100% of cash) from 3.2x in 2021 amid EBITDA deterioration and higher debt. Nevertheless, Kometa delayed a large part of the originally planned expansionary capex for the year and invested the bond proceeds into fixed-term interest-yielding term deposits. The leverage metric – assuming restricted cash of HUF 7.1bn to reflect cash earmarked for investments – was still better than our forecasts, since the deterioration in EBITDA was milder than expected amid the positive impact of pricing actions. The sluggish EBITDA growth in H1 2023 led LTM June 2023 Scope-adjusted debt/EBITDA at 4.8x (assumed HUF 7.0bn restricted cash, 2.6x net 100% of cash), but we expect an improvement in leverage by full year 2023 to 4.4x thanks to EBITDA recovery in H2.

Figure 9: Scope-adjusted leverage metrics



Source: Scope estimates

Figure 10: EBITDA interest cover (x)



Source: Scope estimates

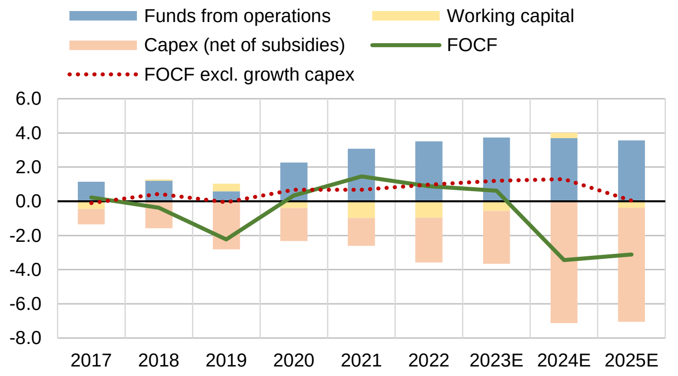
Scope-adjusted debt/EBITDA to remain below 5x

We forecast that Scope-adjusted debt/EBITDA will remain below 5.0x in the medium term. Since Kometa has not depleted but instead increased its cash reserves in 2023 (HUF 13.9bn as of June 2023 compared to HUF 12.2bn as of June 2022), we apply some cash netting for the calculation of the Scope-adjusted debt; in particular, we consider HUF 7.0bn of restricted cash during 2023-2024, since the maximum amount of cash earmarked for capex to be spent in 2024 is HUF 10.7bn, which corresponds to around HUF 7bn after netting around 35% of related subsidies to be received. Additionally, we take comfort from the prudent management approach to delay its large uncommitted project capex until EBITDA has reached satisfactory levels above HUF 4bn, as it has been the case over the past 18 months. By netting 100% of cash from debt, leverage would remain below 3.5x for the entire forecast period. Leverage is supported by Scope-adjusted funds from operations/debt, which has been above 20% over the last three years. The large interest income over 2023-2024 will ensure the metric remains above 15% in the medium term.

High interest income in 2023/24 boosting debt protection metric

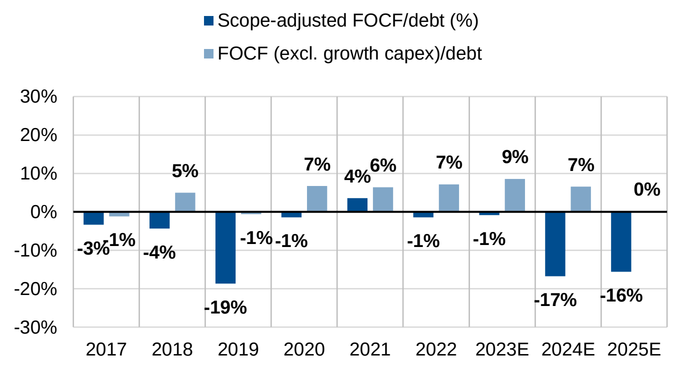
Despite lower EBITDA, increased debt and high interest rates, interest cover will remain particularly strong in the short term and gradually converge toward 4.0x in 2025. Interest cover was high in 2022 at 35x, supported by the interest income of HUF 0.9bn generated by cash parked into fixed-term deposits (around 13% yield), which almost matched the interest expenses of the year. Because liquidity invested in fixed-term deposits will remain largely untouched until 2024, for full-year 2023 the assumed interest income of HUF 1.8bn (yield on deposit was around 15% in H1 2023) will be above interest expenses of around HUF 1.2bn and compensate for the high borrowing costs. Our base case assumes interest income will gradually decrease over time (HUF 0.8bn in 2024; HUF 0.3bn in 2025), while interest expenses will moderately increase to HUF 1.5bn from 2024 due to higher debt. Notwithstanding the high interest rates in Hungary, around 80% of interest-bearing debt is based on fixed interest rates and bank credit lines permit borrowing in euro.

Figure 11: Cash flow sources and uses (HUF bn)



FOCF: free operating cash flow
Source: Scope estimates

Figure 12: Cash flow cover

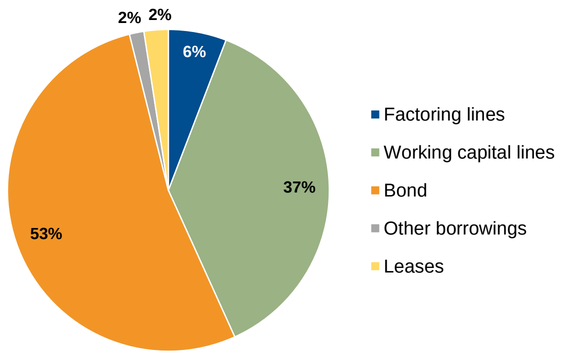


Source: Scope estimates

Weak free cash flow

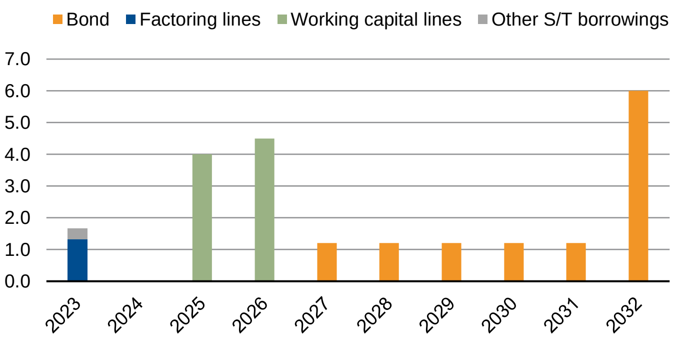
Due to low profitability, volatile working capital and high capex, cash flow has been weak in the last few years. Cash flow should remain slightly negative in 2023 due to low profitability and notwithstanding another postponement in capex. Cash flow will likely be even lower from 2024, when capex (net of received subsidies) will intensify. We project net capex around HUF 3bn in 2023, which should increase to around HUF 7bn from 2024. A more meaningful analysis would be to adjust free operating cash flow by excluding the impact of growth capex. Such an approach should lead to minimal cash flow cover of between 0% and 10% over time.

Figure 13: Interest bearing debt split as of June 2023



Source: Scope estimates

Figure 14: Debt maturity schedule (excluding leases) as of June 2023 (HUF bn)



Source: Scope estimates

Adequate liquidity

Liquidity is adequate and supported by cash and equivalents of HUF 13.9bn as of

June 2023 (versus HUF 13.1bn as of December 2022), a strong liquidity buffer against the HUF 1.5bn short-term factoring lines, which are rolled over each year. We expect liquidity ratios to stay well above 200% over the forecast period, during which the major maturity concerns HUF 4bn of working capital lines (out of the HUF 8.5bn available as of June 2023) expiring in 2025. Growth capex is discretionary as the current green bond framework does not specify the amount of investment required per year.

Balance in HUF m	2023E	2023E	2024E
Unrestricted cash (t-1)	13,106	15,922	15,115
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	1,193	1,296	33
Short-term debt (t-1)	1,385	1,500	5,500
Coverage	**>200%**	**>200%**	**>200%**

Financial covenants

We expect Kometa to remain keep complying with its financial covenants, which include a total debt/EBITDA ratio of below 6x and a debt service coverage ratio of above 1.25x.

Supplementary rating drivers: +/- 0 notches

Financial policy

Management delayed capex in 2022 and 2023 to preserve liquidity and comply with its net leverage target of below 4x. Its approach towards discretionary spending is also conservative: in recent years, management has only pursued a few small acquisitions of established business partners (the upcoming acquisition of Triagro follows this logic) and has not been distributing dividends to founding shareholders.

Parental support

We assume no impact from parent support, although the founding families and majority shareholders have shown a commitment to growing the business. Moreover, owners include government-related entities, but these stakes do not affect the rating as they are either temporary (MFB Invest's 18% stake) or minor (Municipality of Kaposvar's 3.7%).

Corporate structure

The majority shareholders are the founding families of Pedranzini (54% via Komfin) and Ruffini (17% via Ruf Carni). HUF 5bn in equity was injected in 2021 when Hungarian development bank's subsidiary MFB Invest (18%) and Zito (7.7%) became shareholders. This was accompanied by a partial exit of the other (historical) minority shareholder, the City of Kaposvár, which reduced its stake to around 4%. The equity participation from Zito is part of a strategic partnership under which Kometa simultaneously bought 50% (joint venture) of Zito's meat processing activities in Croatia. As of June 2023, Kometa owns 51% of consolidated subsidiary Kometa Italia Srl (Giacomo Pedranzini and the Ruffini family own the remainder) and 24% of Triagro (accounted for as equity, to be fully consolidated by end-2023 after the acquisition of 100% of shares). Subsidiaries in Spain and Germany (via Zito GmbH) were established in 2022.

Long-term debt ratings

Rating for unsecured debt: B+

We expect an 'average' recovery for senior unsecured debt such as the HUF 12bn green bond in a hypothetical default based on liquidation value in 2024. We apply conservative recovery assumptions in view of the risk of additional secured debt entering the financing structure in case of a significant capacity increase, as well the presence of real estate pledges for the state-linked subsidy providers. The removal of the technology and brand pledges from the previous investment loan refinanced by the green bond supports recoverability.

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