Kometa 99 Zrt.
Hungary, Consumer Products

SCOPE B+ STABLE

Key metrics

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	6.3x	8.5x	12.3x	7.5x	4.1x
Scope-adjusted debt/EBITDA	3.6x	3.2x	6.1x	5.3x	4.2x
Scope-adjusted funds from operations/debt	23%	29%	15%	16%	18%
Scope-adjusted free operating cash flow/debt	-1%	4%	-6%	-23%	-25%

Rating rationale

The issuer rating reflects Kometa's high indebtedness and negative free cash flow amid expansionary capex that will intensify over the next years. Other rating constraints include a 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, the resilient demand of its industry, the comfortable liquidity buffer and its operational efficiency thanks to its 'all under one roof' concept.

Outlook and rating-change drivers

The Outlook is Stable and reflects the expectation that Scope-adjusted debt/EBITDA on a gross debt basis will return below 5.0x within the next 18 months while the liquidity cushion remains strong (Scope-adjusted debt/EBITDA on a net debt basis to remain around 3.5x because of the large cash reserves). The Outlook assumes a gradual improvement in EBITDA, which assumes livestock and energy prices will not increase materially from 2022 peaks. The base scenario also assumes net capex will remain below HUF 5.5bn in 2023 and the large liquidity buffer will remain in place until EBITDA can reach around HUF 4bn.

A positive rating action could derive from an improvement in Scope-adjusted debt/EBITDA to 3.5x or below on a sustained basis. This could follow higher EBITDA thanks to a quick ramp-up in capacity, increased market shares in export countries, especially in processed products (PP), and/or a stronger brand.

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

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
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

Corporate Rating Methodology; July 2022

Rating Methodology: Consumer Products; September 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Third largest pork meat processor in Hungary, with stronger domestic position in selected categories, such as MAP packaged meat and cold cuts.	• High leverage and weak free operating cash flow into the medium term amid expansionary capex
• Resilience of the consumer food sector, as demonstrated during the Covid-19 pandemic	• Still small absolute size, although plans to double capacity
• Strong cash interest cover and comfortable liquidity cushion, supported by the postponement of expansionary capex during 2022 and the placement in fixed-term deposits of a large portion of recent bond proceeds	• Limited inherent profitability of core business (fresh meat), with only around 20% of quantities coming from the higher-value-added PP segment
• Better ability than peers to generate operating cost savings based on one-roof concept	• Historically volatile and price-dependent margins; EBITDA being pressured by extremely high energy and raw materials (including livestock) prices
• Extensive diversification across pork products, with one-roof concept enabling easy switching across products based on market trends	• Competitive industry despite good position in some meat categories; still limited bargaining power against large international food retailers, especially abroad
• No major concentration risk on customer/supply side, with affiliate livestock breeder Zito increasing its role as suppliers (vertical integration)	• Limited diversification outside pork products (some turkey PP), with relative dependency on pig price development
• Minority shareholding from government-related entities	• Concentration on Hungary for almost 60% of quantities sold; rest on few export countries (Italy, Croatia, Slovenia)
	• Relatively weak brand value, as the core business is mostly based on private-label agreements (conversely, around 70% of processed products have Kometa brand)
	• 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	• 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 byproduct processing plant.

Activities are divided into two segments: Meat, and Processed Products (PP). The Meat segment (roughly 80% of volumes sold) sells unprocessed meat including fresh, frozen, modified atmosphere packaging (MAP) and food service industry products. The PP 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	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	6.3x	8.5x	12.3x	7.5x	4.1x
Scope-adjusted debt/EBITDA	3.6x	3.2x	6.1x	5.3x	4.2x
Scope-adjusted funds from operations/debt	23%	29%	15%	16%	18%
Scope-adjusted free operating cash flow/debt	-1%	4%	-6%	-23%	-25%
Scope-adjusted EBITDA in HUF m					
EBITDA	2,696	3,177	2,253	3,703	4,748
Operating lease payments	110	116	130	132	135
Other items	(1)	4	-	-	-
Scope-adjusted EBITDA	**2,805**	**3,296**	**2,383**	**3,835**	**4,883**
Funds from operations in HUF m					
Scope-adjusted EBITDA	2,805	3,296	2,383	3,835	4,883
less: (net) cash interest paid	(442)	(390)	(194)	(509)	(1,203)
less: cash tax paid per cash flow statement	(46)	(86)	(43)	(104)	(83)
add: dividends from associates	-	-	-	-	-
Other items	(41)	263	50	-	-
Funds from operations	**2,276**	**3,083**	**2,196**	**3,222**	**3,597**
Free operating cash flow in HUF m					
Funds from operations	2,276	3,083	2,196	3,222	3,597
Change in working capital	(388)	(982)	(335)	(2,246)	(1,206)
Non-operating cash flow	-	-	-	-	-
less: capital expenditure (net)	(1,941)	(1,628)	(2,664)	(5,525)	(7,424)
less: operating lease payments	(91)	(96)	(108)	(109)	(111)
Free operating cash flow	**(144)**	**377**	**(912)**	**(4,658)**	**(5,144)**
Net cash interest paid in HUF m					
Net cash interests per cash flow statement	(423)	(370)	(172)	(485)	(1,179)
Interest expense pensions	-	-	-	-	-
Interest component operating leases	(19)	(20)	(22)	(23)	(24)
Net cash interest paid	**(442)**	**(390)**	**(194)**	**(509)**	**(1,203)**
Scope-adjusted debt in HUF m					
Reported gross financial debt	9,542	10,019	20,000	20,000	20,000
Subordinated debt	37	-	-	-	-
less: cash and cash equivalents	(313)	(4,109)	(13,079)	(8,323)	(3,080)
add: non-accessible cash	313	4,109	7,079	8,323	3,080
add: pension adjustment	-	-	-	-	-
add: leasing adjustment	389	410	461	468	479
Other adjustments (contingencies)	134	55	28	-	-
Scope-adjusted debt	**10,102**	**10,484**	**14,489**	**20,468**	**20,479**

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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 a series of relevant ESG factors, we believe those to be credit-neutral for the time being. In general, the key environmental risks for a meat processor derive from intensive energy and water consumption during production as well as carbon emissions, especially on livestock breeding. On the social side, major risks concern the trend towards less meat consumption as well as litigation and/or reputational risks from product safety and animal welfare (supply-chain control).

Kometa invested more than local peers into sustainability

Kometa has invested more than the local average in pursuing ESG targets, in terms of both environmental and corporate social responsibility. This supports the sustainability of its brand. Having its own water-treatment plant and byproducts plant supports environmental and circular economy goals and benefits operating efficiency but are not yet material enough to have a rating impact. On the social side, Kometa initiated the Honest Food/Honest Pig programme, consisting in certifications of animal welfare and less use of antibiotics. The issuance of a green bond validates the company's sustainable path and will involve further green investments, including the construction of more energy-efficient technologies and the installation of solar panels for renewable energy.

[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-

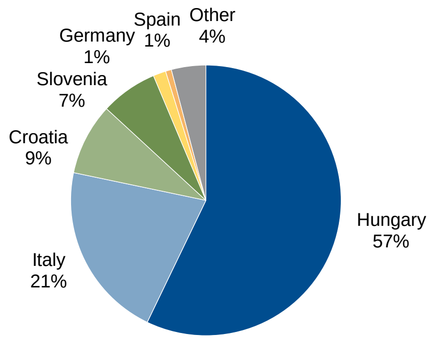
Industry risk profile: A

In view of Kometa's business model, we have used our non-durable consumer product methodology. Kometa acquires livestock and meat from suppliers (which breed and feed the animals) and then proceeds to slaughter, process and package the final product. The industry risk profile of non-durable consumer products is rated A based on the low cyclicality of food products and medium barriers to entry. Required capital investment is generally moderate, while attaining adequate economies of scale and establishing customer bases are more difficult. Substitution risk is low reflecting the generally non-discretionary nature of food products.

Increasing capacity

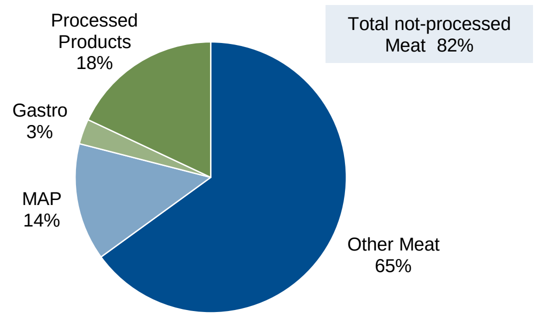
Kometa has a production capacity of 1m pigs for slaughtering and processing. Its Meat segment has a capacity of 80,000 tonnes/year (planned to increase by 50% to 120,000 tonnes/year in the long term), and its PP segment has a capacity of 17,000 tonnes/year (planned to increase by 200% to 50,000 tonnes/year). With close to 800 employees and HUF 58bn of revenues in 2021 (around EUR 150m), 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. Its capex plan aims to double capacity within four to five years.

Figure 1: Geographical split of sales (2021)



Source: Scope estimates

Figure 2: Revenue split by product segment (2021)



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 pork volumes sold. Of the other top-three companies, Pick focuses on the PP segment, where it dominates in the traditional Hungarian winter salami product category, while Hungary Meat operates in the fresh meat segment.

Leader in domestic packaged meat (MAP), weaker in PP

Overall, 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. Within PP, 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 materially lower.

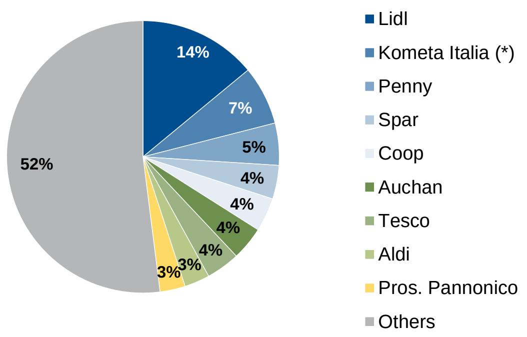
Around 60% reliance on domestic sales

Exports make up an increasingly significant proportion of sales (43% in FY 2021 vs 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. The rest of the world accounts for the remaining 4% of sales.

Size and pressure from large international discounters still constrain market position

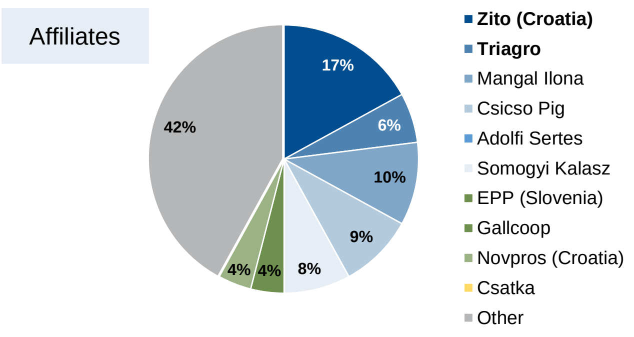
Overall, the market share assessment factors in the company's small absolute size, the competitive nature of its business, including margin pressure from large food retailer customers. We believe the company can improve its market position once it expands production and establishes itself as a reliable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

Figure 3: Top customers (2021)



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

Figure 4: Top livestock suppliers (2021)



Source: Scope estimates

Key role of large international food retailers

The customer base is moderately diversified and includes several-hundred partners, but large international food retailers have a key place. 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 (28%) and Penny (13%) together account for around 40% of sales and the top five account for over 60%. Local PP sales have a slightly more granular customer base, with the top three (Lidl, Coop, Tesco) accounting for around 40% of sales. On exports, customer structure is more diversified, with Kometa Italia being the largest client, effectively acting as a distributor to the Italian market, covering over 200 clients, including small wholesalers and clients within the hotel, restaurant and catering industries.

Control over largest livestock supplier; diversified on the rest

Livestock and meat are the key raw materials and the pork prices are based on weekly market data from Germany (ZMP). Kometa has over 150 suppliers, with the top five accounting for around 50% of livestock in 2021. The largest supplier was affiliate Zito (Croatia). Kometa acquired 50% of its meat operations (consisting in three local companies: COPADIO doo, Prosciutto Pannonico doo and Salami Aurea doo), 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.

Highly diversified, flexible pork production, in part complemented by poultry

Despite most sales deriving from the pork, Kometa's major strengths include its ability to produce a large variety of pork products and use every part of the animal except its blood. The company distinguishes among a dozen fresh-meat product groups and even more within PP. Nails and fur, along with other meat waste, are processed in the byproducts facility to produce meat powder and industrial lard, mostly for pet food. In addition to pork, Kometa sells processed poultry products, which are not slaughtered in-house. The poultry category has been gradually increasing in importance and is estimated to reach nearly 10% of sales in the long term.

Partial vertical integration benefits production flexibility

Partial vertical integration between Meat and PP, along with the company's one-roof concept, 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 eases switching between different types of production, besides reducing dependence on procurement (it can source the raw spices directly).

Distribution mostly via food retailers

Kometa's distribution channels are rather concentrated, with around two-thirds distributed to food retailers. Yet there is a wide variety within this group: primarily large international discounters (especially for Meat), hypermarkets and cash and carrys (especially for PP), 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 is partially constraining to the overall diversification score. While running everything under one roof does save costs, a catastrophic event in the Kaposvár plant could disrupt the business.

Profitability sensitive to livestock price volatility

Overall, purchase of livestock makes up a large share of costs at over 60% of revenues (aggregate cost of goods sold: around 85% of revenues). Prices are contracted weekly in Meat but are negotiated 3-4 times a year in PP. Product segmentation, along with a strategic alliance with suppliers Zito and Triagro, helps reduce price volatility.

Meat segment has lower margins but shows less volatility

The Meat segment has lower margins than PP but has been less volatile in recent years because it can adjust more quickly to livestock prices. This is also explained by the shorter expiration of meat products (days or weeks) than PP products (months). The meat business shows some seasonality, with the period between October and April being the strongest. In line with the general food industry, demand is resilient and the company saw a material increase in MAP volumes sold during the pandemic. Conversely, exported PP suffered during the pandemic, especially in Italy, where sales are more dependent on the hospitality channel. Kometa is mostly a price taker, with exposure to foreign exchange changes being mostly limited to euros. Foreign exchange gains or losses have impacted the P&L by up to 1% of revenues during the past five years, although it may have a moderately larger impact in 2022 amid the significant depreciation in the forint; costs in euro are generally higher than euro export sales.

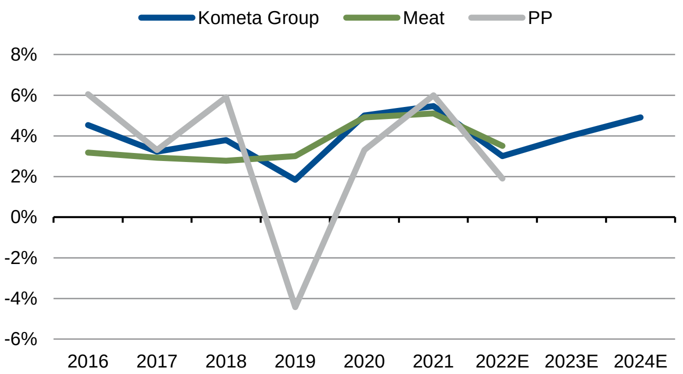
EBITDA margin down to 3% in 2022 on rising energy and livestock prices...

Profitability remains volatile and susceptible to changes in the raw materials price. Food inflation in Hungary is highest in the European Union in 2022 at 35% YoY, which was tackled by strong pricing actions and great temporary pressure on profitability. After a solid 2021 with a HUF 3.2bn EBITDA and 5.5% Scope/adjusted EBITDA margin, profitability is expected to bottom out in 2022 at a HUF 2.3bn EBITDA and a 3% margin. This will be due to rapidly increasing energy and livestock prices that cannot be offset by timely price increases. After benefiting from declining livestock prices in 2020-21, price increases in 2022 for both pig and turkey were more adverse than in 2019. Despite Kometa's ability to increase sales prices accordingly, the time delay in the adjustment negatively impacted profitability, with a 3.5% EBITDA margin as of June 2022. This was most evident within PP, where contracts are renegotiated less frequently. For FY 2022, the margin is expected to decline further to 3% on the additional burden of high energy costs and despite the build-up of frozen raw meat stock at beginning of the year at cheaper prices that can be sold later at a higher price. Nevertheless, profitability will remain well above the almost 2% margin in the most recent low-cycle year of 2019; the improvement is mainly due to a better portfolio mix within Meat and more frequent price adjustments within PP (annually in the past).

…to gradually recover to around 5% on pricing and cost saving initiatives

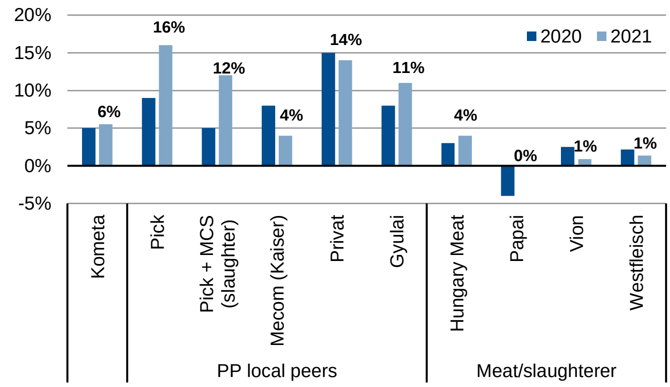
We expect EBITDA to increase to HUF 4.7bn until 2024, with margins of 4%-5% during 2023-24. Despite inflation continuing to affect raw materials and staff costs, Kometa will benefit from recent price increases and we do not forecast further abrupt increases in livestock and energy prices. Energy saving initiatives will also save costs, including a change of utility contract terms, the installation of solar panels in 2023 (covering up to 15% of electricity needs) and investments in more energy-efficient technology. Lean operation projects with external consultants will also save costs. Personnel expenses will increase due to inflation but the delayed capex will provide some short-term relief.

Figure 5: EBITDA margins



Source: Scope estimates

Figure 6: Peer comparison of EBITDA margins



Source: Scope, company data

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.

However, Kometa has still room to improve within PP. It underperforms against leader Pick, even after including the unconsolidated slaughterhouse MCS, which benefits from a stronger brand and a higher-value-added product (longer maturation for main salami product). It also underperforms against local peers that do not have slaughterhouse activities and focus on a single product.

Having everything under one roof brings operating cost savings

Whilst the differing business models among peers makes margins hard to compare, Kometa's 'all under one roof' concept and newer technology do provide operating cost savings. Its personnel and logistics costs are much lower and can be leveraged if production capacity increased as planned. Additionally, regarding the byproduct processing plant built in 2019 (running at less than 50% capacity), 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 than if it focused on one standard process. We believe margins could reach towards 10% if the company can expand capacity significantly and increase its product mix towards PP while strengthening its brand.

Emerging brand within PP segment

Kometa's brand is still emerging. Meat is based on private labels; PP is positioned in the 'good value (quality) for money' category 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 PP, Kometa-branded products make up around 80% of local sales, with the company increasing advertising spending through the years (from 0.4% of revenues in 2014 to around 1.3% in 2021).

Financial risk profile: B+

Key adjustments of the rating case include:

- EBITDA adjusted for operating lease payments of HUF 130m-135m p.a.
- Capex considered net of received subsidies
- Scope-adjusted debt netted for around 50% of the HUF 12bn bond proceeds from Feb 2022; this is to reflect cash in fixed-term deposits and management's intention to preserve cash in the short term. No netting of cash is applied from 2023 onwards.
- Scope-adjusted debt includes operating lease adjustments of around HUF 0.5bn p.a.

Base scenario assumptions

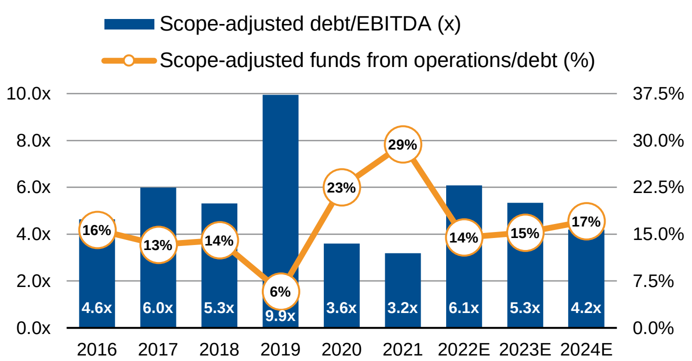
The financial risk profile remains at B+. Key assumptions in our base scenario include:

- EBITDA improving from HUF 2.2bn in 2022 to HUF 4.7bn in 2024
- Interest expense of HUF 1.0bn-1.3bn p.a.
- Interest income of around HUF 0.8bn in 2022-23
- Negative working capital for the entire period of the capacity increase
- Strong liquidity buffer kept in the short term
- Net capex of around HUF 3bn in 2022, HUF 5.5bn in 2023 and HUF 7.4 in 2024
- No further debt until 2024
- No material acquisitions
- No dividends paid (Kometa only pays HUF 99m p.a. for the buy-back option to minority shareholder MFBI)

HUF12bn green bond issued in 2022

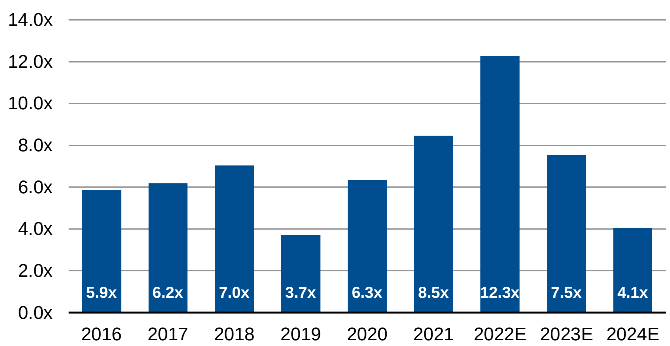
Kometa issued a HUF 12bn green bond under Hungary's Bond Funding for Growth Scheme in February 2022. The bond has a tenor of 10 years with 10% of its face value subject to amortisation in 2027, 10% yearly in 2028-31 and the remaining 50% in 2032. The coupon of 5% is fixed and payable yearly, which is 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.

Figure 7: Scope-adjusted leverage metrics



Source: Scope estimates

Figure 8: EBITDA interest cover (x)



Source: Scope estimates

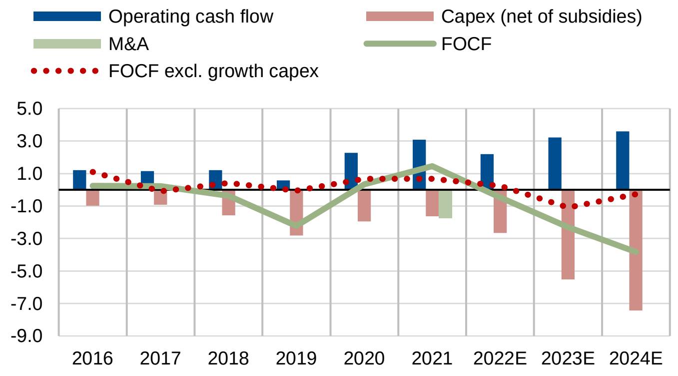
Leverage to surpass 5.0x in 2022 but return below 4.5x within 18 months

In the past years, Kometa has grown significantly. This has required increasing capex and kept leverage high but finally managing to improve Scope-adjusted debt/EBITDA below 4.0x in 2020 and 2021. Kometa will surpass the negative rating-change driver of 5.0x in 2022, yet this will be compensated for by the high liquidity cushion, due to the prudent decision to postpone most of the year's expansion capex and invest well over half of proceeds of the HUF 12bn green bond issued in Mar 2022 in interest-yielding term deposits. After better-than-forecasted leverage in 2021 of 3.2x, the combination of lower EBITDA and higher Scope-adjusted debt during 2022 will lead to a deterioration in leverage. For 2022, leverage will exceed 6x based on Scope cash adjustments (leverage would be below 3.5x if netting 100% of available cash), improving to almost 5x in 2023 and only able to return below 5.0x in 2024 thanks to the gradual EBITDA recovery. Leverage as measured by Scope-adjusted funds from operations/debt supports the overall leverage score as we foresee it ranging within 15%-17% over the medium term.

Interest cover to remain strong, supported by interest income in 2023-24

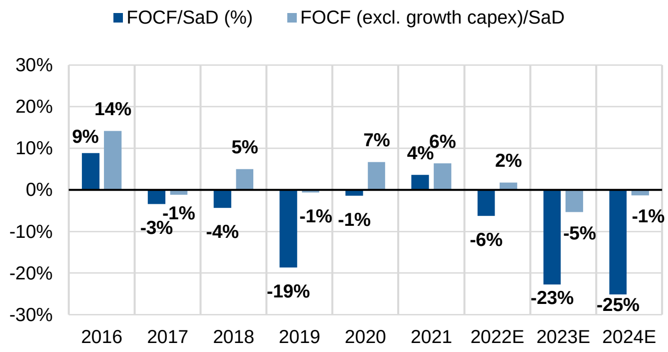
Despite the lower EBITDA and materially higher Scope-adjusted debt expected in the short term, interest cover will remain strong at above 4x over the entire forecast period. This will be supported by interest income on term deposits, expected in large part to be held at least until mid-2023 and to generate interest income of above HUF 800m during 2022-23. The interest income will compensate for the higher interest expense on the increased debt, at HUF 1.0bn-1.3bn a year, thereof HUF 600m includes the yearly bond interest payment (5% fixed coupon). Notwithstanding the high interest rates in Hungary, 70% of interest-bearing debt is based on fixed interest rates and bank credit lines permit borrowing in euro.

Figure 9: Cash flow sources and uses



Source: Scope estimates

Figure 10: Cash flow cover



Source: Scope estimates

Expansionary capex to burden free cash flow generation

Due to low profitability, cash flow generation has been moderate, impacted by the volatile working capital. Kometa's rapid growth has resulted in high capex that has absorbed much of its free operating cash flow (FOCF), even surpassing it in some years (for example, in 2019 when the by-products plant was built). Cash flow cover (Scope-adjusted FOCF/debt) was positive at 4% in 2021 thanks to capex postponement but will turn negative in 2022 and further deteriorate later when capex (net of received subsidies) will intensify. We project net capex in 2023 to remain below HUF 5.5bn before increasing to around HUF 7.5bn in 2024.

FOCF/debt of around zero after excluding growth capex

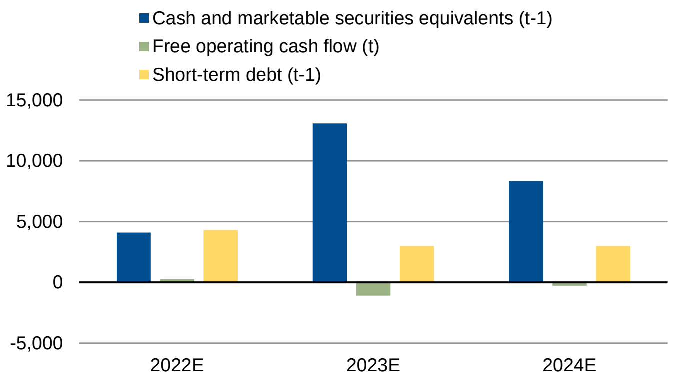
Consequently, cash flow cover based on Scope-adjusted FOCF/debt is estimated to be deeply negative for 2023-24. A more meaningful analysis would be to adjust FOCF by excluding the impact of growth capex. Such an approach leads to a minimal cash flow cover metric of around zero given the low margins and expected working capital needs.

Adequate liquidity

Liquidity is adequate and supported by cash and equivalents of HUF 12.2bn as of June-2022 (vs HUF 1.1bn as of December 2021), a strong liquidity buffer of well above the HUF 3.0bn of short-term factoring lines. Kometa also received HUF 5.0bn in three-year working capital lines guaranteed at 75% by state-owned credit guarantee institution Garantiqa Hitelgarancia Zrt. The combined HUF 8bn in bank credit lines were provided by two large banks and around HUF 3.2bn of them are kept as cash. Liquidity ratios are expected to be well above 110% from 2023.

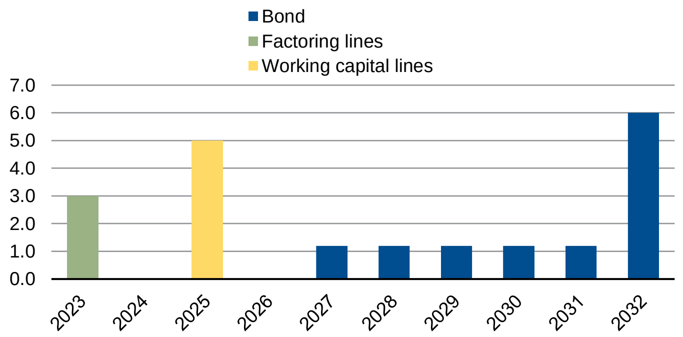
Balance in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	4,109	13,079	8,323
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	252	(1,092)	(266)
Short-term debt (t-1)	4,311	3,000	3,000
Coverage	**101%**	**>200%**	**>200%**

Figure 11: Liquidity sources vs short-term debt (HUF bn)



Source: Scope estimates

Figure 12: Debt maturity schedule Jun 2022 (HUF bn)



Source: Scope estimates

Compliance with financial covenants expected

Financial covenants - to be tested from December 2022 - include a total debt/EBITDA ratio of below 6x and a debt service coverage ratio of above 1.25x. While we expect Kometa to continue to comply with the covenants, we also expect the covenants to be replaced with the standard covenants under the Bond Funding for Growth Scheme.

Supplementary rating drivers: +/- 0 notches

Financial policy

We expect the financial policy to remain conservative. Management delayed capex in 2022 to preserve liquidity and comply with its net leverage target of below 4x during expansion. The approach towards discretionary spending is also conservative: management pursued only a few small acquisitions of established business partners in the past years and historically did not distribute 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 (i.e. the MFB’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 MFB (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% (JV structure) of Zito’s meat processing activities in Croatia. Kometa owns 51% of consolidated subsidiary Kometa Italia Srl (remainder owned by Giacomo Pedranzini and Ruffini family) and 24% of Triagro Kft (accounted for as equity). Subsidiaries in Spain and Germany (via Zito GmbH) were recently established.

Long-term and short-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 increase in capacity, as well the presence of real estate pledges for the subsidy providers (state-linked). The removal of the technology and brand pledges from the investment loan refinanced by the green bond is on the other hand positive for recoverability.

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