Szabó Fogaskerékgyártó Kft.
Hungary, Capital Goods

B NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	Net interest positive	Net interest positive	Net interest positive	4.7x
Scope-adjusted debt/EBITDA	4.7x	2.6x	7.7x	5.8x
Scope-adjusted funds from operations/debt	23%	40%	14%	14%
Scope-adjusted free operating cash flow/debt	-11%	12%	-97%	-2%

Rating rationale

The rating affirmation reflects expected Scope-adjusted EBITDA of around HUF 300m in 2024-25, the completion of the investment programme in 2024, leading to much lower capex beyond 2024, the absence of major refinancing in 2025-26 and a robust interest coverage as a result of low net interest paid. Szabó Fogaskerékgyártó's (hereafter Szabó) issuer rating of B is based on our assessments of its business risk profile, which is unchanged at B-, and its financial risk profile, which we have revised to B+ from BB+. The revision reflects our revised expectation for Scope-adjusted EBITDA in 2024-25, now with weaker anticipated credit metrics in these years.

Outlook and rating-change drivers

The revised Outlook to Negative from Stable reflects the expected deterioration in credit metrics in 2024. This is a result of the anticipated decline in revenue, as indicated by the H1 2024 figures. It also reflects the general deterioration in the business environment, which makes the development of sales volumes beyond 2024 quite uncertain. Given Szabó's vulnerable business model with high customer and product concentration, we see an increased risk that the assumed recovery in Scope-adjusted EBITDA and credit metrics in 2025/2026 may not materialise.

To return to a Stable Outlook, there should be clear signs of a recovery in Scope-adjusted EBITDA and Scope-adjusted debt/EBITDA e.g. leverage should not settle significantly above 4.0x. A rating upgrade is remote at this stage but is possible if the company increased its size and improved its diversification.

A negative rating action could result if the assumed recovery in Scope-adjusted EBITDA and credit metrics in 2025/2026 does not materialise and Scope-adjusted debt/EBITDA remains well above 4x on a sustained basis. It could also result from weaker liquidity or the loss of a major customer.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
18 Dec 2024	Outlook change	B/Negative
22 Dec 2023	Outlook change	B/Stable
21 Dec 2022	Outlook change	B/Negative

Ratings & Outlook

Issuer	B/Negative
Senior unsecured debt	B+

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Related Methodology and Related Research

General Corporate Rating Methodology; October 2023

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Good and robust operating profitability (Scope-adjusted EBITDA) compared to peers • Long relationships with largest customers • Robust interest coverage as a result of low net interest paid	• Deteriorated 2024 business environment and weak 2025 visibility • Very small niche player in the European capital goods market with revenue of HUF 2.6bn (roughly EUR 6m) in 2023 • Weak diversification with regard to products and customers, over 85% of revenue from only two customers • Business nature entails a very low share of recurring revenue (mainly project business) and lack of aftermarket activities, which usually provide for lower volatility • Weak Scope-adjusted free operating cash flow (FOCF) in 2022-2024 due to lower Scope-adjusted EBITDA and investment cycle • Key person risk (ESG factor), as the entire management of the company rests with the current CEO Ferenc Szabo (the sole owner of Szabó Fogaskerékgyártó Kft.) and his son Krisztian Szabo, the executive vice president

Positive rating-change drivers	Negative rating-change drivers
• EBITDA and leverage to recover in 2025/2026 based on improved business environment, e.g. leverage not settling well above 4.0x • Greater size and improved diversification (deemed remote)	• Assumed recovery in Scope-adjusted EBITDA and credit metrics in 2025/2026 does not materialise and Scope-adjusted debt/EBITDA remains well above 4x on a sustained basis • Deterioration in liquidity, loss of a major customer

Corporate profile

Founded in 1976, Szabó is a gear manufacturer based in Kaposvár, Hungary. It is a family-operated business and Ferenc Szabó is the sole owner.

Szabó specialises in gear manufacturing. The company’s activities include computer numerical control (CNC) hobbing, CNC milling, gear shaping, CNC turning, contact surface testing heat treatment, CNC gear grinding, broaching, and 3D CNC measuring. The main product lines are spur gears, helical gears, worm gears, planetary gears, spline shafts, straight bevel gears and geared axes.

In 2023, Szabó reported revenue of around HUF 2.6bn (EUR 6m) with a Scope-adjusted EBITDA margin of 32%. The company has a 3,500 sq m production facility located in Kaposvár and employs more than 50 people. The site Szabó currently operates in is owned by its 100%-owned subsidiary Szabó Hajtástechnológia. Szabó Hajtástechnológia’s total revenue in 2023 was HUF 32m (2022: HUF 32m), consisting mainly of rental income from the parent company.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	97.8x	Net interest positive	Net interest positive	Net interest positive	4.7x	5.9x
Scope-adjusted debt/EBITDA	1.7x	4.7x	2.6x	7.7x	5.8x	3.7x
Scope-adjusted funds from operations/debt	55%	23%	40%	14%	14%	22%
Scope-adjusted free operating cash flow/debt	-51%	-11%	12%	-97%	-2%	1%
Scope-adjusted EBITDA in HUF m						
EBITDA	611.7	526.8	793.1	273.3	403.2	570.8
less: capitalised development costs	0.0	0.0	0.0	0.0	0.0	0.0
add: share-based compensation expense[1]	0.0	0.0	66.0	0.0	-80.0	-80.0
Scope-adjusted EBITDA	**611.7**	**526.8**	**859.1**	**273.3**	**323.2**	**490.8**
Funds from operations in HUF m						
Scope-adjusted EBITDA	611.7	526.8	859.1	273.3	323.2	490.8
less: (net) cash interest paid	-6.3	66.4	77.5	24.1	-68.2	-82.7
less: cash tax paid per cash flow statement	-31.1	-38.7	-32.3	0.0	0.0	-6.8
less: pension interest	0.0	0.0	0.0	0.0	0.0	0.0
less: capitalised development costs	0.0	0.0	0.0	0.0	0.0	0.0
Profit/loss on disposals	0.0	0.0	0.0	0.0	0.0	0.0
Funds from operations (FFO)	**574.3**	**554.5**	**904.3**	**297.4**	**254.9**	**401.3**
Free operating cash flow in HUF m						
Funds from operations	574.3	554.5	904.3	297.4	254.9	401.3
Change in working capital	-83.0	234.5	20.3	53.4	-37.5	-79.9
Non-operating cash flow	399.2	944.5	23.1	-105.4	-14.5	-77.8
less: capital expenditure (net)	-1,067.1	-959.2	-671.3	-2,285.1	-244.9	-224.9
add/less: special items[2]	-352.3	-1,038.1	0.0	0.0	0.0	0.0
Free operating cash flow (FOCF)	**-528.9**	**-263.9**	**276.4**	**-2,039.8**	**-41.9**	**18.7**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	6.3	-66.4	-77.5	-24.1	68.2	82.7
add: interest component, pension	0.0	0.0	0.0	0.0	0.0	0.0
Net cash interest paid	**6.3**	**-66.4**	**-77.5**	**-24.1**	**68.2**	**82.7**
Scope-adjusted debt in HUF m						
Reported gross financial debt	1,016.2	2,432.3	2,226.8	2,080.5	1,886.9	1,798.4
less: cash and cash equivalents[3]	0.0	0.0	0.0	0.0	0.0	0.0
add: non-accessible cash	0.0	0.0	0.0	0.0	0.0	0.0
Other items	25.0	25.0	25.0	25.0	0.0	0.0
Scope-adjusted debt (SaD)	**1,041.2**	**2,457.3**	**2,251.8**	**2,105.5**	**1,886.9**	**1,798.4**

[1] In 2023: write-offs of receivables (among other expenses); in 2025-26: adjustment for non-cash changes in accrued liabilities (among other income)
[2] In 2020-2021: granting and repayment of loans to the shareholder and the subsidiary; in 2022: adjustment for the state subsidy
[3] No cash netting applied as cash positions are not deemed as permanent and accessible at all times.

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Environmental, social and governance (ESG) profile[4]

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)

Overall, ESG factors have no immediate impact on this credit rating action.

Key person risk

There is key person risk (ESG factor), as the company is completely managed by CEO Ferenc Szabo, the 100% owner of Szabó Fogaskerékgyártó Kft., and his son Krisztian Szabo, the executive vice president. Ferenc Szabo and Krisztian Szabo entered into an official agreement on the joint management of the company in February 2022, whereby Krisztián Szabó became the managing director of the company alongside his father and was given independent signing authority. Ferenc Szabo is responsible for strategic decisions, which are always made in consensus with Krisztian Szabo. Szabo senior also undertakes the representative tasks of the company, trains the mechanical engineers, and plays an active role in formulating pricing and other policies. Krisztian Szabo is responsible for the operative managerial tasks, taking an active role in production planning, either directly or through engineer colleagues, and the ERP system. Financial planning and accounting are his responsibility. He is also in charge of R&D and the first line of contact with international business partners. Overall, the company could prove vulnerable to structural changes in management.

[4] 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: BBB

As a manufacturer of gears, Szabó is exposed to the capital goods industry. This industry has medium cyclicality, medium barriers to entry and medium substitution risk. We assess industry risk at BBB.

Very small niche player in the European capital goods market

With revenue of around HUF 2.6bn (EUR 6m), Szabó is a small niche player in the European capital goods market with relatively weak market positioning. The company specialises in gear manufacturing, the production of geared parts, and machining.

Figure 1: **Examples of products**

Source: Scope

Vulnerable position due to concentration risk

In addition to its size, Szabó's business risk profile continues to be constrained by weak product and customer diversification.

Diversification is main constraint

The key constraints regarding diversification are:

- Highly concentrated product portfolio as indicated by relatively low revenue (around EUR 6m). The company's turnover is 99% gear and gearbox production, with waste management and heat treatment providing 1% of total turnover.
- High dependence on certain strategic customers, as the top two customers account for more than 85% of total revenue. We note positively that relationships with those two clients go back 20-30 years. Szabó not only manufactures gears for its customers, but is also involved in product development and testing, which promote customer loyalty.
- High end-market concentration: around 90% of revenues are generated from companies in the agricultural machinery sector.
- Low geographical diversification and high currency risk: exports account for 56% of the company's total net sales and Germany accounts for around 90% of total export sales. Although 44% of revenue is generated in Hungary, the share of EUR-based revenue is much higher at around 95%, as a large part of domestic revenue is also EUR-based. As Szabó's manufacturing capacity is located only in Hungary, more than 30% of costs, mainly personnel and some material costs, are incurred in HUF. Currency risk is not hedged.

Further constraint: very low share of recurring revenue and lack of aftermarket activities

The business risk profile is also constrained by Szabó's business nature. This entails a very low share of recurring revenue (mainly project orders with a short lead time of one to six months) and a lack of aftermarket activities, which usually lead to low volatility.

Profitability, as measured by the Scope-adjusted EBITDA margin, remains the main pillar of the company's business risk profile in the context of the peer group.

Scope-adjusted EBITDA margin improved in 2023

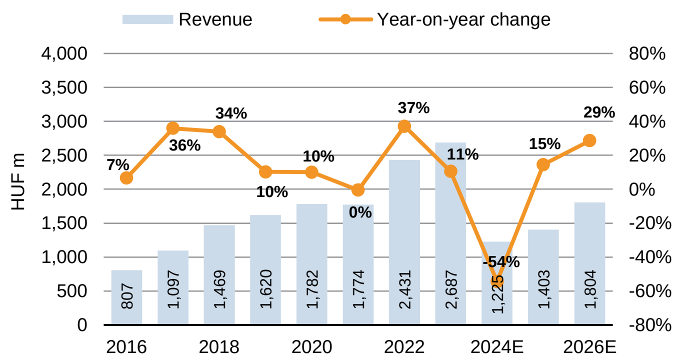
After two years of decline, the Scope-adjusted EBITDA margin improved to 29.7% in 2023 from 21.7% in 2022 on the back of a gross profit margin increase from 38.4% in 2022 to 51% in 2023. The gross margin decrease in 2022 and increase in 2023 both reflect the late conclusion of price negotiations to pass on higher material prices in Q4 2022, resulting in a gross profit margin of around 32% in 2022 compared to about 52% in 2023. A greater improvement in profitability was prevented by a further 38% YoY increase in personnel costs (after +37% in 2022) due to continued wage inflation and a rise in headcount from 50 in 2022 to 54 in 2023. It also reflects an additional one-off cost of HUF 50m related to the owner's personal income tax. Mitigated by 10% YoY top-line growth, personnel expenses as a percentage of revenues increased from 13.6% in 2022 to 16.9% in 2023.

Scope-adjusted EBITDA was up from HUF 527m to HUF 860m in 2023 driven by higher profitability and revenue growth of 11% YoY to HUF 2.7bn.

Revenue rose in 2023 thanks to price increases

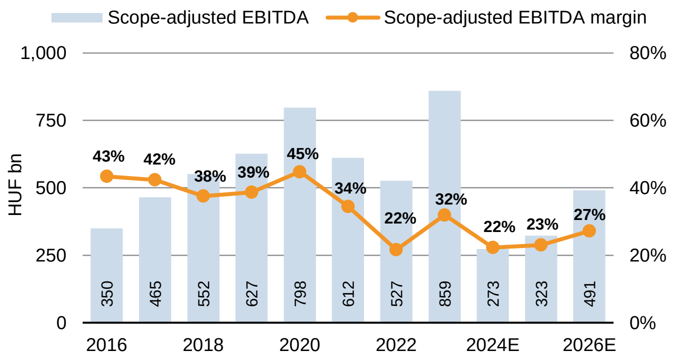
Total revenue growth was boosted by a 19% YoY increase in export revenues, supported by price adjustments in Q4 2022. In contrast, domestic revenue growth, mainly driven by demand from the main domestic customer, was flat YoY despite price increases, indicating lower sales volumes.

Figure 2: Revenue, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Figure 3: Scope-adjusted EBITDA margin, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Significant deterioration in business environment in 2024

Significant revenue decline expected in 2024

The business environment has deteriorated sharply in 2024. Revenue decreased by 58% YoY to HUF 577m in H1 2024 from HUF 1.4bn in H1 2023, reflecting a sudden drop in volumes from the company's two largest customers. As a relatively small supplier, Szabó is generally severely affected by even small reductions in demand from its much larger customers. In this context, Szabó has assured us that there are no outstanding issues between the company and its main customers. It has also referred to its order backlog for 2025, for which both customers have already placed orders. For the full year 2024, we have factored in revenue of around HUF 1.2bn (down 54% YoY).

Profitability proved robust in an extreme stress scenario

Scope-adjusted EBITDA revised downward on lower revenue

The reported EBITDA margin decreased to 21.3% in H1 2024 from 35.5% in H1 2023 due to the lower cost coverage resulting from the decline in revenue. However, it remained strongly positive. We attribute this robustness in an extreme stress scenario to the relatively low fixed cost base and the company's operational flexibility. Based on the H1 2024 results, we expect the Scope-adjusted EBITDA margin to fall to around 22% in 2024. Together with our revenue forecast, this translates into a downward revision of Scope-adjusted EBITDA of around HUF 275m.

Low visibility in 2025

Revenue likely to remain low in 2025

In view of the fragile global economic environment, revenue visibility in 2025 is rather low. Szabó's has a vulnerable business model with low customer and product diversification. Due to the relatively short lead time (1-6 months on average), the current order backlog provides only limited visibility into 2025. There is uncertainty as to whether and to what extent the volumes from the largest customers will return in 2025. We have assumed that Szabó will maintain the relatively low level of revenue in 2025 and have factored in revenue of HUF 1.4bn. This expectation is based on the current order backlog for 2025 of HUF 794m and the assumption that 20% of potential sales opportunities amounting to HUF 2.95bn will be converted into sales in 2025.

No material recovery in EBITDA in 2025

With a Scope-adjusted EBITDA margin of around 23% in 2025, we expect Szabó's profitability to remain broadly unchanged compared to 2024. A significant improvement is likely to be prevented by the fact that a substantial recovery in volumes is still not expected and some additional costs will be incurred for the relocation of production capacity from the old plant to the new one. By contrast, the gradual headcount reduction in 2024 will take full effect in 2025 and have a positive impact on profitability. We assume that Scope-adjusted EBITDA will increase to HUF 325m in 2025 due to the somewhat higher revenue.

Financial risk profile: B+

Financial risk profile up to B+

The significant revision of the financial risk profile to B+ from BB+ reflects our revised expectation for Scope-adjusted EBITDA in 2024-25, now with weaker expected credit metrics in these years.

The company's reported financial debt of HUF 2.2bn at year-end 2023 largely comprises corporate notes of HUF 1.5bn issued in February 2022 under the MNB Bond Funding for Growth Scheme, bank loans (HUF 448m) and financial leases (HUF 235m). Around 95% of Szabó's total debt was fixed coupon at end-2023.

We have made an adjustment for an EU investment grant of HUF 25m (part of accrued liabilities), which will terminate in 2025. Based on this adjustment, we calculate Scope-adjusted debt of HUF 2.3bn at year-end 2023. The slight decrease compared to HUF 2.5bn at the end of 2022 reflects the repayment of the OTP bank loan and the reduction of financial leases.

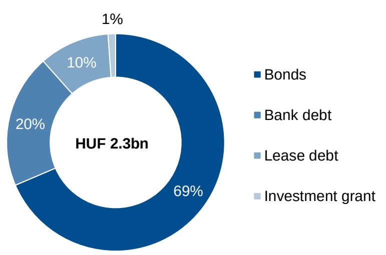
HUF 1bn subsidy not considered due to low probability of repayment

Our Scope-adjusted debt does not include subisidies of HUF 1.0bn received to finance the company's investments under the Economic Development and Innovation Operational Programme Plus. The subsidy is in principle non-refundable, but linked to the growth rate of gross value added compared to GDP growth. The compliance period will start in 2025. Underachievement on the milestones would lead to a pro-rated repayment of subsidies rather than a full repayment of the subsidies received.

Plan to reduce financial debt by HUF 350m by 2025

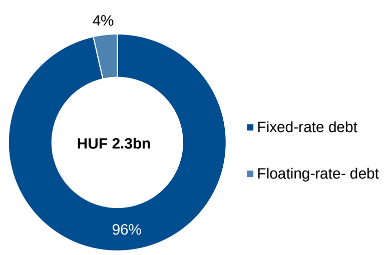
Szabó plans to further reduce its financial debt by a total of around HUF 350m by the end of 2025, as the bank debt maturing will not be replaced and the equipment used under finance leases will be substituted by self-purchased machinery. Based on these deleveraging plans, we expect a decrease in Scope-adjusted debt to around HUF 2.1bn by year-end 2024 and around HUF 1.9bn by year-end 2025.

Figure 4: Funding structure at end-2023



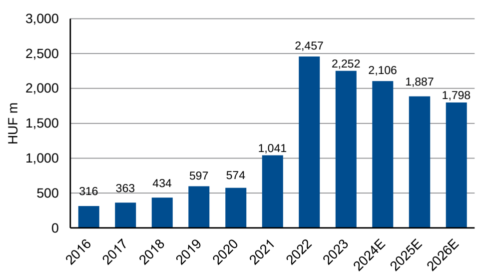
Sources: Szabó, Scope

Figure 5: Interest profile of interest-bearing debt at end-2023



Sources: Szabó, Scope

Figure 6: Trend in Scope-adjusted debt, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Leverage will rise sharply in 2024 and remain high in 2025

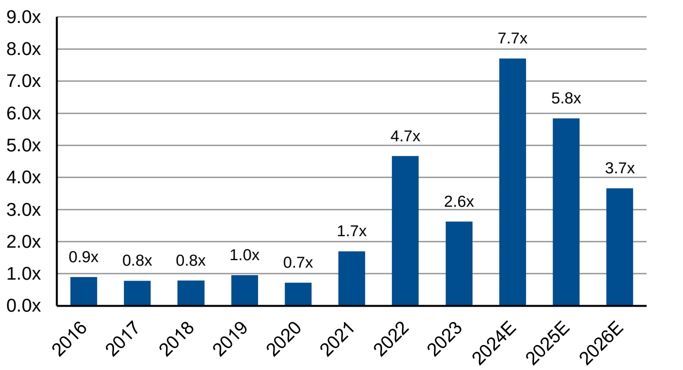
Leverage, as measured by Scope-adjusted debt/EBITDA, improved to 2.6x in 2023 from 4.7x in 2022 largely driven by the increase in Scope-adjusted EBITDA. Based on our revised expectations for Scope-adjusted EBITDA in 2024, we foresee Scope-adjusted debt/EBITDA increasing to around 7.7x in 2024. As we do not expect Scope-adjusted EBITDA to recover significantly before 2026, we anticipate that Scope-adjusted debt/EBITDA will still be relatively high at 5.8x in 2025. Assuming that volumes return in 2026, e.g. through the acquisition of new customers, and lead to a material recovery in Scope-adjusted EBITDA, we expect a stronger improvement in Scope-adjusted debt/EBITDA in 2026 to around 3.7x.

Interest result to turn negative after 2024

Good interest cover after 2024

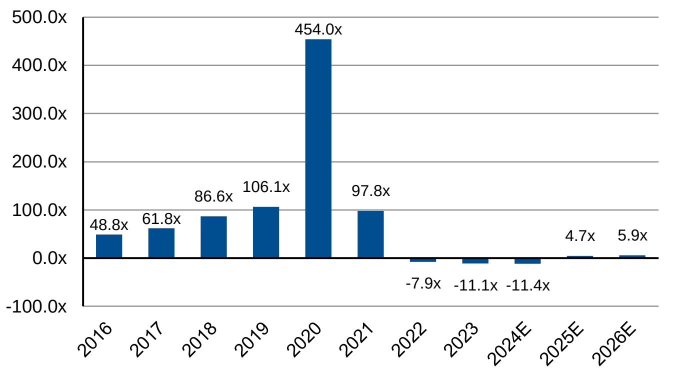
The interest result was positive in 2022-23, supported by interest income on the high cash reserves in those years and the fact that the payment of interest on the bond started in 2023. As indicated by the 9M 2024 results, we expect Szabó to generate interest income again in 2024. We expect the interest result to turn negative in 2025, as cash reserves will decrease in 2024 due to the negative anticipated Scope-adjusted FOCF. Overall, we expect a good interest cover of around 4.7x in 2025 and around 5.9x in 2026, signaling the company's ability to sustain its debt position.

Figure 7: Scope-adjusted debt/EBITDA, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Figure 8: Scope-adjusted EBITDA/interest, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Low EBITDA and lower interest income to weigh on FFO in 2024-25

In 2023, Scope-adjusted funds from operations (FFO) increased slightly to around HUF 904m, from HUF 555m in 2022, thanks to the higher Scope-adjusted EBITDA. Due to the expected drop in Scope-adjusted EBITDA, we see Scope-adjusted FFO falling to around HUF 297m in 2024. For 2025, we see a further slight decline in Scope-adjusted FFO to about HUF 255m. This is because we expect the positive effect from the slightly higher forecasted Scope-adjusted EBITDA to be more than offset by the net interest result, which is likely to become negative in contrast to the last three years.

FOCF turned positive in 2023

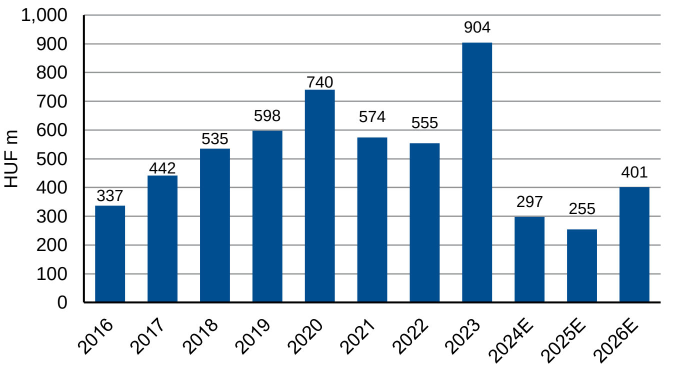
Capex will peak and weigh heavily on cash flow in 2024

After two previous years of negative Scope-adjusted FOCF as a result of an investment programme in production capacities initiated in 2021, Scope-adjusted FOCF turned positive in 2023 at HUF 276m. This was the effect of higher Scope-adjusted EBITDA as well as lower capex, which largely reflects the delayed completion of the programme due to the postponed property development. As part of its investment programme, Szabó has been investing in a new 5000 sq m production hall in the industrial park of Kaposvár. This project is supported by the government with a state subsidy of HUF 1bn under the Economic Development and Innovation Operational Programme Plus. We expect capex to peak at around HUF 2.3bn in 2024 and weigh heavily on cash flow. Overall, we expect negative Scope-adjusted FOCF of HUF -2.0bn in 2024.

Lower capex after 2024, but FOCF to remain around zero due to low EBITDA

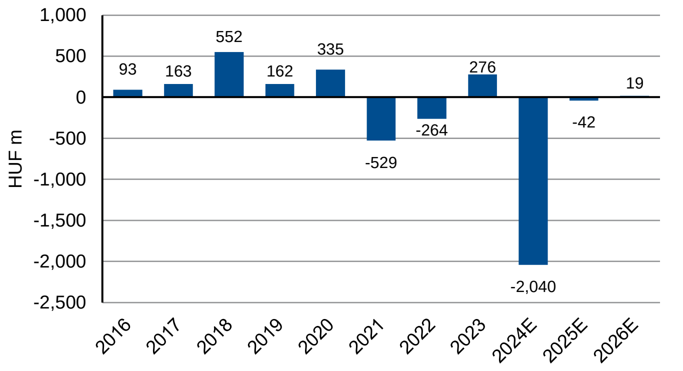
The investment programme will end in 2024 and we assume that Szabó will significantly reduce its capex to around HUF 245m in 2025. Nevertheless, we forecast slightly negative Scope-adjusted FOCF of around HUF -40m. This essentially reflects our expectation that Scope-adjusted EBITDA will remain relatively low in 2025 and that net interest result will be negative in contrast to the last three years.

Figure 9: **Scope-adjusted FFO, 2016 to 2026E**



Source: Szabó, Scope (estimates)

Figure 10: **Scope-adjusted FOCF, 2016 to 2026E**

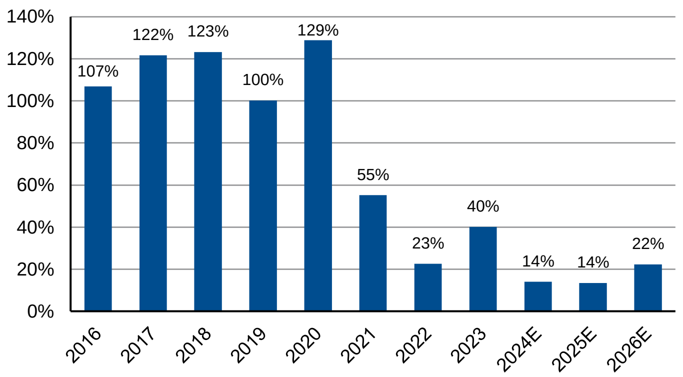


Source: Szabó, Scope (estimates)

Scope-adjusted FFO/debt at around 15% in 2024-25

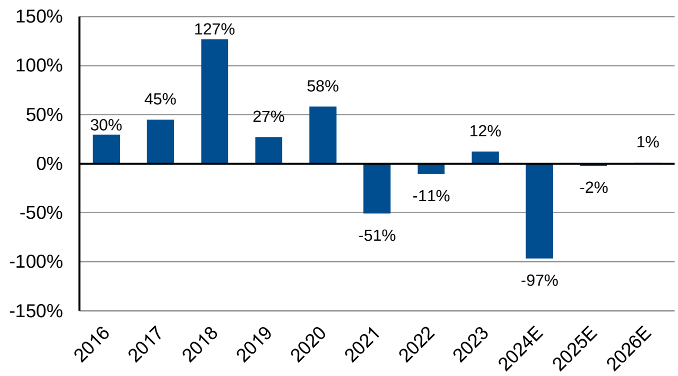
Scope-adjusted FFO/debt improved to 40% in 2023 from 23% in 2022, largely in line with our expectation. We foresee Scope-adjusted FFO/debt declining to around 15% in 2024-25, based on our lowered expectations for Scope-adjusted EBITDA and the absence of a material positive impact from interest income after 2024.

Figure 11: Scope-adjusted FFO/debt, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Figure 12: Scope-adjusted FOCF/debt, 2016 to 2026E



Sources: Szabó, Scope (estimates)

Cash flow to remain weak

Cash flow cover improved to 12% in 2023, after being negative for two years. Taking into account the record capex, we expect cash flow cover to turn negative in 2024. Based on our forecast for Scope-adjusted FOCF, we see cash flow cover of around 0% in 2025-26.

Adequate liquidity

We consider liquidity and financial flexibility to be adequate as the company's available cash sources cover its short-term debt by well over 150% over the next two years. We note positively the company's well stretched debt maturity structure, with no major repayments in 2025-26, and the available new five-year loan of HUF 180m signed with ERSTE Bank in October 2024, in addition to the cash on the balance sheet. Our liquidity assessment also reflects the significantly lower FOCF pressure expected in 2025 compared to 2024 as capex is cut back following the completion of the investment programme.

Bond has an accelerated repayment clause

Szabó's HUF 1.5bn senior unsecured bond issued under the Hungarian Central Bank's bond scheme in February 2022 has an accelerated repayment clause. The clause requires the nominal amount (HUF 1.5bn) to be repaid within 10 business days after the bond rating falls below B-. There is a two-year grace period for a B/B- bond rating, which means that to avoid the accelerated repayment the company must ensure the debt rating returns to B+ before the grace period ends. 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 and the Negative Outlook, the company must at least maintain its current credit profile to avoid triggering the rating-related covenant.

Possible date for repayment of the subsidies is 2026, no repayment assumed

Testing for repayment of the HUF 1.0bn subsidy starts in 2026. Failure to meet the milestone will result in a pro-rata repayment of the subsidy rather than a 'full' repayment. We expect Szabó to either meet the milestone or find a way to avoid repayments, as seen in other cases.

Balance in HUF m	2024E	2025E	2026E
Unrestricted cash (t-1)	2,419	388	243
Open committed credit lines (t-1)	0.0	180	180
Free operating cash flow (t)	-2,040	-42	19
Short-term debt (t-1)	239	284	179
Coverage	**>150%**	**>150%**	**>200%**

Cash sources

Liquidity sources comprise:

i) Cash on the balance sheet of HUF 2.4bn at end-2023 (HUF 1.2bn at end-June 2024) and HUF 388m expected at year-end 2024,

ii) Short-term financial assets (short-term bank deposits as well as short-term government bonds) of HUF 83m at end-2023 (HUF 333m at end-June 2024).

In October 2024, the company signed a new loan of EUR 445,000 (HUF 180m) with ERSTE Bank, maturing in October 2029. This loan can be used for general business purposes.

Cash uses

Expected cash uses include:

i) Expected negative Scope-adjusted FOCF of around HUF -42m in 2025,

ii) Debt repayments (net of debt raised) in the amount of around HUF 146m in 2025 and around HUF 97m in 2026.

Neither Szabó's bond issued under the Hungarian Central Bank's bond scheme nor its bank loans are subject to financial covenants.

No financial covenants

Bank loans are not subject to financial covenants. However, the banks require a certain percentage of annual sales to be paid into the respective bank accounts.

The bond prospectus contains the usual conditions: non-payment, insolvency, cross default, deterioration of external rating, change of control, pari passu, negative pledge, new loan above 10% of equity (subject to permission), and the limitation of dividend payments between 2021-23 to HUF 50m yearly.

Supplementary rating drivers: +/- 0 notches

Supplementary rating drivers are credit-neutral. We have a neutral view on the company's capital allocation.

Dividend stopper in place from 2022 to 2024, no dividends expected in 2025-26

With regard to capital allocation, Szabó has tended to distribute the entirety of FOCF as shareholder dividends in recent years. As provided for in the bond prospectus, the company has committed to reduce the annual dividend to HUF 50m during the investment cycle from 2022 to 2024. The dividend payment of HUF 50m was already made in 2024. Given the current economic environment, Szabó does not plan to pay a dividend in 2025-26.

No further loans to owner and sister company in 2022-24

In 2018, Szabó started to provide loans to its shareholder and its subsidiary, run by Krisztian Szabo, son of the owner of Szabó Fogaskerékgyártó Kft. and executive vice president of Szabó Fogaskerékgyártó Kft. Loans provided to the shareholder amounted to HUF 9.8m at end-June 2024 compared to HUF 76.6m at YE 2023 and HUF 80.1 at YE 2022. Loans provided to the subsidiary were largely reimbursed in 2021 (HUF 44.3m at YE 2023 vs. HUF 411.4m at year-end 2020) but increased slightly to HUF 50.6m at end-June 2024. This will be repaid shortly and no further support is planned in the near future. Therefore, we have not factored in any capital transfer from Szabó Fogaskerékgyártó Kft to its shareholder and its subsidiary.

Long-term debt rating: B+

Senior unsecured debt rating: B+

We have affirmed the B+ rating for senior unsecured debt, one notch above the issuer rating, based on an above average recovery prospect in the event of a default.

In February 2022, Szabó issued a HUF 1.5bn senior unsecured bond (ISIN: HU0000361480) through the Hungarian central bank's Bond Funding for Growth Scheme. The bond's tenor is 10 years, with a fixed coupon rate of 5.5% and repayment is in six tranches of 10% in 2027, 2028, 2029, 2030 and 2031 and of 50% in 2032.

Banking loans and the HUF 1bn subsidy are secured by a pledge on the property of Szabó and on some selected machines, vehicles, trucks and cars. To determine claimholders, we ranked the repayment obligation for the HUF 1bn subsidy and banking loans at the simulated point of default senior to the claims on the bond.

In October 2024, the company signed a new five-year loan of EUR 445,000 (HUF 180m) with ERSTE Bank. We expect this loan to be drawn in a potential distress scenario. Szabó has informed us that the loan is collateralised by a 70% state guarantee (through a state agency) and a mortgage on the inventory of Szabó.

We assume that the business plan will be executed as planned, with no additional bank debt or other senior ranking financings ahead of the planned bond.

Our recovery analysis indicates an above average recovery for the senior unsecured bond and for the senior unsecured debt category, translating into a rating one notch above the issuer rating of B. Our recovery analysis used a liquidation value of HUF 2.6bn for a hypothetical default scenario in 2025. This value is based on a haircut on the assets and reflects liquidation costs of 10% for the assets. The relatively high assumed liquidation value reflects the large amount of PPE as a result of the ongoing investment programme, which started in 2021 and ends in 2024.

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