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Caola Zrt.

February 2022

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Caola Zrt.		Initial Credit Rating
	Date of Rating Committee:	11.02.2022
	Date of Publication:	14.02.2022
Issuer Rating	**Long-term Rating:**	**BB-**
	Outlook:	Stable
Bond Rating	**Long-term Rating:**	**BB**
	Outlook:	Stable

1) Prior to the present publication the credit rating and rating outlook was disclosed to the rated entity or related third party. Following that disclosure amendments in the credit rating and rating outlook have not been made;
2) During the last 2 years, BCRA Credit Rating Agency AD has not provided ancillary services to the rated entity or a related third party.

BCRA – CREDIT RATING AGENCY AD (BCRA) *is the third fully recognized rating agency in the EU, registered pursuant to Regulation No. 1060/2009 of the European Parliament and the Council. The credit ratings assigned by the BCRA are valid throughout the EU and are fully equal to those of the other agencies, recognized by the European Securities and Markets Authority, without any territorial or other limitations.*

On the 11th of February 2022, the **Rating Committee** of BCRA had a session, on which the assigning of initial credit ratings to Caola Zrt. was discussed. The session was headed by Dr. Kiril Grigorov - chairmen of the Rating Committee. The members of the Rating Committee reviewed numerous qualitative and quantitative risk factors included in the Initial Credit Rating Report, in accordance with our Corporate Rating Methodology. Accordingly, the Rating Committee decided to assign the following initial credit ratings:

- Long-term Issuer Rating: **BB-**, Outlook: **Stable**;
- Long-term Bond Rating: **BB**, Outlook: **Stable**.

BCRA's officially adopted methodology for assigning a Corporate credit rating is used: *https://www.bcra-bg.com/files/Corporate_Methodology_2016_en.pdf)*

The users of the rating can find information on the meaning of each rating category, including the definition of default in the published Global rating scale on the BCRA's website: *https://www.bcra-bg.com/files/global_scale_en.pdf*

Company Overview

Table 1: General Information

Company name:	Caola Zrt.
Address:	Homokbanya ut 77, Diosd, Pest, Hungary
Registration number:	13-10-041783
Main business activity:	2042. Manufacture of perfumes and toilet preparations
Subscribed capital:	HUF 621 000 000

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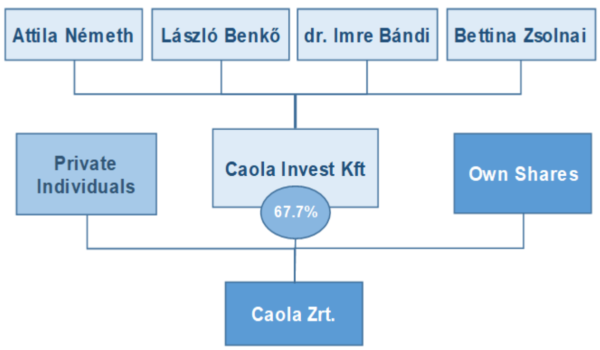
Caola is one of the oldest brands in Hungary and Caola Zrt. is the second oldest continuously operating Hungarian company as its legal predecessor was established back in 1831. The company's main activity is the production and sale of beauty, personal, home and laundry care products. Given its outstanding history, Caola has contributed to the commercial and scientific development of the sector in Hungary in the last one and a half-century.

Figure 1: Ownership structure of Caola Zrt. as of January 2022



Still owned by Hungarian individuals, the company's ownership changed throughout the years. In April 2020, Caola Invest Kft. has acquired a majority stake in Caola Zrt. with the clear aim to bring the company brand back among the market leaders.

The main activity of Caola Invest Kft. is the leasing of real estate to Caola Zrt. In addition, Caola Invest Kft owns the Caola brand name for the use of which Caola Zrt. pays a royalty fee.

The subscribed capital of Caola Zrt. amounted to HUF 621 mln as of end-2021.

The management team is well qualified with adequate education profiles, long experience, and a wide range of expertise. At present, key management positions are held by Dr. Imre Bandi (Owner & CEO) and Dr. Anikó Szaraz (Deputy-CEO).

Current leadership acquired the company in a weaker financial position but managed to revive the business via its new strategy shift in production to disinfectants in the depths of the COVID-19 pandemic. The mission of the management is Caola to regain its old fame and be a key player in the region with a renewed product portfolio with well-known brands.

Caola Zrt. plans a bond issuance of HUF 7.5 bln to indirectly finance its parent company's acquisition and to partially finance the investment in the new production factory in Martonvásár. Through the acquisition, the group plans to strengthen its position and increase its market share as the target is a competitor company producing disinfectants, home care, personal and beauty products.

Operating Environment

Given the fact that Caola is headquartered in Hungary and all of its production capacities are located there, the sovereign risk of Hungary is considered as a definitive factor for the company's performance. The sovereign risk is assessed according to the unsolicited sovereign rating of Hungary assigned by BCRA. The full rationale, as well as the history of ratings, can be found at the following link: https://www.bcra-bg.com/en/ratings/hungary-rating.

Caola Zrt. is manufacturing beauty, personal, home and laundry care products, being part of the chemical industry. Pre-pandemic, the industry already operated within a highly regulated framework of self-regulation and standardisation, strict branch legislation and policy directives that consider a spectrum of factors - from national and general safety to best industry standards observance and client satisfaction adherence. Intra-pandemic, the enterprises had to adapt to the moving targets that such a global event set forth. Various response mechanisms, be they government-initiated or private (for- or non-profit in their origin) set adjacent weight on compliance for the companies. Additionally, pre-pandemic sensitivity to safety ("less-damaging" beauty products) shifted to focus on personal hygiene as part of public hygiene, intensifying scrutiny on the sector.

Concurrently, Beauty and Personal Care market is one of the fastest-growing consumer markets mainly driven by Cosmetics and Skin Care segments. The main reason for the strong growth is the generational shift in the consumer base as young consumers with new shopping habits are entering the market. In this regard, the significance of social media marketing and e-commerce is rapidly increasing.

Market Position

The brand Caola is a respected Hungarian brand that is associated with quality, stability and tradition. Accordingly, Caola Zrt. has a strong, well-diversified product portfolio and committed partnerships with distributors and customers as well.

Regarding the Beauty Personal Care and Home Laundry Care market, Caola mainly focuses on the production and sales of Personal Care, Skin Care and Cosmetic products, while its most successful business segments are personal hygiene products and disinfectants.

Targeting in Retail Segment is well-diversified among the generation groups, as Caola is offering from classic cosmetics, through household products and baby care products, to disinfectants. Sales strategy envisages product development and rebranding. In the short term, the company plans to launch new products, namely luxury products, as well as bio, vegan and eco-friendly products. Rebranding is planned by new logos, a new portfolio outlet, and change of packaging. Reflecting the above-mentioned market trends, the management aims to increase B2C marketing through online communication channels. Also, the opening of a Flagship store is targeted in the long term.

Caola Group has 2 production sites in Hungary, in Budapest and Diósd. Concurrently, it is building a new manufacturing facility in Martonvásár and plans another in Csíkszereda, Romania. Caola Group also owns a research laboratory.

In 2020, Caola Zrt. won non-refundable state subsidies of HUF 2.3 bln for partially financing its capacity-increasing developments (new factory building and renewal of machinery). The total cost of the greenfield investment is HUF 4.25 mln. The project was launched in January 2021 and the completion of the Martonvásár plant is planned till the end of 2022. Following the relocation in 2023, Caola Invest Kft. intends to sell the property in Diósd.

In the new factory of Martonvásár the production of liquid hygienic products can be significantly increased for surgical disinfectants, hand and skin disinfectants, instrument and tool disinfectants and surface disinfectants.

Caola maintains good relations and cooperation with a range of suppliers of contracted manufacturing, raw materials, and packaging material. However, the concentration is elevated as Top 10 suppliers accounted for 91% of total supplies in 2021.

Figure 2: Suppliers

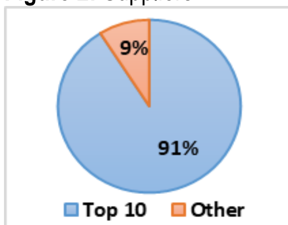
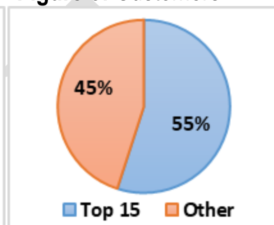


Figure 3: Customers



Concurrently, the customer base is well-diversified with Top 15 customers accounting for about 55% of total sales. The company has a strong sales pipeline in B2B business focused on professional disinfectants.

In 2021, the Hungarian government launched a public tender for disinfectant procurement mainly for hospitals favoring Hungarian companies as suppliers. The goal of the initiative is to make Hungary less dependent on imports. To boost Hungarian disinfectant production in 2021, the Hungarian state gave ~HUF 50 bln subsidies to Hungarian disinfectant producer companies for development purposes and plans to announce further public procurement tenders favoring Hungarian companies in 2022 and 2023 as well.

Being one of 15 selected companies, Caola successfully applied to participate in the disinfectant procurement system announced by the Directorate General for Public Procurement and Supply (KEF). The announcement of the KEF for 2021-2022 refers to purchases with a total amount of HUF 45 bln, of which Caola will take orders for HUF 2.2 bln and is likely to win another totalling HUF 1.5 bln.

Traditionally the market has been ruled by multinational companies, thus, Caola occupies an insignificant relative market share of 1%. However, Caola has managed to become one of the TOP 5 market players regarding professional disinfectants in Hungary and aims to gain a market leader position by eliminating competitors by acquisition.

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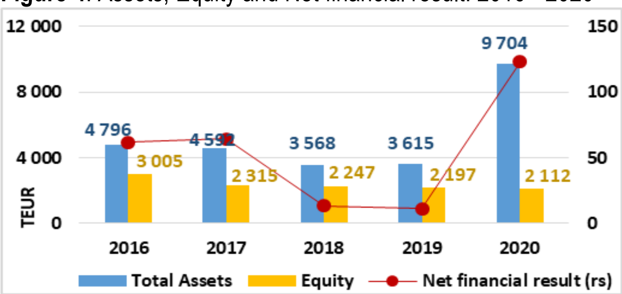
Financial Analysis

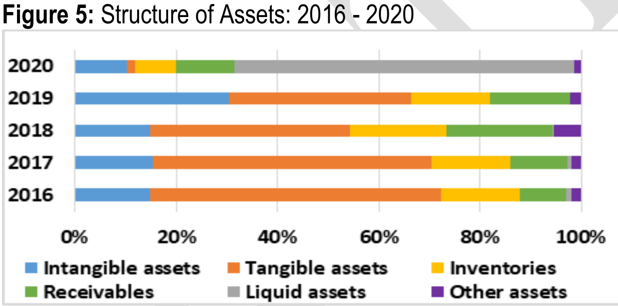
Figure 4: Assets, Equity and Net financial result: 2016 - 2020



Total assets of Caola peaked at TEUR 9 704 as of end-2020, which represented a total increase of 137.5 % against the beginning of the analysed period. While the assets dynamic between 2016 and 2019 has been generally subdued, in 2020, the sum of assets recorded an extraordinary increase of 196.5% as the company received a cash subsidy to expand its production capacity.

In parallel, the shareholders' equity has marked a moderate downward trend, falling to TEUR 2 112 at the end of 2020, from TEUR 3 005 in 2016. Following the prominent decrease of 23.2% in 2017 due to a derecognition of revaluation reserves, the equity has recorded three consecutive years with small positive growth rates (this trend can't be observed in Figure 14 due to outpacing HUF depreciation against the EUR) in line the sustained positive financial results.

Figure 5: Structure of Assets: 2016 - 2020



Between 2016 and 2019, the structure of assets has been strongly dominated by tangible assets, however, their relative share marked a declining trend - from 57.3% in 2016 to 36% given the parallel increase in the absolute value of other assets groups, namely intangible assets and receivables.

In 2020, the assets marked a major change in structure which reflected two main factors. First, the company received a non-refundable state subsidy of HUF 2.5 bln and by the end of the year the remaining amount of it was accounted as bank deposits in the balance sheet, thus, the sum of liquid assets rapidly rose to TEUR 6 495 (compared to TEUR 1-3 in the previous two years). Second, in 2020, Caola Zrt. sold the property in Diósd to CAOLA Invest Kft. (the parent company), thus, the balance value of its tangible assets decreased from TEUR 1 303 in 2019 to TEUR 166 as of end-2020. As result, the relative weight of tangible assets fell to only 1.7% of total assets while the share of the liquid assets temporally peaked at 66.9%.

In parallel, total liabilities of Caola recorded a sharp annual increase driven by the accumulation of passive accruals related to the received subsidies. Excluding their effect, the liabilities dropped to TEUR 1 087, from TEUR 1 728 at the end of 2016. Concurrently, loans that occupy the largest portion of liabilities (excl. PA) decreased by TEUR 421.

As of end-2020, gross financial debt amounted to TEUR 767 and was formed from a leasing contract, long-term bank capital loans, and overdraft facilities. All the loans have been repaid regularly, while the long-term Exim working capital loan has been rescheduled given the payment moratorium possibility imposed in Hungary.

Trade payables and advances accounted for 25% of total liabilities on average for the analysed period. In 2020, trade payables record a more prominent annual reduction of 44.3%, thus, their relative decreased by 10 p.p. to 17%. Accordingly, the Trade Accounts Payment Period improved to 23 days, from 59 days in 2019.

The net financial result has remained positive during the last five, expanding from TEUR 62 in 2016 to TEUR 123 in 2020. The negative trend observed between 2017 and 2019 has shifted in 2020 when the profit recorded an outstanding annual increase of 1098%. The dynamics of net sales revenues have been less volatile but again with a negative trend between 2017 and 2019 and a significant increase (+48.3% YoY) in 2020.

Following the Corporate Rating methodology used by BCRA, some key financial metrics of Caola were compared with those achieved by a defined competing Reference group of companies.

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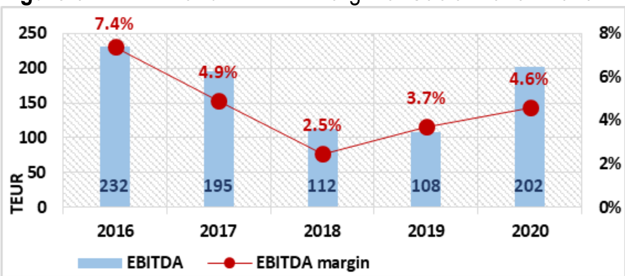
Figure 6: EBITDA and EBITDA margin of Caola: 2016 - 2020



Regarding the achieved profitability, Caola positions itself unfavourable among the defined peer group of companies, especially in 2020. The EBITDA margin of Caola improved to 4.6% in 2020 but in the meantime, the other companies recorded two-digit margins. The unfavourable positioning is confirmed also when comparing the reported ROA.

Given the outpacing annual growth of liabilities (+491.2%) compared to assets (+196.5%), the leverage ratio of Caola rapidly deteriorated to 78.2% as of end-2020, from 39.2% a year ago. However, the reduction of loan liabilities and accordingly – the improvement of the Debt-to-Equity ratio, is assessed positively.

In general, Caola positions relatively well among the reference group of companies and demonstrates prerequisites for gaining an even stronger market position in the medium-term while preserving its financial soundness.

Financial Forecast

Based on the strategy and business plans provided by Caola's management, which are assessed as relevant and broadly achievable, a financial forecast for the period 2021 – 2024 was prepared.

If the revenue targets are successfully met, Caola is expected to record a constantly increasing EBITDA - expanding from TEUR 588 in 2021 to TEUR 4 609 in 2024. Also, the profitability will improve with the EBITDA margin stabilising at about 30% from 2022.

Due to the planned bond issuance, gross financial debt will temporarily peak (at TEUR 21 337) and Net debt-to-Equity ratio will reach 7.6 as of end-2022, before gradually falling to 2.7 at the end of the forecasted period. The proportion of interest expenses in total operating revenues will increase to 15% in 2022, however, the company is expected to generate sufficient free cash flow to timely service its obligations without difficulties.

Bond Rating

Caola Zrt. plans to issue a 10-year bond with a face value of HUF 7.5 bln. The bonds will be issued by way of a public offering addressed to qualified investors in an auction within the framework of the Bond Funding for Growth Scheme launched by the National Bank of Hungary. The auction is planned to take place in February 2022.

The principal repayment schedule envisages 10% annual amortisation starting from the fifth year after issuance and a 50% balloon payment at final maturity. The issue is assumed with a fixed annual coupon of 5.8%. Bond proceeds are earmarked to 1) indirectly finance Caola Invest Kft.'s (parent company) acquisition, and 2) partially finance the investment of a new production factory in Martonvásár. The acquisition target company will be established as a guarantor on the bond issue.

The guarantor company demonstrates moderate leverage and low financial indebtedness. The EBITDA is expected to form a straight upward trend with a sustained high margin of about 20%. Thus, the possibility of loan repayment will exceed the existing liabilities at the end of the forecasted period, indicating that the target company could easily service additional commitments arising in case of potential activation of its guaranty on Caola's bond issue.

The combined credit metrics *(presented in a Table the Appendix)* show that debt service will be well secured by EBITDA interest coverage of above 450% during the whole forecasted period and Net Debt-to-EBITDA ratio falling to 1.6 in 2024.

The long-term credit rating of the **planned guaranteed bond issue** is based on the rating assigned to the issuer, adjusted with BCRA's assessment for the capacity of the guarantor to back the timely servicing of the bond obligations. Accordingly, BCRA has decided to apply **a one-notch upgrade** on the long-term issuer rating "**BB-**" of Caola Zrt., assigning "**BB**" long-term rating to the planned guaranteed bond issue.

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General conclusions: The issuer credit rating of Caola Zrt. is backed by its longstanding history of successful business development and sound credit metrics. On the other side, small market share and track records of moderate profitability represent rating constraints.

The outlook is **stable**, indicating that risks are broadly balanced. Despite the expected increase in gross financial debt, we believe that Caola Zrt. will be able to generate more than sufficient cash flow to timely service its obligations.

The following factors could lead to a rating **upgrade** and/or a positive change in outlook:
1) strengthening of company's market position through future expansion and diversification of product markets;
2) increasing profitability of operating activity;
3) reduction in indebtedness.

The following factors could lead to negative outlook change and/or a rating **downgrade**:
1) unreached revenue targets in case of unsuccessful business development or market turmoil, leading to negative financial results;
2) material increase in leverage;

The long-term credit rating of the **planned guaranteed bond issue** is based on the indicative parameters, provided by Caola's management.

Appendix:

Table 2: Key financial metrics of Caola: 2016 - 2020

TEUR	2020	2019	2018	2017	2016
Total assets	9 704	3 615	3 568	4 592	4 796
Fixed assets	1 171	2 402	1 945	3 244	3 467
Current assets	8 445	1 192	1 491	1 321	1 306
Equity	2 112	2 197	2 247	2 315	3 005
Gross financial debt	767	829	670	583	1 188
Net financial debt	-5 728	827	666	550	1 134
EBITDA	202	108	112	195	232
ratios					
ROA	1.3%	0.3%	0.4%	1.4%	1.3%
ROE	5.8%	0.5%	0.6%	2.8%	2.1%
EBITDA Margin	4.6%	3.7%	2.5%	4.9%	7.4%
Total Leverage (TL /TA)	78.2%	39.2%	37.0%	49.6%	37.3%
Net Debt-to-Equity	-2.71	0.38	0.30	0.24	0.38
Net Debt-to-EBITDA	-28.3	7.6	5.9	2.8	4.9
EBITDA interest coverage	35.6	4.6	7.5	7.1	6.1
Current Liquidity	117.8%	119.6%	165.7%	66.2%	124.5%
Cash Liquidity	89.7%	0.1%	0.4%	1.6%	5.1%

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Table 3: Forecasted combined financial metrics of Caola Zrt. (Issuer) + Target Company (Guarantor): 2021 - 2024

TEUR	2021	2022	2023	2024
Cash	2 504	1 223	3 929	7 922
Gross Financial Debt	5 088	23 622	23 297	23 064
Net Financial Debt	2 585	22 399	19 368	15 143
Assets	32 538	52 313	50 910	51 899
Equity	10 597	12 945	14 281	17 767
Total Liabilities	21 941	39 367	36 629	34 132
Operating Revenues	15 630	22 055	29 668	34 209
OPEX	13 815	18 286	25 914	28 229
EBITDA	2 535	5 301	8 126	9 502
ratios				
Leverage (TL/TA)	67.4%	75.3%	71.9%	65.8%
Gross Debt-to-Equity	0.48	1.82	1.63	1.30
Net Debt-to-Equity	0.24	1.73	1.36	0.85
EBITDA Margin	16.2%	24.0%	27.4%	27.8%
EBITDA interest cover	32.12	4.69	6.63	7.76
Net Debt-to-EBITDA	1.02	4.23	2.38	1.59