Cerbona Élelmiszergyártó Kft
Hungary, Consumer Goods

SCOPE BB- STABLE

Corporate profile

Cerbona Élelmiszergyártó Kft is a Hungarian company which makes cereal-based products to be distributed in Hungary and some other European countries. Cerbona Élelmiszergyártó Kft is based in Székesfehérvár, Hungary and offers a broad range of cereals, muesli bars and other related products. It has become a renowned brand in its domestic market.

The company employs 135 people at its production facility in Székesfehérvár and earns annual turnover of about HUF 4bn, HUF 0.7bn of which is generated through exports.

Key metrics

		Scope estimates		
Scope credit ratios	2018	2019F	2020F	2021F
EBITDA/interest cover (x)	>10x	>10x	>10x	>10x
Scope-adjusted debt (SaD)/EBITDA	1.0x	0.6x	1.7x	1.8x
Scope-adjusted FFO/SaD	>45%	>45%	>45%	>45%
FOCF/SaD	16%	>25%	<5%	>5%

Rating rationale

Scope Ratings assigns a BB- initial issuer rating to Hungarian consumer goods company Cerbona Élelmiszergyártó Kft with a Stable Outlook.

The rating is positively influenced by stable demand for the products offered and the company's efforts to follow consumer needs and trends. Cerbona has a good position in Hungary but needs to work more on solidifying this position and internationalisation. Private label sales and a mix of distribution channels are among the factors that will drive growth. While profitability is stabilising, it remains weaker than that of peers as costs are difficult to control.

Cerbona has adequate financials and is refinancing bank debt from generated cash flow. The planned issuance of a nine year, HUF 1bn bond in 2020 under the Hungarian national bank's Bond Funding for Growth Scheme, is aimed at diversifying sources of financing. Most of the bond's proceeds are intended to finance production expansion projects and refinance existing debt.

Outlook

The Outlook is Stable reflecting the stability of Cerbona's EBITDA margin and limited pressure on credit metrics from the projected bond issuance. We anticipate that leverage, as measured by Scope-adjusted debt (SaD)/EBITDA, will reach a maximum of 2x in the next few years.

A positive rating action could be triggered by an improvement in the company's business through increasing sales or diversification.

A negative rating action could be triggered by a deterioration in credit metrics exemplified by the SaD/EBITDA ratio reaching 3.5x for a prolonged period of time, potentially as a consequence of a large debt-funded acquisition or by significantly higher dividend payments in future, if part of the bond proceeds are used to completely pay back existing bank loans thereby dispensing with the covenants which presently restrict dividend payout.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	BB-

Analysts

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Related Methodology

Corporate Rating Methodology

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Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Market leader or among top five for cereal-related products offered in Hungary • Diversified products allowing differentiation and ability to adapt to customer needs • Diverse distribution channels • Adequate financials	• Concentration on domestic operations • The company's small scale makes it vulnerable to intensive competition • Limited brand recognition outside Hungary • Risk associated with increasing raw material and staff costs • Execution risk for the planned expansion • EBITDA margin below peers

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in the business risk profile through increased sales or diversification	• Deterioration in the company's credit metrics (SaD/EBITDA reaching 3.5x on a sustained basis) stemming from a large acquisition or higher dividend payout.

Financial overview

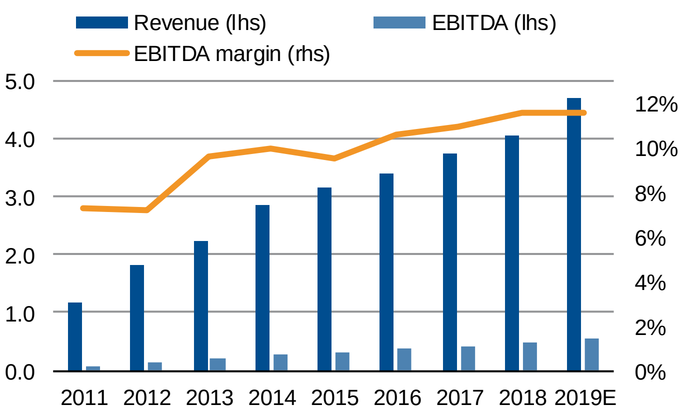
		Scope estimates		
Scope credit ratios	**2018**	**2019F**	**2020F**	**2021F**
Scope-adjusted EBITDA/interest cover (x)	>10x	>10x	>10x	>10x
Scope-adjusted debt (SaD)/EBITDA	1.0x	0.6x	1.7x	1.8x
Scope-adjusted funds from operations/SaD	>45%	>45%	>45%	>45%
Free operating cash flow/SaD	16%	>25%	<5%	>5%
Scope-adjusted EBITDA in HUF m	**2018**	**2019F**	**2020F**	**2021F**
EBITDA	468.6	506.1	546.5	590.3
Operating lease payments in respective year	-	-	-	-
Other	-	-	-	-
Scope-adjusted EBITDA	468.6	506.1	546.5	590.3
Scope-adjusted funds from operations in HUF m	**2018**	**2019F**	**2020F**	**2021F**
EBITDA	468.6	506.1	546.5	590.3
less: (net) cash interest as per cash flow statement	(10.2)	(7.8)	(34.7)	(51.5)
less: cash tax paid as per cash flow statement	(14.7)	(27.3)	(26.0)	(26.1)
add: depreciation component, operating leases	-	-	-	-
Scope-adjusted funds from operations	443.7	470.9	485.9	512.7
Scope-adjusted debt in HUF m	**2018**	**2019F**	**2020F**	**2021F**
Reported gross financial debt	471.1	470.1	1,416.6	1,385.8
less: hybrid bonds	-	-	-	-
less: cash and cash equivalents	(12.8)	(143.6)	(468.1)	(347.5)
add: cash not accessible	-	-	-	-
add: pension adjustment	-	-	-	-
add: operating lease obligations	-	-	-	-
Other	-	-	-	-
Scope-adjusted debt	458.3	326.5	948.5	1,038.3

Business risk profile: B+

A small-scale player in a dynamic industry

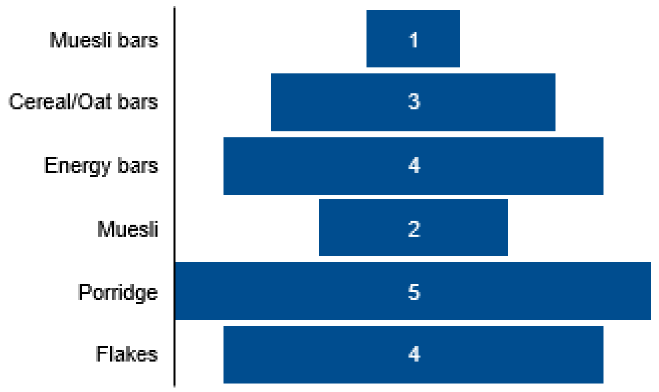
In terms of market position, Cerbona's business is constrained by the company's small scale. While the company has grown at a good pace since 2011 (HUF 1bn in sales versus HUF 4bn today), it remains vulnerable to stiff competition. Cerbona is a market leader in Hungary, holding one of the top five positions in almost every product category it offers. To remain competitive and improve its market share, Cerbona had to focus on continuous product innovation while investing in the production facility to increase the scale of its higher value-added products.

Figure 1: Revenue and EBITDA development (HUF bn)



Source: Cerbona, Scope

Figure 2: Position in main product categories in Hungary

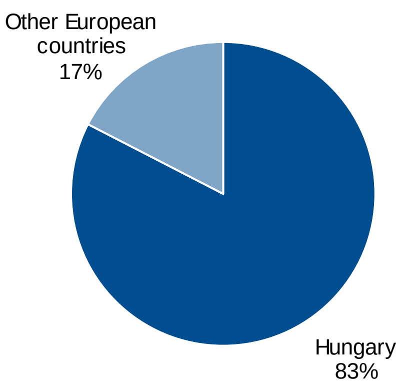


Source: Cerbona, Scope

Concentration on a single country

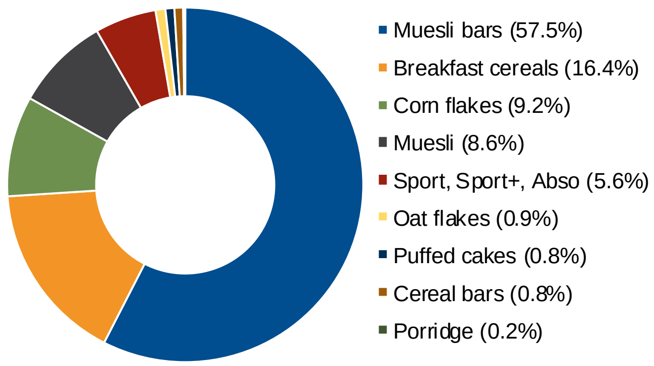
The company is working on its diversification by producing different cereal-related products and following the trend for gluten-free, high-protein and sugar-free products. However, Cerbona is mainly concentrated in Hungary. The brand is largely recognised domestically and exporting to other European countries remains challenging. In order to increase its revenue and exports, Cerbona is using different distribution channels and selling a small proportion of products as private labels to retailers.

Figure 3: Sales split: by country



Source: Cerbona, Scope

by product category



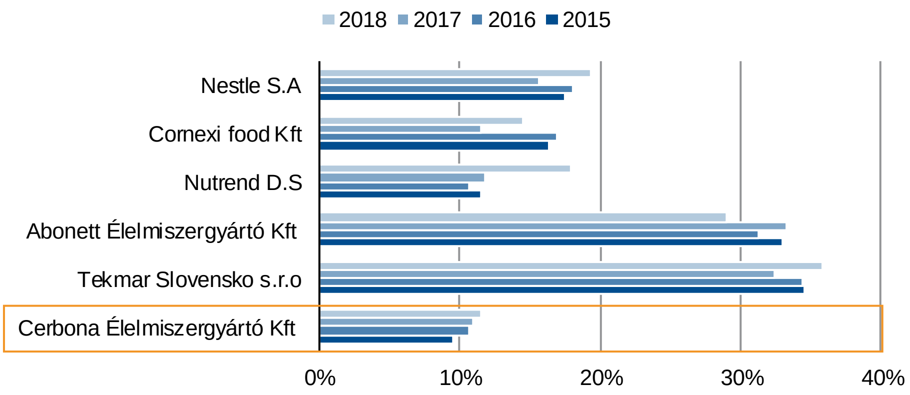
Source: Cerbona. Scope

In terms of profitability, the EBITDA margin has improved year after year since the company is in a growth phase with the aim of improving the margin (around 12% in 2018). This margin is expected to remain stable in the next two years despite the revenue increase as staff and material costs are also rising.

Brand visibility and pricing policy are the two most important factors for Cerbona, deciding the future direction of this company.

Cerbona's profitability is low compared to fast moving consumer goods peers. While it is in a growth phase, the company faces the challenge of cost increases related to personnel and raw materials. In Figure 4, we see that Cerbona's EBITDA margin is lower than Nestle's and that of consumer goods peers located in other countries like the Czech Republic, Slovakia, Bulgaria or Macedonia.

Figure 4: EBITDA margin against competition in the last years



Source: Cerbona, Scope

Financial risk profile: BB

Our assessment of the financial risk profile is forward looking, taking into account forecasts for the next three years.

Low impact on leverage from the planned bond issuance

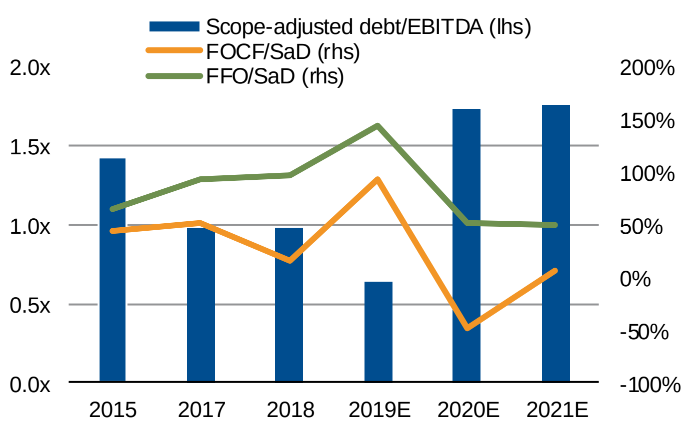
While leverage (SaD/EBITDA) is expected to rise following the planned bond issuance, it is likely to remain below 2x. We believe that the company will use most of the bond proceeds to mainly finance growth and partly refinance maturing debts.

Debt cover such as EBITDA/interest cover will remain very comfortably above 7x once the future financial setup of the group has been achieved.

Deteriorating FOCF in the upcoming years

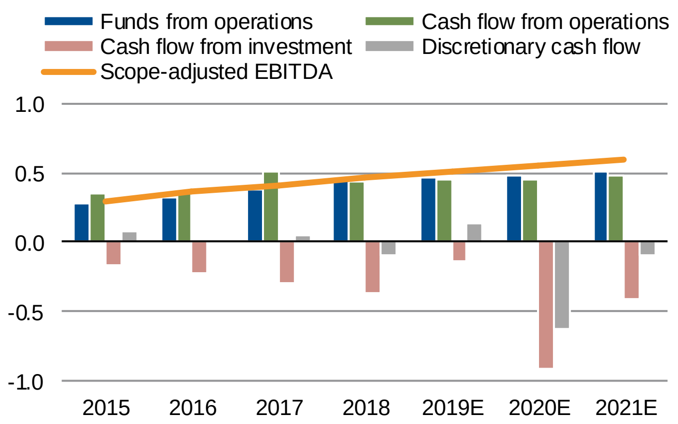
Free cash flow generation will be affected by the planned capital expenditure in 2020 as Cerbona is aiming to grow the business by investing in its production facility. Cash flow cover (FOCF/SaD) is expected to return to more than 5% in 2021.

Figure 5: Scope-adjusted debt related financial ratios



Source: Cerbona, Scope

Figure 6: Cash flow overview (HUF bn)



Source: Cerbona, Scope

We assess Cerbona's liquidity profile as neutral to the rating. Going forward, we assume excess cash generation from 2019 onward which will be used for opportunistic inorganic growth or to finance the investment plan. In addition to the planned bond under the Hungarian central bank (MNB) scheme, Cerbona still maintains bank support with short-term revolving credit lines covering the company's financing needs.

Supplementary rating drivers

We have not made any explicit rating adjustment for supplementary rating drivers.

Senior unsecured rating

Senior unsecured debt: BB-

Recovery is based on a liquidation value in a hypothetical default scenario. Senior unsecured debt is ranked inferior to the pledged bank loans which need to be repaid first. Based on our recovery analysis, we assume an 'average recovery' for the company's future senior unsecured debt, resulting in a rating of BB-.

We expect Cerbona to raise HUF 1bn under the MNB's Bond Funding for Growth Scheme in 2020 from a senior unsecured bond with a maturity of nine years.

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