25 February 2021 Corporates

Hunland Trade Kft
Hungary, Agribusiness

B+ STABLE

Corporate profile

Founded in 1992 and headquartered in Bugyi, Hungary, Hunland Trade Kft has a prominent role in the global livestock and meat trade. It sells and buys livestock (breeding cattle, slaughter cattle, sheep, lambs, goats, pigs and piglets), mainly to supply the group's agriculture companies. It supplies beef, pork and lamb meat as well as poultry meat. Its only subsidiary, with a 90% stake, is Hunland Trans Kft. The company is fully owned by Joseph Janssen (64.7%) and Suzanne Janssen (35.3%).

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover	15x	12x	9x	6x
Scope-adjusted debt (SaD)/EBITDA	4.5x	4.0x	6.2x	8.5x
Scope-adjusted funds from operations/SaD	35%	5%	15%	10%
Free operating cash flow/SaD	20%	12%	22%	-11%

Rating rationale

Scope Ratings has assigned a B+/Stable first-time issuer rating to Hungarian agribusiness company Hunland Trade Kft. The company's planned HUF 22bn guaranteed senior unsecured bond has been rated at (P) B+.

Hunland Trade's business risk profile is supported by its leading position in the Hungarian livestock export market. It benefits from a large customer base, through with some concentration risk. However, the business risk profile is constrained by Hunland Trade's decreasing Scope-adjusted EBITDA margin and a high level of receivables due to the nature of its business.

Our financial risk profile assessment incorporates the planned issuance of a HUF 22bn (equivalent to about EUR 63m) guaranteed senior unsecured bond under the Bond Funding for Growth Scheme of the Hungarian National Bank (MNB). The bond will have a 2.88% coupon, and its 10-year tenor will consist of a five-year grace period followed by amortisation of 10% in years 5-9 and 50% in year 10. The bond's four guarantors are Hunland Trade's sole subsidiary (Hunland Trans Kft) and three of its sister companies (Bovinia Kft, Hunland Production Kft, and Hunland Dairy Kft). Bond proceeds are earmarked for refinancing EUR 40m in short-term debt, investing EUR 3m in new production machines, and providing EUR 20m in intercompany loans to the guarantors to refinance their financial debt (EUR 10.9m) and finance their capex (EUR 9.1m). The bond's terms allow the issuer a unilateral deviation of 10% (or up to EUR 47.3m) from intended uses for its benefit (guarantors' stake down to EUR 15.7m accordingly). Even so, the guarantors will remain entitled to EUR 20m in proceeds. Thus, the guarantors' loans will be repaid even if the issuer uses more of the proceeds, in which case part of the investments realised from the bonds will decrease or will be realised from own funds.

We expect leverage, as measured by the Scope-adjusted debt (SaD)/EBITDA ratio, to increase to 8.5x following the envisaged bond placement and the interest cover ratio to reach above 5.5x. We also expect underlying profitability to deteriorate slightly, mainly due to lower expected net sales in 2020 and higher materials costs over the coming years. Even though cattle prices dropped in 2020, Hunland Trade sold at a lower price to satisfy its partners. The falling prices have also allowed the company to buy young cattle livestock much cheaper, which could later be beneficial unless selling prices fall further. We also expect free operating cash flow (FOCF) to fluctuate between negative and positive numbers.

Ratings & Outlook

Corporate rating	B+/Stable
Guaranteed senior unsecured debt	(P) B+

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Related Methodology

Corporate Rating Methodology, February 2020

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Outlook

Stable Outlook

The Stable Outlook for Hunland Trade incorporates our view that key credit metrics over the next two years will deteriorate, with a SaD/EBITDA of 6.0x-8.5x compared to 3.5x-4.5x in the past. It also incorporates Hunland Trade's position as the leading Hungarian livestock exporter and our expectation that the EBITDA margin will shrink to below 2.5%. Furthermore, we assume the successful issuance of the HUF 22bn MNB bond, with proceeds used as currently planned. The Outlook incorporates an unchanged structure between Hunland Trade and its sister companies, all majority-owned by the Janssen family.

Ratings upside

A positive rating action is deemed remote in light of the increasing indebtedness but could be warranted if the Scope-adjusted EBITDA/interest cover reached above 7x on a sustained basis and if the company's business risk profile improved, for example with a sustained Scope-adjusted EBITDA margin of more than 3.5%.

Ratings downside

The rating could come under pressure if debt protection persisted below 4x, for example, as a result of significantly lower contributions to earnings by cattle and pig sales and/or bond proceeds being used for purposes other than the aforementioned refinancing.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leading Hungarian livestock exporter • Good geographical diversification on the customer side • Adequate expected interest coverage • Benefits from African swine fever due to higher demand for pork not met by China	• Minor role of livestock exports in Hungarian economy • Eastern Europe and Hungary being small livestock producers, though some potential development for Eastern Europe • Lower exports of live animals and lower prices for cattle and lamb • High receivables and pressure on net working capital • Lower geographical diversification regarding the supplier side • Decreasing profitability • High expected SaD/EBITDA and fluctuating FOCF

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted EBITDA/interest cover higher than 7x on a sustained basis • Improving business risk profile, e.g. as displayed by a sustainably improved profitability	• Scope-adjusted EBITDA/interest cover lower than 4x on a sustained basis

Financial overview

			Scope estimates		
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA/interest cover	15x	12x	9x	6x	6x
Scope-adjusted debt (SaD)/EBITDA	4.5x	4.0x	6.2x	8.5x	8.0x
Scope-adjusted funds from operations/SaD	35%	5%	15%	10%	10%
Free operating cash flow/SaD	20%	12%	22%	-11%	9%
Scope-adjusted EBITDA in EUR '000s	**2018**	**2019**	**2020F**	**2020F**	**2021F**
EBITDA	8,459	9,920	6,956	7,339	7,044
Operating lease payments in respective year	-	-	-	-	-
Other	3,145	539	-	-	-
Scope-adjusted EBITDA	**11,604**	**10,459**	**6,956**	**7,339**	**7,044**
Scope-adjusted interest in EUR '000s	**2018**	**2019**	**2020F**	**2020F**	**2021F**
Interest paid	831	848	848	1,727	1,944
less: interest received	-6	-9	-52	-470	-743
add: interest on pensions	-	-	-	-	-
add: interest on operating leases	-	-	-	-	-
Other	-	-	-	-	-
Scope-adjusted interest	**771**	**839**	**796**	**1,257**	**1,200**
Scope-adjusted debt in EUR '000s	**2018**	**2019**	**2020F**	**2020F**	**2021F**
Reported gross financial debt	55,179	42,652	44,331	65,049	65,320
less: hybrid bonds	-	-	-	-	-
less: cash and cash equivalents	-3,428	-1,122	-1,013	-2,315	-9,288
add: cash not accessible	1,015	-	-	-	-
add: pension adjustment	-	-	-	-	-
add: operating lease obligations	-	-	-	-	-
add: asset retirement obligations	-	-	-	-	-
Other (received bank guarantees)	-	-	-	-	-
Scope-adjusted debt	**52,766**	**41,530**	**43,318**	**62,735**	**56,032**

Business risk profile

Hunland Trade's **business risk profile (assessed at B+)** is supported by its market position as Hungary's leading livestock exporter, though profitability and diversification are negative rating drivers.

Animal production accounting for one-third of agricultural output in Hungary

According to Eurostat, animal output accounts for one-third of Hungary's agricultural output and is the country's second biggest source of agricultural income, while crop output accounts for two-thirds of agricultural output and is the top source of agricultural income. Regarding animal output in Hungary, poultry ranks first (11.6% by average agricultural output), followed by pigs (9.7%), milk (7.4%), eggs (2.4%), cattle (3.8%), and sheep and goats (0.8%). Thus, the livestock market on which the issuer depends (cattle, pigs and sheep) accounts for around 15% of agricultural production, which is half of Hungary's animal output and half the size of its cereals production market.

Minor role of livestock exports in Hungary's economy

Hungarian exports of agricultural products, at EUR 9.5bn in 2019, are minor compared to goods and services exports of EUR 119.9bn (source: Eurostat). Commodities made up one-third of agricultural product exports in 2019, with 90% realised in the EU.

Eastern Europe and Hungary are small livestock producers…

Europe is the world's second largest livestock producer by tonnes of protein (behind Asia) with 40% of production, mainly cattle, pork and beef for Western European customers. Eastern Europe, by contrast, accounts for only 20% of European production and 4% of worldwide production.

With 8.5m heads of livestock in 2019, Hungary ranks 15th in Europe, far behind first-ranking Spain with 102.1m heads. Excluding Western European countries, Hungary is among the top five behind Romania, Poland, Greece and Serbia.

Nevertheless, the last two livestock surveys by the European Commission found a decline in the main producing EU member states, except for Poland and Spain. This trend is expected to continue until 2030, accompanied by a partial shift to Poland, Hungary and the Czech Republic.

…but potential development for Eastern Europe

Hunland Trade expects production from Eastern Europe to grow due to land availability. Indeed, livestock production is the world's largest user of land, either directly through grazing or indirectly through the consumption of fodder and feed grains by livestock. Nevertheless, the top three countries for heads of livestock – Spain, the UK and France – have livestock units per hectare that are close to, if not higher than, Hungary's.

Hunland Trade, a major player in the food supply chain in selected markets

Thanks to an active role in livestock and meat trade for more than 25 years, Hunland Trade is a major player in global food supply. It sells to around 40 countries, mainly in Europe. In the EU, Hunland Trade is a leading exporter of breeding cattle to the Commonwealth of Independent States[1] and a top three importer of breeding cattle from Russia.

Leading Hungarian livestock exporter

Hunland Trade's cattle exports account for almost 50% of Hungary's livestock exports, following by pigs (30%), and sheep and goats (30%). This makes the company Hungary's leading livestock exporter. Hunland Trade is also first in Hungary for net sales, followed by its two main competitors, Agrar-Coop and Agrota-2L.

Integrated business

Half of Hunland Trade's 10 main suppliers are its sister companies: Hunland Impex BV, Hunland GmbH, Hunland Production Kft, Hunland Trans Kft, and Bovinia Kft. The last three are also guarantors of Hunland Trade's planned MNB bond. These five suppliers represented 50% of the top 10 suppliers in terms of turnover in 2019. Regarding the other

[1] Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine

five suppliers, Hunland Trade asserts that they work at high standards being EU-approved slaughterhouses, meat processors and breeding companies.

Capex used to increase production efficiency

Capex is aimed at increasing production efficiency, with part of the MNB bond proceeds (equivalent to EUR 3m) planned for new machines and vehicles.

Large customer base with some concentration

Around two-thirds of Hunland Trade's sales are realised within three countries (Hungary, Turkey and Russia). Nevertheless, it has customers in around 40 countries. Its top 10 customers account for 35%-50% of total sales and the largest customer (in Hungary) represents around 10%. As such, the company faces some concentration risk.

High receivables

Hunland Trade's receivables account for almost half of its total balance sheet on average. To reduce the risk of non-payment, Hunland Trade uses credit insurance (EU sales) and credit letters (non-EU sales).

Revenues and EBITDA mainly dependent on livestock activity

Livestock consistently accounts for around 90% of revenues and 85% of EBITDA, followed by meat with around 5%-10% and 10%, respectively. As both activities relate to the same market category, we do not consider revenues to be diversified by sources. Nevertheless, diversification is strong by livestock 'products', with around 50% of total sales from cattle, 30% from pigs, 5% from lamb.

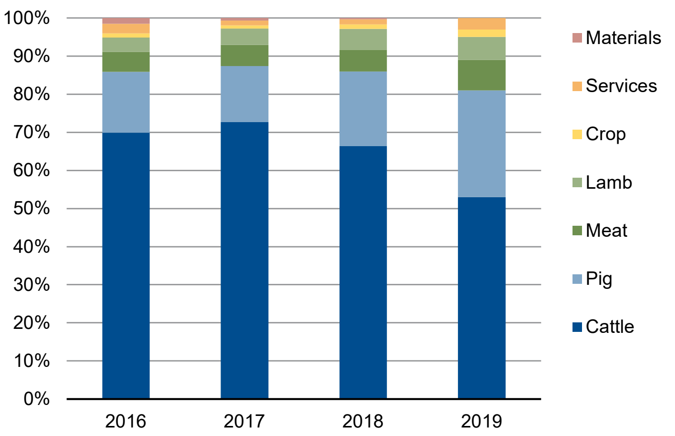
Good geographical diversification on the buyer side but…

On average, two-thirds of sales are realised in four countries (out of around 40 countries). Hungary is now the most important market. Before it was Turkey, which accounted for around one-third of sales until one contract ended in mid-2018.

… lower geographical diversification regarding the supplier side

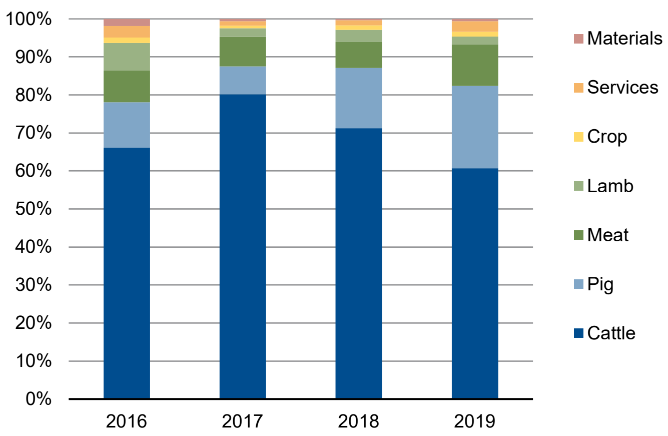
Between one-half and two-thirds of product sales come from two countries (Hungary and Brazil). Hunland Trade is mainly dependent on Hungary, which makes sense as products mostly come from sister companies, the bulk of which are located in Hungary. The remaining sales are split among around 20 countries.

Figure 1: Sales breakdown per product



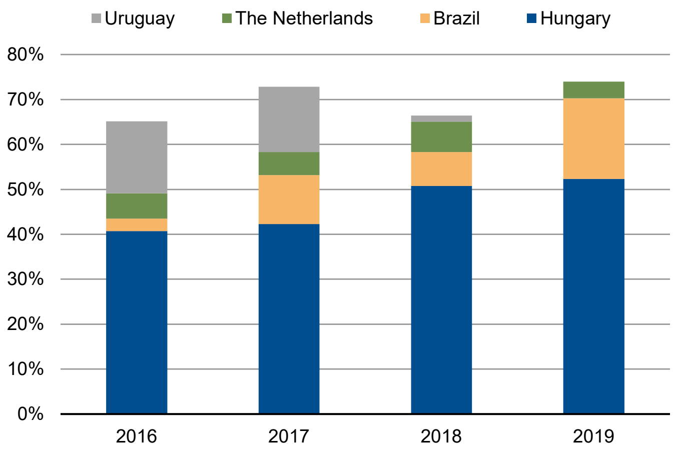
Source: Hunland Trade, Scope

Figure 2: EBITDA breakdown per product



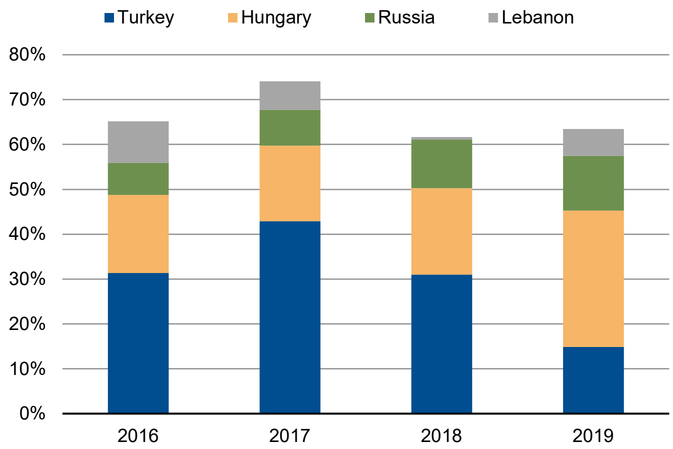
Source: Hunland Trade, Scope

Figure 3: Main origin countries (% of total sales)



Source: Hunland Trade, Scope

Figure 4: Main destination countries (% of total sales)

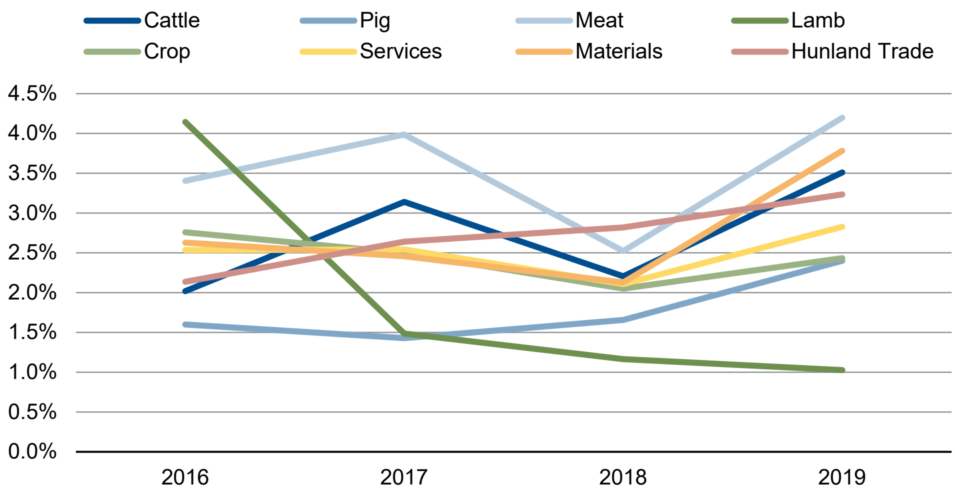


Source: Hunland Trade, Scope

Low profitability

Hunland Trade's EBITDA margin is low at between 2% and 3% The highest margin is for meat followed by materials. Cattle, which accounts for the bulk of EBITDA, only has the third highest margin.

Figure 5: Adjusted EBITDA respective margin per segment



Source: Hunland Trade, Scope

Margin profile expected to decrease

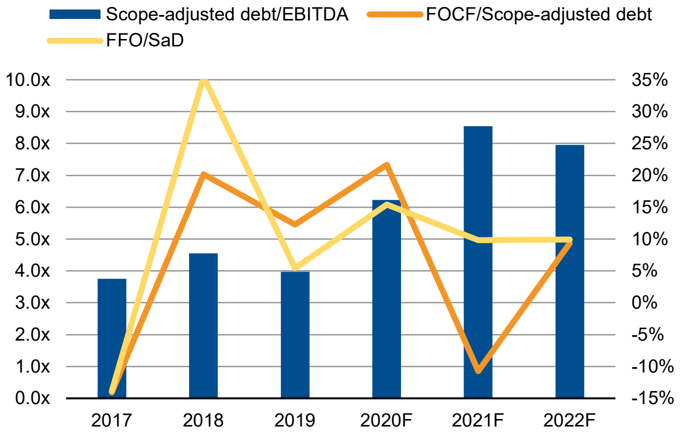
Hunland Trade's profitability is set to decrease, mainly due to lower expected net sales in 2020 and higher material costs over the coming years. Indeed, cattle prices dropped in 2020, but Hunland Trade decided to keep its selling price lower to satisfy its partners. The falling prices have allowed the company to buy young cattle livestock much cheaper, which could later be beneficial unless selling prices fall further.

Given the above facts, we expect EBITDA margin to decrease from 3.2% in 2019 to 2.3% in 2020, 2.4% in 2021 and 2.3% in 2022.

Financial risk profile

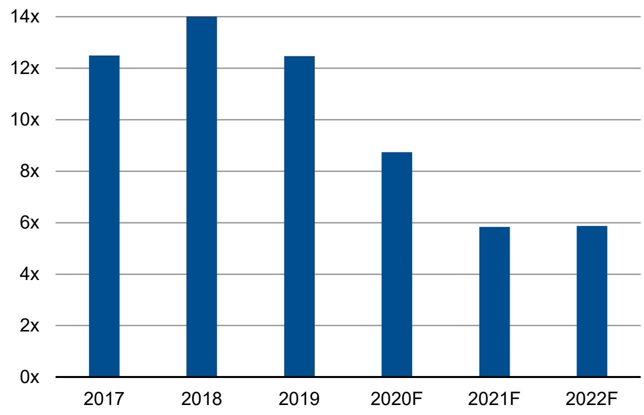
Hunland Trade's **financial risk profile (assessed at B+)** is based on our expectation of financial leverage (SaD/EBITDA) of between 6x and 8.5x following the envisaged bond placement and an interest cover ratio sustained at above 5.5x. We also expect some deterioration in underlying profitability and fluctuating FOCF.

Figure 6: Scope-adjusted leverage



Source: Hunland Trade, Scope

Figure 7: EBITDA interest coverage



Source: Hunland Trade, Scope

Rating reflects high leverage

Leverage has been moderate in recent years at between 3.5x and 4.5x. Nevertheless, our rating case includes an expected SaD/EBITDA of 6.0x-8.5x, reflecting the bond issuance, with such levels to become the norm for the coming years. Expected leverage therefore has a greater weight in the rating assessment.

The funds from operations (FFO)/SaD ratio has been above 5%, except in 2017 when it was negative. However, ratios are expected between 10% and 15% based on the higher SaD expected following the bond issuance.

Adequate interest coverage

Hunland Trade's debt protection – as measured by Scope-adjusted EBITDA/Scope-adjusted interest – was above 10x (2017: 12x, 2018: 15x, 2019: 12%). We expect debt protection to fall below this threshold in the next few years due to higher forecasted interest payments. As we expect the bond to be issued at the end of May 2021, the full impact of the interest payments will be visible from 2021.

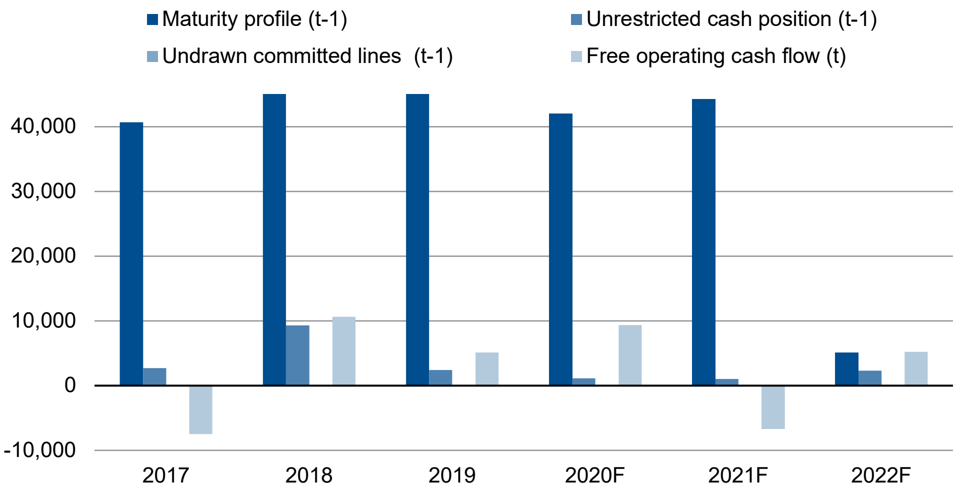
Weak cash flow coverage

Hunland Trade's cash flow cover – as measured by FOCF/SaD – moves between negative and positive positions due to the fluctuation in FOCF. The variation is mainly influenced by the change in working capital.

Adequate liquidity

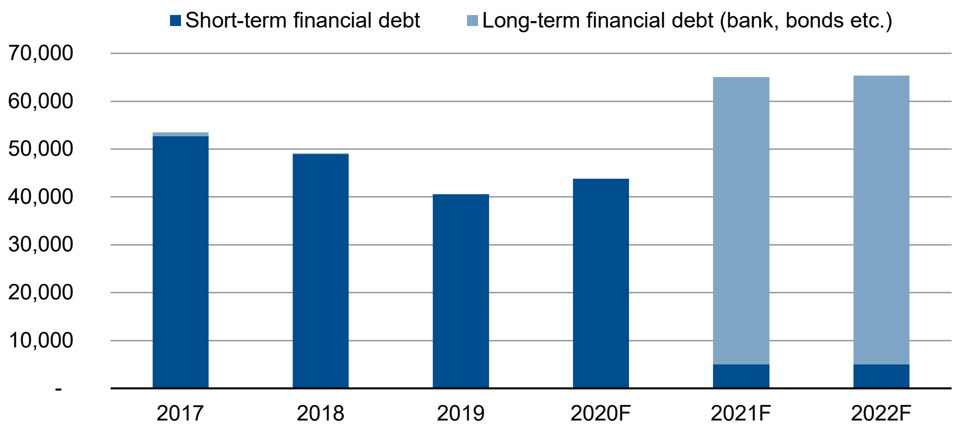
Hunland Trade's liquidity is adequate thanks to the bond issue which will enable the company to refinance the bulk of its short-term financial debt. Hunland Trade will repay EUR 42.1m in debt in 2020. Against this is EUR 1.1m of available cash and equivalents as of 31 December 2019. We expect FOCF to be positive in 2020 but negative in FYE2021 due to a negative working capital variation. Unrestricted cash as of 31 December 2020 (EUR 1m) is unable to cover the negative FOCF and repayment of short-term financial debt, which will lead to a negative liquidity ratio. On the other hand, the proceeds from the planned bond issue will be used to refinance the bulk of short-term financial debt.

Figure 8: Short-term debt repayment amount, available cash and FOCF (in EUR '000s)



Source: Hunland Trade, Scope

Figure 9: Financial debt (in EUR '000s)



Source: Hunland Trade, Scope

Conservative dividend policy

No dividends have been paid since 2017. Further, the bond prospectus asserts that there will be no dividend payments until 2022. Any dividend payments from 2023 would be capped at 50% of net income and contingent on positive FOCF. We believe this dividend policy is conservative. A higher dividend distribution could alter our rating case.

No credit-negative governance-related aspects

Hunland Trade is a privately owned limited liability company (Korlátolt Felelősségű Társaság Kft). The highest decision-making body is the members meeting (taggyűlés), whose members are the two owners: Joseph and Suzanne Janssen.

We found limited risk related to Hunland Trade's governance. The company's governance is also supported by experienced and committed management.

Long-term debt rating for HUF 22bn guaranteed senior unsecured bond

HUF 22bn guaranteed senior unsecured bond to be issued for refinancing, capex and intercompany loans

The rated entity intends to issue a HUF 22bn (equivalent to EUR 63m) guaranteed senior unsecured bond in 2021 under the MNB Bond Funding for Growth Scheme. It will have a 10-year maturity with a five-year grace period followed by amortisation of 10% for years 5-9 and 50% in year 10. The bond will be guaranteed by Hunland Trade's sole subsidiary (Hunland Trans Kft) and three sister companies (Bovinia Kft, Hunland Production Kft, and Hunland Dairy Kft).

The proceeds are primarily planned for refinancing short-term financial debt of EUR 40m, investing EUR 3m in new production machines, and providing intercompany loans to the guarantors for EUR 20m to refinance their debt (EUR 10.9m) and finance their capex (EUR 9.1m).

Proceeds from the intercompany loans will be dispatched as follows:

- Hunland Dairy: EUR 2.5m for capex to build a slurry storage and renovate its barn;
- Hunland Trans: EUR 4.5m for capex to acquire new assets/vehicles;
- Hunland Production: EUR 1m for capex to expand the feed factory and EUR 8.2m to refinance loans; and
- Bovinia: EUR 1.1m for capex to construct two new stables and EUR 2.7m to refinance loans.

(P) B+ bond rating reflects average recovery expectations

Our 'average' recovery expectation for the guaranteed senior unsecured debt is based on an anticipated liquidation value in a hypothetical default scenario. The guaranteed senior unsecured debt ranks below short-term and long-term debt (excluding the bond issue) raised from financial institutions and payables which are secured by asset pledges. Consequently, in a hypothetical default, creditors of the guaranteed senior unsecured bond are likely repaid from the liquidation proceeds remaining after repayments to senior secured debt creditors, the guarantors' current assets, and property, plant and equipment reduced by long- and short-term financial debt, and payables. The recovery expectation takes into consideration the uncertainties regarding the value of claims at the guarantors' level at the point of a hypothetical default of the bond issuer but also the uncertainties about the debt positions of the guarantors at the point of a hypothetical default of the bond issuer and the seniority of the claim. These recovery expectations translate into a preliminary debt instrument rating of (P) B+ prior to the placement of the bond.

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