SCOPE Scope Ratings

02 Jul 2021 - Scope Ratings GmbH

Scope affirms Baromfi-Coop Kft. at BB-/Stable ahead of HUF 23bn senior unsecured green bond issuance

The rating reflects the company's solid EBITDA margin and its position as the largest chicken-processing company in Hungary, its proven track record of expansion, and its resilience. The rating is constrained by weak diversification.

The latest information on the rating, including rating reports and related methodologies, is available at this LINK.

Rating action

Scope Ratings has today affirmed its BB-/Stable corporate issuer rating for Hungary-based Baromfi-Coop Kft. The agency also affirmed its BB- senior unsecured debt rating.

Rating rationale

Following its acquisition of Saga Foods (see Baromfi-Coop acquires Hungarian turkey-processing company Saga Foods), Baromfi-Coop's business risk profile has strengthened but continues to be commensurate with a BB rating, which includes a blended industry rating for agriculture and consumer goods of BBB+. The company's long-term relationship with McDonald's is especially positive. (Up to 15% of all chicken products sold by McDonald's in Europe are supplied by the company and the Baktalórántháza farm has been certified as a McDonald's Flagship Farm since 2015.) With an annual production capacity of up to 64m chickens per year, Baromfi-Coop accounts for around 25% of overall Hungarian chicken-meat production. The company is continually looking to increase output and deepen vertical integration. However, it is still rather small compared to European competitors, and this continues to constrain Scope's assessment of the company's market share. Baromfi-Coop's business risk profile is also constrained by weak diversification, despite positive effects following its acquisition of Saga Foods (e.g. higher scale and broader scope). Diversification is limited by: i) a fairly concentrated customer portfolio, which has broadened somewhat in export markets during the pandemic due to the closure of the HORECA sector in Hungary and lower demand from OSI Group (a McDonald's supplier) and ii) a focus on one poultry species (chicken). Baromfi-Coop's profitability (EBITDA margin) continues to be credit-supportive, with reported EBITDA margins averaging around 12% (2016 to 2019) and coming in at 12.6% in 2020, despite the global economy being hit by Covid-19.

The company's financial risk profile is affirmed at BB-. Thanks to business development in export markets resulting in strong performance in 2020, Baromfi-Coop was not meaningfully affected by the Covid-19 pandemic, save for increased inventory levels in chicken breast products. Demand from major retail chains remained unchanged, McDonald's ramped up its delivery and drive-in supply channels, and the HORECA segment restarted in May 2021, albeit with lower guest numbers at first. Based on the company's acquisition of Saga Foods, its first capex programme, and its recently announced second capex programme, Scope anticipates leverage, as measured by Scope-adjusted debt (SaD)/EBTIDA, of 3.7x at year-end 2021 and 3.9x at 31 December 2022.

Scope's previous assumptions included a second capex cycle in 2021, although there were no details at that stage. Management's second capex programme aims to increase production capacity, logistics capabilities, animal-feed production, biological water sewage, use of by-products (pet-food production), and energy efficiency. The proceeds from the new senior unsecured green bond of HUF 23bn to be issued by Baromfi-Coop Kft. with a corporate guarantee from Master Good Kft. in Q3 2021 within the Bond for Growth framework of the MNB for a 10-year tenor, fixed annual coupon payments, and linear amortization of 10% from year 5 with 50% balloon at maturity will be earmarked for the announced investments. The bond documentation, similarly to the previous two bonds maturing in 2026 and 2028 respectively, will cap dividends paid by the issuer at 20% of profit after tax. Furthermore, the owners plan to contribute in-kind two companies (Steam Cook Kft. and Várda Meat Kft.) in a creditor-friendly fashion into the structure to support further vertical integration at Sága Foods, mainly in the area of frozen convenience food.

Scope anticipates that free operating cash will not improve until 2023, instead of in 2021/2022 as previously assumed, due to the investments mentioned. However, Baromfi-Coop's internal and external liquidity coverage remains weak, as the company continues to disclose considerable amounts of short-term debt every year. Its phased investment programme is divided into several stand-alone projects over the next three years, which provide room to manage liquidity. That said, Scope has not adjusted Baromfi-Coop's financial risk profile, as it has successfully entered capital markets as a source of funding and is expected to refinance maturing short-term debt in the future, based on its previous strategy.

Scope has made no adjustments to supplementary rating drivers due to Baromfi-Coop's neutral financial policy.

Outlook and rating-change drivers

The Outlook is Stable, reflecting Scope's expectation of continued positive performance thanks to a resilient business model with limited vulnerability to the Covid-19 pandemic. Scope's rating scenario anticipates SaD/EBITDA ranging from 3.5x to 4.0x in the medium term.

A positive rating action could be warranted by SaD/EBITDA of less than 3.5x on a sustainable basis. This could occur if Baromfi-Coop's capital allocation policy shifts from repeated capex programmes to debt reduction.

A negative rating action could be required if SaD/EBITDA were to rise above 4.0x on a sustained basis. This could occur if the company orchestrates large M&A or if EBITDA falls short of Scope's projections. Lastly, a rating downgrade could result from continued weak liquidity coverage beyond 2022.

Long-term and short-term debt ratings

All senior unsecured debt has been issued by Baromfi-Coop Kft. and guaranteed by Master Good Kft. Scope's recovery assessment is based on a hypothetical default scenario in 2023, including the assumption that bank debt (2023F: HUF 21.5bn) is ranked senior secured. Scope's recovery analysis indicates an 'average recovery' for senior unsecured debt. This expectation translates into a rating of BB- for this debt category.

Stress testing & cash flow analysis
No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology
The methodologies used for these Credit Ratings and/or Outlook, (Corporate Rating Methodology, 26 February 2020; Rating Methodology: Consumer Products, 30 September 2020), are available on https://www.scoperatings.com/#!methodology/list.
Scope Ratings GmbH and Scope Ratings UK Limited apply the same methodologies/models and key rating assumptions for their credit rating services, while Scope Hamburg GmbH's methodologies/models and key rating assumptions are different from those of Scope Ratings GmbH and Scope Ratings UK Limited. Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/#!governance-and-policies/rating-scale. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/#governance-and-policies/rating-scale. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents

provided on https://www.scoperatings.com/#!methodology/list.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information
The Credit Ratings were not requested by the Rated Entity or its Related Third Parties. The Credit Rating process was conducted:
With the Rated Entity or Related Third Party participation YES
With access to internal documents YES
With access to management YES
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, the Rated Entities' Related Third Parties and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures
These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.
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The Credit Ratings/Outlook were first released by Scope Ratings on 19 September 2019. The Credit Ratings/Outlook were last updated on 30 September 2020.

Potential conflicts
See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

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