Tranzit-Food Kft.
Hungary, Consumer Goods

BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	117.1x	38.9x	32.4x	41.6x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	0.1x	0.5x	1.0x	0.6x
Funds from operations/SaD	805%	211%	90%	153%
Free operating cash flow/SaD	904%	-31%	-65%	56%

Rating rationale

The downgrade reflects a one notch negative supplementary rating adjustment from recurring lack of transparency and clarity (negative ESG driver), driven by a limited visibility, due to lack of forecast guidance and limited reporting disclosure. We also miss certain discloser of key information in a timely manner, which has increased the uncertainties for material changes to our rating case

Outlook and rating-change drivers

The Outlook is Stable and incorporates the expectation that Scope-adjusted debt (SaD)/EBITDA will remain below 3.0x. The Outlook also reflects our expectation that Tranzit will continue to perform positively with EBITDA margin remaining above 12%.

A positive rating action could be warranted by an improvement in Tranzit's business risk profile. This could be achieved via a material increase in size or better diversification. A positive rating action could also be warranted by an improvement in governance linked to adequate financial disclosure and better transparency.

A negative rating action may be taken if SaD/EBITDA reaches around 4.0x on a sustained basis. An increase in leverage could be triggered by a rise in net debt from larger than anticipated capex or from a slower recovery of the poultry market in Hungary, weighing on the company's profitability.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
22 Oct 2019	New	BB/Stable
06 Nov 2020	Affirmation	BB/Stable
16 June 2021	Monitoring review	BB/Stable
17 June 2022	Downgrade	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-
Subordinated hybrid debt	

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Related Methodologies

Corporate Rating Methodology; July 2021

Rating Methodology: Consumer Goods; September 2021

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Market leader in goose production in Europe with 18% market share • Recent entry in the chicken segment providing exposure to a large growing meat market. • Moderate EBITDA margin (12.8% at YE21) despite lower profitability for its chicken operations. • Product diversification with three types of poultry meat.	• Lack of clarity and transparency in financial disclosures (ESG risk) • Small player in the European market. • Weak geographical diversification outside of Europe although likely to improve, and weak customer diversification in the chicken segment. • Recurring negative free operating cash flow due to volatile working capital and large capex plan.

Positive rating-change drivers	Negative rating-change drivers
• BRP improvement through an increase in size and better diversification. • Improvement in financial disclosure (ESG factor)	• SaD/EBITDA above 4.0x on a sustained basis

Corporate profile

The Tranzit group is a Hungary-based poultry company founded in 1990 by the Szabo family. The company employs approximately 1,600 people. Its headquarters are located in Debrecen. Tranzit breeds, slaughters, processes and sells ducks, geese and chickens. Operations also include crop and feed production. Annual sales amounted to HUF 42bn in 2019. The Tranzit group is divided into two subsidiaries: Tranzit-Ker takes care of the agricultural side of the business while the rated entity Tranzit-Food Kft. (Tranzit) focuses on the slaughter, processing and distribution of poultry (geese, ducks and chickens) under the Goldenfood brand. The company owns two slaughterhouses; one dedicated to chickens and the other to handling geese and ducks. Tranzit also has a secondary processing plant. The shareholding structure changed in 2018, with French group LDC controlling 70% of Tranzit and the Szabo family retaining 30%.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	120.8x	117.1x	38.9x	32.4x	41.6x	52.3x
SaD/Scope-adjusted EBITDA	net cash	0.1x	0.5x	1.0x	0.6x	0.3x
Funds from operations/SaD	net cash	805%	211%	90%	153%	267%
Free operating cash flow/SaD	net cash	904%	-31%	-65%	56%	123%
Scope-adjusted EBITDA in HUF m						
EBITDA	5,027	2,766	5,819	7,299	8,519	8,257
Scope-adjusted EBITDA	**5,027**	**2,766**	**5,819**	**7,299**	**8,519**	**8,257**
Funds from operations in HUF m						
Scope-adjusted EBITDA	5,027	2,766	5,819	7,299	8,519	8,257
less: (net) cash interest paid	-42	-24	-150	-225	-205	-158
less: cash tax paid per cash flow statement	-27	-31	-35	-565	-613	-609
Change in provisions	-24	0	0	0	0	0
Funds from operations	**4,933**	**2,712**	**5,634**	**6,509**	**7,703**	**7,493**
Free operating cash flow in HUF m						
Funds from operations	4,933	2,712	5,634	7,247	8,565	8,328
Change in working capital	-3,330	1,321	-4,441	-6,627	-2,682	-1,851
less: capital expenditure (net)	-386	-989	-2,032	-4,588	-2,194	-2,194
Free operating cash flow	**1,217**	**3,043**	**-839**	**-4706**	**2827**	**3448**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	42	24	150	225	205	158
Net cash interest paid	**42**	**24**	**150**	**225**	**205**	**158**
Scope-adjusted debt in HUF m						
Reported gross financial debt	4,933	11,785	14,441	12,912	9,588	9,200
less: cash and cash equivalents	-5,199	-11,449	-11,775	-5,668	-4,569	-6,396
Scope-adjusted debt	**-266**	**337**	**2,665**	**7,245**	**5,019**	**2,804**

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Environmental, social and governance (ESG) profile[1]

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)

Governance is credit negative leading to a one notch rating downgrade.

Tranzit has no dedicated ESG strategy. However, we note the positive turnaround in ESG policy, where, following LDC's lead, the issuer has started an audit to identify key criteria to measure and improve its overall impact. Nevertheless, we identify a risk regarding a lack of clarity and transparency from the issuer. This is driven by a history of constant change of strategy, inadequate communication, poor reporting methods, and failure to disclose key information in a timely manner.

[1] 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: BB

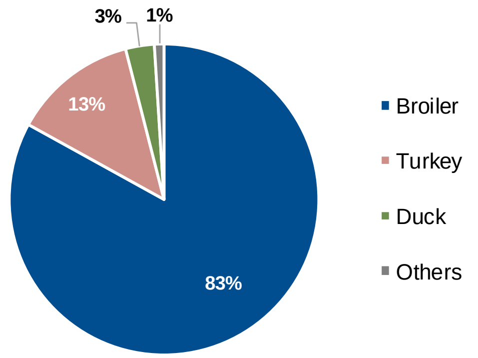
Industry risk profile: A

The company breeds, slaughters, processes and sells ducks, geese and chickens.

Small European player constrained by niche market position

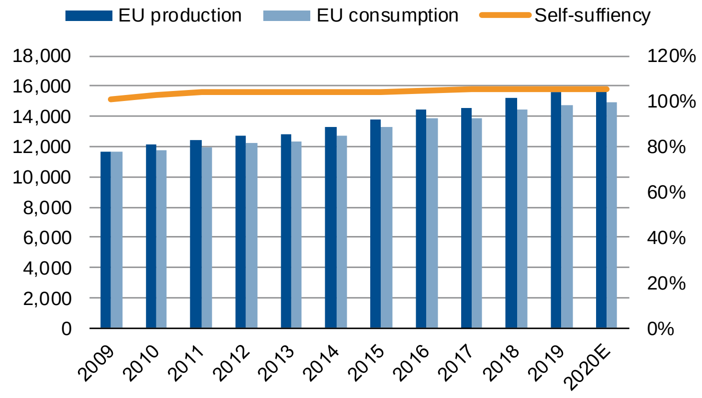
Goose and duck meat production accounts for less than 4% (Figure 1) of the European poultry market, which is widely dominated by the production of broilers (83%). Tranzit is responsible for 50% of the supply of goose meat in Hungary and 18% in Europe. The duck meat market in Hungary is three time bigger than the goose meat market (around 80 kilotons). Tranzit's market share in its home country is 32% and in Europe, 8%. If we include its 40 kilotonnes of chicken production, Tranzit produces around 78 kilotonnes of poultry meat, which is less than 1% of the 15.2m tonnes produced in Europe.

Figure 1: EU Production of poultry meat by type of bird



Source: European Commission (DG ESTAT, DG AGRI)

Figure 2: EU poultry meat production / consumption



Source: European Commission (DG ESTAT, DG AGRI)

Recent entry into chicken segment will expose Tranzit to a larger and growing market

Tranzit started its chicken operations in 2017 following an integrated approach already implemented for its goose/duck production, with Tranzit-Ker supplying the main share of the poultry slaughtered. Chicken allows Tranzit to benefit from the only meat expected to grow between 2017-2030E both in consumption (+4.2%) and production (+4.6%). Global demand is driven by the comparative advantages of poultry over other meats including affordability, convenience, the absence of religious guidelines and a healthy image. As the EU is self-sufficient (Figure 2), most surplus production is likely to be exported outside of the bloc to the Middle East, sub-Saharan Africa and Asia (Vietnam and the Philippines). The EU's main competitor for world demand remains Brazil, which can export at a lower price partly because of its currency devaluation. Due to sustained productivity gains and looser environmental regulations for building new farms, the strongest increase in production is expected in Hungary, Poland and Romania.

The sale and production of chicken runs through the entire year as opposed to goose and duck, which suffer from seasonal effects. Goose tends to be eaten on particular occasions (such as St. Martin's ay in Hungary and Germany, and Christmas, etc.) with selling contracts running from September to Easter.

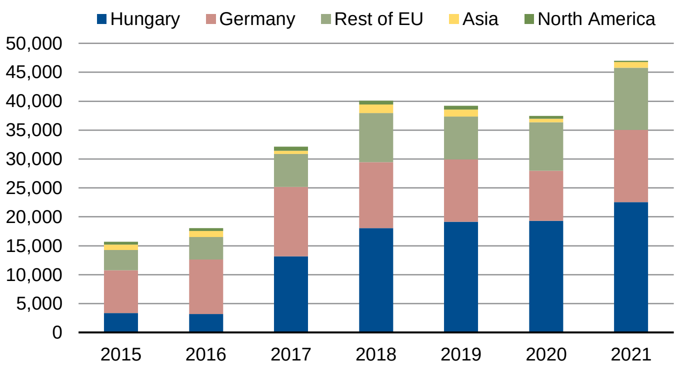
Geographical footprint focused on Europe but aim to increase exports outside this region

Tranzit's geographical footprint is within Europe. This is partially mitigated by the company's strategy to increase exports outside the region with the expected development of its chicken operations.

At YE 2021, Hungary accounted for 47% of Tranzit sales, while Europe's share stood at 97%. This is fairly stable compared to the previous year. Sales in the rest of Europe were achieved in 20 countries, mainly Germany, Slovakia, UK, Austria and Romania. The remaining exposure is largely in Japan, where Tranzit's goose products enjoy great popularity.

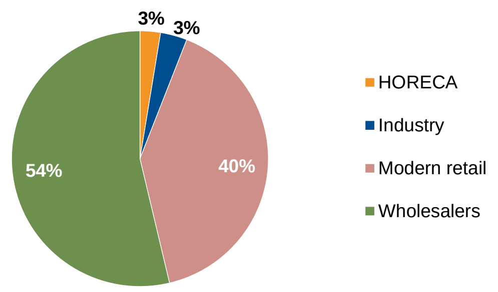
The launch of the chicken segment caused the share of revenue generated in Hungary to surge in 2017. Tranzit's main customers belong to the wholesale and retailing industries (more than 90% of FY 2021 revenues). At the same time, Tranzit has a concentrated portfolio of selling contracts with its top five customers accounting for 80% of sales in FY2021.

Figure 3: Revenue breakdown by region 2015-2021



Source: Tranzit, Scope

Figure 4: Revenue breakdown by sales channel



Source: Tranzit, Scope

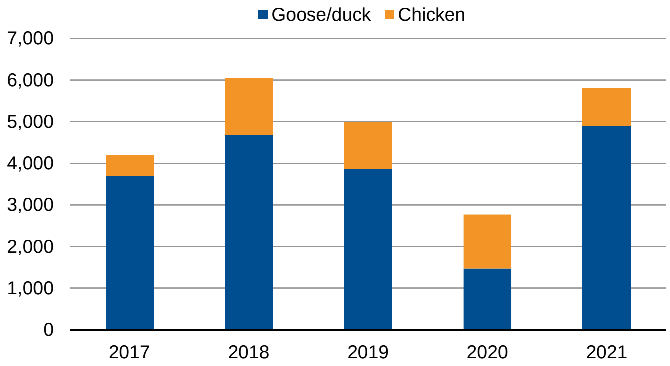
Concentration across products and supply chain, arising from integrated group model

Tranzit markets three types of poultry: ducks, geese and chicken. Although they all belong to the 'poultry' category, they are not consumed the same way: chicken is eaten all year long, while duck and goose are bought on special occasions, which makes their market more predictable quantity-wise but also more elastic. Chicken represented 35% of sales and 16% of EBITDA. We expect product diversification to remain stable on the top line, with chicken contributing around 40% by 2024 since the production of duck (mainly sold frozen to-date) will also ramp up. The EBITDA margin of around 8% generated from chicken is more stable but consistently lower than the 17% margin .generated by duck/goose

The three types of bird are sensitive to avian influenza, which could substantially hamper Tranzit's production in terms of its supply chain. However, this risk is partially mitigated by the fact that customers (retailers) impose strict quality controls. Tranzit-Ker's strategy is to have breeding farms in various regions, spanning four counties. This keeps the birds safe because the distance makes hygienic actions more efficient. In addition, Tranzit does not exclusively source its raw materials from its sister company Tranzit-Ker:

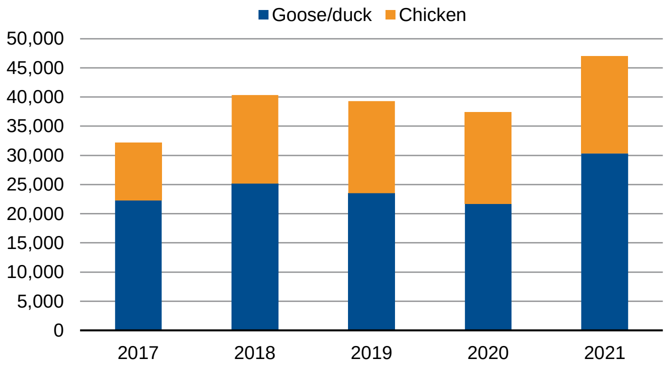
- Goose and duck: a maximum of 65% from Tranzit-Ker while the remaining 35% is bought from selected farmers who purchase their feed from Tranzit-Ker
- Chicken: 50% from Tranzit-Ker while 50% is bought from selected farmers who purchase their feed from Tranzit-Ker.

Figure 5: Revenue breakdown by type of meat 2017-2021 (HUF m)



Source: Tranzit, Scope

Figure 6: EBITDA breakdown by type of meat 2017-2021 (HUF m)



Source: Tranzit, Scope

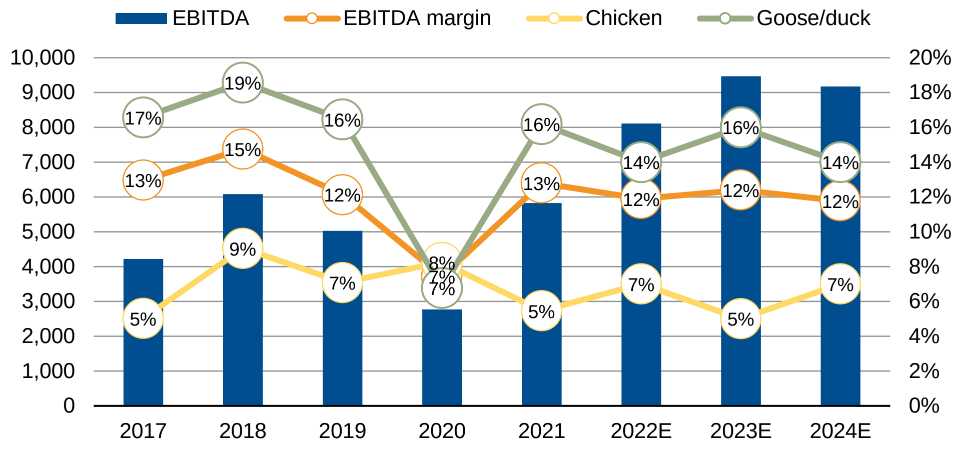
Moderate profitability forecasted to decrease slightly

Tranzit has a moderate historical profitability compared to its Hungarian peers, maintaining an operating margin between 9.5% and 14.5%. The decrease in the EBIDTA margin in 2019 and 2020 is the consequence of i) the larger share of chicken in total revenues as Tranzit ramps up its broiler production. The chicken segment has a substantially lower profitability (8%) than duck/goose (17%); ii) The drop in duck and goose prices (to the lowest in the last 10 years) due to the current down cycle of the goose/duck segment after peaking in 2018. Additionally, margins have been pressured from the rising cost of qualified labour, even if partially offset by the surge in Tranzit's automated processes

We expect Tranzit's EBITDA margin to be stable in 2022 due to:

- The increase in the prices of raw materials such as feed (borne by Tranzit-Ker and passed onto Tranzit Food) is hedged thanks to the group's storage capacity (50k tons) and the ownership of two feed mills allowing a 160k annual production, which mostly meets internal needs.
- The limited impact of price caps implemented by the Hungarian government on chicken breast to offset inflation. Retailers finance most of this cost as they are temporarily allowed to sell below purchase price (anti-dumping regulations are waived). Additionally, Hungarian retailers committed to only buy poultry produced in Hungary.
- Rising selling prices supported by strong demand for duck combined with monthly price adjustments implemented with retailers. Consumers are buying more fresh duck vs frozen implying better margins and less seasonality.
- Operating margins are expected to be impacted by cost inflation on items such as additives, tools, packaging, transport, staff and maintenance. Tranzit recorded one case of avian flu case in the first quarter of 2022, impacting the whole month of February with the EBITDA margin dropping to 4%. Margins recovered to 13% in March 2022 thanks higher than average margins both in the chicken segment (10%) and duck/goose business line (18%)

Figure 7: Profitability. 2017-2024E



Source: Tranzit, Scope estimates

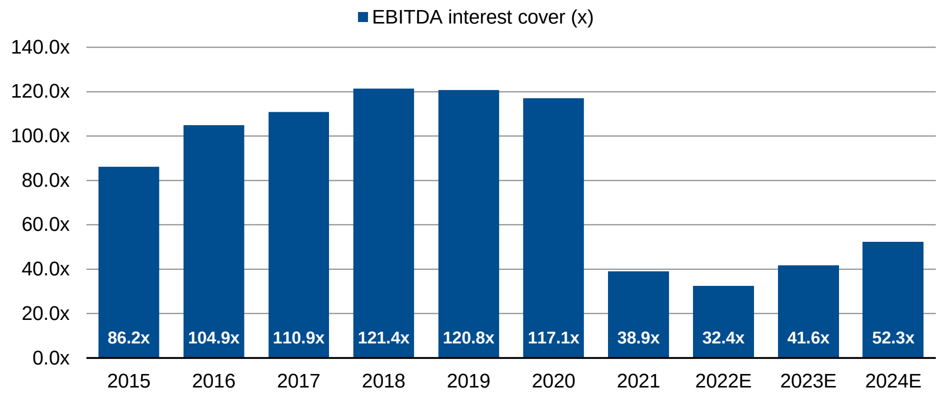
Financial risk profile: BB

Historically high EBITDA interest expense cover expected to remain above 7x

Tranzit had high and growing EBITDA interest cover of above 10.0x between 2015 and 2020. This arose as a result of a very low level of gross interest costs with an average cost of debt below 1%.

Following a HUF 9.2bn bond issue in 2021 with a 1.98% coupon, gross debt has risen from HUF 11.7bn to HUF 14.4bn with the refinancing of two bank loans, including HUF 2.1bn maturing in 2022 and part of a HUF 7.1bn UniCredit loan. While interest payments materially increased in 2021 from HUF 23.6m to HUF 149.6m, Tranzit Food stills exhibits a very strong EBITDA interest cover ratio above 10x. We anticipate that debt protection will drop to 32x by 2022 due to the full year impact of the bond.

Figure 8: EBITDA interest cover – 2015 to 2024E

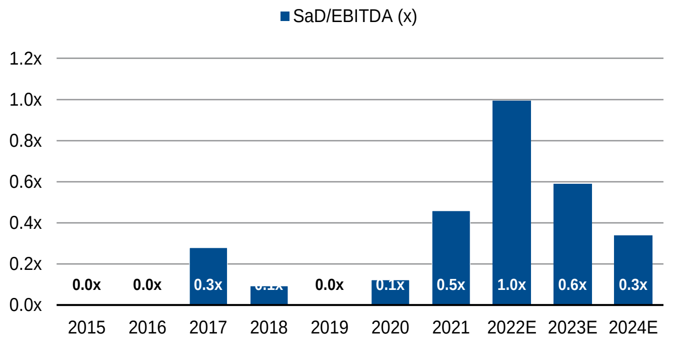


Source: Tranzit, Scope estimates

Negative FOCF due to massive capex programme and negative working capital impact

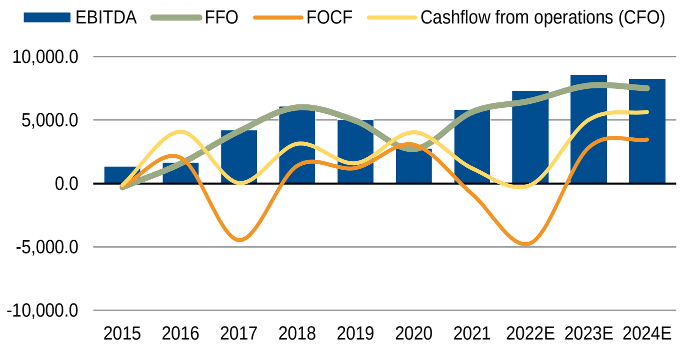
If we look at Tranzit's track record, operating cash flow generation has been volatile but sufficient to cover capex. Nevertheless, the situation changed in 2021 with very negative working capital of HUF 4.4bn because of a decrease in days of purchase outstanding combined with an increase in days of sale outstanding. This is the consequence of Tranzit's growing chicken operations, with more external suppliers implying shorter payment delays. We expect FOCF/SaD to remain negative in 2022 due to a combination of two factors: i) negative working capital consumption is expected to worsen in comparison to 2021 because of inflation and sales growth; and ii) HUF 6bn in development capex for 2022. Investments will focus on increasing chicken slaughterhouse capacity and the launch of new fresh duck recipes such as roast and marinated fresh duck. Tranzit's financial risk profile is mainly constrained by the company's inability to self-finance its upcoming capex.

Figure 9: Leverage – 2015 to 2024E



Source: Tranzit, Scope estimates

Figure 10: Cash flows – 2015 to 2024E



Source: Tranzit, Scope estimates

Leverage increasing to 0.8x in 2022 from 0.1x in 2020

Between 2015 and 2020, Tranzit's consolidated leverage, measured by SaD/EBITDA and funds from operations/SaD, was negative or very low due to its recurring high cash balance.

We forecast that the company will become more leveraged but remaining below 1.0x, with net debt growing between 2020 and 2022E from HUF 0.3bn to HUF 6.0bn. Forecast SaD/EBITDA is expected to continue increasing to around 1x next year, in line with the increase observed in 2021 to 0.5x, on the back of negative free cash flow. On a gross debt calculation basis, the ratio would have been around 2.5x at YE 2021. We assess leverage as volatile and highly sensitive to working capital. Therefore, leverage could evolve in both directions rapidly on the back of an unstable environment. Tranzit favours a mix of funding composed of bank loans and the HUF 9.2bn MNB bond.

Adequate liquidity supported by large unrestricted cash balance

We view Tranzit's liquidity as adequate based on our expectation that sources of liquidity will exceed uses of short-term debt in the next 12 months, following consistently strong liquidity in the past.

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	11,449	11,775	5,668
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	-839	-3,402	1,451
Short-term debt (t-1)	3,542	-4,706	2,827
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: -1 notch

One notch downgrade due to ESG factor

The downgrade reflects the recurring lack of transparency and clarity (governance risk factor as a supplementary rating driver), driven by inadequate reporting methods and failure to disclose key information in a timely manner. This entails a risk of material changes of the rating case.

Long-term rating

Senior unsecured debt rating: BB-

We have downgraded the debt rating to the senior unsecured debt issued by Tranzit Food Kft. to BB-, in line with the issuer rating. This rating is based on a hypothetical liquidation scenario as of year-end 2023, in which Scope has computed an 'average' recovery for holders of senior unsecured debt based on Scope's assumptions of attainable liquidation values.

Appendix: Peer comparison (as at last reporting date)

	Tranzit Food Kft.	Baromfi-Coop Kft	HELL ENERGY Magyarorszag Kft.	Vajda Papir Kft.
	BB-/Stable	BB-/Stable	B+/Stable	B+/Stable
Last reporting date	31 December 2021	31 December 2020	31 December 2020	31 December 2020
Business risk profile				
Size (Revenue in EUR bn)	0.135	0.3	0.2	0.07
Diversification (top 5 customers in sales %)	80%	20%	60%	60%
Operating profitability (EBITDA margin)	9-14%	12-15%	15%	0-6%
Financial risk profile				
Scope-adjusted EBITDA/interest cover	38.9x	17.1x	10.9x	9.7x
SaD/Scope-adjusted EBITDA	0.5x	3.6x	2.8x	3.6x
Funds from operations/SaD	211%	26%	31%	24%
Free operating cash flow/SaD	-31%	-19%	7%	-6%

* Subscription ratings available on ScopeOne

Sources: Public information, Scope

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