17 November 2022 Corporates

Vajda-Papír Kft.
Hungary, Consumer Products

SCOPE B NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	9.7x	2.7x	0.6x	2.2x
Scope-adjusted debt (SaD)/EBITDA	3.9x	11.4x	39.7x	10.6x
Scope-adjusted funds from operations/debt	23%	5%	-2%	5%
Scope-adjusted free operating cash flow/debt	-3%	-70%	-13%	-3%

Rating rationale

The downgrade is triggered by a deterioration in Vajda-Papír's operating profitability. Rising prices for cellulose and energy, two main cost components in the production process, have put pressure on the group's material costs and operating expenses. This has led to reported EBITDA of close to zero for H1 2022 despite several cost-tracking product price increases implemented by Vajda-Papír. Material cost increases have also put pressure on working capital and increased the need for external financing. At the end of 2022, Scope-adjusted EBITDA is expected to remain at 1.6%, a similar level to H1 2022 interim results. This would negatively impact the group's credit metrics.

The issuer rating benefits from Vajda-Papír's comparatively strong business risk profile (assessed at BB-). Vajda-Papír operates in the non-durable products industry, offering non-discretionary products, and demand remains strong for both household paper in general and Vajda Papír's products in particular. This enables the group to maintain its market shares in Hungary and other European countries. The group's diversification also benefits from strong demand for its products as geographical and product portfolio diversification remain unchanged compared to last year. Limited size and deteriorating profitability constrain the assessment.

Vajda-Papír's financial risk profile, assessed at B-, is the main constraint for the issuer rating. It is supported by the group's interest coverage, which is forecasted to improve to above 2x once profitability improvement measures are implemented. This is despite the wider rising interest rate environment and Vajda-Papír's weak operating profitability. The group has fixed its gas prices for up to 33% of its consumption and plans to fix the remaining portion. Furthermore, upon completion of the capex programme, the Phase II plant expansion will enable the group to serve all its internal base-paper needs, mitigating volatile base-paper prices and thus positively affecting operating profitability.

Compared to our previous base-case projection, prevailing unfavourable market conditions have further weakened Vajda-Papír's credit metrics, resulting in a breach of the negative rating trigger for the second year straight. The funds from operations/SaD credit metric was below 10% in 2021, and it is forecasted to remain below 10% for the foreseeable future. Leverage, as measured by the SaD/EBITDA ratio, is expected to rise significantly above 6x in 2023 and remain high in the short-to-medium term, which constrains the financial risk profile. SaD is under pressure from a need for external working capital funding. With available external funds consisting of contracted, unutilised working capital loans and an additional line of credit to be provided by sister company, Vajda-Papír Scandinavia, liquidity is considered adequate. We highlight the fact that both senior unsecured bonds issued by Vajda-Papír include a rating clause triggering repayment if the rating is not restored to at least B+ within two years or if the rating falls below B- the bond acceleration becomes immediate.

Ratings & Outlook

Issuer	B/Negative
Senior unsecured debt	B

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Related Methodologies

Corporate Rating Methodology; July 2022

Rating Methodology: Consumer Products; November 2022

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Bloomberg: RESP SCOP

Outlook and rating-change drivers

The Negative Outlook reflects the uncertainty if recent implemented measures taken by Vajda-Papír will be enough to support the recent negative impact the company has experienced on its profitability and cash flow generation.

A negative rating action could occur if interest coverage, as measured by the Scope-adjusted EBITDA/interest ratio, remained weak at below 1.5x. This could result from unfavourable market conditions (such as the interest rate environment) or an inflated debt portfolio.

A positive rating action (i.e. return to Stable outlook) could be warranted if profitability were to improve significantly from 2022 levels and Funds from operations/SaD move towards 10%.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
21 December 2021	Affirmation	B+/Stable
1 February 2021	Affirmation	B+/Stable

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Group operates in non-durable consumer products industry, with strong underlying demand for products • Completion of the investment programme gives the group an internal supply of base paper, which covers all base-paper needs for manufacturing, mitigating the price volatility of that raw material • A leading market position in Hungary and notable market positions in several other European counties, with a solid customer portfolio of retail chain stores • One of the first Hungarian companies to issue a green bond within the NKP bond framework	• High exposure to volatility of input prices, especially for cellulose and gas, affecting profitability and credit metrics • Historically weak profitability, coupled with a short history of acceptable credit metrics • Group struggles with liquidity issues during unfavorable market environments like those in 2022 • Recent substantial investment phase has hindered deleveraging in the medium term

Positive rating-change drivers	Negative rating-change drivers
• Significant increase in operating profitability and Funds from operations/SaD improving towards 10%	• EBITDA/interest cover remains below 1.5x

Corporate profile

Vajda-Papír Kft. Is a consumer goods group founded in 1999. It manufactures and sells selected hygiene paper products, such as toilet paper, tissues, paper towels and napkins. Vajda-Papír is the market leader in Hungary (combining its private label and own brands), and it exports its products to 24 countries, most of which are in Europe. Vajda Real Estate has been consolidated into Vajda-Papír Kft. since 2018. The group’s majority shareholders are its founders, Attila Vajda and Szilvia Vajda Csata.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	5.4x	9.7x	2.7x	0.6x	2.2x	2.7x
SaD/EBITDA	10.5x	3.9x	11.4x	39.7x	10.6x	8.5x
Scope-adjusted funds from operations/debt	8%	23%	5%	-2%	5%	7%
Scope-adjusted free operating cash flow/debt	-16%	-2%	-66%	-15%	-5%	0%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,209	3,505	1,523	155	2,170	2,831
Operating lease payments	140	399	521	547	574	603
Scope-adjusted EBITDA	**1,349**	**3,904**	**2,044**	**702**	**2,745**	**3,434**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,349	3,904	2,044	702	2,745	3,434
less: (net) cash interest paid	-249	-401	-745	-1166	-1232	-1288
less: cash tax paid per cash flow statement	0	-25	-18	-50	-45	-40
Funds from operations	**1,100**	**3,478**	**1,280**	**-514**	**1,468**	**2,106**
Free operating cash flow in HUF m						
Funds from operations	1,100	3,478	1,280	-514	1,468	2,106
Change in working capital	-2,475	-864	-1,937	1,958	-1,125	-336
Non-operating cash flow	0	51	106	-161	0	0
less: capital expenditure (net)	-779	-2,586	-14,297	-5,150	-1,300	-1,300
less: lease amortisation	-112	-319	-417	-438	-460	-483
Free operating cash flow	**-2,265**	**-241**	**-15,265**	**-4,305**	**-1,416**	**-12**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	221	321	641	1,057	1,117	1,167
add: interest component, operating leases	28	80	104	109	115	121
Net cash interest paid	**249**	**401**	**745**	**1,166**	**1,232**	**1,288**
SaD in HUF m						
Reported gross financial debt	13,609	13,700	21,200	25,700	26,700	26,700
less: cash and cash equivalents	-331	-6,567	-1,244	-1,740	-1,323	-1,312
add: non-accessible cash	331	6,567	1,244	1,740	1,323	1,312
add: operating lease obligations	559	1,596	2,084	2,189	2,298	2,413
SaD	**14,168**	**15,296**	**23,284**	**27,888**	**28,998**	**29,113**

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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)

ESG factors seen as credit-positive

Vajda-Papír was one of the first entities to issue a green bond under the NKP programme, which has a comprehensive green bond framework that sets multiple objectives (mainly related to resource management) that the group must comply with before 2030. Vajda-Papír established a three-member green committee to monitor its bond covenant progress and achievements. In addition, the group is committed to providing annual updates regarding its usage of bond proceeds.

An ESG report is expected to be published soon. It is expected to document the achievement of all green bond covenants along with the completion of the Phase II investment programme and the start of base-paper manufacturing.

[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-

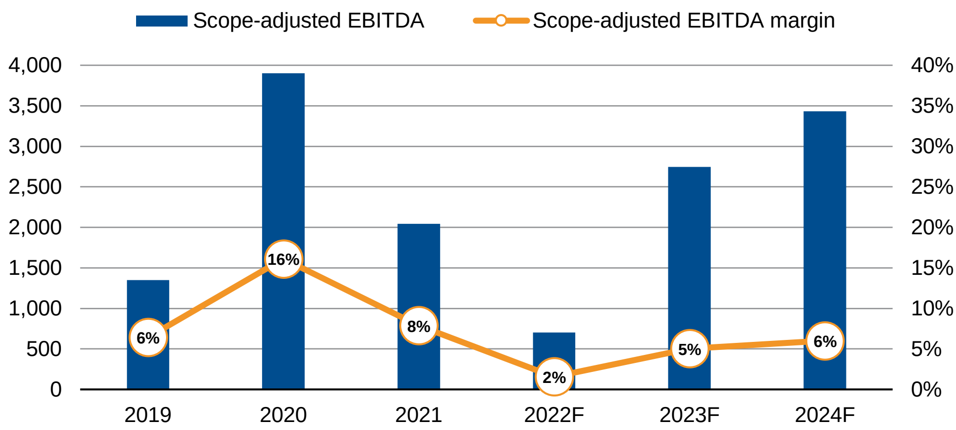
Industry risk profile: A

Vajda-Papír is active in the non-durable consumer products industry, which is characterised by low cyclicality, low substitution risk and medium barriers to entry. The group's products are household hygienic paper products. These are categorised as non-discretionary consumer products, which are not very sensitive to macroeconomic drivers.

The group's business risk profile is supported by its solid domestic position, its moderate geographical and product diversification and its operations within the non-durable consumer goods industry. Despite unfavourable market conditions that have led to multiple price increases, the group has been able to retain its main customers as demand for non-discretionary products remains strong. Based on Vajda-Papír's own estimates, the group has maintained roughly a 40% market share in Hungary (including both private label and own brand sales) and strong geographical diversification with close to 50% of sales from exports. Operating profitability is the main rating constraint given that the group has faced rising prices for cellulose and energy in 2021 and 2022, putting pressure on material costs and operating expenses. This has led to a forecast of weak operating profitability for 2022 and a slow recovery thereafter.

With material costs rising significantly during the past year and causing profitability to decline sharply, Vajda-Papír has taken measures aimed at improving its profitability in 2023. These include fixing prices for up to 33% of the new plant's gas consumption. In addition, the completion of the Phase II investment project will lead to cost savings and sales of surplus base paper. This is expected to positively impact the group's revenue and profitability, although the recovery is forecasted to be slow.

Figure 1: Operating profitability

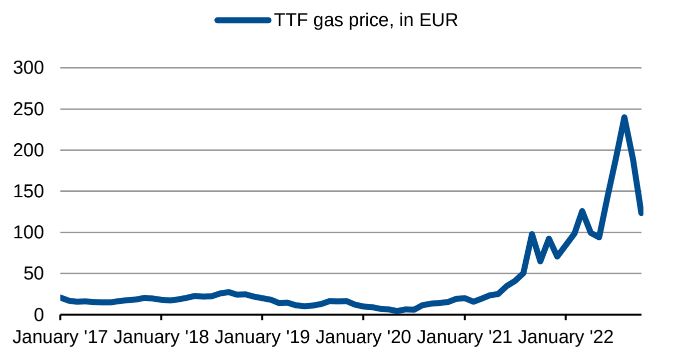


Source: Scope estimates

Vajda-Papír has several brands, each of which has a different price range to distinguish between premium and budget and target a wide range of end users.

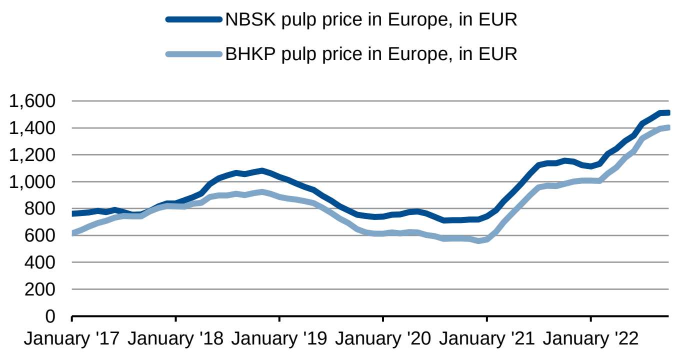
Vajda-Papír's dedication to sustainable forest management also provides a competitive advantage. The group focuses on minimising its environmental impact by continually improving energy efficiency and the share of renewable energy it uses (natural gas and nuclear energy input sources at present). Vajda-Papír has product certifications, including from ISO, HACCP, FSC and Nordic Ecolabel, and these have become more important to its customers lately.

Figure 2: Development of gas price



Source: Vajda-Papír

Figure 3: Development of pulp/cellulose price indices



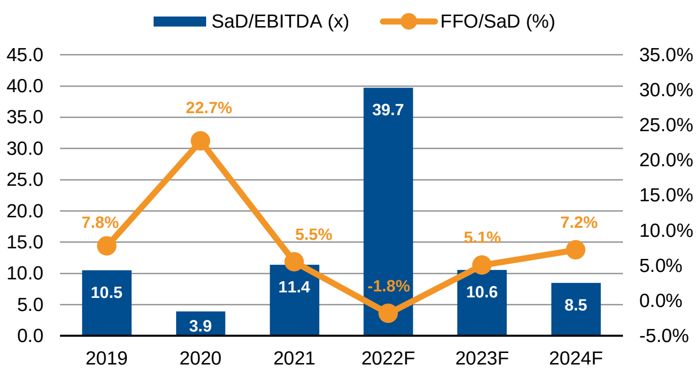
Source: Vajda-Papír

Financial risk profile: B-

Vajda-Papír's financial risk profile remains weaker than its business risk profile (assessed at B-). This has been exacerbated by prevailing unfavourable market conditions. Nevertheless, our analysis incorporates positive developments at the group level that we expect to materialise in the coming year and impact credit metrics. As summarised previously, the group has taken several steps to achieve a more predictable cost structure and thus improve its operating profitability (partially fixing gas prices and eliminating base-paper procurement through own manufacturing). These are forecasted to positively impact its credit metrics.

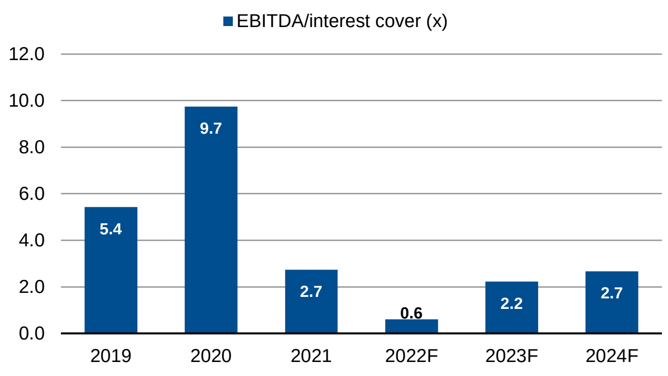
Despite significant demand for the group's products, we estimate a steep decline in EBITDA for 2022 due to the sharp increase in material costs. Also contributing to this decline is negative free operating cash flow, given that the group's large-scale investment project has just been completed and its SaD/EBITDA ratio is forecasted at significantly below 6x.

Figure 2: Leverage credit metrics



Sources: Scope estimates

Figure 3: Scope-adjusted interest cover



Sources: Scope estimates

SaD has been stressed further in 2022 as the group's need for external working capital financing has resulted in it receiving a loan from its sister company, Vajda-Papír Scandinavia. In addition, it is forecasted to utilise a second subordinated loan (of HUF 1bn) from Vajda-Papír Scandinavia and an open credit line of HUF 1bn. With profitability, as measured by Scope-adjusted EBITDA, forecasted to improve to a moderate level of less than 6% in the medium term, credit metrics are also expected to improve slowly. Scope-adjusted debt/EBITDA is expected to deleverage towards 8x, and the group's interest coverage ratio will land around 2x.

Adequate liquidity

Until mid-2022, the group was able to finance itself with an unused portion of government grant and bond proceeds. However, the provided funds were fully spent on the completion of the investment programme. Increased working capital needs were partially financed by Vajda-Papír Scandinavia's subordinated loan and through suppliers. Currently, Vajda-Papír has around HUF 2bn of external funding readily available in the form of a working capital loan and an additional credit line that can be granted by Vajda-Papír Scandinavia (as mentioned above). Our base case assumes both of these open credit lines will be utilised by the end of 2023.

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	6,367	996	1,440
Open committed credit lines (t-1)	2,000	0	0
Free operating cash flow	-15,265	-4,305	-1,416
Short-term debt (t-1)	0	0	0
Coverage	**No ST debt**	**No ST debt**	**No ST debt**

Long-term debt ratings

Senior unsecured debt rating: B

Scope has downgraded Vajda-Papír's senior unsecured debt rating in line with its issuer rating, resulting in a senior unsecured debt rating of B, which includes the HUF 11.2bn and HUF 9.9bn bonds (ISIN codes HU0000359989 and HU0000360474 respectively). These bonds will start their amortisation of 10% in 2025 and 2026 respectively. The bond rating reflects an above-average recovery for senior unsecured debt positions in the hypothetical event of a group default, yet no notching has been applied as the group faces increased working capital and Scope stresses the possibility of further debt issuance.

Two bonds (ISIN codes: HU0000359989 and HU0000360474) constitute a major source of funding for Vajda-Papír. Both bond agreements contain covenants of bond acceleration caused by the deterioration, in case the debt rating drops below B+, the issuer typically has a two-year cure period to return to the minimum accepted level to participate in the Hungarian National Bank's Bond Funding for Growth Scheme, however debt repayment acceleration becomes immediate (typically 15 business days) upon the loss of a B- rating. Therefore, further negative rating actions may accelerate Vajda-Papír's repayment and likely trigger a default, which would create a weakness for the group's liquidity.

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