Hell Energy Magyarország Kft. Hungary, Consumer Products

Corporate profile

Hell Energy is a consumer goods company founded in 2004. It manufactures and sells energy drinks and other non-alcoholic beverages (ice tea, energy coffee, and soft drinks) in more than 50 countries. Hell Energy Drink is currently the third-largest branded energy drink globally. The group is vertically integrated with its own can production and filling lines on-site. Currently, the issuer is the market leader in Hungary, with a market share of 59%, and in nine other countries, most of which are in the CEE and SEE region. The company is 100% privately owned by the Barabás family.

Key metrics

		Scope estimates		
Scope credit ratios	2020	2021E	2022E	2023E
EBITDA/interest cover (x)	10.9x	14.1x	5.6x	6.8x
Scope-adjusted debt (SaD)/EBITDA	2.8x	4.6x	6.1x	4.9x
Scope-adjusted FFO/SaD	31%	20%	13%	17%
FOCF/SaD	7%	-41%	-38%	5%

Rating rationale

Scope Ratings has today downgraded Hungary-based Hell Energy Magyarország Kft's issuer rating from BB/Stable to B+/Stable. Senior unsecured debt is rated B+.

The rating of B+ is supported by a strong market position in CEE, high margins despite the pandemic, and significant growth potential. The rating is constrained by limited product diversification and increasing leverage.

Business risk profile

Hell Energy's business risk profile is primarily supported by the consumer products sector's strong industry risk profile, which benefits from low cyclicality, medium barriers to entry, and is rated A.

The issuer's business risk profile is improving as the company grows, however it is constrained by limited diversification with regard to product categories (non-alcoholic beverages) and large exposure to CEE/CSE markets as well as the company's relatively small absolute size compared to international consumer products peers. We assess the company's business risk profile as BB+.

Financial risk profile

Hell's financial risk profile is strongly affected by a recently announced investment programme of around HUF 80bn, which will be mainly debt-funded.

The rating is supported by strong interest coverage of well above 5.0x and no large debt repayments in the coming years. Free operating cash flow/SaD will stay negative for the next two years according to our base-case forecast. Since the company still lacks absolute size compared to global consumer product brands, we have taken potentially higher revenue and cash flow volatility into account, which constrains the financial risk profile to some extent.

Ratings & Outlook

Corporate rating B+/Stable

Senior unsecured rating B+

Lead analyst

Barna Gáspár
+49 30 278913 25
b.gaspar@scoperatings.com

Related methodologies

Corporate Rating Methodology, July 2021

Consumer Products Methodology, September 2020

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

In addition, the group has issued financial guarantees to third parties covering financial leasing contracts that are now being phased out. Those entities are part of the larger, family-owned Hell Group, but not part of the rated entity. We do not incorporate these in our base-case forecast metrics since we deem the likelihood of any payments resulting from those contingent liabilities to be negligible at this point.

Operating leverage, as measured by Scope-adjusted debt/EBITDA, ranges between 6.1x and 4.9x, which is commensurate with a lower B rating category. We therefore assess Hell Energy's financial risk profile as B.

All ratings reflect ambitious growth figures in our underlying base case starting in 2021. Financial metrics in our base case are therefore subject to larger potential volatility if the issuer cannot achieve those growth plans.

Liquidity has been adequate since the company has minimal short-term debt as of YE 2020 and maintains significant committed short-term credit lines at various banks.

Outlook and rating-change drivers

The rating Outlook is Stable based on expected operating leverage increasing to around 6x by YE 2022, with deleveraging below 4x from 2024 at the earliest due to the expected large-scale investment programme, which will be funded mainly by a planned HUF 67bn corporate bond placement.

A positive rating action is remote at this stage but may be taken if the issuer shows financial leverage measured by SaD/EBITDA of less than 4.0x on a sustained basis.

We may consider a negative rating action if financial leverage deteriorates to more than 6.0x on a sustained basis or if free operating cash flow/SaD stays negative beyond 2023.

Rating drivers

Positive rating drivers	Negative rating drivers
• High diversification in terms of geographies (over 50 countries), customers and suppliers, and new product launches (energy coffee) that have been well received by the market • Robust Scope-adjusted EBITDA margins of 15-20% • Strong market position as the current market leader in 10 countries in its product segment • Benefits from a high degree of vertical integration that decreases capacity constraints and revenue volatility	• Large exposure to the Hungarian and CEE/SEE market that is limited to the beverage product segment • Negative free cash flows and dependence on external financing in recent years due to fast expansion and increase in receivables • Risks associated with changing customer demands and punitive regulation on sugared and/or caffeinated beverages • Large debt-funded CAPEX without fresh equity and increase in working capital significantly boost leverage for the next 3-4 years, similarly to the large can manufacturing-line investment around 2015-2017

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Leverage measured by SaD/EBITDA below 4x on a sustained basis	• Leverage measured by SaD/EBITDA above 6x on a sustained basis, triggered by cost overrun, delays in the investment timeline, a smaller subsidy, or failure to increase revenues in line with installing new production lines • Negative free operating cash flow/SaD beyond 2023

Financial overview

		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover (x)	10.9x	14.1x	5.6x	6.8x
Scope-adjusted debt (SaD)/EBITDA	2.8x	4.6x	6.1x	4.9x
Scope-adjusted funds from operations/SaD	31%	20%	13%	17%
Free operating cash flow/SaD	7%	-41%	-38%	5%
Scope-adjusted EBITDA in HUF ‘000s	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	13,627,921	15,279,137	18,713,200	22,380,727
Operating lease payments in respective year	-	-	-	-
Other	-	-	-	-
Scope-adjusted EBITDA	13,627,921	15,279,137	18,713,200	22,380,727
Scope-adjusted funds from operations in HUF ‘000s	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	13,627,921	15,279,137	18,713,200	22,380,727
less: (net) cash interest as per cash flow statement	-1,246,634	-1,084,631	-3,333,997	-3,292,943
less: cash tax paid as per cash flow statement	-59,338	-149,183	-218,920	-276,171
add: depreciation component, operating leases, provisions	-171,392	29,387	-	-
Scope-adjusted funds from operations	12,150,557	14,074,710	15,160,283	18,811,612
Scope-adjusted debt in HUF ‘000s	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	51,646,196	116,166,558	115,913,150	114,270,990
less: hybrid bonds	-	-	-	-
less: cash and cash equivalents	-13,042,181	-46,817,109	-2,281,151	-5,320,467
add: cash not accessible	-	-	-	-
add: pension adjustment	-	-	-	-
add: operating lease obligations	-	-	-	-
Other	-	1,000,000	1,000,000	-
Scope-adjusted debt	38,604,015	70,349,449	114,631,999	108,950,523

Business risk profile

Non-durable consumer products have a strong industry rating of A

Hell Energy's business risk profile is primarily supported by the consumer products sector's strong industry risk profile, which benefits from low cyclicality, medium barriers to entry, and is rated A. The business risk assessment profile was completed this year with a brand-strength element as published in the Consumer Products Methodology on 23 September 2020.

Market leader in 10 countries with its HELL Energy Drink brand

Regarding market position, the picture is mixed, since the issuer has a leading market position in the energy-drink segment of its home market of Hungary while also being the market leader in nine other countries that are mostly in Central and Southeast Europe, and it has good diversification within the non-alcoholic beverages segment. The recently introduced energy-coffee product quickly became the market leader in five countries. The XIXO branded ice tea is market leader in Hungary.

Strong exposure to CEE/CSE markets, significant growth potential in several countries and regions

Hell Energy has a market presence in over 50 countries, although most of its sales are in the CEE markets, which gives it room for organic growth once production capacity is expanded.

The ultimate number of customers (individual consumers of a drink) is extremely high due to the retail consumer-products portfolio.

Strategic distribution channels often under same ownership, well diversified supplier base

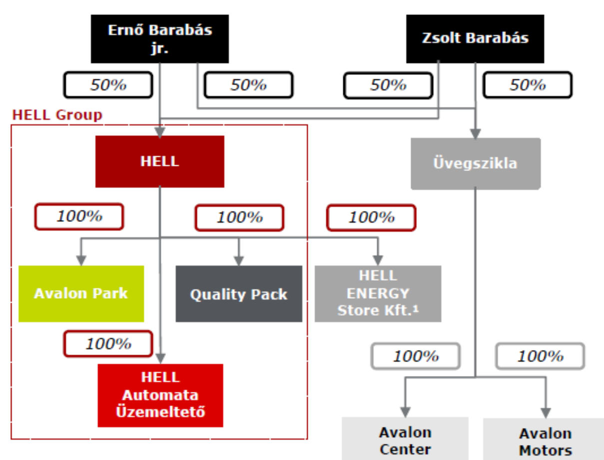
Moreover, there is no material dependency on any third-party distributor or retailer due to the group's strategy of developing and running its own global distribution via its own local operations on the ground or working with different local distributors in every market. Hence, there is no material dependency on single partners. There is also little dependency on suppliers because the main raw materials used are sugar, compound (syrup), and aluminium, which are all globally traded commodities with a large number of potential suppliers.

In terms of diversification, the issuer benefits from a relatively diversified client base, mostly thanks to its retail-focussed product portfolio, its double-track strategy of branded and white-label products, and its wide geographic reach.

Strong profitability in line with global peers

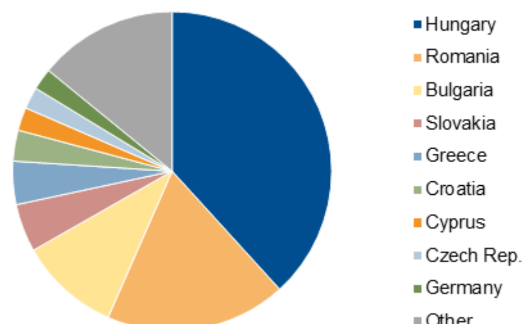
Profitability on a sustainable EBITDA-margin basis is in the range of 15-20%. This is in line with sector peers, particularly given the Hell Group's above-average degree of vertical integration and its relatively new and efficient production facility. The issuer is the market leader in most of its main markets, and it prices its products significantly below its main competitors' price level, which gives it pricing power.

Figure 1: Organisational overview



Source: Scope estimates

Figure 2: Geographical diversification (revenue FY 2020)



Source: Scope estimates

Profitability is expected to shrink temporarily while production ramps up

The issuer's operating profitability has been below the sector average in recent years, mostly due to the rapid expansion of its business and the significant brand-building and market-development expenses that this expansion required. As the group successfully widened its geographic reach and product portfolio, it reached an EBITDA margin of more than 19% in 2018 thanks to high utilisation of production capacity, which continued in 2019 and 2020.

We nevertheless expect the issuer's EBITDA margin to remain around 17-18% for the next two to three business years given that we foresee further initial costs from the launch of new products and developing export markets as well as the fact that sales growth of its (higher margin) branded products cannot immediately match the planned growth in production capacity. In order for the issuer to achieve high utilisation rates, we therefore expect a larger share of (lower margin) white-label business. In the medium term, we think that EBITDA margins can benefit from significant economies of scale.

Financial risk profile

Financial risk profile rated two notches below prior assessment

The issuer's financial risk profile has been rated B and is thus the weaker part of the overall issuer rating we have assigned to Hell Energy.

New HUF 67bn bond planned to finance large-scale investments

Hell's financial risk profile is strongly affected by a recently announced investment programme of around HUF 80bn, of which HUF 67bn is to be financed by a new senior unsecured bond issuance (with a fixed coupon, 10-year maturity, and linear amortization of 10% from year 5 with 50% balloon at maturity, with a corporate guarantee from Quality Pack Zrt. - owned 100% by the issuer) and the remainder from a state subsidy and operating cash flow.

The bond proceeds will be earmarked for capital expenditure to greatly increase production capacity in beverage manufacturing and filling, and aluminium can manufacturing.

No fresh equity is provided for capital expenditure unless there is less than a HUF 11.5bn state subsidy

The state subsidy is not contracted at this stage, and any shortfall arising from a lower subsidy amount will be covered by equity or a subordinated intercompany loan provided by the owners. No equity contribution is planned otherwise. Cost overrun and timing delays are mitigated by using the same technology suppliers as before, and a new filling

line will be quickly installed in place of the existing PET line to boost output needed to achieve high revenue-growth targets.

Successful deleveraging followed by tripling of nominal debt

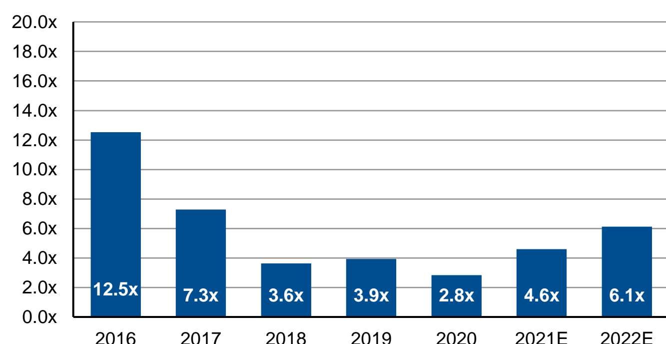
The new investment programme follows a deleveraging from the previous programme that started in 2015 for the can manufacturing facility and additional filling lines, resulting in Scope-adjusted debt/EBITDA of above 7x in 2017. The company successfully deleveraged to SaD/EBITDA of 2.8x by YE 2020. Current SaD/EBITDA projections are slightly more moderate, around 6x at peak with a deleveraging to below 4x in 2024 at the earliest. Scope-adjusted debt is expected to reach HUF 115bn and triple by 2022 compared to 2020 levels. Timing delays, cost overrun, and slow production ramp-up resulting in slower EBITDA growth may further increase leverage significantly.

Robust interest cover, no high debt amortisation, weak FOCF

Interest coverage is rather robust at more than 5.0x on a sustained basis, deteriorating from double-digit levels due to the interest cost increasing from HUF 1.1bn p.a. to HUF 3.4bn p.a. after the new bond issuance.

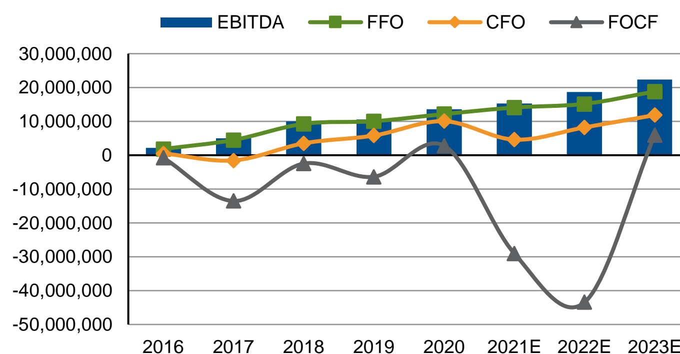
Both CAPEX coverage and free cash flow generation have been weak in the past. This is due to the group's exponential growth in recent years, which is expected to continue with its massive CAPEX programme. Although the group has been heavily dependent on external financing in order to fund its production facilities and its growing working-capital needs, there should be a sustainable improvement in FOCF from 2023-2024E onwards.

Figure 3: Scope-adjusted leverage development



Source: Scope estimates

Figure 4: Cash flow overview



Source: Scope

Adequate liquidity with pressure from investment programme

Liquidity is deemed adequate as there is minimal short-term debt planned in future and there is no significant debt amortisation in the coming years.

From 2021, FOCF will become negative again due to the large CAPEX programme, putting pressure on liquidity.

Supplementary rating drivers

We have not made any explicit rating adjustments under the supplementary rating drivers.

Senior unsecured rating

Average recovery with significant assets under construction

We expect an average recovery for future senior unsecured debt, such as the issued 10-year HUF 28.5bn bond and the planned HUF 67bn bond ranked pari passu with the previous one. Such recovery expectations translate to the same rating as the issuer rating. Our recovery expectations are based on an expected liquidation value in a hypothetical default scenario at YE 2023.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44 020 7340 6347

info@scoperatings.com
www.scoperatings.com

Disclaimer

© 2021 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Ratings UK Limited, Scope Analysis GmbH, Scope Investor Services GmbH, and Scope ESG Analysis GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.