Aranynektár Kft. (Fulmer)
Hungary, Consumer Products

SCOPE B STABLE

Key metrics

Fulmer Hungarian Branch (FHB)			Scope estimates	
Scope credit ratios[1]	2021	2022	2023E	2024E
Scope-adjusted EBITDA/interest cover	30x	Neg.	Neg.	205x
Scope-adjusted debt (SaD)/EBITDA	1.1x	1.1x	1.5x	1.9x
Scope-adjusted funds from operations/debt	87%	97%	64%	49%
Scope-adjusted free operating cash flow/debt	65%	-38%	-23%	-26%

Rating rationale

The rating of Aranynektár continues to be determined by the credit quality of sister company Fulmer Hungarian Branch (FHB).

FHB's business risk profile (rated B+) is rather weak due to its low revenues (below EUR 20m) and market share. Other factors include somewhat concentrated customer diversification (but with good geographical diversification), an underdeveloped brand and good profitability (constrained by medium-to-high volatility).

FHB's financial risk profile (rated BB+) is good due to its having maintained a net cash position at the end of FY 2022, adequate liquidity and strong cash flow generation. EBITDA/interest cover remains strong in the forecasted period and is not under pressure as the drawn debt is fixed-rate. We expect cash flow cover to remain negative and under pressure given capex plans for 2022-23, which constrain the rating.

We have applied a negative notch for governance and structure supplementary rating driver.

Outlook and rating-change drivers

The Outlook is Stable based on higher profitability and the large investment programme having started with low leverage. We believe FHB can deploy its considerable capex programme while maintaining an acceptable financial risk profile, helped by its state subsidy. The Outlook excludes potential external events – beyond the agency's assessment of the credit quality of FHB – that could have a negative impact on the issuer.

A positive rating action could be taken if FHB kept its EBITDA margin high (which would also keep SaD/EBITDA low) while also improving transparency, management size and the scale of its activities.

A negative rating action could be taken if SaD/EBITDA increased well above 3x on a sustained basis, e.g. due to a greater-than-expected drop in profitability. In the event of a downgrade, the repayment acceleration clause in the bond agreement would kick in.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
9 Nov 2022	Affirmation	B/Stable
16 Dec 2021	Outlook change	B/Stable
10 Feb 2021	Outlook change	B/Positive
30 Jan 2020	New	B/Stable

[1] Financial year ends 30 May

Ratings & Outlook

Issuer	B/Stable
Senior unsecured bond rating	B+

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Related Methodologies

Corporate Rating Methodology; July 2022

Rating Methodology: Consumer Goods; September 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Modest geographical diversification • Development of a branded label, albeit gradual • Strong EBITDA/interest cover • Positive development of Scope-adjusted EBITDA margin at around 15%	• Small size creates vulnerable to externalities. • High historical variations in net working capital expected to continue putting pressure on liquidity • Large share of private labels weighs on profitability. • Access to labour is limited and partially needed on a seasonal basis, forcing issuer to use temporary agency personnel. • Unknown effect of subsidy on financial risk profile • Lack of transparency as well as key person risk (ESG factors) • Investments in Ukraine and Russia to source honey entail geopolitical risk.

Positive rating-change drivers	Negative rating-change drivers
• Maintaining a high EBITDA margin and keeping SaD/EBITDA low, with a simultaneous improvement in transparency and scale of activities as well as enlarged management capabilities	• SaD/EBITDA of well above 3x on a sustained basis

Corporate profile

Aranynektár Kft. provides services to one customer, its sister company Fulmer Hungarian Branch (FHB), a Hungarian honey processing company. Both entities are owned either directly or indirectly by Mr Ferenc Takács. Aranynektár prepares and packages the honey processed by FHB, either in glass or PET containers. As an integrated contractor, Aranynektár generates revenues fixed in advance by FHB to cover its operating expenses and produce a margin. The raw material (honey) is collected partially by Ukrainian and Russian sister companies ultimately owned by Mr Takács before it is sold to Aranynektár for processing and packaging.

Financial overview (Fulmer Hungarian Branch)

			Scope estimates	
Scope credit ratios[2]	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	30x	Neg.	Neg.	205x
SaD/EBITDA	1.1x	1.1x	1.5x	1.9x
Scope-adjusted funds from operations/debt	87%	97%	64%	49%
Scope-adjusted free operating cash flow/debt	65%	-38%	-23%	-26%
Scope-adjusted EBITDA in HUF ‘000				
EBITDA	1,302,620	1,199,216	947,225	798,668
Scope-adjusted EBITDA	**1,302,620**	**1,199,216**	**947,225**	**798,668**
Funds from operations in HUF ‘000				
Scope-adjusted EBITDA	1,302,620	1,199,216	947,225	798,668
less: (net) cash interest paid	-43,970	133,679	29,000	-3,900
less: cash tax paid per cash flow statement	0	0	-68,994	-48,163
Funds from operations	1,258,650	1,332,895	907,230	746,604
Free operating cash flow in HUF ‘000				
Funds from operations	1,258,650	1,332,895	907,230	746,604
Change in working capital	-90,738	-645,415	-95,203	-405,987
less: capital expenditure (net)	-226,321	-1,203,994	-1,134,000	-735,000
Free operating cash flow	941,591	-516,514	-321,972	-394,382
Net cash interest paid in Scope-adjusted EBITDA in HUF ‘000				
Net cash interest per cash flow statement	43,970	-133,679	-29,000	3,900
Net cash interest paid	43,970	-133,679	-29,000	3,900
SaD in HUF th				
Reported gross financial debt	1,449,321	1,369,201	1,426,676	1,526,676
less: cash and cash equivalents[3]	2,261,613	1,631,204	1,698,289	1,744,285
SaD	1,449,321	1,369,201	1,426,676	1,526,676

[2] Accounting year ends 30 May
[3] Not netted for B category ratings

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Environmental, social and governance (ESG) profile[4]

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)

Emerging family business

Aranynektár and FHB do not have a dedicated ESG strategy. The production facility is under expansion, with new buildings and modernisation from a relatively old technological base. Energy efficiency measures are a priority to manage the increasing cost base. Own solar energy production is in the planning phase. Alternative energy sources may temporarily be less environmentally friendly than gas usage.

Governance is in line with small family businesses, where management and accounting and controlling are rather thin, and decision making is flat and mostly taken by the owner, entailing some key person and management risk. The bond was structured in a quite complex manner as the main revenue is generated in FHB whereas the bond is placed at sister company Aranynektár, which only has revenues from FHB. This raises transparency concerns.

[4] 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: B+

Industry risk profile: A

Aranynektár packages honey for Fulmer Hungarian Branch (FHB), therefore it is a B2B services company. The credit quality of Aranynektár is fully dependant on that of FHB. We assess the honey business of FHB within the non-durable consumer products industry, which has low cyclicality and medium barriers to entry because it buys raw honey, packages it and sells it to retailers, and demand is not really cyclical or even countercyclical as proven during the pandemic. We therefore apply the consumer products sector assessment.

Symbiotic relationship between FHB and Aranynektár

Due to the close relationship between Aranynektár and FHB, we have performed a credit quality assessment of the latter. Although Aranynektár is the issuing entity, the debt servicing obligations lie with FHB because the intercompany loan matches the bond features issued by Aranynektár to FHB. As a consequence, and due to the co-dependency between the two entities and the guarantee provided by FHB for the prospective bond, our rating focuses on the credit quality of FHB rather than that of Aranynektár.

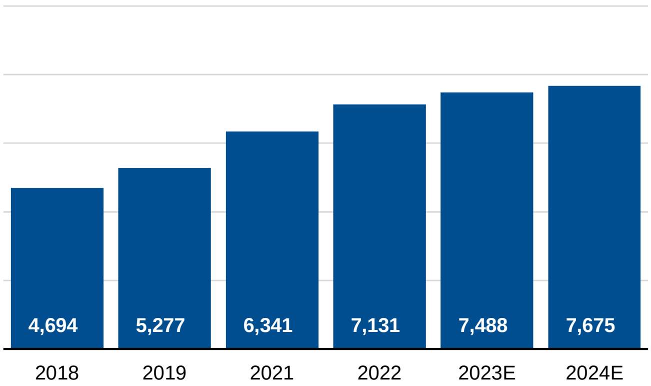
Weak market positioning detrimental to the rating

FHB is strong in Hungary but weak in Europe, with market shares estimated at close to 20% and 1.5% respectively. The issuer plans to boost brand recognition by increasing the number of its own labels (currently at one quarter of sales according to management). FHB's small size limits potential rating uplifts because it implies vulnerability to unexpected externalities.

Sales improving since the pandemic, but still low

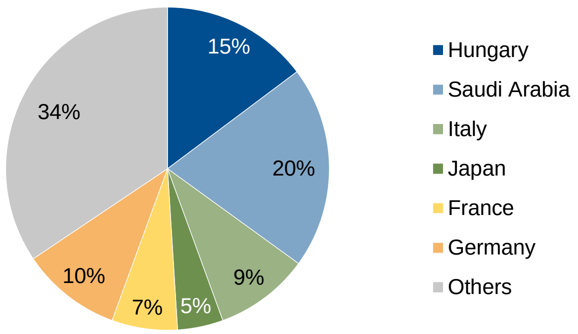
Sales have grown by around 15% since 2019, reaching HUF 7.1bn (EUR 18m) in 2022. This was driven by Covid-19 prompting consumers to favour healthier produce. The issuer is more conservative regarding further revenue growth, despite the capex plan it recently began. Coneuquently, even with modest revenue growth in absolute terms, market shares are expected to remain small at the European level (less than 2%) despite a certain degree of dominance in the Hungarian market.

Figure 1: FHB's revenue with forecasts (in HUF m)



Source: FHB, Scope estimates

Figure 2: FHB's geographical reach



Source: FHB, Scope

Good customer and supplier diversification despite size

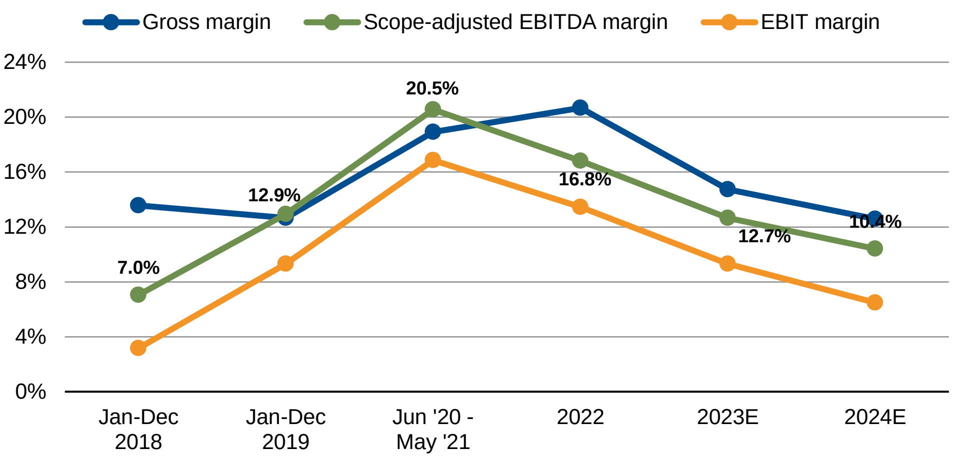
FHB is well diversified in terms of geographical reach. 15% of its total sales were in Hungary (FY 2022), with the rest from abroad. Exposure to Europe is significant at over 50% of sales not including Hungary. The issuer also sells regularly to Saudi Arabia, Japan and the United States. It has had a stable relationship with Lidl for a few years but this relationship poses customer concentration risk. Buyer profiles are somewhat inconsistent, with high variations in a customer's or country's share of total sales through the years. Exports to Saudi Arabia, for example, jumped from nil to 20% in the past three years. These variations in branded label sales per customer are typical for small companies.

Supplier and customer diversification support the rating. FHB has a broad supplier base spread across Europe and beyond. To complement Hungarian honey, the issuer has also set up activities in Ukraine and Russia, where raw honey export prices to Europe are very profitable. The recently established entities in Russia and Ukraine are also owned by Mr Takács and operate outside of the rated entity, which provides us with some comfort. However, this could create supply chain issues or lost investments on the owner side. The honey is sold in barrels to Aranynektár for processing and packaging.

Low diversification due to mono-product focus

FHB's mono-product focus (honey-related) is detrimental to the rating given that a poor harvesting year could heavily impact revenues once inventory is depleted. This is mitigated somewhat by the planned build-up of raw material inventories for the medium term. The issuer uses different formats (glass and PET containers). However, this does not represent real diversification as neither format has features that strongly counter those of the other.

Figure 3: FHB's profitability with forecasts (in %)



Source: FHB, Scope

Profitability expected at around 17%-18%

FHB has increased its profitability significantly (calculated based on the Scope-adjusted EBITDA margin), to close to 20% in FY 2021 from 7% in FY 2018. This is due to multiple factors, including higher demand for healthy food and more channels for raw material sourcing. We view this margin improvement as temporary and forecast between 10%-15% for the coming years, depending on the fluctuation of the cost base. Prices are agreed usually after honey harvesting, but other variable costs may change fast.

The development of branded labels could also increase the individual gross margins of the issuer. However, we did not see progress in the development of branded sales.

Input prices, such as energy, packaging and logistics, grew as expected last year. This can be seen in the Scope-adjusted EBITDA margin for FY 2022, which is 3 pp below the previous year. We note that the issuer has its energy prices hedged for the coming months using last year's prices, so further significant price increase will be needed for next year and the investments in the energy transition, which management has started.

Low brand strength still detrimental to the rating

Brand strength is relatively weak. A high share of private labels dilutes the issuer's visibility at the international level. That said, we expect this distribution channel to grow in the coming years.

Financial risk profile: BB+

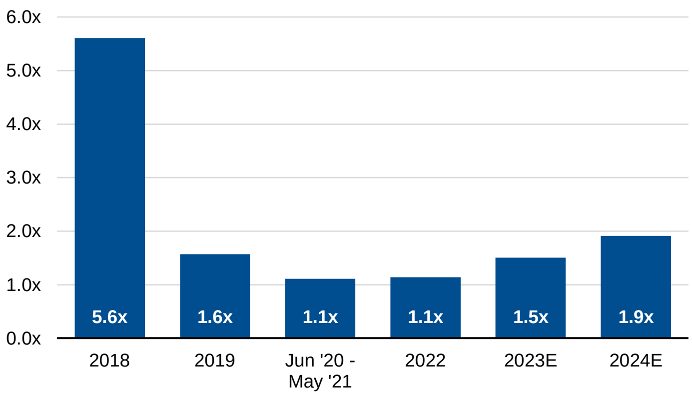
Assumptions and history

Aranynektár issued a HUF 1bn bond in 2020 that expires in 2030. It has a fixed coupon, which is highly advantageous in the current interest rate environment, and is guaranteed by FHB. Aranynektár transferred the proceeds to FHB via an intercompany loan designed to align with the bond's features (including coupons, repayment schedule and maturity). As Aranynektár's cash generation limits its ability to repay the coupons and the bond, FHB will pay the interest and repay the bond to Aranynektár, which will in turn repay bondholders.

Changing the end of the fiscal year has a positive effect on metrics

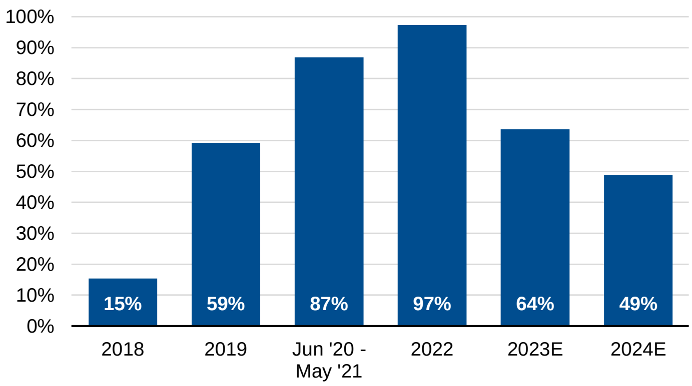
In 2020, Aranynektár and FHB changed the end of their fiscal year from December to May, in line with the honey production cycle. Inventories at the end of May are significantly lower than at the end of December, since fresh produce comes in the summer. This means the financials look slightly better in May due to the effect on net working capital (cash balance, SaD/EBITDA).

Figure 4: Evolution of SaD/Scope-adjusted EBITDA



Source: FHB, Scope estimates

Figure 5: Evolution of funds from operations/SaD



Source: FHB, Scope estimates

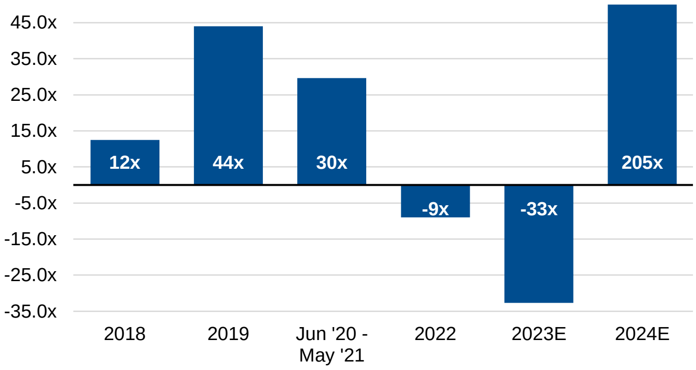
Leverage metrics have greatly improved due to development of EBITDA

Leverage has been improving over the last few years due to stronger EBITDA and the repayment of capex loans. By refinancing short-term debt with the bond issued in 2020, the issuer has decreased its short-term funding requirements to maintain operations. We have not applied cash netting because we deem cash to not be permanent as the multi-phase capex programme is ongoing. Despite a lack of information on the upcoming subsidy, we believe metrics will benefit from a comfortable cash position (currently net cash) as investments are phased in and launched in a conservative fashion. SaD/EBITDA is expected to stay below 2x in the next two years without netting of cash as a result of a moderately shrinking margin and cash spent on investments.

Strong EBITDA/interest cover

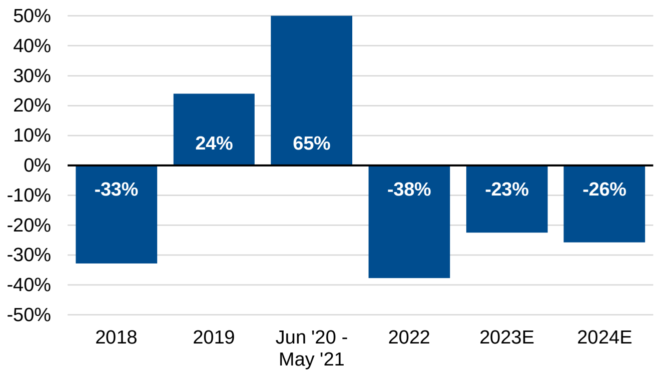
We expect EBITDA/interest cover to remain strong. The issued bond has a fixed coupon of 3.5% p.a., and the issuer has a EUR 1.3m revolving credit facility for working capital that is mostly unused. Current working capital financing is euro-based and has a natural hedge in place due to high export sales. EBITDA/interest cover is therefore not under pressure from soaring HUF interest rates. Furthermore, with current deposit rates well above the bond coupon, interest cover will improve due to interest received (to the extent that interest received would be higher than interest paid).

Figure 6: Evolution of EBITDA/interest cover



Source: FHB, Scope estimates

Figure 7: Evolution of free operating cash flow/SaD



Source: FHB, Scope estimates

Cash flow cover under pressure during investment phase

The ongoing capex programme, which aims to expand production capabilities and raw material storage, is complemented by an energy transition package. This causes negative free operating cash flow for the coming years, which is detrimental to the rating.

Adequate liquidity despite upcoming capex plans

Liquidity is adequate, given the low short-term debt repayment, which is fully covered by high Scope-adjusted EBITDA profitability and cash. While liquidity risk is not present, it could arise if capex or working capital was greater than forecasted. We have excluded the EUR 1.3m working capital facility from our calculations because of its short tenor.

Balance in HUF '000s	2023E	2024E
Unrestricted cash (t-1)	1,631,204	1,698,289
Open committed credit lines (t-1)	n/a	n/a
Free operating cash flow	-321,972	-394,382
Short-term debt (t-1)	192,525	250,000
Coverage	6.8x	5.2x

Further analytical contribution

The recent improvement in financial metrics has exceeded our expectations, bolstered by the strong development of profitability and the gross margin. While our financial risk profile rating could be higher based on our rating thresholds, we have maintained a conservative view for two reasons. The first is uncertainty around the capex programme and related subsidy amounts and the programme's impact on financial metrics. We have therefore taken the precaution of overweighting free operating cash flow/SaD in the financial risk profile sub-rating. The second reason is the issuer's small size. It is managed by one to two key persons, and this is detrimental to the rating because it increases the potential impacts of externalities.

Supplementary rating drivers: -1 notch

The rather weak transparency and governance of the issuer (and its sister companies involved in the supply chain from raw material to sales and distribution activities), including its unusual structure, our lack of comfort about group financials, and related changes in accounting policy, poses a certain degree of information risk. We have therefore continued to subtract one notch for governance (negative ESG factor)

Long-term debt ratings

Senior unsecured bond rating: B+

We have affirmed the rating of B+ on the senior unsecured bond (HU0000359559). We calculated an ‘above-average’ recovery following a hypothetical default in 2024 and therefore maintain one notch of uplift on the assigned issuer rating.

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