# Vajda-Papir Kft.
# Hungary, Consumer Goods

B+ POSITIVE

## Corporate profile

Vajda-Papir is a consumer goods company founded in 1999. It manufactures and sells selected hygiene paper products like toilet paper, tissues, paper towels and napkins. Vajda-Papir is the market leader in Hungary (combining private label and own brands) and exports products to 24 countries, largely in Europe. From 2018, the financial statements of its Vajda Real Estate entity is consolidated into the Vajda Papír Kft. The company is privately owned by the founders, Mr Attila Vajda (50%) and Mrs Szilvia Vajda Csata (50%).

## Key metrics

| | | Scope estimates | | |
|---|---|---|---|---|
| Scope credit ratios | 2018 | 2019F | 2020F | 2021F |
| EBITDA/interest cover (x) | Neg. | 10.1x | 6.5x | 6.6x |
| Scope-adjusted debt (SaD)/EBITDA | Neg. | 7.2x | 3.8x | 3.0x |
| Scope-adjusted FFO/SaD | Neg. | 12% | 21% | 26% |
| Free operating cash flow (FOCF)/SaD | Neg. | 6 % | 17 % | 22 % |

## Rating rationale

**Scope Ratings assigns a corporate issuer rating of B+ to Hungarian-based Vajda-Papir Kft. The rating Outlook is Positive. Future senior unsecured debt is rated B+.**

Vajda-Papir's business risk profile is positively influenced by the stable underlying demand for its hygiene paper products, given the low cyclicality of the consumer goods industry. The company has a solid market position in Hungary, especially for private-label products, but is still a relatively small producer in Europe's overall hygiene paper market. In 2018, the company started focusing on 'away from home' segments, which could increase its market presence further and improve customer diversification. The company has more than 60 customers, which include domestic and multinational retail chain stores like Tesco, Auchan, Penny-Market, Lidl, ICA, CBA, Reál, Metro and Spar. Although the company has some concentration risk regarding its top-five customers (more than 55% of sales), we recognise its ability to be competitive and quality-oriented, which enables it to keep and secure its large customers over time (for both branded products and private label). The company has more than 600 product items, offering low-price, medium-price and premium brands.

Last year, the company reported an operating loss. This was driven by significantly higher raw material input prices, which are deemed volatile and represent more than 50% of the company's cost base. The company's exposure to cellulose prices is particularly high, and these are difficult to hedge, thus constituting a negative aspect for the business risk profile. With a new production facility established in 2018, the company has increased the share of internally supplied base paper to around 50%. This, coupled with lower transportation costs, will boost profitability from 2019 onwards. Thus, despite our expectations of a further increase in staff costs (a general market effect in Hungary, with pressure on salaries due to labour shortages in certain areas), we anticipate profitability margins on average to exceed past levels.

### Ratings & Outlook

| | |
|---|---|
| Corporate issuer rating | B+ |
| Outlook | Positive |
| Senior unsecured rating | B+ |


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### Related Methodology

Corporate Rating Methodology


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Weak profitability coupled with recent high investments had a strong effect on key financial credit metrics in 2018. Our assessment of the financial risk profile still reflects the high leverage and volatile results in the past. As a result, the company's financial risk profile is weaker than the business risk profile. On a positive note, unaudited YTD 2019 financial figures gives us comfort that the company is now beyond the trough and can report a more conservative capital structure within 12-18 months.

Recent historical figures (non-consolidated) show Scope-adjusted debt/EBITDA averaged around 4x, but with significant volatility. We expect an improvement in leverage from 2019 (~7x estimate), driven by a return to positive EBITDA, as a consequence of significantly lower raw material prices in 2019. As a result, our assessment of the financial risk profile is also forward-looking and assumes that excess cash generation from H2 2019 will lead to more conservative Scope-adjusted credit ratios.

We expect that cash flow cover will become a stronger element of the financial risk profile. This is due to the end to the investment period and a deferral of further expansionary capex until credit metrics recover to more adequate levels. Despite our expectation that free operating cash flow (FOCF)/SaD will return to more than 5% this year, we would need more evidence of stability before the rating can benefit. Due to the volatility of EBITDA in the past, we welcome the company's ambition to build up cash to reduce net leverage.

Liquidity and financial flexibility is somewhat constrained at the moment, but with positive prospects. Although the company only had HUF 0.2bn in cash as at YE 2018 – not enough to cover the HUF 1.2bn short-term loan outstanding – it has since agreed on a new three-year HUF 2.5bn working capital facility. We view this positively as it indicates the company could still maintain bank support at the same time when financial covenants had to be waived by lenders. Until the issuance of the new proposed bond under the Hungarian central bank (MNB) scheme and bank loans have been refinanced (expected in Q1 2020), we will continue to assess short-term liquidity and financial flexibility as slightly constrained.

## Outlook

The Positive Outlook reflects Vajda-Papir's ongoing financial transformation – in terms of improved EBITDA from the lower raw material prices, reduced operational costs from producing more base paper inhouse, and the positive liquidity effect from refinancing plans. The Outlook also assumes that management will maintain its financial policy of deferring further expansionary capex in the medium term until leverage and excess cash buffers have reached more conservative levels.

A positive rating action could be warranted if SaD/EBITDA returned below 4x, refinancing plans were successful, and the new bond under the MNB scheme was issued.

A negative rating action is possible if the company failed to reach positive EBITDA in FY 2019 and/or FOCF turned negative. A downgrade is also possible if the company initiates Phase II expansion plans before the cash buffer can fund approximately one-third of the project.

## Rating drivers

| Positive rating drivers | Negative rating drivers |
| --- | --- |
| • Largely stable underlying demand for its products<br>• Sizeable internal supply of base paper after 2018, helping to secure higher profitability margins than in the past<br>• Leading market position in Hungary, and solid customer portfolio of retail chain stores | • High exposure to volatility of input prices, especially for cellulose prices<br>• Historically weak profitability, coupled with recent high investments, putting pressure on key credit metrics<br>• Limited financial flexibility at the moment |

## Rating-change drivers

| Positive rating-change drivers | Negative rating-change drivers |
| --- | --- |
| • Deleveraging to a SaD/EBITDA of below 4x<br>• Refinancing of secured bank debt and issuance of new senior unsecured MNB bond | • Inability to reach positive EBITDA in FY 2019 and/or negative FOCF<br>• Initiation of Phase II expansion plans before cash buffer is able to fund approx. one-third of the project |

## Financial overview

| | | Scope estimates | | |
|---|---|---|---|---|
| **Scope credit ratios** | **2018** | **2019F** | **2020F** | **2021F** |
| EBITDA/interest cover (x) | Neg. | 10.1x | 6.5x | 6.6x |
| SaD/EBITDA | Neg. | 7.2x | 3.8x | 3.0x |
| Scope-adjusted FFO/SaD | Neg. | 12% | 21% | 26% |
| FOCF/SaD | Neg. | 6 % | 17 % | 22 % |
| **EBITDA in HUF m** | | | | |
| Income from operations (EBIT) | -846 | 550 | 1,522 | 1,592 |
| Add: depreciation | 738 | 950 | 925 | 900 |
| **EBITDA** | -107 | 1,500 | 2,447 | 2,492 |
| **Scope-adjusted funds from operations in HUF m** | | | | |
| EBITDA | -107 | 1,500 | 2,447 | 2,492 |
| Less: (net) cash interest per cash flow statement | -91 | -149 | -376 | -378 |
| Less: cash tax paid per cash flow statement | -2 | -40 | -115 | -121 |
| Add: other items | - | - | - | - |
| **Scope-adjusted funds from operations** | -200 | 1,311 | 1,956 | 1,993 |
| **Scope-adjusted debt in HUF m** | | | | |
| Reported gross financial debt | 11,674 | 11,505 | 12,200 | 12,200 |
| Less: cash, cash equivalents | -193 | -656 | -2,967 | -4,619 |
| Add: other items | - | - | - | - |
| **Scope-adjusted debt** | 11,481 | 10,849 | 9,233 | 7,580 |
| **Liquidity ratios** | | | | |
| Liquidity (internal + external) | (3.9) | 0.7 | 4.5 | 9.2 |
| Liquidity (internal) | (3.9) | 0.7 | 8.5 | 13.2 |

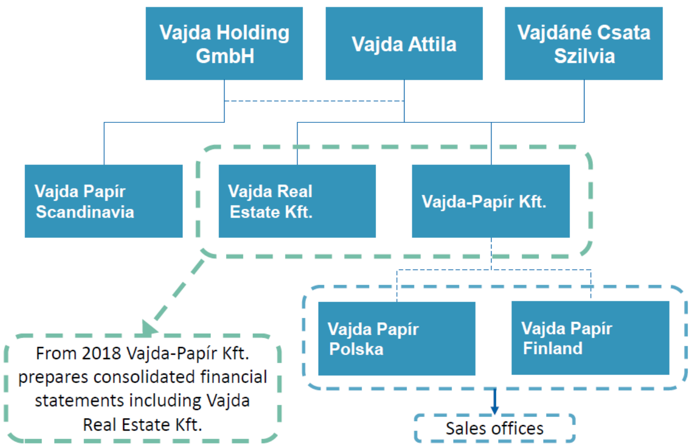
## Summary of business risk profile

Overall, we have assigned a BB rating to the business risk profile of Vajda-Papir, which is supported by the company's solid domestic market position and its operations in the low-cyclicality consumer goods industry. The company calculates a 40% market share in Hungary, which includes private labels and own brands.

The company's high exposure to volatile cellulose prices, which are also difficult to hedge, and its operating loss last year are the main rating constraints. An increasing focus on AFH products (only 5% today), which will improve general diversification, customers.

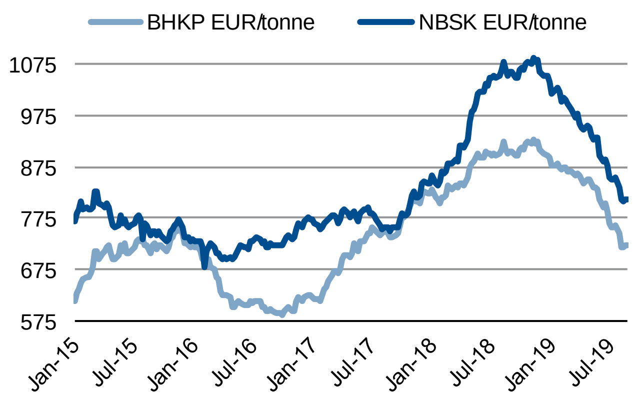
The company's dedication to sustainable forest management also provides a competitive advantage. Vajda-Papir focuses on minimising its environmental impact by continuously improving energy-efficiency and the proportion of energy use from renewables (natural gas and nuclear energy input sources today). The company has product certifications including ISO, HACCP, FSC and Nordic Ecolabel, which have become more important for customers lately.

**Figure 1: Organisational overview Vajda-Papir**




Source: Company

**Figure 2: Development of pulp/cellulose price indices**




Source: Scope, Company

Figure 1 above shows that the rated entity started consolidated financial reporting in 2018. Prior to this, reporting was done by the separate companies. The Scandinavian entity is not directly part of our rating assessment (and funded separately by a Norwegian bank), but we still consider it an important contributor to Nordic operations. Given the recent investment period and current situation, no dividends are expected to be distributed.

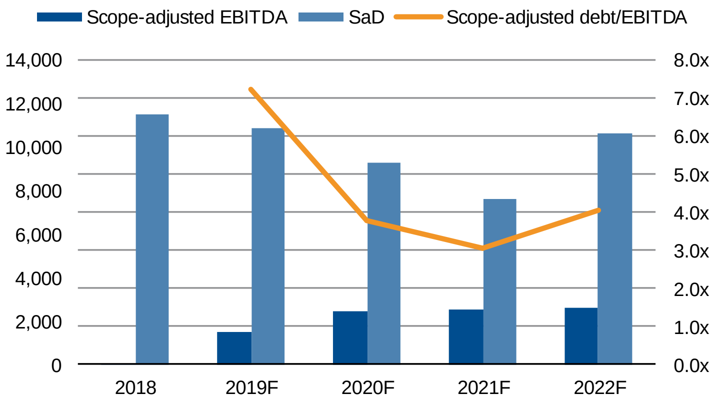
## Summary of financial risk profile

The financial risk profile has been rated B and is thus clearly the weaker part of the overall issuer rating assigned to Vajda-Papir. With a negative EBITDA last year and a break-even result in H1 2019, the company needs to prove it has overcome market difficulties and can report positive FOCF again. The current financial risk profile is hampered by the weak leverage ratios, while interest cover has been strong. The latter is expected to remain solid, also after the refinancing, despite the higher interest rates on longer-term bund funding. Liquidity and financial flexibility is also somewhat constrained at the moment, but is expected to improve in the short term.

For the short term, we forecast deleveraging to a SaD/EBITDA of below 4x, driven by the improvement in operating performance in H2 2019.

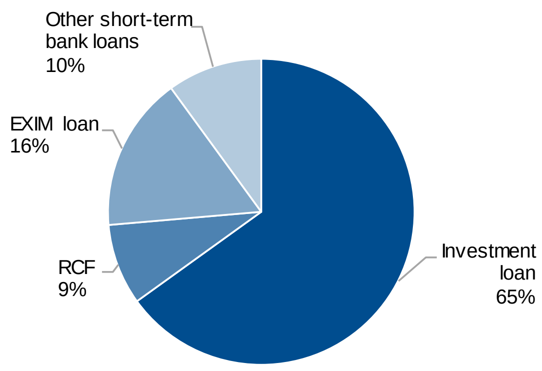
In the longer term, we acknowledge the company's ambition to enter Phase II of its base paper expansion. Although this will increase capex again and reduce FOCF, we take comfort in management's statements that it will defer the project until approx. one-third of the investment can be covered by cash (the remaining part to be financed by state subsidies and bank loans).

**Figure 3: Scope-adjusted leverage development**




Source: Scope estimates

**Figure 4: Debt funding composition as of YE 2018**




Source: Scope, Company

## Supplementary rating drivers

We have not made any explicit rating adjustment under the supplementary rating drivers. Although the company has no official financial policy, it clearly states a focus on increasing profitability and deleveraging (i.e. preserving cash) until there is a cash buffer of around HUF 5bn before starting Phase II of its base paper project.

## Senior unsecured rating

We expect an 'average recovery' for future senior unsecured debt, such as the planned 7-year HUF 11.7bn bond to be issued in 2020 under the MNB Bond Funding for Growth Scheme. Such recovery expectations translate into the same rating as the issuer rating. Our recovery expectations are based on an expected liquidation value in a hypothetical default scenario after the proposed refinancing in 2020, which is expected to release all pledges taken on the company's assets, except for receivables under the new overdraft facility. Until the completion of refinancing, senior unsecured debt has a lower recovery rate and would have been rated below the issuer rating. Moreover, our recovery analysis points out that the company can partially pledge assets again, which we believe is likely when initiating Phase II of the base paper project.

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