Baromfi-Coop Kft.
Hungary, Consumer Products

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	17.1x	15.9x	10.8x	9.7x
Scope-adjusted debt/EBITDA	3.6x	3.9x	3.8x	3.8x
Scope-adjusted funds from operations/debt	26%	24%	24%	23%
Scope-adjusted free operating cash flow/debt	-19%	-19%	-17%	-2%

Rating rationale

Baromfi-Coop remains the largest and most profitable chicken producer in Hungary, with modern infrastructure, although still lagging behind large European consumer products entities in size.

The business risk profile (rated BB) is based on a good market position, with a one-fourth domestic market share and strong export markets including sales to McDonald's. Diversification is rather low due to a single product category and profitability is good, with an EBITDA margin above 10% throughout the pandemic and likely in 2022 as well, despite a challenging inflationary environment.

The financial risk profile (rated BB-) is based on metrics which are in line with our expectations: Scope-adjusted debt/EBITDA just below 4x, strong Scope-adjusted funds from operations/debt around 25%. Interest cover is protected as the company uses mostly fixed rate debt. Due to the intensive capex phase, free operating cash flow remained in negative territory, and we expect it to remain so, which constrains the ratings. Input price inflation boosts working capital needs and requires an increase in secured debt to keep adequate liquidity.

Outlook and rating-change drivers

The Outlook is Stable, reflecting Scope's expectation of Scope-adjusted debt/EBITDA slightly ratio below 4.0x in the medium term, as well as a continued positive performance thanks to a resilient business model.

A positive rating action could be warranted by the Scope/adjusted debt/EBITDA sustained at less than 3.5x. This could occur if Baromfi-Coop's capital allocation policy shifted from intensive capex to debt reduction.

A negative rating action could be required if Scope-adjusted debt/EBITDA were to rise above 4.0x on a sustained basis. This could occur if the company orchestrated large M&A, if EBITDA fell short of our projections or if rising input prices are not passed on to customers. Lastly, a rating downgrade could result from continued weak liquidity coverage beyond 2023.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
7 Dec 2022	Affirmation	BB-/Stable
13 Dec 2021	Confirmation	BB-/Stable
16 Sep 2021	Under review for a possible downgrade	BB-/UR
2 Jul 2021	Affirmation	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies

Corporate Rating Methodology; July 2022

Rating Methodology: Consumer Products, November 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Integrated approach covering the whole value chain, including crop production and processing of chicken meat • Biggest chicken processing company in Hungary, with over 25% of market • Up to 15% of all chicken products sold by McDonald's in Europe are supplied by Baromfi-Coop, through OSI • Long-term relationships with customers • Solid EBITDA margin (10-15%) – current investments in automation and ramp-up of by-products expected to offset higher expected labour costs • Successful management of the pandemic and rising input prices, on both the top line and EBITDA level	• Rather small size compared to European competitors • Weak diversification, characterised by a concentrated customer portfolio and focus on one poultry species (chicken) • Negative free cash flows and weak cash flow cover as a consequence of large capex programmes started in 2019 in 2021

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA of below 3.5x on a sustained basis	• Scope-adjusted debt/EBITDA of above 4.0x on a sustained basis • Continued weak liquidity coverage beyond 2023

Corporate profile

Baromfi-Coop, headquartered in Debrecen, Hungary and with operations in Eastern Hungary, operates along the whole value chain in the chicken-processing industry. The Baromfi-Coop group consists of: (i) Baromfi-Coop Kft. covering the agricultural activities of the group (procurement and corn farming); (ii) Master Good Kft. focusing on primary processing of live poultry, the manufacturing and sales of prepared and further processed products, use of by-products mainly in pet food: and (iii) Sága Foods Zrt. focusing on processed products manufacturing, mainly frankfurters and cooked hams.

Besides its main farm in Kisvárda, Baromfi-Coop operates a hatchery in Petneháza, as well as feed production plants in Nyírkércs, Balsa, and Nyírmada. The Baktalórántháza farm has been certified as a McDonald's Flagship Farm since 2015.

The group deployed a significant investment programme in 2020. In 2021, the group generated sales of about HUF 165bn (EUR 0.4bn) with EBITDA of roughly HUF 16bn (EUR 40m). The Baromfi-Coop group is a family business wholly owned by the Bárány family, which is also involved in its management.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	17.1x	15.9x	10.8x	9.7x	9.4x
Scope-adjusted debt/EBITDA	3.6x	3.9x	3.8x	3.8x	3.8x
Scope-adjusted funds from operations/debt	26%	24%	24%	23%	23%
Scope-adjusted free operating cash flow/debt	-19%	-19%	-17%	-2%	-3%
Scope-adjusted EBITDA in HUF m					
EBITDA	13,855	16,119	20,637	21,372	22,189
Scope-adjusted EBITDA	**13,855**	**16,119**	**20,637**	**21,372**	**22,189**
Funds from operations in HUF m					
Scope-adjusted EBITDA	13,855	16,119	20,637	21,372	22,189
less: (net) cash interest paid	-809	-1,013	-1,918	-2,199	-2,354
less: cash tax paid per cash flow statement	-56	-75	-67	-260	-276
Funds from operations (FFO)	**12,990**	**15,032**	**18,652**	**18,913**	**19,559**
Free operating cash flow in HUF m					
Funds from operations	12,990	15,032	18,652	18,913	19,559
Change in working capital	- 10,757	- 14,342	- 18,438	- 2,608	- 3,568
Non-operating cash flow	626	2,979	- 415	1,173	797
less: capital expenditure (net)	- 14,655	- 15,665	- 13,038	- 19,309	- 19,012
Free operating cash flow (FOCF)	**- 11,796**	**- 11,997**	**- 13,239**	**- 1,830**	**- 2,224**
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-809	-1,013	-1,918	-2,199	-2,354
Net cash interest paid	-809	-1,013	-1,918	-2,199	-2,354
Scope-adjusted debt in HUF m					
Reported gross financial debt	53,133	78,033	83,553	83,568	87,644
less: cash and cash equivalents	-3,538	-15,091	-5,871	-2,556	-2,908
add: non-accessible cash	32	32	32	32	32
Scope-adjusted debt	**49,627**	**62,975**	**77,714**	**81,044**	**84,768**

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Environmental, social and governance (ESG) profile

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Grey leaf	Labour management		Management and supervision (supervisory boards and key person risk)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Focus on circular economy

The group shows a high level of vertical integration from agricultural activity to finished fresh meat products and processed meat products while by-products are also sold with added value as pet food or as fertiliser. Hence the strong focus on circular economy is visible, which has also a credit positive effect.

ESG compliant operations result in efficiencies but high investment cost

New investments are focusing on decreasing energy and water needs, reducing waste and using by-products. Furthermore, the group started developing its own solar energy production plant to cover some of its own energy needs.

Baromfi-Coop received a second party opinion for its green bond issued in 2021 and successfully issued its first green bond as part of its investment strategy. Mastergood, a fully consolidated subsidiary of Baromfi-Coop, issued its first ESG report in 2022. These actions show the group’s commitment towards ESG principles which result in operational efficiencies but at the same time the heavy investment strategy which we have incorporated in our projections. Therefore, we view the business as resilient but with a credit-neutral ESG profile.

Business risk profile: BB

Blended industry risk profile: BBB+

We have assigned a blended industry risk of BBB+ given the company's activities, the procurement and farming of corn, and processing of chicken. This is based on our industry risk profiles for non-durable consumer goods (cyclicality: low; market entry barriers: medium; substitution risk: low; industry outlook: stable) and agriculture (cyclicality: high; market entry barriers: high; substitution risk: low) as well as the company's EBITDA breakdown by division.

Ramping up of processed products production

The group entered the processed poultry products segment with the bolt-on acquisition of Sága Foods in 2020, including its ownership of well-known brands like Füstli and Füstlizer. Sága is fairly small compared to Baromfi-Coop. Consequently, Baromfi-Coop will continue to be concentrated on chicken processing. Furthermore, the owners' ambition to eventually contribute in kind Steam Cook Kft. and Várda Meat Kft. will further increase the group's vertical integration as certain convenience foods from Sága Foods (such as frozen and breaded products) are processed by those two companies, which are both owned by the Bárány family. Future contribution in kind, making those companies part of Baromfi-Coop, is considered creditor-friendly as their leverage is similar to the issuer's leverage and no cash would be paid out from the structure.

Leading player in the Hungarian chicken-processing industry …

The affirmed rating reflects the company's integrated approach, covering the whole value chain in the poultry-processing industry. With an annual production capacity of up to 64m chickens annually, we estimate that Baromfi-Coop accounts for more than a third of Hungarian chicken meat production. Baromfi-Coop is the clear market leader based on sales in a rather fragmented market, where the second largest chicken producer (Hungerit Zrt, controlled by the Csányi family) is less than half the size in revenues.

… but rather small compared to European competitors

Baromfi-Coop's relationship with McDonald's is also a positive rating driver. Baromfi-Coop supplies up to 15% of all chicken products sold by McDonald's in Europe, and McDonald's has been the company's customer for over 15 years. However, Baromfi-Coop's output is rather low compared to European competitors. For instance, France-based LDC and Plukon Food Group, located in the Netherlands, process more than 400m chickens per year, compared to up to 64m chickens processed by Baromfi-Coop.

Diversification is compromised by several aspects

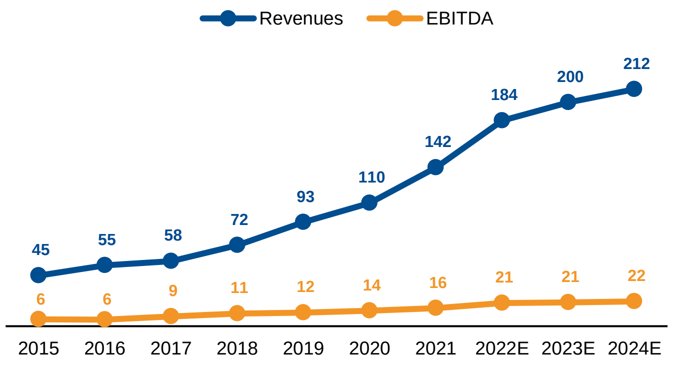
Baromfi-Coop's credit rating continues to be compromised by weak diversification. This is based on: i) a rather concentrated customer portfolio and ii) a focus on processing chicken. In addition, the company's customer portfolio comprises about 250 customers, with its top 10 customers accounting for close to 50% of sales. This negative factor is mitigated by Baromfi-Coop's long-term relationships with customers, along with the fact that its biggest customers are large, well-known retail companies such as SPAR and Tesco, and quantities sold by the group cannot be replaced easily by competitors. Given its focus on the production of chicken meat, Baromfi-Coop would be highly sensitive to a sharp decline in demand for chicken, e.g. due to an unexpected outbreak of avian influenza in Eastern Europe. However, we believe that the company's animal stock is well protected from infection and thus from emergency slaughter in such an event. This assumption is grounded on its stringent hygiene regulations, including farms which operate as self-sufficient systems, including wastewater purification. Sustainability is strengthened by diversification through the use of by-products as pet food and fertiliser, which generate very high margins.

Moderate, stable profitability – despite the war and the pandemic

Our view of Baromfi-Coop's profitability continues to be credit-supportive, based on reported EBITDA margins well above 10%. Even in 2020, when the global economy was in panic mode, the company achieved an EBITDA margin of 12.6%. This was mainly due to stable demand from major retail chains, as McDonald's ramped up its delivery and drive-in supply channels. Nevertheless, demand from OSI Group (a McDonald's supplier) decreased in 2020 but has recovered since. Management successfully boosted export sales channels, which can provide further growth should the HoReCa segment come under pressure due to closures or decreasing purchasing power. Baromfi-Coop managed well both the pandemic and the start of the war and defended its margin. We expect an EBITDA margin above 10% at year-end 2022, which is very good compared to other local peers in consumer products sector experiencing soaring raw material and energy costs.

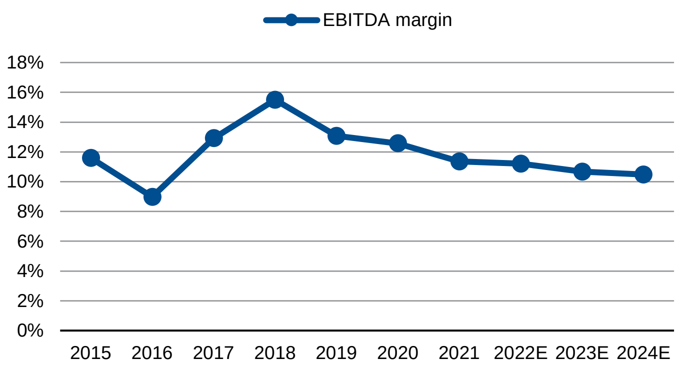
Our rating case projects a moderate increase in Baromfi-Coop's EBITDA with the margin slightly decreasing but still moderate and stable, given: i) its continuing integrated approach, which limits sensitivity to fluctuations in crop prices; ii) efforts to ramp up highly profitable business lines, e.g. the sale of fertilisers and abattoir waste from chicken processing for the pet food industry; iii) capex for automation to counterbalance rising labour costs and in renewable energy production; and iv) considerable pricing power, in tandem with positive effects from acquisitions and contributions in kind.

Figure 1: Revenues and EBITDA evolution (in HUF bn)



Sources: Baromfi-Coop, Scope (estimates)

Figure 2: EBITDA margin evolution



Sources: Baromfi-Coop, Scope (estimates)

Price caps and windfall taxes in Hungary

The price caps in Hungary apply to retail prices, not wholesale prices, so we do not expect an impact on Baromfi-Coop. When the price caps are removed, demand could fall, and Baromfi-Coop may need to increase exports, where sales channels are already well developed. However, chicken is a relatively cheap protein alternative, keeping demand shocks limited and manageable. The food production sector enjoys strong support via state subsidies and subsidised lending and guarantees especially after the pandemic, therefore regulatory risk remains acceptable.

Financial risk profile: BB-

Key rating assumptions

Our key assumptions include:

(i) moderate top line expansion (below historical growth) and growing volumes;

(ii) continued partnership with OSI where the end customer is McDonald's;

(iii) EBITDA margin decrease of 1-2 pp compared to 2021 level, but staying above 10%;

(iv) up to HUF 20bn in annual capex, net of subsidies;

(v) largely fixed rate existing debt coupled with new euro based secured debt;

(vi) cash reserves keep counterbalancing low liquidity indicators;

(vii) low dividend pay-out ratio;

(viii) no large M&A.

Leverage to stay moderate around 4x

The group had HUF 78bn in gross debt at YE 2021 in the form of three senior unsecured bonds totalling HUF 51.5bn, and HUF 26.5bn in senior secured bank loan facilities.

We expect secured lending facilities to increase in the mid-term by HUF 10bn due to inflation in general and the strong increase in feed prices resulting in increased requirements for trade finance facilities.

New debt hinders somewhat the planned deleveraging, with our forecast showing a Scope-adjusted debt/EBITDA ratio of just below 4x in the mid-term which is still good compared to local consumer products sector peers.

The stable leverage comes after good operational results in 2022 with EBITDA around HUF 20bn coupled with a slow EBITDA ramp-up going forward due to pressure on margins. Cash flow generation remains strong, with Scope-adjusted funds from operations/debt well above 20% but decreasing from the previously achieved 31% in 2019.

Rather stable, strong interest cover

The group operates with a high share of fixed interest rate debt facilities, which offer significant debt protection.

All bonds and long-term loans are fixed rate at below 3% p.a., which is very beneficial in the current interest rate environment in Hungary, where the base rate is 13%.

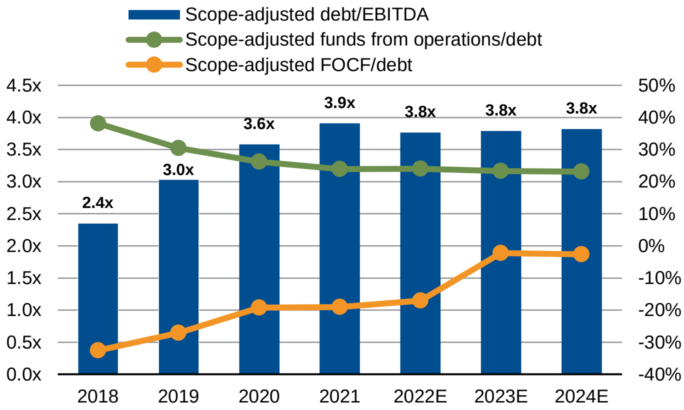
Growth requires additional working capital, which comes at a higher cost compared to existing debt and often at variable rates. Therefore, we expect interest cover to slightly deteriorate, but still remain above 9x.

The cash surplus provides interest income while the weakening Hungarian forint aids the export margins. We have included limited upside potential due to high volatility of rates and because cash is used to finance investments.

Negative free operating cash flow persisting

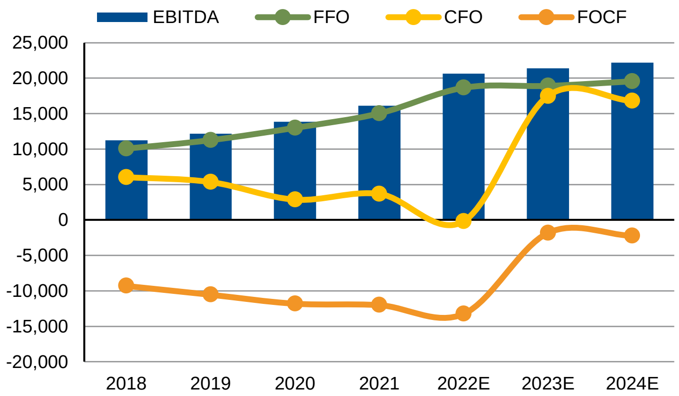
Scope-adjusted free operating cash flow/debt has been historically negative as the family continuously expanded the business after the generation change took place. Until 2021, low finance rates supported the growth which resulted in a negative Scope-adjusted free operating cash flow/debt around minus 20% for 2021-22. We expect a further moderate improvement after the current investment programme is executed, but nevertheless negative free operating cash flows which constrain the financial risk profile.

Figure 3: Leverage and free operating cash flow



Sources: Baromfi-Coop, Scope (estimates)

Figure 4: Cash flow overview



Sources: Baromfi-Coop, Scope (estimates)

Adequate liquidity

Baromfi-Coop's internal and external liquidity coverage remains weak. The company continues to record considerable amounts of short-term debt, which stood at about HUF 8.7bn in 2021 and is set to increase to as much as HUF 20bn in 2023-2024 while free operating cash flows remain negative and cash decreases as bond proceeds are used for investments.

However, we have not adjusted Baromfi-Coop's financial risk profile, as the company successfully entered capital markets as a source of funding and is expected to refinance maturing short-term debt in the future, based on its current strategy. Furthermore, the increase in short-term debt is mainly commodity trade finance where the refinancing risk is low. The first large bond repayment is only in 2026.

We deem leverage and liquidity to be controllable by management due to the phased and well-segmented investment programme and good access to debt capital markets.

Balance in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	15,059	5,839	2,524
Open committed credit lines (t-1)	3,800	3,800	3,800
Free operating cash flow	-13,239	-1,830	-2,224
Short-term debt (t-1)	8,711	16,454	16,395
Coverage	**0.6x**	**0.5x**	**0.3x**

Supplementary rating drivers: +/- 0 notches

Neutral financial policy coupled with family business approach

In our view, Baromfi-Coop continues to be strongly committed to a neutral financial policy, keeping leverage below 4x as demonstrated by accepting and keeping such financial covenants in its loan agreements. This is combined with low dividend payments during the last few years, which are expected to increase in the future up to 20% of annual profit after tax. While the ongoing capex programme has led to higher debt levels, no dividends were paid to shareholders until 2020, while in 2021 HUF 1.35bn was paid out after HUF 9bn in profit after tax, which remains creditor friendly.

The company has taken a disciplined approach to M&A by paying a reasonable price to purchase Sága Foods.

Moreover, the Bárány family has been running the company proactively for decades and remains strongly committed to its long-term success.

Long-term debt ratings

Senior unsecured debt rating: BB-

The recovery assessment is based on a hypothetical default scenario at YE 2024, including the assumption of senior secured bank debt drawn and undrawn up to HUF 40bn, a drawdown of HUF 3.8bn in unfunded secured commitments and a 50% repayment for state subsidies.

As further secured debt may be needed for the expansion of the business and there is a significant senior secured debt amount ranking ahead of the senior unsecured bonds, we do not grant any uplift for the senior unsecured debt category.

This expectation translates into a rating of 'BB-' for the senior unsecured debt category, in line with the issuer rating.

Appendix: Peer comparison (as at last reporting date)

	Baromfi Coop Kft.	Bonafarm Zrt.	Tranzit-Food Kft.	Kometa 99 Zrt.	HELL Energy Magyarország Kft.
	BB-/Stable	BB-/Stable	BB-/Stable	B+/Stable	BB-/Stable
Last reporting date	31 December 2021	31 December 2021	31 December 2021	31 December 2021	31 December 2021
Business risk profile	BB	BB+	BB	BB-	BB+
Financial risk profile	BB-	B+	BB	B+	B
Scope-adjusted EBITDA/interest cover	15.9x	243.6x	38.9x	8.5x	18.3x
Scope-adjusted debt/EBITDA	3.9x	2.4x	0.5x	3.2x *(2022E: 6.1x)*	6.1x
Scope-adjusted funds from operations/debt	24%	41%	211%	29%	16%
Scope-adjusted free operating cash flow/debt	-19%	16%	-31%	4%	-17%
Supplementary Rating Drivers		+1	-1		

Sources: Public information, Scope

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