# Hell Energy Magyarország Kft
# Hungary, Consumer Goods

BB STABLE

## Corporate profile

Hell Energy is a consumer goods company founded in 2004. It manufactures and sells energy drinks and other non-alcoholic beverages in more than 50 countries. Hell energy drink is currently the 3rd largest branded energy drink globally. The group is vertically integrated with own can production and filling lines on-site. Currently, the issuer is market-leader in Hungary with a market share of 55.3% as well as in 8 other countries, mostly in the CEE and SEE region. The company is 100% privately owned and managed by the Barabas family.

## Key metrics

| | | Scope estimates | | |
|---|---|---|---|---|
| Scope credit ratios | 2018 | 2019F | 2020F | 2021F |
| EBITDA/interest cover (x) | 14.5x | 13.0x | 9.1x | 11.0x |
| Scope-adjusted debt (SaD)/EBITDA | 3.6x | 3.9x | 4.7x | 3.5x |
| Scope-adjusted FFO/SaD | 26% | 23% | 19% | 24% |
| Free operating cash flow (FOCF)/SaD | -7% | 15% | -64% | 12% |

## Rating rationale

**Business risk profile**

Hell Energy's business risk profile is primarily supported by the FMCG sector's strong industry risk profile, which benefits from low cyclicality and medium entry barriers. The company is also the market leader in the energy drink segment in Hungary and eight other countries, mostly in Central and South Eastern Europe, and has good diversification, supported by a granular client and supplier base. Profitability on a sustainable EBITDA margin basis is in a range of 15% to 20%. This is in line with sector peers, particularly given the Hell Group's above-average degree of vertical integration.

Hell Energy's business risk profile is constrained by limited diversification with regard to product categories as well as the company's relatively small absolute size compared to international FMCG peers. Scope assesses the company's business risk profile as BB+.

**Financial risk profile**

Hell's financial risk profile is supported by strong interest coverage of well above 7.0x, mostly in the double-digit range, also going forward. It is further supported by positive free operating cash flows as of 2019E and going forward, with the exception of 2020E, when free operating cash flows will temporarily turn negative according to Scope's base case forecast due to planned investments in new production facilities. Since the company still lacks absolute size in comparison with the global FMCG brands, Scope has taken potentially higher revenue and cash flow volatility into account, which constrains the financial risk profile to some extent. In addition, the group has issued financial guarantees to third parties covering financial leasing contracts. Those entities are part of the larger, family-owned Hell Group, but not part of the rated entity (please see figure 1 for details). 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.

### Ratings & Outlook

| | |
|---|---|
| Corporate issuer rating | BB |
| Outlook | Stable |
| Senior unsecured debt rating | BB |


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### Related Methodology

Corporate Rating Methodology


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Bloomberg: SCOP

Operating leverage, as measured by Scope-adjusted debt/EBITDA, ranges between 3.5x and 4.0x, which is commensurate with a lower BB rating category. Scope therefore assesses Hell Energy's financial risk profile as BB-.

All ratings reflect ambitious growth figures in our underlying base case, starting already in 2020. Financial metrics in our base case are therefore subject to larger potential volatility if those growth plans cannot be achieved by the issuer.

**Liquidity**

Liquidity has been at 1.4x as of year-end 2018 and is expected to remain at more than 1.1x going forward with the exception of 2019E, when Scope forecasts that the large cast investments planned for 2020E will burden free operating cash flows. Scope therefore judges liquidity to be adequate.

**Bond issuance**

Based on Scope's base case financial forecast, the agency expects Hell Energy to issue a HUF 28.5bn senior unsecured corporate bond with a maturity of 10 years under the Hungarian national bank's Bond Funding for Growth Scheme.

## Outlook

The rating Outlook is Stable, based on expected operating leverage of 3.5x to 4.0x going forward, with a temporary peak of 4.5x to 5.0x in 2020E due to the expected investment programme, funded by the intended HUF 28.5bn corporate bond placement.

A positive rating action may be taken if the issuer shows financial leverage of less than 3.5x on a sustained basis.

Scope may consider a negative rating action if financial leverage deteriorates to more than 4.0x on a sustainable basis.

## Rating drivers

| Positive rating drivers | Negative rating drivers |
|---|---|
| • High diversification in terms of geographies (50+ countries), customers and suppliers | • Large exposure to the Hungarian and CEE/SEE market and limited to the beverage product segment |
| • Robust EBITDA-Margins of 15% to 20% | • Negative free cash flows and dependence on external financing in recent years due to fast expansion and increase in receivables |
| • Strong market position already being market leader in 9 countries in its product segment | • Risks associated with changed customer demands and punitive regulation on sugared and/or caffeinated beverages |
| • Benefits from high degree of vertical integration that decreases capacity constraints and revenue volatlity | |

## Rating-change drivers

| Positive rating-change drivers | Negative rating-change drivers |
|---|---|
| • Financial leverage of less than 3.5x SaD/EBITDA on a sustained basis | • Financial leverage deteriorates to more than 4.0x on a sustainable basis |

## Financial overview

| | | Scope estimates | | |
|---|---|---|---|---|
| **Scope credit ratios** | **2018** | **2019F** | **2020F** | **2021F** |
| EBITDA/interest cover (x) | 14.5x | 13.0x | 9.1x | 11.0x |
| SaD/EBITDA | 3.6x | 3.9x | 4.7x | 3.5x |
| Scope-adjusted FFO/SaD | 26% | 23% | 19% | 24% |
| FOCF/SaD | -7% | 15% | -64% | 12% |
| **EBITDA in HUF '000** | | | | |
| Income from operations (EBIT) | 7,428,282 | 5,547,487 | 7,787,826 | 9,150,468 |
| Add: depreciation | 2,576,025 | 2,787,995 | 3,602,039 | 4,586,563 |
| **EBITDA** | **10,004,307** | **8,335,483** | **11,389,865** | **13,737,032** |
| **Scope-adjusted funds from operations in HUF m** | | | | |
| EBITDA | 10,004,307 | 8,335,483 | 11,389,865 | 13,737,032 |
| Less: (net) cash interest per cash flow statement | -690,578 | -639,080 | -1,245,054 | -1,245,494 |
| Less: cash tax paid per cash flow statement | -54,985 | -157,500 | -72,657 | -723,755 |
| Less: other items | -9,015 | -3,173 | -4,601 | 0 |
| **Scope-adjusted funds from operations** | **9,249,729** | **7,535,730** | **10,067,553** | **11,767,783** |
| **Scope-adjusted debt in HUF m** | | | | |
| Reported gross financial debt | 38,717,903 | 33,088,969 | 55,260,501 | 50,928,613 |
| Less: cash, cash equivalents | -2,445,336 | -863,617 | -1,770,525 | -2,686,904 |
| Add: other items | 0 | 0 | 0 | 0 |
| **Scope-adjusted debt** | **36,272,567** | **32,225,352** | **53,489,976** | **48,241,709** |
| **Liquidity ratios** | | | | |
| Liquidity (internal + external) | 1.4x | -14.6x | 1.2x | 2.2x |
| Liquidity (internal) | 1.4x | -14.6x | 1.2x | 2.2x |

## Summary of business risk profile

Starting with the industry risk profile ('IRP'), we assigned an 'A' IRP-rating, which reflects the industry risk of the fast-moving consumer goods industry, determined by entry barriers. Cyclicality and substitution risk. This IRP is deemed applicable here since more than 90% of group revenue is created by the core FMCG brand HELL Energy within the group.

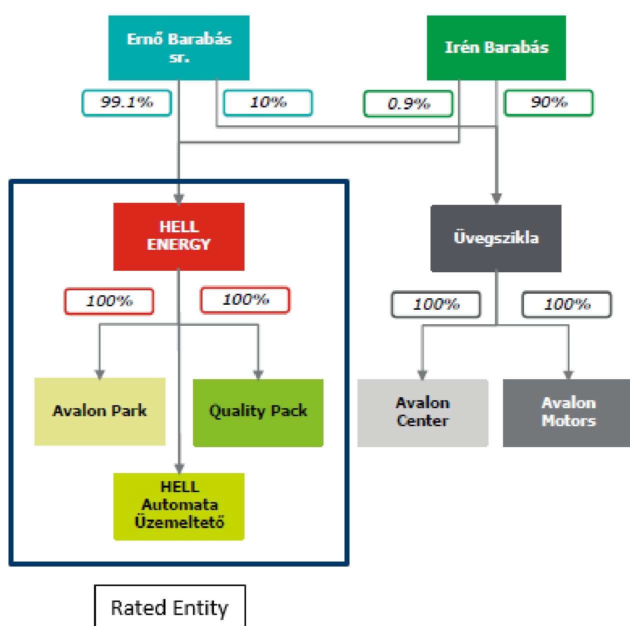
The picture regarding market position is mixed since on the one hand, the issuer has a leading market position in the energy drinks market of its home market Hungary and is also market leader in 8 other countries as of June 2019, according to Nielsen Data. On the other hand, compared to the world's leading FMCG companies, global market share is still very small with EUR ~200m annual sales.

Looking at diversification, the issuer benefits from a relatively diversified client base, mostly thanks to its retail-focussed product portfolio, the double-track strategy of branded and white-label products as well as its wide geographical outreach.

Ultimate number of customers (individual consumer of a drink) is extremely high, due to the retail FMCG products portfolio. Moreover, there is no material dependency on any third-party distributor or retailer due to the group's strategy to develop and run its own global distributions via own local operations on the ground or working together with different local distributors in every market. Hence there is no material dependency on single partners. There is also little dependency on suppliers as the main raw materials used are sugar, syrup and aluminium, which are all globally traded commodities with a large number of potential suppliers.

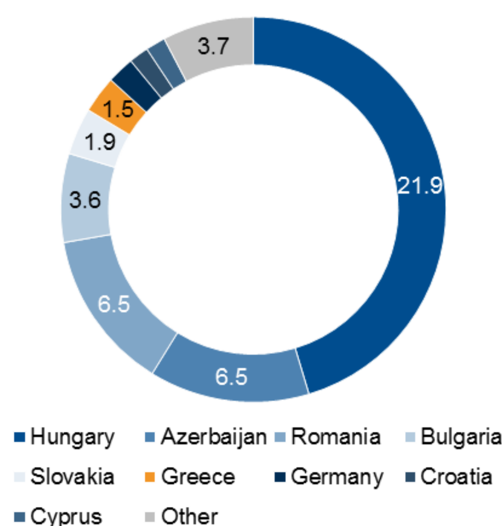
Geographical diversification is relatively high taking into account the limited absolute size of the company. The issuer has a high exposure to its home market Hungary with c. 45% of sales, but the fact that it is the clear market leader in this market can be seen as a risk mitigant in our view.  In total, the group generates sales in 50+ countries globally.

**Figure 1: Organisational overview**




Source: Company

**Figure 2: Geographical diversification (revenue FY 2018 in HUF bn)**




Source: Scope, Company

The issuers operating profitability has been below sector average in recent years, mostly due to the rapid expansion of its business that required significant brand building and market development expenses. As the geographical outreach and the product portfolio has been widened successfully, the group reached a EBITDA-margin of more than 19% in 2018 upon high utilization of its production capacity.

We nevertheless expect the issuers EBITDA-margin to stay below the 18% mark for the next two to three business years as we expect further initial costs from the launch of new products and new export markets and also hint at the fact that the sales growth of its (higher margin) branded products cannot immediately match the planned growth of the production capacity. So in order to achieve high utilization rates, we expect a larger share of (lower margin) white-label business. In the mid-term, we think that EBITDA-margins can benefit from significant economies of scale.

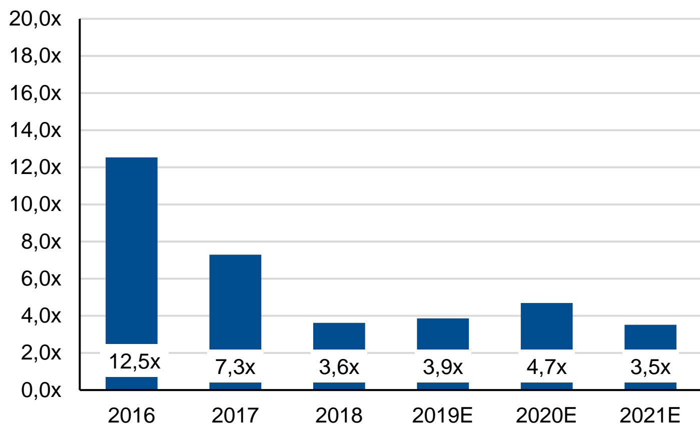
## Summary of financial risk profile

The financial risk profile has been rated BB- and is thus the weaker part of the overall issuer rating assigned to Hell Energy.

While operating leverage on SaD/EBITDA basis is relatively high at 3.5x or more as of year-end 2018 as well as the entire forecast period, interest coverage is rather robust at sustainably more than 7.0x times, mostly even at double-digit levels. We nevertheless forecast significantly higher leverage of more than 4.0x for next year due to the planned debt-financed CAPEX.

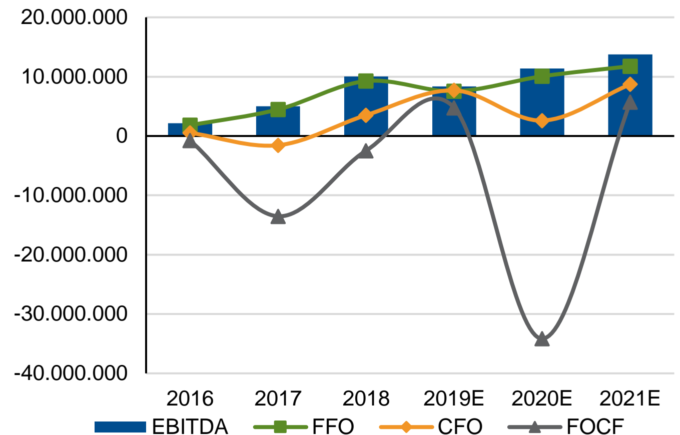
Both CAPEX coverage and free cash flow generation have been weak in the past. This is due to the exponential growth of the group in recent years, that is expected to be continued in 2020 with the massive CAPEX program. Although the group has been heavily dependent on external financing in order to fund its production facilities as well as its growing working capital, there should be a sustainable improvement in FOCF from 2021E onwards.

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




Source: Scope estimates

**Figure 4: Cash flow overview**




Source: Scope, Company

## Supplementary rating drivers

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

## Senior unsecured rating

We expect an ‘average recovery’ for future senior unsecured debt, such as the planned 10-year HUF 28.5bn bond to be issued 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.

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