08 June 2023 Corporates

Tranzit-Food Kft.
Hungary, Consumer Goods

BB- POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	38.9x	41.6x	29.2x	46.7x
Scope-adjusted debt/EBITDA	0.6x	0.9x	0.3x	0.2x
Scope-adjusted funds from operations/debt	141%	105%	295%	526%
Scope-adjusted free operating cash flow/debt	-33%	131%	40%	239%

Rating rationale

The Positive Outlook reflects Tranzit's good 2022 results and low leverage. In 2022 revenues and EBITDA increased by respectively 56% and 70% to reach HUF 72bn and HUF 9.9bn. The issuer rating is still supported by strong credit metrics with low net debt and Tranzit's leading position in goose production in Hungary with a 27% market share. The rating is held back by the lack of clarity and transparency in financial disclosures (ESG risk) and the small size as a poultry producer in the European market.

Outlook and rating-change drivers

The Positive Outlook reflects our expectation that credit metrics will remain strong in the difficult market environment characterised by volatility and bird flu outbreaks; the positive performance will continue with the EBITDA margin remaining above 13%; and no acquisitions will be undertaken in the next 12-18 months.

An upgrade could be warranted by credit metrics remaining at their presently strong levels or an improvement in governance linked to adequate financial disclosures and better transparency.

A reversion of the Outlook to Stable could be triggered by a deterioration of credit metrics. A rating downgrade, although a remote scenario, is possible if a large debt-funded acquisition caused leverage to reach about 4.0x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
10 Jun 2021	Monitoring review	BB/Stable
10 Jun 2022	Downgrade	BB-/Stable
08 Jun 2023	Outlook Change	BB-/Positive

Ratings & Outlook

Issuer	BB-/Positive
Senior unsecured debt	BB

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Related Methodologies

General Corporate Rating Methodology; July 2022

Consumer Products Rating Methodology; November 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong credit metrics with low net debt • Hungary's leading goose producer with 27% market share • Recent entry in chicken segment providing exposure to a large and growing meat market; market share of 8% in Hungary • Moderate EBITDA margin (13.8% at YE 2022) despite lower profitability for its chicken operations	• Lack of clarity and transparency in financial disclosures (ESG risk) • Small player in the European market • Weak geographical diversification outside of Europe, although likely to improve, and weak customer diversification in chicken segment • Volatile free operating cash flow due to seasonal working capital

Positive rating-change drivers	Negative rating-change drivers
• No deterioration of current credit metrics • Improvement in financial disclosure (ESG factor)	• Outlook back to Stable if credit metrics deteriorate • Scope-adjusted debt/EBITDA sustained above 4.0x

Corporate profile

Tranzit-Food Kft. is a Hungarian poultry company founded in 1990 by the Szabo family. The company employs around 1,600 people. Its headquarters are in Debrecen. Tranzit breeds, slaughters, processes and sells ducks, geese and chickens. Operations also include crop and feed production. Annual sales amounted to HUF 72bn in 2022. The Tranzit group is divided into two subsidiaries: Tranzit-Ker, which takes care of the agricultural activities, and the rated entity Tranzit-Food Kft., which focuses on the slaughter, processing and distribution of poultry (geese, ducks and chickens) under the Goldenfood brand. The company owns two slaughterhouses, with one dedicated to chickens and the other to geese and ducks. Tranzit also has a secondary processing plant. The shareholding structure changed in 2018, and French group LDC now controls 70% of Tranzit while the Szabo family has retained 30%.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	117.1x	38.9x	41.6x	29.2x	46.7x	78.1x
Scope-adjusted debt/EBITDA	2.6x	0.6x	0.9x	0.3x	0.2x	net cash
Scope-adjusted funds from operations/debt	38%	141%	105%	295%	526%	net cash
Scope-adjusted free operating cash flow/debt	43%	-33%	131%	40%	239%	net cash
Scope-adjusted EBITDA in HUF m						
EBITDA	2,766	5,819	9,938	10,161	11,991	15,549
Scope-adjusted EBITDA	**2,766**	**5,819**	**9,938**	**10,161**	**11,991**	**15,549**
Funds from operations in HUF m						
Scope-adjusted EBITDA	2,766	5,819	9,938	10,161	11,991	15,549
less: (net) cash interest paid	-24	-150	-239	-348	-257	-200
less: cash tax paid per cash flow statement	-31	-422	-421	-741	-880	-1,186
Change in provisions	0	0	155	0	0	0
Funds from operations	**2,712**	**5,248**	**9,431**	**9,071**	**10,854**	**14,163**
Free operating cash flow in HUF m						
Funds from operations	2,712	5,248	9,434	9,071	10,854	14,163
Change in working capital	1,321	-4,441	3,648	-3,591	-2,435	-3,787
less: capital expenditure (net)	-989	-2,032	-1,331	-4,253	-3,487	-2,776
Free operating cash flow	**3,043**	**-1,226**	**11,751**	**1,228**	**4,931**	**7,601**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	24	150	239	348	257	200
Net cash interest paid	**24**	**150**	**239**	**348**	**257**	**200**
Scope-adjusted debt in HUF m						
Reported gross financial debt	11,785	14,441	13,355	12,535	12,100	11,180
less: cash and cash equivalents	-11,449	-11,775	-13,515	-12,327	-14,946	-19,131
add: restricted cash[1]	6,821	1,059	9,148	2,866	4,909	5,580
Scope-adjusted debt	**7,157**	**3,724**	**8,988**	**3,075**	**2,062**	**-2,371**

[1] We adjust restricted cash by 25%-30% for 2023E-2025E to account for the peak in working capital every Q3. We consider this cash as non-available since it is always used to fund the working capital.

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Environmental, social and governance (ESG) profile[2]

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)

Governance risks lead to one negative notch

Tranzit has no dedicated ESG strategy. However, we note the positive turnaround in its ESG policy, where, following LDC's lead, the issuer has started an audit to identify key criteria to measure and improve its overall impact. Nevertheless, we identify governance risk regarding a lack of clarity and transparency, a result of a history of changes to strategy, inadequate communication, poor reporting methods, and a failure to disclose key information in a timely manner.

[2] 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: BB

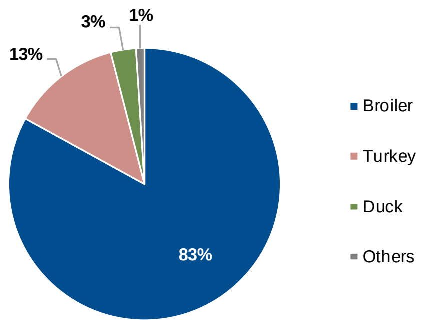
Industry risk profile: A

The company breeds, slaughters, processes and sells ducks, geese and chickens.

Small European poultry producer expanding in the chicken market

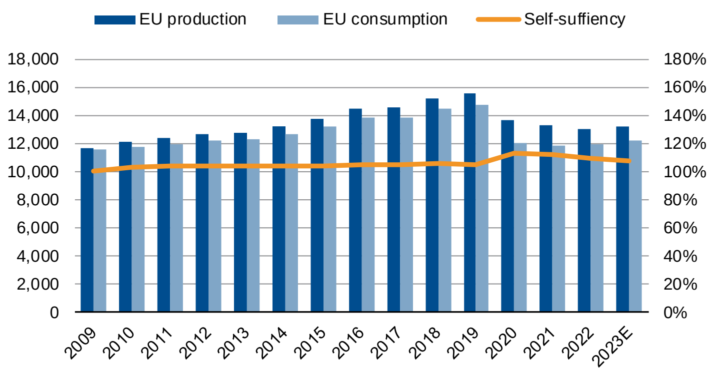
Goose and duck meat production accounts for less than 4% (Figure 1) of the European poultry market, which is dominated by the production of broilers (83%). Tranzit is one of the leading players in Hungary with a 27% market share in duck and goose and 8% in chicken. Tranzit produces around 69 kilotons of poultry meat, of which 32 kilotons is chicken; this is less than 1% of the 13,074 kilotons produced in Europe in 2022.

Figure 1: EU production of poultry meat by type of bird



Source: European Commission (DG ESTAT, DG AGRI)

Figure 2: EU poultry meat production/consumption (in kilotons, lhs) and self-sufficiency (in %, rhs)



Source: European Commission (DG ESTAT, DG AGRI)

Recent entry into chicken segment will expose Tranzit to a larger and growing market

Tranzit started its chicken operations in 2017 using the integrated approach already implemented for its goose and duck production, with Tranzit-Ker supplying most of the poultry slaughtered. Chicken is the only meat expected to grow in 2017-2030E in terms of consumption (+4.2%) and production (+4.6%). Global demand is driven by the comparative advantages of poultry over other meats, including affordability, convenience, the absence of religious guidelines, and the healthy image. As production of chicken in the EU is self-sufficient (Figure 2), surplus production is mostly exported, including to the Middle East, sub-Saharan Africa and Asia (Vietnam and the Philippines). The EU's main global competitor remains Brazil, which can export at a lower price partly because of its currency's devaluation. The strongest increase in production is expected in Hungary, Poland and Romania due to sustained productivity gains and looser environmental regulations for building new farms.

Chicken is sold and produced throughout the year unlike goose and duck, which are seasonal. Goose tends to be eaten on special occasions (such as St. Martin's Day in Hungary and Germany, and Christmas) and its selling contracts run from September to Easter.

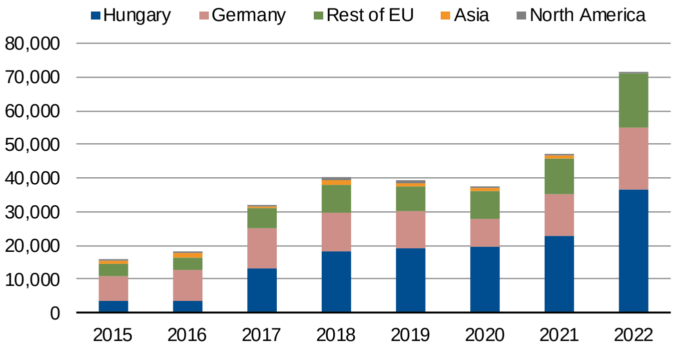
Geographical footprint focused on Europe but aim is to increase exports outside this region

Tranzit's geographical footprint is in Europe. This resulting concentration risk is partially mitigated by the company's strategy to increase exports outside the region, helped by its plans for its chicken operations.

At YE 2022, Hungary accounted for 51% of Tranzit's sales, while Europe's share stood at 98%. This is fairly stable compared to the previous year. Sales in the rest of Europe were in 20 countries, mainly Germany, Slovakia, the UK, Austria and Romania.

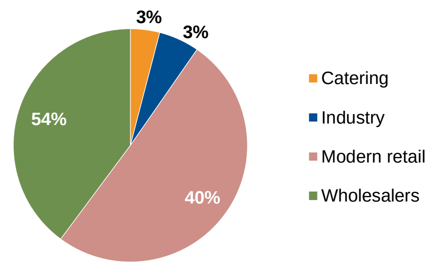
The launch of the chicken segment caused the share of revenue in Hungary to surge in 2017. Tranzit's main customers belong to the Hungarian wholesale and retailing industries (more than 90% of FY 2022 revenues). At the same time, Tranzit has a concentrated portfolio of selling contracts with its top 10 customers accounting for 73% of sales in FY 2022.

Figure 3: Revenue breakdown by region – 2015 to 2022 (in HUF m)



Source: Tranzit, Scope

Figure 4: Revenue breakdown by sales channel



Source: Tranzit, Scope

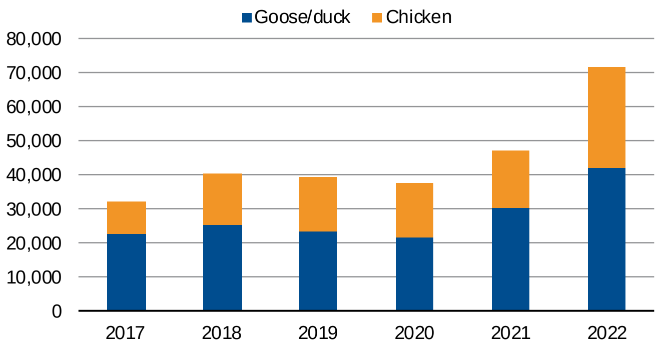
High concentration across products and supply chain due to integrated group model

Tranzit markets three types of poultry: duck, goose and chicken. Although they belong to the same category, they are not consumed the same way: chicken is eaten all year, while duck and goose are consumed on special occasions, which makes their market more predictable quantity-wise but also more elastic. Chicken represented 41% of sales and 13% of EBITDA. We expect product diversification to remain stable on the top line, with chicken contributing around 45% by 2025 since the production of duck (mainly sold frozen to date) will also ramp up. The EBITDA margin of around 5% generated from chicken is more stable but consistently lower than the 17% margin .generated by duck and goose.

The three types of bird are sensitive to avian influenza, which could substantially hamper Tranzit's production in terms of its supply chain. However, this risk is partially mitigated by the fact that customers (retailers) impose strict quality controls. Tranzit-Ker's strategy is to have breeding farms in various regions, spanning four counties. This distance makes hygienic actions more efficient and makes the birds safer. In addition, Tranzit does not exclusively source its raw materials from its sister company Tranzit-Ker but as follows:

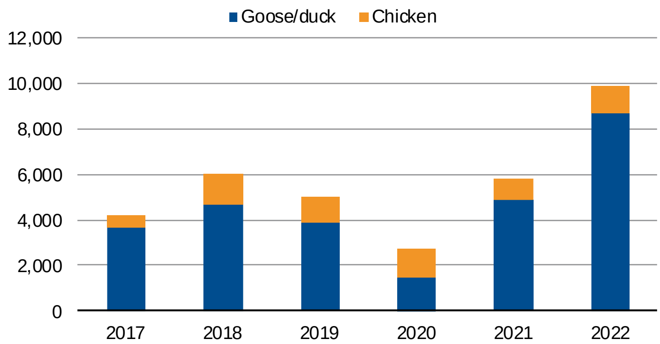
- Goose and duck: a maximum of 65% from Tranzit-Ker while the remaining 35% is bought from selected farmers who purchase their feed from Tranzit-Ker
- Chicken: 50% from Tranzit-Ker while 50% is bought from selected farmers who purchase their feed from Tranzit-Ker.

Figure 5: Revenue breakdown by type of meat – 2017 to 2022 (HUF m)



Source: Tranzit, Scope

Figure 6: EBITDA breakdown by type of meat – 2017 to 2022 (HUF m)



Source: Tranzit, Scope

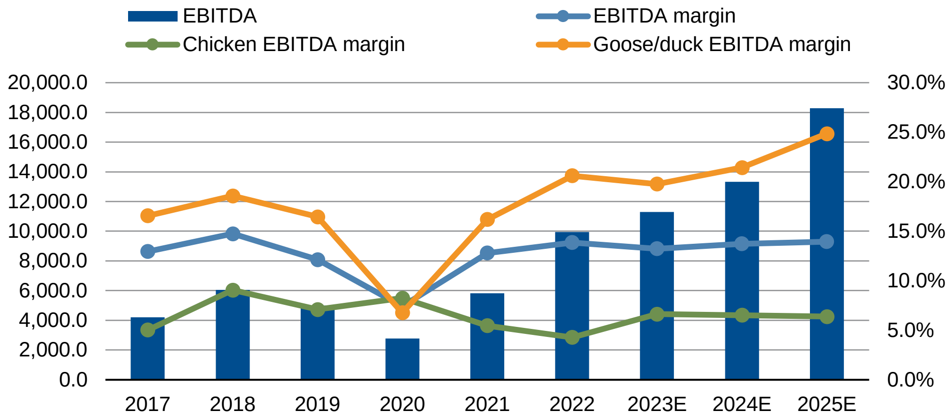
Moderate profitability forecasted to decrease slightly

Tranzit has a moderate historical profitability compared to its Hungarian peers, with an operating margin ranging between 9.5% and 14.5%. The decrease in the EBITDA margin in 2019-2020 was due to the larger share of chicken in total revenues after Tranzit ramped up broiler production. The chicken segment has a substantially lower profitability (4%-6%) than duck/goose (17%-20%). In 2022, the EBITDA margin was supported by the 56% revenue growth driven by the combination of i) the very high increase in price across the year for fresh chicken breast, up on average by 63% from the 2021 average price; ii) the strong increase in the fresh duck price, with the duck breast price increasing by 51% against the 2021 level; and iii) the mixed effect on volume, with goose and duck sales down by 8% and chicken sales up by 6%. Despite the ramp-up in its chicken production (lower margin than duck/goose), the company succeeded in increasing its EBITDA margin to 13.8%, 100 bp above the 2021 profitability.

We expect Tranzit's EBITDA margin to be stable in 2023. This will be due to the following factors:

- The hedging of the increase in raw materials prices such as for feed (borne by Tranzit-Ker and passed on to Tranzit) thanks to the group's storage capacity (around 50,000 tonnes) and ownership of two feed mills with an annual production capacity of around 160,000 tonnes, which mostly meets internal needs.
- Rising selling prices, supported by strong demand and monthly price adjustments implemented with retailers, that allow Tranzit to pass price increases on to customers. H1 2023 selling prices remained high after avian flu cases limited total output. The visibility on prices in H2 2023 remains limited and could revert to 2021 levels if European production recovered.
- More fresh duck bought than frozen, implying better margins.
- The continued mitigation of inflationary pressure from energy (more than 300% increase in 2022), packaging, transport, staff and maintenance, after successful efforts in 2022.

Figure 7: Profitability: EBITDA (in HUF m, lhs), EBITDA margin (in %, rhs)– 2017 to 2025E



Source: Tranzit, Scope estimates

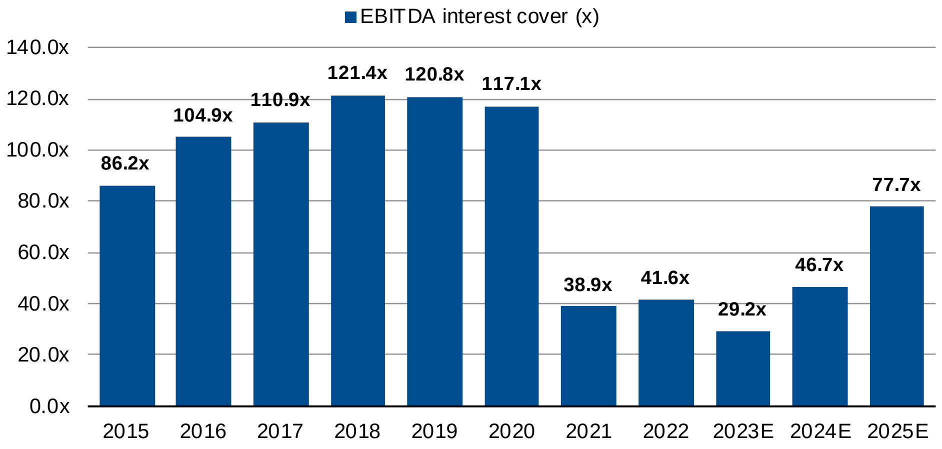
Financial risk profile: BB+

Historically high EBITDA interest expense cover expected to remain above 7x

Tranzit had high and growing EBITDA interest cover of above 10.0x between 2015 and 2020. This arose from the very low gross interest costs of below 1% on average.

Following the HUF 9.2bn bond issue in 2021 with a 1.98% coupon, gross debt has risen from HUF 11.7bn to HUF 14.4bn with the refinancing of two bank loans, including HUF 2.1bn maturing in 2022 and part of a HUF 7.1bn UniCredit loan. While interest payments materially increased by 36% in 2022, Tranzit stills exhibits a very strong EBITDA interest cover ratio of above 10x. We anticipate that debt protection will remain high for the coming years.

Figure 8: EBITDA interest cover – 2015 to 2024E



Source: Tranzit, Scope estimates

Negative free operating cash flow due to massive capex programme and negative working capital impact

Operating cash flow, while volatile, had consistently covered capex. This changed in 2021 when working capital was very negative at -HUF 4.4bn because of a decrease in days of purchase outstanding combined with an increase in the days of sale outstanding. This is the consequence of the expansion of chicken operations, as more external suppliers imply shorter payment delays. We expect Scope-adjusted free operating cash flow/debt to remain positive at year-end 2023/2024 but negative through the calendar year due to: i) negative working capital consumption build-up from Q1 to Q3, peaking in September/October at -HUF -5.5bn on average before reverting to positive in Q4; and ii) HUF 6bn in development capex for 2023/2024. Investments will focus on increasing chicken slaughterhouse capacity and launching new fresh duck products such as roast and marinated fresh duck. Despite volatile free operating cash flow (a constraint on Tranzit's financial risk profile), upcoming capex can still be financed organically.

Figure 9: Leverage – 2015 to 2025E

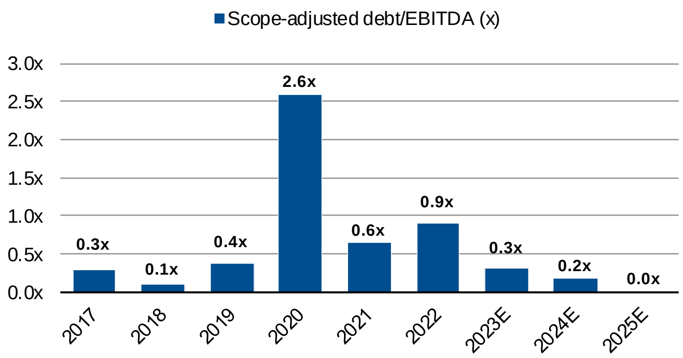
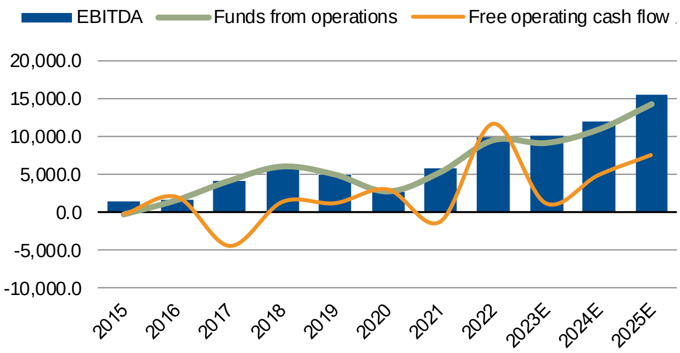


Figure 10: Cash flows (in HUF m) – 2015 to 2025E



Source: Tranzit, Scope estimates

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Leverage decreasing to 0.3x in 2023 from 0.9x in 2022

Between 2015 and 2022, Tranzit's consolidated leverage metrics measured by Scope-adjusted debt/EBITDA and Scope-adjusted funds from operations/debt were very low due to its consistently high cash balance.

We forecast leverage to remain low at below 1.0x. However, leverage is volatile and highly sensitive to working capital movements. Therefore, leverage could rapidly change in any direction on the back of an unstable environment. We have adjusted restricted cash to account for the volatile working capital. Tranzit favours a mix of funding, composed of bank loans and the HUF 9.2bn bond issued under the Hungarian National Bank's scheme.

While the cash balance is high, most of it is earmarked for acquisitions or to offset large negative working capital consumption, making it unavailable for general use.

Adequate liquidity supported by large unrestricted cash balance

Liquidity is adequate based on our expectation that sources of liquidity will exceed uses of short-term debt in the next 12 months, in line with the consistently strong liquidity in the past.

in HUF m	2022	2023E	2024E
Unrestricted cash (t-1)	10,716	4,367	9,460
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	11,751	1,228	4,931
Short-term debt (t-1)	1,626.0	3,711.5	1,899.0
Coverage	**>200%**	**151%**	**>200%**

Supplementary rating drivers: -1 notch

One notch down due to ESG factor

The negative notch reflects the continued lack of transparency and clarity (governance risk factor as a supplementary rating driver), driven by inadequate reporting methods and the failure to disclose key information in a timely manner. This entails a risk of material changes of the rating case.

Long-term rating

Senior unsecured debt rating: BB

We have upgraded the debt rating on senior unsecured debt issued by Tranzit Food Kft. to BB, one notch above the issuer rating. This rating is based on the 'above average' recovery for holders of senior unsecured debt based on assumptions of attainable liquidation values and a hypothetical liquidation scenario as of year-end 2024.

Appendix: Peer comparison (as at last reporting date)

	Tranzit Food Kft.	Baromfi-Coop Kft	HELL ENERGY Magyarorszag Kft.	Kometa 99 Zrt.
	BB-/Positive	BB-/Stable	B+/Stable	B+/Stable
Last reporting date	31 December 2022	31 December 2021	31 December 2021	31 December 2021
Business risk profile				
Size (revenue in EUR bn)	0.19	0.3	0.2	0.155
Diversification (top five customers in sales %)	60%	20%	60%	30%
Operating profitability (EBITDA margin)	9-14%	12-15%	15%	5%
Financial risk profile				
Scope-adjusted EBITDA/interest cover	41.6x	15.9x	18.3x	8.5x
Scope-adjusted debt/EBITDA	0.9x	3.9x	6.1x	3.2x
Scope-adjusted funds from operations/debt	105%	24%	16%	29%
Scope-adjusted free operating cash flow/debt	131%	-19%	-22%	4%

* Subscription ratings available on ScopeOne

Sources: Public information, Scope

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