Vajda Papír Kft.
Hungary, Consumer Products

SCOPE B+ STABLE

Corporate profile

Vajda Papír Kft. 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 Papír is the market leader in Hungary (combining its private label and own brands) and exports products to 24 countries, largely in Europe. Since 2018, Vajda Real Estate has been consolidated into Vajda Papír Kft. The company is privately owned by the founders, Attila Vajda (50%) and Szilvia Vajda Csata (50%).

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	Neg.	5.3x	9.7x	5.8x
Scope-adjusted debt (SaD)/EBITDA	Neg.	11.0x	4.0x	3.7x
Scope-adjusted funds from operations/SaD	Neg.	7%	20%	20%
Free operating cash flow/SaD	Neg.	Neg.	4 %	15 %

Rating rationale

Scope Ratings affirms its B+ corporate issuer rating on Hungarian-based Vajda Papír Kft. and changes the Outlook to Stable from Positive. Future senior unsecured debt has been affirmed at B+.

Vajda Papír's business risk profile is positively influenced by the underlying demand for its hygiene paper products, given the low cyclicality of the consumer goods industry. Currently, increased demand prompted by the Covid-19 situation is benefiting the company's sales volumes. 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. The company's recent focus to expand 'away from home' segments is increasing its market presence gradually and improving customer diversification. The company has more than 60 customers, which include domestic and multinational retail chains such as Tesco, Auchan, Penny-Markt, Lidl, ICA, CBA, Reál, Metro and Spar. Despite some concentration risk regarding its top-five customers (almost 60% of sales), the company remains competitive and quality-oriented, which enables it to secure and retain large customers over time (for both branded products and the private label). The company has more than 600 product items, including low-price, medium-price and premium brands.

During 2020, the company returned to a more conservative capital structure and significantly improved its operating profit margins. This was driven by significantly lower raw material input prices, which have been volatile and represent more than 50% of the company's cost base. Although the company's exposure to cellulose prices remain high, which is difficult to hedge, its production facility, established in 2018, has helped to increase the share of internally supplied base paper. Our assessment of the financial risk profile still reflects to some degree the high leverage and volatile results of the past, which are improving with the positive free operating cash flow generated in 2020.

Ratings & Outlook

Corporate issuer rating	B+
Outlook	Stable
Senior unsecured rating	B+

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Related Methodology

Corporate Rating Methodology, February 2020

Consumer Products Methodology, September 2020

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Liquidity and financial flexibility did not change as much as expected this year (due to the delayed refinancing) but still have positive prospects. Until the proposed bond under the Hungarian Central Bank (MNB) scheme is issued and bank loans are refinanced (expected in Q4 2020; originally planned for Q1 2020), we will continue to assess short-term liquidity and financial flexibility as slightly constrained. Even so, levels are better than last year's, as Vajda Papír, like many other Hungarian SMEs, agreed a payment moratorium for bank loans in accordance with MNB actions taken in late March.

For supplementary rating drivers, we make no explicit adjustment. However, we note that during the last 12 months, the company's growth ambitions have increased, with deleveraging no longer the main financial goal. The positive effect on sales volumes prompted by Covid-19 sparked new investment in a face-protection production facility and led to the decision to bring forward the start date of the Phase II investment. Still, we believe management is very dedicated to keeping a more conservative capital structure than in the past, to at least maintain its current credit rating.

Outlook

The Stable Outlook reflects Vajda Papír's successful financial transformation – in terms of improved EBITDA from lower raw material prices, reduced operating costs from producing more base paper inhouse, and the positive liquidity effect after refinancing. It also reflects the company's increased financial headroom for its Phase II investment project next year, which could temporarily weaken certain credit metrics.

A positive rating action could be warranted if the Scope-adjusted debt (SaD)/EBITDA ratio reaches below 4x on a sustained basis. This is now less likely in the short term, as the company wants to initiate the Phase II investment soon.

A negative rating action is possible if the company initiates Phase II expansion plans with too much debt in the context of a more negative market where credit metrics are weaker, exemplified, for instance, by a funds from operations (FFO)/SaD of below 10%.

Rating drivers

Positive rating drivers	Negative rating drivers
• Largely stable underlying demand for its products • Sizeable internal supply of base paper after 2018, helping to secure higher profit margins than in the past • Leading market position in Hungary, and solid customer portfolio of retail chain stores	• High exposure to volatility of input prices, especially for cellulose • Historically weak profitability, coupled with short history of acceptable credit metrics • New substantial investment phase likely to limit deleveraging in the medium term

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Deleveraging to a SaD/EBITDA of below 4x	• Initiation of Phase II expansion plans with too much debt in the context of a more negative market • Worsening credit ratios, exemplified by FFO/SaD of less than 10%

Financial overview, in HUF m

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	Neg.	5.3x	9.7x	5.8x
Scope-adjusted debt (SaD)/EBITDA	Neg.	11.0x	4.0x	3.7x
Scope-adjusted funds from operations/SaD	Neg.	7%	20%	20%
Free operating cash flow/SaD	Neg.	Neg.	4 %	15 %
Scope-adjusted EBITDA	**2018**	**2019**	**2020F**	**2021F**
EBIT	-846	236	2,034	1,911
add: depreciation	738	971	1,000	1,000
Scope-adjusted EBITDA	**-107**	**1,208**	**3,034**	**2,911**
Scope-adjusted funds from operations	**2018**	**2019**	**2020F**	**2021F**
EBITDA	-107	1,208	3,034	2,911
less: (net) cash interest as per cash flow statement	-91	-229	-312	-498
less: cash tax paid as per cash flow statement	-2	-23	-293	-240
add: depreciation component, operating leases	-	-	-	-
Scope-adjusted funds from operations	**-200**	**956**	**2,429**	**2,172**
Scope-adjusted debt	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	11,674	13,609	14,699	14,699
less: cash and cash equivalents	-193	-331	-2,446	-4,016
add: cash not accessible	-	-	-	-
add: pension adjustment	-	-	-	-
add: operating lease obligations	-	-	-	-
Other[1]	-	-	-	-
Scope-adjusted debt	**11,481**	**13,279**	**12,253**	**10,683**

[1] Note that the company also has an off-balance sheet bank guarantee related to a state subsidy, of HUF 4.5bn, which in the past had been part of the club loan but will be separated out after the refinancing.

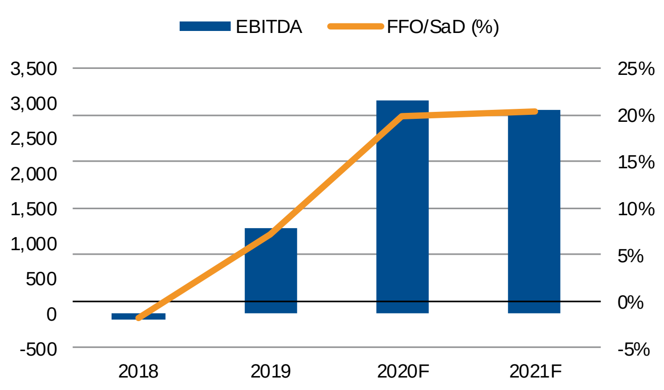
Summary of business and financial risk profile

Overall, we have assessed Vajda Papír's business risk profile at BB, supported by its solid domestic position and operations in the low-cyclicality consumer goods industry. The company calculates a 40% market share in Hungary, which includes its private label and own brands. The main rating constraint is the company's high exposure to volatile cellulose prices, which are also difficult to hedge, although the company is investigating the potential to hedge more in the future. Recently, raw material prices have fallen and the company's profitability has thus improved, indicated by the EBITDA margin more than doubling since 2019, in line with our expectations.

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

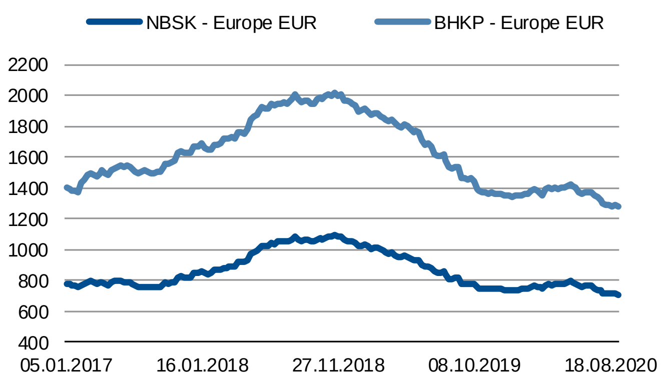
Vajda Papír has several brands, which each have different price ranges to distinguish between premium and budget. In addition to its own brand and private label, the company has also produced for competitors with a shortage of capacity.

Figure 1: EBITDA (LHS) and FFO/SaD (RHS)



Source: Company

Figure 2: Development of pulp/cellulose price indices



Source: Scope, Company

The financial risk profile is still weaker the business risk profile. Still, our analysis incorporates the positive developments in credit metrics during the last 12 months. The increase in H1 2020 sales revenue compared to the 2019 level actually exceeded our expectations, enabled by the expansion of its production unit capacity as well as the initial buying frenzy prompted by Covid-19 during the reporting period. We estimate a strong increase in EBITDA this year, with positive free operating cash flow and a SaD/EBITDA of around 4x at YE 2020. In addition to the higher sales volume, the company has also been positively affected by the lower raw material input prices.

Our updated base case financial projection still does not incorporate the potential Phase II investment, as we are awaiting the company's final decision. This means that after refinancing, liquidity and financial flexibility will improve, which should increase the financial headroom within the current rating to take on more investments. Although the financing is yet to be finalised, we already assume that approximately one-third of the investments will consist of government grants.

Supplementary rating drivers

For the supplementary rating drivers, we make no explicit adjustment. However, we note that during the last 12 months, the company's growth ambitions have increased, with deleveraging no longer the main financial goal. The positive Covid-19 effects on sales volumes sparked a new investment in a face protection production facility and led to the decision to bring forward the start date on the Phase II investment. Still, we believe that management is very dedicated to keeping a more conservative capital structure than in the past, to at least maintain its current credit rating.

Based on the new indication from management, we acknowledge the strategic rationale for launching the Phase II investment earlier. We also note that the base paper production machine will be used to produce raw materials for kitchen paper rolls, paper tissues and paper napkins. This allows the company to produce the raw materials for all hygienic paper products manufactured, processed and sold by the group.

Senior unsecured rating

We expect an 'average recovery' for future senior unsecured debt, such as the planned 10-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 refinancing is complete, senior unsecured debt has a lower recovery rate and would be rated below the issuer rating. Moreover, our recovery analysis points out that the company can partially pledge assets again, which is possible once Phase II of the base paper project has been initiated.

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