3 August 2022

Corporates

Agrár Kft.
Hungary, Agribusiness

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA interest cover	-40.6x	-16.8x	9.3x	13.0x
Scope-adjusted debt/EBITDA	0.4x	3.5x	3.1x	2.0x
Scope-adjusted funds from operations (FFO)/debt	299%	29%	27%	42%
Scope-adjusted free operating cash flow (FOCF)/debt	45%	-30%	-22%	6%

Rating rationale

The upgrade of the issuer rating from B to B+ is driven by the improving credit metrics and the reversal of the negative one notch on the financial risk profile for previous concerns about liquidity, reflecting uncertainties regarding the availability and frequency of operational subsidies from the European Union's Common Agricultural Policy.

The main constraint of the rating continues to be the business risk profile (improved to B). The company's limited size in both the European and domestic contexts renders it more vulnerable to macroeconomic shocks and makes it harder to handle changes in market conditions. The overdependence on a single product category is also credit-negative. The rating is positively driven by operational profitability, benefitting from raw material procurement from around 1,000 hectares of own farmland.

Agrár's financial risk profile (improved to BB+) is supported by its history of adequate credit ratios, thanks to its past moderate financial leverage. We assume moderate revenue growth in 2022, until the pig farm's expansion is completed, which should result in a significant revenue increase from 2023 onwards. We also expect EBITDA margin at close to historical average, with the framework of agricultural subsidies unchanged in the coming years.

Liquidity is adequate, benefitting from the HUF 1.69bn unrestricted cash available as of FYE 2021, fully covering the negative free operating cash flow of HUF 0.9bn and short-term debt repayment of HUF 0.5bn forecasted for 2022.

Outlook and rating-change drivers

The Stable Outlook reflects the successful execution of the company's capex phase along with a robust financial risk profile that is signaled by a sustained leverage (SaD/EBITDA) of around 3.0x on average. This reflects Scope's expectation that the company will be able to pass on increased procurement cost through increased selling prices and continued reception of operating agricultural operational subsidies that will keep the company's EBITDA margin at a level higher than 20%

.A positive rating action is deemed as being remote for the time being due to the company's constrained outreach and scale. A positive rating action would require a significantly improved business risk profile and operational scale.

A negative rating action could be required if the company's leverage (SaD/EBITDA) moved towards 4.0x amid its expansion phase or if the company's faced significant pressure regarding keeping its EBITDA margin at 20% or higher in case it failed to pass on higher input prices to customers or to collect operational subsidies.

Rating history

Date	Rating action	Issuer rating & Outlook
03 August 2021	New	B/Stable

Ratings & Outlook

Issuer B+/Stable

Guaranteed senior unsecured bond BB-

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Related Methodology

Corporate Rating Methodology; July 2022

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Positive rating drivers	Negative rating drivers
• Long-standing experience in farming, especially pig breeding; ownership of related companies in various supporting industries such as animal feed production or agricultural equipment repair and maintenance • Financial risk profile (assessed at BB+), supported by history of solid credit metrics • Intra-group procurement of animal feeds reducing the risk of distortions in the supply chain of input materials	• Weak diversification, with a focus on one animal species, high customer concentration and weak geographical diversification, making the company vulnerable to potential event risk such as animal diseases • Relatively small company; weak market position in an industry with low price setting power • High dependence on the EU Common Agricultural Policy subsidies making the company vulnerable to changes in the subsidy framework • Execution risk due to large capex programme in relation to the size of the company; dividend payments maintained

Positive rating-change drivers	Negative rating-change drivers
• Significantly improved business risk profile and operational scale	• Scope-adjusted Debt/EBITDA moves towards 4.0x amidst the expansion phase • Scope-adjusted EBITDA margin decreasing below 20 % caused by worsening gross margin (failure to pass on higher input prices to customers) or lower level of operational subsidies

Corporate profile

Agrár Kft., based in Somogyszob (Hungary), breeds, raises, fattens and sells piglets. It is fully owned by the Claessens family and is part of the integrated agricultural company Claessens Group. The Claessens Group covers the complete cow and pig value chain from crop production to the raising and selling of the animals. In 2021, Agrár achieved sales of HUF 5.1bn and a reported EBITDA of HUF 1.5bn.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	-73.6x	-40.6x	-16.8x	9.3x	13.0x	16.6x
Scope-adjusted debt/EBITDA	0.5x	0.4x	3.5x	3.1x	2.0x	1.6x
Scope-adjusted FFO/debt	214%	299%	29%	27%	42%	57%
Scope-adjusted FOCF/debt	103%	45%	-30%	-22%	6%	12%
Scope-adjusted EBITDA in HUF '000						
EBITDA	1,452,179	1,910,059	1,484,687	1,270,835	1,743,480	2,185,703
Non-operational subsidies	0	-26,418	-532,720	0	0	0
Disposal gains fixed assets	-23,137	58,895	0	0	0	0
Scope-adjusted EBITDA	**1,429,042**	**1,942,536**	**951,967**	**1,270,835**	**1,743,480**	**2,185,703**
Funds from operations in HUF '000						
Scope-adjusted EBITDA	1,429,042	1,942,536	951,967	1,270,835	1,743,480	2,185,703
less: (net) cash interest paid	19,404	47,875	56,706	-136,170	-133,879	-131,820
less: cash tax paid per cash flow statement	-65,523	-331	-37,752	-74,313	-94,858	-107,407
add: dividends from associates	0	0	0	0	0	0
Other operational income/expense	4,098	86,512	-21,567	30,000	30,000	30,000
Funds from operations	**1,387,021**	**2,076,592**	**949,354**	**1,090,352**	**1,544,744**	**1,976,476**
Free operating cash flow in HUF '000						
Funds from operations	1,387,021	2,076,592	949,354	1,090,352	1,544,744	1,976,476
Change in working capital	-677,893	-1,191,705	-18,881	-209,982	-462,176	-554,395
Non-operating cash flow	15,651	-60,573	427,934	232,303	408,764	93,038
less: capital expenditure (net)	-59,224	-508,433	-2,359,059	-1,997,225	-1,292,518	-1,105,228
less: operating lease repayments	0	0	0	0	0	0
Free operating cash flow	**665,555**	**315,881**	**-1,000,652**	**-884,552**	**198,814**	**410,891**
Net cash interest paid in HUF '000						
Net cash interest per cash flow statement	19,404	47,875	56,706	-136,170	- 133,879	-131,820
add: interest component, operating leases	0	0	0	0	0	0
Change in other items	0	0	0	0	0	0
Net cash interest paid	**19,404**	**47,875**	**56,706**	**-136,170**	**-133,879**	**-131,820**
Scope-adjusted debt in HUF '000						
Reported gross financial debt	769,360	935,328	5,056,861	4,806,845	3,794,409	3,609,670
less: subordinated (hybrid) debt	0	0	0	0	0	0
less: cash and cash equivalents (50 % of cash per balance sheet)	-121,787	-240,238	-1,685,334	-811,115	-228,533	-191,609
add: non-accessible cash	0	0	0	0	0	0
add: pension adjustment	0	0	0	0	0	0
Scope-adjusted debt	**647,573**	**695,091**	**3,371,527**	**3,995,730**	**3,565,876**	**3,418,061**

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Environmental, social and governance (ESG) profile[1]

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)

ESG Factors: credit-positive

The profitability of the industry is highly dependent on the price of input materials, namely the animal feed. The price, quality and availability of feed are highly dependent on weather conditions and are affected by the climate crisis. There have been serious draughts in Central Hungary this summer, and the Hungarian Ministry of Agriculutre expects 20-25% lower yields in certain crops than in 2021. Subsidies addressing the agricultural damage caused by unfavourable weather conditions mitigate this risk to a certain extent.

Agrár is especially vulnerable to regulatory risk, namely changes in the EU Common Agricultural Policy. In addition to the one-off subsidies such as investment-related ones or draught damage relief, any change in the framework of operational subsidies can significantly affect profitability.

Additionally, Agrár aims to significantly decrease its energy consumption by using the most efficient technology and renewable energy sources in the expanded pig farm, reducing exposure to the change in energy costs.

[1] 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: B

Industry risk profile: BBB

The company is active in the agricultural industry, which is highly cyclical, has high market entry barriers, low substitution risk and a stable industry outlook.

Agrár's competitive position is the main constraint on its business risk profile. The company has a weak market share and concentrated business, which is somewhat balanced by solid yet cyclical profitability.

Small size, low diversification

Agrár is a small market player located in south-west Hungary, with much of its activity carried out in this region. Agrár's geographical diversification is low as its products are sold solely on the Hungarian market. With a revenue of HUF 5.1bn in 2021, Agrár Kft is a small market player both in the Hungarian and European context.

Hungary's pig herd has decreased by 15% since 2015. In 2021 it amounted to roughly 2.7m pigs, with about 150,000 (50,000-60,000 fatteners, rest are piglets) of those bred by Agrár (market share: ~5%). The intended capacity expansion of up to 280,000 animals would double Agrár's market share, placing it amongst medium-sized pig farms on a heavily fragmented domestic market.

Figure 1: Selective players in the Hungarian pig farming industry

Company	Fiorács Kft	Csicsó Pig Kft	Mangal Ilona Kft	Triagro Kft	Agrár Kft
Sales (2021, HUF bn)	22.2	4.7	6.5	2.7	5.1

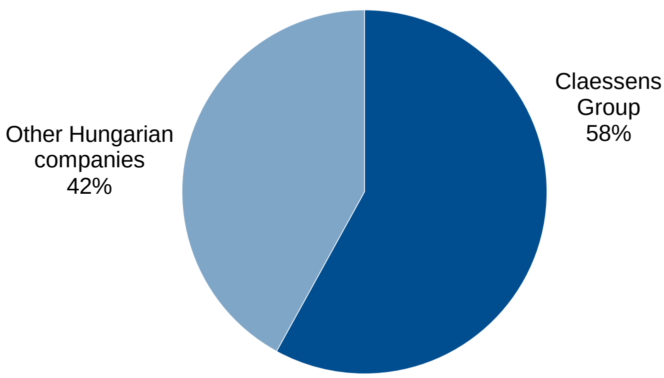
Source: Agrár, Scope

The low product diversification reduces the company's ability to mitigate the volatility of prices as the company has little influence on market prices. Additionally, in case of potential risk events such as disease or supply chain disruptions Agrár has limited ability to reduce the negative effects affecting the output. Overdependence on a single product category is regarded as credit-negative.

Highly concentrated customer portfolio

The typical customers for piglets are pig processors and wholesale companies. Fatteners are sold to slaughterhouses and food processing companies. In 2021 roughly 58% of Agrár's sales were generated via other members of the Claessens Group (Somogyi Kalász Kft, TBZ Táp Kft and Claessens Kft). While the other 42% of Agrár's sales appears fairly diversified in terms of customer concentration, we consider that the company has a strong consumer concentration.

Figure 2: Sales by customer



Source: Agrár, Scope

Moderate supplier concentration

Agrár's suppliers are moderately concentrated. The required raw materials, especially maize and wheat, are procured from subsidiaries such as TBZ Táp Kft. This is set to remain so after the intended capacity expansion. The intra-group procurement of animal feeds helps to mitigate the possible distortions in the supply chain of input goods.

Strong operating profitability, but high dependence on operational subsidies

Operating profitability has historically been solid, but subject to fluctuations, with Scope-adjusted EBITDA (including operational subsidies, opposed to the previous review, when subsidies were fully excluded from the Scope-adjusted EBITDA calculation) ranging between 19% and 41% in the past three years. Agrár's profitability is highly dependent on the price of input materials, especially animal feed. The rapid increase of input prices is partially mitigated by the fact that currently about 70% of all animal feed (maize, corn) needs are covered by intercompany sources. After the completion of the capacity expansion, this proportion will be closer to 60%. Additionally, high dependence on operational subsidies makes the company vulnerable to any changes in the legislative framework of the subsidy system of the European Union.

Financial risk profile: BB+

Key adjustments to the rating case include:

- Reported EBITDA is adjusted for non-operational and one-off subsidies, while EU Common Agricultural Policy subsidies are part of the Scope-adjusted EBITDA
- Haircut on forecasted cash in accordance with our General Corporate Ratings Methodology

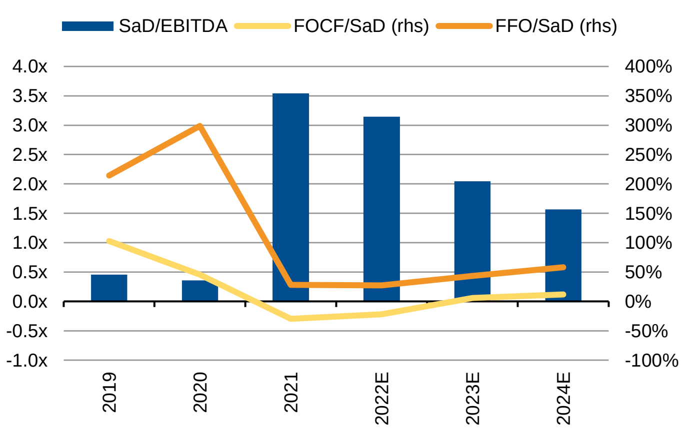
Comfortable interest coverage post-issuance

Before the issuance of the HUF 3.26bn senior unsecured guaranteed bond in 2021, Agrár operated with a low level of interest-bearing debt, realising net interest income in the previous years. Post-issuance, Scope-adjusted debt/EBITDA landed around 3.5x, with a gradual improvement expected below 2.0x in the medium term, in line with the development of EBITDA and the amortisation of various medium-term bank loans.

Moderate leverage

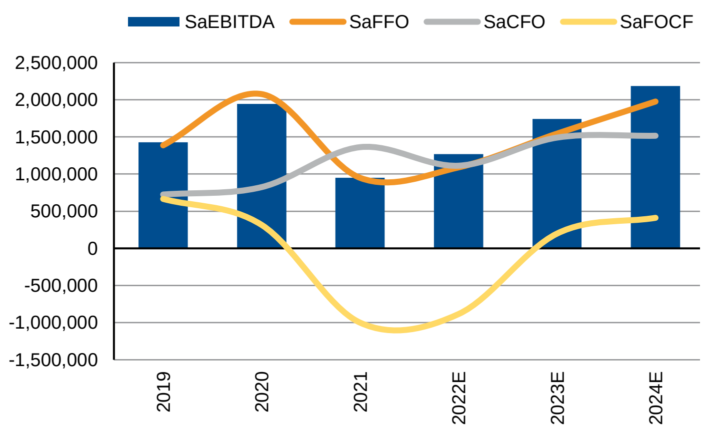
Since Agrár realised net interest income before the issuance of the HUF 3.26bn bond, data before 2022E is not meaningful. After the first full-year coupon payment (coupon rate: 2.9%; HUF 92.5m), which will be responsible for the majority of interest expense in the upcoming years, the yearly interest is expected to be around HUF 140m.

Figure 3: Development of leverage and cash flow cover



Sources: Agrár, Scope (estimates)

Figure 4: Cash flow (HUF '000)



Sources: Agrár, Scope (estimates)

Negative FOCF till the end of the investment period

Following Agrár's bond issuance of HUF 3.26bn in 2021, its credit profile deteriorated temporarily in 2021 compared to historical metrics. Scope-adjusted FFO remains positive thanks to the strong operating profitability. Scope-adjusted FOCF will remain negative at least until the completion of the ongoing investments. As per Agrár's instructions, the discretionary cash flow includes a yearly dividend payment of HUF 300m – the maximum amount prescribed in the bond covenants.

Agrár plans to spend roughly HUF 8.0bn on capex by end-2023. This is to be financed via a bond offering as well as investment subsidiaries. The capex programme poses significant execution risks considering the total amount of planned capital expenditure relative to Agrár's size (total assets: HUF 15bn). So far the execution is going according to plan. The completion rate is about 30% as of June 2022. The programme will expand the sow and farrowing house as well as the pig farm. In addition, a new slurry storage facility is planned in order to apply manure to the surrounding fields.

Adequate liquidity

Liquidity is adequate, benefitting from the HUF 1.69bn of unrestricted cash available as of FYE 2021, fully covering the FOCF of HUF -0.88bn and short-term debt repayment of HUF 0.5bn forecasted for 2022.

Balance in HUF '000	2021	2022E	2023E
Unrestricted cash (t-1)	240,238	1,685,334	811,115
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	-1,000,652	-884,552	198,814
Short-term debt (t-1)	468,574	498,272	1,064,032
Coverage	**-1.6x**	**1.6x**	**0.9x**

Long-term debt rating

Senior unsecured guaranteed debt rating: BB-

In August 2021, Agrár issued a HUF 3.26bn senior unsecured guaranteed bond (ISIN: HU0000360672) through the Hungarian central bank's Bond Funding for Growth Scheme. The bond's tenor is 10 years, with a fixed coupon rate of 2.9% and repayment in six tranches of 10% in 2026, 2027, 2028, 2029 and 2030 and of 50% in 2031. The bond has been issued with a guarantee from related company Agro-Build Kft.

The recovery analysis indicates an 'above average' recovery for the senior unsecured guaranteed bond and for all other senior unsecured debt positions at the level of Agrár Kft even after all senior secured debt would have been fully recovered. The recovery is benefiting from the high level of fixed assets (mainly consisting of PPE), translating into a debt instrument rating of the senior unsecured guaranteed bond one notch above the issuer rating (BB-). The guarantee of Agro-Build Kft has no significant effect on the expected recovery of the debt instrument.

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