Envien Magyarország Kft.
Hungary, Integrated Chemicals

SCOPE BB STABLE

Corporate profile

Envien Magyarország Kft. is a full subsidiary of Malta-based Envien International Ltd, the consolidating entity of the leading biofuel producer in Central and Eastern Europe (CEE), Envien Group. Envien Magyarország is a pure trader of animal feed products, primarily using the by-products of Envien Group's biofuel production. Envien International provides an unconditional and irrevocable guarantee on the bond issued by Envien Magyarország. Envien Group has around 450 employees.

Key metrics (Envien International)

		Scope estimates		
Scope credit ratios	2020	2021E	2022E	2023E
EBITDA/interest cover	67.4x	146.6x	45.9x	49.5x
Scope-adjusted debt (SaD)/EBITDA	0.4x	0.5x	1.7x	1.8x
Scope-adjusted funds from operations/SaD	247%	182%	54%	52%
Free operating cash flow/SaD	158%	-45%	-10%	12%

Rating rationale

Scope has affirmed the issuer rating of BB/Stable on Envien Magyaroraszág Kft along with the BB rating on the senior unsecured HUF 5.5bn bond issued under Hungary's Bond Funding for Growth Scheme.

Envien Magyarország's ratings are derived from the BB/Stable corporate rating of its parent, Envien International, reflecting the parent's implicit guarantee given the shared name identity, brand responsibility, intercompany funding and the rated entity's importance to Envien Group. The ratings also reflect the parent's explicit, unconditional and irrevocable guarantee on the bond issued by Envien Magyaroraszág under Hungary's Bond Funding for Growth Scheme.

We continue to assess the business risk profile at B+. This is mainly supported by: i) the significant market shares in biofuel production in some CEE countries, especially Slovakia, and leading positions in biodiesel in Hungary and bioethanol in the Czech Republic, with strong business ties with its main customer, MOL Group, a large oil and gas company; ii) the regulatorily driven demand on biofuel used as an additive in petroleum-based fuels; iii) the diversification of production and agro-commodity trading activities across several countries.

The business risk profile is constrained by: i) limited pricing power, with profitability dependent on volatile upstream and downstream prices, which are in turn linked to feedstock and crude oil prices; ii) the low profitability margins (Scope-adjusted EBITDA margin of around 10%); iii) the small production capacity within the EU; iv) concentration on a single product group (biofuels) with a modest contribution from specialty products; v) limited diversification in terms of geographies (over 55% of sales in Slovakia and Hungary) and customers (around 70% from MOL Group).

We continue to assess the financial risk profile at A-, reflecting the low Scope-adjusted debt (SaD) that benefits from a very strong cash position. Our base case includes EBITDA reaching a record high of around EUR 125m in 2021, corresponding to an EBITDA margin of over 15%, benefitting from a positive timing between sales and purchases amid spiralling prices.

Ratings & Outlook

Corporate rating	BB/Stable
Short-term debt rating	-
Guaranteed senior unsecured bond rating (ISIN: HU0000360193)	BB

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Related Methodologies

Corporate Rating Methodology, July 2021

Rating Methodology Chemical Corporates April 2021

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From 2022 onwards, we assume the EBITDA margin to reverse towards its historical mean of 10% as raw material prices are expected to further increase and not be compensated for by increased final product prices. The large price increase during 2021 also led to significant working capital needs not only for inventory and receivables but also for VAT receivables. This, together with high capex of around EUR 23m, led to negative free operating cash flow (FOCF) and increased SaD, driven mostly by overdraft use and partly by the EUR 15.7m bond issuance from Envien Magyarország.

Leverage as measured by SaD/EBITDA was a low 0.5x in 2021 due to an exceptionally high EBITDA that offset the increased debt. For 2022/23, we expect SaD/EBITDA to increase to just under 2x. This will be driven by lower EBITDA, combined with higher debt due to working capital needs, capex at around EUR 25m, and the expected acquisition of Poland's Lotos Biopaliwa (production of FAME for biodiesel) for an undisclosed amount but which we assume to remain comfortably below EUR 50m. The funds from operations/SaD leverage metric is expected to remain comfortably over 45%, strengthening the leverage of Envien International.

Interest cover is also very strong, reflecting not only the low interest rate regime until 2021 but also the limited debt of Envien Group. Cash flow cover (FOCF/SaD) is expected to fluctuate over time due to price volatility, turning negative in 2021 due to extremely high working capital needs, then improving during 2022/23. However, it will remain below 15% amid high capex of up to EUR 25m yearly, including a large portion directed towards development projects aimed at increasing the share of advanced biofuels produced.

Outlook and rating-change drivers

The Outlook is Stable. This assumes that the EBITDA margin will reverse from its strong levels towards its historical mean from 2022. We also expect leverage to increase towards 2x and the volatile FOCF/SaD metric to remain below 15% in the short to medium term.

A positive rating change is possible in case of an improved business risk profile for Envien Group or a SaD/EBITDA sustained below 1x.

A negative rating could be driven by a change in parent ownership for Envien Magyarország. It could also occur if the SaD/EBITDA of Envien International reached above 3.0x, due to protracted pressure on production margins and/or the introduction of large capex investments to build second-generation facilities that are not included in our base case. Additionally, liquidity risk may arise in case of a further large increase in working capital that unused overdraft lines cannot cover or an unexpected cancellation of one or more of such lines.

Rating drivers

Positive rating drivers	Negative rating drivers
• Past and future demand generated by regulatory requirements (biofuels) • Strong market presence in CEE, especially in Slovakia (100% market share) • Strong financial metrics • Diversification of production and agro-commodity trading activities across several countries	• Limited EBITDA margins fluctuating at around 10% over time amid dependency on price volatility both upstream and downstream • Portfolio mostly consisting of commodity products with limited pricing room • Concentration on single product group (biofuels) • Large single customer concentration (MOL) • Geographical concentration in Slovakia and Hungary (55% of sales) • Small production capacity within EU

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA of parent improving below 1.0x on a sustained basis • Improvement in business risk profile of Envien Group	• Change of majority owner of Envien Magyaroraszág • SaD/EBITDA of parent reaching above 3.0x due to protracted pressure on production margins and/or large capex to build second-generation facilities • Liquidity risk from further large increase in working capital needs that existing unused overdraft lines cannot cover, or the unexpected cancellation of one or more of such lines

Financial overview (Envien International - consolidated)

		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	67.4x	146.6x	45.9x	49.5x
Scope-adjusted debt (SaD)/EBITDA	0.4x	0.5x	1.7x	1.8x
Scope-adjusted funds from operations/SaD	247%	182%	54%	52%
Free operating cash flow/SaD	158%	-45%	-10%	12%
Scope-adjusted EBITDA in EUR '000	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	58,888	127,436	43,602	52,915
Less: disposal gains, fixed assets	(18)	(18)	-	-
Scope-adjusted EBITDA	58,870	127,418	43,602	52,915
Scope-adjusted funds from operations in EUR '000	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	58,888	127,436	43,602	52,915
less: (net) cash interest as per cash flow statement	(873)	(869)	(950)	(1,070)
less: cash tax paid as per cash flow statement	(5,174)	(12,083)	(2,937)	(3,642)
Less: disposal gains fixed assets	(18)	(18)	-	-
Scope-adjusted funds from operations	54,753	115,725	40,715	49,202
Scope-adjusted debt in EUR '000	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	91,843	139,862	146,862	162,862
less: hybrid bonds	-	-	-	-
less: cash and cash equivalents	(72,311)	(78,573)	(73,171)	(70,589)
add: cash not accessible	-	-	-	-
add: pension adjustment	566	566	566	566
Other	2,075	1,782	1,489	1,196
Scope-adjusted debt	22,173	63,637	75,746	94,035

Business risk profile: B+

Industry risk profile of BBB for integrated chemicals

We place Envien Group in the integrated chemicals industry, which we rate at BBB. Price risks come from both upstream and downstream. The industry faces high cyclicality due to a great sensitivity to fluctuations in raw material prices, especially for commodity products. Market entry barriers are high due to extensive capex requirements and intellectual property rights. Substitution risk is low due to the strict technical production requirements, a lack of alternative production methods, and product uniqueness (especially bespoke chemical solutions).

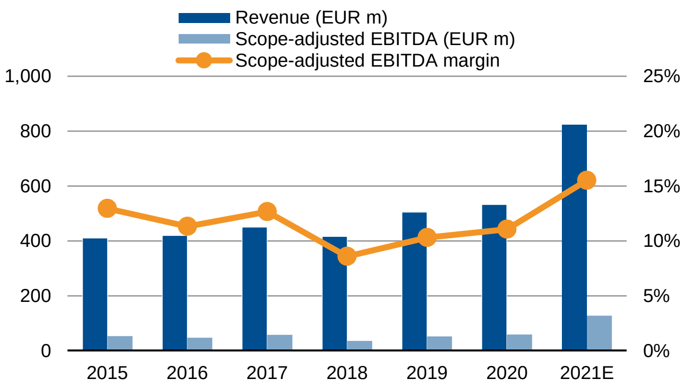
Key product demand mandated by government regulations

The group's key products – biofuels mixed with conventional diesel and gasoline to meet EU requirements – use agricultural commodities as inputs to produce oils and ethanol in large volumes. According to Envien Group, the group is ranked ninth for bioethanol production in the EU and 10th for fatty acid methyl esters (FAME) for biodiesel. The EU Renewable Energy Directive II (Directive (EU) 2018/2001) mandates the increasing use of biofuels to promote renewable energies and meet EU emission reduction targets. As such, demand is primarily driven by changes in these mandates, with an increasing tendency to move away from supporting biofuels using traditional agricultural commodities such as feedstock (first-generation biofuels).

Recovering demand for biofuels post-Covid

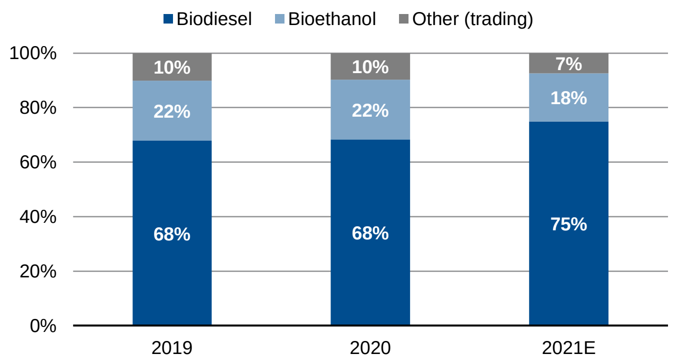
Global biofuel production was 1.7m barrels a day in 2020 (1.8m in 2019), with the vast majority produced in the US and South America, while Europe produces less than 15%. In 2022, we expect global fuel demand to increase after the downturn since 2020 due to Covid-19 travel restrictions and the slowdowns in Q4 2021 and Q1 2022. However, in the long run, we expect growth in biofuels to be constrained by generalised fuel efficiency despite growing transport use. The move away from fossil fuels to electric and hydrogen vehicles will also curb demand.

Figure 1: Envien International – key financial figures



Source: Envien, Scope estimates

Figure 2: Envien International – sales by product



Source: Envien, Scope estimates

Strong position in CEE, but limited market position within EU

Envien Group has a strong position within the CEE region, albeit in a small niche, and is less strong in the EU. Envien Group has strong positions in its core markets: it produces all of Slovakia's biofuel; its market share in Hungary is primarily in biodiesel; and in the Czech Republic, the market share is higher in bioethanol. Envien Group reported a record EUR 822m revenues in 2021, but this was driven by price developments. Generally, Envien Group's revenues have ranged between EUR 400m and 550m during 2015 to 2020.

Production and procurement spread across different sites

The business risk profile benefits from diversification as Envien Group's production capacity is spread across its CEE subsidiaries. There are five biofuels production plants across Slovakia (Enviral and Meroco), Hungary (Rossi Biofuels), the Czech Republic (Ethanol Energy) and Croatia (Biodizel Vukovar); one rapeseed oil plant (intermediate process) in Slovakia (Polnoservis); and agro-commodity trading in Slovakia (Enagro), Hungary (Envien Magyarország) and Switzerland (Envien Trading SA).

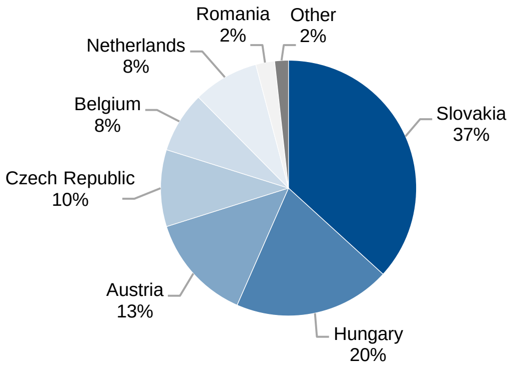
Limited product and geographical diversification

Market portfolio diversification is restricted to the commodities of bioethanol and biodiesel as well as their by-products and related trading. Geographic is modest, with over 55% of sales from Slovakia and Hungary. Further, own products are sold only in CEE countries (including Czech Republic, Austria and Romania), while the trading activity of Envien Switzerland (trading of related agricultural products) is directed towards several EU countries.

Key customer concentration on MOL for around 70%

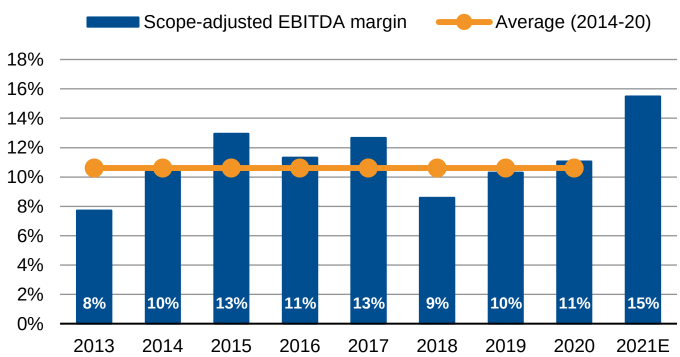
On the customer side, there is a clear concentration on Hungarian oil and gas group MOL (including its subsidiary Slovnaft), at close to 70% of sales. However, this risk is mitigated somewhat by the fact that a material part of the exposure derives from Rossi Biofuels, an entity owned by both Envien Group (majority) and MOL (minority) that is also located at MOL's site in Hungary. This close and synergistic relationship has little risk of deteriorating. The supplier side is more diversified, with the largest supplier, Interagros, representing around 20% of supplies and the top five covering close to 50%.

Figure 3: Envien International – sales by country (2020)



Source: Envien

Figure 4: Envien International – Scope-adjusted EBITDA margin



Source: Envien, Scope estimates

Profitability dependent on commodity price

Profitability for biofuel producers is closely related to price developments in input and market prices, which in turn are linked to feedstock prices and crude oil prices. The Scope-adjusted EBITDA margin fluctuated around the 10% mark during 2013-20. The year 2021 saw record-high prices for feedstock (raw material) and biofuels (end-product), which tend to be correlated. Envien Group managed to buy cheap and sell high, resulting in a record EBITDA that year of around EUR 125m, resulting in a margin of over 15%. The current upswing in biofuel prices is driven primarily by the recovering oil prices amid reduced supply. We expect prices in 2022 to remain high, with the Russian-Ukraine war only aggravating the existing situation. This would result in a lower EBITDA margin than in 2021, converging towards its multi-year average and possibly even below. Generally, it is difficult to predict margins beyond one year as the business is highly dependent on prices.

Manageable impact of rising energy costs

Increasing energy prices will negatively impact the profitability of Envien Group in terms of higher electricity costs as energy prices are not included in the pricing mechanism. Still, the impact of energy costs is limited, at around 2-3% of sales during 2020-21; in the past 10 years it averaged 4% but never reached 5%. Therefore, we expect only a contained impact in 2022. In this regard, the company is looking to reduce energy consumption, including through the implementation of photovoltaic panels or biogas production options in the medium term. Envien has no direct exposure to Russian counterparties.

Some natural price hedge from timing of purchases and mix of long-term vs spot contracts

Price risk management is based mostly on buying most feedstock during harvest (when prices are generally lower), which would cover not only the production needs of the harvest period but also around 25% of needs for the rest of the year. Feedstock is represented by rapeseed (harvest period in July to August) and corn (harvest period at the end of September until December), whose prices tend to rise in the summer. The company is satisfied with this natural hedge and therefore does not use financial hedges but can if necessary. The risk strategy also involves having a mix of long-term (five years) and spot contracts to diversify risk. The pricing of long-term contracts is modified based on market development: while sourcing contracts are mostly based on variable market prices, supply contracts use a price formula that included premium or discount over a specific benchmark.

Financial risk profile: A-

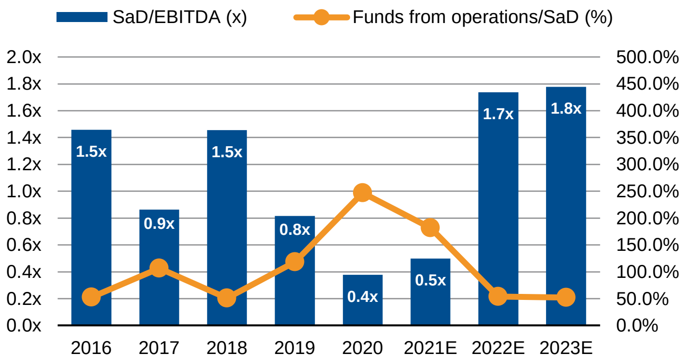
Credit metrics based on Envien International

As mentioned earlier, we base the rating of Envien Magyarország on the credit metrics of Envien International, given the latter's unconditional and irrevocable guarantee for Envien Magyarország's bond issuance (no other material financial debt at Hungarian subsidiary).

Robust credit metrics amid increasing debt

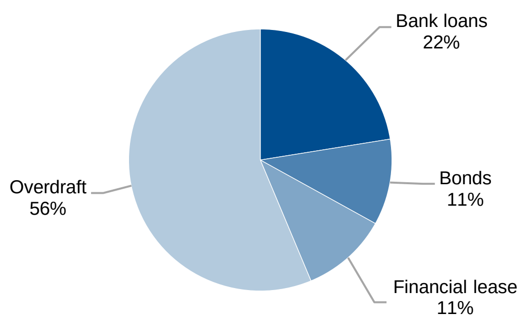
Envien International (the consolidating entity of Envien Group) shows robust credit metrics and we continue to assess the financial risk profile at A-. Envien Group generally has low SaD thanks to its strong cash position, although debt rose in 2021 to EUR 64m from EUR 22m, mostly driven by the increased use of overdrafts for working capital needs and partly due to the issuance of Envien Magyarország's bond of around EUR 15.7m. Most of the bank loans (EUR 32m) refer to investment loans received in 2020 for the adoption of the RepCat technology, which allows the company to produce advanced biofuels from lower-quality raw materials (potential for lower operating costs in the future).

Figure 5: Envien International – leverage metrics



Source: Scope estimates

Figure 6: Envien International – debt split as of Dec 2021E



Source: Envien, Scope estimates

Strong leverage below 2.0x

The SaD/EBITDA leverage metric is strong, reflecting the moderate levels of debt. Leverage has been comfortably below 2.0x over the past five years, although subject to fluctuations, mostly driven by commodity price volatility. We expect SaD/EBITDA to remain below 2.0x during the rating period, increasing from the lows in 2020/21 of around 0.5x to close to 2.0x during 2022/23. This is driven by some margin pressure after an extremely positive 2021 and increasing debt from sustained capex and acquisitions. Funds from operations/SaD is also forecast to remain comfortably over 45%, strengthening Envien International's leverage.

Sound interest cover

Interest cover is also very strong, reflecting not only the low interest rate regime until 2021, but also the limited long-term financial debt of Envien Group. Interest cover is expected to remain above 40x as in the past years, unless the company enters into large investment programmes that lead to a substantial increase in debt amid rising interest rates.

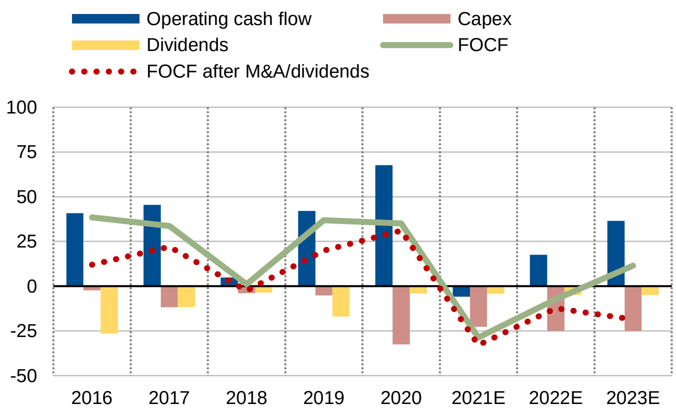
Volatile cash flow cover, to be capped at 15% in near term

Cash flow cover, measured as FOCF/SaD, was generally strong until 2020, benefitting from low debt as well as operating cash flow of comfortably above working capital and capex needs. FOCF/SaD became negative due to rising materials prices in 2021, but such working capital needs are exceptional, and the ratio is set to normalise in the coming years. However, capex under the cycle started in 2020 (net capex of EUR 32m largely driven by the investment into RepCat technology) is set to remain well above the maintenance capex of around EUR 6m, also in subsequent years due to investments in advanced biofuels. We assume capex up to EUR 25m per year during 2021-23, incorporating a large portion of project capex, which management expects to materially decrease from 2023. The presence of project capex, in combination with the Lotos Biopaliwa acquisition for an undisclosed amount and continued high material prices, is expected to pressure FOCF in the medium term to remain below 15% of SaD. The acquisition of Lotos Biopaliwa (production of FAME for biodiesel), announced earlier this year, is expected to close in late 2022 once regulatory approvals are received since this transaction is part of a larger deal involving the acquisition of Grupa Lotos by PKN Orlen. In our base case, we assume the transaction will proceed, with the entity fully consolidated from 2023. We assume that the transaction will remain well below EUR 50m based on an assumed EUR 100m topline for the company, an EBITDA margin estimated below 10% (this was the approximate profitability level pre-Covid of the consolidating parent Grupa Lotos) applied to a mid-single digit EV/EBITDA multiple.

Investments in second-generation facilities would be credit-negative

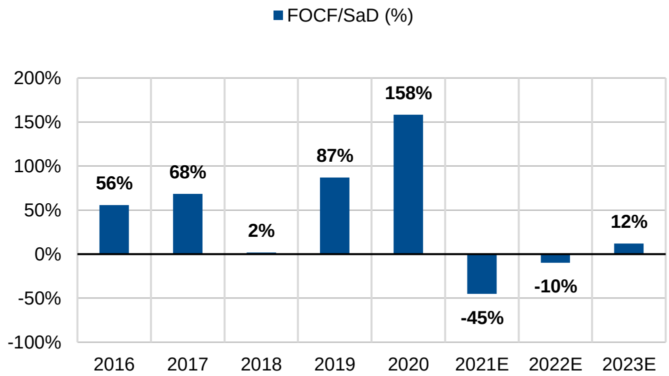
The company has not excluded the possibility of entering into large projects to build second-generation facilities in the coming years. Such projects usually require investment that runs into the hundreds of millions of euros, performed generally via a joint venture with a refinery partner. The investment would be funded partly by additional equity, but the significant expected increase in indebtedness could trigger a negative rating action. This event is not included in our base case scenario.

Figure 7: Envien International – cash flow



Source: Scope estimates

Figure 8: Envien International – cash flow cover



Source: Scope estimates

Cash flow cover and liquidity adequate

Liquidity is adequate. Envien Magyarország has no short-term debt and the bond is the first time it has held long-term debt. Envien International's liquidity is also adequate, with short-term debt primarily consisting of utilised overdraft lines, most of which are kept as cash and some as the short-term portion of finance leases. In line with general practice in the country, Envien Group has short-term revolving overdraft lines in place with a handful of banks, with different maturities with each bank over the course of the year to reduce liquidity risk. Most of these lines have been in place for years; the oldest has been regularly renewed in the last 10 years. Liquidity benefits from long-term debt maturing not earlier than 2029. Internal coverage alone is greater than 100% over the past years, while the internal and external coverage is comfortably trending towards 200%.

Supplementary key rating drivers

Conservative financial policy

Envien Magyarország's financial policy is characterised by a minimal risk appetite. The company has no short-term debt, and the issued bond is earmarked to repay an intercompany loan with the parent company. Dividend upstream to Envien International is done not automatically but when financial results are sufficient. Envien International does not explicitly commit to any credit metrics levels. Yet, it has managed them prudently in the last years, with SaD/EBITDA below 2.0x since 2015. We also have not seen any major appetite for discretionary spending in past years.

Similarly, the company does not have a specific dividend policy. Dividend payouts were higher in the past. Since 2020, the ratio has been reduced during years of lower profits or higher capex. Therefore, we maintain a neutral score on financial policy since management has kept credit metrics strong.

Parent support

We have equalised the issuer rating of Envien Magyarország with that of 100% owner Envien International based on expected parent support. After a recent shareholder transaction in December 2021, there is no ultimate beneficial owner that directly or indirectly controls Envien International with at least 25% of shares and/or voting rights. Based on the applicable law, the members of the board of directors (R. Spisak, S. Toth, T. Jacobsen) are the ultimate beneficial owners.

Governance and structure

We have no specific issues with the governance and structure of Envien Magyarország or Envien International.

ESG factors

We assess ESG factors as neutral. While the increased use of biofuels (as per regulation) allows for lower carbon emissions and Envien regularly invests in improving sustainability, the company is not deemed an outlier within its industry.

Guaranteed bond

Envien Magyarország issued HUF 5.5bn bond in 2021

Envien Magyarország issued a HUF 5.5bn (EUR 15.7m) bond in May 2021 (ISIN HU0000360193), which was oversubscribed by 10% (company fully utilised the HUF 0.5bn overallotment provision). Envien International provided an unconditional and irrevocable guarantee for the issue. The bond has a 10-year tenor (due in 2031) and a fixed coupon of 2.5% per year (HUF 125,000 per year for the first five years, then decreasing according to scheduled amortisation). Amortisation will be 10% in 2026, 10% in 2027, 10% in 2028, 10% in 2029, 10% in 2030 and the remaining 50% in 2031. The guaranteed amount for the bond is HUF 6.1bn, representing the full value plus a contingency buffer.

Guarantee is unconditional and irrevocable

Given the unconditional and irrevocable guarantee for the bond, we rate the guaranteed debt at the same level as the senior unsecured debt of guarantor Envien International.

Rating for guaranteed debt: BB

Based on a liquidation scenario at the level of Envien Group, we assess an ‘average’ recovery for the senior unsecured bond. We therefore affirm the BB rating, which is in line with the issuer rating.

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