Tranzit-Food Kft.
Hungary, Consumer Goods

BB STABLE

Corporate profile

The Tranzit group is a Hungarian based poultry company founded in 1990 by the Szabo family. The company employs approximately 1,600 people. Its headquarters are located in Debrecen. Tranzit breeds, slaughters, processes and sells ducks, geese and chickens. Operations also include crop and feed production. Annual sales amounted to HUF 42bn in 2019. The Tranzit group is divided into two subsidiaries: Tranzit-Ker takes care of the agricultural side of the business while the rated entity Tranzit-Food Kft. (Tranzit) focuses on the slaughtering, processing and distribution of poultry (geese, ducks and chickens) under the Goldenfood brand. The company owns two slaughterhouses, one dedicated to handling chickens and the other to handling geese and ducks. Tranzit also has a secondary processing plant. The shareholding structure changed in 2018, with French group LDC controlling 70% of Tranzit and the Szabo family retaining 30%.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	121.4x	120.8x	26.1x	19.0x
Scope-adjusted debt (SaD)/EBITDA	0.1x	net cash	1.0x	1.7x
Free operating cash flow (FOCF)/SaD	457%	net cash	(-) FOCF	(-) FOCF
Scope-adjusted FFO/SaD	1059%	net cash	90%	54%

Rating rationale

Scope Ratings has today affirmed its BB/Stable corporate issuer rating to Hungary-based Tranzit-Food Kft. The agency has also affirmed its BB senior unsecured debt rating.

The issuer rating is largely supported by Tranzit's leading position in Europe as a goose and duck processor. Tranzit is responsible for 50% of the goose meat supply in Hungary (18% in Europe). For duck, Tranzit's market share in its home country and Europe is 32% and 8% respectively. We view positively the ongoing diversification of Tranzit's poultry meat production. The company has recently started to develop its chicken operations by acquiring a further processing plant (Marnevall Zrt.) early in 2020. This first investment was financed via a capital increase and banking loans, as opposed to the initial plan of issuing a HUF 9.2bn (EUR 30m) Hungarian National Bank (MNB) bond under the MNB Bond Funding for Growth Scheme. The company does not foresee the issuance of such a bond in the near future. The second main investment is in the expansion of its chicken slaughterhouse capacity from 15m pieces to 25m pieces. Although this type of meat is less profitable than duck or goose, it should allow Tranzit to continue benefiting from the larger chicken market while maintaining duck and goose as niche markets. The company's creditworthiness is also supported by strong liquidity, a track record of low leverage and a strong operating margin. Tranzit has a good track record in terms of profitability, with an EBITDA margin ranging between 10% and 14%. However, profitability was negatively impacted in 2019 and the first half of 2020, dropping below 10%. This was the result of lower prices in the overall poultry market, driven by production overcapacity and temporarily limited export opportunities due to the Covid-19 crisis.

Ratings & Outlook

Issuer rating	BB/Stable
Senior unsecured debt	BB

Analysts

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Related Methodologies

Corporate Rating Methodology, February 2020

Consumer Products Methodology, September 2020

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The rating is constrained by Tranzit's limited size compared to other European players, as well as concentration issues regarding its footprint and customer portfolio (especially for chicken). The lower profitability (8%) of the broiler segment combined with the future increase of Tranzit's exposure to chicken is likely to weigh on its overall EBITDA margin, further limiting the rating. We expect the impact of the Covid-19 crisis to be fairly limited for the company. This is because the non-discretionary nature of the goods it sells affords a general resilience to economic downturns. We forecast that leverage will increase materially from 1.0x in 2020 to 1.7x by 2021. Despite good credit metrics, Tranzit's financial risk profile is constrained by forecasted negative free operating cash flow (FOCF) due to massive capex which cannot be financed organically.

Outlook and rating-change drivers

The Outlook is Stable and incorporates the expectation that Scope-adjusted debt (SaD)/EBITDA will remain below 3.0x. The Outlook also reflects our expectation that Tranzit will continue to perform positively, thanks to a resilient business model, with limited vulnerability to the Covid-19 pandemic.

A positive rating action could be warranted by an improvement in Tranzit's business risk profile. This could be achieved via a material increase in size or better diversification.

A negative rating action may be taken if SaD/EBITDA reaches around 4.0x on a sustained basis. An increase in leverage could be triggered by a rise in net debt from larger than anticipated capex or from a slower recovery of the poultry market in Hungary weighing on the company's profitability.

Long-term and short-term debt ratings

All senior unsecured debt has been issued by Tranzit-Food Kft. Our recovery assessment is based on a hypothetical default scenario in 2022, including bank debt (2022F: HUF 9.9bn) ranked senior unsecured. Our recovery analysis indicates an 'average recovery' for senior unsecured debt. This expectation translates into a rating of BB for this debt category.

Rating drivers

Positive rating drivers	Negative rating drivers
• Market leader in goose production in Europe with 18% market share • Recent entry into the chicken segment providing exposure to a large, growing meat market • Good EBITDA margin despite low profitability of chicken operations • Product diversification with three types of poultry meat	• Small player in the European market • Weak geographical diversification outside of Europe although this is likely to improve; weak customer diversification in the chicken segment • Recurring negative FOCF due to volatile working capital and large capex plan

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in business risk profile through an increase in size and better diversification	• SaD/EBITDA above 4.0x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	121.4x	120.8x	26.1x	19.0
Scope-adjusted debt (SaD)/EBITDA	0.1x	net cash	1.0x	1.7x
FOCF/SaD (%)	457%	net cash	(-) FOCF	(-) FOCF
Scope-adjusted FFO/SaD	1059%	net cash	90%	54%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	6,084.4	5,026.9	3,119.5	3,527.6
Operating lease payments in respective year	0	0	0	0
Other items	0	0	0	0
Scope-adjusted EBITDA	6,084.4	5,026.9	3,119.5	3,527.6
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	6,084.4	5,026.9	3,119.5	3,527.6
less: (net) cash interest as per cash flow statement	-50.1	-41.6	-119.5	-185.6
less: cash tax paid as per cash flow statement	-17.1	-27.5	-152.3	-60.0
Other	-35.6	-24.4	0.0	0.0
Scope-adjusted funds from operations	5,981.5	4,933.4	2,847.7	3,282.0
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	5,633.7	4,932.6	6,326.9	8,622.9
less: cash and cash equivalents	-5,068.9	-5,198.8	-3,164.1	-2,509.5
add: cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other items	0	0	0	0
Scope-adjusted debt	564.9	-266.2	3,162.8	6,113.4

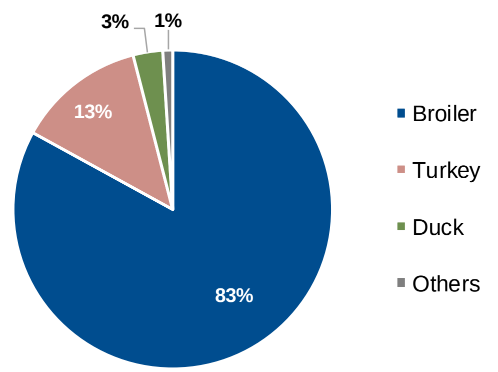
Business risk profile

Small European player constrained by niche market position

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

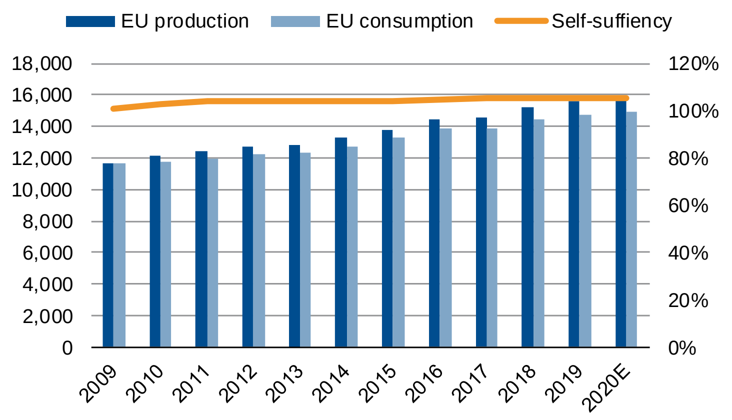
Goose and duck meat production accounts for less than 4% (Figure 1) of the European poultry market, which is widely dominated by the production of broilers (83%). Tranzit is responsible for 50% of the goose meat supply in Hungary and 18% in Europe. The duck meat market in Hungary is three time bigger than the goose meat market (78.77 kilotons) and Tranzit's market share in its home country and Europe is 32% and 8% respectively. If we include its 40 kilotons of chicken production, Tranzit produces around 78 kilotons of poultry meat, which is less than 1% of the 15.2 m tons produced in Europe.

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



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 following an integrated approach already implemented for its goose/duck production, with Tranzit Ker supplying the main share of the poultry slaughtered. Chicken allows Tranzit to benefit from the only meat expected to grow between 2017-2030 both on the consumption (+4.2%) and the production side (+4.6%). Global demand is driven by the comparative advantages of poultry over other meats including affordability, convenience, the absence of religious guidelines and a healthy image. As the EU is self-sufficient (Figure 2), most surplus production is likely to be exported outside of the continent to the Middle East, sub-Saharan Africa and Asia (Vietnam and the Philippines). The EU's main competitor for world demand remains Brazil, which can export at a lower price partly because of its currency devaluation. Due to sustained productivity gains and looser environmental regulation for the building of new farms, the strongest increase in production is expected in Hungary, Poland and Romania.

The sale and production of chicken occurs through the whole year as opposed to goose and duck, which suffer from a seasonal effect. Goose tends to be eaten on particular occasions (such as St. Martin's day in Hungary and Germany, Christmas, etc.) with selling contracts running from September to Easter.

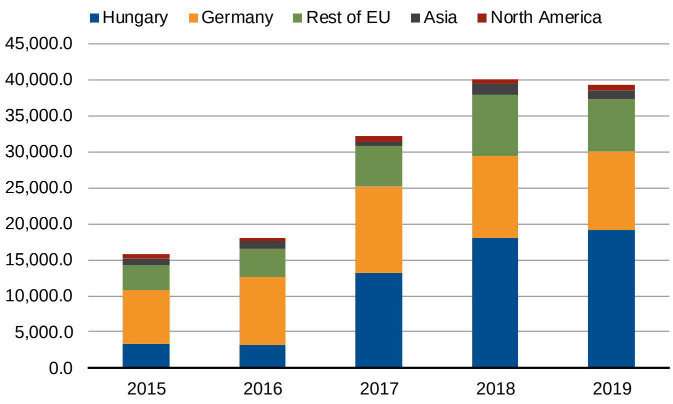
Geographical footprint focused on Europe but aim to increase exports outside this region

Tranzit's geographical footprint is clearly within Europe. However, this is partially mitigated by the company's strategy to increase its exports outside the region with the expected development of its chicken operations.

At YE 2019, Hungary accounted for 48% of Tranzit sales, while Europe's share stood at 95%. This is fairly stable compared to the previous year. Sales in the rest of Europe were achieved in 20 different countries, mainly Germany, Slovakia, Great Britain, Austria and Romania. The remaining exposure is largely dominated by Japan, where Tranzit's goose products enjoy great popularity. Tranzit is less likely to suffer from import restrictions from countries located outside of Europe.

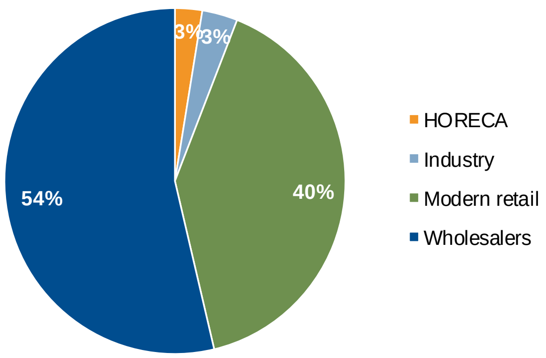
The launch of the chicken segment caused the share of revenue generated in Hungary to surge in 2017. Tranzit's main customers belong to the wholesale and retailing industries (94% of FY 2019 revenues). At the same time, Tranzit has a diversified portfolio of selling contracts.

Figure 3: Revenue breakdown by region 2015-2019



Source: Tranzit, Scope

Figure 4: FY2019 revenue breakdown by sales channel



Source: Tranzit, Scope

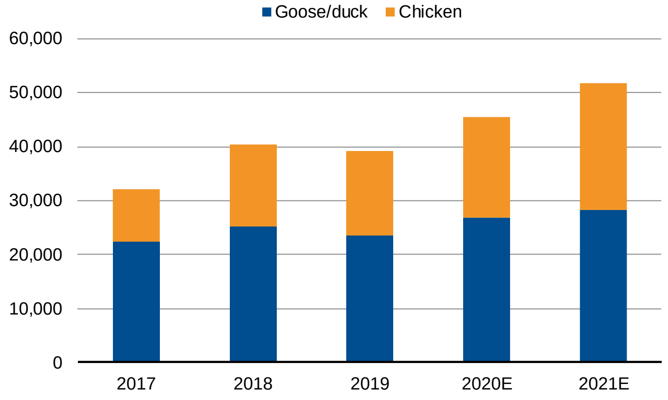
Concentration across products and supply chain, arising from integrated group model

Tranzit markets three types of animal: ducks, geese and chicken. Although they all belong to the 'poultry' category, they are not consumed the same way: while chicken is eaten all year long, duck/goose is bought on special occasions, which makes their market more predictable quantity-wise but also more elastic. Chicken represents 40% of sales and 22% of EBITDA. We expect product diversification to improve on the top line side, with the contribution from chicken reaching 65% by 2022. The EBITDA margin generated from chicken is more stable but consistently lower than the margin generated by duck/goose, at around 8%.

The three types of bird are sensitive to the 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 visible customers (retailers) impose strict quality controls. Tranzit Ker's strategy is to have breeding farms in various regions, spanning four different counties. This keeps the birds safe because the distance makes hygienic actions more efficient. In addition, Tranzit does not exclusively source its raw materials from its sister company Tranzit Ker:

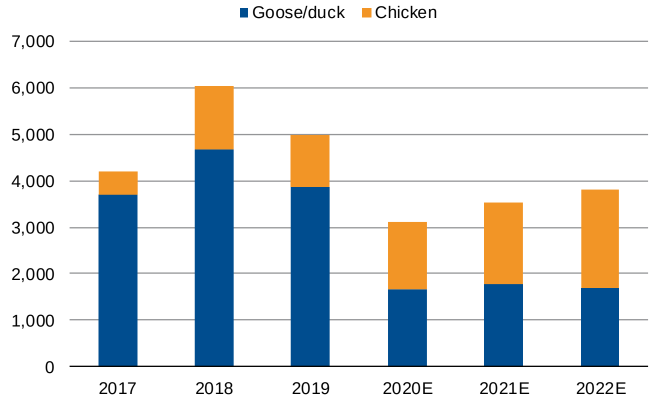
- Goose and duck: a maximum of 65% from Tranzit Ker while the remaining 35% are bought from selected farmers who purchase their feed from Tranzit Ker
- Chicken: 50% from Tranzit Ker while 50% are bought from selected farmers who purchase their feed from Tranzit Ker.

Figure 5: Revenue breakdown by type of meat 2017-2022E (HUF m)



Source: Tranzit, Scope

Figure 6: EBITDA breakdown by type of meat 2017-2022E (HUF m)



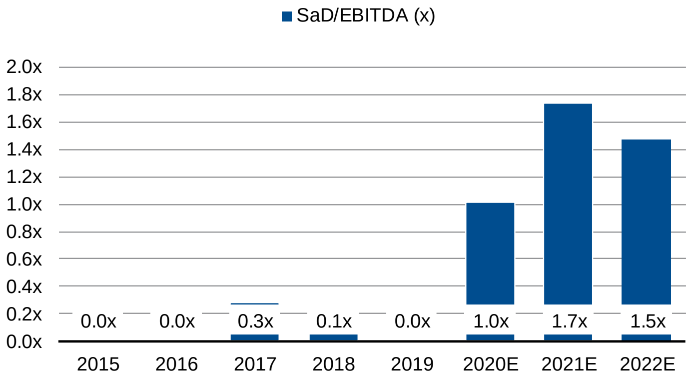
Source: Tranzit, Scope

Strong profitability forecasted to decrease slightly

Tranzit has strong historical profitability compared to its Hungarian peers, maintaining an operating margin between 9.5% and 14.5%. We expect Tranzit's EBITDA margin to decrease from 2020 onwards due to: i) the larger share of less profitable chicken in total revenue as Tranzit ramps up its broiler production; and ii) the recent drop in duck and goose prices (lowest in the last ten years) caused by lower demand and overproduction. We view margin pressures from rising labour costs as limited because they will be offset by the greater use of automated processes and the growth of the poultry market. Tranzit's profitability has medium volatility because: i) price pressure risk is mitigated by the company's ability to deliver high quality products (GMO-free and free range) to end-customers with high standards, cementing long-term relationships with buyers; and ii) sales contracts provide visibility on production and pricing power.

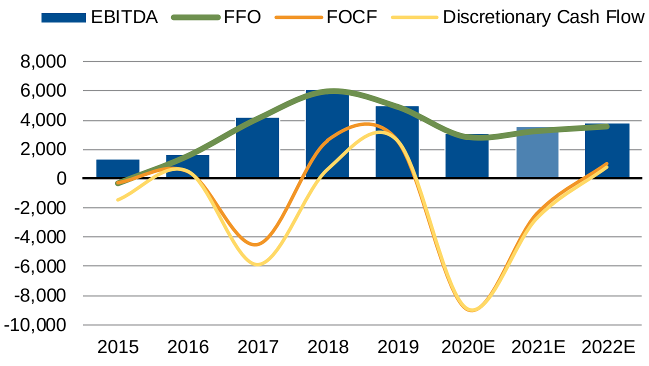
Financial risk profile

Figure 7: Leverage – 2015 to 2022E



Source: Tranzit, Scope

Figure 8: Cash flows – 2015 to 2022E



Source: Tranzit, Scope

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

Tranzit had growing and high EBITDA interest expense cover above 7.0x between 2015 and 2019. This level was thanks to a very low level of gross interest costs with an average cost of debt below 1%.

We anticipate that debt protection will drop to 19x by 2021 due to a significant change in the future debt position with newly issued debt of HUF 7.2bn between 2020 and 2021 to finance expansion capex.

Negative FOCF due to massive capex programme despite lower negative working capital impact

If we look at Tranzit's track record, operating cash flow generation has been volatile and insufficient to cover capex. Working capital was negative at the end of 2017, 2018 and 2019 because of a sharper decrease in days of purchase outstanding than in days of sale outstanding. This is the consequence of Tranzit's new chicken operations, with more external suppliers implying shorter payment delays. We expect FOCF/SaD to remain negative between 2020 and 2021 due to a combination of two factors: i) negative working capital consumption is expected to continue but to a lesser extent because Tranzit Ker will ramp up its chicken production, reducing exposure to external suppliers; and ii) HUF 16bn in development capex split between 2020 and 2021. Tranzit's financial risk profile is mainly constrained by the company's inability to self-finance its upcoming capex in addition to a potential increase in dividend pay-outs in a high investment phase.

Leverage increasing to 1.7x in 2021 from 0.1x in 2018

Since 2015, Tranzit's consolidated leverage, measured by SaD/EBITDA and funds from operations/SaD, has been negative or very low due to its recurring high cash balance.

We forecast that the company will become much more leveraged, with net debt growing between 2019 and 2021 from HUF 4.9bn to HUF 8.6bn. Forecasted gross debt is lower than the amount which we previously anticipated (around HUF 17bn). This is because the company ultimately decided not to issue the EUR 30m (HUF 9,270m) MNB bond. Tranzit favours a mix of funding composed of bank loans and a capital increase from LDC, the main shareholder, to complete its large new investments in Tranzit Food.

Liquidity supported by large unrestricted cash balance and undrawn credit facilities

We view Tranzit's liquidity as adequate based on our expectation that sources of liquidity will exceed uses of short-term debt in the next 12 months, following consistently good liquidity in the past.

Figure 9: Liquidity

(in HUF m)	2015	2016	2017	2018	2019E	2020E	2021E
Short-term debt (t-1)	397.4	397.4	677.5	2,547.8	2,123.9	2,208.3	333.0
Unrestricted cash (t-1)	5,692.8	5,692.8	6,016.9	5,478.5	5,068.9	5,198.8	3,164.1
Open committed credit lines (t-1)	2,500.0	2,500.0	3,179.8	4,138.0	3,478.0	2,647.0	2,500.0
Free operating cash flow (t)	494.1	494.1	-4,490.6	2,582.7	2,607.9	-8,918.4	-2,377.4
Liquidity (internal)	1557%	1557%	225%	316%	361%	-168%	236%
Liquidity (internal+external)	2186%	2186%	695%	479%	525%	-49%	987%

Source: Tranzit, Scope

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