Hunland Trade Kft
Hungary, Agribusiness

SCOPE B+ STABLE

Corporate profile

Founded in 1992 and headquartered in Bugyi, Hungary, Hunland Trade Kft has a prominent role in the global livestock and meat trade. It sells and buys livestock (breeding cattle, slaughter cattle, sheep, lambs, goats, pigs and piglets), mainly to supply the group's agriculture companies. It supplies beef, pork and lamb meat as well as poultry meat. Its only subsidiary, with a 90% stake, is Hunland Trans Kft. The company is fully owned by Joseph Janssen (64.7%) and Suzanne Janssen (35.3%).

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover	12.5x	9.8x	6.2x	6.2x
Scope-adjusted debt (SaD)/EBITDA	4.0x	5.8x	7.5x	6.4x
Scope-adjusted funds from operations/SaD	7%	22%	1%	14%
Free operating cash flow/SaD	14%	-3%	1%	4%

Rating rationale

Scope Ratings GmbH (Scope) has today affirmed its B+/Stable issuer rating on Hunland Trade Kft., a Hungarian agribusiness company. Scope has also affirmed its B+ rating on the HUF 24.15bn guaranteed senior unsecured corporate bond.

The rating action reflects our unchanged view on the company's credit quality amid the creation of a group holding company (Hunland Group Holding Kft) and the creation of the group holding (Hunland Group Holding Kft), series of demergers which has taken place in Hunland Group in order to separate its production, trading and maintenance business lines into different legal entities. On 1 January 2022, Hunland Group Holding Kft, which is a pure holding company and is fully directly owned by Mr. and Ms. Janssen, was created and has become one of the guarantors of the bond issued as part of the MNB programme. Hunland Trade Kft was demerged from its B2C trading business (named Hunland Feed). This demerger has a limited impact on the ratings as most assets and liabilities remain in the demerged Hunland Trade Kft. Besides, B2C trading activity only accounted for less than 2.5% of net revenues and EBITDA. Hunland Feed (B2C trading activity) has become one of the guarantors of the bond. Three of the four guarantors have also been demerged, leading to the following seven guarantors: Hunland Trans Kft, Bovinia Kft, Hunland Production Kft, Hunland Dairy Kft, HLT Production, Hunland Service and HLT Telep. In the course of 2022, the group plans to merge its B2C feed trading companies (Hunland Feed and HLT Production) and its maintenance companies (Hunland Service, HLT Telep and HLT Farm). These new entities will guarantee the bond, along with Hunland Trans Kft, Bovinia Kft, Hunland Production Kft and Hunland Dairy Kft.

Hunland Trade's business risk profile is still supported by its leading position in the Hungarian livestock export market. The company continues to benefit from a large customer base, though with some concentration risk. However, Hunland Trade's business risk profile remains constrained by its high level of receivables. This is due to the nature of its business and the low diversification of its activities.

Regarding Hunland Trade's financial risk profile, we expect leverage, as measured by the Scope-adjusted debt (SaD)/EBITDA ratio, to remain high: peaking at 7.5x in 2021 before decreasing to below 6.5x. We expect the interest cover ratio to reach above 6x and underlying profitability to remain low, but stable, at around 2.5%. We also expect free operating cash flow (FOCF) to be positive.

Ratings & Outlook

Corporate rating	B+/Stable
Guaranteed senior unsecured debt rating	B+

Analyst

Anne Grammatico, CFA, CESGA
+33 182882364
a.grammatico@scoperatings.com

Related Methodology

Corporate Rating Methodology, July 2021

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Outlook and rating-change drivers

Stable Outlook

The Stable Outlook for Hunland Trade incorporates our view that key credit metrics over the next three years will be weaker overall, with SaD/EBITDA of 5.5x-7.5x. It also incorporates Hunland Trade's position as the leading Hungarian livestock exporter and our expectation that Hunland Trade's EBITDA margin will remain stable at around 2.5%.

Ratings upside

A positive rating action is remote in light of Hunland Trade's increasing indebtedness. However, it could be warranted by Scope-adjusted EBITDA/interest cover of above 7x on a sustained basis and by an improved business risk profile, for example with a sustained Scope-adjusted EBITDA margin of over 3.5%.

Ratings downside

The rating could come under pressure if debt protection remained persistently below 4x, for example as a result of significantly lower contributions to earnings from cattle and pig sales.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leading Hungarian livestock exporter • Good geographical diversification on the customer side • Adequate expected interest coverage • Stable, but low, profitability	• High expected SaD/EBITDA • Minor role of livestock exports in Hungarian economy • Eastern Europe and Hungary are small livestock producers, although there is some potential for development in Eastern Europe • Lower exports of live animals and lower prices for cattle and lamb • High receivables and pressure on net working capital • Lower geographical diversification on the supplier side

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted EBITDA/interest cover above 7x on a sustained basis • Improving business risk profile, e.g. demonstrated by improved profitability on a sustained basis	• Scope-adjusted EBITDA/interest cover below 4x on a sustained basis

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	12.5x	9.8x	6.2x	6.2x	6.3x
Scope-adjusted debt (SaD)/EBITDA	4.0x	5.8x	7.5x	6.4x	5.6x
Scope-adjusted funds from operations/SaD	7%	22%	1%	14%	14%
Free operating cash flow/SaD	14%	-3%	1%	4%	15%
Scope-adjusted EBITDA in EUR '000s	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	9,920	7,411	7,781	8,417	8,455
Operating lease payments in respective year	-	-	-	-	-
Other: profit/loss on asset disposal	539	51	-	-	-
Scope-adjusted EBITDA	**10,459**	**7,462**	**7,781**	**8,417**	**8,455**
Scope-adjusted interest in EUR '000s	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Interest paid	848	774	1,526	1,956	1,956
less: interest received	-9	-11	-277	-605	-605
add: interest on pensions	-	-	-	-	-
add: interest on operating leases	-	-	-	-	-
Other	-	-	-	-	-
Scope-adjusted interest	**839**	**762**	**1,249**	**1,351**	**1,351**
Scope-adjusted debt in EUR '000s	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	42,652	45,839	69,443	70,713	70,563
less: hybrid bonds	-	-	-	-	-
less: cash and cash equivalents	-1,122	-2,921	-11,491	-16,941	-23,209
add: cash not accessible	-	214	214	214	214
add: pension adjustment	-	-	-	-	-
add: operating lease obligations	-	-	-	-	-
add: asset retirement obligations	-	-	-	-	-
Other (received bank guarantees)	-	-	-	-	-
Scope-adjusted debt	**41,530**	**43,131**	**58,166**	**53,986**	**47,568**

Business risk profile

Hunland Trade's **business risk profile (assessed at B+)** is supported by its market position as Hungary's leading livestock exporter, though profitability and diversification are negative rating drivers.

Animal production accounts for one-third of agricultural output in Hungary

According to Eurostat, animal output accounts for one-third of Hungary's agricultural output and is the country's second biggest source of agricultural income, while crop output accounts for half of agricultural output and is the top source of agricultural income. Regarding animal output in Hungary, poultry ranks first (12% by average agricultural output), followed by pigs (10%), milk (8%), eggs (2%), cattle (4%), and sheep and goats (1%). Thus, the livestock market on which the issuer depends (cattle, pigs and sheep) accounts for around 15% of agricultural production, which is half of Hungary's animal output and half the size of its cereals production market.

Minor role of livestock exports in Hungary's economy

Hungarian exports of agricultural products, at EUR 9.6bn in 2020, are minor compared to goods and services exports of EUR 107bn (source: Eurostat). Commodities made up one-third of agricultural product exports in 2020, with 90% realised in the EU.

Eastern Europe and Hungary are small livestock producers…

Europe is the world's second largest livestock producer by tonnes of protein (behind Asia) with 40% of production, mainly cattle, pork and beef for Western European customers. Eastern Europe, by contrast, accounts for only 20% of European production and 4% of worldwide production.

With 8.5m heads of livestock in 2019, Hungary ranks 15th in Europe, far behind first-ranking Spain with 102.1m heads. Excluding Western European countries, Hungary is among the top five behind Romania, Poland, Greece and Serbia.

Nevertheless, the last two livestock surveys by the European Commission found a decline in the main producing EU member states, except for Poland and Spain. This trend is expected to continue until 2030, accompanied by a partial shift to Poland, Hungary and the Czech Republic.

…but potential for development in Eastern Europe

Hunland Trade expects production from Eastern Europe to grow due to land availability. Indeed, livestock production is the world's largest user of land, either directly through grazing or indirectly through the consumption of fodder and feed grains by livestock. Nevertheless, the top three countries for heads of livestock – Spain, the UK and France – have livestock units per hectare that are close to, if not higher than, Hungary's.

Hunland Trade is a major player in the food supply chain in selected markets

Thanks to an active role in livestock and meat trade for more than 25 years, Hunland Trade is a major player in global food supply. It sells to around 40 countries, mainly in Europe. In the EU, Hunland Trade is a leading exporter of breeding cattle to the Commonwealth of Independent States[1] and a top three importer of breeding cattle from Russia.

Leading Hungarian livestock exporter

Hunland Trade's cattle exports account for almost 50% of Hungary's livestock exports, following by pigs (35%), and sheep and goats (35%). This makes the company Hungary's leading livestock exporter. Hunland Trade is also first in Hungary for net sales, followed by its two main competitors, Agrar-Coop and Agrota-2L.

Integrated business

Half of Hunland Trade's 10 main suppliers are its sister companies: Hunland Chile Ganadera, Hunland Production Kft, Hunland Trans Kft, and Bovinia Kft. The last three are also guarantors of Hunland Trade's MNB bond. These four suppliers represented 40% of the top 10 suppliers in terms of turnover in 2020. According to Hunland Trade, the other

[1] Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine

five suppliers work to high standards as they are EU-approved slaughterhouses, meat processors and breeding companies.

Large customer base with some concentration

More than 50% of Hunland Trade's sales are realised in three countries (Hungary, Egypt and Turkey). Nevertheless, it has customers in around 40 countries. Its top 10 customers account for 35%-50% of total sales and the largest customer (in Hungary) represents around 10%-20%. As such, the company faces some concentration risk.

High receivables

Hunland Trade's receivables account for almost half of its total balance sheet on average. To reduce the risk of non-payment, Hunland Trade uses credit insurance (for EU sales) and credit letters (non-EU sales).

Revenues and EBITDA mainly dependent on livestock activity

Livestock consistently accounts for around 90% of revenues and 85% of EBITDA, followed by meat at around 5%-10% and 10%, respectively. As both activities relate to the same market category, we do not consider revenues to be diversified by sources. Nevertheless, diversification is strong by livestock 'products', with around 50% of total sales from cattle, 30% from pigs and 5% from lamb.

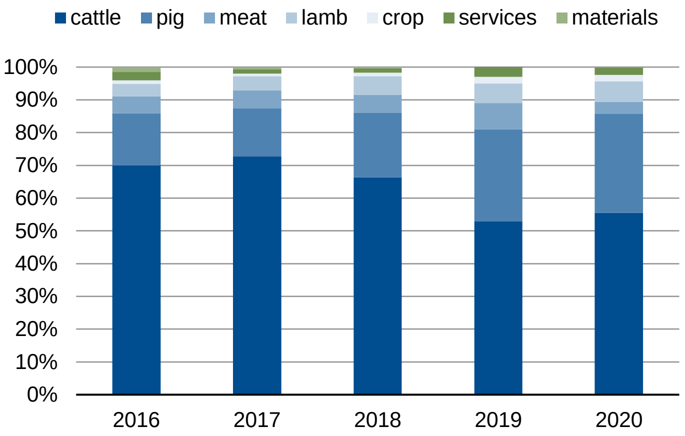
Good geographical diversification on the buyer side but…

On average, two-thirds of sales are realised in four countries (out of around 40 countries). Hungary is now the most important market. Previously it was Turkey, which accounted for around one-third of sales until one contract ended in mid-2018.

… lower geographical diversification on the supplier side

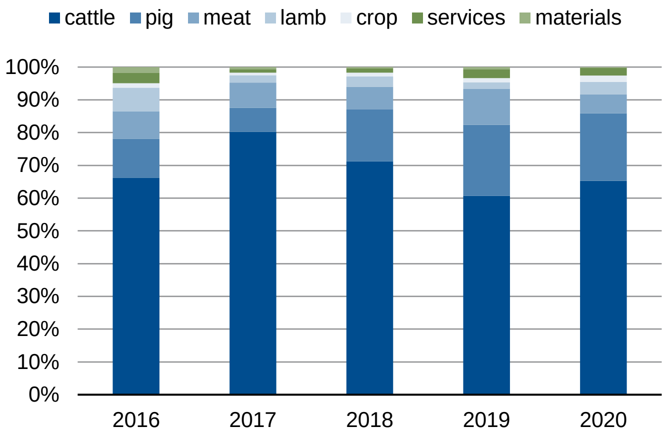
Between one-half and one-third of product sales come from two countries (Hungary and Brazil). Hunland Trade is mainly dependent on Hungary, which makes sense as products mostly come from sister companies, the bulk of which are located in Hungary. The remaining sales are split between around 20 countries.

Figure 1: Sales breakdown by product



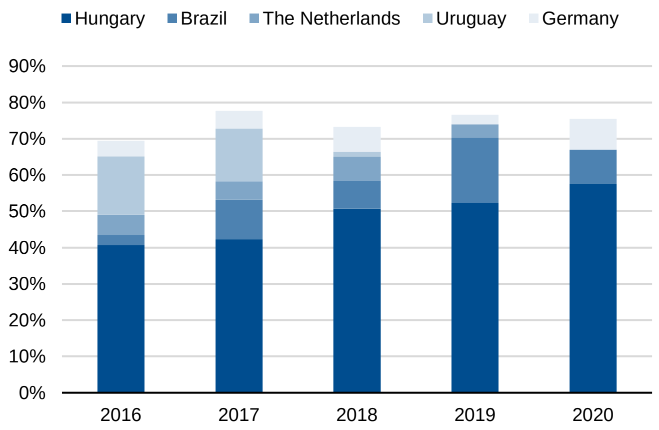
Source: Hunland Trade, Scope

Figure 2: EBITDA breakdown by product



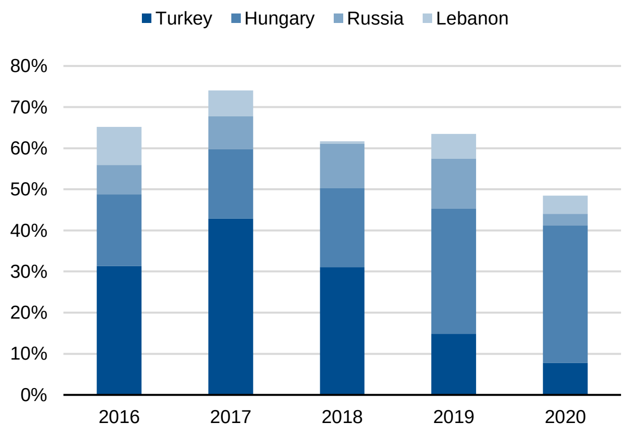
Source: Hunland Trade, Scope

Figure 3: Main origin countries (% of total sales)



Source: Hunland Trade, Scope

Figure 4: Main destination countries (% of total sales)

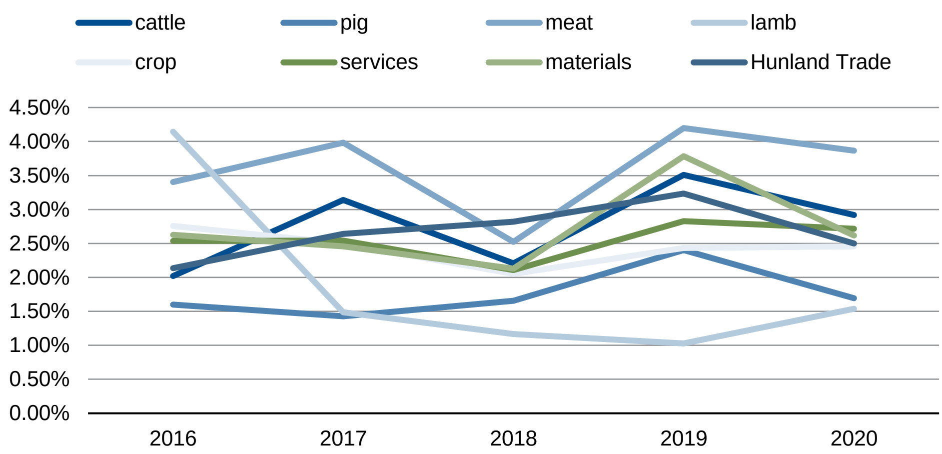


Source: Hunland Trade, Scope

Low profitability

Hunland Trade's EBITDA margin is low at between 2% and 3%. The highest margin is for meat followed by materials. Cattle, which accounts for the bulk of EBITDA, only has the third highest margin.

Figure 5: Adjusted EBITDA margin per segment



Source: Hunland Trade, Scope

Margin profile expected to remain stable

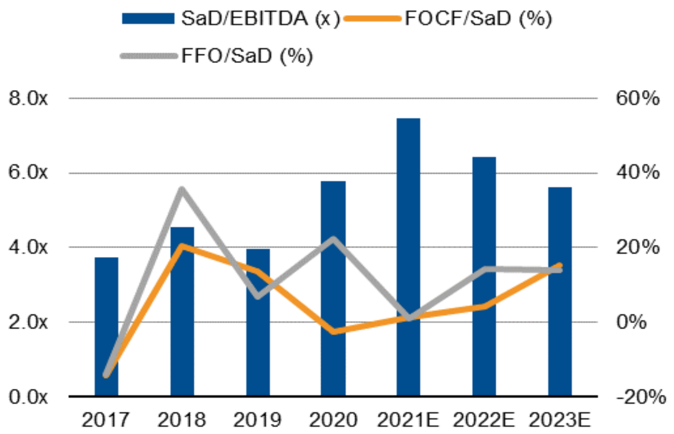
Hunland Trade's profitability is set to remain stable after having decreased in 2020 mainly as a result of lower net sales in 2020 and higher material costs. Indeed, cattle prices dropped in 2020, but Hunland Trade decided to keep its selling price lower to satisfy its partners. The falling prices have allowed the company to buy young cattle livestock much more cheaply, which could be beneficial later unless selling prices fall further.

Given the above facts, we expect Hunland Trade's EBITDA margin to remain at the 2020 level of around 2.5%.

Financial risk profile

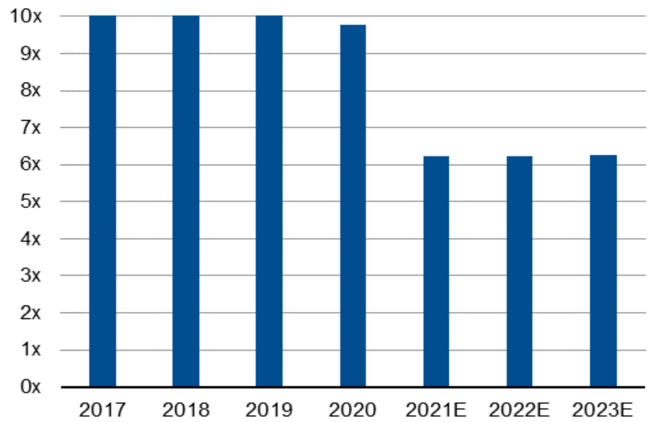
Hunland Trade's **financial risk profile (assessed at B+)** is based on our expectation of financial leverage (SaD/EBITDA) of between 5.0x and 7.5x and an interest cover ratio sustained at above 6.0x. We also expect stable profitability and positive FOCF.

Figure 6: Scope-adjusted leverage



Source: Hunland Trade, Scope estimates

Figure 7: EBITDA interest coverage



Source: Hunland Trade, Scope estimates

Rating reflects high leverage

Leverage has been moderate in recent years at between 3.5x and 4.5x, except in 2020 when Covid-19 led to leverage of 5.8x due to lower sales and lower EBITDA. Nevertheless, our rating case includes expected SaD/EBITDA of 5.5x-7.5x, reflecting the bond issuance in 2021, with these levels becoming the norm in the following years. The expected ratio therefore has a greater weight in our rating assessment.

The funds from operations/SaD ratio has been above 5%, with the exception of 2017 when it was negative. However, we expect this ratio to be at the higher end of 0% and 15% based on higher expected SaD following the bond issuance.

Adequate interest coverage

Hunland Trade's debt protection – as measured by Scope-adjusted EBITDA/Scope-adjusted interest – was above 10x (2017: 12x, 2018: 15x, 2019: 12%). We expect debt protection to fall below this threshold in the next few years due to higher forecasted interest payments.

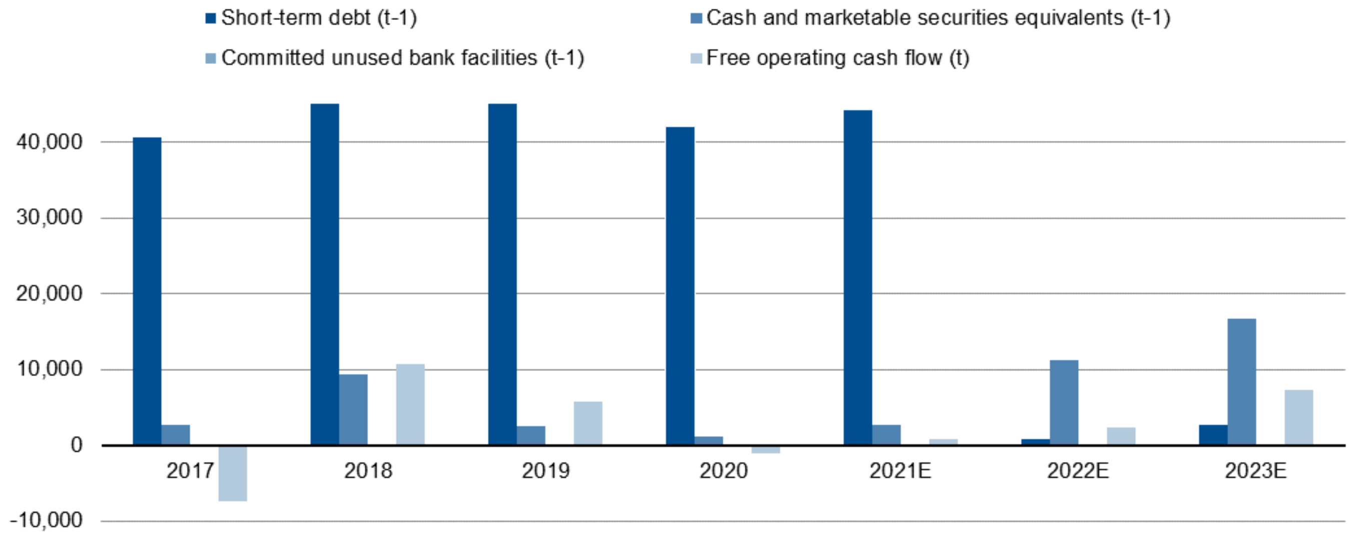
Weak cash flow coverage

Hunland Trade's cash flow cover – as measured by FOCF/SaD – has moved between negative and positive positions due to the fluctuation in FOCF. The variation is mainly influenced by the change in working capital. For the coming years, we expect FOCF to be positive but low compared to SaD.

Adequate liquidity

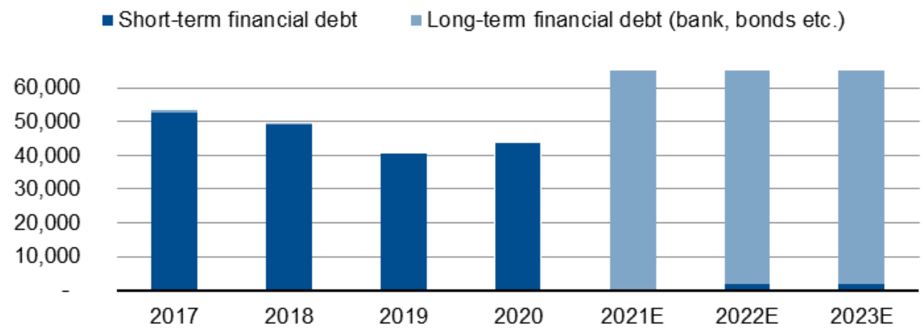
Hunland Trade's liquidity is adequate thanks to the bond issue, which will enable the company to refinance the bulk of its short-term financial debt. Hunland Trade will repay EUR 44.3m in debt in 2021. This compares to EUR 2.7m of available cash and equivalents as of 31 December 2020. We expect FOCF to be positive in 2021 thanks to a positive working capital variation. Unrestricted cash as of 31 December 2021 (EUR 11.3m) and positive FOCF of EUR 0.8m cannot cover the repayment of short-term financial debt. On the other hand, part of the proceeds from the bond issue under the MNB programme will be used to refinance the bulk of short-term financial debt.

Figure 8: Short-term debt repayment amount, available cash and FOCF (in EUR '000s)



Source: Hunland Trade, Scope estimates

Figure 9: Financial debt (in EUR '000s)



Source: Hunland Trade, Scope estimates

Supplementary rating drivers

Conservative dividend policy

No dividends have been paid since 2017. Further, the bond prospectus states that there will be no dividend payments until 2022. Any dividend payments from 2023 would be capped at 50% of net income and contingent on positive FOCF. We believe this dividend policy is conservative. A higher dividend distribution could alter our rating case.

No credit-negative governance-related aspects

Hunland Trade is a privately owned limited liability company (Korlátolt Felelősségű Társaság Kft). The highest decision-making body is the members meeting (taggyűlés), whose members are the two owners: Joseph and Suzanne Janssen.

We see limited risk related to Hunland Trade's governance. The company's governance is also supported by experienced and committed management.

Long-term debt rating for HUF 24.15bn guaranteed senior unsecured bond

HUF 24.15bn guaranteed senior unsecured bond issued for refinancing and intercompany loans

The rated entity issued a HUF 24.15bn (equivalent to EUR 67.2m) guaranteed senior unsecured bond in 2021 under the MNB Bond Funding for Growth Scheme. It has a 10-year maturity with a five-year grace period followed by amortisation of 10% for years 5-9 and 50% in year 10. The bond was guaranteed by Hunland Trade's sole subsidiary (Hunland Trans Kft) and three sister companies (Bovinia Kft, Hunland Production Kft and Hunland Dairy Kft). Following the demergers, the current new guarantors are the following entities: Hunland Trans Kft, Bovinia Kft, Hunland Production Kft, Hunland Dairy Kft, HLT Production, Hunland Service, HLT Telep and Hunland Feed.

The proceeds were primarily earmarked for the refinancing of short-term financial debt of EUR 40m, the investment of EUR 3m in new production machines, and the provision of intercompany loans to the guarantors for EUR 20m to refinance their debt (EUR 10.9m) and finance their capex (EUR 9.1m).

Proceeds from the intercompany loans were earmarked as follows:

- Hunland Dairy: EUR 2.5m for capex to build a slurry storage and renovate its barn;
- Hunland Trans: EUR 4.5m for capex to acquire new assets/vehicles;
- Hunland Production: EUR 1m for capex to expand the feed factory and EUR 8.2m to refinance loans; and
- Bovinia: EUR 1.1m for capex to construct two new stables and EUR 2.7m to refinance loans.

In practice, the proceeds are used as follows:

- EUR 44.3m to refinance Hunland's short-term bank debt;
- EUR 8.2m to refinance Hunland Production's bank debt;
- EUR 2.7m to refinance Bovinia bank debt;
- EUR 5.5m to finance Bovinia's capex; and
- EUR 0.8m to finance Hunland Dairy's capex.

Thus, EUR 10.9m have been used to refinance guarantors' bank debt and EUR 6.3m are dedicated to guarantors' capex, meaning that a total of EUR 17.2m are dedicated to the guarantors. Overall, EUR 61.5m has been assigned to a specific purpose, which leads to an unused amount of EUR 5.7m. According to Hunland Trade, it plans to keep this amount as a cash buffer.

Bovinia and Hunland Dairy investments are prioritised as those entities' investment projects can benefit from government subsidies (40%-50%). Hunland Trade's investment has been postponed, leading to higher-than-expected bank debt refinancing.

B+ bond rating reflects average recovery expectations

Our 'average' recovery expectation for guaranteed senior unsecured debt is based on an anticipated liquidation value in a hypothetical default scenario. Guaranteed senior unsecured debt ranks below short-term and long-term debt (excluding the bond issue) raised from financial institutions and payables which are secured by asset pledges. Consequently, in the event of a hypothetical default, creditors of the guaranteed senior unsecured bond are likely to be repaid from the liquidation proceeds remaining after repayments to senior secured debt creditors; the guarantors' current assets; and property, plant and equipment; reduced by long- and short-term financial debt, and payables. Our recovery expectation takes into consideration uncertainties regarding the value of claims at the guarantors' level at the point of a hypothetical default of the bond issuer but also uncertainties about the debt positions of the guarantors at the point of a hypothetical default of the bond issuer and the seniority of the claim. These recovery expectations translate into a rating of B+.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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