03 August 2021 Corporates

Agrar Kft.
Hungary, Agribusiness

B STABLE

Corporate profile

Agrar Kft., based in Somogyszob (Hungary), breeds, raises, fattens and sells piglets. It is fully owned by the Claessens family and part of the integrated agricultural company Claessens Group. The Claessens Group covers the complete cow and pig value chain – from its own crop production to raising and selling the animals. In 2020, Agrar achieved sales of about HUF 4.7bn and an EBITDA of about HUF 1.9bn.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	-50.3x	-29.9x	21.5x	9.6x
Scope-adjusted debt (SaD)/EBITDA	0.5x	0.3x	3.3x	2.8x
Scope-adjusted FFO/SaD	177%	344%	27%	29%
Free operating cash flow (FOCF)/SaD	40%	-43%	-99%	-50%

Rating rationale

Scope Ratings GmbH (Scope) has today assigned a B/Stable corporate issuer rating to Hungarian Agrar Kft. Scope has also assigned a senior unsecured debt rating of B+.

Agrar's issuer rating is hampered by its business risk profile of B- and supported by a stronger financial risk profile of BB. The company's profitability figures (EBITDA margin) are volatile but solid, which is the main support for its competitive position. However, our EBITDA margin calculation excludes subsidies received as part of the EU's Common Agricultural Policy. Prices for pigs and piglets are highly transparent, standardised and allow companies to exert only limited pricing power. At the same time, Agrar's profitability generation benefits from its raw material procurement via around 1,000 hectares of farmland and its long track record in pig farming, among others. On the flipside, profitability is compromised by the company's small size, resulting in a weak market share in the Hungarian pig breeding and fattening industry, together with weak diversification.

Agrar's financial risk profile is supported by its history of very healthy credit ratios, thanks to operating with moderate financial leverage. The company's financial risk profile is hampered by an anticipated deterioration in credit metrics and free operating cash flow generation from 2021 onwards, together with significant execution risk regarding the planned large capex programme and dependency on EU Common Agricultural Policy subsidies. Agrar's financial risk profile is also compromised by inadequate liquidity as Agrar heavily depends on external funding.

Ratings & Outlook

Corporate rating	B/Stable
Senior unsecured debt	B+

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Related Methodologies

Corporate Rating Methodology July 2021

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Bloomberg: SCOP

Outlook and rating-change drivers

Stable Outlook

The Stable Outlook reflects Scope's expectations about a temporary deterioration of AGRAR's financial risk profile along the envisioned capex plan and dependence on external funding. A reversion of the credit metrics is expected by year-end 2023 after the completion of the capex programme.

Positive rating trigger

A positive rating action can be considered in case of: i) a successful execution of expansion strategy, and/or ii) dispelled concerns about liquidity constraints, i.e. lower dependence on external funding, subsidies payments from the Common Agricultural Policy of the European Union.

Negative rating trigger

A negative rating action could be the result of SaD/EBITDA moving towards 4.0x, which might be the result of higher costs for the capacity expansion than originally planned.

Rating drivers

Positive rating drivers	Negative rating drivers
• Relatively strong profitability (excluding subsidies received as part of the EU Common Agricultural Policy), despite being rather cyclical • Long-standing experience in pig breeding and farming • Financial risk profile (assessed at BB), supported by history of very healthy credit metrics but held back by inadequate liquidity and dependency on EU Common Agricultural Policy subsidies	• Weak market position in an industry with low price setting power • Weak diversification, with focus on one animal species, high customer concentration and weak geographical diversification • Focus on one animal species makes the company vulnerable to potential event risk, such as animal diseases and a consequent fall in market prices for pigs and piglets • Execution risk due to large capex programme in relation to the size of the company, while dividend payments are maintained

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Successful execution of the capex programme or dispelled concerns about liquidity constraints	• SaD/EBITDA moving towards 4.0x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	-50.3x	-29.9x	21.5x	9.6x
Scope-adjusted debt (SaD)/EBITDA	0.5x	0.3x	3.3x	2.8x
Scope-adjusted FFO/SaD	177%	344%	27%	29%
Free operating cash flow (FOCF)/SaD	40%	-43%	-99%	-50%
Scope-adjusted EBITDA in HUF thousand	**2019**	**2020**	**2021E**	**2022E**
EBITDA	1,452,179	1,910,059	2,142,943	2,612,463
Operating lease payments in respective year	-	-	-	-
Other items[1]	-477,026	-480,978	-899,998	-1,347,043
Scope-adjusted EBITDA	975,153	1,429,081	1,242,945	1,265,420
Scope-adjusted funds from operations (FFO) in HUF thousand	**2019**	**2020**	**2021E**	**2022E**
EBITDA	1,452,179	1,910,059	2,142,943	2,612,463
less: (net) cash interest as per cash flow statement	19,404	47,875	-57,845	-131,630
less: cash tax paid as per cash flow statement	-65,523	-331	-105,306	-120,650
less: pension interest	0	0	0	0
add: depreciation component, operating leases	-	-	-	-
add: dividends received from equity-accounted entities	0	0	0	0
less: disposal gains on fixed assets included in EBITDA	-23,137	58,895	0	0
less: capitalised interest	0	0	0	0
Other items[2]	-449,791	-453,361	-899,998	-1,347,043
Scope-adjusted funds from operations	933,132	1,563,137	1,079,795	1,013,140
Scope-adjusted debt (SaD) in HUF thousand	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	769,360	935,328	4,440,048	4,039,029
Hybrid debt	-	-	-	-
less: cash and cash equivalents	-243,574	-480,475	-328,076	-436,270
Cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	-	-	-	-
Other items (contingent liabilities)	0	0	0	0
Scope-adjusted debt	525,786	454,853	4,111,972	3,602,759

[1] Adjusted for EU Common Agricultural Policy subsidies and investment credits and gains from the sale of fixed assets
2 Adjusted for EU Common Agricultural Policy subsidies and investment credits, gains from the sale of fixed assets and miscellaneous items

Business risk profile: B-

Industry risk profile: BBB…

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

… but weak competitive position

Agrar'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 figures on profitability, although these are rather cyclical.

Small player in an industry with limited pricing power

Agrar's weak market position is evidenced by its herd size (up to 150,000) benchmarked against the total pig population of around 3m in Hungary in 2020. Even after the intended capacity expansion to up to 280,000 animals per year, Agrar's market share will remain quite low. The Hungarian pig processing industry is heavily fragmented, with several larger players. In addition, prices for piglets and fattening pigs are transparent and standardised, allowing only limited pricing power.

Figure 1: Selective players in the Hungarian pig farming industry

Company	Boly	Fioracs	Dalmand	Bonafarm	Agrar
Sales (HUF m)	24	15	15	30	4

Source: Agrar, Scope

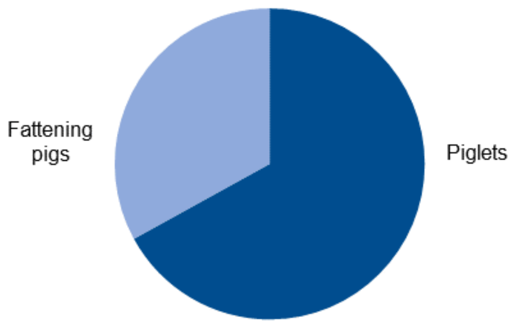
Four pillars of our diversification assessment

Our assessment of diversification is based on: i) geographical diversification; ii) diversification by segment/product; iii) diversification by customer; and iv) diversification by supplier.

Regional focus on Hungary

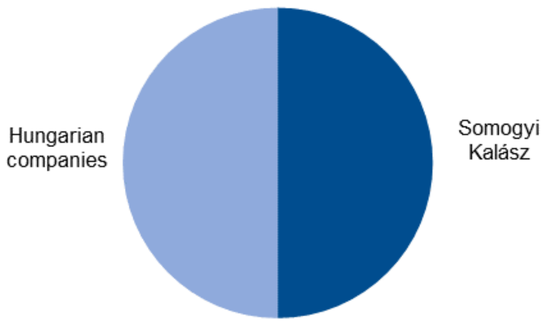
All of the Claessens Group sites are located in the south-west of Hungary, although Agrar is located in Somogyszob and all sales are generated in Hungary. Agrar's business model is focussed on pig processing, which implies no product diversification. Agrar's focus on one animal species makes it vulnerable to potential event risk, such as animal diseases and a consequent fall in market prices.

Figure 2: Sales by product type



Source: Agrar, Scope

Figure 3: Sales by customer



Source: Agrar, Scope

Weak product diversity

However, product diversification is somewhat improved by the breakdown between different aged animals/product types, as these are often supplied to different after-markets and customers. After completion of the expansion programme, the share of fatteners should shrink to below 25%, implying a more concentrated product mix.

Concentrated customer portfolio

The typical customers for piglets are pig processors and wholesale companies, whereas fatteners are sold to slaughterhouses and food processing companies. As displayed in Figure 3, roughly 50% of Agrar's sales are generated via Somogyi Kalász, part of the Claessens Group. The entity is focused on fattening piglets before selling them to slaughterhouses or food processing companies. While the other 50% of Agrar's sales appear fairly diversified in terms of customer concentration, we judge the company to have strong consumer concentration. On the basis of our understand, if Somogyi Kalász is lost as a customer, this would result in lower profitability as piglets would have to be sold on the market and fattening pigs would have to be transported to slaughterhouses located further away.

Concentrated supplier portfolio

Agrar's suppliers are also very concentrated. The required raw materials, especially maize and wheat, are procured from subsidiaries Somogyi Mező Ltd, Somogyszobi Ltd, Böhönye Agro Ltd, Böhönye Grain Ltd, Terebezd Grain Ltd, Dél-Dunántúli Plant Ltd. This will also be the case after the intended capacity expansion, as Agrar has assured us that the subsidiaries will still be able to meet its requirements.

Profitability is a supporting factor

Agrar's figures on profitability are volatile but solid in a commoditised industry. In contrast to the company's financial reporting, our calculation of the EBITDA margin excludes agricultural subsidies from the EU and the Hungarian government. We believe Agrar's profitability generation is supported by its long-standing experience in pig breeding and farming, in tandem with backward integrated operation in the farming of maize and wheat.

Financial risk profile: BB

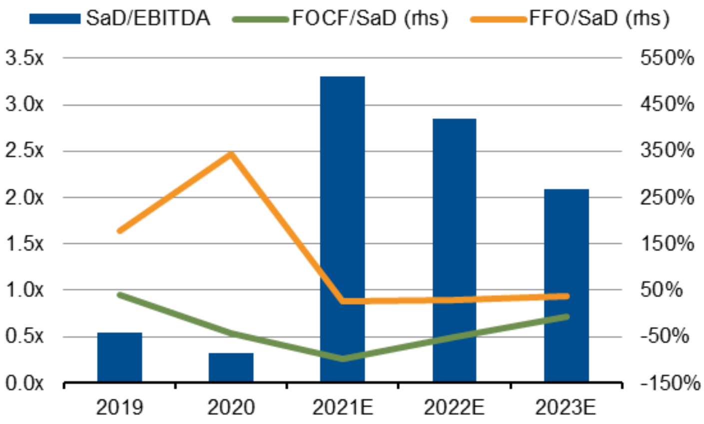
Key adjustments of the rating case include:

- Reported EBITDA is adjusted for EU Common Agricultural Policy subsidies and investment credits
- Haircut on forecasted cash in accordance with our Corporate Ratings Methodology

Main elements in brief

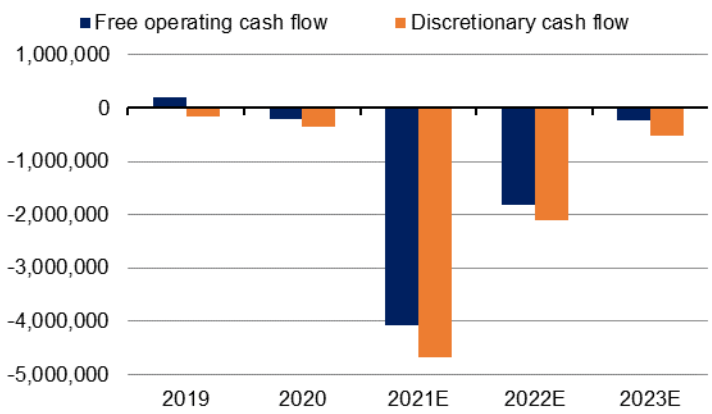
Agrar's financial risk profile is supported by its history of very healthy credit ratios, thanks to operating with moderate financial leverage. On the other hand, the company's financial risk profile is hampered by an anticipated deterioration in credit metrics and free operating cash flow generation from 2021 onwards, together with significant execution risk from the large capex programme and dependency on EU Common Agricultural Policy subsidies. Agrar's financial risk profile is also compromised by inadequate liquidity.

Figure 4: Credit metrics



Source: Agrar, Scope expectations

Figure 5: Free operating and discretionary cash flow (HUF thousand)



Source: Agrar, Scope expectations

Deterioration of credit profile following large capex programme

By year-end 2023, Agrar plans to spend roughly HUF 8.0bn on capex. This should be financed via a bond offering as well as subsidiaries from the Hungarian government and the EU. The capex programme poses significant execution risk if we compare the total amount (roughly HUF 8.0bn between 2020 and 2023) to Agrar's size (sales of HUF 4.7bn; property, plant and equipment of HUF 4.8bn in 2020). 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. Following Agrar's planned bond offering of up to HUF 3.0bn in 2021, we anticipate that its credit profile will deteriorate significantly in 2021 and remain weak until at least 2023. In particular, we foresee negative free operating cash flow generation and FOCF/SaD. In this context, Agrar intends to maintain dividend payments to its owners.

Key rating case assumptions

For the period 2021 to 2023, we expect only small growth in sales and EBITDA as existing capacities have reached their limits. However, we project that the EBITDA margin will remain in line with historic figures, thanks to favourable market prices for piglets and fattening pigs. Once the new capacities come online in 2024, we expect faster sales growth and a surge in EBITDA. Our main rating scenario assumptions are: i) ongoing dividend payments of HUF 600m in 2021 and HUF 300m from 2022 onwards, partly netted with the repayment of shareholder loans; ii) investments in working capital, especially in 2022 and 2023; iii) ongoing subsidies from the EU Common Agricultural Policy.

Liquidity: Inadequate

We judge Agrar's liquidity to be inadequate based on our Corporate Rating Methodology. Although the company benefits from historically satisfying ratios on internal and external liquidity coverage, it lacks access to external sources of liquidity such as a committed credit facility, and depends heavily on external funding.

Long-term rating

Senior unsecured debt rating: B+

We expect Agrar to successfully issue the planned HUF 3.0bn senior unsecured bond within the MNB Funding for Growth Scheme in 2021 for investment financing. The amortisation schedule of the 10-year, fixed interest instrument (coupon: 2.9%) assumes repayment in six tranches of 10% in 2026, 2027, 2028, 2029, 2030 and 50% in 2031. Agro-Build Kft. will act as guarantor. Any new credit facility/ loan above 10% of equity can be taken by the issuer if there is a prior contact and analysis to the rating agency and the expected rating after new credit facility/ loan will not deteriorate under B+ rating class.[3]

Our recovery analysis for Agrar indicates an 'above average' recovery for senior unsecured debt, translating into a debt category rating of B+. Our calculation included the following key assumptions: i) anticipated liquidation value established via a hypothetical default scenario at year-end 2023; ii) short- and long-term bank debt, investment credits and payables ranking higher than senior unsecured debt in the waterfall; and iii) our understanding that the Claessens family via Agro-Build Kft. act as guarantor.

[3] The paragraph regarding the senior unsecured bond was added on 16 August 2021. It was not included in the original publication.

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