Hell Energy Magyarország Kft.
Hungary, Consumer Products

B+ POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	18.3x	5.7x	5.6x	5.8x
Scope-adjusted debt/EBITDA	6.1x	5.4x	5.0x	4.7x
Scope-adjusted funds from operations/debt	16%	15%	16%	17%
Scope-adjusted free operating cash flow/debt	-22%	-42%	-20%	0%

Rating rationale

The revision of the Outlook to Positive is supported by the start of deleveraging as production ramps up, the strong market position in Central and Eastern Europe (CEE) with further significant growth potential, especially in south-eastern Europe, and the high margins despite strong expansionary and inflationary pressures.

The rating is constrained by the limited product diversification, still high leverage, and the shortfall in state subsidies which the parent will not cover as Hell Energy's liquidity situation does not require it.

Hell Energy's business risk profile (assessed BB+) is supported by the strong risk profile of its underlying industry of consumer products (rated A), which benefits from low cyclicality and medium barriers to entry, and by the company's moderate competitive position underpinned by its regional market leadership and high share of branded products.

The financial risk profile (assessed B) is being adversely affected by the ongoing investment programme, exacerbated by the shortfall in state subsidies. Leverage started to improve in 2022 but remains high, with Scope-adjusted debt/EBITDA decreasing to 5.4x from 6.1x in 2021. Scope-adjusted debt/EBITDA is expected to stay at 4x-5x in the medium term thanks to the recovery of operating profitability and the successful production ramp-up.

Outlook and rating-change drivers

The Outlook is revised to Positive from Stable. This is based on the expectation of continued deleveraging reflected by Scope-adjusted debt/EBITDA moving below 5.0x and free operating cash flow approaching positive values.

An upgrade could be warranted if the company reached and could maintain Scope-adjusted debt/EBITDA below 5.0x and free operating cash flow approached positive values.

A return to a Stable Outlook would be warranted in case of an inability to delever to below Scope-adjusted debt/EBITDA of 5.0x or improve free operating cash flow towards positive values.

Further ratings downside is considered remote at this stage.

Ratings & Outlook

Issuer	B+/Positive
Senior unsecured debt	B+

Lead Analyst

Barna Gáspár
+49 30 278913 25
b.gaspar@scoperatings.com

Related Methodologies

Corporate Rating Methodology; October 2023

Rating Methodology: Consumer Products; November 2023

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

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
19 Dec 2023	Outlook change	B+/Positive
30 Jun 2022	Affirmation	B+/Stable
13 Jul 2021	Downgrade	B+/Stable
30 Oct 2020	Monitoring review	BB/Stable

Rating and rating-change drivers

Positive rating drivers

- High diversification in terms of geographies (over 50 countries), customers and suppliers; new product launches (Ice Coffee) well received by market
- Robust Scope-adjusted EBITDA margins (12%-19%)
- Strong market position as market leader in product segment in several countries
- High vertical integration freeing up capacity and reducing revenue volatility

Negative rating drivers

- High exposure to Hungarian and Central and Southern European market, also limited to beverage product segment
- Negative free cash operating flows and dependence on external financing in recent years due to rapid expansion
- Risks associated with changing customer demands and punitive regulation on sugared and/or caffeinated beverages
- Large debt-funded capex causing persistently high leverage

Positive rating-change drivers

- Leverage measured by Scope-adjusted debt/EBITDA sustained below 5x
- Free operating cash flow approaching positive values

Negative rating-change drivers

- Leverage measured by Scope-adjusted debt/EBITDA of above 5x
- Very negative Scope-adjusted free operating cash flow/debt

Corporate profile

Established in 2004, the Hell Group (Hell Energy Magyarország Kft. and its fully owned and consolidated subsidiaries) is a Hungarian family-owned company (Barabás family through holding companies). The Hell energy drink is the third largest branded energy drink globally.

The group is vertically integrated with its own can production and filling lines on-site in Szikszó, Hungary with all production under one roof. Hell Energy is present in over 50 markets outside of Hungary and is market leader in ten countries, mainly in Central and Southern Europe.

Yearly production in 2022 exceeded 1.3bn soft drinks under the Hell, XIXO and Swiss Laboratory brands, as well as private label.

The Hell Group is under intensive expansion and is investing to increase can production and filling capacities to 2.7 billion cans annually.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	10.9x	18.3x	5.7x	5.6x	5.8x	7.1x
Scope-adjusted debt/EBITDA	2.8x	6.1x	5.4x	5.0x	4.7x	4.0x
Scope-adjusted funds from operations/debt	31%	16%	15%	16%	17%	21%
Scope-adjusted free operating cash flow/debt	7%	-22%	-42%	-20%	0%	2%
Scope-adjusted EBITDA in HUF m						
EBITDA	13,628	17,115	18,452	25,093	25,903	31,079
Scope-adjusted EBITDA	**13,628**	**17,115**	**18,452**	**25,093**	**25,903**	**31,079**
Funds from operations in HUF m						
Scope-adjusted EBITDA	13,628	17,115	18,452	25,093	25,903	31,079
less: (net) cash interest paid	(1,247)	(934)	(3,244)	(4,491)	(4,441)	(4,391)
less: cash tax paid per cash flow statement	(59)	(56)	(123)	(693)	(482)	(710)
Funds from operations	**12,322**	**16,125**	**15,085**	**19,908**	**20,980**	**25,978**
Free operating cash flow in HUF m						
Funds from operations	12,322	16,125	15,085	19,908	20,980	25,978
Change in working capital	(2,067)	(10,013)	(33,518)	1,703	(4,393)	(5,781)
Non-operating cash flow	(171)	29	-	-	-	-
less: capital expenditure (net)	(7,305)	(28,955)	(23,433)	(46,825)	(16,823)	(17,490)
Free operating cash flow	**2,778**	**(22,813)**	**(41,866)**	**(25,214)**	**(236)**	**2,707**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	(1,247)	(934)	(3,244)	(4,491)	(4,441)	(4,391)
Net cash interest paid	**(1,247)**	**(934)**	**(3,244)**	**(4,491)**	**(4,441)**	**(4,391)**
Scope-adjusted debt in HUF m						
Reported gross financial debt	51,646	114,438	106,940	135,500	129,500	128,500
less: cash and cash equivalents	(13,042)	(56,781)	(7,551)	(12,365)	(6,695)	(3,447)
add: non-accessible cash	-	45,000	-	-	-	-
Scope-adjusted debt	**38,604**	**103,657**	**100,389**	**126,635**	**122,805**	**125,053**

Table of Content

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)

Front-runner in dedicated ESG strategy and green bond issuance

Hell Energy has a dedicated ESG strategy. The company has state-of-the-art production facilities with a high automation rate. Cans are produced using recycled aluminium. Hell Energy obtained a second party opinion for its green bond. Efforts at greener and more cost-efficient production and reporting are credit-positive.

Efficient production and recycled aluminium input for packaging

While the more than 1.35bn aluminium cans produced yearly are from recycled aluminium, below 50% of output is recycled after first use in most distribution markets of Hell Energy and hence does not yet fully contribute to the circular economy. This creates a mixed ESG picture, although the company does not bear the full responsibility; regulators and retailers are also part of this process in Western Europe, where recycling rates reach above 90% for used cans and consumers are motivated with a deposit system. Hungary and Romania will introduce their deposit system in 2024 for cans which will provide the opportunity to recycle packaging widely and will motivate consumers to recycle.

Improving packaging recycling in most markets with the introduction of deposit systems

The product portfolio concentrates on small packaging, mostly 250 millilitres, with no plans to offer drink dispensers and syrups, resulting in the transport of water. Some competitors in the beverage segment offer concentrated syrups, biodegradable cups and cups that can be reused at dispensers.

Good product safety but products are high in sugar/sweetener and caffeine

Production plants have high health and safety certifications as required in the industry. Product safety is a priority for the company; however energy drinks are still taxed with public health product tax (so-called chips tax or "NETA" in Hungary) and are considered less healthy than other beverages (such as juices, milk-based products) by authorities. Hell Energy has a zero-sugar line and the company has diversified into soft drinks without sugar or caffeine.

Corporate structure complexity is medium. Some related entities are not consolidated (such as Üvegszikla Kft, which owns the automated warehouse).

[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: BB+

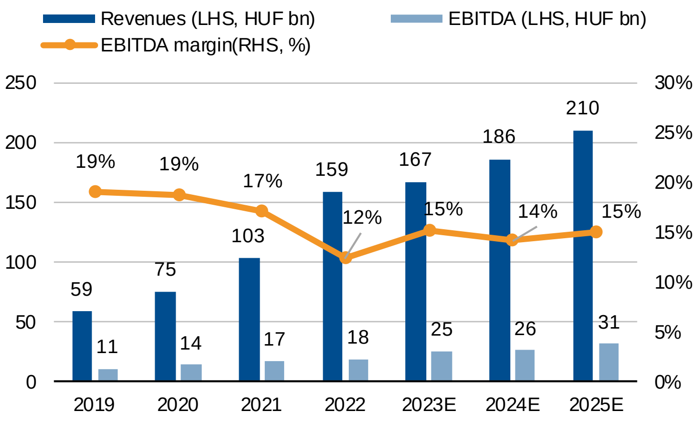
Industry risk profile: A

Hell Energy's business risk profile is primarily supported by the consumer products sector's strong industry risk profile, which benefits from low cyclicality, medium barriers to entry and an A industry rating.

Family-owned business

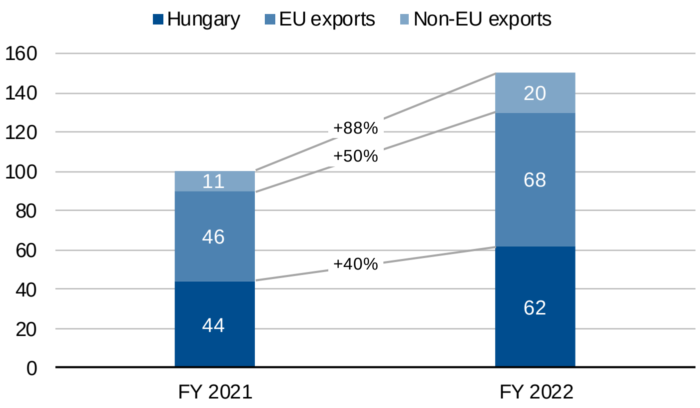
The Barabás family has majority ownership and control over the issuer (more than 95%) via its holding companies. The company structure above the issuer was altered with introduction of a few holding companies, all registered in Hungary. Such restructuring is credit-neutral.

Figure 1: Revenues and EBITDA (in HUF bn) and operating profitability (%)



Sources: Hell Energy, Scope (estimates)

Figure 2: Geographical diversification based on revenues (in HUF bn)



Sources: Hell Energy annual report, Scope

Strong exposure to Central/Southern European markets, significant growth potential in several countries

Hell Energy has a market presence in over 50 countries, although most of its sales are in the CEE/CSE markets (Hungary and Romania make up half of the revenues). This gives it room for organic growth as production capacity expands. We expect further significant growth in India and in the Balkans.

The ultimate number of customers (individual consumers of a drink) is extremely high as Hell Energy provides retail consumer products.

Well-diversified customer and supplier base

Moreover, there is no material dependency on any third-party distributor or retailer because the group either develops and runs distribution via its own local operations, or works with local distributors. There is also minimal dependency on suppliers because the main raw materials used – sugar, compound (syrup) and aluminium – are all globally traded commodities with numerous potential suppliers. The company has also developed relationships with several suppliers for each category to mitigate supplier risk.

In terms of diversification, the company benefits from a relatively diversified client base, mostly thanks to its retail product offering, its dual strategy of branded and white-label products, and its wide geographic reach.

Growing revenues and restored profitability

Revenues in 2023 are similar to 2022 levels. H1 2023 showed 3.8% YoY growth, explained by the somewhat lower volumes as inflation peaked but also strong pricing effects to raise profitability.

Profitability was under pressure due to input cost inflation, price and currency volatility, and the company's strong expansionary ambitions. This pressure comes after the outstanding 40% growth YoY in 2022, which pushed up the top line to HUF 158.6bn (ca. EUR 0.4bn). Regarding margins, H1 2023 saw a return to the historical 18% EBITDA margin, which is a significant improvement from 13.3% in H1 2022. This was a result of the improved EBITDA in H1 2023 of HUF 14.0bn from HUF 9.9bn in H1 2022. Such an improvement led to the deleveraging, much expected after the heavy investment phase.

The high operating profitability of Scope-adjusted EBITDA margin of 15%-20% puts Hell Energy at the high end of Hungarian consumer products entities and above average at the European level. The company's above-average vertical integration and efficient, relatively new production facility have shielded its profitability from the strong wage inflation in Hungary. The facility also provides an advantage over competitors with less modern, less automated production facilities.

Input cost inflation managed by price increases

A strong volatility in input costs (sugar, aluminium, energy, transport) and production ramp-up costs have put pressure on margins. We expect the company to use its pricing power to keep its EBITDA margin around 15%, somewhat lower than in H1 2023.

The company's operating profitability has been below the sector average in recent years, mostly due to the rapid expansion of its business and the significant brand-building and market-development expenses that this expansion required.

We nevertheless expect the issuer's EBITDA margin to remain at around 14%-15% for the next two to three business years given that further initial costs are likely from new products and the development of export markets. The fact that sales growth of its (higher-margin) branded products cannot immediately match the planned growth in production capacity is another impediment. For the company to achieve high utilisation rates, we therefore expect a larger share of (lower-margin) white-label business. In the medium term, we think EBITDA margins can benefit from a significant improvement in economies of scale.

Financial risk profile: B

The company's financial risk profile remains unchanged compared to last year's and is thus the weaker part of the overall issuer rating, mostly due to the high leverage.

Planning assumptions

Our planning assumptions include:

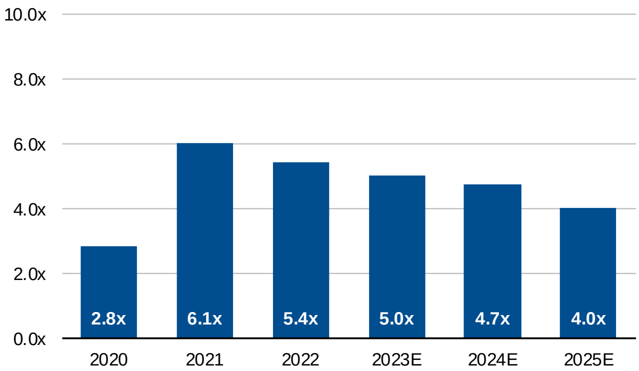
- Revenue growth of ca. 10% yearly, much below previous years' growth rate of 30-40% due to subdued demand and capacity constraints
- EBITDA margin normalising to around 14%-15%
- HUF 47bn capex in 2023 followed by HUF 15bn-20bn (net) yearly from 2024
- No adjustment for cost overruns on top of the assumed 10%
- HUF 13.5bn in state subsidies expected in 2023 conservatively excluded from cash flow, financed from own cash flows; a late EU approval for such subsidies will come as an upside to the rating case
- All receivables are insured, and all-risk insurance is in place.
- No new debt, no M&A
- Dividend payout at up to 20% of profit after tax as set out in the bond prospectus

High leverage

The financial risk profile is being adversely affected by the ongoing investment programme, exacerbated by the shortfall in state subsidies. Leverage started to improve in 2022 but remains high, with Scope-adjusted debt/EBITDA decreasing to 5.4x from 6.1x in 2021. Scope-adjusted debt/EBITDA is expected to stay at 4x-5x in the medium term thanks to the recovery of operating profitability and the successful production ramp-up.

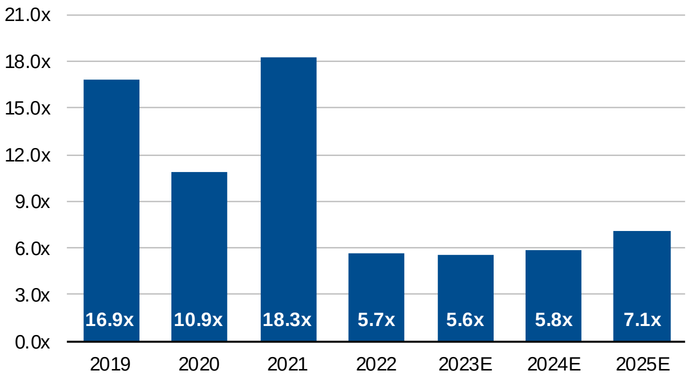
Scope-adjusted funds from operations/debt has been moderate at around 15% in 2021-2022 and we expect it to increase as input prices normalise and expansion slows.

Figure 3: Leverage measured by Scope-adjusted debt/EBITDA



Sources: Hell Energy, Scope (estimates)

Figure 4: Debt protection measured by Scope-adjusted EBITDA/interest cover



Sources: Hell Energy, Scope (estimates)

Shortfall in subsidies not covered by parent

Subsidies of HUF 13.5bn were expected in 2023 but did not materialise. The owners had expressed that they would cover any shortfall in subsidies with equity or a subordinated intercompany loan, but saw no need to do so in 2023 as deleveraging had started without the fresh equity after cash flow generation improved significantly.

Robust interest cover

Interest coverage is rather robust, at above 5.0x Scope-adjusted EBITDA interest cover in 2022 (after the expansionary debt issuances) and we expect it to be protected as most of the debt is fixed rate: the two bonds and EUR 20m out of the EUR 50m working capital facility as well as the old capex financings.

Exposure to euro growing; natural hedge in place

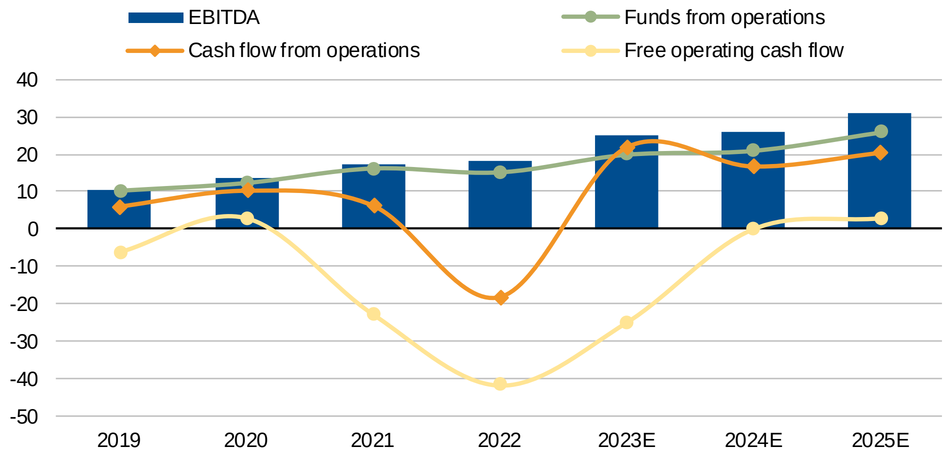
The company has expanded well beyond Hungary, which also means financing has to be adapted to the use of other currencies. Interest rates for euro-denominated facilities are lower than in Hungarian forint, which also support the Scope-adjusted EBITDA interest cover ratio. FX risk is limited as there is natural hedge arising from revenues in euros.

Negative free operating cash flow, but to improve from 2024

Our base case forecast shows that Scope-adjusted free operating cash flow/debt will stay negative in 2023. This is because management matches the capex phase with the liquidity situation. The negative free operating cash flow is due to the company's massive capex programme and working capital build up. Although the company has depended on external financing to finance its new production facilities and growing working-capital needs, free operating cash flow should improve from 2024 onwards, thereby enabling deleveraging.

The huge financing gap (Figure 5) is expected to disappear in 2024, which would cause the overall financial risk profile to improve.

Figure 5: Cash flows (in HUF bn)



Sources: Hell Energy, Scope (estimates)

Adequate liquidity

Liquidity has been adequate, with the external liquidity ratio expected to be under pressure in 2023 due to increased working capital, higher capex and the subsidy shortfall, which was managed by contracting EUR 50m in new debt in H1 2023. We expect the liquidity ratio to reach above 200% from 2024 once free operating cash moves closer to zero and turns positive from 2025 as a result of decreasing capex and lower working capital swings than in previous years.

Balance in HUF m	2023E	2024E	2025E
Unrestricted cash (t-1)	7,551	12,365	6,695
Open committed credit lines (t-1)	8,500	7,500	7,500
Free operating cash flow (t)	-25,214	-236	2,707
Short-term debt (t-1)	-4,749	-5,000	-5,000
Coverage	**Neg.**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

In the past, the issuer expanded aggressively but maintained a prudent financial policy. Existing covenants allow a reasonable dividend payment ratio of up to 20% of profit after tax).

Parent support is credit-neutral.

The group has changed its structure above the company level to a holding structure with entities incorporated in Hungary. These changes do not affect the issuer's credit quality.

Long-term debt ratings

Senior unsecured debt rating: B+

Senior unsecured debt is rated in line with the issuer rating based on our expectation of an 'average' recovery, considering a hypothetical default scenario at YE 2024 and applying reasonable discounts to existing assets and assets under construction.

Hell Energy issued two senior unsecured bonds with 10-year tenors under the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond issued in 2020 (ISIN: HU0000359377) at HUF 28.5bn with a fixed coupon of 2.7% yearly and the bond issued in 2021 (ISIN: HU0000360722, guaranteed by subsidiary Quality Pack Zrt) at HUF 67bn with a fixed coupon of 3.0% yearly were used mainly for capex. Bond repayments start in tranches from 2026 with a high balloon payment.

We note that Hell Energy's senior unsecured bonds have accelerated repayment clauses requiring repayment of the nominal amounts in case of rating deterioration (two-year cure period for a B/B- rating, immediate repayment if the bond rating falls below B-, which could have default implications). In addition to the rating deterioration covenant, bond covenants include a number of soft covenants, such as change of control and dividend restrictions.

Appendix: Peer comparison (as at last reporting date)

	Hell Energy Magyarország Kft.	Vajda-Papír Kft.	Kometa 99 Zrt.	Baromfi-Coop Kft.	Bonafarm Zrt.
Issuer rating with supplementary rating drivers	**B+/Positive**	**B/Stable**	**B+/Stable**	**BB-/Positive**	**BB/Stable**
Last reporting date	30 June 2023	31 December 2022	31 December 2022	30 June 2023	30 June 2023
Business risk profile	**BB-**	**BB-**	**BB-**	**BB**	**BB+**
Size (revenue in EUR bn)	0.4	0.1	0.2	0.6	0.8
Diversification	Beverages; Hungary and exports	Paper products; Hungary and exports	Mainly pork; Hungary and exports	Agriculture and chicken; Hungary and exports	Agriculture, pork and milk; Hungary and exports
Operating profitability (EBITDA margin)	12-19%	0-5%	3-5%	10-13%	7-11%
Financial risk profile	**B**	**B-**	**B+**	**BB-**	**BB-**
Scope-adjusted EBITDA/interest cover	5.7x	0.4x	35x	32x	Negative
Scope-adjusted debt/EBITDA	5.4x	73x	4.5x	2.3x	0.9x
Scope-adjusted funds from operations/debt	15%	-2%	26%	41%	117%
Scope-adjusted free operating cash flow/debt	-42%	-16%	-1%	-3%	1%
Supplementary rating drivers	**-**	**-**	**-**	**-**	**+1**
Parent support	-	-	-	-	+1

Sources: Public information, Scope

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

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

Disclaimer