23 December 2022

Corporates

Hunland Trade Kft
Hungary, Agribusiness

POSITIVE

B+

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	9.8x	6.8x	6.9x	-8.5x[1]
Scope-adjusted debt/EBITDA	5.8x	6.1x	7.6x	7.3x
Scope-adjusted funds from operations/debt	22%	-36%	12%	13%
Scope-adjusted free operating cash flow/debt	-3%	9%	-5%	5%

Rating rationale

The ratings are supported by Hunland Trade's vertical business integration within the Hunland Group but also by its leading position as Hungarian livestock exporter which benefits from a good geographical diversification of customers.

The main rating constraints relate to the high indebtedness and the minor role of livestock exports in the Hungarian economy.

Outlook and rating-change drivers

The Positive Outlook for Hunland Trade incorporates the expected improvement in debt protection thanks to the cross-currency interest rate swaps progressively implemented in 2022. It also incorporates the high indebtedness with a Scope-adjusted debt/EBITDA ratio above 6.5x.

An upgrade could occur if the company kept Scope-adjusted EBITDA/interest cover significantly above 7.0x on a sustained basis, e.g. if the net cash interest paid is reduced substantially as a result of the swaps.

A negative rating action, such as a revision to a Stable Outlook, could be triggered by a deterioration in credit metrics if Hunland Trade exhibits a Scope-adjusted EBITDA/interest cover below or at 7.0x on a sustained basis. This could be caused by significantly lower contributions to earnings from cattle and pig sales.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
23 Dec 2022	Outlook change	B+/Positive
02 Feb 2022	Affirmation	B+/Stable
25 Feb 2021	New	B+/Stable

[1] The negative Scope-adjusted EBITDA/interest cover results from the negative net cash interest paid position.

Ratings & Outlook

Issuer	B+/Positive
Guaranteed senior unsecured bond	B+

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Related Methodology

Corporate Rating Methodology; July 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Vertical business integration which enables Hunland Trade to be less exposed to economic downturns • Leading Hungarian livestock exporter • Good geographical diversification on the customer side • Adequate expected interest coverage • Stable, but low, profitability	• High expected Scope-adjusted debt/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

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted EBITDA/interest cover significantly above 7.0x on a sustained basis	• Scope-adjusted EBITDA/interest cover below or at 7.0x on a sustained basis

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 an 88% stake, is Hunland Trans Kft. The company is fully indirectly owned by Joseph Janssen (74.69%) and Suzanne Janssen (25.31%).

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover[2]	9.8x	6.8x	6.9x	-8.5x	-9.0x
Scope-adjusted debt/EBITDA	5.8x	6.1x	7.6x	7.3x	6.7x
Scope-adjusted funds from operations/debt	22%	-36%	12%	13%	19%
Scope-adjusted free operating cash flow/debt	-3%	9%	-5%	5%	8%
Liquidity (internal and external)	<100%	<100%	>200%	>200%	>200%
Scope-adjusted EBITDA in EUR '000s					
EBITDA	7,411	7,524	7,117	7,193	7,306
Operating lease payments in respective year	0	0	0	0	0
Disposal gains (losses) on fixed assets	51	565	0	0	0
Scope-adjusted EBITDA	**7,462**	**8,089**	**7,117**	**7,193**	**7,306**
Scope-adjusted funds from operations in EUR '000s					
EBITDA	7,411	7,524	7,117	7,193	7,306
less: net cash interest paid	-762	-1,186	-1,029	843	815
less: cash tax paid as per cash flow statement	-136	-432	-207	-251	-336
add: depreciation component of operating leases	0	0	0	0	0
add: dividends received from equity	900	880	395	395	395
Other changes	2,275	-24,705	457	-1,329	929
Funds from operations (FFO)	**9,688**	**-17,919**	**6,734**	**6,852**	**9,109**
Free operating cash flow in EUR '000s					
Funds from operations	9,688	-17,919	6,734	6,852	9,109
Change in working capital	-10,935	23,951	-9,257	-3,380	-2,465
Non-operating cash flow	0	0	0	0	0
less: capital expenditure (net)	185	-883	26	-899	-2,650
add: disposal gains (losses) on fixed assets	-51	-565	0	0	0
Free operating cash flow (FOCF)	**-1,114**	**4,584**	**-2,497**	**2,573**	**3,994**
Net cash interest paid in EUR '000s					
Net cash interest per cash flow statement	762	1,186	1,029	-843	-815
Net cash interest paid	**762**	**1,186**	**1,029**	**-843**	**-815**
Scope-adjusted debt in EUR '000s					
Reported gross financial debt	45,839	67,343	67,039	67,048	67,760
less: hybrid bonds	0	0	0	0	0
less: cash and cash equivalents	-2,921	-18,256	-12,916	-15,052	-18,885
add: cash not accessible	214	213	213	213	213
Scope-adjusted debt	**43,131**	**49,300**	**54,336**	**52,209**	**49,088**

[2] The negative Scope-adjusted EBITDA/interest cover in 2023 and 2024 results from the negative net cash interest paid position.

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Environmental, social and governance (ESG) profile[3]

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)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

No dedicated ESG strategy

Hunland Trade has no dedicated ESG strategy. The livestock industry has a huge carbon footprint. According to the UN, it represents approximately 14% of all greenhouse gas emissions globally. More than 20% of global emissions stem from agriculture and land use. Within agriculture, cattle farming is the most environmentally intensive form of food conversion: it requires significant land resources for feed production and water, but it also releases methane. Even if methane remains a shorter time in the atmosphere than carbon dioxide, it does have a considerably greater global warming potential. Besides 83% of all agricultural land is dedicated to livestock, and meat and dairy contribute to 60% of agriculture's greenhouse gas emissions. The increasing awareness of the livestock industry's carbon footprint has led to a new way of eating, namely vegan diets. The importance of animal welfare is also increasing. The livestock industry is going to experience regulatory pressure but also changes in consumer demand preferences, who will be looking for plant-based substitutes but also healthier, more natural, organic and antibiotic-free meat products.

[3] 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: B+

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% going to 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) 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 head of livestock in 2019, Hungary ranks 15th in Europe, far behind first-ranking Spain with 102.1m head. 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 livestock numbers – 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[4] and a top three importer of breeding cattle from Russia.

Leading Hungarian livestock exporter

Hunland Trade's cattle exports account for around 50% of Hungary's cattle 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 …

At least one-third of Hunland Trade's 10 main suppliers are its sister companies: Hunland Production Kft, Hunland Trans Kft and Hunland Veal Farm Kft. The former two are also guarantors of Hunland Trade's bond issued under the MNB program. These three suppliers represented 30% of the top 10 suppliers in terms of turnover in 2021. According

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

to Hunland Trade, the other suppliers work to high standards as they are EU-approved slaughterhouses, meat processors and breeding companies.

…which protects Hunland Trade from economic downturns

Thanks to its vertical business integration into Hunland Group, Hunland Trade is somewhat less exposed to economic downturns and can better deal with the current economic environment.

Large customer base with some concentration

Around 50% of Hunland Trade's sales are realised in two countries (Hungary and Egypt). 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 30%-50%. 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 letters of credit for non-EU sales.

Foreign exchange risk

Due to the nature of its business and its worldwide partners (clients but also suppliers), Hunland Trade is exposed to foreign-exchange risk as more than 60% of its revenues is in euros. In order to mitigate this risk, it uses foreign-exchange forward contract. When it makes purchases in US dollars, they are naturally covered by revenues in US dollars.

Regarding the issued bond under the MNB program, as it was in forint while Hunland Trade's functional currency is the euro, the company used cross-currency interest swaps in order to hedge the interest payments. However, it will be exposed to exchange rate risk at the end of the swaps when the principal will be exchanged back.

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 50%-65% of total sales from cattle, 20%-30% from pigs and 5% from lamb.

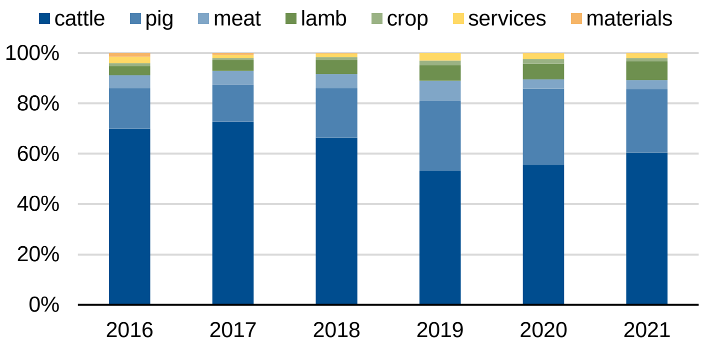
Good geographical diversification on the buyer side but …

On average, half of sales are realised in three 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

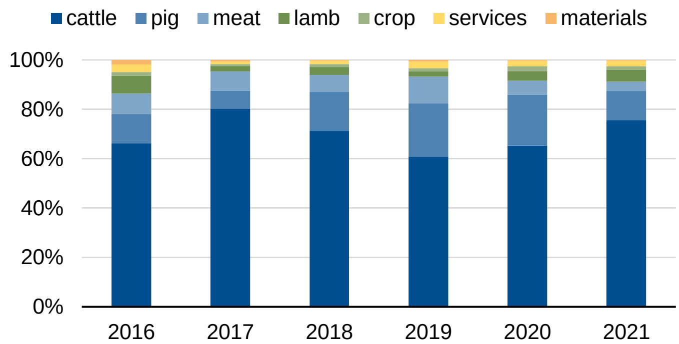
On the supplier side, half of supplies come from Hungary, typically sister companies, and the rest from about 20 other countries.

Figure 1: Sales breakdown by product



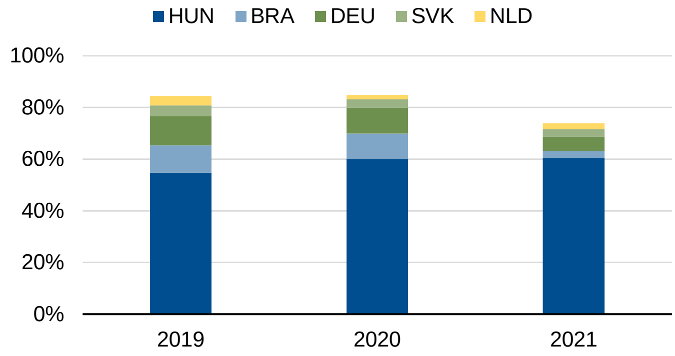
Source: Hunland Trade, Scope

Figure 2: EBITDA breakdown by product



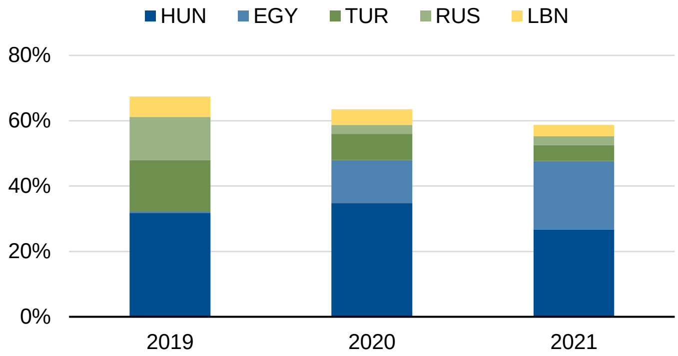
Source: Hunland Trade, Scope

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



Source: Hunland Trade, Scope

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

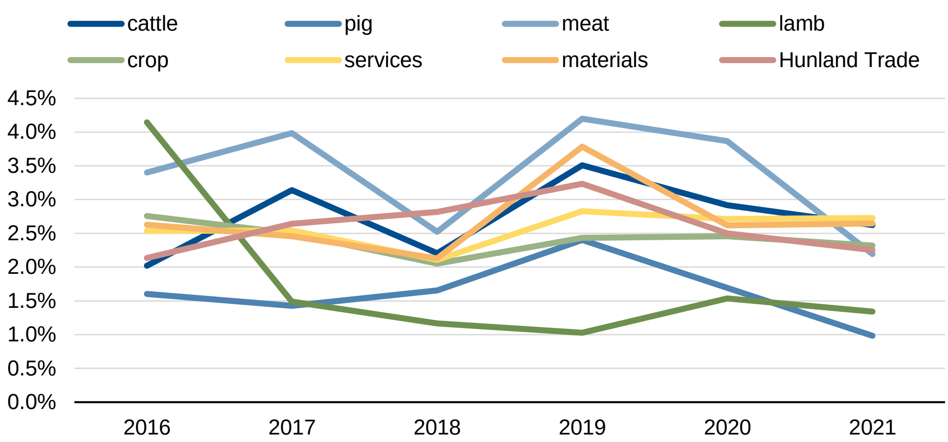


Source: Hunland Trade, Scope

Low profitability

Hunland Trade's EBITDA margin is low at between 2% and 3%. The highest margin is usually 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

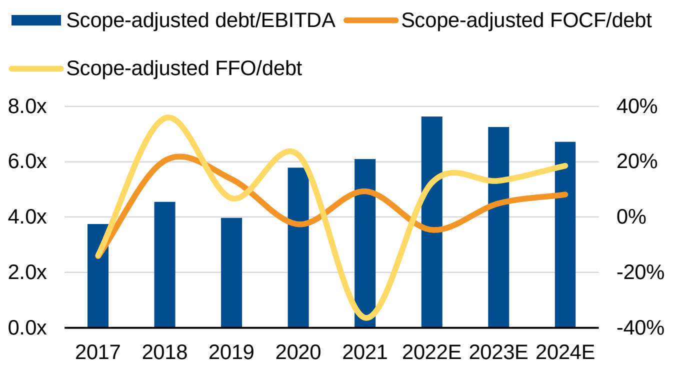
Hunland Trade's profitability is set to remain stable after having decreased to 2.5% in 2020 mainly as a result of lower net sales and higher material costs that year, followed by a decline to 2.1% in 2021 due to higher material costs. Indeed, cattle prices dropped in 2020, but Hunland Trade decided 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 around 2.0%.

Financial risk profile: B+

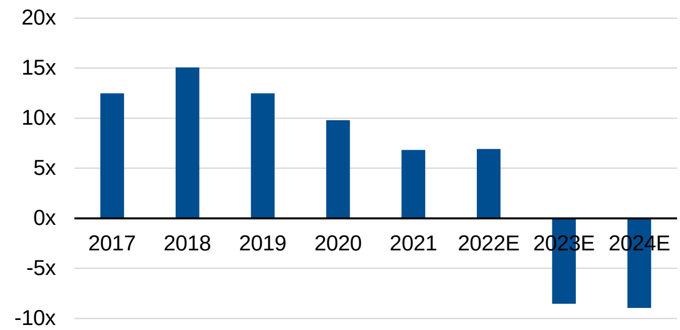
Hunland Trade's financial risk profile (assessed at B+) is based on our expectation of financial leverage (Scope-adjusted debt/EBITDA) above 6.5x and an interest cover ratio sustained at above 6.0x. We also expect stable profitability and positive FOCF, except in 2022.

Figure 6: Scope-adjusted leverage and cash flow cover



Source: Hunland Trade, Scope (estimates)

Figure 7: EBITDA interest coverage*



*Negative ratios in 2023 and 2024 result from the negative net cash interest paid position.

Source: Hunland Trade, Scope (estimates)

Rating reflects high leverage

Before 2020, leverage has been moderate at between 3.5x and 4.5x. In 2020, it increased to 5.8x due to lower sales and lower EBITDA while in 2021 it increased to 6.1x following the bond issue in July 2021. Our rating case includes expected Scope-adjusted debt/EBITDA of above 6.5x, with this level becoming the norm in the following years. The expected ratio therefore has a greater weight in our rating assessment.

The Scope-adjusted funds from operations/debt ratio has been above 5%, except for 2017 and 2021 when it was negative. However, we expect this ratio to be at the higher end of the 0%-20% range based on higher expected Scope-adjusted debt due to the bond issuance.

Good interest coverage

Hunland Trade's debt protection – as measured by Scope-adjusted EBITDA/interest – was above 10x (2017: 12x, 2018: 15x, 2019: 12%). Following the bond issue, debt protection deteriorated to 6.8x. We expect debt protection to be at 6.9x in 2022 while in 2023 it will likely improve by turning negative due to negative net cash interest paid. This improvement will result from to the use of cross-currency interest rate swaps which were progressively implemented in the course of 2022. Those swaps will likely enable Hunland Trade to pay interest in euros instead of forint as it swapped the notional amount in forint to euro. However, as the base interest rate difference between euro and forint was significant, the swaps resulted in having negative interest rates in euro (-0.8% on average) meaning that Hunland Trade is actually receiving interests instead of paying them. As a result, forecasted interest payments will be much lower than over the last two years, a positive rating-change driver. We have not yet fully reflected this improvement in our assessment given the high sensitivity of this ratio.

Weak cash flow coverage

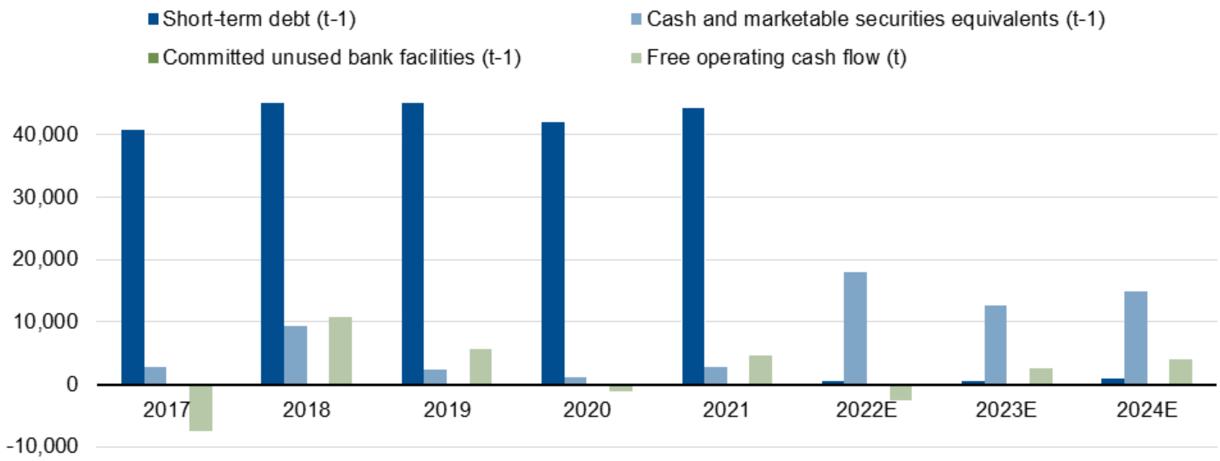
Hunland Trade's cash flow cover – as measured by Scope-adjusted FOCF/debt – has moved between negative and positive positions due to the fluctuation in FOCF. The variation is mainly influenced by the change in working capital. For the coming years, we expect FOCF to turn negative in 2022 only.

Adequate liquidity

Hunland Trade's liquidity is adequate thanks to the bond issue, which enabled the company to refinance the bulk of its short-term financial debt. We expect Hunland Trade to repay EUR 520,000 in financial debt and financial leases in 2023. This compares to

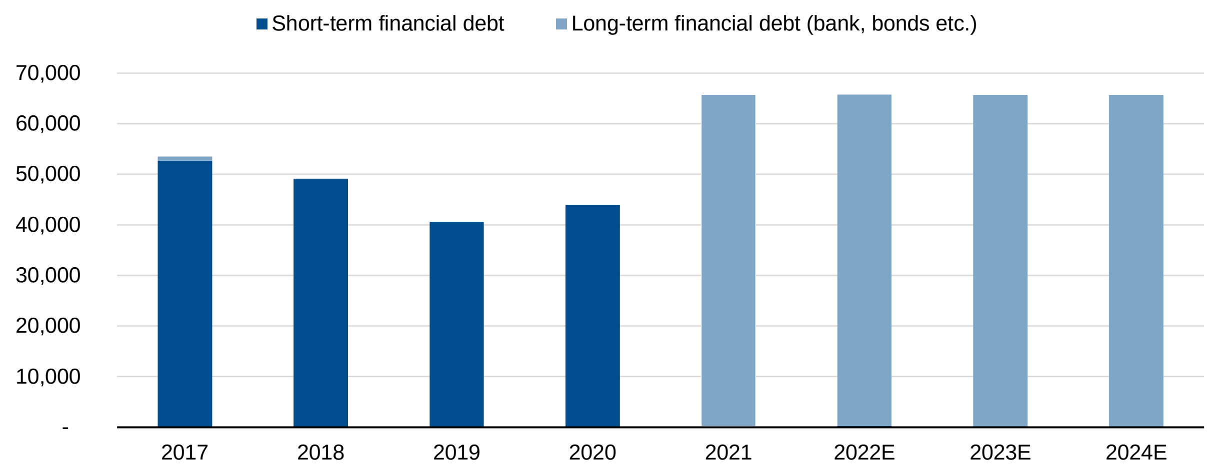
EUR 13m of expected available cash and equivalents as of 31 December 2022. We expect positive FOCF in 2023 due to a positive working capital variation. Overall, the repayment of short-term financial debt is expected to be fully covered in the coming years.

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)

Balance in EUR '000s	2022E	2023E	2024E
Unrestricted cash (t-1)	18,042	12,703	14,839
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	-2,497	2,573	3,994
Short-term debt (t-1)	452	520	836
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

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, or 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

HUF 24.2bn guaranteed senior unsecured bond issued for refinancing and intercompany loans

The rated entity issued a HUF 24.2bn (equivalent to EUR 65.6m) 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, Hunland Feed and Hunland Group Holding.

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 unit 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 has been used to refinance guarantors' bank debt and EUR 6.3m is dedicated to financing guarantors' capex, meaning that a total of EUR 17.2m is dedicated to the guarantors. Overall, EUR 61.5m has been assigned to a specific purpose, which leads to an unused amount to be seen as a cash buffer according to Hunland Trade.

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 above average recovery expectations

Our 'above average' recovery expectation for guaranteed senior unsecured debt is based on an anticipated liquidation value in a hypothetical default scenario. The guaranteed senior unsecured bond ranks below short-term and long-term debt raised from financial institutions (excluding the bond issue) 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. Our recovery expectation takes into consideration uncertainties regarding the value of claims at the guarantors' level but also uncertainties about the debt positions of the guarantors at the point of a hypothetical default of the rated entity and the seniority of the claims. Thus, we have refrained from granting any notch uplift. These recovery expectations translate into a rating of B+.

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