Magyar Gomba Kertesz Kft.
Hungary, Consumer Products

B STABLE

Corporate profile

Magyar Gomba Kertesz Kft. (MGK) is a Hungarian based company established in 2009. The entity is structured as a cooperative company and acquires raw mushrooms from its members, the owners/shareholders of MGK. MGK has grown from 10 founding members to 46 members, including primary producers, sole proprietors, and other producer companies. The company is responsible for the storage, packaging and canning of the mushrooms, the organisation of the related logistics and distribution activities and also the sales process to customers (retail chains). MGK produced 8,097 tons of mushrooms in 2020. Its turnover in the same year amounted to HUF 6.9bn. MGK operates under the brand name Korona Gomba. Fresh and canned mushrooms account for 85% of its revenue. The company intends to issue a HUF 2.5bn bond in order to finance a new production facility, which it will own and operate. In the new production facility, raw mushrooms will be processed (and packaged) into other semi-finished goods (e.g. frozen products).

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	22.1x	46.3x	43.4x	7.7x
Scope-adjusted debt (SaD)/EBITDA	5.9x	4.5x	2.9x	3.5x
Scope-adjusted FFO/SaD	16%	22%	32%	24%
FOCF/SaD	-47%	-12%	-47%	-27%

Rating rationale

Scope Ratings GmbH (Scope) has assigned Magyar Gomba Kertesz Kft. (MGK) an issuer rating of B/Stable. Scope has also assigned a debt category rating on senior unsecured debt of B+.

MGK's business risk profile is largely supported by its good profitability. Its EBITDA margin improved from 10.8% in 2018 to 14.1% in 2020 thanks to better yield rate production, currency effects (with export sales denominated in EUR accounting for 42% in 2020), and the rise in mushroom market prices. The compound annual growth rate of the average net market price of mushrooms between 2015 and November 2021 was 8.99%. However, MGK's EBITDA margin could deteriorate slightly from 2022 onwards due to rising labour prices and the risk of higher procurement prices. Indeed, the company sources its mushrooms from the members of the cooperative, which are also the shareholders of MGK. The company's leading position in Hungary – where it is responsible for 29% of the mushroom supply – is positive. Nevertheless, the rating is constrained by MGK's limited overall size compared to other European players. MGK's 2020 revenues stood at HUF 6.8bn and it sold around 8,000 tons of mushrooms. This represents a market share in Europe of under 1%, even if the company will increase sales volumes by utilizing and building on existing customer relations with well-known retail chains (expansion on domestic and regional markets).

Diversification is negative for the company's business risk profile. MGK is mainly exposed to the Hungarian market, which accounts for 58% of total revenues. We expect this concentration to worsen as Hungary will account for 66% of the company's turnover by 2023. MGK's product portfolio is also very limited as it markets almost only mushrooms,

although the company focuses on adapting to end-customer needs (canned mushroom, semi-finished, frozen mushroom products). Additionally, customer diversification is rather

Ratings & Outlook

Corporate rating	B/Stable
Senior unsecured rating	B+

Analysts

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Related Methodology

Corporate Rating Methodology, July 6th 2021

Rating Methodology: Consumer Products, September 30th 2021

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low, as the top five clients account for 87.9% of sales, partially mitigated by the fact that they are large well-known retail chains in Hungary and in the CEE region. The company operates part of its business under the brand Korona Gomba. We assess the brand strength as low, given the fact that 70% of MGK's sales are made under retailers' private labels.

MGK's financial risk profile is positively driven by an anticipated decrease in leverage from 4.4x in 2020 to 2.9x in 2021E. Although part of this improvement is due to the increase in EBITDA (+47% YoY), state subsidies of HUF 2.1bn granted in 2021 are the main contributor to the deleveraging process. MGK will invest around HUF 2bn per annum (vs HUF 0.6 bn in 2020) in its expansion strategy, which it expects to double its volumes of mushrooms sold from 8,000 tons in 2020 to 18,000 tons in 2023. These investments are expected to be partly financed by the issuance of a HUF 2.5bn senior unsecured bond with ten years' maturity, under the MNB Bond Funding for Growth Scheme. The bond will be amortised at a 10% rate per annum starting in year five until year nine. 50% of the outstanding bond will be repaid at maturity.

The combination of a large capex programme and recurring negative working capital, driven by the surge in sales, will put pressure on free cash flow generation and cause leverage to deteriorate starting in 2022. We forecast that leverage, measured by Scope-adjusted debt (SaD)/EBITDA will remain between 3.0x and 4.0x while reaching 3.5x in 2022E. Free operating cash flow (FOCF) is the main constraint on MGK's financial risk profile as it is recurringly negative and is not expected to improve in the medium term. The company's creditworthiness is also limited by a track record of inadequate liquidity due to a low cash balance, negative free cash flow generation and the lack of undrawn credit facilities. The limited transparency of financial disclosures and governance concern, including the relationship between the shareholders and the cooperative, are further risks.

Outlook and rating-change drivers

Stable Outlook

The Outlook is Stable and incorporates our expectation of stable credit metrics, with net debt/EBITDA in the 3.0-4.0x range and EBITDA interest coverage of above 7x. The Outlook also includes our expectation that liquidity (which we currently view as inadequate) will not improve in the next 12 to 18 months.

Ratings upside

A positive rating action could be achieved if the company successfully ramps up production that positively affects the overall business risk profile and shows ability to generate positive FOCF that will keep leverage at moderate levels for the rating category.

Ratings downside

A negative rating action could be required if leverage surges above 4.0x on a sustained basis. Financial leverage exceeding 4.0x could, for example, be triggered by a significant deterioration in working capital and lower than expected operating profitability.

Long-term and short-term debt ratings

B+ senior unsecured rating

We assign a B+ to the senior unsecured debt category. This instrument rating is based on a hypothetical liquidation scenario as of year-end 2023, in which we computed an above-average recovery for senior unsecured debt holders based on our assumptions of attainable liquidation values.

Rating drivers

Positive rating drivers	Negative rating drivers
• Good profitability driven by improving yield production and increasing market prices • Industry characterized by low cyclicality and medium barriers to entry • Hungarian leader with 29% market share • Financial risk profile supported by good leverage	• Small mushroom player in the European market • Inadequate liquidity due to low cash balance and lack of undrawn credit facilities • Negative to weak free cash flow driven by high capex and recurring negative working capital • Weak geographical diversification outside of Hungary, strong customer concentration and limited product offer • Limited brand strength

Rating-change drivers

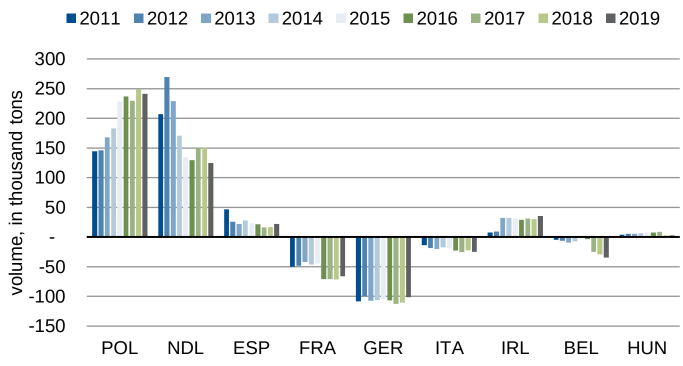
Positive rating-change drivers	Negative rating-change drivers
• Successful ramps up production that positively affects the overall business risk profile • Generation of positive FOCF on a sustained basis.	• SaD/EBITDA above 4.0x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	22.1x	46.3x	43.4x	7.7x
Scope-adjusted debt (SaD)/EBITDA	5.9x	4.5x	2.9x	3.5x
Scope-adjusted funds from operations/SaD	16%	22%	32%	24%
Free operating cash flow/SaD	-47%	-12%	-47%	-27%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	658	882	1,300	1,716
Operating lease payments in respective year	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	658	882	1,300	1,716
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	658	882	1,300	1,716
less: (net) cash interest as per cash flow statement	-29	-19	-29	-222
less: cash tax paid as per cash flow statement	-2.3	0.0	-60	-64
less: pension interest	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted funds from operations	626	863	1,210	1,430
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	3,074	3,019	2,794	5,032
add: hybrid bonds	0.0	0.0	0.0	0.0
less: cash and cash equivalents	0.0	0.0	0.0	0.0
add: cash not accessible	0.0	0.0	0.0	0.0
add: pension adjustment	0.0	0.0	0.0	0.0
add: operating lease obligations	0.0	0.0	0.0	0.0
Other	816	945	945	945
Scope-adjusted debt	3,891	3,964	3,740	5,978

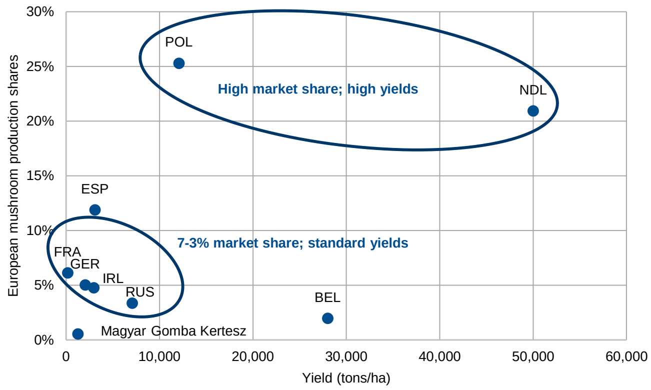
Business risk profile: B+

Figure 1: Mushroom balance of trade per country



Source: FAO, EMGG, Eurostat, Scope

Figure 2: Market yields and market shares in Europe, 2019



Source: FAO, MGK, Scope

European market characteristics

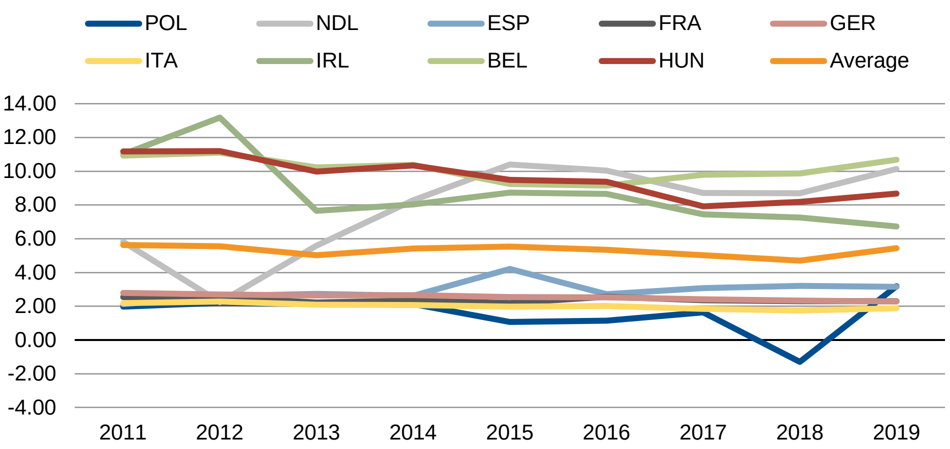
The Hungarian and European 'mushroom industries' are characterised by many small- to medium-sized companies and are therefore rather fragmentated. The industry itself can be split into three revenue sources: mushroom spawn production, mushroom compost production and final mushroom products (whether canned or packaged for fresh consumption). There is no seasonality for growing mushrooms; it takes between four and six weeks to grow them.

According to the latest data released by the FAO, the EU is the second biggest mushroom producer in the world (12% of global mushroom and truffle production) after Asia, which is far ahead with 82.8% of world mushroom. In 2014-2019, the European mushroom production market had a compound annual growth rate of 2.03%.

In terms of volume, the main mushroom producers in the EU are Poland and the Netherlands, respectively producing 27% and 23% of Europe's total mushroom volume in 2019. Hungary accounts for only 2% of production.

In terms of yield rate of production, the market is very diverse. The Netherlands has a yield of 50,000 tons per hectare, compared to the European average yield of 19,200 tons per hectare.

Figure 3: Mushroom consumption per year per capita (kg)



Source: FAO, EMGG, Eurostat, Scope

Hungary is a small fragmented market dominated by two main companies

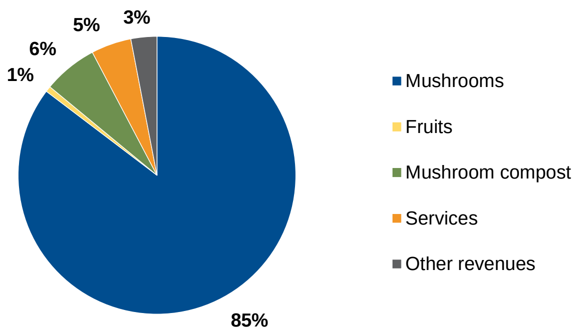
The Hungarian mushroom market is fairly small in a European context. It accounts for 1.9% of European mushroom production, providing around 27,000 tons of mushrooms according to the latest data released by the FAO. The Hungarian mushroom production market had a compound annual growth rate of 2.95% in 2014-2019.

The market is very fragmented. There are about 15 SMEs, of which Magyar Gomba Kertész Kft. is the biggest mushroom producer, with around 8,000 tons, followed by Bio-Fungi Kft., its main competitor, which produces between 6,000 and 7,000 tons of mushrooms. In terms of market shares, MGK and Bio-Fungi Kft. mushroom production represents more than 50% of Hungarian mushroom and truffle production. MGK and Bio-Fungi mainly sell the same type of mushrooms (white and brown button mushrooms, which account for 90% of domestic mushrooms). The third mushroom producer in Hungary based on revenues is Pilze-Nagy (around 5.5% of Hungarian mushroom production). Pilze-Nagy is mainly specialised in oyster mushrooms, which are sold at a higher price than white/brown button mushrooms (almost twice as expensive).

Strong market share in Hungary offset by limited overall size

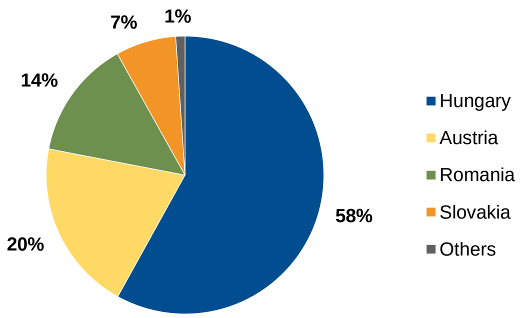
MGK owns 28.6% of the Hungarian mushroom production market. Even if the market is very fragmented, this only represents a 0.6% share of the European mushroom production market. It is in this area that MGK aims to expand. We assess MGK's market share as very low in the context of the European market. This limited size is a negative rating driver as it weakens bargaining power with retailers.

Figure 4: Revenue breakdown by product 2020



Source: Source: MGK, Scope

Figure 5: Geographical diversification



Source: Source: MGK, Scope

Geographical concentration in Hungary expected to worsen over the next few years

At year-end 2020, Hungary accounted for 58% of MGK's sales, while the rest of Europe represented 42%. The rest of Europe includes three different countries, namely Slovakia, Austria and Romania.

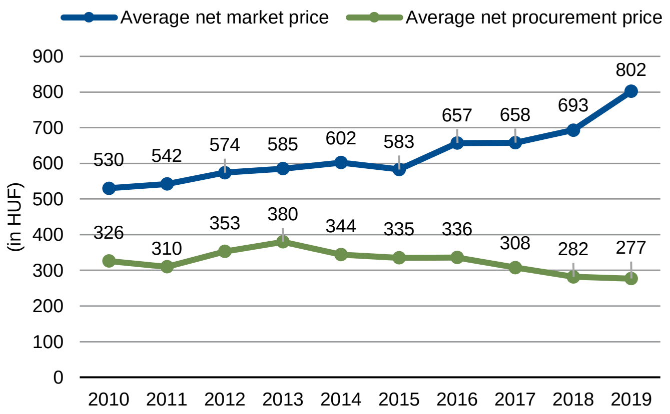
The surge in Hungary' share in 2020 versus 2018 (48%) is due to the organic growth of domestic sales while export sales remained fairly stable. Management does not expect to increase its exports outside of Hungary from 2020 onwards, with domestic mushroom sales reaching 66% by 2025, causing geographical diversification to deteriorate further.

Lack of diversification across product offer; concentrated customer base

MGK's main customers belong to the retail industry (Lidl, Spar and Metro). The top five customers accounted for 87.9% of 2020 sales with Lidl representing 49.5% of mushrooms sold. Therefore, MGK is heavily dependent on a single customer. This concentration is slightly mitigated by the fact that the company mainly works together with well-known retails chains.

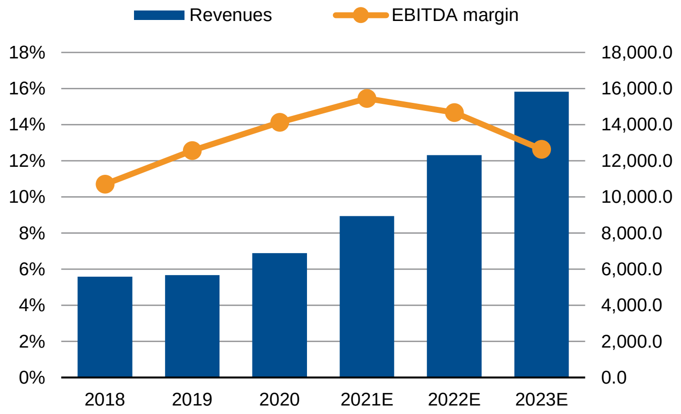
MGK mainly markets two types of products: fresh mushrooms and canned mushrooms. Although the company produces a variety of mushrooms (white, oyster, brown and shitake), they all belong to the same product category. We do not expect product diversification to improve in the future although MGK will start selling frozen mushrooms in the short term. Overall, MGK owns a highly concentrated product portfolio, primarily based on a single discretionary product type.

Figure 6: Net mushroom prices in Hungary



Source: Hungarian Central Statistical Office, 2020

Figure 7: Profitability margin 2018-23E



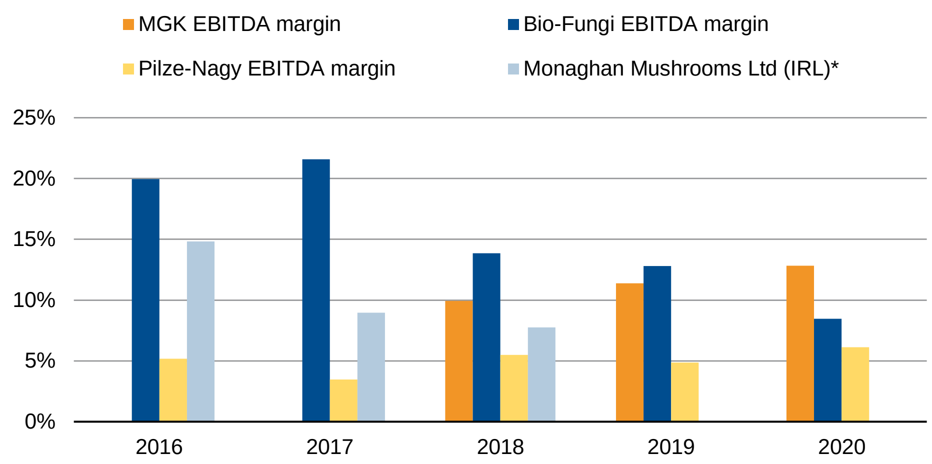
Source: MGK, Scope

Good profitability driven by increasing market prices…

MGK has good historical profitability compared to its Hungarian peers, maintaining its operating margin above 10% since 2018. Two positive effects have improved the company's EBITDA margin:

- The combined effect of market prices increasing while procurement prices have tended to level off. The compound annual growth rate of the average net market price of mushrooms between 2015 and 2021 was 8.99%, which is good for MGK's revenues in the long run, as it can be passed on to retailers. On the other hand, mushrooms in Hungary are one of the few vegetables for which the net average procurement price has stabilized since 2013, reducing MGK's expenses for purchasing mushrooms from its cooperative's members.
- MGK's export sales are denominated in EUR. HUF/EUR has been decreasing by 12.5% since 2018. The company does not have a dedicated hedging strategy.

Figure 8: EBITDA margins of Magyar Gomba Kertész Kft and its Hungarian competitors



*(fiscal year ending 31/12 until 2016 then on 30 June N+1) Source: MGK, Scope

…which are forecasted to decrease slightly starting in 2022

We expect MGK's EBITDA margin to decrease from 2022 onwards due to: i) the share of exports decreasing where margins are higher, and prices increasing faster; and ii) pressures from rising labour costs.

We consider the volatility of profitability to be medium, supported by:

- Price inflation risk in Hungary (+7.4% between January 2021 and January 2022). This has been mitigated by the Hungarian government, which recently started to cap prices for food products, mushrooms not being included in this policy for the moment.
- The pricing policy between producers and MGK remains unclear, which could lead to an increase in the cost base.
- MGK remains sensitive to currency fluctuations as it has no hedging policy. In 2020, 42% of revenues were realized in EUR.

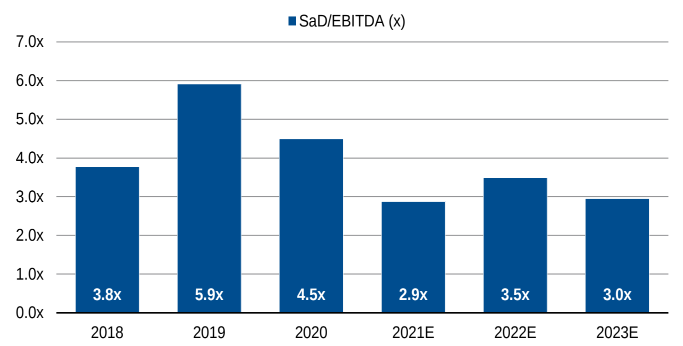
Financial risk profile: B

Track record of high leverage, which should decrease by 2021 thanks to state subsidies

Since 2018, MGK's consolidated leverage, measured by SaD/EBITDA and funds from operations/SaD, has been quite high due to a low cash balance and negative free cash flows. At year-end 2020, gross debt included shareholder loans and subordinated liabilities owed to shareholders for 43% of total debt.

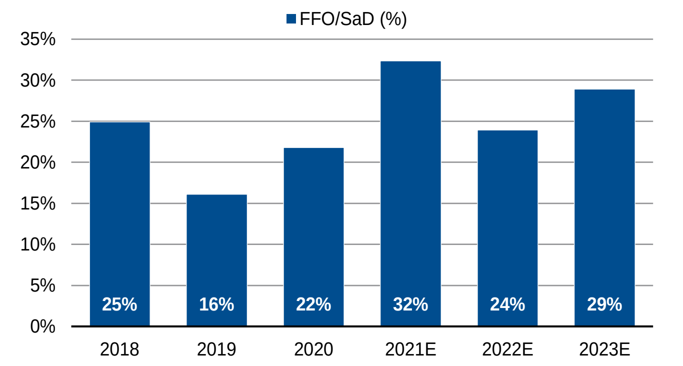
We forecast that the company will become less leveraged, with net debt dropping from HUF 3.9bn to HUF 3.7bn between 2020 and 2021. This is based on a large subsidy of HUF 2.1bn received in 2021. Additionally, we expect EBITDA to grow by 47% in 2021 on the back of strong revenue growth (+29%), increasing mushroom market prices and an improving production yield. We therefore expect SaD/EBITDA to drop to 2.9x in 2021. Looking forward, despite the increase in EBITDA in 2022, leverage will deteriorate as recurring negative free cash flow pushes SaD/EBITDA towards 3.5x.

Figure 9: SaD/EBITDA – 2018 to 2023E[1]



Source: MGK, Scope estimates

Figure 10: FFO/SaD – 2018 to 2023E



Source: MGK, Scope estimates

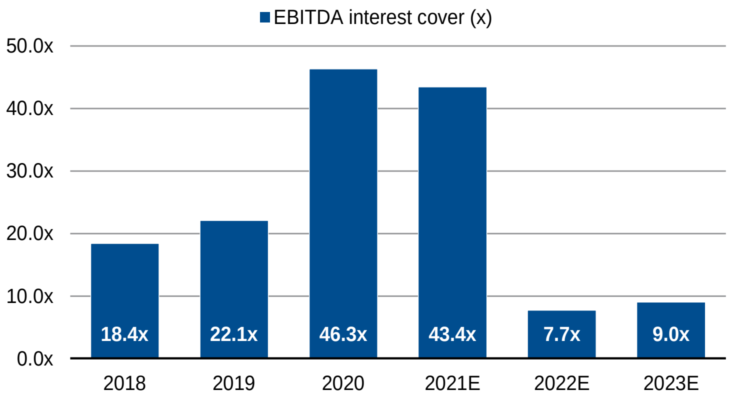
High EBITDA interest expense cover expected to remain above 7x after the bond issuance

MGK had high EBITDA interest expense cover of above 10x between 2018 and 2020. This was thanks to very low gross interest costs with an average cost of debt below 1.5%. The company also benefitted from non-interest-bearing loans from shareholders, which lowered interest expenses.

We anticipate that debt protection will drop to 7.7x by 2022. This is due to a significant change in MGK's future debt position, with the new HUF 2.5bn bond issued at the beginning of 2022 under the MNB programme. We expect a fixed coupon rate of 5.5% for the bond.

[1] Editorial note: Figure 9 was corrected on 14 February 2022 to display the chart for SaD/EBITDA. In the original publication, it displayed the graph for EBITDA interest cover (see Figure 11).

Figure 11: EBITDA interest cover – 2018 to 2023E[2]



Source: MGK, Scope estimates

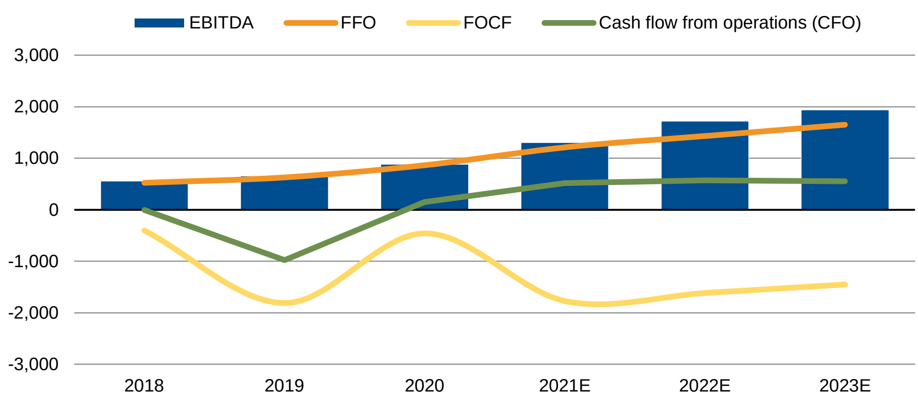
Negative FOCF driven by large negative working capital

MGK has a track record of volatile operating cash flow generation, which has been insufficient to cover its capex. Working capital was negative at the end of the year in 2018, 2019 and 2020 standing at HUF -0.5bn, HUF -1.6bn and HUF -0.7bn respectively. This was because of a decrease in days payables outstanding (from 185 days in 2018 to 42 days in 2020) while days receivables outstanding remained fairly stable (from 62 days in 2018 to 65 days in 2020).

We expect FOCF/SaD to remain negative between 2021 and 2023 because of a combination of two factors: i) negative working capital consumption, which we expect to continue but at a lower extent as MGK ramps up its mushroom production. Strong revenue growth should reduce exposure to external suppliers (we do not see the payment date going lower than after 40 days); and ii) over HUF 2bn per annum in development capex between 2021 and 2023.

We do not expect operating cash flows to be sufficient to cover capex. Given the low cash balance, MGK will rely on the 2022 HUF 2.5bn bond and large subsidies of HUF 2.1bn in 2021 to finance its investments. Investments include the setting up of a logistics centre, the installation of multiple solar panels and the automation of mushroom compost.

Figure 12: Cash flows (in HUF m) – 2018 to 2023E



Source: MGK, Scope estimates

[2] Editorial note: Figure 11 was amended on 14 February 2022 to display the chart for EBITDA interest cover. In the original publication, it displayed the graph for SaD/EBITDA (see Figure 9).

Inadequate liquidity, driven by no undrawn credit facilities and negative free cash flow

MGK's liquidity is constrained by:

- Fully used committed short term credit lines.
- Stretched working capital management, due to decrease in days payable outstanding driven by suppliers/shareholders. Risks of shorter deferred payment could lead to further working capital consumption.
- Significant low cash balance on a recurring basis viewed as non-permanent.

Figure 13: MGK's liquidity

(in HUF m)	2019	2020	2021E	2022E	2023E
Short-term debt (t-1)	1,269	1,196	634	971	951
Unrestricted cash (t-1)	0.0	0.0	0.0	0.0	0.0
Open committed credit lines (t)	0.0	0.0	0.0	0.0	0.0
FOCF (t)	-1,812	-462	-1,772	-1,618	-1,453
Liquidity (internal)	-143%	-39%	-279%	-166%	-153%
Liquidity (internal + external)	-143%	-39%	-279%	-166%	-153%

Source : MGK, Scope estimates

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