Aranynektár Kft
Hungary, Business Services

SCOPE B POSITIVE

Corporate profile

Aranynektár is an entity solely acting as a commercial partner to Fulmer Hungarian Branch (FHB). Both entities are owned either directly or indirectly by Mr Ferenc Takács. Aranynektár's business consists of the preparation and packaging of honey – either in glass or PET containers. Acting as an integrated contractor, Aranynektár generates revenues fixed in advance by FHB to cover its operating expenses and produce a margin.

Key metrics

Fulmer Hungarian Branch (FHB)			Scope estimates	
Scope credit ratios	2019	Jan-May 2020[1]	2021F	2022F
EBITDA/interest cover (x)	44.0x	10.8x	13.2x	12.6x
Scope-adjusted debt (SaD)/EBITDA	1.6x	N/A	0.2x	1.3x
Scope-adjusted FFO/SaD	59%	N/A	568%	68%
FOCF/SaD	24%	N/A	32%	-86%

Rating rationale

Scope affirms Aranynektár Kft's issuer rating of B and changes the Outlook to Positive from Stable. Aranynektár'ssenior unsecured bond is affirmed at B+.

The rating of Aranynektár Kft continues to be determined by the credit quality of its sister company FHB. Aranynektar is an integrated business service to FHB, which not only owns all the assets used by the issuer but is also its sole customer. Management has not indicated any willingness to develop the activities of Aranynektár outside of the scope of FHB. We therefore consider Aranynektár to be fully dependent on the relationship between the two entities, with a severance of their business links leading to the immediate bankruptcy of Aranynektár.

FHB has benefitted greatly from the Covid-19 pandemic, which has significantly increased sales and profitability, due to a shift in consumer preferences towards healthy produce. That said, FHB remains a small player on the international European scene, where it is constrained by its size and low market share, within a geographical region pressured by a large number of imports. The group's development of branded labels (stagnating at close to 26% of total sales) was hindered by the cancelation of fairs last year due to the pandemic. However, we expect the development of this line of produce to resume once lockdowns are lifted. This would improve the group's diversification and brand strength, which remain weaknesses – together with the high exposure to international sales.

Ratings & Outlook

Corporate ratings	B/ Positive
Senior unsecured bond rating	B+

Analysts

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Related Methodology

Corporate Rating Methodology, February 2020

Rating Methodology: Consumer Products, September 2020

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Bloomberg: RESP SCOP

[1] *Due to new reporting end dates, numbers are based on the 5 months period between Jan-May 2020. Thus, certain credit metrics are not applicable and put as N/A.*

FHB has improved its profitability from 12.9% in 2019 to 17.7% in May 2020, supported by a comparable increase in the gross margin from 12.7% to 23.2% (in the same period). We expect this growth in profitability to slow down and decrease towards historical levels, as demand normalises. FHB has changed the end of its reporting year from December to May. We believe this will support the group's performance because it increases cash generation in May 2020 due to a positive effect on net working capital.

FHB's financial risk profile has benefitted considerably from the above-mentioned growth in Scope-adjusted EBITDA, which has translated into an overall improvement in metrics. FHB has also increased its cash position to a historically high level and is waiting for a subsidy to launch a new capex programme. We expect the group's cash position to decrease significantly in the coming years. Despite a lack of information on the upcoming grant/subsidy, Scope believes 2021 and 2022 metrics should benefit from a comfortable cash position. Scope-adjusted debt (SaD)/EBITDA is expected to fall below 1.5x in the coming two years, before deteriorating to levels above 2x the following year. We expect cash flow cover to come under pressure given the expansions plans of the group. FHB has announced its intention to invest in production and storage facilities in the coming years. We anticipate that this will considerably increase capex levels, leading to negative free operating cash flow (FOCF)/SaD going forward.

Liquidity is adequate. The bond issuance has allowed FHB to repay the majority of short-term debt, limiting any repayment walls in the coming years. The improvement in metrics last year could warrant a higher issuer rating. However, we have maintained a relatively conservative stance, overweighting the FOCF/SaD ratio in our financial risk profile assessment, given the expectation of a high investment phase. In the overall rating, we overweight the business risk profile subrating. This is because of the group's small size, which makes it more vulnerable to external factors.

We apply a negative notch for governance and structure, due to the complexity of the bond issuance and intercompany loan structure. A lack of transparency regarding forecasts, the impact of the state subsidy and potentially high capex are also detrimental to the rating (ESG: credit-negative governance factor).

Outlook

The Outlook is Positive, based on the improvement in credit metrics and growth of the group over the last few months, which have exceeded our expectations. We believe FHB will be able to deploy a considerable capex programme while maintaining an acceptable financial risk profile, partly financed with a state subsidy. The Outlook also includes our understanding that Aranynektar will remain unaffected by external events – beyond our assessment of the credit quality of FHB – which could have a negative impact on the issuer.

A positive rating action may be taken if FHB successfully maintains a high EBITDA margin, which would result in SaD/EBITDA remaining at low levels, while simultaneously improving transparency and the scale of its activities. This could be achieved via the development of branded goods, which could increase the group's recognition and ability to charge a premium.

A negative rating action (including the return to a Stable Outlook) may be taken if SaD/EBITDA increases above 3x on a sustained basis, e.g. due to a greater than expected drop in profitability and a larger than anticipated net capex investment programme.

Rating drivers

Positive rating drivers	Negative rating drivers
• Modest geographical diversification • Development of a branded label, albeit gradual • High EBITDA interest cover • Positive development of Scope-adjusted EBITDA margin last year (17.7%)	• Small group size makes it vulnerable to externalities • High historical variations in net working capital expected to continue putting pressure on liquidity • Large share of private labels weighs on profitability • Access to labour limited, forcing group to use temporary agency personnel • Unknown effect of subsidy on financial risk profile • Lack of transparency

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Maintenance of high EBITDA margin, keeping SaD/EBITDA low, with simultaneous improvement in transparency and scale of activities	• SaD/EBITDA above 3x on a sustained basis

Financial overview of Fulmer Hungarian Branch

			Scope estimates	
Scope credit ratios for FHB	**2019**	**Jan / May 2020***	**2021F****	**2022F**
EBITDA/interest cover (x)	44.0x	10.8x	13.2x	12.6x
Scope-adjusted debt (SaD)/EBITDA	1.6x	N/A	0.2x	1.3x
Scope-adjusted funds from operations/SaD	59%	N/A	568%	68%
Free operating cash flow/SaD	24%	N/A	32%	-86%
Scope-adjusted EBITDA in HUF m	**2019**	**Jan / May 2020**	**2021F**	**2022F**
EBITDA	683	534	548	494
Extraordinary items	0	0	0	0
Scope-adjusted EBITDA	683	534	548	494
Scope-adjusted funds from operations in HUF m	**2019**	**Jan / May 2020**	**2021F**	**2022F**
EBITDA	683	534	548	494
less: (net) cash interest as per cash flow statement	-16	-49	-42	-39
less: cash tax paid as per cash flow statement	-31	-39	-23	-9
Scope-adjusted funds from operations	636	446	484	446
Scope-adjusted debt in HUF m	**2019**	**Jan / May 2020**	**2021F**	**2022F**
Reported gross financial debt	1,119	1,592	1,448	1,342
less: cash and cash equivalents	-46	-1,002	-1,363	-683
less: liquid securities	0	489	0	0
Scope-adjusted debt	1,073	101	85	659

** Due to new reporting end dates, numbers are based on the 5 months period between Jan-May 2020. Thus, certain credit metrics are not applicable and put as n/a.***June 2020 – May 2021 going forward

Business risk profile: B+

Symbiotic relationship between FHB and Aranynektár

Due to the close relationship between Aranynektár and FHB, we have performed a credit quality assessment of the latter. Although Aranynektár is the issuing entity, the debt servicing obligations lie with FHB because the intercompany loan matches the bond features issued by Aranynektár to FHB. As a consequence, and due to the co-dependency between the two entities and guarantee provided by FHB for the prospective bond, our rating focuses on the credit quality of FHB, rather than of Aranynektár.

Weak market positioning detrimental to the rating

FHB has a relatively strong position on the national market but a weak position in Europe, with market shares estimated at close to 20% and 1.5% respectively. The group plans to boost its brand recognition by increasing the number of its own labels (currently representing 26% of sales, according to management). However, Covid-19 has impeded the launch of branded labels due to the cancellation of fairs with which the group was planning to develop its brands abroad. We view FHB's small size as detrimental to the rating because it implies a vulnerability to unexpected externalities. This was illustrated by the 15% revenue decline in 2018 caused by the bankruptcy of the group's Italian customer. The group's size therefore limits potential rating uplifts.

Improving sales during lockdowns with shift towards healthier eating

Sales grew by 12.5% over the 2018-2019 reporting period. This was driven by Covid-19 prompting changed consumer purchasing behaviour in favour of more healthy produce. In addition, the Hungarian government allowed FHB to continue operations in 2020, whereas international competitors were subject to restrictions. These factors, alongside a low crop in Hungary last year, should also increase sales in the coming year.

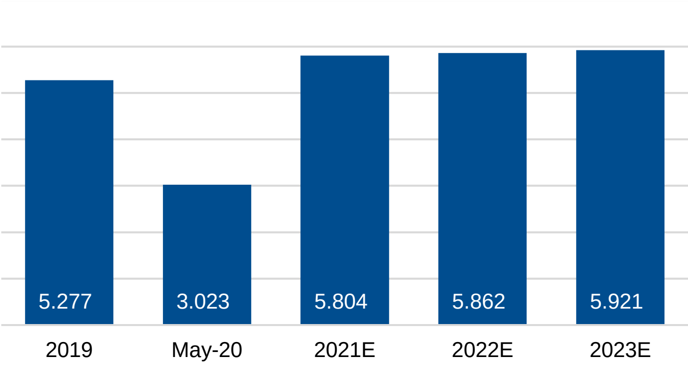
Going forward, we expect FHB to grow its revenue, bolstered by: i) the normalisation of revenue growth post 2018; ii) the development of own brand; iii) growing demand; and iv) capex aimed at enhancing production capabilities.

Good customer and supplier diversification despite group size

FHB is well diversified in terms of geographical outreach. The group makes only 17% of its total sales in Hungary (Dec 2020), with the rest dispatched throughout the world. Exposure to European countries is significant, at over 50% of total sales exported outside of Hungary. The group also sells consistently to Japan and USA, which accounted for 14% of total sales made abroad in Dec 2020. However, there is a certain inconsistency in terms of buyers' profiles, with high variations in the share of sales made to different countries in different years. Exports to Saudi Arabia, for example, jumped from nil to 14% last year. These variations in branded labels sales per customer are inherent in the business of relatively small companies.

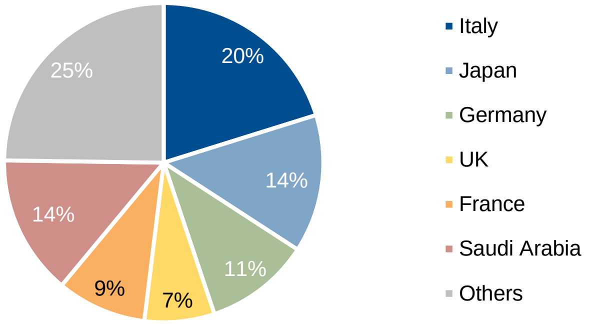
Supplier and customer diversification support the rating. FHB has a broad supplier base, spread across Europe and beyond. The group has also set up some activities in Ukraine and is exploring the idea of expanding into Russia, where export prices to Europe are very profitable. The customer mix is stable, at similar levels at last year.

Figure 1: FHB's revenue with forecasts (in HUF m)



Source: FHB, Scope estimates

Figure 2: FHB's geographical outreach

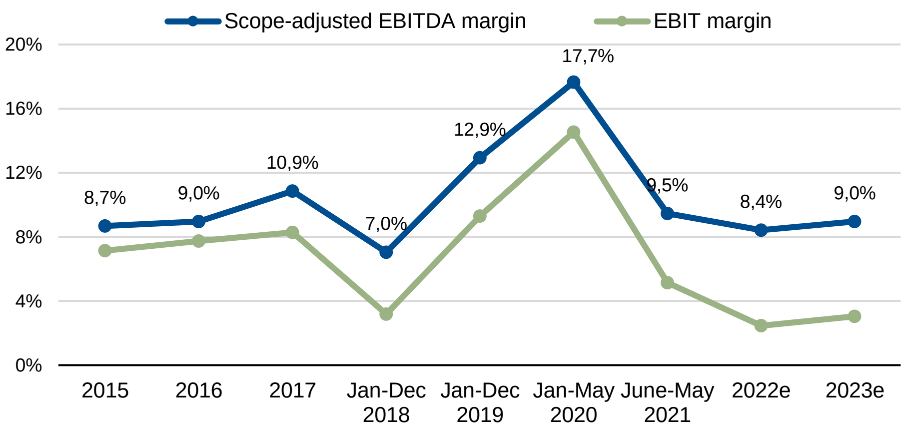


Source: FHB, Scope

Low diversification due to mono-product focus

FHB's mono-product focus (honey related) is detrimental to the rating as poor harvesting could heavily impact group revenues once its inventory is depleted. The group uses different formats (glass and PET containers). However, this does not represent real diversification because neither format has strong features which are countercyclical to the other format.

Figure 3: FHB's profitability with forecasts (in %)



Source: FHB, Scope

Profitability expected to be maintained at around 9%

FHB has increased its profitability significantly (calculated based on the Scope-adjusted EBITDA margin), to close to 13% in Dec 2019 from 7% the year before. Multiple factors have contributed to this rise in revenue, such as higher consumer demand for healthy food. In addition, production facilities were kept operational while competitors in many other countries were subject to lockdown restrictions. This allowed the group to benefit from constant production, while peers were suffering from national prevention measures in terms of both operations and supplies. We view this margin improvement as temporary and forecast a certain normalisation towards lower levels in the coming years. Further improvement is possible if the new production and storage facilities – which should start being set up at the end of the year – become operational more quickly than expected. The development of branded labels should also increase the individual gross margins of the group.

Low brand strength still detrimental to the rating

Brand strength, which is a new rating component in our consumer goods methodology, is relatively weak. The high share of private labels dilutes the group's visibility on an international level. That said, we expect this distribution channel to increase in the coming years.

Financial risk profile: BB

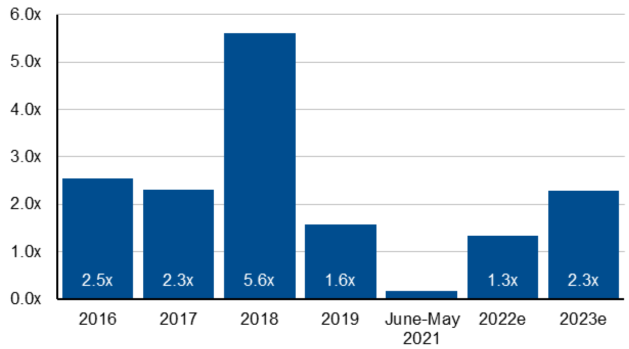
Successful bond issuance, proceeds earmarked for capex

Aranynektár successfully issued a bond of HUF 1bn in Q2 2020 expiring in 2030. The bond is guaranteed by FHB. Aranynektár transferred the proceeds to FHB via an intercompany loan, designed to have exactly the same features (including coupons, repayment schedule and maturity). As Aranynektár does not have the financial capabilities to repay the coupons or the bond with its limited cash flow generation, FHB will pay the interests and repay the bond to Aranynektár, which will, in turn, repay the bondholders.

Changing the end of fiscal year has positive effect on metrics

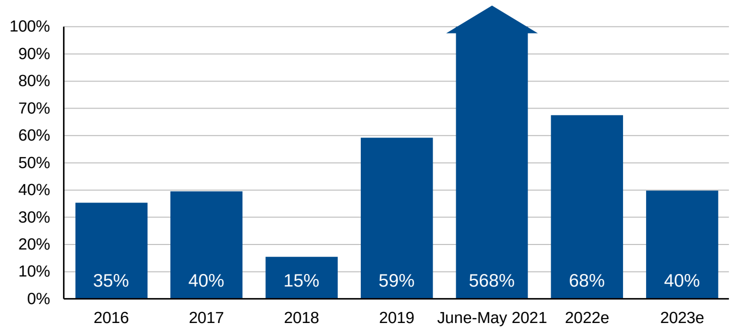
Aranynektár and FHB have changed the end of their fiscal year from December to May, in line with the honey production cycle. At the end of May inventories are significantly lower than at the end of December, since the fresh produce comes in the summer. Therefore, the group's financials look slightly better in May, due to an effect on net working capital (cash balance, SaD/EBITDA), than at the end of December.

Figure 4: Evolution of SaD/Scope-adjusted EBITDA



Source: FHB, Scope estimates

Figure 5: Evolution of funds from operations/SaD



Source: FHB, Scope estimates

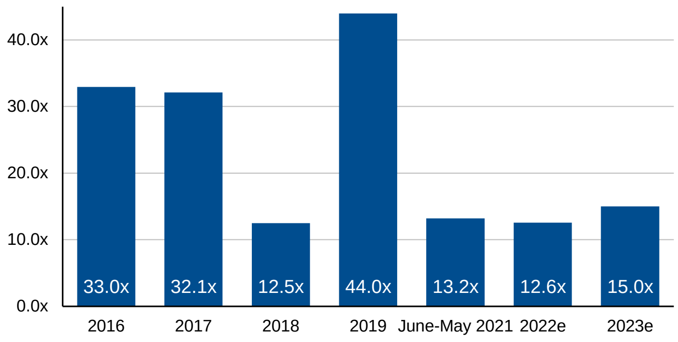
Leverage metrics have greatly improved due to development of EBITDA

Leverage has been developing positively over the last few years, bolstered by an overall improvement in both EBITDA and leverage levels. By refinancing its short-term debt with the bond issuance in 2020, the group has decreased its short-term funding requirements to maintain operations. We believe the decrease in both leverage ratios in the coming two years will remain exceptional. This is based on our expectations that Scope-adjusted EBITDA will normalise to lower levels and that capex will drain the cash on the balance sheet substantially.

FOCF cover expected to come under pressure

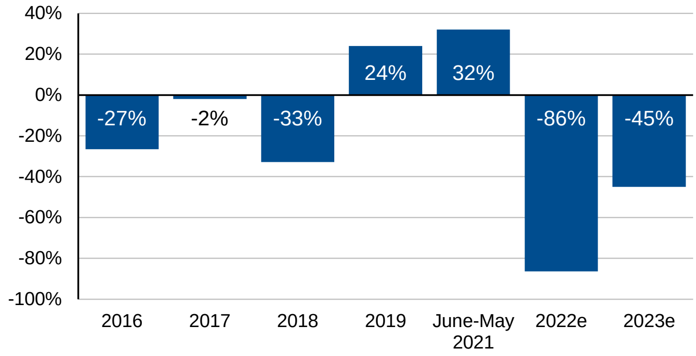
We expect EBITDA interest cover to remain relatively high given the past repayment of group debt and the group's low overall interest expenses. On the other hand, we expect cash flow cover to suffer from high volatility, given management's announcement that the group is in a development phase. These growth ambitions suggest that capex and net working capital will absorb cash in the coming years.

Figure 6: Evolution of EBITDA interest cover



Source: FHB, Scope estimates

Figure 7: Evolution of FOCF/SaD



Source: FHB, Scope estimates

Adequate liquidity despite upcoming capex plans

Liquidity is adequate, given low short-term debt repayment, which is fully covered by high Scope-adjusted EBITDA profitability and the group's cash position. While we do not see any liquidity risk for the group at present, pressure could arise if capex is greater than forecasted.

Liquidity (in HUF '000)	2020	2021E
Cash and marketable securities equivalents (t-1)	46,296	1,491,442
Short-term debt (t-1)	755,345	144,462
Free operating cash flow (t)	431,236	27,356
Liquidity (%)	0.6x	10.5x

-1 notch for governance

The rather weak transparency and governance of the issuer (and its sister company), including the unusual structure, lack of comfort about group financials and related changes in accounting policy pose a certain information risk. We therefore continue to subtract one notch for governance.[2]

Further analytical contribution

The recent improvement in financial metrics has exceeded our expectations, bolstered by the strong development of profitability and the gross margin. While our financial risk profile rating could be higher based on our rating thresholds, we have maintained a conservative view for two reasons. The first is uncertainty around the capex programme and its impact on financial metrics. We have therefore taken the precaution of overweighting FOCF/SaD in the financial risk profile subrating. The second reason is the small size of the group, which we see as detrimental to the rating as it increases the potential impacts of externalities. We have changed the Outlook to Positive to reflect the development of credit metrics as well as these uncertainties.

Senior unsecured rating

Senior unsecured bond is affirmed at B+. The rating is based on our assessment of an 'above average' recovery following a hypothetical default in 2022.

[2] ESG factor

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