Nitrogenmuvek Zrt.
Hungary, Integrated Chemicals

SCOPE BB- STABLE

Corporate profile

Nitrogenmuvek Zrt., headquartered in Pétfürdő (Hungary) is a producer of various nitrogen-based fertilisers such as calcium ammonia nitrate (CAN), ammonia nitrate, urea-ammonium nitrate (UAN) and urea. The company also sells crop protection, pesticides and seeds to farmers in countries including Hungary, Austria, Slovakia, and the Czech Republic. Nitrogenmuvek spent substantial capex in 2013-19 to modernise and expand its production site. The Bige family owns Nitrogenmuvek. In 2020, sales were HUF 94.8bn and EBITDA at HUF 23.1bn.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	3.1x	3.9x	2.2x	5.0x
Scope-adjusted debt (SaD)/EBITDA	3.3x	2.1x	4.0x	1.3x
Scope-adjusted FFO/SaD	15%	33%	14%	57%
Free operating cash flow (FOCF)/SaD	36%	36%	-5%	39%

Rating rationale

Scope Ratings GmbH has today affirmed the BB-/Stable corporate issuer rating on Hungarian Nitrogenmuvek Zrt. The BB- senior unsecured debt rating was also affirmed.

The issuer rating continues to reflect a business risk profile of B+ and a financial risk profile of BB+. The rating benefits from Nitrogenmuvek's position as the sole producer of nitrogen fertilisers in Hungary and its solid position in other countries in Central and Eastern Europe (CEE). In this region, the company is supported by its Genezis partner network, as well as trading activities allowing it to leverage on existing business with farmers. However, its limited scale (sales of around EUR 250m) in relation to those of chemical companies globally, fertiliser companies in particular, hampers its market position. Weak diversification also holds back Nitrogenmuvek's competitive position: the company has only one production site, product concentration on nitrogen fertilisers, which are sold in one end-market, and a modest contribution of specialty chemicals products to sales. Despite volatile profitability (EBITDA margin), the EBITDA margin remains credit-positive, averaging 19% during 2010-20.

The financial risk profile still constitutes the main support for the rating, despite we expect key credit ratios to deteriorate in the current year. More precisely, we expect the most relevant ratio for the assessment, FFO/SaD, to plummet to 14% in 2021 from 33% in 2020 and revert to 57% in 2022. This assumes a likely penalty payment arising from an investigation by the Hungarian Office of Economic Competition to determine whether the company infringed competition law. According the Nitrogenmuvek, similar investigations in Hungary led to penalty payments equating to 1%-10% of sales. The decision can still be appealed, which could result in a partial or full refund of the penalty payment. Even so, Nitrogenmuvek's free operating cash flow generation remains a positive rating factor, as the company have achieved to strengthen it since 2019. Based on our understanding the company will come to a decision on an additional expansion programme not before year-end 2022.

Ratings & Outlook

Corporate rating	BB-/Stable
Senior unsecured rating	BB-

Analyst

Klaus Kobold
+49 69 6677389 23
k.kobold@scoperatings.com

Related Methodologies

Chemical Corporates Rating Methodology April 2021

Corporate Rating Methodology July 2021

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Tel. +49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Liquidity also remains adequate, with improved ratios on internal and external liquidity sources, primarily helped by positive free operating cash flow since 2019 and limited short-term debt.

We continue to make no adjustment for supplementary rating drivers. We maintain our positive view on the financial policy based on the achieved deleveraging, which we reflect in the company's financial risk profile.

Outlook and rating-change drivers

Stable Outlook

The Outlook is Stable. This assumes FFO/SaD remains above 15% in 2022, which goes hand in hand with the key assumption of our base case. The Outlook also assumes that the site has no unexpected major outages and that the second round of the capex programme occurs after 2022.

Positive rating action

A positive rating action may be triggered if business activities expand while FFO/SaD remains above 30%, for instance, through a higher profit contribution from crop trading together with reduced costs in the core business.

Negative rating action

A negative rating action may be warranted if FFO/SaD persisted below 15%, for instance, if the company faces additional penalties and/ or severe production outages than reflected in our base case.

Rating drivers

Positive rating drivers	Negative rating drivers
• Hungary's sole producer of nitrogen-based fertilisers, with a solid position in other CEE countries • Genezis partner network and trading activities enable company to leverage on existing business with farmers • Free operating cash flow to strengthen in the coming years with the end to the capex programme • Solid profitability (19% average EBITDA margin in 2010-20) • Financial risk profile (rated BB+)	• Smaller than peers, leading to a lack of global outreach • Weak diversification: one production site, leading to increased sensitivity to production outages; modest contribution of specialty chemicals to sales • Profitability highly cyclical and subject to natural gas, electricity and nitrogen fertiliser prices • History of high leverage and negative free operating cash flow • Concentrated maturity profile

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• FFO/SaD of above 30% on a sustained basis combined with an expansion of business activities	• FFO/SaD of below 15% on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	3.1x	3.9x	2.2x	5.0x
SaD/EBITDA	3.3x	2.1x	4.0x	1.3x
Scope-adjusted FFO/SaD	15%	33%	14%	57%
Free operating cash flow/SaD	36%	36%	-5%	39%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	17,596	23,051	12,499	27,520
Operating lease payments in respective year	-	-	-	-
Other items	-12	-4	-10	-10
Scope-adjusted EBITDA	17,584	23,047	12,489	27,510
Scope-adjusted funds from operations (FFO) in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	17,596	23,051	12,499	27,520
less: (net) cash interest as per cash flow statement	-5,595	-5,970	-5,690	-5,490
less: cash tax paid as per cash flow statement	-59	-70	-67	-1,440
less: pension interest	0	0	0	0
add: depreciation component, operating leases	-	-	-	-
add: dividends received from equity-accounted entities	0	0	0	0
less: disposal gains on fixed assets included in EBITDA	-12	-4	-10	-10
less: capitalised interest	0	0	0	0
Other items	-3,442	-1,291	0	0
Scope-adjusted funds from operations	8,488	15,716	6,732	20,580
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	88,138	94,057	90,345	86,530
Hybrid debt	-	-	-	-
less: cash and cash equivalents	-30,623	-46,849	-40,743	-50,912
Cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	-	-	-	-
Other items (contingent liabilities)	193	210	210	210
Scope-adjusted debt	57,708	47,418	49,812	35,828

Business risk profile: B+

Blended industry risk profile: BBB

We have assigned a blended industry risk of BBB given Nitrogenmuvek's industries as well as the company's EBITDA breakdown by divisions. This is based on our industry risk profiles for integrated chemicals (cyclicality: high; market entry barriers: high; substitution risk: medium) and trading (cyclicality: high; market entry barriers: low; substitution risk: low).

Leading producer in Hungary with a favourable cost position

Nitrogenmuvek is Hungary's sole producer of nitrogen fertilisers. The company's modernisation and expansion of its production site has led to a favourable cost position, with solid gross margins and profitability. As a member of the Genezis partner network, the company also covers the marketing and distribution of final products (branded Genezis in Hungary) to farmers. The company estimates its customer retention at around 69%. Since 2014, Nitrogenmuvek has traded crops and distributed seeds and pesticides. Farmers tend to buy products from one source. Nitrogenmuvek is therefore reinforcing its market position by deepening its relationships with farmers.

Figure 1: Capacity following the capex programme

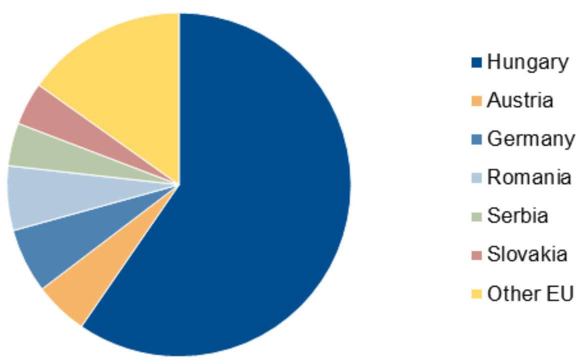
Product	Capacity (tonnes/day)	Capacity (tonnes/year)
Argon gas	9,000	2,970,000
Nitrogen gas	7,000	2,310,000
Ammonia	1,400	497,000
Nitric acid	2,950	1,018,000
Urea	600	298,000
Prilled CAN	1,800	558,000
Granulated CAN	3,360	1,092,000
UAN	1,800	594,000

Source: Scope, Nitrogenmuvek

Weak diversification

Diversification is the weak point in Nitrogenmuvek's business risk profile. The company only operates one production site and its portfolio mainly consists of commodity products. This makes the company vulnerable to production outages and results in a heavy dependency on not only the agricultural industry but also prices for nitrogen fertilisers and natural gas (more than 30% of operating expenses). On the positive side, as the production of CAN also requires calcium and magnesium, dolomite is obtained from a nearby mine (under long-term supply contract). That said, Nitrogenmuvek benefits from the diversification of its portfolio with the ramp-up of its trading activities, its various byproducts (e.g. from ammonia production), and some product diversity as the product portfolio includes urea, urea-ammonium nitrate, and prilled and granulated CAN. Although Nitrogenmuvek has some concentration on Hungary, with roughly 64% of sales, the size of its customer portfolio (around 13,000 farmers) and its activities in numerous other CEE countries mitigates this.

Figure 2: Sales by country (2020)



Source: Nitrogenmuvek, Scope

Solid profitability (EBITDA margin 2020: 24%) and 2020E: 12% …

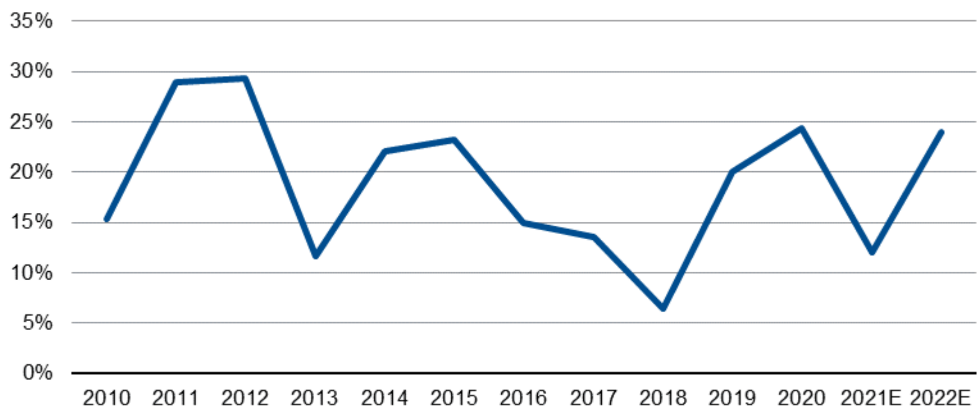
… though threatened by impending decision from Hungarian Office of Economic Competition

In accordance with our chemical corporates rating methodology, we assess profitability and operating efficiency by considering the peak-to-trough EBITDA margin. Nitrogenmuvek's profitability in 2010-20 averaged 19%, which is positive for the rating, while it is highly cyclical and subject to natural gas, electricity and nitrogen fertiliser prices. In 2021, we expect profitability to weaken from in 2020. This is despite strong demand from farmers for fertiliser, because agricultural products such as corn are trading at high prices and nitrogen-based fertiliser prices have been rising for some time. A likely penalty payment from the Hungarian Office of Economic Competition investigation will have a negative impact.

Rear-view mirror: strong H1 2020

The first half of 2020 saw a considerable decline in natural gas prices, whereas prices for nitrogen fertilisers, such as CAN (which are measured by CAN cif Germany), did not fully followed this development. This strengthened Nitrogenmuvek's profitability in 2020, especially in the first half.

Figure 3: Profitability (EBITDA margin)



Source: Nitrogenmuvek, Scope, Bloomberg

Financial risk profile: BB+

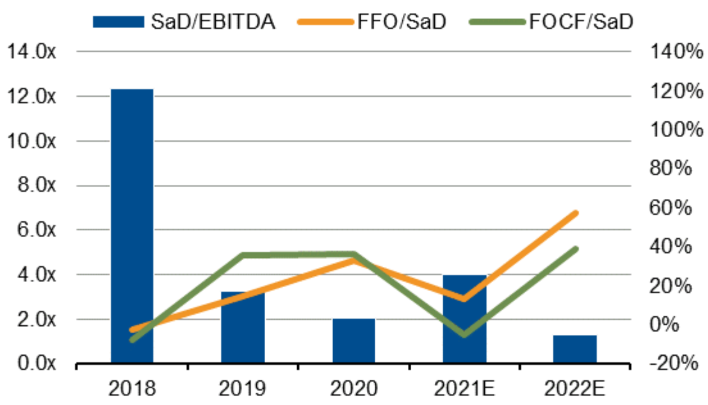
Key adjustments of the rating case include:

- 80% of provisions for environmental protection (contingent liabilities) are included in SaD and 5% of contingent liabilities included in Scope-adjusted interest expense to reflect the interest proportion of these liabilities
- Interest adjusted for (estimated) contingent liabilities

The financial risk profile still constitutes the main support for the rating, despite we expect key credit ratios to deteriorate in the current year. This will be supported by solid free operating cash flow, thanks to limited capex and the commitment to deleverage.

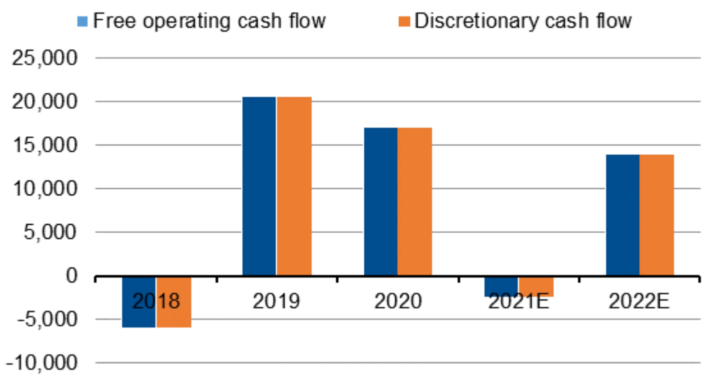
However, the company may be liable for a penalty payment related to an investigation by the Hungarian Office of Economic Competition to determine whether the company infringed competition law. According Nitrogenmuvek, similar investigations in Hungary led to penalties equating to 1%-10% of sales. A successful appeal of the decision could lead in a partial or full refund of the penalty payment. In case the company is penalized with a higher penalty payment, than reflected in our rating case, this would be negative for the financial risk profile and compromising company's efforts on deleveraging.

Figure 4: Credit metrics



Source: Scope

Figure 5: Free and discretionary cash flow (HUF m)



Source: Scope

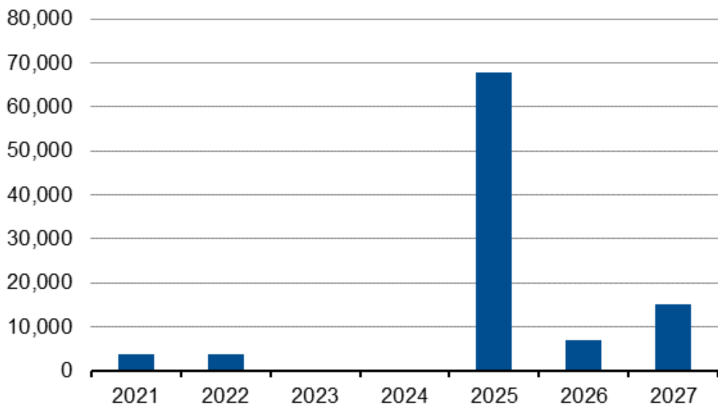
Key assumptions for 2021 and 2022

The core assumptions for the rating include: i) no unexpected major production outages at the site, ensuring high capacity utilisation; ii) capex of maximum HUF 3.0bn yearly; the company is deciding on an additional expansion programme not before year-end 2022; iii) no dividend payments to shareholders in the foreseeable future; and iv) up to HUF 3.5bn to purchase CO2 emission certificates in 2022. We also expect Nitrogenmuvek to benefit from the rising prices for nitrogen-based fertiliser, thanks to higher prices for many soft-commodity products.

Temporary deterioration of credit profile in 2021 expected

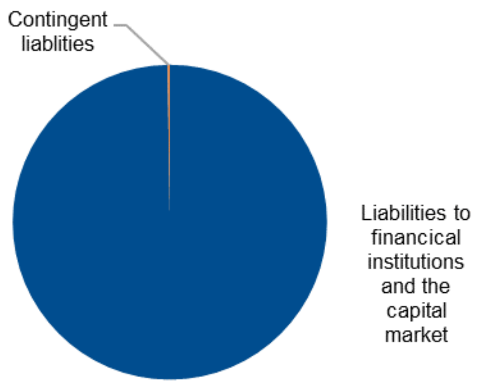
These factors should translate into an EBITDA of about HUF 12.5bn in 2021 and EBITDA of roughly HUF 27.5bn in 2022. We expect the most relevant ratio for the rating case (FFO/SaD) to plummet to 14% in 2021 from 33% in 2020 and revert to 57% in 2022.

Figure 5: Maturity profile (HUF m; 31 December 2020)



Source: Nitrogenmuvek, Scope

Figure 6: Composition of SaD (2020)



Source: Nitrogenmuvek, Scope

Liquidity: adequate

Liquidity is adequate. This is based on improved ratios on internal and external liquidity sources, primarily helped by positive free operating cash flow since 2019 and limited short-term debt.

Concentrated maturity profile

Considering the company's maturity schedule and composition of SaD, worth mentioning is that the company is mainly financed by a bond (ISIN: XS1811852521; EUR 200m) maturing in 2025. This represents substantial cluster risk. Based on our understanding, Management will explore refinancing options for the bond but not before 2022.

Supplementary rating drivers

No adjustments made

We continue to make no adjustment for supplementary rating drivers (financial policy, peer context, parent support, governance and structure).

Financial policy and

Our view on Nitrogenmuvek's financial policy remains positive, based on achieved deleveraging and our understanding that ratios on leverage before 2019 are a thing of the past. We reflect this in the company's financial risk profile.

… governance and structure are of importance

Mr. Laszló Bige, the majority shareholder, has a pending litigation with the Hungarian government and authorities. That said, we think Nitrogenmuvek's not to be directly affected by this issue. In this regard, the company has not recorded material provisions as of 31 December 2020.

Long-term and short-term debt ratings

Rating for senior unsecured debt: BB-

All senior unsecured debt has been affirmed at BB-, the level of the issuer rating. The recovery analysis is based on a hypothetical default scenario in 2022, including the following key assumptions: i) provisions for environmental protection are ranked above senior unsecured debt; ii) bank debt is ranked pari passu to senior unsecured debt; and iii) the committed credit line is fully drawn. The outcome of our recovery analysis indicates an 'average recovery' for senior unsecured debt.

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44 020 7340 6347

info@scoperatings.com
www.scoperatings.com

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