Aranynektár Kft
Hungary, Business Services

SCOPE B STABLE

Corporate profile

Aranynektár Kft is provides services to one customer, its sister company Fulmer Hungarian Branch (FHB), a Hungarian honey processing company. Both entities are owned either directly or indirectly by Mr Ferenc Takács. Aranynektár prepares and packages the honey processed by FHB, either in glass or PET containers. As an integrated contractor, Aranynektár generates revenues fixed in advance by FHB to cover its operating expenses and produce a margin. Raw material honey is collected partially by Ukrainian and Russian sister companies owned by Mr Takács before it is sold to Aranynektár for processing and packaging.

Key metrics

Fulmer Hungarian Branch (FHB)			Scope estimates	
Scope credit ratios	Jan-Dec 2019	Jun '20-May '21[1]	2022E	2023E
EBITDA/interest cover (x)	44x	30x	24x	24x
Scope-adjusted debt (SaD)/EBITDA	1.6x	1.1x	1.3x	1.3x
Scope-adjusted funds from operations/SaD	59%	87%	76%	71%
Free operating cash flow/SaD	24%	65%	-59%	12%
Liquidity/SaD	0.8x	16.8x	6.0x	11.5x

Rating rationale

Scope Ratings GmbH has affirmed Aranynektár Kft's issuer rating of B and changed the Outlook to Stable from Positive. Aranynektár's senior unsecured bond has been affirmed at B+.

The Outlook change to Stable from Positive reflects the risks posed by the large capex programme initiated for Aranynektár and its sister companies in Hungary, Ukraine and Russia, including FHB, whose credit quality determines Aranynektár's rating. The capex programme will take place in several phases. The rise in honey prices has necessitated investment in a Russian sister company to enable raw material to be sourced locally. Further increases in other input prices such as for energy and packaging as well as increased management risk support the Outlook change, despite currently sound financial leverage metrics. New external risk factors include geopolitical risk and soaring energy prices that can create volatility in profitability and is sometimes out of management's normal control.

The rating of Aranynektár continues to be determined by the credit quality of sister company FHB. Aranynektár provides 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 the scope of FHB. We therefore consider Aranynektár to be fully dependent on FHB as a severance of the business link would lead immediately to the issuer's bankruptcy.

[1] Accounting year was changed to the honey agricultural year ending in May.

Ratings & Outlook

Corporate ratings	B/ Stable
Senior unsecured bond rating	B+

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Related Methodologies

Corporate Rating Methodology, July 2021

Consumer Products Methodology, September 2021

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Bloomberg: RESP SCOP

FHB's honey processing business has benefitted greatly from the Covid-19 pandemic. Its sales and profitability increased significantly due to the shift in consumer preferences towards healthy produce.

That said, in Europe, FHB remains constrained by its size and low market share, within a geographical region under pressure from a large number of imports. Raw honey imports are diversified with supply points established by the issuer's owners in Ukraine and Russia outside of the rated entity, which come, however, with some geopolitical risk and exposure to volatile currencies.

The group's development of its branded labels (stagnating at close to one-fourth of sales) was hindered by the cancellation of trade fairs last year due to the pandemic and agreements to accept branding done by the retailers or sales partners. The development of branded labels would improve FHB's diversification and brand strength, two weak areas in the rating assessment.

FHB's profitability (Scope-adjusted EBITDA) improved from 12.9% in 2019 to above 20% in May 2021, in line with management's expectations. However, we expect that this growth in profitability cannot be sustained as input prices are rising (raw materials – honey, energy, packaging, logistics). Margins can be planned well and defended as the company reprices its products around October, just ahead of the main sales season for the produce and when the quality and quantity of the crops for the year can be reliably ascertained. However, we note the relatively small size and pricing power of FHB.

FHB's financial risk profile has benefitted considerably from the growth in its Scope-adjusted EBITDA, which has translated into an overall improvement in metrics. FHB has also increased its cash position to a new high and received a state subsidy to launch a new capex programme. We expect FHB's cash position to decrease significantly in the coming years. Despite a lack of information on the upcoming subsidy, we believe 2021 and 2022 metrics will benefit from a comfortable cash position as investments are phased in and launched in a conservative fashion. Scope-adjusted debt (SaD)/EBITDA is expected to stay below 1.5x in the coming two years without a netting of cash. We also expect cash flow cover to come under pressure given the expansion plans in 2022. FHB has announced its intention to invest in production and storage facilities in the coming years in four phases. We anticipate that this will considerably increase capex, leading to a negative free operating cash flow/SaD ratio going forward.

Liquidity is adequate. The bond issuance has allowed FHB to repay the majority of its 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 conservative stance, overweighting the free operating cash flow/SaD ratio in the financial risk profile assessment given the expectation of a high investment phase. In the overall rating, we have overweighted the business risk profile sub-rating. This is because of FHB's and Aranynektár's small size, which makes them more vulnerable to external factors.

We also applied 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 very small management and very manual accounting and planning processes are detrimental to the rating (ESG: credit-negative governance factor).

Outlook

The Outlook is Stable, based on the higher profitability and the large investment programme started with low leverage. We believe FHB can deploy its considerable capex programme while maintaining an acceptable financial risk profile, helped by the state subsidy. The Outlook excludes potential 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 kept its EBITDA margin high, which would also keep SaD/EBITDA low, while simultaneously improving transparency, management size and the scale of its activities.

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

Rating drivers

Positive rating drivers	Negative rating drivers
• Moderate geographical diversification • Development of a branded label, albeit gradual • High EBITDA interest cover • Positive development of Scope-adjusted EBITDA margin in last two years, reaching 20%	• 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 and partially needed on a seasonal basis, forcing group to use temporary agency personnel • Unknown effect of subsidy on financial risk profile • Lack of transparency as well as key person risk (ESG factors) • Investments in Ukraine and Russia to source honey entail geopolitical risk

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 and enlarged management capabilities	• SaD/EBITDA of above 3x on a sustained basis

Financial overview of Fulmer Hungarian Branch

			Scope estimates	
Scope credit ratios	**Jan-Dec 2019**	**Jun '20-May '21***	**2022E**	**2023E**
EBITDA/interest cover (x)	44x	30x	24x	24x
Scope-adjusted debt (SaD)/EBITDA	1.6x	1.1x	1.3x	1.3x
Scope-adjusted funds from operations/SaD	59%	87%	76%	71%
Free operating cash flow/SaD	24%	65%	-59%	12%
Scope-adjusted EBITDA in HUF '000s	**Jan-Dec 2019**	**Jun '20-May '21***	**2022E**	**2023E**
EBITDA	682,388	1,302,620	1,056,167	1,055,162
Extraordinary items	0	0	0	0
Scope-adjusted EBITDA	682,388	1,302,620	1,056,167	1,055,162
Scope-adjusted funds from operations in HUF '000s	**Jan-Dec 2019**	**Jun '20-May '21***	**2022E**	**2023E**
EBITDA	682,388	1,302,620	1,056,167	1,055,162
less: (net) cash interest as per cash flow statement	-15,510	-43,970	-43,970	-43,970
less: cash tax paid as per cash flow statement	-31,441	0	0	-64,754
Scope-adjusted funds from operations	635,437	1,258,650	1,012,197	946,437
Scope-adjusted debt in HUF '000s	**Jan-Dec 2019**	**Jun '20-May '21***	**2022E**	**2023E**
Reported gross financial debt	1,119,313	1,449,321	1,326,676	1,326,676
less: cash and cash equivalents**	-13,694	-46,296	0	0
less: liquid securities	-46,296	0	0	0
Scope-adjusted debt	1,073,017	1,449,321	1,326,676	1,326,676

* Accounting year end was changed to May to align with the agricultural year for honey.

** No cash netting applied from 2022 as cash was not deemed to be permanent and available.

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

Improving sales during lockdowns with shift towards healthier eating

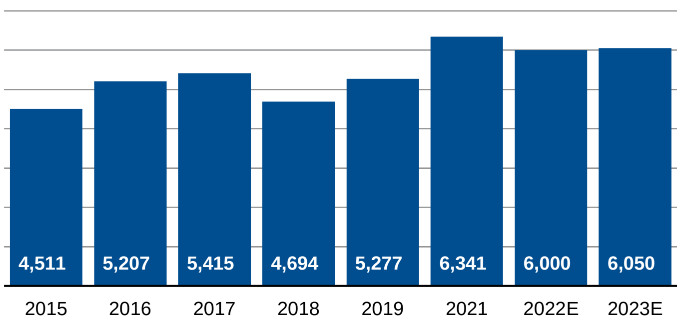
Sales grew by 12.5% over the 2018-19 reporting period and by 20% in FY 2021. This was driven by Covid-19 prompting consumers to favour healthier produce. In addition, the Hungarian government allowed FHB to continue operations in 2020, whereas international competitors were subject to restrictions. These factors, alongside a low crop yield in Hungary last year, should also lead to increased sales in FY 2021. The company is more conservative in further revenue growth, despite its recently started capex plan.

Good customer and supplier diversification despite group size

FHB is well diversified in terms of geographical outreach. Less than 20% of its total sales were in Hungary (FY 2021), with the rest from throughout the world. The exposure to Europe is significant, with over 50% of sales outside of Hungary. The group also sells regularly to Japan and USA, which accounted for 14% of sales abroad in December 2020. However, buyer profiles are somewhat inconsistent, with high variations in a country's share of total sales across the years. Exports to Saudi Arabia, for example, jumped from nil to 20% in the past two years. These variations in branded label sales per customer are typical for small companies.

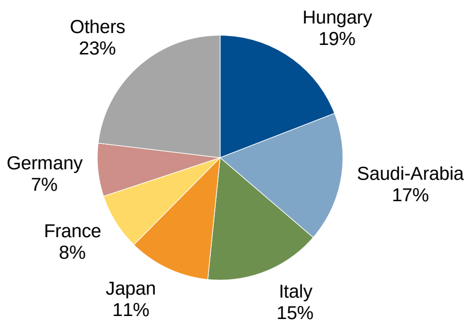
Supplier and customer diversification support the rating. FHB has a broad supplier base, spread across Europe and beyond. The group has also set up activities in Ukraine and is finishing an expansion into Russia, where raw honey export prices to Europe are very profitable. The recently established entity in Russia, while also owned by Mr Takács, operates outside of the rated entity. Honey is expected to be sourced cheaper in Russia than in Ukraine. From there, it is sold in barrels to Aranynektár for processing and packaging. The customer base is stable: there is a large exposure to LIDL, the Saudi distributor, and to the Italian distribution company owned by Mr Takács.

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



Source: FHB, Scope estimates

Figure 2: FHB's geographical outreach

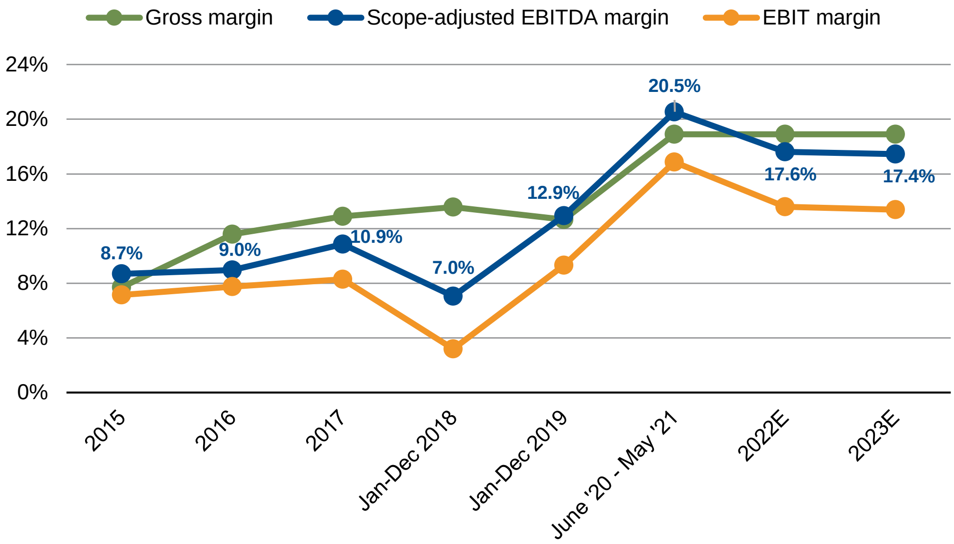


Source: FHB, Scope

Low diversification due to mono-product focus

FHB's mono-product focus (honey-related) is detrimental to the rating as a poor harvesting year could heavily impact revenues once inventory is depleted. The group uses different formats (glass and PET containers). However, this does not represent real diversification as neither format has features that strongly counter those of the other.

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



Source: FHB, Scope

Profitability expected at around 17%-18%

FHB has increased its profitability significantly (calculated based on the Scope-adjusted EBITDA margin), to close to 20% in FY 2021 from 7% in FY 2018. This is due to multiple factors including higher demand for healthy food and more channels for raw material sourcing. The group was also able to continue production throughout the pandemic while many international competitors could not, which affected both the operations and supplies of the latter. We view this margin improvement as temporary and forecast a certain normalisation towards lower levels in the coming years.

As honey prices have risen in Russia, maintaining the improved profitability is possible if the new sourcing and storage facility in Russia becomes operational in the sister company of the rated entity.

The development of branded labels could also increase the individual gross margins of the group. However, we did not see progress in the development of branded sales.

Input prices such as energy, packaging and logistics are set to soar in FY 2022-23 and we expect profitability to be negatively affected. We note that the company has its energy prices hedged for the coming months.

Low brand strength still detrimental to the rating

Brand strength 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+

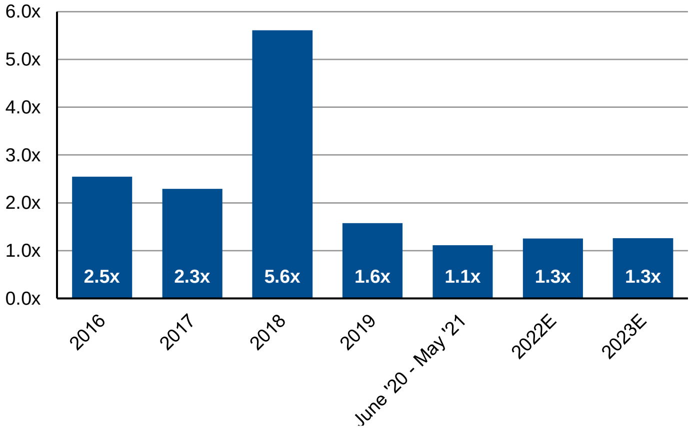
Successful bond issuance; proceeds earmarked for capex

Aranynektár issued a HUF 1bn bond in Q2 2020 expiring in 2030. The bond is guaranteed by FHB. Aranynektár transferred the proceeds to FHB via an intercompany loan designed to align with the bond's features (including coupons, repayment schedule and maturity). As Aranynektár's cash generation limits its ability to repay the coupons or the bond, FHB will pay the interest and repay the bond to Aranynektár, which will, in turn, repay bondholders.

Changing the end of fiscal year has positive effect on metrics

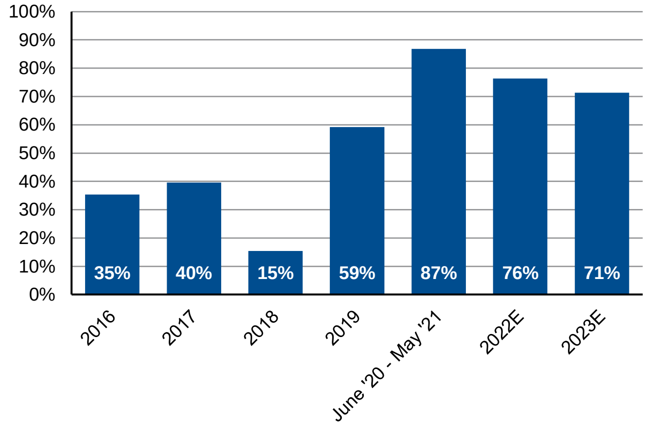
In 2020, Aranynektár and FHB have changed the end of their fiscal year from December to May, in line with the honey production cycle. Inventories at the end of May are significantly lower than at the end of December, since the fresh produce comes in the summer. Therefore, financials look slightly better in May due to the 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

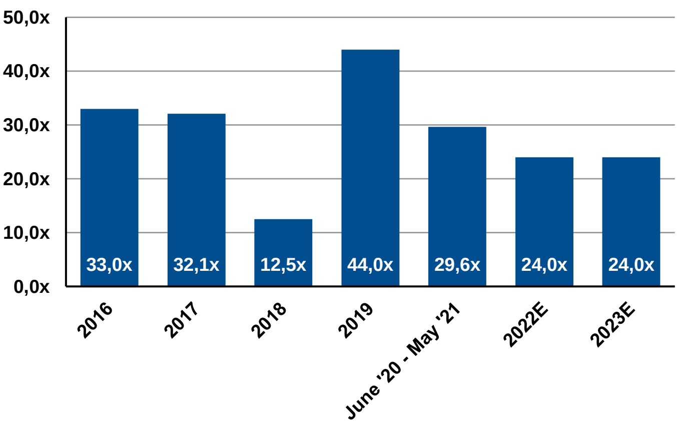
Leverage metrics have greatly improved due to development of EBITDA

Leverage has been improving over the last few years due to stronger, EBITDA. By refinancing short-term debt with the bond issued in 2020, the group has decreased its short-term funding requirements to maintain operations. We have not applied cash netting as we deem cash not permanent as the multi-phase capex programme is ongoing.

Cash flow cover expected to come under pressure

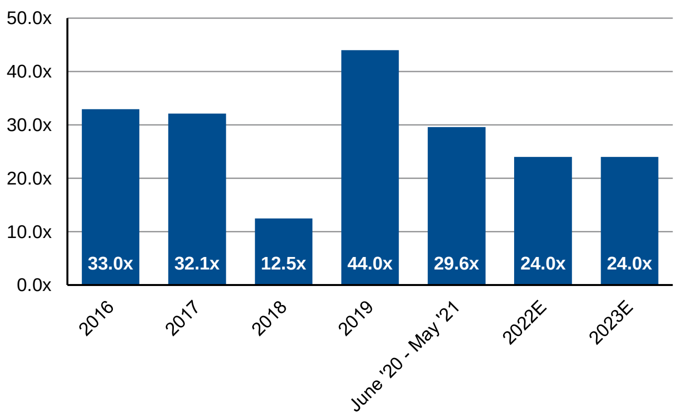
We expect EBITDA interest cover to remain high given the past repayment of group debt and the group's low overall interest expenses. On the other hand, we expect cash flow cover to be highly volatile, given management's announcement that the group is in a development phase. These growth ambitions suggest 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 free operating cash flow/SaD



Source: FHB, Scope estimates

Adequate liquidity despite upcoming capex plans

Liquidity is adequate, given the low short-term debt repayment, which is fully covered by high Scope-adjusted EBITDA profitability and cash. While liquidity risk is not present, it could arise if capex or working capital is greater than forecasted.

Liquidity (in HUF '000s)	FY 2021	FY 2022E
Cash and marketable securities equivalents (t-1)	2,261,613	1,562,676
Short-term debt (t-1)	243,964	150,000
Free operating cash flow (t)	941,591	-787,547
Liquidity (%)	16.8x	6.0x

One notch down for governance

The rather weak transparency and governance of the issuer (and its sister companies involved in the supply chain from raw material to sales and distribution activities), 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 related subsidy amounts and its impact on financial metrics. We have therefore taken the precaution of overweighting free operating cash flow/SaD in the financial risk profile sub-rating. The second reason is the small size of the group, managed by one to two key persons, which is detrimental to the rating as it increases the potential impacts of externalities. We have changed the Outlook to Stable to reflect the development of credit metrics with increased capex, as well as these uncertainties .

Senior unsecured rating

We have affirmed the rating of B+ on the senior unsecured bond (HU0000359559). We calculated an 'above-average' recovery following a hypothetical default in 2023 and therefore maintain one notch of uplift on the assigned issuer rating.

[2] ESG factor

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