Nitrogenmuvek Zrt.
Hungary, Integrated Chemicals

BB- STABLE

Corporate profile

Headquartered in Pétfürdő, Hungary, Nitrogenmuvek is a producer of various nitrogen-based fertilisers such as calcium ammonia nitrate (CAN), ammonia nitrate (AN), Urea-ammonium nitrate (UAN) and urea. In addition, the company sells crop protection, pesticides and seeds to farmers in Hungary, Austria, Slovakia, and the Czech Republic, among others. In order to modernise and expand its production side, Nitrogenmuvek went through a period of substantial capex between 2013 and 2019. Owned by the Bige family, Nitrogenmuvek generated sales of around HUF 88bn and EBITDA of HUF 17bn in 2019.

Key metrics

			Scope estimates		
Scope credit ratios	2018	2019	2020F	2021F	2022F
EBITDA/interest expense (x)	1.2x	3.1x	5.4x	3.7x	2.9x
Scope-adjusted debt (SaD)/EBITDA	12.4x	3.3x	1.4x	1.7x	2.1x
Scope-adjusted FFO/SaD	-3%	15%	47%	31%	20%
Free operating cash flow (FOCF)/SaD	-8%	36%	42%	20%	23%

Rating rationale

Scope Ratings has today assigned a BB-/Stable corporate issuer rating to Hungary-based Nitrogenmuvek. The agency has also assigned a senior unsecured debt rating of BB-.

The assigned issuer rating consists of a business risk profile of ‘B+’ and a financial risk profile of ‘BB+’. This reflects Nitrogenmuvek’s position as the sole producer of nitrogen fertilisers in Hungary with an annual production capacity of ammonia (497,000 tonnes), CAN (1,345,000 tonnes), among others. However, its limited scale (sales of around EUR 250m) for the global chemical industry in general and the fertiliser industry in particular, hampers its market position. The rating is held back by relatively weak diversification, as the company only operates one production site and its portfolio consists of commodity-like products. Despite volatile profitability (EBITDA margin), the rating is supported by an EBITDA margin averaging 19% for 2010 to 2019.

Following the completion of Nitrogenmuvek’s EUR 320m capex programme in 2013 to 2019, we anticipate that its credit profile will improve. This is supported by considerable tailwinds from a sharp drop in natural gas prices in Q1 2020, with prices for major products declining at a slower pace, combined with a jump in the production and delivery of products. Despite we believe prices for nitrogen fertilizers to decrease in the remainder of 2020, we anticipate Nitrogenmuvek’s EBITDA to be around HUF 29bn. The foreseen positive development in credit metrics should be accompanied by a rise in Free cash flow generation. Liquidity is classified as ‘adequate’ in accordance with our Corporate Rating Methodology.

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

Ratings & Outlook

Corporate rating	BB-/Stable
Senior unsecured rating	BB-

Analysts

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Related Methodology

Rating Methodology Chemical Corporates

Corporate Rating Methodology

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Outlook

Stable Outlook

The Outlook is Stable based on our expectation of FFO/SaD significantly above 15% in 2021 and 2022. In the view of the completed capex programme, deleveraging will be very important for Nitrogenmuvek, in tandem with ramping up production of the capacities built. With regard to Covid-19, we anticipate limited business cutbacks, as farmers have to use fertilisers in order to generate high crop yields.

Rating upside

A rating upgrade may be triggered if Nitrogenmuvek expands its business activities combined with FFO/SaD sustainably above 30%. For instance, by higher profit contribution of the Crop Trading division, together with further improvement of cost position in Nitrogenmuvek's core business.

Rating downside

A negative rating action may be warranted if FFO/SaD persistently falls below 15%, for instance, if the company's financial policy becomes more aggressive, e.g. with significant dividend payments.

Rating drivers

Positive rating drivers	Negative rating drivers
• Sole producer of nitrogen-based fertilisers in Hungary with a strong position in other CEE countries • 'Genezis partner network' and trading activities make it possible to leverage existing business with farmers • Capex programme is complete, thus no significant capex in the coming years, which should improve Free cash flow • Solid profitability (EBITDA margin 2010 to 2019: 19%) • High emphasis on deleveraging will strengthen financial risk credit profile (rated BB+)	• Small size compared to peers leads to lack of global outreach • Strong dependency on natural gas, electricity and nitrogen fertiliser prices • Weak diversification (one production site makes the company sensitive to production outages) • Historically high leverage • Profitability is highly cyclical

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• FFO/SaD of above 15% 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	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA/interest expense (x)	1.2x	3.1x	5.4x	3.7x	2.9x
Scope-adjusted debt (SaD)/EBITDA	12.4x	3.3x	1.4x	1.7x	2.1x
Scope-adjusted FFO/SaD	-3%	15%	47%	31%	20%
Free operating cash flow (FOCF)/SaD	-8%	36%	42%	20%	23%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA	6,198	17,596	29,215	19,561	14,411
Operating lease payments in respective year	0	0	0	0	0
Other items	-57	-12	-10	-10	-10
Scope-adjusted EBITDA	6,141	17,584	29,205	19,551	14,401
Scope-adjusted Funds from operations (FFO) in HUF m	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA	6,198	17,596	29,215	19,561	14,411
less: (net) cash interest as per cash flow statement	-5,001	-5,595	-5,400	-5,230	-5,010
less: cash tax paid as per cash flow statement	-99	-59	-1,351	-505	-68
less: pension interest	0	0	0	0	0
add: depreciation component operating leases	0	0	0	0	0
add: dividends received from equity-accounted entities	0	0	0	0	0
less: disposal gains on fixed assets included in EBITDA	-57	-12	-10	-10	-10
less: capitalised interest	-124	0	0	0	0
Other items	-2,895	-3,442	-3,300	-3,300	-3,300
Scope-adjusted Funds from operations	-1,978	8,488	19,154	10,516	6,022
Scope-adjusted debt (SaD) in HUF m	**2018**	**2019**	**2020F**	**2021F**	**2022F**
Reported gross financial debt	91,885	88,138	83,608	79,999	76,425
Hybrid debt	0	0	0	0	0
less: cash and cash equivalents	-16,032	-30,623	-43,035	-46,215	-46,327
Cash not accessible	0	0	0	0	0
add: pension adjustment	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0
Other items (contingent liabilities)	40	193	194	194	194
Scope-adjusted debt	75,893	57,708	40,767	33,978	30,291

Business risk profile

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 the sole producer of nitrogen fertilisers in Hungary. Following the capex programme to modernise and expand its production site, Nitrogenmuvek has a favourable cost position, with solid gross margins and profitability. As a member of the 'Genezis partner network', the company's business also covers the marketing and distribution of final products (branded Genezis in Hungary) to farmers. Based on company estimates, the customer retention rate is around 69%. Since 2014/2015 Nitrogenmuvek has been engaged in crop trading and the distribution of seeds and pesticides. Farmers tend to buy their products from one source. Nitrogenmuvek is therefore reinforcing its market position by deepening its relationships with farmers.

Figure 1: Capacity following the capex programme

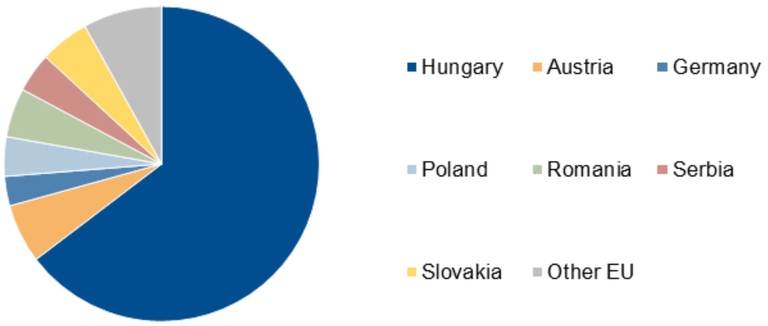
Product	Capacity (tonne/day)	Capacity (tonne/year)
Argon gas	9,000	2,970,000
Nitrogen gas	7,000	2,310,000
Ammonia	1,400	497,000
Nitric acid	2,950	1,018,000
Urea	600	298,000
Prilled CAN	1,800	558,000
Granulated CAN	3,360	1,092,000
UAN	1,800	594,000

Source: Scope, Nitrogenmuvek

Weak diversification

Diversification is the weak point in Nitrogenmuvek's business risk profile, as the company only operates one production site and its portfolio mainly consists of commodity products. In addition, as the production of CAN requires calcium and magnesium, dolomite is obtained from a closely located mine. This setup makes the company vulnerable to production outages and results in a heavy dependency on agricultural industry prospects, as well as prices changes for nitrogen fertilisers and natural gas. That said, the following factors are positive: 1) Nitrogenmuvek is diversifying its portfolio by ramping up its trading actives; 2) various byproducts e.g. from ammonia production; and 3) Nitrogenmuvek also produces urea, UAN, as well as prilled CAN and granulated CAN. With regard to byproducts, the gases nitrogen and argon are worth mentioning. Although Nitrogenmuvek has some Hungarian market concentration (roughly 64% of sales), this is somewhat mitigated by the size of its customer portfolio (around 13,000 farmers) and its activities in numerous other Central and Eastern Europe countries.

Figure 2: Sales by country (2019)

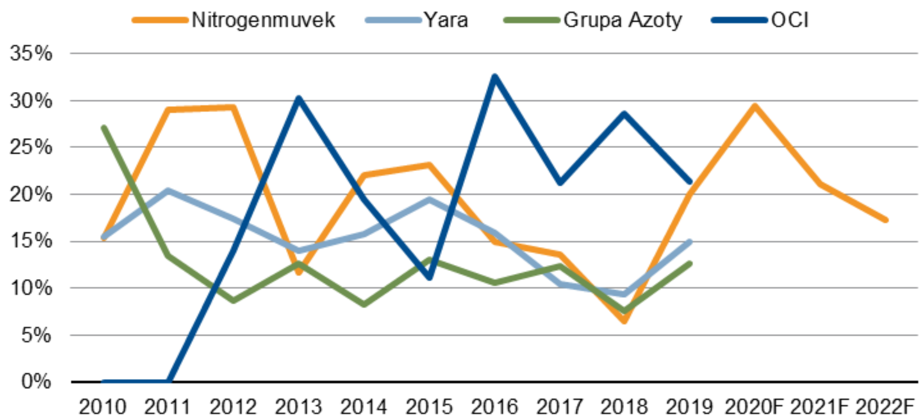


Source: Scope, Nitrogenmuvek

Solid profitability (EBITDA margin 2019: 20%) and 2020F: 31%

In accordance with our rating methodology for chemical corporates, we assess profitability and operating efficiency by considering the peak-to-trough EBITDA margin. For 2010 to 2019, Nitrogenmuvek's profitability averaged around 19%, which we consider a positive rating driver. While natural gas prices have declined considerably in the current year, prices for nitrogen fertilisers, such as CAN (which are measured by CAN cif Germany) have not fully followed this development. As a consequence, the company's profitability was considerably bolstered by this development (EBITDA margin Q1 2020: 29%) and will be significantly higher for the full year 2020. For the years beyond 2020, we anticipate that EBITDA will remain solid and largely in line with peers. This assumption incorporates: 1) provisions for emission allowances of around HUF 2.0bn; 2) headwinds due to expected higher natural gas prices; and 3) scheduled planned maintenance in 2022.

Figure 3: Profitability (EBITDA margin): Nitrogenmuvek versus selected peers



Source: Nitrogenmuvek, Scope, Bloomberg

Financial risk profile

Key adjustments of the rating case include:

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

Credit profile expected to improve after completion of capex programme

Nitrogenmuvek's capex programme in 2013 to 2019 was mostly financed by the issuance of a USD 200m bond (ISIN: XS0928972909; duration: 2013-2020) which was refinanced with a EUR 200m bond (ISIN: XS1811852521; duration: 2018-2025). In total, Nitrogenmuvek spent roughly EUR 320m on a new nitric acid plant, a second CAN granulation plant, and capacity expansion at its ammonia plant, among others. At the same time, the company's EBITDA were negatively affected by planned and unplanned shutdowns and provisions made due to emission allowances within the scope of the European Emission Trading System. Against this backdrop, leverage, measured by SaD/EBTIDA, stands at 3.3x together with interest cover (EBITDA/interest expense) of 3.1x at the year-end 2019. Given our understanding that Nitrogenmuvek is focussing on deleveraging, we anticipate that key credit metrics will stronger in the period to 2022. This is based on the following key assumptions: 1) natural gas prices will not jump, i.e. will remain below prices for CAN (measured by market prices for Germany CAN 27 cif inland); 2) the site will not suffer any unplanned major production outages; 3) capex of HUF 2.0bn max; and 4) no dividend payments to shareholders.

Strong tailwind in 2020

We foresee the greatest effect on Nitrogenmuvek's credit metrics in the current year, thanks to the significant drop in natural gas prices, while prices for major products have declined at a slower pace, combined with a jump in the production and delivery of products. Although we anticipate prices for e.g. AN, CAN, and urea to fall in the remainder 2020, Nitrogenmuvek's EBITDA for 2020 should be around HUF 29bn and roughly HUF 19bn in 2021. That said, interest cover should remain weaker, compared to ratios on leverage and cash flow coverage, as the largest part of interest expense is represented by the EUR 200m bond with a coupon of 7.0%.

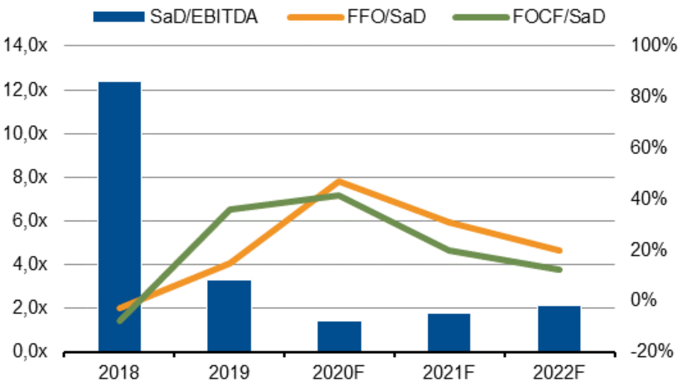
Higher EBITDA and lower capex – Positive Free cash flow generation

The foreseen positive development of Nitrogenmuvek's credit metrics will be accompanied by positive Free cash flow generation, as capex will only be required for maintenance reasons. Based on our understanding of Nitrogenmuvek's strategy, no decisions regarding investment in growth will be made until 2022/2023 at the earliest. In addition, we think conduction M&A is unlikely given company's setup and industry structure.

Liquidity: 'Adequate'

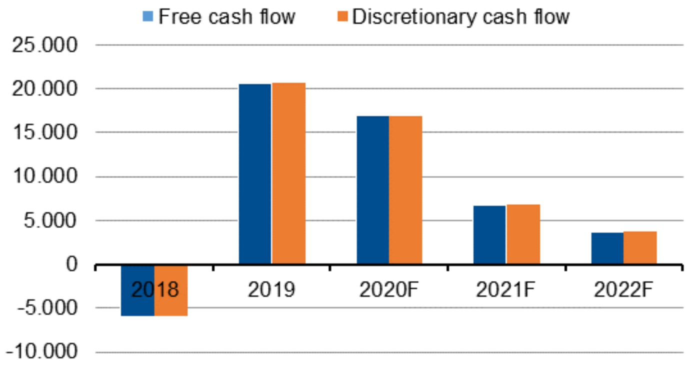
Nitrogenmuvek's liquidity is classified as 'adequate'. Although internal liquidity was held back by negative Free operating cash flow during the investment phase, we anticipate that liquidity will strengthen. This will be due to the expected rise in Free cash flow versus short-term debt/ annual annuities of HUF 3.4bn (2020), HUF 3,6bn (2021) and HUF 3.5bn (2022). That said, we see concentration of the company's maturity schedule in 2025 when the EUR 200m bond will mature.

Figure 4: Credit metrics



Source: Scope

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



Source: Scope

Supplementary rating drivers

No adjustments made

We have made no adjustment for supplementary rating drivers (financial policy, peer context, parent support, governance and structure). Nitrogenmuvek's capex programme has significantly increased indebtedness. However, the company has clearly communicated a commitment to lower indebtedness with dividend payments a secondary priority – which we view as positive for financial policy.

Senior unsecured debt rating

Rating for senior unsecured debt: BB-

All senior unsecured debt has been assigned a rating of 'BB-', the level of the issuer rating. Recovery 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. This expectation translates into a rating of BB- for this debt category.

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