CLA Pig Kft.
Hungary, Agribusiness

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	-16.8x	-10.5x	5.3x	6.7x
Scope-adjusted debt/EBITDA	3.5x	4.2x	2.1x	2.2x
Scope-adjusted funds from operations/debt	29%	24%	37%	37%
Scope-adjusted free operating cash flow (FOCF)/debt	-29%	14%	14%	-13%

Rating rationale

The business risk profile (assessed at B) continues to be the main constraint of the issuer rating. As witnessed in the 2022 accounts, CLA Pig has limited ability to mitigate the increased pressure on EBITDA margin from the raw material costs, due to a limited company size and highly concentrated product portfolio. The ongoing capacity expansion (new pig farm located in Kisbaráti, Hungary) of up to 280k animals would double CLA Pig's market share, and significantly increase the energy efficiency of the expanded pig farm by utilising renewable energy sources, reducing exposure to the change in energy costs (credit positive ESG factor). The financial risk profile (assessed at BB+) remains supported by robust interest coverage, as the Scope-adjusted EBITDA/interest is expected to stay above 6.0x over the medium term. Leverage, measured by Scope-adjusted debt/EBITDA has deteriorated above 4.0x in 2022, while a gradual recovery is forecasted, improving to below 2.0x by 2025. Cash flow cover is projected to be volatile, heavily impacted by the capital expenditures and investment subsidies received.

Outlook and rating-change drivers

The Stable Outlook reflects the assumption that CLA Pig's credit metrics will develop in line with our rating case forecast and that leverage, as measured by Scope-adjusted debt/EBITDA, will decrease to around 3.0x in the medium term. We deem the deterioration of operating profitability to be temporary, and assume an EBITDA margin close to historical averages (near 20%) beyond 2023. Additionally, we assume the successful execution of CLA Pig's ongoing capex programme, without significant delays or cost overruns.

A positive rating action is remote for the time being due to the company's constrained outreach and scale. A positive rating action would require a significantly improved business risk profile and operational scale.

A negative rating action could be required if the company's leverage increased to significantly above 4.0x amid its planned expansion phase or if the company faced significant pressure in keeping its EBITDA margin at 20% or higher in case it failed to pass on higher input prices to customers or to consistently collect operational subsidies.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
14 April 2023	Monitoring review	B+/Stable
3 August 2022	Upgrade	B+/Stable

Ratings & Outlook

Issuer	B+
Guaranteed senior unsecured bond	BB-

Analyst

Istvan Braun
+49 302 7891 378
i.braun@scoperatings.com

Related Methodology

General Corporate Rating Methodology; July 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Long-standing experience in farming, especially pig breeding; ownership of related companies in various supporting industries such as animal feed production or agricultural equipment repair and maintenance • Financial risk profile (assessed at BB+), supported by solid credit metrics • Intragroup procurement of animal feeds reducing the risk of distortions in the supply chain of input materials • Operational efficiency (ESG factor)	• Weak diversification, with a focus on one animal species, high customer concentration and weak geographical diversification, making the company vulnerable to event risks such as animal diseases • Relatively small company; weak market position in an industry with little price-setting power • High dependence on EU Common Agricultural Policy subsidies, making the company vulnerable to policy changes • Execution risk due to large capex programme relative to the size of the company

Positive rating-change drivers	Negative rating-change drivers
• Significantly improved business risk profile and operational scale	• Scope-adjusted debt/EBITDA sustained at above 4.0x during the expansion phase • Scope-adjusted EBITDA margin decreasing to below 20% in the medium term, caused by a worsening gross margin (failure to pass on higher input prices to customers) or lower operational subsidies

Corporate profile

CLA Pig Kft. is based in Somogyszob (Hungary). It breeds, raises, fattens and sells piglets. It is fully owned by the Claessens family and is part of the integrated agricultural company Claessens Group. Claessens Group covers the complete cow and pig value chain from crop production to the raising and selling of the animals. In 2022,CLA Pig achieved sales of HUF 5.5bn and a reported EBITDA of HUF 0.7bn.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	-40.6x	-16.8x	-10.5x	5.3x	6.7x	8.6x
Scope-adjusted debt/EBITDA	0.4x	3.5x	4.2x	2.1x	2.2x	1.7x
Scope-adjusted funds from operations/debt	288%	29%	24%	37%	37%	50%
Scope-adjusted free operating cash flow/debt	35%	-29%	14%	14%	-13%	33%
Scope-adjusted EBITDA inHUF '000						
EBITDA	1,910,059	1,484,687	712,791	1,300,644	1,452,938	1,701,512
Non-operational subsidies	-26,418	-532,720	0	0	0	0
Disposal gains fixed assets	58,895	0	0	0	0	0
Scope-adjusted EBITDA	**1,942,536**	**951,967**	**712,791**	**1,300,644**	**1,452,938**	**1,701,512**
Funds from operations in HUF '000						
Scope-adjusted EBITDA	1,942,536	951,967	712,791	1,300,644	1,452,938	1,701,512
less: (net) cash interest paid	47,875	56,706	68,127	-244,000	-216,952	-196,756
less: cash tax paid per cash flow statement	-331	-37,752	-46,204	-33,209	-41,349	-62,332
add: dividends from associates	0	0	0	0	0	0
Other operational income/expenses	14,495	10,628	0	0	0	0
Funds from operations	**2,004,575**	**981,549**	**734,714**	**1,023,436**	**1,194,637**	**1,442,424**
Free operating cash flow in HUF '000						
Funds from operations	2,004,575	981,549	734,714	1,023,436	1,194,637	1,442,424
Change in working capital	-1,191,705	-18,881	271,735	158,792	-410,584	-374,386
Non-operating cash flow	-60,574	427,934	-105,322	-1,581	0	0
less: capital expenditure (net)	-508,433	-2,359,059	-482,015	-802,366	-1,221,928	-115,533
less: lease amortisation	0	0	0	0	0	0
Free operating cash flow	**243,863**	**-968,457**	**419,112**	**378,280**	**-437,876**	**952,505**
Net cash interest paid in HUF '000						
Net cash interest per cash flow statement	47,875	56,706	68,127	-244,000	-216,952	-196,756
add: interest component, operating leases	0	0	0	0	0	0
Change in other items	0	0	0	0	0	0
Net cash interest paid	**47,875**	**56,706**	**68,127**	**-244,000**	**-216,952**	**-196,756**
Scope-adjusted debt in HUF '000						
Reported gross financial debt	935,328	5,056,861	4,580,376	4,187,725	4,037,098	3,919,702
less: subordinated (hybrid) debt	0	0	0	0	0	0
less: cash and cash equivalents (50% of cash per balance sheet	-240,238	-1,685,334	-1,555,065	-1,397,880	-792,981	-1,060,535
add: non-accessible cash	0	0	0	0	0	0
add: pension adjustment	0	0	0	0	0	0
Scope-adjusted debt	**695,091**	**3,371,527**	**3,025,311**	**2,789,845**	**3,244,117**	**2,859,167**

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Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend

Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Operations vulnerable to regulation and external factors

As evidenced by the decreasing EBITDA margin in 2022, the profitability of the industry is highly dependent on the price of input materials, namely the animal feed. The price, quality and availability of feed are highly dependent on weather conditions and are affected by the climate crisis. Subsidies addressing the agricultural damage caused by unfavourable weather conditions mitigate this risk to a certain extent.

CLA Pig is especially vulnerable to regulatory risk, namely changes in the EU Common Agricultural Policy. In addition to one-off subsidies such as investment-related ones or draught damage relief, any change in the framework of operational subsidies can significantly affect profitability.

Credit-positive operational efficiency

Additionally, CLA Pig aims to significantly decrease its energy consumption by using the most efficient technology and renewable energy sources in the expanded pig farm it is currently investing in, reducing its exposure to fluctuations in energy costs.

Some structural weaknesses but not leading to negative rating adjustment

CLA Pig is directly owned by members of the Claessens family, in a similar manner to its sister companies operating across the agribusiness value chain. While the transactions between sister companies are regulated by transfer pricing agreements, the lack of a single consolidating entity, and the fact that there are no group level financial disclosures make the financial analysis of the issuer more challenging.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B

Industry risk profile: BBB

The company is active in the agricultural industry, which is highly cyclical, has high market entry barriers, low substitution risk and a stable industry outlook.

CLA Pig's competitive position and highly concentrated product portfolio remain the main constraints on its business risk profile. The limiting factors of the business risk profile are somewhat balanced by solid yet cyclical and volatile operating profitability.

With a revenue of HUF 5.5bn in 2022, CLA Pig is a small market player in both the Hungarian and European context. In 2022, Hungary's pig herd amounted to roughly 2.7m, stagnant YoY. High feed prices in the same year, however, initiated a consolidation process across the market, as smaller market players have closed production, or have been acquired by larger companies. CLA Pig's market share is estimated at 5-7% (based on company information). The intended capacity expansion of up to 280k animals would double its market share, placing it amongst the medium-sized pig farms on a heavily fragmented domestic market.

Figure 1: Selective players in the Hungarian pig farming industry

Company	Fiorács Kft.	Csicsó Pig Kft.	Mangal Ilona Kft.	Triagro Kft.	CLA Pig Kft.
Sales (2022, HUF bn)	15.3	7.9	11.4	4.2	5.5

Source: CLA Pig, Scope

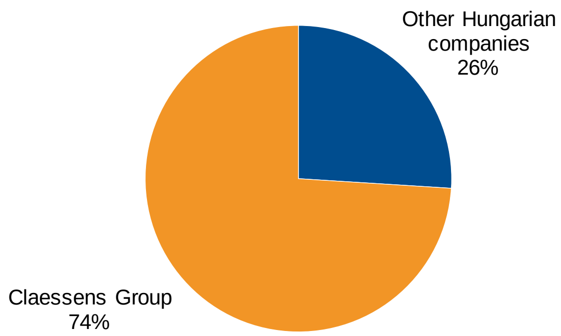
Small size and low diversification as main rating constraints

Low product diversification reduces CLA Pig's ability to mitigate the volatility of prices as the company has little influence over market prices. Additionally, CLA Pig has a limited ability to mitigate any negative effects in case of risk events such as disease or supply chain disruptions. Overdependence on a single product category is credit-negative.

Customer portfolio highly concentrated on intragroup buyers

The typical customers for piglets are pig processors and wholesale companies. Fatteners are sold to slaughterhouses and food processing companies. CLA Pig's 2022 sales were strongly focused on intragroup buyers compared to the previous year: roughly 74% of CLA Pig's sales were generated via other members of the Claessens Group (CLA Pork Kft., CLA Feed Kft. and CLA Milk Kft.), versus 58% in 2021. While CLA Pig's third-party customer portfolio appears fairly diversified, we consider that the company's consumer concentration is high overall.

Figure 2: Sales by customer 2022



Source: CLA Pig, Scope

Supplier concentration remains moderate

CLA Pig's suppliers are moderately concentrated. The required raw materials, especially maize and wheat, are procured from subsidiaries such as CLA Feed Kft. This is set to remain so after the planned capacity expansion. The intragroup procurement of animal feed helps to mitigate possible distortions in the supply chain.

Lower profitability in 2022 deemed temporary

The 2022 EBITDA margin has been significantly lower than historical averages, as it was under strong pressure from rising raw material prices, which drive up the selling price of pork, but with a certain lag and thus cannot be instantly transferred to customers. The rapid increase in energy prices has resulted in elevated fertiliser prices (highly energy-intensive product), which resulted in record-high animal feed prices. Peaking in 2022, animal feed prices have decreased by about 20% for certain products since January 2023. At the same time, the price of pork (Nord-West, 25 kg) has increased from about EUR 50 in January 2023 to EUR 91 in June 2023, driving up margins. This is most likely the delayed effect of the increased input prices appearing in the selling price of pork. The positive effect of the price developments can be witnessed in the management accounts up until May 2023, which show a record-high EBITDA margin (around 30%), providing evidence that the deterioration of EBITDA margin is a one-off event and does not mark the beginning of a long-term decline.

Beyond 2023, we expect a significant increase in EBITDA margin, as the finished Kisbaráti investment is expected not only to have a positive effect on revenue, but also on CLA Pig's profit-generating capacity.

Financial risk profile: BB+

Key adjustments to the rating case include:

- Reported EBITDA adjusted for non-operational and one-off subsidies; EU Common Agricultural Policy subsidies are part of the Scope-adjusted EBITDA
- No interest income included in the financial base case forecast
- Haircut on forecasted cash within the computation of Scope-adjusted debt in accordance with our General Corporate Ratings Methodology

Solid interest coverage despite rapid increase in variable interest rates

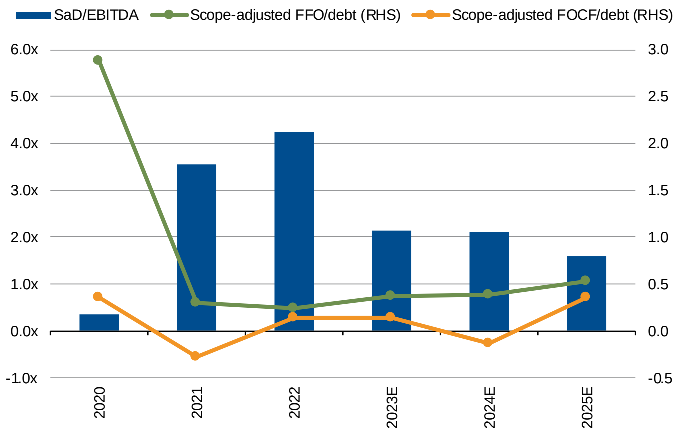
In 2022, CLA Pig exhibited net interest income, benefitting from the high liquid assets on its accounts and the favourable yield paid on short-term deposits. As a sizable portion of CLA Pig's bank debt has a variable interest rate, based on Hungarian three-month interbank rate (BUBOR, currently at around 14%), the interest payable increased significantly compared to previous years (HUF 244m expected in 2023 versus HUF 199m in 2022), resulting in Scope-adjusted EBITDA/interest of around 5.3x in 2023.

CLA Pig's variable interest rate working capital loan has been refinanced by a more favourable working capital loan within the Baross Gábor Programme (at a fixed 6% interest rate).

Leverage peaking in 2023, gradual improvement forecasted afterwards

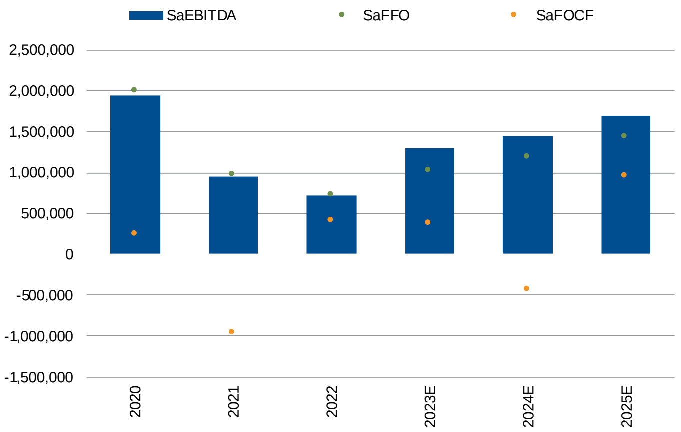
Deteriorating profitability resulted in Scope-adjusted debt/EBITDA reaching above 4.0x in 2022 (at 4.2x), which should be temporary based on the interim management accounts and additional market information. In the medium term, we expect leverage to improve to around 2.0x, considering the expected increase in EBITDA and the fact that no additional third-party debt is expected to be drawn until 2025 based on management information.

Figure 3: Development of leverage and cash flow cover



FFO: funds from operations
Sources: CLA Pig, Scope (estimates)

Figure 4: Cash flow (HUF '000)



Sa: Scope-adjusted
Sources: CLA Pig, Scope (estimates)

Weak FOCF generation until the end of the investment cycle

Till the end of 2024, CLA Pig plans to spend roughly HUF 3.0bn on capex. This includes the second Kisbaráti pig farm (financed by the bond proceeds and investment subsidy) and the reconstruction of the Somogyszob pig farm damaged by fire (financed through equity). While the Kisbaráti farm is 50% completed, the capex programme still poses execution risks if we compare the total amount (roughly HUF 10.0bn between 2020 and 2024) to CLA Pig's size (total assets: HUF 16.7bn). So far, the execution is going according to plan and there is no deviation from the original timeline and budget. The programme will expand the sow and farrowing house as well as the pig farm. In addition, a new slurry storage facility is planned in order to apply manure to the surrounding fields.

Following CLA Pig's bond placement of HUF 3.26bn in 2021, its credit profile deteriorated temporarily in 2022. While Scope-adjusted funds from operations remain strong, Scope-adjusted FOCF is volatile (remaining positive in 2023 thanks to cash subsidies received, driving down net capex) but is expected to be negative in 2024. As per CLA Pig's business plan, discretionary cash flow includes a yearly dividend payment of HUF 300m, i.e. the maximum amount prescribed in the bond covenants.

Adequate liquidity

Liquidity is adequate, benefitting from the HUF 1.55bn unrestricted cash available as of YE 2022 and positive free operating cash flow of HUF 0.4bn expected for 2023, fully covering the short-term debt repayments of HUF 0.3bn forecasted for 2023.

Balance in HUF '000	2022	2023E	2024E
Unrestricted cash (t-1)[2]	1,685,334	1,555,065	1,397,880
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	419,112	378,280	-437,876
Short-term debt (t-1)	498,272	327,614	224,710
Coverage	**4.2x**	**5.9x**	**4.3x**

[2] 50% of cash as per the company's balance sheet.

Long-term debt ratings

Senior unsecured guaranteed debt rating: BB-

In August 2021, CLA Pig issued a HUF 3.26bn senior unsecured guaranteed bond (ISIN: HU0000360672) through the Hungarian central bank's Bond Funding for Growth Scheme. The bond's tenor is 10 years, with a fixed coupon rate of 2.9% and repayment in six tranches of 10% in 2026, 2027, 2028, 2029 and 2030 and a 50% tranche in 2031. The bond has been issued with a guarantee from the related company CLA Service Kft.

The recovery analysis indicates an 'above average' recovery for the senior unsecured guaranteed bond and for all other senior unsecured debt positions at the level of CLA Pig even after all senior secured debt would have been fully recovered. The recovery benefits from the high level of fixed assets, translating into a debt instrument rating of the senior unsecured guaranteed bond one notch above the issuer rating (BB-). The guarantee of CLA Service Kft. has no significant effect on the expected recovery of the debt instrument.

We note that CLA Pig's guaranteed senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clause requires CLA Pig to repay the nominal amount (HUF 3.26bn) in case of a rating deterioration pertaining to the debt instrument rating (two-year cure period for a B/B- rating, repayment 30 days after the bond rating falls below B-, which could have default implications). From today's perspective, there is solid headroom before that covenant would be breached.

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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