THURSDAY, 17/11/2022 - Scope Ratings GmbH

Scope downgrades Vajda-Papír to B with Negative Outlook

A deterioration in the financial risk profile drives the rating action as rising prices for cellulose and energy have weakened operational profitability and caused an increased need for working capital financing, negatively impacting credit metrics.

The latest information on the rating, including rating reports and related methodologies, is available on this **LINK**.

Rating action

Scope Ratings GmbH (Scope) has today downgraded the issuer rating of Hungary's Vajda-Papír Kft. (Vajda-Papír) to B/Negative from B+/Stable. Vajda-Papír's senior unsecured debt has also been downgraded to B from B+.

Rating rationale

The downgrade is triggered by a deterioration in Vajda-Papír's operating profitability. Rising prices for cellulose and energy, two main cost components in the production process, have put pressure on the group's material costs and operating expenses. This has led to reported EBITDA of close to zero for H1 2022 despite several cost-tracking product price increases implemented by Vajda-Papír. Material cost increases have also put pressure on working capital and increased the need for external financing. At the end of 2022, Scope-adjusted EBITDA is expected to remain at 1.6%, a similar level to H1 2022 interim results. This would negatively impact the group's credit metrics.

The issuer rating benefits from Vajda-Papír's comparatively strong business risk profile (assessed at BB-). Vajda-Papír operates in the non-durable products industry, offering non-discretionary products, and demand remains strong for both household paper in general and Vajda Papír's products in particular. This enables the group to maintain its market shares in Hungary and other European countries. The group's diversification also benefits from strong demand for its products as geographical and product portfolio diversification remain unchanged compared to last year. Limited size and deteriorating profitability constrain the assessment.

The group completed its Phase II investment in July 2022, with slight cost overruns of less than HUF 250m and a slight time overrun compared to the originally scheduled finish date in Q1 2022. This investment involved the procurement of a base-paper manufacturing machine with annual production capacity of 80,000 tonnes of base paper. This enables the group to not only serve its internal base-paper needs but also sell the surplus to third parties. The production of the group's own base-paper demand mitigates the impact of volatile base-paper prices and is expected to positively impact the group's revenue and operating profitability.

To further improve its forecasted profitability in 2023, Vajda-Papír has fixed its gas prices for up to 33% of its consumption and plans to fix the remaining portion. Based on these measures, Scope expects improvements in operating profitability in 2023 and 2024, positively affecting the group's leverage and interest cover metrics.

Compared to Scope's previous base-case projection, prevailing unfavourable market conditions have further weakened Vajda-Papír's credit metrics, resulting in a breach of the negative rating trigger for the second year straight. The funds from operations/Scope-adjusted debt (SaD) credit metric was below 10% in 2021, and it is forecasted to remain below 10% for the foreseeable future.

Vajda-Papír's financial risk profile, assessed at B-, is the main constraint for the issuer rating. Scope views Vajda-Papír's credit metrics for 2022 as significantly weaker than what its financial risk profile assessment calls for. Yet the agency uses a forward-looking approach, bearing in mind the start of the group's recovery, forecasted for 2023. The financial risk profile is supported by the group's interest coverage, which is forecasted to improve to above 2x once profitability improvement measures are implemented. This is despite the wider rising interest rate environment and Vajda-Papír's weak operating profitability.

Leverage, as measured by the SaD/EBITDA ratio, is expected to rise significantly above 6x in 2023 and remain high in the short-to-medium term, which constrains the financial risk profile. SaD is under pressure from a need for external working capital funding. With available, unused external funds liquidity is considered adequate.

Vajda-Papír's second bond is a green bond. The group was one of the first entities to issue a green bond within the NKP bond framework. This green bond framework sets multiple objectives, primarily related to resource management, that the group must comply with by 2030 (positive ESG factor).

Scope highlights the fact that both senior unsecured bonds issued by Vajda-Papír include a rating clause triggering repayment if the rating is not restored to at least B+ within two years or if the rating falls below B- the bond acceleration becomes immediate.

One or more key drivers of the credit rating action are considered ESG factors.

Outlook and rating-change drivers

The Negative Outlook reflects the uncertainty if recent implemented measures taken by Vajda-Papír will be enough to support the recent negative impact the company has experienced on its profitability and cash flow generation.

A negative rating action could occur if interest coverage, as measured by the Scope-adjusted EBITDA/interest ratio, remained weak at below 1.5x. This could result from unfavourable market conditions (such as the interest rate environment) or an inflated debt portfolio.

A positive rating action (i.e. return to Stable outlook) could be warranted if profitability were to improve significantly from 2022 levels and Funds from operations/SaD move towards 10%.

Long-term and short-term debt ratings

Scope has downgraded Vajda-Papír's senior unsecured debt rating in line with its issuer rating, resulting in a senior unsecured debt rating of B, which includes the HUF 11.2bn and HUF 9.9bn bonds (ISIN codes HU0000359989 and HU0000360474 respectively). The bond rating reflects an above-average recovery for senior unsecured debt positions in the hypothetical event of a group default, yet no notching has been applied as the group faces increased working capital and Scope stresses the possibility of further debt issuance.

Stress testing & cash flow analysis

No stress testing was performed. Scope performed its standard cash flow forecasting for the group.

Methodology

The methodologies used for these Credit Ratings and Outlook, (General Corporate Rating Methodology, 15 July 2022; Consumer Products Rating Methodology, 4 November 2022), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Credit Ratings were not requested by the Rated Entity or its Related Third Parties. The Credit Rating process was conducted:
With the Rated Entity or Related Third Party participation YES

With access to internal documents	YES
With access to management	YES

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, and Scope Ratings' internal sources.

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Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and Outlooks and the principal grounds on which the Credit Ratings and Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and Outlook are UK-endorsed

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The Credit Ratings/Outlook were first released by Scope Ratings on 28 October 2019. The Credit Ratings/Outlook were last updated on 21 December 2021.

Potential conflicts

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