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Scope affirms Vajda-Papír's B rating and revises Outlook to Stable from Negative

The improved Outlook reflects Scope's view that favourable market conditions paired with sound initiatives have led to recovering profitability and 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 affirmed the B issuer rating on Hungary's Vajda-Papír Kft. (Vajda-Papír) and revised the Outlook to Stable from Negative. Vajda-Papír's long-term senior unsecured debt rating has been upgraded to B+ from B.

Rating rationale

The Outlook change to Stable from Negative was partly initiated by the improved market conditions after both energy and cellulose prices started to normalise in 2023, leading to better operating profitability (reported EBITDA margin of 10.8% in H1 2023), and partly due to the issuer's measures to reduce the volatility of its operating profitability going forward. Initiatives include vertical integration (i.e. the manufacturing of base paper, leading to stable prices and a more diversified product portfolio through sales to third parties), the option to fix energy prices for the next two years and the automatisation of production. These are all expected to help stabilise the Scope-adjusted EBITDA margin after 2023, strengthening credit metrics.

The issuer rating continues to benefit from Vajda-Papír's business risk profile (assessed at BB-). The group is one of the leading consumer goods companies in Hungary with market shares of around 35% in the household paper market, and demand is expected to remain strong as its products are non-discretionary. It also maintains strong market positions in several European countries (e.g. in the Nordics), therefore also upholding strong geographical diversification with more than 50% of its revenue coming from exports. The business risk profile is hindered by Vajda-Papír's limited size, low product diversification, below-average brand strength compared to peers and historically volatile profitability.

In 2022 Vajda-Papír's operating profitability, measured by the Scope-adjusted EBITDA margin, dropped to 0.8% after input prices of cellulose and energy drastically increased. In Q4 2022 Vajda-Papír fixed its gas prices for up to 33% of its consumption and going forward it intends to fix around 50%. In 2023 the prices started to normalise, which together with the initiatives taken by the group led to the significantly improved Scope-adjusted EBITDA margin of 12.5% in H1 2023. Although the implemented measures are expected to mitigate the volatility of operating profitability, Scope expects pricing pressure to remain due to declining retail volumes and strong competition. This will lead to a slight deterioration of the currently robust profitability margin by the end of the year. Scope forecasts the group's Scope-adjusted EBITDA margin to normalise at around 7.5% after 2023. However, volatility is only partially mitigated as the group plans to fix prices for only part of its energy consumption while cellulose prices remain exposed to forex risk.

Despite the stronger credit metrics expected after 2023 due to the improving operating profitability, the group's financial risk profile (assessed at B-) remains the main constraint for the issuer rating. The significantly weak credit metrics of 2022 were only temporary, but last year's unfavourable macroeconomic environment led to Vajda-Papír substantially increasing indebtedness in 2023 to finance working capital needs (proceeds of the NKP bonds have been fully used for the second investment phase to increase base paper manufacturing capacity). As a result, Vajda-Papír arranged for around HUF 6.75bn of overdrafts and working capital credit lines (of which around HUF 6.25bn was utilised as at H1 2023) in addition to the HUF 4.5bn in intercompany loans granted by affiliate companies Vajda Papír Scandinavia AS and Vajda Holding GmbH in 2022.

Vajda-Papír's financial risk profile is supported by the relatively strong interest coverage, as measured by the Scope-adjusted EBITDA/interest cover ratio, which Scope forecasts to improve and remain between 2.5x-3.5x. Leverage, as measured by the Scope-adjusted debt/EBITDA ratio, is expected to remain well above 6x in the next years, continuing to be the main constraint of the financial risk profile. Scope expects the Scope-adjusted debt to remain fairly stable as management has committed to limiting working capital financing to below HUF 8.5bn in the next two years. Once the investment plan ends, cash flow cover is forecasted to return to positive, further giving merit to the stable indebtedness forecast for the next years.

The need to fund working capital externally created pressure in 2022 and 2023. As such, the issuer has contracted sufficient funding for the next years – assuming low volatility in performance – however its liquidity is highly dependent on the annual roll-over of the significant short-term credit lines. Based on available, unused external funds and a high ratio of liquid inventory, Scope considers the group's liquidity as adequate. Scope notes, that any deterioration in banking relationships may have an immediate effect on the issuer's liquidity.

One of Vajda-Papír's bonds (ISIN code: HU0000360474) is a green bond. The group was one of the first entities to issue a green bond within the NKP framework. This green bond framework sets multiple objectives, primarily related to resource management, that the group must comply with by 2030 (positive ESG factor). In April 2022 Vajda-Papír published the bond's allocation report, which details its fulfilment of NKP framework objectives.

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

Outlook and rating-change drivers

The Stable Outlook reflects Scope's view that in addition to the improvement in profitability and credit metrics, Vajda-Papír has committed to stable indebtedness for the next 2 years (Scope-adjusted debt/EBITDA normalising at around 7x). This commitment is emphasised by the absence of investment capex plans until 2025.

A negative rating action could occur in case liquidity deteriorates further, potentially as a result of the issuer's inability to roll-over its significant short-term lines) or if the Scope-adjusted EBITDA/interest cover ratio dropped to below 2x. These could result from unfavourable market conditions (such as the interest rate environment) or an inflated debt portfolio.

A positive rating action could be warranted if liquidity improved and Scope-adjusted debt/EBITDA leverage reduced to below 6x on a sustained basis.

Long-term debt rating

Scope has upgraded Vajda-Papír's senior unsecured debt rating to B+ from B, which includes the HUF 11.2bn and HUF 9.9bn bonds (ISIN codes HU0000359989 and HU0000360474 respectively). The upgraded long-term debt rating reflects the above-average recovery for the senior unsecured debt positions in a hypothetical event of a company default. The hypothetical default scenario occurs in 2025 and assumes no collateral on the group's property, plant and equipment, and outstanding working capital credit lines of HUF 8.5bn together with an intercompany loan of HUF 4.5bn. The rating upgrade is driven partly by the higher liquidation value of fixed assets due to the successful integration of capex investment that eliminates execution risk, and partly by management's commitment to keep indebtedness stable for the next two years.

The HUF 11.2bn senior unsecured bond (ISIN: HU0000359989) was issued in November 2020 and the HUF 9.9bn senior unsecured green bond (ISIN: HU0000360474) in May 2021, both through the Hungarian central bank's Bond Funding for Growth Scheme. The second bond is guaranteed by VAJDA REAL ESTATE Kft., which belongs to the same corporate group as Vajda-Papír.

Bond proceeds were used for refinancing loans, investment capex to increase base-paper production and working capital financing. Both bonds have tenors of 10 years and fixed coupon rates of 3.5%. The bond repayment schedule is the same for the two bonds: in six instalments with 10% of the face value payable yearly starting in the fifth year and a balloon payment of 50% at maturity. The bonds start amortisation in 2025 and 2026, respectively.

Scope notes that both senior unsecured bonds have an accelerated repayment clause related to the loss of the B+ rating. The clause requires repayment of the nominal amount (HUF 11.2bn and HUF 9.9bn) in case of a rating deterioration (two-year cure period for a B/B- rating; repayment within 30 days after the bond rating falls below B-, which could have default implications). After the rating action dated 17 November 2022, the issuer entered the two-year cure period preceding bond acceleration. Today's rating action has remedied the covenant breach within the defined cure period. Bond covenants in addition to the rating deterioration covenant include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, change of control and dividend payment covenants.

Stress testing & cash flow analysis

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

Methodology

The methodologies used for these Credit Ratings and Outlook, (General Corporate Rating Methodology, 16 October 2023; 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.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and Outlook 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 17 November 2022.

Potential conflicts

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