

📅 THURSDAY, 14/03/2024 - Scope Ratings GmbH

Scope affirms Envien's issuer rating at BB/Stable, downgrades senior unsecured bond rating to BB-

The downgrade on the bond rating reflects the change in recovery assessment on higher bank debt. The issuer rating is derived from the rating of the guarantor parent, Envien International Ltd, and reflects deteriorated yet still good credit metrics.

The latest information on the rating, including rating reports and related methodologies, is available on this [LINK](#).

Rating action

Scope Rating GmbH (Scope) has today affirmed the BB/Stable issuer ratings on Hungary-based Envien Magyarország Kft. and Envien International Ltd. In addition, Scope has downgraded to BB- from BB the senior unsecured HUF 5.5bn bond (ISIN: HU0000360193) issued by Envien Magyarország Kft. under the Hungarian National Bank's Bond Funding for Growth Scheme, which is guaranteed by Envien International Ltd.

Rating rationale

The issuer rating of Envien Magyarország is based on the credit metrics of its direct parent, Envien International, which is the holding company of Envien Group, the leading biofuel producer in Central and Eastern Europe. Within the group, Envien Magyarország is a pure trader of animal feed products that primarily uses the by-products of Envien Group's biofuel production. The issuer rating is based on Envien International's implicit guarantee to Envien Magyarország given the shared name identity, brand responsibility, intercompany funding and Envien Magyarország's importance for the group, as well as the parent's explicit, unconditional and irrevocable guarantee on the bond issued by Envien Magyarország.

The issuer rating of Envien International reflects a moderate business risk profile (assessed at BB-), coupled with a good but deteriorating financial risk profile (revised to BBB- from BBB).

Envien's business risk profile continues to be supported primarily by its moderate market position and the diversification of its production and agricultural commodity trading activities across several countries. The group has significant market shares in the production of biofuels in several mature and relatively protected markets in Central and Eastern Europe, particularly in Slovakia - where Envien covers the entire demand - but also in Hungary, the Czech Republic and, following the acquisition of Biopaliwa in 2022, in Poland. Other elements supporting the business risk profile are the strong business ties with the main customer, MOL Group, a large oil and gas company, and the regulation-driven demand for biofuels as an additive to petroleum-based fuels.

The main constraints on the business risk profile are: i) strong exposure to highly volatile commodity markets; ii) limited production capacity within the EU; iii) concentration of over 80% on a single product group (biofuels) with a moderate contribution from by-product sales and trading activities of related products (not produced in-house); iv) lack of exposure to less cyclical products; and v) rather limited customer diversification with over 50% of sales concentrated on MOL - including its Slovakian subsidiary Slovnaft. However, regarding the latter, Scope notes an improvement in customer concentration following the acquisition of Biopaliwa, which added other large customers such as PKN Orlen and Aramco Poland. The concentration risk to MOL is further

mitigated by the fact that a significant part of Envien's sales exposure comes from the activities of Rossi Biofuels, a joint venture between Envien International and MOL, which is also located at MOL's site in Hungary, creating a close and synergistic relationship with little risk of deterioration.

Profitability is also a constraint on the business risk profile, being the weakest link. Envien shows rather volatile margins, mainly driven by fluctuating commodity market prices, with Scope-adjusted EBITDA margin, averaging around 11% in 2014-2022. Based on preliminary unaudited figures, Scope-adjusted EBITDA decreased significantly to around EUR 49m in 2023 (EUR 91m in 2022), leading to a Scope-adjusted EBITDA margin of 5.5%. This result reflects a very weak performance in H1 2023 amid adverse market conditions such as high energy prices. In addition, both the bioethanol crush margin and the biodiesel esterification margin were impacted by higher feedstock prices and declining price quotations due to higher import volumes from non-EU countries. Envien was able to partially recover margins in H2 2023, benefiting from better supply conditions for corn and rapeseed and the decline in energy prices. Scope forecasts a gradual increase in Scope-adjusted EBITDA to between EUR 58m and EUR 63m in 2024-2026, resulting in a gradual recovery in profitability to around 8%, in continuation with the trend observed in H2 2023. Scope incorporated a prudent level of conservatism within its projections to account for the risk associated with sustained pressure from elevated import volumes originating outside of Europe - mainly from the US and Brazil for bioethanol and China and Asian countries for biodiesel. Nevertheless, Scope expects that Envien's exposure to relatively mature and protected markets and its strategic partnership with key customers will mitigate further pressure on its margins.

The financial risk profile has further deteriorated to BBB- from BBB, reflecting the significant decline in EBITDA and higher interest payments in 2023 amid a still high level of Scope-adjusted debt of around EUR 155m. Net debt only moderately decreased in 2023, driven by higher long-term loans offset by lower overdraft utilisation and higher cash resources. This followed the material increase in Scope-adjusted debt in 2022 due to higher working capital related overdrafts.

Scope-adjusted debt/EBITDA deteriorated to 3.2x in 2023 from 1.8x in 2022 due to weaker Scope-adjusted EBITDA, especially in Q1 2023. Although Scope anticipated a deterioration in leverage at last year's review amid worsening market conditions, the actual outcome came in slightly below expectations. Scope expects leverage to return to below 3.0x in 2024, but to remain close to this level for the foreseeable future as profitability gradually improves. Scope-adjusted EBITDA interest cover weakened significantly to around 5x in 2023 due to higher interest payments and weaker EBITDA. Net interest paid increased to around EUR 10m in 2023 from EUR 2.7m in 2022, mainly due to the increase in reference rates and a higher debt burden. Scope forecasts a gradual reduction in net interest payments from 2025 onwards amid decreasing gross debt over time, leading to a recovery of Scope-adjusted EBITDA interest cover to between 6.0x and 7.0x. Cash flow cover – as measured by Scope-adjusted FOCF/debt – improved to 48% in 2023 (well above Scope's forecast of close to 15%), thanks to working capital releases of EUR 50m and moderate capex of EUR 15m. Going forward, Scope expects cash flow cover to remain constrained between 10% and 15%, with working capital normalising and capex conservatively assumed at around EUR 20m per annum (excluding capex earmarked for potentially large strategic projects). The rating case assumptions also include an annual dividend payout of EUR 15m to EUR 20m and no significant M&A transactions. However, Scope includes some moderate investments in 2024 in the 50/50 Indian joint venture with Zuari Industries to expand ethanol capacity (expected to start production in H2 2025).

Liquidity is adequate, with short-term debt of EUR 112m as of December 2023 primarily consisting

of utilised overdraft lines of EUR 80m (covering around 30% of gross debt in 2023). In line with general practice in the country, Envien Group has uncommitted short-term revolving overdraft lines with a handful of banks, with different maturities with each bank over the course of the year to reduce liquidity risk. Most of these lines have been in place for years (even decades) and primarily serve to finance inventory needs. Scope projects that internal liquidity coverage will exceed 100% for the next few years, even without considering the contribution of inventories as a potential source of liquidity. Regarding financial covenants, Envien is subject to several different bank covenants at various subsidiary levels. At consolidated level, the only financial covenants relate to maintaining an equity to debt ratio of more than 30% and a debt service coverage ratio of at least 1.5x, both of which were met in 2023. At the subsidiary level, Envien reported covenant breaches on some bank loans as of December 2023; however, based on communication with management, Scope assesses these breaches as one-offs and that they will be remedied smoothly with relevant creditors. The rating case assumes that Envien Group will be in compliance with covenants in 2024.

Furthermore, Scope highlights that Envien Magyarország's senior unsecured bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 5.5bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B-. Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is two notches. Scope therefore sees no significant risk of the rating-related covenant being triggered.

Regarding supplementary rating drivers, Scope considers the financial policy as credit neutral. Management has a record of being prudent since leverage has been kept below 2.5x over the past ten years, with a deviation in the most recent year due to extremely negative market conditions. There is no specific dividend policy; the company strives to maximise shareholder distribution while ensuring healthy credit metrics. Moreover, certain bank agreements include negative covenants on permitted dividend distribution, restricting cash disbursement during less favourable years.

Scope sees the complex corporate structure as negatively impacting the credit assessment (ESG factor). This is due to the fact that various group entities raise debt with local banks and financial covenants are largely established at the level of individual subsidiaries, rather than on a consolidated basis. Additionally, the assessment takes into account the intricate shareholding structure above Envien International, which consists of numerous legal entities and multiple intermediate levels leading up to the ultimate private owners. Although this complexity does not trigger a negative rating adjustment under the supplementary rating drivers, it contributes to a cautious evaluation of the financial risk profile and its overall weight within the issuer rating.

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

Outlook and rating-change drivers

The Stable Outlook incorporates Scope's assumption that Scope-adjusted EBITDA will recover and stabilise at around EUR 60m in 2024, following the weak performance in 2023, leading to a Scope-adjusted debt/EBITDA close to 3.0x over the next 12-18 months. Additionally, Scope assumes that Scope-adjusted EBITDA interest cover will remain above 5.0x on a sustained basis, and there will be no changes in regulation, taxation, or law. However, it is worth noting that the previously available rating headroom has been used up and cannot absorb any further decline in credit metrics. Moreover, the Stable Outlook assumes an unchanged ownership for Envien Magyarország Kft.

A negative rating action could be driven by Scope-adjusted debt/EBITDA of Envien International remaining above 3.0x or Scope-adjusted EBITDA interest cover dropping to below 4.0x on a sustained basis due to protracted pressure on production margins and/or the execution of large debt-funded investments not included in Scope's rating case. Additionally, liquidity risk may arise in case of a significant increase in working capital that unused overdraft lines cannot cover or in case of an unexpected cancellation of one or more credit lines as a consequence of potential covenant breaches.

A positive rating action, although remote in the short term, is possible in case of Scope-adjusted debt/EBITDA sustained below 1.5x.

Long-term debt rating

Envien Magyarország Kft. issued a HUF 5.5bn bond in 2021 under the Hungarian National Bank's Bond Funding for Growth Scheme (ISIN: HU0000360193). The bond's tenor is 10 years, maturing in May 2031. Bond proceeds were earmarked for the repayment of an intercompany loan with the parent company, Malta-based Envien International Ltd., to be used for capex, working capital and general corporate purposes and to increase liquidity buffers at the group level. Envien International Ltd has provided an unconditional and irrevocable guarantee to the bond issued by Envien Magyarország, totalling HUF 6.1bn for the full value of the bond plus a contingency buffer to cover all costs incurred by Envien Magyarország. The bond is unconditional and unsubordinated, ranking as senior unsecured debt for Envien International.

Based on a liquidation scenario at the level of Envien Group in 2025, Scope assesses the recovery for the senior unsecured bond as low (revised from average), following the material increase in higher-ranking bank debt over the past two years. The conservative assessment is also driven by the complex corporate structure with various group entities issuing debt and financial covenants largely established at standalone level. Consequently, Scope has downgraded the bond rating to BB- from BB, one notch below the issuer rating.

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/or Outlooks, (General Corporate Rating Methodology, 16 October 2023; Chemicals Rating Methodology, 17 April 2023), 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://cerp.esma.europa.eu/cerp-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/or Outlooks and the principal grounds on which the Credit Ratings and/or Outlooks are based. Following that review, the Credit Ratings and/or Outlooks were not amended before being issued.

Regulatory disclosures

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

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The Credit Ratings/Outlooks were first released by Scope Ratings on 24 March 2021. The Credit Ratings/Outlooks were last updated on 17 March 2023.

The final Credit Rating for the bond (ISIN: HU0000360193) was first released by Scope Ratings on 6 May 2021. The final Credit Rating assigned to the bond was last updated on 17 March 2023.

Potential conflicts

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ISSUERS 2

INSTRUMENTS 1