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Ratings

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Research Update:

Finland-Based Food Packaging Company Huhtamäki Oyj Assigned 'BB+' Rating; Outlook Stable

May 25, 2022

Rating Action Overview

- Huhtamäki Oyj recently acquired Turkey-based sustainable flexible packaging supplier, Elif Holding AS, which it financed with a $500 million multi-currency bridge loan.
- Despite a spike in S&P Global Ratings-adjusted debt to EBITDA to 3.5x to facilitate the acquisition, we expect management will maintain its prudent financial policy of reported net debt to EBITDA of 2.0x-3.0x in the long term, while continuing to focus on growing the business both organically and through acquisitions.
- We assigned our 'BB+' long-term issuer credit rating to Huhtamäki.
- The stable outlook reflects our view that Huhtamäki Oyj will experience further growth and stable demand, together with debt to EBITDA of about 3.0x and funds from operations (FFO) to debt of 25%-27% over the next 12 months.

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Rating Action Rationale

Huhtamäki's business risk profile factors its leading position as a foodservice packaging company in specialty markets, long-standing relationships with blue-chip companies, and its broad geographic diversification. Huhtamäki's ability to innovate is key in maintaining its long-standing relationships of more than 40 years with some of its blue-chip customers, where the top five clients make up 20%-25% of revenue. The company's business benefits from its exposure to resilient end-markets of food-on-the-go and food-on-the shelf, each representing about 50% of revenue. At the same time, it benefits from growth in emerging markets, where it generates about 35% of its revenue. In our view, Huhtamäki faces limited substitution risk from other substrates since its product offering is based on diversified raw materials such as paperboard, fiber, and plastic resin. As such, we think Huhtamäki benefits from the plastic substitution trend, while benefitting from its flexible packaging, which particularly in the food industry cannot be fully replaced. Huhtamäki also benefits from raw material cost pass-through mechanisms that have enabled it to maintain stable EBITDA margins of about 13% on average over the past five years.

In our view, the group's smaller size compared with peers and the highly commoditized nature of the products constrain the company's business risk profile. The group has a smaller revenue and EBITDA base compared with some rated peers across the industry. For example, in 2021, Smurfit Kappa Group PLC (BBB-/Stable/--) generated €10.1 billion of revenue with adjusted EBITDA of close to €1.7 billion, and DS Smith PLC (BBB-/Stable/A-3) generated €6.8 billion of revenue together with adjusted EBITDA of €889 million. With almost €3.6 billion revenue and adjusted EBITDA of €460 million generated in 2021, we think Huhtamäki's scale is closer to that of Sealed Air Corporation (BB+/Stable/--), which generated revenue of €4.8 billion in 2021. However, we acknowledge that Huhtamäki operates in different markets than the larger rated peers. At the same time, Huhtamäki operates in a highly competitive market due to the commoditized nature of its products with limited differentiation, which partly offsets its competitive advantages. Furthermore, given that Huhtamäki is a converter and does not own any mills, we view the barriers to entry as low, which in our view could constrain Huhtamäki's pricing power if stronger peers were to enter the markets.

Huhtamäki's financial risk profile reflects the company's financial policy of maintaining net debt to EBITDA at 2.0x-3.0x. However, given the recent debt-funded acquisition of Elif, adjusted debt increased to €1.63 billion in 2021. This mainly comprised the equivalent of a $430 million drawing under the $500 million bridge loan facility, €325 million bonds, some Schuldscheins totaling €345 million, long-term loans of about €375 million, and the equivalent of €79 million of drawings under the €400 million revolving credit facility (RCF). We also include pension and post-retirement debt of about €175 million, and reported lease liabilities and contingent considerations of a total of about €297 million. From this, we net the year-end cash balance of €179 million. We forecast adjusted EBITDA of €540 million-€560 million in 2022 (versus €460 million in 2021), resulting in adjusted debt to EBITDA of 2.9x-3.1x in 2022 (from 3.5x in 2021), at the higher end of our significant financial risk profile.

We anticipate that investments will constrain deleveraging. We forecast capital expenditure (capex) in 2022 and 2023 to be significantly higher than the €259 million in 2021, mainly for growth investments and plastic substitution projects. At the same time, we expect Huhtamäki to maintain large dividend payments to shareholders of about €100 million per year. However, given the company's prudent financial policy and track record of maintaining reported net debt to EBITDA between 2.0x and 3.0x, we anticipate the company would lower its capex if needed in order not to exceed net debt to EBITDA of 3.0x for a prolonged period.

Outlook

The stable outlook reflects our view that Huhtamäki will experience further growth and stable demand, together with debt to EBITDA of about 3.0x and FFO to debt of 25%-27% over the next 12 months.

Downside scenario

We could lower the rating if adjusted FFO to debt declined to 20% on a prolonged basis.

This could happen in the event of lower demand for food packaging along with difficulty in passing through higher raw material prices, affecting profitability. Large debt-funded shareholder distributions or growth investments including debt-funded acquisitions could also result in higher leverage.

Upside scenario

We could raise the rating if:

- Adjusted debt to EBITDA remained below 2.5x; and
- Adjusted FFO to debt increased and stayed above 30%.

We could also consider raising the rating if the company generated positive discretionary cash flow sustainably.

Company Description

Finland-based Huhtamäki Oyj is a leading provider of food packaging. The company reported revenue of €3.57 billion and adjusted EBITDA of €460 million in 2021 and it is publicly listed on the Nasdaq Helsinki.

Sales are equally split between food-on-the-go and food-on-the-shelf, and serve several end-markets: quick service restaurants, food delivery, fast moving consumer goods (FMCG), and retail. Huhtamäki operates through the following segments: fiber packaging and foodservice in Europe, Asia, and Oceania (35% of 2021 revenue) and North America (32% of revenue), and flexible packaging (32% of revenue). The raw materials used are paperboard, recycled fiber, and plastic resins. Each represents about one third of the materials used by the company.

Huhtamäki generates about 35% of its revenue in emerging markets (Asia, Oceania, Africa, and Latin America), 32% in the U.S., and the remaining portion in other countries.

Our Base-Case Scenario

Assumptions

- We forecast revenue growth of 7-8% in 2022, partly supported by the full consolidation of the Elif acquisition, which represents 6% of external growth. Revenue growth of 8.3% in 2021 reflected a faster recovery from the pandemic in the second half of the year, as restrictions eased, while the company continued to benefit from solid demand from its sustainable packaging solutions. We expect revenue growth to moderate to 3%-5% from 2023.
- We anticipate some recovery in the adjusted EBITDA margin to 14%-15% in 2022 from 12.9% in 2021, which incorporated some pressure from higher raw material prices. We expect the integration of Elif, which has higher margins (about 20%), and realized cost synergies to be the key drivers of margin improvement in 2022 and beyond.
- Capex significantly higher in 2022 and 2023 than the 2021 capex of €259 million, mainly for growth investments and plastic substitution projects.
- We assume no acquisitions in our base case.
- Working capital outflows of about €5 million-€10 million in 2022, and €20 million thereafter.
- Dividends of about €100 million in 2022 and €105 million in 2023.

Key metrics

Based on these assumptions, we arrive at the following credit measures:

- Adjusted debt to EBITDA of about 2.7x-3.2x in 2022 and 2023, from a peak of 3.5x in 2021.
- FFO to debt of 25%-27% in 2022, from 22% in 2021, approaching about 30% after 2023.

Liquidity

We assess Huhtamäki's liquidity as adequate, and expect its liquidity sources to cover its liquidity uses by over 1.2x over the 12 months started March 31, 2022. Our assessment is further supported by sufficient covenant headroom, sound bank relationships, and our view of the company having satisfactory standing on the credit markets.

Principal liquidity sources for the 12 months from March 31, 2022 include:

- €215 million of available cash;
- €381 million availability under the €400 million RCF and $500 million bridge loan facility;
- €250 million in drawings under a two-year loan facility; and
- Our forecast of cash FFO of about €438 million.

Principal liquidity uses over the same period include:

- Debt maturities of €578 million, excluding the $500 million bridge loan facility* issued for the acquisition of Elif, which we expect Huhtamäki to refinance;
- Working capital outflows up to €20 million including seasonal working capital of about €10 million;
- Capex up to €85 million, including maintenance capex of €55 million and investments in efficiency of €30 million; and
- Dividend payments of €100 million-€105 million.

*The bridge loan is due in August 2022, but has two six-month extensions available, at the option of Huhtamäki.

Covenants

Huhtamäki's €400 million multi-currency RCF and $500 million bridge loan facility are subject to a 3.75x net leverage covenant, to be tested quarterly. We currently forecast sufficient headroom under this covenant.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors are an overall neutral consideration in our credit rating analysis of Huhtamäki Oyj.

Since two thirds of its packaging is sustainably sourced and recyclable, we see the company's exposure to environmental and social risks as comparable with the broader industry. However, about one third of Huhtamäki's production is plastic-resin-based, and we view plastic packaging companies with single-use or single-serve applications as exposed to substitution risk from other substrates. As a producer of single-use plastic products that are under scrutiny, the company may be subject to future restrictive policies and regulations.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/--

Business risk: Satisfactory

- Country risk: Low risk
- Industry risk: Intermediate risk
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb+

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

New Rating	
Huhtamäki Oyj	
Issuer Credit Rating	BB+/Stable/--

Regulatory Disclosures

Huhtamäki Oyj

- Primary Credit Analyst: Omega Collocott, Director
- Rating Committee Chairperson: Kathryn Archibald
- Date initial rating assigned: May 25, 2022
- Date of previous review: N/A

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Materials Used In The Credit Rating Process: Sufficient information in general consists of both (i) financial statements that describe the Issuer's financial condition, results of operations and cash-flows, and (ii) a description of the activities and obligations of the entity including of its governance and legal structure.

This credit rating was disclosed to the rated entity or related third party before being issued.

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Glossary

- Anchor: The starting point for assigning an issuer a long-term rating, based on its business risk profile assessment and its financial risk profile assessment.
- Business risk profile: This measure comprises the risk and return potential for a company in the market in which it participates (its industry risk), the country risks within those markets, the competitive climate, the company's competitive advantages and disadvantages (its competitive position).
- Comparable rating analysis: This involves taking a holistic review of a company's stand-alone credit risk profile (SACP), because each of the subfactors that ultimately generate the SACP can be at the upper or lower end, or at the midpoint, of such a range. It may also touch upon the overall comparative assessment of an issuer in relation to its peers across industry and jurisdiction and may capture some factors not (fully) covered, such as a short operating track record, entities in transition, unusual structures, or contingent risk exposures.
- Competitive advantage: The strategic positioning and attractiveness to customers of the company's products or services, and the fragility or sustainability of its business model.
- Competitive position: Our assessment of a company's: competitive advantage; operating efficiency; scale, scope, and diversity; and profitability.
- Corporate Industry and Country Risk Assessment (CICRA): Derived by combining an issuer's country risk assessment and industry risk assessment.
- Country risk: This measures a country's influence on the overall credit risks for a rated company with regards to a country's economic, institutional and governance effectiveness, financial system, and payment culture/rule of law risks.
- CreditWatch: This highlights the potential direction of a short- or long-term rating over the short term, typically less than three months. Ratings may be placed on CreditWatch where, in our view, an event or a deviation from an expected trend has occurred or is expected and additional information is necessary to determine the rating impact.
- Creditworthiness: Ability and willingness of a company to meet its debt and debtlike obligations; measured by assessing the level current and future resources relative to the size and timing of its commitments.
- Diversification/portfolio effect: Applicable to conglomerates. An assessment of the extent to which an entity's multiple core business lines are correlated and whether each contributes a material source of earnings and cash flow.
- Earnings: Proxy for profit or surplus yielded by an entity after production and overhead costs have been accounted for in a given period.

- EBITDA margin: This is EBITDA as a fraction of revenues.
- EBITDA: This is earnings before interest, tax, depreciation, and amortization.
- Economies of scale: This is the cost advantage that arises with increased size or output of a product.
- Efficiency gains: Cost improvements.
- Financial headroom: Measure of deviation tolerated in financial metrics without moving outside or above a predesignated band or limit typically found in loan covenants (as in a debt-to-EBITDA multiple that places a constraint on leverage) or set for the respective rating level. Significant headroom would allow for larger deviations.
- Financial risk profile: This measure comprises our assessment of a company's cash flow/leverage analysis. It also takes into account the relationship of the cash flows the organization can achieve given its business risk profile. The measure is before assessing other financial drivers such as capital structure, financial policy, or liquidity.
- Free operating cash flow: Cash flow from operations minus capital expenditure.
- Funds from operations: EBITDA minus interest expense minus current tax.
- Group rating methodology: The assessment of the likelihood of extraordinary group support (or conversely, negative group intervention) that is factored into the rating on an entity that is a member of a group.
- Industry risk: This addresses the major factors that affect the risks that companies face in their respective industries.
- Issue credit rating: This is a forward-looking opinion about the creditworthiness of an obligor with respect to a specific class of financial obligations or a specific financial program.
- Issuer credit rating: This is a forward-looking opinion of an obligor's overall creditworthiness.
- Leverage: The level of a company's debt in relation to its earnings before interest, tax, depreciation, and amortization.
- Liquidity: This is the assessment of a company's monetary flows, assessed over a 12 to 24 month period. It also assesses the risk and potential consequences of a company's breach of covenant test, typically tied to declines in EBITDA.
- Management and governance: This addresses how management's strategic competence, organizational effectiveness, risk management, and governance practices shape the issuer's competitiveness in the marketplace, the strength of its financial risk management, and the robustness of its governance.
- Operating efficiency: The quality and flexibility of the company's asset base and its cost management and structure.
- Outlook: This is the assessment of the potential direction of a long-term issuer rating over the short to intermediate term (typically six months to two years).
- Scale, scope, and diversity: The concentration or diversification of business activities.
- Stand-alone credit profile (SACP): S&P Global Ratings' opinion of an issue's or issuer's creditworthiness, in the absence of extraordinary intervention or support from its parent, affiliate, or related government or from a third-party entity such as an insurer.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,