Inotal Zrt.
Hungary, Metals and mining

SCOPE B+ STABLE

Corporate profile

Inotal Zrt. is a private Hungary-based aluminium processor, slag recycler and trader. The company's key products are wire rod, slugs, strips, and drawn wire. Wire rod is primarily sold to the electrical industry, slugs to the cosmetics and food industries, strips to the building and transformer industries, and drawn wire to the lightning conductor, electrical and food industries. Over 70% of production is exported to nearby countries. The company employs 332 people and operates from three sites in Hungary.

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover (x)	10.6x	12.8x	11.8x	10.8x
Scope-adjusted debt (SaD)/EBITDA	3.8x	3.2x	2.7x	2.9x
Scope-adjusted funds from operations/SaD	23.0%	28.6%	34.2%	31.4%
Free operating cash flow/SaD	8.3%	12.9%	4.9%	10.9%

Rating rationale

Scope rates Inotal Zrt B+/Stable. Senior unsecured debt is also rated B+.

Inotal's business risk profile (assessed at B) is constrained by its relatively small size by global standards, its concentration on commodity products, and relatively low margins. Inotal ranks as the third largest aluminium processor in Hungary after Arconic and Norsk Hydro. The rating is supported by good geographical, customer and end market diversification, direct customer relationships, access to scrap through associate Martin Metals and its slag recycling operation, and effective management of metals price risk through customer/supplier contracts and hedging. The company performed relatively well in 2020, with most of its end markets (except for cosmetics) holding up well during the pandemic. The introduction of preliminary and final import duties by the European Union on rolled and extruded aluminium products from China in 2020 and 2021, along with rising freight rates, has had a significant positive impact on market conditions in the European aluminium industry, which we expect to last for the next two years.

The company's financial risk profile (assessed at BB-) reflects moderate leverage, with Scope-adjusted debt (SaD)/EBITDA of just below 3x expected in 2021-2022, and a long-term debt maturity profile comprising a HUF 6bn bond maturing in 2027 with a first instalment (12.5%) due in 2023. Free operating cash flow/SaD has been volatile in the past however, driven primarily by fluctuations in working capital. Capex has been stable at or just above the level of depreciation, and is expected to remain at this level in 2021-22, whilst dividends are prohibited under the terms of the bond. This should result in positive discretionary cash flow generation, before considering working capital flows.

We consider liquidity to be adequate, with no debt maturities in 2021 and 2022.

Ratings & Outlook

Corporate ratings B+/Stable

Senior unsecured rating B+

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Related Methodology

Corporate Rating Methodology, February 2020

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Outlook and rating change drivers

The Outlook is Stable and reflects stable demand from Inotal's key end markets in Europe, the building, electrical and food industries. The EU anti-dumping duties on Chinese imports are also likely to stabilise market conditions for the next few years. In our base case scenario, we expect Inotal's leverage (SaD/EBITDA) to remain just below 3x over the next two years.

A negative rating action could occur if leverage exceeded 4x on a sustained basis. This could result from weaker market conditions, significantly higher capex or debt-financed acquisitions.

A positive rating action could be warranted if we believe the improved profitability can be maintained over the long term (also post EU anti-dumping duties), leading to leverage sustainably below 2.5x.

Rating drivers

Positive rating drivers	Negative rating drivers
• Focus on stable end markets • Metals price and premium risk eliminated through sales contacts and hedging • Good diversification by customer and end market; direct customer relationships • No short-term debt • No dividend payments permitted under the bond terms and conditions	• Small niche player with limited economies of scale • Relatively low value-added products • Limited asset and product diversification • Low profitability • High cash flow volatility induced primarily by working capital swings

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA sustainably below 2.5x	• SaD/EBITDA sustainably above 4x

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	10.6x	12.8x	11.8x	10.8x
Scope-adjusted debt (SaD)/EBITDA	3.7x	3.0x	2.5x	2.5x
Scope-adjusted funds from operations/SaD	23.8%	29.9%	34.8%	35.4%
Free operating cash flow/SaD	8.6%	4.0%	3.9%	11.4%
Scope-adjusted EBITDA (EUR '000)	**2019**	**2020**	**2021E**	**2022E**
EBITDA	3,445	5,250	6,230	5,721
Dividend income from Salker Kft.	1,000	0	0	0
Scope-adjusted EBITDA	4,445	5,250	6,230	5,721
Scope-adjusted funds from operations (EUR '000)	**2019**	**2020**	**2021E**	**2022E**
EBITDA	3,445	5,250	6,230	5,721
less: (net) cash interest as per cash flow statement	-418	-411	-529	-529
less: cash tax paid as per cash flow statement	0	0	-243	-197
add: dividends received	1,000	0	200	200
Other changes	-124	-110	0	0
Scope-adjusted funds from operations	3,903	4,727	5,657	5,193
Scope-adjusted debt (EUR '000)	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	17,000	16,551	16,551	16,551
Scope-adjusted debt	17,000	16,551	16,551	16,551

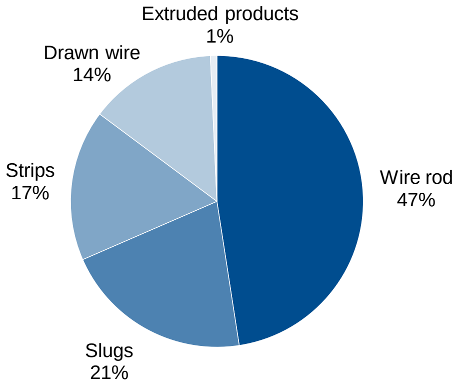
Business risk profile: B

Industry risk of BB: high cyclicality, medium barriers to entry, medium substitution risk

We classify Inotal as a metals and mining company, an industry we rate BB based on a high level of cyclicality, a medium risk of substitution, and medium barriers to entry.

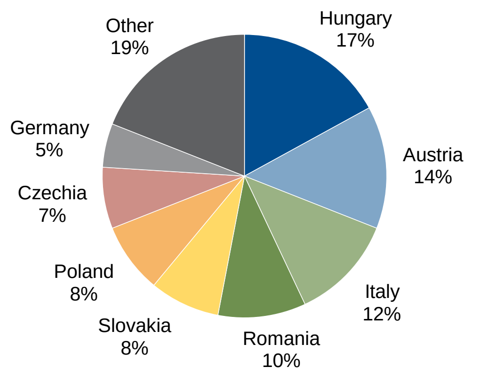
Inotal's business risk profile (assessed at B) is constrained by its relatively small size by global standards, its concentration on commodity products and relatively low margins. The rating is supported by good geographical, customer and end market diversification, direct customer relationships, access to scrap through associate Martin Metals and its slag recycling operation, and effective management of metals price risk through customer/supplier contracts and hedging.

Figure 1: Sales by product, 2020



Source: Inotal, Scope

Figure 2: Sales by country, 2020



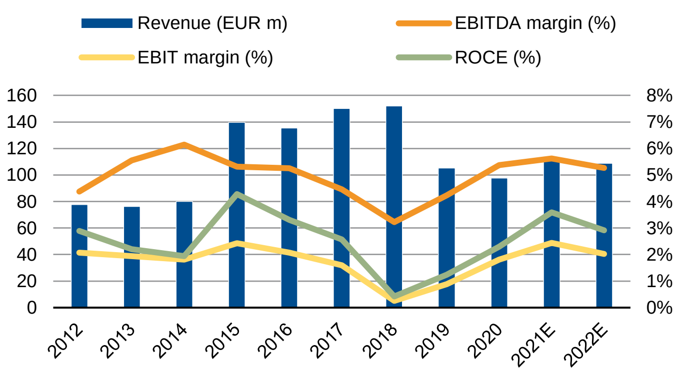
Source: Inotal, Scope

Inotal ranks as the third largest aluminium processor in Hungary after Arconic and Norsk Hydro. With production of 40,000 tons Inotal is a relatively small player by international standards. Regional peers generally produce in excess of 100,000 tons and the global leaders in excess of one million tons.

Broad customer and end market diversity

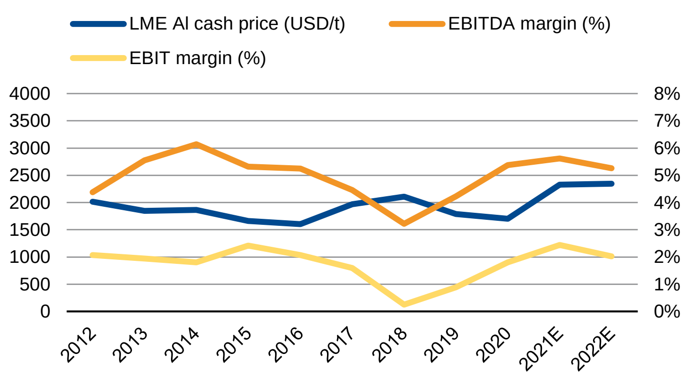
Production is focused on wire rod, slugs, strips and drawn wire, with diverse end markets, including the electrical, building materials, cosmetics, and food industries (see Figure 1). Customer and geographic diversity are also broad, focusing on markets within a 1,500km radius of Hungary (see Figure 2). Sales are almost exclusively direct to end customers. Products are relatively low value added, although the company is increasingly focused on alloyed material (around 60% of production), which provides for higher margins and can be produced with a relatively high ratio of scrap (38%). External scrap is sourced through Inotal's own slag recycling operation and associated aluminium recycler Martin Metals.

Figure 3: Scope-adjusted revenue, margins and ROCE



Source: Inotal, Scope

Figure 4: Scope-adjusted margins and the aluminium price



Source: Inotal, Scope

Price risk managed through supplier/customer contracts and hedging

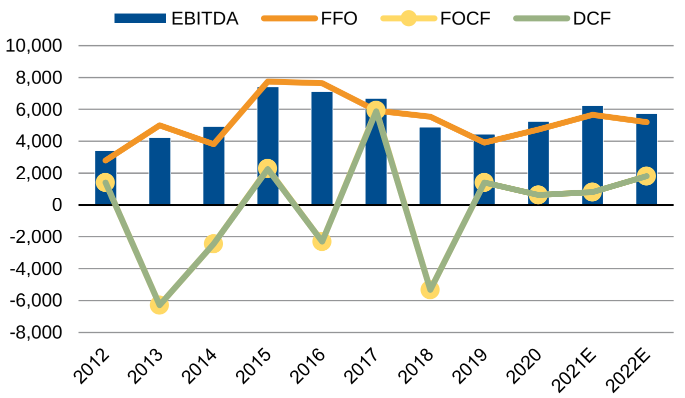
Aluminium processing is a margin business, where the price risk is broadly eliminated through contracts with suppliers and buyers, as well as metals price hedging. Inotal's EBITDA margin has ranged between 3% and 6% over the past decade (see Figures 3 and 4), in line with small to medium sized peers focused on lower value-added products. The company performed relatively well in 2020, with most of its end markets (except for cosmetics) holding up well during the pandemic. A reduction in headcount in 2020 from 369 to 332 resulted in a significant uplift in earnings. The introduction of preliminary and final import duties by the European Union on extruded and rolled aluminium products from China in 2020 and 2021, along with rising freight rates, also had a significant positive impact on market conditions in the European aluminium industry, which we expect to last for the next two years.

Financial risk profile: BB-

Anti-dumping duties and higher freight rates to support local demand in Europe

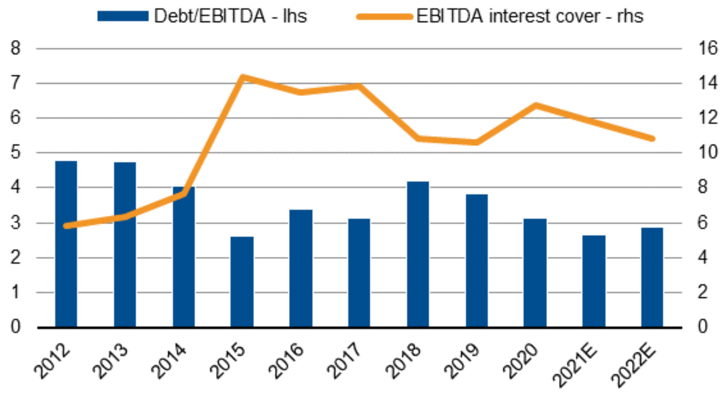
Inotal's financial risk profile (assessed at BB-) reflects moderate leverage and a long-term debt maturity profile. We expect credit metrics to remain supportive in 2021 and 2022 as the EU anti-dumping duties on Chinese imports support market conditions and increase demand for Inotal's products in Europe.

Figure 5: Scope-adjusted cash flow (EURm)



Source: Inotal, Scope

Figure 6: Scope-adjusted leverage and debt service



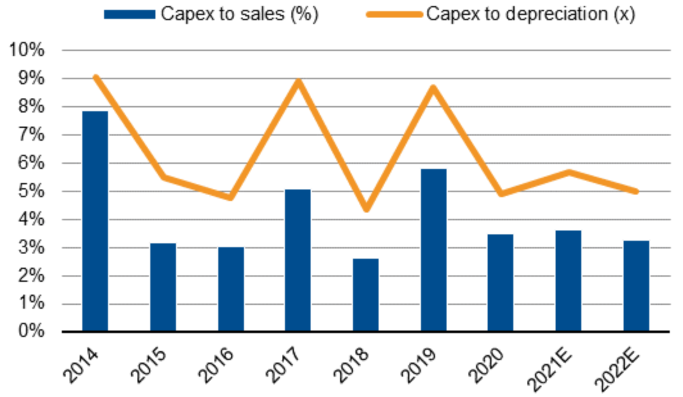
Source: Inotal, Scope

FOCF and DCF around breakeven with capex at or just above deprecation

We expect Scope-adjusted debt/EBITDA to remain just below 3x in 2021-2022 and below 4x over the long term, where the metric has remained since 2014 (see Figure 6). Cash flow is more volatile than earnings, driven primarily by fluctuations in working capital (see Figure 5).

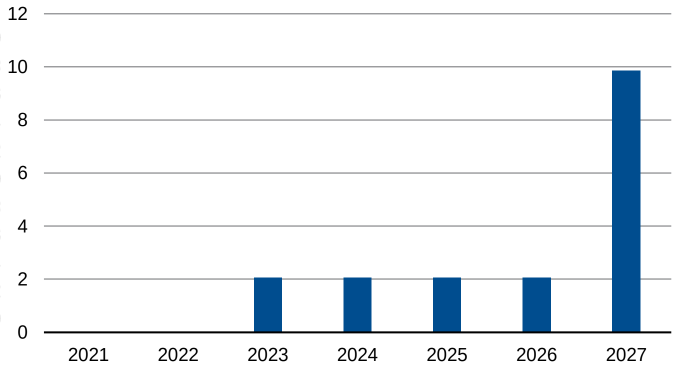
Free operating cash flow and discretionary cash flow have been around the breakeven level over the long term, with capex around or above the level of depreciation and no dividend payments (see Figure 5). We expect capex to remain at or just above the level of deprecation going forward, with investments focused on efficiency improvements and higher value-added products, rather than capacity enhancement. Dividends are not permitted under the terms of the HUF 6bn bond.

Figure 7: Capex to sales and depreciation



Source: Inotal, Scope

Figure 8: Debt maturity profile, 2020



Source: Inotal, Scope

Liquidity is adequate with no debt maturities in 2021-2022

We consider liquidity to be adequate, with no debt maturities in 2021 and 2022. The first instalment (12.5%) under the HUF 6bn bond is in 2023 (see Figure 6). The company has a short-term EUR 3m receivable factoring facility, which is currently unutilised.

Senior unsecured debt

We rate the HUF 6bn senior unsecured bond at the same level as the issuer, based on our assessment of an 'average' (30%-50%) recovery for senior unsecured lenders in a hypothetical default scenario. This assessment assumes limited prior ranking debt and other liabilities, including about 20% of trade payables to micro- and small-sized companies (priority creditor under Hungarian law) and EUR 3m of receivable factoring.

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