Naturtex Kft.
Hungary, Consumer Products

SCOPE B+ STABLE

Corporate profile

Naturtex' core business is the production of duvets and pillows filled with goose feathers and down, as well as products using other natural and synthetic fibres. The company operates four production plants in Hungary and exports to more than 45 countries throughout the world. The company employs around 170 people and had a total turnover of approx. HUF 9bn (EUR 25m). Naturtex is headquartered in Szeged, Hungary, and is a 100% family-owned company.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	61.8x	24.1x	8.9x	10.3x
Scope-adjusted debt (SaD)/EBITDA	1.1x	2.9x	2.5x	2.4x
Scope-adjusted funds from operations/SaD	84%	31%	32%	34%
Free operating cash flow/SaD	27.7 %	-14.7 %	-4.0 %	2.0%

Rating rationale

Scope Ratings has a corporate issuer rating of B+/Stable on Hungary's Naturtex Kft. Senior unsecured debt is also rated B+.

As one of the leading bedding brands in Hungary, Naturtex has a healthy domestic market share. Nonetheless, it is a relatively small producer in the fragmented European bedding market. Inherent cyclicality risk is reduced by the generation of around 80% of revenue through exports and by the acceptable customer diversification. Naturtex' distribution network has more than 250 resellers, 13 franchise partners and several partnerships with national hypermarket chains. Hungarian goose down and feathers have a special quality and image on the global market, which allows Naturtex to charge higher prices than some competitors. Recently, the company's EBITDA margin exceeded the long-term average of 10%, but cyclicality and clear seasonal volatility remain evident.

Naturtex' financial risk profile is stronger than its business risk profile. Despite negative Covid-19 effects on the top line in FY 2020, financial leverage remained conservative for the rating category, with credit ratios such as Scope-adjusted debt (SaD)/EBITDA at below 3x and funds from operations (FFO)/SaD at above 30%. Going forward, we expect the company to maintain and even improve the financial risk profile. We also expect Naturex to use some of the proceeds from the HUF 2.8bn bond issued under the Hungarian National Bank's bond programme last year to increase inventory and provide greater flexibility to tackle the seasonal nature of raw material purchases (feather and down). Free operating cash flow (FOCF) has been somewhat volatile in the past and is expected to remain so going forward. Following the planned discretionary inventory build-up, we do not expect FOCF to be positive before 2022, which remains a key constraint on the financial risk profile.

Overall, the weaker business risk is still overweighted by Scope when assigning the overall issuer rating.

Ratings & Outlook

Corporate issuer rating	B+/Stable
Senior unsecured debt	B+

Lead Analyst

Henrik Blymke
+47 23 96 48 49
h.blymke@scoperatings.com

Related Methodologies

Corporate Rating Methodology, February 2020

Rating Methodology: Consumer Products, September 2020

Scope Ratings GmbH

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 36

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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Outlook and rating change drivers

Although Scope maintains the Stable Outlook, it acknowledges that the company is in a positive direction in 2021 after being negatively affected by the pandemic last year. Scope expects the company to benefit from new contracts, higher demand, and fewer Covid-19 restrictions on exports going forward. Still, the expected inventory build-up this year will cause FOCF to remain negative in Scope's base case in 2021 and adds to the uncertainty of the magnitude of how quickly an improvement will happen. Overall, the stable outlook reflects Scope's balanced expectation of a moderate FRP improvement, accompanied with short-term recovery uncertainty and start-up risks of the new NTT Manufacturing JV factory.

A positive rating action could be warranted if Naturtex experiences higher demand than we expect, translating into stable profitability and cash flow, accompanied by lower negative working capital build-up. This could be exemplified by positive FOCF on a sustained basis, which is being used for strengthening the balance sheet.

A negative rating action is possible if SaD/EBITDA reaches above 4x and FFO/SaD below 15% on a sustained basis, resulting from a more aggressive debt-financed growth strategy or tougher market conditions.

Rating drivers

Positive rating drivers	Negative rating drivers
• Healthy domestic market position with acceptable profitability margins over time • Strong geographical diversification and distribution platforms • Historically low leverage, with management and owners steering towards a conservative financial policy	• Small private company operating in an industry with cyclical characteristics as well as seasonal volatility • Negative FOCF due substantially negative working capital effects • Recent negative trade/shipping effects from the Covid-19 pandemic restrictions

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Reduced working capital build-up and return to a positive FOCF on a sustained basis, which is used to strengthen the balance sheet	• Weakening operating conditions, resulting in a FFO/SaD of below 15% on a sustained basis • SaD/EBITDA of above 4x on a sustained basis

Financial overview, figures in HUF m

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	61.8x	24.1x	8.9x	10.3x
SaD/EBITDA	1.1x	2.9x	2.5x	2.4x
Scope-adjusted FFO/SaD	84%	31%	32%	34%
FOCF/SaD	27.7 %	-14.7 %	-4.0 %	2.0%
EBITDA	**2019**	**2020**	**2021E**	**2022E**
Income from operations (EBIT)	1,050	882	881	990
add: depreciation	159	166	165	165
EBITDA	**1,209**	**1,048**	**1,046**	**1,155**
Scope-adjusted funds from operations	**2019**	**2020**	**2021E**	**2022E**
EBITDA	1,209	1,048	1,046	1,155
less: (net) cash interest as per cash flow statement	-20	-44	-118	-112
less: cash tax paid as per cash flow statement	-57	-44	-59	-68
add: other	-24	0	-30	-30
Scope-adjusted funds from operations	**1,108**	**961**	**839**	**945**
Scope-adjusted debt	**2019**	**2020**	**2021E**	**2022E**
Reported gross debt	1,797	3,599	3,459	3,149
Cash, cash equivalents	-451	-1,337	-942	-488
cash not accessible	-	-	-	-
Pension adjustment	-	-	-	-
Guarantees to joint venture (NTT Manufacturing Ltd)	-	800	106	106
Scope-adjusted debt (SaD)	**1,346**	**3,062**	**2,622**	**2,767**

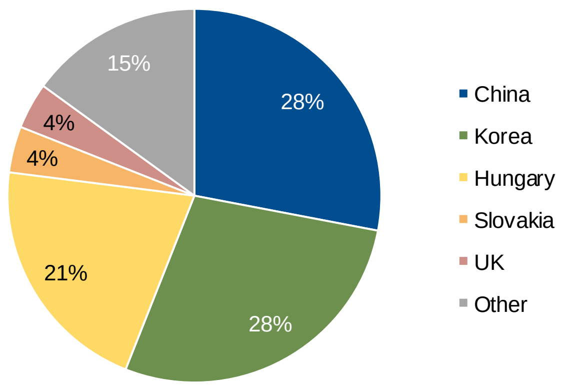
Business risk profile

Business risk profile rated B+

The B+ rating on Naturtex' business risk profile is supported by acceptable profitability margins over time and the strong geographical diversification and distribution platform, despite its small size. Despite a healthy domestic market share (company estimate: 35%), Naturtex is not protected from price competition in a fragmented market, as most of its revenue comes from export markets. As a player in durable consumer products, the company is exposed to medium cyclicality as the goods it produces have more of a discretionary nature. This cyclicality was evident amid the Covid-19 lockdowns. However, with restrictions and logistics issues easing, demand is picking up as more spend on home textiles than before.

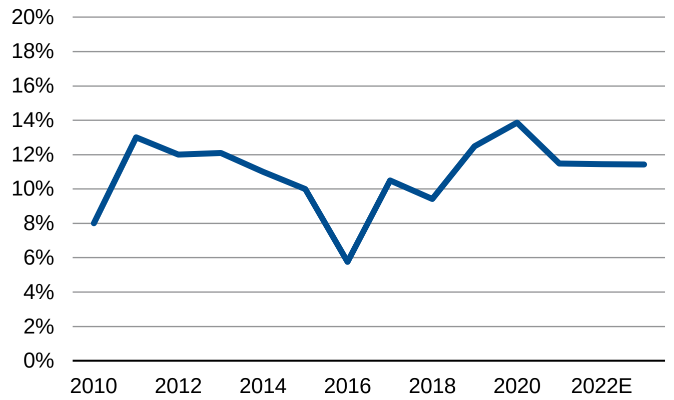
While we acknowledge that the company has many different products, they make up one large category, i.e. bedding. More importantly, Naturtex has developed a good distribution network over time, with more than 250 resellers, 13 franchise partners and several partnerships with national hypermarket chains. Among new and important contracts signed the last 12 months, we highlight two contracts adding millions of euros of sales in 2021: a new contract with Asian partners and a re-negotiated loyalty promotion contract in Q4 2021.

Figure 1: Sales by country



Source: Scope estimates

Figure 2: EBITDA margin development



Source: Scope estimates

Above 10% EBITDA margin with seasonality patterns

Following years of production upgrades and investments, technological standards are good with a high degree of automatisation. The fact that Hungarian goose down and feathers have a special quality and image on the global market helps Naturtex to price its products in the premium category. Forex volatility (US dollar and euro in particular) is mainly hedged through futures. In addition to yearly volatility in demand patterns, the company is also exposed to substantial seasonal volatility, with the majority of sales occurring during Q4.

Financial risk profile

Financial risk profile rated BB

Naturtex' financial risk profile is rated BB and is thus stronger than its business risk profile.

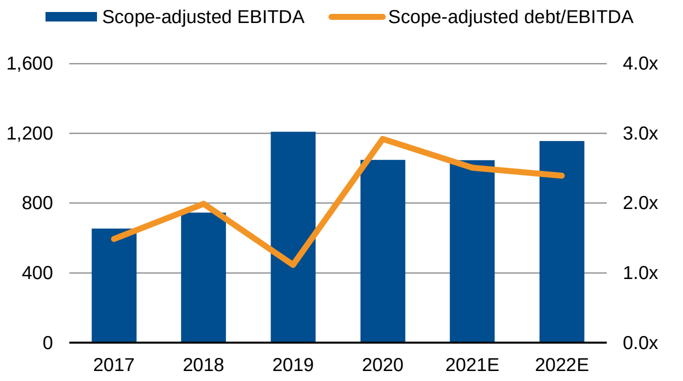
We view positively the company's relatively conservative financial leverage in the recent past, with a SaD/EBITDA of below 3x and an FFO/SaD of above 30%. Going forward, we foresee credit metrics improving from YE 2020, with SaD/EBITDA at 2-3x and FFO/SaD at close to 35% in the medium term. The improvement is expected despite the company's plan to use bond proceeds (MNB) to increase inventory this year and provide greater flexibility to tackle the seasonal nature of its business.

Naturtex' financial risk profile is mainly held back by expected negative FOCF in the short term. However, this is less concerning than before given the significantly reduced liquidity and refinancing risks following last year's bond issuance.

At YE 2020, the company had more than HUF 1.3bn of cash, which comfortably covers the debt maturing in the next two years. Due to the balloon structure of the maturity profile (i.e. first bond instalment in 2025 at 25% of nominal), liquidity is mainly driven by working capital decisions.

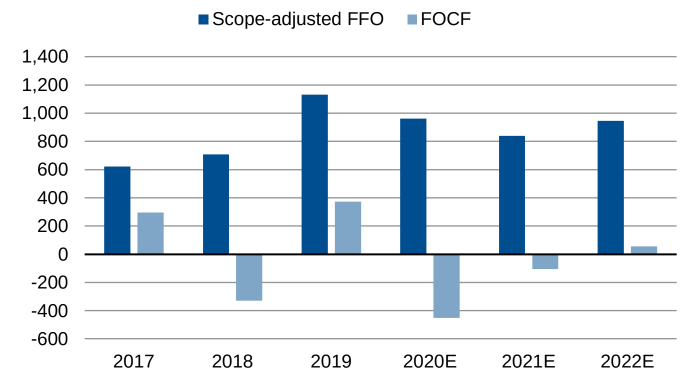
FOCF/SaD has been somewhat volatile and we expect it to remain so going forward. Following the planned discretionary inventory build-up, we do not expect positive FOCF. We have assumed that most of the inventory build-up will take place in 2021, represented by a working capital outflow of almost HUF 1.2bn that year. However, due to the significant reduction in receivables expected for 2021, net working capital will be much less negative. This reduction of receivables comes after a significant build-up before YE 2020, largely from Asian customers, following severe logistics problems related with Covid-19 lockdowns. Ordinary maintenance investment needs are expected to be low going forward at around HUF 200m p.a.

Figure 3: EBITDA (HUF m) and SaD/EBITDA development



Source: Scope estimates

Figure 4: FFO and FOCF development over time (HUF m)



Source: Scope

NTT Manufacturing (joint venture company) to start operating in H2 2021

Naturtex has also established a joint venture company (NTT Manufacturing Ltd.) to support its growth and expansion ambitions and reduce risk. Naturtex and T-Trans Ltd. have equal ownership of the joint venture, which is expected to begin operations in H2 2021. The credit guarantee that Naturtex has issued for this company will be reduced later this year (when the new facility is ready). The maximum exposure during the agreement period (until 2023) is added to SaD (see page 4).

Supplementary rating drivers

Sound financial policy targets

We have not made any explicit rating adjustment for supplementary rating drivers. Although the company has no officially communicated financial policy, we understand that the owners and management aim to maintain a conservative dividend policy and are interested in keeping the sound financial condition. This has been demonstrated in the past, with a targeted dividend pay-out ratio of 10%-30%.

Long-term and short-term debt ratings

Senior unsecured debt rated in line with issuer rating

We expect an average recovery for senior unsecured debt, such as the HUF 2.8bn bond issued in 2020 under the Bond Funding for Growth Scheme of the Hungarian National Bank. This recovery expectation result in no notching from the issuer rating, giving a senior unsecured debt rating of B+. Although the recovery analysis could indicate an even higher recovery, we have taken a conservative view based on our sensitivity analysis. Our recovery expectations are based on an expected liquidation value in a hypothetical default scenario. In this scenario we assume tough market conditions and that the outstanding bank facility at that time is fully drawn.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44 020 7340 6347

info@scoperatings.com
www.scoperatings.com

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