25 April 2023

Corporates

Naturtex Kft.
Hungary, Consumer Products

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022P**	**2023E**
Scope-adjusted EBITDA/interest cover	15.8x	12.6x	34.2x	6.0x
Scope-adjusted debt/EBITDA	5.7x	5.8x	5.9x	6.1x
Scope-adjusted funds from operations/debt	16%	15%	27%	15%
Scope-adjusted free operating cash flow/debt	-10%	-10%	15%	4%

Rating rationale

Naturtex's business risk profile continues to benefit from relatively strong operating profitability, a strong international profile and its products' brand strength in its domestic market. However, due to the challenging macroeconomic environment, high input prices put pressure on Naturtex's profitability in the near term. We expect Naturtex's profitability of Scope-adjusted EBITDA margin to remain around 11% in 2023-2025. The business risk profile is hindered by the company's low market share and diversification despite strong geographical diversification. As the company remains small and exposed to a single product category, its business risk profile remains at B+.

The deterioration of the financial risk profile (B+, down from BB-) is due to adjustments to credit metrics (to reflect the company's operating profitability and indebtedness) and the issuance of a working capital loan of EUR 0.65m to enhance liquidity. Naturtex's financial risk profile benefits from strong interest cover supported by favourable fixed interest rates and adequate liquidity. It is hindered by the company's high leverage and low cash flow cover, which are expected to peak in 2023. From then on, we expect both metrics to improve as the bank guarantee exposure will likely decrease, as it follows the amortisation of its subsidiary's (NTT Manufacturing) debt.

Outlook and rating-change drivers

The Outlook for Naturtex is Stable and incorporates our view that the higher materials and input costs may still adversely affect operating profitability. We expect Naturtex's leverage to peak at above 6x after the issuance of the Baross Gabor loan and remain at 4.5x-6x in the following years.

A positive rating action could be warranted if the Scope-adjusted debt improved to below 3.5x on a sustained basis.

A negative rating action is possible if Scope-adjusted debt/EBITDA remained above 6x on a sustained basis, for example, resulting from tougher market conditions or a more aggressive debt-financed growth strategy.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
25 Apr 2023	Affirmation	B+/Stable
19 Apr 2022	Affirmation	B+/Stable
20 May 2021	Affirmation	B+/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	B+

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Related Methodologies and Related Research

General Corporate Rating Methodology; July 2022

Consumer Products Rating Methodology; November 2022

ESG considerations for credit ratings of consumer goods companies

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Relatively strong interest cover backed by favourable fixed interest rate debt instruments • Healthy domestic market position with acceptable profitability margins in the long term • Solid geographical diversification and distribution platforms • Domestically known brand name	• Small private company operating in an industry with cyclical characteristics and seasonal volatility • High leverage complemented by a long-term bank guarantee for NTT Manufacturing • Negative free operating cash flow due to substantially negative working capital effects

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA sustainably declining to below 3.5x	• Weaker operating conditions, resulting in Scope-adjusted debt/EBITDA remaining above 6x

Corporate profile

Naturtex Gyapjú- és Tollfeldolgozó Kft's (Naturtex) core business is the production of duvets and pillows filled with goose feathers and down as well as bedding using other natural and synthetic fibres. The company operates four plants in Hungary and exports to more than 45 countries. It employs around 170 people and had a turnover of around HUF 11bn (EUR 31m) in 2021. Naturtex is headquartered in Szeged, Hungary, and is 100% family owned.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022P**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	15.8x	12.6x	34.2x	6.0x	6.7x	7.8x
Scope-adjusted debt/EBITDA	5.7x	5.8x	5.9x	6.1x	5.1x	4.4x
Scope-adjusted funds from operations/debt	16%	15%	27%	15%	21%	26%
Scope-adjusted free operating cash flow/debt	-10%	-10%	15%	4%	2%	1%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,055	1,375	1,613	919	1,135	1,309
Operating lease payments	136	155	188	190	194	201
Other items[1]	**-157**	-237	-710	-119	-286	-392
Scope-adjusted EBITDA	**1,034**	**1,292**	**1,090**	**990**	**1,042**	**1,118**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,034	1,292	1,090	990	1,042	1,118
less: (net) cash interest paid	-65	-103	-32	-165	-154	-143
less: cash tax paid per cash flow statement	-44	-15	-83	-50	-62	-72
Other items[2]	0	-54	-8	-40	-40	-40
Funds from operations	**924**	**1,119**	**967**	**735**	**786**	**863**
Free operating cash flow in HUF m						
Funds from operations	924	1,119	967	735	786	863
Change in working capital	-1,311	-1,711	716	448	-130	-264
Non-operating cash flow	400	759	117	0	0	0
less: capital expenditure (net)	-501	-799	-696	-800	-425	-400
less: lease amortisation	-102	-116	-141	-142	-145	-151
Free operating cash flow	**-590**	**-748**	**963**	**240**	**86**	**48**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	32	64	15	117	105	92
add: interest component, operating leases	34	39	47	47	48	50
Net cash interest paid	**65**	**103**	**32**	**166**	**155**	**144**
Scope-adjusted debt in HUF m						
Reported gross financial debt	3,599	5,069	3,872	3,682	3,177	2,927
less: cash and cash equivalents	-1,337	-1,913	-1,500	-1,269	-898	-889
add: non-accessible cash	1,337	1,913	1,500	1,269	898	889
add: operating lease obligations	678	775	940	949	968	1007
Other items[3]	1,609	1,609	1,609	1,409	1,209	1,009
Scope-adjusted debt	**5,886**	**7,453**	**6,421**	**6,041**	**5,355**	**4,943**

[1] Includes non-recurring revenues and expenses (e.g. real estate sales proceeds, non-refundable subsidies, capitalised R&D costs).
[2] Includes other financial income and expenses.
[3] Includes the bank guarantee towards NTT Manufacturing Kft.

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Environmental, social and governance (ESG) profile[4]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Environmental, social and governance (ESG) considerations have no significant effect on Naturtex's credit quality.

The company is working on sustainability as it is replacing a part the energy used in its production process with renewable energy (it has recently invested in solar energy, now accounting for 10-15% of Naturtex's energy consumption). The company also has a dedicated R&D facility that has developed products and packaging using recycled and recyclable materials.

The company's first ESG report is expected in 2023 as many of its customers will require their suppliers, including Naturtex, to provide such non-financial information from 2024 onwards.

[4] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: B+

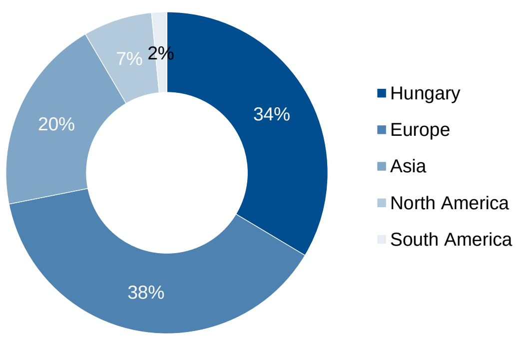
Industry risk profile: BB

Naturtex operates in the durable consumer products market, which is characterised by medium cyclicality, medium entry barriers and medium substitution risk. We assess the industry risk profile at BB.

Naturtex's B+ business risk profile continues to be supported by acceptable profitability margins, a strong geographical diversification and distribution platform together with a domestically well-known brand for a small company. Despite the company being one of the market leaders in Hungary, Naturtex is not protected from price competition in a fragmented market, as most of its revenue comes from export markets. As a player in the durable consumer products industry, the company is exposed to medium cyclicality as it produces discretionary goods. However, Naturtex was able to make up for lost 2020 sales as demand for its products has grown since 2021, roughly returning to pre-Covid-19 levels in 2022.

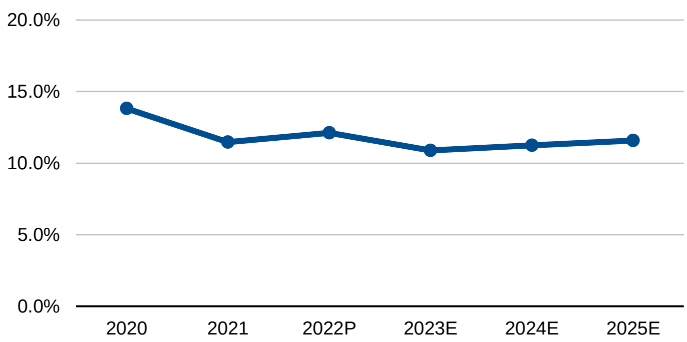
While Naturtex has many different products, they are all part of the bedding category, making the company exposed to a single industry. Naturtex has developed a good distribution network over time, with more than 250 resellers, 13 franchise partners and several partnerships with national hypermarket chains.

Figure 1: Sales by continent, 2022 (preliminary)



Sources: Naturtex, Scope

Figure 2: Scope-adjusted EBITDA margin development



P: preliminary
E: expected
Sources: Naturtex, Scope (estimates)

Scope-adjusted EBITDA margin around 11%, with seasonal patterns

Following years of production upgrades and investments, technological standards are good and include a high degree of automation. 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 natural hedging in addition to futures, as export sales cover most material costs. In addition to yearly volatility in demand (typical for durable consumer products), the company is also exposed to substantial seasonal cyclicality, with the majority of sales occurring in the last quarter of each year.

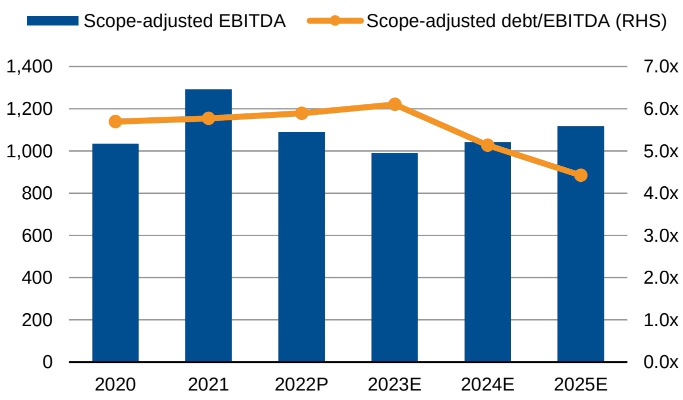
Financial risk profile: B+

Naturtex's financial risk profile is assessed at B+ (revised from BB-). The deterioration is mainly due to adjustments that were applied to credit metrics to i) better reflect the company's operating profitability (free from non-operating income effects, e.g. income from real estate sales); and ii) correct indebtedness levels, including the company's operating lease liabilities and bank guarantee for its subsidiary's investment loans. The deterioration is also due to Naturtex's decision to take out a working capital loan of EUR 0.65m in the Baross Gabor loan programme to enhance liquidity in 2023. The eurodenominated loan will have a favourable fixed interest rate of 3.5%, a three-year term and linear amortisation with a one-year grace period.

Interest cover will continue to be strong and benefit the financial risk profile, supported by the favourable fixed interest rates of the largest debt balances (existing HUF 2.8bn bond and upcoming Baross Gabor loan). Interest cover is expected to drop to 6x in 2023 due to the issuance of the new loan, however by 2025 it is forecasted to increase to 7.8x.

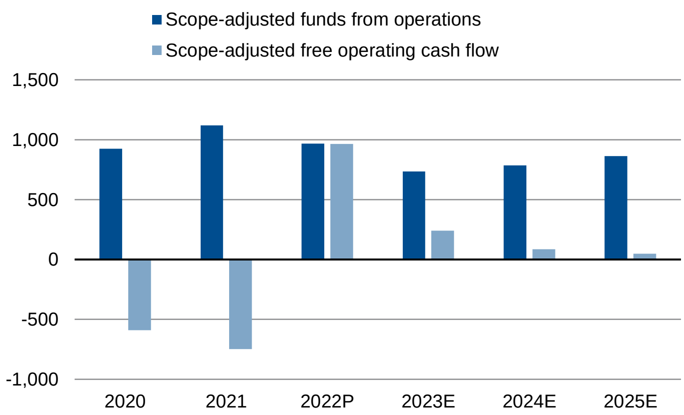
The financial risk profile is hindered by the company's high leverage, which includes the bank guarantee for NTT Manufacturing and operating lease adjustments in addition to the interest-bearing debt. Scope-adjusted debt/EBITDA has been stable at between 5.7-5.9x since the issuance of the bond and is expected to peak at 6.1x in 2023. With the deterioration of the bank guarantee mirroring the outstanding debt of NTT Manufacturing, we expect Naturtex's leverage to decrease to around 4.4x by 2025. Naturtex's financial risk profile is also held back by its low cash flow cover, which we expect to remain below 5% between 2023 and 2025.

Figure 3: Scope-adjusted EBITDA (HUF m) and Scope-adjusted debt/EBITDA development



Sources: Naturtex, Scope (estimates)

Figure 4: Scope-adjusted funds from operations and Scope-adjusted free operating cash flow (HUF m)



Sources: Naturtex, Scope (estimates)

Adequate liquidity

Liquidity is adequate, based on the current cash reserves (HUF 1.9bn as of end-December 2022) in combination with high cash flow in 2022. The bond is scheduled to amortise in 2025, however in addition to Naturtex's further loans (including investment loans and working capital loans), the new Baross Gabor loan will start linearly amortising in 2024. Internal liquidity will be adequate to cover this as cash generation is more than 200% of the scheduled debt amortisation in 2023 and 2024.

Balance in HUF m	2022P	2023E	2024E
Unrestricted cash (t-1)	1,813	1,400	1,169
Free operating cash flow	1,674	359	372
Short-term debt (t-1)	1,333	446	531
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: 0 notches

We have not made any explicit rating adjustments for supplementary rating drivers. Although the company has not officially communicated its financial policy, we understand that the owners and management aim to maintain a conservative dividend policy. Naturtex's management prioritises the sound financial condition of the company, as it demonstrated with a targeted dividend payout ratio of 30%, which has been set as a financial covenant in the bond.

Long-term debt rating

Senior unsecured debt rating: B+

We expect an 'average recovery' for senior unsecured debt, given the senior unsecured bond (ISIN: HU0000359922) of HUF 2.8bn issued in September 2020 under the Hungarian Central Bank's Bond Funding for Growth Scheme. This recovery expectation results in no notching relative to the issuer rating, leading to a senior unsecured debt rating of B+. Our recovery expectations are based on an expected liquidation value in a hypothetical default scenario in 2025. In this scenario, we assume tough market conditions and that all available bank facilities would be fully drawn in the event of insolvency.

Out of the HUF 2.8bn senior unsecured bond proceeds, 35% were used to refinance loans and 65% to finance working capital. The bond has a seven-year tenor and a fixed coupon of 3%. Bond repayment is in two tranches: first in 2025, with 25% of the face value and the second, a 75% balloon payment, at maturity. We note that the HUF 2.8bn bond has an accelerated repayment clause. The clause requires Naturtex to repay the nominal amount (HUF 2.8bn) if its rating deteriorates (two-year cure period for a B/B- rating, repayment within 15 business days after the bond rating falls below B-, which could have default implications). In addition to the rating deterioration covenant, bond covenants include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, change of control and dividend covenants.

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