MetMax Europe Zrt.
Hungary, Capital Goods

B+ STABLE

Corporate profile

MetMax Europe Zrt. is a Hungarian metalworking company with a history spanning decades. In 2016, the company was acquired by a group of Hungarian private investors led by András Csoma. MetMax is a strategic supplier to large international companies based in Europe. Its production focuses on small to medium series. The company employs about 130 people. Its key production site is a factory hall in Györ. MetMax is currently investing to significantly expand production capacity.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	-40.2x	-363.3x	145.9x	N.M.
Scope-adjusted debt (SaD)/EBITDA	0.0x	0.0x	1.9x	2.2x
Scope-adjusted funds from operations/SaD	5893%	-12741%	52%	45%
Free operating cash flow/SaD	753%	-6269%	27%	-15%

Rating rationale

Scope Ratings assigns a B+/Stable first-time issuer rating to MetMax Europe Zrt. Senior unsecured debt has been rated at the same level as the issuer at B+.

MetMax plans to issue a HUF 5.0bn bond with a 10-year maturity (amortising 10% every year during 2025-2029, and 50% in 2030) and coupon of around 3% p.a. under the Hungarian National Bank's Bond Funding for Growth Scheme. Proceeds from the bond issuance are planned for investments to expand production capacity (real estate, building, and new machines) and refinance existing debt at the parent company.

MetMax's business risk profile, rated B, is constrained by the company's size, low diversification and high customer concentration. MetMax is a small niche player in Europe's capital goods market, with revenues of HUF 3.9bn in 2019. It is a strategic supplier to large international companies based in Europe, with production focused on small-to-medium series of high-precision and complex parts. The company produces more than 4,000 parts such as combustion nozzles, electric motor components, parts for railway braking systems, pumps, industrial clamping and gripping machines. Regarding diversification, the limited product range, small share of aftermarket business, and low end-market diversification are constraints of the business risk profile. The key constraint is the significant customer concentration, with the top five customers representing more than 80% of revenues.

MetMax is also involved in outsourcing the projects of its customers where, in the longer term, its customers outsource key machining expertise and transfer know-how to suppliers such as MetMax. We view this positively as it speaks for MetMax's technological expertise and strengthens the supplier relationship. Profitability is the major support for the business risk profile. EBITDA margin has ranged between 24% and 32% in the past five years. For 2020, MetMax expects revenues in a range of HUF 4.3bn-4.5bn (+13% YoY), based on expected order fulfilments until year end and business booked in the first half of 2020. We forecast EBITDA of HUF 1.25bn in 2020, which would translate into an EBITDA margin of 28% (27% in H1 2020).

Ratings & Outlook

Corporate rating B+/Stable

Senior unsecured rating B+

Analyst

Werner Stäblein
+49 69 6677389 12
w.staeblein@scoperatings.com

Related Methodology

Corporate Rating Methodology, February 2020

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

MetMax has recently added new customers, which should boost revenue growth going forward. To accommodate higher business volumes, production capacity will be increased as part of the current investment programme, which foresees a 50% expansion in existing floor space.

The rating is supported by the BBB financial risk profile. The HUF 5.0bn investment programme for expanding production capacity will allocate HUF 2.2bn for real estate and buildings and HUF 2.8bn for new machinery. The new production site will allow the internalisation of HUF 200m of current rental payments and should lead to operational savings of HUF 50m. Investment will start in 2020 and will last for the next five years, and the completion of the real estate investment is expected in late 2021. Investments carried out via sister company MetMax Vagyonkezelö Kft. will lead to negative free operating cash flows in 2021, mainly because spending on real estate is mostly scheduled for that period. Beyond 2021, however, underlying cash flow should support positive free operating cash flows despite the heavy investment. The investment programme is expected to be supported by a state subsidy.

Scope-adjusted debt (SaD) was slightly negative at year-end 2019. Gross financial debt at 31 December 2019 consisted of an intra-group loan due to MetMax's parent and a small drawing under a lease facility. All financial debt was covered using unrestricted cash. The proceeds from the planned bond are partly for refinancing acquisition debt of EUR 8.0m (around HUF 3.0bn) at the parent level. This debt is committed for another eight years but will be replaced with parts of the prospective bond issue. Afterwards, MetMax's capital structure will consist solely of the HUF 5.0bn bond. In view of the very low indebtedness prior to the investment programme and the acquisition debt taken out at the parent level, credit ratios should remain solid in 2020 and beyond.

Leverage as measured by SaD/EBITDA is expected at below 2.0x in 2020 and only mildly above 2.0x in 2021 due to the large cash payouts planned for real estate and buildings. Deleveraging to below 2.0x should begin in 2022, supported by good cash generation. Our calculation accounts for the proportionate receipt of subsidies commensurate with investments made in the respective years.

We view MetMax's liquidity and financial flexibility as adequate as sources cover uses by more than 2x in 2020. Going forward, with no financial debt other than the long-dated prospective bond, financial maturities will amount to nil.

Outlook and rating-change drivers

The Stable Outlook incorporates the successful placement of the HUF 5.0bn bond under the Hungarian National Bank's Bond Funding for Growth Scheme and the arrangement of state subsidies for the duration of the investment programme. It also includes the expectation of mid-to-high single-digit revenue growth in 2021 while margins remain at current levels, translating into a SaD/EBITDA of around 2.0x in 2021.

At this stage, we deem an upgrade of the rating to be remote unless MetMax can improve its business risk profile, in terms of customer concentration and product/end-market diversification, while maintaining credit metrics at the forecasted levels.

A negative rating action could result from SaD/EBITDA increasing above 3.0x on a sustained basis, caused by EBITDA margin pressure from rising staff costs or investment that goes beyond the current plan.

Rating drivers

Positive rating drivers	Negative rating drivers
• Strong operating profitability; EBITDA margin was 31% in 2019 and 24% in 2018 • Solid credit metrics leading to a solid financial risk profile • Solid expected revenue development with growth rates of about 5% annually	• Very small niche player in Europe's capital goods market (HUF 3.9bn in revenues in 2019) • Low product diversification and low share of recurring revenues (aftermarket sales) • High customer concentration, with top five accounting for more than 80% of revenues • Weak geographical diversification with high share of domestic sales • Risks from rising labour costs and exchange rate fluctuations

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Stronger business risk profile, e.g. through improvements in end-market diversification or customer concentration, while maintaining current credit metrics	• SaD/EBITDA increasing above 3.0x on a sustained basis

Financial overview

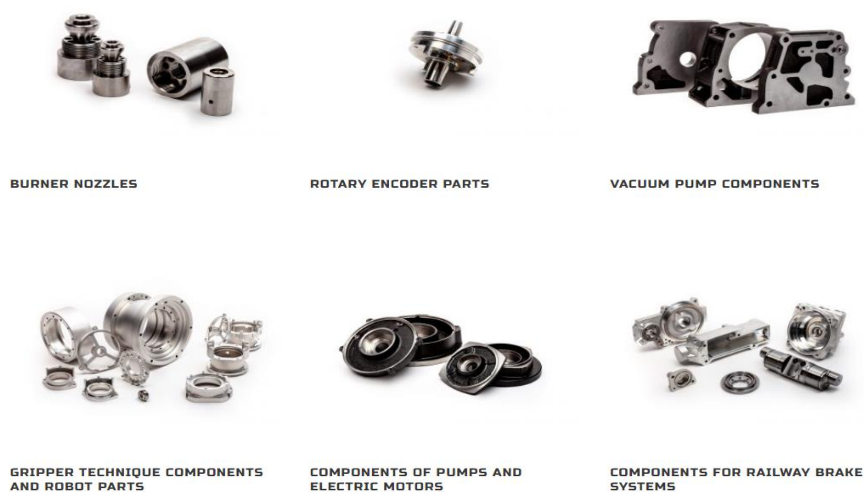
			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover (x)	-40.2x	-363.3x	145.9x	N.M.
Scope-adjusted debt (SaD)/EBITDA	0.0x	0.0x	1.9x	2.2x
Scope-adjusted funds from operations/SaD	5893%	-12741%	52%	45%
Free operating cash flow/SaD	753%	-6269%	27%	-15%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	822.2	1,183.9	1,240.5	1,302.9
Operating lease payments in respective year	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	**822.2**	**1,183.9**	**1,240.5**	**1,302.9**
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	822.2	1,183.9	1,240.5	1,302.9
less: (net) cash interest as per cash flow statement	20.4	3.3	-8.5	0.0
less: cash tax paid as per cash flow statement	-47.6	-73.2	0.0	0.0
add: depreciation component, operating leases	0.0	0.0	0.0	0.0
Scope-adjusted funds from operations	**795.1**	**1,113.9**	**1,232.0**	**1,302.9**
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	57.7	175.5	5,000.0	5,000.0
less: cash and cash equivalents	-44.2	-184.3	-2,639.1	-2,107.6
add: cash not accessible	0.0	0.0	0.0	0.0
add: pension adjustment	0.0	0.0	0.0	0.0
add: operating lease obligations	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted debt	**13.5**	**-8.7**	**2,360.9**	**2,892.4**

Business risk profile: B

Small niche player in fragmented market

With revenues of HUF 3.9bn in 2019, MetMax is a very small niche player in the European capital goods market. More than 4,000 companies in Hungary are active in metalworking, 115 of which have revenues of HUF 1bn-10bn. In Hungary, most metalworking companies (and metalworking suppliers in general) supply to the automotive and consumer electronics industries, two industries characterised by mass production, fierce price competition, and high cyclicality on their respective end-markets. MetMax is not present in these two cyclical markets. MetMax is a strategic supplier to large international companies based in Europe. It focuses on low-to-medium series production with smaller batch sizes (300-500 pieces; up to 50,000-70,000 a year), and products with a lower degree of automation but high value-added for customers. MetMax produces more than 4,000 types of parts.

Figure 1: Overview of some of MetMax's products



Source: MetMax

Persistently high share from domestic sales

Geographical diversification of MetMax's revenues is limited, with 70% generated in Hungary in 2019 – though this is an improvement on the much smaller levels in preceding years. The distribution of sales into domestic/export, however, provides only a partial picture of the parts and components supplied by MetMax. For instance, the company's largest customer, Knorr-Bremse Hungaria Kft., operates one of the largest production facilities for rail infrastructure (rail brakes, bogie equipment) within the Knorr-Bremse group, and all products assembled by Knorr-Bremse in Hungary are eventually sold worldwide.

Diversification by end-markets moderate

End-market diversification is moderate. Products manufactured by MetMax are mainly used as parts for railway undercarriages, rail braking equipment, water pumps, waste recovery, and vacuum pumps. Currently, management is negotiating with additional suppliers from industries such as crude oil and natural gas, power transmission and healthcare equipment.

Substantial customer concentration

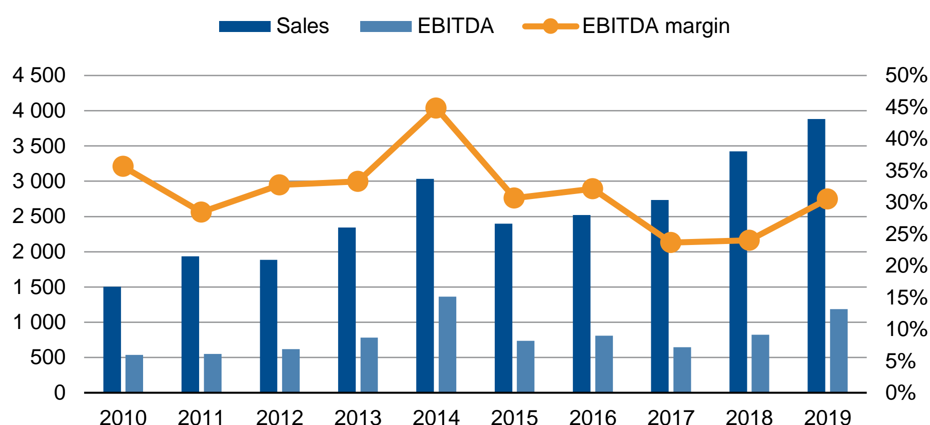
The key credit-negative for the business risk profile is the high customer concentration. While MetMax's products are strategically important for its customers, its dependence on a few customers is nevertheless significant. The top five customers represent more than 85% of revenues and the largest customer represents almost 40%.

Profitability a major support for business risk profile

Profitability is the major supporting factor for MetMax's business risk profile. The EBITDA margin has ranged between 24% and 31% in the last five years. The strong profitability

compared to its Hungarian sector peers is attributable to the high share of value-added sales in the overall mix and the low share of business generated in mass markets such as automotive or consumers goods.

Figure 2: **Long-term overview of sales, EBITDA, and EBITDA margin***



Source: MetMax, Scope
*Sales and EBITDA in HUF m

Financial risk profile: BBB

MetMax in the middle of an investment cycle

MetMax is in the middle of an investment cycle and is planning to significantly expand production capacity with a new facility, projected for completion in 2021. The facility will have a total production and warehousing area of 10,000 square metres and will be located in Töltéstava, near Györ, where MetMax is located. Total investment in the new production facility is planned at HUF 5.0bn, of which HUF 2.2bn will be allocated for real estate and the remainder (HUF 2.8bn) for new machinery. The new machines to be procured should improve production efficiency through their ability to produce complex parts without idle time. The acquisition of the new production site (real estate) also provides the option to expand capacity in the future while reducing costs such as rent.

Planned HUF 5.0bn bond to fund investments

To finance the investments, Metmax plans to issue HUF 5.0bn in unsecured corporate notes under the Hungarian National Bank's bond scheme. We have also considered the arrangement of state subsidies for the planned investment program in our assessment of the financial risk profile.

Low starting level of debt ahead of bond

SaD was slightly negative at year-end 2019. Gross financial debt at 31 December 2019 consisted of an intra-group loan due to MetMax's parent and a small drawing under a lease facility. All financial debt was covered using unrestricted cash.

Acquisition debt at parent level to be taken out with bond

Proceeds from the planned HUF 5.0bn bond issuance are partly earmarked to refinance acquisition debt of EUR 8.0m (around HUF 3.0bn) at the parent level (CNC Tökebefektetö Kft.). This debt is committed for another eight years but will be replaced with parts of the prospective bond issue. MetMax's capital structure will consist solely of the HUF 5.0bn bond once the transaction is completed, with no further financial liabilities at either sister company or parent company levels. In view of the very low level of indebtedness at MetMax prior to the investment programme and the acquisition debt taken out at the parent level, credit ratios should remain solid in 2020 and beyond.

De-leveraging possible from 2022 with good cash generation

Leverage as measured by SaD/EBITDA is expected at below 2.0x in 2020 and mildly above 2.0x in 2021 due to the large cash payouts for real estate and buildings. Deleveraging to below 2.0x should begin in 2022, supported by good cash generation.

This calculation accounts for the proportionate receipt of subsidies commensurate with investments made in the respective years.

Liquidity

Adequate liquidity and financial flexibility

Liquidity and financial flexibility are adequate as sources cover uses by more than 2x in 2020. Going forward, with no financial debt other than the long-dated prospected bond, financial maturities will be nil.

Financial policy

Credit-neutral financial policy

We view the financial policy of MetMax as credit-neutral. There were no aggressive M&A or dividend payments in the past few years.

Long-term and short-term debt ratings

Planned bond issue of HUF 5.0bn

MetMax Europe Zrt. plans to issue a senior unsecured HUF 5.0bn bond with a 10-year maturity (amortising 10% every year during 2025-2029, and 50% in 2030) and coupon of around 3% p.a. under the Hungarian Central Bank's Bond for Growth Scheme. Proceeds from the bond issuance are planned for investments to expand production capacity (real estate, building, and new machines) at its sister company. The investments at the sister company are planned to be funded through funds provided by MetMax Europe Zrt. The remaining amount of the bond proceeds are planned to be used to refinance debt at the parent company (HUF 3.0bn). Therefore, total bond proceeds will be lended to either the parent company or the sister company.

Bond suggests 'average' recovery

Scope's recovery analysis uses the liquidation value in a hypothetical default in 2022 of HUF 3.8bn. This value is based on a haircut of around 50% on the assets and reflects liquidation costs for the assets of 10%. The haircut also assumes that the intra-group receivable from the parent used to refinance the acquisition debt would become non-recoverable in the event of payment default. This suggests 'average' recovery prospects for bondholders in a simulated event of default.

Assumption of no other debt in the capital structure

To determine claimholders, Scope has ranked the repayment obligation for subsidies at the simulated point of default senior to the claims on the prospective bond. Scope assumes the business plan and investment program will be executed as planned with no additional bank debt or other senior ranking financings ahead of the planned bond. Scope also assumes the existing undrawn bank facilities will be cancelled while mortgages and pledges over assets currently in place will be released.

Bond rated at same level as issuer

In view of the expected recovery rate, Scope assigns a B+ rating to the senior unsecured debt class, the same as the issuer rating.

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

London

3rd Floor
111 Buckingham Palace Road
UK-London SW1W 0SR

Madrid

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

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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Scope Ratings GmbH, Lennéstraße 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Guillaume Jolivet.