Naturtex Kft.
Hungary, Consumer Products

SCOPE B+ STABLE

Corporate profile

Naturtex Gyapjú- és Tollfeldolgozó Kft's 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. The company 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.

Key metrics

		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover (x)	29.8x	11.9x	6.7x	7.7x
Scope-adjusted debt (SaD)/EBITDA	4.2x	4.0x	4.1x	3.3x
Scope-adjusted funds from operations (FFO)/SaD	22%	21%	19%	24%
Free operating cash flow (FOCF)/SaD	-9%	-8%	-7%	1%

Rating rationale

Scope has affirmed its B+/Stable issuer rating on Naturtex Gyapjú- és Tollfeldolgozó Kft. and has also affirmed its rating for the senior unsecured debt category at B+.

In 2021 the company was able to make up for the lost sales in 2020. However, due to additional short-term loans taken out to finance a temporary business expansion and increased input costs in 2022, Scope expects no major improvement in credit ratios in 2021 and 2022.

Naturtex's business risk profile (assessed at B+) continues to benefit from its comfortable operating profitability, strong international profile and its product's brand strength on its domestic market. However, due to the current post-pandemic situation and geopolitical conflict, many input costs have significantly increased, including raw materials, energy and transport costs. Together with planned increase in staff costs, these are all expected to put pressure on Naturtex's profitability in the near term. The company successfully implemented a price increase at the beginning of 2022, but future price increases are constrained by various pricing clauses with partners and by customer behaviour trends. Scope expects Naturtex's profitability to return to average historical levels of Scope-adjusted EBITDA of around 11% after 2023.

As a small producer in the fragmented European bedding market, Naturtex can take advantage of shifting market trends. Due to high transport costs and delivery issues many buyers face in relation to their Asian suppliers, buyers have had to search for alternative European suppliers. This plays in favour of Naturtex's expansion strategy. With the completion of the joint venture with NTT Manufacturing Kft., Naturtex will be able to increase its output by 40% in the following years and fulfil the expected rise in demand for its products.

Ratings & Outlook

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

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Related Methodologies

Corporate Rating Methodology, July 2021

Consumer Products Rating Methodology September 2021

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Bloomberg: RESP SCOP

Following increased sales in 2021 due to the Covid-19 lockdown and delayed partner promotions, Naturtex took out a short-term non-recourse project finance loan to finance a promotion project of one of its main buyers. The net impact of the higher sales and higher debt was broadly unchanged credit metrics. Naturtex received close to HUF 0.75bn of government grants in 2021 to finance new machinery, a solar park and renovations.

The agency expects Scope-adjusted Debt to EBITDA to remain around 4.0x (at the high end of the tolerance for the rating) in 2021 and 2022 and sees prospects for improvement in 2023 onwards.

Outlook and rating-change drivers

The Outlook for Naturtex is Stable and incorporates Scope's view of the negative effects that the rapidly increasing material costs may have on operating profitability. Although the company successfully implemented a significant product price increase in 2022, the different contractual timeframes of price changes for its wholesale buyers may pressure margins in the near term. The company has built up a substantial inventory of raw materials and products to mitigate its exposure to immediate price increases; however, this caused free operating cash flow to remain negative in Scope's base case in 2021. Furthermore, government grants have allowed the company to expand capex plans, with negative free operating cash flow forecast in 2022.

Rating-change drivers have not changed significantly. A positive rating action could be warranted if profitability and cash flow stabilised in the coming years. This could be exemplified by positive sustained free operating cash flow, which would strengthen the balance sheet.

A negative rating action is possible if Scope-adjusted debt/EBITDA increased to over 4x and funds from operations/Scope-adjusted debt fell 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 in the long term • Solid geographical diversification and distribution platforms • Historically low leverage, with management and owners steering towards a conservative financial policy	• Small private company operating in industry with cyclical characteristics as well as seasonal volatility • Negative FOCF due to substantially negative working capital effects • Significant materials and staff costs increases, causing stress on 2022E and medium-term profitability

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 would strengthen the balance sheet	• Weaker operating conditions, resulting in an FFO/SaD sustained below 15% • SaD/EBITDA sustained above 4x

Financial overview

		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover (x)	29.8x	11.9x	6.7x	7.7x
SaD/EBITDA	4.2x	4.0x	4.1x	3.3x
Scope-adjusted FFO/SaD	22%	21%	19%	24%
FOCF/SaD	-9%	-8%	-7%	1%
Scope-adjusted EBITDA in HUF m	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	1,055	1,344	948	986
Operating lease payments in respective year	11	11	11	11
Other	0	0	0	0
Scope-adjusted EBITDA	1,066	1,355	959	997
Scope-adjusted FFO in HUF m	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	1,055	1,344	948	986
less: (net) cash interest as per cash flow statement	-32	-110	-139	-125
less: cash tax paid as per cash flow statement	-44	-91	-55	-60
add: depreciation component, operating leases	6	6	6	6
Other	0	-30	0	0
Scope-adjusted FFO	986	1,119	760	808
SaD in HUF m	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	3,599	5,069	3,734	3,734
less: hybrid bonds	0	0	0	0
less: cash and cash equivalents	-1,337	-1,998	-941	-941
add: cash not accessible	1,337	1,998	941	941
add: pension adjustment	0	0	0	0
add: operating lease obligations	84	84	84	84
Other	800	210	106	0
SaD	4,483	5,363	3,924	3,328

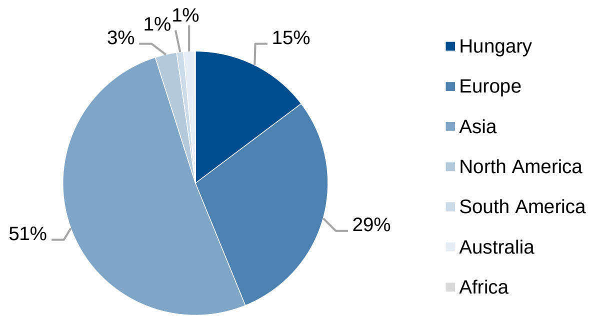
Business risk profile

Business risk profile assessed at B+

The B+ assessment of Naturtex's business risk profile is supported by acceptable profitability margins over time and a strong geographical diversification and distribution platform despite the company's small size. Even with a healthy domestic market share (company estimate: 35%, excluding bedding sales of IKEA), 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, Naturtex was able to make up for its lost 2020 sales in 2021 and expects demand to return to pre-Covid-19 levels.

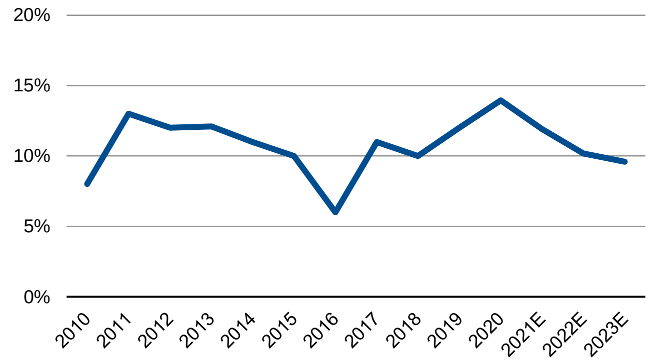
While we acknowledge that the company has many different products, they make up one large category, i.e. bedding. More importantly, Naturtex has developed a good distribution network over time, with more than 250 resellers, 13 franchise partners and several partnerships with national hypermarket chains. Demand for the company's products is expected to increase since many buyers are looking to change their Asian suppliers in favour of European ones.

Figure 1: Sales by continent, 2020



Source: Naturtex, Scope

Figure 2: EBITDA margin development



Source: Naturtex, Scope

Around 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 in the last quarter of each year.

Financial risk profile

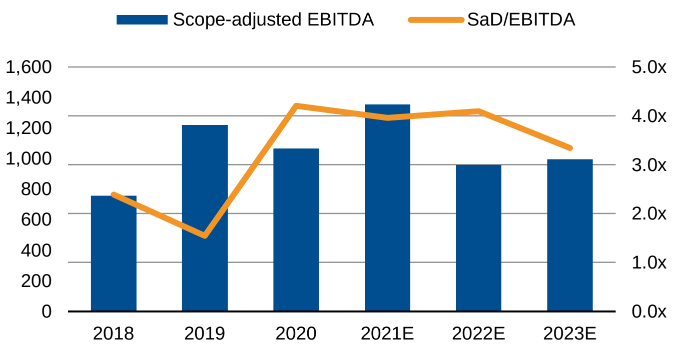
Financial risk profile assessed at BB-

Naturtex's financial risk profile is assessed at BB- and is thus stronger than its business risk profile.

We view positively the company's relatively conservative financial leverage in the recent past before the bond issuance, with a SaD/EBITDA ratio of below 4x and FFO/SaD of above 20%. In 2021 Naturtex was able to make up for the lost sales of 2020. For a temporary business expansion the company took up a short-term non-recourse project finance loan; however, we expect credit metrics to remain broadly stable for 2021E and 2022E. Furthermore, Naturtex received government subsidies of around HUF 0.75bn for several investments (including in machinery, a solar power park and renovations) in 2021. Naturtex's financial risk profile is mainly held back by its negative FOCF, which is expected to remain negative in 2021E and 2022E due to ambitious capex plans and working capital build-up in 2021E and a partial reduction in 2022E. Ordinary maintenance investment needs are expected to be low going forward, at around HUF 200m-300m per year.

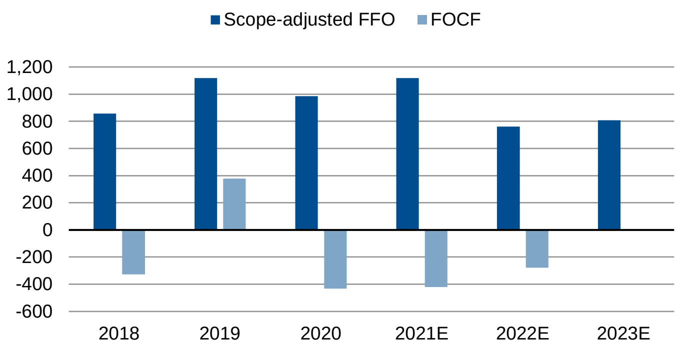
At YE 2021E, the company had more than HUF 1.9bn of cash, which is expected to comfortably cover the debt maturing in the following years. Due to the balloon structure of the maturity profile (i.e. first bond instalment in 2025 at 25% of the nominal amount), liquidity requirements are mainly driven by working capital decisions.

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



Source: Naturtex, Scope estimates

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



Source: Naturtex, Scope estimaes

Supplementary rating drivers

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 and are interested in maintaining the sound financial condition of the company. This has been demonstrated in the past, with a targeted dividend payout ratio of 30%, which has also been set as a financial covenant in the bond prospectus.

Long-term debt ratings

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 results in no notching compared to the issuer rating, giving a senior unsecured debt rating of B+. 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 all available bank facilities are fully drawn on the path to insolvency.

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