MetMax Europe Zrt.
Hungary, Capital Goods

SCOPE B+ NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	519.5x	5.1x	6.9x	6.0x
Scope-adjusted debt/EBITDA	3.6x	6.7x	5.0x	5.3x
Scope-adjusted funds from operations/debt	26%	11%	16%	15%
Scope-adjusted free operating cash flow (FOCF)/debt	26%	14%	6%	8%

Rating rationale

MetMax Europe Zrt's B+ issuer rating is based on the assessments of the business risk profile, unchanged at B, and financial risk profile, downgraded to BB- from BB. The business risk profile remains constrained by the company's size, low diversification and high customer concentration, while profitability continues to be the major support. The downgraded financial risk profile reflects weaker credit metrics in 2021 and our expectation that they will not recover significantly in the near future.

Outlook and rating-change drivers

The expectation that credit metrics will not improve in the short term has driven the Outlook change to Negative. The Outlook also reflects the expectation of a weaker Scope-adjusted FOCF/debt of around 5% until 2023 based on the FOCF expected after the merger with Vagyonkezelő Kft. It also reflects the increased uncertainty regarding revenues in 2023 and assumes inflationary pressure on costs will lead to an EBITDA margin of around 20% in 2022-23, well below MetMax's 30% target. This will ultimately weaken leverage as measured by Scope-adjusted debt/EBITDA.

In order to return to a Stable Outlook, MetMax's Scope-adjusted FOCF/debt would need to be back at 5-10%. Scope may consider additional upside on the rating if Scope-adjusted FOCF/debt improved above 10% on a sustained basis e.g. due to the ability to drive revenue growth and/or EBITDA margins.

A negative rating action may be triggered by Scope-adjusted FOCF/debt falling below 5% on a sustained basis, due to lower revenues and/or EBITDA margins from rising staff costs or investment that goes beyond the current plan. In this context, we note that MetMax's senior unsecured bond issued under the Hungarian Central Bank's Bond Scheme has an accelerated repayment clause. The clause requires MetMax to repay the nominal amount (HUF 5bn) within 10 business days after the bond rating falls below a B-, which could have a default implication.

Rating history

Date	Rating action	Issuer rating & Outlook
11 Nov 2022	Outlook change	B+/Negative
7 Dec 2021	Affirmation	B+/Stable
27 Oct 2020	Initial rating	B+/Stable

Ratings & Outlook

Issuer	B+/Negative
Senior unsecured debt	B+

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Related Methodology and Related Research

Corporate Rating Methodology; July 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Strong operating profitability, with Scope-adjusted EBITDA margin at 20.2% in 2021, 32.5% in 2020 and 25.5% in 2019 • Adequate liquidity • Ability to drive revenue growth	• Minor niche player in European capital goods market (HUF 4.0bn in revenues in 2021) • Low product diversification and recurring revenues (aftermarket sales) • High customer concentration, with top four accounting for around 90% of revenues • Weak geographical diversification with high share of domestic sales • Risks from rising labour costs and exchange rate fluctuations • Key person risk (ESG factor)

Positive rating-change drivers	Negative rating-change drivers
• To return to a Stable Outlook, Scope-adjusted FOCF/debt would need to be back at 5-10% • We may consider additional upside on the rating if Scope-adjusted FOCF/debt improves above 10% on a sustained basis	• Scope-adjusted FOCF/debt sustained below 5%

Corporate profile

MetMax Europe Zrt. is a Hungarian metalworking company with a decades-long history. In 2016, it was acquired by a group of Hungarian private investors led by András Csoma. Now, MetMax is a strategic supplier to large international companies based in Europe. The company focuses on small to medium-sized series and employs about 130 people. Its key production site is in Györ. MetMax is currently significantly expanding its production capacity.

MetMax is a 100% subsidiary of CNC Tőkebefektető Kft, itself owned by Hungarian private individuals. The majority owner with around 54% is András Csoma, who is also MetMax's CEO. MetMax has no subsidiaries. On 31 December 2022, Vagyonkezelő Kft. will merge with MetMax, upon which it will be renamed MetMax Vagyonkezelő Kft. and thereafter cease to be a company. MetMax Europe Zrt. will become its legal successor and take on all assets and liabilities of MetMax Vagyonkezelő.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	1,047.7	519.5x	5.1x	6.9x	6.0x	6.3x
Scope-adjusted debt/EBITDA	0.3x	3.6x	6.7x	5.0x	5.3x	5.3x
Scope-adjusted funds from operations/debt	351%	26%	11%	16%	15%	16%
Scope-adjusted FOCF/debt	173%	26%	14%	6%	8%	5%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,184.0	1,402.6	815.8	1,099.7	949.4	948.1
less: capitalised development costs						
add: share-based compensation expense						
Scope-adjusted EBITDA	**1,184.0**	**1,402.6**	**815.8**	**1,099.7**	**949.4**	**948.1**
Funds from operations in HUF m						
EBITDA	1,184.0	1,402.6	815.8	1,099.7	949.4	948.1
less: (net) cash interest paid	-1.1	-2.7	51.5	-29.7	-38.7	-38.7
add: intra-group charges to parent/sister			-210.6	-129.3	-120.3	-111.3
less: cash tax paid per cash flow statement	-73.2	-91.8	-38.9	-45.1	-24.7	-18.5
less: pension interest						
add: share-based compensation expense						
Profit/loss on disposals						
Other	4.4	48.0	-6.1			
Funds from operations	**1,114.0**	**1,356.0**	**611.7**	**895.6**	**765.8**	**779.5**
Free operating cash flow in HUF m						
Operating cash flow	836.1	1,734.8	902.7	770.3	1,025.1	897.5
less: capital expenditure (net)	-288.0	-416.5	-137.8	-430.0	-650.0	-650.0
less: amortisation of leases						
Free operating cash flow	**548.1**	**1,318.2**	**764.9**	**340.3**	**375.1**	**247.5**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	1.1	2.7	-51.5	29.7	38.7	38.7
add: intra-group charges to parent/sister			-210.6	-129.3	-120.3	-111.3
add: interest component, pension						
Net cash interest paid	**1.1**	**2.7**	**159.0**	**159.0**	**159.0**	**150.0**
Scope-adjusted debt in HUF m						
Reported gross financial debt	175.5	5,000.0	5,000.0	5,000.0	5,000.0	5,000.0
less: cash and cash equivalents						
add: lease obligations	141.7	117.6				
add: pension adjustment						
Scope-adjusted debt	**317.3**	**5,117.6**	**5,500.0**	**5,500.0**	**5,500.0**	**5,500.0**

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Environmental, social and governance (ESG) profile[1]

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)

Key person risk

Key person risk is high. MetMax CEO András Csoma, who is responsible for daily operations and the execution of investment programme, is also its majority owner (54%).

[1] 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: BBB

MetMax is exposed to the capital goods industry as a manufacturer of investment goods. These include components for railway brake systems, vacuum pump components, gripper technique components and robot parts, components of pumps and electric motors, rotary encoder parts and burner nozzles. We deem this industry to have medium cyclicality, medium entry barriers and medium substitution risk. We therefore assess its industry risk at BBB.

Business risk profile still rated B

The business risk profile, with an unchanged rating of B, is constrained by the company's size, low diversification and high customer concentration but supported by its profitability.

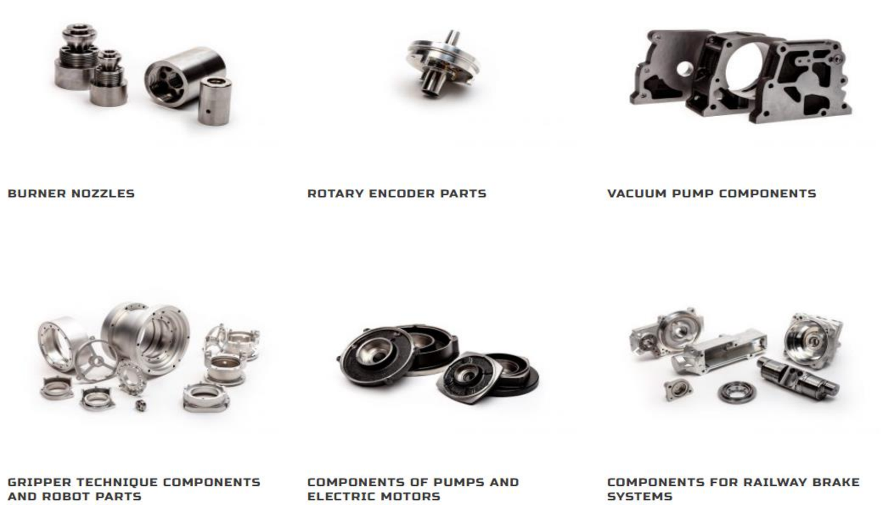
Small niche player in fragmented market

With revenues of around HUF 4.0bn in 2021 (around EUR 10m), MetMax is a minor niche player in the European capital goods market. More than 4,000 companies in Hungary are active in metalworking. Most of them supply to the automotive and consumer electronics industries, both of which are characterised by mass production, fierce price competition, and high cyclicality on their respective end-markets. MetMax focuses on traditional industrial segments and excludes automotive and consumer goods from its business. It is less involved in mass production as 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 lower automation but high value-added for customers. In such a fragmented market, customers choose suppliers based on quality, precision and reliability (just-in-time). MetMax is established in this market, with a proven ability to attract big-name customers, recently demonstrated by the acquisition of names such as Alfa Laval, DMG Mori Europe and PlanSee.

Concentrated product portfolio

MetMax has a concentrated product portfolio, indicated by its low revenue of around EUR 10m. It mainly produces high-precision, complex-toothed devices; parts in individual small/medium series; and high-complexity, high-quality machine parts. Its lack of aftermarket activities is credit-negative, however, as such activities come with lower volatility, high profitability and recurring sales.

Figure 1: Overview of some of MetMax's products



Source: MetMax

Limited geographical diversification

Geographical diversification of revenues is limited, with 61% generated in Hungary in 2021, though this is an improvement on the much smaller levels in preceding years.

Moreover, MetMax's production capacities are only in Hungary. Exchange rate risk is managed in part using a natural hedge: most of the price agreements and costs are in euro.

The distribution of sales into domestic/export provides only a partial picture of the parts and components supplied by MetMax. For instance, the 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.

Moderate diversification by end-market

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.

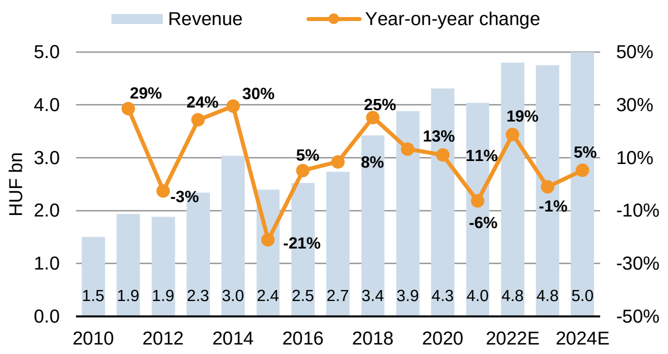
Substantial customer concentration

The key credit-negative for the business risk profile is the high customer concentration. While MetMax's products are strategically important for its customers, it remains dependent on a small number of customers. The top two represent around 60% of revenues and the top four, almost 90%.

Profitability supports business risk profile

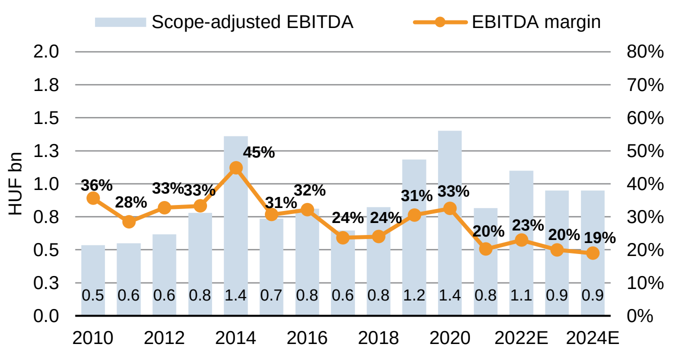
Profitability as measured by the Scope-adjusted EBITDA margin is still the major support for the business risk profile, even with its decrease in 2021 to 20.2% from 32.5% in 2020. The decrease was mainly due to a lower gross profit margin (47% in 2021 from 55% in 2020) due to higher materials costs in Q2. The change in the product mix also had a negative impact, with fewer products not containing raw materials (subcontracting). One-off costs regarding the relocation of production to a new facility had a negative impact on the gross profit margin by around 100 basis points.

Figure 2: **Revenues, 2010 to 2024E**



Source: MetMax, Scope (estimates)

Figure 3: **Scope-adjusted EBITDA (margin), 2010 to 2024E**



Source: MetMax, Scope (estimates)

Gross profit margin susceptible to metals prices

MetMax's gross profit margin is particularly vulnerable to changes in metals prices: raw materials and tool costs are around 25% of sales. MetMax sources raw materials with price escalation clauses, allowing price increases to be automatically passed on to customers, though this always comes with a time lag. According to MetMax, it is not facing a shortage of raw materials, only less availability and sometimes longer lead times.

Low exposure to gas and electricity sectors

The exposure to the gas and electricity sectors is of secondary importance at around 3% of 2021 revenues. According to MetMax this percentage will increase to around 7% in 2022, driven by recent price increases. In February, MetMax entered into a contract with a state-owned distributor that ensures its utility prices are hedged until 31 March 2024.

Higher staff costs weighed on margin in 2021

The around 14% increase in staff costs against previous year due to labour market conditions and inflation also weighed on profitability. The percentage of staff costs to revenue increased to 26% in 2021 compared to 21% previously. The shift of production from the old to the new facility also had a negative impact on profitability. It also explains part of the increase in the staff cost ratio, as the decreased production was not accompanied decreased staff costs. Furthermore, during the transfer process between November 2021 and March 2022, two sites were effectively in operation.

Lower revenues also put pressure on 2021 EBITDA

In addition to the higher costs, lower revenues also put pressure on EBITDA, which at HUF 816m in 2021 was well below the previous year's HUF 1.4bn. In 2021, revenues decreased by around 6% YoY to HUF 4.0bn due to a 14% YoY drop in domestic sales, reflecting lower demand from the railway segment. Export revenues in 2021 increased by 10% YoY.

Relocation to new facility had slightly negative impact on production

The relocation also had a slightly negative impact on production in the end-2021 period. The new production facility was completed in October 2021 and relocation started at the end of October and was technically completed in December 2021. MetMax estimates that the production ramp-up in the new facility, which needed until mid-March 2022, resulted HUF 500m-600m in lost sales.

Higher revenues in H1 2022 due to price increases and currency effects…

…but lower EBITDA due to higher staff costs

Despite the ramp-up at the new plant, revenues increased by 11% YoY at H1 2022 to HUF 2.4bn. The increase is due to price increases applied to major customers to offset rising raw materials and energy costs, supported by positive currency effects thanks to price agreements being in euro. Despite higher revenues, EBITDA in H1 2022 of around HUF 559m was slightly below the HUF 583m in H1 2021 due to the 24% YoY increase in staff costs. Positively, the gross profit margin improved in H1 2022 to 48.8% from 46.9% in H1 2021, driven by the aforementioned price increases for major customers. All in all, the EBITDA margin decreased to 23.0% in H1 2022 from 26.6% in H1 2021.

2022: revenues expected at HUF 4.8bn (+19% YoY) and EBITDA at HUF 1.1bn

For full-year 2022, we expect revenues of around HUF 4.8bn (+19% YoY), supported in H2 by the further depreciation of the forint against the euro and a 52% gross profit margin due to price increases to customers. However, higher staff costs by 10% in September 2022 will weigh on profitability, with the EBITDA margin forecast at around 23% and EBITDA at HUF 1.1bn.

2023: revenues expected at HUF 4.8bn and EBITDA at HUF 950m

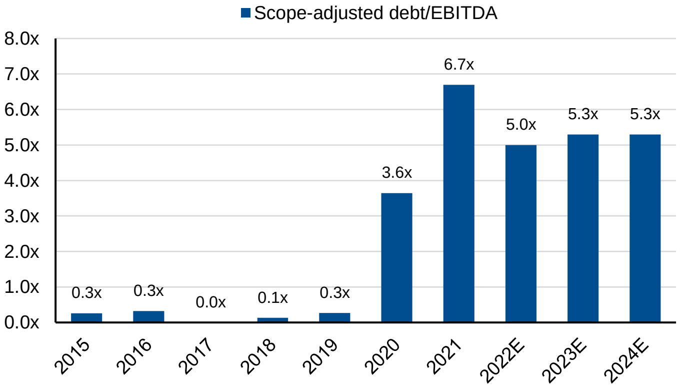
For 2023, revenue visibility is limited due to the short lead times on the order backlog (30-60 days). According to MetMax, two of its main customers expect higher demand, one expects stable volumes, and one expects lower volumes. We expect revenues of HUF 4.8bn and a higher gross profit margin due to rent expense saved with the move to the new facility (4-5% of 2020-21 revenues). We expect the inflationary environment to persist and personnel costs to continue to weigh on profitability. The EBITDA margin is expected at around 20% and EBITDA at HUF 950m.

Financial risk profile: BB-

Financial risk profile lowered to BB- from BB

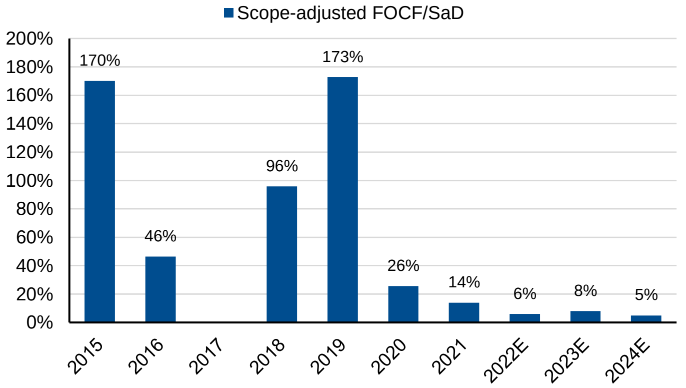
The downgrade of the financial risk profile to BB- from previously BB reflects weaker credit metrics in 2021 due to lower EBITDA as well as our expectation that credit metrics will not recover significantly in the near future. Leverage as measured by Scope-adjusted debt/EBITDA increased to 6.7x in 2021 (3.6x in 2020). Cash flow cover decreased to 14% in 2021 (26% in 2020).

Figure 4: **Scope-adjusted debt/EBITDA, 2015 to 2024E**



Source: MetMax, Scope (estimates)

Figure 5: **Scope-adjusted FOCF/SaD, 2015 to 2024E**



Source: MetMax, Scope (estimates)

Scope-adjusted debt/EBITDA to remain high; cash flow cover to decline around 5% after merger

We expect Scope-adjusted debt/EBITDA to improve due to a higher EBITDA. However, the leverage ratio will remain high at 5.0x-6.0x until 2023 as we do not expect MetMax to return to its targeted EBITDA margin of close to 30% due to the rise in inflation and personnel costs. We also expect cash flow cover of around 5% until 2023 based the expected post-merger FOCF.

Debt mostly comprises corporate notes

Reported financial debt of HUF 5.5bn at year-end 2021 largely comprises corporate notes of HUF 5bn issued in December 2020. MetMax also has a HUF 500m credit line from the NHP Hajrá programme as a three-year facility due in January 2024, of which HUF 111m was used to repay financial leases in 2021 and the rest to pre-finance the state subsidy for the investment programme. Scope-adjusted-debt was HUF 5.5bn at year-end 2021 against HUF 5.1bn at year-end 2020 (2020 amount adjusted for HUF 118m of leases).

Merger will add no debt

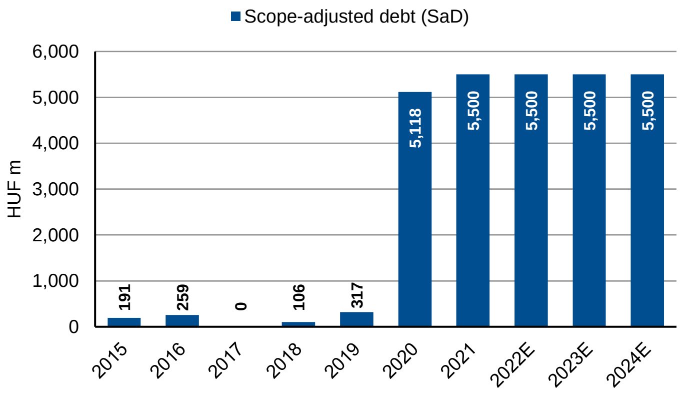
In 2020, MetMax initiated a HUF 5.0bn investment programme for five years. It was agreed with the Hungarian Investment Authority that the programme will be implemented at the level of the sister company, MetMax Vagyonkezelő Kft., a 100% subsidiary of CNC Tőkebefektető Kft, MetMax's parent company. Vagyonkezelő Kft. is merging with MetMax (effective 31 December 2022). The merger will not add debt as MetMax Vagyonkezelő financed the investment programme with intercompany loans and subsidies. We expect Scope-adjusted debt to remain unchanged at year-end 2022.

Investments to be financed from cash flow and subsidies

Scope-adjusted debt to remain stable into 2023

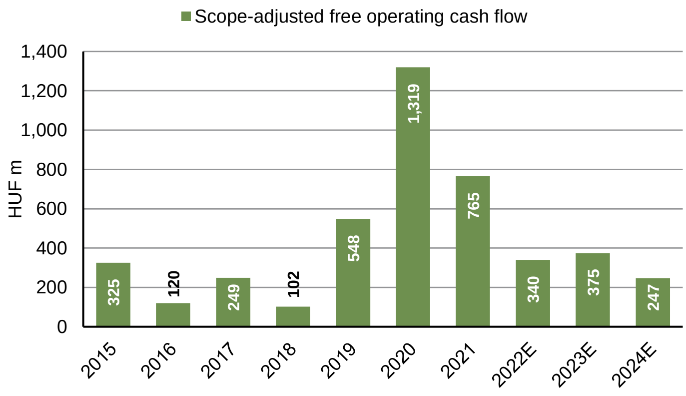
Following the merger, the investment programme will continue at MetMax. Around HUF 3.9bn has been so far invested as of July 2022. We expect the remaining HUF 1.1bn to be financed via cash flow and additional subsidies. As of 30 September 2022, MetMax Vagyonkezelő received HUF 1.19bn in subsidies out of an expected total of HUF 1.75bn. A further HUF 150m has been approved and will be paid in January 2023. MetMax expects to receive HUF 285m in 2023 and HUF 230m in 2024. We expect no additional debt in 2023 and Scope-adjusted debt to remain unchanged at year-end 2023.

Figure 6: Trend in Scope-adjusted debt



Sources: MetMax, Scope (estimates)

Figure 7: Trend in Scope-adjusted free operating cash flow



Source: MetMax, Scope (estimates)

Internal cash flow supports financial risk profile

Internal cash flow, with positive FOCF since 2013, continues to support the financial risk profile. In 2021, operating cash flow decreased to HUF 903m (2020: HUF 1.7bn), mainly due to lower EBITDA. This resulted in FOCF decreasing to HUF 805m against HUF 1.3bn in 2020. In H1 2022, operating cash flow was HUF 332m against HUF 368m in H1 2021. Due to higher capex, FOCF decreased to HUF 144m against HUF 327m in H1 2021.

Despite higher post-merger investments, we expect FOCF to remain positive at around HUF 340m in 2022 and HUF 375m in 2023. Here, we expect capex of around HUF 430m in 2022 and HUF 650m in 2023.

Capital allocation during 2021: HUF 1.5bn in intercompany loans to parent/sister companies

Regarding capital allocation, MetMax transferred a further HUF 1.5bn to parent/sister companies in 2021 in form of intercompany loans (around HUF 540m to CNC Tőkebefektető and HUF 880m to MetMax Vagyonkezelő). Intercompany loans therefore increased to HUF 7.2bn at year-end 2021 (HUF 7.5bn at end-June 2022). The additional money transfer was prompted by the merger with MetMax Vagyonkezelő. Due to this, assets were not leased to MetMax, no income stream was built in MetMax Vagyonkezelő, and investments were financed through intercompany loans. Money was also transferred to CNC Tőkebefektető to finance the acquisition of the minority share in CNC Tőkebefektető in 2021 from X Zrt. The capital transfer will cancel out upon consolidation after the merger. In 2022, we expect a capital transfer to CNC Tőkebefektető of HUF 270m. From 2023, we expect intercompany loans to reduce through dividends received from MetMax of HUF 300m a year.

Capital allocation during 2021: HUF 365m dividend payment

A further HUF 365m in intercompany dividends was transferred to CNC Tőkebefektető, of which dividends to be paid to ultimate shareholders (i.e. payable by CNC Tőkebefektető) were approved at HUF 240m. HUF 125m remained in CNC Tőkebefektető for the repayment of intercompany loans.

Limited protection from dividend stopper

For 10 years, dividends at the parent level will only be allowed when consolidated EBITDA exceeds HUF 800m, and only the portion exceeding HUF 800m can be used. The consolidated EBITDA was HUF 1.4bn in 2020. The protective effect of this dividend restriction, however, is rather limited as it applies to dividend payments to ultimate shareholders and still allows MetMax to distribute more than 100% of its forecasted net income to its parent.

No dividends in 2022, intercompany dividends in 2023-24; no dividends to ultimate shareholders before 2026

Due to the drop in EBITDA in 2021 (consolidated EBITDA was HUF 885.1m), MetMax has refrained from paying dividends in 2022. We expect intercompany dividends of around HUF 430m in 2023 and HUF 420m in 2024, paid by MetMax to CNC Tőkebefektető, which will be returned to MetMax through the repayment of intercompany loans and interest payments. Therefore the net cash effect will be zero. MetMax plans to resume dividend payments to ultimate shareholders in 2026.

Adequate liquidity

Liquidity and financial flexibility are ‘adequate’, which is supported in particular by the absence of major financial debt except for the bond with a 10-year maturity (amortising 10% every year during 2025-29, and 50% in 2030).

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	607	47	116
Open committed credit lines (t-1)	0	0	0
Free operating cash flow (t)	765	340	375
Short-term debt (t-1)	0	0	500
Coverage	**No short-term debt**	**No short-term debt**	**98%**

Cash sources

Liquidity comprises:

- Balance sheet cash of HUF 47m at end-December 2021 (HUF 44m at end-June 2022).
- For 2022 and 2023, FOCF of around HUF 340m and around HUF 375m
- Cash from subsidies of around HUF 285m in 2023 and HUF 230m in 2024

Cash uses

Expected cash uses include:

- Net capital transfer in the form of intercompany loans of HUF 270m in 2022; no further intercompany loans in 2023-24,
- No dividend payment to external shareholders in 2022-24, but dividends to CNC Tőkebefektető of around HUF 430m in 2023 and HUF 420m in 2024, which, however, flow back through the repayment of intercompany loans and interest; therefore, no effect on liquidity
- Repayment of HUF 500m in 2023; no debt repayments in 2024

Long-term debt rating

B+ senior unsecured debt rating

In December 2020, MetMax issued a HUF 5.0bn senior unsecured bond with a 10-year maturity (amortising at 10% each year during 2025-29, then at 50% in 2030) and a coupon of around 3% p.a. under the Hungarian Central Bank’s Bond Funding for Growth Scheme. Bond proceeds were transferred to sister company MetMax Vagyonkezelő (around HUF 2bn) for investments to expand production capacity and to parent company CNC Tőkebefektető (around HUF 3bn) to repay management buyout debt and acquisition debt.

In line with the affirmed issuer rating, we have affirmed the B+ senior unsecured debt rating based on ‘average’ recovery prospects in a simulated event of default.

In addition, MetMax has had a three-year HUF 500m credit line from the NHP Hajrá programme since 2021. This credit line is secured by pledges on selected machines. This line will mature in early 2024, but MetMax plans to repay it in 2023. In simulated point of default we assume that the credit line will be fully repaid. We assume the business plan and investment programme will be executed as planned with no additional bank debt or other senior ranking financings ahead of the planned bond. The merger of MetMax Vagyonkezelő with MetMax will add no debt, as MetMax Vagyonkezelő financed its investment programme with intercompany loans and subsidies. The merger will contribute around HUF 4.0bn in assets (around HUF 3bn in real estate).

After the merger, effective in 31 December 2022, the former guarantee by MetMax will be cancelled and a pledge placed on the property of MetMax to the benefit of the Hungarian Investment Promotion Agency. To determine claimholders, we ranked the repayment obligation for subsidies at the simulated point of default to be senior to the claims on the bond.

Our recovery analysis uses the liquidation value in a hypothetical default in 2024 of HUF 3.9bn. This value is based on a haircut 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.

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