MetMax Europe Zrt.
Hungary, Capital Goods

B STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	5.1x	5.9x	5.7x	4.1x
Scope-adjusted debt/EBITDA	6.7x	5.6x	6.1x	7.6x
Scope-adjusted funds from operations/debt	11%	15%	13%	10%
Scope-adjusted free operating cash flow/debt	10%	8%	4%	4%

Rating rationale

MetMax Europe Zrt.'s issuer rating of B is based on our assessments of its business risk profile, which is unchanged at B, and its financial risk profile, which we have downgraded to B+ from BB-. The gloomy overall outlook and the company's fragile business model given its product and customer concentration also played a role in this decision. 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 our revised expectation for profitability in 2023-24, now with weaker expected credit metrics.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that MetMax's Scope-adjusted free operating cash flow (FOCF)/debt ratio will remain between 0%-5% in 2023-24 and that MetMax will be able to manage its upcoming maturities (NHP Hajrá line due in January 2024 and bond redemption starting in 2025) using its cash flow. MetMax says it has started discussions with HIPA about the possible launch of a new programme to support the next five years of investment activity. Approval could lead to higher investments and burden cash flow coverage. Due to the uncertain outcome of these negotiations, we have not included this scenario in our current base case.

We could consider a positive rating action if the Scope-adjusted FOCF/debt ratio improved to above 5% on a sustained basis, e.g. due to revenue growth and/or improved profitability.

A negative rating action could be triggered if the Scope-adjusted FOCF/debt ratio turned negative on a sustained basis. This could be due to lower revenues and/or lower EBITDA margins from rising staff costs or capital allocation that goes beyond the current plan. Liquidity problems, especially against the backdrop of upcoming maturities, could also lead to a negative rating action. 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 B- (there is a two-year cure period for a B/B- rating), which could have default implications.

Rating history

Date	Rating action	Issuer rating & Outlook
6 Nov 2023	Downgrade	B/Stable
11 Nov 2022	Outlook change	B+/Negative
7 Dec 2021	Affirmation	B+/Stable

Ratings & Outlook

Issuer	B/Stable
Senior unsecured debt	B

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Related Methodology and Related Research

General Corporate Rating Methodology; October 2023

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Good operating profitability in a peer group context as measured by Scope-adjusted EBITDA margin • Adequate liquidity	• Minor niche player in European capital goods market (revenues of HUF 5.0bn in 2022) • 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
• Scope-adjusted FOCF/debt ratio above 5% on a sustained basis	• Scope-adjusted FOCF/debt ratio below 0% on a sustained basis

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. Today MetMax is a strategic supplier to large international companies based in Europe.

The company manufactures combustion nozzles, electric motor components, parts for railway brake systems, pumps, industrial clamping and gripping machines. It produces more than 4,000 parts overall with a focus on small to medium-sized series.

MetMax is a 100% subsidiary of CNC Tőkebefektető Kft., which is owned by Hungarian private individuals. The majority owner is MetMax's CEO András Csoma with a stake of around 54%. MetMax has no subsidiaries. The current circle of ownership defines itself as a long-term strategic investor. Its goal is to make MetMax a leading company in the Central and Eastern European metalworking market.

MetMax Vagyonkezelő Kft. merged with MetMax Europe effective 31 December 2022. Following the merger, MetMax Vagyonkezelő Kft. ceased to exist as a standalone company and MetMax Europe Zrt. was established in place of the two companies as the ultimate legal successor to MetMax Vagyonkezelő Kft. All assets and liabilities of MetMax Vagyonkezelő Kft. were automatically transferred to MetMax Europe Zrt.

The company employs about 145 people. It reported revenues of HUF 5.0bn in 2022.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	519.5x	5.1x	5.9x	5.7x	4.1x	4.8x
Scope-adjusted debt/EBITDA	3.6x	6.7x	5.6x	6.1x	7.6x	5.9x
Scope-adjusted funds from operations/debt	26%	11%	15%	13%	10%	13%
Scope-adjusted free operating cash flow/debt	26%	10%	8%	4%	4%	7%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,402.6	815.8	991.0	941.9	776.5	916.1
less: capitalised development costs						
less: non-cash items				-44.2	-64.9	-85.1
Scope-adjusted EBITDA	**1,402.6**	**815.8**	**991.0**	**897.7**	**711.5**	**831.0**
Funds from operations in HUF m						
EBITDA	1,402.6	815.8	991.0	897.7	711.5	831.0
less: (net) cash interest paid	-2.7	51.5	67.7	-22.5	-48.9	-57.1
add: intra-group charges to parent/sister		-210.6	-236.1	-134.7	-125.7	-116.7
less: cash tax paid per cash flow statement	-91.8	-38.9	-79.7	-36.0		-11.3
less: pension interest						
add: share-based compensation expense						
Profit/loss on disposals						
Other	48.0	-6.1	90.1			
Funds from operations	**1,356.0**	**611.7**	**833.1**	**704.5**	**536.9**	**646.0**
Free operating cash flow in HUF m						
Funds from operations	1,356.0	611.7	833.1	704.5	536.9	646.0
Change in working capital	115.8	224.1	-191.7	-124.0	44.7	-70.2
Non-operating cash flow	261.9	-169.1	63.9	209.8	229.7	57.9
less: capital expenditure (net)	-415.6	-97.6	-274.0	-559.7	-584.3	-274.1
Free operating cash flow	**1,318.1**	**569.1**	**431.2**	**230.6**	**227.1**	**359.5**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	2.7	-51.5	-67.7	22.5	48.9	57.1
add: intra-group charges to parent/sister		210.6	236.1	134.7	125.7	116.7
add: interest component, pension						
Net cash interest paid	**2.7**	**159.0**	**168.3**	**157.2**	**174.6**	**173.8**
Scope-adjusted debt in HUF m						
Reported gross financial debt	5,000.0	5,500.0	5,560.0	5,500.0	5,434.0	4,934.0
less: cash and cash equivalents						
add: lease obligations	117.6					
add: pension adjustment						
Scope-adjusted debt	**5,117.6**	**5,500.0**	**5,560.0**	**5,500.0**	**5,434.0**	**4,934.0**

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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

From a governance perspective, we still see a high risk to key personnel as we believe MetMax's business is still dependent on András Csoma, the CEO and majority owner (54%). However, we have a positive view on the transformation of the operational side of the organisation in general and the expansion of management in particular. MetMax has decided to establish a three-member board of directors structure instead of the current CEO-led structure. On 1 May 2023, András Sávos joined MetMax as a new member of the board of directors. The board of directors thus consists of Andras Csoma, Andras Savos and Ganor Nagy. Roles and responsibilities were clearly distributed among the members of the board to strengthen its focus and better utilise management capacity. At the board level, new authorised signatories were appointed among the second-level managers (head of finance, technical and quality) to increase the managers' personal involvement in decision-making and improve control functions.

[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 for 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 (unchanged at B) is constrained by the company's size, low diversification and high customer concentration. Yet it is supported by good profitability.

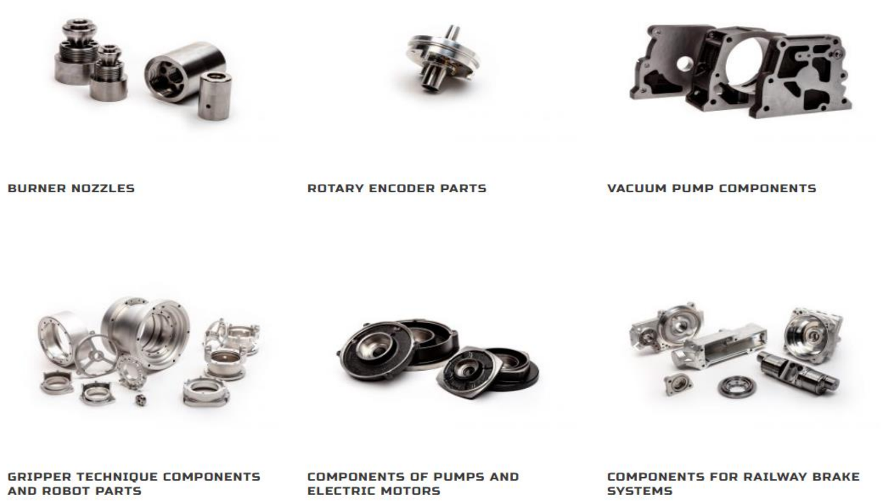
Small niche player in a fragmented market

With revenues of around HUF 5.0bn in 2022 (equivalent to around EUR 13m), 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 the automotive and consumer electronics industries, both of which are characterised by mass production, fierce price competition, and high cyclicality in 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 well established in this market, with a proven ability to attract big-name customers as recently demonstrated by the acquisition of names like Alfa Laval, DMG Mori Europe and PlanSee.

Concentrated product portfolio

MetMax has a concentrated product portfolio as indicated by its low revenue of around EUR 13m. 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 59% generated in Hungary in 2022, although this is an improvement over the much lower levels of preceding years. Moreover, MetMax's production capacities are only in Hungary. Exchange rate risk is partially managed using a natural hedge; most price agreements and costs are in euros.

The distribution of sales into domestic or export only provides a partial picture of the parts and components that MetMax supplies. For instance, its 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 factor for the business risk profile is 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 represent almost 90%.

Profitability still a major support for business risk profile

Profitability as measured by the Scope-adjusted EBITDA margin in the context of the peer group remains the main support for MetMax's business risk profile, despite another decrease in profitability in 2022.

Continuing pressure on labour costs weighed on profitability in 2022 …

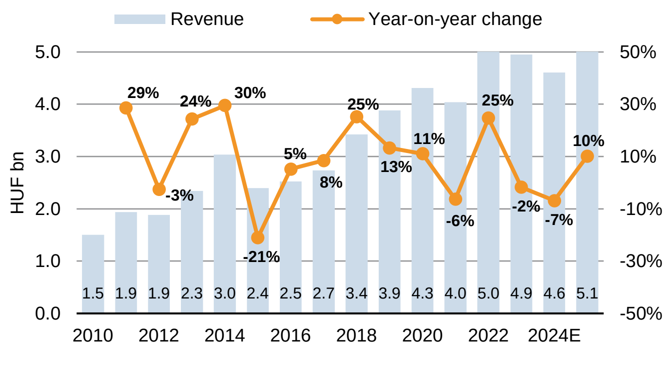
… in contrast, the gross profit margin stabilised at 47.0%

The Scope-adjusted EBITDA margin declined for the second year in a row in 2022, from 20.2% in 2021 to 19.7% in 2022. The decline is mainly due to continued pressure on wage costs as several salary rounds in 2022 led to a 31% increase in personnel costs compared to the previous year. High rates of overtime along with the usual Saturday shifts to clear order backlogs and provide additional volume to meet high demand also drove up personnel costs. In contrast, the gross profit margin stabilised at 47.0% (46.9% in 2021). This was thanks to higher costs for raw materials, tooling and energy due to higher procurement prices being offset by savings on purchased services, mainly due to lower rental costs as a result of MetMax moving into its own building.

Higher revenue more than offset lower profitability in 2022

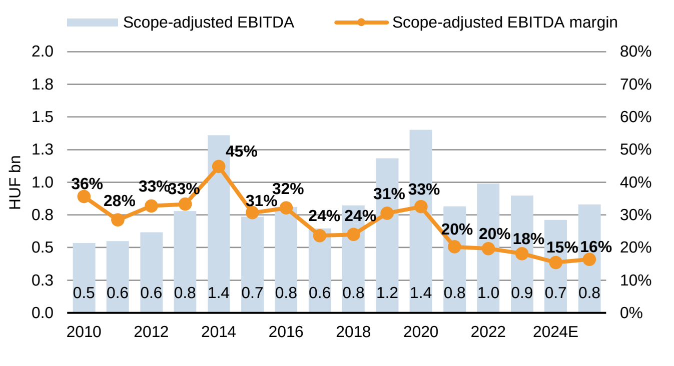
The roughly 25% increase in revenue to HUF 5.0bn in 2022 compared to HUF 4.0bn in 2021 more than offset the lower Scope-adjusted EBITDA margin, resulting in an improvement in Scope-adjusted EBITDA to HUF 991m in 2022 from HUF 815m in 2021.

Figure 2: Revenues, 2010 to 2025E



Source: MetMax, Scope (estimates)

Figure 3: Scope-adjusted EBITDA (margin), 2010 to 2025E



Source: MetMax, Scope (estimates)

We attribute the revenue increase in 2022 to three main factors: i) strong customer demand due to efforts to reduce pandemic backlogs among end customers and efforts to replenish inventories after the collapse of supply chains during the Covid period; ii) the depreciation of the Hungarian currency against the euro as 100% of the company's revenues are EUR-based; and iii) price increases for key customers implemented during 2022 to offset rising costs for raw materials and energy.

Higher revenue after H1 2023 driven by export sales while domestic volumes dropped

Based on unaudited figures, MetMax's revenue increased by 5.4% YoY to HUF 2.6bn after H1 2023 compared to HUF 2.4bn after H1 2022. Domestic sales were 10% lower YoY at HUF 1.3bn. Given price increases in early 2023 for its main customers, this points to a sharp drop in volumes in the first half of 2023. In contrast, export revenues increased by 31% YoY to HUF 1.2bn.

Another sharp increase in personnel costs weighed on profitability in H1 2023

Despite higher revenues, reported EBITDA of HUF 470m in H1 2023 was lower than last year's HUF 559m as another sharp increase in personnel costs (+25% YoY) weighed on MetMax's profitability. This is due to the fact that 2022 saw two salary increases (implemented in April and September), i.e. the base for H1 2022 is relatively low – and that the salary increase in 2023 was implemented in Q1, i.e. the data for H1 2023 partially includes the impact of the increase in 2023. Higher costs for raw materials and utilities led the gross profit margin to decline to 47.6% in the first half of 2023 compared to 48.8% in the first half of 2022, also negatively impacting profitability. Overall, the reported EBITDA margin fell to 18.4% in H1 2023 compared to 23% in H1 2022.

MetMax's full-year revenue guidance implies lower revenues in H2 2023

For the full year 2023, MetMax has guided for revenue growth of between -3% and +3%. Based on 5.4% revenue growth in the first half of 2023, this means that the company expects lower revenue growth in the second half of 2023. According to MetMax, this outlook reflects increased volatility in demand, with massive shifts needed each month and quarter to optimise customer stock levels. For 2023, we currently expect revenues of HUF 4.9bn.

We lack a track record for MetMax's 'Scale Up Strategy' launched in Q2 2023

MetMax expects to generate higher revenues in 2024 by acquiring new customers as part of the 'Scale Up Strategy' it launched in Q2 2023. The strategy focuses on active business development and sales rather than passive management of incoming enquiries. According to MetMax, various new customer acquisitions are at different stages, from the evaluation of offers/negotiations to the start of prototype construction, sample orders or even series orders. Although we are positive about this strategy in the long term, at this stage we lack a track record and especially clarity on how many clients will be acquired and how much they will contribute to revenues.

We have factored in revenues of HUF 4.6bn for 2024

The current outlook for 2024 is very uncertain and has recently deteriorated. Due to relatively short lead times (30-60 days on average), the current order backlog does not provide any visibility into 2024. Given the company's fragile business model, with its high product and customer concentration, we see increased risks for 2024 and have factored in lower revenue of HUF 4.6bn for 2024.

Expectation for Scope-adjusted EBITDA margin revised downwards

Considering the continued pressure from rising personnel costs, we have revised our expectation for the Scope-adjusted EBITDA margin downwards, and we forecast this margin will remain well below 20%. We see the Scope-adjusted EBITDA margin at 18% in 2023, which translates into Scope-adjusted EBITDA of around HUF 900m. This expectation assumes a slightly higher gross profit margin in the second half of 2023, supported by: i) the price increases negotiated in the first half of 2023; and ii) the impact of falling raw materials prices, which will become evident in the second half of the year as some of the materials used in the first half were purchased at higher prices in 2022. Profitability is also expected to benefit from slightly lower staff costs in H2 2023 compared to H1 2023. This is because there will be less overtime in H2 2023 compared to H1 2023 and because MetMax has reduced its headcount by around 5% in H2 2023 due to a weaker revenue outlook and a significant decline in certain project areas that mainly require manual labour (deburring). These effects are mitigated by an average salary increase of 10.5% implemented in Q1 2023.

MetMax plans to reduce its material costs to improve profitability

MetMax is currently working on a strategy it will introduce in H1 2024 to return to its long-term profitability target of a 25% EBITDA margin. In our conversation with MetMax, we understood that the company considers improving the gross profit margin by reducing material costs to be the main lever to achieve its 25% EBITDA margin target.

Innovation and renegotiations should improve profitability in the long term

In the long term, the improvement in the gross profit margin could be achieved through technology innovation, new tooling development or renegotiating raw materials purchasing schemes (and prices), for example.

In the medium term, savings should help improve gross margin by up to 5% by 2025

In order to improve its gross profit margin in the medium term, the company says it has launched a number of internal projects to increase efficiency, which it expects to improve the margin by up to 5% by 2025 (the full impact is not expected until the 2025 figures). These measures are aimed primarily at the following cost factors: i) tooling cost savings (approx. 1.5% margin impact planned until 2025); ii) internal quality cost savings (approx. 1.5%-2% margin impact planned until 2025); and iii) onsite renewable energy supply (approx. 3.5%-5% margin impact planned until 2025 in multiple phases).

Two ongoing photovoltaic projects should help reduce energy costs

As a result of the significant changes in the energy market in recent years, energy costs have become the third most important cost factor after labour and raw materials costs, with a revenue share of around 6% in 2022. MetMax signed a 24-month electricity purchase contract with a state-owned distributor in February 2022. The pricing is around 0.17 EUR/kWh (compared to the previous 0.05 EUR/kWh), so MetMax is hedged against utility price changes until 31 March 2024. Moreover, MetMax is currently in the process of implementing a photovoltaic power plant with roughly 1.7MwP, partly using the roof of the production hall and partly using the roughly 1 ha development area owned by MetMax adjacent to the production hall. There are two projects. The first is expected to go into production in 2023, and the second is expected to go into production during Q2 or Q3 of 2024. According to preliminary calculations, the two projects together can cover about 40% of MetMax's energy needs.

Pace and extent of improvement not clear yet

Staff costs will continue to weigh on profitability in 2024

Although we are positive about the company's efforts to improve its profit margin, we want to wait and see the pace and extent of the improvement before including it in our base case. For 2024, we expect inflationary pressures to persist and staff costs to rise, albeit at a slower pace than in 2022-23. We expect a Scope-adjusted EBITDA margin of around 15.5% in 2024, which translates into Scope-adjusted EBITDA of around HUF 710m.

Financial risk profile: B+

Financial risk profile lowered to B+ from BB-

The downgrade of the financial risk profile to B+ from BB- reflects our revised expectation for profitability in 2023-24, now with weaker expected credit metrics.

Reported financial debt of HUF 5.56bn at year-end 2022

The company's reported financial debt of HUF 5.56bn at year-end 2022 largely comprises corporate notes of HUF 5bn issued in December 2020. Bond proceeds of around HUF 2bn were transferred to sister company MetMax Vagyonkezelő Kft. for investments to expand production capacity, while around HUF 3bn was transferred to parent company CNC Tőkebefektető Kft. mainly to refinance existing debt.

In addition, MetMax has a HUF 500m credit line from the NHP Hajrá programme as a three-year facility (to mature in January 2024). HUF 111m under this credit line was used to repay existing financial leases in 2021. The rest was used to pre-finance the state subsidy for the investment programme in H2 2021.

After repayment in 2021, MetMax no longer has any lease obligations.

As regards factoring, MetMax has a programme with BNP Paribas Dublin and with Raiffeisen Bank Hungary. Under these programmes, receivables are sold without recourse and are therefore not included in the Scope-adjusted debt (SaD) calculation.

In addition, we do not include received subisidies of HUF 1.75bn in the SaD calculation due to the low probability of repayment.

SaD was HUF 5.6bn at year-end 2022 vs HUF 5.5bn at year-end 2021.

Merger of Vagyonkezelő Kft. with MetMax Europe did not create any additional debt

At the end of 2022, MetMax Europe completed the merger of Vagyonkezelő Kft. with MetMax Europe. The merger did not create any additional debt as MetMax Vagyonkezelő Kft. financed its investment programme with intra-group loans from MetMax Europe and subsidies.

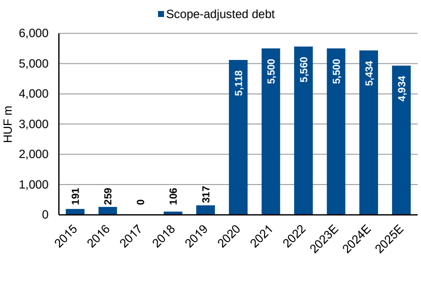
MetMax has agreed on a green financing facility of up to HUF 434m

H1 2023 saw MetMax agree on a green financing facility of up to HUF 434m with Raiffeisen Bank for the construction of photovoltaic power plants. This line is due in December 2023. It has a fixed interest rate of 5% (HUF basis) as part of the EXIM Bank-refinanced Baross Gábor programme. The line is currently undrawn and open for disbursement until 31st December 2024. We expect MetMax to call this line in 2024.

Scope-adjusted debt of around HUF 5.5bn expected in 2023-24

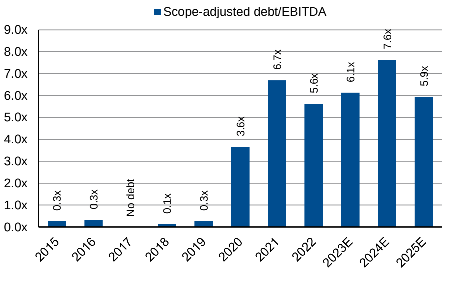
We expect no additional debt to be raised in 2023 and see SaD at around HUF 5.5bn at year-end 2023 and HUF 5.4bn at year-end 2024.

Figure 4: Scope-adjusted debt, 2015 to 2025E



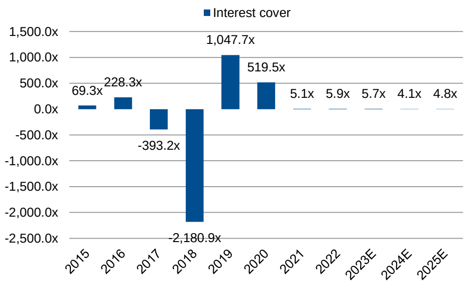
Sources: MetMax, Scope

Figure 5: Scope-adjusted debt/EBITDA, 2015 to 2025E



Sources: MetMax, Scope (estimates)

Figure 6: Scope-adjusted EBITDA interest cover, 2015 to 2025E



Sources: MetMax, Scope (estimates)

Leverage to increase in 2023-24 vs 2022

Leverage as measured by the Scope-adjusted debt/EBITDA ratio improved to 5.6x in 2022 from 6.7x in 2021, driven by the increase in Scope-adjusted EBITDA as higher revenue more than offset the lower margin. Based on our revised expectations for Scope-adjusted EBITDA and the expected increase in SaD in 2024, we see the Scope-adjusted debt/EBITDA ratio at around 6.0x in 2023 and around 7.5x in 2024.

We consider the "gross interest" expense when calculating the interest coverage ratio

Due to higher Scope-adjusted EBITDA, the interest coverage ratio improved slightly to 5.9x in 2022 compared to 5.1x in 2021. Proceeds from the bonds were transferred to sister company MetMax Vagyonkezelő Kft. (approx. HUF 2bn) and parent company CNC Tőkebefektető Kft. (approx. HUF 3bn). MetMax Europe Zrt. (the bond issuer)'s interest payments on the bond were then offset by interest payments from the parent and sister company, and the "net" interest line in MetMax Europe's P&L was more or less "zero". After the consolidation of MetMax Vagyonkezelő Kft. (the merger took effect on 31 December 2022), MetMax Europe will only pass on the interest accrued on the bond to the parent company (for taking over the acquisition financing), so the "net" interest line in MetMax Europe's P&L is no longer "zero". That said, given that the parent has no operations of its own and its ability to pay depends on dividends from MetMax Europe Zrt., we consider the "gross interest" expense and not the "interest net" due to intra-group charges. This results in an interest coverage ratio of around 5.5x in 2023 and around 4.0x in 2024. Since there is almost no debt apart from the fixed-interest bond, there is no interest rate risk either.

Internal cash flow generation supports financial risk profile

Internal cash flow generation, with positive Scope-adjusted FOCF since 2013, is a supportive factor for MetMax Europe's financial risk profile.

Higher Scope-adjusted FFO but lower Scope-adjusted FOCF in 2022 vs 2021

In 2022, Scope-adjusted FFO increased to around HUF 833m from HUF 612m in 2021, supported by higher Scope-adjusted EBITDA. In contrast, the Scope-adjusted FOCF of MetMax Europe (excluding MetMax Vagyonkezelő Kft.) decreased to HUF 431m in 2022 from HUF 569m in 2021, due to the increase in inventories and higher investments.

Reported FOCF after H1 2023 below the previous year's level

In H1 2023, unaudited reported FOCF was HUF 63m (HUF 144m in H1 2022). This was because higher capital expenditure (HUF 435m in H1 2023 compared to HUF 188m in H1 2022) impacted FOCF due to the consolidation of MetMax Vagyonkezelő Kft.

HIPA programme is coming to an end

As most of the investments under the HIPA programme have already been made by MetMax Vagyonkezelő Kft. and the HIPA programme is coming to an end, we expect lower investments of around HUF 600m per year in 2023-24. In 2020 MetMax initiated a HUF 5.1bn investment programme over a period of five years, comprising real estate (HUF 2.2bn) and new machinery purchases (HUF 2.8bn). As agreed with HIPA (Hungarian Investment Authority), this programme has been implemented at the level of the sister company, MetMax Vagyonkezelő Kft., a 100% subsidiary of CNC Tőkebefektető Kft. Following the merger of Vagyonkezelő Kft. with MetMax Europe (effective 31 December 2022), the investment programme will continue at MetMax Europe. According to MetMax, the company has invested around HUF 4.3bn under this investment programme until June 2023, thus completing most of the investment programme. Of the total budget based on the HIPA contract, MetMax still has around HUF 0.8bn to spend.

We expect inventories to normalise gradually in 2023-24

We expect inventories to normalise gradually in 2023 and 2024. They have increased significantly in recent years due to deteriorating supply chain flexibility, reflected in an inventory-to-revenue ratio of around 19% in 2021-22 compared to 17% in 2020 and 15% in 2019. As the supply side appears to be normalising in 2023, we expect MetMax will gradually return to normal stock levels over the next few years. MetMax plans to decrease its inventory-to-revenue ratio by one percentage point each year until its target of 15% is reached. However, this also depends on the development of its customer base and/or the logistical models it applies. In general, MetMax could build up inventory if: i) there is a takeover guarantee from a customer; ii) a larger scale of manufacturing has significantly higher economies of scale than the cost of inventory. The ratio of trade receivables to revenue declined from over 11% before 2020 to 4%-6% in 2020-22 due to the use of non-recourse factoring instruments, which started in 2020. Since non-recourse factoring instruments are still in use, we forecast the ratio of trade receivables to revenue will be below 11%.

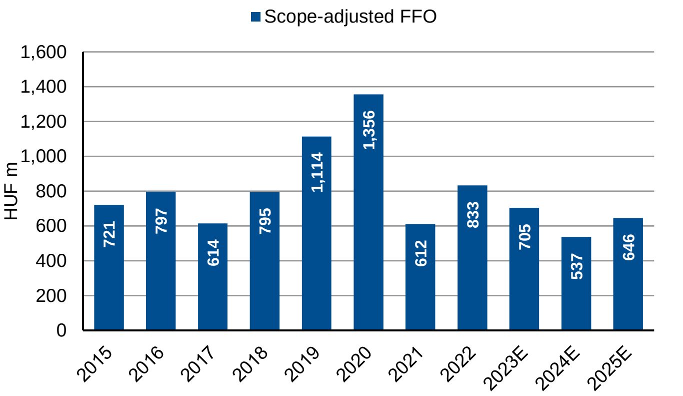
Scope-adjusted FOCF in 2023-24 to be around HUF 230m, well below the 2022 level

For 2023 as a whole, we expect Scope-adjusted FOCF to remain positive at around HUF 230m, although this is well below the 2022 level. We do not expect the gradual normalisation of NWC to offset the expected weaker revenues or the downward revision of the Scope-adjusted EBITDA margin, and we see Scope-adjusted FOCF relatively unchanged at around HUF 230m in 2024.

Discussions with HIPA about the possible launch of a new programme; outcome uncertain

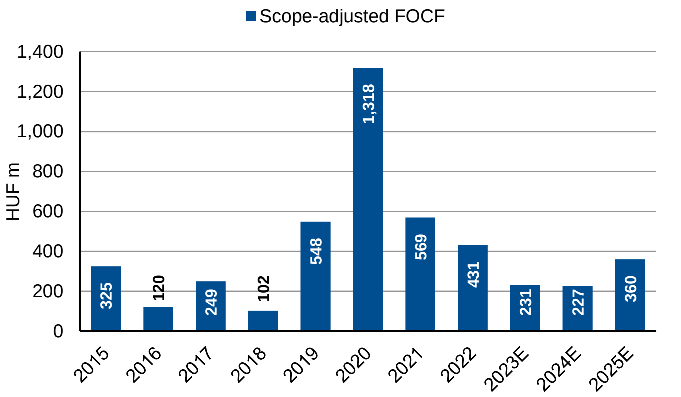
MetMax tells us that it has started discussions with HIPA about the possible launch of a new programme to support the next five years of investment activity. MetMax does not expect the negotiations to yield any results before H2 2024. Approval could lead to higher investments and burden cash flow coverage. Due to the uncertain outcome of these negotiations, we have not included this scenario in our current base case.

Figure 7: **Scope-adjusted FFO, 2015 to 2025E**



Source: MetMax, Scope (estimates)

Figure 8: **Scope-adjusted FOCF, 2015 to 2025E**



Source: MetMax, Scope (estimates)

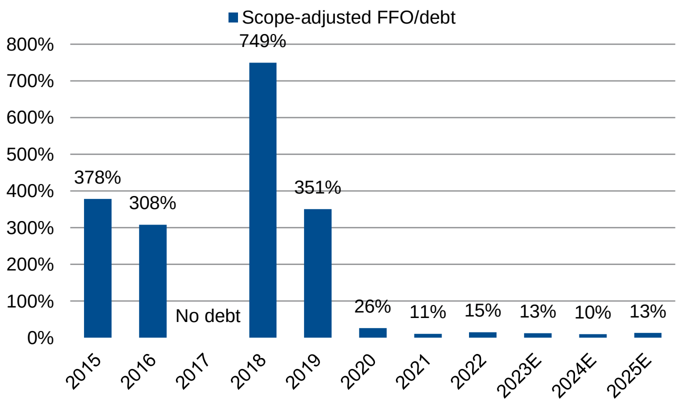
Scope-adjusted FFO/debt ratio in the 10-15% range for 2023 and 2024

Supported by higher Scope-adjusted FFO, the Scope-adjusted FFO/debt ratio improved to 15% in 2022 from 11% in 2021. We expect a Scope-adjusted FFO/debt ratio in the range of 10-15% for 2023 and 2024.

Cash flow cover below 5% in 2023 and 2024

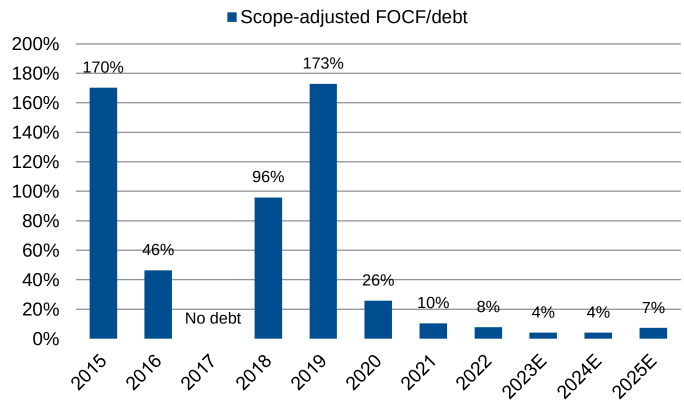
Cash flow cover (excluding the consolidation of MetMax Vagyonkezelő Kft.) decreased slightly from 10% in 2021 to 8% in 2022 due to lower Scope-adjusted FOCF. Based on our current expectations for Scope-adjusted FOCF, we see cash flow cover at below 5% in 2023 and 2024.

Figure 9: Scope-adjusted FFO/debt, 2015 to 2025E



Sources: MetMax, Scope (estimates)

Figure 10: Scope-adjusted FOCF/debt, 2015 to 2025E



Sources: MetMax, Scope (estimates)

Further capital transfer to parent and sister company during 2022

Regarding capital allocation, we note that MetMax Europe made an additional transfer of around HUF 498m during 2022. Of this, around HUF 185m went to its parent company CNC Tőkebefektető Kft. while around HUF 313m went to MetMax Vagyonkezelő Kft. in the form of intercompany loans. Subsequently, the total amount of intercompany loans increased to HUF 7.7bn at year-end 2022 (from HUF 7.2bn at year-end 2021). With the merger of MetMax Vagyonkezelő Kft. and MetMax Europe, around HUF 3.2bn of capital transferred to MetMax Vagyonkezelő Kft. has been consolidated away.

Dividend stopper in place for a period of 10 years

There is a dividend stopper in place for a period of 10 years. It specifies that dividends paid by the parent to ultimate shareholders are only permissible if consolidated EBITDA at the level of CNC Tőkebefektető Kft exceeds HUF 800m – and only the part exceeding HUF 800m can be used for dividend payments. Consolidated EBITDA in 2022 was HUF 991.6m, which left room for a dividend of HUF 91.6m. However, MetMax has decided not to pay a dividend in 2023, just as it did in 2022. According to MetMax, the company could resume dividend payments to ultimate shareholders depending on cash flow and the fulfilment of the EBITDA covenants set out in the bond prospectus. Based on our expectations for 2023-24, we have not included this dividend payment in our base case scenario.

Dividend stopper does not apply to the dividend paid to CNC Tőkebefektető Kft.

The dividend stopper does not apply to the dividend paid to the parent company for the annual repayment of intercompany loans and interests. Thus, these dividends are returned to MetMax Europe Zrt. through the repayment of intercompany loans and interest payments and have a zero net cash effect.

Adequate liquidity

We consider MetMax Europe Zrt.'s liquidity and financial flexibility to be 'adequate', supported by 100% coverage of upcoming maturities from available cash, particularly the NHP Hajrá line due in January 2024 and the bond redemption starting in 2025 (10% each year between 2025 and 2029 and 50% in 2030).

Balance in HUF m	2022	2023E	2024E
Unrestricted cash (t-1)	47	256	427
Open committed credit lines (t-1)	0	0	0
Free operating cash flow (t)	431	231	227
Short-term debt (t-1)	0	0	500
Coverage	**No short-term debt**	**No short-term debt**	**131%**

Cash sources

Liquidity comprises:

MetMax Europe Zrt.'s liquidity at end-December 2022 comprised:

- Cash on balance sheet of HUF 254m (HUF 235m at end-June 2023).
- We expect Scope-adjusted FOCF of around HUF 230m in 2023-24.
- The total amount of subsidies received at year-end 2022 was HUF 1.19bn out of an expected total of HUF 1.75bn. We have factored in cash receipts from subsidies of around HUF 285m in 2023 and around HUF 230m in 2024.

Cash uses

Expected cash uses include:

- No dividend payments to external shareholders in 2023-24, but dividends to CNC Tőkebefektető Kft. of around HUF 435m in 2023 and HUF 425m in 2024. However, these flow back through the repayment of intercompany loans and interest and have no effect on liquidity.
- No debt repayments in 2023. Repayment of the HUF 500m NHP Hajrá line due in January 2024 and the bond redemption starting in 2025 (10% each year between 2025 and 2029 and 50% in 2030).

Long-term debt rating: B

Senior unsecured debt rating: B

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 downgraded issuer rating, we have downgraded the senior unsecured debt rating to B. The senior unsecured debt rating is still based on 'average' recovery prospects in a simulated event of default.

Our recovery analysis uses a liquidation value of HUF 4.1bn in a hypothetical default in 2025. This value is based on a haircut on the assets and reflects liquidation costs of 10% for the assets. 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 a payment default.

MetMax says it agreed on a green financing facility of up to HUF 434m from Raiffeisen Bank in H1 2023. This credit line is a senior secured facility. We assume that this line will be drawn in a hypothetical default scenario.

We also 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 with MetMax Vagyonkezelő Kft. did not generate any additional debt as MetMax Vagyonkezelő financed its investment programme with intra-group loans and subsidies. However, the merger raised about HUF 5.0bn in assets (about HUF 4.5bn in real estate).

After the merger of MetMax Europe and its sister company MetMax Vagyonkezelő Kft. (effective 31 December 2022), the guarantee previously provided by MetMax Europe was cancelled and a pledge was placed on the property of MetMax Europe to the benefit of HIPA, the Hungarian Investment Promotion Agency. To determine claimholders, we have ranked the repayment obligation for subsidies at the simulated point of default senior to the claims on the prospective bond.

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