NATURTEX Kft.
Hungary, Consumer Products

B+ NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023P**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	34.8x	73.4x	5.0x	4.7x
Scope-adjusted debt/EBITDA	5.8x	10.9x	5.8x	5.4x
Scope-adjusted funds from operations/debt	15%	9%	11%	12%
Scope-adjusted free operating cash flow/debt	10%	3%	0%	-3%

Rating rationale

Naturtex's business risk profile (assessed at B+) benefits from its relatively high operating profitability, a strong international profile and its adequate brand strength of its products in the domestic market. However, due to the challenging macroeconomic environment, high inflation continues to put pressure on Naturtex's sales and profitability, which is why we expect the company's Scope-adjusted EBITDA margin to remain at around 10% in 2024-2026. The business risk profile is hampered by the company's low market share and diversification, despite strong geographic diversification, as the company remains small and exposed to a single product category.

The financial risk profile (assessed at B+) benefits from a relatively strong interest cover supported by favourable fixed interest rates and adequate liquidity. It is constrained by the company's high leverage and low cash flow cover, which are expected to bottom out in 2023. From then on, we expect all credit metrics to improve partly due to the decrease in Naturtex's Scope-adjusted debt, as the company will no longer have to guarantee its subsidiary's debt of HUF 1.6bn.

Outlook and rating-change drivers

The Outlook for Naturtex is Negative, reflecting our view that the subdued demand and high inflation environment is likely to negatively impact operating profitability going forward. We expect Naturtex's leverage to peak at over 10x in 2023, before recovering towards 6x thereafter.

A downgrade could occur if Scope-adjusted debt/EBITDA remains at or above 6x, for example, due to continued challenging market conditions.

A positive rating action, expressed as a return to a Stable Outlook, could be warranted if Scope-adjusted debt improves to below 6x on a sustained basis; further rating upside is currently deemed remote.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
24 Apr 2024	Outlook change	B+/Negative
25 Apr 2023	Affirmation	B+/Stable
19 Apr 2022	Affirmation	B+/Stable

Ratings & Outlook

Issuer	B+/Negative
Senior unsecured debt	B+

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Related Methodologies and Related Research

General Corporate Rating Methodology; October 2023

Consumer Products Rating Methodology; November 2023

ESG considerations for credit ratings of consumer goods companies

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Relatively strong interest cover backed by favourable fixed interest rate debt instruments • Healthy domestic market position with acceptable profitability margins in the long term • Solid geographical diversification and distribution platforms • Domestically known brand name	• Small private company operating in an industry with cyclical characteristics and seasonal volatility • Significant material and staff costs increases, causing stress on 2023P and medium-term profitability • High leverage complemented by a long-term bank guarantee for NTT Manufacturing, which is assumed to cease in 2024 • Volatile free operating cash flow due to substantially negative working capital effects

Positive rating-change drivers	Negative rating-change drivers
• Return to Stable: Scope-adjusted debt/EBITDA below 6x	• Downgrade: Scope-adjusted debt/EBITDA at or above 6x

Corporate profile

Naturtex Gyapjú- és Tollfeldolgozó Kft’s (Naturtex) core business is the production of duvets and pillows filled with goose feathers and down as well as bedding using other natural and synthetic fibres. The company operates four plants in Hungary and exports to more than 45 countries. It employs around 150 people and had a turnover of around HUF 10bn (EUR 26m) in 2022. Naturtex is headquartered in Szeged, Hungary, and is 100% family owned.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023P**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	12.6x	34.8x	73.4x	5.0x	4.7x	5.0x
Scope-adjusted debt/EBITDA	5.8x	5.8x	10.9x	5.8x	5.4x	5.2x
Scope-adjusted funds from operations/debt	15%	15%	9%	11%	12%	13%
Scope-adjusted free operating cash flow/debt	-10%	10%	3%	0%	-3%	-2%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,375	1,613	795	802	841	882
Operating lease payments	155	188	190	199	209	220
Other items[1]	-237	-686	-367	-240	-252	-264
Scope-adjusted EBITDA	**1,292**	**1,115**	**618**	**761**	**798**	**838**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,292	1,115	618	761	798	838
less: (net) cash interest paid	-103	-32	-8	-152	-171	-169
less: cash tax paid per cash flow statement	-15	-83	-59	-26	-21	-27
Other items[2]	-54	-8	40	-110	-104	-82
Funds from operations (FFO)	**1,119**	**992**	**591**	**473**	**502**	**559**
Free operating cash flow in HUF m						
Funds from operations	1,119	992	591	473	502	559
Change in working capital	-1,711	-250	431	141	-74	-65
Non-operating cash flow	759	1,041	-89	-	-	-
less: capital expenditure (net)	-799	-1,007	-585	-450	-400	-400
less: lease amortization	-116	-141	-142	-149	-157	-165
Free operating cash flow (FOCF)	**-748**	**634**	**206**	**14**	**-129**	**-70**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	64	-15	-39	102	118	114
add: interest component, operating leases	39	47	47	50	52	55
Net cash interest paid	**103**	**32**	**8**	**152**	**171**	**169**
Scope-adjusted debt in HUF m						
Reported gross financial debt	5,069	3,872	4,160	3,433	3,258	3,225
less: cash and cash equivalents	-1,913	-1,500	-1,825	-1,271	-1,152	-1,230
add: non-accessible cash	1,913	1,500	1,825	1,271	1,152	1,230
add: operating lease obligations	775	942	949	996	1,046	1,099
Other items[3]	1,609	1,609	1,609	-	-	-
Scope-adjusted debt (SaD)	**7,453**	**6,424**	**6,718**	**4,429**	**4,304**	**4,324**

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

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

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

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

Credit neutral ESG impact

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

The company emphasises sustainability in its ESG strategy as it strives to primarily utilise renewable energy for its energy consumption needs (it has already invested in a solar energy park, accounting for 10-15% of Naturtex's energy consumption). The company also has a dedicated R&D facility that has developed products and packaging using recycled and recyclable materials.

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

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

Business risk profile: B+

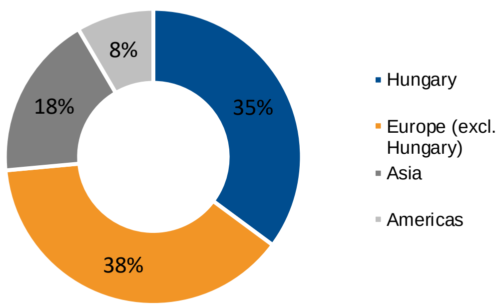
Industry risk profile: BB

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

Naturtex's B+ business risk profile continues to be supported by acceptable profitability margins, a strong geographical diversification and distribution platform together with a domestically well-known brand for a small company. Despite a healthy domestic market share (estimated at 35% by the company, excluding bedding sales of IKEA), Naturtex is not protected from price competition in a fragmented market, since most of its revenue comes from export markets. As a player in the discretionary consumer products industry, the company is exposed to medium cyclicality as evidenced by the volatile net sales in the past five years. In 2023 sales decreased by 20% also putting pressure on profitability.

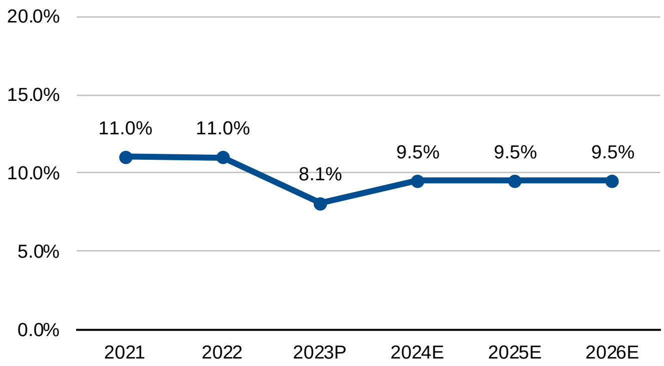
While Naturtex has many different products, they are all part of the bedding category, making the company exposed to a single industry. Naturtex has developed a good distribution network over time, with more than 250 resellers, 13 franchise partners and several partnerships with national hypermarket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

Figure 1: Sales by continent, 2022



Sources: Naturtex, Scope

Figure 2: Scope-adjusted EBITDA margin development



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

Scope-adjusted EBITDA margin around 9.5% with seasonal patterns

The decline of sales combined with the high inflationary environment negatively impacted the Scope-adjusted EBITDA margin which declined to 8.1% from 11-13% in previous years. The Scope-adjusted EBITDA margin is expected to remain at around 9.5% as the unfavourable macroeconomic factors prevalent in 2023 are expected to continue to put pressure on profitability in the future.

Following years of production upgrades and investments, technological standards are good and include a high degree of automation. The fact that Hungarian goose down and feathers have a special quality and image on the global market helps Naturtex to price its products in the premium category. Forex volatility (US dollar and euro in particular) is mainly hedged through natural hedging in addition to futures, as export sales cover most material costs. In addition to yearly volatility in demand (typical for durable consumer products), the company is also exposed to substantial seasonal cyclicality, with the majority of sales occurring in the last quarter of each year.

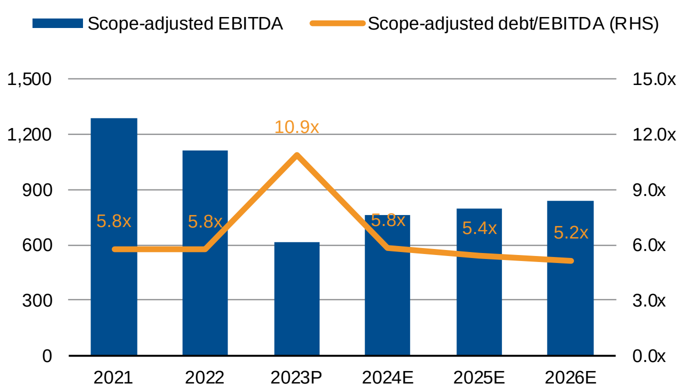
Financial risk profile: B+

Credit metrics deteriorated in 2023 due to the combined negative effects of the significant loss in sales and the decline in profitability margin. Although the downward pressure is expected to persist on both sales and profitability, credit metrics are forecasted to improve as Scope-adjusted debt is to decrease due to the relief of the HUF 1.6bn guarantee from 2024 onwards (because NTT Manufacturing Kft., subsidiary of Naturtex, has fulfilled its contractual obligations based on its 2023 preliminary financial statements for Naturtex to stop providing the guarantee).

Naturtex's financial risk profile (assessed at B+) continues to benefit from the strong interest cover which is supported by the favourable fixed interest rates of the largest debt balances (existing HUF 2.8bn bond and Baross Gabor loan). Interest cover is expected to drop to around 5x in 2024 where it is likely to oscillate in the following years as the persisting high interest rate environment will impact the cost of debt of the loan to be issued for refinancing the first tranche of the bond amortising in 2025.

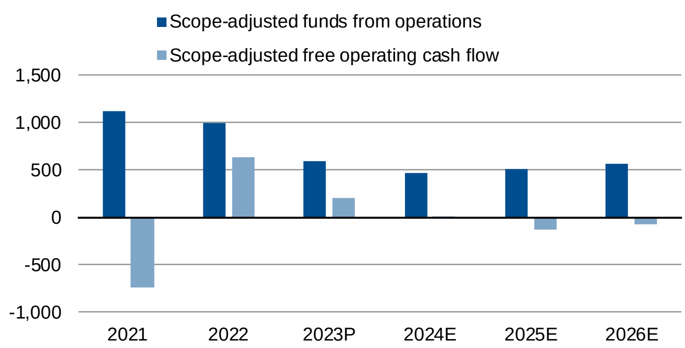
The financial risk profile remains constrained by the high leverage and low and volatile cash flow cover. Credit metrics are expected to bottom out in 2023 before improving: leverage as measured by Scope-adjusted debt/EBITDA deteriorates to above 10x in 2023 before returning to below 6x next year and further improving towards 5x by 2026, while Scope-adjusted funds from operations/debt improves from 9% in 2023 towards 15% by 2026. Scope-adjusted free operating cash flow/debt is forecasted to oscillate around 0% in the following years.

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



Sources: Naturtex, Scope (estimates)

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



Sources: Naturtex, Scope (estimates)

Adequate liquidity

Liquidity is adequate, based on the current cash reserves (HUF 1.8bn as of end-December 2023). The bond is scheduled to start to amortise in 2025 by HUF 0.7bn in addition to Naturtex's further loans (including investment loans and working capital loans), which typically amortise linearly. Internal liquidity will be adequate to cover this as cash generation is more than 200% of the scheduled debt amortisation in 2024. We do not anticipate any immediate refinancing risks over the forecasted period. However, in 2027, when the second tranche (HUF 2.1) of the bond matures, we see some refinancing risk due to the relatively large size of the future debt maturity.

Balance in HUF m	2023P	2024E	2025E
Unrestricted cash (t-1)	1 400	1 725	1 171
Free operating cash flow	206	14	(129)
Short-term debt (t-1)	446	727	875
Coverage	**>200%**	**>200%**	**119%**

Supplementary rating drivers: 0 notches

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

Long-term debt rating

Senior unsecured debt rating: B+

We expect an 'average' recovery for senior unsecured debt, which includes the senior unsecured bond (ISIN: HU0000359922) of HUF 2.8bn issued in September 2020 under the Hungarian Central Bank's Bond Funding for Growth Programme. This recovery expectation results in no notching relative to the issuer rating, leading to a senior unsecured debt rating of B+. Our recovery expectations are based on an expected liquidation value in a hypothetical default scenario in 2026. In this scenario, we assume tough market conditions and that all available bank facilities would be fully drawn in the event of insolvency.

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

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