Inotal Zrt.
Hungary, Metals and Mining

B+ POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	8.3x	21.4x	60.7x	11.2x
Scope-adjusted debt/EBITDA	3.6x	2.4x	2.3x	2.7x
Scope-adjusted funds from operations/debt	24.1%	41.7%	41.2%	32.4%
Scope-adjusted free operating cash flow/debt	55.8%	-11.9%	2.6%	-12.6%

Rating rationale

The revised outlook is driven by positive developments in the issuer's operating profitability, with the EBITDA margin (2022: 4.5%, 9M 2023: 7.8%) exceeding our financial forecast. The main reason for the higher EBITDA margin is the suspension of the production of aluminium slugs, a low-margin product mainly used by the cosmetics and food industry.

The business risk profile (assessed at B) continues to be supported by strong geographical, customer and end-market diversification. The business risk profile is also supported by improving operating profitability, with the EBITDA margin expected to stay above 5% on a sustained basis. The EDITDA margin benefits from the improved gross margin of the product portfolio and from continuing investments. Currently, there are three ongoing capex projects (a new sludge storage facility, a sludge processing machine line and a solar plant investment with 6 MW capacity) aimed at increasing capacity and efficiency. The business risk profile is constrained by the issuer's limited absolute size in a European and global context.

The financial risk profile has been upgraded to BBB- from BB- because of stronger credit metrics. Leverage as measured by the Scope-adjusted debt/EBITDA margin has shown persistent improvement since 2021 and is expected to stay close to 2.5x in the medium term. EBITDA interest coverage remains robust as interest on financial debt is moderate (average interest rate of 3.3%) and fixed during the whole tenor of the debt. FOCF is expected to remain negative or close to zero until 2025, mainly as a result of strong investment activity forecasted at EUR 6.2m in 2023 and 2024, and EUR 4m in 2025. Liquidity is adequate as sources (EUR 6.7bn of free cash as of YE 2022 and positive FOCF of EUR 0.4m) fully cover uses (short-term debt of EUR 1.9m). We expect liquidity to stay significantly above 100%.

Outlook and rating-change drivers

The Positive Outlook reflects our assumption that Inotal can maintain its robust financial risk profile by concentrating on its core activities, despite still being affected slightly by softer end-market demand. Our financial base case assumes Inotal can maintain its robust financial risk profile in the medium term, with the Scope-adjusted EBITDA interest cover ratio remaining above 10x and leverage as measured by the Scope-adjusted debt/EBITDA ratio remaining below 3x.

A positive rating action, i.e. a rating upgrade, could be warranted if cash flow cover as measured by the Scope-adjusted FOCF/debt margin turned positive and moved above 5% on a sustained basis while the EBITDA margin remained above 5% over the medium term.

A negative rating action, including revising the Outlook to Stable, could occur if Inotal was not able to reach positive cash-flow cover, with profitability deteriorating below 5%. Additionally, Scope-adjusted debt/EBITDA moving above 4x on a sustained basis would warrant further downside, i.e. a rating downgrade.

Ratings & Outlook

Issuer	B+/Positive
Senior unsecured debt	B+

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Related Methodologies

Corporate Rating Methodology; October 2023

Metals and Mining Rating Methodology; October 2023

Inotal Zrt.

Hungary, Metals and Mining

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
7 December 2023	Outlook change	B+/Positive
7 December 2022	Affirmation	B+/Stable
8 April 2022	Monitoring review	B+/Stable

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Robust financial risk profile despite more challenging market conditions • Good customer and end-market diversification with direct customer relationships • Strong liquidity of well above 100%, even after the beginning of MNB bond amortisation	• Small niche player with limited economies of scale • Relatively low value-added products • Negative FOCF in the medium term, due to high capex

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted FOCF/debt ratio moving towards 5%, while EBITDA margin stays above 5%	• Inability to bring FOCF to positive levels in the medium term • Scope-adjusted debt/EBITDA ratio moving above 4x

Corporate profile

Inotal Zrt. is a private Hungarian aluminium processor, slag recycler and trader. Its key products are wire rod, slugs, strips, and drawn wire. Wire rod is primarily sold to the electrical industry, slugs to the cosmetics and food industries, strips to the building and transformer industries, and drawn wire to the lightning conductor, electrical and food industries. Over 70% of production is exported to nearby countries. Inotal employs 322 people and operates three sites in Hungary. It has been fully owned by financial investor KETER Investments Zrt. since May 2023.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	12.8x	8.3x	21.4x	60.7x	11.2x	14.6x
Scope-adjusted debt/EBITDA	3.2x	3.6x	2.4x	2.3x	2.7x	2.1x
Scope-adjusted funds from operations/debt	28.6%	24.1%	41.7%	41.2%	32.5%	42.6%
Scope-adjusted free operating cash flow/debt	12.9%	55.8%	-11.9%	2.6%	-12.6%	7.7%
Scope-adjusted EBITDA in EUR '000s						
EBITDA	5,250	4,543	6,284	6,922	5,067	5,424
Other items	0,00	0,00	0,00	0,00	0,00	0,00
Scope-adjusted EBITDA	5,250	4,543	6,284	6,922	5,067	5,424
Funds from operations inEUR '000s						
Scope-adjusted EBITDA	5,250	4,543	6,284	6,922	5,067	5,424
less: (net) cash interest paid	-412	-549	-293	-114	-452	-371
less: cash tax paid per cash flow statement	0,00	0,00	0,00	-306	-168	-371
add: dividends from associates	0,00	0,00	405	6	0,00	0,00
Change in provisions	-111	-60	0,00	0,00	0,00	0,00
Funds from operations (FFO)	4,728	3,934	6,395	6,508	4,447	4,929
Free operating cash flow in EUR '000s						
Funds from operations	4,728	3,934	6,395	6,508	4,447	4,929
Change in working capital	816	10,981	-6,307	139	24	-4
Non-operating cash flow	0,00	-545	150	0,00	0,00	0,00
less: capital expenditure (net)	-3,411	-5,263	-2,060	-6,240	-6,198	-4,032
Free operating cash flow (FOCF)	2,133	9,107	-1,822	408	-1,726	894
Net cash interest paid in EUR '000s						
Net cash interest per cash flow statement	-418	-412	-549	-293	-114	-452
Change in other items	0,00	0,00	0,00	0,00	0,00	0,00
Net cash interest paid	-418	-412	-549	-293	-114	-452
Scope-adjusted debt in EUR '000s						
Reported gross financial debt	16,551	16,325	15,320	15,807	13,695	11,582
less: cash and cash equivalents	NA	NA	NA	NA	NA	NA
add: non-accessible cash	NA	NA	NA	NA	NA	NA
Other items	0,00	0,00	0,00	0,00	0,00	0,00
Scope-adjusted debt (SaD)	16,551	16,325	15,320	15,807	13,695	11,582

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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)	Grey leaf	Labour management		Management and supervision (supervisory boards and key person risk)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

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

Credit-neutral ESG factors

About 20% of Inotal's production is based on recycled aluminium, which is mostly sourced from related company Martin Metals Kft. Recycled aluminium exhibits minimal debris and quality loss and requires about 5% of the energy needed to produce primary aluminum.

[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: BB

We classify Inotal as a metals and mining company. We rate this industry BB based on high cyclicality, medium substitution risk and medium barriers to entry. Given the highly commoditised nature of the industry, all market players are price-takers as metal prices depend on global demand.

Aluminium prices have been subject to increased volatility since early 2021. Prices peaked around USD 4,000/tonne around March 2022 as financial sanctions on Russia fuelled worries about supplies from major Russian producers. Prices then started to gradually decline from Q2 2022, stabilising close to USD 2,000/tonne, mainly driven by recession fears and lower demand.

Business risk profile: B

Inotal's business risk profile (assessed at B) is constrained by its small size by global standards, its concentration on commodity products and its relatively low margins. The rating is supported by good geographical, customer and end-market diversification; direct customer relationships; access to scrap through associated company Martin Metals and its slag recycling operation; and effective management of metals price risk through customer and supplier contracts and hedging.

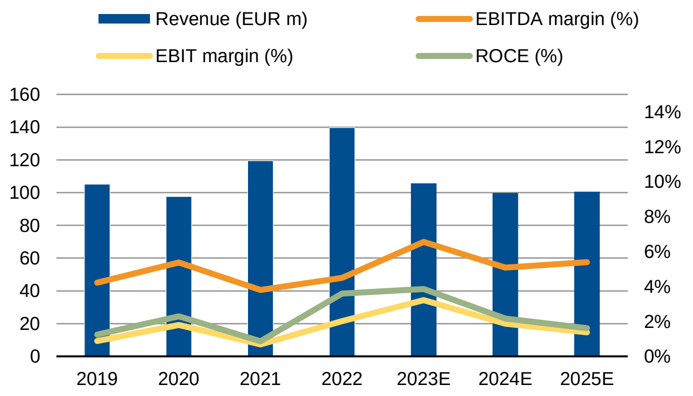
Limited company size in a European context

Inotal is the third largest aluminium processor in Hungary after Arconic and Norsk Hydro. With yearly production of 35,000 to 40,000 tonnes, Inotal is a small player by international standards. Regional peers generally produce more than 100,000 tonnes yearly, and global leaders generally produce more than 1m tonnes yearly. Constant changes in the cost of aluminium, alum earth and energy prices have significantly restructured the market. In Europe, major aluminium producers and manufacturers of aluminium-based semi-finished goods have reduced or interrupted their output to minimise losses. In 2023 Inotal decided to suspend production of one of its products (aluminum slugs), reducing yearly revenue by approximately 25%.

High degree of end-market, customer and geographical diversification

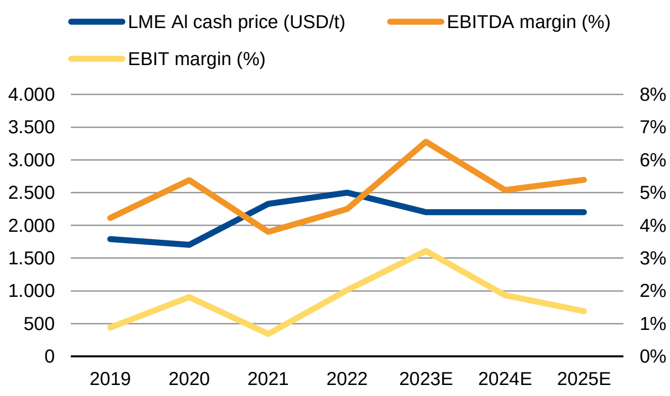
Production is focused on wire rod, strips, drawn wire and granules. End markets are diverse and include the electrical, construction, food and steel industries. The issuer operates three furnaces (10, 15 and 25 tonnes), with production focusing on markets within a 1,500 km radius of Hungary. Its most important export markets in 2022 included Romania, Austria, Italy and Poland. Sales are almost exclusively direct sales to end customers. Products are relatively low value added, although the issuer is increasingly focusing on alloys (around 60% of production), which generate higher margins and can be produced with a relatively high ratio of scrap (38%). External scrap is sourced through Inotal's own slag recycling operation and associated aluminium recycler Martin Metals.

Figure 1: Scope-adjusted revenue, margins and ROCE



Sources: Inotal, Scope (estimates)

Figure 2: Scope-adjusted margins and aluminium price



Sources: Inotal, Scope (estimates)

Operating profitability improving after revision of product portfolio

Aluminium processing is a margin business, where price risk is broadly eliminated through contracts with suppliers and buyers as well as through metal price hedging. Inotal's EBITDA margin has ranged between 3% and 6% over the past decade (Figures 1 and 2), in line with small-to-medium sized peers focused on lower value-added products.

Following the elimination of its loss-making slug manufacturing, the issuer's EBITDA margin is expected to be at the higher end of the historical 3-6% range. While no significant drop in demand from the end market side is forecasted, we apply a more conservative approach to the profitability forecast beyond 2023, in line with management's projections. Inotal has stated that it is planning to mitigate challenges in the market environment through: i) a EUR 6m investment in a solar park (6 MW capacity), which is expected to reduce electricity consumption by about 25%; ii) dynamic order management, focusing on less energy-intensive, higher value-added products; and iii) additional capital expenditure, aimed at improving efficiency and increasing production capacities.

Financial risk profile: BBB-

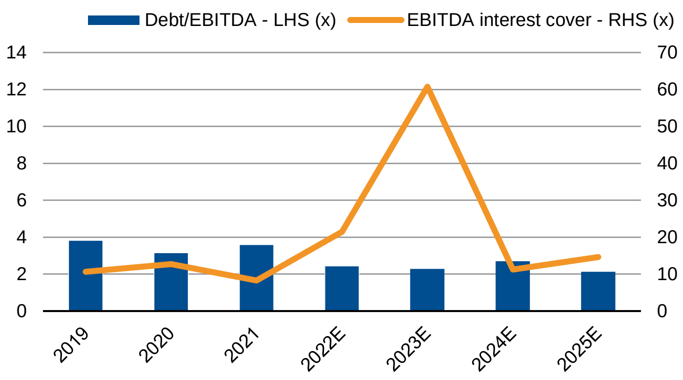
Financial risk profile: BBB-

Inotal's financial risk profile (assessed at BBB-, upgraded from BB-) reflects moderate leverage and a long-term debt maturity profile. The gross margin is expected to stay above historical averages, with a slight deterioration in the medium term in line with our more conservative profitability assumptions. For 2023 we expect material costs will be around 82% of revenue, and we assume 10% annual wage inflation. After 2023 we expect material costs to use up around 85% of total revenue and wage inflation to slow to 8% and 2% in 2024 and 2025 respectively. Other operating expenses and operating costs are expected to remain in line with historical averages.

Modest leverage

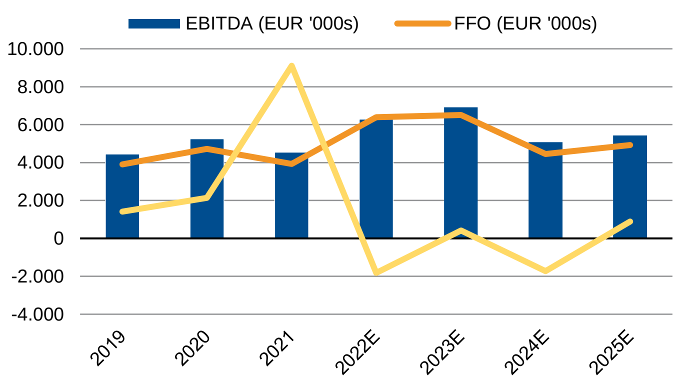
The leverage ratio has shown rapid improvement in previous years and is expected to stay close to 2.5x in the medium term. The Scope-adjusted debt/EBITDA ratio benefits from: i) debt amortisation, with 12.5% of the MNB bond's face value and 10% of the investment loan repaid YoY; and ii) strong profitability, with the EBITDA margin above 5% on a sustained basis thanks to streamlined production and investments in machinery and equipment. No additional debt intake is forecasted until 2025, in line with information from management. The Scope-adjusted FFO/debt ratio is also expected to remain strong (between 30 % and 45%) due to strong EBITDA and moderate interest costs.

Figure 3: Scope-adjusted interest cover and leverage



Sources: Inotal, Scope (estimates)

Figure 4: Cash-flow analysis



Sources: Inotal, Scope (estimates)

Strong interest coverage

EBITDA interest coverage remains robust, with significant interest income realised through short-term depositing of cash in 2022 and 2023 (no interest income is assumed beyond that time). Interest on the issuer's financial debt is moderate (3.2% on the bond and 3.5% on the investment loan) and fixed during the whole tenor of the debt, so developments in the debt protection metric depend on profitability – which is forecasted to move in a positive direction. With no interest income assumed from 2024 onwards, we forecast that EBITDA interest coverage will stabilise above 10x.

Volatile free cash-flow cover

Cash flow is more volatile than earnings, driven primarily by fluctuations in capex. FOCF is expected to remain negative or close to zero until 2025, mainly because of strong investment activity forecasted at EUR 6.2m in 2023 and 2024, and EUR 4m in 2025, as per information from management. These investments are financed by equity, absorbing most of the additional cash generated by higher EBITDA. We assume the issuer's working capital needs will remain relatively flat in upcoming years.

Adequate liquidity

Liquidity is adequate as sources (EUR 6.7bn of free cash as of YE 2022 and positive FOCF of EUR 0.4m) fully cover uses (short-term debt of EUR 1.9m). We expect liquidity to stay significantly above 100%, benefitting from strong cash generation. Bond amortisation started in 2023, with a tranche of EUR 1.9m payable yearly.

Balance in EUR '000s	2022	2023E	2024E
Unrestricted cash (t-1)	8,159	6,733	6,888
Open committed credit lines (t-1)	0,00	0,00	0,00
Free operating cash flow	-1,822	408	-1,726
Short-term debt (t-1)	0,00	1,912	1,912
Coverage	**No ST debt**	**373%**	**270%**

Long-term debt rating

Senior unsecured debt rating: B+

In September 2020, Inotal issued a HUF 6bn senior unsecured bond (ISIN: HU0000359948) through the Hungarian central bank's Bond Funding for Growth scheme. The bond proceeds have been used to refinance existing third-party debt. The bond has a tenor of seven years and a fixed coupon of 3.2%. Bond repayment is in five tranches: 12.5% of the face value payable yearly between 2023 and 2026, and 50% at maturity in 2027.

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