Abroncs Kereskedőház Kft
Hungary, Retail

Corporate profile

Abroncs Kereskedőház Kft (AKH) is one of the leading BtoB and BtoC distributors and servicers of tyres in Hungary and Slovakia, with presence in many neighbouring Central and Eastern European countries. It sells more than 1.3m tyres annually and distributes products supplied by more than 30 well-known tyre manufacturers. The group operates in central European countries including Hungary, the Czech Republic, Romania, Croatia, Slovenia and Slovakia. In addition to tyres, AKH also markets lubricants as well as car and tyre services. The group has around 310 employees. It generated HUF 24bn in net sales and HUF 1.1bn in EBITDA in 2020 (the fiscal year ends on 31 December).

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover (x)	3.9x	9.6x	8.2x	11.1x
Scope-adjusted debt (SaD)/EBITDA	2.1x	0.5x	0.9x	2.0x
Scope-adjusted funds from operations/SaD	32%	159%	96%	44%
Free operating cash flow/SaD	110%	126%	-16%	-6%

Rating rationale

Scope Ratings has affirmed the BB/Stable issuer rating and BB senior unsecured debt rating of Abroncs Kereskedőház Kft.

The affirmation reflects AKH's good 2020 results and the expectation that the financial risk profile will not be materially constrained by the ARS acquisition.

The affirmation of the issuer rating is supported by the company's strong results in 2020. Despite the Covid pandemic and a weaker Hungarian tyre market, AKH increased EBITDA from HUF 638m to HUF 1.14bn and doubled the EBITDA margin to 4.6%. In the same year, AKH also successfully placed a HUF 3.5bn bond under the Hungarian central bank's Bond Funding for Growth Scheme (MNB scheme). This new bond has a maturity of seven years, with amortisation and 50% repayment upon maturity. The bond proceeds are earmarked only for refinancing all debt except the overdraft facility. In October 2021, AKH announced the full acquisition of Slovakian dealer ARS from Bridgestone. ARS is a retail specialist in Passenger Car, Truck and Bus tyres. It operates seven outlets across the country. In Truck and Bus tyres, ARS has a market share over 30%. The newly acquired company, generates HUF 4bn-5bn in revenues and has 80 employees.

The issuer rating continues to reflect AKH's leading position and high market share in tyre retailing, holding more than 30% of the Hungarian market. This is the consequence of the company's strong presence in BtoB and BtoC, supported by the extended brand portfolio and well-spread presence in Hungary. The partial integration of its model, brought by car services stores and the exclusive partnership with BP Lubricants (around 7% market share), has also allowed it to reduce its exposure to the seasonality inherent to the tyre market and diversify its offering beyond only one product type. In addition to lubricants, AKH can rely on its strong relationship with its suppliers, exhibited by the balanced mix between exclusive and semi-exclusive products and other brands including those of worldwide tyre-makers (among them, Continental and Bridgestone). Despite the

Ratings & Outlook

Issuer rating	BB/Stable
Senior unsecured rating	BB

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Related Methodologies

Corporate Rating Methodology, 06 July 2021.

Retail and Wholesale Corporates, 17 March 2021.

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Bloomberg: RESP SCOP

strong market share in Hungary, the business risk profile is limited by AKH's small size, strong competitors, low prospect for domestic growth and low potential for expansion.

The business risk profile is also still constrained by the weak diversification by geography (80% of revenues from Hungary) and by type of product sold. The acquisition of ARS, while expanding the geographical outreach (expecting to reduce the share of revenues from Hungary to below 70%) and types of products sold, does not change the overall business risk profile assessment due to the company's limited size. On the other hand, we view positively the diversified pool of customers (car leasing companies and retailers) and the diversified sales channels with an increasing share of BtoC online sales. The latter has grown by 250% during the pandemic crisis, above the HUF 1bn revenue mark. In addition to a better brand mix and controlled opex, profitability surged from 2.3% in 2019 to 4.6% in 2020. Nevertheless, the margin, driven by seasonality and the high share of BtoC in revenues, remains below average and continues to put pressure on the rating.

AKH's financial risk profile is a clear support of the rating case thanks to the good credit metrics including high interest cover and low leverage. With the acquisition of ARS, credit metrics including the Scope-adjusted net debt/EBITDA ratio are expected to remain under control at below 3.0x. In addition, liquidity is adequate with no large, short-term debt except for the HUF 200m bond amortisation in 2021 and 2022 following the refinancing of bank loans with the bond issued under the MNB scheme. The negative driver of the financial risk profile is the volatile free operating cash flow generation driven by low capex (below 2% of sales) but highly volatile working capital. The consolidation of ARS should lead to a higher working capital consumption and higher capex. Consequently, this is expected to weigh on free operating cash flow.

The rating base case assumes ARS's consolidation into the group from 1 January 2022 (although it was acquired in the second half of 2021) as well as no shareholder remuneration.

Outlook and rating-change drivers

The Outlook is Stable and incorporates our expectation that Scope-adjusted debt (SaD)/EBITDA will remain below 3.0x and the assumption that no dividends will be paid in the coming years. The Outlook also reflects our expectation of continued positive performance with a limited impact from the Covid pandemic.

A positive rating action could be warranted by an improvement in AKH's business risk profile, which could be achieved via better diversification, or a material increase in operating margins.

A negative rating action may be taken if SaD/EBITDA increased towards 3.5x on a sustained basis or significant shareholder remuneration was undertaken contrary to our expectations. An increase in leverage could be triggered by a rise in net debt from larger-than-anticipated capex and working capital consumption.

Long-term and short-term debt ratings

Senior unsecured debt is issued by Abroncs Kereskedőház Kft. Our recovery assessment is based on a hypothetical default scenario in 2022. Our recovery analysis indicates an 'average' recovery for senior unsecured debt. This expectation translates into a rating of BB for this debt category.

Rating drivers

Positive rating drivers	Negative rating drivers
• Strong but volatile credit metrics driven by overstocking in 2018 and 2019 and by general dependence on working capital management • Good supplier diversification with a good share of exclusive products • Leading or significant position in BtoB and BtoC tyre distribution and servicing business tyre business in Hungary • Strong financial risk profile overall	• Below-average profitability • Limited financial size capped by the Hungarian market • Limited but improving diversification by geographies, distribution channels and products • Seasonality of operations

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in business risk profile via increased operating margins and better diversification	• SaD/EBITDA sustained above 3.5x

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover (x)	3.9x	9.6x	8.2x	11.1x
Scope-adjusted debt (SaD)/EBITDA	2.1x	0.5x	0.9x	2.0x
Scope-adjusted funds from operations/SaD	32%	159%	96%	44%
Free operating cash flow/SaD	110%	126%	-16%	-6%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	581.3	1,102.8	1,003.2	1,290.7
Operating lease payments in respective year	56.9	53.1	54.8	69.0
Other	0.0	0.0	0.0	0.0
Scope-adjusted EBITDA	638.2	1,155.9	1,058.0	1,359.7
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	581.3	1,102.8	1,003.2	1,290.7
less: (net) cash interest as per cash flow statement	-125.9	-85.1	-98.0	-86.0
less: cash tax paid as per cash flow statement	-27.9	-27.3	-52.5	-48.8
add: depreciation component, operating leases	18.6	17.2	23.2	32.8
Variations of provisions	-3.1	0.0	0.0	0.0
Scope-adjusted funds from operations	443.1	1,007.3	876.0	1,188.7
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	2,372.4	3,500.0	3,354.0	3,298.0
less: cash and cash equivalents	-1,813.3	-3,488.9	-3,078.5	-1,777.9
add: operating lease obligations	812.8	621.4	641.4	807.5
add: guarantees	0.0	0.0	0.0	365.0
Scope-adjusted debt	1,371.9	632.5	917.0	2,692.6

Business risk profile

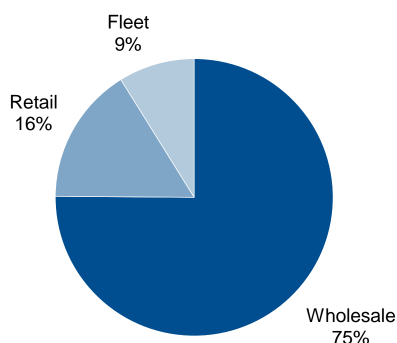
AKH's business risk profile is supported by its market positioning in Hungary, while diversification and profitability are negative rating drivers.

Strong market share offset by small market size

AKH reports having close to 30% of the Hungarian market (based on the number of pieces imported into the country) versus 33% in 2019. After a long period of growth, domestic tyre sales in 2018 and 2019 reached a volume of nearly 3m. The group also sells lubricants, with an exclusive partnership with BP (Castrol, Aral). AKH is the number three player in this business, with a market share of around 7%.

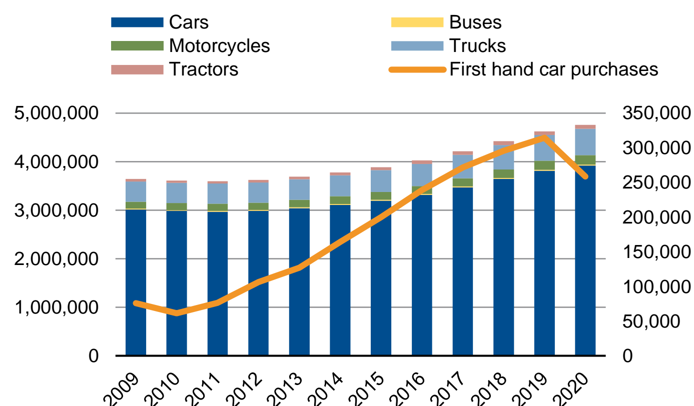
In terms of strategy, AKH intends to improve profitability while maintaining its market share. The strategy is based on: i) increasing the BtoC distribution channel by opening additional car services; ii) growing the share of its retail segment and online sales; iii) continuing to reduce the seasonality of its sales through its lubricant and services businesses; and iv) maintaining its numerous commercial agreements with most of the largest tyre manufacturers in the world (e.g. Continental, Michelin) for light-vehicle tyres.

Figure 1: AKH revenue split by segment (2020)



Source: AKH

Figure 2: Hungarian fleet by type of vehicle (2009-20)



Source: AKH

Despite its good market share, AKH is small (EUR 80m in sales). This is due to its core market, restricted growth opportunities, limited pricing power and strong competitors.

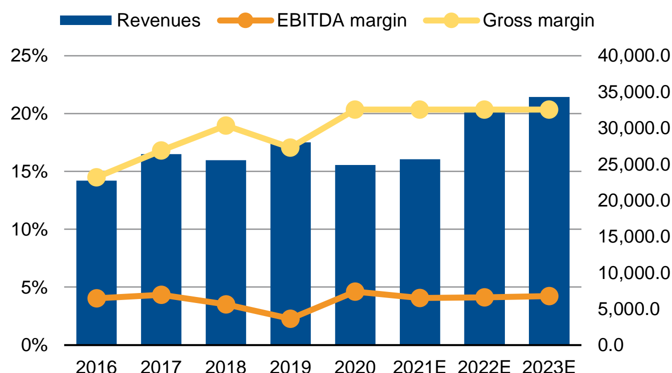
Concentrated product portfolio and limited geographical diversification

Diversification is the main weakness in AKH's business risk profile. With regard to geography, AKH sells 80% of its products in Hungary. Sales realised through exports or its foreign subsidiaries account for 20%, with no country representing a majority share. That said, AKH's strategy to expand abroad is moving its limited geographical diversification in the right direction. The recent acquisition of ARS is expected to bring AKH's exposure to Slovakia to around 19% of sales in 2022. Nevertheless, we consider this improvement too limited to result in a positive re-assessment of the overall diversification factor.

AKH's product diversification is also weak. Sales are only related to one segment, the automotive industry, and cover all types of tyres (passenger and large tyres for trucks), lubricants and services.

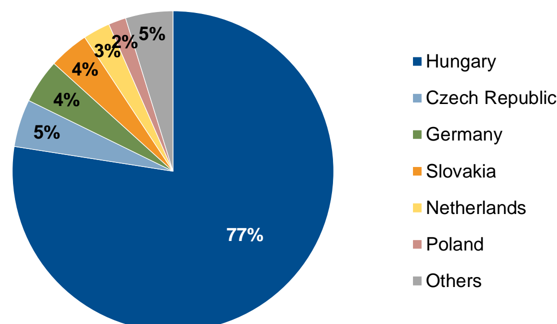
We recognise the group's multiple sales channels (online BtoB distribution, online BtoC distribution, brick and mortar retail and fleet servicing). Although the predominance of BtoB distribution limits diversification, AKH appears to advance further towards an omnichannel selling structure, also outside of Hungary.

Figure 3: Group profitability



Source: AKH, Scope estimates

Figure 4: Geographical diversification (revenues 2020)



Source: Scope estimates

Below-average profitability

Between 2016 and 2018, AKH's EBITDA margin ranged from around 3% to 4%. It started to decrease in 2018 and hit 2.3% in 2019. This was a consequence of: i) a warmer-than-anticipated winter in 2018 leading to a larger inventory; and ii) logistics issues leading to losses in H2 2019. In order to normalise the large stock acquired in 2018, AKH lowered its prices for both winter and summer tyres during the first three quarters of 2019. The group recovered its profitability in 2020 in line with the 2016/17 level thanks to:

- a better and optimised brand mix (focusing on much more profitable tyre segment, increasing the ratio of exclusive and semi-exclusive brands);
- the extended retail capacity on existing service stations;
- an increasing ratio of retail activity (product/service) and its exposure to online BtoC; and
- an optimised in-house warehousing efficiency.

Financial risk profile

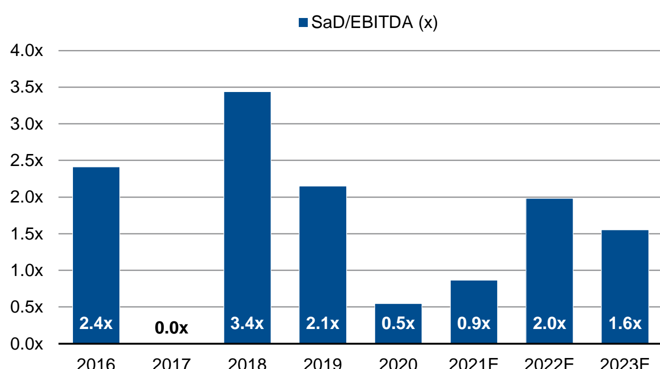
AKH's financial risk profile is clearly supportive of the overall rating case. Our assumptions are in line with the assumptions made by management in terms of sales, EBITDA and capex. We expect the EBITDA margin to remain above 4%, given the effort realised on cost management, the better sales mix (with more sales of premium tyres and exclusive brands), and the increasing share of retail activity.

Sill low leverage despite ARS acquisition

AKH has benefited from an investment grade level leverage. However, leverage is volatile due to the volatility in EBITDA. Our operating lease adjustment represents a large part of SaD, at around 17%. The rest of gross debt is only composed of the HUF 3.5bn bond used solely to refinance the two loans maturing in 2023 and 2025 for HUF 2.2bn (exposure in August 2020). Only the overdraft facility of HUF 600m has not been refinanced and increased to HUF 1bn. Nevertheless, the latter is not incorporated into gross debt at year-end as its usage is very seasonal and usually at its lowest at the end of December.

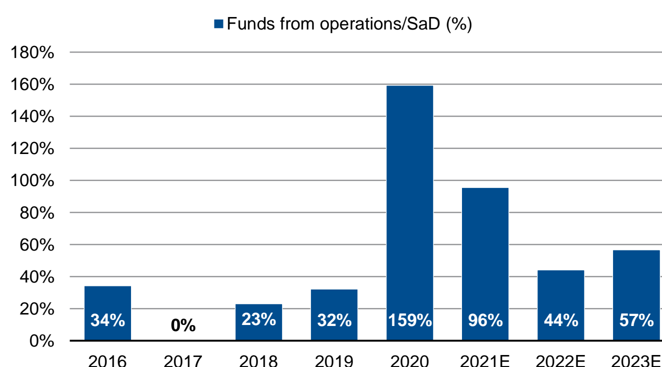
As EBITDA has recovered to 2017 levels, both in terms of amount and profitability, we expect SaD/EBITDA to remain below 3.0x. The acquisition of ARS (consolidated in 2022), the additional capex needed by this new company, and the deteriorating working capital are expected to temporarily put leverage under pressure though at a manageable 2.0x.

Figure 5: AKH's SaD/EBITDA



Source: Scope estimates

Figure 6: AKH's funds from operations/SaD

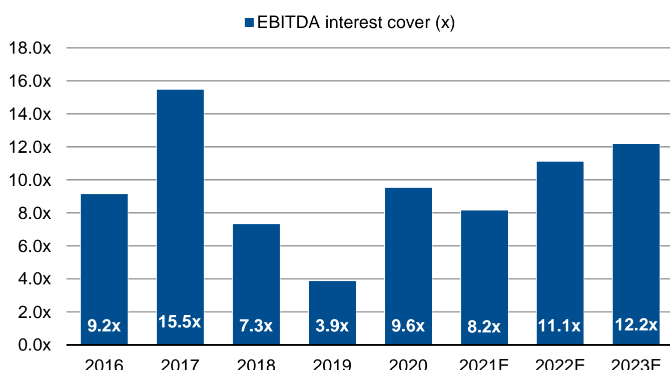


Source: Scope estimates

The funds from operations/SaD ratio has developed in a similar way. Our assessment of leverage factors in the possibility of higher capex and worse-than-expected working capital, in addition to potential integration risk of the newly acquired company.

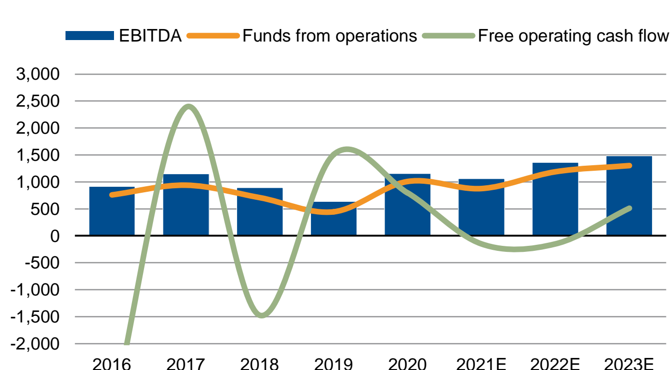
Net interest cover is fairly high. Following the bond issuance, the refinancing process has materially impacted the cost of debt.

Figure 7: AKH's interest cover



Source: Scope estimates

Figure 8: AKH's cash flows



Source: Scope estimates

The group's operating cash flow was enough to cover capex in 2020. Maintenance capex stands at around HUF 230m. The upcoming development capex for ARS for acquiring machinery and completing digital investments is expected to put pressure on free operating cash flow generation. This project to introduce a system to enhance warehouse management will cost nearly HUF 400m by the end of 2021.

Free operating cash flows are expected turn negative in 2021 and 2022 following a potential drop in AKH's working capital consumption. The latter is expected to be more significant in 2022 with the consolidation of ARS (additional inventory). As the ratio could therefore move towards either end of the rating grid, our expectations remain conservative.

Strong liquidity with low level of short-term debt

Liquidity is better than adequate going forward. The group has used the proceeds of the bond to refinance all loans with the exception of the HUF 600m working capital facility. The latter has been increased to HUF 1bn. We have included in the short-term debt repayment the amortisation of the bond (around HUF 200m per year).

Figure 9: AKH's liquidity

(in HUF m)	2020	2021E	2022E	2023E
Short-term debt (t)	229	200	254	398
Unrestricted cash (t-1)	1,813	3,488	3,078	1,777
Open committed credit lines (t)	600	1,000	1,000	1,000
Free operating cash flow (t)	798	-151	-150	512
Liquidity (internal)	1,140%	1,669%	1,153%	575%
Liquidity (internal + external)	1,402%	2,169%	1,547%	827%

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