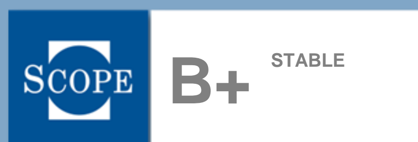
AutoWallis Nyrt.
Hungary, Retail



Corporate profile

AutoWallis Nyrt. is a Hungarian holding company operating in retail and wholesale sales of vehicles, parts and accessories; repair and maintenance services; and short- and long-term vehicle rentals. The group's regional focus is on Hungary (64% of revenues in 2018) and the Balkan region. AutoWallis is 80% owned by Mr Tibor Veres through private equity firm Wallis Asset Management Zrt.

Members of the AutoWallis group include Wallis Automotive Europe, Wallis Motor Pest, Wallis Motor Danube and Wallis Car Rental. The group in its present form originated in 2018 through a reverse acquisition, whereby Wallis Asset Management purchased Altera, and Altera acquired 100% of the Wallis group's four automotive trading and service provider companies by way of in-kind contributions.

Brands represented by the group include BMW cars and motorbikes, Mini, Jaguar, Land Rover, Maserati, Isuzu, SsangYong, and Sixt Rent a Car. The partnerships with BMW and Sixt go back more than 20 years. Around 90% of group revenues stem from the distribution of passenger cars (retail and wholesale); the remaining 10% comprises rental and technical services, and spare-parts sales. In 2018, AutoWallis generated revenues of HUF 64bn and an EBITDA of HUF 2.1bn.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	12.0x	8.7x	9.1x	7.3x
Scope-adjusted debt (SaD)/EBITDA	2.4x	3.7x	4.7x	4.6x
Scope-adjusted FFO/SaD	34%	18%	16%	17%
Free operating cash flow (FOCF)/SaD	-10%	-11%	-3%	-1%

Rating rationale

Scope Ratings assigns a B+ first-time issuer rating to AutoWallis Nyrt., with a Stable Outlook. The senior unsecured debt category is rated B+.

AutoWallis' issuer rating is supported by the BB- rated business risk profile. With approx. 70% of total revenues in 2018 generated through JaguarLandRover and BMW brands, AutoWallis is positioned towards the premium car segment. This segment is serviced by only a handful of manufacturers, with BMW the segment leader. AutoWallis has a five-year dealership contract with BMW, which we consider to represent a market entry barrier for competitors. The dealership contract authorises AutoWallis to sell the vehicles of BMW Group, to perform services such as repair and maintenance in accordance with specified standards, and to purchase original parts from BMW. According to AutoWallis, there are 15 BMW dealerships in Hungary, three of them located in Budapest. AutoWallis, with its two dealerships in Budapest, serves around 40% of the BMW market in Hungary. In our view, AutoWallis' position as BMW retailer in Hungary is supported by its long partnership with BMW and the well-established brand.

Ratings & Outlook

Corporate ratings	B+/Stable
Sen. unsecured rating	B+

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Related methodology

Corporate Rating Methodology

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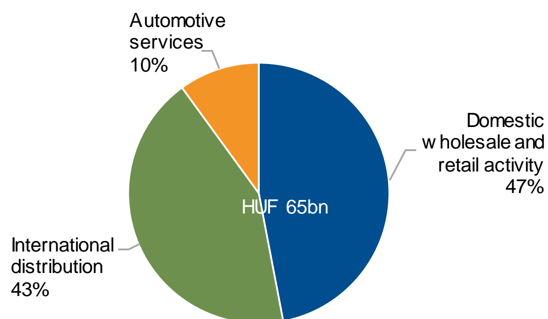
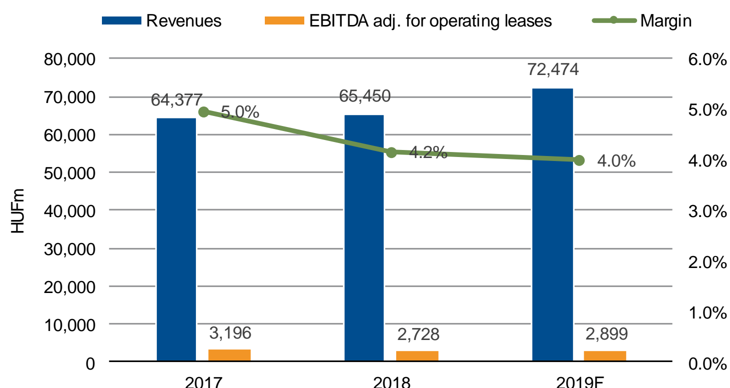
We note, however, that based on newly registered cars in Hungary, AutoWallis' market share was around 2% in 2018. This constrains the company's market positioning. In international distribution (this relates particularly to the wholesale segment for car marques JaguarLandRover, Isuzu and Ssangyong), the company benefits from being the exclusive distributor in several central and south-eastern European countries.

Figure 1: **Breakdown of revenues by segment 2018**



Source: AutoWallis, Scope

Figure 2: **Three-year trend in revenues and EBITDA**



Source: AutoWallis, Scope

AutoWallis' aftermarket business, though small in terms of revenues, is a major EBITDA contributor. Similar to the retail business, the company's aftermarket services are regulated by BMW, and we believe there are only a few contracted service providers for BMW in Hungary. AutoWallis has a solid market position in rental services, and is the only Hungarian company in the Sixt network. Main rental competitors are Mercur (Hertz), Eurent (Europcar) and Otokoc (Budget). Mercur (Hertz) dominates the market, and the others are similar in size. AutoWallis is market leader in airport car rental.

Product diversification is a restraining factor for the company's business risk profile, with around 90% of revenues stemming from car sales. Some diversification is achieved through sales channels: retail accounts for around 30% of car sale revenues and wholesale for 60%. Diversification through the different marques is also limited, with the two premium ones, JaguarLandRover and BMW, accounting for around 70% of total revenues. Going forward, AutoWallis plans to widen brand variety, bringing in new brands including, among others, Wallis OPEL, the second-largest OPEL and KIA dealer in Hungary and currently owned and incubated by Wallis Asset Management. Negatively, the services business (mainly aftersales and car rental) takes up a small share of total revenues at around 10%.

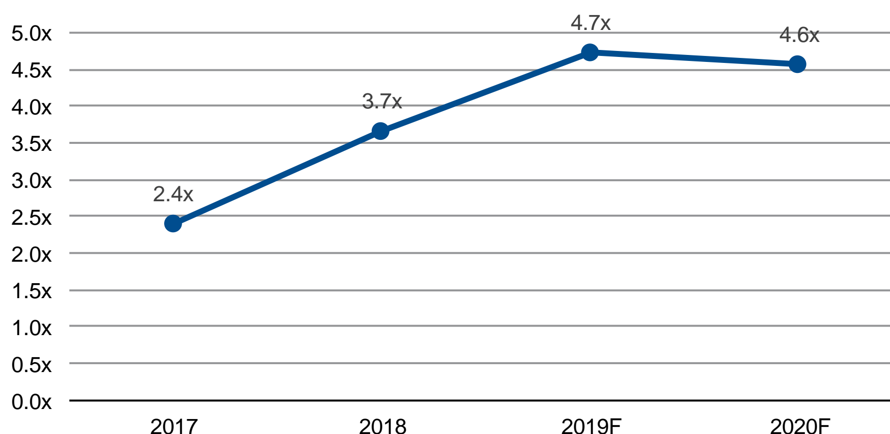
The business risk profile benefits from the company's geographical positioning across 14 countries. Having said that, we note the strong dependence on two countries, Hungary and Croatia. Hungary represented 64% of total revenues in 2018, and the two countries combined represented 75%-80%. AutoWallis intends to broaden its geographic presence by introducing existing marques into new countries and acquiring new brands and markets.

The low profitability is another constraint for the company's business risk profile. EBITDA margin was 3.4% in 2018, or around 4% when adjusting for operating leases. This is mainly attributable to automotive sales. The services business, on the other hand, is very profitable, contributing around 50% of total EBITDA in 2018 despite a very low revenue share. We expect revenues to increase substantially in the next few years, with organic growth likely driven by the further ramp-up of JaguarLandRover imports. These imports started in 2016 but new markets, new products, new dealerships (ordering basic stocks

and long-awaited customer cars) opened sequentially in new regions. We also expect growth to be driven by new markets: Slovakia and the Czech Republic for Isuzu's importer activity (in 2019); and new BMW, Mini, JaguarLandRover models and aftersales business. The aftersales business should benefit from increasing unit sales. In addition, the company plans to take over three companies currently owned and incubated by Wallis Asset Management, which we expect to add around HUF 8bn in revenues over the next three years. AutoWallis also intends to make smaller acquisitions with proceeds from the planned bond issuance. Overall, we project: revenues of HUF 72.5bn for 2019F and HUF 84bn for 2020F; an increased reported EBITDA margin to 4.0% in 2019 due to the impact of IFRS 16; and stable margins for 2020F.

AutoWallis' overall credit risk is held back by its B+ rated financial risk profile. Financial debt amounted to HUF 8.1bn at year-end 2018, mostly comprising inventory loans for the financing of the vehicle stock. We calculate Scope-adjusted debt (SaD) at HUF 10.0bn as at end-December 2018, derived by adjusting reported financial debt for operating leases totalling HUF 4.0bn. SaD to EBITDA was 3.7x at year-end 2018. The company is currently in a growth phase and we expect SaD to increase going forward. We expect SaD to rise to around HUF 14bn at year-end 2019, mainly due to the growth in Sixt leasing lines. AutoWallis plans to use the proceeds from the bond to repay some of its existing credit lines, in particular to replace the operative leasing contracts of the Sixt franchisee and Wallis Motor Pest. We expect another increase for 2020E due to the planned acquisitions (AutoWallis plans to finance 70% of its acquisitions payment of around HUF 3bn through new debt). We understand that banks have signalled their willingness to provide additional debt for this purpose. The planned take-over of some entities from the parent company will be financed via a share exchange for in-kind contributions; cash will thus not be required. As result of the expected higher SaD, we anticipate that the group's net leverage will come in at around 4.7x at year-end 2019F. Leverage should remain above 4.5x in 2020F due to the relatively large M&A expected this year. Free cash flow was negative in 2017 and 2018 and we do not expect it to turn positive in the forecast period. Residual-value risk is limited as only 8% of the company's assets at year-end 2018 were exposed to this risk.

Figure 3: **SaD/EBITDA, 2017 to 2020F**



Source: AutoWallis, Scope

Internal cash flow generation is a weak point, in our view. Free cash flow was negative in 2017 and 2018 and we do not expect it to turn positive in the forecast period.

Liquidity

We view AutoWallis' liquidity and financial flexibility to be 'adequate' in accordance with our methodology. This view is supported by the substantial amount of inventories (around HUF 10bn at year-end 2018). Here, we note the direct financing for each vehicle, which ensures an outstanding loan is fully covered by the value of a particular vehicle. As a result, we calculate short-term debt coverage at more than 2.0x. Positively, we note that financing institutions continued to provide credit lines during the automotive market downturn in 2008-09.

We expect a cash balance of around HUF 1.6bn at FY-end 2019E.

AutoWallis' cash sources at end-December 2018 comprised:

- Cash of HUF 1.5bn
- Marketable securities of HUF 541m

AutoWallis has available debt capacities of HUF 2.5bn under its existing credit lines. We expect the company to raise HUF 3bn through the issuance of corporate notes in 2019.

We expect the following contractual and potential uses of liquidity in 2019F and 2020F:

- Negative free cash flow at roughly HUF 400m in 2019F and HUF 300m for 2020F
- Payments for acquisitions of HUF 750m for 2019F and around HUF 2bn for 2020F, 30% of which should be financed through equity and 70% through new debt;
- Dividend payments of HUF 565m in 2019F, although HUF 541m of this amount has been returned in the form of a repayment of a previous liability to AutoWallis; dividend payments of HUF 219m in 2020F, of which HUF 175m will be repaid in the form of a share capital increase.

Covenants

The available credit lines require the group's subsidiaries to maintain a minimum equity ratio, calculated based on the subsidiaries' standalone financial statements prepared according to Hungarian accounting standards. According to AutoWallis, covenants are monitored quarterly and contracts allow the subsidiaries to report an equity ratio at below the threshold two times in any given year. One subsidiary's equity ratio was below the threshold at year-end 2018; according to AutoWallis, this did not breach covenants, based on contractual terms. Moreover, AutoWallis has informed us that all subsidiaries' equity ratios were above threshold in the first two quarters of 2019.

Senior unsecured debt

Based on our recovery analysis performed on the year 2020F, in particular due to the comparatively high level of senior secured debt ranking ahead in a hypothetical default scenario, as well as due to AutoWallis' low balance of property, plant and equipment, we calculate a recovery rate of around 50% for senior unsecured debt. Our recovery analysis is based on the liquidation value in a potential default scenario. Our recovery rate calculation assumes: i) that all financial debt, except for the overdraft facilities, ranks senior to the bond; and ii) a higher seniority for the payables in comparison to the bond. This is because we believe that payables would have a first-ranking pledge (assignment) benefitting auto manufacturers in a hypothetical default scenario. We also note that importer trade receivables (which account for around 80% of total trade receivables) are covered by a third-party bank guarantee. We have therefore assumed a 100% recovery rate for this part of receivables. Furthermore, the planned replacement of operating lease contracts will add assets to the company's balance sheet, increasing the liquidation value. We therefore rate senior unsecured debt equal to the issuer rating.

Outlook

The Stable Outlook reflects our expectation that the company will execute its growth plans and SaD/EBITDA will remain in the range of 4-5x. Moreover, it reflects the planned usage of bond proceeds mainly for refinancing of operating leases.

We may upgrade the rating if profitability increased, for instance, through a higher percentage of services revenues and/or an improvement in SaD/EBITDA to below 3.5x on sustained basis. A negative rating action could be the result of a SaD/EBITDA of above 5.5x on a sustained basis, for example, due to higher-than-expected negative free cash flow and/or higher-than-expected payments for acquisitions. A negative rating action could be also triggered by the loss of important dealership/importer contracts and/or the usage of bond proceeds for purposes other than the aforementioned refinancing, e.g. larger debt-financed M&A transactions.

Rating drivers

Positive rating drivers	Negative rating drivers
• Solid market position as Hungary's largest BMW dealer (approx. 40% market share); exclusive distributor for several brands in several central and south-eastern European countries • Solid market position in rental services • Strong regional presence of 14 countries	• Relatively high net leverage, which is expected to remain high mainly due to the growth in Sixt leasing lines (4.7x leverage expected for 2019F vs 3.7x in 2018) • Weak internal cash flow generation, with negative free cash flow in 2017 and 2018; no expectations for positive free cash flow in 2019-20 • Low profitability: EBITDA margin of around 4% (adjusted for operating leases) in 2018 • Weak product diversification, with around 90% of revenues from car sales

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA of below 3.5x on sustained basis • Increased profitability, for instance, through a higher percentage of services revenues	• SaD/EBITDA of above 5.5x on a sustained basis, for instance, due to higher-than-expected negative free cash flow and/or higher-than-expected payments for acquisitions • Loss of important dealership or importer contracts • Usage of bond proceeds for purposes other than the refinancing, e.g. larger debt-financed M&A transactions

Financial overview

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	12.0x	8.7x	9.1x	7.3x
Scope-adjusted debt (SaD)/EBITDA	2.4x	3.7x	4.7x	4.6x
Scope-adjusted FFO/SaD	34%	18%	16%	17%
FOCF/SaD	-10%	-11%	-3%	-1%
Scope-adjusted EBITDA in HUF m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	2,693	2,149	2,899	3,368
Operating lease payments in respective year	503	579	0	0
Other items	0	0	0	0
Scope-adjusted EBITDA	3,196	2,728	2,899	3,368
Scope-adjusted funds from operations in HUF m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	2,693	2,149	2,899	3,368
less: (net) cash interest as per cash flow statement	-132	-164	-320	-460
less: pension interest	0	0	0	0
less: cash tax paid as per cash flow statement	-292	-565	-394	-486
Add: depreciation component, operating leases	368	428	0	0
Scope-adjusted funds from operations	2,636	1,849	2,185	2,422
Scope-adjusted debt in HUF m	**2017**	**2018**	**2019F**	**2020F**
Reported gross financial debt	6,198	8,075	15,796	17,621
less: cash, cash equivalents	-1,733	-2,076	-2,081	-2,219
Cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	3,232	4,003	0	0
Scope-adjusted debt	7,697	10,003	13,714	15,401

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