

AXIÁL Javító, Kereskedelmi és Szolgáltató Kft – Hungary, Retail


BB STABLE

Key metrics

Scope credit ratios	2020	2021	Scope estimates	
			2022E	2023E
Scope-adjusted EBITDA/interest cover	32x	37x	11x	11x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	1.0x	1.4x	2.0x	2.0x
Scope-adjusted funds from operations/SaD	135%	58%	51%	42%
Free operating cash flow (FOCF)/SaD	82%	-25%	3%	5%

Rating rationale

The ratings are supported by the company's strong financial risk profile, which benefits from low leverage. The ratings are further supported by the good operating profitability, AXIÁL's status as one of the top three agricultural machinery dealers in Hungary with the leading position in spare parts and a market share of 20%-25% in Hungary's agricultural machinery sector and an adequate product diversification.

The main constraints on the ratings are the ageing and shrinking agricultural labour force but also the lack of geographical diversification compared to European peers as well as its small scale and reach in a European context.

Outlook and rating-change drivers

The Stable Outlook for AXIÁL incorporates our view that key credit metrics will remain strong over the next three years, with a SaD/Scope-adjusted EBITDA ratio of around 2x, while the issuer remains a top-three agricultural machinery dealer in Hungary. Our rating case also projects stable profitability, with a Scope-adjusted EBITDA margin of around 9%.

A positive rating action is seen as remote but could be warranted if AXIÁL's business risk profile improved. This could occur because of significant growth or greater geographical diversification, in combination with SaD/Scope-adjusted EBITDA reaching below 2x on a sustained basis. The latter could be triggered by continual improvements in working capital management and/or a lower dividend payout.

The ratings could come under downward pressure if AXIÁL's leverage (SaD/Scope-adjusted EBITDA) moved towards 4x on a sustained basis due, for example, to higher capital expenditures and/or a higher dividend payout.

Rating history (last three rating actions)

Date	Rating action/monitoring	Issuer rating & Outlook
16 May 2022	Affirmation	BB/Stable
14 Jun 2021	Upgrade	BB/Stable
25 Mar 2021	Placement under review for potential upgrade	BB-/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB+

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Related Methodologies

Corporate Rating Methodology,
July 2021

Retail and Wholesale Corporates
Methodology, April 2022

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Bloomberg: RESP SCOP

Positive rating drivers

- Relative importance of agriculture for Hungarian population and economy
- Top-three agricultural machinery dealer in Hungary with the leading position in spare parts and a market share of 20%-25% in the country's agricultural machinery sector
- Exclusive distributor of globally known brands including Claas, Manitou, Fendt, Horsch and Hyundai
- Adequate inventory level despite some low turnover
- Adequate product diversification
- Good, expected Scope-adjusted EBITDA to around 9% in the near future
- Very strong interest cover of more than 10x and low leverage (SaD/Scope-adjusted EBITDA) of 1x-2.0x

Negative rating drivers

- Ageing, shrinking agricultural labour force
- Comparatively small scale and reach in a European context
- Lack of geographical diversification compared to European peers

Positive rating-change drivers

- Improved business risk profile and SaD/Scope-adjusted EBITDA ratio below 2x on a sustained basis

Negative rating-change drivers

- SaD/Scope-adjusted EBITDA ratio near 4x on a sustained basis

Corporate profile

Founded in 1991 and headquartered in Baja, Hungary, AXIÁL Javító, Kereskedelmi és Szolgáltató Kft plays a prominent role in Hungarian agriculture and construction. It sells machines (e.g. tractors, construction machines, forklifts, and second-hand machinery), spare parts, and GPS products (e.g. GPS-controlled products, fleet tracking, GPS devices, and software). It also provides services, such as guarantees and installation, machine rentals, and financing solutions. AXIÁL's primary focus is agriculture, accounting for almost 50% of total turnover, with a secondary focus on construction, material handling and warehousing.

AXIÁL is fully owned by two individuals: Zsolt Harsányi (50%) and Gyöngyi Harsányi Fodor (50%).







Financial overview

Scope credit ratios	2020	2021	Scope estimates		
			2022E	2023E	2024E
Scope-adjusted EBITDA/interest cover	32x	37x	11x	11x	12x
SaD/Scope-adjusted EBITDA	1.0x	1.4x	2.0x	2.0x	2.0x
Scope-adjusted funds from operations/SaD	135%	58%	51%	42%	61%
FOCF/SaD	82%	-25%	3%	5%	14%
Liquidity (internal and external)	<100%	>100%	>100%	<100%	>100%
Scope-adjusted EBITDA in HUF m					
EBITDA	13,400	16,362	12,976	12,741	12,543
Operating lease payments in respective year	-	-	-	-	-
Disposal gains/losses on fixed assets	-3,856	-3,875	-2,955	-2,955	-2,955
Scope-adjusted EBITDA	9,545	12,487	10,021	9,786	9,589
Scope-adjusted funds from operations in HUF m					
EBITDA	13,400	16,362	12,976	12,741	12,543
less: net cash interest as per cash flow statement	-297	-342	-910	-877	-800
less: cash tax paid as per cash flow statement	-603	-828	-266	-266	-257
add: depreciation component, operating leases	-	-	-	-	-
add: dividends received from equity	25	63	29	29	29
Other ¹	746	-5,402	-1,860	-3,156	-20
Scope-adjusted funds from operations	13,271	9,853	9,970	8,472	11,496
Free operating cash flow in HUF m					
Funds from operations	13,271	9,853	9,970	8,472	11,496
Working capital change	2,622	-2,612	-1,608	1,292	-1,032
Non-operating cash flow	58	26	10	-20	0
Profit/loss on disposals	-3,856	-3,875	-2,955	-2,955	-2,955
less: capital expenditure (net)	-4,045	-7,637	-4,902	-5,771	-4,965
FOCF	8,050	-4,246	515	1,018	2,544
Net cash interest paid in HUF m					
Cash interest paid as per cash flow statement	325	372	960	927	850
less: cash interest received as per cash flow statement	-28	-30	-50	-50	-50
Net cash interest paid	297	342	910	877	800
Scope-adjusted debt in HUF m					
Reported gross financial debt	23,139	24,947	25,670	22,920	20,500
less: cash and cash equivalents	-13,741	-8,239	-6,474	-3,370	-2,123
add: cash not accessible	405	405	405	405	405
add: operating lease obligations	-	-	-	-	-
add: pension adjustment	-	-	-	-	-
add: net asset retirement obligations	-	-	-	-	-
SaD	9,803	17,114	19,601	19,955	18,782

¹ This item includes the variation in current assets and liabilities, excluding inventories, receivables and payables.

ESG profile²

Environment	Social	Governance
Resource management (reduced water, energy, raw materials consumption, emissions; fuel efficiency; etc.)	Labour management	Company control , supervisory boards, key person risk 
Efficiencies (production process, etc.)	Safety	Clarity/transparency of financial disclosures, transparency of communication/ability to communicate 
Product innovation (costs to transition, substitution of products and services, green buildings, clean tech, renewables, etc.)	Clients and supply chain (geographical/product diversification)	Corporate structure: complexity 
Physical risks (business/asset vulnerability, diversification, etc.)	Regulatory and reputational risk	Stakeholder management: shareholder payouts & respect for creditors 

No dedicated ESG strategy

AXIÁL has no dedicated ESG strategy. Nevertheless, regarding environment, it is committed to reduce its carbon footprint. It aims to reduce its energy consumption and emissions in its outlets. It also uses solar panels and electric cars. Besides, it is involved in tree-planting programmes. As for its social responsibility, AXIÁL trains the next generation of farmers and is currently welcoming refugees from Ukraine and collecting some aid.

As a wholesaler, AXIÁL is exposed to the shortage of raw materials and natural resources but also to reputational risks (labour force management). The environmental management of a shop (costs related to refurbishment or energy) and the environmental footprint linked to logistics are the main elements for the environmental aspect.

² 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: BB-

AXIÁL's business risk profile continues to be supported by its profitability and market positioning in Hungary, with diversification being a negative rating driver.

Relative importance of agriculture for Hungary

Agricultural output remains important in Hungary despite having contributed only 3.1% to GDP in 2021. In 2016, rural regions accounted for 28% of the national territory (vs 52% in France and 68% in Romania), while 60% of farms were run by a household that consumed more than 50% of final production (vs 2% in France and 86% in Romania). The agricultural sector also benefits from EU subsidies such as the Common Agricultural Policy. According to AXIÁL, the Hungarian government is willing to continue stimulating investment in agriculture even if EU subsidies decrease. This can be seen in Hungary's digital agricultural strategy for 2019-2022. The 'Agriculture 4.0' reform impacts farm management and includes substantial support packages for farmers³.

Features of Hungarian agricultural sector: an advantage in the short and medium term

The Hungarian agricultural sector is dominated by small farms (defined as less than five hectares) with small economic sizes⁴ (under EUR 4,000) and owners who are more than 55 years old, according to 2016 Eurostat data. The active agricultural population decreased by 25.5% from 2010 to 2016.

The large amount of small farms benefits AXIÁL as it means more potential customers. Nevertheless, the company must deal with a dwindling population of farmers, in part due to ageing. This could be overcome by requests from bigger farms (300-3,000 hectares) for larger and more efficient machinery.

AXIÁL among top three dealers in Hungary

AXIÁL's main competitors are Kite Zrt. and Agrotec Kft. Together, the three companies account for around 80% of total Western-made agricultural machinery sales in Hungary.

Distributor of well-known brands

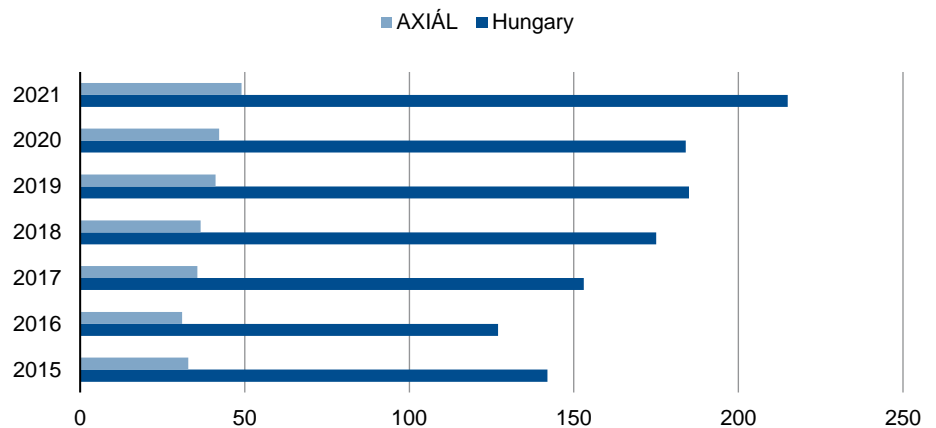
AXIÁL is the exclusive distributor of globally known brands, such as Claas (since 2000), Manitou (since 1998), Fendt (since 2002), Landini (since 1998), Horsch (since 2007) and Hyundai (since 2004). Claas is Hungary's second strongest brand after John Deere (whose exclusive distributor is Kite Zrt.). In addition, AXIÁL has had success in gaining new suppliers, such as Gregoire for agricultural machines and JEKKO for construction machinery.

AXIÁL's sales of agricultural machinery account for 20%-25% of Hungarian sales

AXIÁL's sales of agricultural machinery account for 20%-25% of sales of Hungarian agricultural machinery. Its market share is 40%-45% for combine harvesters (the second largest product category in agricultural machinery), 20%-25% for tractors (largest) and 40% for telescopic loaders.

³ The aim is to modernise farming, including data-driven precision farming. Approximately HUF 150m non-repayable grant per farmer. At least 7% of each application must be dedicated to digital solutions or services.

⁴ The standard output of an agricultural product is the average monetary value of the agricultural output at farm-gate price, in euro per hectare or per head of livestock. There is a regional standard output coefficient for each product, as an average value over a reference period (5 years, except for the standard output 2004 coefficient calculated using the average of 3 years). The sum of all the standard output per hectare of crop and per head of livestock in a farm is a measure of its overall economic size, expressed in euro.

Figure 1: Agricultural machinery sales (in HUF m)


Sources: AXIÁL, Scope

Leader in spare parts sales

AXIÁL has a market share of 50% in the spare parts retail market, which was its main business at inception. This history provides visibility as well as recognition as an expert in the field. This provides a competitive advantage, reinforced by AXIÁL's logistics and infrastructure.

Spare parts activity is even more important now with the rise of built-in components in agricultural and construction machinery, which has led to a 50% higher need for spare parts.

Larger product offering to attract and retain customers

AXIÁL continually seeks to improve product diversification. Recently, it introduced: i) DeLaval milking technology; ii) mAXI-CAM, an optical weed recognition-based cultivation system developed by AXIÁL; iii) mAXI-MAP, a module that enables mapping of precision farming data, gives the possibility of efficient visual comparison of different maps but also gives other information related to precision farming; and iv) mAXI-net 2.0, a correction signalling tool for automated agricultural machines. The company has complemented its product portfolio with machine accessories (items not supplied by manufacturers, such as tyres, batteries and oils), and it has even developed an in-house brand (Ister).

Strong after-sales business

AXIÁL's after-sales business is stronger than that of competitors thanks to its large workshop, which has an area of over 16,000 sq m. An extension to its spare-parts logistics centre has been operational since mid-2021. This activity will become more important as machinery gets more complex. It is worth mentioning that materials maintenance consistently accounts for 6% of Hungarian agricultural expenses, according to Eurostat, equivalent to around EUR 275m per year. Having a strong after-sales business enables the company to retain its customers and perpetuate its business.

Capex used to improve service, efficiency, capacity and working environment

According to management, capex is directed into three areas: digital infrastructure, human resources and productive assets/facilities.

The company is investing in digital solutions to support internal processes (barcode, QR code, NFC, digital product sheet, rental machines application, digital inventory, video conferencing, etc.) and external processes (e-worksheet, e-invoice, digital sales contract, digital communication, etc.). Increasing digitalisation should not only lower operational costs but also show that the company is a pioneer in such solutions.

In terms of its investment in HR, the company enrolls trainees and offers benefits to attract and retain employees. AXIÁL aims at avoiding a level of employee turnover that entails costs for the company.

There is a site development plan in Felsőzsolca that should lead to a 640 sq m workshop, a 665 sq m storage facility, a 210 sq m washer, a 300 sq m parts warehouse, a 1,500 sq m machine demonstration area and a 300 sq m storage facility for Manax machines by the end of 2022. AXIÁL is also building a mobile workshop in Baja, which should be completed by the end of 2022. The company wants to invest in a new fleet of construction machine mobile service vans and new equipment in workshops. It also expects to renovate some of its outlets and sites. Current investments should foster AXIÁL's activities by enabling the company to serve more customers more efficiently. No other investments are in the pipeline.

Large customer base mainly in agricultural sector

AXIÁL has an extensive base of 37,000 customers in total, 10,000 of which it deals with frequently. Its customers are mainly from agriculture (about 90%) and located in Hungary. Its domestic customer base is spread across the country with around half in the west, one third in the centre and the rest in the east.

Close customer relations

AXIÁL sees customer relations as the most important part of its business. That is why it has 19 outlets across Hungary that are accessible within 75 km. It also sells directly to customers. With this strong customer focus, we expect costs for customers to switch to another supplier as high.

Adequate inventory levels despite some low turnover

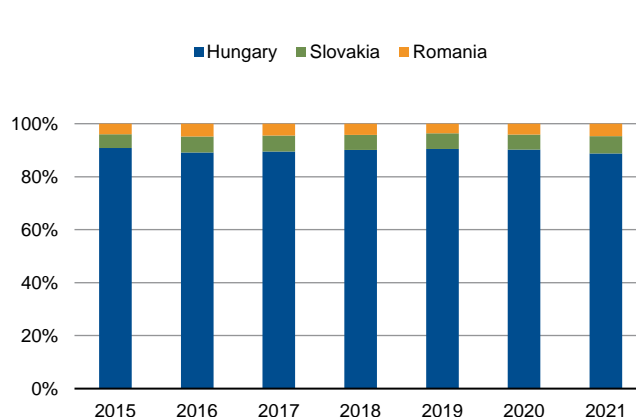
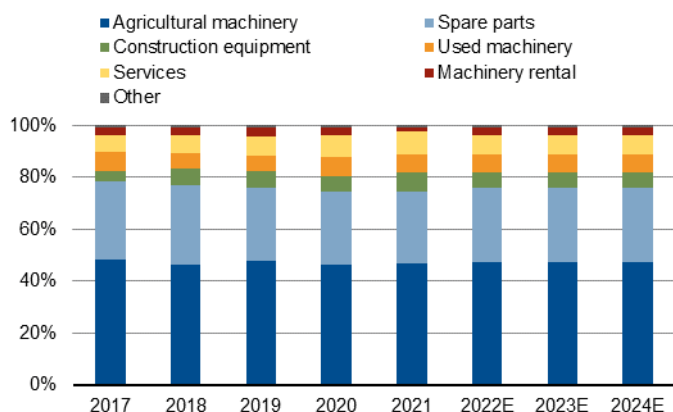
Inventory levels are a key constraint in retail. AXIÁL says it keeps inventory low but sufficient to meet customer needs. Inventories consistently account for just under 50% of the total balance sheet, in line with the industry. Lower inventory turnover versus rated automotive peers is mainly due to differences in business models (vehicles are sold more frequently than agricultural machinery.)

Revenue diversified only by activity

Agricultural machinery consistently accounts for almost 50% of revenues, followed by spare parts (around 30%). Hungary accounts for 90% of AXIÁL's turnover.

Figure 2: Revenue by segment (%)

Figure 3: Revenue by country (%)



Sources: AXIÁL, Scope estimates

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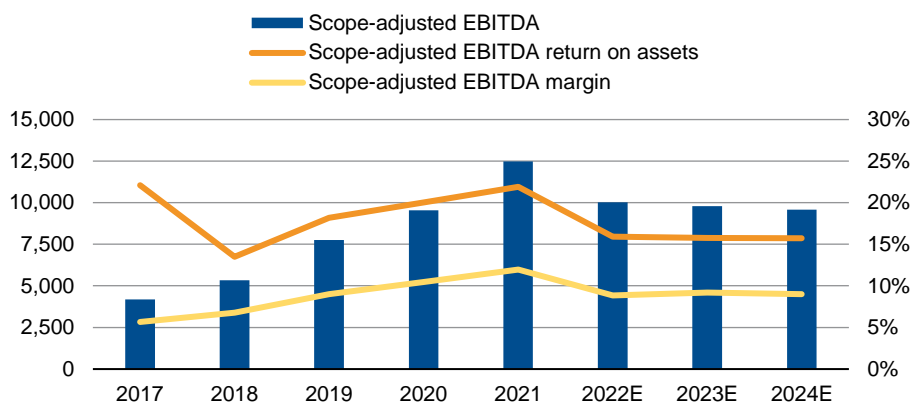
Improving operating profitability

The Scope-adjusted EBITDA margin is good, especially compared to rated peers. The margin has also improved year after year to 11.9% in 2021 from 5.7% in 2017. AXIÁL does not disclose EBITDA by segment.

Margin profile expected to be sustained at around 9%

As mentioned earlier, capex is aimed at improving service, efficiency, capacity, and the working environment. We therefore expect AXIÁL's Scope-adjusted EBITDA margin to remain around 9%. We do not expect this margin to be impacted by higher machine prices due to inflation as AXIÁL can pass such increases on to its customers as long as farmers' incomes continue to benefit from higher commodities prices.

Figure 4: Scope-adjusted EBITDA return on assets (% , RHS), Scope-adjusted EBITDA (HUF m, LHS) and profitability (% , RHS)



Sources: AXIÁL, Scope estimates

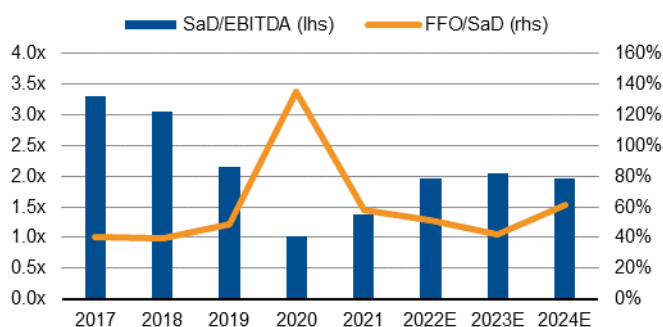
Low return on assets

We expect AXIÁL's Scope-adjusted EBITDA return on assets to remain stable, ranging between 15%-20%, which is low compared with peers' return on assets. This means the company is less effective at translating higher tangible assets (one third of the total balance sheet) and inventories (50%) into EBITDA. We expect a ratio of around 16% for the next few years.

Financial risk profile: BB+

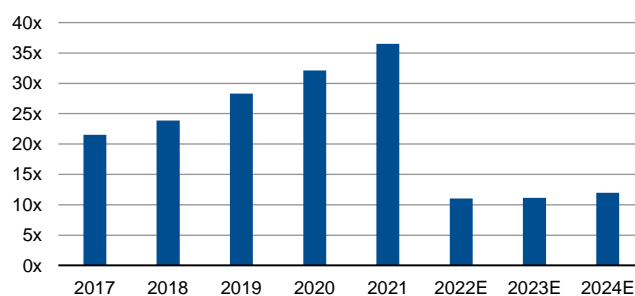
AXIÁL's financial risk profile continues to support the issuer rating. We expect financial leverage to remain around 2x in the medium term and interest cover to hover above 10x. The overall financial risk profile remains constrained by FOCF generation.

Figure 5: Scope-adjusted leverage



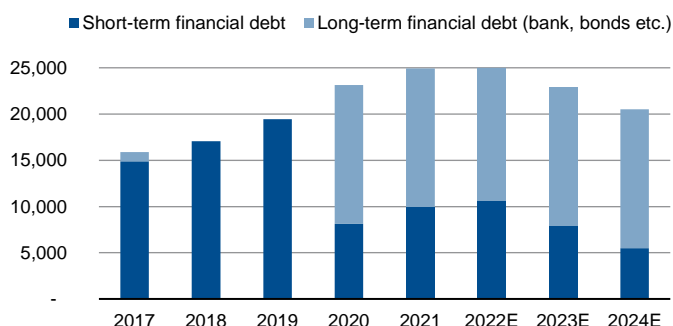
Sources: AXIÁL, Scope estimates

Figure 6: Scope-adjusted EBITDA interest coverage



Sources: AXIÁL, Scope estimates

Figure 7: Composition of financial debt (in HUF m)



Sources: AXIÁL, Scope estimates



Rating reflects investment-grade leverage

Our rating case reflects a SaD/Scope-adjusted EBITDA ratio of around 2x. Note that EBITDA has been adjusted to reflect profit from asset disposals. This item relates to regular disposals of old leased machinery to farmers who are unable to afford new machinery. The funds from operations/SaD ratio is expected to remain above 40%.

Very strong interest coverage

Debt protection as measured by Scope-adjusted EBITDA interest cover is expected to remain above 10x. We expect lower debt protection in the coming years due to a spike in short-term interest rates.

Weak cash flow coverage

Cash flow cover as measured by FOCF/SaD has shifted between positive and negative. This is because of fluctuations in FOCF due mainly to working capital changes. In both 2018 and 2021, FOCF turned negative as a result of higher inventories (up 12.4% and 24.5% in 2018 and 2021 respectively). From 2022, we expect FOCF to be positive thanks to an improvement in working capital.

Adequate liquidity position

AXIÁL's liquidity position is adequate as: i) most short-term debt has been repaid from bond proceeds; and ii) the company benefits from undrawn committed short-term credit lines totalling HUF 2.9bn⁵. As such short-term debt repayments for 2022 (HUF 9.9bn) are fully covered by available sources, namely cash and equivalents (HUF 7.8bn as at YE 2021), available credit lines (HUF 2.9bn as at YE 2021 and forecasted positive free operating cash flow (HUF 0.5bn for 2022).

Position in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	7,833	6,069	2,965
Open committed credit lines (t-1)	2,901	2,901	2,901
Free operating cash flow	515	1,018	2,544
Short-term debt (t-1)	9,947	10,670	7,920
Coverage	>100%	<100%	>100%

Supplementary rating drivers: +/- 0 notches

Conservative dividend policy

We expect the dividend payout to remain below 40% of net income in the coming years. In 2021, some 56% of net income was distributed. We believe a level of less than 40% strikes a balance between shareholder and creditor interests. A higher ratio could affect the rating.

No risk related to governance

AXIÁL is a Hungarian private limited liability company. The highest decision-making body is the members meeting (taggyűlés), whose members are the two owners, Zsolt Harsányi and Gyöngyi Harsányi Fodor, who happened to be a married couple. Financial decisions are taken by executive management, which comprises three directors: Zsolt Harsányi, Gyöngyi Fodor and Zsolt Pintér.

The supervisory board controls management's activities and regularly reports to the members meeting. As stipulated by Hungarian corporate law, the supervisory board must oversee the lawful conduct of the company and has the right and responsibility to request that management demonstrate compliance with relevant laws.

Despite a lack of real separation between board members and management, we found no related risk in AXIÁL's governance. The company's governance is further supported by experienced and committed senior management.

⁵ We assumed short-term committed credit lines would be fully rolled over based on the issuer's track record. Previously, the rolled-over amount was HUF 3bn. Following the bond issuance, AXIÁL did not renew some existing lines. However, it did renew its historic line in 2021. As a result, as of FYE 2021, total working capital facilities amounted to HUF 6.1 bn (vs HUF 1.2bn in 2020 and HUF 5.8 bn as of FYE 2019).



BB+ rating for senior unsecured debt

Long-term debt rating

We have affirmed senior unsecured debt at BB+. We still expect an 'above average' recovery for senior unsecured debt, such as the HUF 15bn bond issued in September 2020 under the Hungarian National Bank's Bond Funding for Growth Scheme. This recovery expectation translates into a BB+ rating for senior unsecured debt. We highlight that senior unsecured debt has a subordinate ranking to payables and to debt raised for working capital financing.



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