14 September 2022 Corporates

Ontime Corporate Union S.L.
Kingdom of Spain, Road logistics

SCOPE

Stable

BB-

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	5.9x	5.5x	8.2x	7.0x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	2.4x	6.8x	3.5x	3.8x
Funds from operations/SaD	33%	13%	23%	21%
Free operating cash flow/SaD	-22%	-22%	8%	2%

Rating rationale

Ontime Corporate Union S.L.'s rating (Ontime) is supported by its good profitability, although it is expected to decline due to more outsourcing and margin dilution from acquisitions. The acquisition of Acotral has made Ontime an average size company with about EUR 500m in pro-forma revenue in 2021. Ontime's market share will keep improving driven by the multiple upcoming acquisitions to consolidate the Spanish road logistics market. The integrated business model partially mitigates the risk of having a concentrated customer portfolio, with high value-added services contributing to client retention. The rating also benefits from a financial risk profile supported by a strong EBITDA interest cover ratio. The rating is constrained by Ontime's moderate but increasing leverage as it pursues external growth. The financial risk profile is also limited by the negative to low free operating cash flow pressured by high working capital and decreasing profitability. In addition to a lack of customer diversification, the company lacks geographical diversification with 90% of sales in Spain.

Outlook and rating-change drivers

The Stable Outlook anticipates that the group's financial leverage will remain above 3.5x due to the multiple upcoming acquisitions done in the light of Ontime's expansion strategy. The rating case also assumes that Ontime will successfully comply with its financial covenants in 2022 and 2023.

A positive rating action could be warranted if an indication of a less aggressive M&A policy leads to Scope-adjusted debt/EBITDA moving below 3.5x on a sustained basis and if free operating cash flow remains positive while Ontime maintained its current business risk profile.

A downgrade could be triggered if the company showed financial leverage over 5.0x Scope-adjusted debt/EBITDA on a sustained basis. A financial leverage exceeding 5.0x could be triggered by a significant deterioration of operating profitability in its core segments or higher-than-expected working capital requirements. A negative rating action could also be warranted if the company failed to comply with its financial covenants, leading to inadequate liquidity.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
14 Sep 2022	Downgrade	BB-/Stable
03 Sep 2021	New	BB/Stable

Ratings & Outlook

Issuer	BB-/Stable
Short-term debt	S-3
Senior unsecured debt	BB-

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Related Methodology and Related Research

Corporate Rating Methodology; July 2022

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Good operating margins, although expected to decrease due to higher operational costs (outsourcing) and dilution from acquisitions.	• Moderate leverage expected to increase following the expansion strategy based on external growth.
• Average size company and moderate market share in the Spanish market. Market share is expected to increase in the medium term due to an ambitious expansive strategy.	• Weak free cash flow generation increasing working capital.
• Business model including higher value-added services like IT systems, documentation, total traceability of orders, purchase order management.	• Concentrated geographical footprint and low customer diversification partially mitigated by strong integration providing low client churn rate.
• Financial risk profile supported by strong EBITDA interest cover.	• Execution risks with regards to the change in operating strategy as well as potential M&A transactions.

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted-debt/EBITDA decreases below 3.5x on a sustained basis while free operating cash flow remains positive.	• Scope-adjusted-debt/EBITDA above 5.0x on a sustained basis. • Covenant breach leading to inadequate liquidity.

Corporate profile

Grupo Ontime is headquartered in Madrid and was founded in 1991. It is a logistic services group specialised in personalised multimodal services for large corporations. Its offerings range from urgent, domestic, and international courier services, distribution of parcels and palletised cargo and storage. The company employs 4,900 professionals, has around 4,500 vehicles and 30 service centres. The group is privately owned and generated EUR 149m in net sales and EUR 12m EBITDA in 2021 (fiscal years end on 31 December). The group mainly operates in Spain.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	2.6x	5.9x	5.5x	8.2x	7.0x	6.3x
SaD/Scope-adjusted EBITDA	4.0x	2.4x	6.8x	3.5x	3.8x	3.7x
Funds from operations/SaD	14%	33%	13%	23%	21%	21%
Free operating cash flow/SaD	19%	-22%	-22%	8%	2%	3%
Scope-adjusted EBITDA in EUR '000s						
EBITDA	10,220	14,691	11,562	38,228	44,258	48,561
Operating lease payments	1,790	12,573	24,192	57,640	64,482	71,307
Other items[1]	1,227	1,457	-1,225	0	0	0
Scope-adjusted EBITDA	**13,237**	**28,721**	**34,530**	**95,868**	**108,740**	**119,868**
Funds from operations in EUR '000s						
Scope-adjusted EBITDA	13,237	28,721	36,395	95,868	108,740	119,868
less: (net) cash interest paid	-4,885	-4,350	-4,921	-8,559	-11,013	-13,893
less: cash tax paid per cash flow statement	-529	-1,246	2,182	-6,031	-7,528	-7,624
less: interest component operating leases	-127	-539	-1,379	-3,069	-4,580	-5,092
Funds from operations	**7,696**	**22,586**	**32,278**	**78,210**	**85,620**	**93,260**
Free operating cash flow in EUR '000s						
Funds from operations	7,696	22,586	32,278	78,210	85,620	93,260
Change in working capital	-2,581	-17,247	-37,481	-5,010	-854	3,411
less: capital expenditure (net)	6,423	-8,049	-21,924	9,600	-16,000	-17,000
less: operating lease payments	-1,663	-12,034	-22,813	-54,571	-59,902	-66,215
Free operating cash flow	**9,875**	**-14,744**	**-49,941**	**28,229**	**8,864**	**13,456**
Net cash interest paid in EUR '000s						
Net cash interest per cash flow statement	4,885	4,350	4,921	8,559	11,013	13,893
add: interest component, operating leases	127	539	1,379	3,069	4,580	5,092
Net cash interest paid	**5,012**	**4,888**	**6,300**	**11,627**	**15,592**	**18,985**
Scope-adjusted debt in EUR '000s						
Reported gross financial debt	56,440	68,038	212,876	215,055	274,408	281,321
less: cash and cash equivalents	-8,546	-34,642	-49,342	-46,326	-48,442	-47,311
add: operating lease obligations	5,370	37,719	72,576	172,920	193,446	213,921
Other items[2]	0	-2,600	-2,000	-2,000	-2,000	-2,000
Scope-adjusted debt	**53,263**	**68,515**	**234,109**	**339,648**	**417,411**	**445,931**

[1] Non-recurring costs include legal fees, due diligence fees, accounting adjustments
[2] Bank deposit classified as short-term financial asset

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Environmental, social and governance (ESG) profile[3]

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)	

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

ESG analysis is credit neutral

Ontime has no dedicated ESG strategy, with most requirements stemming from financial lenders' own ESG strategies. However, we see a need for a more pro-active approach by Ontime to address key ESG-related risks ahead: i) risk of stranded assets (especially for ageing fleet); ii) social equity (wage dumping in Europe for lorry drivers); and iii) regulatory risk (changing requirements for existing lorry fleet to reduce CO2 emissions could lead to higher capex or lease expenses).

[3] 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-

Industry risk profile: B+

Industry risk for Ontime is high as it is mainly exposed to the road transportation sector.

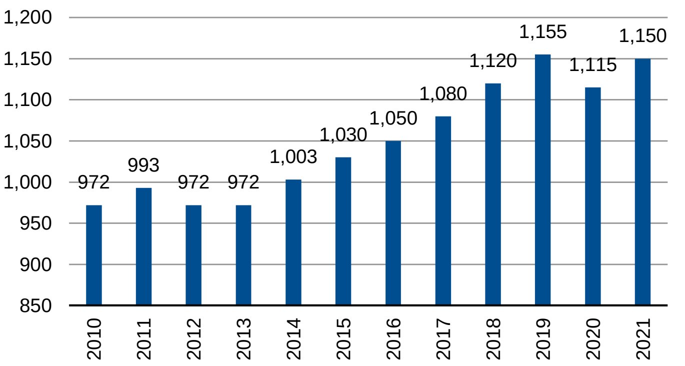
We assess cyclicality in the road transportation industry as medium. Since a vast majority of goods are transported by road logistics, at least on the last stretch of their route, the size of the overall market is very large. It has been growing steadily in line with GDP and industrial production globally. However, since a large portion of road cargo consists of essential goods like fresh and packaged food, beverages and healthcare products, there is a very much stable transportation volume. Moreover, European road freight volumes have been on a positive trend, outpacing GDP growth for more than a decade. GDP growth sensitivity was below 1x, for instance, in the 2009 recession.

Entry barriers to road freight logistics are very low, as evidenced by a six-digit number of competing companies in Europe. According to estimates, more than 80% of European road freight companies operate 0 to 10 lorries in total, leading to an extremely fragmented market with only 1% of companies operating more than 50 lorries. The Spanish market displays the same picture with more than 600 road logistics companies.

Substitution risks are medium to low in our view. Despite a clear commitment of many market participants and governments alike to curb carbon emissions and move cargo volume to more environmentally friendly modes of transport like rail, the overall transport industry still depends heavily on lorries. The last 0 to 100km to the cargo's final destination can only be covered by road transport in most cases. Increased levels of national and international trade have always lifted road transport volumes in absolute terms, and road's relative share has been very stable over the last few decades.

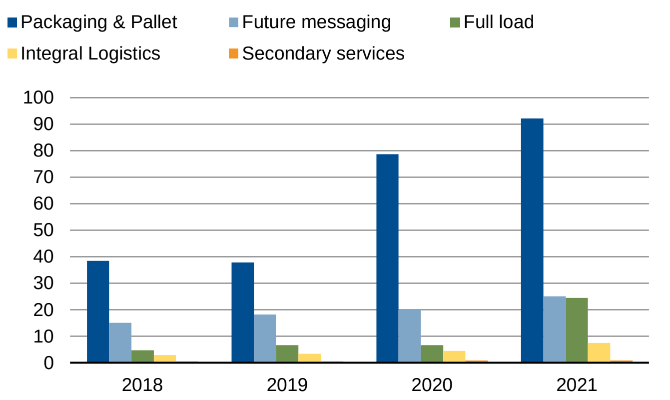
Blended industry risk is B+, based on the weights of the EBITDA contribution to consolidated group numbers. We assigned a 22% weighting to the courier services industry risk profile (assessed BBB), applicable to the EBITDA contribution from the courier segment, and a 78% weighting to the road logistics industry risk profile (assessed B).

Figure 1: Logistics market size in Europe (EUR bn).



Sources: Statista, Scope

Figure 2: Segment revenues (EUR m)



Sources: Ontime, Scope

Improving market share thanks to transforming acquisitions

We regard Ontime as an average-sized logistics company, on an absolute scale. The group has done several acquisitions that have increased both revenue and market share. Following the Acotral acquisition in 2021 for EUR 70m, the company increased its revenues from EUR 110m in 2020 to EUR 499m in 2021 on a pro-forma basis including around EUR 350m from Acotral. The latter is the No. 1 road logistics supplier in

Andalucía, supplying 80% of road logistics to Mercadona, the leading Spanish retailer, with EUR 27.8bn in revenues in 2021.

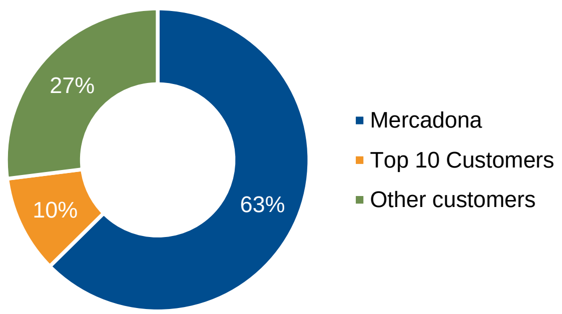
Ontime is ahead of schedule in reaching its turnover target of EUR 300m, and the Acotral acquisition allowed it to reach a 2.6% market share in the fragmented Spanish road logistics market.

With a fleet size of 3,800 vehicles and numerous warehouses, the company compares favourably vs its Spanish peers, but its limited scale still prevents Ontime from winning large contracts and meeting pan-European services demand, with its promising prospects. Additionally, we see Ontime's present focus on B2B (business-to-business) as a limiting factor as the B2C is faster growing due the emergence of e-commerce.

Integrated business model offers many advantages

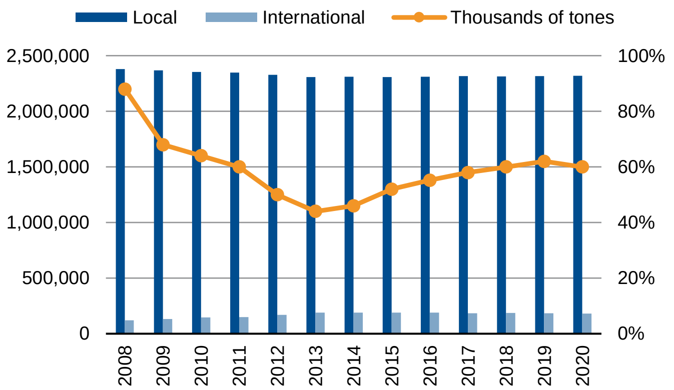
Ontime is one of the few companies in Spain with a complete and integrated offering of logistical services (5PL or 'fifth party logistics'). Integrated logistics, coordinating and automating much of the logistics chain, is in high demand, and boosts customer retention. Key competitive advantages are the customer satisfaction, efficiency and flexibility in a market with limited differentiating opportunities. There is no pricing power nor market dominance in the fragmented European road freight market, with the top 10 players only covering about 10% of freight volume. This is even more the case for Spain, with more than 600 companies, making even large players price takers, in our view. We nevertheless acknowledge that the integrated business model allows Ontime to mitigate competitive pricing by offering more value-added services, although entailing less flexibility than handling contracts via subcontractors.

Figure 3: Customer portfolio breakdown (in %), 2021



Sources: Ontime, Scope

Figure 4: Road freight transport in Spain (1000 tonnes, lhs) and breakdown by destination (rhs)



Sources : OTLE, Ministerio de Transportes, Movilidad y Agencia Urbana, Scope

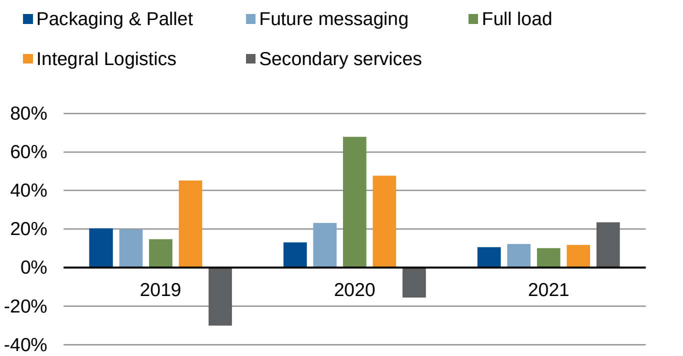
Weak geographical diversification

Ontime has limited geographical diversification and derives at least 90% of its revenues from Spain, with the rest in Portugal, following the Acotral acquisition. The business segment diversification level for Ontime is assessed as fair by including domestic and international courier services, distribution of parcels, industrial parcels, campaign and promotion materials and storage, although it is still constrained by being concentrated on the industrial parcel services (61% of sales), its business-to-business (B2B) delivery operation.

Acotral acquisition led to a more concentrated customer portfolio

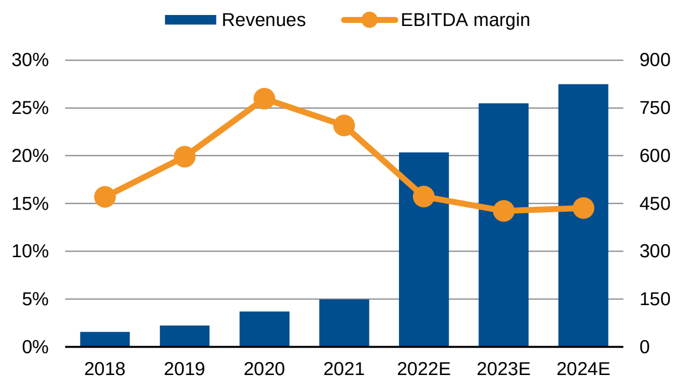
The company has numerous leading multinational companies among its clients, from diversified sectors including retailers, consumer goods, telecommunication operators and construction contractors. Its customer diversification deteriorated after the acquisition of Acotral: the top 15 clients previously accounted for around 38% of sales in 2020, while one customer (Mercadona) currently accounts for 63% of pro forma sales (70% expected in 2022). The concentration risk is mitigated by the fact that, excluding Acotral, the top 30 clients have been working with Ontime since at least 2017, with 1/3 since 2011, showing good customer loyalty. In addition, the contract between Acotral and Mercadona has existed since 2003 and is renegotiated yearly, including changes in the transportation costs (petrol and staff expenses), and both parties have committed to extend their business agreement until at least 2024. Finally, the risk of Mercadona switching to another logistics company is mitigated by the fact that Mercadona requires modern lorries.

Figure 5: Reported EBITDA margin per segment (%)



Sources: Ontime, Scope

Figure 6: Profitability (Scope-adjusted EBITDA, lhs) vs revenues (in EUR m, rhs)



Sources: Ontime, Scope estimates

Good profitability thanks to its integrated model…

The road logistics business is characterised by slim margins due to intensive competition. This is partly driven by the business model being based on commissions or forwarding fees and contracts on an order-by-order basis. This means that turnover is often more important than margins and costs. This again leads to little resistance to price cuts to match competitors' prices and win contracts. EBIT margins vary from 1% to 8%. The range is due to different company strategies in the logistics sector.

Ontime's profitability (EBIT margin) has been averaging around 8.9% from 2018-2021, above its European peers. The good profitability is due to its integrated business model where most of services are performed in-house while peers tend to outsource their operations due to a larger outreach. Ontime, on the contrary, delivers higher margins by focusing only on Spain and increasing its efficiency. The good and stable profitability was maintained during the pandemic in 2020 when multiple lockdowns did not negatively affect the overall operating margin.

…expected to decrease in the coming years

In 2021, an overall slight decline in reported EBITDA margin from 13% to 8% came from:

- The shift in strategy where Ontime relied more on subcontractors (independent lorry owners for example). This led to an increased cost base although it improved working capital management.

- Profitability dilution from acquisitions. Acotral's reported EBITDA margin in 2020 stood at around 4%.

We anticipate an overall slight decline in EBITDA margin in the coming years due to the same factors observed in 2021. The inflationary environment is expected to have a limited impact going forward. Ontime has the capacity to pass on fuel price increases to customers since sale contracts for large clients are either adjusted quarterly or are cost-based, with Ontime applying a pre-defined margin above expenses.

Financial risk profile: BB-

Increasing leverage due to deteriorating EBITDA margin and acquisitions

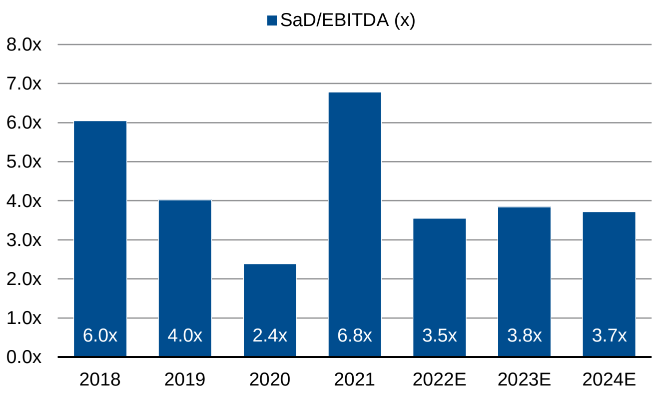
Following the acquisition of Acotral for EUR 70m in Q4 2021, including a EUR 49m payment in 2021 and EUR 21m contingent payment booked as financial debt, as well as assuming EUR 100m in Acotral's debt, Scope-adjusted-debt/EBITDA has increased from 2.4x to 6.8x (2.8x on pro-forma basis). The EUR 26m capital increase realised in 2021, following the EUR 20m equity issuance in 2020, has allowed Ontime to reduce the impact of the Acotral acquisition on its leverage.

Indebtedness is expected to increase in 2022 and 2023 as the expansion phase undertaken by Ontime heavily relies on external growth. As no additional capital increase is expected in that period, the multiple acquisitions will be debt-funded. Credit metrics are expected to remain volatile due to many unknowns such as the size and the timeline of the expected acquisitions in addition to the debt in the companies acquired. The increase in leverage is also driven by an anticipated drop in the EBITDA margin. Profitability will be pressured by the operating margin dilution from acquiring targets more exposed to inflation through greater reliance on outsourcing.

Therefore, we expect that leverage will increase to 3.6x by the end of 2022.

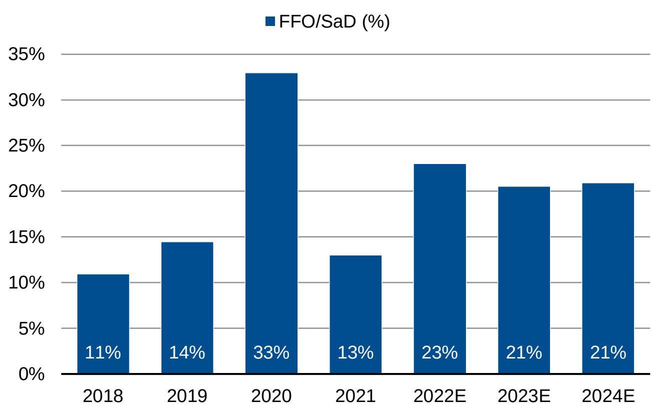
The company has two covenants (maximum capex and net debt/EBITDA) for its syndicated facility signed in 2021 and for the Alantra loan signed 2020.

Figure 7: Scope-adjusted debt/EBITDA



Sources: Ontime, Scope (estimates)

Figure 8: Fund from operations/EBITDA



Sources: Ontime, Scope (estimates)

Low free operating cash flow driven by high working capital requirements and moderate capex

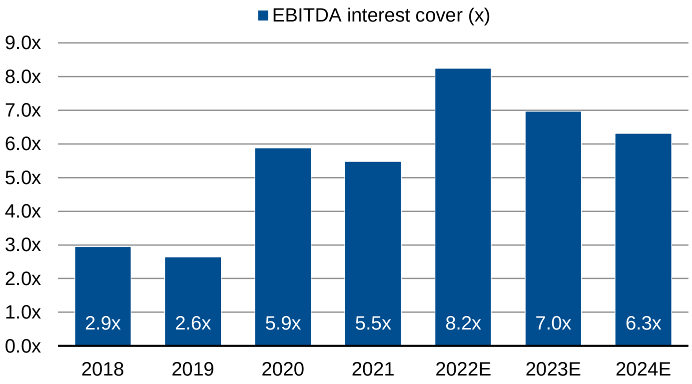
Cash flow generation was negatively impacted over the last three years by large working capital needs due to the surge in sales (up 43.4% in 2019, +66.4% in 2020 and +34% in 2021) and Ontime's business model. Most of its services have been provided in-house with limited use of subcontractors so expenses are paid right away while cash collection from customers is deferred.

Working capital requirements are expected to decline in 2024 following the completion of the expansion phase in Spain. Indeed, the multiple upcoming acquisitions will reduce working capital as the acquired targets rely more on subcontractors. The spread between receivables and payables will also narrow because the acquired Acotral has lower days of sales outstanding than days of payables.

The operating cash flow has been too low to organically fund large capex (accounting for 14% of sales over the period 2018-2021, peaking at 25% in 2021) which can be explained by the organic growth phase undertaken by Ontime. The forecasted decrease in the capex-to-sale ratio from 2022 onwards is based on Ontime's new strategy of switching to a more asset light model. Capex will be used to renew Acotral's fleet as its main customer, Mercadona, requires modern lorries for its logistics. The level of investments in the fleet is limited by its capex covenant on its EUR 30m Alantra loan allowing capex up to a maximum of EUR 20m per year in 2022/2023 and EUR 10m in 2024.

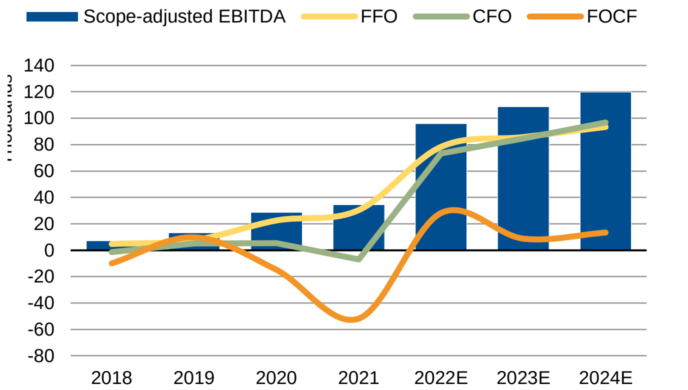
The positive free operating cash flow displayed in 2019 and expected in 2022 mainly come from large divestments, viewed as non-recurring. We nevertheless expect the free operating cash flow to turn slightly positive on the back of improving working capital and lower capex.

Figure 9: Scope-adjusted EBITDA/interest cover



Sources: Ontime, Scope (estimates)

Figure 10: Cash flows (EUR m)



Sources : Ontime, Scope (estimates)

Adequate liquidity supported by headroom from unrestricted cash and undrawn credit

We view Ontime's liquidity as adequate. This is based on our expectation that liquidity sources will exceed uses by more than 200% in the next 12 months following consistently high liquidity in the past.

Balance in EUR '000s	2022E	2023E	2023E
Unrestricted cash (t-1)	46,326	48,442	47,311
Open committed credit lines (t-1)	41,662	41,662	41,662
Free operating cash flow	28,229	8,864	13,456
Short-term debt (t-1)	25,447	30,334	30,334
Coverage	**>200%**	**>200%**	**>200%**

Long-term and short-term debt ratings

Senior unsecured debt rating: BB-

We downgrade Ontime's debt instrument rating on senior unsecured debt to BB-, one notch down in line with the issue rating. This instrument rating is based on a hypothetical liquidation scenario as of end-2023, in which we computed an average recovery for senior unsecured debt holders based on our assumptions of attainable liquidation values.

Short-term debt rating: S-3

We affirm Ontime's debt instrument rating on short-term debt at S-3. The issuer has launched a EUR 50m commercial paper programme in 2021, with EUR 26m already used.

Appendix: Peer comparison (as at last reporting date)

	Ontime	Waberer's International Nyrt.	BHS Trans Kft	Illes Holding Zrt
	BB-/Stable	B+/Stable	B+/Stable	B+/Stable
Last reporting date	31 December 2021	31 December 2021	31 December 2021	31 December 2020
Business risk profile				
Revenues (in EUR m)	499[4]	591	35	54
Exposure to domestic market (in % of revenues)	96%	30%	79%	72%
Customer concentration	High	Low	High	High
EBITDA margin	15-25%	7-11%	20-25%	15-17%
Financial risk profile				
Scope-adjusted EBITDA/interest cover	5.5x	16.9x	26.8x	11.9x
SaD/Scope-adjusted EBITDA	6.8x	2.7x	4.8x	3.0x
Funds from operations/SaD	13%	12%	20%	30%
Free operating cash flow/SaD	-22%	3%	-51%	-7%

Sources: Public information, Scope

[4] Pro-forma basis

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