BHS Trans Kft.
Hungary, Industry

B+ STABLE

Corporate profile

BHS Trans Kft. is a Hungarian transport and logistics company, headquartered in Dunakeszi. The company is 100% owned by the CEO Gabor Herbszt (since 2014). The BHS Group comprises BHS Trans Kft. and its three subsidiaries BHS Trans Srl. (transport services and logistics in Romania, established in 2016), BHS Raktarlogisztika Kft. (warehousing, established in 2019) and Pallethouse Kft. (pallet sales and manufacturing, established in 2017). In 2020, BHS Group generated consolidated revenues of HUF 12.7bn and consolidated EBITDA of HUF 2.7bn (21% margin). The rated entity BHS Trans Kft. currently generates nearly 90% of consolidated group revenues and earnings.

Key metrics

		Scope estimates		
Scope credit ratios	2020	2021E	2022E	2023E
EBITDA/interest cover (x)	26.8x	16.0x	8.7x	9.0x
Scope-adjusted debt (SaD)/EBITDA	4.8x	3.7x	4.3x	3.7x
Scope-adjusted FFO/SaD	20%	24%	20%	23%
FOCF/SaD	-51%	0%	-10%	11%

Rating rationale

Scope Ratings GmbH (Scope) has today assigned a first-time issuer rating of B+/Stable to Hungary-based logistics company BHS Trans Kft. Senior unsecured debt has been rated B+, in line with the issuer rating.

BHS Trans' business risk profile, rated B+, is constrained by the company's relatively small size, limited diversification and high customer concentration. BHS Trans is a relatively small player in a highly fragmented transportation industry. However, the company's exposure to the extremely price-competitive spot market accounts for only 5% of its business, the lion's share coming from contract logistics with large corporate customers/partners. Stable long-term relationships and strong customer loyalty have so far avoided any significant volatility in revenues, thus mitigating the risk inherent to the annual renewal of most contracts and the limited number of multi-year contracts.

Key constraints in terms of diversification are BHS Trans' limited geographical outreach and high customer concentration. An active customer acquisition strategy and the planned investment in complex warehousing in Romania will help diversify the client base, although the process will take time due to the continued strong growth of its largest customer (Hell Group). In terms of business lines, the vast majority of revenues are derived from road transportation. BHS Trans is stepping up its efforts to diversify its service portfolio and, in parallel, offer more services per customer.

Operating profitability is the main support for the company's business risk profile. EBITDA margins (above 20%) are relatively strong, at the upper end of the peer group. Earnings volatility has been limited in the past few years, and BHS Trans has managed to keep its EBITDA margin in the 20%-25% range since 2017. The expansion of value-added services and complex warehousing will help improve underlying profitability and provide a buffer against potential fluctuations in the core transportation business.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	B+

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Related Methodology

Corporate Rating Methodology: July 2021

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We assess BHS Trans’ financial risk profile at B+. In the absence of audited consolidated financial statements, our financial base case is based on the parent company, which currently represents 80%-90% of the group’s revenues, EBITDA and financial debt. We calculate Scope-adjusted debt (SaD) of HUF 11.4bn at year-end 2021 and HUF 15.5bn at year-end 2022, assuming a successful bond issuance in 2022. We forecast that credit metrics will decline in 2022 and start to improve in 2023. Due to the high investment cycle which started in 2020, free operating cash flow is under pressure and will remain so until 2023. The improvement in free operating cash flow expected in 2023 will positively impact cash flow cover as well as liquidity, which we assess as adequate.

Outlook and rating change drivers

The Outlook is Stable based on our expectation that BHS Trans will successfully issue the planned HUF 4.8bn senior unsecured bond and that the proceeds from this bond will be used as planned. It also reflects our expectation that BHS Trans will retain its main customers and implement the warehousing expansion project from its business plan. The Outlook reflects our further expectation that no dividend payments will be made during the current heavy investment cycle.

A positive rating action could occur if SaD/EBITDA strengthened towards 3.5x on a sustained basis. An upgrade may also be warranted if BHS Trans improves its business risk profile in terms of customer concentration and business line/geographical diversification, while maintaining credit metrics at the forecasted levels.

A negative rating action could be warranted by an increase in leverage to SaD/EBITDA above 5x on a sustained basis. A rating downgrade could also be triggered by a significant decline in its largest customer’s activity or a substantial decrease in the order volume from this key customer, leading to much lower profitability than expected. A significant liquidity deterioration could likewise drive a negative rating action.

Rating drivers

Positive rating drivers	Negative rating drivers
• Strong track record in terms of profitability, the Scope-adjusted EBITDA margin averaged 23% over 2017-2020 • Longstanding relationship with key customers • Ongoing expansion into more added-value services (complex logistics and warehousing) • Well positioned to leverage untapped market potential in Romania • Strong interest cover metric	• Small player in a highly fragmented road freight and logistics industry • Relatively high customer concentration (top three represent over 55% of revenues) with strong reliance on one historical business partner • Limited geographical outreach • Weak free cash flow generation in recent years

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Decrease in leverage to SaD/EBITDA towards 3.5x on a sustained basis • Improved business risk profile in terms of customer concentration and business line/geographical diversification, while maintaining credit metrics at the forecasted levels	• Increase in leverage to SaD/EBITDA of above 5x on a sustained basis • Strong decline in largest customer's business activity or substantial decrease in order volume from this key customer • Significant liquidity deterioration, which could be caused by sustained negative free operating cash flow

Financial overview

		Scope estimates		
Scope credit ratios	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover (x)	26.8x	16.0x	8.7x	9.0x
Scope-adjusted debt (SaD)/EBITDA	4.8x	3.7x	4.3x	3.7x
Scope-adjusted funds from operations/SaD	20%	24%	20%	23%
Free operating cash flow/SaD	-51%	0%	-10%	11%
Scope-adjusted EBITDA in HUF m	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	2,417	2,847	3,414	3,909
Operating lease payments in respective year	0	188	161	161
Scope-adjusted EBITDA	**2,417**	**3,035**	**3,574**	**4,070**
Scope-adjusted funds from operations in HUF m	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	2,417	2,847	3,414	3,909
less: (net) cash interest as per cash flow statement	-105	-177	-389	-439
less: cash tax paid as per cash flow statement	-30	-103	-112	-130
add: depreciation component, operating leases	0	176	139	146
Scope-adjusted funds from operations	**2,282**	**2,743**	**3,052**	**3,486**
Scope-adjusted debt in HUF m	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	11,556	9,794	14,048	13,855
less: cash and cash equivalents	-160	-529	-201	-555
add: cash not accessible	160	529	201	555
add: operating lease obligations	0	492	356	214
Other (guarantees on subsidiaries' financial debt)	124	1,096	1,096	1,096
Scope-adjusted debt	**11,680**	**11,382**	**15,500**	**15,165**

Business risk profile: B+

BHS Trans was founded in 2011 and is based in Dunakeszi, Hungary. The company is active in road transportation and logistics, primarily in Hungary and Romania.

Industry risk assessed at B

BHS Trans' industry risk is high as it is primarily exposed to the road transportation sector, which has medium cyclicality, low entry barriers and medium to low substitution risks.

Medium cyclicality

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 and has been growing steadily in line with the volume of GDP and production volumes globally. There is a certain degree of correlation with GDP growth, which is due to the swings in industrial production throughout the economic cycle. However, since a large portion of road logistics cargo consists of essential goods like fresh and packaged food, beverages and healthcare products, there is a substantial level of very stable transportation volumes. Moreover, European road freight volumes have been on an overall positive trend, outpacing GDP growth for more than a decade. Sensitivity to GDP growth was below 1x during the 2008/2009 recession.

Low entry barriers

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 with less than 10 trucks, leading to an extremely fragmented market with only 1% of companies operating more than 50 trucks. The Hungarian market has similar features with more than 40,000 road logistics companies, primarily small and medium-sized companies.

Medium to low substitution risks

Substitution risks are medium to low. Despite a clear commitment from many market participants and governments alike to curb carbon emissions and therefore move cargo volume to more environmentally friendly modes of transport like rail, the overall transport industry still depends largely on trucks. In particular the last 0 to 100km until the cargo's final destination can only be covered by road transport in the vast majority of cases. Increased levels of national and international trade have always led to a rise in road transport volumes in absolute terms, accounting for a very stable relative share over the last decades.

As road logistics and related services dominate the company's activities, we have given them a 100% weighting (no blending) and retained the B rating for BHS Trans' industry risk profile.

BHS Trans' business risk profile is primarily supported by its high operating profitability. The major constraints include its limited absolute size in a fragmented industry, its weak market shares, highly concentrated customer and supplier bases as well as its limited geographical outreach.

Market positioning constrained by small size and low market shares

We consider BHS Trans (and BHS Group alike) to be a fairly small-sized company on an absolute scale (2020 revenues equivalent to EUR 36m at group level and EUR 32m at parent level). It is a relatively small player in a highly fragmented logistics industry with estimated market shares below 1% in its two major markets (Hungary and Romania). In terms of fleet size, with around 700 vehicles in 2021, the company is moderately sized in a Hungarian context. This fleet compares favourably with that of Trans-Sped (about 500 vehicles, of which only 48% are own fleet) but is considerably smaller than Waberer's, which is a leading logistics player in Hungary with an active fleet of 2,000 trucks in Q3 2021 (heading toward 1,600 units following the new downsizing strategy initiated in 2020).

Weak diversification across the board

BHS Trans has limited diversification in terms of business lines, client granularity and geographical outreach. While road transportation remains its dominant business, the company is gradually diversifying its service portfolio, expanding into more added-value services such as warehousing and complex logistics.

BHS Trans has a large number of customers (roughly 700 at end-2020). However, this client base is highly concentrated with the top 10 clients accounting for about 73% of revenues, of which energy drink producer Hell Energy, its largest customer and historical business partner, accounts for 35%. At group level, the entire Hell Group represents an even higher share of 40%-45% of revenues. BHS Trans is striving to reduce this high dependency on Hell Energy and has recently successfully diversified its client base (DS Smith, Wellis, Lisse). However, due to Hell Energy's sustained strong growth, reducing its share of BHS Trans' revenues will take time, even if the planed warehouse investment in Romania should help as it will generate mainly non-Hell-related revenues (75%-80%).

There is also high supplier concentration, the top 10 accounting for 60% of the procurement bill. Finally, BHS Trans has a limited geographical breadth as it derives 90% of its revenues from Hungary at the parent level and around 79% at group level (thanks to Romania, which is set to grow fast and could reach 25% of group revenues by 2025).

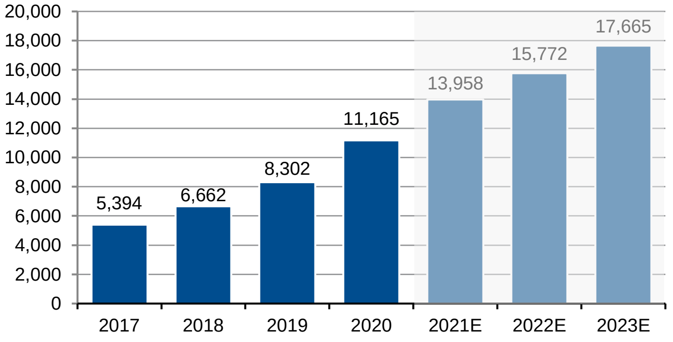
Very strong profitability, underpinned by an integrated business model

BHS Trans' strong operating profitability stands out in an industry that generates slim margins due to intense competition. This feature of the road logistics business is partly driven by a business model often based on commissions or forwarding fees and contracts on an order-by-order basis. This means that turnover is often more important than margin and cost. Consequently, competitors' prices become the standard and there is little resistance to price cuts in a race to win contracts. Spot bulk transportation is usually characterised by fierce competition, but this segment represents only 5% of BHS Trans' activity, as the lion's share of its transportation business is related to contract logistics with long-term relationships with large corporate partners.

Against this backdrop, BHS Trans has experienced limited volatility in operating profitability in the past few years and has managed to keep its reported EBITDA margins in the 20%-25% range since 2017. This strong profitability is primarily due to the company's integrated business model where almost all services (except for sea and air freight forwarding) are performed in-house (with its own personnel, vehicle fleet and warehouses), while many competitors tend to outsource parts of their operations. BHS Trans does not intend to shift to a more 'asset-light' strategy as the current model ensures full control over the quality of services provided as well as the ability to optimise utilisation rates. Furthermore, tenders for business partners such as Magyar Posta, Nagel, Coop, Lidl, Thyssen and Hell Energy increasingly require service providers to use their own vehicles.

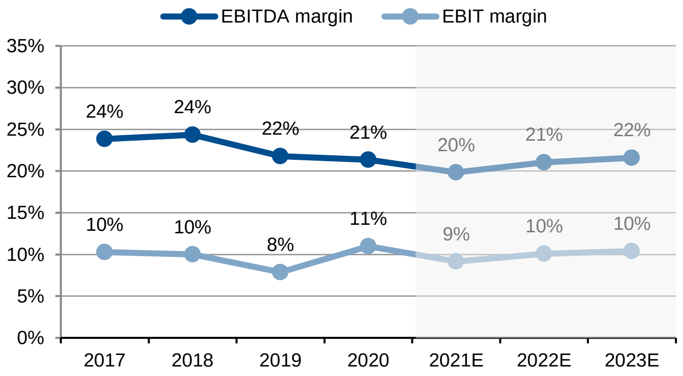
The expansion of value-added services and complex warehousing will help improve underlying profitability and provide a buffer against potential fluctuations in the core transportation business. For 2021, management has guided for EBITDA margins below the 21%-22% range initially targeted, due to fleet order delays in international transport leading to a temporary revenue/cost mismatch. With a much improved asset utilisation rate (e.g. four recently established warehouses, which were only running at 40%-60% of capacity at the end of 2021), strong transportation needs and higher freight rates, margin recovery should be secured in 2022 despite material cost inflation (mostly mitigated by indexation clauses) and a continued increase in headcount. Before adjustments for operating lease payments, our forecasts point to an EBITDA margin below 20% in 2021 and slightly above 21% in 2022.

Figure 1: Revenue trend (HUF m) – parent company



Source: BHS Trans, Scope estimates

Figure 2: Reported EBITDA and EBIT margins (parent)



Source: BHS Trans, Scope estimates

Financial risk profile: B+

Financial risk profile assessed at B+

BHS Trans' financial risk profile is assessed at B+. In the absence of audited consolidated financial statements, our base case is based on the parent company, which represents 80%-90% of the group's revenues, EBITDA and financial debt. All guarantees granted to subsidiaries (HUF 1.1bn) are accounted for in the figure for Scope-adjusted debt (SaD).

Scope-adjusted debt set to rise to HUF 16.2bn at year-end 2022

We calculate SaD of HUF 11.4bn at year-end 2021 (following the settlement of a subsidy pre-financing loan of HUF 956m in November 2021) and SaD of HUF 15.5bn at year-end 2022, assuming a successful bond issuance in 2022. We forecast that credit metrics will deteriorate in 2022 and start to improve in 2023.

Leverage to increase in 2022

Leverage as measured by SaD/Scope-adjusted EBITDA is expected to improve in 2021 (3.7x vs 4.8x in 2020), thanks to a slight decrease in SaD and robust EBITDA, before rising again to 4.3x in 2022, as a consequence of the HUF 4.8bn planned bond issue. Higher EBITDA will improve the ratio to 3.7x in 2023.

Interest cover will remain strong

Interest cover has been very strong in recent years, thanks to very low interest paid, combined with robust EBITDA development. The sharp increase in interest expenses forecasted from 2022 onwards (planned bond issuance at a much higher rate than the current average) will inevitably cause this metric to deteriorate. We expect interest cover to fall from 16x in 2021 to 8.7x in 2022 and 9x in 2023.

Weak free operating cash flow generation due to high capex

Cash flow cover has been negative over the past few years and is expected to remain weak in 2021/2022 before recovering in 2023. Due to the heavy investment cycle that started in 2020 (a large part of which will be borne by the Romanian subsidiary), free operating cash flow is under pressure and will remain so until 2023. The weak cash flow cover also reflects the impact of the loan to the Romanian subsidiary, which will handle the planned investment in warehousing to be financed by the planned bond issue.

Liquidity is adequate

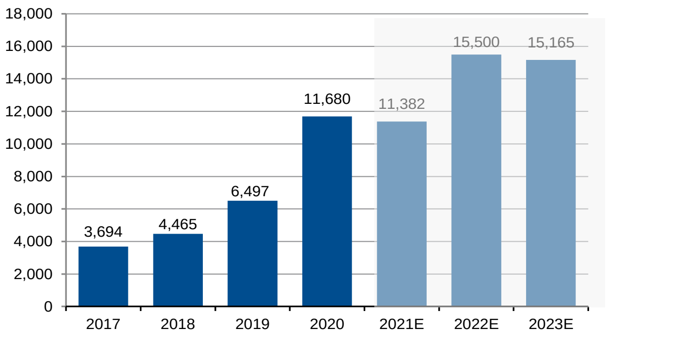
We assess BHS Trans' liquidity as adequate. However, we point to negative coverage of short-term maturities by internal liquidity sources and thus a recurring dependence on external liquidity provision, especially in times of negative free cash generation. A gradual normalisation of the Capex cycle will lead to a visible improvement in free operating cash flow and thus liquidity from 2023 onwards. Although there are currently no long-term committed credit line arrangements between the group and its banking partners, BHS Trans is exploring the possibility of entering into credit facility agreements with some of its financing banks.

Figure 3: Liquidity (HUF m)

Liquidity	2020	2021E	2022E	2023E
Cash and marketable securities equivalents (t-1)	78	160	529	201
Restricted cash (t-1)	78	160	529	201
Committed unused bank facilities (t-1)	0	0	0	0
Short-term debt (t-1)	1,293	2,695	1,835	2,056
Free operating cash flow (t)	-5,999	38	-1,529	1,640
Liquidity (%) - internal	**-464%**	**1%**	**-83%**	**80%**
Liquidity (%) - internal+external	**-464%**	**1%**	**-83%**	**80%**

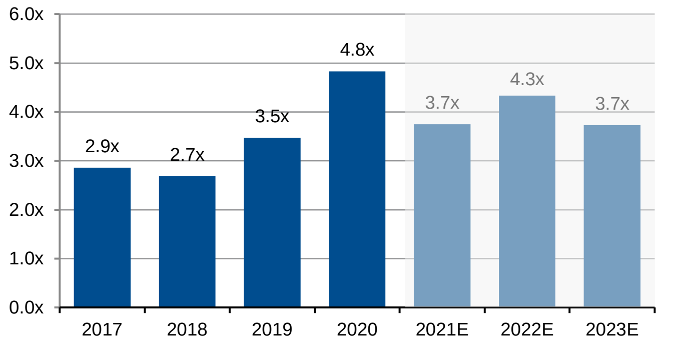
Source: BHS Trans, Scope estimates

Figure 4: Scope-adjusted debt (HUF m)



Source: BHS Trans, Scope estimates

Figure 5: Scope-adjusted debt/EBITDA



Source: BHS Trans, Scope estimates

Issuer rating at B+

All in all, with no supplementary risk drivers, we assign BHS Trans a B+ issuer rating.

Long-term debt rating

B+ rating assigned to senior unsecured debt class

We have assigned a B+ rating to senior unsecured debt, in line with the issuer rating. We calculated an 'average' expected recovery for senior unsecured debt holders, based on the attainable liquidation value in a hypothetical default in 2023 (including asset haircuts and liquidation costs of 10%.) We factored in the underlying value of the assets (warehouses in Romania), which will be funded via the planned bond issue, as well as the guarantees granted for the subsidiaries' financial debt.

HUF 4.8bn planned bond issue

BHS Trans plans to issue a HUF 4.8bn senior unsecured corporate bond under the Hungarian National Bank's Bond Funding for Growth Scheme. The bond will feature a 10-year tenor, 10% annual amortisation of the principal amount between 2027-31 and a 50% bullet repayment at maturity (2032). The bond coupon will be fixed (planned around 5.5%, subject to market conditions) and payable on an annual basis. Proceeds from the bond issue are earmarked for the building of four warehouses in Romania.

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