16 October 2024

Corporates

Abroncs Kereskedőház Kft.
Hungary, Retail

SCOPE BB- NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	10.2x	4.9x	5.2x	6.9x
Scope-adjusted debt/EBITDA	2.1x	4.0x	3.8x	2.9x
Scope-adjusted funds from operations/debt	45%	16%	21%	28%
Scope-adjusted free operating cash flow/debt	10%	-7%	5%	7%

Rating rationale

The rating is supported by the strong positioning in the domestic market as one of two market leaders, thanks to solid brand recognition and long-term relationships with international manufacturers. The cyclical nature of the products offered by AKH is a negative rating driver, but service integration and a comprehensive offering partially compensate for this limitation. The rating is also supported by the solid interest cover and the adequate liquidity. The rating is constrained by the issuer's small size and low profitability.

Outlook and rating-change drivers

The Negative Outlook reflects the risk that Scope-adjusted debt/EBITDA will remain above 4x as, although EBITDA is expected to improve gradually, market instability and earnings volatility could jeopardise AKH's ability to restore Scope-adjusted EBITDA and deleverage.

The upside scenario for the rating and Outlook is:

- Scope-adjusted debt/EBITDA below 4x on a sustained basis

The downside scenario for the rating and Outlooks is:

- Scope-adjusted debt/EBITDA at or above 4x on a sustained basis

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
16 Oct 2024	Outlook change	BB-/Negative
18 Oct 2023	Downgrade	BB-/Stable
18 Oct 2022	Affirmation	BB/Stable

Ratings & Outlook

Issuer	BB-/Negative
Senior unsecured (guaranteed) bond (HU0000360177)	BB-

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Related Methodologies and Related Research

General Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2024

European retail: defaults still on rise after jump in 2023; discretionary-goods suppliers at risk; July 2024

European retailers: persistent inflation, low consumer confidence threaten demand, squeeze margins; June 2023

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Leading position in the Hungarian market • Good supplier diversification with a good share of exclusive products • Improved geographical diversification with increased presence in Slovakia • Adequate liquidity	• Below-average profitability • Limited size, capped by the Hungarian market • Seasonality of operations

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA returning below 4x on a sustained basis	• Scope-adjusted debt/EBITDA remaining at or above 4x on a sustained basis

Corporate profile

Abroncs Kereskedőház Group (AKH) is one of the leading wholesale tyre retailers in Hungary, distributing products from more than 30 well-known tyre manufacturers. It operates in central Europe, including Hungary, Czechia, Romania and Slovakia. In addition to tyres, AKH offers lubricants as well as car and tyre services. With around 300 employees, it generated net sales of HUF 41bn and EBITDA of HUF 1bn in 2023.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	8.1x	10.2x	4.9x	5.2x	6.9x	7.9x
Scope-adjusted debt/EBITDA	1.8x	2.1x	4.0x	3.8x	2.9x	2.4x
Scope-adjusted funds from operations/debt	44%	45%	16%	21%	28%	35%
Scope-adjusted free operating cash flow/debt	29%	10%	-7%	5%	7%	9%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,284	1,820	952	831	1,069	1,180
Operating lease payments	251	649	645	677	708	740
Other items	-	-	(60)[1]	-	-	-
Scope-adjusted EBITDA	**1,535**	**2,469**	**1,537**	**1,508**	**1,777**	**1,920**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,535	2,469	1,537	1,508	1,777	1,920
less: (net) cash interest paid	(190)	(243)	(311)	(288)	(257)	(242)
less: cash tax paid per cash flow statement	(34)	(101)	(131)	-	(54)	(92)
Other operating changes	(72)	276	(132)	-	-	-
Funds from operations (FFO)	**1,239**	**2,401**	**963**	**1,220**	**1,466**	**1,586**
Free operating cash flow in HUF m						
Funds from operations	1,239	2,401	963	1,220	1,466	1,586
Change in working capital	383	(843)	440	(11)	(148)	(140)
Non-operating cash flow	(1)	-	179	-	-	-
less: capital expenditure (net)	(650)	(533)	(1,540)	(400)	(410)	(450)
less: lease amortisation	(164)	(508)	(490)	(513)	(543)	(575)
Free operating cash flow (FOCF)	**807**	**517**	**(448)**	**296**	**365**	**421**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	103	102	155	124	92	78
add: interest component, operating leases	87	141	156	164	165	164
Net cash interest paid	**190**	**243**	**311**	**288**	**257**	**242**
Scope-adjusted debt in HUF m						
Reported gross financial debt	3,826	3,131	3,693	3,224	2,736	2,184
less: cash and cash equivalents	(4,117)	(3,859)	(3,916)	(3,619)	(3,373)	(3,117)
add: haircut on cash (amount considered non accessible)	-	2,701	2,741	2,533	2,362	2,182
add: operating lease obligations	2,714	2,923	3,289	3,289	3,289	3,289
Other items[2]	406	406	395	277	158	-
Scope-adjusted debt (SaD)	**2,829**	**5,302**	**6,202**	**5,704**	**5,172**	**4,538**

[1] Change in provisions
[2] Guarantee to Bridgestone for the acquisition of ARS.

Abroncs Kereskedőház Kft.

Hungary, Retail

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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 neutral

AKH does not have a dedicated ESG strategy.

Reputational risk is a major social criterion for retailers. For example, product or labour management that has a negative social impact may prompt consumer boycotts, affecting sales, margins and inventory value. However, we believe AKH's position as a national wholesaler reduces that risk substantially. AKH has initiated several social responsibility projects including staff training.

Discretionary goods companies like AKH are also under growing pressure to ensure the sustainability of their products, namely in terms of durability and repairability. A strong commitment in this regard is likely to improve brand value. To this end, AKH is currently expanding into the all-season tyre segment.

Lastly, the environmental footprint of any company's brick-and-mortar shops will remain fundamental to its development. AKH is well protected against environmental risks as the number of its stores across the country is low outside of Budapest, given that the network relies on franchises. AKH has implemented some energy savings measures over the years (LED lighting, electric forklifts, warm protection door systems), and it organises or takes part in multiple charity events each year.

[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: B+

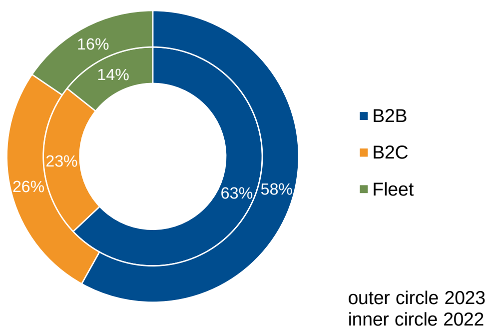
Industry risk profile: BB

AKH's business belongs to the car parts and automotive industry. We classify this industry as discretionary retail, with medium cyclicality, low entry barriers and low substitution risk. The industry risk profile is BB.

Market share in domestic market remains strong

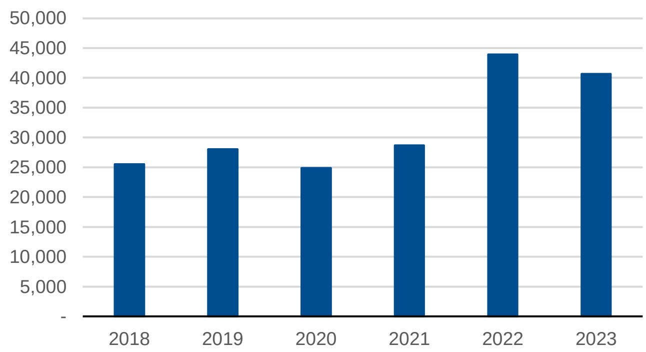
AKH's business risk profile is enhanced by its strong position in the domestic market, Hungary, where it is one of the leading tyre distributors, together with Marso (B+/Stable). 2022 was a very favourable year for sales, as the market benefitted from high inflation (which initially did not affected consumer behaviour) and government policies which attracted many OEMs to build plants in Hungary. 2023 saw a reverted trend, and the issuer's sales remained stable compared to 2022. Nonetheless, AKH was able to keep its market share unchanged. While the dominant position is a positive rating driver, the issuer's size (HUF 41bn in 2023, EUR 0.1bn) compared to large international players is a constraint, and its growth opportunities are limited by strong competition and limited pricing power.

Figure 1: AKH's revenue split by segment (2023)



Sources: AKH, Scope

Figure 2: Revenue evolution over the years (HUF m)



Sources: AKH, Scope

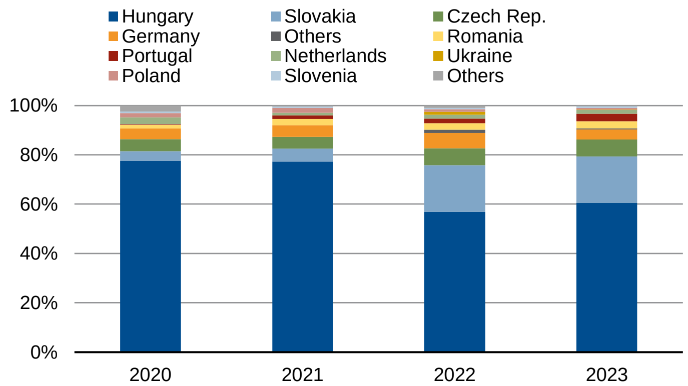
Improved geographical diversification

Although the Hungarian market still represents the lion's share of AKH's revenues, 61% in 2023, the issuer has substantially expanded the portion of revenues from non-domestic markets over the last two years. Following the acquisition of ARS at the end of 2021, Slovakian sales increased significantly, representing 19% of total sales in 2023, from 5% in 2021. Revenues followed a similar growth path in the other countries in which the issuer sells its products through export or subsidiaries, although the portion of the total remains limited.

Weak product diversification…

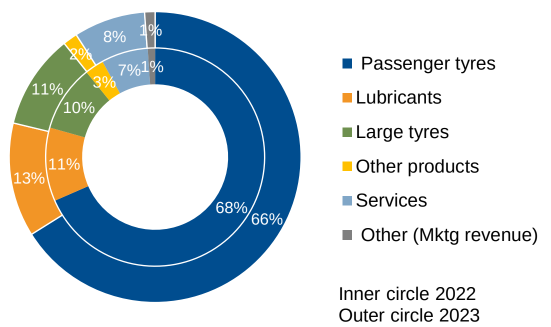
With sales related to only one segment (the automotive industry) and covering only tyres, lubricants and related services, AKH is highly exposed to the cyclicality of its industry. This was clearly demonstrated by the decline in profits during 2023. Nonetheless, we see service integration as a positive. AKH offers a wide range of services beyond tyre replacement and storage, including minor repairs and maintenance. It also has a solid presence in the lubricants sector. All of these factors are less sensitive to an economic downturn.

Figure 3: Geographical diversification by revenue



Sources: AKH, Scope

Figure 4: Product diversification (% of revenue)



Sources: AKH, Scope

… but granular suppliers and customer base

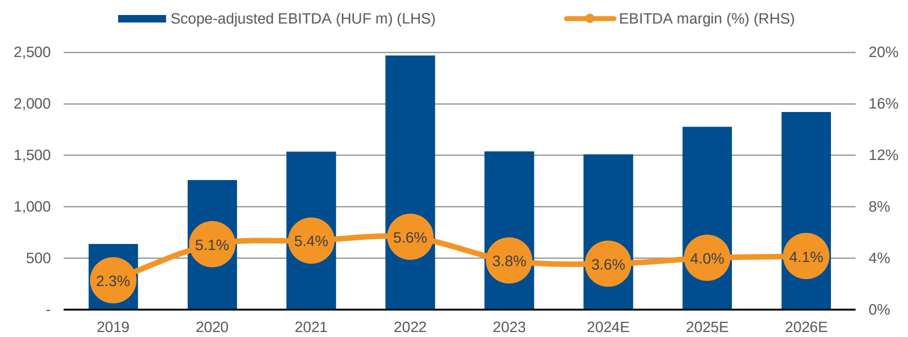
AKH has a well balanced mix of exclusive, semi-exclusive and non-exclusive tyre brands and a history of over 10 years of collaboration with its main tyre suppliers. In addition, none of the largest suppliers have a particularly high portion of material costs (the top three suppliers represented 11% in 2023). We deem this credit-positive as it limits dependency risk. Likewise, the customer portfolio is well diversified when corporate customers are included, with the top three customers representing 24% of total revenue in 2023.

Below-average profitability

AKH's profitability, as measured by the Scope-adjusted EBITDA margin, is lower than that of its retail peers, although the trend was positive from 2020 to 2022. In our view, this low profitability is due to: i) the high level of competition, exacerbated by the entry of Asian manufacturers, who are typically able to offer lower prices; ii) the fact that Abroncs derives most of its sales from the wholesale business.

In 2023, the decline in revenues combined with an increase in the cost of sales and salaries, due to inflation, led to a sharp fall in profitability to 3.8% from 5.6% in 2022. We expect profitability to remain below 4% in the forecast scenario, as the H1 2024 results show modest sales growth and a Scope-adjusted EBITDA margin of around 3.3% (after adjusting for operating lease payments). In 2025, we expect the margin to improve to around 4% thanks to efficiency measures (the reduction of operating costs in Slovakia, the divestiture of the Slovenian business and the decreasing impact of the export tax on opex).

Figure 5: Scope-adjusted EBITDA margin



Sources: AKH, Scope estimates

Likewise, the Scope-adjusted EBITDA return on assets is below that of the issuer's peers. It has ranged between 10% and 15% in recent years, since AKH tends to keep a high inventory level and footprint. We expect the ratio to improve going forward, driven by the expected increase in EBITDA and a better inventory management.

Financial risk profile: BB

AKH's financial risk profile has historically benefited from strong credit metrics but has been weakened by the negative profit trend.

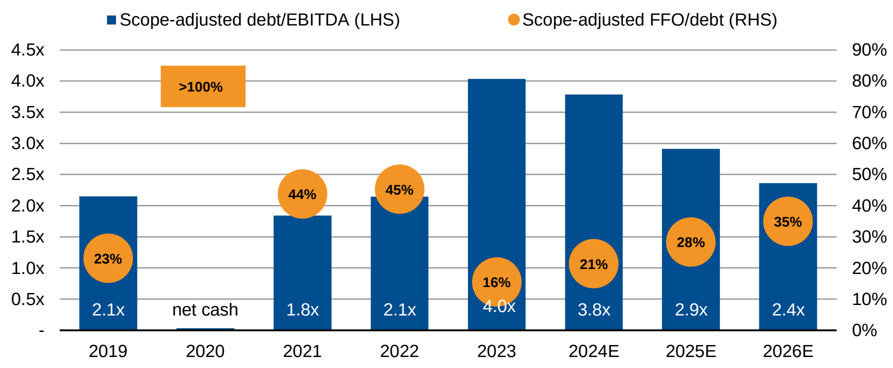
Weakening profitability putting pressure on leverage

Leverage has historically been low. Following weakening EBITDA in 2023, combined with increasing debt for the purchase of a property in Budapest, leverage (measured by Scope-adjusted debt/EBITDA) has increased to 4x. We expect it to slightly reduce in 2024 as an EBITDA recovery will be delayed. However, going forward, we expect AKH to lower its debt, driven by the repayment of the bond and the mortgage, as well as the reduction of the guarantee given to Bridgestone for the purchase of ARS (which is expected to reach 0 after 2026, after the payment of the remaining instalments).

Our scenario does not include any new debt issuance. However, we highlight the high volatility of net working capital, which peaked twice during the year, putting pressure on the issuer's cash and leverage.

Similarly, Scope-adjusted funds from operations/debt remain significantly lower in 2023. We forecast that this ratio will remain below historical levels in 2024 but expect it to return to above 20% from 2025, driven by sustained EBITDA growth.

Figure 6: Leverage



Sources: AKH, Scope estimates

Interest cover reduced but to remain solid

Interest cover has historically been above 7x, benefiting from the fact that most of the balance sheet debt (HUF 3.5bn bond amortising from 2022) was at fixed interest rates. In 2023, the ratio suffered from rising debt, as AKH took out a mortgage to buy the property that houses the Budapest office and EBITDA declined. We expect interest coverage to remain constrained by low EBITDA in 2024. However, gradual deleveraging combined with a better interest rate environment and increasing EBITDA in 2025 should bring the ratio towards 7x from 2025 onwards.

The company's free cash flow generation has recently been depressed by the level of capex, which increased from 2021 to finance a system to improve warehouse management, and the inclusion of ARS' capex. Further exceptional capex in 2023 related to the purchase of property assets resulted in negative FOCF. After 2023, capex is expected to return to near maintenance levels. However, FOCF can often be negative over the year due to the seasonality of the business.

Adequate liquidity

Liquidity is adequate. Available cash and FOCF, which is expected to return to positive territory from 2024, largely cover short-term debt obligations, with the balloon payment of the bond (HUF 1,750m) not expected until 2027. The issuer also has an uncommitted credit facility of HUF 2,000m, with maturity in 2027, which it is using to cover for seasonality.

The issuer is exposed to foreign exchange risk as a significant portion of supplier transactions are denominated in euro (52% in 2023). However, this is partially mitigated by the fact that AKH generates around 40% of its revenues in foreign currency (28% in euro in 2023).

AHK's senior unsecured guaranteed bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 3.5bn) if the debt rating of the bonds stays below B+ for more than two years (grace period) or drops below B- (repayment in 90 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is one notch. We therefore see no significant risk of the rating-related covenant being triggered.

Balance in HUF m	2023	2024E	2025E
Unrestricted cash (t-1)	3,859	3,916	3,619
Open committed credit lines (t-1)	1,518	2,000	2,000
FOCF (t)	(448)	296	365
Short-term debt (t-1)	213	469	488
Coverage	**>200%**	**>200%**	**>200%**

Long-term debt rating

Senior unsecured (guaranteed) debt instrument rating (HU0000360177): BB-

AKH issued a HUF 3.5bn senior unsecured bond (ISIN: HU0000360177) in December 2020 through the Hungarian central bank's Bond Funding for Growth Scheme. The bond proceeds were used for refinancing purposes. The bond has a tenor of seven years and a fixed coupon of 2.8%. Bond repayment is in four tranches starting from 2021, with 5.7% of the face value payable yearly in 2021, 2022 and 2023, 10% of the face value payable in 2024, 10.7% of the face value payable in 2025, 12% of the face value payable in 2026, and a 50% balloon payment at maturity. The bond is guaranteed by the following related entities: AKH Vagyonkezelő és Ingatlanhasznosító Korlátolt Felelősségű Társaság; Abroncs Hungária Kereskedőház Korlátolt Felelősségű Társaság; AKH Pnevmatike Trgovina d.o.o.; AKH Pneu CZ s.r.o.; AKH Slovakia s.r.o.; SC Anvelonet s.r.l.; AKH Gume d.o.o..

We assigned a BB- rating to AKH's senior unsecured guaranteed bond ((ISIN: HU0000360177). Our assessment considered the liquidation value based on a hypothetical default scenario in 2025, resulting in an above average recovery. However, we refrained from up-notching the rating due to the risk and possibility that senior secured debt could increase on the path to default (volatility of the capital structure and the proportion of senior unsecured debt).

The senior unsecured debt rating has been withdrawn for business reasons.

Appendix: Peer comparison (as at last reporting date)

	Abroncs Kereskedőház Kft	Marso Kft.	Tegeta Motors LLC	JSC Nikora Trade	Autowallis Nyrt
	BB-/Negative	B+/Stable	BB-/Negative	BB-/Stable	B+/Stable
Last reporting date	31 December 2023	31 December 2023	31 December 2023	31 December 2023	31 December 2023
Business risk profile					
Country retail strength	Medium-high	Medium-high	Medium-low	Medium-low	Medium-high
Market position	Strong	Strong	Strong	Strong	Medium
Consumer good category	Discretionary	Discretionary	Discretionary	Non-discretionary	Discretionary
Geographical exposure	Immediate neighbours	One country	Immediate neighbours	One country	Immediate neighbours
Financial risk profile					
Scope-adjusted EBITDA interest cover	4.9x	7.9x	3.3x	7.1x	7.5x
Scope-adjusted debt/EBITDA	4.0x	3.5x	3.0x	2.0x	2.7x
Scope-adjusted FFO/debt	16%	25%	23%	42%	28%
Scope-adjusted FOCF/debt	-7%	22%	-26%	4.1%	-8%

Sources: Public information, Scope

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