ITK Holding Zrt.
Hungary, Business Services & Automotive

BB- STABLE

Corporate profile

ITK Holding Zrt. is a Hungarian company focused on public transportation services, vehicle manufacturing and services related to IT, telecommunications, energy and the environment, and facilities management. The company provides bus services in three of Hungary's 10 largest cities and produces Mercedes-Benz branded buses and vans in Hungary in partnership with Daimler. The company is established as a joint venture between MOL Group and ITK Invest Ltd. ITK's estimated revenue and EBITDA for 2020 were HUF 27.3bn and HUF 1.6bn respectively. In the same year it had over 500 employees.

Key metrics

			Scope estimates		
Scope credit ratios	2019	2020E	2021E	2022E	2023E
EBITDA interest cover (x)	2.4x	3.0x	3.0x	2.7x	3.0x
Scope-adjusted debt (SaD)/EBITDA (x)	12.0x	11.1x	9.1x	8.1x	6.0x
FFO/SaD (%)	4.7%	5.8%	7.2%	7.8%	11.0%
FOCF/SaD (%)	-29.1%	-36.8%	-18.3%	-3.8%	-1.4%

Rating rationale

Scope Ratings GmbH (Scope) has assigned a first-time issuer rating of BB-/Stable to Hungarian public transportation services provider and vehicle manufacturer ITK Holding Zrt. (ITK). Senior unsecured debt is also rated BB-.

The BB- rating on ITK incorporates a three-notch uplift for strong support from majority shareholder MOL Group, which adds financial stability, risk management and professional backing to the company.

ITK's business risk profile (assessed at B+) is underpinned by a stable public transportation services business. The company has four long-term (10 years or more from inception) contracts for the provision of bus services in Budapest, Debrecen and Kecskemet, with a high certainty of cost recovery over the term of the contracts. ITK also benefits from a relatively modern bus fleet. Its smaller business services operations also have a long track record of stable margins. This is balanced by higher risk in its newly established vehicle manufacturing business, which started production in 2019. This business benefits from a partnership with Daimler, whereby all vehicles (buses and vans built on Mercedes-Benz base vehicle/product) produced by ITK carry the Mercedes-Benz brand and the two firms cooperate in the production of new vehicle models. ITK produces vehicles to order, most of which are lower value-added modifications to near-ready vehicles, although a growing share of production comprises 'bodybuilding' on Mercedes-Benz drivable chassis. The key to success will be the ability to ramp up the production volume and to increase the share of higher value-added units.

Profitability is strong and stable in business and transportation services, but vehicle manufacturing has been operating at a loss due to start-up costs and sub-optimal production volumes. We expect profitability to improve gradually over the next three years, and for the entire group to generate a positive net profit over the 2021-2023

[1] The credit rating and outlook(s) provided in this document are deemed inside information and may not be shared with any unauthorized third party.

Ratings & Outlook

Corporate rating	BB-/Stable
Senior unsecured rating	BB-

Analysts

Tommy Träsk
+49 69 66 77 389-36
t.traesk@scoperatings.com

Related Methodologies

Corporate Rating Methodology

Rating Methodology: European Automotive and Commercial Vehicle Manufacturers

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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period. Supplier and customer concentration is high, but most are well-established industry players with high credit standing.

ITK's financial risk profile (assessed at B-) reflects very high leverage, measured by Scope-adjusted debt(SaD)/EBITDA estimated at 11x at the end of 2020. The high leverage stems from significant investments (around HUF 11bn) in PPE, working capital for vehicle manufacturing operations and the bus services fleet in 2019 and 2020, far exceeding operating cash flow generation of HUF 1.5bn. We expect sizeable investments in the bus fleet to continue in 2021-2023 (HUF 9.2bn). With a ramp up of vehicle production and growth in revenues from services operations, we expect the company to reach free operating cash flow (FOCF) breakeven in 2024. We understand that shareholders do not expect to extract dividends from the company in this period, but will prioritise growth. The company is looking to issue a HUF 20bn bond under the Hungarian National Bank's Bond Funding for Growth Scheme. This will refinance most of its existing debt and provide it with a long-dated debt maturity, matching the long-term cash flow profile of its public transportation services business.

The Stable Outlook reflects the stability of revenues and earnings from long-term public transportation contracts, and the assumption that ITK successfully places the HUF20 billion bond to strengthen its liquidity position and that financial support from MOL Group remains available for planned projects and temporary liquidity needs, if needed. We expect the company to gradually improve its profitability and move towards FOCF neutrality over the next three years.

A negative rating action is possible if FOCF remains negative and the company is unable to reduce leverage in terms of SaD/EBITDA. This could result from a failure to increase sales and the production of higher value-added vehicles. MOL Group exiting the joint venture or not extending financial support when needed could also trigger a downgrade.

Stronger than anticipated growth in sales and/or margins, resulting in leverage sustainably below 6x (12x in 2019), could trigger an upgrade. Closer integration with MOL Group could also warrant a higher rating.

Rating drivers

Positive rating drivers	Negative rating drivers
• Long-term contracts provide earnings and margin stability for the transportation services business • Daimler partnership provides competitive advantages in technology, design, manufacturing, logistics, quality, marketing etc. • Strong financial and operational support from the majority shareholder, MOL Group • Complementary nature of business lines	• High leverage and negative FOCF • High demand volatility and high fixed costs in the vehicle manufacturing industry • Start-up nature and relatively small size of vehicle manufacturing operations • High supplier and customer concentration in transportation services and vehicle manufacturing

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Stronger than anticipated growth in sales and/or margins, resulting in leverage (SaD/EBITDA) sustainably below 6x (12x in 2019) • Closer integration with MOL Group	• Lower than anticipated vehicle sales volumes and failure to improve margins, resulting in continuous negative FOCF and inability to reduce leverage • MOL Group exiting the joint venture or not extending financial support when needed

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
EBITDA interest cover (x)	2.4x	3.0x	3.0x	2.7x	3.0x
SaD/EBITDA (x)	12.0x	11.1x	9.1x	8.1x	6.0x
FFO/SaD (%)	4.7%	5.8%	7.2%	7.8%	11.0%
FOCF/SaD (%)	-29.1%	-36.8%	-18.3%	-3.8%	-1.4%
Scope-adjusted EBITDA (HUF m)					
EBITDA	923	1,572	2,344	2,755	3,752
Scope-adjusted EBITDA	923	1,572	2,344	2,755	3,752
Scope-adjusted FFO (HUF m)					
EBITDA	923	1,572	2,344	2,755	3,752
less: (net) cash interest as per cashflow statement	-390	-522	-769	-1,011	-1,252
less: cash tax paid as per cashflow statement	-17	-38	-38	0	-27
Scope-adjusted FFO	**517**	**1,012**	**1,537**	**1,744**	**2,473**
Scope-adjusted debt (HUF m)					
Reported gross debt	11,284	19,228	22,540	25,146	27,315
Cash and cash equivalents	-240	-1,768	-1,163	-2,935	-4,789
Scope-adjusted debt (SaD)	**11,044**	**17,460**	**21,377**	**22,211**	**22,526**

Source: Company, Scope

Business risk profile (B+)

BBB- industry risk reflects a mix of stable contracted business and volatile cyclical industries

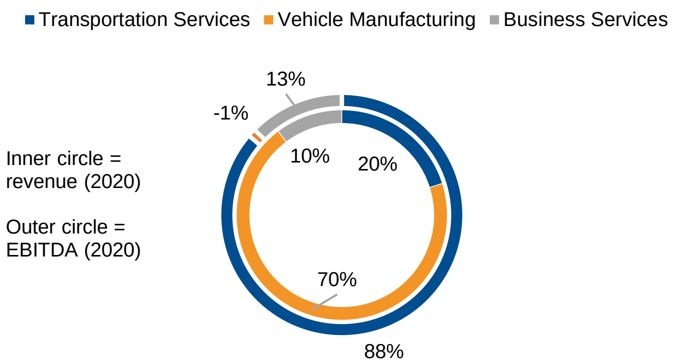
We assess ITK's industry risk as BBB-, reflecting the weighted average industry risk of business services (BBB) and automotive and commercial vehicle manufacturing (BB). Cyclicality and entry barriers are medium for business services and high for automotive and commercial vehicle manufacturers. The risk of substitution is medium for both industries. The bulk of earnings are derived from public transportation services, but most revenues are generated from vehicle sales (see Figure 1).

Long-term bus services contracts provide stability to the business

ITK's business risk profile (assessed at B+) is underpinned by a stable public transportation services business. The company has four long-term (10 years or more from inception) contracts for the provision of bus services in Budapest, Debrecen and Kecskemet, with a high certainty of cost recovery over the term of the contracts. ITK also benefits from a relatively modern bus fleet. Its smaller business services operations also have a long track record of stable margins.

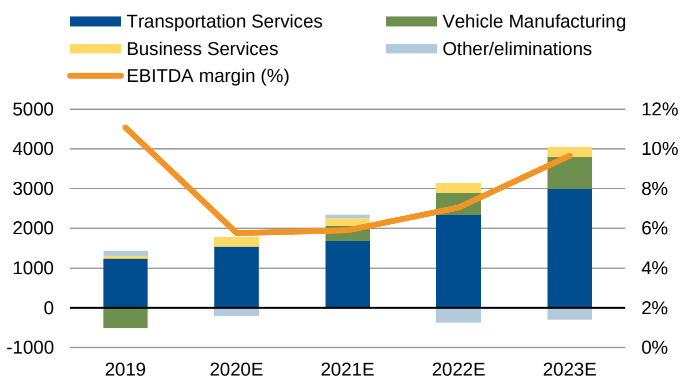
This is balanced by higher risk in the newly established vehicle manufacturing business, which started production in 2019. This business benefits from a partnership with Daimler, whereby all vehicles (buses and vans built on Mercedes-Benz base vehicle/product) produced by ITK carry the Mercedes-Benz brand and the two firms cooperate on the production of new vehicle models. ITK produces vehicles to order, most of which are lower value-added modifications to near-ready vehicles, although a growing share of production comprises 'bodybuilding' on Mercedes-Benz drivable chassis. The key to success will be the ability to ramp up the production volume and to increase the share of higher value-added units.

Figure 1: Expected revenue and EBITDA by business segment, 2020



Source: Company, Scope

Figure 2: EBITDA (HUF m) by segment and EBITDA margin

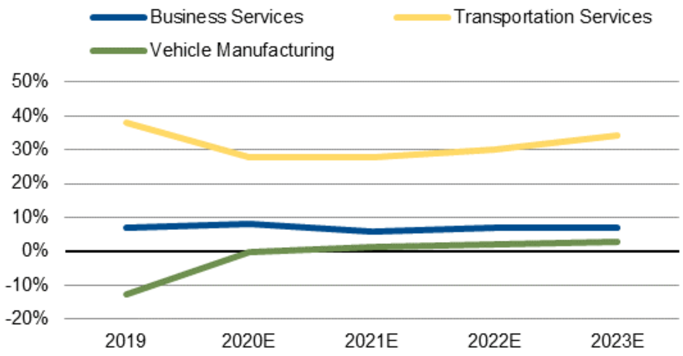


Source: Company, Scope

Profitability is strong and stable in business and transportation services, but vehicle manufacturing has been operating at a loss due to start-up costs and sub-optimal production volumes (see Figure 3). We expect profitability to improve gradually over the next three years, and for the entire group to generate a positive net profit over the 2021-2023 period. ITK is a relatively small operator compared to state owned Volánbusz and VT-Arriva, owned by Deutsche Bahn. Its EBITDA margins are the highest in the peer group however (see Figure 4).

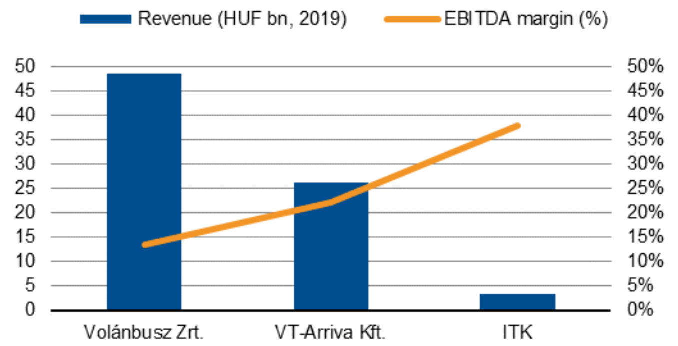
ITK's business is concentrated on Hungary, with relatively high supplier and customer concentration, although most are well-established industry players with high credit standing.

Figure 3: EBITDA margin by business segment



Source: Company, Scope

Figure 4: Hungarian bus service operators, 2019



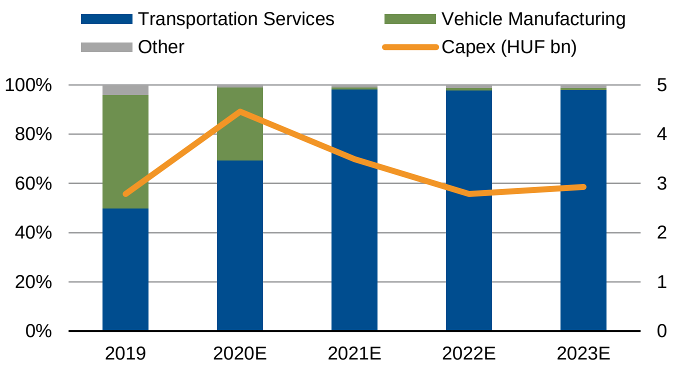
Source: Scope, public information

Financial risk profile (B-)

High capex directed to bus fleet expansion and vehicle manufacturing

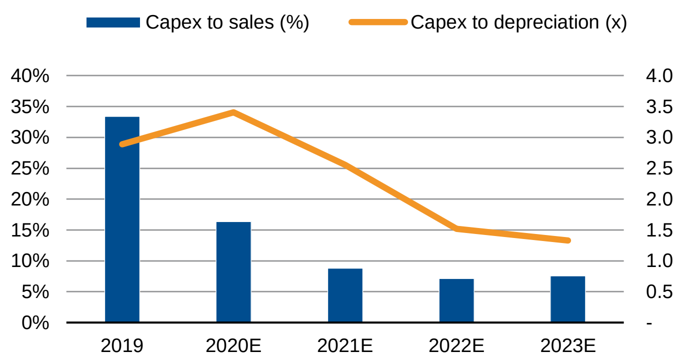
ITK's financial risk profile (assessed at B-) reflects very high leverage, measured by SaD/EBITDA estimated at 11x at the end of 2020. The high leverage stems from significant investments (around HUF 11bn) in PPE, working capital for vehicle manufacturing operations and the bus services fleet in 2019 and 2020 (see Figures 5 and 6). We expect sizeable investments in the bus fleet to continue in 2021-2023 (HUF 9.2bn).

Figure 5: Capex by business segment (HUF bn)



Source: Company, Scope

Figure 6: Capex to sales and depreciation

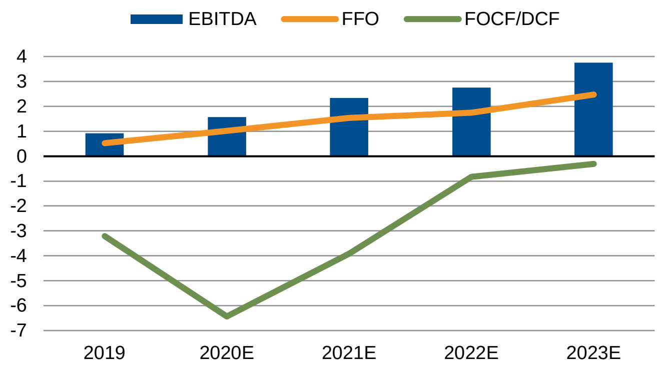


Source: Company, Scope

We expect the company to reach FOCF breakeven in 2024

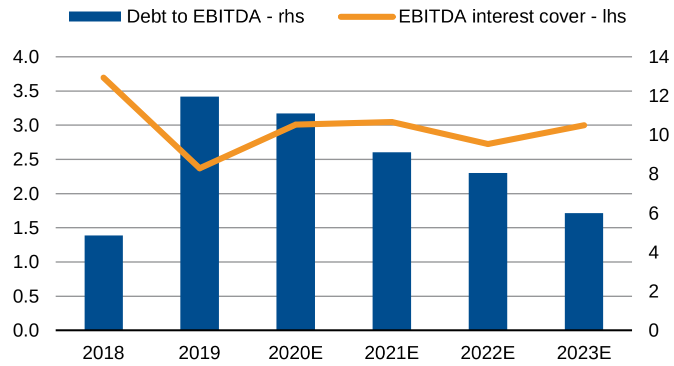
With a ramp up of vehicle production and growth in revenues from services operations, we expect the company to reach FOCF breakeven in 2024 (see Figure 7). We understand that shareholders do not expect to extract dividends from the company in this period, but will prioritise growth. The stronger cash generation should gradually reduce leverage (SaD/EBITDA) towards 6x (see Figure 8).

Figure 7: Scope-adjusted cash flows (HUF bn)



Source: Company, Scope

Figure 8: Scope-adjusted leverage and debt service



Source: Company, Scope

The company is looking to issue a HUF 20bn bond under the Hungarian National Bank's Bond Funding for Growth Scheme, which will refinance most of its existing debt and provide it with a long-dated debt maturity, matching the long-term cash flow profile of its public transportation services business (see Figure 9). ITK has relied extensively on investment and working capital loans from its majority shareholder MOL Group to date. Pro forma of the bond issuance, it will have around HUF 3bn of mortgage and fleet financing remaining (see Figure 10) and is subject to debt-service coverage ratio covenants set at a minimum of 1.1x, with moderate (at least 10%) headroom.

Solid liquidity profile during expansion phase

Going forward, ITK intends to use bank loans to fund working capital needs. This relates mainly to the financing of working capital, including receivables and raw materials (chassis and other components), for vehicle manufacturing.

Figure 9: Debt maturity profile, pro forma of planned HUF 20bn bond issuance (HUF m)

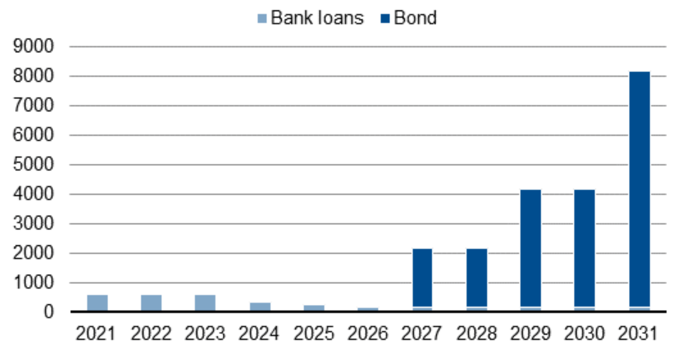
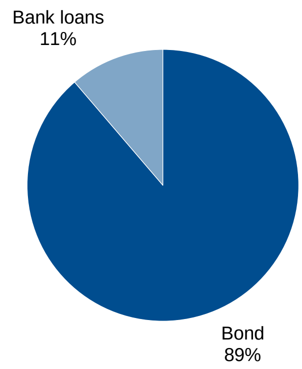


Figure 10: Funding sources, pro forma of planned HUF 20bn bond issuance



Source: Company, Scope

Liquidity underpinned by debt term-out post bond issuance and shareholder support

ITK had HUF 1.8bn of liquid assets and HUF 3.9bn of short-term debt at the end of 2020 (see Figure 11). We consider ITK's liquidity position to be adequate however, due to limited short-term debt outstanding after the planned bond issuance. We also take comfort from the fact that financial support is available from MOL Group. ITK intends to repay all parent company loans from the proceeds of the planned bond, but we assume that financial support from MOL Group remains available for planned projects and temporary liquidity needs, if needed.

Figure 11: Liquidity

EUR m	2019	2020E	2021E

Cash and cash equivalents (t-1)	382	240	1,768
Committed unused bank facilities (t-1)	0	0	0
Short-term debt (t-1)	873	1,272	3,920
Free operating cash flow (t)	-3,213	-6,433	-3,917
Liquidity (%) – internal	-324%	-487%	-55%
Liquidity (%) – internal + external	-324%	-487%	-55%

Source: Company, Scope

Supplementary rating drivers

Strong financial and operational backing from majority shareholder

ITK Holding Zrt. is a joint venture between MOL Group and ITK Invest Ltd. Although MOL Group has 74% of the economic interest, decisions are made by the two partners jointly. The MOL Group Treasurer and the Head of Mobility are both members of ITK's board of directors.

MOL Group has extended significant investment and working capital loans to ITK and provides parent company guarantees in certain cases. The loans are to be repaid with the proceeds of the planned HUF 20bn bond issuance, but parent company guarantees will continue also after the bond issuance. We understand the planned bond indenture will include a change of control provision.

In addition to financial support, MOL Group supports ITK in areas such as risk management and IT.

Overall, parent support warrants a three-notch uplift from the B- standalone rating, resulting in a final issuer credit rating of BB-.

Short-term and long-term debt ratings

We rate senior unsecured debt in line with the issuer rating, based on pari passu ranking and a negative pledge provision in the planned bond documentation, limiting the extent of secured debt in the capital structure.

Scope's base case financial forecast assumes the successful placement of a HUF 20bn senior unsecured bond with a fixed annual coupon under the Hungarian National Bank's Bond Funding for Growth Scheme. Scope expects the bond to have a 10-year tenor, with amortisation of 10% per annum in 2027 and 2028, 20% per annum in 2029 and 2030 and a 40% bullet maturity in 2031.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 2 30315 814

Scope Ratings UK Limited

111 Buckingham Palace Road
London SW1W 0SR

Phone +44 20 7340 6347

info@scoperatings.com
www.scoperatings.com

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