Unix Auto Kft.
Hungary, Auto Retail

SCOPE BB- STABLE

Corporate profile

Unix Auto Kft (Unix Auto) is a privately-owned Hungarian auto-parts retailer founded in 1990. It holds around 35% of its domestic market and also operates in Romania and Slovakia. It has more than 160 branches and employs approximately 4,000 people. The company's founder, Antal Zombori, owns 100% of its shares.

Key metrics

			Scope estimates	
Scope credit ratios	2017	2018	2019F	2020F
EBITDA/interest cover (x)	64.4x	43.3x	16.9x	8.5x
Scope-adjusted debt (SaD)/EBITDA	1.8x	2.4x	2.7x	3.3x
Scope-adjusted FFO/SaD	52%	39%	34%	25%
Free operating cash flow (FOCF)/SaD	-24.2 %	-14.7 %	-12.3 %	-23.6 %

Rating rationale

Scope Ratings assigns a corporate issuer rating of BB- to Hungarian-based Unix Auto Kft. The Outlook is Stable. We also assign a BB- to the company's senior unsecured debt.

Unix Auto's business risk profile is positively influenced by its dominant market share in the Hungarian auto-parts market and by its well-known brand domestically. Current economic conditions and solid GDP growth in its two main countries of operation, Hungary and Romania, are also credit-positive for industry aspects. Diversification is good in terms of suppliers and customers, with no parties representing a meaningful share of the total. Moreover, the company has a massive spare-parts product range, as well as some business in services and special-tool rental, which helps to diversify its product offering to some degree. However, the relatively high geographical dependence on Hungary (~70% of sales) somewhat negatively affects our diversification assessment. Additionally, we have slight concerns over the recent decline in EBITDA margin, declining from 9.3% in 2015 to 6.2% in 2018 mainly due staff cost increases. Based on our assumptions, measures taken by the company and the competitive environment, we anticipate continued high sales growth, while EBITDA margins are expected in the 5-6% range in the short term.

We note that the auto spare-parts market in Europe is evolving along with the transformation of the general retail segment, with more automatisation in logistics. The company also has the ambition to expand outside of Hungary. This could expose creditors to some event risk, in our view, either through industry consolidation or through the high organic growth ambitions of its own businesses.

The company's financial risk profile is mixed. Our assessment favours the strong interest cover and acceptable historical leverage ratios, but also reflects the negative free cash flow generation, due to the company's high growth and investments.

In recent years, Scope-adjusted leverage ratios have weakened somewhat (from 1.2x in 2016 to 2.4x at YE 2018). Based on the company's current business plan, we expect Scope-adjusted debt (SaD)/EBITDA and FFO/SaD to deteriorate further into the medium term. The more aggressive financial risk profile is mainly due to ambitions to grow more

Ratings & Outlook

Corporate issuer rating	BB-
Outlook	Stable
Senior unsecured rating	BB-

Lead Analyst

Henrik Blymke
+47 21 62 31 41
h.blymke@scoperatings.com

Related Methodology

Corporate Rating Methodology

Scope Ratings GmbH

Haakon VII's gate 6
0161 Oslo

Tel. +47 21 62 31 42

Headquarters

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

rapidly abroad, including more branch networks. Moreover, the company plans to establish more logistics distribution centres and grow its A.Z. Meisterteile brand. Although the plan is expected to be positive for diversification and profitability in the longer term (the A.Z. Meisterteile brand entails higher margins than the company's other brands), the investment period will take 2-3 years, during which both cash flow and the capital structure will suffer. In 2020, the company will direct more capex towards the completion of the main logistics centre in Budapest, which includes increased floor and storage capacity, as well as a new self-developed automatisation system. With negative FOCF, this credit metric is the key negative driver for the financial risk profile assessment.

Positively, the company's FFO has been solid in relation to Scope-adjusted debt, with acceptable levels expected going forward as well. However, with high growth expected to continue into the future, working capital needs remain a key issue for cash flow and funding. Although operating cash flow is positive, it is not enough to cover recent capex nor the capex programme expected for the next 1-3 years.

We note the currently high dependence on short-term borrowing, which makes the company somewhat reliant on the bank's willingness to roll over debt each year. This has so far been easily done, which we also expect going forward. Still, we note that the company has had to initiate amendment discussions for its financial covenants structure to increase allowed headroom, given its anticipated growth strategy. We expect the banks to be supportive given the secured funding and good relationships. Should the company issue a new long-term bond under the MNB scheme to accelerate its growth ambitions, it may be positive for the liquidity, as some of the funding will be used to refinance short-term debt. It will also open another funding source for the company, and thus diversify its debt structure and improve the average debt maturity tenor. Still, we expect liquidity to remain constrained in the longer run, based on our methodology metrics, due to the high investment levels through to 2021.

Outlook

The Stable Outlook reflects our expectations that Unix Auto will continue to dominate the Hungarian auto-parts market and can decelerate the pace of the deteriorating profitability margins seen of late. It also assumes that the company will improve its liquidity somewhat by introducing a new senior unsecured long-term bond, but this will be countered by weaker credit metrics due to its continued high growth strategy, which will continue to result in negative FOCF according to our estimates.

A positive rating action could be warranted if the business risk profile improved. This could be through a stronger position in non-domestic markets and improved profit margins with a higher share of own-brand spare-parts sales. An upgrade is also possible if both FOCF and net debt improve, as reflected in a FOCF/SaD of more than 5% on a sustained basis.

A negative rating action is possible if the financial risk profile deteriorated, exemplified by SaD/EBITDA moving above 4x on a sustainable basis and FFO/SaD moving below 15%.

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant market share (35%) in Hungarian auto parts • Solid growth and well-known brand domestically, and limited dependence on individual customers or suppliers • Modest leverage and interest cover for the rating category at the moment	• Somewhat weak geographical diversification, with the Hungarian market driving sales and profits • Declining profit margins due to increasing labour costs • Negative FOCF due to high investment and working capital needs, with liquidity and financial flexibility currently influenced by a high dependence on short-term debt and limited financial covenant headroom (expected to be amended)

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in business risk profile through increased diversification and stabilisation of profit margins • Positive free operating cash flow, resulting in a FOCF/SaD of above 5% on a sustained basis	• Deterioration of financial risk profile, exemplified by a SaD/EBITDA of above 4x on a sustained basis • Continued declined in EBITDA margins and an FFO/SaD of below 15% on a sustained basis

Financial overview

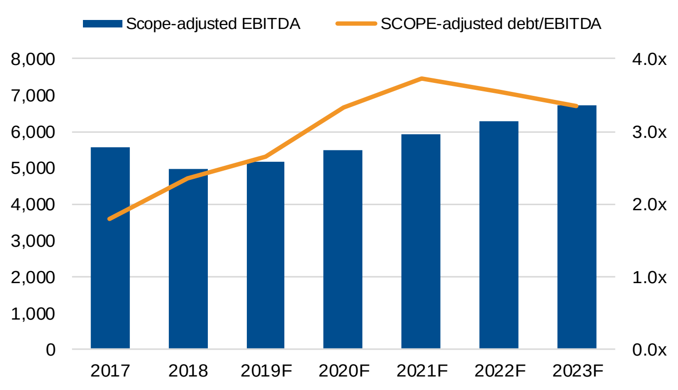
			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	64.4x	43.3x	16.9x	8.5x
SaD/EBITDA	1.8x	2.4x	2.7x	3.3x
Scope-adjusted FFO/SaD	52%	39%	34%	25%
FOCF/SaD	-24.2%	-14.7%	-12.3%	-23.6%
EBITDA in HUF m				
Income from operations (EBIT)	4,215	3,233	3,250	3,481
Add: depreciation	1,329	1,715	1,900	2,000
EBITDA	**5,545**	**4,949**	**5,150**	**5,481**
Scope-adjusted funds from operations in HUF m				
EBITDA	5,545	4,949	5,150	5,481
Less: (net) cash interest per cash flow statement	-86	-114	-304	-642
Less: cash tax paid per cash flow statement	-309	-243	-207	-199
Add: other items	0	0	10	10
Scope-adjusted funds from operations	**5,149**	**4,592**	**4,649**	**4,650**
Scope-adjusted debt in HUF m				
Reported gross financial debt	10,127	11,907	23,582	23,257
Less: cash, cash equivalents	-170	-228	-9,915	-4,978
Add: cash not accessible	-	-	-	-
Add: pension adjustment or operating leases	-	-	-	-
Scope-adjusted debt	**9,957**	**11,679**	**13,667**	**18,279**
Liquidity ratios				
Liquidity (internal + external)	(0.4)	(0.2)	(0.1)	0.5
Liquidity (internal)	(0.4)	(0.2)	(0.1)	0.5

Summary of business and financial risk profiles

Overall, we have assigned a BB rating to the business risk profile of Unix Auto, which is supported by the company's leading position in Hungary in terms of market shares and product range, among others. The pressure on profitability margins is one of the factors currently constraining the business risk profile.

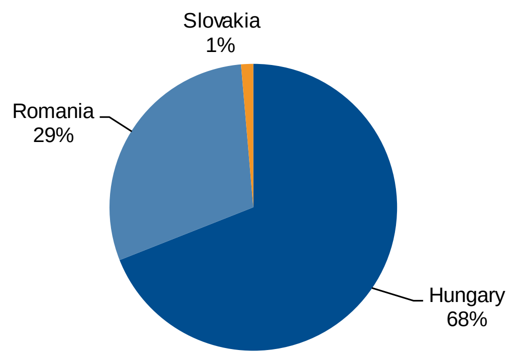
Although certain financial metrics are currently conservative for the rating category, we stress that the financial risk profile assessment is to a high degree weighing on the expected deterioration in credit metrics in the short to medium term, following the company's expansionary investment plans. As a result, we see the financial risk profile as weaker than the business risk profile, with the former rated at BB-. In addition to the expected deterioration of credit metrics, the financial risk profile is also to a certain degree affected by the company's financial flexibility and liquidity constraints.

Figure 1: EBITDA (in HUF m) and leverage ratio (x) RHS



Source: Scope estimates

Figure 2: Sales by country in % (FY 2018)



Source: Scope, Company

Supplementary rating drivers

We have not made any explicit rating adjustment under the supplementary rating drivers. Although the company has no publicly stated financial policy, the company refers to its financial bank covenants. The company has historically balanced its growth funding between external debt and internally generated cash flow, but we notice that the current investment plan will involve more external financing going forward.

Senior unsecured rating

We expect an 'average recovery' for senior unsecured debt, such as the planned HUF 12bn MNB bond. Such recovery expectations translate into a BB- rating for the senior unsecured debt category. Today, a significant share of total assets on the balance sheet is pledged to banks, which includes inventories, receivables and most of the fixed assets. Our recovery expectations are based on an expected liquidation value in a hypothetical default scenario at the end of 2021, when most of the new expansionary investments are completed.

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

1 Cour du Havre
75008 Paris

Phone +33 1 82885557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Madrid

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

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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