AXIÁL Javító, Kereskedelmi és Szolgáltató Kft – Hungary, Retail

SCOPE **BB** STABLE

Corporate profile

Founded in 1991 and headquartered in Baja, Hungary, AXIÁL Javító, Kereskedelmi és Szolgáltató Kft plays a prominent role in Hungarian agriculture and construction. It sells machines (e.g. tractors, construction machines, forklifts, and second-hand machinery), spare parts, and GPS products (e.g. GPS-controlled products, fleet tracking, GPS devices, and software). It also provides services such as guarantees and installation, the renting-out of machines, and financing solutions. AXIÁL's primary focus is agriculture, accounting for almost 50% of total turnover, with the secondary focus on construction, material handling and warehousing.

AXIÁL is fully owned by Zsolt Harsányi (50%) and Gyöngyi Harsányi Fodor (50%).

Key metrics

			Scope estimates	
Scope credit ratios	2019[1]	2020	2021E	2022E
EBITDA/interest cover	28x	32x	20x	21x
Scope-adjusted debt (SaD)/EBITDA	2.2x	1.0x	2.1x	2.0x
Scope-adjusted funds from operations/ SaD	49%	135%	47%	57%
Free operating cash flow/SaD	2%	82%	-30%	10%

Rating rationale

Scope Ratings GmbH (Scope) has today upgraded the issuer rating of Hungarian agricultural and construction machinery distributor AXIÁL Javító, Kereskedelmi és Szolgáltató Kft to BB/Stable from BB- under review for possible upgrade. Senior unsecured debt issued by AXIÁL has been upgraded to BB+ from BB under review for possible upgrade.

The rating action resolves the placement under review for a potential upgrade of AXIÁL's issuer rating that followed the release on 17 March 2021 of the new rating methodology on retail and wholesale corporates. The new methodology defines rating criteria specific to business risk profiles in the sector, including an industry risk rating that distinguishes between cyclical and non-cyclical product categories as well as a competitive positioning evaluation that reflects market shares, diversification, and profitability.

The application of the new rating methodology resulted in a stronger business risk profile assessment for AXIÁL, supported by the continued strength of its operations despite the 2020 economic cooldown. This resulted in the rating upgrade.

AXIÁL's business risk profile has benefited from a better profitability assessment thanks to the high Scope-adjusted EBITDA margin for a retail player, which has also steadily improved to 10.5% in 2020 from 5.7% in 2017. This has been despite a low Scope-adjusted EBITDA return on assets, which means the issuer is not as effective at using its increasing tangible assets (one-third of the total balance sheet) and inventories (50% of total balance sheet) to generate EBITDA. The better profitability assessment has also outweighed negative adjustments related to diversification and industry. Low geographical diversification is the main constraint for the business risk profile: its home

[1] The small discrepancies were because the previously used 2019 data were unaudited. EBITDA/interest cover was 35%, SaD/EBITDA was 2.0x, Scope-adjusted FFO/SaD was 50% and FOCF/SaD was -11%.

Ratings & Outlook

Corporate rating BB/Stable

Senior unsecured rating BB+

Analyst

Anne Grammatico, CFA
+33 182882364
a.grammatico@scoperatings.com

Related Methodologies

Corporate Rating Methodology, 26 February 2020

Retail and Wholesale Corporates Methodology, 17 March 2021

Scope Ratings GmbH

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

market represents more than 90% of total net sales, insufficient to offset any negative macro developments in Hungary.

AXIÁL's financial risk profile remains stronger than its business risk profile. We expect the financial leverage ratio to remain at around 2x in the medium term and the interest cover ratio at above 20x. The overall financial risk profile remains constrained by free operating cash flow (FOCF) generation, which we expect to be negative in 2021.

Outlook and rating-change drivers

The Stable Outlook for AXIÁL incorporates our view that key credit metrics over the next two years will remain strong, with a Scope-adjusted debt (SaD)/EBITDA ratio of around 2x, while the issuer remains a top-three agricultural machinery dealer in Hungary. Our rating case also projects stable profitability, with a Scope-adjusted EBITDA margin of around 9%.

A positive rating action is seen to be remote but could be warranted if AXIÁL's business risk profile improved, for example, through significant growth in size and greater geographical diversification, while SaD/EBITDA reached below 2x on a sustained basis. The latter could be triggered by a constant improvement in working capital management and/or a lower dividend payout.

The ratings could come under downward pressure if AXIÁL's leverage (SaD/EBITDA) moves towards 4x on a consistent basis, for example, due to higher capital expenditures and/or a higher dividend payout.

Rating drivers

Positive rating drivers	Negative rating drivers
• Relative importance of agriculture for Hungarian population and economy • Top-three agricultural machinery dealer in Hungary with the leading position in spare parts and a market share of 20%-25% in the country's agricultural machinery sector • Exclusive distributor for globally known brands including Claas, Manitou, Fendt, Horsch and Hyundai • Adequate inventory level despite some low turnover • Adequate product diversification • Good Scope-adjusted EBITDA margin of 8% on average, with improvement foreseen to around 9% in the near future • High interest cover of more than 20x and low leverage (SaD/EBITDA) of 1x-3.5x	• Ageing and decreasing agricultural labour force • Comparatively small scale and outreach on a European basis • Lack of geographical diversification compared to European peers

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improving business risk profile and SaD/EBITDA sustained below 2x	• SaD/EBITDA towards 4x on a sustained basis

Financial overview

			Scope estimates		
Scope credit ratios	**2019[2]**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	28x	32x	20x	21x	23x
SaD/EBITDA	2.2x	1.0x	2.1x	2.0x	1.7x
Scope-adjusted funds from operations/SaD	49%	135%	47%	57%	71%
FOCF/SaD	2%	82%	-30%	10%	28%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	9,720	13,400	11,618	11,691	11,786
Operating lease payments in respective year	-	-	-	-	-
Disposal gains/losses on fixed assets	-1,959	-3,856	-2,725	-2,725	-2,725
Scope-adjusted EBITDA	7,760	9,545	8,893	8,966	9,062
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	9,720	13,400	11,618	11,691	11,786
less: (net) cash interest as per cash flow statement	-274	-297	-447	-427	-396
less: cash tax paid as per cash flow statement	-327	-603	-305	-327	-332
add: depreciation component, operating leases	-	-	-	-	-
add: dividends received from equity	22	25	21	21	21
Other	-959	746	-1,858	-593	-51
Scope-adjusted funds from operations	8,182	13,271	9,028	10,365	11,028
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	19,436	23,139	22,645	21,110	19,590
less: cash and cash equivalents	-3,156	-13,741	-4,632	-3,336	-4,514
add: cash not accessible	405	405	405	405	405
add: operating lease obligations	-	-	-	-	-
add: pension adjustment	-	-	-	-	-
add: net asset retirement obligations	-	-	-	-	-
Scope-adjusted debt	16,685	9,803	18,418	18,178	15,480

[2] The small discrepancies were because the previously used 2019 data were unaudited.
EBITDA/interest cover was 35%, SaD/EBITDA was 2.0x, Scope-adjusted FFO/SaD was 50% and FOCF/SaD was -11%.

Business risk profile: BB-

AXIÁL's **business risk profile has been upgraded to BB- from B+.** It is still supported by the issuer's profitability and market positioning in Hungary, with diversification a negative rating driver.

Relative importance of agriculture for Hungary

The agricultural sector remains important in Hungary despite having contributed only 4.1% to GDP in 2019. In 2016, rural regions accounted for 28% of the national territory (vs 52% in France and 68% in Romania), while 60% of farms were run by a household that consumed more than 50% of the final production (vs 2% in France and 86% in Romania). The agricultural sector also benefits from EU subsidies such as the Common Agricultural Policy. According to AXIÁL, the Hungarian government is willing to keep stimulating investment in agriculture, even if EU subsidies decrease.

Features of Hungarian agricultural sector: an advantage in the short and medium term

The Hungarian agricultural sector is dominated by small farms (defined as under five hectares) with small economic sizes (under EUR 4,000) and whose owners are more than 55 years old, according to 2016 Eurostat data. The active agricultural population decreased by 25.5% from 2010 to 2016.

The large amount of small farms benefits AXIÁL as it means more potential customers. Nevertheless, the company has to deal with the falling population of farmers, in part due to ageing. This could be overcome by requests for larger and more efficient machinery from bigger farms (300-3,000 hectares).

AXIÁL among top three dealers in Hungary

AXIÁL's main competitors are Kite Zrt. and Agrotec Kft. All three account for around 80% of total Western-made agricultural machinery sales in Hungary.

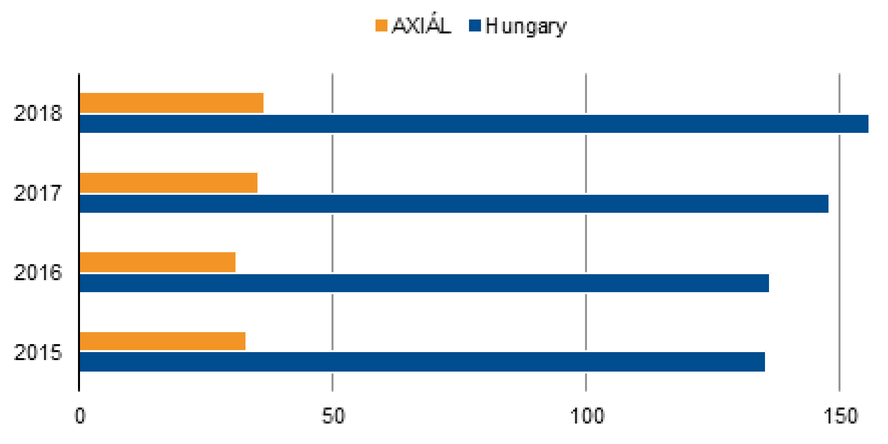
Distributor of well-known brands

AXIÁL is the exclusive distributor of globally known brands such as Claas (since 2000), Manitou (since 1998), Fendt (since 2002), Landini (since 1998), Horsch (since 2007), and Hyundai (since 2004). Claas is Hungary's second strongest brand behind John Deer (whose exclusive distributor is Kite Zrt.).

AXIÁL's sales of agricultural machinery account for 20%-25% of Hungarian net sales

AXIÁL's sales of agricultural machinery account for 20%-25% of Hungarian agricultural machinery net sales. Its market share is 40%-45% for combine harvesters (the second largest product category in agricultural machinery), 20%-25% for tractors (largest) and 40% for telescopic loaders.

Figure 1: Agricultural machinery net sales (in HUF m)



Source: MEGOSZ, AXIÁL, Scope

Leader in spare parts sales

AXIÁL has a market share of 50% in the spare parts retail market, which was its main business at inception. This history provides visibility as well as recognition as an expert in the field. This gives a competitive advantage, reinforced by AXIÁL's logistics and infrastructure.

Spare parts activity is even more important now with the increase of built-in components in agricultural and construction machinery, which has led to a 50% higher need for spare parts.

Larger product offering to attract and retain customers

AXIÁL continually seeks to improve product diversification. Recently, it introduced DeLaval, a milking technology, and mAXI-CAM, an optical weed recognition-based cultivation system developed by AXIÁL. The company has complemented its product portfolio with machine accessories (items not supplied by manufacturers such as tyres, batteries and oils) and has even developed an inhouse brand (Ister).

Strong after-sales business

AXIÁL's after-sales business is stronger than competitors' thanks to its workshop area of over 16,000 sqm. It begun extending its spare-parts logistics centre in summer 2020, which will be operational soon. This activity will become more important as machinery gets more complex. It is worth mentioning that materials maintenance consistently accounts for 6% of Hungarian agricultural expenses, according to Eurostat, equivalent to around EUR 275m.

Capex used to improve service, efficiency, capacity and working environment

According to management, capex is used to improve AXIÁL's service, efficiency, capacity and working environment. The spare parts logistics centre will be expanded by 2,400 sqm to install narrow-aisle warehouse solutions. The development of the Felsőzsolca site will lead to a 640 sq m workshop, 665 sq m in storage, a 210 sq m washer, a 300 sq m parts warehouse, a 1,500 sq m machine demonstration area, and 300 sq m in storage for Manax' machines. No other investments are in the pipeline.

Large customer base mainly in agriculture sector

AXIÁL has an extensive customer base of 37,000 in total, 10,000 of which it deals with frequently. Its customers are mainly from agriculture (about 92%) and Hungary. AXIÁL's domestic customer base is spread across the country, with around half in the west, one-third in the centre, and the rest in the east.

Close customer relations

AXIÁL sees customer relations as the most important to its business. That is why it has 19 outlets across Hungary that are reachable within 75km. It also sells directly to customers. The company's motto, a quote from Henry Ford, is: "Service is more important than profit, profit is not the aim, but the result of service." With this customer focus, we expect costs for customers to switch to another supplier to be high.

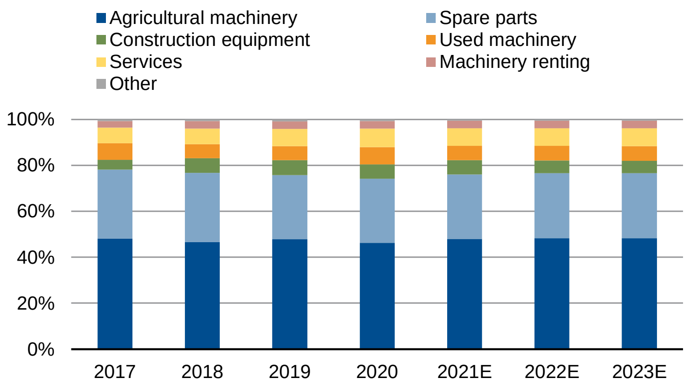
Adequate inventory levels despite some low turnover

Inventory levels are a key constraint in retail. AXIÁL says it keeps inventory low but sufficient to meet customer needs. Inventories consistently account for just under 50% of the total balance sheet, in line with the industry. AXIÁL's lower inventory turnover than rated automotive peers is mainly due to differences in business models (vehicles sold more frequently than agricultural machines.)

Revenue diversified only by activity

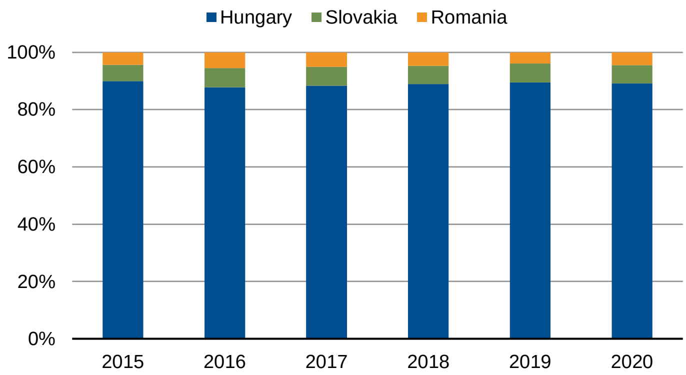
Agricultural machinery consistently accounts for almost 50% of revenues, followed by spare parts (around 30%). Hungary accounts for 90% of AXIÁL's turnover.

Figure 2: Revenue by segment (%)



Source: AXIÁL, Scope

Figure 3: Revenue by country (%)



Source: AXIÁL, Scope

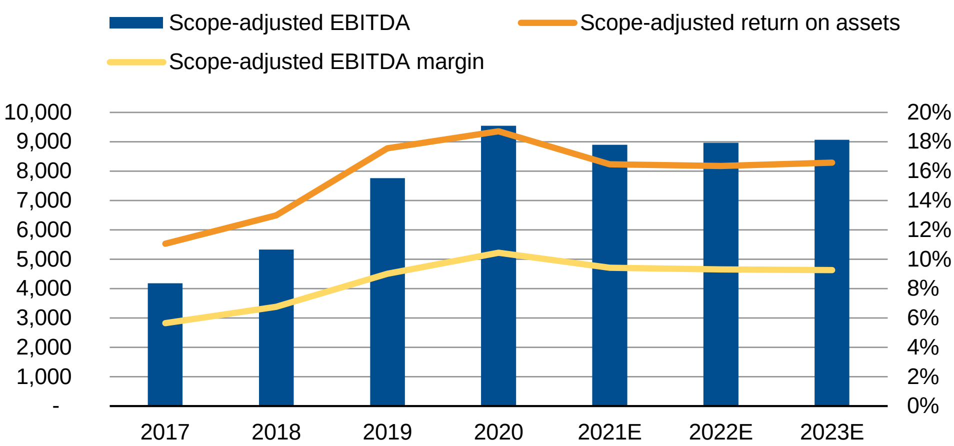
Improving profitability

The Scope-adjusted EBITDA margin is good, especially compared to rated peers'. The margin has also improved year over year from 5.7% in 2017 to 10.5% in 2020. AXIÁL does not disclose EBITDA by segment.

Margin profile expected to be sustained between 9% and 9.5%

As mentioned earlier, capex is aimed at improving service, efficiency, capacity, and the working environment. We therefore expect AXIÁL's Scope-adjusted EBITDA margin to remain stable between 9% and 9.5%.

Figure 4: Scope-adjusted EBITDA (HUF m, lhs) and profitability (%, rhs)



Source: AXIÁL, Scope

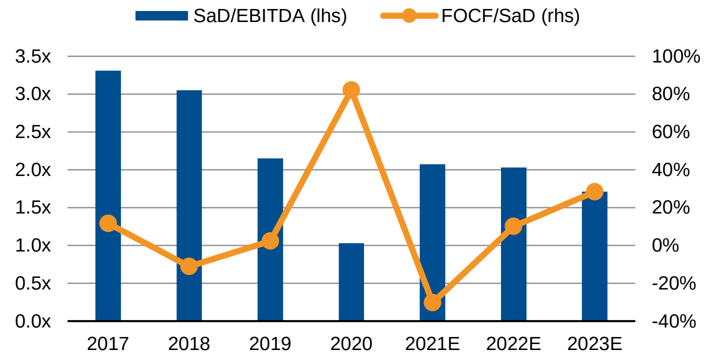
Low but improving return on assets

Even if AXIÁL's return on assets were to improve, it would still be a low 10%-20% compared with peers' return on assets. This means the issuer is less effective at translating the increasing tangible assets (one-third of the total balance sheet) and inventories (50%) into EBITDA. For the coming year, we expect a ratio of 16%-17%.

Financial risk profile: BB+

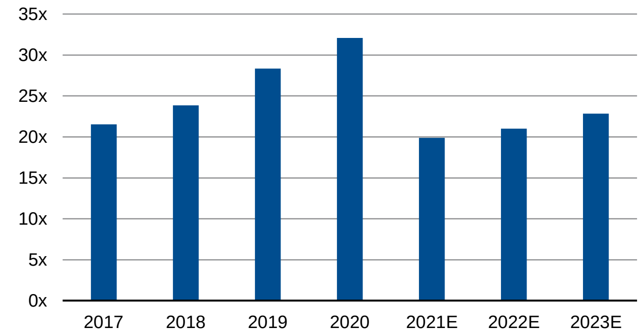
AXIÁL's **financial risk profile (assessed at BB+)** continues to support the issuer rating. We expect financial leverage to remain at around 2x in the medium term and interest cover at above 20x. The overall financial risk profile remains constrained by FOCF generation, which we expect to be negative in 2021.

Figure 5: Scope-adjusted leverage



Source: AXIÁL, Scope

Figure 6: EBITDA interest coverage



Source: AXIÁL, Scope

Rating reflects investment grade leverage

Our rating case reflects a SaD/EBITDA of around 2x, which we expect to improve as short-term financial debt continues to decrease in the next few years. Please note that EBITDA has been adjusted with the profit on asset disposals. This item relates to the regular disposal of old leased machinery to farmers who are unable to afford new machinery.The funds from operations/SaD ratio remains above 40%. The ratio in 2020 is exceptional as it resulted from a temporary high in payables. We expect the ratio to remain above 45% but below the 2020 level.

Strong interest coverage

AXIÁL's debt protection – as measured by Scope-adjusted EBITDA/Scope-adjusted interest – is above 20x, a level we expect for the next few years. The expected decrease in short-term financial debt will improve this ratio.

Weak cash flow coverage

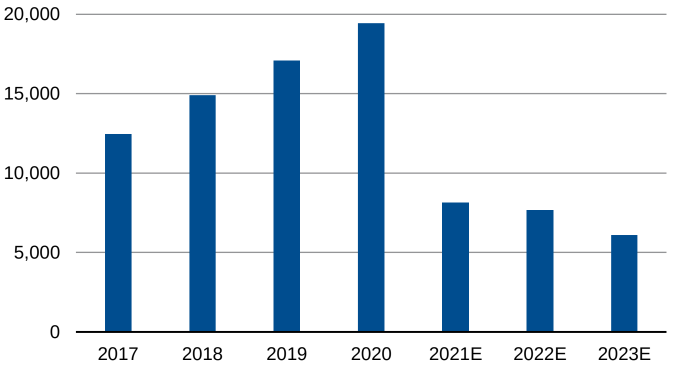
AXIÁL's cash flow cover – as measured by FOCF/SaD – moves between positive and negative. This is because of the fluctuation in FOCF due mainly to working capital changes. In 2018, FOCF turned negative as a result of higher inventories (+12.4%). In 2021, we expect a negative figure based on our conservative assumption that the high payables in 2020 were exceptional.

Adequate liquidity position

AXIÁL's liquidity position is adequate as i) most short-term debt has been repaid from bond proceeds; and ii) the issuer benefits from committed short-term credit lines totalling HUF 720m[3]. The company must repay HUF 8.1bn in 2021. AXIÁL also has HUF 13.4bn of available cash and equivalents as of 31 December 2020. For 2021, despite the negative expected FOCF, unrestricted cash will amount to HUF 4.2bn, to be reinforced by short-term committed lines expected at HUF 720m.

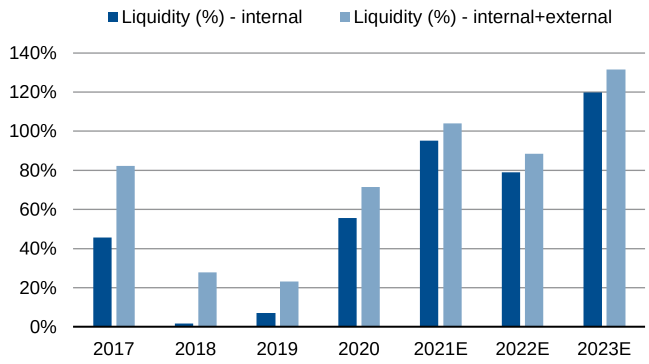
[3] We assumed the short-term committed credit lines to be fully rolled over based on the issuer's track record. Previously, the rolled-over amount was HUF 3bn. Following the bond issuance, AXIÁL did not renew some existing lines. As a result, as of FYE2020, total working capital facilities amounted to HUF 1.2bn (vs HUF 5.8bn as of FYE2019).

Figure 7: Maturity schedule of financial debt (in HUF m)



Source: AXIÁL, Scope

Figure 8: Liquidity ratios



Source: AXIÁL, Scope

Conservative dividend policy

We expect the dividend payout to remain at less than 40% of net income in the coming years, except in 2021, when 56% is planned. We believe this level strikes a balance between shareholder and creditor interests. A higher ratio could affect the rating.

No risk related to governance

AXIÁL is a Hungarian private limited liability company. The highest decision-making body is the members meeting (taggyűlés), whose members are the two owners, Zsolt Harsányi and Gyöngyi Harsányi Fodor, who are also married. Financial decisions are taken by executive management comprising three directors: Zsolt Harsányi, Gyöngyi Fodor and Zsolt Pintér.

The supervisory board controls management's activities and regularly reports to the members meeting. As stipulated by Hungarian corporate law, the supervisory board must oversee the lawful conduct of the company and has the right and responsibility to request that management demonstrate compliance with the relevant laws.

Despite a lack of real separation between the board members and the management, we found no related risk in AXIÁL's governance. The company's governance is also supported by an experienced and committed top management.

Long-term debt rating

BB+ rating for senior unsecured debt

We have upgraded the senior unsecured debt to BB+ from BB following the one-notch uplift in the issuer rating. We still expect an 'above average' recovery for senior unsecured debt, such as the HUF 15bn bond issued in September 2020 under the Hungarian National Bank's Bond Funding for Growth Scheme. This considers potential macro changes and that some aspects of the sub-ratings are well within low non-investment grade, meaning any macro changes could cause a rapid deterioration in credit metrics. This recovery expectation translates into a BB+ rating for senior unsecured debt. We highlight that senior unsecured debt has a subordinate ranking to debt raised from financial institutions for working capital financing as well as to payables.

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 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44 020 7340 6347

info@scoperatings.com
www.scoperatings.com

Disclaimer