7 May 2024 Corporates

AXIÁL Javító, Kereskedelmi és Szolgáltató Kft Hungary, Retail

BB NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	33x	8x	6x	9x
Scope-adjusted debt/EBITDA	0.6x	2.1x	2.7x	2.2x
Scope-adjusted funds from operations/debt	221%	28%	23%	33%
Scope-adjusted free operating cash flow/debt	78%	-48%	25%	10%

Rating rationale

The ratings are supported by good operating profitability; AXIÁL's position as one of the top-three agricultural machinery dealers in Hungary; its leadership position in spare parts; a market share of around 25% in Hungary's agricultural machinery sector; and adequate product diversification.

The main constraints on the ratings are the ageing and shrinking agricultural labour force in Hungary, the lack of geographical diversification compared to European peers, the company's small scale and reach in a European context and the inadequate liquidity.

Outlook and rating-change drivers

The Negative Outlook reflects the risk of continued inadequate liquidity given the financial outlay to fund the growth of the rental fleet to meet changing customer demand. In addition, the Outlook reflects continued pressure on credit metrics with leverage of around 2.5x (Scope-adjusted debt/EBITDA) and lower debt protection of around 10x due to limited visibility on end-customer funding.

A positive rating action, such as a revision of the Outlook to Stable, could be warranted if AXIÁL's liquidity ratio were to return to an adequate level, while leverage, as measured by Scope-adjusted debt/EBITDA, could be kept below 2.5x on a sustainable basis.

The rating could be downgraded if AXIÁL's liquidity ratio were to remain inadequate due to the high proportion of short-term financial debt.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
07 May 2024	Outlook change	BB/Negative
15 May 2023	Affirmation	BB/Stable
16 May 2022	Affirmation	BB/Stable

Ratings & Outlook

Issuer	BB/Negative
Senior unsecured debt	BB+

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Related Methodologies

General Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2024

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong interest cover of more than 9x, except in 2024, and relative low leverage (Scope-adjusted debt/EBITDA) of 1.0x-2.5x since 2020 • Good, expected Scope-adjusted EBITDA margin of between 8% and 10% • 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 of globally known brands including Claas, Manitou, Horsch and Hyundai • Importance of agriculture for Hungarian population and economy • Adequate product diversification • Adequate inventory despite some low turnover	• Ageing, shrinking agricultural labour force that could lead to a lower number of customers and so decreasing sales • Comparatively small scale and reach in a European context • Lack of geographical diversification compared to European peers • Inadequate liquidity

Positive rating-change drivers	Negative rating-change drivers
• Adequate liquidity and Scope-adjusted debt/EBITDA below 2.5x on a sustained basis	• Inadequate liquidity on a sustained basis

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 warranties and installation, machine rentals, and financing solutions. AXIÁL's primary focus is agriculture, accounting for around two-thirds of total turnover, with a secondary focus on construction, material handling and warehousing.

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

Financial overview

			Scope estimates		
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	33x	8x	6x	9x	11x
Scope-adjusted debt/EBITDA	0.6x	2.1x	2.7x	2.2x	2.1x
Scope-adjusted funds from operations/debt	221%	28%	23%	33%	37%
Scope-adjusted free operating cash flow/debt	78%	-48%	25%	10%	8%
Liquidity (internal and external)	>200%	-36%	63%	52%	40%
Scope-adjusted EBITDA in HUF m					
Reported EBITDA	25,145	20,622	14,279	15,824	16,385
Disposal gains/losses on fixed assets	-3,770	-4,009	-3,222	-3,222	-3,222
Scope-adjusted EBITDA	**21,375**	**16,613**	**11,057**	**12,602**	**13,163**
Scope-adjusted funds from operations in HUF m					
EBITDA	21,375	16,613	11,057	12,602	13,163
less: net cash interest as per cash flow statement	-641	-2,054	-1,833	-1,360	-1,200
less: cash tax paid as per cash flow statement	-985	-445	-271	-452	-517
add: dividends received from equity	22	40	30	30	30
Other (other financial cash incomes/expenses and other current liabilities and assets changes)	9,874	-4,314	-2,195	-1,501	-1,191
Scope-adjusted funds from operations (FFO)	**29,644**	**9,840**	**6,787**	**9,318**	**10,285**
Scope-adjusted free operating cash flow in HUF m					
Funds from operations	29,644	9,840	6,787	9,318	10,285
Working capital change	-9,385	-15,536	9,897	1,200	0
Non-operating cash flow	0	0	0	0	0
less: capital expenditure (net)	-9,717	-11,168	-9,250	-7,675	-7,990
Scope-adjusted free operating cash flow (FOCF)	**10,542**	**-16,864**	**7,435**	**2,843**	**2,295**
Net cash interest paid in HUF m					
Cash interest paid as per cash flow statement	969	2224	2333	1760	1500
less: cash interest received as per cash flow statement	-327	-170	-500	-400	-300
Net cash interest paid	**641**	**2,054**	**1,833**	**1,360**	**1,200**
Scope-adjusted debt in HUF m					
Reported gross financial debt	25,273	40,582	34,300	29,499	27,499
less: cash and cash equivalents	-12,248	-5,656	-4,809	-1,756	-221
add: cash not accessible	405	405	405	405	200
Scope-adjusted debt	**13,430**	**35,331**	**29,897**	**28,148**	**27,478**

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Environmental, social and governance (ESG) profile[1]

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)

No dedicated ESG strategy

AXIÁL has no dedicated ESG strategy. As a wholesaler, AXIÁL is exposed to the shortage of raw materials and natural resources but also to reputational risks (labour force management). The environmental management of a shop (costs related to refurbishment or energy) and the environmental footprint linked to logistics are the main elements for the environmental aspect.

On the environmental front, it is committed to reducing its carbon footprint and aims to reduce its energy consumption and emissions in its outlets. It also uses solar panels and electric cars. Besides, it is involved in tree-planting programmes. As for its social responsibility, AXIÁL trains the next generation of farmers by developing close relations with relevant educational institutions, hiring interns and participating in graduate programs.

[1] 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: BB-

AXIÁL's business risk profile continues to be supported by its profitability and market positioning in Hungary, with diversification being a negative rating driver.

Relative importance of agriculture for Hungary

Agricultural output remains important in Hungary despite having contributed only 4.1% to gross domestic product in 2022. In 2016, rural regions accounted for 28% of the national territory (versus 52% in France and 68% in Romania, two countries known for their agricultural activity) and 60% of farms were run by a household that consumed more than 50% of final production (versus 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 would be willing to continue stimulating investment in agriculture even if EU subsidies decreased.

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

The Hungarian agricultural sector is dominated by small farms (defined as less than five hectares) with low economic sizes2 (under EUR 4,000) and owners who are over 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 must deal with a dwindling population of farmers, in part due to ageing and no renewal of the labour force. This could be overcome by requests from bigger farms (300-3,000 hectares) for larger and more efficient machinery.

AXIÁL among top three dealers in Hungary

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

Distributor of well-known brands

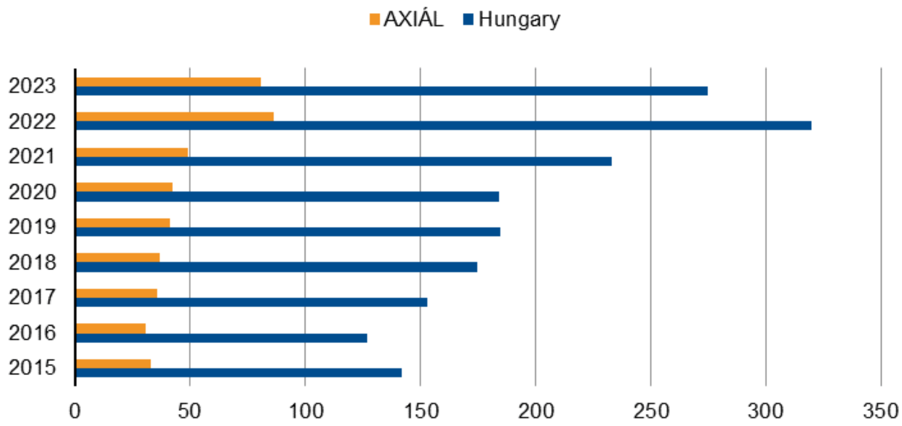
AXIÁL is the exclusive distributor of globally known brands, such as Claas (since 2000), Manitou (since 1998), Landini (since 1998), Horsch (since 2007) and Hyundai (since 2004). Claas is Hungary's second strongest brand after John Deere (whose exclusive distributor is Kite Zrt.). In addition, AXIÁL had success in gaining new suppliers, such as Gregoire for agricultural machines and JEKKO for construction machinery in 2021.

AXIÁL's sales of agricultural machinery represent around 25% of Hungarian sales

AXIÁL's sales of agricultural machinery account for around 25% of sales of Hungarian agricultural machinery. 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.

[2] The standard output of an agricultural product is the average monetary value of the agricultural output at farm-gate price, in euro per hectare or per head of livestock. There is a regional standard output coefficient for each product, as an average value over a reference period (5 years, except for the standard output 2004 coefficient calculated using the average of 3 years). The sum of all the standard output per hectare of crop and per head of livestock in a farm is a measure of its overall economic size, expressed in euro.

Figure 1: Agricultural machinery sales (in HUF m)



Sources: AXIÁL, Scope

Leader in spare parts

AXIÁL has a market share of 40% in the spare parts retail market, which was originally its main business. This history provides the company with visibility and recognition as an expert in the field. It constitutes a competitive advantage, reinforced by AXIÁL's extensive and efficient logistics and infrastructure.

The rise of built-in components in agricultural and construction machinery has driven up the importance of spare parts and has led to a 50% increase in demand for spare parts.

Larger product offering to attract and retain customers

AXIÁL continually seeks to improve product diversification. Recently, it introduced: i) DeLaval milking technology; ii) mAXI-CAM, an optical weed recognition-based cultivation system developed by AXIÁL; iii) mAXI-MAP, a module that enables mapping of precision farming data, enabling visual comparisons of different maps but also providing other information related to precision farming; and iv) mAXI-net 2.0, a correction signalling tool for automated agricultural machines. The company has complemented its product portfolio with machine accessories (items not supplied by manufacturers, such as tyres, batteries and oils), and it has even developed an in-house brand (Ister).

Strong after-sales business

AXIÁL's after-sales business is stronger than that of competitors thanks to its large workshop, which has an area of over 16,000 sq m. An extension to its spare parts logistics centre has been operational since mid-2021. This activity will become more important as machinery gets more complex with the inclusion of digital equipment for instance. It is worth mentioning that materials maintenance consistently accounts for 6% of Hungarian agricultural expenses, according to Eurostat, equivalent to around EUR 275m per year. Having a strong after-sales business enables the company to retain its customers and perpetuate its business.

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

According to management, capex goes towards three areas: digital infrastructure, human resources and productive assets/facilities.

The company is investing in digital solutions to support internal processes (barcode, QR code, NFC, digital product sheet, rental machines application, digital inventory, video conferencing, etc.) and external processes (e-worksheet, e-invoice, digital sales contract, digital communication, etc.). Increasing digitalisation should not only lower operational costs but also place the company as a pioneer in such solutions.

In terms of its investment in HR, the company enrols trainees and offers benefits to attract and retain employees. AXIÁL aims to manage employee turnover so as to minimise costs for the company.

AXIÁL plans to increase its building area, including investments into a warehouse, related to the service business by more than 20% in the coming years to better meet the demand.

Large customer base mainly in the agricultural sector

AXIÁL has an extensive base of 37,000 customers in total, 10,000 of which it deals with frequently. Its customers are mainly from agriculture (about 90%) and located in Hungary. Its 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 part of its business. This is why it has 19 outlets across Hungary that are accessible within 75 km distance. It also sells directly to customers. Given this strong customer focus, we expect that switching supplier would entail high costs for customers.

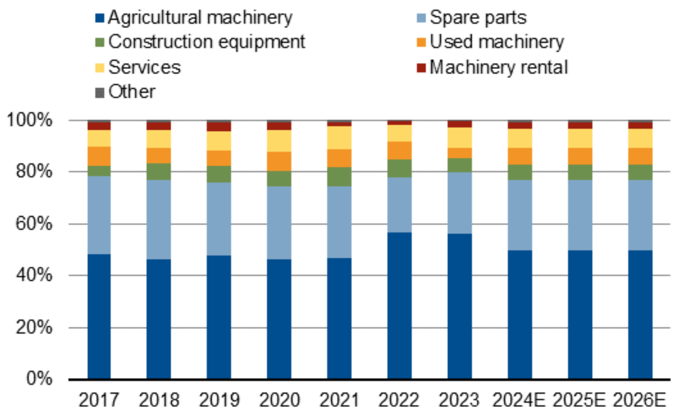
Adequate inventory levels despite some low turnover

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

Revenue diversified only by activity

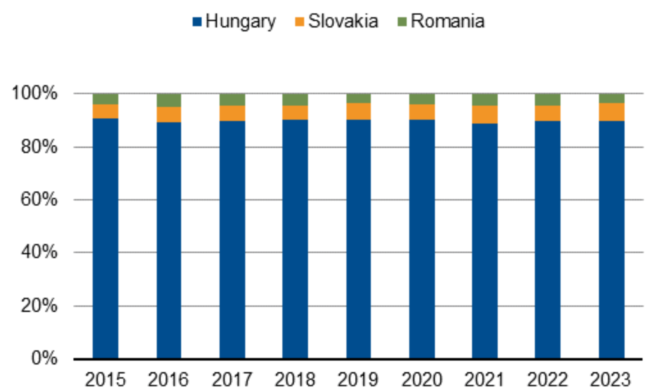
Agricultural machinery consistently accounts for almost 50% of revenue, followed by spare parts (around 30%). Hungary accounts for 90% of AXIÁL's turnover.

Figure 2: Revenue by segment (%)



Sources: AXIÁL, Scope estimates

Figure 3: Revenue by country (%)



Sources: AXIÁL, Scope

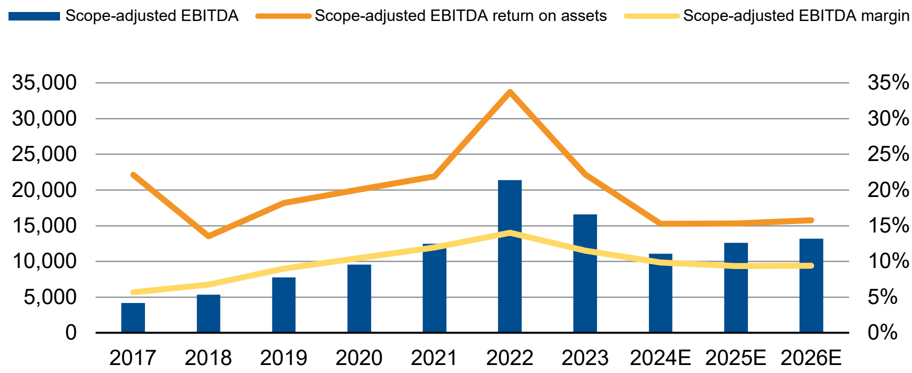
Lower operating profitability

The Scope-adjusted EBITDA margin is good, especially compared to rated peers. The margin improved year after year to 14.1% in 2022 from 5.7% in 2017 but declined to 11.6% in 2023, reverting to recent historical levels. AXIÁL does not disclose EBITDA by segment. The significant increase in profitability in 2022 (up 53.7% YoY) was mainly driven by euro-denominated sales (supplies also denominated in euro) supporting revenue growth due to the depreciation of the forint against the euro, given that most operating expenses are incurred in forint.

Margin profile expected to be sustained at between 8-10%

We expect AXIÁL's Scope-adjusted EBITDA margin to remain between 8% and 10%. For 2024, we expect a lower margin than in 2023 due to the forecasted lower sales and increased staff costs.

Figure 4: Scope-adjusted EBITDA return on assets (%, RHS), Scope-adjusted EBITDA (HUF m, LHS) and profitability (%, RHS)



Sources: AXIÁL, Scope estimates

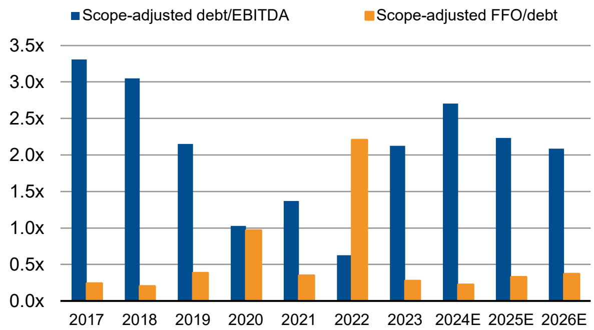
Low return on assets

We expect AXIÁL's Scope-adjusted EBITDA return on assets to decrease, ranging between 15%-25%, which is low compared with peers' return on assets. This means the company is less effective at translating higher tangible assets (one-third of the total balance sheet) and inventories (50%) into EBITDA.

Financial risk profile: BB

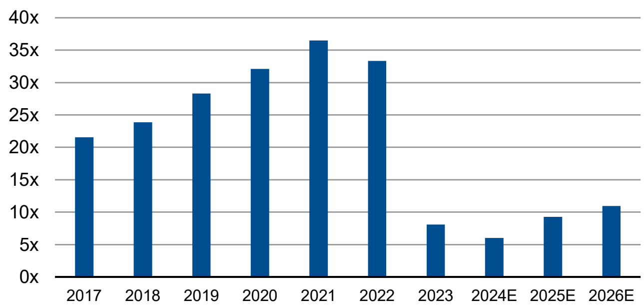
Despite the strains on AXIÁL's financial risk profile, it continues to support the issuer rating. We expect financial leverage to be around 2.5x in the medium term and interest cover to hover above 9x on average. The overall financial risk profile remains constrained by FOCF which is deemed weak but also by an inadequate liquidty.

Figure 5: Scope-adjusted debt/EBITDA and Scope-adjusted FFO/debt



Sources: AXIÁL, Scope estimates

Figure 6: Scope-adjusted EBITDA/interest cover



Sources: AXIÁL, Scope estimates

Pressure on leverage

Leverage, as measured by Scope-adjusted debt/EBITDA, deteriorated to 2.1x in 2023 due to farmers' partial postponement of their investments. AXIÁL's revenues decreased by 5.5% to HUF 144.2bn as a result of lower sales from new machinery but also second-hand machinery. Those lower sales were partially compensated by higher demand from rental machinery and by the increase in revenues from services and spare part. The company had to invest more in rental machinery leading to a higher working capital need to be financed. This is why short-term financial debt climbed by almost 115% to HUF

22.2bn in 2023. Scope-adjusted EBITDA decreased to HUF 16.6bn in 2023 (down by 22% YoY). 2024 will be a transitional year for the company as farmers are waiting to know the exact amount of subsidies they will receive. This information should be available by end of 2024. This is why we expect AXIÁL's revenue to decrease by more than 20% in 2024 but to improve by around 20% and 5% in both 2025 and 2026. We forecast the same trend in Scope-adjusted EBITDA which is expected to be lower by almost 35% in 2024 and higher by around 15% and 5% in respectively 2025 and 2026. Short-term financial debt is expected to be lower and partially refinanced by long-term financial debt. As a result, we forecast a peak of 2.7x in leverage, reflecting the transitional year, before improving to around 2x from 2025. Scope-adjusted FFO/debt is expected to remain above 20%. Our forecasts are supported by the company's good track record. Indeed, AXIÁL has been able to exceed our expectations, except in 2023 due to the postponement of investments, and has shown caution in the day-to-day running of its business.

Strong interest coverage

Debt protection as measured by Scope-adjusted EBITDA interest cover deteriorated to 8x in 2023. This resulted from the spike in short-term financial debt to finance inventories in a high interest rates environment which led to an increase in interests paid from HUF 1bn in 2022 to HUF 2.4bn in 2023. We forecast a low debt protection of 6x in 2024, reflecting the transitional year, before improving to, respectively, around 10x on average.

Weak cash flow coverage

Cash flow cover as measured by Scope-adjusted FOCF/debt has shifted between positive and negative between 2017 and 2023. This is because of fluctuations in FOCF due mainly to working capital changes. In 2018, 2021 and 2023, FOCF turned negative as a result of higher inventories (up 9.1% YoY in 2023). We expect FOCF to turn positive in 2024 mainly due to a positive working capital change.

Inadequate liquidity

AXIÁL's liquidity is seen as inadequate following the spike in the use of short-term financial debt in 2023. As a consequence, cash sources (HUF 5.3bn of available cash and equivalents as of end-2023, committed short-term credit lines totalling HUF 1.9bn and expected positive free operating cash flow of HUF 7.4bn in 2024) will not be sufficient to cover cash uses (short-term debt of HUF 22.2bn). We expect this situation to remain for the upcoming years but see associated risk to be manageable. The company has a strong track record in rolling over short-term debt, which was its preferred source of funding prior to the issuance of bonds under the MNB Bond Programme, which replaced most of its short-term debt obligations. We gain further comfort as short-term financing is provided under a syndicated loan agreement that determines the accessible financing by a formula which limits the overfinancing risk and reduces the liquidity risk. In addition, we expect the issuer to be able to refinance some of its short-term debt with new long-term financing, given its favourable access to bank loans. This reflects the company's strong position in the Hungarian market as one of the leading agricultural distributors. In addition, AXIÁL may sell some of its fixed assets and inventories in order to meet its financial obligations.

Position in HUF m	2024E	2025E	2026E
Unrestricted cash (t-1)	5,251	4,403	1,351
Open committed credit lines (t-1)	1,208	1,208	1,208
FOCF (t)	7,435	2,843	2,295
Short-term debt (t-1)	22,158	16,300	12,000
Coverage	**63%**	**52%**	**40%**

Supplementary rating drivers: +/- 0 notches

Conservative dividend policy

We expect the dividend payout to remain below 40% of net income in the coming years. In 2023, 35% of net income was distributed. We consider that a distribution of up to 40% 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 married. Financial decisions are taken by executive management, which comprises 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 prove compliance with relevant laws.

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

Long-term debt rating

BB+ rating for senior unsecured debt

In September 2020, AXIÁL issued a HUF 15bn senior unsecured bond (ISIN: HU0000359930) through the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond proceeds were fully used to refinance its short-term financial debt. The bond has a tenor of 10 years and a fixed coupon of 2.0% with a bullet maturity. We note that AXIÁL's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has no accelerated repayment clause but bond covenants include a pari passu clause and negative pledge.

We have affirmed the senior unsecured debt category at BB+. We still expect an 'above average' recovery for senior unsecured debt, including for the HUF 15bn bond issued in September 2020 under the Hungarian National Bank's Bond Funding for Growth Scheme. This recovery expectation translates into a BB+ rating for senior unsecured debt. We highlight that senior unsecured debt has a subordinate ranking to payables and to debt raised for working capital and capex financings.

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