ITK Holding Zrt.
Hungary, Business Services & Automotive

SCOPE 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. Estimated revenue and EBITDA for 2021 are HUF 27.3bn and HUF 1.6bn respectively. It has over 500 employees.

Key metrics

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA interest cover (x)	2.8x	4.3x	3.1x	3.3x	2.6x
Scope-adjusted debt (SaD)/EBITDA (x)	10.4x	15.2x	8.5x	11.0x	8.3x
Funds from operations (FFO)/SaD (%)	6.0%	5.0%	7.6%	6.1%	7.1%
FOCF/SaD (%)	-27.0%	-30.7%	-28.7%	-38.0%	-16.2%

Rating rationale

Scope Ratings GmbH (Scope) takes no action on ratings for ITK Holding Zrt. as it expects the company to further pursue its growth strategy with support from majority shareholder MOL Group and with financial leverage in line with previous expectations.

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

The business risk profile (assessed at B+) is underpinned by a stable public transportation business. The company has six long-term contracts (five of which being 10 years or more from inception) for the provision of bus services in Hungary, with a high certainty of cost recovery over the term of the contracts. Two important contracts were added since our last review and the relatively modern (aged 6.6 years on average) fleet now stands at 409 vehicles. The smaller business services operations also have a long track record of stable margins and performed particularly well in 2021. This is balanced by higher risk in the newly established vehicle manufacturing business, which started production in 2019. The company produced only 149 vehicles in 2021, against a forecasted 380, although we expect earnings to be broadly in line with our expectations. We expect a significant ramp-up in production over the coming three years to over 400 vehicles per annum. ITK itself needs 400-500 additional buses for its own fleet by YE 2024, equal to around one-third of the expected production.

Profitability is strong and stable in business and transportation services, whereas vehicle manufacturing is only operating at breakeven due to sub-optimal production volumes. We expect profitability to improve gradually over the next three years, and for the group as a whole to generate a positive net profit from 2021 onwards. Supplier and customer concentration is high, but most are well-established industry players with good credit standing.

Ratings & Outlook

Corporate rating	BB-/Stable
Senior unsecured debt 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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ITK's financial risk profile (assessed at B-) reflects very high leverage, measured by Scope-adjusted debt (SaD)/Scope-adjusted EBITDA estimated at 8.5x at the end of 2021. With sizeable investments in the bus fleet to continue in 2022-2024 (around HUF 29bn), leverage is expected to rise in 2022 to around 11x and reduce gradually thereafter towards 8x as we see the full year contribution of the expanded fleet. A potential investment in a new HUF 20bn production plant at Debrecen could also add to the financial leverage (final investment decision expected by end of May 2022).

The company issued a HUF 20bn bond under the Hungarian National Bank's Bond Funding for Growth Scheme in June 2021, which was used primarily for refinancing. The 10-year tenor and pricing at 2.9% for the bond has added stability to the capital structure of the company.

ITK had HUF 3.1bn of liquid assets and HUF 1.4bn of short-term debt at the end of 2021. We expect the growth in the fleet to be financed primarily by new secured bank loans, and to a lesser extent by subordinated loans and equity from MOL Group. We understand that shareholders do not expect to extract dividends from the company in the short to medium term.

Outlook and rating change drivers

The Stable Outlook reflects the stability of revenues and earnings from long-term public transportation contracts and a relatively low-cost, long-term debt profile after ITK successfully placed the HUF 20bn bond. We understand financial support from MOL Group remains available for planned projects and temporary liquidity requirements, if needed. We expect the company to gradually improve its profitability and move towards a neutral free-operating cash flow (FOCF) 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/Scope-adjusted 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 (8.5x expected in 2021), 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. • The 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/Scope-adjusted EBITDA) sustainably below 6x • 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**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA interest cover (x)	2.8x	4.3x	3.1x	3.3x	2.6x
SaD/Scope-adjusted EBITDA (x)	10.4x	15.2x	8.5x	11.0x	8.3x
Scope-adjusted funds from operations/SaD (%)	6.0%	5.0%	7.6%	6.1%	7.1%
Free operating cash flow/SaD (%)	-27.0%	-30.7%	-28.7%	-38.0%	-16.2%
Scope-adjusted EBITDA (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	1,085	1,182	2,872	3,460	5,350
Scope-adjusted EBITDA	**1,085**	**1,182**	**2,872**	**3,460**	**5,350**
Scope-adjusted FFO (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	1,085	1,182	2,872	3,460	5,350
less: (net) cash interest paid/received	-386	-273	-913	-1,043	-2,078
less: cash tax paid	-19	-17	-87	-84	-114
Scope-adjusted FFO	**679**	**891**	**1,872**	**2,333**	**3,159**
Scope-adjusted debt (HUF m)	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross debt	11,521	19,759	27,694	42,093	47,246
Cash and equivalents	-240	-1,768	-3,142	-4,081	-2,980
Scope-adjusted debt (SaD)	**11,281**	**17,991**	**24,552**	**38,012**	**44,266**

Source: ITK, Scope estimates

Business risk profile (B+)

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

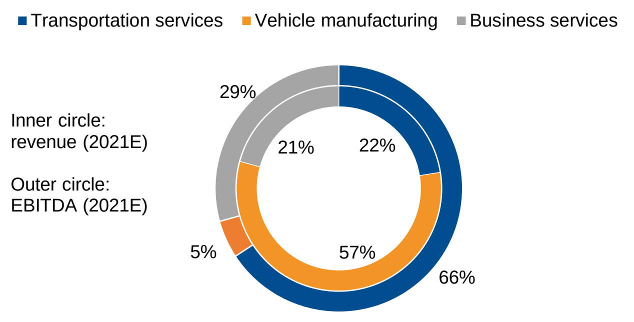
We assess ITK's industry risk at BBB-, reflecting the weighted average industry risk of business services (BBB) and automotive and commercial vehicle manufacturing (BB). Cyclicality and entry barriers are medium for business services and high for automotive and commercial vehicle manufacturers. The risk of substitution is medium for both industries. Most of ITK's earnings are derived from public transportation and business services, but the majority of revenues are generated from vehicle sales (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 business. The company has five long-term (10 years or more from inception) contracts for the provision of bus services in Budapest, Debrecen and Kecskemet, as well as a nationwide contract with the national Swimming Association, with a high certainty of cost recovery over the term of the contracts. ITK also benefits from a relatively modern bus fleet with an average age of 6.6 years. Its smaller business services operations also have a long record of stable margins.

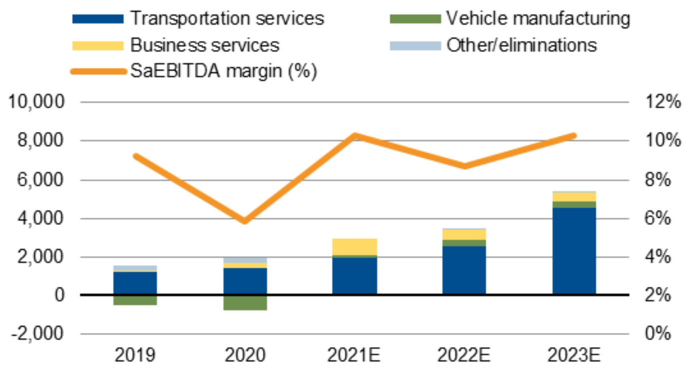
This is balanced out by higher risk in the newly established vehicle manufacturing business, which started production in 2019. This business benefits from a partnership with Daimler, whereby all vehicles (buses and vans) produced by ITK carry the Mercedes-Benz brand. ITK produces vehicles to order, most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

Figure 1: Expected revenue and EBITDA by business segment, 2021



Source: ITK, Scope estimates

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

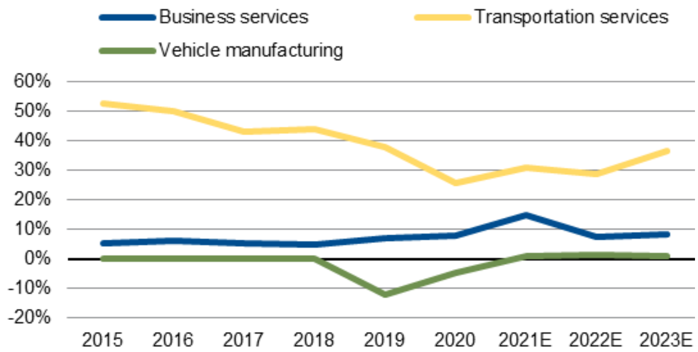


Sa=Scope-adjusted, Source: ITK, Scope estimates

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 (Figure 3). We expect that profitability will improve gradually over the next three years and that the entire group will generate a positive net profit from 2021. ITK is a relatively small operator compared to state-owned Volánbusz and VT-Arriva, owned by Deutsche Bahn. ITK's EBITDA margins are however the highest in the peer group (Figure 4).

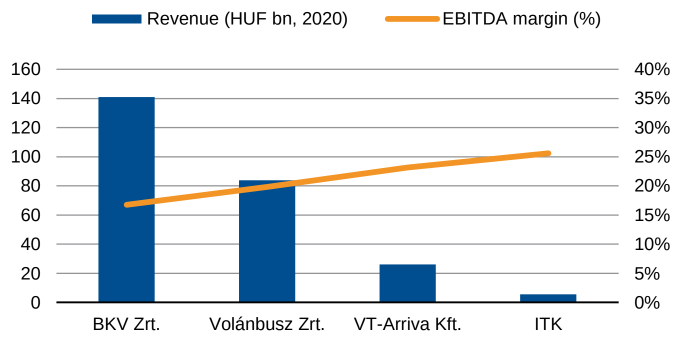
ITK's business is concentrated in Hungary, with relatively high supplier and customer concentration, although most are well-established industry players with high credit standing.

Figure 3: EBITDA margin by business segment



Source: ITK, Scope estimates

Figure 4: Hungarian bus service operators, 2020



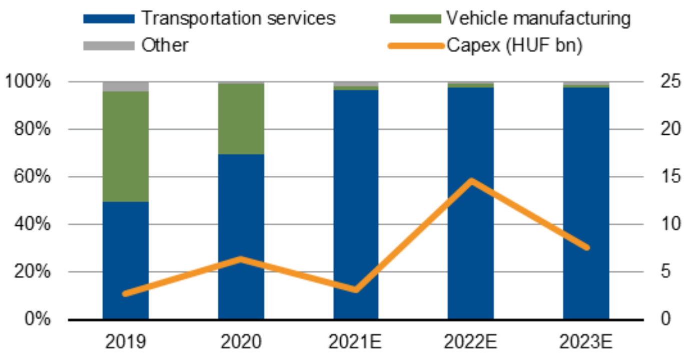
Source: ITK, public information

Financial risk profile (B-)

ITK's financial risk profile (assessed at B-) reflects very high leverage, measured by SaD/Scope-adjusted EBITDA estimated at 8.5x at YE 2021. The high leverage stems from significant investments in property, plant and equipment; working capital; and the bus fleet expansion in 2019-2021 (Figures 5 and 6). We expect that sizeable investments (HUF 35bn) in the bus fleet will continue in 2022-2024, fulfilling 2022 contracts. A potential investment in a new HUF 20bn production plant at Debrecen could also add to the debt levels going forward (final investment decision expected by end of May 2022). This potential investment is not included in our base case forecast however, and if it goes ahead, we expect it to be financed in a way that preserves the current credit profile.

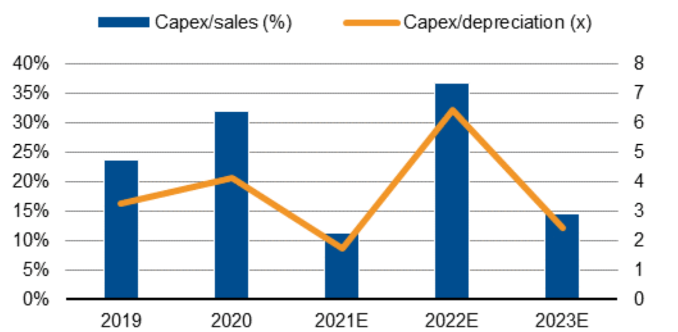
High capex directed to bus fleet expansion

Figure 5: Capex by business segment (HUF bn)



Source: ITK, Scope estimates

Figure 6: Capex to sales and depreciation



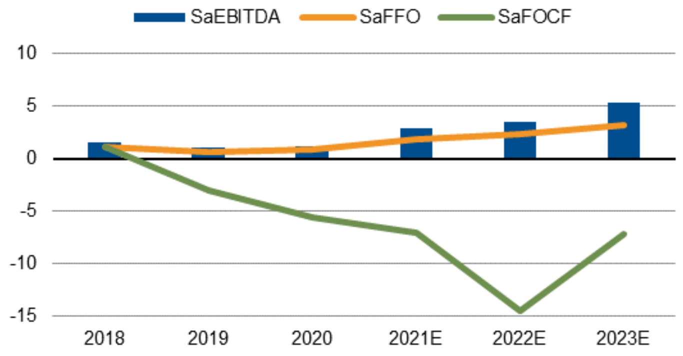
Source: ITK, Scope estimates

Expansionary investments to continue with negative FOCF expected until at least 2025

EBITDA and debt to grow with leverage remaining broadly unchanged

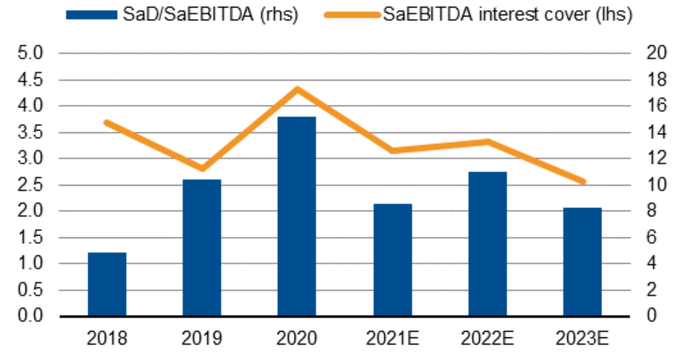
With the new bus services contracts and the expected ramp-up of vehicle production, we expect the company to remain FOCF-negative during the coming three years (Figure 7) and the absolute level of adjusted debt to increase. We understand that shareholders do not expect to extract dividends from the company in this period, but will prioritise growth. A commensurate increase in EBTIDA should result in financial leverage (SaD/Scope-adjusted EBITDA) remaining broadly unchanged (Figure 8). New bus services contracts will also likely be added in future years, promoting business growth, with leverage remaining at its current high level (over 8x).

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



Sa=Scope-adjusted, Source: ITK, Scope estimates

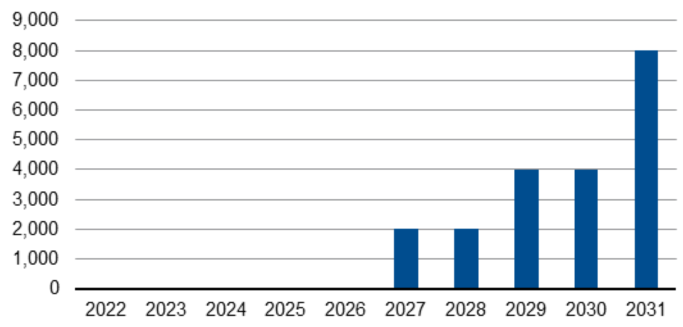
Figure 8: Scope-adjusted leverage and debt service



Sa=Scope-adjusted, Source: ITK, Scope estimates

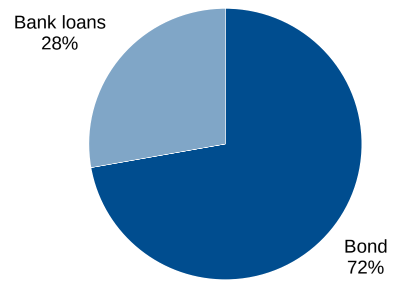
The company issued a HUF 20bn bond under the Hungarian National Bank's Bond Funding for Growth Scheme in June 2021, which was used primarily for refinancing. The 10-year tenor and pricing at 2.9% for the bond has added stability to the capital structure and debt service of the company (Figure 9). The balance of external funding comprises long-term vehicle and mortgage financings (Figure 10). The company is well protected against rising interest rates with 92% of fixed rate debt at YE 2021.

Figure 9: Bond maturity profile (HUF m), YE 2021



Source: ITK, Scope

Figure 10: Funding sources, YE 2021



Source: ITK, Scope

Liquidity underpinned by long-term debt maturity profile and shareholder support

ITK had HUF 3.1bn of liquid assets and HUF 1.4bn of short-term debt at the end of 2021. We expect the growth of the fleet to be financed primarily by bank loans secured on the vehicles and subordinated loans and equity from MOL Group. The adequate liquidity assessment reflects the standalone liquidity position, as well as the fact that financial support from MOL Group remains available for planned projects and temporary liquidity requirement, if needed.

Figure 11: Liquidity

HUF m	2021E	2022E
Cash and cash equivalents (t-1)	1,768	3,142
Committed unused bank facilities (t-1)	0	0
Short-term debt (t-1)	5,535	1,434
FOCF (t)	-7,034	-14,460
Liquidity (%): internal	-95%	-789%
Liquidity (%): internal + external	-95%	-789%

Source: ITK, Scope estimates

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 jointly by the two partners. The MOL Hungary CFO and the Head of Group Mobility are both members of ITK's board of directors.

MOL Group has extended significant investment and working capital loans to ITK in the past and provides parent company guarantees in certain cases. The loans were repaid with the proceeds of the HUF 20bn bond issuance, but parent company guarantees have continued after the bond issuance. The bond indenture includes 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 bond documentation, limiting the extent of secured debt in the capital structure.

The bond has 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 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 2 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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