Ontime Corporate Union S.L. Spain, Road Logistics

BB STABLE

Corporate profile

Grupo Ontime is headquartered in Madrid and was founded in 1991. It is a logistic services group specialized in personalized multimodal services for large corporations. Its offerings range from urgent, domestic and international courier services, distribution of parcels and palletised cargo and storage. The company employees 1,500 professionals, has 950-1,000 vehicles and 30 service centres. The group is privately owned and generated EUR 111m in net sales and EUR 16m EBITDA in 2020 (fiscal years end on 31 December). The group mainly operates in Spain.

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
Scope-adjusted EBITDA interest cover (x)	2.6x	5.3x	8.8x	9.1x
Scope-adjusted debt (SaD)/SaEBITDA (x)	4.0x	2.4x	2.9x	2.8x
Scope-adjusted FFO/SaD (%)	14%	32%	26%	27%
Scope-adjusted FOCF/SaD (x)	19%	(-) FOCF	(-) FOCF	1%

Rating rationale

Scope assigns Ontime Corporate Union S.L. an issuer rating of BB/Stable, a debt category rating on senior unsecured debt of BB and short-term debt rating of S-3.

The issuer's business risk profile is driven by the small size of the company. The group generated around EUR 111m revenues in 2020. Thanks to anticipated organic growth and multiple acquisitions, Ontime expects to triple in size to reach a turnover of EUR 290-330m in the medium term, although it should remain a small player in the Spanish road logistics market. The current strategy is to participate in the consolidation of the marketby acquiring more than five companies in Spain during the next three to four years.

The business risk profile is positively impacted by the very strong operating margins. Historically, Ontime has shown EBIT margins of 8% to 12%. The high profitability derives from the strong integration of the business model where the strategy is to offer services covering all the aspects of the logistics chain. The focus on fully integrated services in Spain was initiated in 2014 and is a key differentiating factor as few Spanish players offer the same level of services. In a very fragmented market where road logistics companies often compete on prices, Ontime achieves high customer retention. This is due to multi-year contracts including high value-added services such as warehousing and automated processes. The high EBIT margin also derives from the strategy of limiting outsourcing. This business model, although profitable, constrains the company's scalability and is working capital intensive. Therefore, Ontime is currently shifting its business model from relying mainly on its own truck fleet, drivers and warehouses to a more asset light structure by using more subcontractors. This, in addition to the expected acquisitions, should weigh on the company's profitability in the medium term.

The blended industry risk profile of B+ is constrained by the large exposure to the road logistics sector, which shows very low entry barriers as evidenced by the high market fragmentation, paired with medium cyclicality. The competitive positioning is also constrained by limited geographical diversification. Ontime generates more than 90% of its revenues in Spain.

All in all, the business risk profile is assessed as BB-.

Ratings & Outlook

Corporate ratings	BB/Stable
Senior unsecured rating	BB
Short-term debt rating	S-3

Analysts

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Related Methodologies

Corporate Rating Methodology, July 2021

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Bloomberg: RESP SCOP

The financial risk profile of the issuer is deemed BB, constrained by the very low to negative cash flow generation. Financial leverage as measured by Scope-adjusted- Debt/Scope-adjusted EBITDA has been decreasing over the past business years to a level of 2.4x as of year-end 2020 from 6.0x in 2018. This is mainly due to the EUR 19m equity injection in 2020 and the synergies of the companies acquired in the last years. The shareholders that have participated in the recent capital increase are composed of executives and other relevant investors who have an industrial profile. Looking forward, we expect the issuer to show leverage in a range of 2.5x to 3.0x for the next two business years, based on our financial base case that incorporates the successful completion of four acquisitions. Nevertheless, the planned investments could lead to volatile credit metrics given that targets still have to be set, in addition to their prices and timing of acquisition. Although Ontime will reduce its capex for the period 2021-2023, the company will continue to have structurally large working capital requirements.

Liquidity is deemed adequate thanks to the 2021 refinancing realized through a syndicated facility and we expect the main part of the remaining short-term financial maturities, including factoring and commercial paper, to be rolled over.

Outlook and rating change drivers

The outlook for Ontime Corporate Union S.L. is Stable. This incorporates financial leverage ranging from 2.5x to 3.0x going forward. Moreover, this forecast assumes that the company is able to successfully complete its expansion plan through various acquisitions and to successfully launch a commercial paper program in 2021 with proceeds earmarked for financing of its working capital.

A positive rating may be warranted if the company improves its FOCF/SaD above 10% on a sustained basis while maintaining its current business risk profile. This could be achieved in the light of improved operating cash flow through a reduced impact from negative working capital.

A negative rating action might be warranted if the company shows financial leverage of more than 3.5x SaD/EBITDA on a sustained basis. A financial leverage exceeding 3.5x could for example be triggered by a significant deterioration of operating profitability in its core segments or higher-than-expected working capital requirements or larger payments for the various acquisitions.

Rating drivers

Positive rating drivers	Negative rating drivers
• Very strong operating margins, although expected to be diluted by acquisitions. • Strong integration of the business model granting a competitive advantage and allowing low customer turnover. • Good customer diversification. Diversified business model including higher value-add services like warehousing, IT systems, documentation, total traceability of orders, purchase order management, • Shift of operating strategy increasing its potential scalability.	• Weak market positioning impacted by the small size of operations. • Execution risks with regards to the change in operating strategy as well as potential M&A transactions. • Concentrated geographical footprint. • Weak free cash flow generation impacted a high negative working capital.

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• FOCF/SaD above 10% on a sustained basis.	• SaD/EBITDA above 3.5x on a sustained basis

Ontime Corporate Union S.L.

Spain, Road Logistics

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	2.6x	5.3x	8.8x	9.1x
Scope-adjusted debt/Scope-adjusted EBITDA (x)	4.0x	2.4x	2.9x	2.8x
Scope-adjusted FFO/SCOPE-adjusted debt (SaD)	14%	32%	26%	27%
FOCF/Scope-adjusted debt (SaD)	19%	(-) FOCF	(-) FOCF	1%
Scope-adjusted EBITDA in EUR k	**2019**	**2020**	**2021E**	**2022E**
EBITDA	11,447.3	16,147.8	21,925.3	25,881.3
Operating leases expenses	1,790.0	12,573.0	14,573.0	16,573.0
Scope-adjusted EBITDA	13,237.3	28,720.8	36,498.3	42,454.3
Scope funds from operations in EUR k	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA	13,237.3	28,720.8	36,498.3	42,454.3
less: cash interest as per cash flow statement	-4,885.0	-4,349.7	-2,119.1	-2,341.5
less: cash tax paid as per cash flow statement	-529.4	-1,246.3	-4,813.1	-5,771.5
less: interest portion of leases	-253.2	-1,077.2	-2,036.0	-2,336.0
Scope funds from operations	7,569.7	22,047.6	27,530.2	32,005.4
Scope-adjusted debt in EUR k	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	56,439.6	68,038.2	84,762.0	93,660.0
less: cash, cash equivalents	-8,546.8	-37,242.5	-24,297.2	-24,038.0
Cash not accessible	0.0	0.0	0.0	0.0
add: Operating leases	5,370.0	37,719.0	43,719.0	49,719.0
Scope-adjusted debt	53,262.8	68,514.6	104,183.8	119,341.0

Business risk profile: BB-

Blended industry risk of B+

Industry risk for Ontime is high as it is mainly exposed to the road transportation sector.

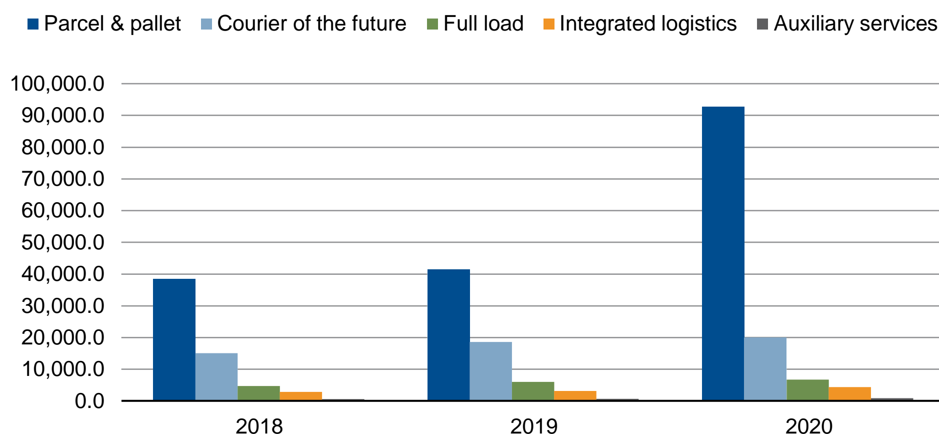
We assess cyclicality in the road transportation industry as medium. Since a vast majority of goods are transported by road logistics, at least on the last stretch of their route, the size of the overall market is very large. It has been growing steadily in line with GDP and industrial production globally. There is a certain degree of correlation to GDP growth, which is due to swings in industrial production throughout the economic cycle. However, since a large portion of road logistics cargo consists of essential goods like fresh and packaged food, beverages and healthcare products, there is a substantial level of very stable transportation volume. Moreover, European road freight volumes have been on a positive trend, outpacing GDP growth for more than a decade. GDP growth sensitivitywas below 1x, for instance in the 2009 recession.

Entry barriers to road freight logistics are very low, as evidenced by a six-digit number of competing companies in Europe. According to estimates, more than 80% of European road freight companies operate 0 to 10 trucks in total, leading to an extremely fragmented market with only 1% of companies operating more than 50 trucks. The Spanish market displays the same picture with more than 600 road logistics companies.

Substitution risks are medium to low in our view. Despite a clear commitment of many market participants and governments alike to curb carbon emissions and move cargo volume to more environmentally friendly modes of transport like rail, the overall transport industry still depends heavily on trucks. In particular the last 0 to 100km to the cargo's final destination can only be covered by road transport in the vast majority of cases. Increased levels of national and international trade have always lifted road transport volumes in absolute terms, and road's relative share has been very stable over the last few decades.

Blended industry risk is B+, based on the weights of the EBITDA contribution to consolidated group numbers. We assigned a 23% weighting to the courier services industry risk profile (assessed BBB), applicable to the EBITDA contribution from the courier segment, and a 77% weighting to the road logistics industry risk profile (assessed B).

Figure 1: Segment revenues (EURm)



Sources: Ontime, Scope

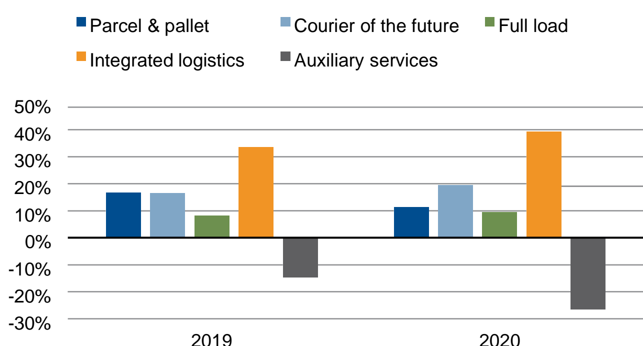
Weak market positioning mitigated by strong integration

We regard Ontime as a rather small-sized logistics company, on an absolute scale. The group generated around EUR 111m revenues in 2020. This represents a market share below 5%. As for fleet size and number of warehouses, the company compares favourably vs its Spanish peers. The group owns a fleet of 950-1,000 vehicles and has 1,500 employees. Ontime benefits from a broad footprint in Spain with more than 30 logistics centres across the country. Its limited scale prevents Ontime from winning large contracts and meeting pan-European services demand, which exhibits better prospects. Additionally, we see Ontime's present focus on B2B (business-to-business) as a limiting factor for its market positioning since, with the emergence of e-commerce, the B2C market is expected to exhibit higher growth rates.

Integrated business model offers many advantages

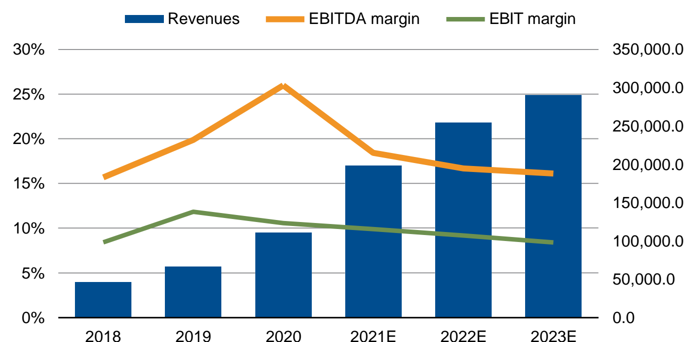
Ontime is able to offer a complete and integrated panel of logistical services (5PL or 'fifth party logistics'). Ontime is one of the few 5PL companies in Spain. In addition to a high demand for integrated logistics, such providers are better at retaining customers as they coordinate the different aspects of the logistic chain including automation systems. Key competitive advantages are the customer satisfaction, efficiency and flexibility in a market with limited differentiating opportunities. There is no pricing power nor market dominance here as the overall European road freight market is very fragmented, with the top 10 players only covering about 10% of freight volume. This is even more the case for Spain, with more than 600 companies. This makes even large players price takers in our view. We nevertheless acknowledge that the integrated business model allows Ontime tomitigate competitive pricing by offering more value-added services; although entailingless flexibility than handling contracts via subcontractors.

Figure 2: Reported EBITDA margin per segment. 2019-2020 (%)



Sources : Ontime, Scope estimates

Figure 3: Profitability (Scope-adjusted EBITDA and EBIT) vs revenues. 2018-2023E



Sources: Ontime, Scope estimates

Weak geographical diversification offset by a fair client portfolio granularity

Ontime has limited geographical diversification and derives at least 95% of its revenues from Spain, with the rest in Portugal. The diversification level for Ontime in terms of business segments is assessed as fair by including domestic and international courier services, distribution of parcels, industrial parcels, campaign and promotion materials and storage, although it is still constrained by being concentrated on the industrial parcel services (59% of sales), its business-to-business (B2B) delivery operation.

The company can count numerous leading multinational companies among its clients, belonging to diversified sectors including retailers, consumer goods companies, telecommunication operators and construction contractors. In addition, Ontime's diversification assessment is supported by the fact that its top 15 clients account for around 38% of sales.

Very strong profitability expected to slightly deteriorate

The road logistics business is characterized by slim margins burdened by intensive competition. This is partly driven by the business model: a model often based on

commissions or forwarding fees and contracts on an order-by-order basis. This means that turnover is often more important than margins and costs. This again leads to competitors' prices becoming the standard with little resistance to price cuts in a race to win contracts. EBIT margins generally vary from 1% to 8%. The range is due to different company strategies in the logistics sector.

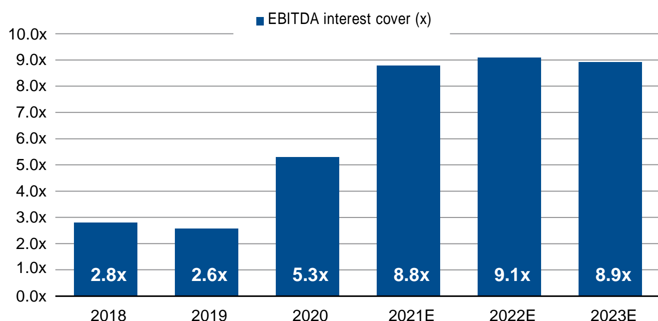
Ontime's profitability (EBIT margin) has been ranging from 8.4% to 11.8% from 2018 to 2020, above the level of its European peers. The very strong profitability is due to its integrated business model where most of services are performed in-house while peers tend to outsource their operations due to a larger outreach. Ontime, on the contrary, is able to deliver higher margins by focusing only on Spain and increasing its efficiency. The good and stable profitability was maintained during the pandemic in 2020 when multiple lockdowns did not negatively affect the overall operating margin.

We anticipate an overall slight decline in EBITDA margin in the coming years due to the following:

- The shift in strategy starting in 2021 where Ontime will rely more on subcontractors (freelance drivers for example) in order to improve its working capital management. This will lead to an increased cost base weighing on overall profitability.
- Profitability dilution from the various upcoming acquisitions.

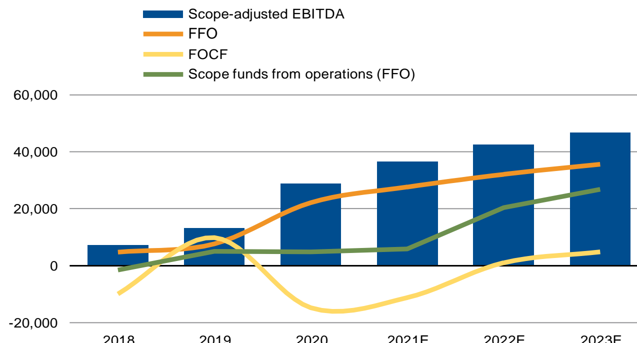
Financial risk profile: BB

Figure 4: Scope-adjusted EBITDA interest cover (x)



Sources: Ontime, Scope estimates

Figure 5: Scope-adjusted cash flows (EUR k)

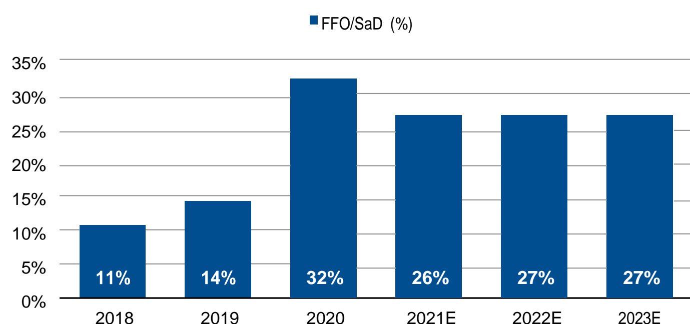


Sources: Ontime, Scope estimates

Leverage measured by SaD/Scope-adjusted EBITDA expected at around 3.0x

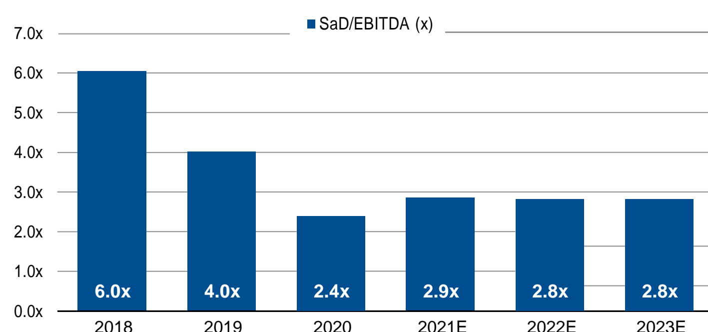
The leverage has drastically dropped from 4.0x to 2.4x, as shown in Figure 7. The key reason was the EUR 19m capital increase in 2020. We do not believe this level is sustainable and expect the SaD/EBITDA to increase around 2.8x-2.9x for the next two years due to the expansion phase. Credit metrics remain volatile due to i) the small size of the company, ii) the volatile and recurringly high working capital and iii) many unknown factors such as the size and the timeline of the expected acquisitions and the still to be decided method of funding them. Our projections include four acquisitions in 2021 and two more in 2022.

Figure 6: Scope-adjusted funds from operations/SaD (%)



Sources : Ontime, Scope estimates

Figure 7: SaD/Scope-adjusted EBITDA



Sources: Ontime, Scope

Weak free operating cash flow generation inherent to a fast-growing company

The cash flow generation was negatively impacted over the last three years by large working capital requirements due to the combination of i) the surge in sales by +34.2% in 2018, 43.4% in 2019 and +66.4% in 2020 and ii) the structural need for high working capital inherent in Ontime's business model: most of the services are provided in-house with limited use of subcontractors which implies paying expenses directly while deferring cash collection from customers. We do not expect the working capital requirements to stabilize before 2024 when the expansion phase ends, although they should grow more slowly over 2021-2023 in line with the strategy shift toward more subcontractors.

The operating cash flow has been too low to fund organically large capex (accounting for 15% of sales over the period 2018-2020) which can be explained by the organic growth phase undertaken by Ontime. We forecast a decrease in capex following the completion of this phase, when Ontime achieves a more asset light model. The positive free operating cash flow displayed in 2019 comes from one large divestment, viewed as non- recurring. Therefore, we expect the FOCF to remain very low to negative.

Stronger EBITDA interest cover due to successful debt refinancing.

In April 2021, the company successfully refinanced 75% of its gross debt, EUR 42m, through a EUR 80m syndicated facility maturing in 2025 and 2026 including EUR 72m in credit lines and a factoring line of EUR 8m. The remaining part of the facility will be used to finance capex, acquisitions, and daily operating cash management. The average interest rate will drop accordingly to 2.5% from 7%. Consequently, Ontime is expected to exhibit a stronger EBITDA interest cover in 2021 and 2022 above 8.0x.

Adequate liquidity

Ontime had a cash position of about EUR 37.2m as of year-end 2020. Following a successful debt refinancing in 2021 through a syndicated facility, the company has coped with the large amount of maturing debt in 2021. Cash balance and undrawn committed credit lines will sufficiently cover short-term financial debt maturities, including factoring and commercial paper, while they are being rolled over.

Long-term debt instrument ratings

BB senior unsecured debt ratingassigned

We assign a 'BB' debt instrument rating to senior unsecured debt of Ontime Corporate Union S.L. This instrument rating is based on a hypothetical liquidation scenario as of year-end 2022, in which we computed an average recovery for senior unsecured debt holders based on our assumptions of attainable liquidation values.

S-3 short term debt ratingassigned

We assign a 'S-3' debt instrument rating to short-term debt. The issuer plans to launch a EUR 50m commercial paper program in 2021. The forecasted level of utilization is to be around 40% to 50%. The assigned S-3 short-term rating reflects the company's adequate liquidity profile with upcoming debt maturities comfortably covered by internal cash sources, undrawn committed credit lines of EUR 15.3m and a good relationship with its banking pool.

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