Marso Kft
Hungary, Retail

STABLE

BB-

Corporate profile

Marso Kft is a leading wholesale tyre retailer in Hungary. Marso developed its position through strong relationships with both suppliers and customers, targeting high market shares at the price of profitability. This aggressive strategy has been successful. The group has closed exclusivity agreements with some of the largest global tyre retailers (e.g. Michelin, Bridgestone, Continental) and deepened customer loyalty via different selling networks.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
EBITDA/interest cover (x)	16x	15x	5.4x	7.7x
Scope-adjusted debt (SaD)/EBITDA	1.7x	2.3x	3.1x	3.3x
Scope-adjusted FFO/SaD	52%	39%	25%	25%
Free operating cash flow (FOCF)/SaD	-12%	-26%	-13%	-35%

Rating rationale

The issuer rating mainly reflects the high market share of the Hungarian wholesaler. Scope views interest cover as a support to the rating, but considers low profitability, negative free operating cash flow and weak diversification to be negative rating drivers. Senior unsecured debt is rated BB.

Marso's credit profile is broadly unchanged, leading to no rating action at this point. The group has successfully weathered the effects of the depressed environment for automotive-related industries, thanks to its dominance of relevant markets in the sector of wholesale tyres. Operating performance in 2020 is fully in line with our rating case and is expected to remain so over the next few years. We therefore expect credit metrics to remain commensurate with the current BB-/Stable issuer rating. We expect Scope-adjusted leverage within the 3-4x range, funds from operations (FFO)/Scope-adjusted debt (SaD) of above 20%, and EBITDA interest cover remaining above 5x. Liquidity is comfortable, with no major refinancing needs over the next two years. The temporary burden on the free operating cash flow (FOCF)/SaD ratio due to negative FOCF during the current investment period is not a major credit negative.

We continue to expect an 'above average' recovery for senior unsecured debt, which supports the BB rating for the debt category.

Outlook

The Stable Outlook reflects our expectation of: i) the prospective bond's successful issuance by YE 2019 and the use of bond proceeds to mainly refinance debt and initiate the investment phase; and ii) leverage metrics of around 3x for the coming two years.

A positive rating action could be triggered if SaD/EBITDA fell below 2x on a sustained basis.

A negative rating action could be triggered if SaD/EBITDA increased to above 4x on a sustained basis.

Ratings & Outlook

Corporate ratings	BB-/Stable
Senior unsecured rating	BB

Analysts

Adrien Guerin
+49 69 6677389 16
a.guerin@scoperatings.com

Related Methodology

Corporate Rating Methodology

Scope Ratings GmbH

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Tel. +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant market shares in Hungary	• Margins affected by the COVID-19 impact of • Low diversification and profitability
• High interest cover	• Small market with limited expansion potential and fierce competition
• Low level of short-term debt supporting the liquidity	• Execution risk linked to upcoming development of warehouses
• High share of exclusive products	• Deterioration in metrics due to increase in leverage from bond issuance and high capex

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA of below 2x on a sustained basis	• SaD/EBITDA of above 4x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
EBITDA/interest cover (x)	16x	15x	5.4x	7.7x
Scope-adjusted debt (SaD)/EBITDA (x)	1.7x	2.3x	3.1x	3.3x
Scope-adjusted funds from operations/SaD (%)	52%	39%	25%	25%
Free operating cash flow/SaD (%)	-12%	-26%	-13%	-35%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020e**	**2021e**
EBITDA	992	1.015	772	985
Operating lease payments in respective year	448	460	460	460
Other items	-	-	-	-
Scope-adjusted EBITDA	1.439	1.475	1.232	1.445
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020e**	**2021e**
EBITDA	992	1.015	772	985
less: (net) cash interest as per cash flow statement	1	-5	-137	-97
less: cash tax paid as per cash flow statement	-69	-68	-30	-51
add: depreciation component, operating leases	358	368	368	368
Variation in provisions	-7	-	-	-
Scope-adjusted funds from operations	1.276	1.310	974	1.206
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020e**	**2021e**
Reported gross financial debt	1.092	1.537	4.000	4.000
less: cash and cash equivalents	-433	-48	-2.008	-1.426
add: operating lease obligations (estimated based on annual rental payments with a factor 4)	1.791	1.840	1.840	1.840
Scope-adjusted debt	2.451	3.329	3.832	4.814

Business risk profile (B+)

Marso's business risk profile is supported by its dominant market position in Hungary. Diversification and profitability are negative rating drivers.

Strong market share impacted by niche market

Marso benefits from its market shares for the import of light and heavy vehicle tyres in Hungary, at 24% and 26% respectively based on 2018 year-end figures. This provides the wholesaler with a dominant national position. Marso also sells agricultural tyres. Its strong market position is mainly due to two factors: good relationships with suppliers, and a progressive integration of customers into a streamlined process.

Marso has long-term commercial agreements with the most of the large global tyre suppliers, leading to numerous exclusivity agreements (with Michelin, Nokian Tyres, and Continental, among many others). We consider these relationships to be durable as Marso's relatively low margins enhance the related market shares of the suppliers. As of 31 December 2018, exclusive products represented close to 50% of total sales.

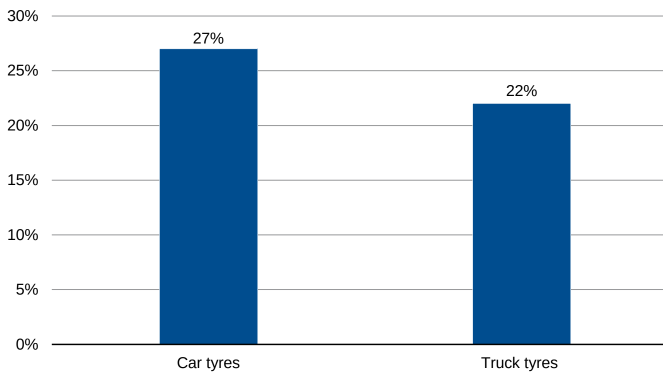
Progressive integration of customers enhances loyalty

Marso attracts customers with different types of offer. In 2020, close to 30 shops are being operated as franchises, doubling the shop network from last year. These franchises, called Marsoponts, obtain the full product range and receive financial support from Marso if needed. The group has also developed a network of customers under the 'Marso Network Partner' label. These customers receive exclusive products and favourable commercial agreements in exchange for a royalty fee paid to Marso. The two systems are supported by MOND, a webshop platform.

Positive evolution amid Covid-19 pandemic

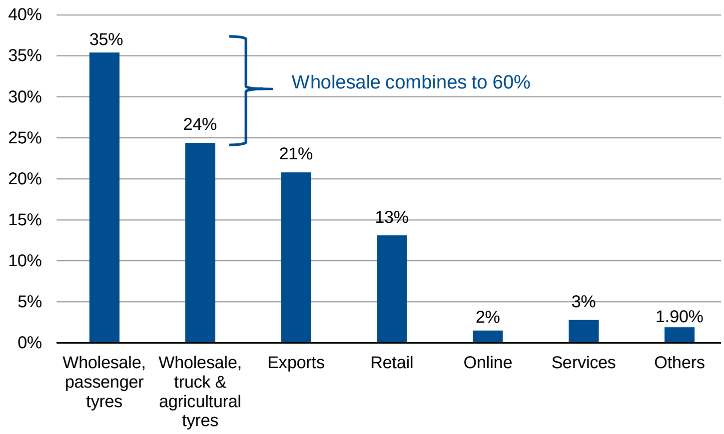
The global pandemic has deeply affected the retail sector due to temporary closures of most 'non-essential' shops across Europe. Due to its operations in Hungary, Marso has benefitted from less severe lockdown measures than its European competitors. This translated into an increase in sales of close to 7% YoY over the first half of the year. However, we remain more conservative than management regarding the growth rate of sales for YE 2020 due to the risks and uncertainties that Marso faces in the last quarter of 2020.

Figure 1: Domestic market shares in car and truck tyres (YE 2018)



Source: Scope estimates

Figure 2: Sales diversification (YE 2018)



Source: Marso Kft

Small size constrains the rating

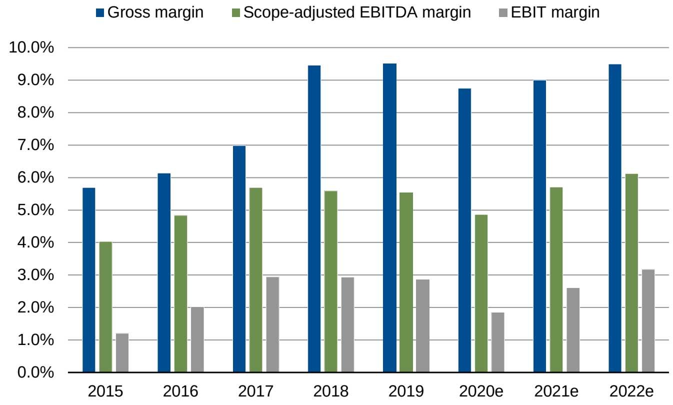
While Marso's high market share is a positive rating driver, it remains a relatively small retailer due to its small absolute size of the market. We forecast increased size in the medium term, through the construction of two warehouses (aimed at streamlining variations in inventory) and planned updates to sales processes. At the same time, competition is relatively fierce on this market, even with the benefits afforded by Marso's exclusivity programme (e.g. low substitution risk).

Diversification is a negative rating driver

Diversification is one of the most negative factors in Marso's business risk profile. Marso is involved in only one category of consumer goods sales (automotive) and in mainly one sales channel (bricks and mortar; 94% of sales). On the other hand, sales to international customers are higher than among rated peers, at around 20% of total sales, which is credit positive.

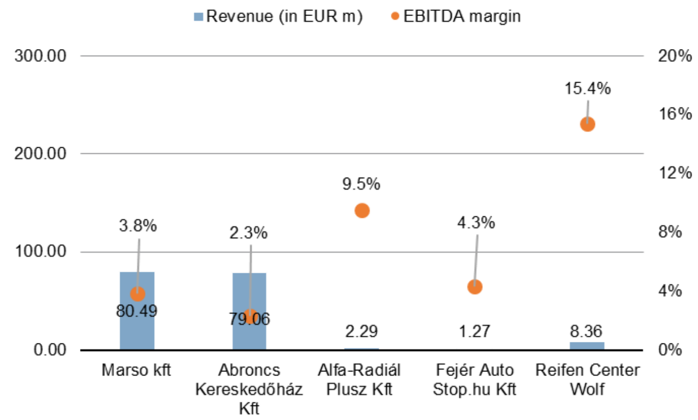
The country with the highest sales, following Hungary, represents only 5% of total sales. This is too low to offset any negative macro developments in the group's core market of Hungary. We recognise the presence of multiple sales channels (wholesale, retail, online) but the predominance of wholesale does not help to strengthen diversification, as Marso appears to be far from establishing an omnichannel sales structure.

Figure 3: Group profitability



Source: Marso Kft, Scope estimates

Figure 4: Profitability on reported EBITDA versus peers (YE 2018 data)



Source: Public sources, Scope estimates

Due to its expansion of market share at the expense of profitability, Marso's Scope-adjusted EBITDA margin is weaker than that of national and rated peers.

Covid-19 has increased risks around profitability…

Despite significant growth in profitability at H1 2020 YoY, Covid-19 has impacted the overall profitability of the group. We have conservative expectations regarding the evolution of profitability over the last quarter of the year. This is because the sales made in Q4 will be crucial due to the seasonality of the tyre retail sub-industry. The second lockdown across Europe could have a deeper impact on the Hungarian economy (Hungary was the first country to reinforce lockdown measures in the summer) and on Marso's tourism-related services. Risk may also arise from a warmer winter, which would decrease households' need to change their tyres.

… leading to lower forecasted profitability for YE 2020

Based on these premises, we expect a lower margin than forecasted last year (around 5.5% going forward). We also expect Marso's Scope-adjusted EBITDA margin to drop to close to 5% at YE 2020, before recovering to historical levels the following year. The group is also exposed to forex risk, given its lack of a hedging strategy. Nonetheless, Marso has almost four months to take advantage of the best currency exchange rates because its orders peak bi-annually.

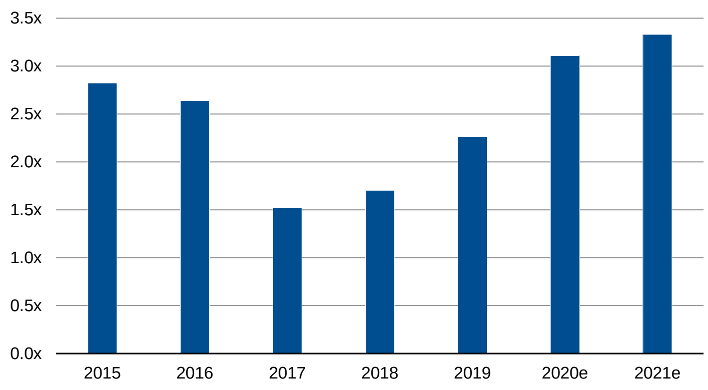
Financial risk profile (BB+)

Our assumptions regarding the group's financial risk profile include the fact that Marso Kft and Marso Holding Kft hold a cross-guarantee system. Based on our assessment of the financial metrics of Marso Holding Kft, a scenario in which only the holding entity falls into bankruptcy is unlikely.

Future warehouse will provide key to unlock growth potential

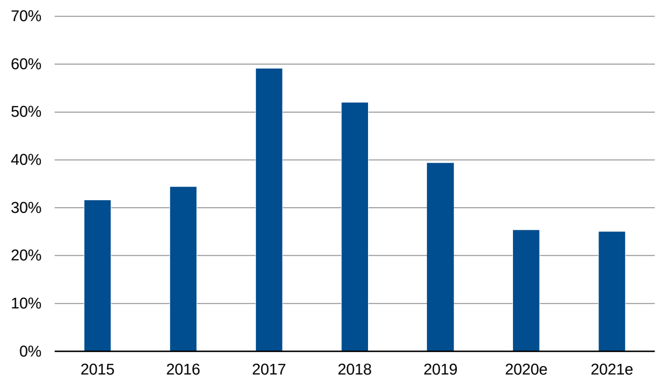
Our financial forecast uses many of management's assumptions as they are sufficiently conservative. However, we applied large haircuts to revenue growth for each year, similar to the approach taken in our 2019 rating report. We expect slow sales growth and lower profitability for 2020 and 2021, reflecting the impact of Covid-19 on services and tourism in Q4 2020 and a potential shift in customer behaviour. We remain confident that the completion of the warehouse will unlock higher growth potential as it will provide Marso with the ability to serve more customers.

Figure 5: Development of SaD/EBITDA



Source: Marso Kft, Scope estimates

Figure 6: Evolution of FFO/SaD



Source: Marso Kft, Scope estimates

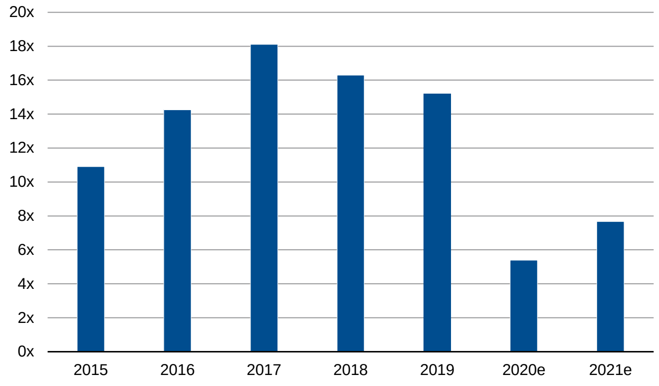
Leverage metrics in line with forecasts

Marso continues to benefit from a relatively low level of indebtedness, supported by a high overall cash position. The bond issuance has increased group debt, in line with our expectations. However, SaD/EBITDA and FFO/SaD at YE 2020 is expected to remain closely in line with last year's forecasts (slightly above 3x for SaD/EBITDA and close to 25% for FFO/SaD) for YE2020.

EBITDA interest cover expected to remain high

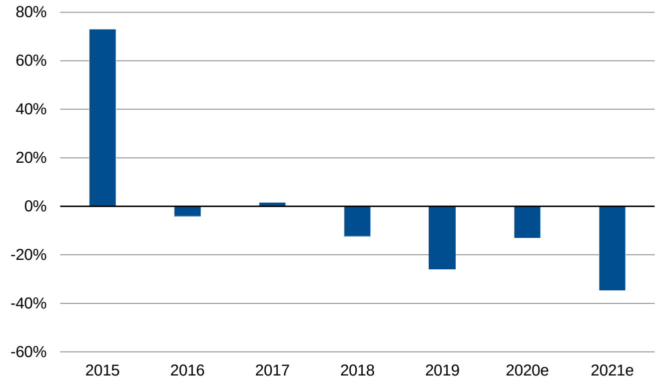
Net interest expense is low, with a high share of interest income countering the level of interest expense. Interest income stems from financial investments by Marso Kft in either a company in its group (including Marso Holding Kft entities) or in its franchisees. We expect EBITDA interest cover to remain strong in line with our forecasts from last year, despite the impact of Covid-19.

Figure 7: Development of EBITDA interest cover



Source: Marso Kft, Scope estimates

Figure 8: Development of FOCF/SaD



Source: Marso Kft, Scope estimates

Negative FOCF putting pressure on the rating due to investment phase

As is typical for companies in expansion, capex has taken a toll on FOCF, and is expected to remain under pressure in the short term to medium term. The construction of the warehouse will start in 2020. This will lead to a significant increase in capex compared to levels before 2019. We forecast that capex will be high until YE 2021, when the warehouse should be completed.

Liquidity expected to recover due to absence of short-term debt in 2021

We forecast that liquidity will remain under pressure in 2020 due to negative FOCF. However, we currently expect no short-term debt liabilities to be repaid from YE2020 on. This leads to adequate liquidity.

Senior unsecured debt rating at BB

The senior unsecured rating takes into consideration Marso Holding Kft, an entity with no equity link to Marso Kft but whose shareholders are the same as the rated entity's. This is based on: i) the system of cross-guarantees between the two entities; and ii) Marso Holding Kft's ownership of the shops operated by the franchisees of Marso Kft. Based on our recovery assessment, liquidation value estimates and a hypothetical default in 2021, we calculate a superior recovery, which leads to a one-notch uplift from the issuer rating.

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

London

3rd Floor
111 Buckingham Palace Road
London SW1W 0SR

Madrid

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

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo

Karenslyst allé 53
0279 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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