ITK Holding Zrt
Hungary, Business Services

BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023P**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	0.9x	1.1x	1.7x	2.2x
Scope-adjusted debt/EBITDA	51.0x	13.4x	10.7x	9.4x
Scope-adjusted funds from operations/debt	0%	1%	3%	6%
Scope-adjusted free operating cash flow/debt	-40%	9%	4%	5%

Rating rationale

ITK's business risk profile (assessed at B+) is supported by the moderate operating profitability, underpinned by a stable public transportation services business with high degree of recurring revenues. Operating profitability returned close to historical averages in 2023 and is expected to remain stable going forward. The business risk profile is constrained by the absolute size and limited diversification, with service offering highly focused on transportation, and a highly concentrated nature of the customer and supplier portfolio.

The financial risk profile (revised to CCC from B-) reflects leverage, measured by Scope-adjusted debt/EBITDA sustained at high levels. We forecast gradual deleveraging, in line with the debt amortization schedule. Interest cover remained weak, as interest expense almost tripled between 2022 and 2023. High growth capex has resulted in significant negative Scope-adjusted free operating cash flow. Going forward capex is expected to decrease significantly, due to the end of the current investment cycle. Liquidity is assessed as adequate. The issuer rating on ITK continues to incorporate a three-notch uplift to the standalone rating, reflecting strong support from shareholder MOL Group.

Outlook and rating-change drivers

The Outlook is Stable, reflecting our expectation that the profitability of ITK can be sustained at a level comparable to historical averages (Scope-adjusted EBITDA margin between 7-10%), benefitting from the long-term contracts and high level of recurring revenues from the transportation service segment. While we anticipate that leverage will remain elevated in the medium term (Scope-adjusted debt/EBITDA around 10.0x), the rating agency forecasts a gradual improvement of credit metrics, with interest cover consistently around 2.0x and positive free operating cash flow thanks to substantially reduced capital expenditure and improved working capital management. We expect that the financial support of MOL Group will remain available if needed, and no further changes in the shareholder structure. The Outlook also reflects the fact that the lack of transparency is temporary due to the transitional period the company is going through (change of management and cessation of vehicle production).

A positive rating action could be driven by stronger-than-anticipated growth in sales and/or margins, resulting in leverage (Scope-adjusted debt/EBITDA) of sustainably below 6x. A positive rating action could also be triggered by further integration into MOL, including hard debt guarantees and name equality among others.

A negative rating action could occur if Scope-adjusted EBITDA interest cover would deteriorate to below 1.0x. This could result from a failure to increase sales or from continued cost pressures in transport services that cannot be passed on to customers. A deterioration in liquidity or our perception of weakened parent support, i.e. MOL Group reducing its stake in ITK or not extending financial support when needed, could also trigger a downgrade. A negative rating action is also possible if the transparency issues are not resolved in the short term.

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	B+

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Related Methodologies

Corporate Rating Methodology; October 2023

European Business and Consumer Services Rating Methodology, January 2024

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
24 May 2024	Affirmation	BB-/Stable
28 Nov 2023	Under review placement	BB- under review for possible upgrade
13 Apr 2023	Affirmation	BB-/Stable

Rating and rating-change drivers

Positive rating drivers

- Strong financial and operational support from the shareholder, MOL Group
- Long-term contracts provide earnings and margin stability for the transportation services business
- General distributor role for Mercedes Benz bus and truck boost visibility, brand

Negative rating drivers

- Highly loss-making manufacturing business
- Weak financial risk profile, with high leverage and negative FOCF in 2023
- High supplier and customer concentration in transportation services and general distribution
- Weak transparency

Positive rating-change drivers

- Stronger than anticipated growth in sales and/or margins, resulting in leverage (Scope-adjusted debt/EBITDA) sustainably below 6x
- Further integration into MOL Group (name lending, debt guarantees)

Negative rating-change drivers

- Interest cover consistently below 1.0x
- Weakened parent support from MOL Group

Corporate profile

ITK Holding Zrt. is a Hungarian company focused on public transportation services, vehicle manufacturing, wholesale of buses, trucks and spare parts for these vehicles. The company provides bus services in three of Hungary's 10 largest cities. The company provides bus services in three of Hungary's 10 largest cities and is the wholesaler of Mercedes-Benz branded buses and trucks in Hungary in partnership with Daimler. The company has been established as a joint venture between MOL Group and ITK Invest Ltd. MOL acquired full ownership of the company in Q4 2023. ITK's consolidated revenue and Scope-adjusted EBITDA for 2023 (unaudited preliminary accounts) are HUF 39.2bn and HUF 3.8bn respectively and it employed over 670 people.

Financial overview

				Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023P**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	3.1x	0.9x	1.1x	1.7x	2.2x
Scope-adjusted debt/EBITDA	10.7x	51.0x	13.4x	10.7x	9.4x
Scope-adjusted funds from operations/debt	6%	0%	1%	3%	6%
Scope-adjusted free operating cash flow/debt	-36%	-40%	-9%	4%	5%
Scope-adjusted EBITDA in HUF m					
EBITDA	2,634	903	3,817	4,565	5,001
Other items	-	-	-	-	-
Scope-adjusted EBITDA	**2,634**	**903**	**3,817**	**4,565**	**5,001**
Funds from operations in HUF m					
Scope-adjusted EBITDA	2,634	903	3,817	4,565	5,001
less: (net) cash interest paid	-837	-967	-3,341	-2,754	-2,312
less: cash tax paid per cash flow statement	-10	-33	-22	-135	-43
Other non-operating charges before FFO	-68	107	-177	-	-
Funds from operations (FFO)	**1,719**	**10**	**277**	**1,677**	**2,646**
Free operating cash flow in HUF m					
Funds from operations	1,719	10	277	1,677	2,646
Change in working capital	-3,606	-67	199	1,706	1,421
Non-operating cash flow	-	-	-	-	-
less: capital expenditure (net)	-8,311	-18,310	-4,852	-1,500	-1,500
Free operating cash flow (FOCF)	**-10,198**	**-18,367**	**-4,376**	**1,883**	**2,566**
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-837	-967	-3,341	-2,754	-2,321
Change in other items	-	-	-	-	-
Net cash interest paid	**-837**	**-967**	**-3,341**	**-2,754**	**-2,321**
Scope-adjusted debt in HUF m					
Reported gross financial debt	28,145	46,067	50,987	48,927	46,775
less: cash and cash equivalents[1]	n/a	n/a	n/a	n/a	n/a
add: non-accessible cash	-	-	-	-	-
Other items	-	-	-	-	-
Scope-adjusted debt (SaD)	**28,146**	**46, 067**	**50,987**	**48,927**	**46,775**

[1] Cash netting is only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible. As the standalone rating is B-, no cash netting is applied.

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Environmental, social and governance (ESG) profile[2]

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)	Grey leaf
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)	Red leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Limited transparency hinders the visibility on financial health of ITK

We note the lack of transparency and clarity in terms of governance. In particular, we regard the transparency of communication as a credit-weakness. The delayed and inconsistent disclosures provide constrained comfort about the company's true underlying financial health, and hinder the visibility on the company's financial performance.

[2] 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: B+

Industry risk profile: BB

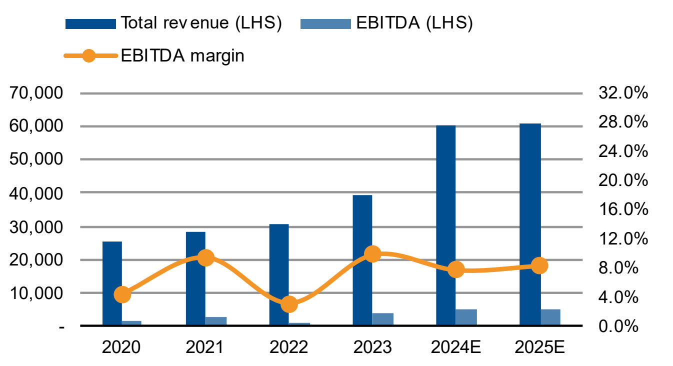
The industry risk of ITK is assessed at BB, reflecting the industry risk of business services (an asset-heavy balance sheet with an unspecialised workforce, leading to a BB industry rating) and wholesale of discretionary goods (also a BB industry rating). The cyclicality and barriers to entry are medium for business services and low for discretionary wholesale. The risk of substitution is medium for business services and low for wholesale. Most of the weighting is determined by the business services industry, as ITK's public transportation and business services contributed the majority of the 2023 EBITDA, even though a larger part of revenues is generated by the wholesale of vehicles.

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 services business. The company has five long-term contracts with municipalities (with 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. ITK has also several smaller, private contracts mainly related to worker transportation. The business risk profile benefits from a relatively modern bus fleet comprising more than 600 vehicles as of YE2023.

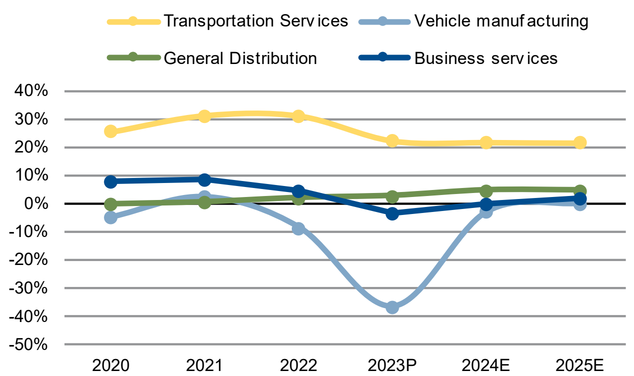
With revenues of around HUF 39bn (EUR 97m), ITK remains a market player of limited size in both the European and domestic context. However, our market share assessment is supported by the scalability of the services, the long-term contracts with a high degree of recurring revenues and the requirement of public tenders, which acts as an additional barrier to entry into the segment.

Figure 1: Development of consolidated revenue and EBITDA (HUF '000s)



Sources: ITK, Scope estimates

Figure 2: Scope-adjusted EBITDA margin per business line



Sources: ITK, Scope estimates

Profitability varies by segment; vehicle manufacturing remains loss making

The standalone EBITDA margin per business line shows significant volatility in the previous years. Profitability is the highest for the transportation services, most notably in ITK's Budapest contract with BKV (Inter Tan-ker City).

Vehicle manufacturing has been operating at a loss due to earlier startup costs, suboptimal production volumes, supply chain issues and then dampened demand starting from 2022. This segment was the primary focus of the reorganization and rationalization plan established by ITK's main shareholder MOL in Q4 2023. This included optimising the workforce and real estate usage to align with the anticipated changes in manufacturing from May 2024. These changes will result in the closure of chassis manufacturing and the downsizing of all other activities to a significantly smaller scale. We expect profitability of the manufacturing business to improve gradually over the next two years but remain only slightly above breakeven.

General distribution of trucks and buses, as a wholesale business, has inherently lower margins compared to the other segments. It is anticipated that the margins of general distribution will improve by up to 5% from the 3% recorded in 2023. This is due to the forecasted increase in sales volumes and the improving economic environment, which should have a favourable impact on the sales of trucks and buses.

Highly concentrated customer and supplier portfolio

Diversification remains limited, with a high concentration both in terms of service offering (highly focused on transportation services) and customer portfolio (bus services are provided in 3 of the top 10 cities in Hungary and a nationwide contract for the National Swimming Association). The general distribution business is even less diversified (the only supplier is Mercedes-Benz and the only customer is the Hungarian retailer).

Moderate service strength, driven by recurring income

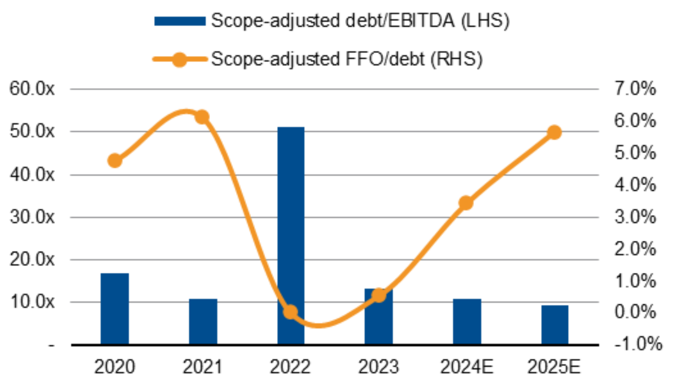
ITK operates its bus lines under the brand name of the local public service provider (e.g. BKV in Budapest), so it has little brand strength of its own, which limits the service strength subscore. However, revenue stability and predictability is high, due to the majority of contracts being long term, with annual inflation indexation and relatively high switching costs for the customer. This is due to the fact that there are relatively few domestic companies with fleets of 600 buses. The degree of service integration is moderate, with some customers, such as the National Swimming Association, receiving transport services on an exclusive basis.

Financial risk profile: CCC

Leverage remains sustained at a high level, very gradual deleveraging forecasted

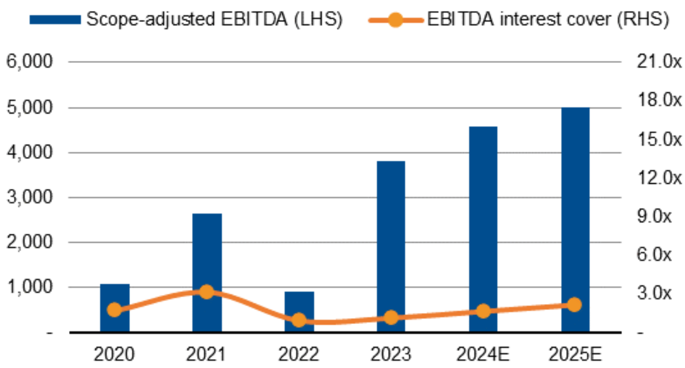
The financial risk profile (revised to CCC from B-) reflects leverage, measured by Scope-adjusted debt/EBITDA sustained at high levels, remaining around 10.7x in 2024. We forecast gradual deleveraging, in line with the debt amortization schedule, with profitability forecasted to remain relatively flat going forward.

Figure 3: Development of Scope-adjusted leverage metrics



Sources: ITK, Scope estimates

Figure 4: Development of Scope-adjusted EBITDA (HUF '000s) and EBITDA interest cover



Sources: ITK, Scope estimates

interest cover remains under pressure

While the interest cover benefits from the favourable interest rate of the HUF 20bn MNB bond (2.9%), interest expense almost tripled between 2022 and 2023, resulting in an interest cover only slightly above 1.0x. Most of the debt is fixed to the BUBOR rate, subject to high volatility in the past two years. In the medium term, we forecast the interest cover trending towards 2.0x, positively affected by the lower interest costs, decreasing in line with the debt amortization.

Free operating cash flow benefits from lower CAPEX and positive working capital developments

High growth capex has resulted in significant negative FOCF in recent years and in 2023. Going forward capex is expected to decrease significantly. We forecast capex of HUF 1.5bn in 2024, down from HUF 4.9bn in 2023 due to the end of the current investment cycle, and the business strategy focusing on rationalization. Together with the positive cash contribution from working capital (mainly driven by the reduction of inventories) FOCF will reach break-even, allowing for a gradual deleveraging going forward.

Adequate liquidity

Liquidity is assessed as adequate, as cash sources (HUF 0.5bn available cash and HUF 15.5bn of unused, committed bank facilities – both as at YE2023 as well as HUF 1.9bn in FOCF forecasted for 2024) cover cash uses (scheduled debt amortization of HUF 2.9bn in 2024) by more than 200%.

Balance in HUF '000s	2023P	2024E	2025E
Unrestricted cash (t-1)	260	537	360
Open committed credit lines (t-1)	15,530	15,530	5,500
FOCF	-4,376	1,883	2,566
Short-term debt (t-1)	3,286	2,875	4,152
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +3 notches

The issuer rating on ITK continues incorporates a three-notch uplift to the standalone rating, reflecting strong support from shareholder MOL Group, which adds financial stability, risk management and professional backing to the issuer. We consider ITK to be of significant strategic importance to MOL, forming part of its Mobility strategy, with key areas including car sharing, bike sharing, fleet management and public transportation.

Long-term debt rating

Senior unsecured debt rating: B+

In 2021, ITK issued a HUF 20bn senior unsecured bond (ISIN: HU0000360631) with a fixed annual coupon under the Hungarian National Bank's Bond Funding for Growth Scheme. The bond refinanced most existing debt and 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.

We have downgraded the rating on senior unsecured debt issued by ITK to B+ from BB-, one notch below the issuer rating. We expect a 'low' recovery for outstanding senior unsecured debt in a hypothetical default scenario occurring in 2025 based on the liquidation value approach. The debt category rating reflects the ranking of the senior unsecured debt below approximately HUF 29.3bn of secured loans and credit lines, as working capital lines are expected to be fully drawn in a distressed financial situation.

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