MARSO Kft.
Hungary, Retail

SCOPE BB- NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	15.8x	14.1x	4.9x	7.2x
Scope-adjusted debt/EBITDA	3.7x	2.1x	4.0x	3.2x
Scope-adjusted funds from operations/debt	24%	43%	19%	26%
Scope-adjusted free operating cash flow/debt	-41%	13%	-1%	8%

Rating rationale

Marso operates as a discretionary retailer (industry risk profile assessed at BB). Its business risk profile benefits from the company's leading market position and relatively strong profitability. Its Scope-adjusted EBITDA margin is expected to drop in 2023 due to a supply surplus in H1 2023. It faces strong competition as market players sell off inventory built up in 2022 now that headwinds from the Russia-Ukraine war have turned out to be less severe than anticipated. The decline in its Scope-adjusted EBITDA margin is seen as temporary, with the Scope-adjusted EBITDA margin forecasted to normalise at 5.5% in 2024 backed by Marso's premiumisation strategy. The business risk profile is impaired by the company's small size and low diversification.

The comparatively strong financial risk profile is forecasted to temporarily deteriorate due to the pressure on profitability from surplus supply and strong competition. Marso's long-term loan profile is expected to remain broadly unchanged. However, its seasonal working capital requires it to use working capital loans biannually (typically in Q1 and Q3). The financial risk profile is supported by relatively strong interest coverage but hindered by high leverage and volatile working capital requirements.

Outlook and rating-change drivers

The Negative Outlook incorporates our view that while Marso's long-term loan profile will remain stable in the coming years and that credit metrics will deteriorate in 2023. This is exemplified by the company's Scope-adjusted debt/EBITDA ratio declining to 4x. A timely recovery in 2024 could be hindered as strong competition puts pressure on margins.

A return to a Stable Outlook could be triggered if Marso successfully executed its premiumisation strategy and the Scope-adjusted debt/EBITDA ratio returned to above 4x in a timely manner. Although a positive rating action or upgrade is remote, it could be triggered if Marso's Scope-adjusted EBITDA margin strengthened significantly and its Scope-adjusted debt/EBITDA ratio increases to above 3x on a sustained basis. One way this could happen is through efficient management of working capital.

A downgrade could be triggered if the Scope-adjusted debt/EBITDA ratio drops towards 4.5x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
20 Sep 2023	Outlook change	BB-/Negative
21 Sep 2022	Affirmation	BB-/Stable
21 Oct 2021	Affirmation	BB-/Stable

Ratings & Outlook

Issuer	BB-/Negative
Senior unsecured debt	BB

Analyst

Vivianne Anna Kapolnai
+49 69 6677389 88
v.kapolnai@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2023

ESG considerations for the credit ratings of retail corporates; November 2021

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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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong market position • Comparatively strong financial risk profile • High share of exclusive products	• Low diversification • Small company size in niche market with limited expansion possibilities and stiff competition • Deterioration of interest cover due to high interest rate environment • Negative impact of supply chain disruptions and inflationary environment on working capital management

Positive rating-change drivers	Negative rating-change drivers
• Return to Stable Outlook if Scope-adjusted debt/EBITDA ratio returns to above 4x in a timely manner • Upgrade is remote (Scope-adjusted debt/EBITDA ratio above 3x on a sustained basis)	• Scope-adjusted debt/EBITDA declines towards 4.5x.

Corporate profile

MARSO Kft. is a leading wholesale tyre dealer in Hungary offering products in all three main tyre segments (passenger, truck and agriculture). Marso developed its position through strong relationships with both suppliers and customers. The company has exclusive agreements with some of the largest global tyre manufacturers (e.g. Michelin, Bridgestone) and has a long-term business development agreement with Continental. Marso has deepened its customer loyalty via different sales networks, which include its own brick-and-mortar store network, a franchise network of around 30 partners and the Marso Partner Network distribution network of more than 100 members.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	19.8x	15.8x	14.1x	4.9x	7.2x	6.8x
Scope-adjusted debt/EBITDA	2.3x	3.7x	2.1x	4.0x	3.2x	2.9x
Scope-adjusted funds from operations/debt	38%	24%	43%	19%	26%	28%
Scope-adjusted free operating cash flow/debt	18%	-41%	13%	-1%	8%	10%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,322	1,444	2,498	1,230	1,586	1,650
Operating lease payments	559	590	515	584	607	631
Scope-adjusted EBITDA	**1,882**	**2,033**	**3,013**	**1,814**	**2,193**	**2,281**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,882	2,033	3,013	1,814	2,193	2,281
less: (net) cash interest paid	17	-10	-110	-255	-182	-211
less: cash tax paid per cash flow statement	-95	-95	-32	-31	-70	-73
Change in provisions	2	-1	-3	-	-	-
Other items[1]	-112	-118	-103	-117	-121	-126
Funds from operations (FFO)	**1,693**	**1,809**	**2,765**	**1,411**	**1,820**	**1,870**
Free operating cash flow in HUF m						
Funds from operations	1,693	1,809	2,765	1,411	1,820	1,870
Change in working capital	139	-261	-651	-203	-277	-197
less: capital expenditure (net)	-591	-4,182	-875	-800	-479	-499
less: lease amortisation	-447	-472	-412	-467	-486	-505
Free operating cash flow (FOCF)	**794**	**-3,106**	**827**	**-59**	**578**	**669**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-17	10	110	255	182	211
add: interest component, operating leases	112	118	103	117	121	126
Net cash interest paid	**95**	**128**	**213**	**372**	**303**	**337**
Scope-adjusted debt in HUF m						
Reported gross financial debt	4,001	5,302	5,250	5,620	5,620	5,620
less: cash and cash equivalents	-3,087	-1,441	-2,111	-1,951	-2,387	-2,795
add: non-accessible cash	100	100	100	100	100	100
add: operating lease obligations	2,237	2,360	2,059	2,334	2,428	2,525
Other items[2]	1,161	1,257	1,167	1,167	1,167	1,167
Scope-adjusted debt (SaD)	**4,414**	**7,578**	**6,466**	**7,270**	**6,928**	**6,617**

[1] Other items include leasing adjustment for interest.
[2] Other items include off-balance sheet commitments.

Table of contents

Environmental, social and governance (ESG) profile[3]

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)

Adequate ESG profile

Reputational risk is a major criterion for the social aspect of a retailer. For example, product or labour management that has a negative social impact can prompt consumer boycotts, affecting sales, margins and inventory value. However, we believe Marso's position as a national wholesaler decreases this risk substantially. It has initiated several social responsibility projects (such as operating a tennis court in Nyíregyháza and establishing IMKE, a community development association).

Discretionary goods companies such as Marso are also under increasing pressure to ensure the sustainability of their products, namely in terms of durability and repairability. Strong commitment in this regard is likely to improve brand value. Although Marso does not offer tyre retreading, the company has partnered with Continental and collects used tyres to ensure their proper disposal and recycling. In 2020 it collected more than 4,400 tonnes of used tyres.

Lastly, the environmental footprint of a company's brick-and-mortar shops will remain fundamental to its development. Marso is well protected against environmental risks as it has a low number of stores across the country.

[3] 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

Marso is categorised as a discretionary retailer. Its industry risk profile remains assessed at BB given the medium cyclicality, low entry barriers and low substitution risk of the automotive parts wholesale segment.

Marso's business risk profile is supported by its dominant market position in Hungary and relatively strong profitability. However, its relatively small size (revenue of EUR 108m in 2022), strong competitors and weak diversification remain negative rating drivers.

Strong market positioning

The company's market shares for the import of light and heavy vehicle tyres in Hungary give it a dominant national position. Marso also sells agricultural tyres. Its strong market position is mainly due to two factors: good relationships with suppliers and integrating customers into a streamlined process. While Marso's market share is high, which is a positive rating driver, its small absolute size and fierce competition restrain the market share assessment, even with the benefits afforded by Marso's exclusivity programme (e.g. low substitution risk).

Low diversification …

Diversification is one of the weakest factors in Marso's business risk profile. Marso is involved in only one category of consumer goods (automotive parts) and one main sales channel (brick and mortar, 94% of sales). We recognise the presence of multiple sales channels (wholesale, retail, online) but the predominance of wholesale does not help strengthen diversification as Marso appears to be far from establishing an omnichannel sales structure.

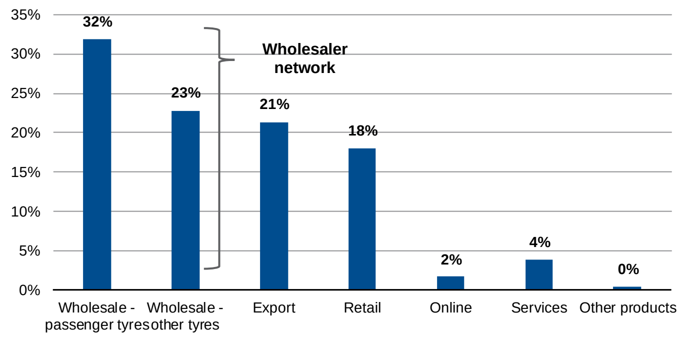
… despite high export sales in peer context

On the other hand, sales to international customers are higher than among rated peers at around 20% of total sales in 2022. Although this is seen as credit-positive, the country with the second highest sales after Hungary represents only 7% of total sales. This is too low to offset any negative macro developments in the company's core market of Hungary.

Although Marso has long-term commercial agreements with most major global tyre suppliers, leading to numerous exclusivity agreements (with Michelin, Nokian Tyres, and Continental, among many others), supplier concentration is high (the top five suppliers account for more than 60% of cost of goods sold). However, we consider these relationships to be durable because Marso is competitive compared to other wholesalers. As of 31 December 2022, exclusive products represented close to 50% of total sales.

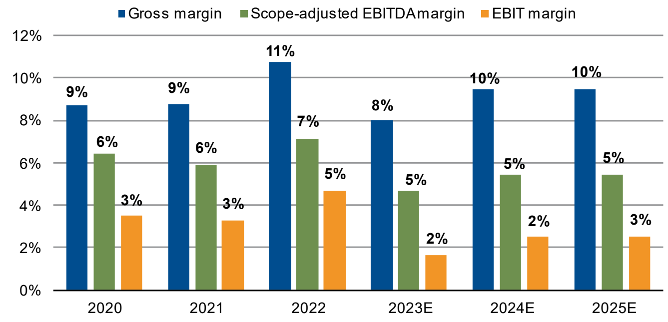
Marso attracts customers with several types of offers. In 2022, approximately 30 shops were operated as franchises. These franchises, called Marsoponts, carry the full product range and receive financial support from Marso if needed. The company has also developed a network of customers under the 'Marso Network Partner' label. These customers receive exclusive products and favourable commercial agreements in exchange for paying a royalty to Marso. The two systems are supported by MOND, an e-commerce platform. This multi-channel sales strategy results in a low concentration of customers (top 10 customers excluding affiliates account for less than 15% of sales).

Figure 1: Sales diversification (2022)



Sources: Marso, Scope

Figure 2: Profitability



Sources: Marso, Scope estimates

Relatively strong profitability

The business risk profile benefits from Marso's relatively strong profitability. 2022 was an exceptional year for Marso despite the multiple threats market players faced (i.e. in addition to the energy price crisis, raw material shortages and supply chain disruptions within the global tyre industry due to the Russia-Ukraine war) as its Scope-adjusted EBITDA margin increased to 7.1%. During 2022 many manufacturers and market players built up large inventories as they anticipated headwinds caused by the war. However, as these issues subsided, market players had to reduce their excess inventory. In H1 2023 the market was filled with cheap supply, putting pressure on Marso's profitability. This resulted in a Scope-adjusted EBITDA margin of 4.3% in mid-2023. As the surplus dwindles, pressure on margins is also expected to weaken. However, due to strong competition, we forecast Marso's Scope-adjusted EBITDA margins will normalise at around 5.5%, in line with historical, pre-pandemic profitability levels. This will be supported by Marso's premiumisation strategy (i.e. it plans to cater to its extensive network of wholesalers by protecting their margins in comparison to retail customers).

Financial risk profile: BB

Relatively strong financial risk profile

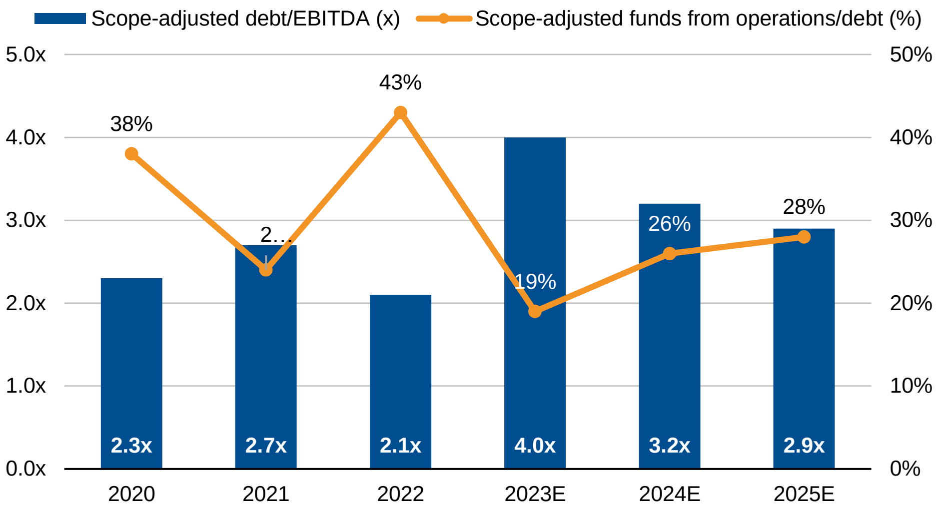
The comparatively strong financial risk profile (assessed at BB) is the main support for the issuer rating. Our assumptions regarding the group's financial risk profile include the fact that MARSO Kft. and MARSO Holding Kft. have cross-guarantees. Based on our assessment of the financial metrics of MARSO Holding Kft., a scenario in which only the holding entity falls into bankruptcy is unlikely.

Marso's credit profile includes the HUF 3.6bn NKP bond issued in 2019 and an additional HUF 1.7bn in loans utilised in 2021. These loans have been refinanced in the amount of HUF 2.1bn in 2023 under the Baross Gabor loan programme (which provides favourable, fixed interest rates to SMEs), complemented by the HUF 1.2bn warranty Marso has provided for MARSO Holding Kft.'s loans. The profile is forecasted to remain broadly unchanged. The company is expected to utilise short-term working capital loans seasonally during the year when needed, typically twice (in Q1 and Q3), repaying as soon as cash generation allows, thus not impacting the year-end profile.

The financial risk profile continues to benefit from relatively high interest coverage despite the high interest rate environment because the majority of company debt has fixed interest rates (both for the NKP bond and for the refinanced Baross Gabor loans). The refinanced, fixed-rate loans are scheduled to mature in 2025 and 2026, which will sustain relatively strong interest coverage between 4x-7x in the coming years.

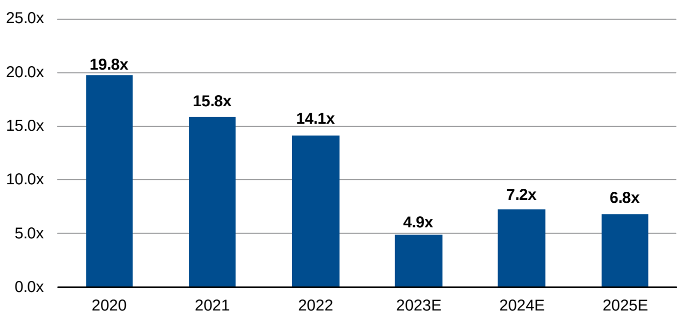
Credit metrics are forecasted to deteriorate with the drop in profitability in 2023. However, the expected recovery in Scope-adjusted EBITDA, backed by Marso's premiumisation strategy, is forecasted to gradually improve credit metrics. With the deterioration in credit metrics, the Scope-adjusted debt/EBITDA ratio is set to rise to 4x in 2023, after which it is forecasted to recover to around 3x, while the Scope-adjusted funds from operations/debt ratio and cash flow cover are expected to normalise at above 20% and around 10% respectively.

Figure 3: Leverage



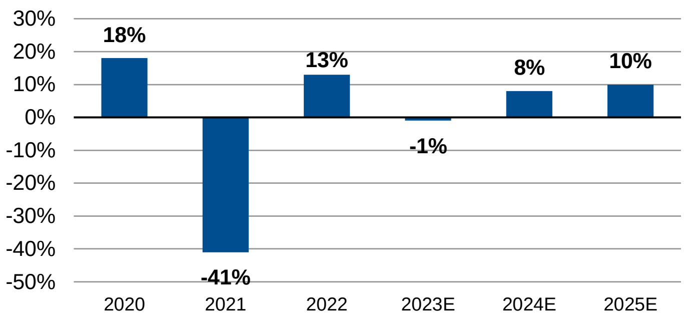
Sources: Marso, Scope estimates

Figure 4: Interest cover



Sources: Marso, Scope estimates

Figure 5: Cash flow cover



Sources: Marso, Scope estimates

Adequate liquidity

Liquidity is considered adequate, with minimal short-term debt amortisation scheduled for 2023 and 2024. However, negative fluctuations in working capital are expected.

Balance in HUF m	2023E	2024E	2025E
Unrestricted cash (t-1)	2,011	1,851	2,287
Free operating cash flow	-59	578	669
Short-term debt (t-1)	50	-	720
Coverage	**>200%**	**No short-term debt**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB

We have affirmed the BB rating of Marso's senior unsecured debt. Recovery expectations for senior unsecured debt are superior, even after senior secured debt (primarily consisting of the drawn loan amount of HUF 2bn) has been fully covered. We applied a one-notch positive adjustment to the senior unsecured debt rating while maintaining its conservative treatment of Marso's current liabilities, primarily due to the high volatility of the company's working capital. This results in the BB rating, one notch above the issuer rating. Recovery expectations are based on an expected liquidation value in a hypothetical default scenario in 2025.

In December 2019, Marso issued a HUF 3.6bn senior unsecured bond (ISIN: HU0000359393) through the Hungarian central bank's Bond Funding for Growth Scheme. The bond is guaranteed by MARSO Holding Kft., which belongs to the same corporate group as Marso. The bond proceeds were used for warehouse capex. The bond has a tenor of 10 years and a fixed coupon of 2.3%. Bond repayment is in three tranches starting from 2027, with 33.3% of the face value payable yearly. We note that Marso's senior unsecured bond issued under the Hungarian central bank's bond scheme has an accelerated repayment clause. The clause requires Marso to repay the nominal amount (HUF 3.6bn) in case of a rating deterioration (two-year cure period for a B/B- rating; repayment within 10 working days after the bond rating falls below B-, which could have default implications). Bond covenants in addition to the rating deterioration covenant include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, change of control and dividend payment covenants.

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

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 02 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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