

AXIÁL Javító, Kereskedelmi és Szolgáltató Kft - Hungary, Retail


BB-^{STABLE}

Corporate profile

Founded in 1991 and headquartered in Baja, Hungary, AXIÁL Javító, Kereskedelmi és Szolgáltató Kft plays a prominent role in Hungarian agriculture and construction services. Its activities include selling machines (such as tractors, construction machines, forklifts, and second-hand machinery), spare parts, and GPS products (GPS-controlled products, fleet tracking, GPS devices, and software). It also provides services, such as guarantees and installation, the renting-out of machines and financing solutions. AXIÁL's primary focus is the agriculture industry (agricultural machinery accounts for almost 50% of total turnover), with a secondary focus on construction, material handling and warehousing. AXIÁL is fully owned by Mr Zsolt Harsányi (50%) and Dr Gyöngyi Harsányi Fodor (50%).

Key metrics

Scope credit ratios	Scope estimates			
	2018	2019	2020F	2021F
EBITDA/interest cover (x)	37x	35x	>20x	>20x
Scope-adjusted debt (SaD)/EBITDA	2.0x	1.9x	2.2x	2.0x
Scope-adjusted funds from operations/SaD	99%	50%	40%	47%
Free operating cash flow/SaD	-11%	4%	-10%	17%

Rating rationale

Scope Ratings assigns a BB-/Stable first-time issuer rating to Hungarian agricultural and construction machinery distributor AXIÁL Javító, Kereskedelmi és Szolgáltató Kft. Senior unsecured debt issued by AXIÁL is rated BB.

AXIÁL's business risk profile is supported by the importance of agriculture for the Hungarian population and economy. The company is one of the top three agricultural machinery dealers in Hungary with the leading position in spare parts and a market share of 20%-25% in the Hungarian agricultural machinery sector. It benefits from a good position in a niche market, which ensures stable revenues. Furthermore, AXIÁL is the exclusive distributor of several globally well-known brands, such as Claas, Manitou Fendt, Horsch and Hyundai, which emphasises its status as an expert in the sector.

Despite adequate product diversification (50% of total net sales come from agricultural machinery and 30% from spare parts), AXIÁL's business risk profile is constrained by its low geographical diversification. The highest country exposure represents a mere 7% of total net sales, too small to offset any negative macro developments in its home market of Hungary. AXIÁL also has to deal with an ageing and decreasing labour force in the agricultural sector. This negative factor could be overcome by focusing more on construction, where sales have been minor compared to agriculture.

AXIÁL's financial risk profile is stronger than its business risk profile. Our rating case incorporates the company's plans to issue a HUF 15bn senior unsecured corporate bond under the MNB Bond Funding for Growth Scheme. We assume that the planned bond will have a 2.0% coupon and a bullet maturity with a tenor until 2030. Proceeds from the bond are earmarked for refinancing. We expect AXIÁL's financial leverage ratio to remain stable in the medium term, between 2x and 2.5x, and its interest cover ratio to be above 20x. We also expect some improvement in underlying profitability despite free cash flow fluctuating from positive to negative numbers.

Ratings & Outlook

Corporate ratings BB-/Stable
Senior unsecured rating BB

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Related Methodology

Corporate Rating Methodology,
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Bloomberg: SCOP

Outlook

The Stable Outlook for AXIÁL incorporates our view that key credit metrics over the next two years will remain at levels comparable to those in 2019, i.e. Scope-adjusted debt (SaD)/EBITDA of between 2x-2.5x and debt protection as measured by EBITDA/interest cover of above 20x, with the issuer to remain among the top three agricultural machinery dealers in Hungary. Furthermore, we assume a successful issuance of a HUF 15bn bond under the MNB Bond Funding for Growth Scheme, with proceeds used to refinance the bulk of short-term financial debt. Our rating case also projects stable profitability, with an EBITDA margin at around 10%.

A positive rating action is seen to be remote but could be warranted if AXIÁL's business risk profile improved through, e.g. greater geographical diversification while SaD/EBITDA decreased below 2x on a sustained basis. This could be triggered by either a constant improvement in working capital management and/or a lower dividend payout.

The ratings could come under downward pressure if AXIÁL's leverage deteriorated above 4x on a consistent basis, e.g. as a result of higher capital expenditures, a higher dividend payout and/or a use of bond proceeds for purposes other than the aforementioned refinancing.

Rating drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none"> • Importance of agriculture for Hungarian population and economy • Among top three agricultural machinery dealers in Hungary with the leading position in spare parts and a market share of 20%-25% in Hungary's agricultural machinery sector • Exclusive distributor for several globally well-known brands, such as Claas, Manitou Fendt, Horsch and Hyundai • Adequate level of inventories despite some low turnover in them • Adequate product diversification • Good EBITDA margin of between 8.5% and 10.5% in the past and around 10% in the foreseeable future • High interest cover of more than 20x and comparatively low leverage of around 2x 	<ul style="list-style-type: none"> • Ageing and decreasing labour force in the agricultural sector • Comparatively small scale and outreach on a European basis • Lack of geographical diversification compared to European peers.

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • Improving business risk profile • SaD/EBITDA of below 2x on a sustained basis 	<ul style="list-style-type: none"> • SaD/EBITDA of above 4x on a sustained basis



Financial overview

Scope credit ratios	2018	2019	Scope estimates	
			2020F	2021F
EBITDA/interest cover (x)	37x	35x	>20x	>20x
Scope-adjusted debt (SaD)/EBITDA	2.0x	1.9x	2.2x	2.0x
Scope-adjusted funds from operations/SaD	99%	50%	40%	47%
Free operating cash flow/SaD	-11%	4%	-10%	17%
Scope-adjusted EBITDA in HUF m	2018	2019	2020F	2021F
EBITDA	8,275	8,709	8,595	8,692
Operating lease payments in respective year	-	-	-	-
Other	-	-	-	-
Scope-adjusted EBITDA	8,275	8,709	8,595	8,692
Scope-adjusted funds from operations in HUF m	2018	2019	2020F	2021F
EBITDA	8,275	8,709	8,595	8,692
less: (net) cash interest as per cash flow statement	-223	-246	-242	-377
less: cash tax paid as per cash flow statement	-153	-199	-187	-180
add: depreciation component, operating leases	-	-	-	-
add: dividends received from equity	17	22	20	20
Other	8,235	8	-534	-
Scope-adjusted funds from operations	16,151	8,293	7,652	8,154
Scope-adjusted debt in HUF m	2018	2019	2020F	2021F
Reported gross financial debt	17,076	19,433	19,524	17,780
less: hybrid bonds	-	-	-	-
less: cash and cash equivalents	-1,243	-3,153	-598	-669
add: cash not accessible	414	405	405	405
add: pension adjustment	-	-	-	-
add: operating lease obligations	-	-	-	-
Other	-	-	-	-
Scope-adjusted debt	16,247	16,685	19,330	17,515

Importance of agriculture for Hungarian population

Features of Hungarian agricultural sector: an advantage in the short and medium term

AXIÁL is among the top three dealers in Hungary

Distributor of well-known brands

AXIÁL's sales of agricultural machinery account for 20%-25% of Hungarian net sales

Business risk profile

AXIÁL's **business risk profile (assessed at B+)** is supported by its profitability and market positioning in Hungary, with diversification a negative rating driver.

Despite a contribution of only 3.6% to GDP in 2018, the agricultural sector is still important in Hungary. In 2016, rural regions accounted for 28% of the national territory (vs 52% and 68% for France and Romania respectively), while 60% of farms had a household which consumed more than 50% of their final production (vs 2% in France and 86% in Romania). The agricultural sector also benefits from subsidies from the European Union (e.g. the Common Agricultural Policy). According to AXIÁL, the Hungarian government would be willing to keep stimulating investment in the agricultural sector, even if European subsidies decrease.

The Hungarian agricultural sector is characterised by small farms (under five hectares) with small economic sizes (under EUR 4,000) whose owners are more than 55 years old, according to 2016 Eurostat data. Furthermore, the active agricultural population decreased by 25.5% from 2010 to 2016.

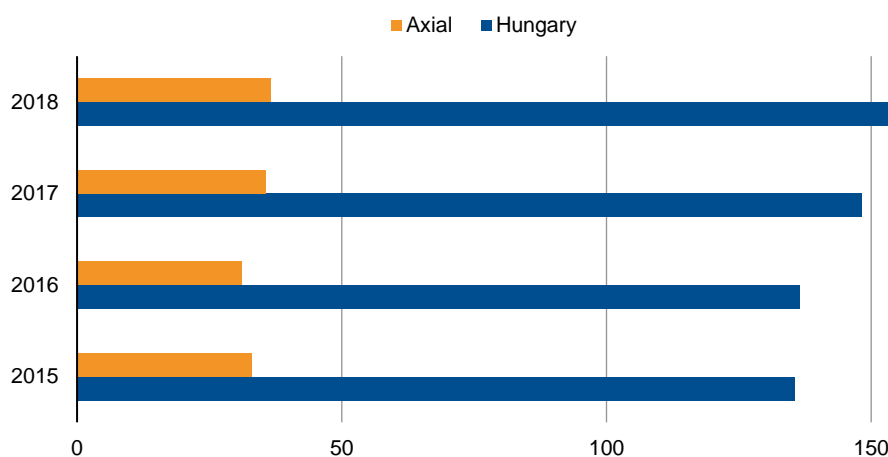
Having plenty of small farms is an advantage for AXIÁL as it increases the number of potential customers. Nevertheless, the company has to deal with the ageing population of farmers as well as the falling share of the population which is active in agriculture. This could be overcome by requests for larger and more efficient machinery from bigger farms (300-3000 hectares).

AXIÁL's main competitors are Kite Zrt. and Agrotec Kft. All three account for around 80% of total Western-made agricultural machinery sales in Hungary.

AXIÁL distributes exclusively globally well-known brands such as Claas (since 2000), Manitou (since 1998), Fendt (since 2002), Landini (since 1998), Horsch (since 2007), and Hyundai (since 2004). Claas is considered the second strongest brand in Hungary behind John Deer (which is only distributed by Kite Zrt.).

AXIÁL's sales of agricultural machinery account for 20%-25% of Hungarian agricultural machinery net sales. Its market share is 40%-45% for combine harvesters (which are the second largest product category in agricultural machinery), 20%-25% for tractors (the largest product category in agricultural machinery) and 40% for telescopic loaders.

Figure 1 – Agricultural machinery net sales (in HUF m)



Source: MEGOSZ, AXIÁL, Scope



Leader in spare parts sales

AXIÁL has a market share of 50% in the spare parts retail market. At the beginning of its existence, spare parts activity was its main business. This provided it with visibility and recognition as an expert. AXIÁL's logistics and infrastructure, combined with its expert status, give it a competitive advantage.

Spare parts activity is even more important nowadays, as built-in components in agricultural and construction machinery have increased, leading to a 50% higher need for spare parts.

Larger product offer in order to retain customers and attract new ones

AXIÁL is continually seeking to further diversify its product portfolio, with the introduction of products such as DeLaval milking technology and mAXI-CAM, an optical weed recognition-based cultivation system developed by AXIÁL. The company has complemented its product portfolio with machine accessories (items not supplied by manufacturers, such as tyres, batteries and oils) and has even developed an inhouse brand (Ister).

Strong after-sales business

Compared to competitors, AXIÁL has a strong after-sales business thanks to a workshop area of over 16,000 sqm. An extension of its logistics centre will begin in summer 2020 and should be operational by summer 2021. This activity should gain in importance due to the increased complexity of machines. It is worth mentioning that, according to Eurostat, materials maintenance consistently accounts for 6% of Hungarian agricultural expenses, which represents around EUR 275m.

Capex used to improve service, efficiency and working environment

According to the management, capex is used to improve AXIÁL's service, efficiency and working environment. AXIÁL is currently expanding its spare parts logistics centre by 2,400 sqm to install narrow aisle warehouse solutions. The company has no other investments in the pipeline.

Large customer base mainly in agriculture sector

AXIÁL has an extensive customer base of 37,000 partners, of which 10,000 are customers with which it has frequent dealings. Its customers are mainly from the agriculture sector (about 92%). The overwhelming majority are domestic customers, with foreign customers accounting for only a few percent. AXIÁL's domestic customers are from the whole of the country, with around 50% in the west, one third in central Hungary and the rest in the east.

Close to its customers

AXIÁL sees its customer relationships as the most important part of its business. That is why it has 19 outlets, across Hungary, which are reachable within a 50 km distance. It also sells directly to customers.

The company's motto quotes Henry Ford: "Service is more important than profit, profit is not the aim, but the result of service."

As the customer relationship is highly valuable to AXIÁL, we can expect costs for customers switching to another supplier to be high.

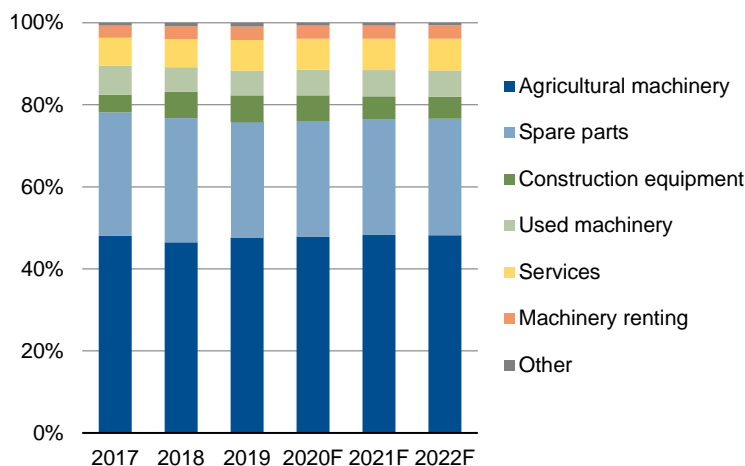
Adequate inventory levels despite some low turnover

Inventory levels are one of the main constraints in the retail business. AXIÁL states that it keeps its inventory levels low but adequate to meet customer needs. Inventories consistently account for just under 50% of the total balance sheet, which is in line with the industry standard. AXIÁL recorded a lower inventory turnover than rated automotive peers, which is mainly due to the difference in business models (sales of vehicles are more frequent than sales of agricultural machines.)

Diversified sources of revenue only in terms of activities

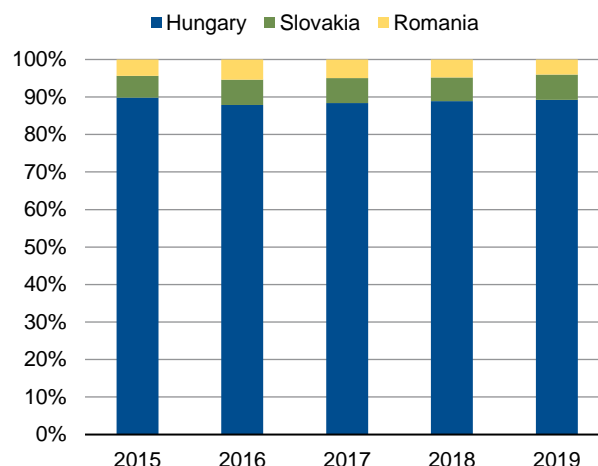
Agricultural machinery consistently accounted for almost 50% of revenues, followed by spare parts (around 30%). Regarding geographical diversification, 90% of turnover is recorded in Hungary.

Figure 2 – Revenue breakdown per segment (%)



Source: AXIÁL, Scope

Figure 3 – Geographical revenue breakdown (%)



Source: AXIÁL, Scope

Adequate but fluctuating profitability

AXIÁL has an adequate adjusted EBITDA margin compared to rated peers. Nevertheless, performance fluctuates, from 8.5% to 10.5% between 2017 and 2019. AXIÁL does not want to disclose its EBITDA contribution per segment.

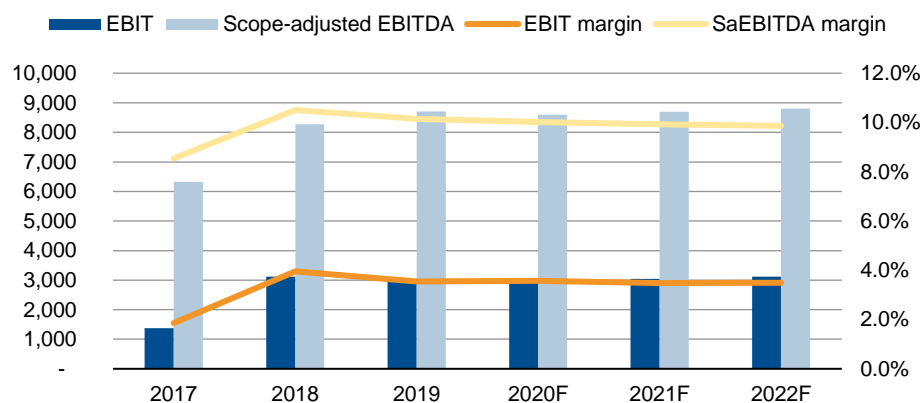
Margin profile expected to be sustained

AXIÁL will expand its spare parts logistics centre by 2,400 sqm to install narrow aisle warehouse solutions. This extension should be operational by summer 2021.

Although it is too early to assess the full impact of Covid-19, it should not overwhelm AXIÁL's performance. According to the management: i) agricultural machines sales¹ are in line with the budget (after a strong Q1, orders for harvesting machinery are at the same level as in the past year despite lower orders of 8% for other self-propelled machines and equipment); ii) spare parts revenues have not fallen compared to the previous year; iii) orders for used machinery have increased by 50%; and iv) the maintenance service is working at full capacity. Furthermore, no lockdown has been imposed on the agricultural industry.

We therefore expect AXIÁL's EBITDA margin to remain stable at around 10%.

Figure 4 – EBIT and adjusted EBITDA in HUF m and their respective margin



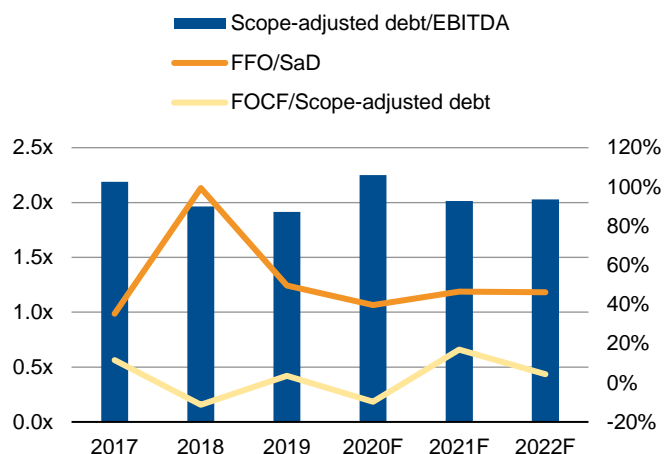
Source: AXIÁL, Scope

¹ According to Axiál, purchasing attitudes are influenced by the current weather, the EUR/HUF rate, and commodity prices. As such they have not been negatively affected by the pandemic so far.

Financial risk profile

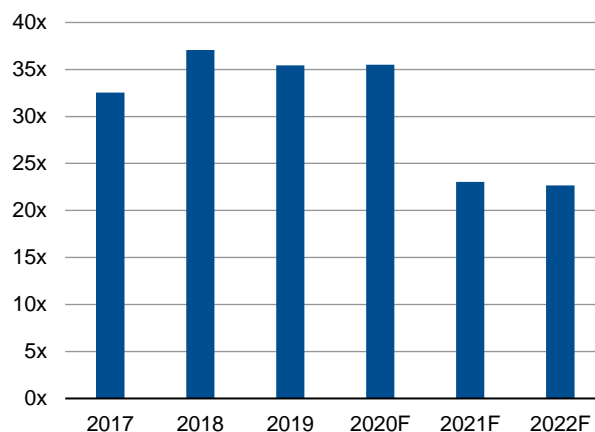
AXIÁL's **financial risk profile (assessed at BB+)** supports the overall issuer rating. We expect AXIÁL's financial leverage ratio to remain stable in the medium term, between 2x-2.5x, and its interest cover ratio to be above 20x. We also expect some improvement in underlying profitability despite fluctuating free cash flow.

Figure 5 – Scope-adjusted leverage



Source: AXIÁL, Scope

Figure 6 – EBITDA interest coverage



Source: AXIÁL, Scope

Rating reflects investment-grade leverage

Our rating case reflects SaD/EBITDA ranging between 2x-2.5x. We expect AXIÁL's leverage to remain at the lower end of this range over the next few years, thanks to a stable level of financial debt.

The funds from operations (FFO)/SaD ratio remains above 30%. FFO recorded in 2018 were exceptional (the impact of HUF 12.6bn in proceeds from the sale of rented machinery). We expect this ratio to remain at the higher end of the 30%-50% range.

Strong interest coverage

AXIÁL's debt protection – as measured by Scope-adjusted EBITDA/Scope-adjusted interest – is above 20x (2017: 33x). We expect AXIÁL to keep exceeding this threshold over the next few years despite a decrease in the ratio in 2021 and 2022 resulting from our higher forecasted interest payments. To be noted, 2020 forecasted interest coverage benefits from lower interest payments due to the recognition of accrued interests).

Weak cash flow coverage

AXIÁL's cash flow cover – as measured by free operating cash flow (FOCF)/SaD – moves between positive and negative positions due to the fluctuation in FOCF. FOCF variation is mainly influenced by changes in working capital. In 2018, FOCF turned negative as a result of higher inventories (+12.4%). In 2020, it is the result of our conservative assumptions regarding receivables and inventories due to Covid-19. Our FOCF forecast for 2021 FYE benefits from working capital returning to normal levels.

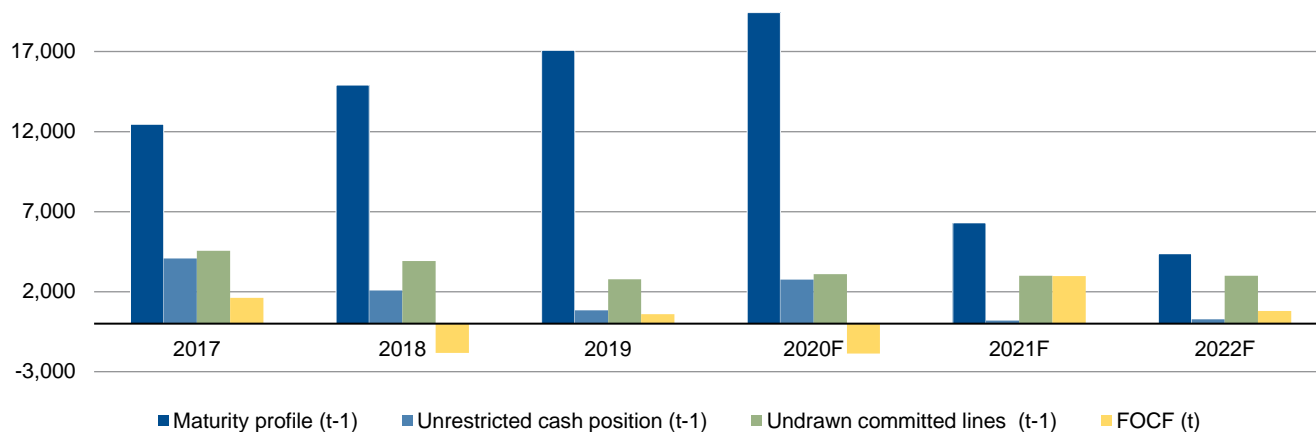
Adequate liquidity position

AXIÁL's liquidity position is considered adequate due to the fact that i) the majority of short-term debt will be repaid from bond proceeds; and ii) the issuer will benefit from the sustained provision of committed short-term credit lines totalling HUF 3bn². Indeed, the company must repay HUF 19.4bn in 2020, of which 77% will be covered by the bond issuance of HUF 15bn. AXIÁL also has HUF 2.8bn in available cash and equivalents as of 31 December 2019. We expect negative FOCF in 2020, a result of higher inventories and receivables. The FOCF forecast for 2020 strongly impacts the amount of unrestricted cash available as of 31 December 2020, which will stand at only HUF 193m. However,

² Please note that we assumed the short-term committed credit lines to be fully rolled over based on the issuer's track record regarding those facilities.

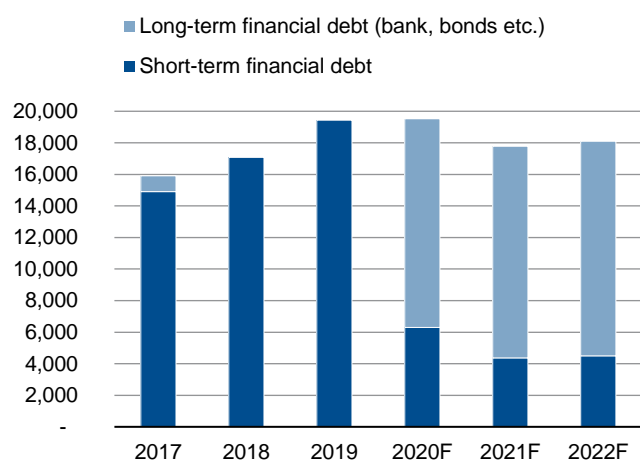
this low amount will be compensated for by expected positive FOCF of HUF 3bn generated in 2021 and undrawn committed lines of HUF 3bn.

Figure 7 – Short-term debt repayment amount, available cash and FOCF (in HUF m)



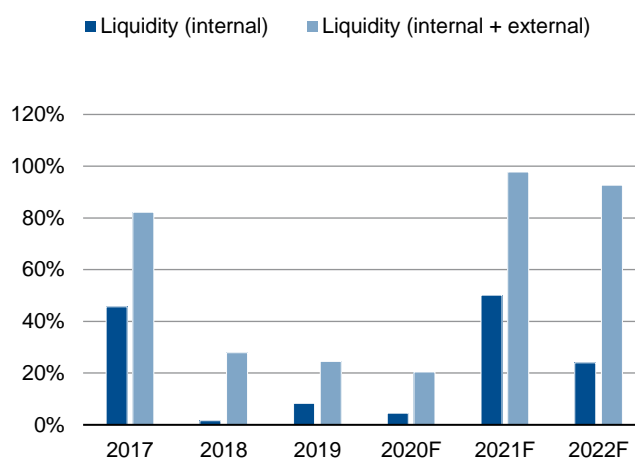
Source: AXIÁL, Scope

Figure 8 – Financial debt (in HUF m)



Source: AXIÁL, Scope

Figure 9 – Liquidity ratios



Source: AXIÁL, Scope

Conservative dividend policy

The dividend payout has been less than 40% of net income and we expect the same level of distribution in the coming years. We believe this dividend policy strikes a fair balance between shareholders' and creditors' interests. A higher dividend distribution could alter our rating case.

No risk related to governance

AXIÁL is a privately owned limited-liability company (Korlátolt Felelősségű Társaság (Kft.)). The highest decision-making body is the taggyűlés (members meeting). The members are the two owners: Mr Zsolt Harsányi and Dr Gyöngyi Harsányi Fodor (husband and wife). Financial decisions are delegated to the management, which consists of three managing directors, Mr Harsányi, Dr Gyöngyi Fodor and Mr Zsolt Pintér.

The supervisory board controls management's activities and reports to the members meeting on a regular basis. According to Hungarian corporate law, the supervisory board is responsible for overseeing the lawful conduct of the company and has the right and



responsibility to request that management demonstrate and prove that operations are lawful.

Despite a lack of real separation between the members and the management, we found no related risk in AXIÁL's governance. The company's governance is also supported by an experienced and committed top management team.

Long-term debt rating

We expect an above-average recovery for senior unsecured debt, such as the planned HUF 15bn MNB bond. This recovery expectation translates into a BB rating for the senior unsecured debt category. Our recovery expectations are based on an anticipated liquidation value in a hypothetical default scenario at the end of 2022. We highlight that debt raised from financial institutions for working capital financing as well as payables rank higher than senior unsecured debt; hence, such debts would be repaid first.

BB rating for senior unsecured debt



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