ITK Holding Zrt.
Hungary, Business Services & Automotive

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA interest cover	1.7x	3.1x	1.5x	1.8x
Scope-adjusted debt/EBITDA	17.4x	10.8x	31.3x	10.5x
Scope-adjusted FFO/debt	4.6%	6.0%	1.1%	4.2%
Scope-adjusted FOCF/debt	-28.8%	-35.9%	-40.3%	-16.7%

Rating rationale

The rating affirmation reflects ITK's expected capacity to deleverage following macroeconomic challenges that drove a spike in leverage in 2022. However, an improvement from this elevated level will likely be delayed over the next several years as the company still maintains significant investment in its bus fleet and its more newly established operations in higher value-added vehicle manufacturing, sales and general distribution.

Outlook and rating-change drivers

The Stable Outlook reflects the stability of revenues and earnings from long-term public transportation contracts and the fact that financial support from MOL Group remains available if needed. Scope expects the company to gradually recover its profitability and move towards free operating cash flow neutrality over the next three years.

A negative rating action could occur if the company was unable to reduce leverage (as measured by the Scope-adjusted debt/EBITDA ratio) or bring free operating cash flow (FOCF) closer to breakeven (as measured by FOCF/Scope-adjusted debt). This could result from a failure to increase sales and production of higher value-added vehicles or from continued cost pressures not being passed on to customers. Deterioration in liquidity or MOL Group exiting the joint venture or not extending financial support when needed could also trigger a downgrade.

Scope also notes that ITK's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clauses require ITK to repay the nominal amount (HUF 20bn) in case of a rating deterioration (2-year cure period for a B/B- rating, repayment immediately after the bond rating falls below B-, which could have default implications).

Stronger-than-anticipated growth in sales and/or margins, resulting in leverage sustainably below 6x, could trigger an upgrade. Closer integration with MOL Group could also warrant a higher rating.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
20 Apr 2022	Monitoring review	BB-/Stable
14 Apr 2021	New rating	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies

Corporate Rating Methodology; July 2022

European Automotive and Commercial Vehicle Manufacturers Rating Methodology; February 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Long-term contracts provide earnings and margin stability for the transportation services business. • The Daimler partnership provides competitive advantages in technology, design, manufacturing, logistics, quality, marketing, etc. • Strong financial and operational support from the majority shareholder, MOL Group • Complementary nature of business lines • General distributor role for Mercedes Benz trucks boosts visibility and brand	• High leverage and negative FOCF • High demand volatility and high fixed costs in the vehicle manufacturing industry • Startup nature and relatively small size of vehicle manufacturing operations • High supplier and customer concentration in transportation services and vehicle manufacturing • Concentrated exposure to single country market and macroeconomic pressures, especially on costs (fuel, energy, wages)

Positive rating-change drivers	Negative rating-change drivers
• Stronger-than-anticipated growth in sales and/or margins, resulting in leverage (Scope-adjusted debt/EBITDA) sustainably below 6x • Closer integration with MOL Group	• Lower-than-anticipated vehicle sales volumes and failure to improve margins, leading to inability to reduce leverage and bring FOCF/SaD closer to breakeven • MOL Group exiting the joint venture or not extending financial support when needed

Corporate profile

ITK Holding Zrt. is a Hungarian company focused on public transportation services, vehicle manufacturing and services related to IT, telecommunications, energy and the environment, and facilities management. The company provides bus services in three of Hungary's 10 largest cities and produces Mercedes-Benz branded and co-branded buses and vans in Hungary in collaboration with Daimler. The company is established as a joint venture between MOL Group and ITK Invest Ltd. In 2022, revenue and EBITDA stood at HUF 29.3bn and HUF 1.4bn respectively and the company employed over 650 people.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	2.8x	1.7x	3.1x	1.5x	1.8x	1.9x
Scope-adjusted debt/EBITDA	10.6x	17.4x	10.8x	31.3x	10.5x	8.6x
Scope-adjusted FFO/debt	4.5%	4.6%	6.0%	1.1%	4.2%	5.6%
Scope-adjusted FOCF/debt	-27.9%	-28.8%	-35.9%	-40.3%	-16.7%	-9.5%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,085	1,081	2,633	1,423	4,994	6,372
Operating lease payments	0	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**1,085**	**1,081**	**2,633**	**1,423**	**4,994**	**6,372**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,085	1,081	2,633	1,423	4,994	6,372
less: (net) cash interest paid	-392	-631	-837	-967	-2,812	-3,291
less: cash tax paid per cash flow statement	-19	-3	-10	-41	0	0
add: dividends from associates	0	0	0	0	0	0
Other changes before FFO	-154	429	-68	66	0	0
Funds from operations (FFO)	**520**	**876**	**1,718**	**481**	**2,182**	**3,081**
Free operating cash flow in HUF m						
Funds from operations	520	876	1,718	481	2,182	3,081
Change in working capital	-948	338	-3,606	-438	-3,136	-1,359
Non-operating cash flow	0	0	0	0	0	0
less: capital expenditure (net)	-2,782	-6,649	-8,311	-18,001	-7,798	-6,915
less: lease amortisation	0	0	0	0	0	0
Free operating cash flow (FOCF)	**-3,210**	**-5,435**	**-10,198**	**-17,958**	**-8,752**	**-5,193**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-399	-639	-857	-1,043	-2,812	-3,291
add: interest component, operating leases	7	7	20	76	0	0
Change in other items	0	0	0	0	0	0
Net cash interest paid	**-392**	**-631**	**-837**	**-967**	**-2,812**	**-3,291**
Scope-adjusted debt in HUF m						
Reported gross financial debt	11,521	18,845	28,415	44,513	52,320	54,830
less: subordinated (hybrid) debt	0	0	0	0	0	0
less: cash and cash equivalents	0	0	0	0	0	0
add: non-accessible cash	0	0	0	0	0	0
add: pension adjustment	0	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted debt (SaD)	**11,521**	**18,845**	**28,415**	**44,513**	**52,320**	**54,830**

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Environmental, social and governance (ESG) profile[1]

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)

ESG considerations

We see ESG as a neutral rating factor for ITK. The buses the company has developed use stainless steel frames for the body, which extends the life of the body by at least 20 years. Electric buses accounted for 27% of the number of buses ITK built in 2021 and 5% in 2022, but an outsized proportion of the value of vehicles built (in 2021, 40 electric buses built and sold represented 40% of the value of all vehicles built during that year).

ITK's business services subsidiary Pandant installs charging stations for electric vehicles. ITK is collaborating with Daimler, ZF and other international players in the development of electric and fuel cell technologies.

[1] 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 reflects mix of stable contracted business and volatile cyclical industries

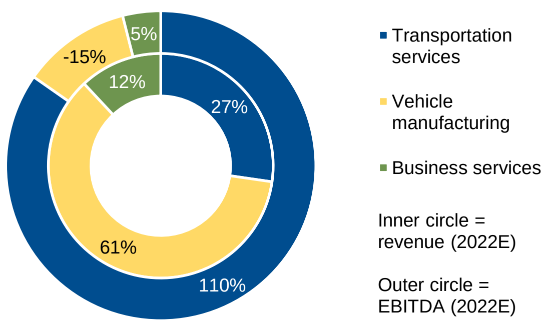
We assess ITK's industry risk at BBB-, reflecting the weighted average industry risk of business services and automotive/commercial vehicle manufacturing. Cyclicality and barriers to entry are medium for business services and high for automotive and commercial vehicle manufacturing. The risk of substitution is medium for both industries. Most of the weighting is determined by the business services industry as ITK's public transportation and business services contributed nearly all of 2022 EBITDA (through Intertanker, Intertanker City, and Pandant), even though a larger part of revenues is generated from vehicle manufacturing and sales (ITE and ITE Bus and Truck).

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 six long-term contracts (five of which are 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 also benefits from a relatively modern (aged 6.6 years on average) bus fleet comprising 528 vehicles at the end of 2022.

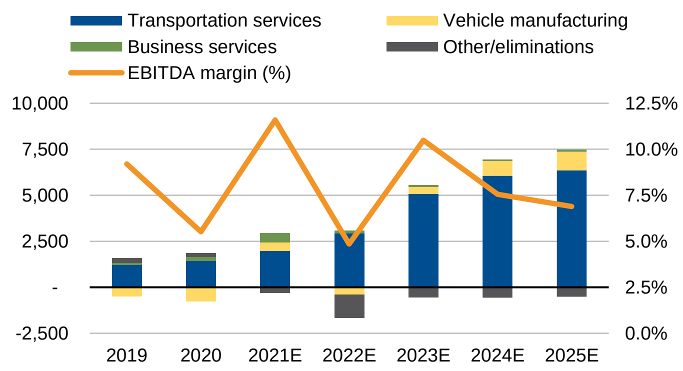
The company's smaller business services operations have a long track record of stable margins. They performed particularly well in 2021, although 2022 reflected a drop in performance as certain profitable contracts were non-recurring. Risk has also risen in the newly established vehicle manufacturing business, which started production in 2019. This business benefits from a collaboration with Daimler, whereby all vehicles (buses and vans) produced by ITK carry the Mercedes-Benz logo. Alongside its own Reform brand, ITK produces vehicles to order, most of which are lower value-added modifications to near-ready vehicles, although a growing share of production comprises bodybuilding on Mercedes-Benz drivable chassis and electric buses. The key to success will be ITK's ability to ramp up production volume and increase the share of higher value-added units.

Figure 1: Revenue and EBITDA by business segment, 2022



Sources: ITK

Figure 2: EBITDA margin and contribution by business segment (HUFm, LHS)



Sources: ITK, Scope (estimates)

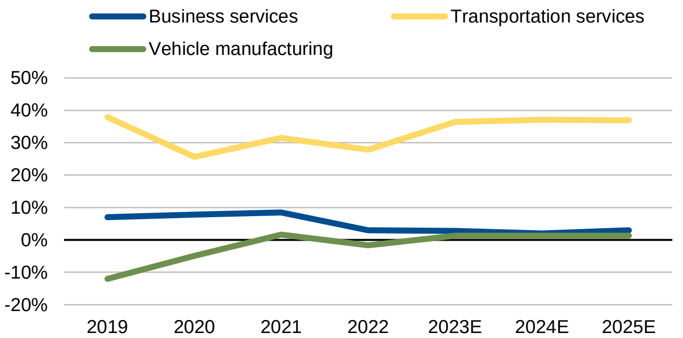
Profitability varies by segment; vehicle manufacturing and sales could be dilutive

Profitability is strong and stable in business and transportation services. But vehicle manufacturing has been operating at a loss due to earlier startup costs, suboptimal production volumes, supply chain issues and then dampened demand in 2022. The company produced only 149 vehicles in 2021 and increased production to 258 in 2022, both below expectations. We expect profitability at ITE and ITE Bus and Truck (including the new general distribution operation) to improve gradually over the next three years but remain only slightly above breakeven.

ITK (under Intertanker and Intertanker City) is a relatively small bus operator compared to state-owned Volánbusz and VT-Arriva, owned by Deutsche Bahn. However, ITK's EBITDA margins are the highest in the peer group. We expect profitability here to improve in 2023 as price increases are passed on to customers through revised contracts in transportation services. We expect the overall group margin to show some dilution from the ramp-up of lower-margin vehicle manufacturing, sales and general distribution.

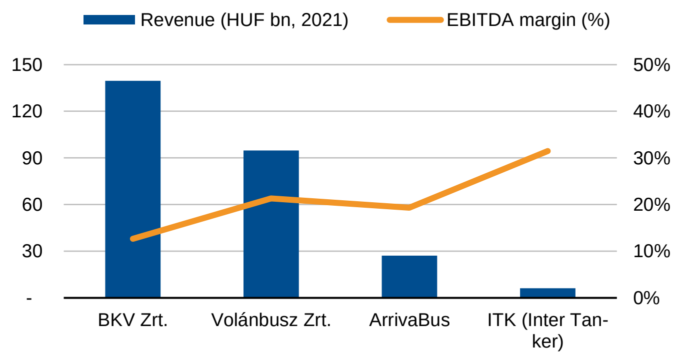
ITK's business is concentrated in Hungary, with relatively high supplier and customer concentration, although most are well-established industry players with a good credit standing.

Figure 3: EBITDA margin by business segment



Sources: ITK, Scope (estimates)

Figure 4: Hungarian bus service operators, 2021



Sources: Company filings, Opten

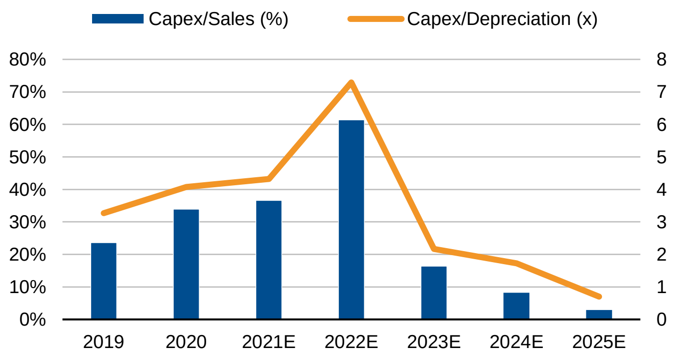
Financial risk profile: B-

ITK's financial risk profile (assessed at B-) reflects very high leverage, measured by a Scope-adjusted debt/EBITDA ratio estimated at over 30x in 2022.

EBITDA and debt to grow with decreasing, although still elevated leverage

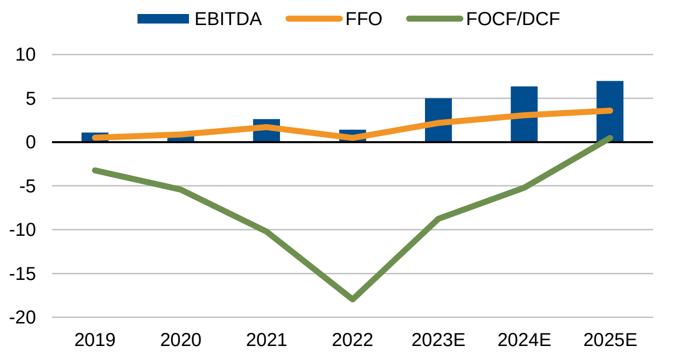
Leverage spiked in 2022 with significant investments in the bus fleet for services contracted under long-term agreements. This coincided with macroeconomic pressures, resulting in unexpectedly higher costs and lower demand in manufacturing. Leverage is expected to decline towards 10.5x in 2023E as the first full-year contribution from the expanded fleet and contracted price increases takes effect. Thereafter, leverage is expected to gradually fall to around 8.0x in 2025E.

Figure 5: Capex to sales and depreciation



Sources: ITK, Scope (estimates)

Figure 6: Scope-adjusted cash flows (HUF bn)



Sources: ITK, Scope (estimates)

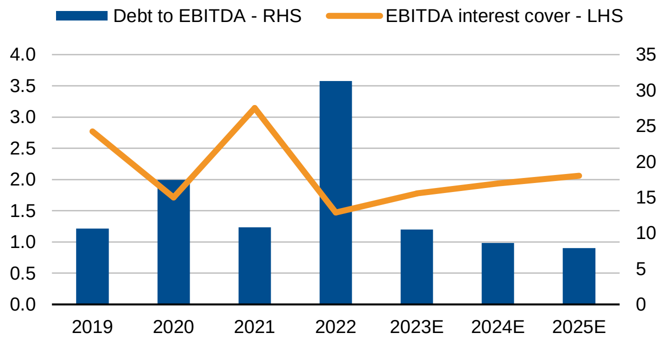
Expansionary investments directed to bus fleet expansion

ITK ruled out a potential investment in a new HUF 20bn production plant at Debrecen due to economic and financial circumstances. However, the company recently closed on deals with Mercedes Benz to become its general distributor for trucks in Hungary starting in early to mid-2023. We expect sizeable investments of around HUF 10bn, primarily in

Negative FOCF expected until at least 2024

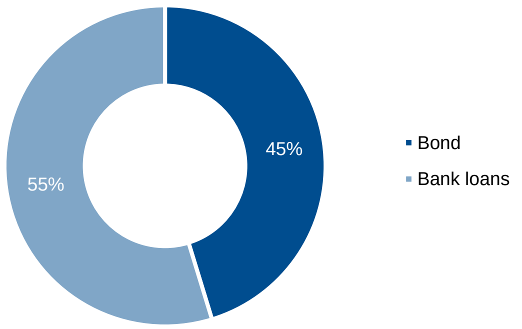
the bus services fleet for Intertanker and Intertanker City, to continue in 2023-25. With a ramp-up of vehicle production and growth in revenues from adjacent services operations (ITE/ITE Bus and Truck), we expect the company to reach free operating cash flow breakeven in 2025, a year later than previously forecasted due to 2022's outlier financial results. We understand that shareholders prioritise growth and do not expect to extract dividends from the company in the short to medium term.

Figure 7: Scope-adjusted leverage and debt service



Source: ITK, Scope estimates

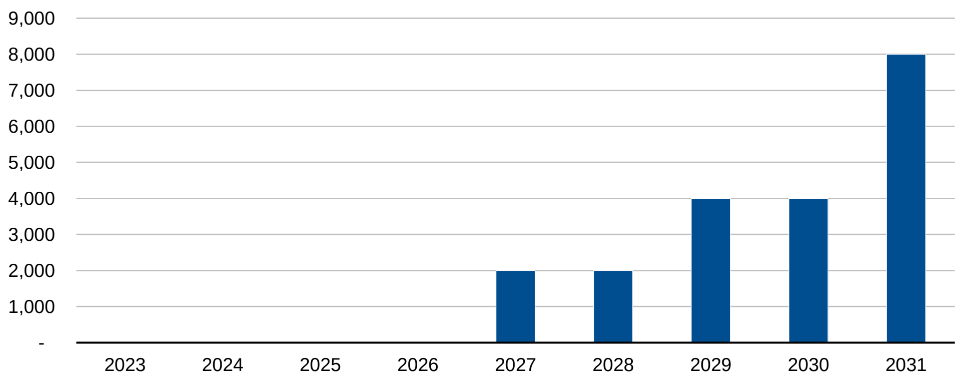
Figure 8: Funding sources, YE 2022



Source: ITK

Interest cover is helped by the 2.9% coupon on the HUF 20bn 10-year bond issued in July 2021. The bond accounted for around 45% of total debt at the end of 2022. Its long tenor and fixed coupon help keep overall interest costs from spiraling higher as interest rates rise, but additional debt taken on in 2022 primarily to fund Intertanker investments also drove up interest expense. Other debt is also HUF-based, long term and secured (mostly on the bus fleet). 91% of debt was fixed-rate at year-end 2022, although some was at higher rates due to the elevated interest rate environment.

Figure 9: Bond maturity profile (HUF m), YE 2022



Source: ITK

Adequate liquidity underpinned by long-term debt maturity profile and shareholder support

ITK had HUF 1.4bn of liquid assets and HUF 4.4bn of short-term debt at the end of 2022. We expect fleet growth to be financed primarily by bank loans secured on the vehicles and, to a lesser extent, by subordinated loans and equity from MOL Group. Though the company remains highly dependent on the availability of short-term external funding, we still consider ITK's liquidity position to be adequate due to the potential to receive financial support from MOL Group for planned projects and temporary liquidity needs.

Balance in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	1,414	864	896
Open committed credit lines (t-1)	0	0	0
Free operating cash flow	-17,958	-8,752	-5,193
Short-term debt (t-1)	4,351	2,143	3,178
Coverage	**-380%**	**-368%**	**-135%**

Supplementary rating drivers: +3 notches

Strong financial and operational backing from majority shareholder

ITK Holding Zrt. is a joint venture between MOL Group and ITK Invest Ltd. Although MOL Group has 74% of the economic interest, decisions are made jointly by the two partners. MOL Hungary's CFO and the Head of Group Mobility are both members of ITK's board of directors.

MOL Group has extended significant investment and working capital loans to ITK in the past and provides parent company guarantees in certain cases. The loans were repaid with proceeds from the HUF 20bn bond issuance, but parent company guarantees have continued after the bond issuance. The bond indenture includes a change of control provision. MOL has supported ITK's current fleet investments with three subordinated shareholder loans.

In addition to financial support, MOL Group supports ITK in areas such as risk management and IT.

Overall, parent support warrants a three-notch uplift from the B- standalone rating, resulting in a final issuer credit rating of BB-.

Long-term debt ratings

Senior unsecured debt rating: BB-

We rate senior unsecured debt in line with the issuer rating, based on pari passu ranking and a negative pledge provision in the bond documentation, limiting the extent of secured debt in the capital structure.

The bond 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.

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