21 September 2022 Corporates

MARSO Kft.
Hungary, Retail

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	19.8x	15.8x	6.6x	4.9x
Scope-adjusted debt /EBITDA	2.3x	3.7x	3.1x	3.8x
Scope-adjusted funds from operations/debt	38%	24%	26%	20%
Scope-adjusted free operating cash flow (FOCF)/debt	18%	-41%	-2%	3%

Rating rationale

The rating is supported by MARSO's resilient business model after the completion of the warehouse near Budapest and full utilisation of the NKP bond proceeds in 2021. Despite the tyre wholesaler facing several threats in its core market pressuring its credit metrics, both its business and financial risk profiles remain commensurate with the rating. By placing the warehouse in service at the beginning of 2022, MARSO's gross margin increased, however, the jump is considered temporary as labour market conditions and rising input prices are expected to weaken MARSO's Scope-adjusted EBITDA margin to around 5% in the medium term. The company's comparatively strong financial risk profile is forecasted to remain broadly unchanged. Despite MARSO's strong market position in the wholesale tyre markets and its pricing strategy, the current market conditions are forecasted to weaken MARSO's credit metrics, primarily its interest cover and secondly its profitability metrics after 2022. We expect that MARSO's long-term loan profile will remain stable in the following years and credit metrics will remain commensurate with the issuer rating.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that with the elimination of the execution risk related to the large-scale investment programme of the warehouse, MARSO's long-term loan profile will remain stable in the next three years and as a result the company's Scope-adjusted debt/EBITDA will remain commensurate with the rating at an expected range of between 3-4x in that period.

The rating-change drivers remain the same as last year: a positive rating action could be triggered if MARSO's premiumisation strategy strengthened the Scope-adjusted EBITDA margin and Scope-adjusted debt/EBITDA fell below 3x on a sustained basis, for example, through an efficient management of working capital.

A negative rating action could be triggered if Scope-adjusted debt/EBITDA reached above 4x on a sustained basis, as a potential consequence of the new strategy not lifting the EBITDA margins or from a further significant working capital expansion.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
15 Sep 2022	Affirmation	BB-/Stable
21 Oct 2021	Affirmation	BB-/Stable
18 Nov 2020	Rating unchanged	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB

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Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2022

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

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Strong market position • Comparatively strong financial risk profile • High share of exclusivity of products sold	• Low diversification • Small company size in niche market with limited expansion possibilities and high 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
• Scope-adjusted debt/EBITDA below 3x on a sustained basis • The premiumisation strategy positively impacts profitability	• Scope-adjusted debt/EBITDA remains above 4x on a sustained basis

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 selling networks, which includes its own brick-and-mortar store network, a franchise network of around 30 partners and the Marso Partner Network distribution network that has more than 100 members.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	13.3x	19.8x	15.8x	6.6x	4.9x	6.1x
Scope-adjusted debt/EBITDA	2.8x	2.3x	3.7x	3.1x	3.8x	3.8x
Scope-adjusted funds from operations/debt	32%	38%	24%	26%	20%	21%
Scope-adjusted FOCF/debt	-14%	18%	-41%	-2%	3%	2%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,114	1,322	1,444	2,030	1,582	1,662
Operating lease payments	474	559	590	449	471	495
Scope-adjusted EBITDA	**1,588**	**1,882**	**2,033**	**2,479**	**2,054**	**2,157**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,588	1,882	2,033	2,479	2,054	2,157
less: (net) cash interest paid	-25	17	-10	-284	-328	-255
less: cash tax paid per cash flow statement	-76	-95	-95	-100	-56	-68
less: leasing adjustment (interest)	-95	-112	-118	-90	-94	-99
Change in provisions	2	2	-1	-	-	-
Funds from operations	**1,395**	**1,693**	**1,809**	**2,005**	**1,576**	**1,735**
Free operating cash flow in HUF m						
Funds from operations	1,395	1,693	1,809	2,005	1,576	1,735
Change in working capital	274	139	-261	-1,013	-438	-653
less: capital expenditure (net)	-1,913	-591	-4,182	-750	-540	-560
less: depreciation component, operating leases	-379	-447	-472	-359	-377	-396
Free operating cash flow	**-623**	**794**	**-3,106**	**-118**	**221**	**126**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	25	-17	10	284	328	255
add: interest component, operating leases	95	112	118	90	94	99
Net cash interest paid	**120**	**95**	**128**	**374**	**422**	**354**
Scope-adjusted debt in HUF m						
Reported gross financial debt	4,542	4,001	5,302	5,250	5,200	4,950
less: cash and cash equivalents	-3,181	-3,087	-1,441	-870	-773	-346
add: non-accessible cash	100	100	100	300	300	300
add: operating lease obligations	1,897	2,237	2,360	1,796	1,886	1,980
Other items[1]	1,061	1,161	1,257	1,257	1,257	1,257
Scope-adjusted debt	**4,420**	**4,414**	**7,578**	**7,733**	**7,869**	**8,141**

[1] Other items include bank guarantees and the warranty MARSO has provided for MARSO Holding.

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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)	Grey leaf	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)	Grey 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	Grey leaf	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)

ESG profile: adequate

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 may prompt consumer boycotts, affecting sales, margins and inventory value. However, we believe MARSO's position as a national wholesaler decreases this risk substantially. MARSO has initiated several social responsibility projects (such as the operation of a tennis court in Nyíregyháza and established 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 they 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 the number of its stores across the country is low.

[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 profile remains rated at BB given the medium cyclicality and low entry barriers of the automotive parts wholesale segment. MARSO's new designation as a 'discretionary' retailer from 'cyclical' follows the update of the Retail and Wholesale Rating Methodology, however, it has no effect on the industry risk profile.

MARSO has so far withstood the depressed conditions in automotive-related industries thanks to its strong position in the wholesale tyre markets. Even so, MARSO had redefined its strategy in 2020-2021 due to the pandemic and the general changes in the tyre market – including retail digitalisation and customers' increased price sensitivity. MARSO plans to cater to its extensive network of wholesalers by protecting their margins in comparison to retail customers.

In 2022, MARSO and other market players face multiple threats in their core market: the Russian-Ukrainian war has caused raw material shortages and supply chain disruptions within the global tyre industry in addition to energy price increases. Thus some tyre manufacturers have adjusted their strategy, including closing some production facilities. Nokian, as one of MARSO's top suppliers, has closed its Russian factory and exited the country. Furthermore, the high inflationary environment also puts pressure on customer behaviour and working capital management.

The warehouse, which cost HUF 5.5bn, was completed by the end of 2021, entered service in early 2022, and was partially financed by the HUF 3.6bn NKP bond and a HUF 0.7bn government subsidy. After relocating MARSO's inventory from scattered, smaller rental storage sites to the new warehouse, a significant number of rental agreements were terminated, resulting in a stronger gross margin, improving profitability. The spike is forecasted to be short-lived as labour market conditions and rising input prices are expected to deteriorate MARSO's Scope-adjusted EBITDA margin to around 5% for the medium term, after the elevated level of 6.5% forecasted for 2022.

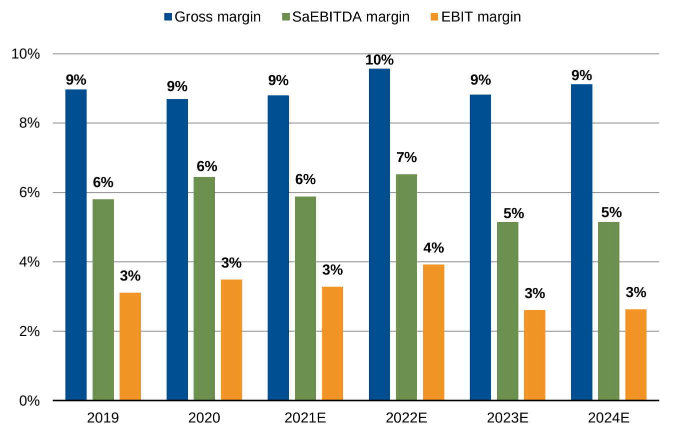
MARSO's business risk profile is supported by its dominant market position in Hungary. However, its company size (revenue of EUR 96m) and weak diversification remain negative rating drivers.

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 integration of customers into a streamlined process.

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). We consider these relationships to be durable because MARSO is competitive compared to other wholesalers. As of 31 December 2021, exclusive products represented close to 50% of total sales.

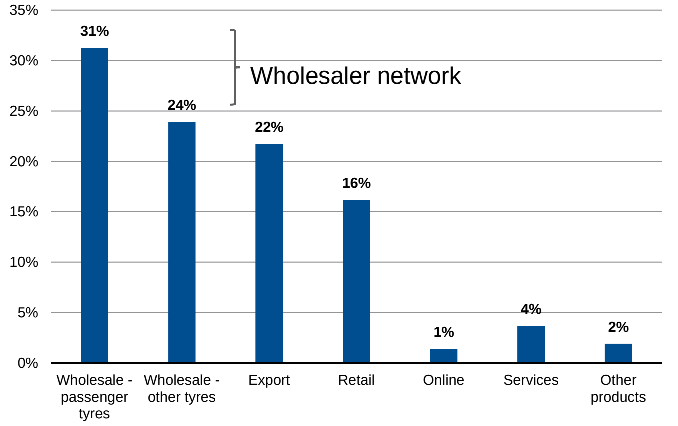
MARSO attracts customers with several types of offers. In 2021, approximately 30 shops were operated as franchises. These franchises, called Marsoponts, carry the full product range and receive financial support from MARSO if needed. The company has also developed a network of customers under the 'Marso Network Partner' label. These customers receive exclusive products and favourable commercial agreements in exchange for a royalty paid to MARSO. The two systems are supported by MOND, a web-shop platform.

Figure 1: Profitability



Sources: MARSO, Scope estimates

Figure 2: Sales diversification (YE 2021)



Sources: MARSO, Scope

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).

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). 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 second highest sales, after Hungary, represents only 6% of total sales. This is too low to offset any negative macro developments in the company'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.

Financial risk profile: BB

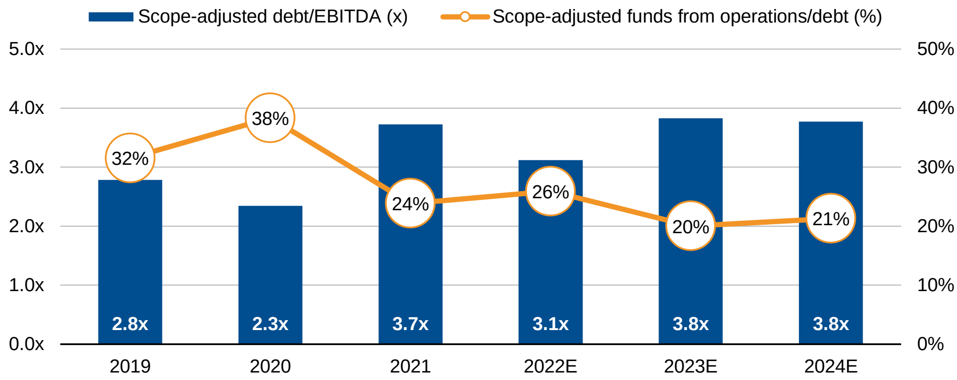
Our assumptions regarding the group's financial risk profile include the fact that MARSO Kft. and MARSO Holding Kft. have cross-guarantees. Based on our assessment of the financial metrics of MARSO Holding Kft, a scenario in which only the holding entity falls into bankruptcy is unlikely.

MARSO's credit profile includes the HUF 3.6bn NKP bond issued in 2019 and the additional HUF 1.7bn loans utilised in 2021, complemented with 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, repaying as soon as cash generation allows, thus not impacting the year-end profile. The company has so far withstood the depressed conditions in the automotive-related industries thanks to its strong position in the wholesale tyre markets allowing it to partially pass on price increases. Even so, the current market conditions (e.g. the high interest rate environment) are forecasted to deteriorate MARSO's credit metrics, primarily its interest cover and secondly its profitability metrics.

We forecast credit metrics to remain commensurate with the current issuer rating: Scope-adjusted debt/EBITDA is expected to remain within 3-4x, Scope-adjusted funds from operations/debt at above 20% (Figure 3), and EBITDA interest cover between 4-6x (Figure 4).

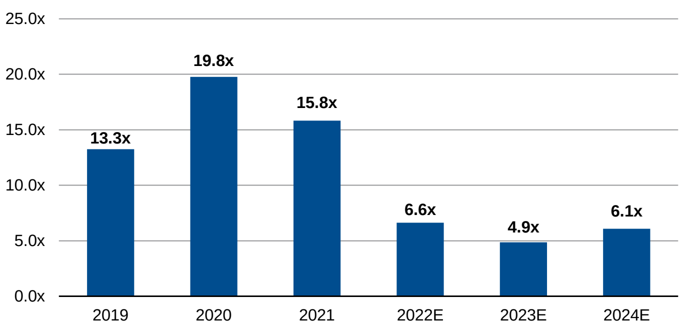
As is typical for companies in expansion, capex has taken a toll on free operating cash flow (FOCF) in 2021 and is expected to remain under pressure in the short to medium term (Figure 5).

Figure 3: Leverage



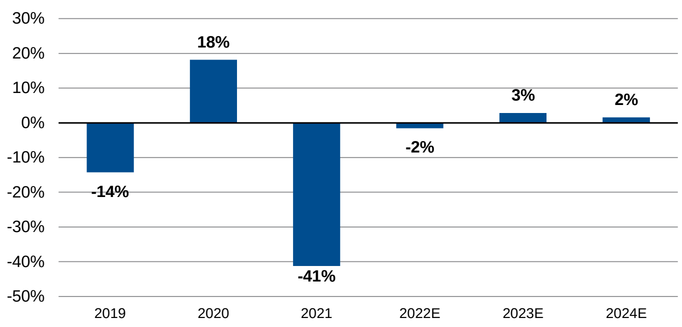
Sources: MARSO, Scope estimates

Figure 4: Scope-adjusted EBITDA/interest cover



Sources: MARSO, Scope estimates

Figure 5: Cash flow cover



Sources: MARSO, Scope estimates

Adequate liquidity

Liquidity is considered adequate, however negative fluctuations of working capital are expected. The 2021 temporary burden on the Scope-adjusted FOCF/debt ratio due to negative FOCF during the investment period and inventory stocking is not considered a negative rating driver as it is not expected to remain as such.

Balance in HUF m	2022E	2023E
Unrestricted cash (t-1)	1,341	570
Free operating cash flow	-118	221
Short-term debt (t-1)	52	50
Coverage	**>200%**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB

We regard the rating of MARSO's senior unsecured debt as BB. Recovery expectations for senior unsecured debt are 'superior', even after senior secured debt (primarily consisting of the redrawn loan amount of HUF 1.7bn) has fully been 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 forecasted negative fluctuations of the 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 2024.

Appendix: Peer comparison (as at last reporting date)

	MARSO	Abroncs Kereskedőház Kft.**	AutoWallis Nyrt.	Unix Autó Kft.
	BB-/Stable	BB/Stable	B+/Stable	BB-/Stable
Last reporting date	31 Dec 2021	31 December 2020	31 December 2021	31 December 2021
Business risk profile	**B+**	**B+**	**B+**	**BB**
Country retail strength	High-medium	High-medium	High-medium	High-medium
Market position	Strong	Strong	Medium	Strong
Revenue size (EUR bn)	0.1	0.1	0.5	0.3
Consumer goods category	Discretionary	Discretionary	Discretionary	Discretionary
Online diversification	Low	Low	Moderate	Moderate
Geographical exposure	Immediate neighbours	Immediate neighbours	Immediate neighbours	Immediate neighbours
Product diversification	Low and cyclical	Low and cyclical	Low and cyclical	Low and cyclical
Profitability assessment	Moderate	Moderate	Moderate	Moderate
Financial risk profile	**BB**	**BBB-**	**B+**	**BB-**
Scope-adjusted EBITDA/interest cover	14.1x	7.2x	9.5x	9.9x
Scope-adjusted debt/EBITDA	3.0x	1.2x	6.0x	2.7x
Scope-adjusted funds from operations/debt	30%	96%	15%	32%
Scope-adjusted free operating cash flow/debt	-8%	73%	203%	0%

* Subscription ratings available on ScopeOne

Sources: Public information, Scope

** Assessment on previous methodology

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