Illés Holding Zrt.
Hungary, Road Logistics

B+ STABLE

Corporate profile

Illés Holding was established in 2011 as the holding company for all the companies invested in by the owner Mr. Tamás Illés. The group currently consists of twenty companies and operates in several business lines, mainly in Hungary and its neighbouring countries. Illés Holding's main business line is road and rail transportation, primarily the transportation of speciality and bulk goods. It is also active in several other industries: passenger transportation, fuel retail, energy production, healthcare services, construction, building material wholesaling and airport operation.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020E**	**2021E**
EBITDA/interest cover (x)	15.7x	11.9x	5.7x	5.2x
Scope-adjusted debt (SaD)/EBITDA	2.2x	3.0x	3.9x	4.3x
Scope-adjusted FFO/SaD	41%	30%	21%	15%
FOCF/SaD	-34%	-7%	-29%	-25%

Rating rationale

Scope has today assigned a first-time issuer rating of B+/Stable to Illés Holding Zrt. A first-time rating of B+ has also been assigned to the group's senior unsecured debt.

Illés Holding's business risk profile is driven by the group's niche market position and slightly different business model within the highly fragmented transportation industry. Although the group is a small market player, it specialises in the transportation of speciality cargo (e.g. oil and gas, construction materials and bulk agricultural products). This requires dedicated equipment for both the transportation and storage of goods, leading to a more stable customer portfolio with long-term, multi-year contracts. Although operating profitability is relatively strong, we note that it is volatile because: i) it is determined by the total utilisation rate of the group's vehicle park; and ii) most of the group's customers operate in industries with medium to high cyclicality. Illés Holding manages peak periods with subcontractors, while closely monitoring the utilisation of its trucks. Investments in new vehicles are made in line with their estimated utilisation based on customer acquisition and the business development of the group's road and rail divisions.

Illés Holding has a moderately diversified service portfolio. We expect the newly acquired solar power plant to strengthen the group's operating profitability while simultaneously decreasing its volatility. The solar park will start operations in Q1 2022, with the capacity of 20MW under the Hungarian KAT feed-in tariff programme of the Hungarian Energy and Public Utility Regulatory Authority, resulting in stable cash flow generation. We believe that the new energy division will strengthen the group's financial risk profile in the long term.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	B+

Analysts

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Related Methodology

Corporate Rating Methodology: July 2021

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Regarding the group's financial risk profile, the highly leveraged solar power plant investment project has weakened 2021 credit metrics. Our financial base case includes the fully consolidated financials and dividend payment to minority shareholders for Illés Holding's rail division in 2021 and looking forward – due to its majority share of 51% in the subsidiary. We forecast that credit metrics will decline further next year, assuming the successful issuance of the planned HUF 6bn NKP bond in Q1 2022. We forecast that Scope-adjusted debt (SaD)/EBITDA will increase to above 4.0x in 2022 but expect this to be temporary. Furthermore, interest cover is relatively strong. Illés Holding's investment plans will lead to significant negative free operating cash flows for the next years. We also see liquidity as adequate.

Outlook and rating change drivers

The Stable Outlook reflects Scope's expectation that Illés Holding's will successfully issue the planned HUF 6bn senior unsecured bond in 2022, that its new solar power plant will start operation in 2022 and that the group's rail division financials will remain fully consolidated. The Outlook also factors in Scope's expectation that the group will maintain a prudent financial policy consistent with the credit metrics required for the rating category.

A positive rating action may be warranted if Scope-adjusted debt/EBITDA strengthens to below 3.5x on a sustained basis, for instance, if the group successfully expands its main business line. An upgrade may also be warranted by an improvement of the group's business risk profile.

A negative rating action might be warranted by financial leverage not improving towards the breakeven level in the mid-term, after the completion of the investment program.

Rating drivers

Positive rating drivers	Negative rating drivers
• Fair profitability supported by long-term contracts, which is expected to benefit from new feed-in tariff solar park business line • Moderate diversification in terms of business lines, geographical coverage and customer types and exposure • Operates in niche market within the highly competitive transportation industry • Comparatively strong interest cover despite increasing interest rate environment	• Small player in highly fragmented market • Volatile profitability due to customers operating in cyclical industries (e.g. construction) • Highly leveraged investment plans (e.g. solar park, asset acquisitions)

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Decrease in leverage to SaD/EBITDA below 3.5x on a sustained basis • Improved business risk profile in terms of market position and diversification	• Financial leverage not improving towards the breakeven level in the mid-term

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020E**	**2021E**
EBITDA/interest cover (x)	15.7x	11.9x	5.7x	5.2x
Scope-adjusted debt (SaD)/EBITDA	2.2x	3.0x	3.9x	4.3x
Scope-adjusted funds from operations/SaD	41%	30%	21%	15%
Free operating cash flow/SaD	-34%	-7%	-29%	-25%
Scope-adjusted EBITDA in EUR m	**2018**	**2019**	**2020E**	**2021E**
EBITDA	2,701	2,484	2,536	3,325
Operating lease payments in respective year	559	761	789	819
Other	-	-	-	-
Scope-adjusted EBITDA	3,259	3,245	3,325	4,144
Scope-adjusted funds from operations in EUR m	**2018**	**2019**	**2020E**	**2021E**
EBITDA	2,588	2,484	2,536	3,325
less: (net) cash interest as per cash flow statement	-68	-128	-417	-625
less: cash tax paid as per cash flow statement	-79	-103	-61	-68
add: depreciation component, operating leases	419	617	620	644
Other	63	-	60	60
Scope-adjusted funds from operations	2,924	2,869	2,738	3,336
Scope-adjusted debt in EUR m	**2018**	**2019**	**2020E**	**2021E**
Reported gross financial debt	4,640	6,348	9,591	14,216
less: hybrid bonds	-	-	-	-
less: cash and cash equivalents	-2,503	-3,708	-3,135	-2,764
add: cash not accessible	2,503	3,708	3,135	2,764
add: pension adjustment	-	-	-	-
add: operating lease obligations	2,433	3,314	3,437	3,566
Other	-	-	-	-
Scope-adjusted debt	7,073	9,662	13,028	17,782

Business risk profile

Blended industry risk of B+

Illés Holding's industry risk is high. It is mainly exposed to the road transportation sector, which we consider to have medium cyclicality, low entry barriers and medium to low substitution risks. The blended industry risk of the group is B+ based on the weights of each sector as per its EBITDA contribution to the consolidated group (we assigned an 85% weighting to the road logistics industry, assessed at B).

Small market player on a highly fragmented market

The road transportation industry is a highly fragmented market with around 40,000 players in Hungary, most of them SMEs. The group operates in a niche market, transporting specialty cargo, which requires dedicated equipment and special licenses and documentation. Although this leads to decreased immediate competition, it simultaneously exposes the business to the underlying industries' performance.

In 2020, the group's road division (together with its subcontractors) delivered 4.8m tons of goods, which implies a market share in Hungary of around 2.6%. In addition, the majority share acquisition of rail cargo transporter MMV Zrt. in 2016 means that the group offers intermodal transportation. We estimate that the subsidiary has a market share in Hungary of about 2.8%.

In total, Illés Holding owns around 500 road transport vehicles and uses 18 engines with 200 wagons. This makes its size moderate compared to immediate competitors.

Moderate diversification

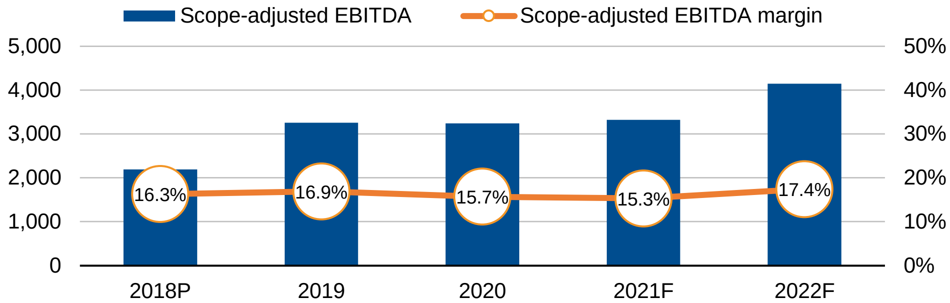
Illés Holding has moderate diversification in its segments and in terms of geographical coverage. However, the main divisions (both the road and rail divisions) have high customer concentration, with the top 10 customers accounting for around 90% of revenues. The high concentration is somewhat mitigated by the long-term relationships and contracts Illés Holding has with its partners; however, the loss of a single customer may significantly impact the group's performance. We also see high supplier concentration: the top 10 account for 75% and 90% of material costs, for road and rail respectively. Of these, 40% of the rail division's costs are related to the utilisation of the railway infrastructure.

Comparatively strong operating profitability with medium to high volatility

In general, the road logistics business has slim margins and is burdened by intense competition. This is driven by business models based on commissions or forwarding fees and order-by-order contracts. Illés Holding's transportation of speciality cargo has allowed it to establish a slightly different business model. The group has long-term contracts with its main customers and owns a sizeable vehicle fleet with dedicated trailers for different types of cargo. Due to the seasonality of the business, Illés Holding only owns/leases vehicles that have a high enough utilisation rate and manages peak orders through subcontractors. EBITDA volatility is high, since most of the group's transportation division customers operate in highly cyclical industries.

We expect the solar park investment to increase profitability and provide much needed stability from 2022 on. We expect Scope-adjusted EBITDA to increase to above 17%.

Figure 1: Scope-adjusted EBITDA and margin



Source: Scope estimates

Financial risk profile

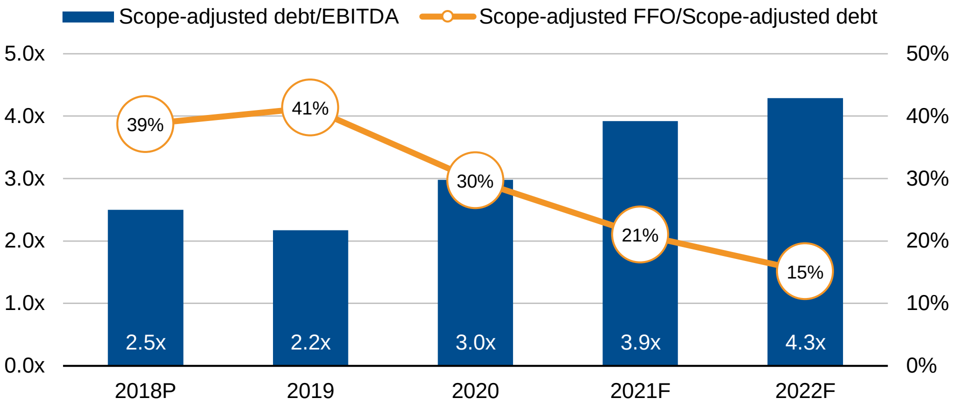
Financial risk profile assessed at B+

The group has a large amount of outstanding long-term debt (utilising both financial and operating leases to finance its vehicle fleet in an efficient way). The largest outstanding loan at present is the investment loan issued in 2021 for the construction of the solar power plant. This has already caused Illés Holding's historically investment grade leverage to deteriorate. We assume that the NKP bond of HUF 6bn will be issued in 2022, which will weaken leverage further. We expect leverage of 3.5x to 5x in the following years.

Interest cover has historically been above 10x. However, due to the additional debt issuances in 2021 and 2022 we expect this metric to drop to 5.7x and 5.2x respectively. Cash flow cover has been volatile and negative historically. We expect it to remain negative for 2021 and 2022 as the bond proceeds are used for investments and business expansion.

We see liquidity as adequate. However, we forecast that it will be negative in the next two years, mainly due to negative cash cover. The group has significant outstanding short-term obligations to pay because the amortisation of most of its debts and other financial obligations (i.e. leases) is linear.

Figure 2: Leverage credit metrics



Source: Scope estimates

Long-term debt rating

We have assigned a B+ debt rating to Illés Holding's senior unsecured debt. The instrument rating is based on a hypothetical liquidation scenario in 2023, in which we computed an 'above average' recovery for senior unsecured debt holders. This is based on our assumptions of attainable liquidation values. No notching was applied to the issuer rating.

Illés Holding plans to issue a HUF 6bn senior unsecured corporate bond under the MNB Bond Funding for Growth Scheme. The bond is expected to have a 10-year tenor with amortisation beginning in the fifth year and a 50% bullet repayment at maturity. West-Bridge Kft and Transolut Magyarorszag Kft, two of the issuer's subsidiaries, will act as guarantors. The bond coupon will be fixed and payable on an annual basis. Proceeds are earmarked for the acquisition of vehicles.

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