B+N Referencia Zrt.
Hungary, Business Services

SCOPE B+ Positive

Corporate profile

B+N Referencia Zrt (B+N) is a facility management company operating in Hungary. It provides cleaning services, technical services, document management, uniform management, textile management, laundry services, winter works, and horticulture services.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2019**	**2020F**	**2021F**
Scope-adjusted EBITDA interest cover (x)	>10x	>10x	>10x	>10x
Scope-adjusted debt (SaD)/EBITDA (x)	0.9x	0.2x	0.3x	2.3x
Scope-adjusted FFO/SaD (%)	98%	570%	323%	37%
FOCF/SaD (%)	61%	427%	154%	29%
Liquidity	>100%	>100%	>100%	>100%

Rating rationale

Scope Ratings has today affirmed the B+ issuer rating on Hungary-based B+N Referencia Zrt and raised the outlook from Stable to Positive. The senior unsecured debt rating has been affirmed at B+.

The rating action reflects Scope's view on B+N's robust financial risk profile, in light of recurring revenue from procured contracts, and takes into account possible acquisitions planned in the next years.

Outlook

The Outlook is positive and reflects Scope's expectation of a resilient EBITDA margin and limited pressure on credit metrics from projected growth, leading to a forecasted Scope-adjusted debt/EBITDA of 1-3x for the next few years.

A positive rating action could be triggered by one or a combination of those factors: improvements in the business risk profile, the development of a more creditor-friendly financial policy, removal of the uncertainty regarding execution of the acquisition and its financing; and a SaD/EBITDA below 1x on a sustained basis.

A negative rating action could be prompted by a deterioration in credit metrics stemming from a loss of major contracts exemplified by a Scope-adjusted debt/EBITDA of above 3x for a prolonged period.

Ratings and Outlook

Corporate rating	B+/Positive
Senior unsecured rating	B+

Analyst

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Related Methodology

Corporate Rating Methodology

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Bloomberg: SCOP

Rating drivers

Positive rating drivers	Negative rating drivers
• Procurement contracts won (2-3 years in duration), allowing a good standing in the facility management market • Strong growth through the years and acquired expertise • Stable profitability; flexibility upon a downturn or when major contracts end • Comparatively strong financial risk profile	• Facility management market's high fragmentation and low entry barriers • Small company scale • Weak diversification and concentration on domestic market and government-related institutions • Aggressive financial policy • Key person risk

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improved business risk profile • More creditor-friendly financial policy • SaD/EBITDA below 1x on a sustained basis	• SaD/EBITDA of above 3x on a sustained basis due to loss of major contracts

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Scope-adjusted EBITDA interest cover (x)	>10x	>10x	>10x	7.0x
SaD/EBITDA	0.9x	0.2x	0.3x	2.3x
Scope-adjusted FFO/SaD	98%	570%	323%	37%
FOCF/SaD	61%	427%	154%	29%
Scope-adjusted EBITDA in HUF '000s	**2018**	**2019**	**2020F**	**2021F**
EBITDA	3,234,523	5,214,304	7,802,833	8,973,258
Operating lease payments in respective year	0	0	0	0
Restructuring costs	0	0	0	0
Scope-adjusted EBITDA	**3,234,523**	**5,214,304**	**7,802,833**	**8,973,258**
Scope-adjusted funds from operations in HUF '000s	**2018**	**2019**	**2020F**	**2021F**
EBITDA	3,234,523	5,214,304	7,802,833	8,973,258
less: (net) cash interest as per cash flow statement	(21,493)	(240,619)	(275,944)	(620,000)
less: cash tax paid as per cash flow statement	(259,203)	(481,664)	(597,292)	(666,857)
add: dividends received	0	0	0	0
Scope-adjusted funds from operations	**2,953,827**	**4,973,259**	**6,929,597**	**7,686,401**
Scope-adjusted debt in HUF '000s	**2018**	**2018**	**2020F**	**2021F**
Reported gross financial debt	3,484,353	10,010,108	11,110,00	21,110,000
less: cash and cash equivalents	(455,054)	(9,137928,)	(8,962,766)	(200,671)
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other adjustments	0	0	0	0
Scope-adjusted debt	**3,029,299**	**876,180**	**2,147,234**	**20,909,329**

Business risk profile

Small player in a fragmented market

The business risk profile is mainly constrained by the company's small scale, which exposes it to the risk of changes in macroeconomic conditions or of a loss of major contracts. The company grew strongly during 2016-19. This was driven by successful tenders for major contracts and by smaller acquisitions. However, such a pace could not have been maintained if Hungarian economic growth was slower. The outsourcing of public sector projects through public-private partnerships has allowed B+N and other players to increase their footprint. Still, facility management services companies in Hungary have tapped less than 35% of the addressable market in contrast to above 50% in eastern Europe. However, we do not expect B+N to reach a size that would enable it to withstand stiff competition in its core market. Such size requires considerable investment in labour and resources in order to create technology-driven services and meet global standards regarding quality, safety, health and the environment. The facility management market is characterised by very low entry barriers, owing to easily replicable services, and a dependence on labour, which is short in supply in Hungary. However, the company's multi-year service contracts with major clients are credit-positive, providing good cash flow visibility over the next 2-3 years.

The coronavirus crisis increased the demand for B+N cleaning services which will contribute to higher sales in 2020 and more generated cash flow to be invested in organic or inorganic expansion.

Limited diversification bears the risk of a sharp revenue decline if demand weakens

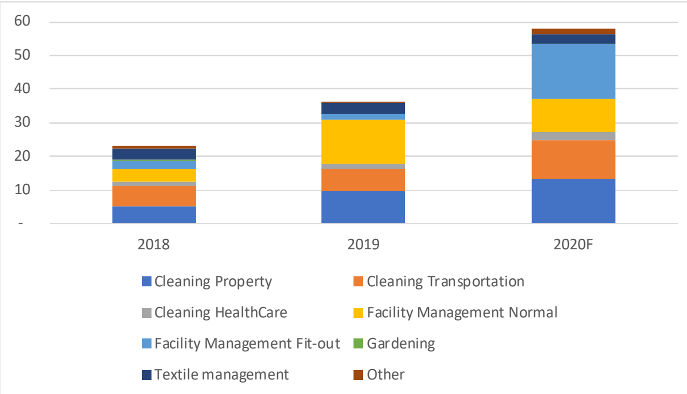
B+N's diversification is weakened by its domestic operations and primary reliance on public-sector procurement contracts. That said, concentration risks stemming from major contracts within B+N's overall cash flow pattern are significant. We acknowledge the company's willingness to diversify into multiple services. Along with the cleaning segment, there is an increasing revenue proportion from segments such as facility management Commercial clients and corporates are potential areas of growth, in our view. But for now, corporate clients account for only 7%.

Stable profitability

The rating is also limited by relatively low but stable profitability, at 11-13% over the past few years. The company risks losing market share if competitors initiate a price war that hinders the company from renewing contracts.

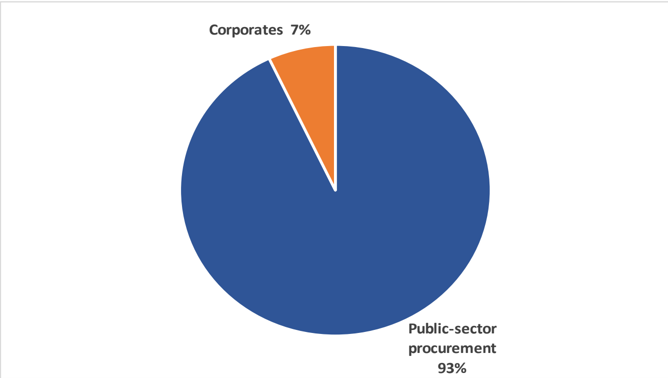
For the time being, the won contracts and increasing demand for cleaning post Covid-19 provide a visibility about profitability for the next two years.

Figure 1: Top contracts revenue split by activity in HUF bn



Sources: B+N, Scope

Figure 2: Customers split



Sources: B+N, Scope

Financial risk profile

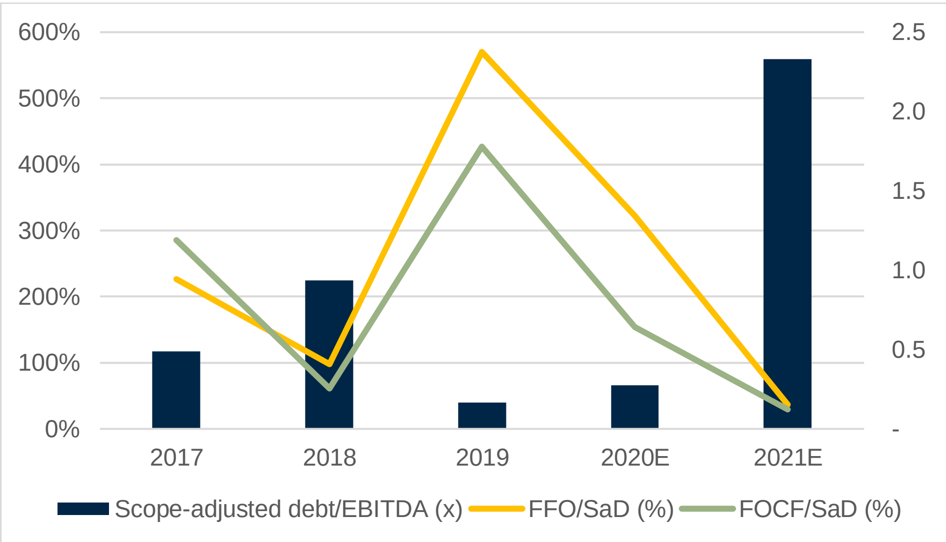
Solid credit metrics

B+N's financial risk profile supports the overall rating. While leverage (SaD/EBITDA) is expected to rise in case of a major acquisition, it will likely remain below 3x going forward. Half of the bond proceeds were used for the refinancing of short-term debt and some investments. While the rest will be used in 2020 for bolt on acquisitions. Besides, we expect the debt protection in terms of EBITDA/interest coverage to remain very comfortable at above 7x.

B+N's liquidity profile is neutral for the rating. Following the refinancing of existing short term loans with some of the proceeds of the planned bond, short-term debt is HUF 10m in 2020. This can be amply covered by internal cash sources and the bond proceeds.

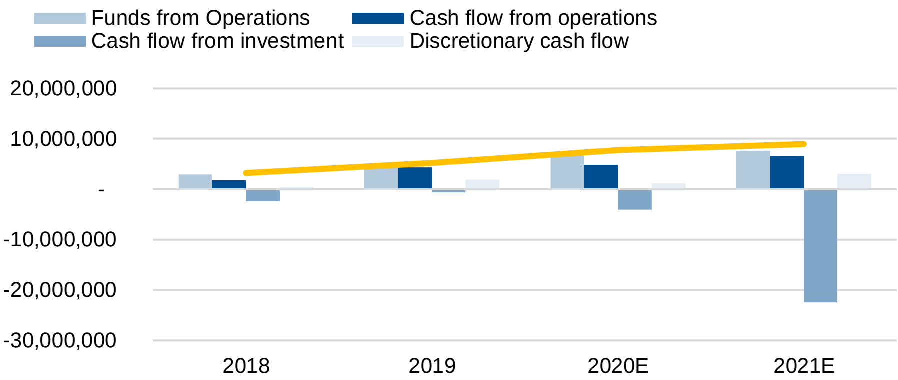
The rating also incorporates our negative stance on the company's financial policy (ESG factor). B+N has a dynamic growth strategy as regards potential M&A. Moreover, there is key person risk (ESG factor) regarding the CEO, whom we regard as instrumental not only for contract renewals and success in tenders but also for dividend policy.B+N spending is mainly for business acquisitions. Operations require no maintenance and the company has opted for inorganic expansion. We highlight the execution risk attached to multiple acquisitions.

Figure 3: Development in Scope-adjusted debt ratios



Sources: B+N, Scope estimates

Figure 4: Cash flows (HUF '000s)



Sources: B+N, Scope estimates

Senior unsecured debt: B+

Scope has affirmed the rating of the senior unsecured debt category at B+. The recovery assessment is based on a hypothetical default scenario in 2022, including the assumption that additional bank debt required for a potential large acquisition is ranked senior secured. Scope's recovery analysis indicates an 'above average recovery' for senior unsecured debt. While this would qualify for a uplift of the senior unsecured debt rating of one notch in relation to the issuer rating, Scope decided to equalize both ratings due to the uncertainty with regard to a potential acquisition and its financing implications.

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