B+N Referencia Zrt.
Hungary, Business Services

BB NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	63.6x	27.9x	9.4x	12.2x
Scope-adjusted debt/EBITDA	1.1x	1.8x	2.6x	1.9x
Scope-adjusted funds from operations/debt	80%	43%	29%	39%
Scope-adjusted free operating cash flow/debt	46%	-15%	7%	15%

Rating rationale

B+N's business risk profile (assessed as BB-) remains the main constraint of the issuer rating, as the group's good operating profitability and market positioning are hindered by its weak diversification. B+N has grown significantly in past years, partly due to its acquisitions in CEE which has lessen the group's geographic concentration, however in 2022 around 75% of revenues are still generated in Hungary. The high customer concentration and public contract dependency are also a negative impact which further enhance the key person risk (ESG factor).

In 2023E B+N's financial risk profile (assessed as BBB+) is forecasted to deteriorate, however remains supported by strong interest coverage and leverage. The assessment is hindered by weak and historically volatile cash flow cover, together with inadequate liquidity. Although year-end liquidity is seen as adequate, intra-year cash levels are volatile due to large swings in working capital (exemplified by HUF 22.4bn cash in 2022 year-end versus HUF 5.6bn in H1 2023).

The negative rating adjustment of one notch reflects concerns regarding key person risk and limited transparency on reporting, dividend policy and financial policy (ESG factor).

Outlook and rating-change drivers

The Outlook for B+N is Negative and incorporates our view of leverage measured by Scope-adjusted debt/EBITDA ratio deteriorating to above 2.5x in 2023, a deteriorated cash flow cover and its continued liquidity concerns given the group's many government-related customers.

A downgrade could occur if the Scope-adjusted debt/EBITDA ratio fails to recover to below 2.5x. This may be caused by an increase in debt (e.g. working capital financing).

A positive rating action could be warranted as follows: i) a return to a Stable Outlook would require the recovery of leverage to below 2.5x on a sustained basis; or ii) further ratings upside would require adequate liquidity or the removal of the negative notch assigned for the key person risk and lack of transparency, however this is currently deemed as remote.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
17 Jan 2024	Outlook change	BB/Negative
20 Jan 2023	Upgrade	BB/Stable
18 Oct 2022	Placement under Review for a developing outcome	BB-/Under review

Ratings & Outlook

Issuer	BB/Negative
Senior unsecured debt	BB

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Related Methodologies and Related Research

General Corporate Rating Methodology;
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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong growth: has won procurement contracts lasting 2-3 years, which give B+N a good standing in the facility management market • Market leader in Hungary, with top market positions in several other CEE countries • Relatively stable profitability of cleaning division provides flexibility in case of a downturn or when major contracts end • Robust financial risk profile	• Facility management market is highly fragmented and has low entry barriers • Weak diversification and concentration on Hungarian market with dependence on government-related entities • Limited transparency regarding financial policy (ESG factor) • Key person risk (ESG factor)

Positive rating-change drivers	Negative rating-change drivers
• Return to stable if Scope-adjusted debt/EBITDA recovers to below 2.5x on a sustained basis • Upgrade if liquidity turns adequate or if the negative notch assigned for the key person risk and the lack of transparency is removed (however this is seen as remote at the moment)	• Scope-adjusted debt/EBITDA above 2.5x on a sustained basis, e.g. from working capital financing

Corporate profile

Founded in 1993, B+N Referencia Zrt. (B+N) is headquartered in Tardona, Hungary, and operates as a facility management group in Hungary and in CEE. The group's service portfolio includes the following divisions: Cleaning and hygiene, Healthcare cleaning, Facility management, Textile management and protective equipment, Gardening, landscaping and forestry and Fit-out. The group acquired the CEE division of ISS Facility Service in 2021, becoming a major market player in the region.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	47.6x	63.6x	27.9x	9.4x	12.2x	14.5x
Scope-adjusted debt/EBITDA	0.8x	1.1x	1.8x	2.6x	1.9x	1.7x
Scope-adjusted funds from operations/debt	116%	80%	43%	29%	39%	45%
Scope-adjusted free operating cash flow/debt	194%	46%	-15%	7%	15%	27%
Scope-adjusted EBITDA in HUF m						
EBITDA	16,572	28,842	20,439	14,747	19,498	21,409
Scope-adjusted EBITDA	**16,572**	**28,842**	**20,439**	**14,747**	**19,498**	**21,409**
Funds from operations in HUF m						
Scope-adjusted EBITDA	16,572	28,842	20,439	14,747	19,498	21,409
less: (net) cash interest paid	-348	-453	-732	-1,575	-1,602	-1,481
less: cash tax paid per cash flow statement	-769	-2,181	-4,156	-2,061	-3,123	-3,558
Change in provisions	-	-8	42	-	-	-
Funds from operations (FFO)	**15,455**	**26,200**	**15,593**	**11,112**	**14,772**	**16,370**
Free operating cash flow in HUF m						
Funds from operations	15,455	26,200	15,593	11,112	14,772	16,370
Change in working capital	13,805	-7,421	-15,131	-3,343	-3,655	-790
less: capital expenditure (net)	-2,723	-2,005	-3,398	-2,500	-2,600	-2,700
less: lease amortisation	-697	-1,832	-2,496	-2,530	-2,803	-2,995
Free operating cash flow (FOCF)	**25,840**	**14,942**	**-5,432**	**2,739**	**5,714**	**9,885**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	-348	-453	-732	-1,575	-1,602	-1,481
Net cash interest paid	**-348**	**-453**	**-732**	**-1,575**	**-1,602**	**-1,481**
Scope-adjusted debt in HUF m						
Reported gross financial debt	13,336	32,588	35,953	38,088	38,016	36,433
less: cash and cash equivalents	-25,723	-40,334	-22,383	-13,494	-12,252	-14,274
add: non-accessible cash	25,723	40,334	22,383	13,494	12,252	14,274
Scope-adjusted debt (SaD)	**13,336**	**32,588**	**35,953**	**38,088**	**38,016**	**36,433**

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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)

Negative supplementary rating drivers

B+N's financial policy (ESG factor) is a negative rating driver due to the group's lack of transparency regarding dividend policy. Moreover, the negative rating driver also incorporates 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 the aforementioned dividend policy.

Regarding labour management, the group's Polish subsidiary employs disabled workers for which both the employer and its clients receive benefits. Additionally, B+N Referencia Zrt. contracts the services of underprivileged minorities as subcontractors.

[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: BB-

Industry risk profile: BBB

B+N operates in the business services sector as a facility management service provider. The industry risk profile of this subsector is BBB as it is characterised by medium cyclicality, medium market entry barriers and medium substitution risk.

B+N's business risk profile, assessed as BB-, has remained unchanged and continues to constrain its issuer rating.

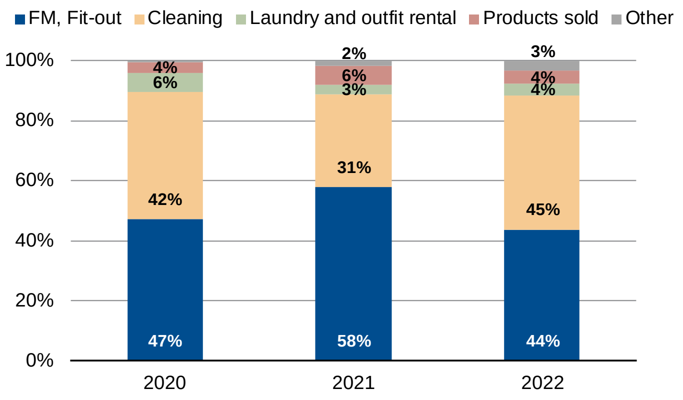
B+N grew strongly between 2016-2022, driven by multiple factors: i) successful tenders for major contracts, ii) small acquisitions and iii) increased demand for the group's services during the Covid pandemic. The past years' trend to outsource public sector projects to public-private partnerships has also allowed B+N (and other Hungarian market players) to increase their footprint. The revenue's positive trend is forecasted to temporarily stagnate in 2023 as the loss of business in the fit-out division cancels out the growth of the remaining business lines.

The facility management market is characterised by low entry barriers, owing to easily replicable services, and a dependence on labour. Although labour is in short supply in Hungary, B+N has distinguished itself by ensuring reliability and the ability to meet increasing demand, even during the years of the pandemic.

In addition to being the market leader in Hungary, following the acquisition of the CEE subsidiaries of ISS in 2021 and further acquisitions in the region in 2022 and 2023, the group has also gained significant market position in CEE. Such acquisitions have also reduced B+N's concentration on Hungary, improving its geographical diversification and reducing to some extent its dependence on Hungarian state procurement contracts. However, the large exposure to the Hungarian market and high customer concentration remains, exposing B+N to the risk of changes in macroeconomic conditions or a loss of major contracts. This is partially mitigated by the company's multi-year service contracts with major clients. The acquisitions have also broadened the company's service portfolio which allows B+N to participate in tenders for clients that prefer to contract fully integrated facility management providers. However, despite the group's broad service portfolio, all of them belong to the broader facility management services.

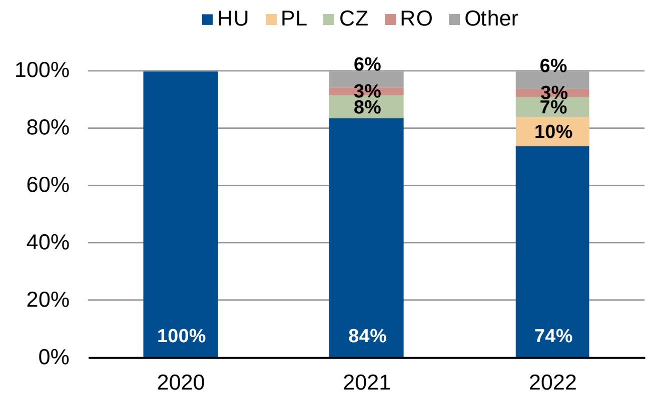
The high inflationary environment which was already present in 2022 considerably impacted B+N's operating profitability in 2023. The margin of such long-term fixed price contracts which have been agreed upon in previous years continuously deteriorated, leading to an expected stressed Scope-adjusted EBITDA margin of 8% in 2023. This trend was further intensified by the decrease in the fit-out division (of which many mandates were previously agreed-upon fixed price contracts) and a significant client lengthening its contract with unfavourable pricing conditions by one year. Going forward Scope expects that the unfavourable market conditions will continue to impact B+N's operating profitability, however a gradual improvement from 2023's Scope-adjusted EBITDA of 8% is expected, to 9% and 9.5% in 2024 and 2025, respectively. Recovery is partly driven by the maturing long-term contracts which allow B+N to renegotiate its pricing.

Figure 1: Revenue breakdown by activity



Sources: B+N, Scope

Figure 2: Revenue breakdown by country



Sources: B+N, Scope

Financial risk profile: BBB+

B+N's robust financial risk profile continues to be the strongest rating driver of the issuer rating.

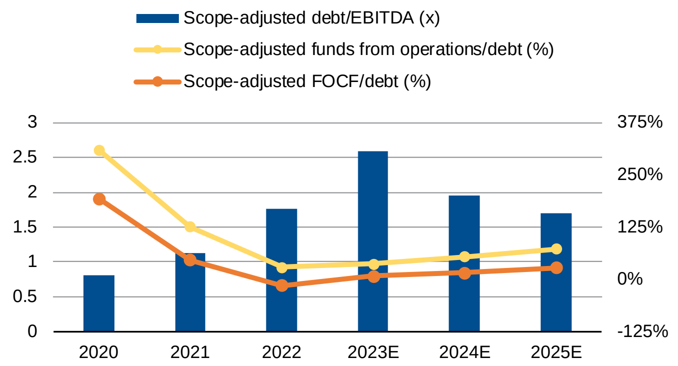
B+N's financial risk profile (assessed as BBB+) is expected to deteriorate in 2023E in line with its Scope-adjusted EBITDA margin. As operating profitability is expected to start recovering in 2024E, the credit metrics are forecasted improve as exemplified by Scope-adjusted debt/EBITDA increasing to below 2x from around 2.6x in 2023E. The financial risk profile continues to be supported by the group's strong interest coverage (measured by Scope-adjusted EBITDA/interest cover) which is forecasted to be above 10x by 2024E (in 2023E the credit metric drops to around 9x) as majority of the debt portfolio has favourable, subsidised fixed interest rates.

Deteriorated cash flow coverage and inadequate liquidity

The main constraints of the financial risk profile are the relatively weak cash flow cover (measured by Scope-adjusted free operating cash flow/debt) together with the inadequate liquidity of B+N. The stressed cash generation of B+N paired with the historically volatile working capital changes negatively impact its cash flow coverage. In 2023E the cash flow cover is forecasted to improve significantly from its 2022 level of -15% and will trend between 7% and 27%. The large swings in working capital also effect B+N's liquidity. Although year-end liquidity is seen as adequate, with sufficient internal and external funds to cover short-term debt obligations, the intra-year liquidity was at times inadequate (cash and cash equivalent levels in 2022 year-end were HUF 22.4bn versus HUF 5.6bn in H1 2023). In 2023 B+N also utilized parental support to temporarily boost its cash levels (ESG factor). Scope notes that the bonds under the Bond Funding for Growth Scheme start amortising in 2024 and 2026 with HUF 1.65bn and HUF 2.5bn, respectively.

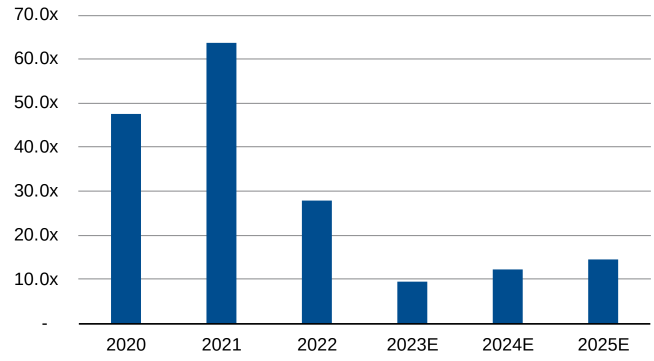
In 2023 B+N acquired two smaller targets (Tespranet Services and Tespranet Landscaping s.r.o.) in the Czech Republic and Sagad s.r.l. in Italy, partly financed through debt (~HUF 1.7bn).

Figure 3: Development of key credit metrics



Sources: B+N, Scope (estimates)

Figure 4: Interest expense



Sources: B+N, Scope (estimates)

Balance in HUF m	2023E	2024E	2025E
Unrestricted cash (t-1)	22,383	13,494	12,252
Free operating cash flow	2,739	5,714	9,885
Short-term debt (t-1)	3,789	5,919	6,316
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: -1 notches

B+N's financial policy is a negative rating driver (ESG factor) due to the limited transparency on B+N's reporting and dividend policy, exemplified by the late publications of the audited 2021 financial statements and dividends categorized as other expenses. 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.

Long-term debt rating

Senior unsecured debt rating: BB

We have affirmed B+N's BB senior unsecured debt rating based on the issuer rating and an 'above average' recovery expectation for this debt category. Although the 'above average' recovery allows for a one-notch uplift compared to the issuer rating, no uplift is made due to the negatively assessed financial policy of B+N and the risk related to the integration of its newly acquired subsidiaries.

The HUF 10bn senior unsecured bond (ISIN: HU0000359419) was issued in December 2019 and the HUF 13.2bn senior unsecured bond (ISIN: HU0000360623) in June 2021, both through the Hungarian central bank's Bond Funding for Growth Scheme.

Bond proceeds were used for refinancing loans, financing acquisitions and investment capex. Both bonds have tenors of 10 years and fixed coupon rates of 2.9% and 3.5%, respectively. The bond repayment schedule for HU0000359419: in four equal instalments with 25% of the face value payable yearly starting in the seventh year. The bond repayment schedule for HU0000360623: in eight equal instalments with 12.5% of the face value payable yearly starting in the third year. The bonds start amortisation in 2026 and 2024, respectively.

We note that both senior unsecured bonds have an accelerated repayment clause if the debt rating fell below B+. The clause requires repayment of the nominal amount (HUF 10bn and HUF 13.2bn) in case of a rating deterioration (two-year cure period for a B/B- rating; repayment within 5 business days after the bond rating falls below B-, which could have default implications). Bond covenants in addition to the rating deterioration covenant include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, change of control, dividend payment and asset covenants.

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