4iG Nyrt
Hungary Telecommunication services

SCOPE **BB-** Stable

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	>20	5.7x	2.8x	2.7x
Scope-adjusted debt/EBITDA	Net cash	35.4x	6.9x	5.6x
Scope-adjusted funds from operations/debt	Net cash	2%	10%	12%
Scope-adjusted free operating cash flow/debt	Net cash	3%	-2%	5%

Rating rationale

We have upgraded 4iG's issuer rating to BB-/Stable from B+ under review for a possible upgrade.

The business risk profile (assessed at BBB-) is supported by the gains in market share following the acquisition of Vodafone Hungary, both in mobile and fixed broadband. The acquisition has little impact on the company's degree of diversification. However, profitability is likely to improve due to Vodafone Hungary's higher margins, the expiry of Hungary's temporary telecommunications tax and progressive merger-related cost savings.

The company's financial risk profile (assessed at B+) is helped by a slightly improved future leverage as measured by Scope-adjusted debt/EBITDA forecasted at around 4.5x in 2024. The company is benefitting from equity financing from state-owned holding company Corvinus for the Vodafone Hungary acquisition, supporting interest coverage at more than 3x. 4iG has no significant debt maturing in the next three years as maturities, including recent issuance, are spread over an extended period time. Scope deems liquidity to be adequate in the short term.

As regards supplementary rating drivers, we assess 4iG's financial policy as a negative rating driver (by one notch): with an originally limited exposure to telecoms and very large, mainly debt-funded acquisitions, it leads to increased execution and integration risks.

Outlook and rating-change drivers

The Outlook is Stable and reflects: 1) the acquisition of Vodafone Hungary for a Scope estimated amount of up to HUF 715bn in January 2023; 2) new loans at subsidiary level of Scope estimated HUF 340bn and 3) expected Scope-adjusted debt/EBITDA of below 5x by 2024.

A positive rating action could result from an improved financial policy exemplified by stabilisation of the group structure with no new material M&A activity, the successful integration of the acquired companies indicated by improved operational performance or Scope-adjusted debt/EBITDA reaching significantly below 4x.

A negative rating action could be triggered by the issuer's inability to further deleverage with Scope-adjusted debt/EBITDA remaining above 5x on a sustained basis.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
06 Jan 2023	Upgrade	BB-/Stable
09 Nov 2022	Placement under review	B+ under review for a possible upgrade
02 Dec 2021	Downgrade	B+/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodology

General Corporate Rating Methodology; July 2022

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Number two mobile operator in Hungary and market leader in fixed broadband in Hungary • Market leader in mobile services in Albania and Montenegro, number two position in fixed broadband in Albania • Low cyclicity of telecoms • Improved telecom revenue diversification and wider customer base, with Hungary remaining the core market (around 85% of revenue) • Solid EBITDA margin, above 30%	• Weak credit metrics as mostly debt-financed acquisitions • Heightened execution and integration risks related to recent acquisitions

Positive rating-change drivers	Negative rating-change drivers
• Stabilisation of the group structure with no new material M&A; successful integration of the acquired companies • Scope-adjusted debt/EBITDA significantly below 4x	• Inability to deleverage with Scope-adjusted debt/EBITDA remaining over 5x

Corporate profile

4iG has been for several years one of the largest players in Hungary's fragmented IT market and has recently engaged in strong M&A-driven growth, which transformed the group into a telecom-focused group, as telecoms now represent about 70% of group revenue. All acquired telecom businesses are now regrouped under the 76% subsidiary Antenna Hungaria (of which the Hungarian state owns 23%), both in Hungary (DIGI, Invitech) and abroad (One in Albania and Montenegro). The joint acquisition of Vodafone Hungary by Antenna Hungary and state-owned holding Corvinus will more than double 4iG's telecom revenue. The company is listed on the premium segment of the Budapest Stock Exchange, with Gellért Jászai as a controlling shareholder.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	>20	>20	5.7x	2.8x	2.7x	3.3x
Scope-adjusted debt/EBITDA	Net cash	Net cash	35.4x	6.9x	5.6x	4.6x
Scope-adjusted funds from operations/debt	Net cash	Net cash	2%	10%	12%	15%
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	3%	-2%	5%	3%
Scope-adjusted EBITDA in HUF m						
EBITDA	4,076	5,048	12,096	75,498	172,016	201,165
Operating lease payments	0	0	0	0	0	0
Other items	0	0	0	4,000		0
Scope-adjusted EBITDA	**4,076**	**5,048**	**12,096**	**79,498**	**172,016**	**201,165**
Funds from operations in HUF m						
Scope-adjusted EBITDA	4,076	5,048	12,096	79,498	172,016	201,165
less: (net) cash interest paid	-12	-41	-2,109	-28,377	-62,953	-60,380
less: cash tax paid per cash flow statement	-415	-773	-1,426	2,817	3,853	-1,057
add: dividends from associates	0	0	0	0	0	0
Change in provisions	0	0	0	0	0	0
Funds from operations	**3,649**	**4,234**	**8,561**	**53,938**	**112,916**	**139,726**
Free operating cash flow in HUF m						
Funds from operations	3,649	4,234	8,561	53,938	112,916	139,726
Change in working capital	3,161	-1,504	5,782	13,702	21,396	1,616
Non-operating cash flow	421	855	3,633	-33,415	0	2
less: capital expenditure (net)	-1,470	-1,229	-9,849	-39,900	-61,560	-93,160
less: lease amortisation	337	-162	3,502	-6,550	-23,550	-23,550
Free operating cash flow	**6,098**	**2,194**	**11,619**	**-12,225**	**49,202**	**24,634**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	12	41	2,109	28,377	62,953	60,380
add: interest component, operating leases	0	0	0	0	0	0
Change in other items	0	0	0	0	0	0
Net cash interest paid	**12**	**41**	**2,109**	**28,377**	**62,953**	**60,380**
Scope-adjusted debt in HUF m						
Reported gross financial debt	2,198	4,012	425,813	543,572	955,272	927,722
less: cash and cash equivalents	-6,237	-7,205	-266,530	-65,322	-72,474	-93,108
add: non-accessible cash	0	0	266,530	65,322	72,474	93,108
add: pension adjustment	0	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0	0
Other items	200	627	2,456	4,899	4,899	4,899
Scope-adjusted debt	**-3,839**	**-2,566**	**428,269**	**548,471**	**960,171**	**932,621**

Table of Content

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)

Recent growth in telecoms through debt-financed acquisitions

While Mr Jászai (51% controlling shareholder) plays a key role in the company, 4iG has appropriate governing bodies and an experienced management. The group has significantly expanded its management team following its recent growth. The recent growth in telecoms within the group's activities was achieved through acquisitions, mostly debt-financed, leading to significant execution and integration risks.

[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.

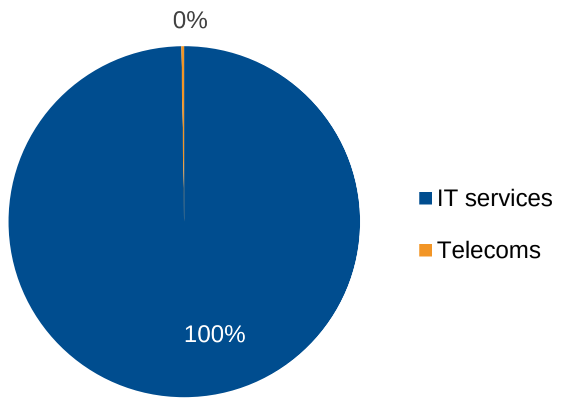
Business risk profile: BBB-

Industry risk profile: A

The industry risk profile for telecoms stands at A, based on low cyclicality (subscriptions are for a basic, necessary service), medium entry barriers (licences, network rollout), and medium-to-low substitution risk (over-the-top services).

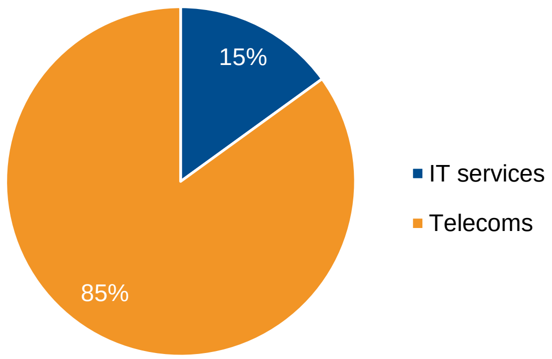
4iG's revenue mix has shifted significantly from being almost exclusively IT-focused in 2020 to mostly telecoms. The acquisition of Vodafone Hungary is only reinforcing this trend, as we expect IT services to represent about 15% of total revenue in 2023E.

Figure 1: 4iG group revenue by business (2020)



Source: 4iG

Figure 2: 4iG group revenue by business (2023E)



Sources: 4iG, Scope estimates

Numerous telecoms acquisitions

4iG has made the following telecoms acquisitions:

-June 2021: HDT, a Hungarian very small aperture Terminal service provider with a revenue of HUF 5bn;

-September 2021: Invitech, a Hungarian corporate telecom & IT service provider, with a revenue of HUF 25bn;

-December 2021: Telenor Montenegro, a mobile-only operator in Montenegro, with a revenue of HUF 15bn;

-January 2022: DIGI, a Hungarian fixed broadband provider, with a revenue of HUF 70bn;

-March 2022: ALBtelecom, an Albanian mobile (and fixed broadband) operator, with a revenue of HUF 20bn;

- March 2022: One Telecommunication, an Albanian mobile-only operator, with a revenue of HUF 25bn.

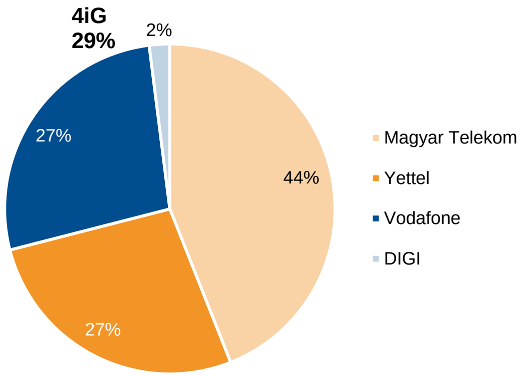
In April 2022, the state-owned national TV and radio broadcaster Antenna Hungaria (with a revenue of HUF 40bn) was taken over by 4iG, with the 4iG bringing all its telecom activities. 4iG now owns 77% of Antenna Hungaria (and the state owns 23%), which now own all telecom activities. In August 2022, 4iG announced that it would take control of Vodafone Hungary, a Hungarian mobile and fixed broadband provider with a revenue of about HUF 280bn, while state-owned holding Corvinus will acquire a minority share (49%). The deal closed in January 2023.

Number two on the Hungarian mobile market

Market leader in broadband in Hungary

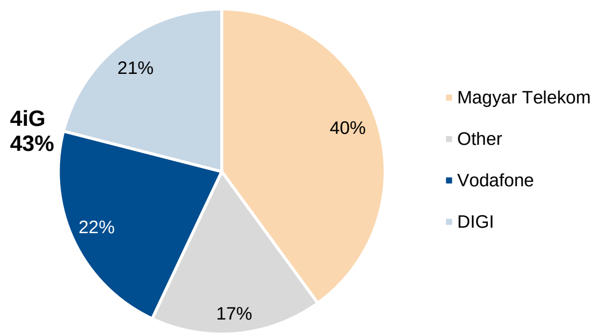
The acquisition of Vodafone Hungary provides 4iG with a substantial market share in the large domestic mobile market, where the DIGI's share was negligible; these two subsidiaries put together have about 3.2 million subscribers. In the smaller fixed broadband market, Vodafone Hungary's and DIGI's combined share (Vodafone having previously acquired UPC Hungary) makes 4iG the market leader with about 1.5 million subscribers, ahead of the incumbent Magyar Telekom, a rare situation in Europe. In the TV market, 4iG is now the market leader with about 47% of combined market share. With the Vodafone acquisition, the market share of 4iG within the Hungarian telecoms market is now good.

Figure 3: Mobile market shares in Hungary (% subscribers)



Sources: 4iG, Scope estimates

Figure 4: Fixed broadband market shares in Hungary (% subscribers)



Sources: 4iG, Scope estimates

In Albania, 4iG's business is complemented by two operators ALBtelecom and One Telecommunication, making it the clear market mobile leader, with a market share of about 60%, an exceptionally high level in Europe. In Montenegro, the subsidiary is the market leader in (in revenue) in a three-player mobile market.

Moderate diversification

Diversification remains moderate as the acquisition of Vodafone Hungary has increased service diversification (mobile) and widened the customer base, but this is somewhat compensated by the higher concentration of revenues in Hungary (about 85% in 2023).

Slightly improving profitability

Vodafone Hungary's higher average EBITDA margins will slightly improve 4iG's margins. In 2024, with the end of the special transitory telecommunication tax in Hungary and some early synergies (bundled offers, network and management sharing), we forecast EBITDA margins above 30% for 4iG, compared with 28% reported by 4iG group for the first nine months of 2022.

Financial risk profile: B+

Our base case assumes i) a successful acquisition of Vodafone Hungary by 4iG's subsidiary and state-owned holding Corvinus, with a valuation of up to HUF 715bn; ii) about HUF 340bn of new loans taken out by 4iG subsidiary level and iii) revenue growth, partly driven by price increases and improving margins.

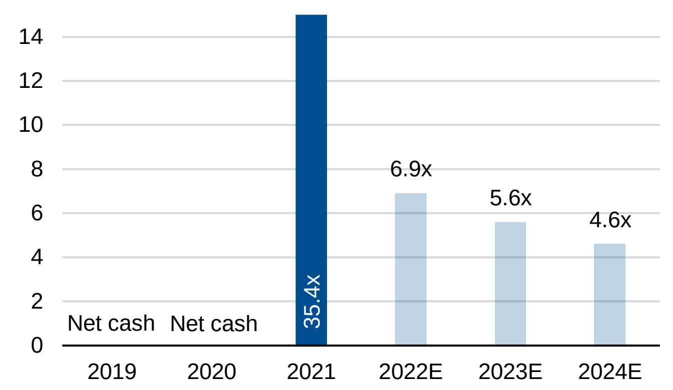
No cash netting

We do not include cash and cash equivalent in our Scope-adjusted debt calculation, as due to the size and complexity of transactions as well as the pledges granted for the new loans, cash and cash equivalent might not be permanent and accessible.

Scope-adjusted debt/EBITDA trending to 4.5x

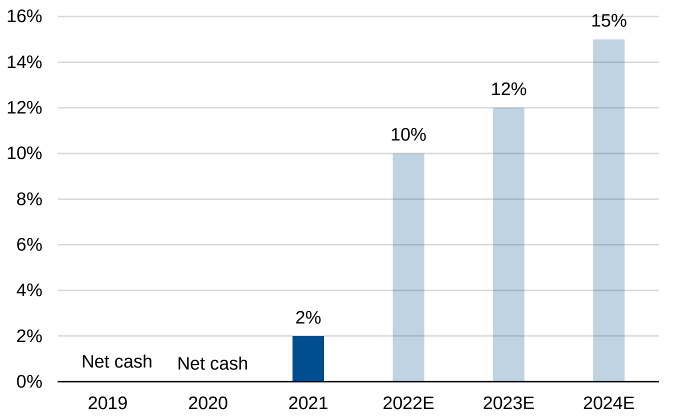
Leverage has been partly distorted by the fact that not all newly acquired subsidiaries were consolidated over 12 months Following the acquisition of Vodafone Hungary, we expect that in 2024, Scope-adjusted debt/EBITDA should trend toward 4.5x, helped by synergies starting to show and the end of the special transitory telecommunication tax in Hungary. Similarly, we expect Scope-adjusted funds from operations/debt to be around 15% in 2024.

Figure 5: 4iG group Scope-adjusted debt/EBITDA (x)



Sources: 4iG, Scope estimates

Figure 6: 4iG group Scope-adjusted funds from operations/debt (%)

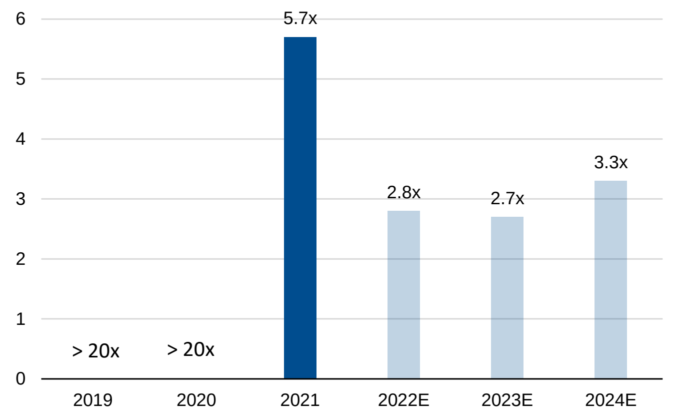


Sources: 4iG, Scope estimates

EBITDA/interest cover trending toward 3x

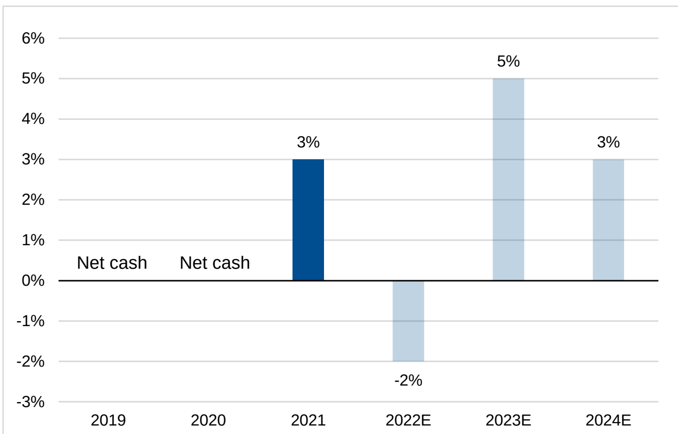
Following the acquisition of Vodafone Hungary, the average cost of debt for the group will increase slightly (with new debt bearing interest at around 9%), as the average bond interest rate was around 6%, but interest cover will improve progressively toward 3x with the expected EBITDA improvement, driven by synergies starting to show up and the end of the special transitory telecommunication tax in Hungary

Figure 7: Scope-adjusted EBITDA/interest cover (x)



Sources: 4iG, Scope estimates

Figure 8: Scope-adjusted FOCF/debt (%)



Sources: 4iG, Scope estimates

Scope-adjusted FOCF/debt expected to remain below or at 5%

We expect Scope-adjusted FOCF/EBITDA to remain weak in the coming years as the group will make significant investments to integrate all acquired telecom subsidiaries, in particular IT systems. As a result, we expect Scope-adjusted FOCF/debt to remain below 5% in the forecasting period. This might be compensated with the one-off disposal of some redundant assets in 2023 following the acquisition of Vodafone.

Adequate liquidity

Liquidity is adequate in the short term. Nevertheless, it could become an issue, e.g. in the event of sharp working capital swings, large capex or if approaching debt maturities were not refinanced. For 2023, we expect short-term financial debt to be more than 2x covered by a combination of available cash and cash equivalents as well as positive expected free operating cash flow.

Balance in HUF m	2022E	2023E	2024E
Unrestricted cash (t-1)	266,530	65,322	72,474
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	-12,225	49,202	24,634
Short-term debt (t-1)	0	39,000	4,000
Coverage	**NM**	**>200%**	**>200%**

Supplementary rating drivers: -1 notch

Credit-negative financial policy

We note the strong involvement of the state into 4iG via the provision of equity, loans and guarantees. As regards supplementary rating drivers, we assess 4iG's financial policy as a negative rating driver. This is due to its very large, mainly debt-funded acquisitions and originally limited exposure to telecom services, leading to heightened execution and integration risks. As a result, we have adjusted 4iG's standalone credit quality of BB downwards by one notch.

Long-term debt rating

Senior unsecured debt rating: BB-

Our base case forecasts the successful acquisition of Vodafone Hungary by 4iG's subsidiary, with the following estimates: about HUF 340bn of new loans, with no maturity for the next ten years and bearing an interest rate of around 9%. Our recovery analysis indicates an 'average recovery' for senior unsecured debt. Scope sees some pressure on expected recovery rates due to i) pledges in favour of creditors, which could lead to restrictions on the transfer of funds within the group, and ii) future debt issuance will mainly take place at 4iG subsidiary level, resulting in structural subordination of senior unsecured debt at 4iG level. This expectation translates into a BB- rating for this debt category, the same level as the issuer rating. The recovery is based on an expected distressed enterprise value as a going concern in a hypothetical default scenario in 2024.

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