B+N Referencia Zrt.
Hungary, Business Services

SCOPE B+ Stable

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**	**2018**	**2019F**	**2020F**
Scope-adjusted EBITDA interest cover (x)	>10x	>10x	>10x	7.0x
Scope-adjusted debt (SaD)/EBITDA (x)	0.5x	0.9x	2.6x	1.8x
Scope-adjusted FFO/SaD (%)	>100%	98%	35%	44%
FOCF/SaD (%)	>100%	61%	30%	30%
Liquidity	>100%	>100%	>100%	>100%

Rating rationale

Scope Ratings assigns a B+/Stable initial issuer rating to Hungarian facility management company B+N Referencia Zrt. Senior unsecured debt has been rated B+.

The B+ private issuer rating is driven by B+N's small scale, which makes the company vulnerable to a deterioration in macroeconomic conditions or a loss of major contracts. The rating is positively driven by the strong credit metrics, which we believe will be maintained even after the planned issuance of a HUF 10bn bond under the MNB Bond Funding for Growth Scheme. Most of the bond proceeds are intended for opportunistic bolt-on acquisitions and the refinancing of short-term debt.

Outlook

The Outlook is Stable and reflects our expectation of a resilient EBITDA margin and limited pressure on credit metrics from projected growth, leading to a forecasted leverage – measured as Scope-adjusted debt (SaD)/EBITDA – of between 1-3x for the next few years.

A positive rating action appears to be remote but could be triggered by improvements in the company's diversification and outreach, or the development of a more creditor-friendly financial policy.

A negative rating action could be prompted by a deterioration in credit metrics stemming from a loss of major contracts or an increase in dividend payouts, exemplified by a SaD/EBITDA of above 3x for a prolonged period.

Ratings and Outlook

Corporate ratings	B+/Stable
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 diversification • More creditor-friendly financial policy	• SaD/EBITDA of above 3x on a sustained basis due to loss of major contracts or higher dividend payouts

Financial overview

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
Scope-adjusted EBITDA interest cover (x)	>10x	>10x	>10x	7.0x
SaD/EBITDA	0.5x	0.9x	2.6x	1.8x
Scope-adjusted FFO/SaD	>100%	98%	35%	44%
FOCF/SaD	>100%	61%	30%	30%
Scope-adjusted EBITDA in HUF ‘000s	**2017**	**2018**	**2019F**	**2020F**
EBITDA	2,014,288	3,234,523	3,607,042	4,508,803
Operating lease payments in respective year	0	0	0	0
Restructuring costs	0	0	0	0
Scope-adjusted EBITDA	**2,014,288**	**3,234,523**	**3,607,042**	**4,508,803**
Scope-adjusted funds from operations in HUF ‘000s	**2017**	**2018**	**2019F**	**2020F**
EBITDA	2,014,288	3,234,523	3,607,042	4,508,803
less: (net) cash interest as per cash flow statement	(43,609)	(21,493)	(24,845)	(618,136)
less: cash tax paid as per cash flow statement	(141,246)	(259,203)	(263,943)	(277,092)
add: dividends received	400,000	0	0	0
Scope-adjusted funds from operations	**2,229,433**	**2,953,827**	**3,318,254**	**3,613,574**
Scope-adjusted debt in HUF ‘000s	**2017**	**2018**	**2019F**	**2020F**
Reported gross financial debt	1,360,070	3,484,353	11,429,383	11,166,883
less: cash and cash equivalents	(375,435)	(455,054)	(2,052,906)	(2,908,324)
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other adjustments	0	0	0	0
Scope-adjusted debt	**984,635**	**3,029,299**	**9,376,476**	**8,258,558**

Business risk profile

Small company 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 2016-18, with revenues up by 98% and EBITDA by 82%. 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.

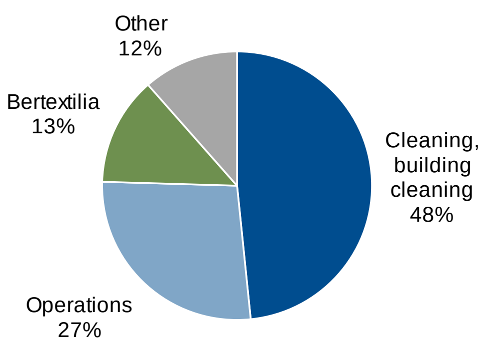
Limited diversification bears the risk of a sharp revenue decline if demand weakens

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 services other than cleaning. However, the contribution from these activities remains small and the offered services are limited. Commercial clients and corporates are potential areas of growth, in our view. But for now, corporate clients account for only 10%.

Stable profitability

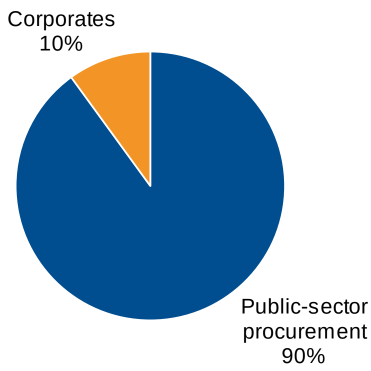
Despite the company's ability to adjust costs to maintain margins, the risk of a sharp decline in total cash flows remains. The rating is also limited by relatively low but stable profitability, at 11-13% over the past few years. The company risks losing market share if competitors initiate a price war that hinders the company from renewing contracts.

Figure 1: Revenue split by activity



Sources: B+N, Scope

Figure 2: Customers split



Sources: B+N, Scope

Financial risk profile

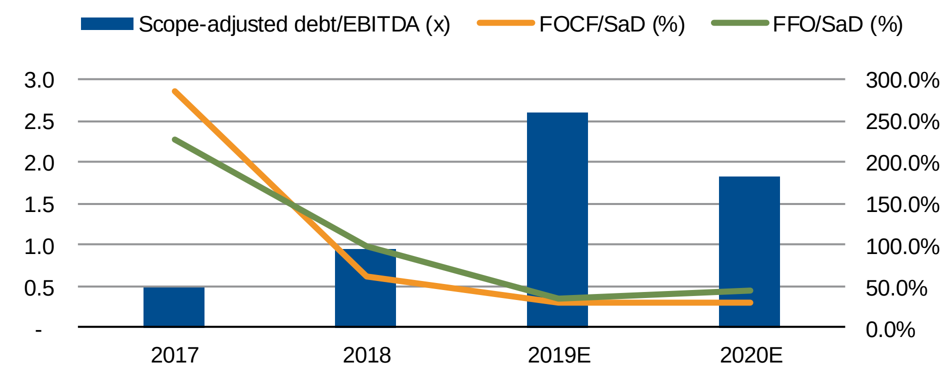
Strong debt protection

B+N's financial risk profile supports the overall rating. While leverage (SaD/EBITDA) is expected to rise significantly following the planned bond issuance, it will likely remain below 3x going forward. We believe the company will use most of the bond proceeds for discretionary bolt-on acquisitions and the refinancing of short-term debt. Nevertheless, we expect debt protection metrics such as EBITDA/interest coverage to remain very comfortable at above 7x after the future financial setup of the group.

B+N's liquidity profile is neutral for the rating. Following the envisaged refinancing of existing credit facilities and factoring lines with some of the proceeds of the planned bond, short-term debt will reduce to less than HUF 1bn 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. B+N has a dynamic growth strategy as regards potential M&A. Moreover, there is key person risk regarding the CEO, whom we regard as instrumental not only for contract renewals and success in tenders but also for dividend policy.

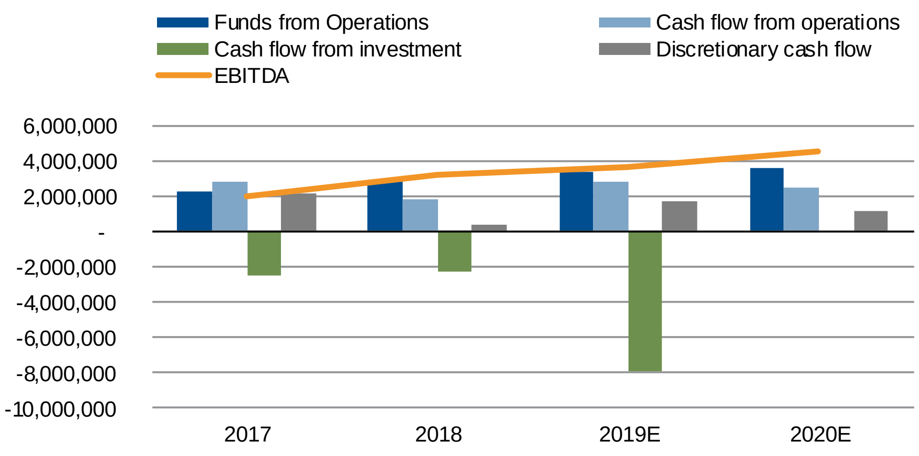
Figure 3: Development in Scope-adjusted debt ratios



Sources: B+N, Scope estimates

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 4: Cash flows (HUF '000s)



Sources: B+N, Scope estimates

Senior unsecured debt: B+

We expect an 'average recovery' for the company's senior unsecured debt, resulting in a

B+ rating. The recovery rate is based on an expected distressed enterprise value as a going concern in a hypothetical default scenario.

Outlook

Outlook: Stable

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