B+N Referencia Zrt.
Hungary, Business Services

SCOPE BB STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	47.6x	63.6x	15.1x	15.6x
Scope-adjusted debt/EBITDA	0.8x	1.1x	1.7x	1.6x
Scope-adjusted funds from operations/debt	116%	80%	49%	51%
Scope-adjusted free operating cash flow/debt	194%	46%	-15%	65%

Rating rationale

The upgrade reflects B+N's strong financial risk profile paired with a solid project backlog despite unfavourable macroeconomic factors (the inflationary environment, the increase in minimum wages and the Hungarian labour market shortage) the group faces in 2022-2023 and the expected declining contribution of the fit-out division to the group's revenue and profitability.

The recent publication of B+N's 2021 consolidated financial statements based on IFRS showed two main differences compared to the Hungarian reporting standards: i) the addition of financial leases; and ii) the recategorisation and treatment of permanently transferred funds from being operating expenses to be dividend cash outflows for 2020-2021 in the amounts of HUF 7.8bn and HUF 2.1bn, respectively. Both these differences have impacted the credit metrics as the Scope-adjusted debt increased as financial leases are treat as debt (e.g. in 2020 the Scope-adjusted debt becomes HUF 13.3bn instead of HUF 11.1bn) and the significant increase of Scope-adjusted EBITDA compared to our previous calculations (e.g. in 2020 the Scope-adjusted EBITDA becomes HUF 16.6bn instead of HUF 7.5bn), leading to the improved credit metrics of 2020 and 2021.

While in 2020-2022, B+N's fit-out division was one of the main contributors to both group revenues and profitability, B+N is planning to reduce its fit-out workforce as contracted projects have been completed. B+N has substituted most of its fit-out revenues with cleaning and facility management contracts, therefore we do not expect a decrease in B+N's 2023 revenues.

Outlook and rating-change drivers

The Outlook for B+N is Stable and incorporates our view of a relatively stable indebtedness level characterised by a Scope-adjusted debt/EBITDA ratio between 1-2x for the following years with the amortisation of the 2031 bond starting in 2024.

A positive rating action could be warranted if B+N's financial policy became more transparent about financial reporting and the group's dividend payment strategy. However since the one notch adjustment also reflects the key person risk associated with the management, such an action is unlikely for the time being. Additionally, a positive rating action could result from the improvement of B+N's business risk profile, either through market share or improved diversification.

A negative rating action could occur if the Scope-adjusted debt/EBITDA ratio rose above 2.5x on a sustained basis or through the recurrence of liquidity issues. Such an increase in leverage could be triggered by an increase in debt (e.g. a debt-funded acquisition).

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
20 January 2023	Upgrade	BB/Stable
18 October 2022	Placement under Review for a developing outcome	BB-/Under review
15 October 2021	Upgrade	BB-/Positive

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

Analyst

Vivianne Anna Kapolnai
+49 69 6677389 88
v.kapolnai@scoperatings.com

Related Methodology

Corporate Rating Methodology; July 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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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 • 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
• Improvement in market share or diversification • Less volatile liquidity • More transparent financial policy	• Scope-adjusted debt/EBITDA above 2.5x on a sustained basis, e.g. from debt-funded acquisitions

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**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	47.6	63.6	15.1	15.6	15.4
Scope-adjusted debt/EBITDA	0.8	1.1	1.7	1.6	1.6
Scope-adjusted funds from operations/debt	116%	80%	49%	51%	53%
Scope-adjusted free operating cash flow/debt	194%	46%	-15%	65%	40%
Scope-adjusted EBITDA in HUF m					
EBITDA	16,572	28,842	20,325	21,342	20,915
Scope-adjusted EBITDA	**16,572**	**28,842**	**20,325**	**21,342**	**20,915**
Funds from operations in HUF m					
Scope-adjusted EBITDA	16,572	28,842	20,325	21,342	20,915
less: (net) cash interest paid	-348	-453	-1,343	-1,368	-1,358
less: cash tax paid per cash flow statement	-769	-2,181	-2,071	-2,161	--2,088
Change in provisions	-	-8	-	-	-
Funds from operations (FFO)	**15,455**	**26,200**	**16,912**	**17,813**	**17,469**
Free operating cash flow in HUF m					
Funds from operations	15,455	26,200	16,912	17,813	17,469
Change in working capital	13,805	-7,421	-17,303	9,625	458
less: capital expenditure (net)	-2,723	-2,005	-2,750	-2,250	-2,250
less: lease amortisation	-697	-1,832	-2,144	-2,469	-2,592
Free operating cash flow (FOCF)	**25,840**	**14,942**	**-5,286**	**22,719**	**13,085**
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-348	-453	-1,343	-1,368	-1,358
Net cash interest paid	**-348**	**-453**	**-1,343**	**-1,368**	**-1,358**
Scope-adjusted debt in HUF m					
Reported gross financial debt	13,336	32,588	34,336	34,829	32,972
less: cash and cash equivalents	-25,723	-40,334	-11,858	-18,655	-22,402
add: non-accessible cash	25,723	40,334	11,858	18,655	22,402
Scope-adjusted debt	**13,336**	**32,588**	**34,336**	**34,829**	**32,972**

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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 is a facility management group that falls under the business services industry (assessed as BBB).

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

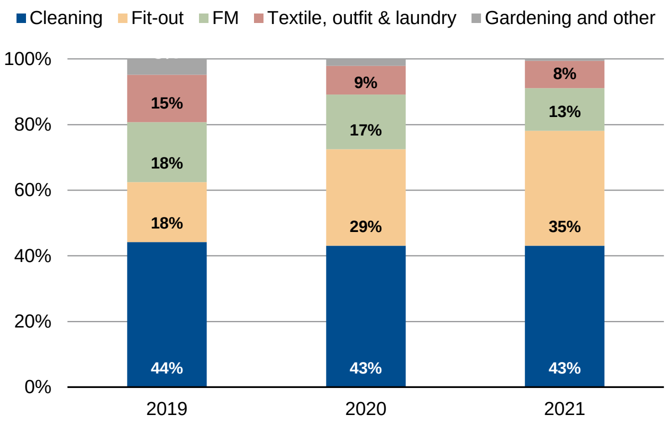
B+N grew strongly between 2016-2022, driven by successful tenders for major contracts and small acquisitions. The past years' trend to outsource public sector projects to public-private partnerships has allowed B+N (and other Hungarian market players) to increase their footprint. In 2020, the Covid pandemic further increased the demand for B+N's services, which also supported the company's strong revenue growth cash flow for 2021. However, we do not expect the impact of the pandemic to contribute significantly to 2022 sales.

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 Poland and Bulgaria in 2022, B+N has become the market leader in CEE. Furthermore, it has reduced its concentration on Hungary, supporting 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. These are seen as credit-positive, providing good cash flow visibility over the next two to three years. The ISS Group acquisitions have also broadened the company's service portfolio by adding catering and security services, allowing B+N to participate in tenders for clients that prefer to contract fully integrated facility management providers.

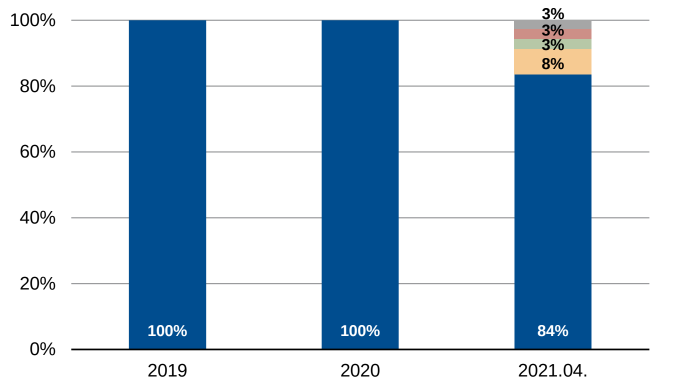
Profitability in terms of the EBITDA margin has historically ranged between 10% and 13%, however in 2020 and 2021 the Scope-adjusted EBITDA increased significantly, reaching 23% and 19%, respectively. The increase was partly due to the pandemic-related cleaning services boom and the higher margin fit-out business. With the more challenging macroeconomic conditions facing B+N and less boost from cleaning and fit-out, we forecast a return of operating profitability (measured by Scope-adjusted EBITDA margin) to historical levels of around 11%. We also expect additional costs from resolving significant labour shortages in Hungary to restrain the EBITDA margin going forward.

Figure 1: Revenue breakdown by activity



Sources: B+N, Scope

Figure 2: Revenue breakdown by country



Sources: B+N, Scope

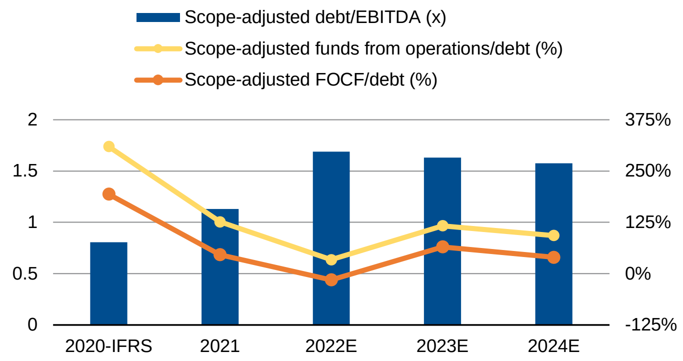
Financial risk profile: A-

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

B+N recently published its 2021 consolidated financial statement reported based on international financial reporting standards (IFRS). The two main differences between the Hungarian standards and IFRS are: i) the addition of financial leases; and ii) the recategorisation and treatment of permanently transferred funds from being categorised as other operating expenses to be dividend cash outflows for 2020 and 2021 in the amounts of HUF 7.8bn and HUF 2.1bn, respectively. Both these changes have affected the credit metrics as the Scope-adjusted debt increases by financial leases being treated as debt (e.g. in 2020 the Scope-adjusted debt becomes HUF 13.3bn instead of HUF 11.1bn) and the significant increase of Scope-adjusted EBITDA (e.g. in 2020 the Scope-adjusted EBITDA becomes HUF 16.6bn instead of HUF 7.3bn), leading to the improved credit metrics of 2020 and 2021. Previously, we excluded the dividend-like payouts from Scope-adjusted EBITDA as they were considered to be possibly recurring expenses, however B+N's management has said that the payouts were extraordinary events and will not be repeated in the future.

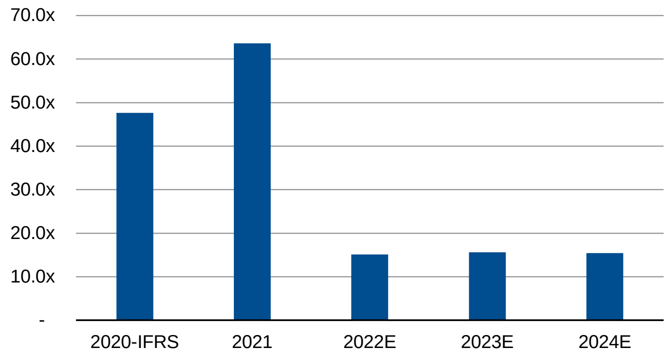
B+N's financial risk profile is supported by the group's strong interest coverage (measured as Scope-adjusted EBITDA/interest cover) of above 15x and strong leverage credit metrics (Scope-adjusted debt/EBITDA around 1.7x and Scope-adjusted funds from operation/debt of around 50%). The financial risk profile is constrained by the cash flow cover, measured by Scope-adjusted free operating cash flow/debt, since the group's active M&A expansion strategy and large public contract dependence has led to volatile net working capital trends and unexpected large cash absorption, negatively impacting the credit metric and constraining liquidity. Although year-end liquidity was adequate, with sufficient internal and external funds to cover short-term debt obligations, the intra-quarter liquidity was at times inadequate. As B+N's public contract exposure with a significant bearing on working capital remains, we consider the inadequate liquidity to be a persisting threat that necessitates the introduction of significantly larger committed credit lines.

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	2022E	2023E	2024E
Unrestricted cash (t-1)	35,334	6,858	13,654
Open committed credit lines (t-1)	-5,286	22,719	13,085
Free operating cash flow	500	500	500
Short-term debt (t-1)	2,824	3,149	4,923
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: -1 notch

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 previous 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

B+N issued a HUF 10bn senior unsecured bond (ISIN: HU0000359419) in 2019 and a HUF 13.2bn senior unsecured bond (ISIN: HU0000360623) in 2021 under the Hungarian Bond Funding for Growth Scheme. Our recovery assessment is based on a hypothetical default scenario in 2023 and assumes outstanding senior unsecured debt of HUF 24.3bn, including a convertible bond of HUF 1.1bn (ISIN: HU0001300313). Our recovery analysis indicates an 'average' recovery (30%-50%) for B+N's outstanding senior unsecured debt.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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