4iG Nyrt.
Hungary, Telecom and Business Services

SCOPE B+ STABLE

Corporate profile

4iG Nyrt. is one of the largest players in Hungary's fragmented IT market. The company's main activities include hardware and software sales as well as a range of IT services. 4iG is pursuing strong, M&A driven growth, which will transform it into a diversified telecom, IT and space & defence group. The company is listed in the premium segment of the Budapest Stock Exchange and has more than 1,800 employees. 4iG is controlled by Gellért Jászai through indirect stakes of around 59%. He also serves as chairman of the board of directors and CEO of the company.

Key metrics

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E pro forma**	**2022E**	**2023E**
EBITDA/interest cover	>20	>20	3.5	3.8	4.3
Scope-adjusted debt (SaD)/EBITDA	Net cash	Net cash	5.9	5.4	4.7
Funds from operations (FFO)/EBITDA	Net cash	Net cash	12%	13%	16%
Free operating cash flow (FOCF)/SaD	Net cash	Net cash	0%	4%	-3%

Rating rationale

Scope Ratings GmbH (Scope) has downgraded the issuer rating of 4iG Nyrt. (4iG) to B+/Stable from BB- under review for a possible downgrade. Concurrently, Scope has downgraded the senior unsecured debt rating to B+ from BB- under review for a possible downgrade.

The rating action reflects a weakened financial risk profile and heightened execution and integration risk from large, mainly debt-funded acquisitions, which outweigh the positive impact on 4iG's business risk profile from the significant growth being pursued.

4iG is pursuing strong, M&A driven growth, which will transform it into a diversified telecom, IT and space & defence group. Once these transactions have been successfully completed, we believe 4iG's business risk profile will benefit from the acquired companies' scale and reach in terms of industries, customers, geographies and higher EBITDA margins.

From a financial perspective, we expect a significant deterioration in credit metrics with leverage, as measured by Scope-adjusted debt (SaD)/EBITDA, of above 4x in the next couple of years. While credit metrics are somewhat supported by a solid interest cover ratio of around 4x, they are burdened by weak free operating cash flow cover at around breakeven.

As regards supplementary rating drivers, we see 4iG's financial policy as a negative rating driver. This is due to its very large, mainly debt-funded acquisitions and still-limited exposure to telecom services, leading to heightened execution and integration risk. As a result, we have adjusted 4iG's standalone credit quality of BB- downwards by one notch.

Ratings & Outlook

Corporate rating	B+/Stable
Senior unsecured rating	B+

Analyst

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Related Methodologies

Corporate Rating Methodology (July 2021)

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Outlook and rating-change drivers

The Outlook is Stable and reflects: i) the successful placement of a HUF 350bn bond in Q4 2021; ii) successful equity increase transactions totalling more than HUF 100bn in Q4 2021-Q1 2022; iii) the execution of the announced M&A strategy; and iv) SaD/EBITDA of below 5x in the next few years.

A positive rating action could result from a stabilisation of the group structure with no new material M&A activity and/or the successful integration of the acquired companies, indicated by improved operational performance and stronger credit metrics, with SaD/EBITDA of around 4x on a sustained basis.

A negative rating action could be triggered by a deterioration in credit metrics as indicated by SaD/EBITDA of significantly above 5x on a sustained basis, e.g. due to an inability to generate sufficient new business or if execution risk around targeted acquisitions materialises. A negative rating action could also result from liquidity issues, e.g. caused by very sharp working capital swings.

Rating drivers

Positive rating drivers	Negative rating drivers
• Dominant exposure to telecom industry with high share of recurring revenues • Solid presence in fixed broadband in Hungary and IT infrastructure/ services, good presence in selected telecom markets of the Western Balkans • Unique position of Antenna Hungaria in national media/broadcasting landscape • Improved geographical diversification, however Hungary remains core market • More granular customer structure, although exposure to public sector remains significant • Solid EBITDA margin at around 25%-30% • Spacecom’s expertise in satellite communication market	• Weak credit metrics • Very weak position in Hungarian mobile market • Strong competition in the main relevant markets including satellite communication • Heightened execution and integration risk related to acquisitions • Increased foreign exchange risk

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Stabilisation of the group structure and successful integration of the acquired companies • SaD/EBITDA at around 4x on a sustained basis	• Deterioration in credit metrics, e.g. SaD/EBITDA of significantly above 5x on a sustained basis • Liquidity issues

Financial overview[1]

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E pro forma[2]**	**2022E**	**2023E**
EBITDA/interest cover	>20	>20	3.5	3.8	4.3
SaD/EBITDA	Net cash	Net cash	5.9	5.4	4.7
Funds from operations/SaD	Net cash	Net cash	12%	13%	16%
Free operating cash flow/SaD	Net cash	Net cash	0%	4%	-3%
Scope-adjusted EBITDA in HUF bn					
EBITDA	4.1	5.0	101.7	107.0	111.8
Operating lease payments in respective year	-	-	-	-	-
Associate dividends	-	-	8.0	8.0	8.0
Scope-adjusted EBITDA	4.1	5.0	109.7	115.0	119.8
Scope-adjusted funds from operations in HUF bn					
Scope-adjusted EBITDA	4.1	5.0	109.7	115.0	119.8
deduct: (net) cash interest paid	-0.0	-0.0	-31.4	-30.2	-27.6
deduct: cash tax paid	-0.4	-0.8	-0.8	-1.8	-2.9
add: depreciation component, operating leases	-	-	-	-	-
Scope-adjusted funds from operations	3.6	4.2	77.5	83.1	89.3
Scope-adjusted debt in HUF bn					
Reported gross financial debt	2.2	4.0	628.3	603.4	552.7
deduct: cash & cash equivalents	-6.2	-7.2	-99.0	-104.9	-46.3
add: restricted cash	-	-	99.0	104.9	46.3
add: operating lease obligations	-	-	-	-	-
add: guarantees	0.1	0.5	1.5	1.5	1.5
add: other	0.1	0.1	13.5	13.5	13.5
Scope-adjusted debt	-3.8	-2.6	643.3	618.4	567.7

[1] Financial projections reflect our view and are based on conservative assumptions.
[2] Figures under the assumption that the target companies were part of 4iG group from 1 January 2021.

Business risk profile

Dynamic development following ownership change in 2018

The company has grown rapidly recently, both in terms of size and expertise. Development has been dynamic following the ownership change in 2018, with Gellért Jászai becoming the main shareholder, chairman of the board of directors and subsequently CEO of the company. The new management has revised 4iG's business strategy and reshaped its organisational structure. The company has focused on large (primarily public sector) projects, streamlined sales organisation and made selective small-scale acquisitions. The total number of employees grew from 376 at YE 2018 to 924 at YE 2020.

Strong M&A driven growth since the beginning of 2021

Since the beginning of 2021, 4iG has been pursuing strong, M&A driven growth, which will transform it into a diversified telecom, IT and space & defence group. The main acquisition targets are listed below.

HDT

On 1 June 2021, 4iG acquired 75% of the shares in Hungaro DigiTel Kft. (HDT). The remaining 25% are held by Antenna Hungária Zrt. HDT provides VSAT and satellite broadcasting services via its satellite communication system. HDT generated revenue of HUF 5bn and EBITDA of HUF 3bn in 2020.

Invitech

On 30 September 2021, 4iG acquired 100% of the shares in Invitech ICT Services Kft. (Invitech) for an undisclosed amount. Invitech is one of the leading providers of telecommunication and infrastructure solutions in Hungary. Its portfolio includes broadband business internet, data centre, IT security and cloud solutions, as well as voice and IT services. The company employs around 600 people and serves more than 5,000 corporate, institutional and wholesale customers. In 2020, its consolidated revenue was HUF 25bn and its EBITDA adjusted for one-off items was HUF 9bn.

Spacecom

On 11 October 2021, Hungaro DigiTel Kft., the subsidiary of 4iG and Antenna Hungária Zrt., entered into a definitive agreement with Space-Communication Ltd. (Spacecom) to acquire via a private placement 51% of the shares in Spacecom for an amount of NIS 221m (around HUF 22bn). The transaction may be completed in Q4 2021-Q1 2022 subject to the necessary approvals from the general shareholder meeting of Spacecom and third parties including the Israeli Ministry of Communication. Spacecom is an Israel-based fixed-satellite operator and satellite service provider. Spacecom operates the AMOS fleet of four geosynchronous satellites at various orbital positions and has a global offering of broadcast and broadband satellite services. Spacecom is listed on the Tel Aviv Stock Exchange. In 2020 its revenue was HUF 26bn and its EBITDA adjusted for one-off items reached HUF 19bn.

Telenor Montenegro

On 27 October 2021, 4iG signed a binding agreement to acquire 100% of the shares in Telenor d.o.o. (Telenor Montenegro) for an undisclosed amount. The transaction could be completed in Q4 2021. Telenor Montenegro is the market leader in Montenegrin mobile telecom services. The company has around 350,000 subscribers, served through more than 400 base stations. In 2020, its revenue was HUF 15bn and its EBITDA reached HUF 5bn.

DIGI Hungary

On 29 November 2021, 4iG signed a binding agreement to acquire 100% of the shares in DIGI Távközlési Szolgáltató Kft. and its subsidiaries, Invitel Zrt., i-TV Zrt. and DIGI Infrastruktúra Kft. (DIGI Hungary) for EUR 625m (around HUF 230bn). The transaction may be completed in Q1 2022 subject to the necessary competition authority approval. DIGI Hungary is one of the leading telecommunications service providers in Hungary, with a broad service portfolio covering cable TV, fixed internet and data, mobile telecommunication services, fixed-line telephony and direct-to-home services. DIGI Hungary employs over 3000 people, serves more than 1.1 million subscribers and has around 2.5 million revenue generating units. In 2020, its consolidated revenue was HUF 70bn and its EBITDA reached HUF 19bn.

Further telecom assets

4iG is targeting further telecom assets in the Western Balkans.

Antenna Hungária

On 25 August 2021, 4iG signed a preliminary agreement with the Hungarian government to acquire a majority stake in Antenna Hungária Zrt. via a transfer of telecommunication companies to be acquired by 4iG. The transaction could be completed in Q1 2022 subject to due diligence, asset valuation and the conclusion of a final agreement. Antenna Hungária's main activities include national terrestrial television and radio broadcasting, as well as wireless business telecommunication. The company also owns 25% of the shares in Telenor Magyarország Zrt. (Telenor Hungary) and 100% of the shares in MVM NET Zrt. The company employs over 500 people. In 2020, its consolidated revenue was HUF 41bn and its EBITDA adjusted for one-off items was HUF 9bn.

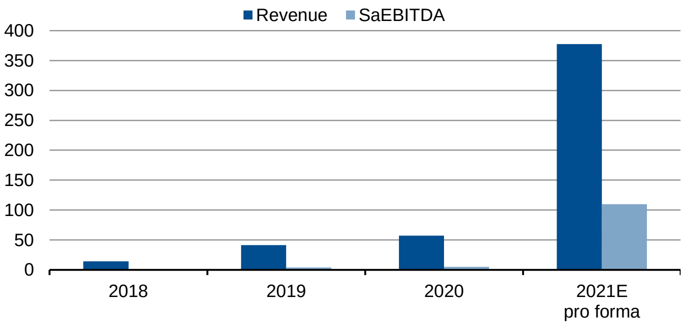
Acquisitions will have a significant positive impact on 4iG's business risk profile

Once these transactions have been completed successfully, we believe 4iG's business risk profile will benefit from the acquired companies' scale and reach in terms of industries, customers, geographies and higher EBITDA margins.

Dominant exposure to telecom industry

Total 2021 pro-forma revenue of the enlarged group is expected to reach around HUF 380bn and pro-forma EBITDA is expected to exceed HUF 100bn, which is far above 4iG's 2020 revenue of HUF 57bn and EBITDA of HUF 5bn. In terms of industries, telecom services including satellite communication are expected to account for a dominant share in total revenue and EBITDA. The remainder is mainly IT, IT infrastructure and media/event services.

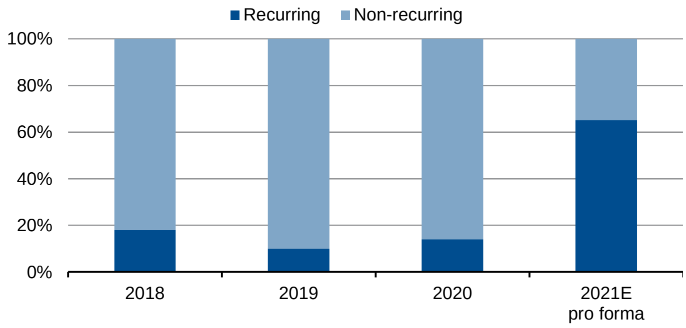
Figure 1: Revenue and EBITDA development (HUF bn)



SaEBITDA = Scope-adjusted EBITDA

Source: 4iG, Scope

Figure 2: Revenue split by nature



Source: 4iG, Scope

Solid presence in selected markets and a higher share of recurring revenues

The market positioning of the new group will be mainly driven by its solid presence in fixed broadband in Hungary (market share of over 20%) and IT infrastructure/services, the unique position of Antenna Hungaria in the media/broadcasting landscape, a good presence in selected telecom markets in the Western Balkans, and Spacecom's expertise in the satellite communication market. The share of recurring revenues is expected to exceed 60% compared to less than 20% in 2020. 4iG's market positioning is held back by a very weak position in the Hungarian mobile market as well as by strong competition in its main markets including IT and satellite communication.

Improved geographical and customer diversification

The new group will be more diversified. In addition to exposure to the different industries mentioned above, overall diversification will also benefit from a somewhat broader geographical presence, i.e. in Hungary, the Western Balkans and other regions (mainly CEE, the Middle East and Sub-Saharan Africa) via Spacecom. 4iG's overall share of Hungarian operations is expected to decline to around 75%-80% of revenues from over 95%. The customer structure is expected to become more granular, including a significant share of retail clients, and less dependent on public sector customers. These benefits will be partly offset by higher foreign exchange risk.

Solid profitability

4iG's business risk profile further benefits from an estimated group EBITDA margin of around 25%-30%, which is a solid level for a telecom focused capital-intensive business model. We note that EBITDA margins vary substantially depending on the business segment, from less than 10% in IT services to more than 70% in satellite communication.

Financial risk profile

Key planning assumptions

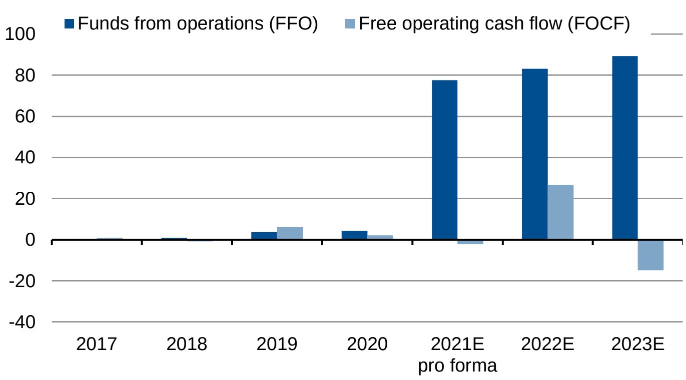
Our financial projections are mainly based on the following conservative assumptions:

- Successful placement in Q4 2021 of the HUF 350bn bond under the Hungarian National Bank (MNB) Bond Funding for Growth Scheme, with proceeds earmarked for the acquisition of companies primarily in Hungary and the CEE region
- Successful equity increase transactions totaling more than HUF 100bn in Q4 2021-Q1 2022
- Execution of the announced M&A strategy with total consideration of around HUF 460bn
- Moderate revenue and EBITDA growth mainly driven by post-pandemic recovery, tariff increases and recently signed contracts

Our adjustments

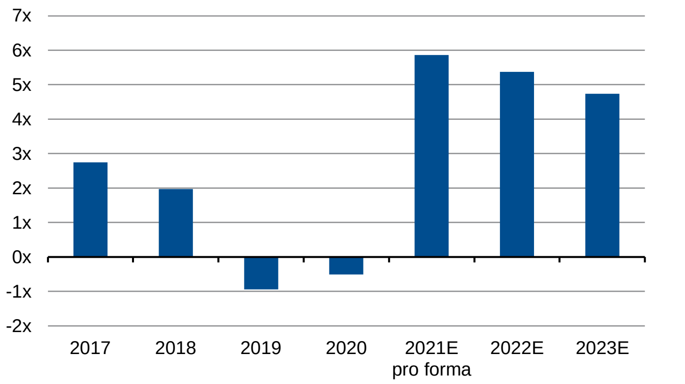
Our calculations are based on reported IFRS numbers. Our SaD calculation includes estimated lease obligations: i) before 2019; and ii) going forward for companies that do not report under IFRS. Also going forward, our SaD calculation will not consider cash and cash equivalents as netting of cash is generally only applicable to ratings in the BB category or higher, and only if the cash is permanent and accessible. Given the size and complexity of the transactions, we believe that cash is not permanent and can be used for working capital, foreign exchange, capex and other needs.

Figure 3: Cash flow generation (HUF bn)



Source: 4iG, Scope

Figure 4: SaD/EBITDA leverage



Source: 4iG, Scope

Significant deterioration in credit metrics…

We expect 4iG's credit metrics to deteriorate significantly with leverage, as measured by SaD/EBITDA, of above 4x in the next couple of years. While credit metrics are somewhat supported by a solid interest cover ratio of around 4x, they are burdened by weak free operating cash flow cover at around breakeven.

…driven by mainly debt-funded acquisitions

The negative development in credit metrics will be driven by mainly debt-funded acquisitions (around 80% of a total consideration of about HUF 460bn). Debt required for the acquisitions largely consists of the prospective HUF 350bn MNB bond, bank loans in the amount of HUF 14bn and available funds from the MNB bond issued in March 2021. Please note that 4iG plans to repay the HUF 100bn MFB bond issued in September 2021 for the financing of the Invitech transaction with proceeds from the prospective MNB bond.

Large equity increase transactions

The company plans to execute equity increase transactions totalling over HUF 100bn in Q4 2021-Q1 2022 with Hungarian and international investors. The proceeds are earmarked for funding the M&A deals and as a capex and foreign exchange reserve.

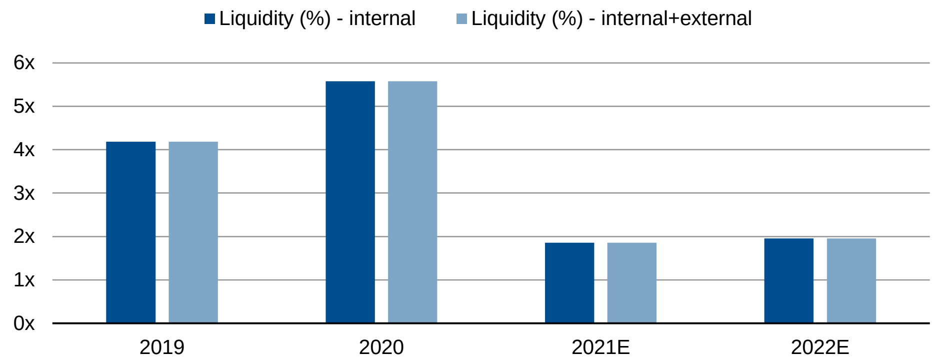
Increase in SaD also reflects consolidation of target companies' debt

In addition, total SaD will increase due to the consolidation of debt (bonds, loans, leases) of target companies, primarily Spacecom, DIGI and Antenna Hungaria. The rise in SaD will only be partly offset by expected EBITDA growth. Further improvement is limited by conservative growth and margin assumptions.

Significant amount of debt will mature in the next couple of years

While debt maturities are spread over an extended time horizon, there is a significant amount of debt maturing in the next couple of years. This is mainly attributable to short-term loans at different group companies and bonds at Spacecom. We expect 4iG to partly refinance this debt via new debt instruments.

Figure 5: Liquidity



Source: 4iG, Scope

Adequate liquidity in short term

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 are not refinanced. For 2022, we expect short-term financial debt to be more than 1x covered by a combination of available cash and cash equivalents, following envisaged debt and equity issuance as well as positive expected free operating cash flows.

Supplementary rating drivers

Credit-negative financial policy

We see 4iG's financial policy as a negative rating driver. This is due to very large, mainly debt-funded acquisitions and 4iG's still-limited exposure to telecom services, leading to heightened execution and integration risk. As a result, we have adjusted 4iG's standalone credit quality of BB- downward by one notch.

No impact from shareholder structure

As of Q3 2021, Mr Gellért Jászai indirectly controls around 59% of 4iG's shares through KZF Vagyonkezelő Kft., Manhattan Invest Kft. and MANHATTAN Magántőkealap. Mr Jászai also serves as chairman of the board of directors and CEO of the company. 4iG has stated that the major shareholder is fully committed to the long-term success of the company. Nevertheless, as 4iG is a publicly listed company, our assessment of its shareholder structure indicates no impact (either negative or positive) on the issuer rating.

Senior unsecured debt

Senior unsecured debt at B+

Our base case financial forecast assumes the successful placement in Q4 2021 of a HUF 350bn senior unsecured bond with a fixed annual coupon under the MNB's Bond Funding for Growth Scheme. We expect the bond to have a 10-year tenor, with 10% annual amortisation commencing in 2026 and a 50% bullet maturity in 2031. The proceeds are earmarked for the acquisition of companies and the refinancing of the existing HUF 100bn MFB bond.

Our recovery analysis indicates an 'average recovery' for senior unsecured debt such as the prospective bond and existing HUF 15bn bond (ISIN: HU0000360276) issued in March 2021. This expectation translates into a B+ 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 2023.

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