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Research Update:

Norway-Based Debt Purchaser B2 Impact ASA Outlook Revised To Positive On Strong Performance; 'B+' Rating Affirmed

October 26, 2023

Rating Action Overview

- Conservative pricing and strong collection performance is expected to serve B2 Impact ASA (B2; previously B2 Holding ASA) well over the coming quarters, despite a weak macroeconomic backdrop.
- Debt levels are likely to remain stable, which, along with cash EBITDA growth over the coming quarters, will lead to steady deleveraging from an S&P Global Ratings-adjusted debt-to-EBITDA peak of 3.0x as of year-end 2022.
- We expect B2 will proactively manage its liquidity needs for the upcoming maturity in 2024, while preserving sufficient covenant headroom.
- As a result, we revised our outlook on B2 to positive from stable and affirmed the 'B+' long-term issuer credit rating.
- The positive outlook indicates that we could raise the rating if, over the next 12 to 18 months, we see a successful refinancing coupled with continued earnings stability that is supportive of a sound financial profile.

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Rating Action Rationale

B2's financial performance in first-half 2023 demonstrated revenue will likely be stronger than expected. Cash revenue and EBITDA are forecast to expand about 9%-10% and 5%-6%, respectively, in 2023 due to an increase in portfolio investments, which we believe have been purchased with robust pricing discipline. As of first-half 2023, investments were tracking Norwegian krone (NOK) 2.2 billion (including purchase commitments), which is ahead of last year's comparable figure of NOK1.5 billion, but in line with the company's own stated targets of NOK2 billion-NOK3 billion per year. Also, unsecured collections have seen strong over-performance in the past two quarters, indicating the company's structured approach to investments is bearing fruit. Secured cash collections and real estate operating asset (REO) sales have remained stable,

as have operating expenses, supporting our forecast for earnings over the next 12-18 months. Both the PIMCO partnership and set-up of Veraltis Asset Management (Veraltis) have proceeded as planned, with the size of the senior financing from PIMCO increased to €180 million (initially €166 million), indicating support for the strategy.

The company's revised strategy is anticipated to reduce the gap to peers. B2's scale and asset mix had at times weighed on its results and potentially could have contributed to past missteps involving negative revaluations in the secured asset book. However, the company has worked to improve its strategic mix to enable a more flexible approach to the current more-challenging environment faced by debt purchasers. This includes working with a co-investor to increase more capital-light revenue streams. While B2's servicing franchise via Veraltis still has room to expand, the co-investment structure with PIMCO is expected to provide better access to more sizeable, secured portfolios.

Proactive liquidity management ahead of B2's maturities next year is vital over the coming months. Higher interest rates have put pressure on coverage metrics, however, revisions to the revolving credit facility (RCF) covenants have allowed some flexibility. More generally, we believe there will be an improvement in coverage in 2024 given EBITDA growth expectations. Also, B2 has a solid track record of smooth maturity management, with past refinancings and RCF extensions, which we believe will help address the necessary funding needed ahead of the €200 million May 2024 maturity of the B2H05 bond. For instance, in first-quarter 2023, B2 efficiently completed a tap issue of B2H06 (September 2026 maturity), which enabled the company to repurchase the outstanding balance of a May 2023 bond. Furthermore, we note that B2 was able to refinance its RCF smoothly with a group of three Nordic banks, including unchanged interest terms. As of second-quarter 2023, €182 million of the RCF was undrawn.

We expect debt to remain stable in 2023-2024. Given we expect relatively robust revenue and cash EBITDA growth, we believe leverage will gradually decline to about 2.50x-2.75x by year-end 2024. We recognize that B2 remains exposed to the risk of negative revaluation of the debt portfolios it holds as well as of the REOs. However, we believe improved conservatism in terms of valuation policies should help limit this risk. Moreover, the declining reliance on REOs will limit its exposure to real estate price risks in the medium term.

Outlook

The positive outlook reflects our expectation that B2 will show largely resilient earnings performance over the next 12-18 months, despite the weak environment in many European markets, and proactively manage its liquidity needs for the upcoming debt maturities.

Upside scenario

We could consider an upgrade over the next 12 months if we continue to see B2 deliver stable earnings, indicating that improved pricing discipline has minimized negative revaluation risks, and that strategic initiatives--including the PIMCO partnership and Veraltis structure--are supportive of revenue generation. At the same time, an upgrade is conditional on B2 refinancing its 2024 maturity while maintaining S&P Global Ratings-adjusted leverage below 3.0x and EBITDA interest coverage above 4.0x.

Although less likely, we could also consider an upgrade if the future focus on unsecured

collections and servicing leads to a better leverage profile, with S&P Global Ratings-adjusted gross leverage improving sustainably to below 2.5x.

Downside scenario

We could lower the rating on B2 if liquidity became constrained over the coming months, which could occur if the company fails to refinance its upcoming maturity via the wholesale funding markets or the bank RCF.

We could also lower the rating if we observe a marked deterioration in secured or unsecured collections, or negative revaluations, leading to diminishing coverage. This would indicate tighter headroom to covenants, which would hinder B2's financial flexibility.

Company Description

Founded in 2011 and domiciled in Norway, B2 Impact has quickly become a well-established pan-European debt purchaser. It has expanded through a combination of organic growth and bolt-on acquisitions of local collection platforms. B2 owns unsecured, and to a lesser extent secured claims and REOs, in 20 countries across Europe with a book value of about NOK15.4 billion. It expects to collect NOK25.4 billion (€2.2 billion, including joint ventures and other assets) on this as of June 30, 2023.

Our Base-Case Scenario

Assumptions

- Annual portfolio acquisitions of about NOK2 billion-NOK3 billion in 2023 and 2024, financed with available cash.
- Strong collection rates that lead to cash revenue growth of about 9%-10% in 2023 and 7%-8% in 2024.
- Costs to collect are stable at about 25%-27% over the next 24 months.
- S&P Global Ratings-adjusted cash EBITDA to reach NOK4 billion in 2024, leading to an EBITDA margin of 61%-63% over the forecast horizon.
- Gross debt is stable at about NOK10.0 billion-NOK10.5 billion.

Key metrics

B2 Impact ASA--Key Metrics

	--Fiscal year ended Dec. 31--			
Mil. NOK	**2021a**	**2022a**	**2023e**	**2024f**
Debt to EBITDA (x)	2.6	3.0	2.5-3.0	2.5-3.0
Debt to EBITDA (x)*	6.8	8.4	>5.0	>5.0
EBITDA interest coverage (x)	5.7	5.1	4.5-5.0	5.0-5.5

B2 Impact ASA--Key Metrics (cont.)

	--Fiscal year ended Dec. 31--			
Mil. NOK	2021a	2022a	2023e	2024f
EBITDA interest coverage (x)*	2.2	1.8	1.5-2.0	2.0-2.5

All figures adjusted by S&P Global Ratings. *EBITDA excluding the add-back for portfolio amortization. a--Actual. e--Estimate. f--Forecast. NOK--Norwegian krone.

Liquidity

We assess B2's liquidity as adequate, since we estimate sources will exceed uses 1.2x in the 12 months started June 30, 2023. Although the PIMCO co-investment structure is fully consolidated, we note that liquidity within this structure is not directly available to B2. This somewhat distorts the consolidated liquidity view we take below.

Principal liquidity sources over the next 12 months from June 30, 2023, include:

- Cash balance of about NOK1.2 billion, including the unrestricted cash balance and short-term deposits.
- The undrawn portion of the RCF and bridge facility of NOK1.8 billion.
- Cash funds from operations of about NOK3.2 billion.

Principal liquidity uses for the same period include:

- Some minor working capital and maintenance capital expenditure (capex) outflows.
- Debt maturities of about NOK2 billion (May 2024).
- Portfolio investments of about NOK2 billion-NOK3 billion, which are subject to market conditions and investment opportunities.
- Shareholder remuneration of about NOK165 million.

Covenants

B2 is subject to maintenance covenants under its bond and RCF documentation. We expect the company will maintain ample headroom.

RCF covenants:

- Net interest coverage ratio: Greater than 4.0x (6.2x as of second-quarter 2023 pro-forma adjusted).
- Leverage ratio: Less than 4.0x (2.3x as of second-quarter 2023 pro-forma adjusted).
- Equity ratio: Greater than 25.0% (32% as of second-quarter 2023).
- Secured loan-to-value ratio: Less than 65% (43% as of second-quarter 2023 per the restricted group that excludes the PIMCO loan and relevant secured assets).
- Total loan-to-value ratio: Less than 75% (69% as of second-quarter 2023).

Bond covenants:

- Net interest coverage ratio: Greater than 4.0x (5.4x as of second-quarter 2023).
- Leverage ratio: Less than 4.0x (2.5x as of second-quarter 2023).
- Secured loan-to-value ratio: Less than 65% (29% as of second-quarter 2023).

Issue Ratings--Recovery Analysis

Key analytical factors

- The issue rating on B2's €200 million and €300 million senior unsecured bonds due in 2024 and 2026 is 'B+' with a recovery rating of '4', indicating our expectation of meaningful recovery (30%-50%; rounded estimate: 45%) in an event of default.
- In our default scenario, we contemplate a default in 2027, reflecting a significant decline in cash flow because of lost clients, difficult collection conditions, or greater competitive pressures, leading to the mispricing of portfolio purchases.
- We use a discrete asset-valuation approach, in line with other debt purchasers with revenue concentrated on own-debt collections.
- We consider the multi-currency senior secured RCF, with a current volume of €610 million. We assume 85% of the facility will be drawn.
- We take the company's portfolio as of year-end 2022, assume 70% of the undrawn RCF balance is used for portfolio purchases, and apply a 25% haircut to the total expected book value as an estimate of resale value in a liquidation.
- Given the carve-out of the secured portfolio (which remains fully consolidated) and its underlying nonrecourse financing structure with PIMCO, we exclude the carved-out assets from our analysis and do not consider the funding received from PIMCO on the debt side.
- In addition, we consider the material volume of REOs and apply a more conservative 45% haircut. This reflects some remaining doubts on the valuation of this real estate.

Simulated default assumptions

- Year of default: 2027
- Jurisdiction: Norway

Simplified waterfall

- Gross enterprise value at default: €896 million
- Administrative costs: 5%
- Net enterprise value after administrative costs: €851 million
- Prior-ranking claims: About €538 million under RCF
- Senior unsecured debt claims: About €684 million
- Recovery expectations: 30%-50% (rounded estimate: 45%)

Note: All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	B+/Positive/-	B+/Stable/-
Business risk:	Fair	Fair
Country risk	Intermediate	Intermediate
Industry risk	Moderately high	Moderately high
Competitive position	Fair	Fair
Financial risk:	Aggressive	Aggressive
Cash flow/leverage	Aggressive	Aggressive
Anchor	bb-	bb-
Modifiers:		
Diversification/Portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Neutral (no impact)	Neutral (no impact)
Financial policy	Neutral (no impact)	Neutral (no impact)
Liquidity	Adequate (no impact)	Adequate (no impact)
Management and governance	Fair (no impact)	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)	Negative (-1 notch)
Stand-alone credit profile:	B+	B+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening, Sept. 25, 2023
- B2Holding's Refinancing Of May 2023 Bond Via Tap Issuance Is In Line With Expectations, Jan. 25, 2023
- Europe's Distressed Debt Purchasers Face Mounting Risks Amid Tough Economic Conditions, Jan. 24, 2023
- B2Holding ASA, Dec. 8, 2022
- B2Holding ASA Outlook Revised To Stable From Positive On Macroeconomic Uncertainty; 'B+' Rating Affirmed, Oct. 26, 2022

Ratings List

Ratings Affirmed		
B2 Impact ASA		
Senior Unsecured	B+	
Ratings Affirmed;/Outlook Action		
	To	**From**
B2 Impact ASA		
Issuer Credit Rating	B+/Positive/--	B+/Stable/--
Ratings Affirmed		
B2 Impact ASA		
Senior Unsecured		
EUR200 mil fltg rate nts due 05/28/2024	B+	
Recovery Rating	4(45%)	
EUR300 mil fltg rate bnds due 09/22/2026	B+	
Recovery Rating	4(45%)	

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