



Intrum Q4 / FY 2018 Results - Leverage Is Really 5x, Not 4.3x?

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- **Key observation #1 – We estimate Intrum’s pro forma (PF) 2018 net debt/Adj EBITDA to be c. 5.0x versus the 4.3x reported by the company, accounting for (structurally senior) debt in the Intrum-Intesa debt purchase joint venture**
- **Key observation # 2 – Intrum’s purchase of Spanish real estate servicer Solvia from Banco Sabadell for EUR 300m risks repeating the impairments Lindorff and Intrum both experienced on their purchase of the Sabadell collection platform carve-out and shows how replenishing the servicing business is capital-intensive when pursued inorganically**
- **Key observation #3 – Operationally the business is at the better performing end of the European debt purchasers, albeit we believe the business was stronger prior to the Lindorff acquisition**
- **Key observation #4 – The 2022 debt maturity wall (c. SEK 21bn, roughly half of Intrum’s net debt) will not be addressed through refinancing with securitisation. Intrum is not currently planning to prime its senior unsecured bondholders**
- **Recommendation – Continue to Avoid all Intrum debt securities and Intrum equity but our preferred shorts in the sector are Arrow equity and Arrow and Lowell senior secured bonds as per our [recent debt purchasers note](#)**
- **Key Observation #1 – We estimate Intrum’s pro forma (PF) 2018 net debt/Adj EBITDA to be c. 5.0x versus the 4.3x reported by the company, accounting for (structurally senior) debt in the Intrum-Intesa debt purchase joint venture (JV)**
- Intrum stated its net debt at FY 2018 at c. SEK 42.1bn and its net debt/PF Adj EBITDA at 4.3x, implying PF Adj EBITDA for 2018 of c. SEK 9.8bn. This is pro forma as if the Intesa JV had been in place from 1/1/18 (rather than just in the final month of 2018)
- The Intesa JV is accounted for as a joint venture and income arising from the JV is recognised using the equity method (the P&L line “participation in associated companies and joint ventures”). We believe Intrum is including this P&L line in its PF Adj EBITDA. This line amounted to SEK 106m in Q4 2018 and FY 2018, reflecting the one month in 2018 for which the JV was in place. Annualised this would give a PF Adj EBITDA contribution of c. SEK 1.3bn from the JV
- The JV, however, is funded 60% with (non-recourse) senior debt which, pertaining to a JV, Intrum does not consolidate even though its Adj EBITDA and Estimated Remaining Collections (ERC) appear to include Intrum’s share of Adj EBITDA and ERC respectively from the JV. If we include Intrum’s 41% share of the c. EUR 1.6bn debt at the JV (which amounts to c. SEK 6.9bn), Intrum’s



PF leverage rises to c 5.0x (total net debt SEK 49bn divided by PF Adj EBITDA of c. SEK 9.8bn). It is unclear whether the 2018 PF Adj EBITDA includes the first 3 months' Adj EBITDA from the Nordic Carve-Out business sold to Lindorff on 31/3/18. If it does, the real PF leverage would be higher still than 5.0x

- We think **the JV structure enables Intrum to take the benefit of its JV P&L within Adj EBITDA without having to consolidate the JV debt.** But the JV senior debt pays down first before cash flows to Intrum's and its co-investor partners' equity in the JV, so although Intrum's PF Adj EBITDA is boosted early on, its expected share in cash flows from the JV are substantially back-loaded, peaking in 2022
- **Key Observation #2 – Intrum's purchase of Spanish real estate servicer Solvia from Banco Sabadell for EUR 300m risks repeating the impairments Lindorff and Intrum both experienced on their purchase of the Sabadell collection platform carve-out and shows how replenishing the servicing business is capital-intensive when pursued inorganically**
- The Solvia acquisition is expected to close in H1 2019. Whilst Intrum expects the transaction to have a deleveraging effect for the group by 2020, it is unclear what the impact will be in 2019. We know that the acquisition will be funded with existing facilities and liquidity and hence increase net debt (all else equal) in early 2019 but we don't know what Adj EBITDA Solvia is expected to bring
- As explained in our recent [European & US Debt Purchasers note](#), Intrum (and Lindorff which it acquired in 2017) experienced write-downs totalling c. EUR 52m on the EUR 159m price paid for Sabadell's collection platform in 2014, which has been the source of its sharp fall in servicing profitability in Spain over 2018
- As we explain in our [debt purchasers](#) note, **servicing EBITDA decays with the decaying collection profile on the portfolios and therefore needs to be replaced, often inorganically through debt-financed business acquisitions. Servicing business is also risky in our view, as it requires fixed costs to be committed in expectation of commissions on collections over multi-year periods on thin margins – any shortfall in collections (and hence commissions) can quickly drive down the EBITDA margin. Solvia is already performing below Intrum's expectations, though it hopes to reflect this in the final acquisition price**
- **Key Observation #3 – Operationally the business is at the better performing end of the European debt purchasers.** A simple comparison: Intrum's portfolio carrying value is 45% greater than Hoist's (Intrum c. SEK 29.6bn including the Intesa JV vs Hoist c. SEK 20.6bn) but Intrum's PF Adj EBITDA is 272% greater than Hoist's (Intrum c. SEK 9.8bn vs Hoist c. SEK 3.6bn in 2018). Clearly Intrum benefits from a vastly greater servicing business but we see that servicing business as the strongest of the large European credit management services firms (EBITDA margin of c. 10% post central cost allocation as per our [debt purchasers](#) note)
- **Key observation #4 – The 2022 debt maturity wall (c. SEK 21bn, roughly half of Intrum's net debt) will not be addressed through refinancing with securitisation. Intrum is not currently planning to prime its senior unsecured bondholders**
- We look at Qualified Receivables Financing carve-out language in the [debt purchaser space in our note](#) and, on balance, view use of such carve-outs as adverse to bondholders though perhaps not to the same extent as some in the market. Intrum senior unsecured bonds have no formal protection against securitisation so it is modestly reassuring that management has no current plans to prime
- **Recommendation** – Although Intrum fares *relatively* well amongst our debt purchaser universe in



terms of bond and equity valuations across our base, stress and bull cases under all of our Everest Research valuation methodologies (DCF; in-force and new business valuation; run-off; and reverse engineered to see what realised gross money multiple is needed to justify current valuations; see our [debt purchaser note](#)) **we continue to Avoid all Intrum debt securities and Intrum equity. Intrum equity still has 88% downside in our stress case and senior unsecured (absent priming) a recovery of 83% in our stress case**

Other observations

- 1. Can Intrum attain its 2.5x to 3.5x leverage target by 2020?** We think, in benign market conditions, Intrum can probably get close to the upper end of this target range (continuing to exclude the Intesa JV debt as per the JV accounting rules). If PF Adj EBITDA remains around the c. SEK 10bn level, portfolio purchasing falls to c. SEK 6bn as intimated by management and other items (tax, interest etc) total c. SEK 2bn, Intrum should be able to reduce net debt from c. SEK 42bn to c. SEK 38bn (two years of positive FCF at SEK 2bn per annum) and then a further c. SEK 1bn from refinancing the Ibercaja property portfolio in H1 2019, leaving 2020 net debt at c. SEK 37bn vs Adj EBITDA c. SEK 10bn. History would suggest, however, that positive FCF is a rarity in the European debt purchase industry! Our approximation here does not reflect the Solvia acquisition which will close in H1 2019 as we do not know the Adj EBITDA from this acquisition, though Intrum has stated the acquisition will be deleveraging by 2020
- 2. Could liquidity get tight?** Intrum was using EUR 646m on its EUR 1.1bn RCF at end 2018, leaving RCF headroom of c. SEK 4.8bn, supplemented with c. SEK 1.3bn in cash and cash equivalents. Whilst this is low compared to expected portfolio purchasing activity of c. SEK 6bn per annum going forward plus the Solvia purchase of c. SEK 3bn to come, we think collections / Adj EBITDA give Intrum enough scope to manage liquidity. The Ibercaja refinancing is also expected to generate c. SEK 1bn of cash in 2019

Results Highlights

METRIC (SEK M)	2018	PF 2017	% CHANGE CONSTANT FX	COMMENT
Credit Management Services (CMS) revenues	9,257	8,852	0%	<ul style="list-style-type: none"> Improving organic trend – excluding Spain +8% yoy in Q4 2018
CMS Adj EBIT	2,489	2,475	-4%	
CMS Adj EBIT margin	27%	28%	-1pp	<ul style="list-style-type: none"> Improving trend across the quarters within 2018. Spanish headwinds relatively well absorbed and



will be offset further in 2019 by servicing for the Intesa JV, Solvia acquisition and full realisation of Lindorff cost synergies

Portfolio Investments (PI) revenues	6,397	5,443	+13%
PI Adj EBIT	3,607	2,883	+22%
PI Adj EBIT margin	56%	53%	+3pp
Adj EBITDA	9,474	8,025	+18%
Net debt / Adj EBITDA	4.3x	4.1x	
Portfolio carrying value	29,576	21,149	+40%
180m ERC	57,382	44,603	+29%
180m gross money multiple on new portfolio purchases	2.0x	1.8x	+0.2x

- Real leverage is c. 5.0x including the Intesa JV debt
- Includes carrying value of investment in Intesa debt purchase JV
- Includes expected cash flows from Intesa debt purchase JV

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