Rating Action: Moody's downgrades Service King's PDR to Caa2-PD, outlook remains negative

07 Aug 2020

New York, August 07, 2020 -- Moody's Investors Service, ("Moody's") today downgraded Midas Intermediate Holdco II, LLC's ("Service King") Probability of Default Rating (PDR) to Caa2-PD from Caa1-PD and the senior unsecured notes rating to Caa3 from Caa2. At the same time, Moody's affirmed the company's Caa1 Corporate Family Rating (CFR) and the B2 rating on its senior secured bank credit facility. The outlook remains negative.

"The downgrade of the PDR and senior unsecured notes rating recognizes the elevated risk due to Service King's looming August 2021 revolver and term loan maturities and potentially lower recovery on the senior unsecured notes that mature in 2022," stated Moody's Vice President Charlie O'Shea. "There is a real possibility that a refinance of the revolver and term loan will result in less flexibility going forward, which would impair Service King's ability to grow, as well as reduce free cash flow," continued O'Shea. "While leverage remains very high, Moody's continues to view the fundamentals of the collision repair sector favorably and believes that management has a strategy that can, if well-executed, reverse weak operating trends."

Downgrades:

..Issuer: Midas Intermediate Holdco II, LLC

.... Probability of Default Rating, Downgraded to Caa2-PD from Caa1-PD

....Senior Unsecured Regular Bond/Debenture, Downgraded to Caa3 (LGD4) from Caa2 (LGD5)

Affirmations:

..Issuer: Midas Intermediate Holdco II, LLC

.... Corporate Family Rating, Affirmed Caa1

....Senior Secured Bank Credit Facility, Affirmed B2 (LGD2 from LGD3)

Outlook Actions:

..Issuer: Midas Intermediate Holdco II, LLC

....Outlook, Remains Negative

RATINGS RATIONALE

Service King's Caa1 corporate family rating reflects its weak credit metrics, with pro forma debt/ EBITDA for the LTM period ended June 30, 2020 of around 11 times and EBIT/interest well below 1 time (including 50% credit for cost savings from front-office re-structuring initiatives executed in early 2020), as well as the looming 2021 debt maturities. Supporting the rating is Service King's solid market position in the highly fragmented collision repair sub-sector, its mutually-beneficial relationships with national and major insurance carriers which represents the vast majority of revenue, and strong industry fundamentals which should support continuing stable demand for its services. However, while demand fundamentals are stable, recent pricing pressure with certain carriers along with higher costs has resulted in an erosion in margins, EBITDA and free cash flow. Moody's expects that new assignment volumes will normalize in FYE 2021, resulting in an improvement in leverage and interest coverage such that they fall below 8 times and approach 1.0 times respectively over the next 12-18 months should the company's successfully execute its operating efficiency initiatives. Additionally, the contribution from recent and future store additions should offset labor pressures and support earnings growth. Service King's liquidity profile is weak, constrained by the August 2021 maturities of its $100 million revolver and $587 million term loan and the rate of cash burn year-to-date. The company has $112 million of balance sheet cash as of June 30, 2020 (including the proceeds from a $92 million draw on its revolving credit facility) which expires in August 2021, with cash reserves available to use for debt repayment of $104 million.

The negative outlook reflects the risks surrounding the speed with and level to which credit metrics will improve, as well as the August 2021 maturity of the senior secured bank credit facility.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Ratings could be downgraded if Service King's near-term maturities are not addressed under reasonable terms in due course. Ratings could also be downgraded if "steady state"operating performance does not show signs of stabilization or if financial strategy becomes more aggressive such that debt/EBITDA remains above 7.5 times or EBIT/interest remains below1.0 time. Ratings could also be downgraded if the company is unable to stem the pace of its free cash flow deficits resulting in a erosion in its already weak liquidity.

Given the negative outlook, an upgrade over the near term is unlikely. Over time, ratings could be upgraded if the company is able to drive meaningful revenue and EBITDA growth such that debt/EBITDA approaches 6.5 times with EBIT/interest sustained materially above 1.25 times. An upgrade would also require the company to maintain at least good liquidity, and the expectation that financial policies will sustain metrics at these levels. Over a shorter horizon, the outlook could return to stable if operating improvements are achieved such that credit metrics begin to generate meaningful positive momentum away from the current downgrade triggers.

Service King is exposed to environmental risk as the company is subject to governmental laws and regulations regarding hazardous waste. Service King could be impacted if they are found to be in purported violation of or subject to liabilities under any of these laws or regulations, or if new laws or regulations are enacted that adversely affect the operations, business, reputation, financial condition, or results of operations. Service King was recently fined by the State of California for failure to adhere with hazardous waste regulations. However, the fine was reduced to an immaterial amount, $1.8 million, following Service Kings early adoption of remediation efforts. Service King has put in a place an ongoing training program to ensure that its employees comply with all hazardous waste requirements going forward. Service King's overall corporate governance risk is high given its financial sponsor ownership. Financial strategy and leverage policy are a key concern with sponsor-owned companies, and in the case of Service King, the key risk is that the sponsor's pursuit of an aggressive pace of debt-funded acquisitions, which has increased total funded debt by more than $300 million since 2014, has resulted in an elevated leverage profile that may limit the company's financial flexibility in the event that earnings deteriorate from current levels.

Headquartered in Richardson, Texas, Midas Intermediate Holdco II, LLC is a leading provider of vehicle body repair services with annual revenue of over $1.1 billion. The company operates under the Service King brand name and operated 339 locations in 24 states as of June 30, 2020.

The principal methodology used in these ratings was Retail Industry published in May 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1120379 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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