24 January 2024 Corporates

Global Refuse Holding Zrt.
Hungary, Business Services

SCOPE BB- POSTIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	93.8x	15.4x	14.0x	9.2x
Scope-adjusted debt/EBITDA	0.5x	1.1x	1.5x	1.7x
Scope-adjusted funds from operations/debt	187%	83%	56%	44%
Scope-adjusted free operating cash flow/debt	84%	93%	5%	2%

Rating rationale

The business risk profile of Global Refuse Holding (GRH) is assessed at B+, supported by its secure local market position, solid operating profitability with EBITDA margins expected to stabilise between 8% and 10% on the medium term. Additionally, the business risk profile is supported by the service strength. The business risk profile is constrained by the diversification, remaining limited in terms of services provided (waste management). Geographical focus of GRH is highly concentrated, with 100% of the revenues generated in Hungary.

The financial risk profile (assessed at BBB+) remains supported by robust interest coverage (Scope-adjusted EBITDA/interest expected to stay above 9.0x) and low leverage (Scope-adjusted debt/EBITDA expected to remain between 1.0x and 2.0x in the medium term). The financial risk profile is constrained by the cash flow cover, as free operating cash flow/Scope-adjusted debt is projected to be volatile till YE 2024, heavily impacted by the capex. Liquidity is adequate, as sources (HUF 2.0bn unrestricted cash forecasted at FYE 2023 and positive free operating cash flow of HUF 125m forecasted for 2024) fully cover the uses (short-term debt of HUF 347m forecasted for 2024).

GRH's limited size and outreach compared to other entities rated in the BB rating category hinder its issuer rating, which is reflected by a negative one-notch adjustment on the standalone credit assessment.

Outlook and rating-change drivers

The Positive Outlook reflects our expectation that GRH's financial risk profile can be sustained at a good level, as signalled by a leverage (Scope-adjusted debt/EBITDA) standing consistently below 2.0x and the generation of consistently positive free operating cash flow despite significant capex, particularly in 2024. This goes along an improved revenue generation capacity driven by the company's prominent position as a regional municipal waste management coordinator in the Hungarian waste management system as a subcontractor. At the same time, the Positive Outlook reflects the likelihood that transparency will be improved on the company's long-term municipal waste contracts and on its consolidated group accounts.

A rating upgrade could be warranted if GRH collectively i) strengthened its business risk profile, most probably through securing of a long-term subcontractor agreement with MOHU, thereby improving the service strength and providing increased visibility on medium-term cash flow generation, ii) provided improved transparency through audited consolidated group accounts and iii) kept its leverage - Scope-adjusted debt/EBITDA - below 2.0x on a sustained basis.

A negative rating action such as a revision of the Outlook to Stable could result if our expectations about improvements on contracts and/or audited consolidated group accounts or expectations regarding the group's sustained leverage are unlikely to materialise. Moreover, a negative rating action, such as a Negative Outlook or a downgrade, might be warranted in case Scope-adjusted debt/EBITDA was expected to move to above 2.0x on a sustained basis.

Ratings & Outlook

Issuer	BB-/Positive
Senior unsecured guaranteed bond	BB

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Related Methodologies

General Corporate Rating Methodology; October 2023

European Business and Consumer Services Rating Methodology; January 2024

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Global Refuse Holding Zrt.

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
24 Jan 2024	Outlook change	BB-/Positive
24 Jan 2023	Upgrade	BB-/Stable
20 Dec 2021	New	B+/Stable

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong regional position as a subcontractor of MOHU MOL, with improved revenue generation capacity in the new concession system • Solid credit metrics, even after the inclusion of Éltex to the scope of consolidation • Contribution towards a circular economy (credit-positive ESG factor) • Sole operator of the Békéscsaba regional waste disposal plant (BVÜ) since 1996	• Geographically limited to one region of Hungary (very limited diversification) • Use of landfill (credit-negative ESG factor) • Very volatile cash flow cover, constrained by high debt-funded capex needs • Medium-term subcontractor agreement with MOHU MOL (potential threat to business continuity at expiry) • No audited consolidated accounts available following the consolidation of Éltex (credit-negative ESG factor)

Positive rating-change drivers	Negative rating-change drivers
• Strengthened business risk profile and improving transparency of financial disclosures while Scope-adjusted debt/EBITDA remains below 2.0x	• Scope-adjusted debt/EBITDA moving above 2.0x for a prolonged period, as the result of weaker profitability or a further increase in debt • Failure to improve transparency regarding contracts and financial disclosures

Corporate profile

GRH has been active in the Hungarian waste management market since 1993. It manages a group of companies that operate in waste management, public cleaning, landfill management and waste trading. GRH is the owner of Tappe Kft. (Tappe), Békéscsabai Városüzemeltetési Kft (BVÜ), Global Refuse Nonprofit Kft. (GRN) and Global Refuse Metal Kft. (GRM) and Éltex Kft. GRH's operates through these subsidiaries.

The ownership structure of GRH is as follows: 80% is owned by Equilor Fund Management Co. through their Central European Opportunity PE Fund and 20% is owned by Coactore Kft.

Tappe is a direct subsidiary of GRH, it has been providing waste collection and transportation services in Békés county since 1993. Following the implementation of the new concession system in July 2023, Tappe is now operating as a regional coordinator in two additional counties and providing facility operator services to MOHU. The main activities of Tappe currently include waste collection and transportation, regional coordination services, waste facility operation and public and road cleaning in the city of Békéscsaba.

GRM joined the GRH group in 2021. Its main activity is waste material trading, which adds a new and growing segment to the group's operations.

In 2022 GRH acquired 70% of the shares of Éltex, a leading industrial waste management service provider in Hungary, focusing on the collection, treatment, utilisation and reuse of industrial waste.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	101.6x	93.8x	15.4x	14.0x	9.2x	10.0x
Scope-adjusted debt/EBITDA	0.4x	0.5x	1.1x	1.5x	1.7x	1.6x
Scope-adjusted funds from operations/debt	212%	187%	83%	56%	44%	47%
Scope-adjusted free operating cash flow/debt	215%	84%	93%	5%	2%	19%
Liquidity	>200%	>200%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,404	1,693	4,035	4,202	3,897	3,950
Operating lease payments	-	-	103	80	80	80
add: other items	-	-	336	-	-	-
Scope-adjusted EBITDA	**1,404**	**1,693**	**4,474**	**4,282**	**3,977**	**4,030**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,404	1,693	4,474	4,282	3,977	4,030
less: (net) cash interest paid	(14)	(18)	(290)	(305)	(432)	(403)
less: cash tax paid per cash flow statement	(54)	(149)	(284)	(544)	(587)	(643)
add: depreciation component operating leases	-	-	91	68	68	71
Funds from operations (FFO)	**1,336**	**1,526**	**3,991**	**3,501**	**3,026**	**3,055**
Free operating cash flow in HUF m						
Funds from operations	1,336	1,526	3,991	3,501	3,026	3,055
Change in working capital	(209)	(2)	(1,046)	(643)	(547)	(119)
Non-operating cash flow	310	(177)	1,766	25	25	25
less: capital expenditure (net)	(82)	(665)	(233)	(2,579)	(2,391)	(1,707)
Free operating cash flow (FOCF)	**1,356**	**682**	**4,478**	**304**	**113**	**1,254**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	14	18	278	292	419	394
Interest component operating leases	-	-	12	13	13	9
Net cash interest paid	**14**	**18**	**290**	**305**	**432**	**403**
Scope-adjusted debt in HUF m						
Reported gross financial debt	455	614	6,167	6,792	6,988	6,559
less: subordinated (hybrid) debt	-	-	-	-	-	-
less: cash and cash equivalents[1]	-	-	(1,908)	(1,005)	(567)	(444)
add: non-accessible cash	-	-	-	-	-	-
add: operating lease obligations	-	-	308	220	151	78
add: asset retirement obligations	175	200	260	285	310	335
Scope-adjusted debt	**630**	**814**	**4,827**	**6,292**	**6,882**	**6,528**

[1] 50% of cash per balance sheet

Table of Content

Environmental, social and governance (ESG) profile[2]

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)

ESG strategy

We flag 'resource management' as credit-positive due to GRH's importance towards a circular economy in Hungary (credit-positive ESG factor).

However, we also highlight the negative effects of using landfills. GRH's subsidiary BVÜ is the sole operator of the Békéscsaba regional waste disposal site since 1996. According to the permit that gives BVÜ the permission to operate landfill, the site must be covered with a temporary sealing layer by the end of the year following the abandonment, and the landfill must be covered and recultivated with a permanent sealing layer no later than 30 years after the abandonment of the site. In the meantime, aftercare is also needed. The calculated provision of aftercare was HUF 260m as of FYE 2022. Due to the stringent EU policies and the high regulatory expenses associated with such landfills, the robustness of the landfill revenue streams is questionable, making this a credit-negative ESG factor.

Following the acquisition of Éltex in 2022 and inclusion of the company in the scope of consolidation, GRH has not been able to provide audited consolidated financial statements, resulting in increased uncertainties regarding transparency of financial disclosures (credit-negative ESG factor). This results in a limited reflection of GRH's solid financial risk profile within the standalone credit assessment.

[2] 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: B+

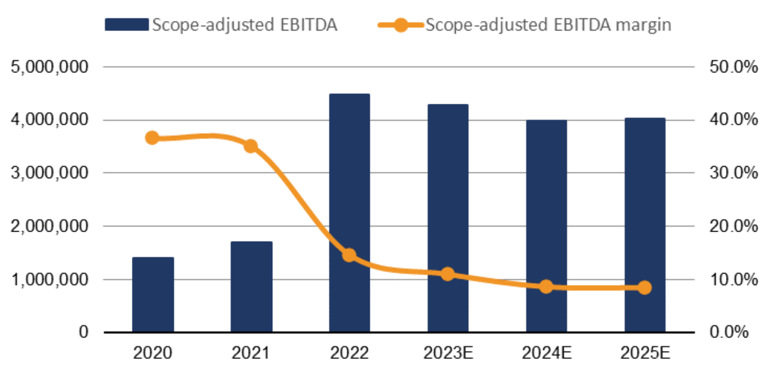
Industry Risk Profile: BB

GRH is a waste management company that falls under the business and consumer services sector. GRH is an asset-heavy service company, which employs mostly non-specialised workforce. This subsector of the industry is defined by medium cyclicality, medium market entry barriers and low substitution risk, leading to a BB industry risk profile.

Quasi-monopolistic market position under the concession system

In February 2021 the Parliament of Hungary approved a new act on waste management. Starting in July 2023 waste management has been transformed into a concession-based system, where MOL Plc's subsidiary MOHU MOL Hulladékgazdálkodási Zrt. (‚MOHU'), as a sole concessionaire, is responsible for operating the municipal waste management system on a national level. MOHU has granted the regional waste management operation in Békés county to Tappe. Tappe also provides regional coordination services to MOHU in Hajdú-Bihar and Szabolcs-Szatmár-Bereg county to MOHU as a concessional subcontractor. In addition to the above, Tappe provides facility operation services to MOHU: operating a waste sorting plant, a mechanical-biological waste treatment plant, four waste transfer stations and nine waste yards, and performing the logistics tasks between the individual sites. Currently there is a medium-term contract between MOHU and Tappe, with the potential for extension up to 10 years, marking the second step in establishing long-term cooperation between the companies. While we believe that there are good chances for an extension of the contracts in the next round of concession allocations, there are still uncertainties whether Tappe will succeed with long-term contracts.

Figure 1: EBITDA & EBITDA margins 2020-2025 (HUF '000)



Sources: GRH, Scope estimates

Still limited geographical and service diversification

Geographical diversification remains limited to the South-Eastern part of Hungary where GRH is the leader in handling municipal waste. However, GRH's geographical scope shows improvement as a regional municipal waste management coordinator since 2022, now operating in three counties and servicing 398 municipalities of instead of servicing one county and 74 municipalities in 2022. While the diversification in its services portfolio is still highly focused on waste management, GRH is also active in supplementary business services of municipal waste management, such as winter road cleaning, waste container rental and waste yard operations. With GRH serving about 92% of the region's population and operating the only major landfill site in Békés county, the group holds a strong position in its service territory.

Service strength is expected to remain strong in the medium term

Taking into consideration the quasi-monopolistic position of Tappe in the field of municipal waste management, revenue stability and predictability is deemed supportive to the business risk profile. Due to the regulatory environment, no company is allowed to provide such service other than the subcontractor of MOHU. This results in low customer churn, signalling a high share of recurring revenues, multi-year contracts and no possibility to switch service providers for households in the region. Service integration is high, deemed as an essential service for households (in a similar manner to public utilities), and provided by Tappe and its subcontractors on an exclusive basis.

Lower EBITDA margin on the group level post-acquisition

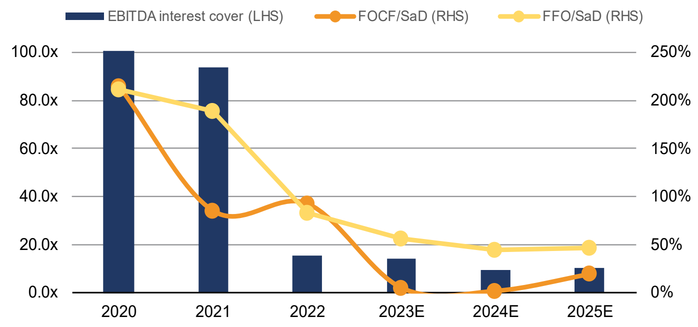
Following the integration of Éltex to the scope of consolidation, EBITDA margin on the group level has decreased significantly, negatively affected by the lower margin of the newly consolidated entity (historically between 6% and 10%, expected to remain on the same level in the medium term). In 2022 this resulted in a group level Scope-adjusted EBITDA margin of 15%, which is expected to gradually deteriorate to between 8% and 9% in the medium term, effected by rising wage costs, increased input prices and costs associated with the regional coordinator role of GRH (e.g. maintenance and operation of customer service offices).

Financial risk profile: BBB+

Strong credit metrics drive the rating

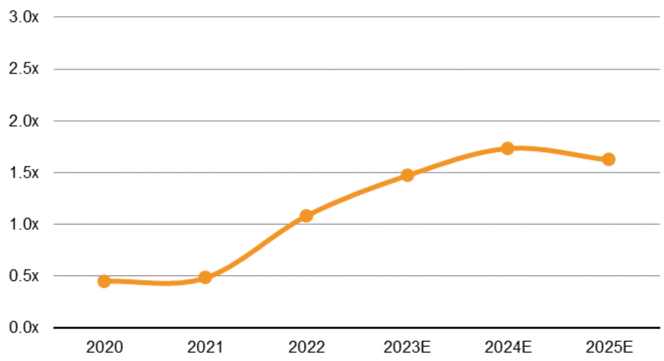
The financial risk profile (assessed at BBB+, raised from BBB-) remains supported by robust interest coverage, with Scope-adjusted EBITDA/interest expected to stay above 9.0x sustainably. The interest coverage benefits from the favourable, fixed interest rate of the bonds issued by the consolidated entities (GRH: 5.1%, Éltex: 3.5%). Average interest rate in 2023 is expected to be around 4.3%, which is expected to increase to close to 6% with the additional debt intake (new loans of Tappe and BVÜ with an interest rate of 6.5%) in 2024.

Figure 2: Scope-adjusted debt protection and cash flow cover



Sources: GRH, Scope estimates

Figure 3: Scope-adjusted leverage (x)



Sources: GRH, Scope estimates

Modest leverage despite additional debt intake forecasted for 2024

Leverage, measured by Scope-adjusted debt/EBITDA, is expected to remain between 1.0x and 2.0x in the medium term, positively affected by the amortisation of the Éltex bonds, but negatively affected by the additional debt intake forecasted for 2024 on the subsidiary level. GRH is expected to reach its peak at 1.7x at YE 2024, driven by the additional debt intake. Beyond 2024, we expect gradual deleveraging, bolstered by debt amortisation and stagnating SaEBITDA development.

Volatile free operating cash flow generation forecasted

Cash flow cover, measured by free operating cash flow/Scope-adjusted debt is projected to be volatile till YE 2024 (the end of the current capex-heavy period), heavily impacted by capex. We expect the investment activity to slow down beyond 2024, resulting in significantly higher free operating cash flow over the medium term.

Adequate liquidity

GRH's liquidity as measured by internal and external liquidity remains above 200% at all times, even in 2023 and 2024 when the liquidity is constrained by low free operating cash flow. Nonetheless, despite rising debt levels, high capex and also dividend payouts (that have not been captured in the business plan by the management), we do not envisage any difficulty in timely reimbursement of GRH's debt over the next three years.

Moreover, benefitting from its long-term relationship with financing banks and good working capital management strategy, we assess GRH's liquidity as adequate. This view is also supported by an expected unrestricted cash balance of HUF 2.0bn at FY2023 and HUF 113m free operating cash flow forecasted for 2024 fully covering the short-term debt of HUF 347m forecasted for 2024.

Balance in HUF m	2022	2023E	2024E
Unrestricted cash (t-1)	1,152	3,816	2,010
Open committed credit lines (t-1)	-	-	-
Free operating cash flow (t)	4,478	304	113
Short-term debt (t-1)	289	640	347
Coverage	**>200%**	**>200%**	**>200%**

Expected compliance with ratings-relevant covenants

We highlight that GRH's senior unsecured guaranteed bond issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 3.5bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (immediate repayment). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is 2 notches. We therefore see no significant risk of the rating-related covenant being triggered. The senior unsecured guaranteed bond issued by GRH has no financial covenants.

Supplementary rating drivers: minus one notch

Negative rating adjustment for peer context

GRH's limited size and outreach compared to other entities rated in the BB category hinder its issuer rating, which is reflected by a negative one-notch adjustment on the standalone credit assessment.

The financial policy is credit-neutral. Moreover, we did not encounter any risk factors related to GRH's governance, which is supported by a well experienced and committed top management. Thus, we assess GRH's governance to be credit-neutral.

The minority shareholder, Ferenc Figura, engages in executive management of the company and he will continue to remain in the management, and thus there is no key person risk attached to the owners.

Weaknesses on transparency reflected in conservative rating assessment

We note that following the acquisition of Éltex and inclusion of the company in the scope of consolidation GRH has not been able to provide audited consolidated financial statements, resulting in increased uncertainties regarding transparency of financial disclosures (negative ESG factor) leading to a low emphasis of the improved financial risk profile within the credit assessment.

Long-term debt rating

Senior unsecured guaranteed debt rating: BB

In January 2022, GRH issued a HUF 3.5bn senior unsecured guaranteed bond (ISIN: HU0000361316) through the Hungarian central bank's Bond Funding for Growth Scheme. The bond's tenor is 10 years, with a fixed coupon rate of 5.1% and repayment in six tranches of 10% in 2027, 2028, 2029, 2030, 2031 and a 50% tranche in 2032. The bond has been issued with a guarantee from the related companies Tappe Kft. and BVÜ Kft. The recovery analysis indicates an 'above average' recovery for the senior unsecured guaranteed bond and for all other senior unsecured debt positions, even after all senior secured debt would have been fully recovered. The recovery is benefiting from the high level of fixed assets (mainly consisting of PPE), translating into a debt instrument rating of the senior unsecured guaranteed bond one notch above the issuer rating (BB).

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