GVC George's Venture Capital Zrt.
Hungary, Business Services

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	32.9x	9.3x	10.0x	11.3x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	Net Cash	3.0x	4.0x	3.5x
Funds from operations (FFO)/SaD	Net Cash	29%	22%	25%
Free operating cash flow (FOCF)/SaD	Net Cash	-31%	-3%	-1%

Rating rationale

The rating downgrade is driven by GVC George's Venture Capital Zrt. (GVC)'s constrained operating profitability, driven mainly by higher prices for raw materials and commodities, which represent a significant portion of the cost base. The company's business model of long-term operating contracts with price adjustments at the beginning of each business year lags behind immediate increases in its cost base. While we believe GVC has purchasing power and an ability to renegotiate service prices with top customers to some extent, elevated production costs will still have a negative effect on profitability in the short-to-medium term. Furthermore, strained EBITDA generation will have a negative impact on the company's financial profile.

Leverage is assessed without netting of cash due to the lowered rating in line with methodology and a high cash balance that Scope expects to be partly used in future instead of serving as a liquidity buffer.

Outlook and rating-change drivers

The Stable Outlook incorporates our expectation that SaD/EBITDA will peak at 4.0x in 2022 and decrease again thereafter.

A positive rating action could follow an improvement in the business risk profile, driven by increasing operating profitability or revenue stream diversification with less exposure to public tenders. A positive rating action could also be warranted if leverage, expressed by SaD/EBITDA, fell below 3.0x. In addition, stabilization and integration of the acquired companies is necessary.

A negative rating action could result from a deterioration in credit metrics as indicated by SaD/EBITDA of above 4.0x on a sustained basis. Weak financial performance could be triggered by an adverse change in regulations and/or macroeconomic conditions, further increasing input costs and putting operating profitability under pressure.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
28 July 2022	Downgrade	BB-/Stable
28 July 2021	Affirmation	BB/Stable
22 September 2020	New	BB/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

Analyst

Zurab Zedelashvili
+49 69 6677389 947
z.zedelashvili@scoperatings.com

Related Methodology and Related Research

General Corporate Rating Methodology, July 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Leading position in Hungary's outsourced catering market • Customer retention rate above 90% underlines positive track record of fulfilling tender requirements • Favourable public contract terms reflected in high EBITDA cash conversion	• Weak diversification with operations only in Hungary and only in one industry • Changeable regulatory framework in terms of food safety requirements

Positive rating-change drivers	Negative rating-change drivers
• Sustained improvement in business risk profile	• SaD/EBITDA above 4x

Corporate profile

GVC has been operating in the Hungarian catering market (corporate, healthcare, social care and schools) for 20 years. The company offers services in major cities throughout the country, including Budapest, Debrecen, Esztergom, Székesfehérvár, Pécs, Siófok, Sárvár and Győr. It serves around 180,000 consumers daily, has over 300 contractual partners, 50 locations nationwide and about 3,000 employees. GVC is a 100% family-owned company.

Financial overview

				Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	n/a	32.9x	9.3x	10.0x	11.3x
SaD/Scope-adjusted EBITDA	Net Cash	Net Cash	3.0x	4.0x	3.5x
FFO/SaD	Net Cash	Net Cash	29%	22%	25%
FOCF/SaD	Net Cash	Net Cash	-31%	-3%	-1%
Scope-adjusted EBITDA in HUF m					
EBITDA	2,868	2,621	2,722	1,953	2,193
Capitalised costs	0	0	0	0	0
Other items	0	-253	0	0	0
Scope-adjusted EBITDA	2,868	2,368	2,722	1,953	2,193
FFO in HUF m					
Scope-adjusted EBITDA	2,868	2,368	2,722	1,953	2,193
less: (net) cash interest paid	38	-27	-247	-150	-150
less: cash tax paid per cash flow statement	-124	-165	-171	-88	-92
Other items	0	0	0	0	0
FFO	2,782	2,176	2,304	1,716	1,953
FOCF in HUF m					
FFO	2,782	2,176	2,304	1,716	1,953
Change in working capital	-459	1,196	-494	-982	-459
Non-operating cash flow	-71	58	0	-71	58
less: capital expenditure (net)	-1,883	-193	-4,331	-1,000	-2,500
Change in provisions	0	0	0	0	0
FOCF	362	3,320	-2,521	-267	-114
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	12	27	292	195	195
Change in other items	0	0	0	0	0
Net cash interest paid	12	27	292	195	195
SaD in HUF m					
Reported gross financial debt	1,565	7,950	7,999	7,744	7,634
less: cash and cash equivalents	-3,487	-10,212	-3,057	-1,885	-1,011
add: Guarantees	77	67	67	60	61
add: Provisions	171	0	0	0	0
add: non-accessible cash	1,500	1,500	3,057	1,885	1,011
SaD[1]	Net Cash	Net Cash	8,066	7,804	7,695

[1] SaD is calculated without netting of cash from 2021 due to the lowered rating in line with methodology and a high cash balance that Scope expects to be partly used in future instead of serving as a liquidity buffer.

Table of contents

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)

[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+

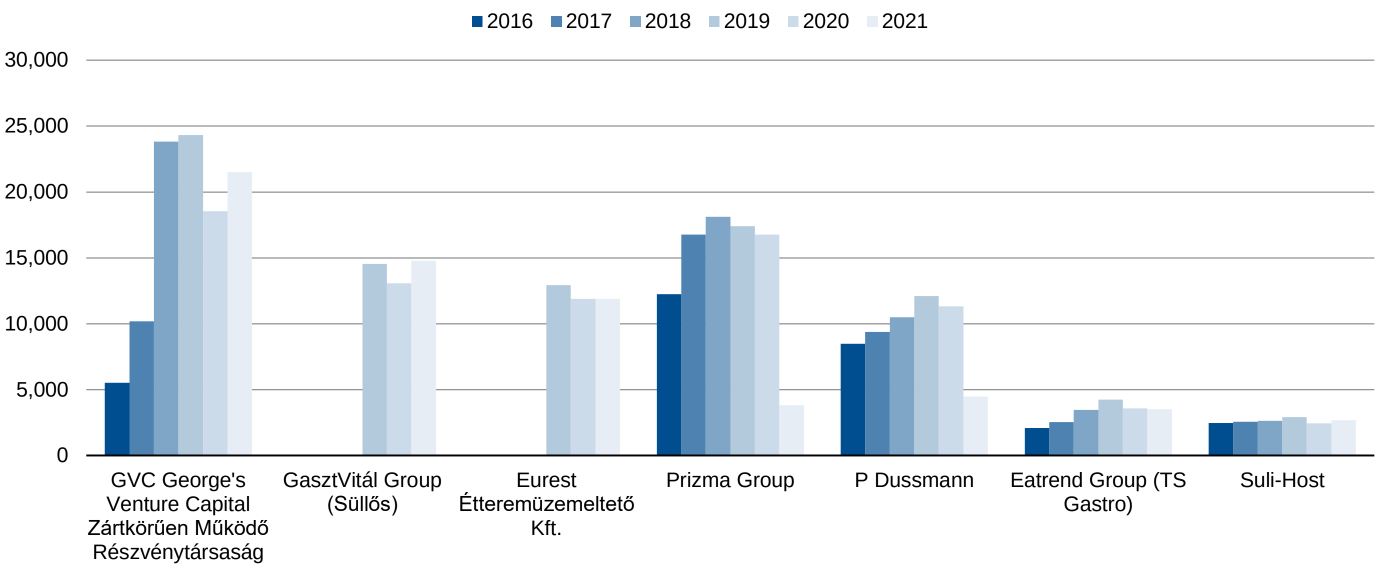
Credit-neutral Industry risk

The underlying business service industry's medium cyclicality, medium barriers to entry and medium substitution risk are credit-neutral for the business risk profile.

Dominant player in Hungarian outsourced catering market

GVC has maintained a leading position in Hungary's fragmented outsourced catering market. The company had more than a 20% share of the state school catering market and around a 6% share of the corporate catering market by sales in 2019. Yet its market position remains constrained by a relatively limited addressable market (<HUF 300bn).

Figure 1: Hungarian catering market snapshot (HUF m)



Sources: GVC, Scope

Diversification is weak component of business risk profile

Geographical diversification remains the weak factor for GVC's business risk profile as the company only operates in one country and one industry. Dependence on public tenders further limits diversification. We do not expect any significant changes in revenue-stream diversification in the medium term.

Sticky market structure could provide additional benefits to GVC in long term

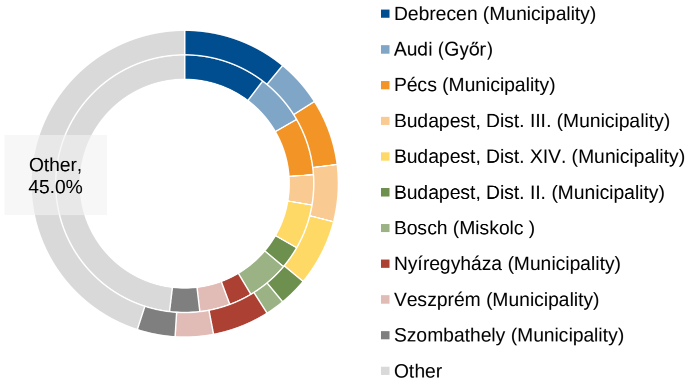
In addition, inorganic growth opportunities will arise in the medium-to-long term from intermittent, selective consolidation potential in a highly fragmented market. This was the case in the past for the Elamen and Sodexo acquisitions in 2016 and 2017 respectively. The Hungarian state spends a considerable amount of money on public catering, yet food quality continues to deteriorate following its agreements with suppliers. Public institutions cannot withdraw from these contracts for a certain period of time even when suppliers use ingredients of poorer and poorer quality. Despite this, our rating case does not incorporate any significant acquisitions in the foreseeable future.

Changing regulatory environment

Several regulatory standards have been introduced on the market to improve the quality of public catering. These could give GVC an additional competitive advantage in its fragmented market. We believe that efforts to reform the public catering market in upcoming years will be incremental rather than dramatic. However, we underline continued high dependence on government-funded revenue streams as a significant risk as any changes to reimbursement portfolios or prices could have a significant adverse effect on companies' business performance.

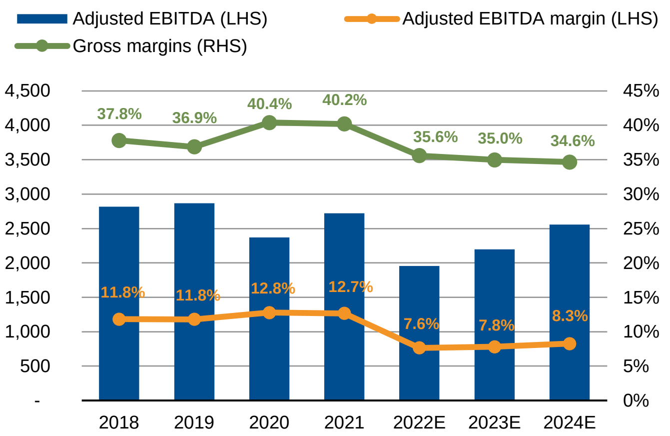
Despite the pandemic's worse-than-expected negative impact on GVC's top line, the company managed to maintain EBITDA of HUF 2.7bn and an EBITDA margin above 10%, as we anticipated in our last base case. This was thanks to its ability to reduce salary costs via layoffs and a gradual improvement in gross margins by optimising the supply chain after the Sodexo acquisition.

Figure 2: GVC's customer concentration (inner circle = 2020, outer circle = 2021)



Sources: GVC, Scope

Figure 3: GVC's operating performance (HUF m)



Sources: GVC, Scope estimates

Profitability under pressure going forward

GVC's operating profitability is expected to deteriorate, with EBITDA margins dropping below 10% as a result of a significantly increased cost base due to expected inflation. The macroeconomic context is unfavourable as Russia's war in Ukraine has exacerbated inflation and supply chain disruptions, cutting short a robust post-Covid recovery. Supply bottlenecks and blockages from the war are squeezing profitability and cash flow. Suppliers of agricultural products are having to contend with soaring commodity prices while also having to hold more inventory amid product shortages and supply chain disruptions.

Financial risk profile: BB

Scope's adjustments and assumptions

Our financial projections are mainly based on the following assumptions:

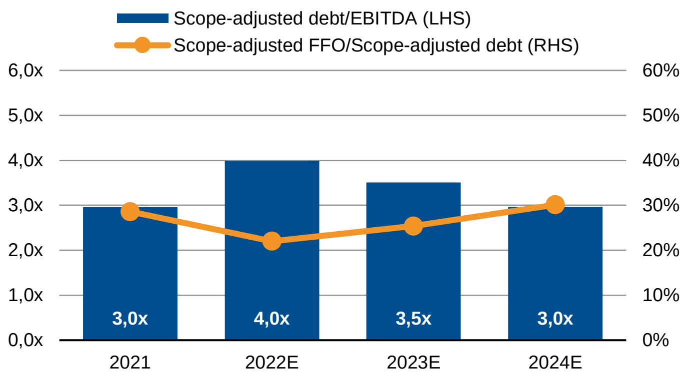
- Top line growth in the mid-single-digit percentage range going forward
- Dividend payments capped at HUF 650m as stated in the bond prospectus
- EBITDA adjusted for changes in provisions and gains on fixed asset disposals
- No acquisitions are expected. No material disposals are expected.

Financial risk profile affirmed at BB

GVC's financial risk profile is expected to be constrained by elevated leverage as a consequence of lower EBITDA generation potential. Although indebtedness has remained flat at around HUF 8.0bn, the expected negative development of EBITDA (in absolute terms) will put leverage at around 4.0x in the short term. Delayed operational integration of twin acquisitions Food Universum and PVK Horog Kft. is limiting EBITDA development. We expect leverage, as expressed by SaD/EBITDA, to decrease toward 3.5x in the medium term.

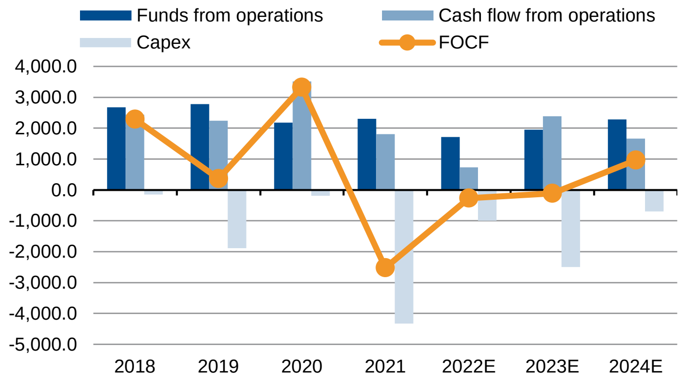
Leverage is assessed without netting of cash due to the lowered rating in line with methodology and a high cash balance that Scope expects to be partly used in future instead of serving as a liquidity buffer.

Figure 4: Leverage



Source: GVC, Scope estimates

Figure 5: Cash flow generation (HUF m)



Source: GVC, Scope estimates

Positive FOCF in medium term

Favourable collection of receivables continues to keep GVC's working capital needs moderate despite expected supply chain bottlenecks.

After the company acquired 20% of Zág Körte in 2021 (the remaining 80% is owned by the Gyorgy family), it expected to use refinanced bank loans to pay back a HUF 4bn intercompany loan to finance the acquisition of the remaining entities in Zalai Group. Given an increasing interest rate environment, management decided to convert its short-term loan to a long-term investment and amortise it over the next 10 years. While the bond prospectus clearly defines the use of proceeds according to the initial plan (development of dietary kitchen R&D and construction, refinancing of existing loans) and the provided intercompany loan could signal a soft covenant breach, the financial statements of Zalai Group (standalone) suggest that management is correct in saying that the intercompany loan can be collected in a short period of time once needed.

Furthermore, we believe intercompany loans would have a limited positive impact on GVC's financial risk profile. Although management communicated 3% interest on intercompany loans without the arm's length principal, interest could be cumulative and have no cash effect in the short-to-medium term. As a result, we have left potential cash interest income out of our metrics calculation.

Fixed interest base

We expect the ratio to remain at a strong level of above 10x in 2022-24 supported by the fixed interest rate on the issued bond.

Adequate liquidity

We consider GVC's liquidity to be adequate. This is driven mainly by a limited short-term debt position and sound EBITDA cash conversion. While an expected increase in maintenance and development capex in upcoming years will turn FOCF negative, the significant cash buffer should be sufficient to fully cover financing and refinancing needs.

Supplementary rating drivers: +/- 0 notches

Credit-neutral financial policy

We have not made any explicit adjustments for supplementary rating drivers. Although the company has not communicated an official financial policy, we understand that the owners and management aim to maintain a conservative dividend policy. Its financials enjoy additional protection thanks to a dividend cap of HUF 650m mentioned in the bond prospectus.

Long-term debt rating

Senior unsecured debt rating downgraded to BB- from BB

Senior unsecured debt issued by GVC has been downgraded to BB- from BB, in line with the issuer rating. This rating is based on a hypothetical liquidation scenario as of year-end 2024, in which we computed an ‘average’ recovery for holders of senior unsecured debt based on our assumption of attainable liquidation values.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer