GVC George's Venture Capital Zrt
Hungary, Business Services

SCOPE BB STABLE

GVC George's Venture Capital Zrt has been operating on the Hungarian catering market (corporate, healthcare, social care and schools) for 20 years. The company offers services in major cities throughout the whole 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 around 3,000 employees. GVC is a 100% family-owned group. GVC has increased company size through Elamen-Bakony Zrt. and Sodexo Hungary Ltd acquisitions in 2016 and 2017 respectively.

Key metrics

			Scope estimates		
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA/interest cover (x)	n/a	n/a	9.4x	13.9x	16.4x
Scope-adjusted debt (SaD)/EBITDA	0.0x	Net Cash	Net Cash	2.3x	1.8x
Scope-adjusted funds from operations/SaD	Net Cash	Net Cash	Net Cash	39%	53%
Free operating cash flow/SaD	Net Cash	Net Cash	Net Cash	-96%	32%

Rating rationale

Scope Ratings has today assigned an issuer rating of BB/Stable to Hungary-based GVC George's Venture Capital Zrt. A rating of BB is assigned to the senior unsecured debt category.

The issuer rating of BB reflects GVC's sound financial performance, driven by relatively high profitability, low maintenance capex requirements and well-established business operations in the Hungarian outsourced catering market. The rating is constrained by limited scale and a lack of geographical and revenue stream diversification.

GVC's business risk profile (rated BB-) benefits from the company's leading position in the fragmented Hungarian outsourced catering market, with more than 15% of state school catering market shares and around 10% of corporate catering market shares by sales. A positive track record of securing public tenders for catering, together with the long-term nature of contracts, provide stable recurring revenues and a competitive advantage over new market entrants as 70% of the company's sales are made through tenders. However, the diversification of revenues streams is limited by this significant exposure to government contracts. In 2020, GVC's top line is expected to take a hit from the Covid-19 pandemic, which led to the closure of educational institutions and production factories in the spring. The economic downturn may intensify, and recovery may be subdued next year, but current assumptions incorporate a rebound in sales in the short term. Profitability margins worsened after the Sodexo acquisition because EBITDA margins from corporates are lower than from public tender contracts. Nevertheless, we believe that GVC will be able to keep EBITDA margins above 10%.

GVC's financial risk profile (rated BBB-) is supported by its healthy operating profitability, which translates into a good underlying cash generation capability. Relatively low financial debt on the balance sheet and prudent operating performance have kept GVC's credit metrics in favourable territory in the past. We therefore believe they are highly likely to remain comfortable in the context of the ratings in the short-to-medium term. GVC's liquidity profile had been adequate in recent years, mainly driven by a limited short-term debt position and

Ratings & Outlook

Corporate rating	BB/Stable
Senior unsecured rating	BB

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Related Methodology

Corporate Rating Methodology

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Bloomberg: SCOP

sound EBITDA cash conversion, with low capital expenditure resulting in stable and positive free operating cash flow (FOCF).

We do not expect significant changes in the company's future capital investment programme and/or debt-financed acquisitions. We believe that GVC will only pursue inorganic growth opportunities to a limited extent over the next few years, focusing on organic growth.

GVC plans to issue a HUF 7.0bn senior unsecured corporate bond under the MNB Bond Funding for Growth Scheme. The planned bond has the following characteristics: 3% coupon and 10 years' maturity amortising in the last four years. Proceeds from the bond are allocated to capital expenditures related to dietary kitchen plants and the refinancing of the existing investment loan in the amount of HUF 529m.

Our recovery expectation for senior unsecured debt translates into a rating equal to GVC's issuer rating.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that the Covid-19 pandemic will not have a negative long-term effect on the company's operations and that SaD/EBITDA will remain below 3.0x on a sustained basis after the successful bond issuance.

A positive rating action could be indicated by an improved business risk profile, driven by increasing size or operating profitability via organic growth, revenue stream diversification with less exposure to public tenders, and increased regional or industry coverage. However, a positive rating action is unlikely in the near future, given the expansion plan for the next three years, which will only bear fruit after 2021.

A negative rating action could result from a deterioration in credit metrics, as indicated by FOCF of below 10% and SaD/EBITDA of above 3.5x on a sustained basis. Weak financial performance could be triggered by an adverse change in regulations, putting operating profitability under pressure, debt-financed acquisitions or higher than expected dividend payments.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leading position in Hungary's outsourced catering market • Significant sales backlog and customer retention rate above 90% underline positive track record in fulfilling tender requirements • Favourable public contract terms regarding price flexibility reflected in solid EBITDA cash conversion • Low leverage	• Weak diversification with operations only in Hungary and only in one industry • Changeable regulatory framework in terms of food safety requirements

Rating-change drivers

Positive rating drivers	Negative rating drivers
• Sustained improvement in business risk profile	• FOCF of below 10% and Scope-adjusted debt (SaD)/EBITDA of above 3.5x

Financial overview

			Scope estimates		
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA/interest cover (x)	n/a	n/a	9.4x	13.9x	16.4x
SaD/EBITDA	0.0x	Net Cash	Net Cash	2.3x	1.8x
Scope-adjusted FFO/SaD	Net Cash	Net Cash	Net Cash	39%	53%
FOCF/SaD	Net Cash	Net Cash	Net Cash	-96%	32%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA	2,816	2,869	1,894	2,774	3,155
Operating lease payments in respective year	0	0	0	0	0
Other	0	0	0	0	0
Scope-adjusted EBITDA	2,816	2,869	1,894	2,774	3,155
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020F**	**2021F**	**2022F**
EBITDA	2,816	2,869	1,894	2,774	3,155
(net) cash interest as per cash flow statement	109	38	-157	-154	-147
cash tax paid as per cash flow statement	-107	-124	-94	-70	-84
Other					
Scope FFO	2,818	2,783	1,643	2,550	2,924
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020F**	**2021F**	**2022F**
Reported gross financial debt	1,062	1,545	7,825	7,685	7,425
Cash, cash equivalents	-1,290	-1,987	-8,456	-1,390	-2,098
Guarantees	0	77	67	67	60
Provisions	178	171	150	150	150
SaD	Net Cash	Net Cash	Net Cash	6,513	5,537

Business risk profile

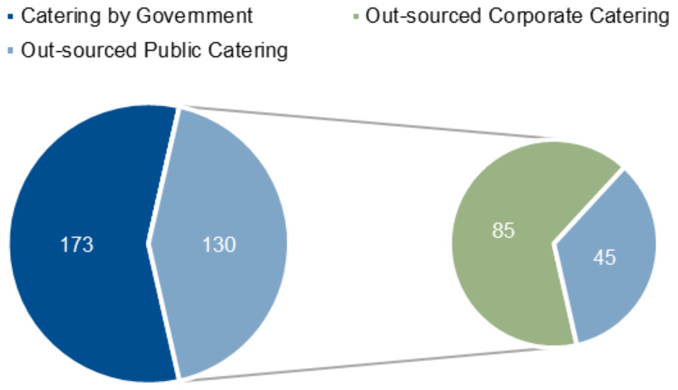
Credit-supportive industry risk

GVC's business risk benefits from the underlying business service industry's medium cyclicality, medium entry barriers and medium substitution risk.

Dominant player on Hungarian outsourced catering market

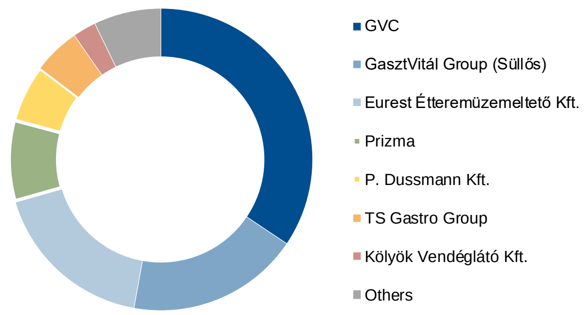
GVC holds a leading position in the fragmented Hungarian outsourced catering market, with more than 15% of state school catering market shares and around 10% of corporate catering market shares by sales.

Figure 1: Catering market structure in Hungary (2018)



Source: GVC, Scope

Figure 2: Outsourced catering market shares in Hungary (2018)



Source: GVC, Scope

Long-term, fixed-price contracts lower top-line vulnerability

GVC's business benefits from a positive track record in securing public tenders for catering and the long-term nature of contracts (on average five,10 and 15 year contracts for public catering, three-year contracts for corporate catering). This is reflected in stable recurring revenues and a competitive advantage over new market entrants as 70% of the company's sales are made through tenders.

In addition, inorganic growth opportunities will arise in the medium-to-long term from intermittent, selective consolidation potential in a highly fragmented market – which led to the Elamen and Sodexo acquisitions in 2016 and 2017 respectively. Nevertheless, our rating case does not incorporate any significant acquisitions in the foreseeable future.

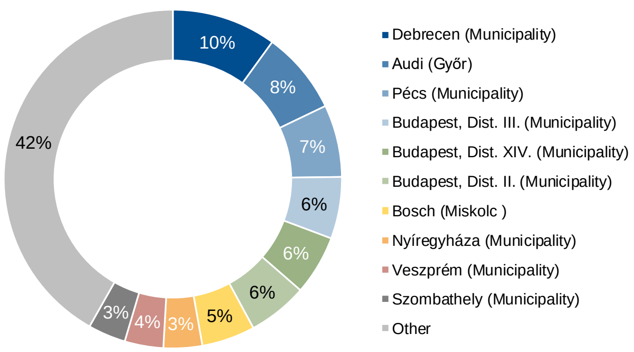
Top-line growth constrained by Covid-19 pandemic in short term

In 2020, GVC's top line is expected to take a hit from the Covid-19 pandemic, which led to the closure of educational institutions and production factories in the spring. The economic downturn may intensify, and the recovery may be subdued next year, but current assumptions incorporate a rebound in sales in the short term.

Diversification is weakest component of business risk profile

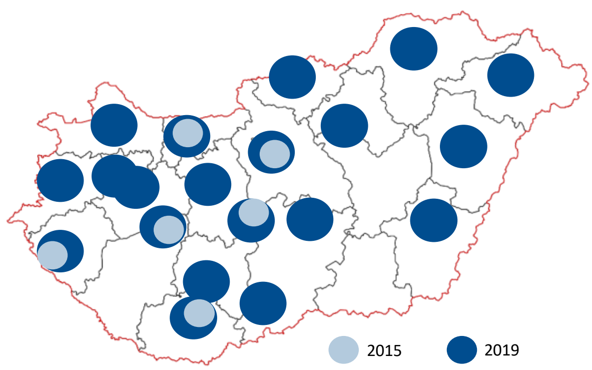
Diversification is the main constraint for GVC's business risk profile as the company operates in only one country and one industry, despite a well-established nationwide network.

Figure 3: Top ten customer concentration



Source: GVC, Scope

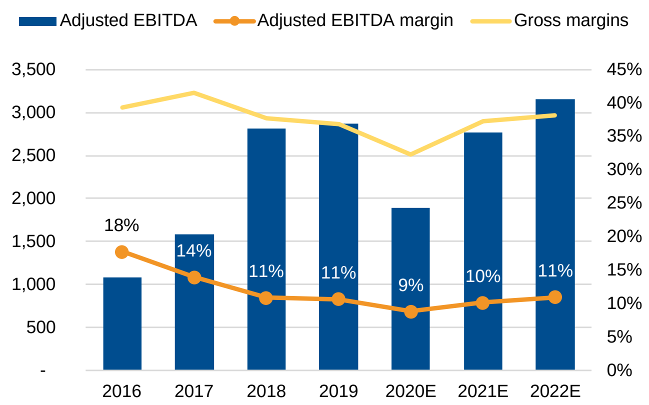
Figure 4: Sustainably developing domestic footprint (2015-2019)



Source: GVC, Scope

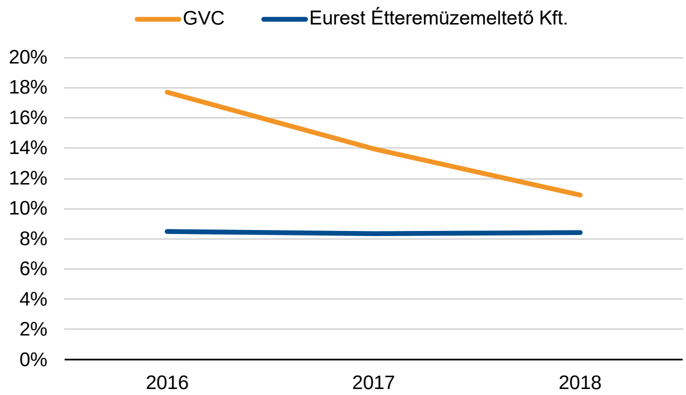
Regulatory requirements (on a national and international level) are intensifying in terms of food safety, hygiene, nutritional intake, compulsory diet elements and gluten-free menu options. At the same time, we believe GVC's current expansion plan will help to diversify its range of product/services and allow it to complement product offerings into the continually growing niche segment of dietary food, which will be positive for its overall business profile. However, we do not give credit for expansion at present as we do not expect sales growth or revenue stream diversification to change significantly in the medium term.

Figure 5: Operating performance



Source: GVC, Scope

Figure 6: EBITDA margins vs peers



Source: GVC, Scope

Relatively high profitability compared to Scope-rated peers

Profitability margins worsened after the Sodexo acquisition because EBITDA margins from corporates are lower than from public tender contracts. Nevertheless, GVC's profitability margins remain relatively high (14% on average) in a local context. GVC's gross margins benefit from: i) flexibility regarding the commercial terms of public tender contracts, which mitigates potential adverse effects from additional special diet-related expenses and increased salary amounts; ii) a presence in markets where demand is stable and less price sensitive on the end-market side; iii) bargaining power with a wide range of easily replaceable suppliers; and iv) economies of scale as 40% of public tender revenues are generated through delivery (largely in Budapest) where additional transportation costs are incurred. Going forward, we believe that GVC will be able to keep profitability margins above 10%.

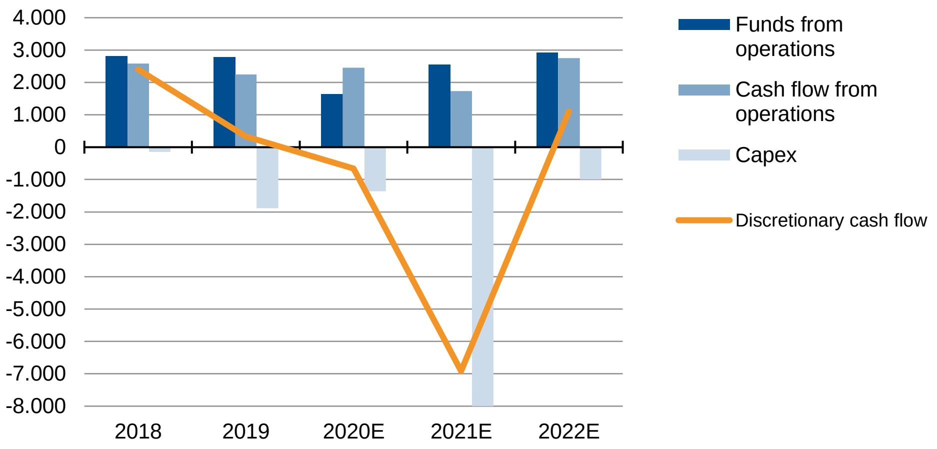
Financial risk profile

Financial risk profile

GVC's financial risk profile is supported by its healthy operating profitability, which translates into a good underlying cash generation capability. Relatively low financial debt on the balance sheet and prudent operating performance have kept GVC's credit metrics in favourable territory in the past. We therefore believe it is highly likely that they will remain comfortable in the context of ratings in the short-to-medium term.

Our rating case incorporates the potential issue of HUF 7.0bn in bonds, which will be used to refinance existing debt and a greenfield investment project expansion plan. The substantial bond issuance will lead to a deterioration in the company's presently very low leverage. However, we expect gradual deleveraging after 2021 once dietary food plants are functional, which are likely to increase the company's scale and operating efficiency/profitability. We expect leverage, as expressed by SaD/EBITDA, to remain comfortably below 3x.

Figure 7: Cash flow generation (HUFm)



Source: GVC, Scope estimates

Despite significantly increased interest expense after the bond issuance, which will decrease EBITDA interest coverage, the ratio will still remain at a good level, above 7.0x in 2020-2022.

A well-organised supply chain, favourable receivable collection terms, good working capital and immaterial tax and interest expenses keep GVC's operating cash flow stable at above HUF 1.5bn. We believe this trend will continue in the foreseeable future. Nevertheless, substantial capital expenditures will turn FOCF negative, resulting in negative FOCF/SaD in 2021.

Adequate liquidity profile

GVC's liquidity profile has been adequate in recent years, mainly driven by a limited short-term debt position and sound EBITDA cash conversion, with low capital expenditure resulting in stable and positive FOCF. The expected increase in maintenance and development capex in the upcoming years will not turn FOCF negative on a sustained basis. We therefore assume that liquidity will remain adequate, benefiting from the bullet structure of the assumed debt portfolio (no short-term debt) after the successful bond placement in 2020, which will mature in 10 years.

We do not expect significant changes in the company's future capital investment programme and/or debt-financed acquisitions. We believe that GVC will only pursue inorganic growth opportunities to a limited extent over the next few years, focusing on organic growth.

Outlook and rating-change drivers

Stable Outlook

The Stable Outlook reflects our expectation that the Covid-19 pandemic will not have a negative long-term effect on the company's operations and that SaD/EBITDA will remain below 3.0x on a sustained basis after the successful bond issuance.

Rating upside

A positive rating action could be indicated by an improved business risk profile, driven by increasing size or operating profitability via organic growth, revenue stream diversification with less exposure to public tenders, and increased regional or industry coverage. However, a positive rating action is unlikely in the near future, given the expansion plan for the next three years, which will only bear fruit after 2021.

Rating downside

A negative rating action could result from a deterioration in credit metrics, as indicated by FOCF of below 10% and SaD/EBITDA of above 3.5x on a sustained basis. Weak financial performance could be triggered by an adverse change in regulations, putting operating profitability under pressure, debt-financed acquisitions or higher than expected dividend payments.

Senior unsecured debt rated in line with issuer rating

Long-term rating

GVC plans to issue a HUF 7.0bn senior unsecured corporate bond under the MNB Bond Funding for Growth Scheme. The planned bond has the following characteristics: 3% coupon and 10 years' maturity amortising in the last four years. Proceeds from the bond are allocated to capital expenditures related to dietary kitchen plants and the refinancing of the existing investment loan in the amount of HUF 529m.

Our hypothetical default year is YE 2022, simulating a scenario in which the company has issued the new, proposed HUF 7.0bn senior unsecured bond and the proceeds have been used accordingly. Our recovery expectation translates into a rating which is equal to the issuer rating.

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