Éltex Kft.
Hungary, Business Services

B+ POSITIVE

Corporate profile

Founded in 1989 and headquartered in Hungary, Éltex Kft plays a prominent role in waste management. The company opened its first foreign plant in 1996.

Éltex specialises in up-to-date, efficient and complex waste-handling; hazardous and non-hazardous waste recycling; the transport and disposal of confidential documents; manufacturing plastics and electronic waste recycling; environmental protection consultation; and the import, export and transit of hazardous and non-hazardous waste.

The company handles all recyclable materials on-site. If waste quantities are very high, it builds a on-site waste handling area to house equipment and serve as storage.

The company is owned equally by Zoltan Vass (50%, direct ownership) and Péter Vermes (50%, indirect ownership via PU&I 2019 Vagyonkezelo Kft, a wealth management company owned solely by Mr Vermes). Both owners have interests in other companies; however, these companies do not form a group and have no influence on the others' operations. This is going to change. Indeed, Éltex UK has already been merged with Éltex Kft. At the end of 2021, Éltex Global Kft, Éltex SR Kft and Éltex International SRO will be merged with Éltex Kft.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	29x	21x	16x	16x
Scope-adjusted debt (SaD)/EBITDA[1]	1.2x	4.2x	2.2x	2.1x
Scope-adjusted funds from operations/SaD[2]	72%	29%	41%	43%
Free operating cash flow/SaD[2]	29%	-4%	-18%	11%
Liquidity (internal and external)	>100%	>100%	>200%	>200%

Rating rationale

Scope Ratings GmbH (Scope) has today affirmed its B+ issuer rating on Éltex Kft. and revised the Outlook to Positive from Stable. Scope has also affirmed its B+ rating on the senior unsecured debt issued by Éltex.

The current rating action reflects the significant increase in revenues during the last quarters of 2021 which is likely to lead to improved credit metrics compared to 2020 levels as well as the redistribution of capex initially planned for 2020 over 2020-22. This leads to better expected operating results and lower expected leverage. As a result, the Scope-adjusted debt/EBITDA ratio is expected to range between 1.5x-2.5x in the medium term. Note that we no longer net cash against debt because we deem the current cash on hand, mainly coming from the bond proceeds, as temporary. Indeed, bond's cash proceeds are intended for financing capex while the expected remaining cash is seen as volatile in the medium term.

[1] Those ratios have been changed based on analytical judgment. Previously, SaD/EBITDA was 1.0x, SaFFO/SaD was 84% and FOCF/SaD was 34% for 2019.

Ratings & Outlook

Corporate rating B+/Positive

Senior unsecured rating B+

Analyst

Anne Grammatico, CFA, CESGA
+33 182882364
a.grammatico@scoperatings.com

Related Methodology

Corporate Rating Methodology, July 2021

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

Éltex's financial risk profile remains slightly stronger than its business risk profile. We expect Éltex's SaD/EBITDA to range between 1.5x-2.5x, its interest cover ratio to remain above 10x in the coming years, and free operating cash to turn positive from 2022 thanks to new contracts and higher demand for recycled raw material.

Éltex's business risk profile is still supported by the increasing need for recycling, especially of industrial waste. The company is top three in waste management in Hungary. It benefits from medium- and long-term contracts with globally well-known groups. The contracts have a high likelihood of being renewed, which ensures stable revenues. Éltex has also committed to not use landfill (credit-positive ESG factor). Its business risk profile is constrained by low diversification: 75% of business is generated in its home market and all activities relate to recycling.

Outlook and rating change drivers

Positive Outlook

The Positive Outlook for Éltex incorporates Scope's view that key credit metrics over the next three years will improve, with SaD/EBITDA expected at between 1.5x-2.5x. It also incorporates Éltex's position as a top-three waste management company in Hungary and our perception that the EBITDA margin will improve to between 8.5%-9.5%. Currently conducted debt-financed growth investments are not expected to pose major execution risk. While interim 2021 financials suggest a significant improvement in year-end credit metrics, we point out their significant volatility both in the past and with regards to the near-term projections, raising doubts regarding their sustainability and execution.

Ratings upside

An upgrade could occur if the company kept SaD/EBITDA below 3.0x on a sustained basis, e.g. as a consequence of significantly stronger operating results than expected and/or lower capex than expected.

Ratings downside

A negative rating action, such as a revision to a Stable Outlook, could be triggered by a deterioration in credit metrics if Éltex is unable to get SaD/EBITDA below 3.0x on a sustained basis. This could be caused by higher capex and/or material debt-financed M&A activities.

Rating drivers

Positive rating drivers	Negative rating drivers
• Increasing need for recycling, especially of industrial waste • Relatively high entry barriers • One of the leaders in waste management in Hungary • Medium and long-term contracts with high likelihood of contract renewals • Clients are globally well-known groups • No use of landfill (credit-positive ESG factor) • Low leverage, which is expected for the foreseeable future • Good EBITDA interest cover of more than 10x for the foreseeable future	• Some market turbulence, even if it has not negatively impacted Éltex • Large exposure to industrial waste collection/recycling, which provides market potential but tends to be more volatile than municipal waste collection • Environmental risk regarding hazardous waste (credit-negative ESG factor) • No activity diversification • Low geographical diversification • Relatively low Scope-adjusted EBITDA margin

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement of SaD/EBITDA below 3.0x on a consistent basis	• Inability to get SaD/EBITDA below 3.0x on a consistent basis

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	29x	21x	16x	16x	19x
Scope-adjusted debt (SaD)/EBITDA[2]	1.2x	4.2x	2.2x	2.1x	1.6x
Scope-adjusted funds from operations/SaD[3]	72%	29%	41%	43%	57%
Free operating cash flow/SaD[3]	29%	-4%	-18%	11%	36%
Liquidity (internal and external)	>100%	>100%	>200%	>200%	>200%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	678	872	1,770	1,865	2,157
Operating lease payments in respective year	42	54	54	54	54
Other	56	5	-	-	-
Scope-adjusted EBITDA	**776**	**931**	**1,824**	**1,919**	**2,211**
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	678	872	1,770	1,865	2,157
less: (net) cash interest as per cash flow statement	-22	-37	-110	-110	-110
less: cash tax paid as per cash flow statement	-9	-20	-81	-82	-96
add: depreciation component, operating leases	37	47	47	47	47
add: dividends received from equity	-	-	-	-	-
Other	-23	265	-16	-16	-16
Scope-adjusted funds from operations	**661**	**1128**	**1,610**	**1,704**	**1,983**
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	792	3789	3,789	3,789	3,299
less: hybrid bonds	-	-	-	-	-
less: cash and cash equivalents	-	-	-	-	-
add: cash not accessible	-	-	-	-	-
add: pension adjustment	-	-	-	-	-
add: operating lease obligations	113	142	142	142	142
Other	19	9	9	9	9
Scope-adjusted debt	**924**	**3,939**	**3,939**	**3,939**	**3,449**

[2] Those ratios have been changed based on analytical judgment. Previously, SaD/EBITDA was 1.0x, SaFFO/SaD was 84% and FOCF/SaD was 34% for 2019.

Business risk profile

Éltex's **business risk profile (assessed at B+)** is supported by its market positioning in Hungary but constrained by its profitability and diversification.

Competitive market…

Most markets for environmental services are very competitive and characterised by increasing technological challenges due to changes in regulation, as well as by the presence of experienced competitors. The competitive landscape is very diverse.

The provision of services like rubbish collection is capital-intensive, with high initial investments required (e.g. a fleet of trucks, facilities). This raises barriers to entry for new competitors. Municipalities and other clients cannot easily switch among providers. Both of these characteristics benefit Éltex.

…subject to EU regulation…

Waste reduction and valorisation are EU priorities. They are regulated via Directive 2018/851, which was updated in May 2018 and includes the following targets:

- By 2024: separate collection of biodegradable waste, or recycling at source (e.g. home composting).
- By 2025: recycling of 55% of municipal waste and 65% of packaging waste; set-up of a separate collection of textile waste and hazardous waste produced by households.
- By 2030: recycling of 60% of municipal waste and 70% of packaging waste; reduction of food losses from producers to consumers in order to contribute to the United Nations target of reducing the volume of food waste by 50% worldwide.
- By 2035: recycling of 65% of municipal waste; share of municipal waste landfilled reduced to a maximum of 10% of the total quantity.

The EU recommends the use of financial instruments such as landfill taxes or incineration taxes.

In addition to the waste directive, the EU also finances research and entrepreneurial projects related to waste reduction through its Horizon 2020 programme.

… and need to meet national goals…

Hungary recently introduced major waste sector reforms. A state-owned company called the National Waste Management Coordination and Asset Management Company (Nemzeti Hulladékgazdálkodási Koordináló és Vagyonkezelő Zrt. or NHKV) has been coordinating and overseeing the delivery of waste services at the local level since 2016. NHKV is responsible for distributing waste fees to the relevant operators, selling recyclable materials, and supervising infrastructure spending and the use of EU funds.

Industrial waste management services are provided by private-sector companies such as Éltex.

The Hungarian government's 2019 priority actions were as follows:

- Gradually increase landfill taxes to phase out landfilling of recyclable and recoverable waste and use the revenues for measures that improve waste management, in line with the waste hierarchy.
- Focus on the implementation of the separate collection obligation to increase recycling rates, including the collection of bio-waste, and develop and implement minimum service standards and support programmes for municipalities.
- Improve the functioning of Extended Producer Responsibility Systems, in line with the general minimum requirements.

Besides this, Éltex confirmed that the government will support the circular economy for at least the next five years.

… should benefit Éltex's business

These goals (at the EU and Hungarian levels) should stimulate demand for recycling and thereby benefit Éltex's business. The relatively high initial investment required should limit the number of newcomers.

Éltex holds required permits

The company holds all of the necessary permits for operation. There are three types of permits: i) national; ii) site-specific; and iii) permits for specific activities regulated by EU and Hungarian laws.

Regarding non-hazardous and hazardous waste, the following activities require permits: trading, treatment, transportation, manufacturing, recycling and recovery.

Permits are required for the operation of waste treatment plants for each location. Each plant owned or rented by Éltex has a site permit, a waste-handling permit and a recycling permit. The permits are regularly renewed by the health and safety executive team.

Éltex is the second company in Europe to obtain R2 certification, which is the highest industry-wide standard for recycling electrical equipment in a sustainable manner.

Large need for recycling in Europe

In 2018, 2.2bn tonnes of waste were generated by European firms and households, but only half of that volume was recycled.

In Europe, 90% of waste is industrial waste and the remainder is municipal waste. In Hungary 80% of waste is industrial.

Thus, demand for recycling in Europe is high, which represents a great opportunity for Éltex to keep expanding its activities.

Market turbulence in waste management…

In 2016, over 70% of the world's plastic waste and 55% of paper waste was sent to China to be recycled. Since 2018, however, the Chinese waste ban has stopped 100% of solid waste imports. Consequently, recycling channels and markets for recyclable waste have practically vanished over the last few years. The ban has led to a massive oversupply in the market, driving waste prices down.

The global waste market has collapsed and recycling costs have increased tremendously, leading to falling profitability and continued loss-making for most companies.

The waste-paper market is also in crisis. In Hungary, specifically, prices started falling in 2019. Now, paper companies not only no longer have to pay for paper waste, but also request payment for accepting the material. The slide in waste-paper prices has had a highly negative effect on private waste management companies and also put the complete value chain at risk.

…has not negatively impacted Éltex

Éltex does not deal with unsorted municipal waste but rather with waste mostly from manufacturing companies in mixed/unsorted form (such as paper and foil) directly on-site. The company continues to send these materials to a cement factory for recycling, just as it did before the Chinese ban. According to Éltex, prices for good-quality industrial waste categories have not changed, partly thanks to EU regulation, which regulates and supports the use of recycled material in new products. Prices for certain materials have even increased, e.g. clean recycled PET, post-industrial PET, and pure cardboard waste. At the same time, prices for municipal mixed waste types have not only dropped sharply but turned into costs. Nevertheless, this development has not affected Éltex's business as the company does not deal with municipal waste.

Éltex has been delivering recycling granulate to China for eight years. Following the Chinese waste import ban, Éltex created a joint venture with its Chinese partner. In 2019, it processed 4,400 tons of foil in Hungary and exported it to China as a product. The company was thus able to turn the situation to its advantage, creating added value and increasing profitability.

Somewhat exposed to environmental risk

Hazardous waste poses a greater risk to the environment and human health than non-hazardous waste and thus requires a stricter control regime. This is laid down in particular in Articles 17 to 20 of Directive 2008/98/EC. As hazardous waste recycling accounts for 2% of total sales on average, Éltex is somewhat exposed to this kind of environmental risk. Nevertheless, we note that Éltex does not use landfill as a solution (credit-positive ESG factor).

One of the leaders in Hungary in terms of revenues

According to Éltex, its main competitors in Hungary are Alcufer Kft (which focuses on metal waste), MEH Zrt (which mainly collects metal waste and paper waste), FCC magyarorszag Kft (a multinational foreign company whose main business is landfill), and Saubermacher Mo. Kft (an Austrian company whose main business is landfill). In terms of revenues, Éltex has ranked among the top three for at least the last three years. Éltex considers itself a regional, leading, medium-size company and aims to become the market leader. Compared to the two world leaders, however, Éltex remains fairly small.

Capex used to increase capacity and efficiency

Éltex has four major projects in progress, which aim at increasing both its capacity and efficiency. All are at the middle phase. The company has other minor investments in the pipeline, which aim at gaining new partners, better serving current partners and ensuring the long-term development of strong business relationships with partners.

Well-known clients with some concentration risk

Éltex's top five clients account for two-thirds of net revenues. This concentration risk is mitigated by its medium/long-term partnerships (between five and 15 years) with well-known international groups. These include P&G, Bosch, Samsung, Henkel and Continental, with which it has medium-term contracts (between two and five years). The average contract length with smaller clients is 3.5 years and the total length of business partnerships averages 7.5 years. Due to these medium/long-term partnerships, we can expect contracts to be easily renewed, which supports Éltex's market position.

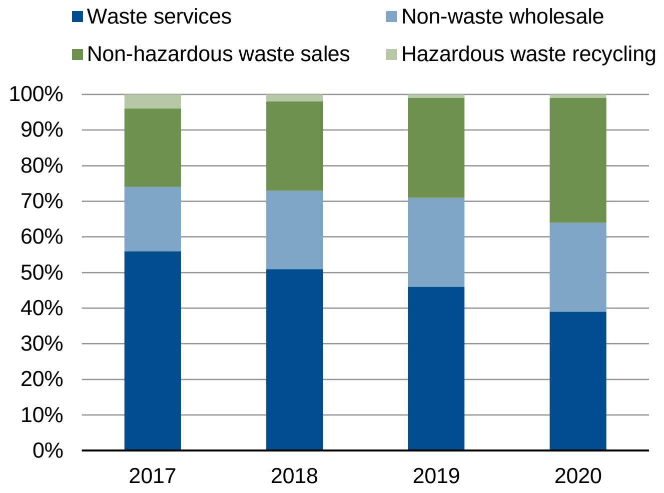
Revenues and EBITDA only related to recycling activity

We do not consider Éltex's revenues and EBITDA to be diversified in terms of sources. Indeed, all of its revenues come from recycling activity. Nevertheless, it is worth noting that the company benefits from a good diversification of services provided.

Somewhat low geographical diversification

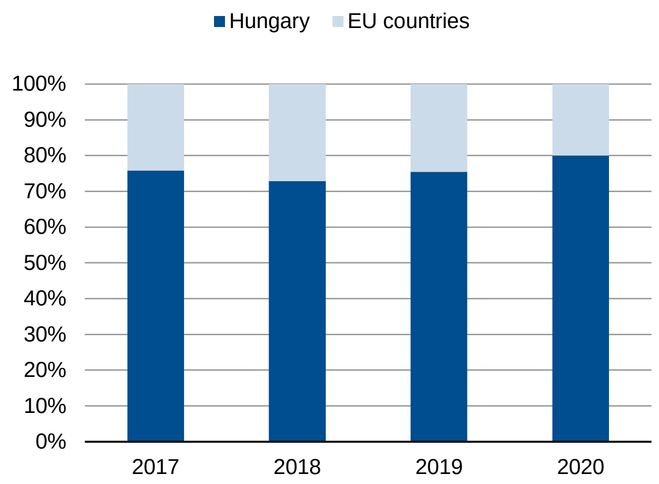
Regarding geographical diversification, 75% of net revenues and EBITDA on average is generated in Hungary. The remainder is generated within Europe. Nevertheless, Éltex has business relationships in more than 20 countries. We do not deem the merger of Éltex UK and the upcoming mergers with Éltex Global Kft, Éltex SR Kft and Éltex International SRO to have any impact on geographical diversification.

Figure 1: Revenue breakdown per segment (%)



Source: Éltex, Scope

Figure 2: Geographical revenue breakdown (%)

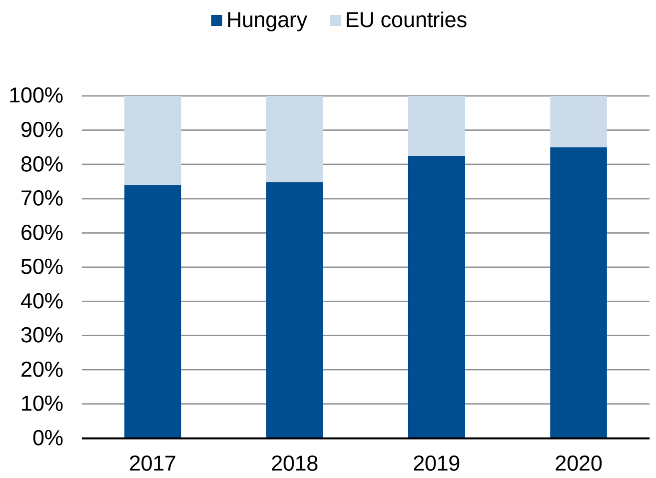


Source: Éltex, Scope

Figure 3: EBITDA breakdown per segment (%)

Source: Éltex, Scope

Figure 4: Geographical EBITDA breakdown (%)



Source: Éltex, Scope

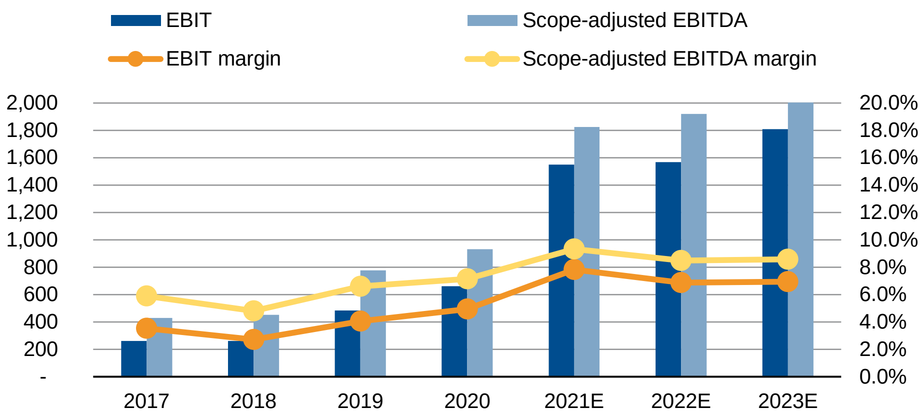
Low profitability

Éltex has a low adjusted EBITDA margin, especially compared to rated peers. Performance also fluctuated from 4.8% to 7.1% between 2017 and 2020. Éltex's margin is mainly generated via waste services, which have the second highest EBITDA margin. The second contributor to EBITDA is non-waste wholesale (products sold after the recycling of waste and the sale of detergent).

Margin profile expected to improve

We expect Eltex's EBITDA margin to improve to between 8.5%-9.5%, thanks to four major investment projects to increase capacity and improve efficiency and despite the higher expected cost of materials.

Figure 5: EBIT and adjusted EBITDA in HUF m and their respective margins



Source: Éltex, Scope

Low Covid-19 impact

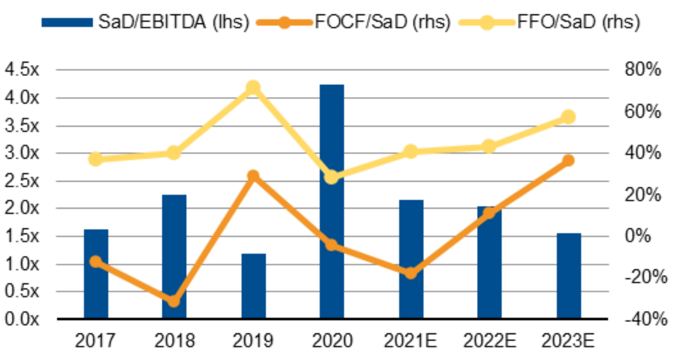
Thanks to its diverse range of clients, Éltex has been able to soften the negative impacts of the pandemic. Some of its partners in the fast-moving consumer goods sector, such as P&G, Henkel, and Reckitt & Benckiser, even increased production during the pandemic by 15%-20%, which generated more waste. Besides, the company has avoided to have partnership with car manufacturers. Éltex targets a client portfolio of modern companies with innovative products that are less sensitive to market cyclicality. Éltex also records a significant volume of revenues from service fees, which ensures fixed monthly revenues.

As of FYE 2020, Éltex successfully grew revenues by 11% compared to FYE 2019, even if it stands at a lower level than the pre-Covid expectation of 25%. EBITDA also grew slower than initially expected by management. On the customer side, bad debt has not increased thanks to a strong client base of modern and financially stable companies.

Financial risk profile

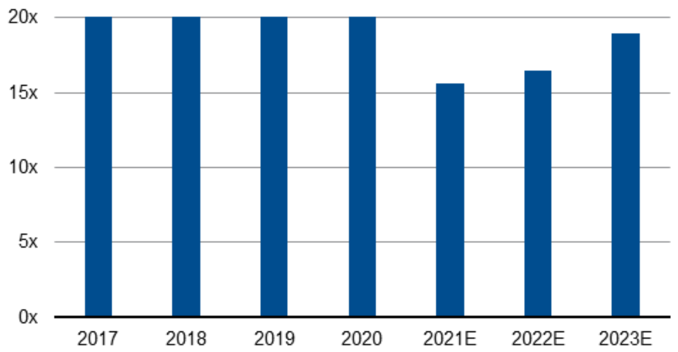
Éltex's **financial risk profile (assessed at BB)** is expected to improve and still supports the overall issuer rating. We expect Éltex's financial leverage ratio to be between 1.5x-2.5x thanks to significant increase in revenues during the last quarters in 2021 as well as the repartition over 2020-22 of the capex initially planned for 2020. We expect its interest cover ratio to remain above 10x. We also expect some fluctuating free cash flow.

Figure 6: Scope-adjusted leverage and cash flow cover



Source: Éltex, Scope

Figure 7: EBITDA interest coverage



Source: Éltex, Scope

Rating reflects improvement in leverage

In previous years, Éltex recorded very good SaD/EBITDA ratios, ranging from 1x to 2.5x.

In 2020, Éltex's SaD/EBITDA deteriorated following the issue in late December 2020 of the bond under the Hungarian National Bank programme. Please note that cash and equivalents were not subtracted from financial debt as we deemed them not to be permanent; otherwise leverage would have been at 1.1%. We expect leverage to decrease from 2021, thanks to the repartition over 2020-22 of the capex initially planned for 2020, the new contracts signed and the higher demand for recycled material. As a result, the current rating case has a lower SaD/EBITDA than previously (between 1.5x-2.5x vs 3.7x-3.8x previously).

The funds from operations/SaD ratio has historically been above 25%. We expect that ratio to remain above that threshold in the coming years.

Good interest coverage

Éltex's debt protection – as measured by Scope-adjusted EBITDA/Scope-adjusted interest – has been above 20x. We expect Éltex to fall below this threshold in the next few years due to higher forecasted interest payments. Please note that the 2020 ratio does not reflect interest payments because the bond was issued in end-December 2020.

Weak cash flow coverage

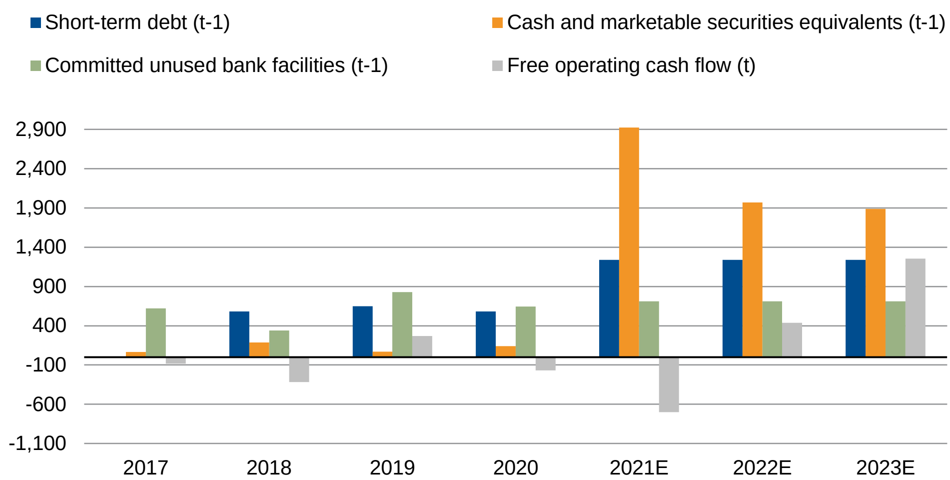
Éltex's cash flow cover – as measured by free operating cash flow (FOCF)/SaD – moves between negative and positive due to the fluctuation in FOCF. The variation is mainly influenced by capex. In light of the 2020 capex redistribution over 2020-22, FOCF is expected to be positive from 2022.

Adequate liquidity position

Éltex's liquidity is adequate, backed by committed credit lines of HUF 712m. Éltex has to repay HUF 1.2bn in 2021. It also has HUF 2.9bn of available cash and equivalents as of 31 December 2020, mostly coming from the bond issue in December 2020. We expect negative FOCF in 2021 and 2022, as a result of higher capex resulting from the four major investment projects but also as a result of negative working capital variations.

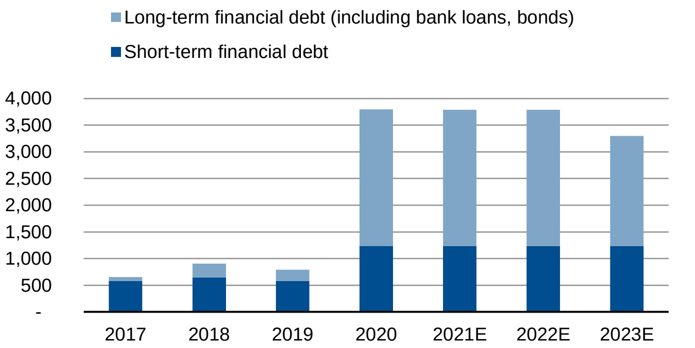
Short-term debt obligations will be fully covered by available sources in 2021, 2022 and 2023 (liquidity ratios will be higher than 150%), mainly thanks to the sustained amount of undrawn committed credit lines but also to the cash generated during the previous period.

Figure 8: Short-term debt repayment amount, available cash and FOCF (in HUF m)



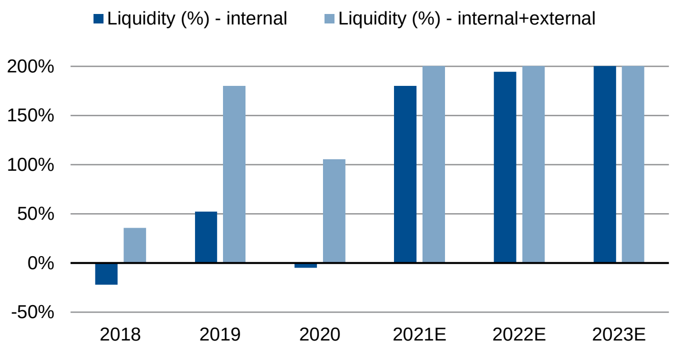
Source: Éltex, Scope

Figure 9: Financial debt (in HUF m)



Source: Éltex, Scope

Figure 10: Liquidity ratios



Source: Éltex, Scope

Conservative dividend policy

The dividend payout has been between 0% and 25% of net income in recent years. In our rating case, we expected a payout ratio of 35%, the maximum allowed in the bond prospectus. We believe this dividend policy strikes a fair balance between shareholder and creditor interests. A higher dividend distribution could alter our rating case.

No risk related to governance

Éltex is a privately owned limited liability company (Korlátolt Felelősségű Társaság [Kft.]). The highest decision-making body is the taggyűlés (members meeting). The members are the two owners: Zoltan Vass (CEO) and Peter Vermes (managing director).

We found no risk related to Éltex's governance. The company's governance is also supported by an experienced and committed top management team.

Long-term debt rating

B+ rating for senior unsecured debt

We expect an 'average' recovery for senior unsecured debt, such as the HUF 2.45bn bond issued under the Hungarian National Bank programme. This recovery expectation translates into a B+ rating for the senior unsecured debt category, in line with the issuer rating. Our recovery expectations are based on an anticipated liquidation value in a hypothetical default scenario at the end of 2023. Short-term and long-term debt (excluding the bond issue) raised from financial institutions, undrawn committed medium- and long-term facilities as well as payables rank higher than senior unsecured debt. Hence, such debts would be repaid first.

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

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