GVC George's Venture Capital Zrt
Hungary, Business Services

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 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 group.

Key metrics

			Scope estimates		
Scope credit ratios	2019	2020	2021E	2022E	2023E
EBITDA/interest cover	n/a	32.9x	17.5x	15.8x	17.9x
Scope-adjusted debt (SaD)/EBITDA	Net cash	Net cash	2.4x	2.1x	1.3x
Scope-adjusted funds from operations/SaD	Net cash	Net cash	39%	45%	69%
Free operating cash flow/SaD	Net cash	Net cash	7%	-68%	34%

Rating rationale

Scope Ratings GmbH has today affirmed its BB/Stable issuer rating on GVC George's Venture Capital Zrt. Scope has also affirmed its BB rating on the senior unsecured debt category.

The affirmation is driven by the company’s solid development despite constrained operations during lockdowns, which clearly affected its top line last year. Although sales declined by 23% last year, EBITDA outperformed our expectations.

GVC’s business risk profile benefits from the company’s leading position in Hungary’s fragmented outsourced catering market. Negative organic growth of around 23% in 2020 resulted from the closure of educational institutions during lockdown. The second wave of the pandemic in H2 2020 heightened the negative effect on GVC’s top-line performance. Revenues from school catering dropped by 45% YoY to HUF 5.72bn in 2020. While GVC’s business operations were partially interrupted by the lockdown in March and April 2021, our current assumptions incorporate a sales rebound in the short term.

Geographical and product diversification remains the main constraint for GVC’s business. However, the company’s expansion plan, initiated with the acquisition of Food Universum, will help to complement product offerings in the continually growing niche segment of dietary food. Despite the higher-than-expected negative affect of Covid-19 on its top line, GVC managed to maintain EBITDA of HUF 2.4bn and an EBITDA margin above 10%.

GVC’s financial risk profile continues to be supported by comparatively healthy operating profitability, which translates into a good underlying cash generation capability. Despite the HUF 7.0bn bond issuance in 2020, indebtedness remains in comfortable territory. We expect leverage, as expressed by Scope-adjusted debt (SaD)/EBITDA, to remain well below 3x.

A well-organised supply chain and favourable receivables collection continue to keep GVC’s operating cash flow stably above HUF 1.5bn. We continue to overweight the company’s weaker business risk when assigning the overall issuer rating.

Ratings & Outlook

Corporate rating	BB/Stable
Senior unsecured rating	BB

Analyst

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Related Methodology

Corporate Rating Methodology: July 2021

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Bloomberg: SCOP

Outlook and rating-change drivers

Stable Outlook

The Stable Outlook reflects our expectation of a sales rebound in 2021, while SaD/EBITDA remain below 3.0x on a sustained basis.

Rating upside

A positive rating action could be warranted by an improved business risk profile, driven by increasing size, revenue stream diversification with less exposure to public tenders, and greater 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 2023.

Rating downside

A negative rating action could result from a deterioration in credit metrics, as indicated by free operating cash flow (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 • Customer retention rate above 90% underlines 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 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 SaD/EBITDA of above 3.5x

Financial overview

			Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA/interest cover	n/a	32.9x	17.5x	15.8x	17.9x
SaD/EBITDA	Net cash	Net cash	2.4x	2.1x	1.3x
Scope-adjusted FFO/SaD	Net cash	Net cash	39%	45%	69%
FOCF/SaD	Net cash	Net cash	7%	-68%	34%
Scope-adjusted EBITDA in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Scope-adjusted EBITDA	2,869	2,621	2,727	3,421	4,763
Operating lease payments in respective year	0	0	0	0	0
Other	0	-253	0	0	0
Scope-adjusted EBITDA	2,869	2,369	2,727	3,421	4,763
Scope-adjusted funds from operations in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EBITDA	2,869	2,369	2,727	3,421	4,764
(Net) cash interest as per cash flow statement	38	-27	-111	-171	-221
Cash tax paid as per cash flow statement	-124	-165	-150	-117	-221
Other					
Scope-adjusted FFO	2,783	2,177	2,466	3,133	4,321
Scope-adjusted debt in HUF m	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Reported gross financial debt	1,545	7,950	7,757	7,647	7,537
Cash, cash equivalents	-1,987	-8,812	-1,369	-660	-1,332
Guarantees	77	67	67	60	61
Provisions	171	0	0	0	0
SaD	Net cash	Net cash	6,455	7,046	6,265

Business risk profile: BB-

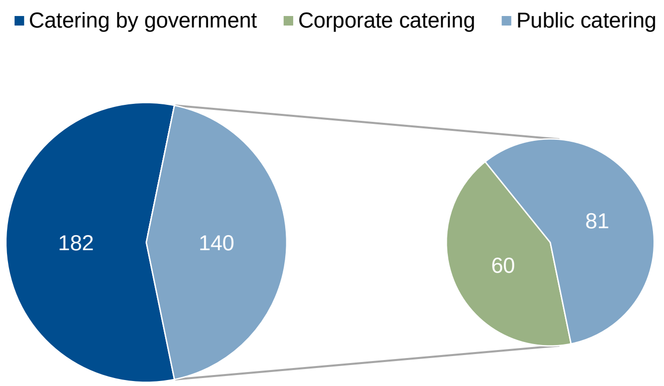
Credit-supportive industry risk

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

Dominant player on Hungarian outsourced catering market

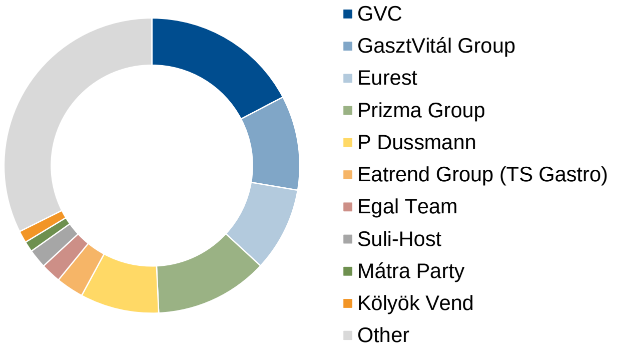
GVC has maintained a leading position in Hungary's fragmented outsourced catering market. The company had more than 20% of state school catering market shares and around 6% of corporate catering market shares by sales in 2019.

Figure 1: Catering market structure in Hungary (2019)



Source: GVC, Scope

Figure 2: Outsourced catering market shares in Hungary (2019)



Source: GVC, Scope

Top-line growth constrained by Covid-19 pandemic…

As we anticipated, GVC's top line took a hit from the Covid-19 pandemic, which led to the closure of educational institutions and production factories in the spring. The result was negative organic growth of around 23% in 2020. The second wave of the pandemic in the H2 2020 heightened the negative effect on the company's top-line performance. Revenues from school catering dropped by 45% YoY to HUF 5.72bn in 2020 (HUF 10.2bn in 2019) while other business lines maintained low to mid-single digit negative growth.

…but we expect sales to rebound in 2021

Although GVC's business operations were partially interrupted by the lockdown in March and April 2021, we assume sales will rebound in the short term. This is based on: i) already extended contracts for the new academic year starting in September; ii) resumed operations in the corporate catering business; and iii) the partial integration of the ready-to-eat food segment from September. We see a low likelihood that the recovery will be subdued next year.

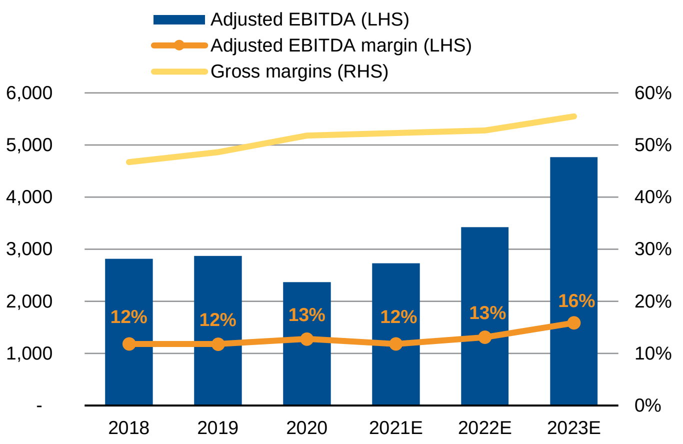
Diversification remains weakest component of business risk profile

Geographical and product diversification remains the main constraint for GVC's business. However, the company's expansion plan, initiated with the acquisition of Food Universum, will help to complement product offerings in the continually growing niche segment of dietary food. While our conservative approach means we do not give credit for the expansion at present, the successful execution of the dietary plants project will be positive for GVC's overall business profile. We do not expect any significant changes in revenue-stream diversification in the medium term.

Ability to balance salary expenses

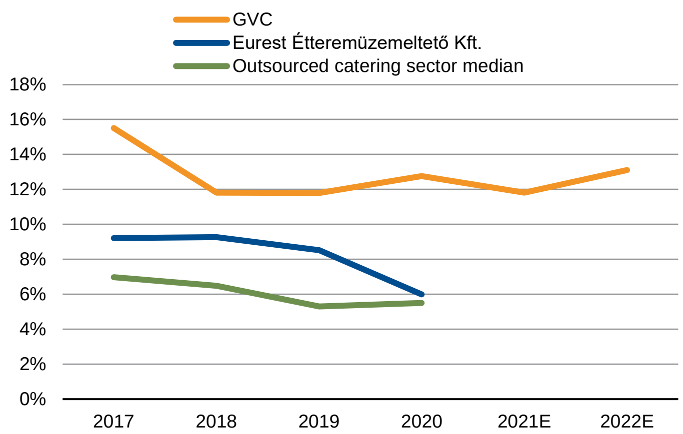
Despite the higher-than-expected negative effect of Covid-19 on GVC's top line, the company managed to maintain EBITDA of HUF 2.4bn and an EBITDA margin above 10%, as we anticipated in our last base case. This was thanks to its ability to reduce salary costs via lay-offs and a gradual improvement of gross margins after the Sodexo acquisition.

Figure 3: Operating performance



Source: GVC, Scope

Figure 4: EBITDA margins vs peers



Source: GVC, Scope

Profitability margins are relatively high compared to local sector median

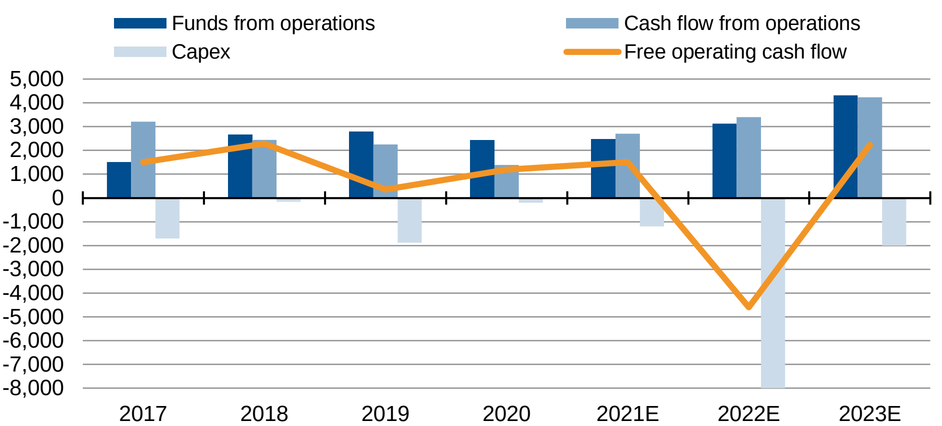
Going forward, we believe that GVC will be able to keep profitability margins above 10%. This is based on: i) flexibility regarding the commercial terms of public tender contracts, which mitigates potential adverse effects from additional special diet-related expenses and increased salary amounts; ii) 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) an 'in house' dietary-food supplier following the Zalai group acquisition.

Financial risk profile: BBB-

Financial risk profile assessed at BBB-

GVC's financial risk profile is stronger than its business risk profile. It continues to be supported by healthy operating profitability, which translates into a good underlying cash generation capability. Despite the HUF 7.0bn bond issuance in 2020, indebtedness remains in comfortable territory. The latest Food Universum and PVK Horog kft acquisitions will help GVC to start sales in the ready-to-eat segment from 2022 – earlier than anticipated – slightly elevating EBITDA performance starting from 2022. We therefore believe credit metrics will remain comfortable from a ratings perspective in the short to medium term, taking into consideration the predictable nature of business and financial flexibility from high cash conversion rates. We expect leverage, as expressed by SaD/EBITDA, to remain comfortably below 3x.

Figure 5: Cash flow generation (HUF m)



Source: GVC, Scope estimates

A well-organised supply chain and favourable receivables collection continue to keep GVC's operating cash flow stably above HUF 1.5bn. We expect 2022 to be an exception when delayed capital expenditures turn FOCF negative.

Strong interest cover

Despite significantly increased interest expense after the bond issuance, which decreased interest cover, the ratio will remain at a good level, above 10.0x in 2021-2023.

Adequate liquidity profile

GVC's liquidity continues to be adequate, mainly driven by a limited short-term debt position and sound EBITDA cash conversion. While an expected increase in maintenance and development capex in the upcoming years will turn FOCF negative, a significant cash buffer and committed credit lines in the amount of HUF 1.3bn should be sufficient to fully cover (re-)financing needs.

Supplementary rating drivers

Credit-neutral supplementary rating drivers

We have not made any explicit rating adjustment for supplementary rating drivers. Although the company has no officially communicated financial policy, we understand that the owners and management aim to maintain a conservative dividend policy and sound financials, which are also protected by a dividend cap of HUF 650m in the bond prospectus.

Long-term rating

Senior unsecured debt affirmed at BB

We expect an average recovery for senior unsecured debt, such as the HUF 7.0bn bond issued in 2020 under the Hungarian National Bank's Bond Funding for Growth Scheme. Our recovery expectations are based on an estimated enterprise value assuming operations are a going concern in a hypothetical default scenario in 2023. In this scenario we assume that market conditions are tough and that the outstanding bank facility at the time is fully drawn. This recovery expectation results in no notching from the issuer rating, translating into a senior unsecured debt rating of BB.

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