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

BB- POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	11.2x	17.4x	15.2x	13.3x
Scope-adjusted debt/EBITDA	3.5x	2.2x	2.5x	2.9x
Scope-adjusted funds from operations (FFO)/debt	23%	40%	35%	30%
Scope-adjusted free operating cash flow (FOCF)/debt	17%	20%	17%	8%

Rating rationale

GVC's issuer rating benefits from its ability to generate consistent revenue through long-term contracts, which allows it to pass on inflationary costs to customers. Additionally, GVC's operational synergies and efficiency contribute to its comparatively high profitability and potential for organic growth reflected in strong leverage metrics. Factors that negatively impact the rating include limited diversification in terms of revenue and geographical reach, as well as the company's relatively small size. The issuer rating is further constrained by significant cash outflows in the form of other receivables and intercompany loans, which do not provide any economic benefits to the company in the medium term.

Leverage is assessed without netting of cash due to a high cash balance, which we expect to be partly used in future instead of serving solely as a liquidity buffer.

Outlook and rating-change drivers

The Positive Outlook reflects our expectation that debt/EBITDA will remain below 3.0x, supported by EBITDA growth. In addition, the Outlook is based on the assumption that GVC will not engage in any increased shareholder-oriented financial policies, such as significant dividend payments or additional third-party borrowings.

The upside scenario for the ratings and Outlook would require (collectively):

1. Debt/EBITDA to remain significantly below 3.0x on a sustained basis
2. Successful execution of the company's growth ambitions
3. Provision of improved transparency, e.g. about intercompany transactions, dividend-like payouts

The downside scenario for the ratings and Outlook would require non-fulfilment of the upside triggers.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
25 July 2024	Outlook Change	BB-/Positive
25 July 2023	Affirmation	BB-/Stable
28 July 2022	Downgrade	BB-/Stable
28 July 2021	Affirmation	BB/Stable

Ratings & Outlook

Issuer	BB-/Positive
Senior unsecured debt	BB-

Analyst

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Related Methodology and Related Research

General Corporate Rating Methodology, October 2023

European Business and Consumer Services Rating Methodology, January 2024

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Leading position in Hungary's outsourced catering market • Customer retention rate above 90%, reflecting a strong record of fulfilling tender requirements • Favourable public contract terms reflected in high EBITDA cash conversion • Low leverage (at 2.2x YE 2023)	• Weak diversification with operations only in Hungary and only in one industry • Changeable regulatory framework in terms of food safety requirements • Significant debt-like payments and intercompany loans

Positive rating-change drivers	Negative rating-change drivers
• Debt/EBITDA to remain significantly below 3.0x on a sustained basis • Successful execution of the company's growth ambitions • Provision of improved transparency, e.g. about intercompany transactions, dividend-like payouts	• Debt/EBITDA to deteriorate to or above 3.0x • Inconsistent execution of the company's growth ambitions • No improvements in transparency, particularly concerning intercompany transactions and dividend-like distributions

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 family-owned company.

Financial overview

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	11.2x	17.4x	15.2x	13.3x
Scope-adjusted debt/EBITDA	3.5x	2.2x	2.5x	2.9x
Scope-adjusted FFO/debt	23%	40%	35%	30%
Scope-adjusted FOCF/debt	17%	20%	17%	8%
Scope-adjusted EBITDA in HUF m				
EBITDA	3,404	6,515	4,921	4,240
Operating lease payment in respective year	979	928	1,021	1,226
Other items	(167)	(736)	0	0
Scope-adjusted EBITDA	**4,216**	**6,707**	**5,942**	**5,466**
FFO in HUF m				
Scope-adjusted EBITDA	4,216	6,707	5,942	5,466
less: (net) cash interest paid	(376)	(386)	(391)	(411)
less: cash tax paid per cash flow statement	(387)	(540)	(321)	(246)
Other items	0	0	0	0
FFO	**3,453**	**5,781**	**5,230**	**4,808**
FOCF in HUF m				
FFO	3,453	5,781	5,230	4,808
Working capital management	(842)	(940)	200	(139)
Non-operating cash flow	1,361	497	0	0
less: capital expenditure (net)	(658)	(1,628)	(2,000)	(2,300)
Amortisation of leases	(841)	(797)	(888)	(1,071)
FOCF	**2,474**	**2,913**	**2,543**	**1,298**
Net cash interest paid in HUF m				
Net cash interest per cash flow statement	238	255	257	257
Interest component operating leases	139	131	134	154
Net cash interest paid	**376**	**386**	**391**	**411**
Scope-adjusted debt in HUF m				
Reported gross financial debt	7,422	7,542	7,542	7,542
less: cash and cash equivalents	0	0	0	0
add: guarantees	2,838	2,838	2,838	2,838
add: provisions	0	0	0	0
add: leasing adjustment	4,484	4,250	4,678	5,613
Scope-adjusted debt	**14,743**	**14,630**	**15,058**	**15,993**

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Environmental, social and governance (ESG) profile[1]

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)

Corporate structure: A significant amount of intercompany loans has been extended to the minority-owned agriculture arm of GVC, namely Zalai Group and Villgroup. The cross-ownership characteristics of the loans raise questions about the benefits they offer to the company. In our previous rating action, we noted that these investments could potentially trigger a breach of the company's soft covenants, because they deviate from the initially provided development plan. Additional guarantees and sureties to subsidiaries of the aforementioned groups have recently been provided. Although we have not made explicit adjustments to supplementary rating drivers, we have excluded any potential positive impact from the agri business, such as cash interest income or dividends received going forward, due to limited visibility and a lack of structure.

Clarity and transparency: Over the past three years, we have identified a pattern of shareholder loan payments occurring concurrently with dividend payments. It is essential to note that the company has limitations on dividend payments as outlined in the bond covenants. Treating intercompany transactions with the owner as dividend-like payments would indicate a breach of these covenants. This view is supported by the fact that none of the downpayments made in the past have been fully repaid. Although we have not made explicit adjustments to the supplementary rating drivers, we have reflected these transparency issues with a conservative assessment of GVC’s financial risk profile.

Management and supervision: GVC has not been able to develop allergen-free meals in the acquired food factory due to an unstable supply chain affecting product development and the ongoing switching between development plans. This raises concerns about management and increases execution and integration risks. Although we have not made explicit adjustments to supplementary rating drivers, we have taken this

[1] 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.

into account by applying a haircut to the company's projections and by overweighting the company's business risk profile in our overall assessment.

Business risk profile: BB-

Credit-neutral industry risk

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

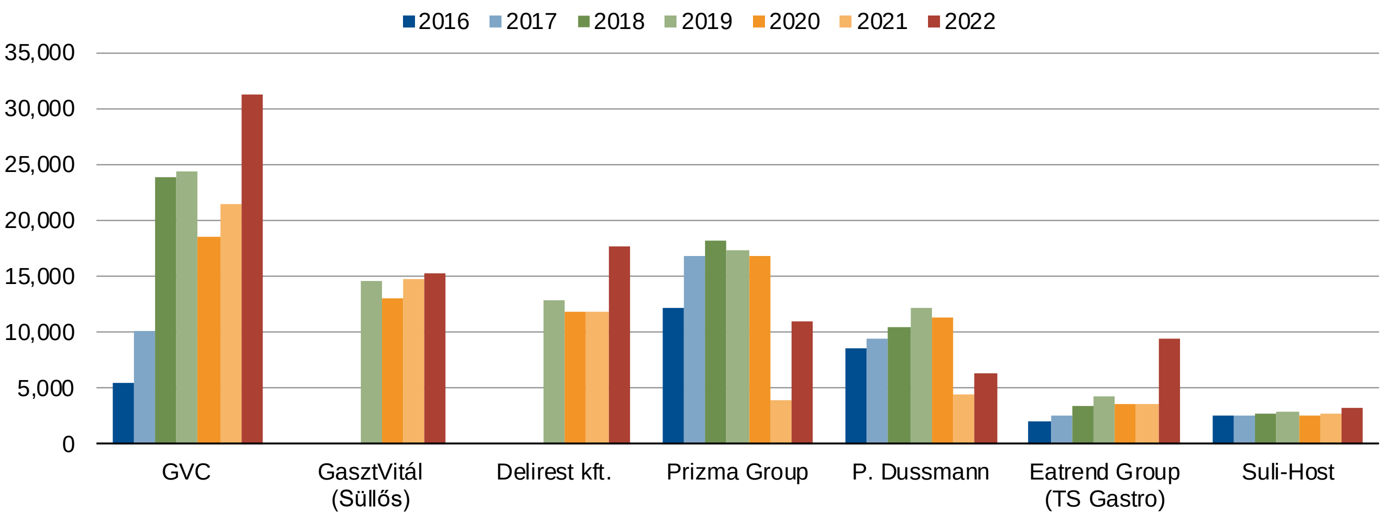
Dominant player in Hungarian outsourced catering market

GVC has maintained a leading position in Hungary's fragmented outsourced catering market. The company had over 20% of the state school catering market and around 6% of the corporate catering market by sales in 2022. Its market position remains constrained by a relatively limited addressable market representing under HUF 300bn.

GVC's performance in 2023 surpassed our expectations, with significant growth in revenue (up 23% year-on-year) and EBITDA (up 60% year-on-year). The company has demonstrated its ability to successfully pass on the rising costs of raw materials and energy to its customers in the past.

We expect continued revenue growth in 2024 (up 5% YoY) due to ongoing sales price negotiations aimed at mitigating the impact of rising operational costs such as increased raw material prices and inflation. In H1 2024, the company provided a comprehensive breakdown of contracts and made necessary price readjustments. The expiration of the Audi contract at the beginning of 2024 will have a 5% negative effect on top-line growth.

Figure 1: Snapshot of Hungarian catering market (HUF m)



Sources: GVC, Scope

Lack of diversification weakens business risk profile

Geographical diversification remains the weak factor in 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 the long term

Inorganic growth opportunities will arise in the medium to long term from intermittent, selective consolidation potential in a highly fragmented market. GVC plans to target aggressive growth. This could pose execution risks around the integration of healthcare catering activities or further M&A.

Although the Hungarian state spends a considerable amount of money on public catering, the quality of the food is continuing to deteriorate. Public institutions cannot withdraw from these contracts for a certain period of time, even if suppliers use increasingly poor quality ingredients. Our rating case does not incorporate any significant acquisitions in the foreseeable future.

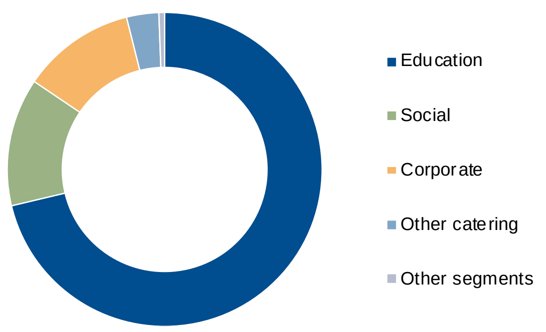
Following the unsuccessful development of allergen-free food products, GVC has decided to convert the previously acquired allergen-free food company into an energy-efficient ready-to-eat food factory. GVC's proposal to bondholders to modify the original purpose of the bond proceeds has been accepted. The funds will now be allocated towards financing the ready-to-eat food factory instead of a dietary kitchen. HUF 1.06bn from the bond proceeds was used in 2023 to cover these costs. In 2024, the focus will remain on similar investments (HUF 1.49bn).

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 the coming years will be incremental rather than dramatic. However, GVC's continued heavy dependence on local municipality-funded revenue streams is a significant risk, as any changes to reimbursement portfolios or prices could have a considerable adverse effect on the company's business performance.

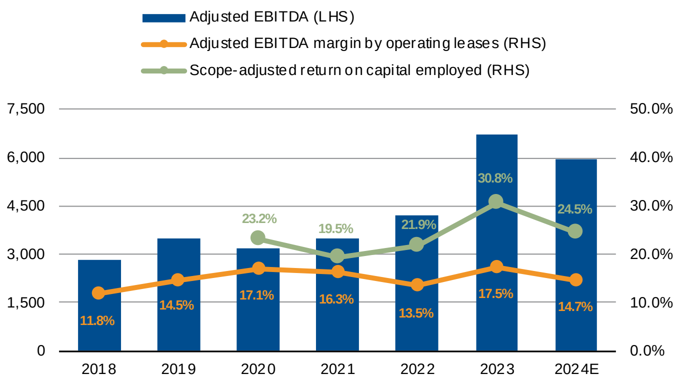
GVC managed to increase reported EBITDA of HUF 6.5bn and an EBITDA margin above 15% in 2023, higher than we anticipated in our last base case. GVC achieved this by gradually improving gross margins through supply chain optimisation and favourable price adjustments in contracts.

Figure 2: GVC's revenue breakdown by market segment (2023)



Sources: GVC, Scope

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



Sources: GVC, Scope estimates

A significant portion of other revenue is attributed to discounts on raw materials provided by suppliers, aimed at fostering partnership loyalty. These discounts are applicable for raw material purchases over a certain amount. The specific rate and conditions of the discount vary depending on the supplier. The discounts are deducted from the bills payable to the suppliers. Following discussions with the company, we have determined that these discounts can be considered cash-relevant and are included in the calculation of EBITDA.

We believe that EBITDA margins are likely to decline in the medium term, mainly due to the expected low profitability of the healthcare catering sector, where GVC intends to increase its exposure in the future. Nevertheless, we expect margins to remain at around 10%.

Financial risk profile: BB+

Adjustments and assumptions

Our financial projections are mainly based on the following assumptions:

- EBITDA is adjusted by operating leases and gains on fixed asset disposals but includes discounts received from suppliers

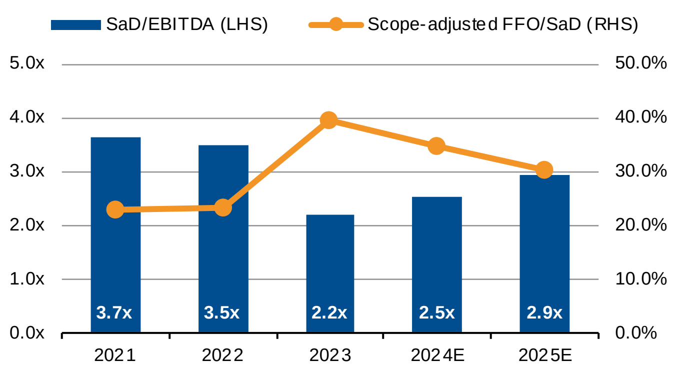
Financial risk profile BB+

GVC's financial risk profile is stronger than its business risk profile. The company's strong growth boosted credit metrics in 2023, with leverage decreasing to 2.2x (from 3.5x in 2022) and funds from operations standing at 40%, due to solid EBITDA growth in absolute terms.

We anticipate that leverage, as measured by Scope-adjusted debt/EBITDA, will remain significantly below 3.0x in the medium term thanks to solid operating performance, with momentum already evident in Q1 2024. We do not expect a significant increase in indebtedness, including new leases. Our assessment of leverage does not include the netting of cash, as the high cash balance is expected to be partly utilised rather than serving solely as a liquidity buffer.

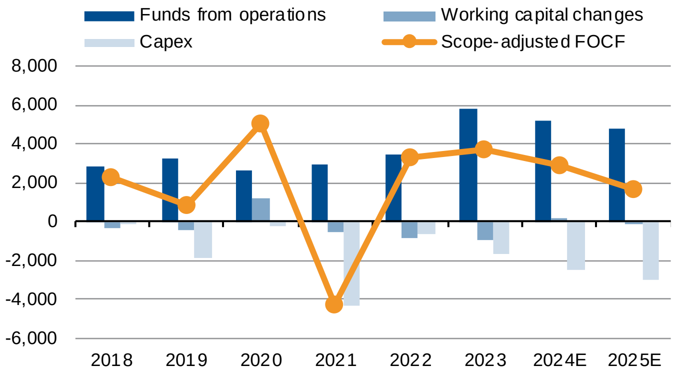
GVC has issued guarantees and made deposits, primarily to members of the agribusiness. It is important to note that the performance of the agribusiness does not impact the overall performance of the GVC group, as these companies are not included in the consolidation of GVC. In order to avoid double counting, guarantees provided to intragroup members within the consolidation are not included in our calculations.

Figure 4: Leverage



Source: GVC, Scope estimates

Figure 5: Cash flow generation (HUF m)



Source: GVC, Scope estimates

Positive free operating cash flow in the medium term

Favourable receivables collection allows GVC to maintain moderate working capital needs despite expected supply chain bottlenecks.

We believe intercompany loans provided to the agri-business arm of GVC will have a limited positive impact on GVC's financial risk profile. Although the company received HUF 52m and accrued HUF 41m in interest in 2023, we have left potential cash interest income out of our calculations as the nature of payment will be highly dependent on the operating performance of the underlying entities.

We had expected GVC's heavy capex phase to be over in 2022. However, the unsuccessful integration of the allergen-free food company has required the company to invest additional funds in the renovation of existing facilities and their conversion into a ready-to-eat food factory. The expected growth strategy for the mid-term is likely to result in a generally adverse impact on the cash flow cover.

Fixed interest base

We expect GVC's EBITDA interest cover ratio to remain strong at above 10x in 2024-2026, supported by the fixed interest rate on the issued bond.

Adequate liquidity

GVC's liquidity is adequate. This is mainly driven by a limited short-term debt position and sound EBITDA cash conversion.

Balance in HUF m	2024 E	2025 E
Unrestricted cash (t-1)	0	0
Open committed credit lines (t-1)	0	0
FOCF (t)	2,543	1,298
Short-term debt (t-1)	0	0
Coverage	**No short-term debt**	**No short-term debt**

GVC's senior unsecured 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 7.0bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 10 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is two notches. We see no significant risk of the rating-related covenant being triggered.

Supplementary rating drivers: +/- 0 notches

Credit-neutral financial policy

We have not made any explicit adjustments for supplementary rating drivers.

In order to support its strategic decision to merge its group entities and streamline its company structure, GVC proposed that the modification of the Change of Control covenant should not be regarded as a breach if GVC's ownership share decreases by up to 5%. This proposal was accepted by bondholders at the end of 2023.

GVC plans to propose an additional amendment to the covenants regarding the maximum amount of dividend payments. Currently, the bond prospectus limits dividend payments to 50% of its consolidated net profit for the year or HUF 650m, whichever is lower. Given the anticipated stronger-than-expected growth, the company wants to remove the HUF 650m limitation while maintaining the 50% net profit covenant. Although we view these anticipated changes neutrally, additional dividend-like payments, such as loans to shareholders, would result in negative adjustments to the financial policy rating.

Long-term debt rating

Senior unsecured debt rating: BB-

We affirmed the rating of senior unsecured debt issued by GVC George's Venture Capital Zrt's. at BB-, in line with the issuer rating. This rating is based on a hypothetical liquidation scenario as of end-2026, in which we computed an 'average' recovery for holders of senior unsecured debt based on our assumptions of attainable liquidation values.

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