Credit Rating Announcement 08 November 2022

Scope upgrades Éltex Kft.’s issuer rating to BB-/Stable from B+/Positive

The upgrade is driven by improving credit metrics thanks to the redistribution of planned capex over a longer period and better-than-expected operating results.

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope Ratings GmbH (Scope) has today upgraded the issuer rating on Éltex Kft., a Hungarian waste management services company, to BB-/Stable from B+/Positive. Scope has also upgraded its rating on the senior unsecured debt issued by Éltex to BB- from B+.

Rating rationale

The rating action reflects the significant improvement in operating results as well as smoother capex over the years. This is leading to better-than-expected operating results and leverage. Éltex’s financial risk profile has improved and remains stronger than its business risk profile. For the next few years, Scope expects Éltex’s Scope-adjusted debt/EBITDA to range between 1.0x-2.0x and its interest cover ratio to remain above 7x. Note that Scope does not net cash against debt because it deems the current cash on hand, mainly coming from bond proceeds, as temporary. Indeed, the bond’s cash proceeds are intended for financing Éltex's four major investment projects while the expected remaining cash is volatile and will likely be used for other capex in the medium term. Free operating cash flow to Scope-adjusted debt is expected to remain above 25% except in 2022, when Scope expects free operating cash flow to become negative due to higher capex for the major investment projects along with negative working capital variations. Free operating cash flow will improve thanks to the new contracts already signed and higher demand for recycled raw materials.

As of 31 August 2022, Éltex recorded revenues of HUF 21.2bn, EBITDA of HUF 1.6bn and capex of HUF 1.3bn. Reported gross financial debt stood at HUF 3.3bn while cash and cash equivalents at HUF 3.8bn.

Éltex’s liquidity is adequate, backed by committed credit lines of HUF 130m and its large cash buffer of HUF 3.8bn (as of 31 December 2021), mostly coming from the bond issue in December 2020. Éltex has to repay HUF 0.6bn in 2022. Scope expects Éltex to repay HUF 0.6bn in 2023 and HUF 1.1bn in 2024. Short-term debt obligations will be fully covered by available sources in 2022, 2023 and 2024 (liquidity ratios will be higher than 200%), mainly thanks to the cash generated during the previous periods.

Éltex’s business risk profile is supported by the increasing need for recycling, especially of industrial waste. As such, its business is fully focussed on circular economies and resource efficiency (credit-positive ESG factor). The company is top three in waste management in Hungary. Revenues are stable, thanks to medium- and long-term contracts that are with globally well-known groups and have a high likelihood of renewal. Éltex has also committed to not use landfill (credit-positive ESG factor) but remains slightly exposed to the risk of hazardous waste treatment (credit-negative ESG factor). Its business risk profile is constrained by low diversification: Hungary accounts for more than 70% of its business while all activities relate to recycling. Scope expects the EBITDA margin to decrease to 6.0%-6.5% due to the higher expected cost of materials and despite the major investment projects to increase capacity and improve efficiency.

Scope deems the ownership change as credit neutral for the rating. Zoltan Vass’ direct ownership has reduced to 15% from 50%. Péter Vermes’ indirect ownership has also reduced to 15% from 50%, still via PU&I 2019 Vagyonkezelo Kft, a wealth management company that he solely owns. The remaining shares are held by Global Refuse Holding Zrt (rated B+/Stable by Scope on 20 December 2021) whose ultimate beneficiaries are Equilor PE fund (80% direct ownership) and Figura Ferenc (20% indirect ownership).

One or more key drivers of the credit rating action are considered an ESG factor.

Outlook and rating-change drivers

The Stable Outlook incorporates Scope’s view that i) key credit metrics over the next three years will improve with Scope-adjusted debt/EBITDA at 1.0x-2.0x and debt protection remaining above 7x; and ii) Éltex will remain top three in waste management in Hungary.

A positive rating action could occur if Scope-adjusted debt/EBITDA were sustained below 1.0x, e.g. due to significantly stronger operating results and/or lower capex than expected. A positive rating action could also be warranted if the company’s business risks were to be reduced while the financial risk profile remained stable. This could be achieved through a significant growth of overall outreach and diversification.

The rating could come under pressure if leverage deteriorated to close to 3x on a consistent basis, e.g. as a result of higher capital expenditures, material debt-financed M&A activities and/or lower-than-expected operating results.

Long-term debt rating

Scope expects an ‘above-average’ recovery for senior unsecured debt, such as the HUF 2.45bn bond issued under the Hungarian National Bank’s programme. Despite the above-average recovery rate, Scope has refrained from granting a rating uplift to senior unsecured debt. This is because the recovery assessment is highly sensitive to the applied advance rates, especially on tangible assets. As such, Éltex needs to execute on its investments before Scope would consider a rating uplift. Thus, this recovery expectation translates into a BB- rating for the senior unsecured debt category, in line with the issuer rating. Scope’s recovery expectations are based on an anticipated liquidation value in a hypothetical default scenario at the end of 2024. 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 in terms of repayment.

Stress testing & cash flow analysis
No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodology used for these Credit Ratings and/or Outlook, (General Corporate Rating Methodology, 15 July 2022), is available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Credit Ratings were not requested by the Rated Entity or its Related Third Parties. The Credit Rating process was conducted:

With the Rated Entity or Related Third Party participation	YES
With access to internal documents	YES
With access to management	YES

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, the Rated Entities' Related Third Parties and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.
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The Credit Ratings/Outlook were first released by Scope Ratings on 20 October 2020. The Credit Ratings/Outlook were last updated on 10 November 2021.

Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

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With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

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