Pick Szeged Zrt.
Hungary, Consumer Products

SCOPE BB STABLE

Rating rationale

The issuer rating on Pick Szeged Zrt continues to be based on the credit metrics of its parent, Bonafarm Zrt (Bonafarm), which is the parent company of the Bonafarm Group. The rating is based on Bonafarm's implicit guarantee given full ownership, consolidation and operational integration, as well as Bonafarm's unconditional and irrevocable guarantee for group debt.

Bonafarm's issuer rating reflects a moderate business risk profile (assessed BB+) and a slightly weaker financial risk profile (assessed BB-), leading to a standalone credit assessment at BB- which indicates a strong focus on the company's financials. Regarding supplementary rating drivers, a one-notch uplift is applied for parent support, supported by history of recurring capital injections.

Pick Szeged's business risk profile reflects a strong presence both in the Hungarian market through its 150-year-old brand and in key export markets such as Germany for its famous winter salami (Pick). Products offered are concentrated on its salami category for over 50% of sales, although we note adequate diversification on the customer and supplier side. While profitability is generally higher than local peers due to strong pricing power, the EBITDA margin has been pressured to around 6% in 2023 (compared to a 11% average in the years 2019-2022) due to high raw material costs and salary increases.

The financial risk profile is based on the credit metrics of parent Bonafarm. The assessment is constrained by a weak cash flow cover and deteriorating leverage due to the consolidation of Hungerit and the deployment of a large capex plan starting in 2024, leading to a Scope-adjusted debt/EBITDA leverage ratio increasing towards 4.0x in 2025. Despite this, the financial risk profile remains unchanged, as it already incorporated some headroom for an increase in leverage and is supported by a very strong EBITDA interest cover. Pick Szeged can access a cash pool provided by its parent for investment, albeit the issuer is rather a contributor to the group cash pool. Pick Szeged's strong cash flow and low-cost fixed-rate debt can be used up to a limited amount by Bonafarm Group and its strategic partners.

Outlook and rating-change drivers

The rating Outlook is Stable, which is aligned with the rating Outlook of the parent company Bonafarm, due consolidation, ownership and guarantee. The Stable Outlook reflects increasing leverage amid the planned investment programme and consolidation of Hungerit but which remains commensurate with the current rating.

A positive rating action of the parent's rating could result in the same rating action for Pick Szeged.

The downside scenario for the ratings and Outlooks is a Scope-adjusted debt/EBITDA of Bonafarm Group deteriorating to 4.0x or above on a sustained basis.

The upside scenario for the ratings and Outlooks is remote in light of the upwards trajectory on leverage, but it could be considered once FOCF of Bonafarm Group becomes breakeven on a sustained basis.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
15 Aug 2024	Affirmation	BB/Stable
17 Aug 2023	Upgrade	BB/Stable
23 Aug 2022	Outlook change	BB-/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

Analyst

Eugenio Piliego, CFA
+49 69 6677389 15
e.piliego@scoperatings.com

Related Methodologies

General Corporate Rating Methodology; October 2023

Consumer Products Rating Methodology; October 2024

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Market leader in Hungary in processed meat, enabling significant pricing power • Future prospects for higher profitability driven by the ongoing investment project for a new moulded salami production facility, together with other smaller investments in automatisation of Pick's production processes • Access to group cash pool for working capital and investments • Strong parent support from Bonafarm Zrt. and from the ultimate beneficial owner	• Negative Scope-adjusted free operating cash flow/debt from 2024 due to heavy investment phase • EBITDA vulnerability to changes in market price ZMP index (German slaughter pigs index) • High inflation in Hungary in past few years, resulting in lower volumes for processed meat and salary increases • Higher production-related headcount than peers' due to delayed investments to modernise plants, low automation at Pick Szeged and production sites being situated at multiple locations

Positive rating-change drivers	Negative rating-change drivers
Positive rating action on the of parent company's rating, i.e.: • Remote in light of the upwards trajectory on leverage but could be considered when FOCF becomes breakeven on a sustained basis	Negative rating action on the of parent company's rating, i.e.: • Scope-adjusted debt/EBITDA deteriorating to 4.0x or above on a sustained basis

Corporate profile

Pick Szeged Zrt. manufactures processed meat for wholesale distribution and is the market leader in its segment. The company, founded in 1869, celebrated its 150th anniversary in 2019. Pick Szeged is owned 99.99% by Bonafarm Zrt., which itself is owned indirectly by Dr Sándor Csányi through holding company Bonitás 2002 Zrt. Pick Szeged was acquired by Bonafarm Zrt. in the 2000s and has been consolidated in Bonafarm Group since 2009. Bonafarm Group, which consists of Bonafarm Zrt. and its fully consolidated subsidiaries (including Pick Szeged Zrt.), is Hungary's largest fresh food producer, with a broad, diversified product portfolio.

In June 2023, Bonitás 2002 Zrt. transferred its shares to a Csányi family trust named Unity Asset Management Foundation for generational change purposes. Ownership interests in Bonafarm Group can be only inherited within the Csányi family. Therefore, we view the family's involvement in the business as supportive to the rating.

Pick Szeged owns three subsidiaries in Hungary (local handball team PICK Kézilabda Zrt. and some smaller subsidiaries), one in Germany (PICK Deutschland GmbH), one in Slovakia (PICK SLOVAKIA s.r.o.) and one in Romania (PICK ARAD S.R.L.) for distribution and sales purposes. Pick Szeged owns two major brands, PICK and Herz. The company's key product is PICK winter salami, which is also the flagship product for Bonafarm Group and enjoys 'Hungaricum' status as a commodity representing Hungarian heritage. There are four production sites, all in southern Hungary: two in Szeged, one in Baja and one in Alsómocsolád.

Pick Szeged is one of the largest employers in Hungary, with a headcount of more than 2,000.

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Environmental, social and governance (ESG) profile

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)

Circular economy in focus

The ESG profile of Pick must be viewed together with parent Bonafarm to capture its high vertical integration as well as common management and ownership.

Bonafarm is the largest Hungarian vertically integrated consumer products and agricultural company with substantial investments in farming and livestock. Production is from crops to processed food, which contributes to the circular economy. Group entities have started developing and implementing ESG principles, which is visible in the group's environmental footprint. The agricultural and livestock leg is rather modern while the processed food plants are rather old and need significant investment, which has been under planning for several years. Therefore, the real change will come from the new and more efficient plant.

Decisions driven by family owners

The Csányi family keeps a hands-on approach to strategic decisions.

Overall, ESG factors have no impact on the rating.

Business risk profile

Industry risk profile

We categorise Pick Szeged within the non-discretionary consumer products industry (industry risk profile assessed at A), which is characterised by low cyclicality. Despite the generally moderate capital investment needed, barriers to entry are medium in view of the efforts necessary to attain the required economies of scale and establish customer bases. At the same time, substitution risk is low, reflecting the generally non-discretionary nature of these products.

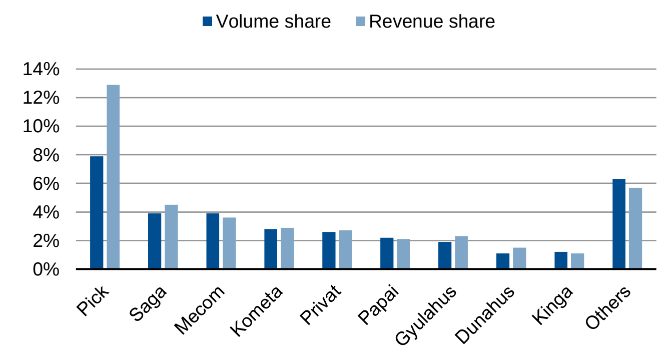
Core market of Hungary hit by inflation and dispute with EU

Our public finance rating for Hungary is BBB/Stable. The country's economic growth after the Covid-19 pandemic was challenged by record-high inflation (inflation soared to 14.6% in 2022, further increased to 17.6% in 2023 before normalising by the beginning of 2024), a weakening local currency, delays in receiving certain EU funds and the related dispute on rule of law, and labour shortages due to an ageing workforce and wage pressure. These are affecting the government's ability to provide investment grants, from which Pick (and Bonafarm Group) benefit greatly.

Soaring food prices resulted in lower volumes in 2023

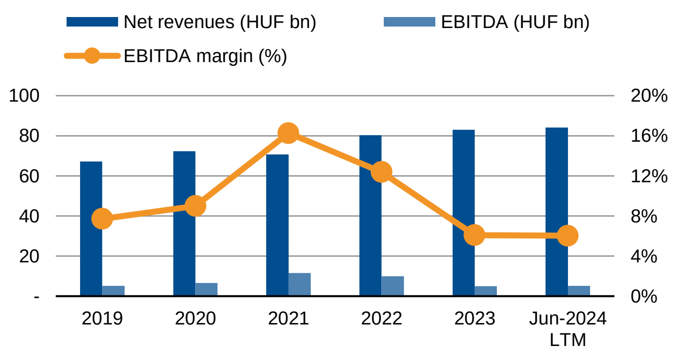
In Hungary, inflation on food products remained particularly high above 30% during the first six months of 2023 – in line with the trend in H2 2022 –, while it gradually eased to below 5% by year-end 2023. Pick Szeged's revenues increased by 3.4% in 2023 to HUF 83bn thanks to higher pricing but despite declining volumes. Both domestic and export sales saw a modest increase in revenues. Domestic growth was weaker than the reference meat processing market, which experienced a 5.4% decline in volume; however, this was more than offset by pricing, resulting in revenues up 15.7%. Pick's revenues increased by nearly 3% in H1 2024 compared to the same period in 2023, indicating a persisting trend of subdued consumer demand.

Figure 1: Market shares Hungarian meat processors 2023



Sources: Bonafarm/Pick, Nielsen

Figure 2: EBITDA and revenue development



Sources: Bonafarm/Pick

Domestic undisputed market leadership as meat processor

In terms of market position, Pick Szeged continues to dominate its market, though its capacity development plans are rather moderate compared to those of competitors. Pick Szeged's market shares in the Hungarian meat processing market were around 13% in 2023 in terms of revenues (14% in 2022), around three times more than the second-largest peer. In terms of volumes sold, Pick's share was lower to around 8% in 2023 (9% in 2022), yet still almost double that of the immediate peer. The marked difference between revenue and volume shares indicates the company's competitive advantage in setting significantly higher prices than the rest of the market thanks to the recognition of PICK as a premium brand. Nevertheless, the high inflation environment in the past couple of years led consumer demand to switch to cheaper products and private labels, resulting in a moderate decline in market shares for Pick Szeged. As inflation has normalised in 2024, we expect market shares for Pick Szeged to slowly but gradually recover over time.

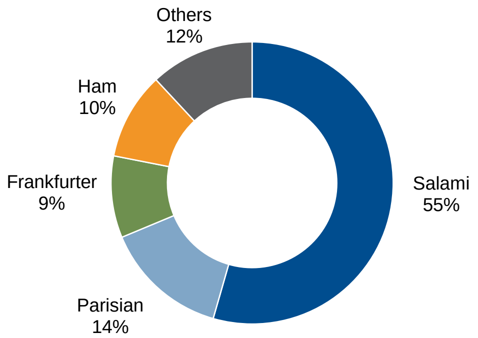
Limited geographical and product diversification

Geographical diversification remains a constraint for Pick Szeged, as over 70% of its revenues in 2023 were concentrated in Hungary, while export sales were moderate, accounting for more than a quarter of revenues and primarily focused on Germany for the salami product. Another constraint for the diversification assessment is Pick Szeged's limited product range, which consists mainly of pork processed meat products, with over 50% of its revenues derived from salami. This is somewhat mitigated by a relatively good international standing and regional distribution agreements with retailers.

Higher share of branded products compared to peers

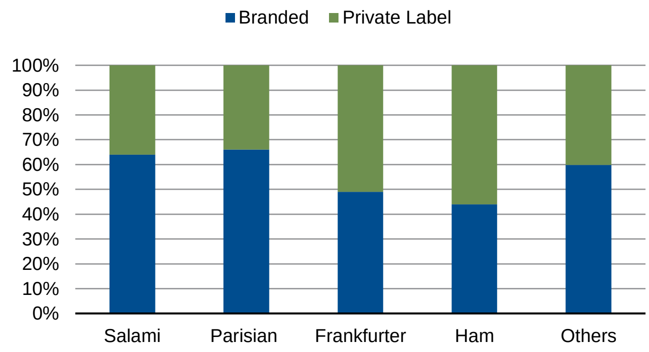
In Hungary, Pick Szeged maintains one of the highest shares of branded products within its portfolio, at approximately 60%, which supports profitability. Certain product categories, such as salami, Parisian and pâté, have well over 60% of branded sales, also due to their strong export focus. Other product categories, such as ham and cold cuts, are largely exposed to the private-label market since they target domestic consumption and do not have a large-volume premium product offering compared to regional peers.

Figure 3: Share of revenues per product category, 2023



Source: Bonafarm/Pick

Figure 4: Share of branded and private label volumes per product category, 2023



Source: Bonafarm/Pick

Diversified customer and supplier base

Conversely, Pick Szeged's customer base is highly diversified, encompassing all relevant retail chains in Hungary. Sales are balanced among retailers, as the PICK brand is in high demand in Hungary. The top ten customers accounted for approximately half of the revenues in 2023, with the top client contributing close to 10%. On the supplier side, Pick Szeged relies on several partners for key raw material items. Additionally, the company benefits from a strategic partnership with MSC Slaughterhouse (owned by Sándor Csányi but not part of Bonafarm Group) for meat supplies and intra-group links with Sole-Mizo (also a subsidiary of Bonafarm) for the supply of additives.

Improving profitability in line with other non-discretionary consumer product companies

EBITDA is moderately volatile, primarily reflecting non-controllable costs such as labor and input costs, which are offset by significant price increases. EBITDA margins were moderate at 5%-6% during the period from 2015 to 2018, improving to 9% in 2020, 16% in 2021, and 12.4% in 2022 (adjusted upwards due to a non-cash, extraordinary write-off of HUF 2.6bn). While profitability is generally higher than that of local peers due to strong domestic pricing power, the EBITDA margin was under pressure in 2023 (EBITDA was HUF 5.0bn) at around 6%, compared to an average of 11% in the years 2019-2022, due to high raw material and salary costs. During the first half of 2024, EBITDA remained stable at around HUF 3.1bn, with the EBITDA margin growing close to 8% thanks to an improving gross margin, as selling prices caught up with higher material costs. Looking ahead, we expect the easing of inflationary pressures to lead to a recovery of the EBITDA margin toward 9% in the medium term. It is worth noting that a large portion of sow meat is purchased at arm's length from MCS Slaughterhouse, which has a significantly lower margin compared to Pick. We estimate that a combined margin of the slaughtering and meat processing business would reduce overall profitability, but it would still remain above the average of local peers.

Slow execution of investments allowing competition to gain market share

Operational efficiency remains a drag to profitability as the ratio of revenue to headcount is half the level of main competitors. The seemingly low efficiency is mostly due to its old production technology (also with modernisation delayed), facilities being situated in multiple locations, and the manual nature of some production processes (salami). The large headcount in production will not be solved in the medium term as new government subsidies come with headcount requirements. For the medium term, Pick Szeged aims to increase output capacity by one-quarter. At the same time, some competitors in processed pork and poultry products in Hungary are set to double capacity.

Strong brands enable pricing power in Hungary

Pick Szeged is the market leader in Hungary with high-quality products and high brand awareness not only locally, but also in some export markets in Europe. PICK winter salami has been granted 'Hungaricum' status as a commodity representing the local heritage. The brand strength, along with the company's leading market position, enables premium pricing, in particular for Pick's moulded salami, which the group is using well in negotiations with retailers.

Financial risk profile

Pick Szeged's rating is based on the unconditional and irrevocable guarantee by the parent Bonafarm Zrt. and its full consolidation within the group, therefore the financial risk profile assessment is equalised with that of Bonafarm Zrt.

Financial risk profile deteriorating but still within the rating headroom

The financial risk profile is constrained by a weak cash flow cover and deteriorating leverage due to the consolidation of Hungerit and the deployment of a large capex plan starting in 2024 (higher than our forecasts last year; capex also includes investments at Hungerit level). Despite this, the financial risk profile assessment remains unchanged at BB-, as it already incorporated some headroom for an increase in leverage and is supported by a very strong EBITDA interest cover.

Leverage (debt/EBITDA) deteriorating towards 4x in 2025

The Scope-adjusted debt/EBITDA ratio is projected to increase to around 3.0x in 2024 and towards 4.0x in 2025, following the strong levels reported in the past couple of years. In fact, leverage bottomed out at 0.9x in 2022 on record operating performance and large cash reserves. It started deteriorating to a still strong level of 1.6x in 2023 due to lower EBITDA and higher capex. Uncertainties remain regarding the potential impact of further M&A activity and capex cost overruns. However, these are mitigated by the possibility of postponing smaller capex projects, as management is committed to keeping net debt/EBITDA below 3.5x. This would also provide a good safety buffer against the bank financing covenant of leverage below 4.0x.

FFO/debt expected to settle at 25-30%

Similarly, Scope-adjusted funds from operations/debt reached a quite strong level over the past couple of years (66% in 2023) but is expected to decrease to a more moderate level of 25% to 30% over the medium term.

Pressured FOCF generation due high capex requirements

The main rating constraint is Scope-adjusted free operating cash flow (FOCF)/debt. We expect very negative FOCF values for the next three years, driven by accelerating capex despite some normalisation in working capital needs thanks to lower inflation. We anticipate total net capex of HUF 178bn in 2024-2026 (HUF 60bn higher than our assumption last year for the 2023-2025 period), with around HUF 70-75bn per year in the first two years, representing a material increase compared to HUF 20bn on average over the past five years. Strategic capex is forecasted at HUF 143bn in 2024-2026 (net of HUF 40bn in assumed subsidies). The main investments are Pick's moulded salami brownfield factory project and Hungerit's poultry slaughterhouse greenfield project. They should comprise over half of the gross strategic capex amount and construction is expected to start in H2 2024. Other investments will be primarily directed towards the development of poultry farming technologies. Our forecasts do not include further acquisitions or dividend payments over the years 2024-2026.

Negative Scope-adjusted free operating cash flow/debt due to investments

Pick Szeged has several large production sites in need of modernisation. The start of the large investment capex in 2024 will lead to very negative Scope-adjusted free operating cash flow/debt in the medium term. Once this phase ends, we expect a robust return to positive cash flow (on top of improved operational efficiency), but this will only happen beyond the rating horizon. As already mentioned, the main investment for Pick consists into a new moulded salami production facility, but the company is also pursuing other smaller projects aimed at increasing automatization in several of its production sites.

Very strong interest cover

Very strong Scope-adjusted EBITDA interest cover supports the financial risk profile, thanks to a financing structure featuring fixed rates between 0% and 2%. Furthermore, Bonafarm generated finance income on excess cash in Hungarian forint, as deposit rates were well above 10% from mid-2022 throughout most of 2023 (currently on a declining trend). This led to net interest income for the years 2022-2023, which we expect to continue in 2024 (around HUF 2bn). We expect a return to yearly net interest payments ranging between HUF 1.2bn and HUF 1.6bn in 2025-2026, which still allows for comfortable EBITDA interest cover of around 20x.

Pick's liquidity benefiting from group cash pooling

Given the cash-pooling agreements between Bonafarm and its subsidiaries and the full consolidation and interlinkage, we assess Pick Szeged's liquidity as equal to its parent, at adequate level. MCS Slaughterhouse (not a group entity) was granted limited access to the cash pool in 2022. Pick Szeged is a contributor to the cash pool, which may lower its liquidity moderately though not significantly.

Adequate liquidity at Bonafarm

Although liquidity coverage ratios for Bonafarm are forecasted to turn negative in 2024 and 2025, driven by the large expansionary capex, these investments are expected to be entirely pre-financed by new debt. Moreover, the debt maturity profile is fairly backloaded, with no large maturities over the next 18 months. The HUF 27bn bond issued by Pick is repayable only at maturity in 2029. The liquidity assessment also reflects the assumption that the company will have the flexibility to postpone smaller capex when needed, although we still expect further shareholder support to cover the negative FOCF.

Bonafarm has a HUF 7.3bn overdraft facility, currently mostly unused and to be renewed in January 2025. Additionally, the group benefits from a large balance of cash and equivalents of HUF 31bn at YE 2023, which we assume to be largely used over the next 18 months to finance the investment projects.

Debt covenants

We note that Pick'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 27bn) if the debt rating of the bond stays below B+ for more than two years (grace period) or drops below B- (immediate repayment). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is three notches. We therefore see no significant risk of the rating-related covenant being triggered. In addition to the rating deterioration covenant, soft covenants include those addressing cross default (with the senior secured club facilities agreement having a net debt/EBITDA covenant of 4.0x, mitigated by the large headroom to actual levels) and a change of control (initially limited to Dr. Sándor Csányi as final beneficial owner; in 2023 bondholders agreed to a change of control to a Csányi family trust). Overall, we still see limited risk of Bonafarm breaching the 4.0x net debt/EBITDA banking covenant.

Supplementary rating drivers

Positive reflection of parent support

We maintain the positive one-notch rating adjustment for parent support, demonstrated by recurring capital injections in the past, and the expectation of further capital increases (and/or a subordinated owner's loan with the intention to convert it into equity), which we assume to cover more than 15% of the resources required for the ongoing large investment projects. Moreover, we expect the continuation of the zero-dividend policy.

Bonafarm is fully controlled by renowned businessman and banker Dr. Sándor Csányi through his holding company Bonitás 2002 Zrt. In June 2023, the shares of Bonitás 2002 Zrt. were transferred to a family trust named Unity Asset Manager Foundation for generation change purposes. Ownership interests can only be inherited within the Csányi family. We therefore see the transaction as credit neutral, since the family's support and the family-run nature of the group will continue to benefit the rating.

Long-term debt rating

Senior unsecured debt rating: BB

The senior unsecured debt rating stands at BB, same as the issuer rating.

Pick Szeged Zrt. issued a HUF 27.0bn senior unsecured bond unconditionally and irrevocably guaranteed by the parent company, Bonafarm Zrt. (ISIN: HU0000359336, issued in December 2019), through the Hungarian Central Bank's Bond Funding for Growth Scheme. The only bond issuance within Bonafarm Group was performed at Pick Szeged level, while Bonafarm Group has other senior unsecured debt ranking pari passu in the form of payables.

The senior unsecured bonds issued by Pick Szeged rank below the HUF 23bn senior secured bank debt of Bonafarm Group. Bonafarm Group has a strong asset base, but we have applied a significant discount to the recovery rates for the ageing processed meat products plants and the growing portion of assets under construction intended to replace them. As a result, we expect an 'average' recovery for outstanding senior unsecured debt in a hypothetical default scenario in 2026. The bond proceeds are earmarked for Pick's new processed meat products plant, whose construction is expected from H2 2024, and for general group financing purposes. The bond proceeds have been set aside as cash and in Hungarian sovereign bonds until construction starts. The bond has a tenor of 10 years, a fixed coupon of 2.0% and bullet repayment.

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

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

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

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