Pick Szeged Zrt. Hungary, Consumer Goods

SCOPE BB- STABLE

Corporate profile

Pick Szeged Zrt. manufactures meat products for wholesale distribution. Bonafarm Zrt. owns 99.987% of company shares and the ultimate parent is Bonitás, the parent company of Bonafarm. Pick Szeged owns four subsidiaries in Hungary (PICK Szállítási és Szállítmányozási Kft., BIOKOMPOSZT Szolgáltató és Termelő Kft., PICK Kézilabda Zrt., and MÖBIUSZ-TRADE Bel-és Külkereskedelmi Kft.), one in Slovakia (ICK SLOVAKIA s.r.o.), one in Romania (PICK ARAD S.R.L.), one in Russia (Magyar Élelmiszerek és Technológiák Zrt.) and two in Germany (PICK Deutschland GmbH and PICK Szeged (Deutschland) GmbH) for distribution and sales purposes. Pick Szeged owns two major brands, Pick and Herz. The company's key product is its Pick Winter Salami, which is also the flagship product for the entire Bonafarm group and enjoys 'Hungaricum' status, which is awarded to commodities representing Hungarian heritage. There are four production sites: two in Szeged, one in Baja and one in Alsómocsolád, all in southern Hungary. The company was founded in 1869 and celebrated its 150th anniversary in 2019. It was acquired by Bonafarm in the 2000s and became part of the Bonafarm Group in 2009.

Key metrics

Rating rationale

Scope Ratings has affirmed the issuer rating of BB-/Stable on Pick Szeged. The company's strong market position remains offset by input price volatility, making EBITDA vulnerable to market price movements. Senior unsecured debt has also been affirmed at BB-.

The rating for Pick Szeged at BB-/Stable is based on the unconditional and irrevocable guarantee provided by the parent Bonafarm Csoport. The company's overall business risk profile reflects a strong presence in the Hungarian market with a 150-year old brand, as well as in key export markets. Volatile profitability coupled with moderate margins and limited diversification tempers the rating.

Pick Szeged accesses a cash pool for investments carried by Bonafarm, the parent, and does not carry its own investment burden. As a result, the financial risk profile for Pick Szeged mirrors that of the parent at B. The issue of HUF 27bn under the MNB Bond Funding for Growth Scheme (HU0000359336) was the first debt issued by Pick Szeged.

Ratings & Outlook

Corporate ratings	BB-/Stable
Short-term rating	-
Senior unsecured rating	BB-

Analysts

John Francis Opie
+49 69 6677389 13
jf.opie@scoperatings.com

Related Methodology

Corporate Rating Methodology, February 2020

Scope Ratings GmbH

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Outlook

The Outlook for Pick Szeged remains Stable, based on the unchanged ownership and guarantee from the parent (Bonafarm Csoport). A positive rating action could be warranted were the parent company to be upgraded. A negative rating action could be warranted were the parent company to be downgraded.

Rating drivers

Positive rating drivers	Negative rating drivers
• Strong market position • Access to cash pool for investments • Prudent financial policy	• Weak diversity • EBITDA vulnerability to market price changes • Free operating cash flow/Scope-adjusted debt negative due to heavy investment phase

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Upgrade of parent (Bonafarm Csoport)	• Downgrade of parent (Bonafarm Csoport)

Business risk profile

Industry risk profile

We categorise Pick Szeged as a producer of non-durable consumer goods. We see substitution risk as high because Pick Szeged has a limited product range (meat products). Other suppliers are available, even though Pick Szeged meat products are in and of themselves unique. Meat products can also be substituted by alternative foods, reflecting consumer preference shifts.

High cyclicality

Input prices for meat, the key ingredient, are strongly cyclical. While both agribusiness and commodity food products are non-discretionary and hence normally have low cyclicality, strong supply swings introduce significant volatility to both costs and prices and hence to both revenues and EBITDA. Both expected (crop forecasts) and unexpected events (bad weather, diseases) can lead to volatility, with supply shortages (increasing prices) and supply gluts (decreasing prices) causing price volatility well in excess of more general price changes. The industry is also subject to volume volatility.

Medium market barriers

Market barriers to entry for non-durable consumer goods are medium. The limited product range leads to an inherent risk of product substitution. Further, consumer preferences change over time and there is increased availability and use of alternative foods to replace meat products.

High substitution risks

While alternative foods and suppliers do not have the same attributes, they are readily available. For this and the above reasons we view substitution risk as high. Pick Szeged's ability to generate high volumes with high quality (which is important for wholesalers) mitigates this risk.

Robust outlook on home market in Hungary continues

Pick Szeged's home market is Hungary, where the winter salami produced by Pick Szeged is considered a 'Hungaricum', a status awarded to commodities representing Hungarian heritage. Overall economic growth remains relatively robust, despite the negative effects of the Covid-19 pandemic but is challenged by negative demographic trends that result in an ageing workforce. Productivity growth to meet this challenge has been strong. The Hungarian economy is open and medium-sized, with cyclical behaviour matching that of the eurozone in general. Robust wage growth, aided by productivity increases, has helped consumer demand grow strongly in recent years. Access to EU markets and a sound infrastructure support the robust outlook.

Scope's public finance rating for Hungary is BBB+/Stable, reflecting the relatively healthy state of the economy and moderate public finance pressure. Government actions to curtail and mitigate Covid-19 pandemic effects have been robust (around 5% of GDP) and have helped Hungary avoid an extreme downturn, despite the strong exposure to global value chains. Economic development is still aided by the ongoing absorption of EU structural funds (Hungary continues its independent monetary stance by maintaining the Hungarian forint) and private sector deleveraging. Consumer sentiment has recovered well after a sharp downturn and remains supported by relatively low unemployment and strong wage increases. The Hungarian forint has weakened, placing some pressure on import prices, but this increases pricing room for domestic manufacturers.

The outlook for pork production in Hungary remains robust and has improved over the last few years, reflecting improved wages and traditional consumer preferences.

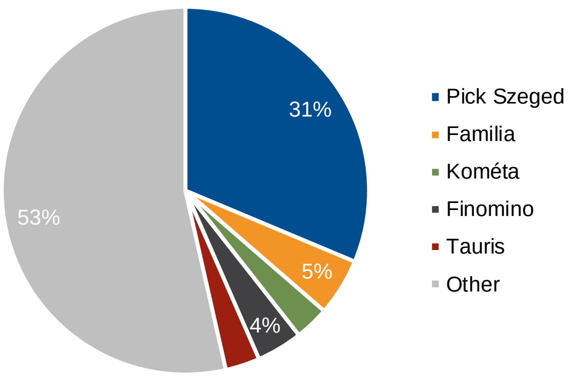
Strong market diversification

According to the company, Pick Szeged is present in 35 countries and is part of 200 international food chains. Exports are centred on central and eastern Europe, some Middle Eastern countries, as well as the US and Canada. Given current demographic trends in these markets, Asian markets are important, but the two largest markets, China and Japan, are currently unavailable as meat exports to these markets have been blocked due to measures taken to prevent African Swine Flu outbreaks. The resolution of this issue may negatively impact price developments when breeding and fattener stocks are expanded in anticipation of regaining market shares, leading to a significant glut on the market.

Competitive positioning

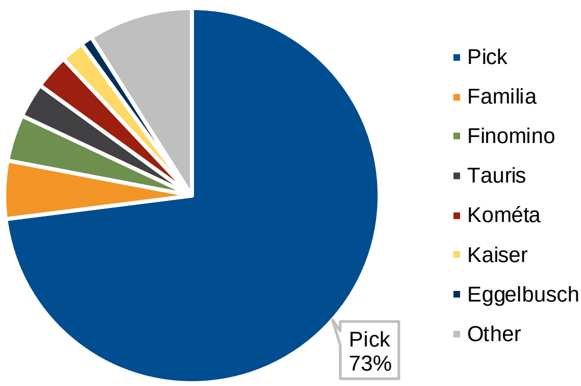
Pick Szeged's market position is dominant, as the company continues to be *prima inter pares* in the overall market. Pick Szeged had a 31% processed meat sale volume market share in 2019 (**Figure 1**) and a 32% sale volume market share in the salami and sausage market, with a consolidated market share in 2019 of 73%. (**Figure 2**). Both strong market positions support Pick Szeged's very good market position in its home market.

Figure 1: Pick Szeged company market position by brands (2019 sale volumes)



Source: Pick Szeged

Figure 2: Pick Szeged market position, salami and sausage market by brands (2019 sales volumes), with private label production and Herz added to Pick Szeged.



Source: Pick Szeged, Scope calculations

Diversification constrained

While Pick Szeged has a broad supplier base and its customer base is diversified, the concentration on a single sector, meat products, constrains diversification and significant cluster risk remains. This is mitigated to a certain degree by a relatively good international standing. A potential shift in consumer sentiment away from meat products in industrialised countries, shrinking domestic demographics and a continued inability to access key Asian growth markets are also constraints.

Profitability vulnerable to market conditions, helped by price increases

Earnings in 2019 were driven primarily by the sharp rise in raw material costs, but Pick Szeged was able to increase sales prices considerably to counter the otherwise strongly negative impact. However, cumulative profit was nonetheless lower. A revaluation of inventories in the wake of consistently higher prices also supported earnings. Sales volumes of sausages and salami were higher but were offset by lower sales of smoked meats.

Capacity expansion plans

The planned capex programme to replace the current plant, which dates to the 1970s, with a new, modular state-of-the-art production facility has been delayed due to time-consuming licensing procedures and planning revisions. Once executed, it is expected to significantly improve EBITDA margins through efficiency gains and increased production capacity, but positive effects will not become apparent until after the rating horizon. The issue of HUF 27bn under the MNB Bond Funding for Growth Scheme (HU0000359336) was the first debt issued by Pick Szeged.

Corporate governance neutral

We view corporate governance as neutral for the rating. We have no issues with external or international governance and recognise the stability afforded by the family-owned nature of the ultimate parent. Ownership is transparent.

Financial risk profile

Key assumptions

Our key assumptions remain: i) no major restructuring of the company or subsidiaries; ii) no major acquisitions or mergers; iii) continuity of management; iv) organic growth for top-line sales of 3% to 4% per year; v) continued strength of the Hungarian domestic market, with low unemployment, strong wage growth and interest rates and exchange rates stable and within targets, supported by central bank monetary policy; vi) no major agribusiness-related event (drought, disease, excluding Covid-19); vii) investment plans executed without meaningful operational or financial risks; and viii) continuity of financial policy with the continued avoidance of dividends, leasing and factoring.

Leverage and debt protection

We assign the same rating of the parent, Bonafarm Csoport, to Pick Szeged, given the cash pool access to finance investments.

Cash flow coverage and free cash flow generation

The rating for cash flow coverage and free cash flow generation continues to be determined by the ongoing heavy investment phase. The ratios are highly variable, reflecting the heavy negative investment cash flow. Once this phase has been completed, we expect a robust return to positive cash flow generation, albeit beyond the rating horizon.

Liquidity

As per our corporate rating methodology, cash-pooling agreements such as the one between Bonafarm Csoport and Pick Szeged are used to determine the minimum entity level at which issuer ratings should apply. We do not issue ratings for bankruptcy remote vehicles. We do not believe that Pick Szeged is a bankruptcy-remote vehicle, as it is neither a special-purpose entity nor would its bankruptcy have little or no impact on the rest of the group. For this reason, liquidity is assessed as equal to that of the parent company, Bonafarm Csoport.

Supplementary rating drivers

Financial policy

Bonafarm Csoport, the parent company, is using its financial policy to significantly expand Pick Szeged as one of the major business units within the Bonafarm group. These investments are for the strategic modernisation and expansion of production facilities and are a wholesale replacement of capacity dating back to the 1970s. The relatively aggressive investment plans constrain the rating. Nonetheless we consider financial policy to be largely prudent and conservative and have moderate expectations for top-line growth and productivity improvements.

Parent support

We assigned the parent of Pick Szeged, Bonafarm Csoport, a one-notch upgrade for parent support due to the expected support from Bonitás 2002 Zrt, the investment company of the Csányi family. This upgrade is also reflected in the issuer rating for Pick Szeged.

Senior unsecured debt

Pick Szeged has issued senior unsecured debt (HUF 27bn, HU0000359336). This senior unsecured debt is rated at the same level as the senior unsecured debt of the parent company, at BB-.

Outlook

The Outlook for Pick Szeged remains Stable, based on the unchanged ownership and guarantee from the parent (Bonafarm Csoport). A positive rating action could be warranted were the parent company to be upgraded. A negative rating action could be warranted were the parent company to be downgraded.

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

London

3rd Floor
111 Buckingham Palace Road
UK-London SW1W 0SR

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan

Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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