Sun Group Kft.
Hungary, Business Services

BB- STABLE

Key metrics

		Scope estimates		
Scope credit ratios	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	5.1x	7.9x	9.7x	6.7x
Scope-adjusted debt/EBITDA	2.7x	2.6x	2.4x	2.3x
Scope-adjusted funds from operations/debt	24%	27%	30%	27%
Scope-adjusted free operating cash flow/debt	-4%	11%	15%	15%

Rating rationale

The issuer rating reflects Sun Group's leading position in Hungarian HR services via the majority ownership in Prohuman Zrt., followed by bolt-on acquisitions in the CEE region with good growth prospects and a moderate financial risk profile which is supported by a deleveraging path towards Scope-adjusted debt/EBITDA of 2.5x.

Sun Group's business risk profile (assessed BB-, revised from B+) is driven by subsidiary Prohuman's moderate regional market shares in CEE in HR services and market leadership in Hungary with revenues expected to exceed HUF 100bn (ca. EUR 260m) in 2023. Sun Group's profitability is moderate with a Scope-adjusted EBITDA margin of 7.8% in 2022 (first year of consolidating Prohuman) and we expect it to stay around 7% in period 2023-25 due to the supportive market conditions. We expect Scope-adjusted EBITDA to be close to HUF 8bn in 2023 (+15% YoY) followed by yearly growth exceeding 5%.

Sun Group's financial risk profile (assessed BB, unchanged) is driven by its decreasing leverage towards 2.5x Scope-adjusted debt/EBITDA at end-2023. For the following two years we expect leverage to slightly decrease. Scope-adjusted free operating cash flow/debt was negative in 2022 due to the increase in working capital of HUF 4.2bn YoY. We expect Sun Group to require further working capital financing of around HUF 1.8-2.2bn yearly as the business expands. Debt protection improved due to fixing interest rate on working capital facilities and reducing interest burden due to state subsidised financing.

No notching was given for supplementary rating drivers. The removal of the negative notch on supplementary rating driver reflects Sun Group's disciplined acquisition policy and moderate shareholder remuneration.

Outlook and rating-change drivers

The Outlook is Stable and assumes that Scope-adjusted debt/EBITDA will be maintained below 3.0x thanks to moderate top-line growth and stable profitability. The Outlook also assumes maintaining full compliance with the financial covenants.

A positive rating action could be warranted if Sun Group improved its diversification in the HR business by services or geographies, including achieving a top-three market share in its countries of operation, with Scope-adjusted debt/EBITDA not exceeding 3.0x and maintaining full compliance with financial covenants.

A negative rating action could be triggered by macroeconomic disruptions resulting in a significant drop in demand for temporary staff followed by a deterioration in credit metrics, e.g. if Scope-adjusted debt/EBITDA increased and stayed above 4.0x. Credit metrics could also deteriorate in the event of another large leveraged acquisition or a large dividend payout in the next two to three years. A negative rating action could also be triggered by weakened liquidity due to very large working capital swings, increased shareholder remuneration or non-compliance with financial covenants.

Ratings & Outlook

Issuer BB-/Stable

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Related Methodologies

General Corporate Rating Methodology; October 2023

Rating Methodology: European Business and Consumer Services Corporates; January 2024

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Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
30 Jan 2024	Upgrade	BB-/Stable
25 Jan 2023	Affirmation	B+/Stable
14 Dec 2022	Affirmation	B+/Stable
21 Dec 2021	New	B+/Stable

Rating and rating-change drivers

Positive rating drivers

- Majority stake in Prohuman (the leading HR business services provider in Hungary)
- Strong regional presence of Prohuman (Hungary, Romania, Serbia, Slovenia and DACH)
- Supportive legal framework to import non-EU (mainly Asian) workforce
- Prohuman’s good standing with 1,600+ customers and a diversified revenue as a one-stop shop for HR business services

Negative rating drivers

- Acquisition of Prohuman funded by debt, leading to a significant increase in leverage
- Increasing working capital need putting pressure on cash flow cover
- Integration risk of acquired entities in CEE (ie. Cityscope in Serbia, BRC Services in Hungary)
- Scarce availability of labour
- Limited covenant headroom

Positive rating-change drivers

- Improved top line and diversification
- Scope-adjusted debt/EBITDA sustained below 3.0x
- Maintaining full compliance with financial covenants

Negative rating-change drivers

- Scope-adjusted debt/EBITDA sustained over 4.0x
- Covenant breaches
- Weakened liquidity

Corporate profile

Sun Group Kft. owns and controls directly and through its subsidiaries the leading Hungarian HR services company Prohuman Zrt. Full consolidation under IFRS has taken place after the acquisition in 2022. Key owners are Mr. Sándor Zakor, Mr. Gyula Kücsön and Mr. Róbert Kiss.

Up until 2021 Sun Group was a small real estate company with assets under management (AUM) of HUF 5bn mostly Budapest located offices and warehouses. The real estate leg became rather insignificant after the acquisition, non-core assets are partially being sold.

Prohuman 2004 Kft. – renamed Prohuman Zrt. as of December 2023 (hereinafter Prohuman) is the market leader HR services company in Hungary with strong CEE presence. The change of the form of incorporation from „Kft.” (limited liability company) to „Zrt.” (company delimited by shares, not listed) is a step towards going public, along with the switch to IFRS.

Financial overview

Due to the acquisition of Prohuman performed in 2022, the historical metrics of 2021 are not relevant.

		Scope estimates		
Scope credit ratios	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	5.1x	7.9x	9.7x	6.7x
Scope-adjusted debt/EBITDA	2.7x	2.6x	2.4x	2.3x
Scope-adjusted funds from operations/debt	24%	27%	30%	27%
Scope-adjusted free operating cash flow/debt	-4%	11%	15%	15%
Scope-adjusted EBITDA in HUF m				
EBITDA	6,844	7,862	8,393	8,671
Scope-adjusted EBITDA	**6,844**[1]	**7,862**	**8,393**	**8,671**
Funds from operations in HUF m				
Scope-adjusted EBITDA	6,844	7,862	8,393	8,671
less: (net) cash interest paid	-1,336	-990	-861	-1,297
less: cash tax paid per cash flow statement	-1,096	-1,351	-1,542	-1,997
Funds from operations (FFO)	4,412	5,521	5,989	5,378
Free operating cash flow in HUF m				
Funds from operations	4,412	5,521	5,989	5,378
Change in working capital	-4,205	-2,226	-1,858	-783
less: capital expenditure (net)	-943	-1,000	-1,000	-1,500
Free operating cash flow (FOCF)	**-736**	**2,295**	**3,132**	**3,095**
Net cash interest paid in HUF m				
Net cash interest per cash flow statement	-1,336	-990	-861	-1,297
Net cash interest paid	**-1,336**	**-990**	**-861**	**-1,297**
Scope-adjusted debt in HUF m				
Reported gross financial debt	19,326	21,826	21,826	21,826
less: cash and cash equivalents	-2,362	-4,530	-4,516	-4,838
add: non-accessible cash[2]	1,559	2,990	2,980	3,193
Scope-adjusted debt (SaD)	**18,523**	**20,286**	**20,291**	**20,181**

[1] Excluding fair value adjustments of HUF 0.7bn.
[2] Partial netting of cash was applied, because we deem two thirds of the cash as not permanent due to working capital swings and potential M&A.

Table of Content

Environmental, social and governance (ESG) profile[3]

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)

ESG profile

Sun Group has a low environmental risk profile as it has become a services company after the acquisition of Prohuman.

Labour management compromises the social aspect of the company. Monthly turnover is high (up to 1,000 employees, more than 5% of total employees) and the industry uses hostels or basic accommodation to accommodate workers in the long term. In case of disruptions such as the pandemic or supply chain issues, temporary staff is let go first, with low protection against unemployment and low local state support thereafter. Stricter labour laws may have negative implications on profitability.

The corporate structure has medium complexity with senior secured loans placed on Prohuman (the operating company) and acquisition finance on Sun Group (holding).

Clarity and transparency have been improving with disclosures towards investors after the bond issuance and the group successfully introduced IFRS reporting since FY 2022.

[3] 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.

Business risk profile: BB-

Sun Group's business risk profile (assessed BB-, revised from B+) is driven by subsidiary Prohuman's moderate regional market shares in CEE in HR services and market leadership in Hungary with revenues expected to exceed HUF 100bn (ca. EUR 260m) in 2023 and its improving diversification.

Industry risk profile: BB

The industry risk rating was changed to BB from BBB following the publication of the applicable sector methodology for European Business and Consumer Services corporates. Sun Group is an asset-light company operating with high share of unspecialised workforce as its main service is temporary staffing. Such sub-sector has medium cyclicality, low market entry barriers and medium substitution risk.

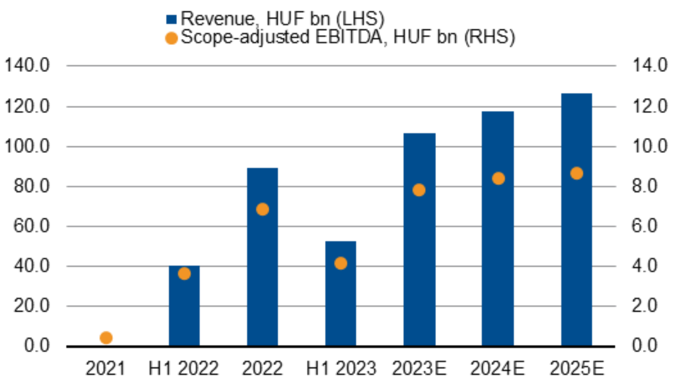
High FDI and low unemployment are supportive to the business

In Hungary, a low unemployment rate (4.1% in October 2023, up from 3.6% in October 2022) and growing staff shortages in many sectors as a result of large foreign direct investments (such as in automotive/e-mobility, shared service centres) are increasing demand for employment agency services. Fulfilling labour needs is a growing challenge that, given the country's ageing society, is not expected to be resolved without intervention. A record EUR 13bn foreign direct investments (mainly in electric vehicle and battery manufacturing) were announced in 2023, that require 30,000+ jobs in the next three years.

Increasing market shares in CEE

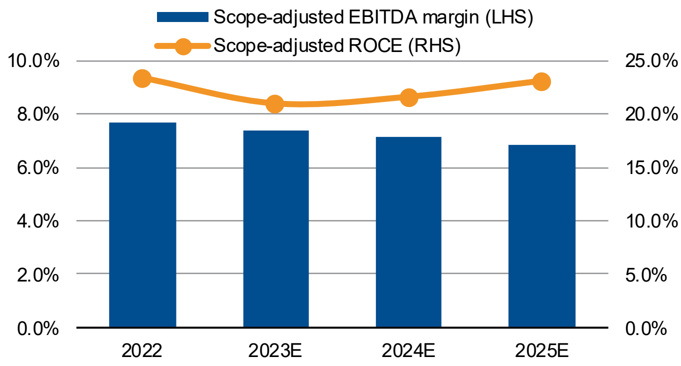
The markets are fragmented but show good growth potential: (i) in Hungary Prohuman is the market leader with ca. one fifth market share which may further increase due to supportive legislation and business environment; (ii) in Romania Prohuman has ca. 15% market share (third largest HR services company) and growth is driven by both white collar placement and blue collar temporary staffing; (iii) in Serbia high growth is expected by the new imported workforce legislation which is largely based on the Hungarian legislation; (iv) further bolt-on acquisitions may further boost inorganic growth in other CEE countries and/or by diversification of service offering.

Figure 1: Revenues and EBITDA



Sources: Sun Group, Scope estimates

Figure 2: Profitability



Sources: Sun Group, Scope estimates

Improving diversification

Prohuman has a long-term client base of 1,600+ companies, high revenue share is provided by blue chip clients. Top 10 clients accounted for one third of revenues, which shows some concentration, although the risk of moving to another service provider is remote. More than 80% of revenues are generated by Hungarian and Romanian activities, however growth prospects in CEE will improve geographical concentration in the medium term. Flagship product is temporary staffing, up selling is driven by payroll and import of foreign workers. Further service offering diversification is envisaged via acquisitions.

Moderate profitability, increasing nominal EBITDA

Sun Group's profitability is moderate with a Scope-adjusted EBITDA margin of 7.8% in 2022 (first year of consolidating Prohuman) and we expect it to stay around 7% in period 2023-25 due to the supportive market conditions. The main service of Prohuman is temporary staffing which is a margin business. This means if wages grow, revenues of Prohuman and its nominal EBITDA will grow as well. The high inflationary environment coupled with labour shortage has had a positive effect in this case on the evolution of nominal EBITDA. The margin effect is visible on the H1 2023 nominal EBITDA of HUF 4.2bn (+13% YoY) as wages are steeply increasing in Hungary.

The employees can be let go very easily in Hungary and in CEE (ESG factor: negative social factor), which shields operating profitability as proven during the pandemic, although stricter labour laws can have negative implications.

Scope-adjusted return on capital employed is good, well above 20% in 2022 and in the following forecasted three years due to the asset-light nature of the business.

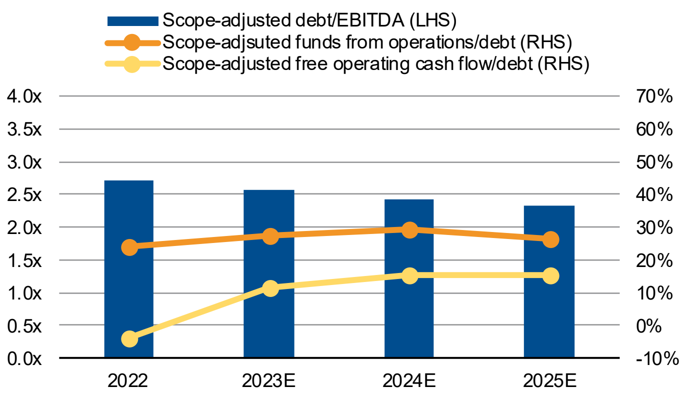
Moderate service strength

Prohuman is a well-known brand in Hungary, somewhat known in Romania and still very small in other countries of operation. Customers work together with multiple service providers. Exclusivity is rare in case of temporary staffing and contracts are easily cancellable. Add-on services provide medium service integration in the customer's business such as payroll, where typical contract length is well above one year. Customer churn rate is measurable based on headcount employed and that shows medium volatility. Headcount as of H1 2023 is largely in line with the end-2021 level (close to 13,000 employees), but composition changed with acquiring a new blue chip flagship client.

Financial risk profile: BB

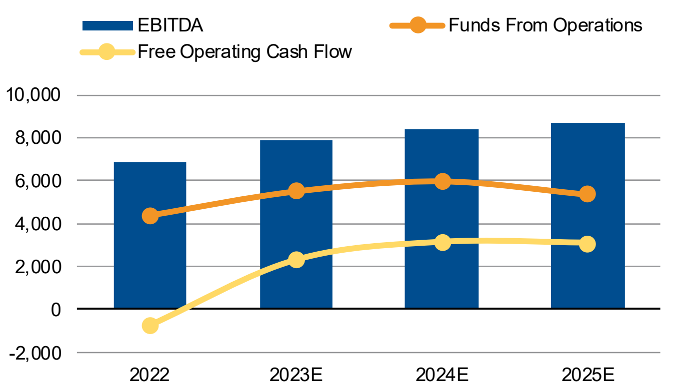
Sun Group's financial risk profile (assessed BB, unchanged) is driven by its decreasing leverage towards 2.5x Scope-adjusted debt/EBITDA at end-2023.

Figure 3: Leverage and cash flow cover



Sources: Sun Group, Scope estimates

Figure 4: Cash flow overview (in HUF m)



Sources: Sun Group, Scope estimates

Volatile cash flow cover

Scope-adjusted free operating cash flow/debt was negative in 2022 due to the increase in working capital of HUF 4.2bn YoY. The agency expects Sun Group to require further working capital financing of around HUF 1.8-2.2bn yearly as the business expands. As an asset-light business, CAPEX needs are limited (HUF 1.0-1.5bn yearly), and working capital swings should normalise, therefore we expect cash flow cover to stay in the range of 10-15% in 2023-25.

Decreasing leverage

The cost of the Prohuman acquisition was covered by a senior unsecured bond, resulting in Scope-adjusted debt/EBITDA increasing to around 3.5x for the post-transaction entity in early 2022. Scope-adjusted EBITDA was HUF 6.8bn at end-2022 (+59% YoY), which resulted in deleveraging to Scope-adjusted debt/EBITDA of 2.7x at end-2022.

We expect gradual deleveraging towards Scope-adjusted debt/EBITDA of 2.5x mainly driven by improving EBITDA which is slowed down by the increase in working capital finance needs due to wage inflation, slower payment from customers, small potential acquisitions and moderate shareholder remuneration.

Cash netting was applied for one third of the cash (ca. HUF 3bn not netted in 2023-25) due to liabilities towards owners (voted but unpaid dividends), further possible working capital swings, distribution to owners and bolt-on acquisitions.

Sun Group's Scope-adjusted funds from operations/debt of 20-30% is moderate, which shows good cash flow generation, which we expect to remain, as Sun Group successfully defended its profitability in 2023 compared to other businesses with less recurring / protected cash flows.

Good debt protection

We estimate a Scope-adjusted EBITDA/interest cover of between 8-10x in 2023-24 (up from 5.1x in 2022). The improvement is driven by the successful refinancing of the factoring line (borrowing cost yearly more than 15%) with a HUF 5.1bn two-year working capital facility with a yearly fixed interest rate of 6.0%. The acquisition-related bond (ISIN: HU0000361225) has a fixed coupon of 5.5% yearly. The two instruments make up more than 90% of the issuer's debt and hence debt protection is high from increasing rates. The fixed-rate state subsidised working capital facility brings a significant improvement in debt protection compared to the previous financing structure.

Adequate liquidity

Sun Group's liquidity is adequate, mainly driven by historically good cash flow and the repayment profile of the issued bond which starts amortising only in 2027. The adequate liquidity assessment is based on HUF 2.3bn cash projected for end-2023, HUF 2.0bn unused financing facilities, free operating cash flow exceeding HUF 3.0bn in 2024-25 and that expiring short-term facilities will be refinanced based on good historical track record and improving financials.

Balance in HUF m	2023E	2024E	2025E
Unrestricted cash (t-1)	2,362	4,530	4,516
Open committed credit lines (t-1)	2,000	2,000	2,000
Free operating cash flow	2,295	3,132	3,095
Short-term debt (t-1)	2,030	2,030	2,030
Coverage	**>200%**	**>200%**	**>200%**

Liquidity could still deteriorate, for example, in the event of very sharp working capital swings due to expansion of the business, delayed customer payments, which would be mitigated by the factoring of receivables.

We highlight that Sun Group Kft.'s senior unsecured bonds issued under the Hungarian National Bank's Bond Funding for Growth Scheme has covenants requiring the accelerated repayment of the outstanding nominal debt amount (HUF 15.4bn) if the debt rating of the bonds stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 5 business days) or in case of breach of net debt/EBITDA ratio (max. 3.0x in 2023 and max. 2.5x afterwards). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is 2 notches, where we see no significant risk of the rating related covenant being triggered while net debt/EBITDA covenant has limited headroom of below 0.5x, however it is likely that such potential breach would be waived.

Supplementary rating drivers: no notching

Negative notch removed

No notching was given for supplementary rating drivers. The negative notch on supplementary rating driver was removed as (i) the minority payouts related to the dividend distribution of Prohuman to Sun Group, which are required to service debt at the issuer level, are not detrimental to creditors; and (ii) Sun Group has demonstrated that it has a disciplined acquisition policy, as evidenced by the recent small bolt-on acquisitions of Cityscope (Serbia) and BRC Services (Hungary) at low transaction multiples, which has allowed the start of deleveraging. Furthermore, transparency towards capital markets and financial planning has improved significantly in 2023 thanks to the full consolidation of the issuer's main subsidiary Prohuman Zrt. under IFRS.

Long-term debt ratings

Bond rated in line with the issuer

In January 2022, Sun Group Kft. issued a HUF 15.4bn senior unsecured bond guaranteed by subsidiary Prohuman Zrt. The bond proceeds were used for the acquisition of Prohuman Zrt. The bond has a tenor of 10 years and a fixed coupon of 5.5% yearly. Bond repayment is in five tranches starting from 2027, with 10% of the face value payable yearly, and 50% balloon payment at maturity.

We expect an 'average' recovery for the senior unsecured (guaranteed) bond (ISIN: HU0000361225), which translates into a BB- rating in line with that of the issuer.

The average recovery is based on the asset-light nature of HR services and the issued bonds' ranking behind the senior secured creditors of Sun Group and the working capital and factoring creditors of Prohuman. The recovery level is based on an expected distressed enterprise value as a going concern in a hypothetical default scenario of around HUF 18.2bn in 2025 and a 10% haircut on that value for administrative claims.

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