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. Of these subsidiaries, PICK Deutschland GmbH is the most important, with 83% of all subsidiary sales. 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 (celebrating its 150th anniversary in 2019) and was acquired by Bonafarm in the 2000s. It became part of the Bonafarm Group in 2009.

Rating rationale

Scope Ratings assigns a corporate rating of BB- with a Stable Outlook to Pick Szeged Zrt. The company's strong market position is offset by input price volatility making EBITDA vulnerable to market price movements. Senior unsecured debt has been rated BB-.

The rating for Pick Szeged is based on the unconditional and irrevocable guarantee by the parent Bonafarm Csoport and is thus assigned the same rating. The overall Business Risk Profile reflects a strong presence in the Hungarian market (as well as in key export markets), tempered by volatile profitability with moderate margins and concentration on one single product group.

The company accesses a cash pool for investments and does not carry its own investment burden (this is carried by Bonafarm, the parent).

This results in an overall issuer rating of BB-, with a senior unsecured debt rating of BB-.

Ratings & Outlook

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

Analysts

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Related methodology

Corporate Rating Methodology

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Outlook

The Outlook is Stable and based on the unchanged ownership and guarantee from the parent (Bonafarm Csoport).

A positive rating action could be warranted in the event of an upgrade of the parent reflecting positive developments there. A negative rating action could be warranted in the event of a downgrade of the parent reflecting a worsening of credit metrics.

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 • FOCF/SaD 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

Pick Szeged operates in the fast-moving consumer goods industry. We see substitution risk as high, due to the company's limited product palette (meat products). While Pick Szeged meat products in and of themselves are unique, they may at the same time be easily substituted by other suppliers. In addition, changing consumer preferences are easily satisfied, i.e. meat products can easily be replaced by alternative foods.

High cyclicality

Key benchmark prices for the major input, meat, are strongly cyclical. Demand for agribusiness and commodity food products is non-discretionary and would hence nominally have low cyclicality. However, strong supply swings introduce significant volatility to both costs and prices and hence both revenues and EBITDA. The industry is also inherently subject to unexpected and unexpectable events (e.g. diseases) that alternately cause supply shortages (increasing prices) and supply gluts (depressing prices), leading to price volatility well in excess of general price changes. The sector is also subject to volume volatility

Medium market barriers

Market barriers to entry are medium, in keeping with the fast-moving consumer goods industry. Given the limited product palette, there is an increased inherent risk of product substitution. Consumer preferences change over time – pork consumption is down in Europe – and there is increased availability and use of alternative food groups to replace meat products.

High substitution risks

Alternative sources for consumers are readily available, if not necessarily with the same attributes. We therefore consider substitution risk to be high. This risk is partly mitigated by the company's ability to generate high volumes while maintaining quality, which is important for wholesalers.

Robust outlook on home market of Hungary

Pick Szeged's home market is Hungary, whose economic growth overall is robust despite negative demographic trends and an ageing workforce, reflecting the strong productivity growth. The Hungarian economy is medium-sized and open, with cyclical behaviour tied to that of the eurozone in general. Robust wage increases have helped growth strongly in recent years. Hungary has access to EU markets and a sound infrastructure.

Scope's public finance rating for Hungary is BBB/Positive, reflecting the relatively healthy state of the economy and relatively moderate public finance pressures on the economy. Economic development is aided by Hungary's ongoing absorption of EU structural funds (Hungary is an EU member but has not accessed the euro), as well as private-sector de-leveraging. Consumer sentiment is strong, supported by strong wage increases, low unemployment and by the relative strength of the Hungarian forint, reducing import costs.

The overall outlook for the pork market in Hungary is relatively robust over time, with recent developments largely positive. Pork consumption in Hungary has increased in the past several years.

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. For the long term, Asian markets are important due to demographic stagnation in existing markets, but both Chinese and Japanese markets are currently unavailable to Pick Szeged because the export of meat products to these markets has been blocked[1]. Given the slow shrinkage of European pork demand, the development of Asian markets remains a priority, but this is currently on hold until a solution can be found. Any resolution of this issue may negatively

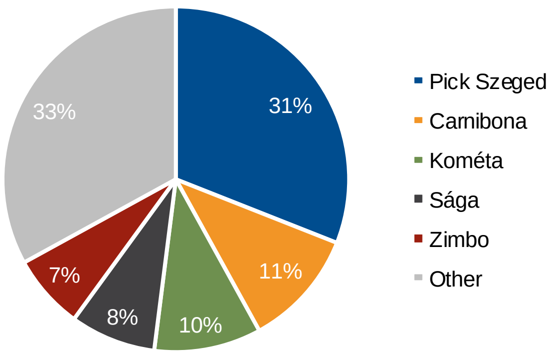
[1] African swine flu transitioned to Asia via Georgia, Estonia and Russia and can only be dealt with through large-scale herd culling. So far in 2019, more than 1m pigs were culled in China alone. African swine flu transitioned to Hungary via wild boars in 2018 but has not transitioned to domestic pig production.

impact price development as affected companies expand both their breeding and fattener stocks in anticipation of regaining market shares.

Competitive positioning

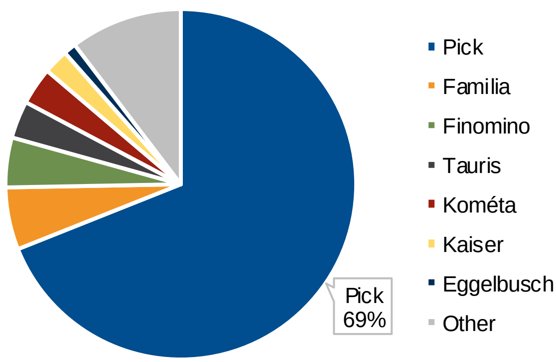
The company enjoys a dominant market position. While Pick Szeged is *prima inter pares* in the overall market, with a 31% sales volume market share in 2018 (**Figure 1**), its dominance in the salami and sausage market is greater, with a consolidated market share in 2018 of 69% (**Figure 2**). This underscores the company's very strong market position in its home market.

Figure 1: Pick Szeged company market position by brands (2018 sales volumes)



Source: Pick Szeged

Figure 2: Pick Szeged market position, salami and sausage market by brands (2018 sales volumes), with private label production and Herz added to Pick Szeged



Source: Pick Szeged, Scope calculations

Diversification constrained

Diversification is constrained by Pick Szeged's concentration on meat products. While Pick Szeged offers a broad range of meat products, a significant product cluster risk remains. The company's relatively good international standing mitigates its limited diversification. At the same time, vulnerability to consumer sentiment shifting away from meat products in industrialised countries, a shrinking demographic base and the continued inability to access key Asian growth markets constrains the rating.

Profitability vulnerable to market conditions

The development of EBITDA shows Pick Szeged's vulnerability to market conditions, with EBITDA margins fluctuating. The strong performance in 2018 was due to a beneficial mix of lower input prices and strong sales and is not reproducible. Further revenue growth is expected to be moderate after a weak 2019. We expect costs to rise more sharply, with material costs mirroring revenue growth. We also expect personnel costs to limit room for improvement via cost management. Operating results reflect the vulnerability to market conditions, with strong variability expected to continue throughout the rating time period. The relatively low margins and the strong variability of operating results constrain the rating.

Capacity expansion

The planned CAPEX – replacing current plant with state-of-the-art new production facilities – aims at significantly improving overall EBITDA margins through efficiency gains and increased production capacity. Positive effects are expected first after the rating horizon. The envisioned issue of HUF 28.5bn (~EUR 86m) under the MNB programme would be the first debt issued by Pick Szeged. [2]

Neutral view on corporate governance

We do not have any issues with overall corporate governance. External governance factors are satisfactory, as are internal governance factors, given the family-owned nature of the company at the ultimate parent. Ownership is transparent.

[2] The sentence was added on 10 October 2019. In the original publication on 6 September 2019 it was not included. Furthermore, the issue volume was corrected on 14 October 2019.

Financial risk profile

Key assumptions

Our key assumptions are as follows: i) no major restructuring of the company or subsidiaries; ii) continuity of management; iii) organic growth of top-line sales between 3% and 4% per year; iv) continued strong growth of the Hungarian domestic market, with real GDP growth remaining well above 3% throughout 2021, low unemployment, strong wage growth, and a consistent central bank monetary policy keeping interest rates within targets and exchange rates stable; v) execution of Pick Szeged's investment plans as presented with no meaningful operational or financial risks; and vi) continuity of financial policy, especially the continued avoidance of dividends, leasing and factoring.

Leverage and debt protection

Given the cash pool access to finance investments via the parent company, we assign the same rating as the parent to Pick Szeged.

Cash flow coverage and free cash flow generation

The rating for cash flow coverage and free cash flow generation is largely determined by the ongoing heavy investment phase. The ratios are highly variable, reflecting the strong negative investment cash flow. We expect a return to robust cash flow generation once the investment phase is closed. However, this period lies outside 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, with no issuance of 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.

Liquidity is assessed to be that of the parent company.

Supplementary rating drivers

Financial policy

The parent company's financial policy aims to expand one of its major businesses (Pick Szeged) considerably. Pick Szeged's relatively large investments are for strategic modernisation and the expansion of manufacturing capacities, reflecting the wholesale replacement of capacity dating back to the 1970s. The relatively aggressive investment plans constrain the rating. We consider financial policy to be largely prudent and conservative, with only moderate expectations for top-line growth going forward.

Parent support

Pick Szeged is a subsidiary of Bonafarm Csoport, in turn a wholly-owned subsidiary of Bonitás, the investment company of the Csányi family. Bonafarm Csoport received a one-notch upgrade for parent support.

Senior unsecured debt

Pick Szeged has not yet issued senior unsecured debt. Scope would assess senior unsecured debt as the same level as the parent company. The rating for the individual debt instruments may vary from this, depending on conditions stated in any future prospectus.

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