WEDNESDAY, 14/12/2022 - Scope Ratings GmbH

Scope affirms Sun Group Kft's B+/Stable issuer rating

The rating reflects the company's acquisition of the leading HR services provider in Hungary but is constrained by its financial policy including debt-funded acquisitions and dividends.

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 affirmed the B+/Stable issuer rating on Hungarian HR services and real estate company Sun Group Kft. Scope has also affirmed the long-term senior unsecured debt rating at B+.

Rating rationale

The issuer rating mainly reflects Sun Group's leading position in Hungarian HR services following its acquisition of a majority stake (80.22%) in Prohumán 2004 Kft. from GI Group Poland SA in Q1 2022, shifting the company's sector focus towards HR. The acquisition was financed by a senior unsecured bond issuance of HUF 15.4bn with a 5.5% yearly fixed coupon, one of the last bonds issued within the Hungarian central bank's Bond for Growth programme.

The issuer rating of the significantly larger Sun Group is mainly driven by the acquisition of Prohumán, which shows moderate cash flow generation compared to its local HR services peers, low maintenance capex requirements and well-established operations in Hungary and neighbouring countries. The rating is constrained by the debt-financed nature of the acquisition coupled with moderate shareholder remuneration, the limited scale of Sun Group's operations and Prohumán's high dependence on a single service (temporary staffing) and low geographical and revenue diversification.

Sun Group's business risk profile (assessed B+) benefits from the acquisition of leading HR services firm Prohumán, with more than 1,000 clients in the fragmented Hungarian market, in which it holds a 17% market share. Once Prohumán is consolidated at end-2022, Hungarian and Romanian HR services will make up more than 80% of consolidated revenue and EBITDA, and operations in Slovenia and other neighboring countries will account for 10%, while the share for the real estate segment will fall below 10%.

The company has a diversified service offering and client base within HR services and is shifting its focus away from the flagship service of temporary staffing to have a better mix with recruitment, payroll and placement that provide more stable, recurring income. However, its services are concentrated around one area and there is a high exposure to the automotive industry accounting for 30% of revenue, which contains some large clients.

Prohumán's profitability is low but slightly improving, with a Scope-adjusted EBITDA margin of around 7%, which is above its local peers. However, European asset-light business services companies typically operate with margins of above 20%.

The temporary staffing market often has poor working and living conditions (especially for imported workforce) and employees are let go immediately in the event of economic downturns, supply chain issues or seasonality in countries with low social support. This constitutes a negative social aspect (ESG factor: credit negative).

Sun Group's financial risk profile (assessed BB) is driven by its moderate leverage post-acquisition coupled with decreasing EBITDA interest cover constraining the rating. It is supported by low capex needs due to the asset-light nature of the business.

Low leverage prior to the acquisition and the moderate price of the acquisition allows for additional indebtedness while keeping leverage commensurate with the assigned rating. The majority share of Prohumán was financed through a senior unsecured bond, resulting in Scope-adjusted debt/EBITDA of close to 3.5x for the post-transaction entity in early 2022. Sun Group has moderate Scope-adjusted funds from operations/debt of 15-20%, which reflects moderate cash flow generation and enables the accumulation of cash. As an asset-light business, capex needs are limited; therefore, Scope expects Scope-adjusted free operating cash flow/debt to stay at around 10%. This allows for deleveraging if the company's financial policy is aligned. Scope expects Scope-adjusted debt/EBITDA to reach about 3x, with a gradual deleveraging due to increasing working capital needs, shareholder remuneration and possible small acquisitions.

Scope estimates an EBITDA/interest cover of around 4x in 2022-2024, with some deterioration due to rising interest rates in Hungarian forint as the base rate increased to 13% from 2.7% in 2021, which heavily impacts the pricing of the group's working capital facilities that have variable interest rates.

Sun Group's liquidity is adequate, mainly driven by historically good cash flow and the repayment profile of the issued bond, allowing amortisation from year five and a 50% balloon payment at maturity. Liquidity could still deteriorate, for example, in the event of very sharp working capital swings due to delayed customer payments, which can be partially mitigated by factoring receivables.

For supplementary rating drivers, Scope has taken one notch off the issuer rating. This is due to limited transparency and loose financial planning due to ongoing group consolidation, the debt structured at the holding level, which entails dividend leakage at debt repayment towards minority quota holders, and Sun Group's shareholder-friendly financial policy (ESG factor: credit negative).

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

Outlook and rating-change drivers

The Outlook is Stable and assumes further development of HR services resulting in a Scope-adjusted debt/EBITDA ratio between 3-4x taking into consideration below inflation revenue growth around yearly 10%, low capex, small acquisitions and moderate shareholder remuneration.

A positive rating action is remote but could be warranted if Sun Group's financial policy becomes more creditor friendly and IFRS consolidation is executed or 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 3x.

A negative rating action could be triggered by events such as supply chain disruptions resulting in a significant downsizing of temporary staff followed by a deterioration in credit metrics, e.g. if Scope-adjusted debt/EBITDA increased and stayed above 4x, or liquidity weakened due to very strong working capital swings or increased shareholder remuneration. Credit metrics could deteriorate because of another large debt-funded acquisition or a major dividend payout in the coming two to three years.

Furthermore senior unsecured bonds issued by Sun Group include a debt acceleration clause triggering early repayment if the rating falls below B+ and is not restored within two years or if the rating falls below B- the debt acceleration becomes immediate.

Long-term debt ratings

Scope expects an 'average' recovery for senior unsecured long-term debt including the HUF 15.4bn bond (maturing in 2032). The recovery is based on an expected distressed enterprise value as a going concern in a hypothetical default scenario at YE 2023. This is based on the asset-light nature of HR services and the debt's ranking behind the senior secured creditors of Sun Group's real estate and the working capital and factoring creditors of Prohumán.

The recovery expectation translates into the same rating as the issuer rating, resulting in a B+ senior unsecured long-term debt rating.

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 Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: 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

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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.
Lead analyst: Barna Szabolcs Gáspár, Associate Director
Person responsible for approval of the Credit Ratings: Philipp Wass, Executive Director
The Credit Ratings/Outlook were first released by Scope Ratings on 21 December 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.
Scope Ratings provided the following Other Services to the Rated Entity and/or its Related Third Parties within the two years preceding this Credit Rating action: Rating Assessment Service.

Conditions of use/exclusion of liability

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