25 July 2022

Corporates

Pannon-Work Zrt.
Hungary, Business Services

SCOPE B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	59.0x	11.6x	6.1x	6.5x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	5.2x	4.5x	4.3x	4.0x
Funds from operations/SaD	18%	14%	21%	20%
Free operating cash flow/SaD	15%	-7%	19%	13%

Rating rationale

Pannon-Work's ratings are supported by its good market position in Hungary in the temporary staffing market. High fragmentation and low entry barriers of the business services industry temper the market position. Customer concentration risk is high, and Pannon-Work strongly depends on the domestic market.

Improvements in service offering such as payroll and diversification to other sectors such as workers' accommodation and solar power generation provide increasing recurring revenue and hence more stable cash flow.

The HUF 3.5bn bond issuance had a negative impact on financials in 2020, resulting in leverage (SaD/Scope-adjusted EBITDA) peaking at 5.2x, which decreased moderately to 4.5x by end-2021. Leverage remains weak with high indebtedness depending on the extent cash is used to finance additional investments.

Outlook and rating-change drivers

The Outlook for Pannon-Work is Stable and reflects our view that the company can retain its major clients and keep its strong cash flow generation. The Stable Outlook reflects our expectation that indebtedness will remain high, at a SaD/Scope-adjusted EBITDA in the 4.0x-4.5x range over the next few years after debt financed investments made that bear fruit.

A positive rating action is remote at this stage but could be warranted if Pannon-Work grows significantly in size benefiting the company's diversification, especially regards customers, while SaD/Scope-adjusted EBITDA improves to below 4x. This could be achieved by improving profitability, a higher EBITDA contribution from HR services or reduced shareholder remuneration.

A negative rating action could occur if SaD/Scope-adjusted EBITDA exceeded 6x on a sustained basis. This could result from lower-than-expected EBITDA from HR-related services, solar energy production assets or further large debt-funded capital expenditure or acquisitions.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
25.07.2022	Affirmation	B+/Stable
11.08.2021	Upgrade	B+/Stable
24.07.2020	Initial rating	B/Stable

Ratings & Outlook

Issuer B+/Stable

Lead Analyst

Barna Gáspár
+49 30 278913 25
b.gaspar@scoperatings.com

Related Methodology

Corporate Rating Methodology; July 2022

Rating Methodology: European Renewable Energy Corporates; January 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• One of the four largest personnel service companies in Hungary • Growth over the years and acquired expertise and market share (recently in payroll services) • Opportunity to expand into neighbouring countries • Diversification into other sectors – renewables and real estate • Strong EBITDA interest cover and cash flow generation	• Impact of the bond issuance and new acquisition/capex loans on financials • High fragmentation and low entry barriers of the business services industry • Customer concentration risk and dependence on the domestic market • High leverage

Positive rating-change drivers	Negative rating-change drivers
• Improved business risk profile (reduced customer concentration) and • SaD/Scope-adjusted EBITDA moving significantly below 4x on a sustained basis	• SaD/Scope-adjusted EBITDA sustained above 6x

Corporate profile

Pannon-Work is a privately owned human resources service provider founded over 20 years ago. It mainly operates in Hungary, its core activities being recruitment and workforce leasing. Furthermore, the company has owned a workers' hostel in Komárom since 2021.

The company acquired ten 0.5 MW solar energy production plants in 2021.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	59.0x	11.6x	6.1x	6.5x	6.7x
SaD/Scope-adjusted EBITDA	5.2x	4.5x	4.3x	4.0x	3.8x
Funds from operations/SaD	18%	14%	21%	20%	21%
Free operating cash flow/SaD	15%	-7%	19%	13%	15%
Scope-adjusted EBITDA in HUF ‘000s					
EBITDA	695,680	941,099	1,019,195	1,040,429	1,038,709
Other items	60,881[1]	-	-	-	-
Scope-adjusted EBITDA	**756,561**	941,099	**1,019,195**	**1,040,429**	**1,038,709**
Funds from operations in HUF ‘000s					
Scope-adjusted EBITDA	756,561	941,099	1,019,195	1,040,429	1,038,709
less: (net) cash interest paid	-12,824	-81,250	-166,773	-160,729	-154,669
less: cash tax paid per cash flow statement	-23,280	-19,422	-52,760	-53,388	-53,309
Change in provisions and other items	-	-258,265	112,487	-2,470	-3,172
Funds from operations (FFO)	**720,457**	**582,162**	**912,149**	**823,842**	**827,558**
Free operating cash flow in HUF ‘000ss					
Funds from operations	720,457	582,162	912,149	823,842	827,558
Change in working capital	-57,860	-851,557	-5,004	-204,430	-156,243
Non-operating cash flow	-70,558	-	-39,539	-42,306	-44,422
less: capital expenditure (net)	-10,000	-18,893	-25,000	-27,500	-30,000
Free operating cash flow (FOCF)	**582,039**	**-288,288**	**842,606**	**549,606**	**596,894**
Net cash interest paid in HUF ‘000s					
Net cash interest per cash flow statement	-12,824	-81,250	-166,773	-160,729	-154,669
Net cash interest paid	**-12,824**	**-81,250**	**-166,773**	**- 160,729**	**-154,669**
Scope-adjusted debt in HUF ‘000s					
Reported gross financial debt	3,899,202	4,280,783	4,375,477	4,164,075	3,952,672
less: cash and cash equivalents[2]					
Scope-adjusted debt	**3,899,202**	**4,280,783**	**4,375,477**	**4,164,075**	**3,952,672**

[1] Associate dividends received from Gamax Media
[2] No netting of cash was applied.

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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)

The company has been successful in digitalising processes related to its core staffing and payroll activities. Gamax (the guarantor) is an IT company that provides know-how in automation, which results in efficiency gains.

The regulatory environment around temporary staffing is socially rather negative as staff can be laid off easily. This may seem to benefit Pannon Work on the short term, however it imposes some regulatory risk for the future, hence our view remains credit neutral for now.

Pannon-Work has built up 5 MW of renewable power generation with a strong cash flow, which supports the rating.

[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: B+

Industry risk profile: BBB+

Pannon-Work is classified as a personnel services company, which we consider a subsegment of the business services industry. It also has exposure to the renewable energy production market. The industry risk is therefore blended (assessed at BBB+) between business services and renewables (one-fifth of EBITDA since mid-2021).

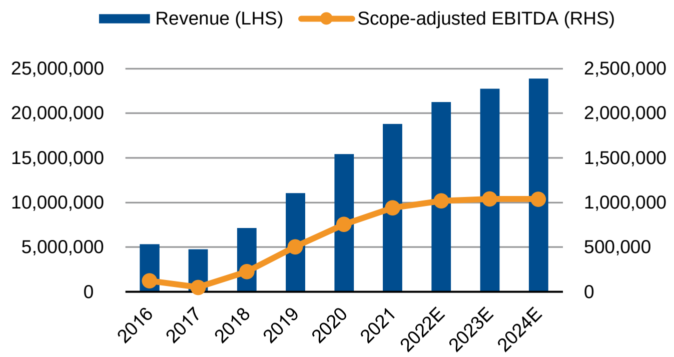
Small-scale player in a fragmented HR services market

Pannon-Work's business risk profile is driven by its position as the fourth largest personnel services provider in Hungary. The Hungarian market is very fragmented, with the top four players holding a market share of around one-third.

Volatile cash flow from workforce leasing largely mitigated by recurring revenue

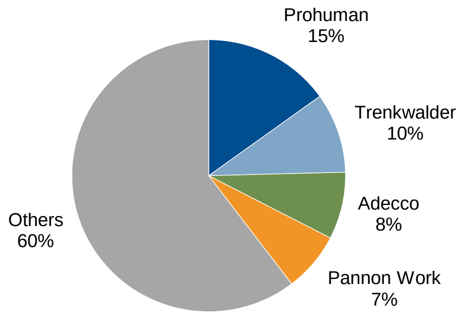
Growth over the years has been driven by the labour shortage in Hungary and companies' need for an intermediary to offer flexibility by leasing out personnel when required. The labour shortage and further workforce needs created by large-scale investments in the automotive, retail and consumer goods sectors may continue to be an issue, enabling the workforce leasing market to grow. At the same time, clients are continuously tendering out contracts with workforce agencies and the leased workforce is the easiest to let go, as seen in the pandemic. Cash flow arising from Pannon-Work's blue collar workforce leasing is therefore volatile and vulnerable. It is difficult to significantly increase HR services revenue due to the competition and exclusivity agreements in place with certain car parts manufacturers.

Figure 1: Pannon-Work revenue and Scope-adjusted EBITDA evolution (HUF '000s)



Sources: Pannon-Work, Scope

Figure 2: Top HR service providers in Hungary[4]



Sources: Pannon-Work, Scope

Despite the company's efforts to expand its range of services, it faces concentration risk due to its sole exposure to Hungary and low customer diversification. Low geographical and client diversification has led to volatile cash flow from Pannon-Work's main activity. Although the top five clients contribute more than two-thirds of revenue, most of them are bound to Pannon-Work for more than five years. Since there are significant investments in Hungary with a need for labour, especially in the automotive parts segment, we expect the blue-collar workforce leasing market to grow, especially in the electric vehicles market, which may provide additional opportunities for Pannon-Work to grow its client base.

Furthermore, recurring revenue from the acquired solar energy production and revenue from outsourced services such as payroll services provided by the recently acquired HR-Face Kft. largely mitigate this vulnerable cash flow since clients change service providers less frequently due to the administrative burden.

Improving profitability, mainly from recurring cash flows

The Scope-adjusted EBITDA margin of 5.0% in 2021 is similar to that in previous years. Improved profitability from historical levels of 2%-3% EBITDA margins is mainly due to recurring revenue and its EBITDA contribution. From 2022 onwards, around one-third of

[4] Market share in 2021 based on revenues

EBITDA is generated by payroll services, accommodation, and green energy production, which have more protected cash flows than blue-collar workforce leasing. The increase in recurring revenues and their EBITDA contribution support the rating.

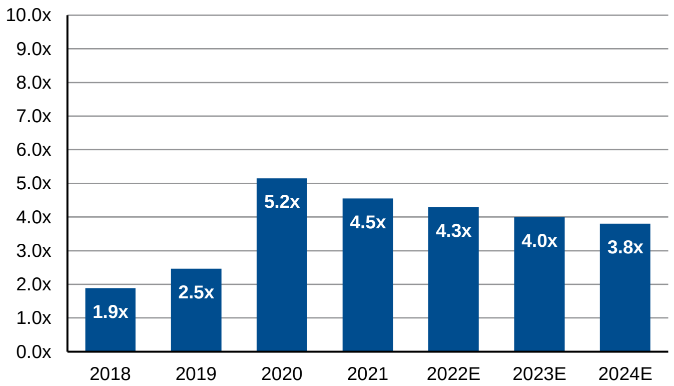
Financial risk profile: BB-

Increased leverage due to investments followed by planned deleveraging

Pannon-Work's financial risk profile is driven by high indebtedness caused by debt financed investments. Leverage is weak but still reasonable, with SaD/Scope-adjusted EBITDA at 4.5x in 2021, up from 2.5x in 2019 and FFO/SaD at around 150%. Debt is mainly composed of a HUF 3.5bn senior unsecured guaranteed bond and of a HUF 700m senior secured long-term loans for capex and acquisitions. Investments in assets generating recurring cash flow support EBITDA growth and allow gradual deleveraging.

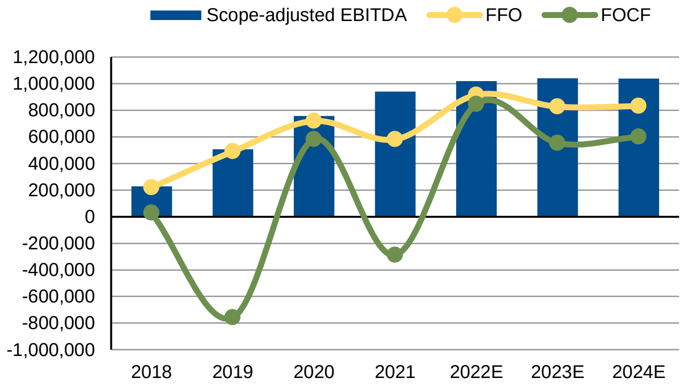
The bond proceeds were used to repay around HUF 1.1bn of Pannon-Work's short-term debt. The remainder was invested in solar power plants that have been generating cash flow since mid-2021. Future investments with the aim to increase solar power generation could weaken leverage once again towards 5x.

Figure 3: Scope-adjusted leverage (SaD/Scope-adjusted EBITDA)



Sources: Pannon-Work, Scope estimates

Figure 4: Cash flow overview (in HUF '000s)



Sources: Pannon-Work, Scope estimates

Interest cover protected as most debt has low fixed interest rate

Scope-adjusted EBITDA interest cover was strong in 2021 at 11.6x. The EBITDA ramp-up is visible in the expansion of the temporary staffing business, solar power generation and real estate segments. Most of the debt instruments are long term and have fixed interest rates of up to 3% per year, which are beneficial in the current soaring interest rate environment in Hungary. The rise in interest rates to above 10% moderately affects Pannon-Work, as the company has only HUF 0.3bn in variable interest rate debt drawn by end-2021 and no large variable-rate debt financing is planned.

Adequate liquidity

Pannon-Work refinanced most of its short-term debt in 2020 with long-term debt, which significantly improved the liquidity ratio. The HUF 950m factoring line is unused and only about 10% of the revolving credit facility of HUF 1.05bn is used, which provide additional headroom. The factoring line was not taken into account when calculating liquidity. The liquidity ratio is projected at above 5x with minimal short-term debt.

Balance in HUF '000ss	2022E	2023E	2024E
Unrestricted cash (t-1)	315,682	1,054,155	1,190,486
Open committed credit lines (t-1)	850,000	850,000	0
Free operating cash flow	842,606	549,606	596,894
Short-term debt (t-1)	177,065	411,402	411,402
Coverage	**> 200%**	**> 200%**	**> 200%**

Supplementary rating drivers: +/- 0 notches

No notching was applied for supplementary rating drivers.

The company distributes reasonable dividends. All acquisitions performed resulted in acceptable leverage and low execution risk. The acquired businesses were either complementary to the core business or operation and maintenance has been outsourced in case of renewables. New businesses provide additional strong recurring cash flow generation pointing towards a successful and fast integration.

Long-term ratings

Senior unsecured debt rating for specific bond: BB-

We expect an above-average recovery in a hypothetical default scenario based on a distressed liquidation value at YE 2023, aided by the high value of the standardised ten 0.5 MW solar power plants acquired and receivables. We therefore rate the issued senior unsecured bond of Pannon-Work (ISIN: HU0000360052) guaranteed by Gamax Kft. one notch above the issuer rating. The rating also reflects the bond’s junior ranking to the existing senior secured loans (for capex, acquisition and working capital).

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 62 31 42

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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