Pannon-Work Zrt
Hungary, Business Services

B STABLE

Corporate profile

Pannon-Work Kft is a human resources service provider operating mainly in Hungary, with core activities in recruitment and workforce leasing.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Scope-adjusted EBITDA/interest cover (x)	32.1x	32.3x	3.8x	3.9x
Scope-adjusted debt (SaD)/SaEBITDA	1.8x	2.4x	6.4x	5.8x
Scope-adjusted funds from operations/SaD	54%	40%	11%	12%
Free operating cash flow/SaD	-55%	6%	8%	10%

Rating rationale

Scope assigns an initial issuer rating of B/Stable to Hungary-based Pannon-Work Zrt. A preliminary rating of (P)B+ has also been assigned to the planned HUF 3.48bn senior unsecured bond (2020-2030) guaranteed by Gamax Kft and to be issued under the Hungarian National Bank's Bond Funding for Growth Scheme.

The issuer rating reflects the company's position as the fourth largest personnel services provider in Hungary but is limited by the concentration and dependence on the country's labour market as well as the weak and volatile credit metrics through the years.

Outlook

The Outlook is Stable and incorporates Scope's view of the Pannon-Work's stable business and ability to generate cash. Furthermore, the Outlook reflects Scope's expectation that indebtedness will remain high over the next few years, with a Scope adjusted debt (SaD)/EBITDA of more than 5x, as a result of the planned bond issuance. In addition, Scope anticipates stable indebtedness of the company's main subsidiaries as well as recurring dividend income from these subsidiaries at a level similar to that of 2019. Moreover, Scope expects no distribution of dividends to the owners of Pannon-Work in the next few years.

A negative rating action could occur if Scope-adjusted free operating cash flow (FOCF)/SaD is below 5% on a sustained basis. e.g. through an adverse operational development leading to reduced profitability and cash flows. A downgrade could also be prompted by worsening liquidity, e.g. through significant delays in customer payments or a reduced ability to recover costs.

A positive rating action could be warranted if SaD/Scope-adjusted EBITDA goes significantly below 5x on a sustained basis.

Ratings & Outlook

Corporate ratings	B/Stable
Senior unsecured rating	(P)B+

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Related Methodology

Corporate Rating Methodology, February 2020

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Rating drivers

Positive rating drivers	Negative rating drivers
• Position as the fourth largest human resources service provider • Increasing need for recruitment intermediation in Hungary • Opportunity to expand beyond Hungary	• Fragmentation of company's core segment • Covid-19 impact on demand for workers • Strong concentration on Hungarian market • High indebtedness and weak credit metrics

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/Scope-adjusted EBITDA significantly below 5x on a sustained basis	• Scope-adjusted FOCF/SaD below 5% on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Scope-adjusted EBITDA/interest cover (x)	32x	32x	3.8x	3.9x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	1.8x	2.4x	6.4x	5.8x
Scope-adjusted funds from operations/SaD	54%	40%	11%	12%
Free operating cash flow/SaD	7%	-55%	6%	8%
Scope-adjusted EBITDA in HUF k	**2018**	**2019**	**2020F**	**2021F**
EBITDA	181,084	255,510	267,219	277,908
Operating lease payments in respective year	0	0	0	0
Recurring dividends	46,800	251,200	250,000	250,000
Scope-adjusted EBITDA	227,884	506,710	517,219	527,908
Scope-adjusted funds from operations in HUF k	**2018**	**2019**	**2020F**	**2021F**
Scope-adjusted EBITDA	227,884	506,710	517,219	527,908
less: (net) cash interest as per cash flow statement	-7,101	-15,669	-135,725	-135,725
less: cash tax paid as per cash flow statement	-130	0	-32,297	-33,229
add: dividend received from @equity	0	0	0	0
Scope-adjusted funds from operations	220,653	491,041	349,227	358,954
Scope-adjusted debt in HUF k	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	429,358	1,249,459	3,480,628	3,480,628
less: cash and cash equivalents	-16,956	-22,124	-184,940	-413,540
add: cash not accessible	0	0	0	0
add: pension adjustment	0	0	0	0
add: operating lease obligations	0	0	0	0
Other	0	0	0	0
Scope-adjusted debt	412,402	1,227,335	3,295,688	3,067,088

Business risk profile

Pannon-Work is classified as a personnel services company, which we consider a subsegment of the business services industry.

Small-scale player in a fragmented industry

Pannon-Work's business risk profile (assessed at B) is driven by its position as one of the largest personnel services providers in Hungary, operating in a very fragmented market in which the four largest players account for only 28% of the segment. The company's growth through the years has been bolstered by the need for an intermediary to fill the current labour shortage as well as the company's ability to provide flexibility by temporarily leasing workers. Pannon-Work has set up a recruitment business in Austria, which will generate revenues from 2020 and integrate the working agency activities of sister company Gamax Kft with those of Pannon-Work. All of these factors reinforce the company's market dominance in view of a possible future slowdown of its business.

To address the accelerating labour shortage in previous years, the Hungarian government launched initiatives to support the recruitment of workers from neighbouring countries. Thus, leased employees are mainly from Serbia or Ukraine. While Pannon-Work targets multiple segments, the majority of its prospective employees apply for work in the processing industries.

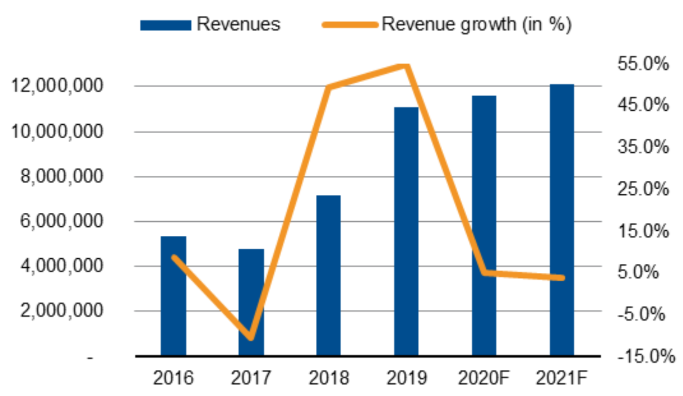
The company offers not only the recruitment and placement of workers but also HR services to improve the productivity and management of workers.

Despite the company's efforts to expand its service range, it still has concentration risk due to the sole exposure to Hungary and dependence on the country's labour market.

While the top 10 clients contribute more than 50% of revenues, they have been bound to the company for more than five years. However, the coronavirus crisis may prompt some workers to be returned to Pannon-Work due to the reduced need.

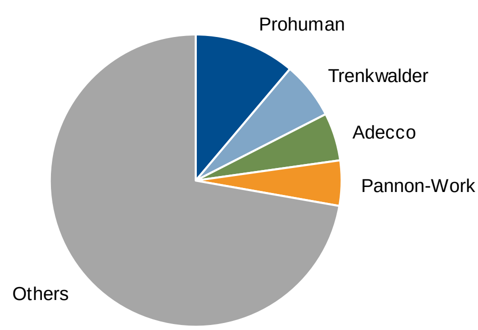
Pannon-Work faces competitive threats due to the very limited entry barriers in the recruitment sector, which result in a fragmented industry in which small to large companies compete. The Covid-19 crisis may trigger consolidation in Hungary's personnel services industry, which would threaten the existence of small players while benefitting the top providers including Pannon-Work.

Figure 1: Pannon-Work revenue growth



Source: Pannon-Work, Scope

Figure 2: Top HR services providers in Hungary



Source: Pannon-Work, Scope

Thin EBITDA margins for personnel services providers

In terms of profitability, while Pannon-Work has enjoyed prosperous growth, as reflected in its revenues, the company has a very thin EBITDA margin, at 1%-3%, which has been volatile through the years in which low margins have been the norm among personnel services providers. The company faces the challenge of rising operating expenses due to higher wages as well as sales prices that are hard to raise due to strong competition and the fragmented market.

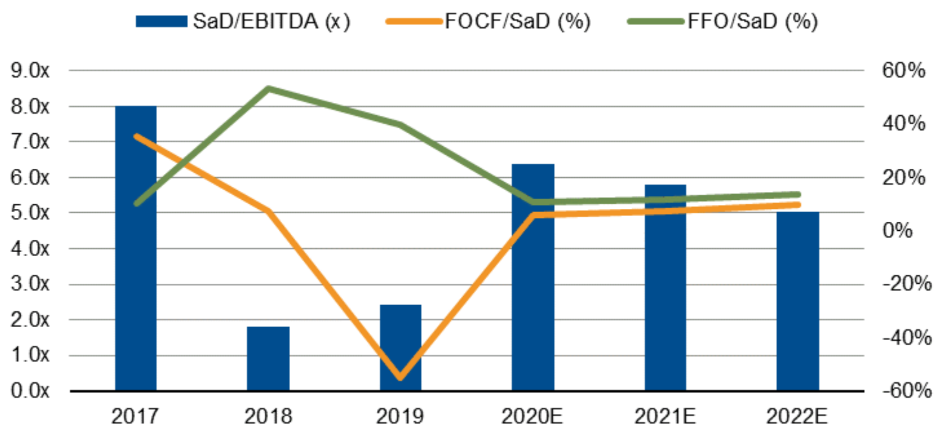
Financial risk profile

Credit metrics to be impacted by the bond issuance

The financial risk profile (assessed at B) is driven by the anticipated weakening in credit metrics following the planned HUF 3.48bn bond issuance. The bond proceeds will be used to repay around HUF 1.21bn of debt, finance HUF 70m of intercompany loans, and invest (around HUF 2.2bn) in a solar plant project that will generate dividends from 2022.

We adjusted EBITDA for dividend income considered to be recurring. Pannon-Work's leverage in terms of SaD/SaEBITDA was previously 2-4x, driven by a reliance on short-term financing and a lack of major long-term debt. The company's ability to collect receivables remains critical for the well-being of its operations. We forecast SaD/EBITDA and funds from operations/SaD to deteriorate significantly (above 5x and below 15%, respectively) in comparison to the previous years' levels. Free operating cash flow fluctuated during the previous year due to the continuing expansion and restructuring but is expected to improve above 5% in the next three years.

Figure 3: Scope key credit metrics



Source: Scope estimates

Very volatile internal liquidity

Liquidity is adequate based on the fact that the bond proceeds will be used to repay the interest-bearing short-term debt. A factoring line and a working capital facility are also available in case generated cash is insufficient to finance the working capital.

Long-term debt rating

A preliminary rating of (P)B+ has been assigned to senior unsecured debt guaranteed by Gamax Kft. This reflects the debt's junior ranking to the potentially existing factoring line and account payables. We expect an 'above-average recovery' (50%-70%) for outstanding senior unsecured debt in a hypothetical default scenario based on a distressed liquidation value, resulting in a one notch of uplift above the issuer rating.

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