Vöröskő Ltd.
Hungary, Retail

BB STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2023/24E**	**2024/25E**
Scope-adjusted EBITDA/interest cover	10.4x	25.8x	11.6x	10.0x
Scope-adjusted debt/EBITDA	2.6x	2.2x	2.3x	2.2x
Scope-adjusted funds from operations/debt	34%	43%	39%	40%
Scope-adjusted free operating cash flow/debt	-54%	29%	0%	1%

Rating rationale

The rating reflects Vöröskő strong credit metrics and market positioning in Hungary and expectation that profitability and leverage will remain commensurate with our rating case in the medium term. We expect leverage to remain below 3x, driven by our forecast of no new debt as HUF 3.4bn is still available on the issued bond to finance the current investment phase. The lack of geographical diversification and the company's small scale constrains the rating uplift.

Outlook and rating-change drivers

The Outlook is Stable and reflects the expectation that profitability will remain at current level or only slightly decline, supported by the opening of five stores to compensate for the overall weak demand and by the company's efficient cost structure, which has proved adaptable to the sales downturn. This combined with the expectation of stable debt is likely to enable the issuer to maintain credit metrics at the current level amid the unfavourable market trend.

A positive credit action could be warranted if Scope-adjusted debt/EBITDA remained well below 3x and profitability stayed resilient in a volatile home market.

A negative credit action could occur if we were to expect leverage, measured by Scope-adjusted debt/EBITDA, to approach 4x or the business risk profile to deteriorate.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
15/12/2023	Affirmation	BB/Stable
15/12/2022	Affirmation	BB/Stable
13/01/2022	New	BB/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

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Related Methodologies and Related Research

Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2023

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong credit metrics supported by the absence of bank loans (excluding MNB Bond and shop-related leases). • Strong liquidity supported by the recent optimisation of inventory and days of payable outstanding. • Strong market positioning within Hungary (top three). • Stable EBITDA despite recent market downturn.	• Small size compared to international competitors. • Geographical outreach limited to a single country limiting the size of the group and enhancing the correlation to the Hungarian economy. • Negative free operating cash flow still constrained by high capex.

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA well below 3x and profitability to remain resilient to volatile market.	• Scope-adjusted debt/EBITDA to approach 4x.

Corporate profile

Established in 1996 as a local cooperative purchasing brand, Vöröskő has since developed into one of the main consumer electronics retailers in the Hungarian market. Joining the Euronics purchasing alliance in 2001 increased the group's international branding and gave it better access to international suppliers. With around 60 shops nationwide, the group has the largest number of stores for electronic goods in Hungary, cementing its strong position in that country. The group currently has around 900 employees.

Financial overview

				Scope estimates		
Scope credit ratios	**LTM Jun-2021[1]**	**2022**	**2023**	**2023/24E**	**2024/25E**	**2025/26E**
Scope-adjusted EBITDA/interest cover	10.3x	10.4x	25.8x	11.6x	10.0x	9.5x
Scope-adjusted debt/EBITDA	2.0x	2.6x	2.2x	2.3x	2.2x	2.0x
Scope-adjusted funds from operations/debt	45%	34%	43%	39%	40%	44%
Scope-adjusted free operating cash flow/debt	-15%	-54%	29%	0%	1%	1%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,873	3,096	3,086	2,774	3,008	3,732
Operating lease payments	1,744	2,236	2,559	2,500	2,500	2,500
Scope-adjusted EBITDA	3,617	5,332	5,645	5,274	5,508	6,232
Funds from operations in HUF m						
Scope-adjusted EBITDA	3,617	5,332	5,645	5,274	5,508	6,232
less: (net) cash interest paid	-1	-66	293	45	-50	-158
less: cash tax paid per cash flow statement	-98	-88	-117	-143	-151	-196
less: interest on OPLA	-349	-447	-512	-500	-500	-500
Funds from operations (FFO)	3,169	4,730	5,309	4,676	4,807	5,378
Free operating cash flow in HUF m						
Funds from operations	3,169	4,730	5,309	4,676	4,807	5,378
Change in working capital	-1,396	-1,789	-2,047	-2,000	-2,000	-2,000
less: capital expenditure (net)	-1,168	-6,591	2,462	-38	-325	-788
less: lease amortisation	-1,699	-3,866	-2,111	-2,600	-2,400	-2,500
Free operating cash flow (FOCF)	-1,093	-7,517	3,613	38	81	90
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	1	66	(293)	(45)	50	158
add: interest component, operating leases	349	447	512	500	500	500
Net cash interest paid	350	514	219	455	550	658
Scope-adjusted debt in HUF m						
Reported gross financial debt	457	7,139	7,154	7,117	7,081	7,045
less: cash and cash equivalents	-323	-2,175	-5,026	-5,016	-5,065	-4,852
add: operating lease obligations	6,978	8,946	10,236	10,000	10,000	10,000
Scope-adjusted debt	7,112	13,910	12,364	12,101	12,016	12,193

[1] In 2021, the group changed its business year to June. We consequently made a proxy on the last twelve months (LTM) at June 2021 to estimate the evolution of the group in 2021.

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Table of Content

Environmental, social and governance (ESG) profile[2]

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 considerations

Vöröskő's home market has a country retail strength of 'high-medium'. As such, we expect ESG considerations to be part of the long-term strategy.

In the ESG analysis, reputational risk is a major criterion for the social aspect of a retailer. For example, a product or labour management that has a negative social impact may prompt consumer boycotts, affecting sales, margins and inventory value.

Discretionary retailers, such as Vöröskő, are under increasing pressure to ensure the sustainability of their products, namely in terms of durability and repairability. Strong commitment in this regard is likely to improve brand value.

Lastly, the group appears to be aware of its ESG engagement. The MNB bond issuance was aligned with the 'green bond principles' and is therefore labelled as a green bond. On more operational matters, the group is well positioned in term of recycling by taking back old devices and disposing of them. These features, while present in many larger stores in western Europe, is a good ESG commitment for a country in the CEE.

[2] 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-

Industry risk profile: BB

Vöröskő is a discretionary retailer, an industry segment that we consider having medium cyclicality, low entry barriers and low substitution risk.

Strong market share in Hungary …

The issuer's business risk profile reflects the strong market position in Hungary, where Vöröskő is one of the top three retailers of consumer electronics. While the market is very fragmented, we consider the group market share (13-16%) to be relatively well protected thanks to the solid presence both online and through brick-and-mortar format. Besides, entering the consumer electronics segment requires investing in large warehouses and stores and developing an effective online channel, which make it onerous for new entrants. Vöröskő's largest competitor is the local subsidiary of MediaMarkt (Ceconomy group, BBB-/Negative), which with HUF 180bn revenue in 2022 is double in size, while the third major company is the online only retailer Extreme Digital – eMag (which in FY 2023 reported HUF 79bn in revenue). The remaining players are significantly smaller.

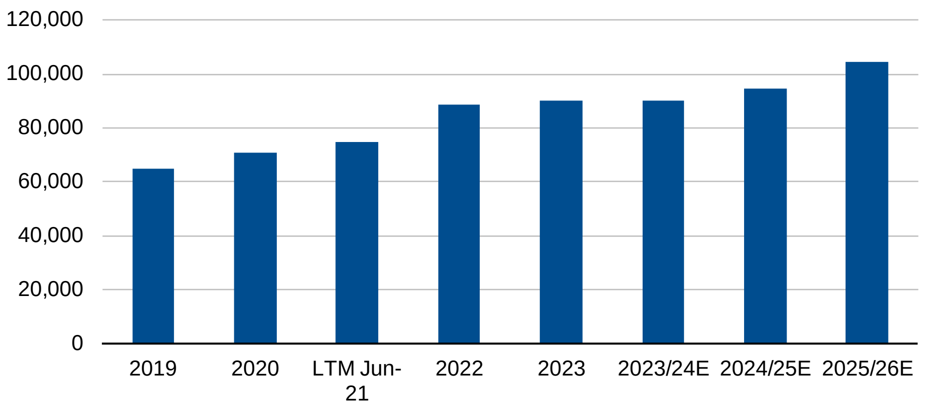
But relatively small scale remains a constraint

Vöröskő's size (HUF 90bn in FY 2023) constrains its potential rating, despite its comfortable share of the national market. Its small size is a natural result of the group focusing solely on Hungary; it can only grow as much as the Hungarian market grows. Contribution from entering the new markets (Croatia and Slovenia e-commerce shop to be launched in FY 2024 and 2025 respectively) is expected to be irrelevant in the medium term.

Consolidating physical and online presence

The group has developed a relatively large network of shops across Hungary but has decreased its total physical presence from 67 shops as of December 2021 to 61 as of December 2022. In 2023 one new store opened in Budaors and five are set to open in 2024 (1 in Budapest and 4 in Eastern Hungary). While the group confirmed a strong online penetration (25% of total sales in FY 2023), they recently observed a return of customers to physical shopping, hence they intend to consolidate their presence in brick and mortar, by establishing footprint in areas not covered by international competitors but rather by small companies. Concurrently they have closed stores that were considered non profitable. In addition, Vöröskő appears to be keenly aware of consumer buying trends, and it is adjusting its retailing methods accordingly, focusing its strategy on a better shopping experience and easy availability of 'popular' goods at its locations. To increase its top line, the group has also proposed some additional B2B and B2C services (such as financial services) from which Vöröskő receives a bonus from the partner banks (3% of turnover). Although still small in terms of their contribution to overall sales (<3%), these services are seen as supporting the overall market share assessment.

Figure 1: Revenue evolution (HUF m)

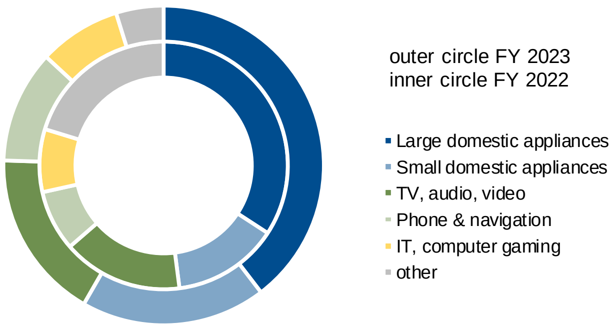


Sources: Vöröskő, Scope estimates

Good product diversification

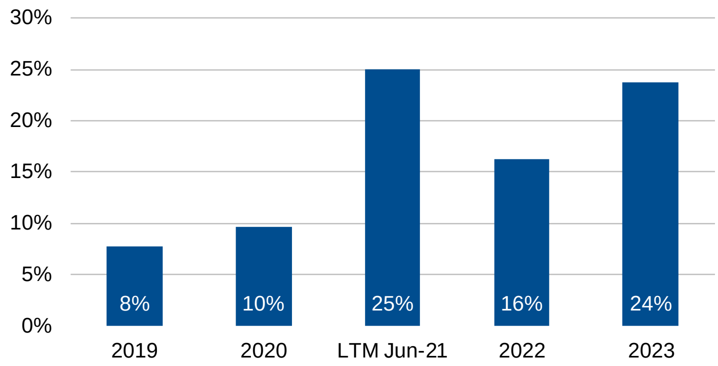
We deem product diversification as good. Vöröskő offer a wide range of products within the household appliance segment and consumer electronics. The latter are more sensitive to intra-year seasonality (Black Friday, Christmas), technological changes and logistics disruptions as they are often shipped from distant suppliers. Going forward we expect Vöröskő to continue to offer a diversified range of products supported by the high storage capacity. Nonetheless we highlight a certain sales concentration in the large and small domestic appliance segments, which increased in 2023 to 58% (48% in 2022). The concentration is confirmed by the supplier's diversification, as the top five suppliers (LG, Gorenje, Samsung, Electrolux and Whirlpool) account for 45.3% of revenue in FY 2023. Nonetheless the issuer has long-term relationships with the main suppliers, with business relationships dating back on average 25 years, which has ensured increasing bonuses and favourable average payment terms, thus we don't see the concentration as credit negative.

Figure 2: Product diversification



Sources: Vöröskő, Scope

Figure 3: Development of the online sales



Sources: Vöröskő, Scope

Weak geographical diversification

The lack of geographical diversification is a major negative rating driver as the group is only present in Hungary, which fully ties its performance to the Hungarian economy. The group was recently awarded Croatian and Slovenian online market operations by the Euronics network. The operation launch in these countries was planned for 2024 and it has been postponed to 2025 and 2026, respectively. The management has postponed the market entry to focus on maintaining profits in the domestic market, given the challenging environment. The projected revenues from the two countries the in the first two years are irrelevant (less than 1%) so we expect that in the medium term Vöröskő will remain fully dependent on the Hungarian market.

Strong e-commerce presence drives diversification assessment

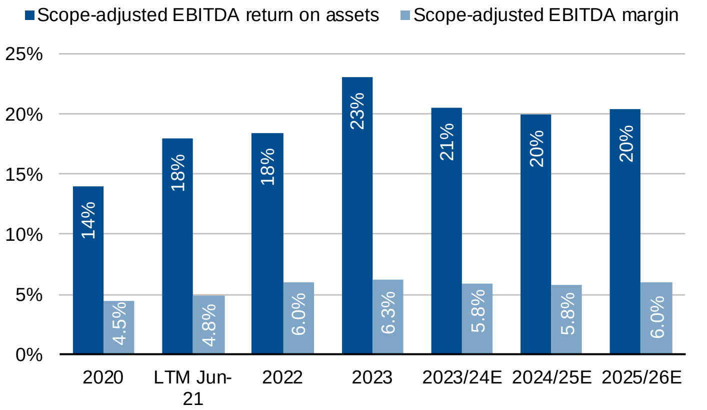
Channel diversification is a positive rating driver. Driven by high consumer acceptance, consumer electronics retailers have often been pioneers in online sales, leading to a relatively high total online sales contribution in comparison with other retailers. Vöröskő benefits from a high percentage of online sales (23.8% in FY 2023, increasing from 16% in FY 2022).

Profitability improved over years

While in 2018-2021, profitability, measured by the Scope-adjusted EBITDA margin, has been on average 4.3%, constrained by the relatively low pricing power and gross margins, the ratio recently improved to 6% in FY 2022. The improved margins were the result of increased gross margins as well as Vöröskő's investments in IT development and warehouse, which led to a better cost structure. In FY 2023, despite the general downward trend for consumer electronic, the issuer managed to keep EBITDA and Scope-adjusted EBITDA margins stable thanks to: i) a 1.8% revenue increase which was mostly inflation driven but also supported by the opening of a new store in Budaoer; ii) saving in energy costs through the reduction of turned-on devices in store; iii) optimisation of store footprint by discontinuing locations that were not profitable enough;

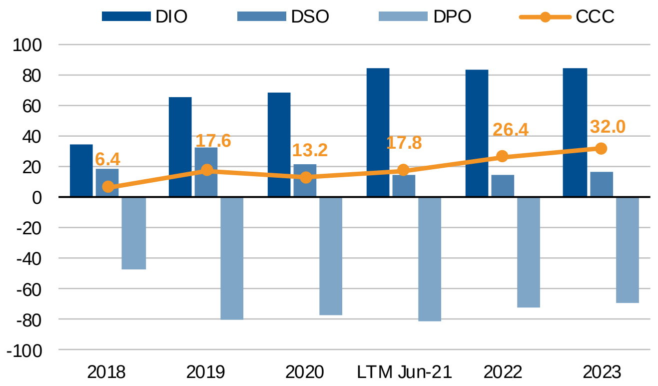
iv) optimisation of suppliers' mix with focus on higher margin suppliers compared to the past. Going forward, we expect that these measures will continue to keep profitability stable at around 6%, despite weak consumer demand persisting in 2024 likely to lead to a 10% decline in Scope-adjusted EBITDA.

Figure 4: Profitability margins



Sources: Vöröskő, Scope estimates

Figure 5: Cash conversion cycle and its components, in number of days



Sources: Vöröskő, Scope

Financial risk profile: BB+

The robust and improving financial metrics as well as the solid liquidity drive the issuer rating.

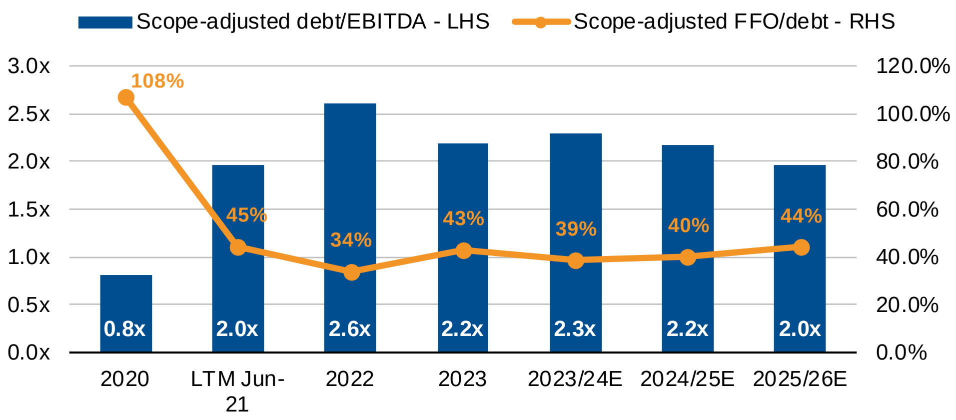
Low leverage

The leverage, measured by the Scope-adjusted debt/EBITDA, declined to 2.2x in FY 2023, from 2.6x in the prior year, sustained by the significant cash generation. The latter was the consequence of: i) the company strategy of better management of warehouse and stores which led to sharply decreased inventory; and ii) EBITDA remaining stable despite the weak revenue (1.8% increase YoY), as the issuer was able to pass inflation to customers and save in energy costs.

Going forward we expect the improvement to be sustained and for leverage to remain below 3x, despite us expecting a 10% decline in EBITDA, driven by the stable financial debt. HUF 3.7bn of the HUF 7bn bond issued in 2022 has been used to finance the purchase of the two rented stores, the renovation of a warehouse in Ullo and the purchase and renovation of the Budapest office site. As HUF 3.3bn remains available for future developments, we do not expect any debt issuance in the medium term.

Likewise, Scope-adjusted funds from operations/debt is anticipated to remain around or above 40%.

Figure 6: Leverage



Sources: Vöröskő, Scope estimates

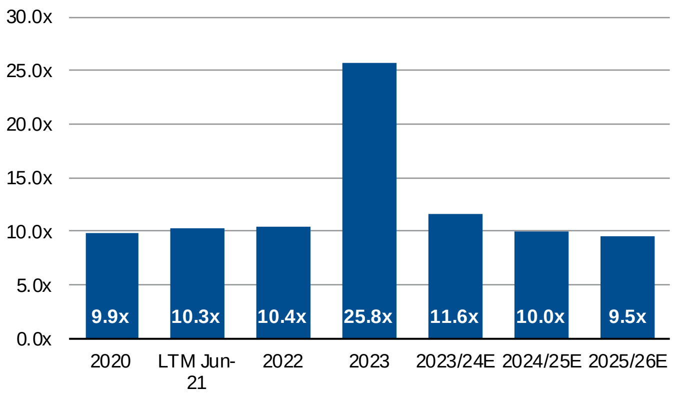
No exposure to interest rate risk

The absence of floating interest rate debt supports the robust debt protection, measured by the Scope-adjusted EBITDA interest cover. Beside the bond issued in 2022, Vöröskő has no significant bank debt and in FY 2023 the high interest rate on the Hungarian cash deposits fully offset the interest payments on the newly issued bond, leading to a net cash position. Going forward we expect deposit rates to be less favourable, nonetheless with no new debt in the forecast period, the interest cover is likely to remain above 10x.

Weak cash flow cover due to capex phase

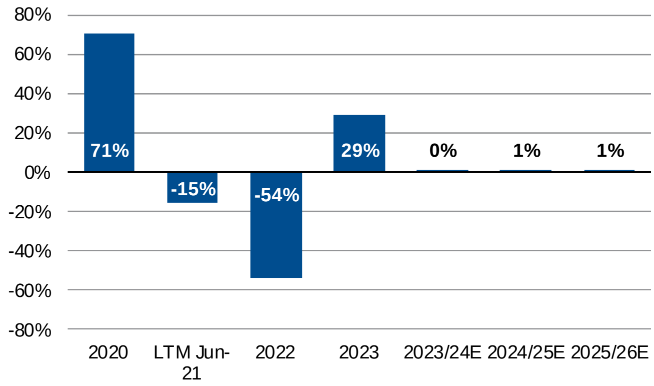
Cash flow cover has been historically weak as a result of net working capital swings. We consider the group to be sensitive to net working capital variation due to its small size. While the FY 2023 was an outlier, as positive free operating cash flow was driven by Vöröskő's strategy to significantly decrease the inventory, we expect free operating cash flow/debt to remain under pressure in the next two years as capex remain high. The capex includes the purchase of rented stores and the renovation of old stores. Nonetheless we expect that the issuer has the flexibility to postpone some of the capex in a worse-than-expected scenario.

Figure 7: Scope-adjusted EBITDA interest cover



Sources: Vöröskő, Scope estimates

Figure 8: Free operating cash flow/debt



Sources: Vöröskő, Scope estimates

Adequate liquidity

We deem liquidity as adequate driven by the absence of substantial short-term debt repayment (the first bond repayment 10% will be due in 2027). The group benefits additionally from a HUF 5.3bn revolving credit facility, which the management confirmed to be rarely used (we have not included in the calculation as it has a 1-year tenor).

Balance in HUF m	2023	2023/24E	2024/25E
Unrestricted cash (t-1)	2,175	5,026	5,016
Free operating cash flow	3,613	38	81
Short-term debt (t-1)	-	36	36
Coverage	**No ST debt**	**>200%**	**>200%**

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Long-term debt rating

Senior unsecured debt rating: BB

We affirm the BB rating of Vöröskő's senior unsecured debt. The assessment considers a hypothetical default scenario in 2025 and is based on the ongoing concern. The HUF 8bn enterprise value that is available to creditors (after deducting 10% administrative claims) compares to the HUF 5.3bn credit line (assumed to be fully overdrawn) and HUF 7bn senior unsecured bond and results in an average recovery of 40%.

In January 2022, Vöröskő issued a HUF 7bn senior unsecured bond (ISIN: HU0000361241) through the Hungarian Central Bank's Bond Funding for Growth Scheme. HUF 3.7bn of the bond proceeds were used for purchasing, opening and renovation of warehouses and stores. The bond has a tenor of 10 years and a fixed coupon of 4.75%. Bond repayment is in five tranches starting from 2027, with 10% of the face value payable yearly, and a 50% balloon payment at maturity. We note that Vöröskő's senior unsecured bond issued under the Hungarian Central Bank's bond scheme has an accelerated repayment clause. The clause requires Vöröskő to repay the nominal amount (HUF 7bn) in case of rating deterioration (2-year cure period for a B/B- rating, repayment within 90 days after the bond rating falls below B-, which could have default implications). In addition to the rating deterioration covenant, bond covenants include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, and dividend.

Appendix: Peer comparison (as at last reporting date)

	Vöröskő Ltd	Ceconomy AG	Axiál Kft.	Unix Autó Kft.	Abroncs Kft.
	BB/Stable	BBB-/Negative	BB/Stable	BB/Stable	BB-/Stable
Last reporting date	30 June 2023	30 September 2022	31 December 2022	31 December 2022	31 December 2022
Business risk profile					
Country retail strength	High-medium	High	High-medium	High-medium	High-medium
Revenue (EUR m)	235	21,768	381	300	111
Consumer good category	Discretionary	Discretionary	Discretionary	Discretionary	Discretionary
Geographical exposure	One country	No countries >50% sales	Immediate neighbours	Immediate neighbours	Immediate neighbours
Product diversification	2 categories	2 categories	1 cyclical	1 cyclical	1 cyclical
Profitability	6.3%	4.4%	10%	11.3%	5.1%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	25.8x	15.3x	33x	10.0x	10.2x
Scope/adjusted debt/EBITDA	2.2x	2.4x	0.6x	1.7x	2.1x
Scope-adjusted funds from operations/debt	43%	32%	78%	54%	42%
Scope-adjusted free operating cash flow/debt	29%	-13%	221%	-2.6%	6%

Sources: Public information, Scope

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