Daniella Kereskedelmi Kft. Hungary, Retail

SCOPE B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	9.5x	8.7x	10.6x	10.9x
Scope-adjusted debt/EBITDA	4.2x	3.2x	2.6x	2.5x
Scope-adjusted funds from operations/debt	21%	28%	43%	36%
Scope-adjusted free operating cash flow/debt	-40%	-2%	11%	6%

Rating rationale

The rating is supported by Daniella's competitive positioning in its home market supported by both strong online and brick and mortar presence. However, the small absolute size of the company (revenues of HUF 26bn in 2021) constrains any potential rating uplift, despite high growth rate of revenues and profitability margin recorded over the last two years. Nonetheless, pressure linked to macro-headwinds (inflation and stop of governmental subsidy at the end of 2023 and 2024) will pressure Scope-adjusted EBITDA margin. Credit metrics are expected to however absorb the deterioration and continue to remain a positive rating driver, given the absence of planned debt issuance and the ability of the wholesaler to finance internally its operations.

Outlook and rating-change drivers

The Outlook is Stable and reflects our view that inflation will have a limited impact on profitability and credit metrics. We expect credit metrics to remain at current levels, with Scope-adjusted debt/EBITDA at around 3x, as Daniella has enough headroom to cope with the likely weakening of the construction market. The Outlook also assumes no M&A. The upcoming spin-off of HAD real estate will have no rating impact as Daniella's credit rating does not incorporate this entity.

A positive rating action is remote at present but would be considered should Daniella significantly increase in size while maintaining credit metrics close to current levels, i.e. Scope-adjusted debt/EBITDA of around 3x and Scope-adjusted funds from operations/debt around 30%. This would result from an expansion to Romania or a ramp-up of industrial customers.

A negative rating action may be taken if the financial risk profile deteriorated, shown by Scope-adjusted debt/EBITDA moving towards 4x, or if the financial policy became aggressive, exemplified by sizeable M&A.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
9 Sep 2022	Upgrade	B+/Stable
10 Sep 2021	Confirmation	B/Stable
26 Mar 2021	Placement under review	B under review for possible upgrade

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

Analyst

Adrien Guerin
+49 162 392 3827
a.guerin@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2022

ESG considerations for the credit ratings of retail corporates; November 2021

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
• Satisfactory operating profitability • Resilient financial model • High online sales for the group’s size	• Limited size in a niche market • Weak diversification due to focus on Hungary

Positive rating-change drivers	Negative rating-change drivers
• Significant increase in size, while maintaining credit metrics close to current levels, i.e Scope-adjusted debt/EBITDA of around 3x and Scope-adjusted FFO/debt around 30%.	• Scope-adjusted debt/EBITDA moving towards 4.0x

Corporate profile

Daniella Kft is a Hungarian retailer specialised in the wholesale of electrical goods for construction and refurbishment. The group sells a wide range of goods from electrical cables, installation units and lamps to renewable energy and lightning protection. The group is private and was founded in 1991. The ownership structure changed with the gradual buyout of the founder’s minority stake.

After the group’s companies were restructured, HAD real estate, an entity created in 2021, will be spun off by YE 2022 with the aim to create a clear separation between retail and real estate activities.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**LTM H1 2022**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	9.5x	8.7x	13.6x	10.6x	10.9x	11.2x
Scope-adjusted debt/EBITDA	4.2x	3.2x	2.0x	2.6x	2.5x	2.4x
Scope-adjusted funds from operations/debt	21%	28%	54%	43%	36%	37%
Scope-adjusted free operating cash flow/debt	-40%	-2%	1%	11%	6%	9%
Scope-adjusted EBITDA in HUF m						
EBITDA	825	1,294	2,332	1,646	1,778	1,841
Operating lease payments	285	506	490	512	553	597
Scope-adjusted EBITDA	**1,110**	**1,799**	**2,822**	**2,158**	**2,331**	**2,438**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,110	1,799	2,822	2,158	2,331	2,438
less: cash tax paid per cash flow statement	-8	-15	-15	-35	-25	-27
less: (net) cash interest paid	-117	-206	-207	-204	-214	-217
add: dividends from associates	18	23	523	500	-	-
Funds from operations (FFO)	**1,003**	**1,602**	**3,123**	**2,419**	**2,092**	**2,193**
Free operating cash flow in HUF m						
FFO	1,003	1,602	3,123	2,419	2,092	2,193
Change in working capital	-114	-854	-2,051	-971	-900	-800
less: capital expenditure (net)	-2,554	-445	-628	-400	-400	-400
less: depreciation component, operating leases	-228	-405	-392	-410	-443	-478
Free operating cash flow (FOCF)	**-1,892**	**-101**	**52**	**638**	**350**	**515**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	60	105	109	102	103	98
add: interest component, operating leases	57	101	98	102	111	119
Net cash interest paid	**117**	**206**	**207**	**204**	**214**	**217**
Scope-adjusted debt in HUF m						
Reported gross financial debt	3,573	3,683	3,824	3,614	3,525	3,525
add: operating lease obligations	1,139	2,023	1,959	2,049	2,213	2,390
Scope-adjusted debt	**4,711**	**5,706**	**5,783**	**5,663**	**5,738**	**5,915**

Daniella Kereskedelmi Kft

Hungary, Retail

Table of Content

Environmental, social and governance (ESG) profile[1]

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 profile: adequate

Reputational risk is a major criterion for the social aspect of a retailer. For example, product or labour management that has a negative social impact may prompt consumer boycotts, affecting sales, margins and inventory value. However, we consider Daniella's position as a national wholesaler to decrease this risk substantially.

Discretionary retailers such as Daniella are also 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 environmental footprint of a company's brick-and-mortar shops will remain fundamental to its development. Daniella is well protected against environmental risks as the number of its stores across the country are low. However, the expansion to Romania could increase Daniella's carbon footprint if it does not set up logistics facilities in the country, which would necessitate deliveries from Hungary.

The transfer of the ownership of the warehouse to HAD real estate, which will soon be spun out, implies that bond proceeds would become unavailable to investors in the event of a bankruptcy-like event, which is seen as a credit-negative ESG factor.

[1] 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-

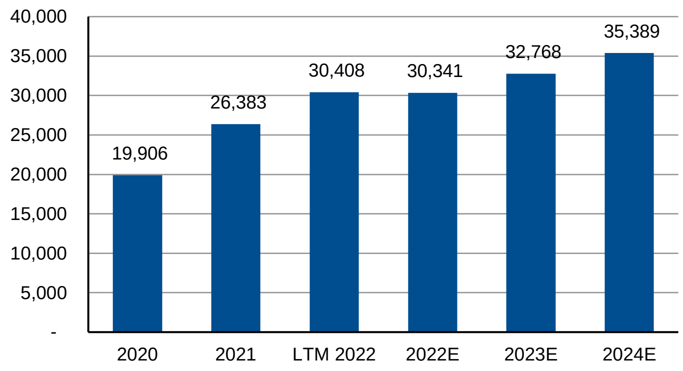
Industry risk profile: BBB

The industry risk profile remains rated at BBB given the low cyclicality and barriers to entry of the do-it-yourself wholesale segment. Daniella's new designation as a 'non-discretionary' retailer from 'non-cyclical' following the update of the Retail and Wholesale Rating Methodology also had no effect on the industry risk profile.

Strong growth...

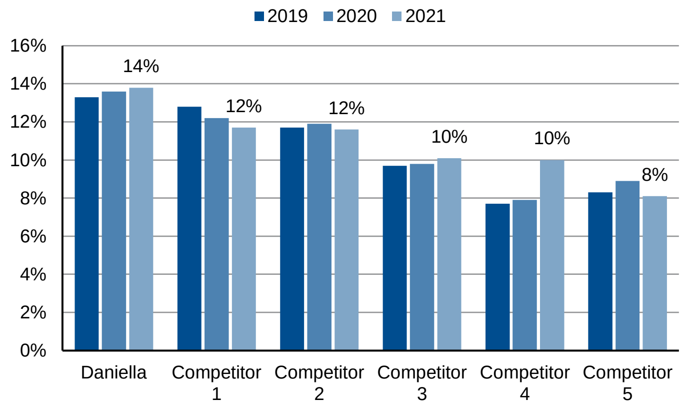
Daniella's market shares continue to be detrimental to its business risk profile. Daniella dominates the wholesale construction materials market in Hungary. However, its revenue potential is capped by the small size of the overall addressable market and related elements. The rating is also limited by the group's absolute size (HUF 30bn of revenue in H1 LTM 2022) but Daniella continues to benefit from the fast development of its market (sales grew by 32.5% in the 2021 business year).

Figure 1: Evolution of revenues (in HUF m) with forecasts



Sources: Daniella Kft, Scope estimates

Figure 2: Development of market shares



Sources: Daniella Kft, Scope

...supported by dynamic market

The overall market has been dynamic over the last years and was largely unaffected by the Covid-19 pandemic. The CSOK governmental subsidies aimed at households combined with resilient economic development has supported the market's growth. Daniella has the leading market share nationally, holding almost 15%. Management's long-term ambition is to reach 20%[2], supported by strong market positioning in term of online and offline presence of the group. We expect the market share to remain stable or even increase them at the expense of weaker competitors. This view is based on the greater flexibility on pricing afforded by its private labels and its gradual shift towards industrial customers (9% versus 1% YoY). We consider M&A to be unlikely given the high growth across the sector, currently considered by management to be a buyer's market.

Pressure is looming

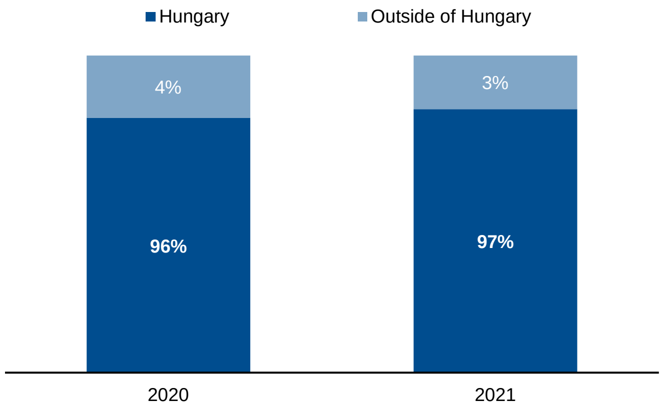
However, pressure on overall revenue growth is likely once CSOK ends as planned by YE 2024 along with the 5% VAT on new housing by YE 2023. While this subsidy programme will likely return, we expect the company's growth rate to weaken slightly in the coming years. Also, high national inflation is likely to add pressure on end-customers (households and private companies) and change purchase behaviour by prompting delays in new construction or a focus on minor renovations. Despite these uncertainties, we remain confident that Daniella can at least maintain its market shares, or even increase them at the expense of weaker competitors in the medium term. This view is based on the greater flexibility on pricing afforded by its private labels and its gradual shift towards industrial customers (9% versus 1% YoY).

[2] Daniella estimates that the customer base is resilient. Daniella reaches 60% of Hungarian electricians (estimated at 10,000), according to their management.

Positive product and customer diversification

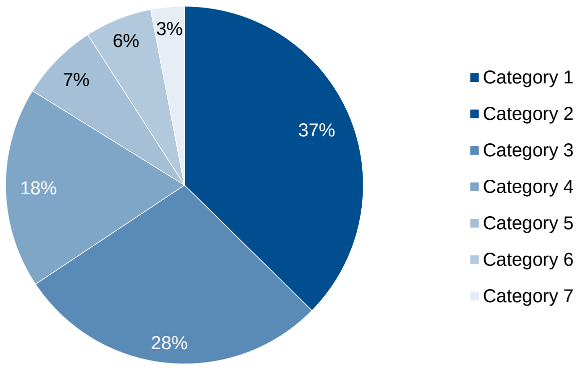
In its niche, Daniella sells a wide range of products (close to 145,000 kinds related to construction) catering to all types of customers. This leads to strong product diversification. The gradual shift towards industrial customers is positive as it diversifies slightly the dependency on households, ensuring recurring revenues in the long term. The group is also well diversified in terms of customers, with the top 10 generating only 7.4% of sales in 2021. The group estimates an equal split between brownfield and greenfield projects within its consumer portfolio (stable over the last years).

Figure 3: Split of sales per country



Sources: Daniella Kft, Scope

Figure 4: Split of sales by product category (YE 2021)



Sources: Daniella Kft, Scope

Country focus limits rating

Daniella's geographical outreach is weak with the focus on expanding in its home market of Hungary. Nonetheless, the expansion to Romania is likely, with ambitions to build a warehouse close to the border and use existing IT infrastructure to deliver there.

Higher online sales

Channel diversification has improved over the last year with online sales reaching 13% (7%-8% in the previous years) of total sales. Unlike other B2C retailers, Daniella's online growth is unlikely to contract in the coming years due to its wholesale activities, due to the recent switch toward a better IT infrastructure of the group. As the group plans to maintain its number of shops (31 at H1 2022) but anticipates strong growth, we expect the share of online sales to improve in the coming years to around 20%.

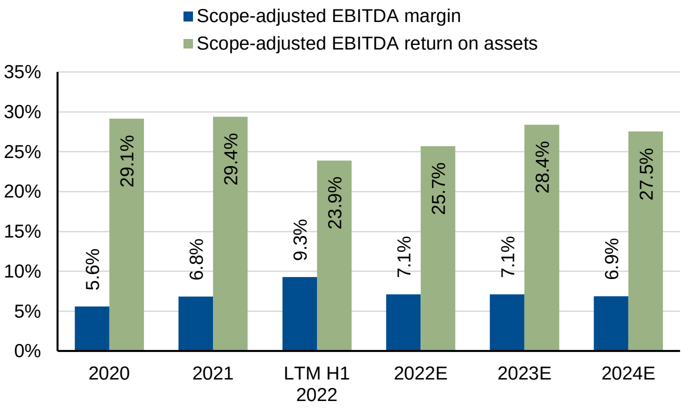
Scope-adjusted EBITDA margin at 9.3% at LTM H1 2022

Profitability increased substantially, with the Scope-adjusted EBITDA up by 62% over the last year, reaching HUF 1.8bn in 2021 (versus 32% for revenue). This growth also led to a large increase in the Scope-adjusted EBITDA margin to 6.8% from 5.6% in the year before. The main driver for better profitability was an overall improvement of the gross margin (close to 13% at H1 LTM 2022, whereas less than 12% at H1 2021), supported mainly by inventory stock-up acquired at a relatively lower cost at the end of 2021. H1 2022 confirmed the success of controlling operating expenses with the Scope-adjusted EBITDA reaching HUF 3.1bn and Scope-adjusted EBITDA margin increasing to 9.3% for LTM H1 2022 (below 7% in 2021 and below 6% in 2020).

The group is well-hedged. It implements 60-90 day forward contracts to hedge against forex changes and has credit insurance on 80%-90% of receivables, including all top-10 customers.

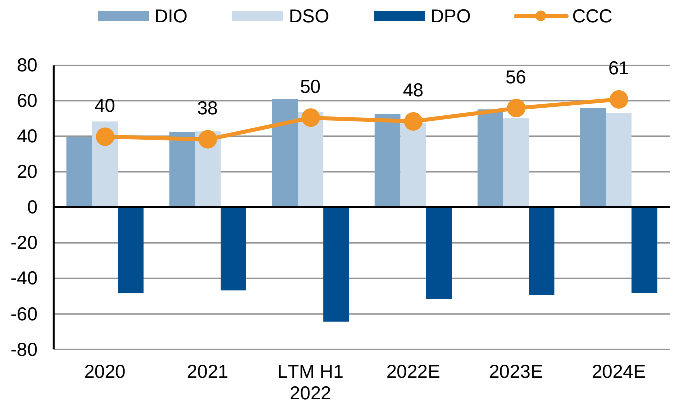
Following the successful set-up of a warehouse close to Budapest in 2021 financed by proceeds from the HUF 3.5bn bond issuance in 2020, the speed and reliability of sorting and picking items from the warehouse increased significantly, improving Daniella's ability to serve customers. The new warehouse is neutral for employee headcount: the replacement of the workforce has been offset by the hiring of engineers to maintain the warehouse.

Figure 5: Evolution of profitability ratios



Sources: Daniella Kft, Scope estimates

Figure 6: Development of cash conversion cycle



Sources: Daniella Kft, Scope estimates

Expectations of a deterioration due to strong headwinds

Despite all the positive developments, we expect the profitability margin to come under pressure from macroeconomic headwinds of inflation and the increase in lower-margin online sales.

High inflation across Europe will not only increase purchasing prices of Daniella's products but also its operating costs. As mentioned earlier, we expect only a slight contraction in the absolute market size as end-customers are more likely to postpone less necessary construction and renovation. While absolute national demand will also contract, leading to a slowdown of sales, we expect that Daniella can pass on much of the additional costs to customers. We view some flexibility in the group's ability to retain customers by adjusting discounts offered.

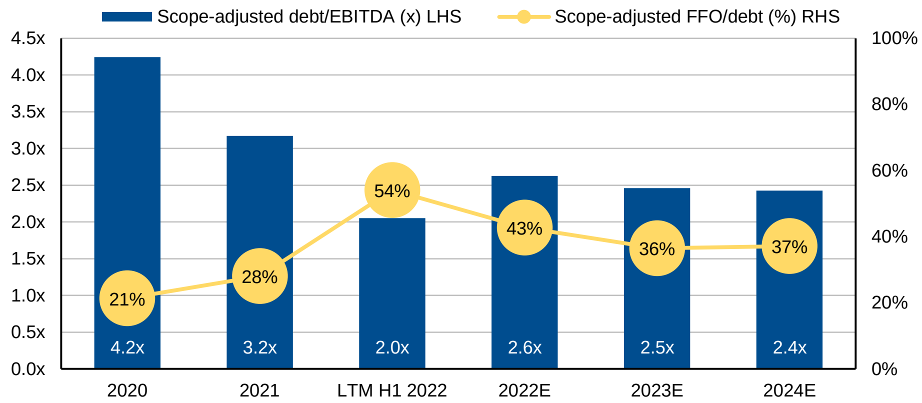
An increase in online sales will also weigh slightly on margins as it is less profitable than brick-and-mortar across Europe. Nonetheless, the ramp-up of private labels will support profitability due to their significantly higher gross margins than branded counterparts (accounting for close to 6% of total sales).

Financial risk profile: BB-

Limited use of debt...

Scope-adjusted debt mostly consists of the HUF 3.5bn bond issued under the MNB's bond funding for growth scheme and operating leases that account for close to HUF 2.0bn as at YE 2021. A smaller amount of debt in terms of absolute value consists of other short-term financial debt. We expect gross debt to remain stable as the bond has a long tenure (10 years) and the group has no plans to open new stores. Furthermore, the bond's covenants only permit the issuance of additional debt with the approval of investors and creditors.

Figure 7: Leverage

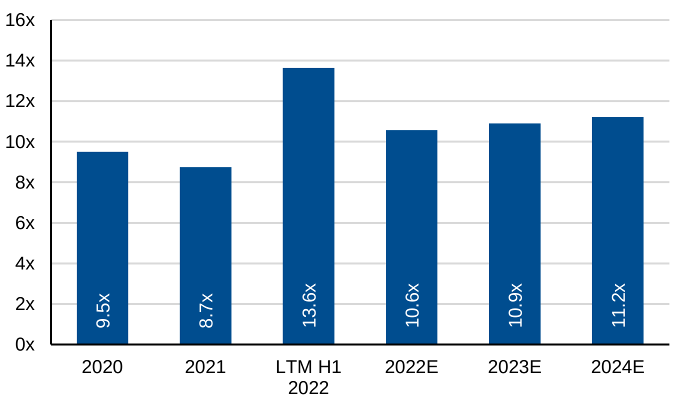


Sources: Daniella Kft, Scope estimates

.. resulting in an improvement of credit metrics

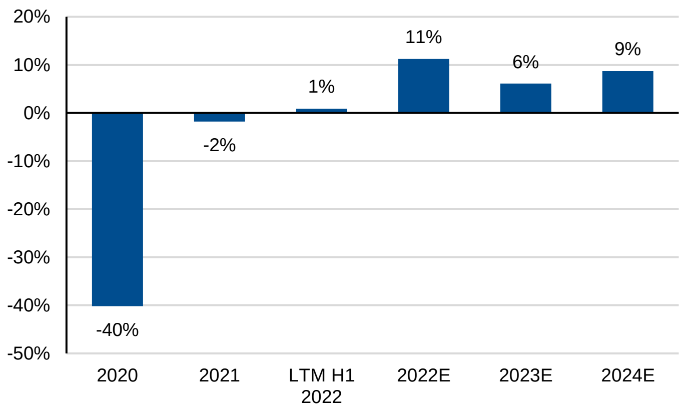
Leverage has improved over the last year, a result of the positive development of the EBITDA and cash generation as Scope-adjusted debt has remained roughly stable. At YE 2021, Scope-adjusted debt/EBITDA decreased to 3.2x (down 1.0x YoY) while the Scope-adjusted FFO/debt benefitted from similar yet a lower improvement, reaching 26% at YE 2021 (up 6pp YoY). Due to solid EBITDA driven by a positive impact of the stock-up at the end of 2021, we expect continuous improvement of leverage compared to 2021. We expect leverage metrics to remain relatively stable going forward, given our forecasts of an overall stable EBITDA in the next years.

Figure 8: Scope-adjusted EBITDA/interest cover



Sources: Daniella Kft, Scope estimates

Figure 9: Cash flow cover



Sources: Daniella Kft, Scope estimates

Scope-adjusted EBITDA/interest cover also benefitted from the strong growth in EBITDA over the last year. We expect the absolute amount of interest expense to remain stable over the coming years, as i) coupons are fixed, ii) no new leased shops nor significant debt issuance are expected, interest cover is consequently expected to remain stable at above 10x.

FOCF remained negative in 2021 and LTM H1 2022. Relatively large working capital outflows as well as the continuation of capex plans have put pressure on FOCF. Despite our forecast of aggressive capex for organic growth, FOCF is expected to turn positive, but at a low level, in the coming years. We expect net working capital outflows to also remain negative in the coming years as we forecast some stockpiling of goods.

Liquidity is adequate

Liquidity is adequate due to the absence of short-term debt. As mentioned, debt is mainly comprised of the bond, which has a remaining duration of eight years. While the group is likely to use small financing lines, mainly for inventory financing, we expect that liquidity will remain robust in the next years.

Balance in HUF m	2022E	2023E
Unrestricted cash (t-1)	176	231
FOCF	638	350
Short-term debt (t-1)	121	89
Coverage	**> 200%**	**> 200%**

Supplementary rating drivers: -1 notch

We maintain the negative notch attributed to the governance of the group. The transfer of the ownership to HAD real estate, which will soon be spun out, implies that bond proceeds would become unavailable to investors in the event of a bankruptcy-like event (ESG factor: credit-negative). That said, we acknowledge the group’s efforts to increase the transparency of its operations, such as the development for next year of an ESG report and the analysis of areas in which corporate governance is lacking.

Long-term debt rating

Senior unsecured debt rating: BB-

We have upgraded the rating on Daniela’s senior unsecured debt to BB- from B+. We estimate an above-average recovery with a liquidation value of close to HUF 10bn under a theoretical bankruptcy scenario in 2024.

.

Appendix: Peer comparison

	Daniella Kft.	Stavmat Építőanyag Kereskedelmi Zrt.	Marso Kft.	Unix Auto Kft.
Home market	Hungary	Hungary	Hungary	Hungary
Status	Public	Public	Public	Public
Business risk profile	**BB-**	**B+**	**B+**	**BB**
Country retail strength	High-medium	High-medium	High-medium	High-medium
Market position	Strong	Strong	Strong	Strong
Revenue size (in EUR bn)	0.1	0.1	0.1	0.3
Consumer good category	Non-discretionary	Discretionary	Discretionary	Discretionary
Online diversification**	High	SCD	Low	SCD
Geographical exposure	One country	One country	Immediate neighbours	Immediate neighbours
Product diversification	low and non-cyclical	low and cyclical	low and cyclical	low and cyclical
Profitability assessment	Moderate	Good	Moderate	Moderate
Financial risk profile ***	**BB-**	**BBB-**	**BB+**	**BB-**
Scope-adjusted debt/EBITDA	3.3x	1.7x	2.6x	2.7x
Scope-adjusted FFO/debt	31%	86%	38%	32%
Scope-adjusted EBITDA/interest cover	9.6x	64.9x	13.5x	9.9x
Scope-adjusted FOCF/debt	-10%	3%	-15%	0%
Liquidity	Adequate	No short-term debt	Adequate	Adequate
Stand-alone rating	**BB-**	**B+**	**BB-**	**BB-**
Outlook	**Stable**	**Stable**	**Stable**	**Stable**

* Available on ScopeOne

** 'SCD' stands for 'single channel distributor'

*** (average Y-1; Y; Y+1)

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 09 38 35

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

Disclaimer