Duna House Holding Nyrt.
Hungary, Business Services

SCOPE **BB-** STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	25.8x	94.0x	20.8x	Net cash interest
Scope-adjusted debt/EBITDA	3.7x	3.1x	3.2x	2.9x
Scope-adjusted funds from operations/debt	22%	34%	31%	40%
Scope-adjusted free operating cash flow/debt	-9%	17%	47%	102%

Rating rationale

The rating of Duna House continues to reflect its leading market position as a real estate broker in Hungary and Poland and the improved diversification following the acquisition of Hgroup, the second largest loan brokerage company in Italy. It also reflects the strong customer granularity with all or most of the transactions targeting single clients. The business risk profile suffers from Duna's small size in highly fragmented markets and weakening profitability over the years. Margins are expected to further decline going forward, driven by rising interest rates which will slow down demand for loans and residential property.

Duna House rating is supported by the asset and debt light business which ensures strong interest coverage and, going forward, we expect the company's high interest income on its cash deposits to generate net interest income. The rating is, however, constrained by the expansion strategy and the real estate development business which drove up the leverage in the past years and exposed the issuer to volatile cash flows. Liquidity is adequate as no substantial debt exists other than the two bonds that will be repayable from 2026.

Outlook and rating-change drivers

The Outlook is Stable. It incorporates our expectation that Duna House will maintain strong debt protection and successfully integrate Hgroup, which provides some diversification and stability to offset the negative market trend in Hungary and Poland. The Stable Outlook also reflects our expectations that, despite weaker demand, the issuer will be able to maintain key metrics in line with the agency's base case.

A positive rating action would require the issuer to show credit metrics above our expectations, i.e. Scope-adjusted debt/EBITDA sustained below 3.0x.

A negative rating action could be warranted if the issuer showed an increase in financial leverage (Scope-adjusted debt/EBITDA) to around 4.0x on a sustained basis. This could be caused by weaker-than-expected revenue due to overall transaction market weakness or substantial additional debt-funded investments beyond our financial base case.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
14 Nov 2022	Affirmation	BB-/Stable
22 Dec 2021	Affirmation	BB-/Stable
22 Jul 2021	Affirmation	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies:

Corporate Rating Methodology; July 2022

European Real Estate Methodology; January 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong market position in CEE real estate and loan brokerage market (no.1 or 2 in Hungary and Poland) and in the Italian loan brokerage market (no. 2) • Asset light business model, hence little financial debt and moderate financial leverage • Diversified among several real estate related services and countries, high customer granularity • Most of debt at fixed rates of interest with average debt maturity of 4.8 years	• Dependency on the general transaction dynamics in the CEE and Italian real estate and loan markets with little non-transaction based recurring revenue • Fierce competition in online real estate brokerage market • International expansion via M&A carries execution and integration risks, particularly given the size and complexity of the recent acquisition in Italy • Volatile cash flows

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA of below 3.0x on a sustained basis	• Scope-adjusted debt/EBITDA around 4.0x on a sustained basis

Corporate profile

Duna House Group was founded in 1998 as a real estate agency based in Budapest to provide consulting services to foreign investors. In 2003 the Company adopted a franchise business model leading to the expansion all over Hungary. In 2004 Duna House further expanded its range of activities to provide a full range of services to sellers and buyers including real estate brokerage, loan brokerage, loan insurance and other financial services, as well as property appraisals. The company is one of the two largest franchise networks of real estate agents in Hungary and the largest in Poland, and it is also present in the Czech Republic.

Recent developments include the 70% acquisition of the second largest real estate broker in Italy, Hgroup, completed in January 2022.

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	25.8x	94.0x	20.8x	Net cash interest	
Scope-adjusted debt/EBITDA	3.7x	3.1x	3.2x	2.9x	3.1x
Scope-adjusted funds from operations/debt	22%	34%	31%	40%	41%
Scope-adjusted free operating cash flow/debt	-9%	17%	47%	102%	22%
Scope-adjusted EBITDA in HUF m					
EBITDA	1,527	1,949	3,938	1,581.4	2,234
Other items[1]	0	0	-349	574.3	0
Scope-adjusted EBITDA	**1,527**	**1,949**	**3,588**	**2,156**	**2,234**
Funds from operations in HUF m					
Scope-adjusted EBITDA	1,527	1,949	3,588	2,156	2,234
less: (net) cash interest paid	-59	-21	-172	356	807
less: cash tax paid per cash flow statement	-219	-253	-340	-334	-571
add: dividends from associates	0	370	454	297	322
Change in provisions	0	0	0	0	0
Funds from operations (FFO)	**1,249**	**2,045**	**3,531**	**2,475**	**2,793**
Free operating cash flow in HUF m					
Funds from operations	1,249	2,045	3,531	2,475	2,793
Change in working capital	-1,520	-893	2,217	4,518	-528
less: capital expenditure (net)	-113	-110	-218	-534	-561
less: lease amortisation	-128	-3	-171	-171	-171
Free operating cash flow (FOCF)	**-512**	**1,039**	**5,359**	**6,288**	**1,533**
Net cash interest paid in HUF m					
Net cash interest per cash flow statement	-59	-20.7	-172	356	807
Change in other items	0	0	0	0	0
Net cash interest paid	**-59**	**-20.7**	**-172**	**356**	**807**
Scope-adjusted debt in HUF m					
Reported gross financial debt	11,795	11,283	15,832	15,774	15,017
less: cash and cash equivalents[2]	-6,902	-6,497	-6,909	-9,857	-8,438
add: non-accessible cash	733	1,271	2,527	253	253
Scope-adjusted debt	**5,626**	**6,056**	**11,450**	**6,170**	**6,830**

[1] EBITDA from the sale of real estate units related to the Forest Hill project.
[2] In our forecast for 2022-2024 we deduct only 70% of cash available from the Scope-adjusted debt, as we consider this amount to be permanently available. This results in a difference from the unrestricted cash reported in the liquidity section (page 7) where as "unrestricted cash' we consider the total cash minus the non-accessible cash.

Table of Content

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)

ESG considerations

No material ESG risk has been identified.

As a real estate agency, the major ESG risks Duna House faces are typically regulatory and reputational, as well as governance risk factors. Environmental risks are not significant given the asset light business model. We believe there is a need to address potential risks coming from:

1) product (loan) mis-selling as a potential social risk factor.
2) lack of independent oversight of the board as a potential governance risk factor.

[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: BB-

Industry risk profile: BBB-

Duna House is a Hungarian-based company operating as a real estate agency offering various services such as loan brokerage, insurance, as well as real estate brokerage, management, and appraisal services.

The industry risk profile is moderate for Duna House. Until recently, the Company has been also active in Real Estate development, but now it is mostly exposed to the business services industry, which has medium cyclicality, as well as medium entry barriers and substitution risk.

Leading market position in Hungary, Poland and Italy …

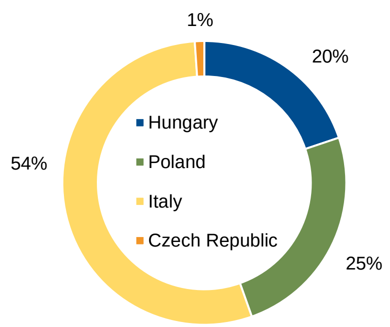
… but relatively small size

The issuer's market position is credit-positive. The group has the largest platform in Poland and one of the two leading real estate brokerage platforms in Hungary along with competitor Otthon Centrum, whose size is similar in terms of listings, offices and salespersons. As of 2021, the market share in real estate mortgages in Hungary and Poland was 6.7% and 4.8%, respectively. With the recent acquisition of Hgroup, Duna house is now also the second largest loan brokerage platform in Italy; with a market share in 2021 of 1.6%. The issuer's single-digit market share in all three markets despite market leadership shows the high fragmentation of its markets. This implies little pricing power but also allows for a potential increase in market share going forward if the real estate brokerage sector continues its consolidation.

Increased geographical and product diversification

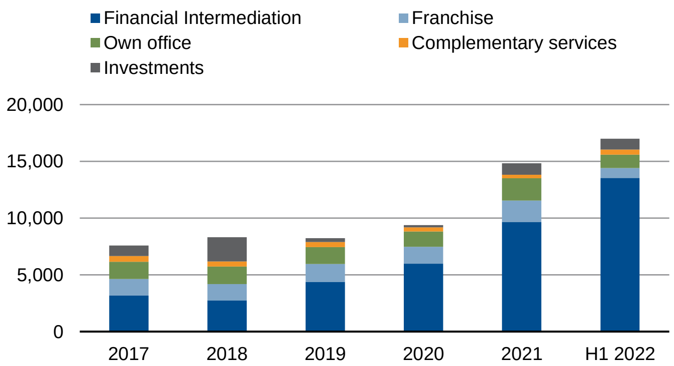
The business risk profile also benefits from increased diversification following the acquisition of Hgroup, which reduced the dependency on two similar markets. Going forward, we expect even more revenues to be generated by the Italian business as Hungary and Poland seem to be more affected by interest rate increases. In addition, the Hgroup has improved its existing product lines to offer a wider range of services with revenue streams not only related to real estate, but also salary-backed loans, personal loans, and insurance brokerage.

Figure 1: Geographical diversification by revenues (H1 2022)



Sources: Duna House, Scope

Figure 2: Revenue breakdown per type of service (HUF m)



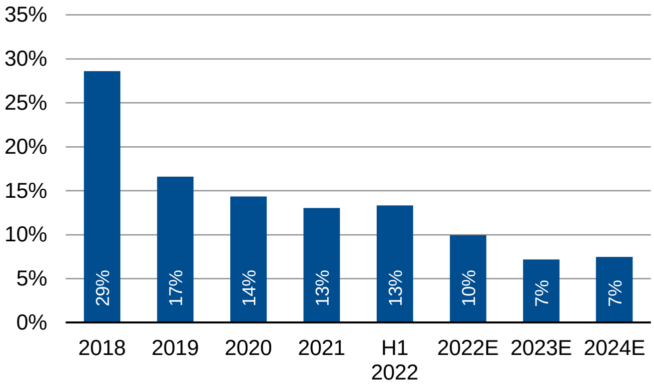
Sources: Duna House, Scope

Customer granularity is very high as the issuer targets only retail clients. Going forward, we expect client diversification to remain stable.

Profitability under pressure due to rising interest rates

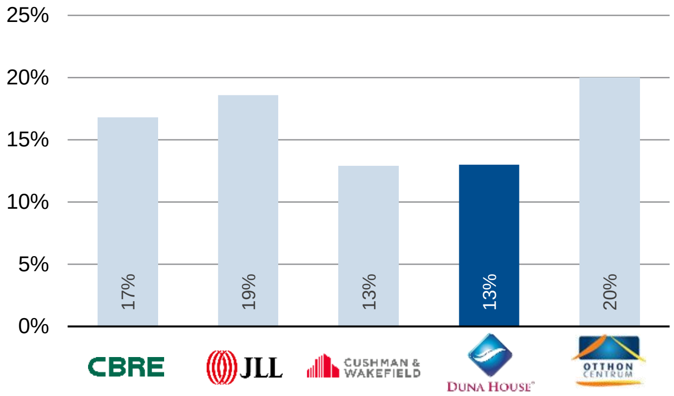
While Scope-adjusted EBITDA margins were in the range of 15%-30% until 2018, more recently margins have declined due to the aggressive expansion policy which has penalised cost efficiency. Going forward, we expect profitability to further weaken as rising interest rates will affect the demand for loans and residential real estate demand, especially in Hungary and Poland.

Figure 3: Scope-adjusted EBITDA margin



Sources: Duna House, Scope

Figure 4: Scope-adjusted EBITDA margin vs. peers 2021



Sources: Duna House, public information

A return to EBITDA margins above 10% could be achieved if Duna House successfully integrates the Hgroup and creates economy of scale as well as offsets the unfavourable interest rate scenario by increasing its market share in all countries.

Financial risk profile: BB

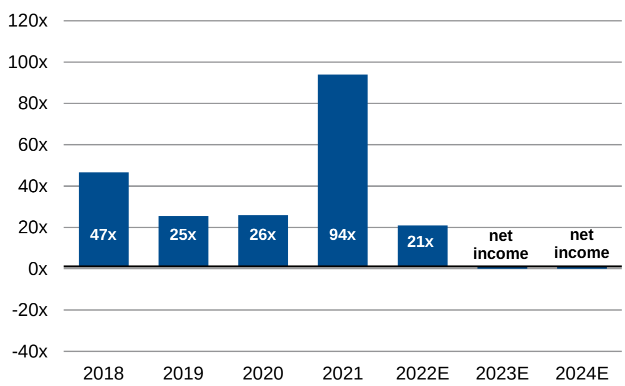
Robust interest cover

Scope-adjusted EBITDA interest cover has been robust over the years thanks to the asset and debt light business model. The issuer currently benefits from highly favourable interest rates on its cash deposits resulting in substantial net interest income, which is expected to continue over the next two years.

While EBITDA and funds from operations have been relatively stable, FOCF has been more volatile, due to the real estate development activities of the group especially driven by the start of the Forest Hill development (Hungary) in 2019. The delivery of the real estate units developed should generate substantial cash flow in 2022 and 2023 to finance the ongoing business, future real estate development or M&A activity.

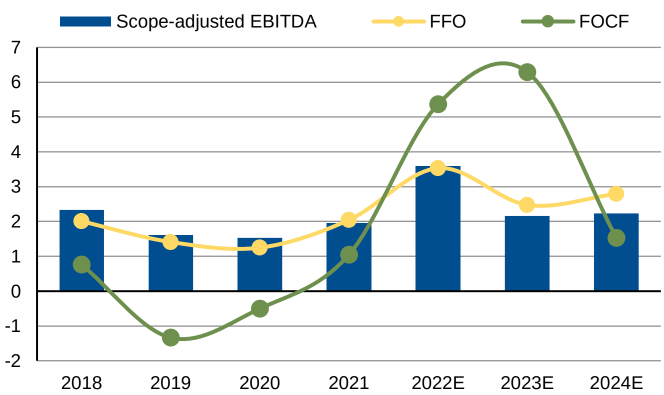
Generally, future cash flow trend will depend on the development activity and the issuers M&A and acquisition strategy. We thus anticipate that cash flow will remain volatile.

Figure 5: Scope-adjusted EBITDA interest cover



Sources: Duna House, Scope estimates

Figure 6: Cash flows (HUF bn)

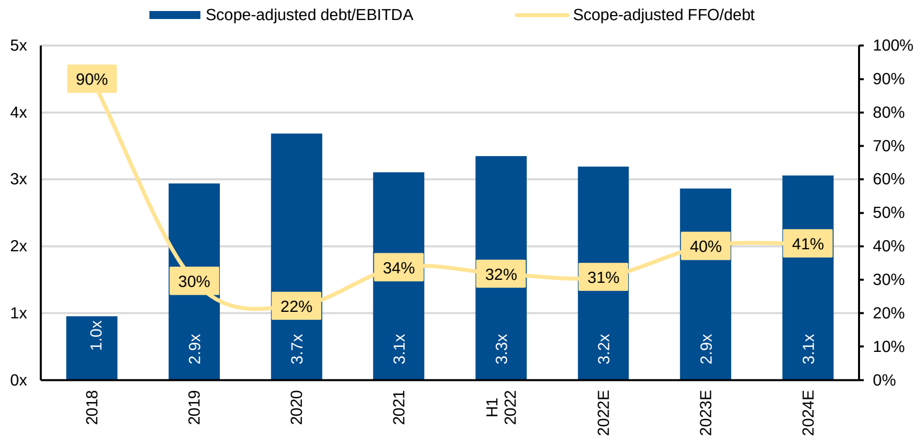


Sources: Duna House, Scope estimates

Leverage to remain stable in the next years

The issuer showed a significant increase in leverage in 2020 and 2021 following debt-financed acquisitions. After the repayment of the long-term debt from the Forest Hill development project in 2022, we expect Scope-adjusted debt/EBITDA to remain around 3x (management guidance: below 3x) mitigating pressure from an anticipated decline in Scope-adjusted EBITDA in 2023 because of negatively impacted demand for loans in Hungary and Poland. We anticipate that the company will be able to finance the ongoing activity with own funds rather than by increased leverage.

Figure 7: Leverage



Sources: Duna House, Scope estimates

Adequate liquidity

Liquidity is deemed adequate as the company's unrestricted cash position, which has improved following the repayment of the Forest Hill project debt in July 2022, plus free operating cash flows excluding discretionary spending, covers short-term debt repayment needs by well over 100% going forward. The two outstanding bonds will not start amortising before 2026.

Balance in HUF m	2021	2022E	2023E
Unrestricted cash (t-1)	6,170	5,227	7,344
Open committed credit lines (t-1)	700	0	0
Free operating cash flow	1,040	5,359	6,288
Short-term debt (t-1)	4,850	4,373	58
Coverage	**163%**	**>200%**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB-

As at June 30, 2022, Duna House had HUF 13bn of senior unsecured capital market debt outstanding. Our recovery analysis incorporates a default scenario in 2024 and is based on Duna House's liquidation value, since the company still has modest assets from real estate development. We see material uncertainty regarding the group's asset values in a hypothetical default scenario, which would likely be driven by increased competition and/or a confidence loss in the business/brand and departure of many licensees and agents.

Appendix: Peer comparison (Business Services Hungary)

	Duna House Holding Nyrt.	Otthon Centrum Kft.	Pannon Work Zrt.	Mobilbox Kft.	Progress Étteremhálózat Kft.
	BB-/Stable	BB-/Stable	B+/Stable	BB/Stable	BB/Stable
Last reporting date	31 December 2021	31 December 2021	31 December 2020	31 December 2021	31 December 2021
Business risk profile					
Services offered	Loan brokerage, real estate brokerage and other financial and management services	Loan brokerage, real estate brokerage and other financial and management services	Human resource services	Rental and sales of office, storage and special containers	Franchisor of McDonalds restaurants in Hungary
Scope-adjusted EBITDA (EUR m)	8.6	3.0	2.3	16.4	26.8
Scope-adjusted EBITDA margin	7-13%	15-20%	5%	40-43%	17%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	94x	22x	11.6x	24.8x	15.2x
Scope-adjusted debt/EBITDA	3.1x	2x	4.5x	0.5x	2.5x
Scope-adjusted FFO/debt	34%	46%	14%	173%	36%
Scope-adjusted FOCF/debt	17%	40%	-7%	70%	0%

Sources: Public information, Scope

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