Daniella Kereskedelmi Kft.
Hungary, Retail

B STABLE

Corporate profile

Daniella Kft (Daniella) is a Hungarian retailer specialised in the wholesale of electrical goods to professional entities active in the construction and refurbishment sectors. The group sells a wide range of goods from electric cables, installation units and lamps to renewable energy and lightning protection. The group is private and was founded in 1991. The ownership structure has changed in recent years with the gradual buyout of the founder's minority shareholder stake.

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover	16.7x	9.0x	6.2x	7.0x
Scope-adjusted debt (SaD)/EBITDA	2.0x	4.2x	4.4x	3.9x
Scope-adjusted FFO/SaD	46%	21%	19%	21%
FOCF/SaD	9%	-25%	-15%	7%

Rating rationale

Scope Ratings GmbH (Scope) has today confirmed the B/Stable issuer rating on Daniella Kereskedelmi Kft. Senior unsecured debt has been confirmed at B+

Over the last year, the retailer increased its sales (+7.5%) at the expense of a small decline in profitability (Scope-adjusted EBITDA margin of 5.6% at YE 2020 versus 6.3% a year before). This was due to additional costs linked to the pandemic and the start of operations of both the new logistic software platform and warehouse. Daniella's market share has remained unchanged over the last year, with a comfortable position within the top three largest retailers in the country. We expect the transfer of activities to the newly built warehouse to help the group maintain its leading positioning in the country, allowing it to provide overnight deliveries and online orders after competitors' shops have closed. The geographical focus on Hungary continues to constrain the group's rating. However, we expect the development towards online sales, with the automation of warehouses and new software, to increase online sales in the coming years and positively impact channel diversification. Following the slip in profitability in 2020, we expect Daniella's Scope-adjusted EBITDA margin to remain close to 6% in 2021 and 6.3% in 2022.

Daniella's financial risk profile remains unchanged from last year. However, we expect an important decrease in the cash position by YE 2021, following the investments announced by the group in property, plant and equipment (PPE). Leasing obligations are expected to gradually increase following payments for the warehouses, whose ownership was transferred to Weerts Logistic Park V Kft. (to be renamed in the short name HAD Real Estate). Leverage metrics, in terms of Scope-adjusted debt (SaD)/EBITDA and funds from operations (FFO)/SaD – unadjusted for the cash position, both deteriorated in 2020 to 4.2x and 21% respectively from 2.0x and 46% a year before. They should peak by YE 2021, which will represent the end of the investment programme financed by the MNB bond. We expect metrics to improve again in the following years.

Ratings & Outlook

Corporate ratings	B/Stable
Senior unsecured rating	B+

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Related Methodologies

Corporate Rating Methodology: July 2021

Rating Methodology: Retail and Wholesale Corporates March 2021

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Despite this positive evolution of the company over the last year, the choice to split the real estate into a new entity, Weerts Logistic Park V Kft, with no existing recourse by Daniella is considered as adverse to the bond investors and has consequently led to a down-notching of -1 in the governance. Should a bankruptcy-like event occur, investors won't be able to have recourse on the newly built warehouse.

Outlook and rating-change drivers

The Outlook is Stable and incorporates our expectation that there will be no debt issuance linked to potential acquisitions in the coming years. We expect SaD/EBITDA to remain at the lower end of the 4.0x - 5.0x range in the coming years. The Outlook also incorporates our expectation that the Romanian subsidiary (new logistics warehouse) will be operational in between 2022-2023.

A positive rating action may be triggered if SaD/EBITDA improved to levels below 4.0x on a sustained basis. This could result from a better development of EBITDA linked to a more efficient usage of assets while demand continues to rebound.

A negative rating action may be triggered if SaD/EBITDA moves toward 6.0x on a sustained basis. This could be the consequence of a worsening in national demand or regulatory changes

Rating drivers

Positive rating drivers	Negative rating drivers
• Satisfactory operating profitability • Online sales relatively high for a group of this size • Limited impact of Covid-19 on sector activity, which demonstrates a lack of cyclicality	• Limited size of the retailer in a niche market constrains the rating • Mono-focus on Hungary weakens diversification • Niche market limits the group's potential development • Deterioration in credit metrics at YE 2021 following investments in PPE • Absence of recourse on the real estate entity

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improvement in SaD/EBITDA to below 4.0x on a sustained basis	• SaD/EBITDA moving toward 6.0x on a sustained basis

Financial overview

				Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	15.4x	16.7x	9.0x	6.2x	7.0x
SaD/EBITDA (x)	2.1x	2.0x	4.2x	4.4x	3.9x
Scope-adjusted FFO/SaD (%)	44%	46%	21%	19%	21%
Scope-adjusted FOCF/SaD (%)	-44%	9%	-25%	-15%	7%
Liquidity (internal + external)	-4.9x	0.4x	-1.5x	no ST-debt	no ST-debt
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Reported EBITDA	794	975	825	779	926
Operating lease payment in respective year	160	190	285	485	456
Scope-adjusted EBITDA	954	1,165	1,110	1,264	1,382
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA	954	1,165	1,110	1,264	1,382
less: (net) cash interest as per cash flow statement	-30	-32	-66	-106	-106
less: cash tax paid as per cashflow statement	-5	-43	-25	-50	-50
add: dividends received	0	13	18	15	15
less: leasing adjustment (Interest)	-32	-38	-57	-97	-91
Scope-adjusted funds from operations	887	1,065	980	1,026	1,150
Scope-adjusted free operating cash flow in HUF m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted cash flow from operations	887	1,065	980	1,026	1,150
less: leasing adjustment (depreciation)	-128	-152	-228	-388	-365
Net working capital	-603	-467	311	-278	-133
Net capex	-1,052	-247	-2,243	-1,200	-300
Scope-adjusted free operating cash flow	-896	200	-1,180	-840	352
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	1,394	1,578	3,573	3,573	3,573
add: leasing adjustment	639	760	1,139	1,942	1,826
Scope-adjusted debt	2,033	2,338	4,711	5,515	5,399

Business risk profile: BB-

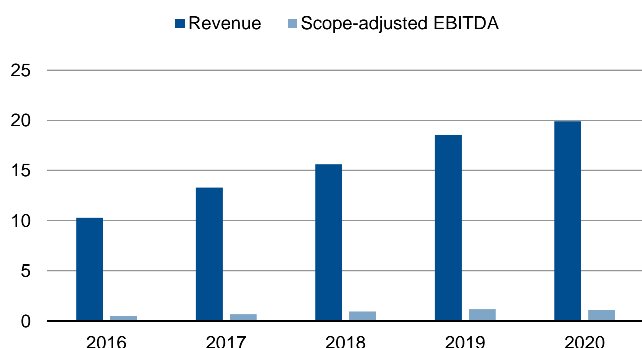
Small player...

Daniella is a small player in the European scene in terms of its size and scale of operations. Following the introduction of the dedicated sectorial methodology, we assess the group's market shares as constrained by its size (HUF 19.9bn of revenues in 2020). Although Daniella operates in a niche market (the wholesaling of construction materials and elements in Hungary), we estimate that it is the largest national player in a market, with a total market share of close to 13% (including the contribution from DL'1, smaller competitor bought over the last years– not consolidated).

... benefitting from a resilient sector of operation

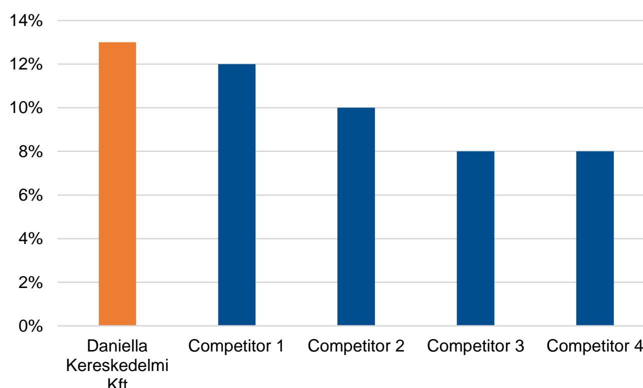
The sector was largely unaffected by the crisis in 2020, illustrated by overall growth (+6% according to Daniella estimates), which the group surpassed (+7.5% sales increase). The market is supported by the Hungarian government, which implemented various schemes for construction and refurbishment[1], supporting demand for green- and brownfield projects. Shops' opening hours were limited (until 3pm) but existing online services took over upon their closure. Daniella reports that the split between revenues from brown- and greenfield projects remains close to 50%-50% due to the overall resilience of the construction market.

Figure 1: Evolution of revenue and EBITDA (in HUF bn) in recent years



Source: Scope Ratings, Daniella Kereskedelmi Kft

Figure 2: Group market share (based on 2019 figures)



Source: Daniella Kereskedelmi Kft., Scope Ratings

New warehouse provides competitive advantage

Daniella moved to its new 12,000 sqm warehouse in December 2020, doubling its available storage capacity (previously flagged by management as a bottleneck in the group's development). It will use close to HUF 300m worth of bond proceeds to automate the warehouse, with automation to be implemented by YE 2021. Nonetheless, the warehouse itself is already functional and has allowed Daniella to increase its competitive advantage by providing next day deliveries after competitors' shops have closed.

Market share development may take the form of M&A

The group acknowledges that future market growth will be driven by online and omnichannel sales. It does not expect to open new stores (31 to date and, sensibly, more than other local competitors). That said, management does not exclude growth via acquisitions due to a certain consolidation of the market.

Possible development of projects and activities in Romania

Currently, the group is aiming to develop its market shares in Romania, with a project named Best Depo to replicate its warehouse across the border. While the potential location has yet to be found, the development of a new logistics centre would allow expansion into the Romanian market via the existing entity Dominant Electric. It would, however, take time for this development to significantly counterbalance Daniella's

[1] including a Home Purchase Subsidy (CSOK) – preferential 5% VAT for new home purchases (down from 27% in 2020) and 50% of renovation costs granted for households living in a flat with a child

activities in Hungary and benefit the group's long-term European market positioning and diversification.

Country retail strength is high-medium

We see the country retail strength of the group's operations as 'high-medium'. Although the market is fairly mature, it still has development possibilities, underlined by currently overall low online penetration in the country.

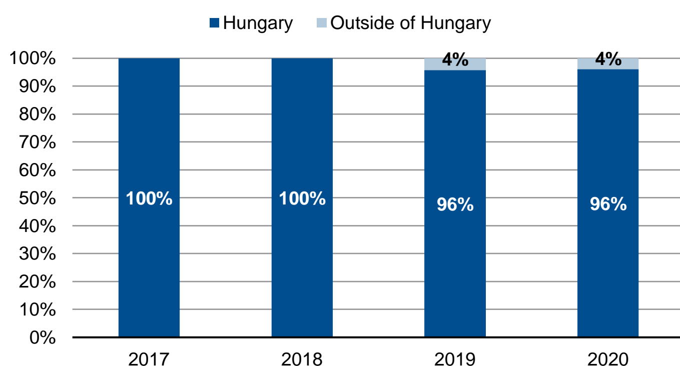
Product diversification good as products sold are non-cyclical

Niche player, Daniella sells a wide range of products (close to 145,000 different sorts). Following the introduction of our new retail methodology and our reclassification of consumer goods in the context of retailers, we consider all of these products to be related to DIY, thus not improving the company's product diversification. However, we do consider these products to be non-cyclical.

Channel diversification is a positive development

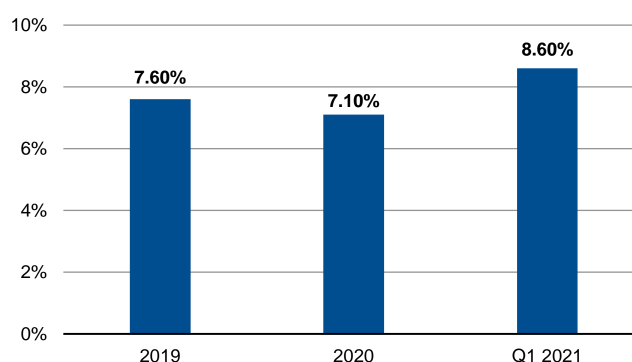
Channel diversification has developed significantly with the opening of the new warehouse. While 2020 saw lower online sales than 2019 (7.1% versus 7.6%), this can be attributed to the movement of the inventory to the new warehouse and the implementation of the new software, which has caused important delays in the first half of the year to the implementation and the rolling-out of the online sales. In Q1 2021 Daniella achieved 8.6% of online sales, which is a positive development. Furthermore, the group has many shops spread across the country, ensuring omnichannel development. We consider the retailer to be well positioned to adapt to changing demand, as it appears to be a local front-runner for online deliveries. As the current warehouse (phase I) not fully filled, the group is renting out some unused shelves and other logistics services. This revenue is currently close to HUF 50m (but is expected to double in future years) and is not large enough to constitute a real diversification with regard to retail sales.

Figure 3: Geographical diversification (in term of sales)



Source: Scope Ratings, Daniella Kereskedelmi Kft

Figure 4: Evolution of online sales as percentage of total revenue



Source: Scope Ratings, Daniella Kereskedelmi Kft

Consumer and supplier diversification is adequate

Daniella's 10 largest suppliers constitute close to 51% (reported at YE 2020), which is essentially the same as last year. Customer diversification has, however, changed slightly as electrical contractors represented 29% at YE 2020, versus 27% a year before, taking the pole position from resellers (28% in 2019 and 24% in 2020). All in all, customers remain better diversified than suppliers, with the top 10 accounting for 11% of total sales (10% in 2019). B2C continues to represent a negligeable 1%. Management has announced its ambition to reinforce its sales towards industrial customers in the medium term.

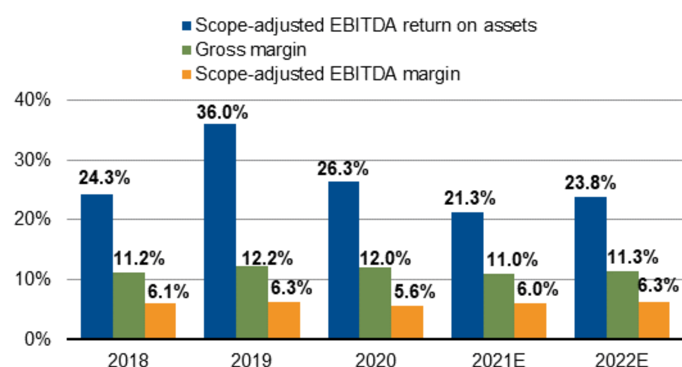
Exposure to Hungary constrains the rating

Geographical diversification remains a constraint for the overall rating. The group remains largely focused on Hungary (96% of sales in 2020). While management has announced that it is looking at options to expand its activities into neighbouring Romania, we believe most sales will be generated in a single country for the foreseeable future.

Profitability more resilient than expected to Covid-19 in 2020

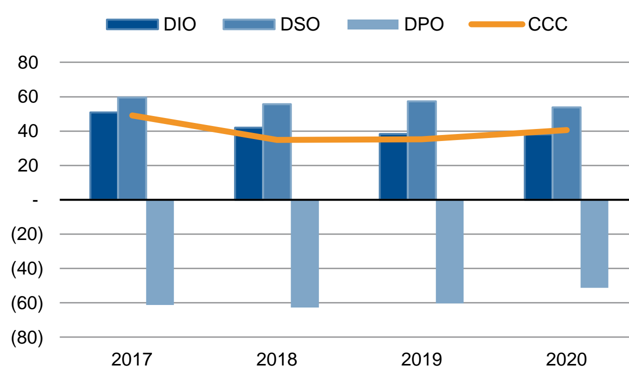
Profitability (measured by the Scope-adjusted EBITDA margin) dropped slightly in 2020 due to a slip in EBITDA (-5% YoY), while revenue increased over the period. This drop is considered by management to be exceptional and non-recurring as it comes from: i) additional Covid-19 costs (new hires and more leeway in employee shifts to avoid local outbreaks); ii) the development and introduction of the new logistic software; and iii) the transfer of inventories and personnel to the new warehouse. Despite this small decline did, however, profitability exceeded our forecasts (reaching 5.6% versus 4.3% forecasted last year). We note that the gross margin has remained roughly stable over the period. This small decline did, however, exceed our forecasts (reaching 5.6% versus 4.3% forecasted last year).

Figure 5: Development of main profitability margins



Source: Scope Ratings, Daniella Kereskedelmi Kft

Figure 6: Evolution of cash conversion cycle and its components, in days[2]



Source: Scope Ratings, Daniella Kereskedelmi Kft

We forecast a stable margin

We expect Scope-adjusted EBITDA to improve to close to 6.0% at YE 2021, despite a haircut to the gross margin (11.3% versus 12% budgeted by management). We expect the new hires made during the pandemic to be maintained in order to support the group's activities. Private labels, while much more profitable than branded goods, are expected to hit a ceiling at close to 10% of total sales (7% today and stable vis a vis last year).

Scope-adjusted EBITDA return on assets is high

Our newly introduced metric, the Scope-adjusted EBITDA return on assets, allows us to measure how well assets are used to generate a certain EBITDA level. Following the demerger of assets associated with the exit of two former owners, Daniella's ratio spiked in 2019 (36% versus close to 25% in previous years). 2020 saw a decrease following the slip in EBITDA to levels close to 26%. We expect Daniella to maintain the ratio below 25% in the coming years, due to the increase in PPE linked to automation and higher inventories because of the group's new capacities.

[2] CCC: cash conversion cycle; DIO: days inventory outstanding; DSO: days supplier outstanding; DPO: days payable outstanding

Financial risk profile: B+

Debt composition unlikely to change

The debt structure appears to be stable and is expected to remain at similar levels for the foreseeable future. The group's gross debt is comprised of a senior unsecured bond, issued last year as part of the MNB programme, and leases.

Limited short-term impact of Romanian project on the group's balance sheet

We expect the new Romanian project, Best Depo, to have a limited impact on credit metrics. While the total costs are estimated at EUR 3.8m, warehouse pre-sales (some parts of the future warehouse – including docking hubs) are expected to represent close to 65% of the total cost. The rest will be split between Daniella (40%) and its Dutch real estate partner (60%). Overall, the retailer expects to contribute close to HUF 180m. Daniella has not provided any guarantees for the project but will retain one part in the future distribution centre to boost its activities in this country.

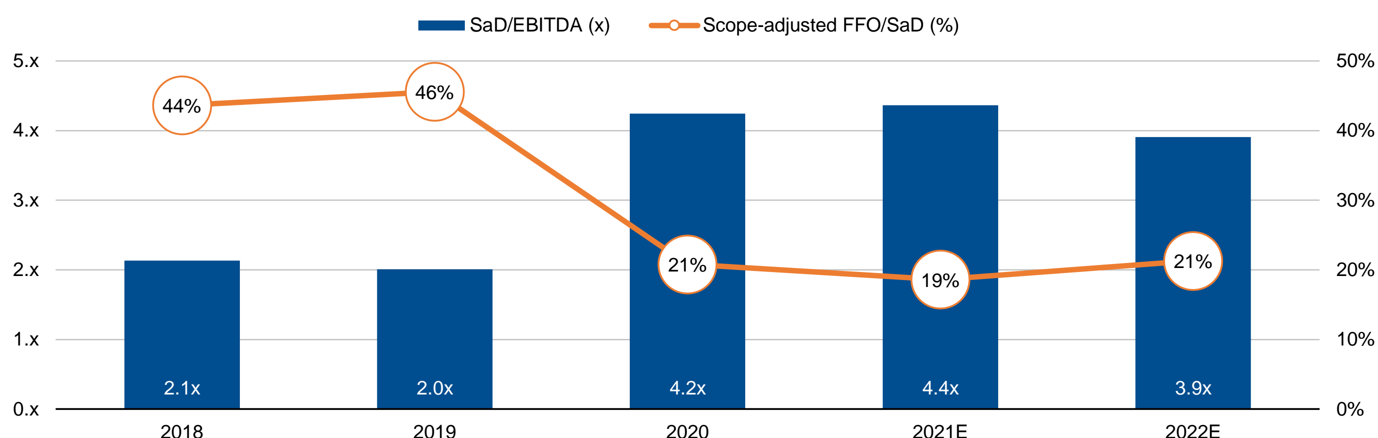
Cash expected to decrease due to CAPEX

The larger cash position at YE 2020 will decrease significantly in 2021 following the investment in new PPE to automate and robotise the newly built warehouse.

Lease payments related to warehouse are expected to rise sharply

We expect leases to be the main element growing in SaD in the coming years, accounting for close to HUF 2bn (versus HUF 3.5bn for financial debt), corresponding to the full payment for the Phase I warehouse operations. 2021 will see an even higher increase, given Daniella's forecasts that Best Depo will be finalised by December 2021.

Figure 7: Evolution of leverage metrics



Source: Scope Ratings, Daniella Kereskedelmi Kft

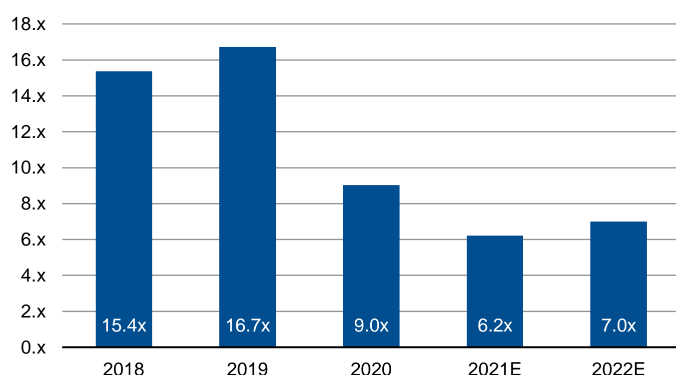
Leverage metrics have exceeded our expectations but will remain weak

Credit metrics worsened in 2020 due to the bond issuance, but are better than our initial forecast, which foresaw a greater impact of Covid-19 on EBITDA and overall cash flow generation. In detail, we expect leverage metrics to deteriorate from 4.2x at YE 2020 to 4.4x at YE 2021 for SaD/EBITDA. Similarly, we expect FFO/SaD to drop from 21% at YE 2020 to 19% at YE 2021, due to the investments carried by the retailer. Based on our forecast of increased cash generation in the following years, we expect leverage metrics to improve to below 4.0x and above 20% respectively from YE 2022 on.

Interest cover should be anchored at close to 6x

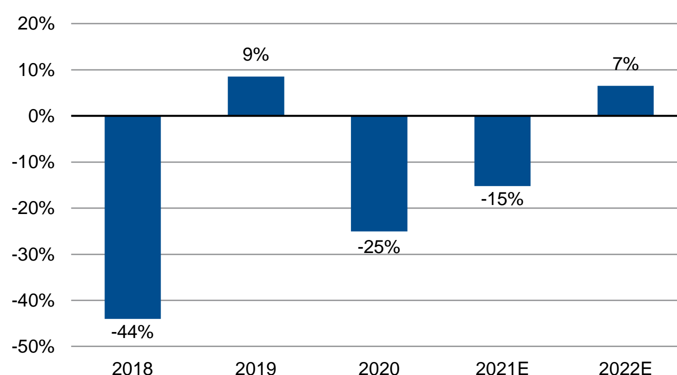
We expect EBITDA interest cover to remain strong but to slip slightly to levels close to 6x in 2021 versus 9x at YE 2020. This expectation is based on: i) the increase in interest expenses related to operating leases; and ii) the full year payment of the coupons (versus half a year's payment in 2020). Interest expenses are expected to increase gradually to levels above 6.5x after YE 2021.

Figure 8: Evolution of EBITDA interest cover



Source: Scope Ratings, Daniella Kereskedelmi Kft

Figure 9: Evolution of cash flow cover



Source: Scope Ratings, Daniella Kereskedelmi Kft

Cash flow cover expected to remain low due to investments

We expect cash flow cover, calculated as free operating cash flow (FOCF)/SaD, to remain low in the coming years (close to 5% if not negative), given Daniella's development ambitions. We also expect net working capital to reverse towards negative levels, based on: i) a normalisation of receivables closer to historical levels; and ii) a slight increase in inventories commensurate with the group's higher storage capacities. Payables should, however, remain in line with historical levels as there is no indication of a change in the group's policies in this respect.

Liquidity is adequate

Liquidity is adequate, supported by the absence of financial debt, leases repayments being already accounted for in FOCF. The HUF 0.3bn credit line (single year) should provide a buffer if required.

Liquidity in HUF m	2021E	2022E
Short-term debt (t-1)	0	0
Unrestricted cash (t-1)	1,053	81
Free operating cash flow (t)	-840	352
Liquidity (internal)	no short-term debt	no short-term debt
Open committed credit lines (t-1)	0	0
Liquidity (internal + external)	no short-term debt	no short-term debt

Supplementary rating drivers

Governance (-1 notch)

The company created a new subsidiary, Weerts Logistic Park V Kft. (to be renamed in the short name HAD Real Estate), in order to separate real estate activities more clearly from wholesale operations following the warehouse construction, which was partially financed by the bond issuance of last year. However, Daniella does not have recourse to the newly created entity. This means that assets financed with bond proceeds would become unavailable to bond investors should a bankruptcy-like event occur (ESG factor: credit-negative governance factor).

Long-term and short-term debt ratings

Senior unsecured debt confirmed at B+

Under a theoretical bankruptcy-like event in 2022, our recourse analysis indicates a recovery of 59% on the bond, assuming a liquidation value of close to HUF 5.5bn. This corresponds to an above-average recovery and therefore warrants an uplift of the senior unsecured debt rating to B+.

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