Daniella Kereskedelmi Kft. Hungary, Retail

B+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2021*	2022	2023E	2024E
Scope-adjusted EBITDA interest cover	8.7x	12.6x	6.9x	6.8x
Scope-adjusted debt/EBITDA	3.2x	2.0x	3.5x	3.2x
Scope-adjusted FFO/debt	28%	46%	24%	26%
Scope-adjusted FOCF/debt	-2%	12%	-1%	3%

* based on Daniella's standalone financials

Rating rationale

The rating is supported by Daniella's competitive positioning in its home market, underpinned by a strong online and brick-and-mortar presence. However, the small absolute size of the group (revenues of HUF 42bn in 2022) constrains any potential rating uplift, despite historically high growth in its revenues and profitability margin in recent years. Nonetheless, unfavourable market conditions (inflation and tightening of governmental subsidies) have led to a slowdown of the group's underlying market, which puts pressure on Daniella's Scope-adjusted EBITDA margin. A decrease in profitability is expected this year, negatively impacting the group's credit metrics; however, this decline is seen as temporary. This is because Daniella's strategy to establish an engineering consultancy and shift its focus towards servicing industrial customers is expected to generate long-term recurring revenue and gradually improve profitability after 2023. The negative supplementary rating driver flags the transfer of warehouse ownership to HAD Real Estate, which was spun out in 2022 (ESG factor: credit-negative).

Given the carve-out of HAD Real Estate and DL'1's material contributions to group performance, Daniella will be assessed at the consolidated level from 2022 on.

Outlook and rating-change drivers

The Outlook is Stable and reflects our view that although macroeconomic headwinds are putting pressure on Daniella's profitability, causing credit metrics to deteriorate, the negative impact is temporary, with the Scope-adjusted debt/EBITDA ratio set to recover to around 3x. The Stable Outlook also assumes no M&A.

A positive rating action is remote at present but would be considered if Daniella significantly increased in size while maintaining its credit metrics at levels in line with the Outlook. This would result from an expansion into Romania or a ramp-up of industrial customers.

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

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
11 Sep 2023	Affirmation	B+/Stable
9 Sep 2022	Upgrade	B+/Stable
10 Sep 2021	Confirmation	B/Stable

Ratings & Outlook

Issuer	B+/Stable
Senior unsecured debt	BB-

Analyst

Vivianne Anna Kápolnai
+49 69 6677389 88
v.kapolnai@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2023

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

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Satisfactory operating profitability • Resilient financial model • High online sales for the group's size	• Limited size in 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 at levels in line with our Outlook	• Scope-adjusted debt/EBITDA ratio moving towards 4.0x

Corporate profile

Daniella Kft. is a Hungarian retailer specialised in wholesale 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, was spun off in 2022 with the aim to create a clear separation between retail and real estate activities.

Financial overview

				Scope estimates		
Scope credit ratios	**2020***	**2021***	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	9.5x	8.7x	12.6x	6.9x	6.8x	7.8x
Scope-adjusted debt/EBITDA	4.2x	3.2x	2.0x	3.5x	3.2x	2.9x
Scope-adjusted FFO/debt	21%	28%	46%	24%	26%	29%
Scope-adjusted FOCF/debt	-40%	-2%	12%	-1%	3%	7%
Scope-adjusted EBITDA in HUF m						
EBITDA	825	1,294	2,778	1,403	1,641	1,902
Operating lease payments	285	506	629	702	737	773
Scope-adjusted EBITDA	**1,110**	**1,799**	**3,407**	**2,104**	**2,378**	**2,676**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,110	1,799	3,407	2,104	2,378	2,676
less: (net) cash interest paid	-117	-206	-271	-305	-351	-345
less: cash tax paid per cash flow statement	-8	-15	-39	-71	-80	-100
add: dividends from associates	18	23	52	-	-	-
Funds from operations (FFO)	**1,003**	**1,602**	**3,149**	**1,729**	**1,947**	**2,231**
Free operating cash flow in HUF m						
Funds from operations	1,003	1,602	3,149	1,729	1,947	2,231
Change in working capital	-114	-854	-1,028	-616	-600	-600
less: capital expenditure (net)	-2,554	-445	-769	-600	-500	-500
less: lease amortisation	-228	-405	-503	-561	-589	-619
Free operating cash flow (FOCF)	**-1,892**	**-102**	**849**	**-48**	**258**	**512**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	60	105	145	165	204	190
add: interest component, operating leases	57	101	126	140	147	155
Net cash interest paid	**117**	**206**	**271**	**305**	**351**	**345**
Scope-adjusted debt in HUF m						
Reported gross financial debt	3,573	3,683	4,300	4,544	4,600	4,600
add: operating lease obligations	1,139	2,023	2,516	2,806	2,946	3,094
Scope-adjusted debt (SaD)	**4,711**	**5,706**	**6,816**	**7,350**	**7,546**	**7,694**

* based on Daniella's standalone financials

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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.

Non-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 it has a low number of stores in its home country. However, expanding into Romania could increase Daniella's carbon footprint if it does not set up logistics facilities there, because this would necessitate deliveries from Hungary.

Transfer of the ownership of the warehouse to HAD Real Estate, which was spun out, implies that bond proceeds will be unavailable to investors in 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-

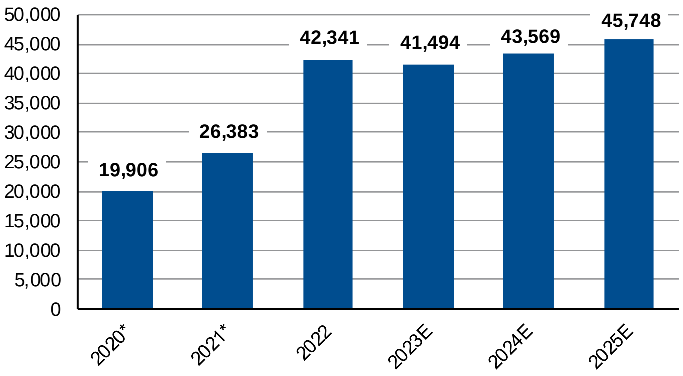
Industry risk profile: BBB

Daniella is categorised as a non-discretionary retailer with an industry risk profile of BBB. This is because low cyclicality, low barriers to entry and low substitution risk characterise the do-it-yourself wholesale segment.

Historically strong growth

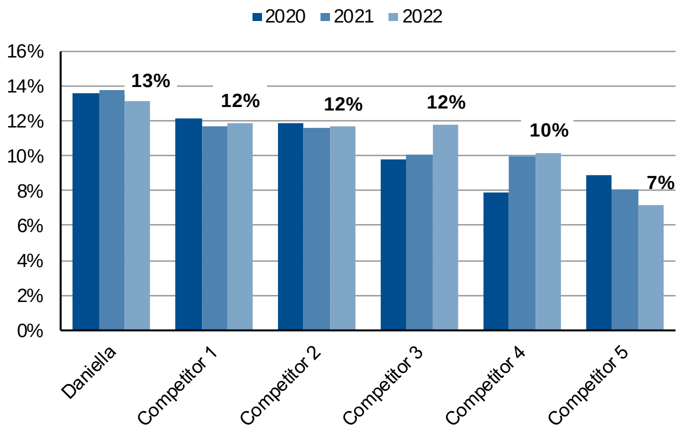
Daniella's market shares continue to be detrimental to its business risk profile. Daniella dominates the wholesale construction materials market in Hungary. However, its revenue potential is capped by the small size of the overall addressable market and related elements. The rating is also limited by the group's absolute size (HUF 42bn of revenue in 2022) although Daniella has benefited from the fast development of its market (sales grew by 29.8% in the 2022 business year). However, the underlying construction market faces a slowdown due to macroeconomic headwinds, limiting the group's growth potential in upcoming years.

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



Sources: Daniella, Scope (estimates)

Figure 2: Development of market shares



Sources: Daniella, Scope

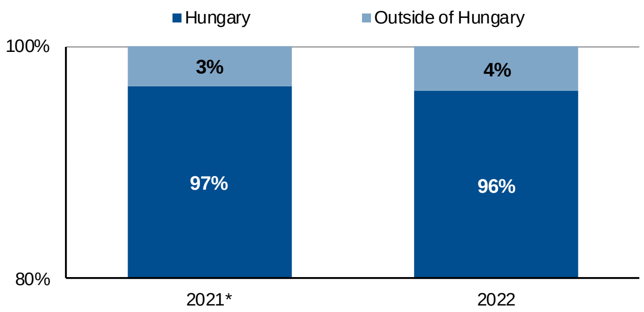
Looming market challenges

In recent years, high growth rates were supported by governmental subsidies (e.g. CSOK). However, these programmes have since been tightened, and the current unfavourable market conditions have led to a decline in group revenues for H1 2023. We expect the group's growth rate to weaken slightly in the coming years. Despite the decline in demand, we do not expect Daniella's leading market position in Hungary to change. The group holds around 13% of the market in terms of revenue, and management's long-term ambition remains 20%. This is supported by strong market positioning in terms of the online and offline presence of the group. Market shares are expected to remain stable or increase in the medium term at the expense of weaker competitors. This view is based on the greater pricing flexibility afforded by its private labels. Additionally, in response to the changes in the market, Daniella has established an engineering consultancy and has shifted its focus towards servicing industrial customers. These changes are expected to generate long-term recurring revenue.

Positive customer diversification

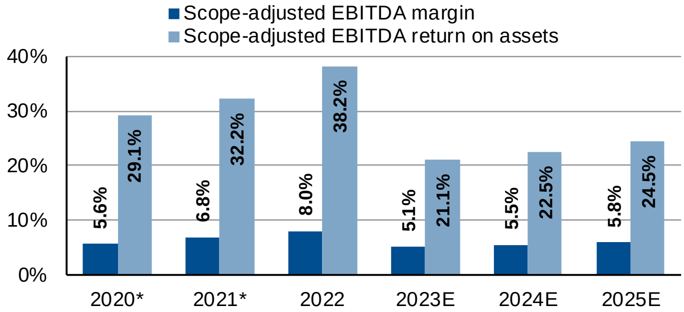
Daniella sells a wide range of products in its niche (close to 145,000 kinds related to construction), catering to all types of customers. However, the products it sells belong to only one consumer goods category. We see the gradual shift towards industrial customers as positive since it will diversify the dependency on households. The group is also well diversified in terms of customers, with the top 10 generating around 7% of sales in 2022. The group estimates an equal split between brownfield and greenfield projects within its consumer portfolio (stable in recent years).

Figure 3: Proportion of sales per country



Sources: Daniella, Scope

Figure 4: Evolution of profitability ratios



Sources: Daniella, Scope (estimates)

Single-country focus limits rating

Daniella's geographical diversification is considered weak, with the majority of sales happening in its home market of Hungary. Nonetheless, an expansion into Romania is likely, where the group has ambitions to build a warehouse near the border, expand its store network in large towns and use existing IT infrastructure to deliver there.

Online sales rising

Sales are conducted through two main channels: Daniella's network of stores (33 at H1 2023) and online. Online sales have improved over the last few years, reaching 13% (7% in 2020) of total sales. Unlike other B2C retailers, Daniella's online growth is unlikely to contract in the coming years due to its wholesale activities given the recent switch toward better group IT infrastructure. Management's goal is to increase online sales to 20%.

Profitability to deteriorate due to strong headwinds

Profitability increased substantially in 2022, with Scope-adjusted EBITDA rising by 52% over the previous year to HUF 3.4bn (versus a 30% increase in revenue). This growth also led to a large increase in the Scope-adjusted EBITDA margin, to 8.0% from 6.9% the year before. The main driver of better profitability was an overall improvement in the gross margin, supported mainly by inventory stock-up acquired at a relatively low cost by the beginning of 2022. However, a reversal effect is apparent for margins in 2023. Due to high inflation rates and tightening of state subsidy programmes, unfavourable market conditions are expected to put pressure on Daniella's profitability in upcoming years. This will lower the Scope-adjusted EBITDA margin to 5% in 2023E. An expected slow recovery will lead this metric to normalise around 6% by 2025E. We base this expectation partly on Daniella being able to pass on a large portion of additional costs to its customers. We see some flexibility in the group's pricing strategy as it has the ability to retain customers by adjusting the discounts it offers.

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

An increase in online sales will also weigh slightly on margins as these are less profitable than brick-and-mortar sales across Europe. Nonetheless, the ramp-up of private labels will support profitability due to significantly higher gross margins than their branded counterparts.

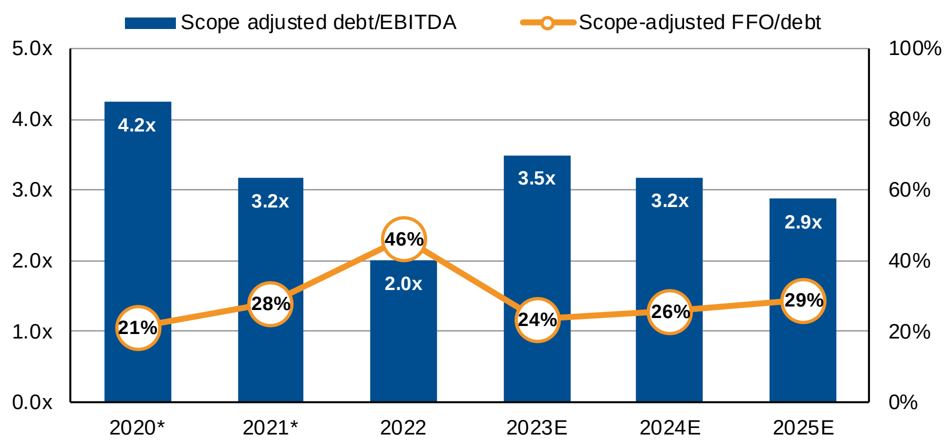
Financial risk profile: BB-

Daniella started reporting consolidated financial statements in 2021 along with its subsidiaries HAD Real Estate and DL'1. Given that a carve-out of HAD Real Estate was planned for 2022, Scope decided to wait for the transaction to close before incorporating DL'1 into Daniella's credit rating. As DL'1 has grown significantly since its acquisition in 2019 and materially contributes to the group's performance, Scope decided to assess Daniella at the consolidated group level from 2022 on.

Relatively stable debt portfolio

Scope-adjusted debt mostly consists of the HUF 3.5bn bond issued under the Hungarian central bank's Bond Funding for Growth Scheme and operating leases that account for close to HUF 2.5bn as at YE 2022. Additionally, the group has open credit lines to finance its working capital expenses. It refinanced these in the amount of HUF 1.3bn in 2023 under the Baross Gabor loan programme, which provides favourable fixed interest rates to SMEs. A smaller amount of debt in terms of absolute value consists of other short-term financial debt. Further debt issuance is unlikely at the moment due to the high interest rate environment and the group's outstanding 2022 performance. The latter gives it reasonable cash positions to weather macroeconomic headwinds in 2023. (Daniella's bond covenants limit its issuance of new debt, however this does not pertain to DL'1.)

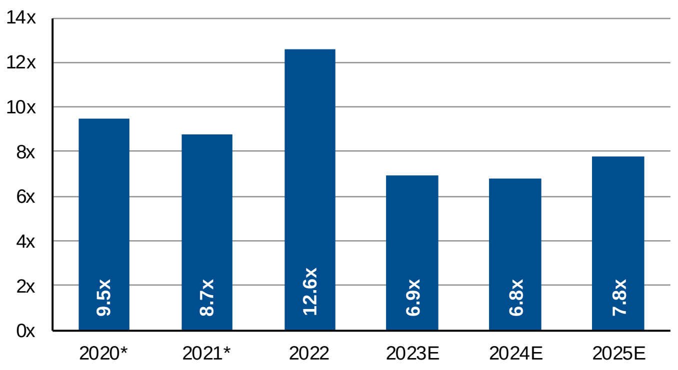
Figure 5: Leverage



Sources: Daniella, Scope (estimates)

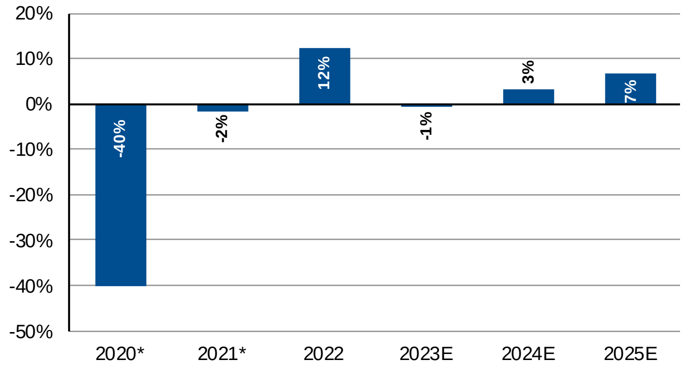
Credit metrics are forecasted to deteriorate in 2023, in line with the expected decline in profitability. Although leverage as defined by the Scope-adjusted debt/EBITDA ratio and the Scope-adjusted funds from operations/debt ratio has improved over the past few years (Scope-adjusted debt improved from 4.2x after the issuance of the bond to 2.0x by YE 2022), it is expected to decrease to 3.5x and 24% respectively in 2023E (compared to 2x and 46% in 2022), after which a gradual recovery is expected towards 3x and 30%.

Figure 6: Interest cover



Sources: Daniella, Scope (estimates)

Figure 7: Cash flow cover



Sources: Daniella, Scope (estimates)

Scope-adjusted EBITDA interest cover also benefitted from the strong growth in EBITDA until 2022. With the refinancing of credit lines, the majority of the group's debt is fixed until 2024, partially mitigating the negative impact of lower profitability in 2023. From 2024 on, interest rates for the short-term credit lines are assumed to be floating, leading to a higher amount of absolute interest expenses for 2024 and 2025. With the expected gradual recovery in profitability, interest cover is expected to remain stable at around 7x.

FOCF remained negative in 2021 and is forecasted to return to negative territory in 2023E. Relatively high working capital as well as the continuation of capex plans have put pressure on FOCF. FOCF is expected to turn positive in 2024E but remain at a low level in the following years. We also expect net working capital outflows to remain negative in the coming years as we forecast some stockpiling of goods.

Adequate liquidity

Liquidity is considered adequate based on current cash reserves (HUF 1.6bn as of YE 2022) in combination with the expectation of solid cash flow. The bond is not scheduled to start amortising until 2026. While we assume the group will partially utilise its credit lines, mainly for inventory financing, we expect liquidity to remain robust in the next few years, with internal liquidity of around 200%.

Balance in HUF m	2023E	2024E	2025E
Unrestricted cash (t-1)	1,630	1,475	1,439
Free operating cash flow	-48	258	512
Short-term debt (t-1)	700	944	1,000
Coverage	**>200%**	**184%**	**195%**

Supplementary rating drivers: -1 notch

We maintain the negative notch attributed to the governance of the group. The transfer of the warehouse ownership to HAD Real Estate (which was spun out in 2022) implies that bond proceeds will be unavailable to investors in 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 publishing an ESG report and performing an analysis of areas where corporate governance falls short.

Long-term debt rating

Senior unsecured debt rating: BB-

Daniella's senior unsecured debt rating has been affirmed at BB-, one notch above the issuer rating. In addition to the HUF 3.5bn bond (ISIN HU0000359872), the recovery assessment assumes the utilisation of credit lines in the amount of HUF 1.3bn. A 'superior recovery' (71%-90%) is expected for outstanding senior unsecured debt in a hypothetical default scenario in 2025 based on the liquidation value method. This level of recovery would normally allow a two-notch uplift, but we have taken a conservative view due to Daniella's expansion plans. These plans are likely to require additional debt issuance so we have limited the uplift to one notch.

In July 2020, Daniella issued a HUF 3.5bn senior unsecured bond (ISIN: HU0000359872) through the Hungarian central bank's Bond Funding for Growth Scheme. The bond proceeds were used for warehouse capex and debt refinancing. The bond has a tenor of 10 years and a fixed coupon of 3%. Bond repayment is in five tranches starting from 2026, with 20% of the face value payable yearly. We note that Daniella's senior unsecured bond issued under the Hungarian central bank's bond scheme has an accelerated repayment clause. The clause requires Daniella to repay the nominal amount (HUF 3.5bn) in case of a rating deterioration (two-year cure period for a B/B- rating; repayment within 10 business days after the bond rating falls below B-, which could have default implications). Bond covenants in addition to the rating deterioration covenant include non-payment, insolvency proceedings, cross-default, pari passu, negative pledge, change of control, dividend payment and additional indebtedness covenants.

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

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