Daniella Kft
Hungary, Retail

SCOPE B STABLE

Corporate profile

Daniella Kft is a Hungarian retailer specialising in the wholesale of electrical goods to businesses active in the construction and refurbishment sectors. The company sells a wide range of goods: from electric cables, installation units and lamps to renewable energy and lightning protection.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
EBITDA/interest cover (x)	15.4x	14.9x	4.4x	6.6x
Scope-adjusted debt (SaD)/EBITDA	2.1x	2.2x	6.0x	4.3x
Scope-adjusted FFO/SaD	45%	41%	11%	18%
FOCF/SaD	-45%	23%	-47%	3%

Rating rationale

The rating is supported by Daniella's relative resilience to the coronavirus pandemic and large shop network. The ability to offer high online sales is a positive rating driver. However, the small absolute size of the company (HUF 18bn based on preliminary 2019 figures) constrains any potential rating uplift. The development of Daniella's warehouse should increase its top line but we expect profitability to remain under pressure. Daniella's financial risk profile is relatively weak but the absence of material short-term debt repayments in the coming years supports liquidity.

Outlook and rating-change drivers

The Outlook is Stable and reflects Scope's expectation of SaD/SaEBITDA stabilising at 3.5x to 4.0x going forward. Scope expects the Covid-19 pandemic to have a significant impact on Daniella's performance. However, YE 2020 metrics will be exceptional and not representative of the group's normal development. Finally, Scope expects a bond issuance of HUF 3.5bn, aimed solely at financing the new warehouse and repaying current loans as stated in the letter of intent or prospectus.

The possibility of a positive rating action is currently seen as remote. It could, however, be warranted by an improved business risk profile, with Daniella becoming an incumbent on the Hungarian market.

A negative rating action could be warranted if SaD/SaEBITDA were to rise above 4.0x on a sustained basis and/or if liquidity were to weaken (e.g. due to a strong revenue decline and high payables). This could occur if Covid-19 impacts the group's top line for longer than expected or if there is a material decrease in profitability. A use of the proceeds which diverges from the one incorporated in Scope's Outlook could also trigger a negative rating action.

Ratings & Outlook

Corporate ratings	B/Stable
Senior unsecured rating	B+

Analysts

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Related Methodology

Corporate Rating Methodology, February 2020

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Rating drivers

Positive rating drivers	Negative rating drivers
• Limited impact of Covid-19 on sector activity • Larger shop network than competitor • On-line sales relatively high for a company of this size • Bond issuance expected to streamline the debt	• Limited size and market share constrain the rating • Expected pressure on financial risk profile in 2020 • Profitability unlikely to significantly increase in the coming years

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Unlikely	• Increase in SaD/EBITDA ratio to 4x on a sustained basis • Bond proceeds used for purposes not included in our Outlook

Financial overview

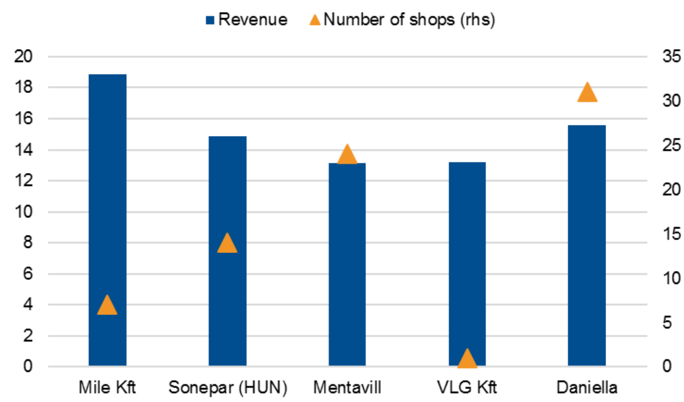
			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020e**	**2021e**
EBITDA/interest cover (x)	15.4x	14.9x	4.4x	6.6x
Scope-adjusted debt (SaD)/EBITDA	2.1x	2.2x	6.0x	4.3x
Scope-adjusted funds from operations/SaD	45%	41%	11%	18%
Free operating cash flow/SaD	-45%	23%	-47%	3%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020e**	**2021e**
EBITDA	794.5	955.7	517.4	837.9
Operating lease payments in respective year	159.9	189.9	200.0	220.0
Other	-	-	-	-
Scope-adjusted EBITDA	954.2	1,145.6	717.4	1,057.9
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020e**	**2021e**
EBITDA	794.4	955.6	517.4	837.9
less: (net) cash interest as per cash flow statement	-30.0	-31.6	-122.5	-109.9
less: cash tax paid as per cash flow statement	-5.3	-43.0	-3.4	-5.5
add: depreciation component, operating leases	127.9	151.9	160.0	176.0
Scope-adjusted funds from operations	886.9	1,033.0	551.4	898.5
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020e**	**2021e**
Reported gross financial debt	1,393.9	1,577.6	3,559.3	3,529.4
add: operating lease obligations	639.3	759.9	800.0	880.0
less: cash and cash equivalents	-59.7	-78.5	-37.2	-145.6
Scope-adjusted debt	1,973.6	2,259.0	4,321.8	4,263.8

Business risk profile: B

Industry risk profile rated BBB

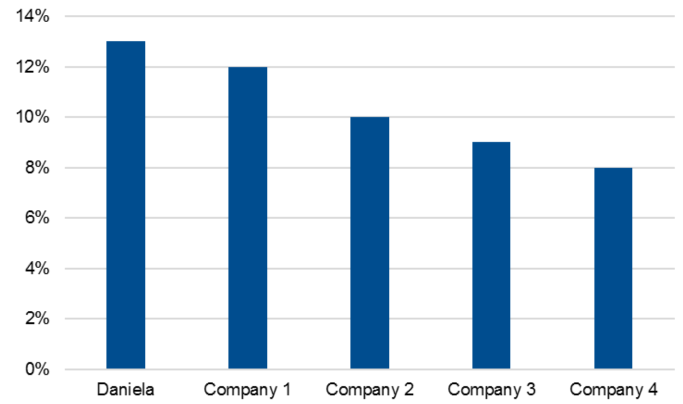
As a wholesaler, Daniella benefits from a BBB industry risk profile, based on medium cyclicality and barriers to entry. Despite significant growth, we see Daniella's underlying sector of activity (construction) as cyclical, which is reflected in the company's competitive positioning.

Figure 1: Daniella's size in term of revenue versus competitors (based on latest published numbers)



Source: Daniella Kft, public information, Scope Ratings

Figure 2: Market share of Daniella (2018 and including acquisition of DI'1) versus competitors



Source: Daniella Kft, Scope Ratings

Market positioning constrained by small absolute size

Daniella's market positioning is the weakest rating driver, constrained by the company's total size in terms of revenues (HUF 18.5bn based on preliminary 2019 results). Based on market share alone, the company is well positioned in Hungary as the largest wholesaler of construction-related goods (if we include the market share acquisition of DL'1, one competitor acquired in 2019). Nonetheless, market share is negligible compared to European peers.

Fierce competition on the Hungarian market is a further negative rating driver. Daniella's main competitors, backed by international companies or financial investors, do actually have slightly lower market shares but are sensibly selling the same products. Daniella's competitive advantage comes from having a larger shop network spread across the country, a high number of on-line sales and a retail alliance founded by Daniella called Fegime, aimed at improving procurement and sharing know-how among international players.

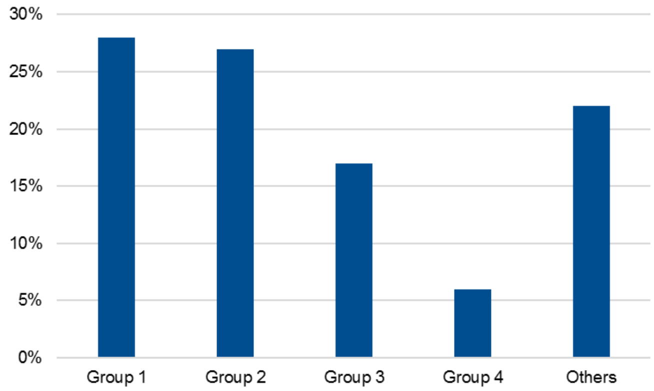
Covid-19 is heavily impacting most non-food retailers. However, we expect the pandemic to affect Daniella less, as numerous commercial real estate owners are using the forced closure of their shops to perform refurbishment and renovation work (which generates around 50% of the company's revenues). We forecast a conservative decrease of 10% in revenue and a gross margin decrease of 22% to 9.5%, to reflect the impact of quarantine on the company.

Going forward, we expect Daniella's top line to recover, assuming the effect of the coronavirus dissipates and the development of a new warehouse to unlock inventory restrictions.

On-line sales support diversification

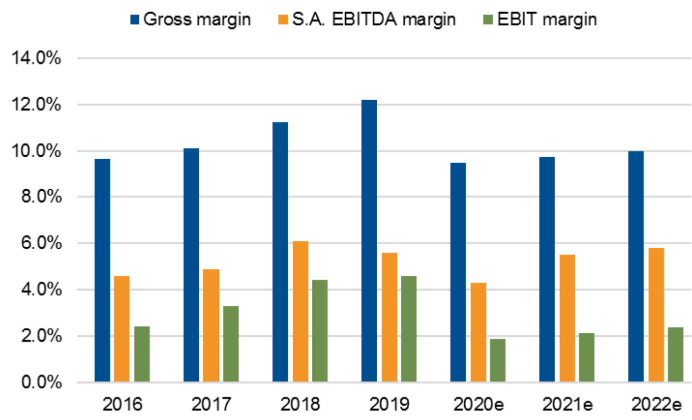
Diversification is relatively weak due to most sales being generated within Hungary (96% of total sales) and the dominance of a single product category (DIY). Supplier and customer diversification is quite high, somewhat decreasing Daniella's dependence on commercial partners. A large share of on-line sales support the sub-rating for diversification.

Figure 3: Sales per customer profiles group (based on YE2018 figures)



Source: Daniella Kft, Scope Ratings

Figure 4: Evolution of the different margins over years



Source: Daniella Kft, Scope Ratings

Low profitability expected to remain at similar levels going forward

With a Scope-adjusted EBITDA margin of 5%-6% in recent years, profitability is also a rating constraint. This is mainly caused by fierce national competition coupled with market actors' strategy of increasing or maintaining their market shares at the expense of higher gross margins. We expect profitability to remain under pressure due to the following factors:

While the new warehouse is expected to increase product availability, Daniella has not expanded its range of products into more profitable areas. Furthermore, most of the goods sold are interchangeable. A rise in the number of products sold is therefore unlikely to have a deep impact on profitability.

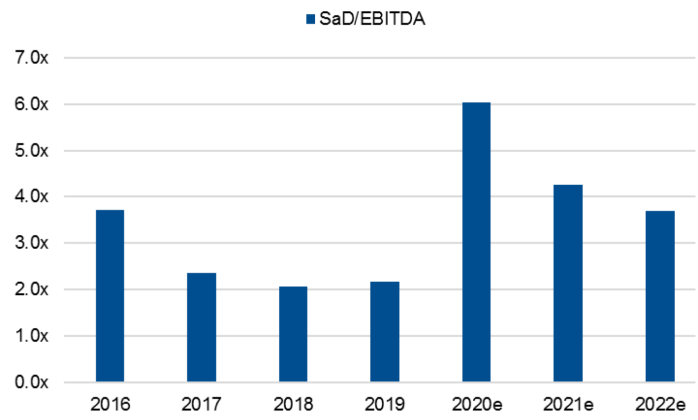
Covid-19 will affect overall profitability because management has limited options to negotiate rent payments with its lessors. The high share of on-line sales should, however, limit the impact of the pandemic on the company.

The deterioration of the Hungarian forint in recent months could also put pressure on the company's gross margin, despite its hedging strategy based on 60-90 forward contracts.

Financial risk profile: B+

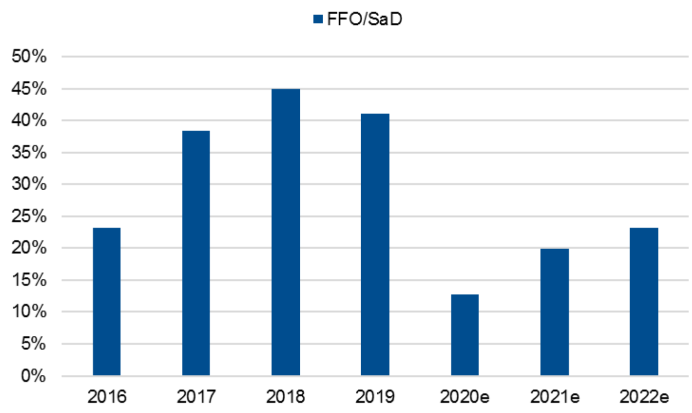
2019 saw an exceptional event in the form of a shareholder buyout. The buyout involved a demerger of HUF 919m worth of assets in 2019, split between HUF 419m in fixed assets and HUF 500m in receivables. The bond issuance is expected to double SaD, despite the fact that HUF 1.5bn will be used to repay the current bank loans. While metrics will be severely affected in 2020, we expect a swift recovery from 2021 on. We expect cash flow generation to increase despite a deepening of net working capital, due to the development of the warehouse which will also be financed by a part of the proceeds stemming from the bond issuance (corresponding to close to HUF 2bn). The remaining HUF 1.5bn will be used for the loan refinancing.

Figure 5: Evolution of the SaD/EBITDA



Source: Daniella Kft, Scope Ratings

Figure 6: Evolution of the FFO/SaD



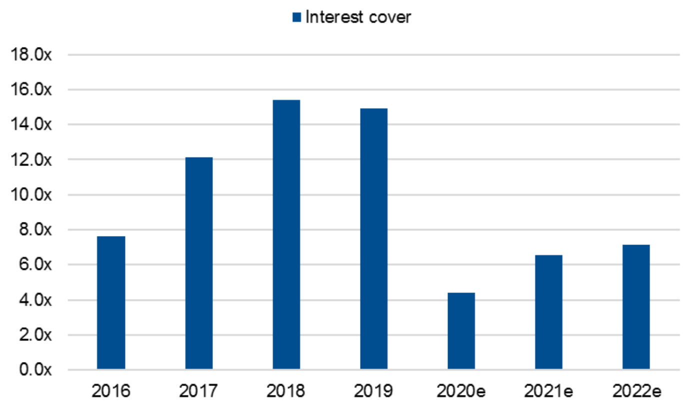
Source: Daniella Kft, Scope Ratings

Leverage expected to recover in 2021

The two-leverage metrics have historically been relatively high with SaD/EBITDA ranging between 2x and 2.5x and funds from operations/SaD of 35% to 45%. We expect a deterioration linked to the impact of Covid-19 on profitability (peaking at 6x for SaD/EBITDA and 13% for funds from operations/SaD), which will be corrected over the following years to SaD/EBITDA of close to 4x and funds from operations/SaD of about 20%.

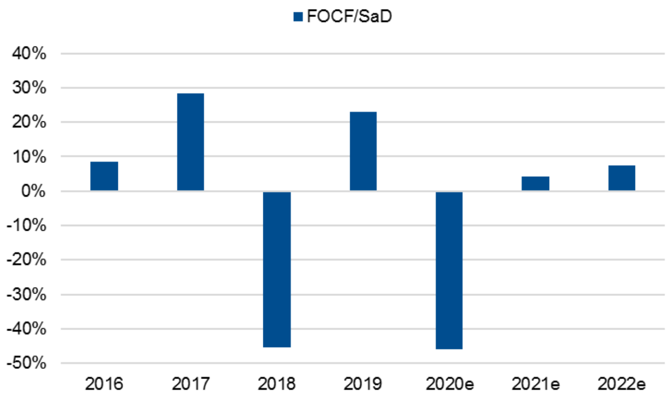
High interest cover, historically above 7x, is the main positive driver for Daniella's financial risk profile. We forecast that interest expenses in 2020 will be higher than the previous years. This is due to the repayment of the last coupons on existing debts added to the coupons on the new bond, leading to a deterioration below 4.5x. Nonetheless, we expect a quick recovery to levels close to 7x by YE 2021.

Figure 7: Evolution of the Interest cover



Source: Daniella Kft, Scope Ratings

Figure 8: Evolution of the FOCF/SaD



Source: Daniella Kft, Scope Ratings

Low FOCF reflects expansion phase

Free operating cash flow (FOCF) generation is relatively low, reflecting considerable capex and a company in expansion. FOCF/SaD has seen significant swings over the last few years, ranging from +30% to -50% (the latter being expected for YE 2020).

Absence of short-term debt supports liquidity

Liquidity has fluctuated sharply in recent years due to heavy variations in FOCF. We expects it to stabilise going forward, thanks to: i) the absence of significant short-term debt – despite the presence of financial leases, the bond will repay outstanding loans; and ii) a new open committed credit line of HUF 0.3bn aimed solely at supporting liquidity.

Daniela liquidity is adequate (excluding the effect of the large CAPEX of 2020). In detail:

Position	YE 2019		YE 2020E	
Unrestricted cash (Y-1)	HUF	59.6m	HUF	78.5m
Free operating cash flow (Y)	HUF	517.7m	HUF	178.2m
open committed credit line (Y-1)	HUF	-	HUF	-
Short-term debt (Y-1)	HUF	711.1m	HUF	-1,988.9m
Coverage		**0.9x**		**-2.7x**

Long-term and short-term debt ratings

Senior unsecured debt: B+

The rated entity plans to issue a HUF 3.5bn senior unsecured corporate bond under the MNB Bond Funding for Growth Scheme. The planned bond has a 2-3% coupon and is amortising after 7 years with a tenor until 2030. Proceeds from the bond are earmarked for refinancing their current loans (HUF 1.5bn) and to acquire and develop a new warehouse (HUF 2bn).

Scope assigns a B+ debt rating to senior unsecured debt issued by Daniella Kft. Scope expects an ‘above average recovery (51-70%) for outstanding senior unsecured debt in a hypothetical default scenario in 2021 based on a liquidation value of HUF 2’021m calculated as a liquidation value.

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