10 September 2024 Corporates

DANIELLA Kereskedelmi Kft.
Hungary, Retail

Key metrics

			Scope estimates	
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	12.7x	6.8x	5.0x	6.4x
Scope-adjusted debt/EBITDA	2.0x	5.6x	4.8x	3.3x
Scope-adjusted funds from operations/debt	46%	18%	17%	25%
Scope-adjusted free operating cash flow/debt	12%	-2%	-2%	8%

Rating rationale

The rating is supported by Daniella's moderate financial risk profile (assessed at BB-), as its relatively stable debt profile, the majority of which has fixed interest rates somewhat mitigates the impact of the adverse market conditions (inflation and tightening of government subsidies) that have led to a slowdown in the group's underlying market. As a result, Daniella's Scope-adjusted EBITDA margin declined significantly in 2023 from 8% to 3%, negatively impacting the group's credit metrics. We expect that these market conditions will continue to put pressure on the group's profitability in 2024. Daniella's business risk profile (assessed at B+) is hindered by the group's small absolute size (revenues of HUF 40.4bn in 2023), one-country focus and volatile operating profitability. 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).

Outlook and rating-change drivers

The Negative Outlook reflects our view that the economic headwinds (weaker demand, challenges in local construction sector) will continue to negatively impact Daniella's operating profitability and its credit metrics. This leads to an assumption of Scope-adjusted debt/EBITDA remaining above 4x. Our base case assumes no further drawing of additional debt, we draw comfort from the covenant structure.

The downside scenario for the ratings and Outlooks would require:

- Scope-adjusted debt/EBITDA remaining above 4.0x on a sustained basis

The upside scenario for the ratings and Outlooks would require:

- Scope-adjusted debt/EBITDA decreasing to 4.0x and below (Outlook revision to Stable)

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
10 Sep 2024	Outlook change	B+/Negative
11 Sep 2023	Affirmation	B+/Stable
9 Sep 2022	Upgrade	B+/Stable

Ratings & Outlook

Issuer	B+/Negative
Senior unsecured debt	BB-

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Related Methodologies and Related Research

Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2024

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

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Fixed interest rate for majority of debt • High online sales for the group's size	• Volatile operating profitability • Significantly increased leverage • Limited size in niche market • Weak diversification due to focus on Hungary

Positive rating-change drivers	Negative rating-change drivers
• Outlook revision to Stable: Scope-adjusted debt/EBITDA decreasing to 4.0x and below	• Scope-adjusted debt/EBITDA remaining above 4.0x on a sustained basis

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	**2021***	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	8.9x	12.7x	6.8x	5.0x	6.4x	9.1x
Scope-adjusted debt/EBITDA	3.1x	2.0x	5.6x	4.8x	3.3x	2.5x
Scope-adjusted funds from operations/debt	28%	46%	18%	17%	25%	35%
Scope-adjusted free operating cash flow/debt	-2%	12%	-2%	-2%	8%	19%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,294	2,778	621	897	1,324	1,795
Operating lease payments	506	629	618	692	761	822
add: dividends from associates	23	40	68	0	0	0
Scope-adjusted EBITDA	**1,823**	**3,447**	**1,308**	**1,589**	**2,085**	**2,617**
Funds from operations in HUF m						
Scope-adjusted EBITDA	1,823	3,447	1,308	1,589	2,085	2,617
less: (net) cash interest paid	-206	-271	-193	-320	-325	-287
less: cash tax paid per cash flow statement	-15	-39	175	-13	-53	-101
Funds from operations (FFO)	**1,602**	**3,137**	**1,290**	**1,256**	**1,707**	**2,230**
Free operating cash flow in HUF m						
Funds from operations	1,602	3,137	1,290	1,256	1,707	2,230
Change in working capital	-854	-1,028	-43	-302	11	172
Non-operating cash flow	0	0	0	0	0	0
less: capital expenditure (net)	-445	-769	-921	-525	-525	-525
less: lease amortization	-405	-503	-494	-554	-609	-658
Free operating cash flow (FOCF)	**-102**	**837**	**-168**	**-125**	**584**	**1,219**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	105	145	69	182	173	122
add: interest component, operating leases	101	126	124	138	152	164
Net cash interest paid	**206**	**271**	**193**	**320**	**325**	**287**
Scope-adjusted debt in HUF m						
Reported gross financial debt	3,683	4,300	4,790	4,790	3,846	3,146
less: cash and cash equivalents	-176	-1,630	-832	-557	-158	-515
add: non-accessible cash	176	1,630	832	557	158	515
add: operating lease obligations	2,023	2,516	2,472	2,769	3,045	3,289
Scope-adjusted debt (SaD)	**5,706**	**6,817**	**7,262**	**7,559**	**6,892**	**6,435**

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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)	Grey leaf
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)	Grey leaf
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)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Red leaf

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: B+

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.

Headwinds lead to revenue decline in 2023

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. In the past years high growth rates were supported by governmental subsidies (e.g. CSOK) but these programmes have since been tightened. On the one hand the current unfavourable market conditions have led to a decline in group revenues in 2023 and we expect that the suppressed demand will continue to negatively affect the group in 2024. On the other 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 primarily based on the group's strategy to shift its focus towards servicing industrial customers.

The rating is limited by the group's absolute size (HUF 40.4bn of revenue in 2023): although Daniella previously has benefited from the fast development of its market, the slowdown in the underlying construction market due to macroeconomic headwinds limits the group's growth potential in upcoming years.

Single-country focus

Daniella's geographical diversification is considered weak, with the majority of sales happening in its home market of Hungary. We consider expansion to neighbouring countries less likely in the short term.

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 8% of sales in 2023.

Sales are conducted through two main channels: Daniella's network of stores and online. Online sales have improved over the last few years, reaching 13% of total sales, however due to the high online price competition, it is unlikely to further increase significantly.

Deteriorated profitability due to strong headwinds

Daniella's business risk profile has been negatively impacted by its deteriorating operating profitability. Due to high inflation rates and tightening of state subsidy programmes, unfavourable market conditions have put pressure on Daniella's profitability in 2023 causing the group's Scope-adjusted EBITDA margin to fall from 8% in 2022 to 3%. This decline illustrates the high volatility of Daniella's profitability, as the group is strongly affected by the high cyclicality of its underlying market.

Based on interim data, the group's revenue growth and Scope-adjusted EBITDA margin has improved as Daniella changed its sales strategy from geographical to project focused after the merger with its subsidiary DL'1 and implemented cost saving measures. The Scope-adjusted EBITDA margin is forecast to slowly increase to 3.5% in 2024E. Over the medium term, operating profitability is expected to increase further towards 5% by 2026E, below the historical average of 6% over the last 5 years.

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.

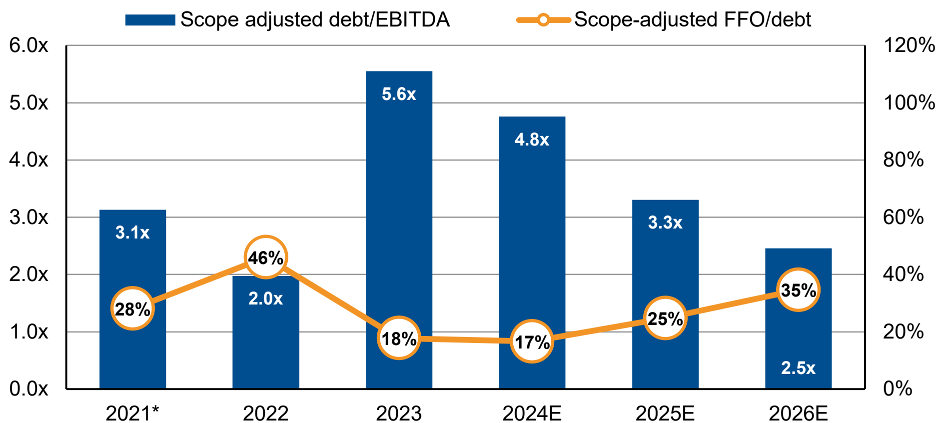
Financial risk profile: BB-

From 2022FY we assess Daniella at a consolidated level: in 2022 HAD Real Estate was carved out of the group due to transparency reasons and in 2024 DL'1 was merged into Daniella as the slowdown of the underlying market no longer supported the two separate brands.

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 2023. 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 in the short-term due to the high interest rate environment and Daniella's bond covenants that limit its issuance of new debt.

Figure 1: Leverage



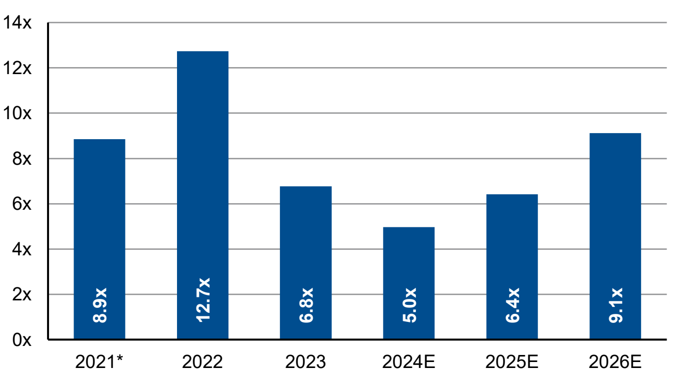
Sources: Daniella, Scope (estimates)

Although Daniella's debt* has remained relatively stable in recent years, the group's low profitability has had a significant negative impact on the 2023 credit metrics. Furthermore, this negative effect is expected to continue to weigh on the 2024 credit metrics due to the forecasted slow recovery of the Scope-adjusted EBITDA margin. Leverage as defined by the Scope-adjusted debt/EBITDA ratio and the Scope-adjusted funds from operations/debt ratio decreased to 5.6x and 18% respectively in 2023 (compared to 2x and 46% in 2022).

Scope-adjusted debt/EBITDA is forecasted to remain above 4x in 2024. The slow recovery in profitability, coupled with the scheduled repayment of the subsidised loan in 2025 and the bond starting in 2026, is expected to significantly improve the credit metrics after 2024: Scope-adjusted debt/EBITDA is expected to decline from 5.6x in 2023 to 2.5x in 2026. The other credit metrics follow a similar trend, as Scope-adjusted funds from operations/debt also forecasted to stagnate before its recovery towards historical levels.

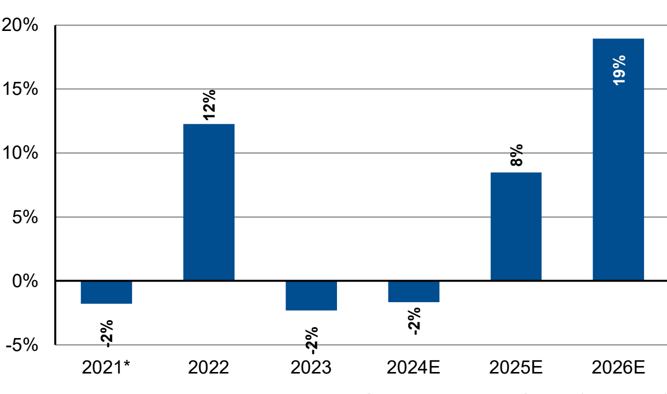
Scope-adjusted free operating cash flow/debt turned negative in 2023 and is forecast to remain negative in 2024E before its expected significant improvement towards 35%. Historically relatively high working capital as well as the continuation of capex plans have put pressure on the credit metric.

Figure 2: Interest cover



Sources: Daniella, Scope (estimates)

Figure 3: Cash flow cover



Sources: Daniella, Scope (estimates)

Scope-adjusted EBITDA interest cover remains the strongest credit metric, benefiting from the fixed coupon of the bond and the state-subsidised Baross Gabor loan. With the refinancing of credit lines in 2022, the majority of the group's debt remain fixed until 2025, partially mitigating the negative impact of lower profitability. After the Baross Gabor loan matures in 2025, interest rates for the short-term credit lines are assumed to be floating, leading to a higher average cost of debt for 2025 and 2026. The metric is forecast to decrease to 5x before recovering towards 9x.

Adequate liquidity

The main liquidity sources are HUF 852m available cash as at December 2023 and the forecasted free operating cash flow. These are insufficient to cover upcoming debt maturities of HUF 1.2m in 2025, including the Baross Gabor loan of HUF 944m. Despite Daniella's internal and external liquidity ratio deteriorating to below 100% in 2025, we still consider the group's liquidity to be adequate. This is because firstly the short-term credit line of HUF 300m is assumed to be automatically renewed as the group holds good banking relationships and secondly as Daniella's inventory levels can also be considered as an alternative source of liquidity.

Balance in HUF m	2023	2024E	2025E
Unrestricted cash (t-1)	1,630	832	557
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	-168	-125	584
Short-term debt (t-1)	700	300	1244
Coverage	**>200%**	**>200%**	**92%**

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-

We have affirmed Daniella's senior unsecured debt rating at BB-, including the HUF 3.5bn (ISIN: HU0000359872) bond, one-notch higher than the issuer rating. This rating is based on a hypothetical liquidation scenario as of end-2026, in which Scope computed an 'above average' recovery for holders of senior unsecured debt based on its assumptions of attainable liquidation values.

In July 2020, Daniella issued a HUF 3.5bn senior unsecured bond 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 rate of 3%. Bond repayment is in five tranches starting from 2026, with 20% of the face value payable yearly. Scope notes that the senior unsecured bond 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). The rating headroom to entering the grace period is 1 notch, therefore Scope sees no significant risk of the rating-related covenant being triggered. Other 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.

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