Vöröskő Ltd
Hungary, Retail

SCOPE BB STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2023**	**2024**	**2024/25**	**2025/26**
Scope-adjusted EBITDA/interest cover	24.3x	27.1x	9.3x	9.5x
Scope-adjusted debt/EBITDA	2.2x	2.1x	1.9x	1.9x
Scope-adjusted funds from operations/debt	43%	46%	54%	47%
Scope-adjusted free operating cash flow/debt	29%	14%	15%	5%

Rating rationale

The rating reflects Vöröskő strong credit metrics and market positioning in Hungary and expectation that profitability and leverage will remain commensurate with our rating case in the medium term. We expect leverage to remain at around 2x, driven by our forecast of no new debt as HUF 2.8bn is still available on the issued bond to finance the current investment phase. The lack of geographical diversification and the company's small scale constrain the rating.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Vorosko will maintain leverage at a level of 2x or below, supported by recovering market demand, driving strong EBITDA generation. The Outlook assumes that gross debt will remain stable as the issuer has no additional financing needs given its strong cash position.

The upside scenarios for the rating and Outlook are (collectively):

- Improved Business Risk Profile with a significant growth in size and geographic reach. A scenario which is considered remote at present
- Scope-adjusted debt/EBITDA sustained below 3x

The downside scenario for the rating and Outlook is:

- Scope-adjusted debt/EBITDA moving towards 4x

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
16 Dec 2024	Affirmation	BB/Stable
15 Dec 2023	Affirmation	BB/Stable
15 Dec 2022	Affirmation	BB/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

Analysts

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Related Methodologies and research

General Corporate Rating Methodology; October 2023

Retail and Wholesale Rating Methodology; April 2024

ESG in Credit Ratings – General Considerations; February 2024

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong credit metrics supported by the absence of bank loans (excluding MNB Bond and shop-related leases) • Strong liquidity • Strong market positioning within Hungary (top three) • Stable Scope-adjusted EBITDA despite recent market downturn	• Small size compared to international competitors. • Geographical outreach limited to a single country limiting the size of the group and enhancing the correlation to the Hungarian economy • Higher inventory going forward, expected to put pressure on free operating cash flow generation

Positive rating-change drivers	Negative rating-change drivers
• Improved business risk profile with a significant growth in size and geographical scope combined with Scope-adjusted Debt/EBITDA below 3x.	• Scope-adjusted debt/EBITDA moving towards 4x

Corporate profile

Established in 1996 as a local purchasing cooperating brand, Vöröskő has since developed itself in the Hungarian market as one of the main consumers electronic retailers. By joining in 2001 the purchasing alliance of Euronics, the group has increased its international branding and got a better access to international suppliers. Vöröskő has the largest number of stores dedicated to electronic goods in Hungary cementing a leadership position in this country. The group currently employs more than 900 employees.

Financial overview

Scope credit ratios	2022	2023	2024	Scope estimates 2024/25E	2025/26E	2026/27E
Scope-adjusted EBITDA/interest cover	11.9x	24.3x	27.1x	9.3x	9.5x	10.4x
Scope-adjusted debt/EBITDA	2.3x	2.2x	2.1x	1.9x	1.9x	1.7x
Scope-adjusted funds from operations/debt	39%	43%	46%	54%	47%	52%
Scope-adjusted free operating cash flow/debt	-48%	29%	14%	15%	5%	11%
Scope-adjusted EBITDA in HUF m						
EBITDA	3,096	3,086	3,042	3,298	3,463	3,636
Operating lease payments	2,237	2,675	2,616	2,694	2,775	2,859
Other items	760	125	(163)	1	-	-
Scope-adjusted EBITDA	**6,093**	**5,886**	**5,495**	**5,993**	**6,238**	**6,495**
Funds from operations in HUF m						
Scope-adjusted EBITDA	6,093	5,886	5,495	5,993	6,238	6,495
less: (net) cash interest paid	(514)	(242)	(202)	(646)	(653)	(627)
less: cash tax paid per cash flow statement	(88)	(117)	(114)	(106)	(115)	(123)
Other changes	-	-	-	930	-	-
Funds from operations (FFO)	**5,491**	**5,527**	**5,179**	**6,171**	**5,470**	**5,745**
Free operating cash flow in HUF m						
Funds from operations	5,491	5,527	5,179	6,171	5,470	5,745
Change in working capital	(6,591)	2,462	(223)	(886)	(923)	(404)
less: capital expenditure (net)	(3,853)	(2,106)	(1,229)	(1,400)	(1,734)	(1,784)
less: lease amortisation	(1,790)	(2,140)	(2,093)	(2,156)	(2,220)	(2,287)
Less: other items			(9)			
Free operating cash flow (FOCF)	**(6,743)**	**3,743**	**1,625**	**1,729**	**593**	**1,270**
Net cash interest paid in HUF m						
Net cash interest per cash flow statement	67	(293)	(321)	107	98	56
add: interest component, operating leases	447	535	523	539	555	571
Net cash interest paid	**514**	**242**	**202**	**646**	**653**	**627**
Scope-adjusted debt in HUF m						
Reported gross financial debt	7,139	7,154	7,109	7,129	7,134	6,439
less: cash and cash equivalents[1]	(2,175)	(5,029)	(6,192)	(6,426)	(6,624)	(6,799)
add: operating lease obligations	8,946	10,700	10,463	10,777	11,101	11,434
Scope-adjusted debt (SaD)	**13,910**	**12,825**	**11,380**	**11,480**	**11,611**	**11,074**

[1] Excludes HUF 35m restricted cash for daily operations

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Environmental, social and governance (ESG) profile[2]

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 consideration

Vöröskő's home market has a country retail strength of 'high-medium'. As such, we expect ESG considerations to be part of the long-term strategy.

In the ESG analysis, reputational risk is a major criterion for the social aspect of a retailer. For example, a product or labour management that has a negative social impact may prompt consumer boycotts, affecting sales, margins and inventory value.

Discretionary retailers, such as Vöröskő, are 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 group appears to be aware of its ESG engagement. The MNB bond issuance was aligned with the 'green bond principles' and is therefore labelled as a green bond. On more operational matters, the group is well positioned in term of recycling by taking back old devices and disposing of them. These features, while present in many larger stores in western Europe, is a good ESG commitment for a country in the CEE.

[2] 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: BB

Vöröskő is a discretionary retailer, an industry segment that we consider having medium cyclicality, low entry barriers and low substitution risk.

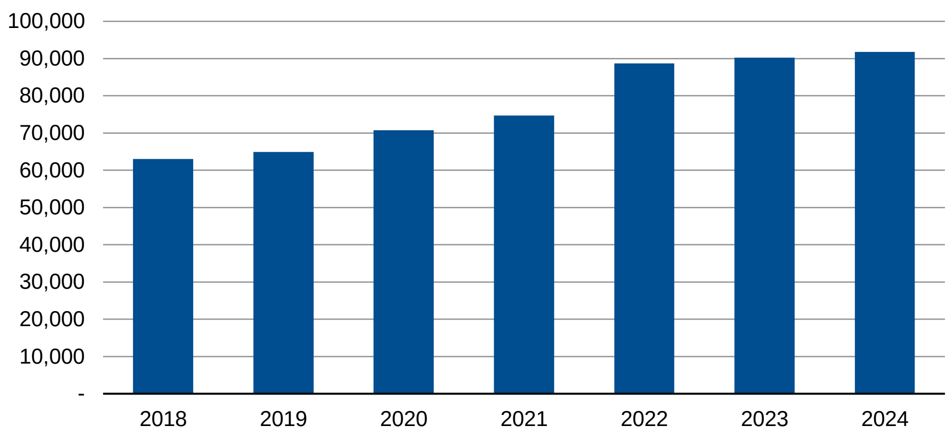
Strong market share in Hungary …

The issuer's business risk profile reflects the strong market position in Hungary, where Vöröskő is one of the top three retailers of consumer electronics. While the market is very fragmented, we consider the group market share (around 15% in FY 2024) to be relatively well protected thanks to the solid presence both online and through brick-and-mortar format. Besides, entering the consumer electronics segment requires investing in large warehouses and stores and developing an effective online channel, which make it onerous for new entrants. Vöröskő's largest competitor is the local subsidiary of MediaMarkt (Ceconomy group, BBB-/Stable), which with HUF 161bn revenue in 2023 is double in size, while the third major company is the online only retailer Extreme Digital – eMag (which in FY 2023 reported HUF 79bn in revenue). The remaining players are significantly smaller.

…but relatively small scale remains a constraint

Vöröskő's size (HUF 92bn in FY 2024) constrains its potential rating, despite its comfortable share of the national market. Its small size is a natural result of the group focusing solely on Hungary; it can only grow as much as the Hungarian market grows. The contribution from potential entry into new markets is not expected to be significant in the medium term.

Figure 1: Revenue evolution (HUF m)

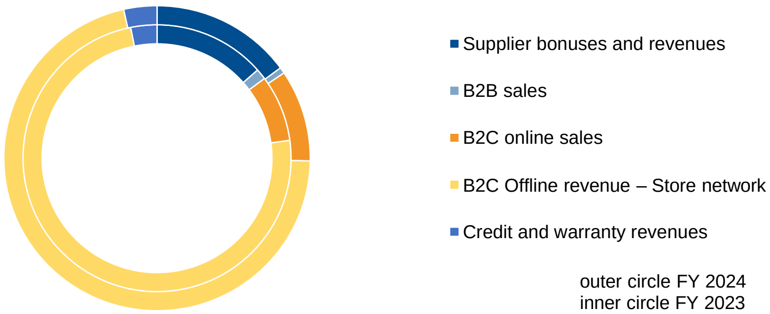


Sources: Vöröskő, Scope estimates

Good product diversification

Product diversification is deemed as good. Vöröskő offer a wide range of products within the household appliance segment and the consumer good electronics. The latter are more sensitive to intra-year seasonality (Black Friday, Christmas), technological changes and logistic disruption as often shipped from distant suppliers. Going forward we expect Vöröskő to continue to offer a diversified range of products supported by the high storage capacity. Nonetheless we highlight a certain sales concentration in the large and small domestic appliance segments (59% in FY 2024). The concentration is confirmed by the supplier's diversification, as the top 5 suppliers (LG, Gorenje, Samsung, Electrolux and Whirlpool) accounts for 45% of revenue (FY 2024); nonetheless the issuer strong and long term relationship with the main suppliers, with business relationship dating back on average 25 years, has ensured increasing bonuses and favourable average payment terms, thus we don't see the concentration as credit negative.

Figure 2: Revenue by segment



Sources: Vöröskő, Scope

Good e-commerce presence drives diversification assessment

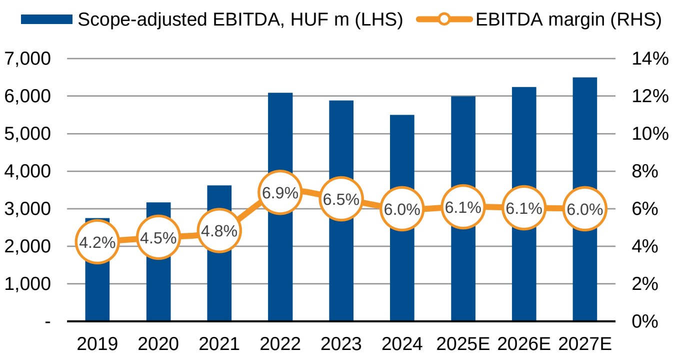
Channel diversification is a positive rating driver. Driven by high consumer acceptance, consumer electronics retailers have often been pioneers in online sales, leading to a relatively high total online sales contribution in comparison with other retailers. Vöröskő benefits from a high percentage of online sales (11% at FY 2024, increasing from 9% in FY 2023). We expect the group to grow its online sales in the coming years, as deliveries, automation and web-engine have been improved in the course H2 2022. We consequently consider Vöröskő to be well positioned in this segment with limited risks.

Resilient profitability

While in 2018-2021, profitability, measured by the Scope-adjusted EBITDA margin, has been on average 4.3%, constrained by the relatively low pricing power and gross margins, the ratio improved to 6% in FY 2022. In the most recent years, despite macroeconomic downturn, the issuer managed to keep stable profitability, thanks to of increased gross margins as well as Vöröskő's investments in IT development and warehouse, which led to a better cost structure. In FY 2024 the resilient profitability was driven by i) Vöröskő's recent improvement of its bricks-and-mortar strategy to increase customer loyalty through better availability of popular goods, emphasis on loyalty cards (which allow it to anticipate consumer needs) and financing services and; ii) five new stores opening in 2024.

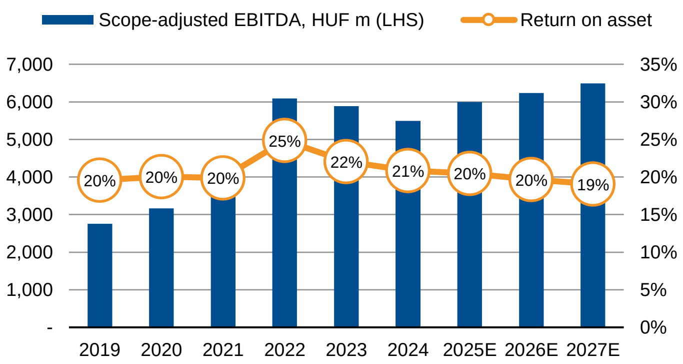
In our base case, we expect profitability to remain at around 6%, as demand for consumer electronics is expected to pick up after two years of stagnation and the issuer may be able to slightly increase gross margins. As Vöröskő will change the strategy with some of its main suppliers (Samsung, Gorenje, TLC, Hisense) by converting bonuses on the purchase of goods into discounts on purchases, the issuer is expected to benefit from this change in terms of the cost of goods sold.

Figure 3: Scope-adjusted EBITDA margin



Sources: Vöröskő, Scope estimates

Figure 4: Scope-adjusted EBITDA return on asset



Sources: Vöröskő, Scope estimates

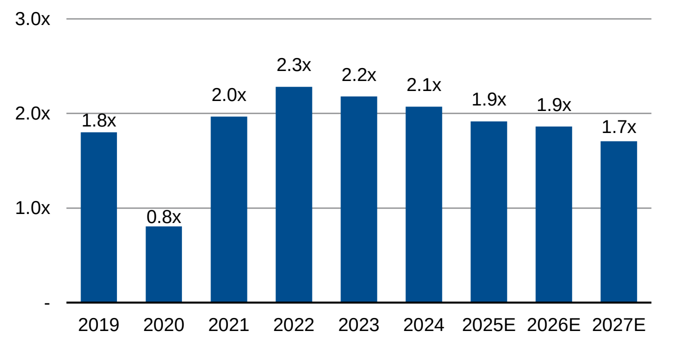
Financial risk profile: BB+

The robust and improving financial metrics as well as the solid liquidity drive the issuer rating.

Low leverage

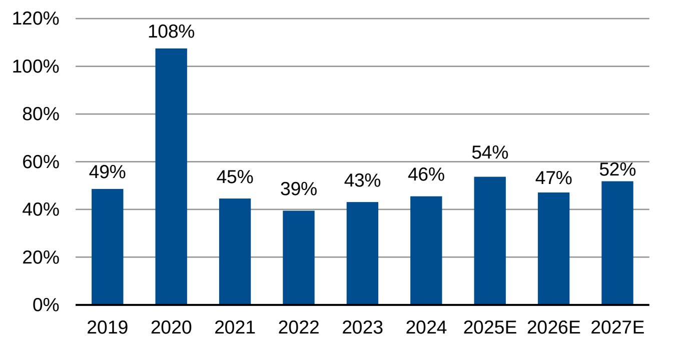
The leverage, measured by the Scope-adjusted debt/EBITDA has been constantly improving driven by the low debt and the EBITDA growth as well as the significant cash generation. In our scenario, we expect leverage to remain at around 2x or lower, driven by the stable financial debt. As HUF 2.8bn still remain available in bond funds, we do not expect any new debt issuance in the medium term. Likewise, we expect Scope-adjusted funds from operations on debt to remain between 45% and 55%.

Figure 5: Scope-adjusted Debt/EBITDA



Sources: Vöröskő, Scope estimates

Figure 6: Scope-adjusted funds from operations/debt



Sources: Vöröskő, Scope estimates

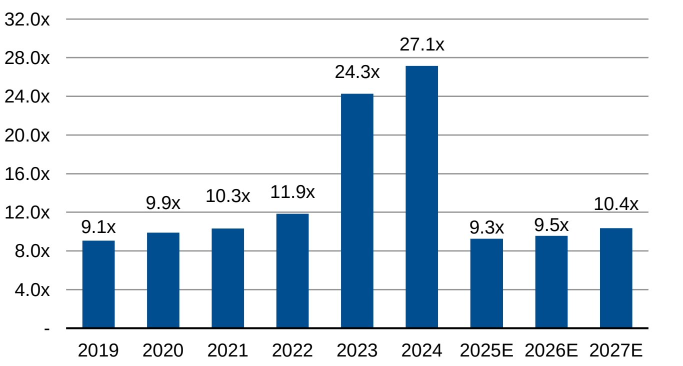
No exposure to interest rate risk

The absence of floating interest rate debt supports the robust debt protection, measured by the Scope-adjusted EBITDA interest cover. Beside the bond issued in 2022, Vöröskő has no significant bank debt and in recent years the high interest rate on the Hungarian cash deposits almost fully offset the interest payments on the newly issued bond. Going forward we expect deposit rates to be less favourable, nonetheless with no new debt in the forecast period, the interest cover is likely to remain between 9x and 10x.

Volatile cash flow cover

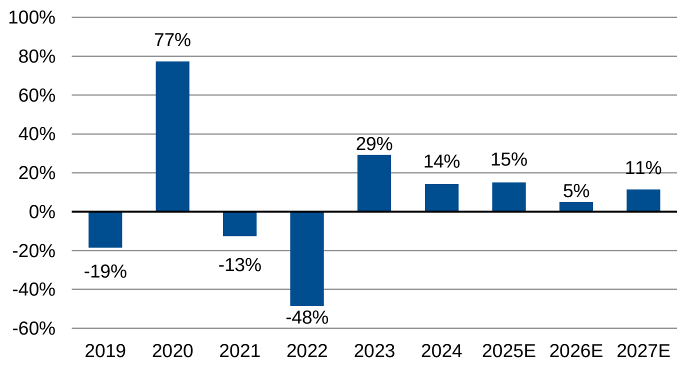
Free operating cash flow has been historically volatile as a result of working capital volatility and high capex in FY 2021/22 and FY 2022/23. While FY 2022/23 was an outlier as the positive free operating cash flow was the result of the issuer's strategy to sharply reduce inventory levels, going forward we expect cash flows to remain positive as the issuer has ended its intensive capex plan but to be in the range of 5% to 15% as lower capex will be partially offset by increasing inventory levels due to the issuer's strategy to return to building inventory to focus on increasing market share.

Figure 7: Scope-adjusted EBITDA interest cover



Sources: Vöröskő, Scope estimates

Figure 8: Scope-adjusted free operating cash flow/debt



Sources: Vöröskő, Scope estimates

Adequate liquidity

Liquidity is adequate given the absence of short-term obligations in the near term (the bond will start amortizing in 2027 at a 10% rate) and significant cash available (HUF 6.2bn as of June 2024). The liquidity is additionally supported by HUF 5.3bn unused overdraft credit line expiring in 2027.

Vöröskő senior unsecured bonds issued under the Hungarian National Bank's Bond Funding for Growth Scheme have a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 7bn) if the debt rating of the bonds stays below B for more than two years (grace period) or drops below B- (repayment within 90 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is 3 notches. We see no significant risk of the rating-related covenant being triggered.

Balance in HUF m	2024	2025	2026
Unrestricted cash (t-1)	5,064	6,227	6,461
Open committed credit lines (t-1)	5,300	5,300	5,300
Free operating cash flow	1,625	1,729	593
Short-term debt (t-1)	36	-	-
Coverage	**>200%**	**>200%**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB

We affirm the BB rating of Vöröskő's senior unsecured debt. The assessment considers a hypothetical default scenario in 2027 and is based on the ongoing concern. The HUF 6bn enterprise value that is available to creditors compares to HUF 5.3bn credit line (assumed to be fully overdrawn) and HUF 7bn senior unsecured bond and results in an average recovery of 50%.

In January 2022, Vöröskő issued a HUF 7bn senior unsecured bond (ISIN: HU0000361241) through the Hungarian Central Bank's Bond Funding for Growth Scheme. The bond proceeds were used for HUF 4.2bn for purchasing, opening and renovation of warehouses and stores. The bond has a tenor of 10 years and a fixed coupon of 4.75%. Bond repayment is in six tranches starting from 2027, with 10% of the face value payable yearly, and 50% balloon payment at maturity.

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