Duna House Holding Nyrt. Hungary, Business Services

SCOPE BB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2022	2023	2024E	2025E
Scope-adjusted EBITDA/interest cover	Net cash interest		16.3x	15.9x
Scope-adjusted debt/EBITDA	3.1x	4.8x	3.3x	2.5x
Scope-adjusted funds from operations/debt	24%	17%	19%	32%
Scope-adjusted free operating cash flow/debt	71%	21%	30%	28%

Rating rationale

The rating on Duna House continues to reflect its leading market position as a real estate broker in Hungary and Poland as well as improved diversification following the acquisition of Hgroup, one of the top three loan brokerage companies in Italy. Duna House's business risk profile is negatively impacted by the company's small size in highly fragmented markets and weakening profitability in recent years. It is also constrained by low service strength because it typically offers one-off transactions, which lessens the possibility of recurring revenues. Scope-adjusted EBITDA declined as predicted in 2023 but is expected to rebound in 2024 amid a market turnaround in Hungary and Poland as well as a more efficient operating structure in Italy. This should bring leverage back to below 4x, following an increase to 4.8x in 2023.

Duna House's asset-light business ensures strong interest coverage, supporting the rating. However, the company's expansion strategy and real estate development business has driven leverage up in recent years and made cash flows volatile. Liquidity is adequate as the only substantial debt amounts are two bonds to be repaid from 2026.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Duna House will maintain strong interest cover and Debt/EBITDA will return to below 4x in 2024 after its peak in 2023 due to an anticipated recovery in EBITDA, amid the market turnaround in Poland and Hungary as well as a more efficient cost structure in Italy.

A positive rating action is seen as remote but would require further significant growth of the business leading to improved diversification and strengthening of the business risk profile while maintaining a Scope-adjusted debt/EBITDA ratio below 3.0x on a sustained basis.

A negative rating action would be warranted if the Scope-adjusted debt/EBITDA were to remain above 4.0x in 2024. This could be caused by weaker-than-expected revenue due to overall transaction market weakness or debt-funded investments substantially beyond Scope's base case.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
17 Jun 2024	Affirmation	BB-/Stable
16 Nov 2023	Affirmation	BB-/Stable
14 Nov 2022	Affirmation	BB-/Stable

Ratings & Outlook

Issuer	BB-/Stable
Senior unsecured debt	BB-

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Related Methodologies:

General Corporate Rating Methodology; October 2023

European Business and Consumer Services Rating Methodology; January 2024

European Real Estate Rating Methodology; March 2024

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong position in Central and Eastern European real estate and loan brokerage markets (ranked first in Hungary, second in Poland) and in the Italian loan brokerage market (top three) • Asset-light business model, hence little financial debt and moderate financial leverage • Diversified across several real estate-related services and countries; high customer granularity • Most debt at fixed rates	• Dependency on general transaction dynamic in the real estate and loan markets in Central and Eastern Europe and Italy, with few non-transaction-based recurring revenues • Fierce competition in online real estate brokerage • International expansion via M&A bearing execution and integration risks, particularly given the size and complexity of the recent acquisition in Italy • Volatile cash flows

Positive rating-change drivers	Negative rating-change drivers
• Significant growth leading to improve diversification and strengthening of the business risk profile combined with Scope-adjusted debt/EBITDA sustained at below 3.0x	• Scope-adjusted debt/EBITDA sustained at above 4.0x

Corporate profile

Duna House Holding Nyrt. was founded in 1998 as a real estate company based in Budapest, providing consulting services to foreign investors. In 2003 the company adopted a franchise business model, leading to its expansion across Hungary. In 2004, Duna House further expanded to provide the full range of services to seller and buyers, which today includes real estate brokerage, loan brokerage, loan insurance, other financial services and property appraisals. The company is market leader in real estate in Hungary and Poland, among the top three in loan brokerage in Hungary and in Italy, and number five in Poland. Duna House is also present in the Czech Republic.

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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)	Grey leaf

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

ESG assessment is neutral

No material ESG risk has been identified.

As a real estate agency, the major ESG risks Duna House is exposed to are typically regulatory, reputational and governance-related. Environmental risks are not significant given the asset-light business model. However, ESG risks could materialise from a mis-selling of loans (social) and the current lack of independent oversight of the board (governance).

We acknowledge a good level of transparency and the timely disclosure of financial information.

[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.

Financial overview

			Scope estimates		
Scope credit ratios	**2022**	**2023**	**2024E**	**2025E**	**2026E**
Scope-adjusted EBITDA/interest cover	Net cash interest	Net cash interest	16.3x	15.9x	15.0x
Scope-adjusted debt/EBITDA	3.1x	4.8x	3.3x	2.5x	2.0x
Scope-adjusted funds from operations/debt	24%	17%	19%	32%	39%
Scope-adjusted free operating cash flow/debt	71%	21%	30%	28%	32%
Scope-adjusted EBITDA in HUF '000s					
EBITDA	4,450,453	3,159,634	4,425,226	4,172,810	4,379,141
less: EBITDA from development project	(1,000,000)	(819,000)	(1,000,000)	-	-
Recurring associates' dividends received	194,500	91,500	-	-	-
Scope-adjusted EBITDA	**3,644,953**	**2,432,134**	**3,425,226**	**4,172,810**	**4,379,141**
Funds from operations in HUF '000s					
Scope-adjusted EBITDA	3,644,953	2,432,134	3,425,226	4,172,810	4,379,141
less: (net) cash interest paid	64,395	390,765	(210,256)	(261,823)	(292,584)
less: cash tax paid per cash flow statement	(1,006,956)	(837,860)	(512,164)	(569,338)	(619,679)
Other non-operating charges before FFO	-	-	(505,364)	-	-
Funds from operations (FFO)	**2,702,392**	**1,985,039**	**2,197,441**	**3,341,649**	**3,466,878**
Free operating cash flow in HUF '000s					
Funds from operations	2,702,392	1,985,039	2,197,441	3,341,649	3,466,878
Change in working capital	5,320,190	311,909	1,860,384	220,347	19,456
less: capital expenditure (net)	510,665	601,998	(200,000)	(200,000)	(200,000)
less: lease amortisation	(236,731)	(440,467)	(440,467)	(440,467)	(440,467)
Non-operating cash flow	(214,439)				
Free operating cash flow (FOCF)	**8,082,077**	**2,458,479**	**3,417,359**	**2,921,529**	**2,845,867**
Net cash interest paid in HUF '000s					
Net cash interest per cash flow statement	(64,395)	(390,765)	210,256	261,823	292,584
Net cash interest paid	**(64,395)**	**(390,765)**	**210,256**	**261,823**	**292,584**
Scope-adjusted debt in HUF '000s					
Reported gross financial debt	16,583,460	15,742,300	15,523,300	15,523,300	14,203,300
less: cash and cash equivalents[2]	(10,738,914)	(8,293,149)	(8,377,018)	(10,281,324)	(10,634,640)
add: non-accessible cash	5,462,007	4,146,575	4,188,509	5,140,662	5,317,320
Scope-adjusted debt (SaD)	**11,306,553**	**11,595,726**	**11,334,791**	**10,382,638**	**8,885,980**

[2] Netting of cash is generally only applicable to ratings in the BB category or higher and only if the cash is permanent and accessible. When calculating Scope-adjusted debt, we have only netted 50% of the available cash for the period 2022-2026E, as we assume that some of the available cash will be used for future acquisitions and/or property development activities. This results in a difference from the unrestricted cash reported in the liquidity section (page 7) where we consider "unrestricted cash' to be total cash minus non-accessible cash.

Business risk profile: BB-

Industry risk profile: BBB-

Duna House is a Hungarian real estate agency whose services include loan brokerage, insurance, real estate brokerage, real estate management and property appraisal. The company has also historically been active in real estate development but will mostly be exposed to business services in the future. Our methodology on business services indicates a BBB industry risk profile sub-score, based on the asset-light business model and specialised workforce. We applied a blended approach to account for the higher industry risk of real estate developers, which translates in a BBB- industry risk profile.

Leading market position in Hungary, Poland and Italy…

The issuer's market position is credit-positive. Duna House has the leading platform in Poland and is one of the two largest real estate brokerage platforms in Hungary (the other is Otthon Centrum's, whose size is similar in terms of listings, offices and salespersons). With the recent acquisition of Hgroup, Duna House is now also a top three loan broker in Italy.

… but relatively small size

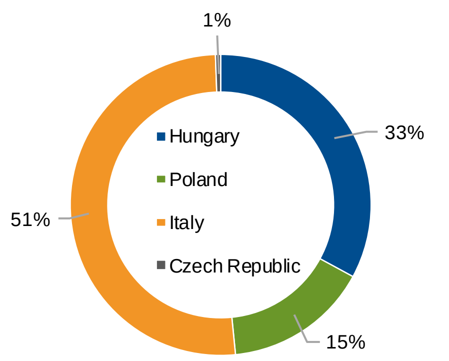
All the markets in which Duna House operates are very fragmented. This implies little pricing power but also allows for a potential increase in market share if the real estate and loan brokerage sector continues to consolidate. We expect Italy to be a major growth driver going forward, despite a relatively weak start in 2024 as consumer confidence is still low in the market. While Hgroup still has little penetration in real estate loan brokerage, the recently signed partnership with Professione Casa, a major Italian real estate agency, is expected to bring in customers. With the agreement, Hgroup purchased a 10% stake in Professione Casa and will exclusively provide loan brokerage services to Professione Casa clients for a fee.

Improved geographical and product diversification

Duna House's business risk profile also benefits from greater diversification following the Hgroup acquisition, which reduced the dependency on two similar markets. Going forward, we expect even more revenues from Italy, driven by the Professione Casa partnership. Hgroup has now also expanded its range of services, with revenues not only from real estate but also salary-backed loans, personal loans and insurance brokerage.

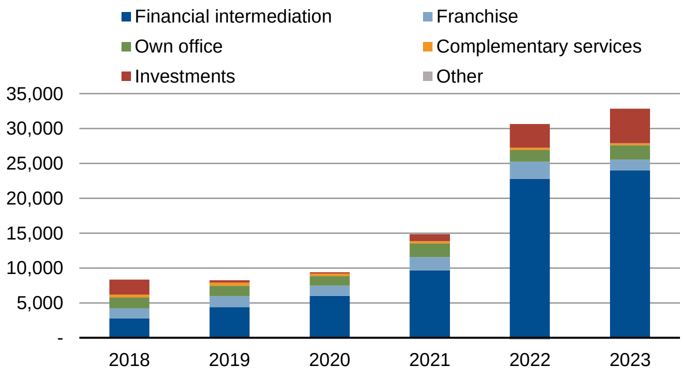
Nonetheless, group revenue will become increasingly dependent on Italy. In 2023, this market represented 51% of revenue. Customer granularity is very high as the issuer only targets retail clients.

Figure 1: Geographical diversification by revenue (2023)



Sources: Duna House, Scope

Figure 2: Revenue breakdown per type of service (HUF m)



Sources: Duna House, Scope

Profitability weakened as a result of the market downtrend…

Duna House's operating profitability, as measured by the Scope-adjusted EBITDA margin, has been in the 15% to 30% range in recent years. Despite growing revenues, EBITDA margins have been declining for years as the aggressive expansion policy has penalised efficiency on the cost side. The 2% revenue growth in 2023 can be explained by the full consolidation of the Italian business (which only represented nine months in

2022). The EBITDA margin has continued to decline to around 8% (from 12.6% in 2022) due to inflation and rising operating costs.

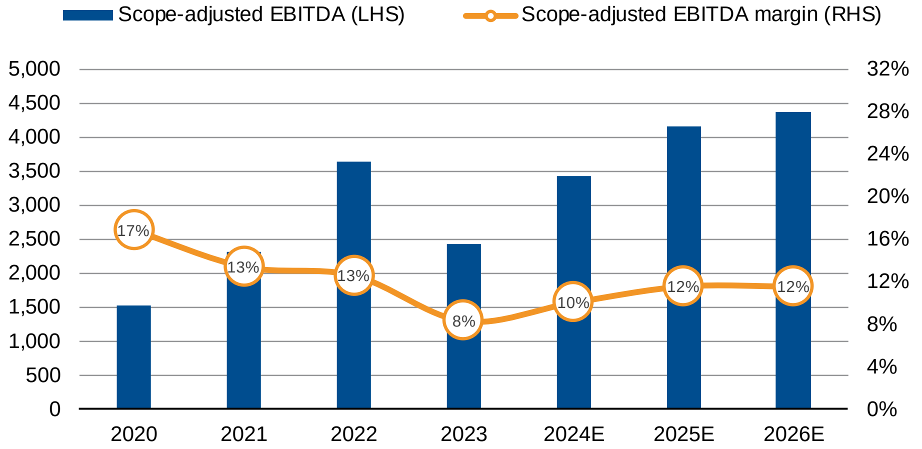
…but already in a recovery phase

We expect the margin to recover to between 10-12% in the future. This will be driven by a recovery in all markets and efficiency measures in the Italian offices.

- Poland: Volumes grew strongly in Q4 2023 thanks to the introduction of government subsidies for first-time buyers. In Q1 2024 the trend slowed to 4.8% QoQ growth. Management expects volumes to maintain this growth rate.
- Hungary: The energy crisis and high inflation in H1 2023, led to a drop in consumer confidence. In H2 2023, buyers partially regained confidence as inflation became less significant and interest rates started to fall. In Q1 2024, loan volumes continued to grow at a rate of 18% compared to Q4 2023. Management expects further growth based on loan applications.
- Italy: The market in Italy remains challenging. Consumers are still reluctant to buy; however, Duna House expects to increase its market share driven by the collaboration with Professione Casa. In Q1 2024, volumes decreased by 7.2% compared to Q4 2023.

Our assumption that EBITDA will recover is supported by the Q1 2024 results, which show HUF 996m in reported core EBITDA (excluding development business), which is an increase by 141% YoY.

Figure 3: Scope-adjusted EBITDA (HUF m) and Scope-adjusted EBITDA margin[3]



Sources: Duna House, Scope estimates

Service strength is low

Service strength is a negative rating driver. While Duna House has a well-established brand in its three main countries of operation, the nature of the services it provides (mostly one-off) provide limited opportunities to established long-term client relationships. In addition, the high competition in the brokerage markets makes it easier for buyers to switch from one provider to the other, depending on the offer. Service strength could be improved by a focus on cross-selling opportunities, especially insurance packages, which source recurring revenues and long-term clients.

Financial risk profile: BB

We continue to assess Duna House's financial risk profile at BB. This reflects strong interest coverage and liquidity, but also volatile leverage and cash flows amid the expansion strategy and the non-core real estate development business.

[3] The Scope-adjusted EBITDA margin excludes the EBITDA and revenue from the real estate development sale as this is considered a non-core business.

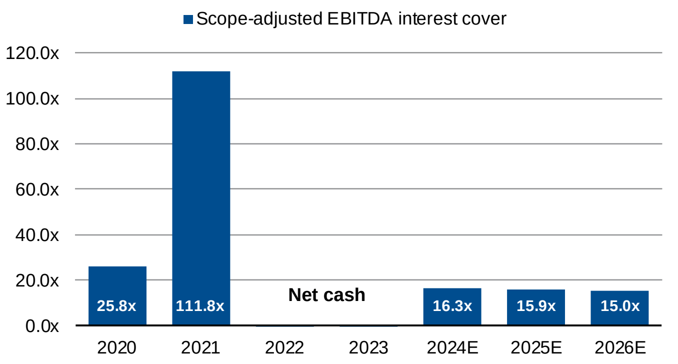
Robust interest coverage

Scope-adjusted EBITDA interest cover has been robust over the years thanks to the asset- and debt-light business model. Favourable interest rates on cash deposits are also yielding substantial net interest income. Interest coverage should remain largely above 10x even if the interest rate falls going forward.

Historically volatile cash flow

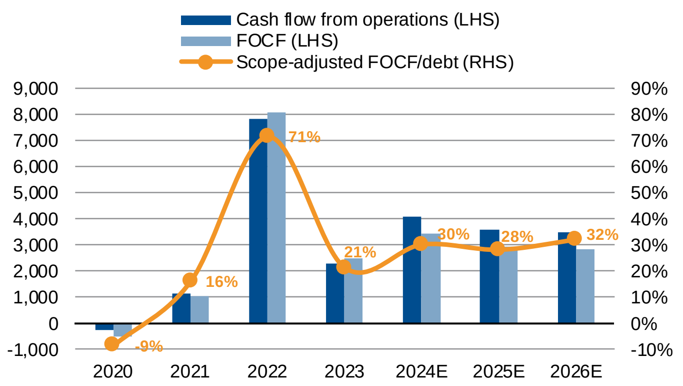
While EBITDA and FFO have been relatively stable, FOCF has been more volatile. This was due to real estate development activities (mainly Forest Hill, Hungary), from 2019. In 2022, the sale of some of the Forest Hill units generated significant cash flow and caused net working capital to decrease. Cash flow will continue to depend on developments, but we anticipate less volatility as no significant projects are in the pipeline.

Figure 4: Scope-adjusted EBITDA interest cover



Sources: Duna House, Scope estimates

Figure 5: Cash flows (HUF m)



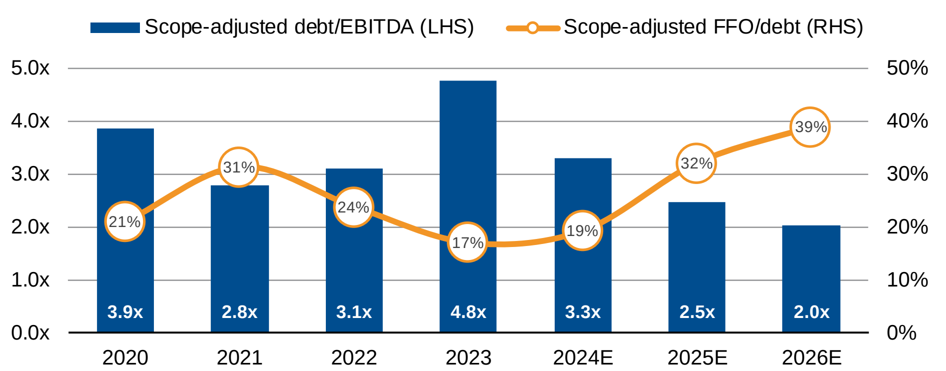
Sources: Duna House, Scope estimates

Lower EBITDA to put temporary pressure on leverage…

…but stable outlook in the medium term

Leverage has been volatile, driven by development activity and lower EBITDA recently. Scope-adjusted debt/EBITDA rose to above 4x in 2023 as a result of weakening EBITDA. However, we expect leverage to recover in 2024 as EBITDA rises, supported by the market upswing and the cost efficiency measure in Italy. We do not expect an increase in debt as the issuer has sufficient funds to cover potential investments. Duna House is not planning any new developments and the Forest Hill project will not require additional expenditure as it is in the sales phase. Duna House reported HUF 500m of restricted cash, but we consider 50% of the cash as restricted to cover potential acquisition and working capital needs.

Figure 6: Leverage



Sources: Duna House, Scope estimates

Adequate liquidity

Liquidity is adequate, supported by strong available cash (around HUF 8.2bn at year-end 2023) and given the absence of significant short-term debt. One of the two bonds will start amortising in 2026 at a rate of 20%, which is largely coverable by available cash and cash flow generation.

We highlight that Duna House's senior unsecured bonds issued under the Hungarian National Bank's Bond Funding for Growth Scheme has a covenant requiring the accelerated repayment of the outstanding nominal debt amount (HUF 12.9bn) if the debt rating of the bonds stays below B+ for more than two years (grace period) or drops below B- (accelerated repayment within 15 days). Such a development could adversely affect the company's liquidity profile. The rating headroom to entering the grace period is 1 notch. We therefore see 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 and negative pledge.

Balance in HUF m	2023	2024E	2025E
Unrestricted cash (t-1)	10,738	8,293	8,377
Open committed credit lines (t-1)	-	-	-
Free operating cash flow	2,458	3,417	2,922
Short-term debt (t-1)	357	309	90
Coverage	**>200%**	**>200%**	**>200%**

Long-term debt rating

Senior unsecured debt rating: BB-

We affirmed the BB- senior unsecured debt rating. Our recovery analysis incorporates a default scenario in 2025 and is based on Duna House's liquidation value since the company still has modest assets from real estate development, resulting in an 'average' recovery. We see material uncertainty regarding the group's asset values in a hypothetical default scenario, which would likely be driven by increased competition, a loss of confidence in the business/brand and/or the departure of many licensees and agents.

Duna House has issued two bonds through the Hungarian Central Bank's Bond Funding for Growth Scheme. The first bond was issued in September 2020 (HUF 6.9bn, HU0000359914) with a tenor of 10 years and a fixed coupon of 3%. Bond repayment starts in 2026 with 20% yearly amortisation. The second bond was issued in January 2022 (HUF 6bn, HU0000361217), with a tenor of 10 years and a fixed coupon of 4.5%. Bond repayment starts in 2028 with a 20% yearly amortisation.

Appendix: Peer comparison (as at last reporting date)

	Duna House Holding Nyrt	Otthon Centrum Kft.	Pannon Work Zrt.	Mobilbox Kft.	Progress Étteremhálózat Kft.
	BB-/Stable	BB-/Stable	B+/Stable	BB/Stable	BB/Stable
Last reporting date	31 December 2023	31 December 2023	31 December 2022	31 December 2022	31 December 2023
Business risk profile					
Service offered	Loan brokerage, real estate brokerage and other financial and management services	Loan brokerage, real estate brokerage and other financial and management services	Human resource services	Rental and sales of office, storage and special containers	Franchisor of McDonalds restaurants in Hungary
Scope-adjusted EBITDA (EUR m)	6.1	1.9	2.8	29.6	33
Scope-adjusted EBITDA margin	9-13%	7-13%	5-7%	40-45%	13-18%
Financial risk profile					
Scope-adjusted EBITDA/interest cover	net cash interest	net cash interest	12.3x	115.3x	24.6x
Scope-adjusted debt/EBITDA	4.8x	1.7x	4.7x	0.7x	3.0x
Scope-adjusted funds from operations/debt	17%	83%	18%	127%	33%
Scope-adjusted free operating cash flow/debt	21%	-2%	5%	23%	22%

* Not published yet

Sources: Public information, Scope

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