1 April 2022 Corporates

Fnac Darty S.A.
French Republic, Retail

SCOPE BBB STABLE

Corporate profile

Fnac Darty S.A. is a French retailer specialising in consumer electronics and editorial products. Despite a strong focus on France (about 83% of group sales at YE 2021), the group also operates in Switzerland, Belgium, Spain and Portugal. Fnac Darty came into existence in 2016 with the merger of two French retailers, Fnac and Darty. This resulted in a product palette combining Fnac's editorial products and brown goods with Darty's white goods.

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
EBITDA/interest cover	11.1x	12.1x	13.2x	13.9x
Scope-adjusted debt (SaD)/EBITDA	2.1x	1.6x	1.2x	0.9x
Scope-adjusted funds from operations/SaD	37%	49%	65%	89%
Free operating cash flow/SaD	12%	11%	9%	4%

Rating rationale

The rating upgrade is driven by the improved profitability and credit metrics as Covid-related operational risks wane.

Fnac Darty's total revenue and Scope-adjusted EBITDA margin improved over 2021, reaching respectively EUR 8.0bn (2020: EUR 7.5bn) and 7.6% (up 20bp YoY). This was accomplished despite difficult business conditions during H1 2021 when Covid restrictions in the group's main market of France led to lower retail footfall. As 2021 progressed, Fnac Darty benefitted from increased consumer confidence and relaxed Covid restrictions. We expect the group's expansion in services (Darty Max and WeFix) to strongly contribute to margins. However, there is still the possibility of renewed Covid restrictions as well as price inflation, though we consider the latter to be easier to pass on to customers due to the group's focus on premium goods.

Scope-adjusted debt (SaD) reduced slightly during 2021 to reach close to EUR 1.0bn from EUR 1.2bn from a year before. This had a positive impact on all financial metrics except free operating cash flow, which got impacted by negative net working capital variation. Leverage as defined by SaD/EBITDA decreased to almost 1.6x and funds from operations/SaD to 49% (from respectively 2.1x and 37% in 2020). As we do not expect significant debt issuance into the medium term, we forecast credit metrics to improve in the coming years, supported by our expectation of the continued improvement of cash flow toward historical levels, backed by the anticipated recovery of the EBITDA margin to close to historical levels (8% at YE 2018 and 2019). Free operating cash flow/SaD is expected to remain slightly under pressure in the coming years as Fnac Darty is planning more capex to maintain its competitive advantage and reinforce Swiss operations (through shop-in-shops with Manor AG). Liquidity remains adequate, supported by strong internal cash flow and the extension of the EUR 500m revolving credit facility to 2028.

Ratings & Outlook

Corporate rating	BBB/Stable
Short-term debt rating	S-2
Senior unsecured debt rating	BBB

Analyst

Adrien Guerin
a.guerin@scoperatings.com

Related Methodologies

Corporate Rating Methodology: July 2021

Rating Methodology: Retail and Wholesale Corporates March 2021

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Outlook and rating-change drivers

The Outlook is Stable and incorporates our expectation of an improved Scope-adjusted EBITDA margin to close to 8% as well as the absence of significant new debt issuances, resulting in SaD/EBITDA approaching 1x in the coming years. The Outlook assumes no significant M&A.

A positive rating action is remote but would be considered if the business risk profile improved through a considerable increase in market shares outside of France while credit metrics remain in line with our rating guidelines.

A negative rating action might be taken if SaD/EBITDA deteriorated above 2x on a sustained basis. This could be the result of M&A, new Covid restrictions that affect shop performance or higher-than-expected price inflation that affects both margins and customer demand.

Rating drivers

Positive rating drivers	Negative rating drivers
• Top three player in Europe and dominant market share in France • Large range of products combining consumer electronics and editorial products • Higher profitability than most international competitors', expected to grow further thanks to repair services aimed at limiting electronics waste • Fast omnichannel transition due to high online sales • Relatively low leverage, leading to a good financial risk profile	• Potential pressure on EBITDA margin linked to cost inflation and changes in purchase behaviour • Inherent threat from e-commerce due to easy substitution of products offered • High seasonality of sales in Q4 • Less geographically diversified than European competitors, with dominant exposure to French market • Limited expansion into other European countries due to strong competition • Free operating cash flow/SaD expected to stagnate at non-investment grade level despite the high level for a retailer

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Remote unless strong improvement of the market shares outside of France	• SaD/EBITDA of above 2x

Financial overview

				Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	8.3x	11.1x	12.1x	13.2x	13.9x
Scope-adjusted debt (SaD)/EBITDA	1.9x	2.1x	1.6x	1.2x	0.9x
Scope-adjusted funds from operations/SaD	38%	37%	49%	65%	89%
Free operating cash flow/SaD	11%	12%	11%	9%	4%
Liquidity (internal and external)	>2x	>2x	>2x	>2x	>2x
Scope-adjusted EBITDA in EUR m	**2019**	**2020**	**2021**	**2022E**	**2023E**
EBITDA	585	551	611	643	670
Operating lease payments in respective year	-	-	-	-	-
Others	-	-	-	-	-
Scope-adjusted EBITDA	585	551	611	643	670
Scope-adjusted funds from operations in EUR m	**2019**	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA	585	551	611	643	670
less: (net) cash interest as per cash flow statement	-67	-47	-48	-46	-45
less: cash tax paid as per cash flow statement	-70	-66	-69	-94	-104
Other adjustments to the funds from operations[1]	-14	-8	-0	-0	-0
Scope-adjusted funds from operations	434	430	493	502	521
Scope-adjusted free operating cash flow in EUR m	**2019**	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted funds from operations	434	430	493	502	521
less: leasing adjustment	-221	-245	-228	-239	-239
Net working capital	52	67	-40	5	-11
Net capex	-145	-108	-115	-200	-250
Free operating cash flow	120	145	111	69	21
Scope-adjusted debt in EUR m	**2019**	**2020**	**2021**	**2022E**	**2023E**
Reported gross financial debt (excluding leasing)	1,013	1,455	934	932	914
IFRS 16 leasing-related debt	1,016	1,114	1,130	1,130	1,130
Pension adjustment	-	-	-	-	-
less: cash net from restricted cash	-896	-1,412	-1,063	-1,294	-1,456
Scope-adjusted debt	1,133	1,157	1,001	768	588

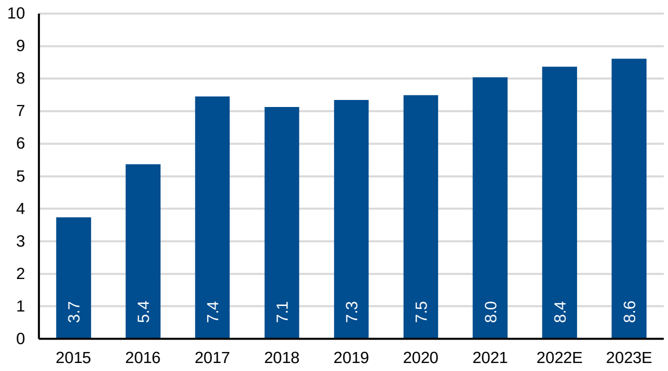
[1] Corresponds to capitalised interest, pension interest and variations in provisions

Business risk profile: BB+

Top three in Europe in physical consumer electronics goods

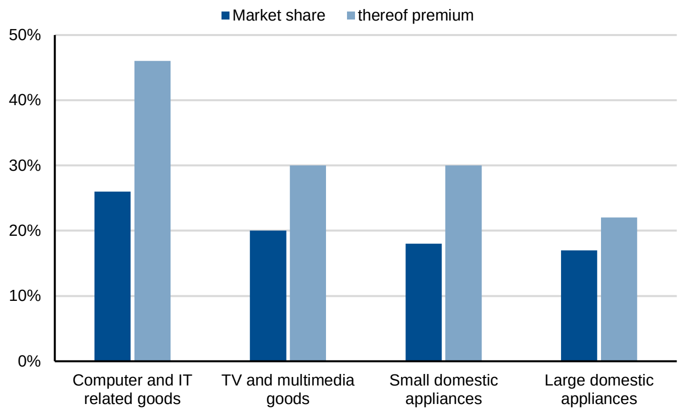
Fnac Darty is the third largest consumer electronics retailer in Europe. In 2021, the lion's share of group revenues came from France and Switzerland (83%), with the rest from the Iberian Peninsula (9%) and Belgium and Luxembourg (8%). These proportions have been stable over the last years. The group announced plans to extend Swiss operations (though these contribute little to revenues) by opening 27 shop-in-shops in the country by H1 2022 in partnership with Manor AG. Management expects this to generate close to EUR 100m every year. In Europe, Fnac Darty ranks behind its main international counterpart, Germany's Ceconomy (more than EUR 20bn of revenues over the last years). There is little competition over the same geographical markets.

Figure 1: Revenue development, 2015 to 2023E, in EUR bn



Sources: Fnac Darty, Scope Ratings

Figure 2: Estimated market share in France (YE 2020)



Sources: Fnac Darty, Scope Ratings

Leading market shares in France...

In France, Fnac and Darty are both iconic: with brand awareness at 99% for each brand and both are the leading omnichannel retailers nationally. The long-standing presence of both in France led to each becoming the largest retailer in their respective sectors, estimated to be significantly ahead of competitors (Conforama, Boulanger, Brut) but close behind pure online player Cdiscount in terms of market share (assumed at less than 10%; same as at YE 2020). The group is therefore first in brick and mortar and second or third in online sales (after Amazon) in France.

... supported by strong omni-channel deployment

Competition remains high in France as most electronic goods are ordered online (higher online penetration than for other retail consumer goods). Fnac Darty has, however, established its online offering well, with strong omnichannel sales (46% of online sales collected in store at YE 2021, 50% at YE 2020) maintaining strong footfall within physical shops, creating the chance for spontaneous purchases (especially for editorial products). We consider this omnichannel presence to be the cornerstone of the group's market share growth as, according to the group, 99% of French households can access an Fnac or Darty shop within 15 minutes. In 2021, the group became the first French retailer to be part of Google's Cloud Retail Search, cementing its online brand recognition.

Development towards B2C services constitutes a large growth driver

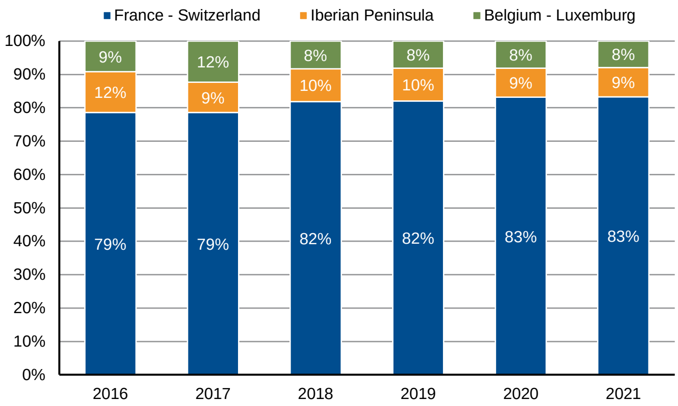
The reinforcement of the group's services is expected to increase customer loyalty. Darty Max, a monthly subscription service for the repair of many products bought at Fnac Darty, was launched in June 2021. The service already has almost 500,000 subscribers (200,000 a year ago). It also displays positive purchase behaviour: in comparison to non-subscribers, purchases are 1.5x more frequent and basket sizes 25% higher. The group targets more than two million subscribers by 2025.

Other new services aimed at increasing customer loyalty include those that tailor advice to customer needs, including live chats (more than 150,000 interactions in 2021 with a conversion rate reported at 2x-3x higher than for a standard web customer) and livestreams (number increased by 2.5x during 2021).

Diversification constrained by weight of France…

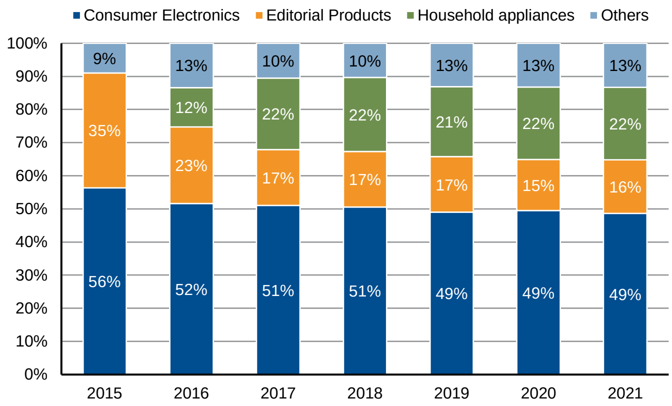
Geographical outreach remains good. That said, France's dominance in revenues and EBIT (almost 90%) continues to limit a better assessment of the company's business risk profile. An acquisition abroad would be needed to change this.

Figure 3: Revenue by country



Sources: Fnac Darty, Scope Ratings

Figure 4: Revenue by product category



Sources: Fnac Darty, Scope Ratings

…but benefits from large array of products

Fnac Darty is active in more product segments than omnichannel peers by providing a mixture of consumer electronics goods (white, grey and brown goods) and editorial products (audio, video and books). Editorial products tend to be purchased spontaneously, which particularly supported group sales once store footfall increased in 2021. The group's household goods (IT and domestic appliances) have ensured constant growth, and the risk of saturated demand remains low. Fnac Darty's offering is also well diversified, with an increasing focus on services that complement its retail activities. We expect these services to increase customer loyalty, thereby further decreasing the group's vulnerability to macro-economic shocks.

Growth in online sales

The group's development of its distribution channels is a main rating driver and remains the cornerstone of its future growth (one of the main goals is maintaining online sales at above 30% of total sales by 2025). The rapid growth in online sales, while impressive, is normal in the sub-industry, with international competitors having seen similar growth rates. Omnichannel represents 46% of Fnac Darty's online sales (click and collect), slightly lower than last year's level (48%-49% due to the normalisation in retail conditions with the easing of Covid restrictions). This high share of omnichannel in sales, combining e-commerce and brick and mortar, supports the group's development and maintains high footfall in shops, making it a main rating driver.

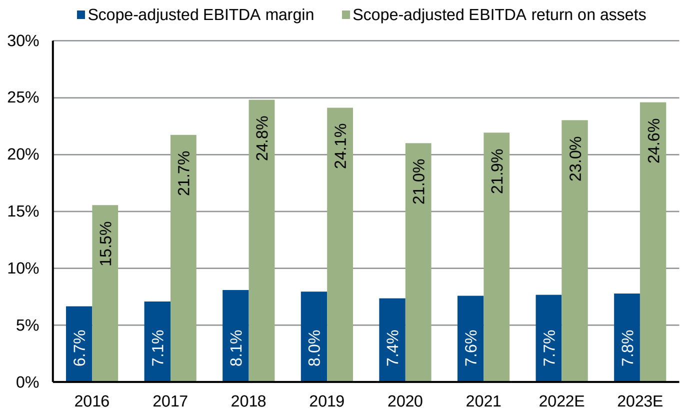
Improvement of EBITDA margin supported by product and services mix

The Scope-adjusted EBITDA margin increased during 2021 to reach almost 7.6% at year-end (up 20bp YoY). This was mainly due to a reversal of the gross margin (up 30bp YoY to 29.5%) due to the positive impact of the product mix (up 40bp) and services (up 30bp), but there was also the impact from the weak performance of franchises (down 25bp) and Nature & Decouverte SA (down 15bp, due to lower footfall in city centres and shopping malls).

Services should be a strong profitability driver in coming years

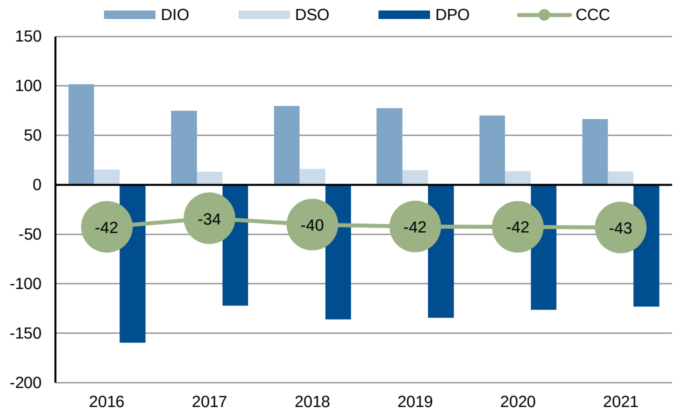
The reinforcement of the services offering is expected to carry profitability in the coming years as they are more lucrative than pure retail. This is highlighted by the strong growth in Darty Max subscribers and the number of WeFix stores (specialised in smartphone repair). We also expect ticketing services and Natures & Découvertes to recover as Covid restrictions ease in France, benefitting group profitability. We therefore expect the Scope-adjusted EBITDA margin to recover to nearly pre-pandemic levels (close to 8% in both 2018 and 2019).

Figure 5: Profitability margins, 2016 to 2023E



Sources: Fnac Darty, Scope Ratings

Figure 6: Cash conversion cycle and related components, 2016 to 2021[2]



Sources: Fnac Darty, Scope Ratings

Scope-adjusted EBITDA return on assets expected to grow

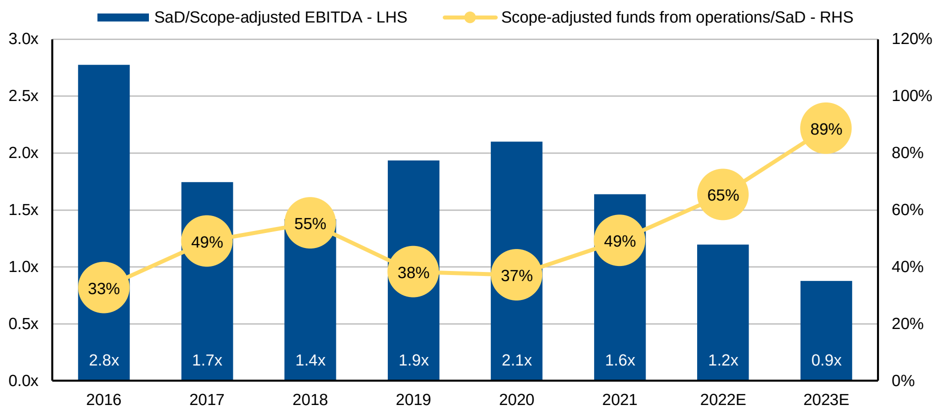
In 2022, Fnac Darty is expected to open 40-50 stores (excluding new shop-in-shops with Manor). We assume most will be opened under franchising agreements and therefore will have no effect on the asset base. Even so, we expect the Scope-adjusted EBITDA return on assets to improve slightly as the EBITDA margin increases, towards 25%.

Financial risk profile: A-

Slight but positive development of Scope-adjusted debt

Over 2021, gross financial debt decreased significantly after the group repaid its entire EUR 500m loan with the French government, part of the 'Prêt Garanti par l'Etat' programme to support businesses during the pandemic. The group also optimised its financing structure by rolling over the EUR 200m 2023 senior term loan to 2027 and extending the maturity of the EUR 500m revolving credit facility to 2028. This led to Scope-adjusted debt decreasing slightly during 2021 to almost EUR 1.0bn (versus EUR 1.2bn at YE 2020). We do not expect large debt issuances in the coming months based on the strong free operating cash flow, which has been positive over the last years and forecasted to remain at comparable levels in the coming years.

Figure 7: Leverage



Sources: Fnac Darty, Scope Ratings

[2] CCC corresponds to cash conversion cycle; DIO to days inventory outstanding; DSO to days supplier outstanding; and DPO to days payable outstanding

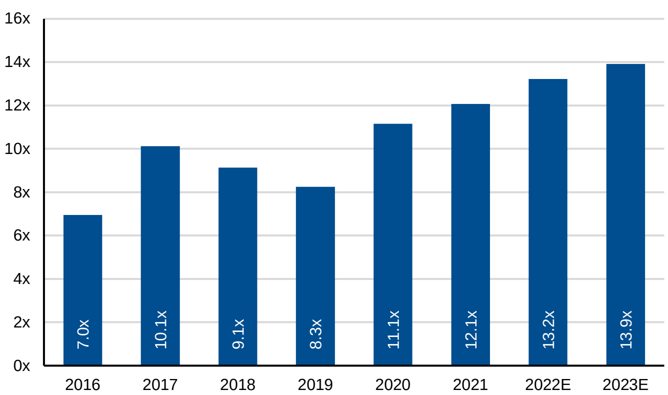
Improved leverage

Leverage metrics SaD/EBITDA and funds from operations/SaD improved to pre-Covid levels as of YE 2021, reaching respectively 1.6x and 49% (2.1x and 37% YoY). We expect both leverage metrics to continue to improve to respectively 1.5-1.0x and above 65%, on the back of our expectation of no new debt and improved profitability.

Interest cover expected to remain above 10x

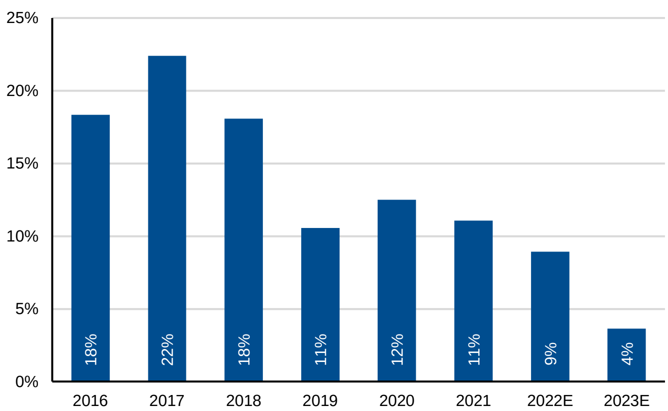
Interest expenses remained relatively stable during 2021 as interest on the loan with the French state was prepaid at issuance. We expect interest expenses to remain somewhat stable in the coming years, supported by our expectation of no new debt issuances or significant debt repayments. All in all, interest cover is expected to remain above 10x.

Figure 8: Scope-adjusted EBITDA/interest cover



Sources: Fnac Darty, Scope Ratings

Figure 9: FOCF/SaD



Sources: Fnac Darty, Scope Ratings

Free operating cash flow expected to remain under pressure

Despite higher funds from operations in 2021 than in 2020, free operating cash flow was impacted by cash outflow linked to net working capital due to the difficult retail environment in 2021. This led to free operating cash flow deteriorating slightly to EUR 111m in 2021 from EUR 145m in 2020. In the coming year, we expect the retail environment to normalise and, with it, net working capital, which we forecast to be relatively flat. We expect the group to continue to deploy high capex, as mentioned earlier. Nonetheless, we forecast free operating cash flow to remain low but positive in the coming years, leaving free operating cash flow/SaD in line with previous years' levels (5%-15%).

Liquidity is adequate

Liquidity is adequate. Internal liquidity is supported by our expectation of no significant debt repayments in the coming years, apart from around EUR 320m in 2024, as well as by the strong cash position. The extension of the EUR 500m revolving credit facility to 2028 also supports liquidity.

In EUR m	2021	2022E	2023E
Short-term debt (t-1)	553	2	18
Unrestricted cash (t-1)	1,412	1,063	1,294
Free operating cash flow (t)	111	69	21
Liquidity (internal)	>2x	>2x	>2x
Open committed credit lines (t-1)	400	500	500
Liquidity (internal and external)	>2x	>2x	>2x

Long-term and short-term debt ratings

Short-term rating: S-2

We have affirmed the S-2 short-term rating, based on the 'better than adequate' internal and external liquidity cover, banking relationships and capital markets standing.

Senior unsecured debt rating: BBB

The rating for senior unsecured debt has been upgraded to BBB, the same level as the issuer rating.

ESG consideration

ESG well embedded in strategy

Given the group's main focus on France, we expect scrutiny among investors to be greater regarding business decisions based on environmental, social and governance aspects. On this matter, the retailer's strategy is well positioned. According to the group, product durability accounts for half of purchasing decisions. As such, it has invested heavily in repair services (WeFix and Darty Max) and expects to repair annually 2.5m products by 2025 (2.1m in 2021 and 1.8m in 2020). We consider these initiatives to be positive for overall profitability as the services generate higher margins than pure retail sales.

Another initiative to decrease its environmental footprint is the 'enlightened delivery', which allows the consumer to choose a delivery mode with a lower carbon footprint.

We consider these initiatives to be positive for ESG considerations, as they not only support profitability and cash flow generation but also reinforce brand strength and in turn market share.

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. Also, the environmental footprint of a company's brick-and-mortar shops will remain fundamental to its development. Retailers will have to continue balancing the challenges of improving the energy efficiency of its larger size shops (comparable to hypermarkets), increasing the flexibility of its space to incorporate additional distribution channels (e.g., click and collect), while maintaining the high shopping experience (shop-in-shops).

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

23 Boulevard des Capucines
F-75002 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

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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