LR Global Holding GmbH
Germany, Retail, Consumer Products

SCOPE BB- Negative

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	19.3x	4.0x	2.2x	2.7x
Scope-adjusted debt*/EBITDA	7.2x	3.2x	4.4x	3.3x
Scope-adjusted funds from operations/debt	14%	16%	12%	17%
Scope-adjusted free operating cash flow/debt	8%	0%	4%	5%

*including EUR 186m shareholder loan for 2020

Rating rationale

The issuer rating continues to reflect Scope's business risk assessment, supported by the company's good position as a manufacturer of premium non-durable consumer goods with health and lifestyle-related attributes. The goods are mostly produced in-house and are distributed through direct selling. The risks posed by LR's small absolute size (about EUR 280m in sales estimated for 2022) are effectively mitigated by a favourable positioning in terms of both its products and its addressable direct selling market. LR's good operating margins (EBITDA) of 9-11% further support the rating. Lack of diversification remains a constraint, as LR is active in one niche market and has high product concentration. The Outlook change reflects weakened credit metrics driven by the decrease in operating profitability in H1 2022 due to the Russia-Ukraine war, as well as the high inflationary environment and its effect on consumer behaviour. The issuance of a bond in 2021 increased the interest burden. Credit metrics, however, still align with the rating case as interest coverage has decreased but remains higher than 2.5x, the threshold for present ratings. Scope also expects that interest cover, the main rating-change driver, will weaken in 2022 due to decreasing operating profitability but will improve in 2023 when operating profitability recovers.

Outlook and rating-change drivers

The Outlook is Negative, reflecting the uncertainty around the ability to maintain operating profitability in the challenging business environment and weakened credit metrics.

Positive trigger (i.e. back to stable outlook) if the challenging environment is less negative on the company's profitability than expected, exemplified by cash interest cover moving back towards 3x or higher rather soon.

A negative rating action could be possible if the cash interest cover were sustained below 2.5x, which may result from deteriorated operating performance.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
08 NOV 2022	Outlook change	BB-/Negative
09 DEC 2021	Affirmation	BB-/Stable
07 DEC 2020	Upgrade	BB-/Stable
23 OCT 2020	New	B+/Stable

Ratings & Outlook

Issuer	BB-/Negative
Short-term debt	-
Senior secured debt	BB-

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Related Methodologies

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2022

Rating Methodology: Consumer Products; November 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• One of the largest direct-selling companies in Europe • Favourable product positioning creating strong growth • Free operating cash flow generation •	• Overall small size in underlying large consumer goods and retail markets • Strongly dependent on leading brands (Aloe Vera) • Limited product diversification • Exposure to Russia including owning a big warehouse

Positive rating-change drivers	Negative rating-change drivers
• Interest cover sustained at above 3x	• Interest cover sustained at below 2.5x

Corporate profile

Founded in 1985, LR Global Holding GmbH produces and sells consumer goods focused on health, nutrition and beauty. LR offers niche products and has a premium pricing strategy. Its exclusive brand is LR Health and Beauty. LR's main unique selling proposition is its distribution: it operates as a direct seller via the internet and a large number of sales partners (about 300,000) to generate revenue through multi-layer marketing without a physical store network. Based in Germany, LR markets about 600 different beauty and healthcare-related products in 28 countries. Customers are usually quality and lifestyle-oriented individuals looking for non-mass-produced, natural products, with price being of lesser importance.

The company is fully owned by German private equity investors Quadriga Capital and Bregal Capital (not represented anymore), which took over LR Global from Apax Partners in 2014.

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	19.3x	4.0x	2.2x	2.7x
Scope-adjusted debt/EBITDA	7.2x	3.2x	4.4x	3.3x
Scope-adjusted debt/EBITDA (excl. Shareholder loan)	2.1x	3.2x	4.4x	3.3x
Scope-adjusted funds from operations/debt	14%	16%	12%	17%
Scope-adjusted free operating cash flow/debt	8%	0%	4%	5%
Scope-adjusted EBITDA in EUR m				
EBITDA	37	37	26	33
Other items	0	0	0	0
Scope-adjusted EBITDA	**37**	**37**	**26**	**33**
Funds from operations in EUR m				
Scope-adjusted EBITDA	37	37	26	33
less: (net) cash interest paid	-1	-14	-12	-12
less: cash tax paid per cash flow statement	-1	-4	0	-3
Funds from operations (FFO)	**34**	**19**	**14**	**18**
Free operating cash flow in EUR m				
Funds from operations	34	19	14	18
Change in working capital	-4	-4	1	-1
Non-operating cash flow	3	-3	-1	-1
less: capital expenditure (net)	-6	-6	-3	-5
less: lease amortisation	-6	-6	-7	-6
Free operating cash flow (FOCF)	**22**	**0**	**4**	**5**
Net cash interest paid in EUR m				
Net cash interest per cash flow statement	2	14	12	12
Change in other items	0	-5	0	0
Net cash interest paid	**2**	**9**	**12**	**12**
Scope-adjusted debt in EUR m				
Reported gross financial debt	290	142	151	151
thereof shareholder loan	186	0	0	0
less: cash and cash equivalents	-29	-27	-39	-44
add: non-accessible cash	0	0	0	0
add: pension adjustment	0	0	0	0
Guarantees	1	1	1	1
Scope-adjusted debt (SaD)	**262**	**117**	**114**	**109**

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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)
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)

Regulatory and reputational risk

LR has decided to continue its operations in Russia despite of Russia-Ukraine war. Russian subsidiary additionally serves Kazakhstan market. Given the company has big warehouse in Russia, the exit from Russian market would have negative economic consequences for LR.

[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: BB-

Industry risk profile: BBB+

We have assigned a blended industry risk of BBB+ to LR as the company is both a producer (90% of products sold are produced in-house) and a distributor (through online channels). The two industries that apply are therefore consumer products (A) and retail (BBB). Within the consumer product market, LR concentrates on the niche segment of health, nutritional additives, and beauty while in the context of its retail profile it focuses on specialised multi-layer marketing and social selling.

Good market shares

While LR is a relatively small company in the context of the multi-billion underlying non-durable consumer goods markets, it has a much smaller addressable market based on its selling concept. LR is not represented in supermarkets or pharmacies, which account for a large part of the underlying market. LR has two distinct features mitigating this disadvantage. First, the company is positioned in specific health-related niche segments, which have attractive growth characteristics due to prevailing green and healthy shopping trends. Secondly, its potential to grow its revenue is underscored by its large self-employed sales force (about 300,000 partners), incentivised according to entrepreneurial aspects. Sales partners benefit from both individual discounts on their own private sales as well as additional cash bonus payments depending on their overall sales from their referral network. In addition, as they progress on their career path, LR provides additional benefits to partners such as eligibility for a company car.

We believe these are effective mitigants to LR's small overall scale from a total market perspective, as direct selling and social selling only represents a fraction – although an increasing one – of a product's global demand. LR had been generating significant above-market growth before the Covid-19 crisis (January and February 2020 revenue grew by 26.1% and 19.8% respectively). Double-digit growth continued in 2021 (gross sales in Q1 grew by 15% and in Q2 by 13%), helped by the launch of innovative product ranges. LR's market share in its five main countries of operation based on the market available for direct selling ranges between 5% and 40% according to PWC. Larger direct selling peers are Amway (generalist) and Herbalife or Avon, which are respectively focused on nutrition and beauty.

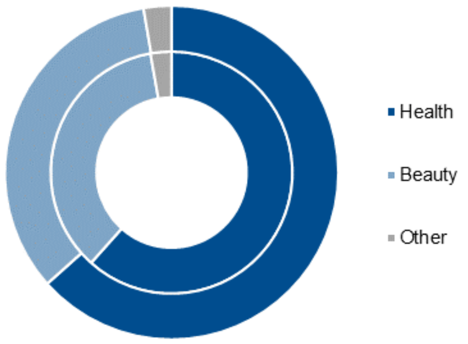
Limited diversification

We believe diversification continues to be LR's weakest point. The underlying market is limited in its product range (the two large health-related product groups Aloe Vera and nutritional additives together account for about 60% of total group sales as at 2021, compared to about 40% in 2016) and its addressable market (direct sales). Thus, product (group) concentration is relatively high.

Geographic exposure is more positive. Overall, LR is active all over Europe and made an entry into South Korea in March 2021. It currently sells products in 28 countries. Since 2022, the company divides its countries of operation into three regions as follows:

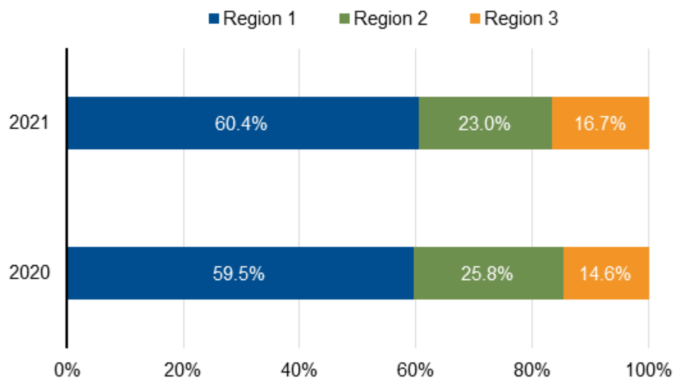
- **Region 1:** Austria, Belgium/Luxembourg, Germany, the Netherlands, and Switzerland
- **Region 2:** Czech Republic, Italy, Poland, Portugal, Slovakia, Spain, and Ukraine
- **Region 3:** Albania, Bulgaria, Denmark, Finland, France, Norway, Sweden, Greece/Cyprus, Hungary, Romania, Russia/Kazakhstan, and Turkey

Figure 1: Gross sales by product segment
(inner cycle:2021; outer cycle: 2020)



Source: Scope estimates

Figure 2: LR sales based on operating regions



Source: Scope estimates

Satisfactory profitability

As a highly integrated producer of non-durable consumer goods, LR has good operating margins in a retail peer context. With the exception of 2018 (an outlier year for several reasons) the company's profitability ranged between 6% and 12%, a good level for a retailer. Since 2018, the operating margin has continued to increase fueled by significant sales growth. During the Covid-19 crisis, the company benefitted from demand for health-related products, which boosted their sales. However, in H1 2022, the Russia-Ukraine war affected sales negatively not only in Ukraine and neighbouring countries, but also in other regions. Uncertainty about war and the high inflationary environment created a shock on customer behaviour. On the other hand, according to management, the shock did not last and sales started to recover by early Q3 2022.

Generally, the company has pricing power as its customers are not price sensitive, which means it can transfer price increases onto customers in an inflationary environment. Additional growth drivers are innovation – today about 15% of sales are generated with new products, compared to 0% four years ago – and the company's intensified incentivisation programme. The cost structure benefits from comparatively lower fixed costs as the sales force is self-employed. Revenue increases therefore have a larger impact on profitability than for most competitors. Raw materials do not play a critical role in LR's profitability either as the company only purchases limited volumes of raw materials. This translates into limited raw material price dependency.

Financial risk profile: BB-

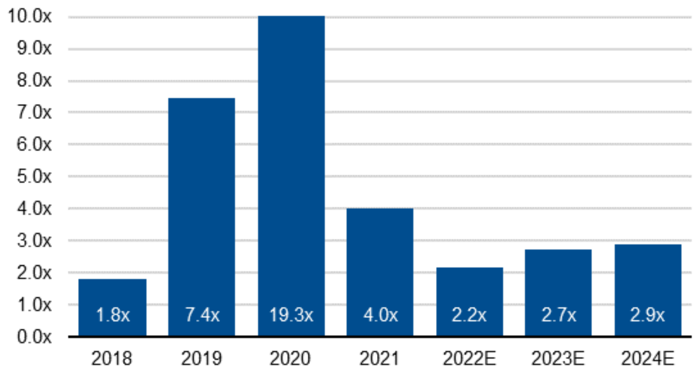
BB- rated financial risk profile

Scope expects that H2 2022 results will partially offset the poor performance in Q1 and Q2 2022. Overall, EBITDA will likely deteriorate significantly at end-2022 before improving again from next year. Interest coverage, which is the main rating-change driver, is expected to decrease to 2.2x in 2022. The main reason behind this is the issuance of a high-yield EUR 125m bond in 2021 and deteriorating EBITDA, although EBITDA should improve starting next year and stay at around 2.7x in 2023. An additional support to LR's financial risk profile is the company's ability to generate free operating cash flow due to its very low maintenance capital expenditure and well-managed working capital.

When the Russia-Ukraine war started, LR's Ukrainian subsidiary in Kiev was temporarily closed (according to management, Ukraine and Russia together account for around 13% of total sales). The war affected not only neighbouring countries, but also Central and Western European countries due to uncertainty. Additionally, high inflationary environment worsened the situation, ensuing temporary change in consumer behaviour resulted in lower sales in H1 2022.

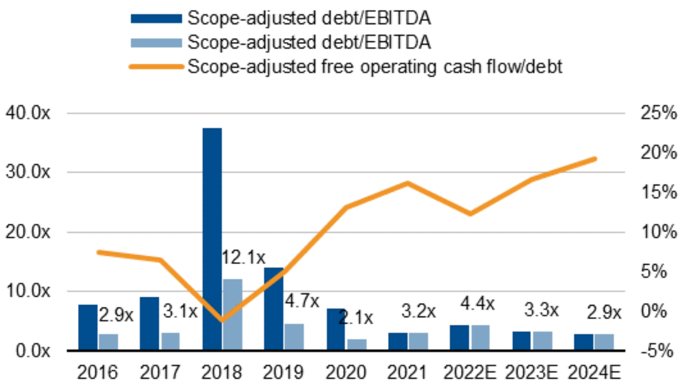
The issued bond has maintenance (leverage ratio equal or less than 4.5x), incurrence (in case of new debt issuance), and distribution covenants. Given financials of company, there is no breach, but the headroom is getting smaller according to our estimates this year.

Figure 3: EBITDA interest cover



Source: Scope estimates

Figure 4: Leverage



Source: Scope

Adequate liquidity

LR's liquidity profile benefits from a solid cash buffer of around EUR 30m in 2020-2022 (EUR 29m on 30 June, 2022), positive free operating cash flow and immaterial short-term debt (only leases). LR's Liquidity profile is therefore adequate.

Long-term debt rating

Senior secured debt rating: BB-

We set the bond's hypothetical default year in 2024, simulating a scenario in which the company had issued the senior secured bond and proceeds had been used according to plan. The recovery analysis indicates 'average' recovery expectation, translating into the same rating as the issuer rating.

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