Fnac Darty S.A.
French Republic, Retail

NEGATIVE

BBB

Key metrics

			Scope estimates	
Scope credit ratios	2021	2022	2023E	2024E
Scope-adjusted EBITDA interest cover	12.0x	10.4x	10.8x	10.3x
Scope-adjusted debt/EBITDA	1.6x	2.2x	2.4x	2.2x
Scope-adjusted funds from operations/debt	49%	35%	34%	36%
Scope-adjusted free operating cash flow/debt	11%	-6%	5%	8%

Rating rationale

Fnac Darty's 2022 results exhibited a leverage increasing to 2.2x from 1.6x. EBITDA and a decrease in profitability because of inflation, including higher salary costs. Leverage increased on the back of an outflow of EUR 131m in connection with litigation relating to the sale of Comet Group Limited in 2012. The rating continues to benefit from Fnac Darty's strong position in the French market, its well-developed omnichannel strategy and good, although decreasing, profitability. The business risk profile remains constrained by geographical concentration, with most of its exposure to the French market and limited expansion into other countries. The financial risk profile continues to benefit from relatively low leverage balancing moderate free operating cash flow (FOCF).

Outlook and rating-change drivers

The Negative Outlook reflects the risk that Scope-adjusted debt/EBITDA stays above 2.0x. Our assumptions include lower EBITDA due to pressure from lower sales volumes and rising energy prices, although the EBITDA margin is assumed to remain between 6.5%-7%. Our rating case reflects stable net debt in 2023 stemming from a neutral impact from working capital, EUR 120m in capex, lower dividend payouts and no material M&A transactions.

A revision of the Outlook back to Stable could be triggered if Fnac Darty succeed in bringing its Scope-adjusted debt/EBITDA ratio below 2.0x. This could be achieved through stronger EBITDA generation combined with a successful appeal in the Comet lawsuit, leading to a positive cash inflow of around EUR 130m, or reversal of 2022's negative net working capital outflow in 2023.

A negative rating action is possible if the Scope-adjusted debt/EBITDA ratio stayed above 2x on a sustained basis. This could be the result of no concrete deleveraging efforts in 2023, an unsuccessful appeal in the Comet lawsuit or no recovery in profitability (Scope-adjusted EBITDA margin) to above 7%.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
4 April 2023	Outlook change	BBB/Negative
1 April 2022	Upgrade	BBB/Stable
6 May 2021	Affirmation	BBB-/Stable

Ratings & Outlook

Issuer	BBB/Negative
Short-term debt	S-2
Senior unsecured debt	BBB

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Related Methodologies

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2022

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
• Top three player in Europe and dominant market share in France • Large range of products combining consumer electronics and editorial products • Good profitability, although decreasing, versus most international competitors, thanks to repair services aimed at limiting electronics waste. • Fast omnichannel transition due to strong online sales • Relatively low leverage, leading to a good financial risk profile	• Potential pressure on the EBITDA margin linked to cost inflation and changes in consumer buying behaviour • Inherent threat from e-commerce due to easy substitution of products offered • High seasonality of sales in Q4 with risk of overstocking. • Less geographically diversified than European competitors, with most of exposure to French market • Limited expansion into other countries due to the presence of strong local or international competitors in Europe

Positive rating-change drivers	Negative rating-change drivers
• Change of Outlook to Stable if Scope-adjusted debt/EBITDA below 2.0x	• Scope-adjusted debt/EBITDA above 2x on a sustained basis

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 2022), the group also operates in Switzerland, Belgium, Spain and Portugal. Fnac Darty came into existence in 2016 through the merger of two French retailers, Fnac and Darty. This resulted in a product range combining Fnac's editorial products and brown goods with Darty's white goods.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	11.2x	12.0x	10.4x	10.8x	10.3x	10.0x
Scope-adjusted debt/EBITDA	2.1x	1.6x	2.2x	2.4x	2.2x	2.0x
Scope-adjusted funds from operations/debt	37%	49%	35%	34%	36%	40%
Scope-adjusted free operating cash flow/debt	13%	11%	-6%	5%	8%	10%
Scope-adjusted EBITDA in EUR m						
EBITDA	551	611	552	529	566	604
Scope-adjusted EBITDA	**551**	**611**	**552**	**529**	**566**	**604**
Funds from operations in EUR m						
Scope-adjusted EBITDA	551	611	552	529	566	604
less: (net) cash interest paid	-47	-48	-47	-48	-53	-59
less: cash tax paid per cash flow statement	-66	-69	-70	-58	-67	-76
less: pension interest	-1	-1	-4	-2	-2	-2
Others[1]	-7	2	8	0	0	0
Funds from operations (FFO)	**430**	**493**	**439**	**421**	**445**	**468**
Free operating cash flow in EUR m						
Funds from operations	430	493	439	421	445	468
Change in working capital	67	-40	-155	-1	12	18
less: capital expenditure (net)	-107	-116	-131	-120	-120	-120
less: lease amortisation	-245	-228	-231	-238	-245	-252
Free operating cash flow (FOCF)	**146**	**109**	**-78**	**63**	**92**	**114**
Net cash interest paid in EUR m						
Net cash interest per cash flow statement	47	48	47	48	53	59
Others[2]	2	3	6	1	2	1
Net cash interest paid	**49**	**51**	**53**	**49**	**55**	**60**
Scope-adjusted debt in EUR m						
Reported gross financial debt	2,569	2,064	2,077	2,095	2,113	2,133
less: cash and cash equivalents	-1,569	-1,181	-932	-944	-990	-1,054
add: non-accessible cash	157	118	93	94	99	105
Scope-adjusted debt (SaD)	**1,157**	**1,001**	**1,238**	**1,245**	**1,222**	**1,184**

[1] Includes changes in provisions and capitalized interests.
[2] Includes capitalized interests and pension interests.

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Environmental, social and governance (ESG) profile[3]

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

ESG well embedded in strategy

Given the group's focus on France, we expect close investor scrutiny of business decisions based on environmental, social and governance aspects. The corporate strategy is well positioned in this realm. According to the group, product durability accounts for half of purchasing decisions. Hence, it has invested heavily in repair services (WeFix and Darty Max) and expects to repair 2.5m products annually by 2025. We consider these initiatives to be positive for overall profitability as services generate higher margins than pure retail sales.

Another initiative that aims to decrease the company's environmental impact is 'enlightened delivery', which allows the consumer to choose a delivery method with a smaller 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, by extension, market share.

Reputational risk is a major criterion for the social side of a retailer. For example, product or labour management practices that have 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 larger shops (comparable to hypermarkets) and increasing the flexibility of their space to incorporate additional distribution channels (e.g. click and collect) while maintaining a high quality shopping experience (shop-in-shops).

[3] 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+

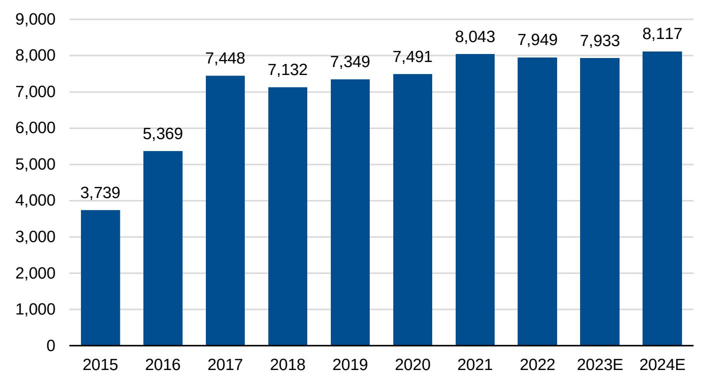
Industry risk profile: BB

Based on products sold (mainly electronic goods), Fnac Darty is a discretionary retailer. This leads to an industry risk profile of BB. Although the group has operations within services, these activities are too limited to warrant a blended approach to its industry risk profile.

Top three in Europe in physical consumer electronics

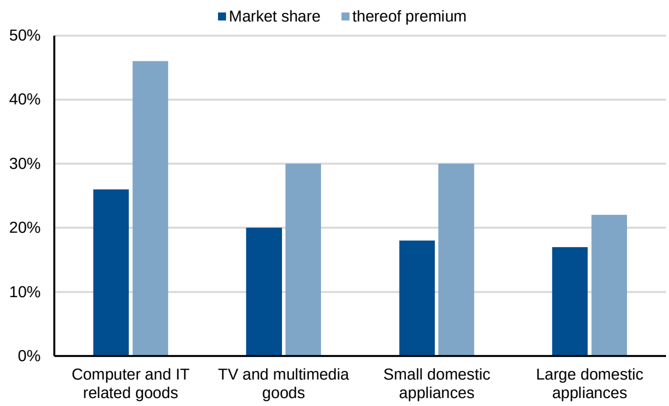
Fnac Darty is the third largest consumer electronics retailer in Europe. In 2022, the lion's share of group revenues came from France and Switzerland (83%), with the rest from the Iberian Peninsula (9%) and Belgium and Luxembourg (8%). It is expected to open 40-50 stores (excluding new shop-in-shops with Manor) within the next few years. Most of these new stores will be opened under franchising agreements. In Europe, Fnac Darty ranks behind its main international counterpart, Germany's Ceconomy (more than EUR 20bn of annual revenues; BBB-/Stable). There is little competition over the same geographical markets. The group's revenues slightly decreased by 1.2% during the course of 2022, driven by lower volumes in France due to a decrease in e-commerce revenues that was somewhat compensated for by brick-and-mortar stores.

Figure 1: Revenue development, 2015 to 2024E, in EUR m



Sources: Fnac Darty, Scope Ratings

Figure 2: Estimated market share in France



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 being the leading omnichannel retailers nationally. Their longstanding presence in France led each of them to become the largest retailer in its respective sector, with a significant presumed lead over competitors (Conforama, Boulanger, Brut) but close behind pure online player Cdiscount in terms of market share (assumed at less than 10%). The group is therefore first in brick-and-mortar sales and second or third in online sales (after Amazon) in France.

... supported by strong omnichannel 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 (50% of online sales are click-and-collect sales) leading to high footfall within physical shops, creating a chance of spontaneous purchases (especially for editorial products). We consider this omnichannel presence to be the cornerstone of the group's market share growth. This is because, as the group claims, 99% of French households can access a Fnac or Darty shop within 15 minutes. In 2021, the group became the first French retailer to join Google's Cloud Retail Search, cementing its online brand recognition.

Development towards B2C services constitutes a large growth driver

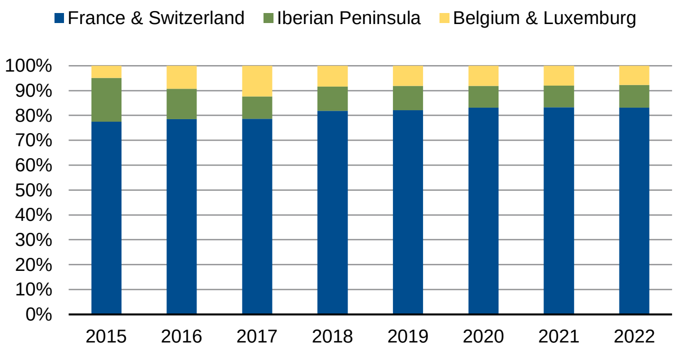
Reinforcing the group's services is expected to increase customer loyalty. Darty Max, a monthly subscription service for repairs of many products bought at Fnac Darty, was launched in June 2021. The service already has close to 800,000 subscribers (500,000 a year ago). It also displays positive buying behaviour as subscriber purchases are 1.5x more frequent and their basket sizes are 25% higher versus non-subscribers. The group is targeting 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 (conversion rate reported to be 2x-3x higher than for a standard web customer) and livestreams.

Diversification constrained by weight of France…

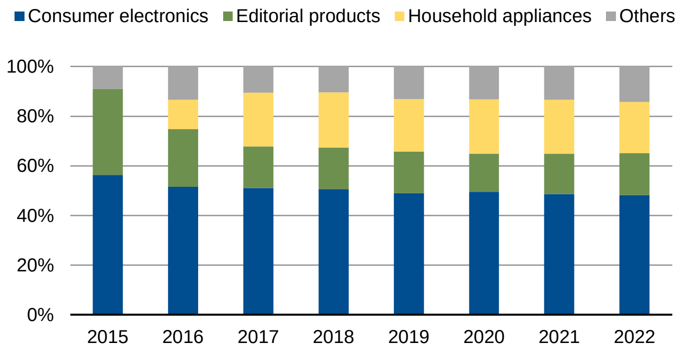
Geographical reach remains good. That said, France's dominance in revenues and EBIT (almost 90%) continues to limit a better assessment of the company's business risk profile. An acquisition abroad would be needed to change this.

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 (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 and 2022. The group's household goods (IT and domestic appliances) have ensured constant growth, and the risk of saturated demand remains low. In addition, its offering is well diversified, with an increasing focus on services that complement its retail activities. We expect these services to increase customer loyalty, further reducing the group's vulnerability to macroeconomic 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). Rapid growth in online sales, while impressive, is normal in its sub-industry, with international competitors having seen similar growth rates. Omnichannel represents 50% of Fnac Darty's online sales (click and collect), which is slightly higher than last year's level (46% 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.

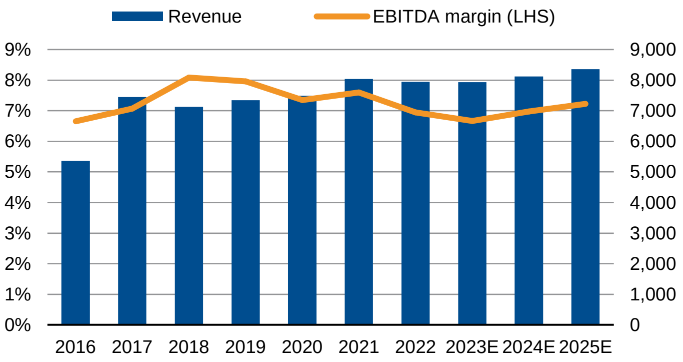
Deterioration of EBITDA margin impacted by inflation, energy costs and salaries

Fnac Darty saw its overall EBITDA margin decrease to 6.9% at YE 2022 (7.6% at YE 2021). This negative development is mainly due to higher salary costs (up 3%), driven by bonuses, store closures and wage increases to compensate for inflation. Inflation in the cost base was only partly offset by a performance plan. The EBITDA margin is expected to continue deteriorating in 2023 as a result of anticipated lower sales in H1 2023, higher energy costs and increasing salary costs. Lower sales in H1 2023 will be driven by lower consumption following a peak in inflation for food retail in April/May, reducing customers' purchasing power for non-food items. The second half is expected to exhibit lower inflation, with price increases increasingly offsetting lower volumes. Additional energy costs (between EUR 30m and EUR 50m) will also put pressure on profitability in 2023. 40% of the group's energy sourcing is subject to fluctuations in market prices (the rest being regulated). Fnac Darty had a hedging contract with Solvay for energy subject to market rates but Solvay cancelled the contract at the end of 2022. This forced Fnac Darty to enter an agreement with another supplier when prices were at their highest.

Services should be a strong profitability driver in upcoming years

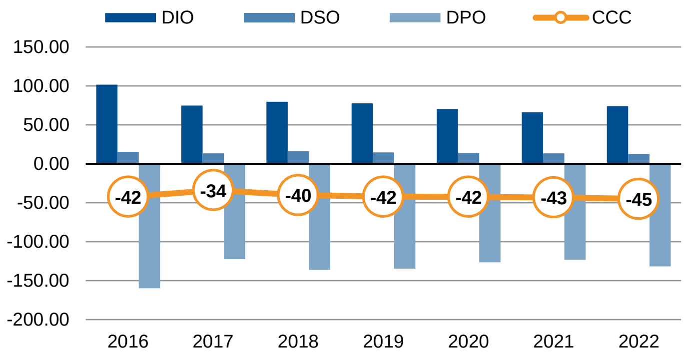
The reinforcement of the services offering is expected to carry profitability in upcoming years as services are more lucrative than pure retail. This is highlighted by the strong growth in Darty Max subscribers and the number of WeFix stores (specialised in smartphone repair). We therefore expect the Scope-adjusted EBITDA margin to recover to near 2020 levels (close to 7.2%) in 2025.

Figure 5: Profitability margin, 2016 to 2023E



Sources: Fnac Darty, Scope Ratings

Figure 6: Cash conversion cycle and related components, 2016 to 2022[4]



Sources: Fnac Darty, Scope Ratings

Financial risk profile: BBB+

Good leverage but deteriorated in 2022 and forecasted to increase in 2023

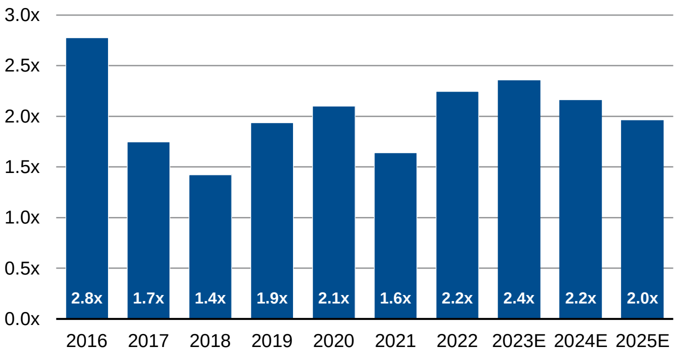
The company's consolidated leverage, measured by the Scope-adjusted debt/EBITDA ratio and the Scope-adjusted FFO/debt ratio, is around 2.0x and 41% on average. They increased to 2.2x and 36% at YE 2022 (1.6x and 49% as at YE 2021). Net debt increased by EUR 238m in 2022 on the back of negative FOCF and a cash outflow of EUR 131m in connection with litigation in late 2022 relating to the sale of Comet Group Limited in 2012. The liquidator alleges that in February 2012, prior to Fnac's acquisition of Darty in 2016, Comet allegedly repaid intra-group debt to KIL when it was already insolvent.

Given our expectations of no new debt and a deterioration in profitability in 2023, we expect both leverage metrics will continue weakening to 2.4x for Scope-adjusted debt/EBITDA and 34% for Scope-adjusted FFO/ debt. EBITDA will continue to be challenged by headwinds in 2023, including lower demand, higher energy prices and wage inflation.

Given that the business environment could start to improve in 2024, we forecast that leverage will decline towards 2.0x in 2025. This decline could accelerate due to positive working capital variation, or a refund of the penalty paid to Comet following a successful appeal.

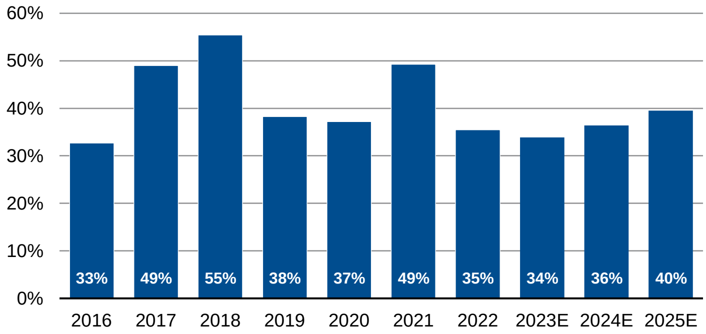
[4] CCC: cash conversion cycle; DIO: days inventory outstanding; DSO: days sales outstanding; DPO: days payable outstanding.

Figure 7: Scope-adjusted debt/EBITDA



Sources: Fnac Darty, Scope estimates

Figure 8: Scope-adjusted FFO/debt

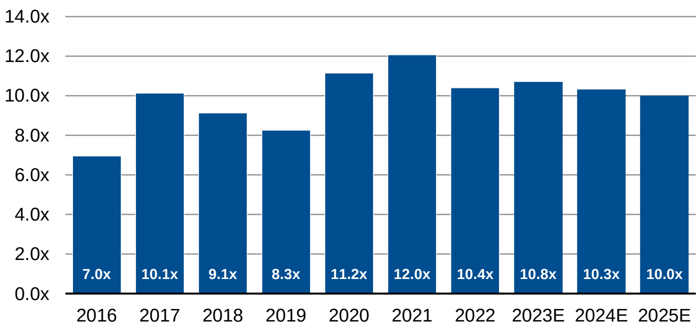


Sources: Fnac Darty, Scope estimates

Slight deterioration in EBITDA interest expense due to bond refinancing

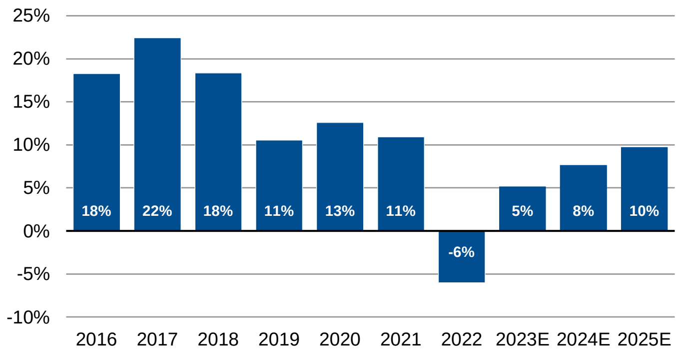
We anticipate debt protection to decline but remain above 10.0x from 2023 onwards. The decline in the ratio will be driven by reduced EBITDA and the bond refinancing in 2024 weighing on net interest paid. Fnac Darty has secured a EUR 300m term loan that could be drawn prior to 2024's EUR 300m bond maturity with a spread of 145bp over the 3m EURIBOR (while the 2024 bond has a coupon of 1.875%).

Figure 9: Scope-adjusted EBITDA/interest cover



Sources : Fnac Darty, Scope estimates

Figure 10: Scope-adjusted FOCF/debt



Sources: Fnac Darty, Scope estimates

Negative free operating cash generation in 2022 driven by high negative working capital

In addition to lower FFO generation in 2022 versus 2021, FOCF was negatively impacted by a variation in net working capital (related outflow of EUR 155m), driven by overstocking at year-end. This led to significant deterioration in the group's FOCF, which dropped to negative EUR 74m in 2022 (versus EUR 109m in 2021). Given that we expect some normalisation in the supply chain, variations in net working capital are expected to normalise in 2024 and are forecasted to be relatively flat. We expect lower capex (EUR 120m) to be deployed to continue growing the business through store openings, logistics and IT.

As a result, we forecast Scope-adjusted FOCF/debt at between 5%-10% in upcoming years. This ratio remains highly sensitive to swings in working capital.

Adequate liquidity

As of 31 December 2022, we assess liquidity as adequate, with EUR 20m in short-term debt maturing in the next 12 months fully covered by EUR 839m in unrestricted cash and EUR 800m in undrawn committed credit facilities.

Balance in EUR m	2023E	2024E	2025E
Unrestricted cash (t-1)	839	850	891
Open committed credit lines (t-1)	800	800	500
Free operating cash flow	65	93	115
Short-term debt (t-1)	20	320	20
Coverage	**>200%**	**>200%**	**>200%**

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB

We have affirmed Fnac Darty S.A.'s senior unsecured debt rating at BBB, in line with the issuer rating.

Short-term debt rating: S-2

We have affirmed the short-term debt rating at S-2. This affirmation reflects the company's underlying BBB/Negative issuer rating and its adequate liquidity profile, with upcoming debt maturities comfortably covered by internal cash sources, committed credit lines of EUR 800m and good access to external funding (bank and capital market debt).

Appendix: Peer comparison (as at last reporting date)

	Fnac Darty S.A.	Ceconomy AG	Vöröskö Kft.	Otto GMBH & CO KG*
	BBB/Negative	BBB-/Stable	BB/Stable	--/--
Last reporting date	31 December 2022	31 December 2021	30 June 2022	31 December 2021
Business risk profile				
Country retail strength	High	High	High-Medium	High
Market position	Strong	Strong with international market shares	Strong	Strong
Revenue (in EUR m)	7,949	21,361	230	16,060
Consumer goods category	Discretionary	Discretionary	Discretionary	Discretionary
Geographical exposure	Immediate neighbours	No countries >50% sales	One country	No countries >70% sales
Scope-adjusted EBITDA margin	6.9%	4.8%	5.3%	5.6%
Financial risk profile				
Scope-adjusted EBITDA interest cover	10.4x	19.6x	10.4x	17.5x
Scope-adjusted debt/EBITDA	2.2x	1.9x	2.6x	2.0x
Scope-adjusted FFO/debt	35%	49%	34%	50%
Scope-adjusted FOCF/debt	-6%	7%	-54%	17%

* Subscription ratings available on ScopeOne

Sources: public information, Scope

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