Fnac Darty S.A.
France, Retail

SCOPE BBB- Stable

Corporate profile

Fnac Darty is a French retailer specialising in consumer electronics and editorial products. Despite a strong focus on France (about 83% of group sales at YE 2020), 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	2018	2019	2020	2021E	2022E
Scope-adjusted EBITDA/interest cover (x)	9.1x	8.3x	11.1x	13.8x	15.2x
Scope-adjusted debt (SaD)/EBITDA (x)	1.4x	1.9x	2.1x	1.7x	1.5x
Scope-adjusted FFO/SaD (%)	53%	38%	37%	47%	54%
Scope-adjusted FOCF/SaD (%)	16%	11%	13%	10%	11%
Liquidity (internal + external)	170.2x	16.9x	18.7x	3.5x	1,177.4x

Rating rationale

The group's credit metrics have proved robust, given the higher resilience of its business than expected. This is due to a fast transition to online sales, which has counterbalanced the decrease in sales in physical shops.

In 2020, Fnac Darty's business model proved resilient and adaptable. The group successfully finished the year with revenue growth of +1.9% YoY/+0.6% on a like-for-like basis. This was despite a complicated macro environment, especially on the Iberian Peninsula (-9.5% growth of revenue YoY/-11.1% on a on a like-for-like basis), which burdened the growth potential of the group. Profitability was impacted, with a drop in EBIT of close to 25% YoY, mainly affected by a gross margin decrease of 120 bps while operating expenditures remained broadly unchanged. The main negative drivers were a decline in in-store traffic and ticketing sales, which impacted the gross margin by 80 bps and 45 bps respectively. Metrics, which are in line with our expectations, should improve from 2021. This is based on our expectation that profitability will recover due to a normalisation of activity in France. We therefore expect Scope-adjusted debt (SaD)/EBITDA of under 2x in the coming years.

Outlook and rating-change drivers

The Outlook is Stable and incorporates our opinion on the resilience of the retailer's business model. It assumes slight growth in revenues and profits in the coming years, correlated with our expectation of a gradual reopening of retail shops. We, however, anticipate slower recovery for the Iberian Peninsula and the ticketing business, which are not expected to return to pre-crisis levels before Q4 2021. We expect a gradual improvement in SaD/EBITDA to below 2x.

A positive rating action could be triggered if SaD/EBITDA stabilises at close to 1.5x on a sustained basis. This could follow a faster rollout and acceptance of the services which would positively impact the cash flow generation of the group. The reopening of the stores and a recovery of the macro condition would also positively impact the EBITDA generation.

Ratings & Outlook

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

Analysts

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Related Methodology

Corporates - Corporate Rating Methodology, February 2020

Corporates - Rating Methodology: Retail and Wholesale Corporates, March 2021

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A negative rating action is possible should the retailer increases its leverage to levels closer to 3x. An increase in leverage could be a result of a continuation of the lockdown measures in France, a low technological ramp-up or an increase of competition putting pressure on the cash flow generation of the group.

Rating drivers

Positive rating drivers	Negative rating drivers
• Top three player in Europe and dominant market share in France • Large range of products combines consumer electronics and editorial products • Higher profitability than most international competitors • Fast omnichannel transition due to high online sales • Relatively low leverage, leading to a good financial risk profile • Adequate liquidity	• 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 full exposure to French market only • Limited expansion into other countries due to the presence of strong local or international competitors in Europe • FOCF/SaD expected to stagnate at a non-investment grade level going forward, despite being relatively high for a retailer

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA close to 1.5x on a sustained basis	• SaD/EBITDA close to 3x on a sustained basis

Financial overview

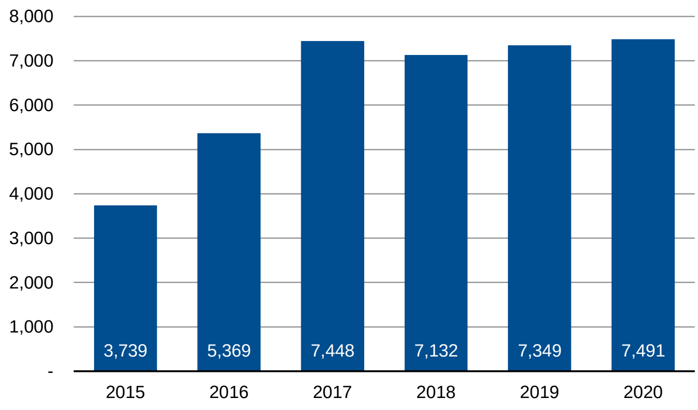
				Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted EBITDA/interest cover (x)	9.1x	8.3x	11.1x	13.8x	15.2x
SaD/EBITDA (x)	1.4x	1.9x	2.1x	1.7x	1.5x
Scope-adjusted FFO/SaD (%)	53%	38%	37%	47%	54%
Scope-adjusted FOCF/SaD (%)	16%	11%	13%	10%	11%
Liquidity (internal + external)	170.2x	16.9x	18.7x	3.5x	1,177.4x
Scope-adjusted EBITDA in EUR m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Reported EBITDA	367	585	551	579	631
Operating lease payment in respective year	210	0	0	0	0
Others	0	0	0	0	0
Scope-adjusted EBITDA	577	585	551	579	631
Scope-adjusted funds from operations in EUR m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Reported EBITDA	367	585	551	579	631
less: (net) cash interest as per cash flow statement	-33	-67	-47	-39	-39
less: cash tax paid as per cashflow statement	-72	-70	-66	-62	-76
less: pension interest expense	-3	-2	-1	-1	-1
add: dividends received	0	0	0	0	0
add: leasing adjustment (depreciation)	187	0	0	0	0
other changes (e.g. non-cash staff costs, capitalised interest)	-15	-12	-7	-7	-7
Scope-adjusted funds from operations	432	434	430	471	508
Scope-adjusted free operating cash flow in EUR m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Scope-adjusted funds from operations	432	434	430	471	508
less: leasing adjustment (depreciation)	-187	-221	-245	-245	-245
Net working capital	1	52	67	25	-5
Net capex	-118	-145	-107	-150	-150
Scope-adjusted free operating cash flow	128	120	145	101	108
Scope-adjusted debt in EUR m	**2018**	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt	911	2,029	2,569	1,816	1,815
add: leasing adjustment	454	0	0	0	0
add: pension adjustment	0	0	0	0	0
add: other off-balance sheet commitments	281	0	0	0	0
less: short-term investments (near cash)	0	0	0	0	0
less: cash net from restricted cash	-827	-896	-1,412	-805	-869
Scope-adjusted debt (SaD)	820	1,133	1,157	1,011	946

Business risk profile: BB+

Dominant player across Europe

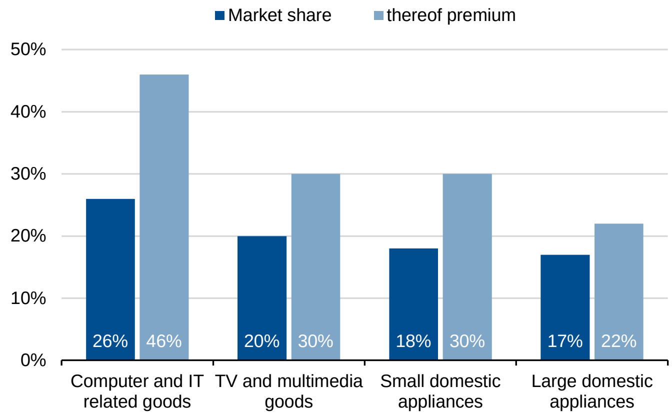
Fnac Darty is one of the top three largest consumer electrics retailers in Europe. France remains the group's main market, with 83% of sales versus 79% of sales one year before. Fnac Darty also operates in Belgium and Luxembourg (together 9% versus 10% one year before), the Iberian Peninsula (8% unchanged) and Switzerland (negligible and consolidated into the French sales data). In 2020, the group sold its activities in the Netherlands ('BCC') to a third party, Mirage Retail. While the main European non-pure player competitors, the German Ceconomy and English Dixon Carphone, remain larger in terms of size, the three retailers have little competition over the same geographical markets.

Figure 1: Fnac Darty's sales (EUR m)



Source: Fnac Darty, Scope Ratings

Figure 2: Fnac Darty's market share per consumer goods category at YE 2020



Source: Fnac Darty, Scope Ratings

Iconic brands in France

Fnac and Darty are iconic names in France, with 99% brand awareness each. Both also lead their national markets in omnichannel retail. The long-standing presence of the two companies in the French domestic market has led to each becoming the largest retailer in its respective sector, estimated to be significantly ahead of the competition (Conforama, Boulanger and But). Amazon and other pure player online retailers have benefitted slightly from the Covid-19 pandemic and consumers' forced transition to online platforms. According to Fnac Darty's management, the group should have a 7% online market share in France, tied with Cdiscount, but lagging behind Amazon's estimated 20%. That said, the group's brick and mortar positioning gives it a slight advantage over its online competitors.

Relatively resistant to Covid-19

Fnac Darty capitalised successfully on its established online distribution channels (which generated under 20% of total sales in recent years), increasing its customer coverage to close to 30% of total sales. The group gained 5 million new online active customers, leading to revenue growth above our expectations (+1.9% growth of revenue YoY/+0.6% on a like-for-like basis). This was despite a complicated macro environment, especially on the Iberian Peninsula (-9.5% growth of revenue YoY/-11.1% on a on a like-for-like basis), which burdened the growth potential of the group. The Iberian Peninsula was harder hit than most of its neighbouring countries, given the harsher lockdown / more constraining opening hours

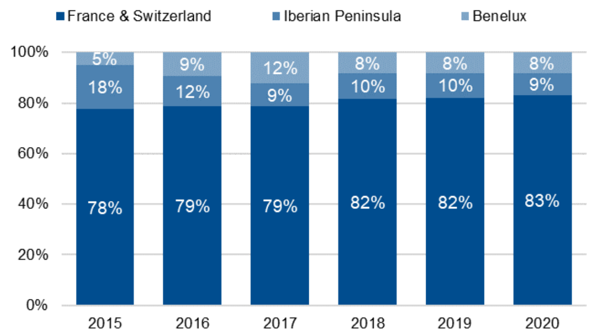
High-medium country retail strength

Our new sector methodology introduces a new analytical factor, 'country retail strength'. As most retailers have a significant national market share in their respective home countries, this factor allows us to classify and rank countries based on their retail size, maturity and growth potential. With the vast majority of Fnac Darty's sales in France, the group has an exposure to 'high-medium' countries. 'High-medium' countries generally have a mature and concentrated market, often in a developed economy. Sudden losses of market shares are therefore unexpected. We expect growth to be steady but lower than in emerging markets. Our assessment will therefore take into consideration alternative distribution channels such as omnichannels, click and collect, and drive.

Geographical outreach dominated by the weight of France

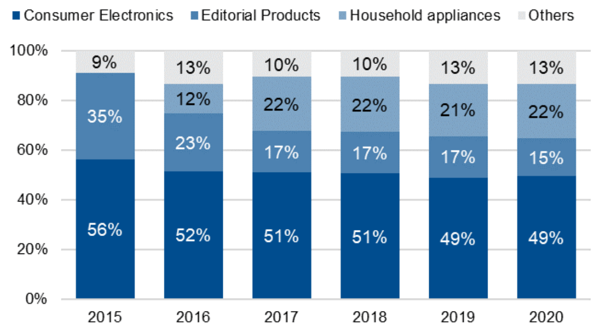
Geographical outreach remains good with high exposure in different countries, which is positive. That said, the dominance of France in the revenue and EBIT mix continues to slightly restrain the potential rating uplift for this criterion. In the absence of an acquisition which materially changes the scope of consolidation, we expect the group to continue to generate most of its sales and EBIT in France. The expected recovery of the Iberian Peninsula post-Covid-19 is likely to alleviate some of the national market pressure on this subrating. However, it is unlikely to sufficiently counterbalance the importance of the home market.

Figure 3: Fnac Darty's split of revenue per country



Source: Fnac Darty, Scope Ratings

Figure 4: Fnac Darty's split of revenue per product



Source: Fnac Darty, Scope Ratings

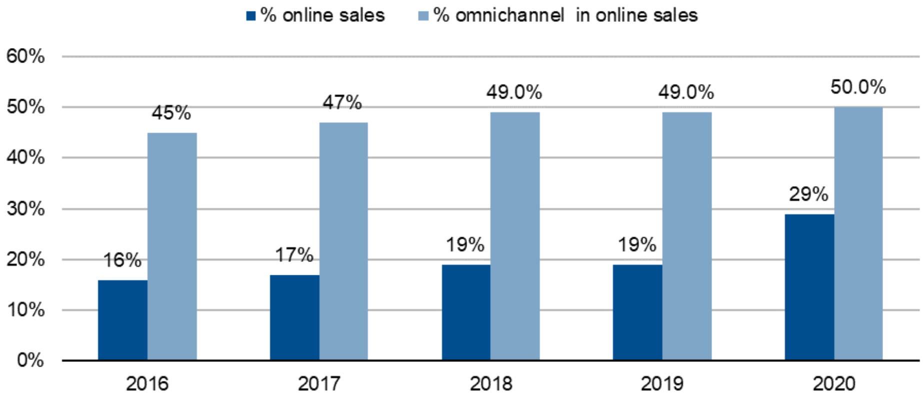
Broad product diversification

Fnac Darty surpasses its omnichannel peers in the number of product segments offered by providing a mixture of consumer electrical and electronics goods (white, grey and brown goods) and editorial products (audio, video and books). The positioning of the group towards home improvement products (IT, large and small domestic appliances) has ensured constant growth, and the risk of demand saturation is remote. The vertical integration of the group with regard to services should allow it to develop a certain recurrence of revenues and customer loyalty.

Omnichannel capability remains cornerstone of the rating

Fnac Darty's distribution channel evolution will be key to the development of the rating and remains the cornerstone for the group's future development (one of the group's main goals is to maintain online sales above 30% in the period to 2025). The rapid evolution of online sales, while impressive, is normal for the sub-industry. International competitors have all seen similar increases – adjusted for the lockdown period in each country. However, within this sales channel, Fnac Darty has reported that omnichannel represents 50% of online sales (click and collect), slightly above previous years' levels (48%-49%). This high share of omnichannel, combining e-commerce and brick and mortar, supports the group's development and maintains high footfall in its shops. We see it as one of the main rating drivers, which keeps online retailers at bay.

Figure 5: Fnac Darty's online channel evolution



Source: Fnac Darty, Scope Ratings

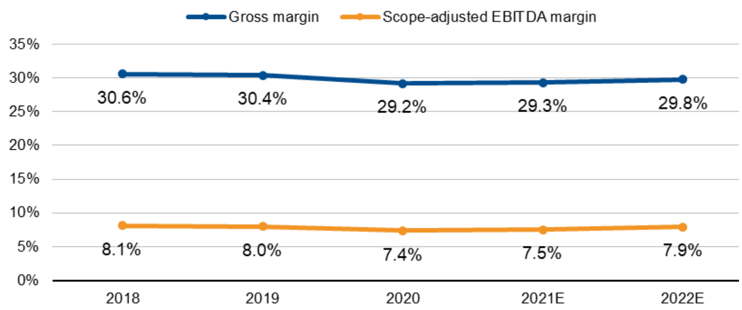
Decrease in gross margin

The pandemic's main impact has been on the gross margin of the group, which decreased by 120 bps due to: i) an unfavourable product mix (-80 bps), linked to a drop in footfall in shops and penalised editorial products; and ii) ticketing services (-45 bps). We view this gross margin decrease as a temporary effect. In 2021 we expect no further extensive lockdowns, temporary store closures, deteriorations in consumer confidence or supply chain issues which would keep profitability down. However, we have cautiously accounted for a relatively low gross margin at YE 2021. This reflects our expectation that lower-margin online sales will still represent a high share of sales.

Potential profitability increase due to strategy revolving around services

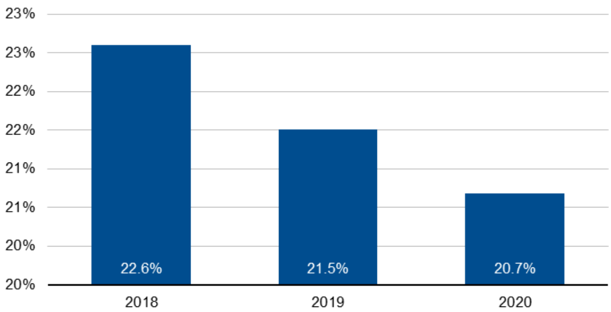
Fnac Darty has developed different initiatives to increase profitability. While horizontal expansion (with the acquisition of Nature & Decouvertes) is intended to increase the group's market shares and visibility, vertical development towards services should increase profitability. The group's 'Darty max' service gained 200,000 subscribers within a year of its launch but aims to serve 2 million customers by 2025. Subscribers to this yearly service receive unlimited repairs. The service will not only considerably increase customer loyalty (according to internal studies, 50% of French households have said they would use it) but also allows for better waste management. While warranty expansions contribute to immediate cash inflows, the Darty Max solution ensures longer and sustainable cash inflows.

Figure 6: Scope-adjusted EBITDA margin



Source: Fnac Darty, Scope Ratings

Figure 7: Scope-adjusted EBITDA return on assets



Source: Fnac Darty, Scope Ratings

Profitability margin expected to recover

The EBITDA margin was mainly impacted in 2020 by the gross margin decrease, which we expect to recover in the coming years. Fnac Darty's ambition to make 100% of its shops profitable (versus 95% today), the development of services, and investments to allow cheaper delivery costs should accelerate the group's profitability growth. We therefore expect the Scope-adjusted EBITDA margin to develop towards 8% of the S.A.EBITDA margin which is close to 2019's level.

Scope-adjusted EBITDA return on assets is high

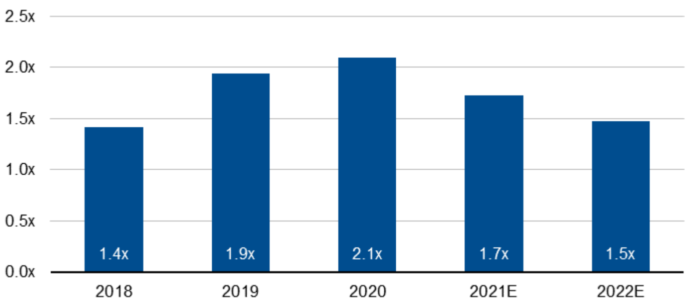
Our new retail and wholesale methodology impacts Fnac Darty's operating profitability rating due to the implementation of our Scope-adjusted EBITDA return on assets ratio. This metric[1] helps us to assess how easily a retailer can generate profits from a fixed base, common to each retailer. Fnac Darty's ratio is close to 21%. Thus, the group's high profitability is burdened by an asset base which is relatively heavy despite the growing weight of franchises over the years. We expect this metric to develop positively going forward, as we anticipate that the group will increase the profitability of all of its stores, gradually shift towards services and optimise store spaces (click and collect/stores in stores).

Financial risk profile: BBB+

Leverage metrics expected to develop positively

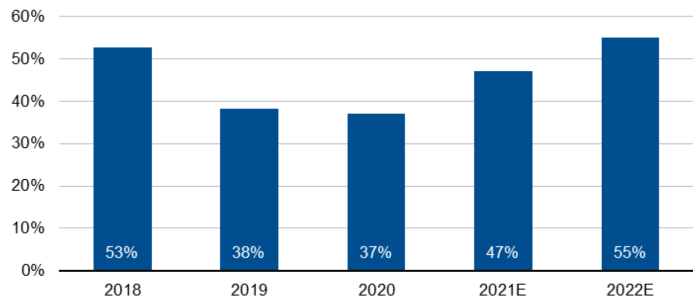
Leverage metrics have deteriorated to their worst levels since 2016. SaD/EBITDA and FFO/SaD reached 2.1x and 37% respectively at YE 2020, indicating the group's low leverage. The decreases in the two ratios are due to lower operating performance, with a slide in Scope-adjusted EBITDA while SaD remained constant. We expect the latter to remain at similar levels while EBITDA increases in the coming years, resulting in an improvement in both leverage ratios.

Figure 8: SaD/EBITDA



Source: Fnac Darty, Scope Ratings

Figure 9: FFO/SaD

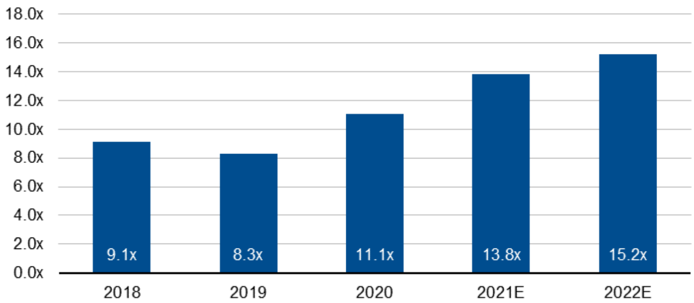


Source: Fnac Darty, Scope Ratings

Interest cover and cash flow cover remain high

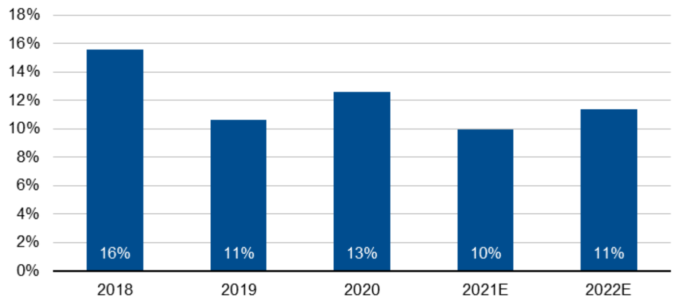
Interest cover remains high (well above the 7x). The refinancing of the term loan with convertible loans (OCEANEs) will bring the interest rate down even further. The FOCF remains surprisingly high for Fnac Darty. The group has very low capex levels (1% of the sales) and has benefitted from positive net working capital over the years. Fnac Darty has guided for capex of around EUR 120m over the next few years (with EUR 40m of additional costs). The group should therefore maintain high FOCF/SaD of close to 10% unless there is an unexpected rise in capex.

Figure 10: EBITDA interest cover



Source: Fnac Darty, Scope Ratings

Figure 11: FOCF/SaD



Source: Fnac Darty, Scope Ratings

[1] Scope-adjusted EBITDA / (PPE + leasing adjustments + inventory)

Liquidity is adequate

We expect liquidity to remain adequate, bolstered by the recently extended credit line of EUR 500m versus EUR 400m a year before. This is despite an anticipated drop in liquidity due to the repayment of the secured state loan of EUR 500m in the first half of 2021.

In EUR m	2020	2021E
Short-term debt (t-1)	77	553
Near-cash financial investments (t-1)	0	0
Unrestricted cash (t-1)	896	1,412
Unused factoring lines (t-1)	0	0
Free operating cash flow (t)	145	101
Liquidity (internal)	14x	3x
Open committed credit lines (t-1)	400	400
Liquidity (internal+external)	19x	3x

New shareholder remuneration programme mitigated by leverage target

The group has announced the launch of a dividend programme, with EUR 1 per share in 2021, increasing to EUR 1.5 in 2022. Fnac Darty has stated that the medium-term pay-out goal is 30%. While shareholder remuneration of this amplitude is new, we do not believe it will adversely impact bondholders. The group intends to maintain net debt/EBITDA below 2.0x – excluding IFRS16 adjustments - and we also expect discretionary cash flow to remain highly positive.

Debt class rating

We affirm the two instrument ratings on senior unsecured debt and short-term debt at BBB- and S-2 respectively. The short-term rating is supported by a strong liquidity (both internal and external) as well as the assumption that the relationships with banks and standing in capital markets are good.

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