Research Update:

Bertelsmann Outlook Revised To Negative On Weaker Growth Prospects; 'BBB+/A-2' Ratings Affirmed

March 27, 2020

Rating Action Overview

- A weakening global economy and structural challenges in linear free-to-air TV broadcasting will likely reduce advertising demand over the next quarters and reduce German media company Bertelsmann SE & Co. KGaA's earnings in 2020.
- In our view, the company's S&P Global Ratings-adjusted leverage could increase above 2.5x in 2020, although the depth and duration of the current economic downturn are uncertain amid severe government COVID-19 containment measures. Still, ample liquidity, solid cash generation, and available financial policy measures support the current rating.
- We are therefore revising our outlook on Bertelsmann to negative from stable and affirming our 'BBB+/A-2' ratings.
- The negative outlook reflects Bertelsmann's very limited rating headroom, while the challenging macro and industry environment could prevent the company from sustaining S&P Global Ratings-adjusted leverage below 2.5x.

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Rating Action Rationale

Contracting economies in Europe and the U.S. will weigh on Bertelsmann's earnings in 2020, diminishing the ratings headroom. Governments' COVID-19 containment measures will cut global economic growth in 2020 and trigger a global recession this year, in our view. We believe advertisers will likely reduce their marketing spending as the coronavirus pandemic escalates and growth sharply falls amid volatile markets and rising credit stress. Given that 22.5% of Bertelsmann's revenue relied on advertising demand in 2019, in particular RTL's TV broadcasting and Gruner+Jahr's magazine business, we expect Bertelsmann's earnings to fall in 2020. In our view, a structural decline in these industries as consumers consume more digital media content in the long term will worsen the fallout. Moreover, additional investment to ramp up new streaming services and content in the broadcasting segment will crimp group earnings. As a consequence, we now expect Bertelsmann's S&P Global Ratings-adjusted debt to EBITDA to rise above 2.5x, compared with 2.3x in 2019.

Uncertainties about the depth and duration of the economic impact of coronavirus and some possible execution risk on disposals cloud our visibility of earnings and cash flows. Given severe government containment measures and their uncertain duration, visibility on the group's earnings and cash generation is low, in our view. Our base case includes Bertelsmann's €600 million planned asset disposals in 2020, of which a significant share is already confirmed. Nevertheless, we believe that risks on the remaining disposals exist amid the weakening economy.

Business diversification will help to offset larger earnings pressure. While the acquisition strategy over the past year prevented the company from deleveraging, it also supported the group's diversification away from advertising-dependent revenue streams. The company ventured into business segments that we expect to be more resilient to macroeconomic forces compared to the global financial crisis in 2008-2009. In particular, we expect the music, education, and Penguin Random House (PRH) business (25% of group revenues) to hold up well this year. In addition, the RTL group generates material revenues from streaming directly to end-consumers, which we believe will be more resilient compared with advertising revenues in the current downturn, and also benefits from faster growing content production business that is less dependent on advertising.

Strong cash generation and available financial policy measures support our rating. The group has demonstrated strong cash conversion, as indicated by about €1.3 billion of free operating cash flow (FOCF) before lease repayments in 2019. In our view, management can materially reduce capital expenditure (capex) and dividends to preserve liquidity. In addition, the company can manage working capital needs and obtain temporary tax relief this year to preserve cash flows. At the same time, we view that a longer suspension of capex could undermine the company's long-term growth. That's because investments in new technology and services are important to sustain Bertelsmann's competitive advantage in light of structural changes and intensifying industry competition.

An ample liquidity buffer will provide financial flexibility over the coming months. Despite tighter credit markets, Bertelsmann was able to place a new benchmark bond. This issuance supports the group's cash balance ahead of the turmoil that we expect over the coming months. While we assess Bertelsmann's liquidity as strong, we understand that the bond proceeds will further support the company's balance sheet, prefund upcoming debt maturities, and will not be used for any additional acquisitions.

Outlook

The negative outlook reflects Bertelsmann's very limited headroom under the rating, while the challenging macro and industry environment could prevent the company from sustaining S&P Global Ratings-adjusted leverage below 2.5x. The outlook also reflects our expectation of weak advertising revenue growth and continued strategic investment needs to offset the structural decline in the broadcasting and magazine industries. If the coronavirus pandemic lasts longer and has a more severe effect on global economic growth and consumer confidence in Europe and the U.S. than we currently expect, it could also increase rating pressure.

Downside scenario

We could lower the rating over the next 18-24 months if Bertelsmann were unable to improve its adjusted leverage to below 2.5x and FOCF to debt to at least 20%, due to either earnings or cash generation underperforming our expectations. This could materialize as a result of a stronger demand decline in the broadcasting and magazine segments than our expectations, without offsetting benefit from more stable business units. A downgrade could also occur if we viewed Bertelsmann's competitive standing less favorably due to intensifying secular pressures in the broadcasting segment.

Upside scenario

We could revise the outlook to stable if Bertelsmann's earnings are less affected by the macroeconomic environment and structural industry changes than we currently expect. We could also revise the outlook to stable if the group manages its financial policy and capital allocation such that its S&P Global Ratings-adjusted leverage remains below 2.5x and FOCF to debt increases above 20% sustainably.

Company Description

Germany-based Bertelsmann is a diversified global media group with €18.0 billion of revenues generated in 2019. The group has a number of distinct business units, including broadcaster RTL Group S.A., book publisher Penguin Random House, magazine publisher Gruner + Jahr, music publisher BMG, media-related services Arvato, Bertelsmann Printing Group, Bertelsmann Education Group, and Bertelsmann Investments.

Our Base-Case Scenario

In our view, the sudden stop to the global economy caused by the coronavirus--and the sweeping efforts to contain it--will likely lead to a global recession. In 2020, we expect the coronavirus outbreak to dampen advertising revenue growth, although the length and severity of this are highly uncertain, which materially limits visibility for our forecasts. We will reassess the situation once the recovery from the outbreak becomes clearer. Our current forecasts assume:

- Revenue decline of up to 5% in 2020, compared with growth of 2% in 2019.
- Reported EBITDA margin of about 15.5% in fiscal 2020 and 2021, after 16% in 2019.
- S&P Global Ratings-adjusted EBITDA of about €2.4 billion-2.5 billion in 2020, after about €2.6 billion in 2019.
- Working capital outflow of about zero to €100 million. annually.
- Annual capex of €600 million-€650 million with flexibility to temporarily reduce if performance deterioration is steeper.
- Dividend payments of about €400 million annually with flexibility to reduce further if operating performance contraction is steeper.
- Asset disposals of €550 million-€650 million.

Based on these assumptions, we arrive at the following adjusted credit measures for 2020 and

2021:

- Debt to EBITDA of 2.4x-2.6x in 2020 and 2.3x-2.5x in 2021, after 2.3x in 2019;
- FFO to debt of 30%-33% in 2020 and 31%-34% in 2021, after 32.1% in 2019;
- FOCF to debt of 16%-18% in 2020 and 2021, after 20% in 2019.

Liquidity

We view Bertelsmann's liquidity as strong because we expect sources of liquidity to exceed uses by slightly about 2.2x over the next 12 months. The group benefits from sufficient committed credit facilities, our expectation of continued positive free cash flow generation, and only minimal debt repayments over the next year. We also consider that Bertelsmann has a strong relationship with banks and high standing in the credit markets, as indicated by the executed benchmark notes issue amid currently stressed capital markets and the fact that the RCF has no financial covenant.

Principal liquidity sources over the 12 months from Dec. 31, 2019, are:

- Unrestricted cash on balance of €1.6 billion;
- €1.2 billion revolving credit facility (RCF) due in 2024, which is currently fully drawn, increasing the cash balance by the same amount;
- Our forecast of cash FFO of about €1.7 billion-€1.8 billion; and
- €675 million acquisition financing facility, which is currently drawn and will be refinanced by asset disposals.

Principal liquidity uses over the same period are:

- Short-term debt maturities of about €350 million (consisting mainly of lease repayments);
- Seasonal and structural working capital outflow of up to €250 million peak intra-year outflow;
- Capex of €600 million-€650 million;
- Committed acquisitions of about €650 million; and
- Dividends of about €400 million.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Negative/A-2

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Media And Entertainment Industry, Dec. 24, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- COVID-19 Increases Pressure On Global Media & Entertainment Ratings, March 26, 2020

Ratings List

Ratings Affirmed	
Bertelsmann SE & Co. KGaA	
Senior Unsecured	BBB+
Junior Subordinated	BBB-

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Bertelsmann SE & Co. KGaA		
Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
Senior Unsecured	BBB+	
Junior Subordinated	BBB-	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.