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Research Update:

Bertelsmann Ratings Affirmed At 'BBB/A-2' On Expectation Of Strong Earnings And Continued Investments; Outlook Stable

April 26, 2022

Rating Action Overview

- Germany-based international media group Bertelsmann SE & Co. KGaA reported strong operating performance in 2021, with organic growth of 11.4% from 2020, improved EBITDA margin, and adjusted leverage reduced to 1.1x.
- We expect Bertelsmann to continue to report strong growth, with its adjusted leverage forecast to remain at about 1.7x-2.0x in 2022-2023. At the same time, we understand that the group's current low leverage is below its medium-term financial policy guidance and think that it could utilize its financial flexibility to invest in organic business growth and acquisitions.
- We affirmed our 'BBB/A-2' issuer credit ratings (ICRs) on Bertelsmann, as well as our 'BBB' and 'BB+' ratings on the group's senior unsecured and hybrid debt, respectively.
- The stable outlook reflects our view that Bertelsmann will maintain adjusted EBITDA margins slightly above 15% and adjusted leverage below 2.5x in 2022 and 2023. This incorporates our assumption that the group will use its existing financial flexibility to invest in growth and to increase shareholder distributions, which could translate into higher leverage compared with our base case.

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Rating Action Rationale

In 2021 Bertelsmann achieved stronger operating performance than we had expected. The group's revenue increased organically by 11.4% from 2020. This reflected a strong recovery in advertising revenue at broadcaster RTL Group (+13.5% organic growth) and content production, along with the solid performance of Arvato's services businesses (+16.8% organic growth). Its publishing business Penguin Random House (PRH) grew by 7.3% organically with the growth of audiobooks and printed books offsetting the reduction in e-books following a strong demand that emerged during the COVID-19 pandemic. The strong recovery in revenues and continued discipline in managing costs helped increase the group's S&P Global Ratings-adjusted EBITDA margins to

15.5% from 15.1% in 2020, despite a €170 million investment into its German cross-media streaming and entertainment platform RTL+ in 2021.

Leverage remains well below our expectations, leaving Bertelsmann with ample financial flexibility for the 'BBB' rating. Bertelsmann also completed the IPO of its customer services provider Majorel in September 2021, which generated €330 million of cash proceeds. The planned acquisition of Simon and Schuster (S&S) for a total consideration of $2.175 billion did not complete in 2021 as we had previously expected because of a lawsuit from the U.S. Department of Justice. As a result, the group has accumulated €4.6 billion of cash on balance and its S&P Global Ratings-adjusted leverage reduced to 1.1x in 2021--or 1.3x on a company-adjusted basis--from 1.8x in 2020, well below our expectations and its financial policy target guidance.

We anticipate in 2022-2023 Bertelsmann will maintain robust organic revenue growth exceeding 5% and sound profitability despite strategic investments. We think its core businesses such as outsourcing services Arvato, book publisher PRH, and music publisher BMG will continue to benefit from strong fundamentals in their respective industries and their strong market positions. Within RTL Group, we expect modest growth at linear TV broadcasters RTL Deutschland, RTL Netherlands, and M6 (which we continue consolidating as the merger with TF1 awaits regulatory approval) and solid growth at Fremantle production studios that will benefit from the strong global demand for content. This should help offset the structural decline in Bertelsmann Printing Group's rotogravure and offset markets, where revenue declined organically by 5.5% in 2021.

Bertelsmann will continue to face structural challenges such as audience fragmentation and migration from traditional media consumption and linear television to predominantly online, user-directed, on-demand video viewing. This will require additional investment in content and its digital distribution technologies, primarily in RTL Group. Bertelsmann plans to invest €5 billion to €7 billion across its businesses by 2025, including approximately €250 million to be invested into its streaming platform RTL+ in 2022. We think this will constrain the group's profitability and expect its adjusted EBITDA margin to remain at about 15.0%-16% in 2022-2023, in line with 15.5% in 2021. Efficiency improvements underpinned by synergies between Bertelsmann's different businesses, such as the recent integration of Gruner + Jahr's German magazine and publishing brands into RTL Deutschland will continue to support margins.

In our view, Bertelsmann's financial policy allows it to increase leverage beyond our base case, which constrains our rating on the group at 'BBB'. We assume the group will ramp up investments in organic business growth and mergers and acquisitions (M&A) in 2022-2023, and could distribute higher shareholder returns, including a modest increase in dividends in 2022. Hence, we expect that following the very low 1.1x S&P Global Ratings-adjusted leverage achieved at the end of 2021, Bertelsmann's adjusted leverage will increase to about 1.7x-2.0x in the next two years.

Bertelsmann's forecasted leverage will likely remain materially below its medium term leverage guidance. The guidance assumes a maximum company-adjusted leverage of up to 2.5x, which translates into about 2.3x S&P Global Ratings-adjusted debt to EBITDA. Given that the group plans significant capital investment, it is uncertain whether and when the S&S acquisition and TF1/M6 merger could complete, and the group has not committed to a stricter financial policy that would assume maintaining lower leverage, our rating remains at 'BBB' despite our forecast of adjusted credit metrics slightly below our upgrade threshold of 2x. At the same time, Bertelsmann has ample financial flexibility and leeway for funding growth initiatives under the current 'BBB' rating.

Bertelsmann's recent acquisition strategy has enabled it to diversify away from advertising-dependent revenue streams. Bertelsmann invested in and successfully repositioned its previously challenged business segments, which we think will support its continued solid operating performance over the next few years and make it more resilient to macroeconomic changes. In particular, we expect the music, education, outsourcing services, and publishing businesses (together generating about 65% of group revenue in 2021) to support growth. The acquisition of U.S. publisher S&S, along with the proposed merger between France-based broadcaster M6 (of which Bertelsmann owns 48.3% through RTL) and TF1 will foster resilience of its operations.

Outlook

The stable outlook reflects our view that over the next 24 months Bertelsmann will achieve solid organic revenue growth and maintain adjusted EBITDA margins slightly above 15% and adjusted leverage below 2.5x. This incorporates our assumption that the group will use its existing financial flexibility to invest in growth and to increase shareholder distributions. While we forecast S&P Global Ratings-adjusted leverage to remain in the 1.7x-2.0x range over the next two years, the rating and outlook consider some uncertainty around several large M&A and disposal transactions completing as planned, and our view that the group's current financial policy allows for higher leverage compared with our base case.

Upside scenario

We could upgrade Bertelsmann if it performs in line with our base case and absorbs ramp-up costs associated with its streaming businesses, such that it maintains solid adjusted EBITDA margins and cash flows, and commits to a financial policy that would, in our view, support S&P Global Ratings-adjusted leverage sustainably below 2x.

Downside scenario

We could lower the rating over the next 24 months if Bertelsmann's adjusted leverage increases above 3x, for example if:

- Its organic revenue growth and profitability weakens due to weaker macroeconomic conditions or an inability to adjust its business to intensifying structural challenges; or
- It pursues large debt-funded acquisitions, increases investments, or shareholder remuneration beyond what we incorporate in our base case, leading to leverage exceeding its current financial policy target guidance.

Company Description

Germany-based Bertelsmann is a diversified global media group with €18.7 billion of revenue and €2.9 billion adjusted EBITDA in 2021. It operates through several business units, including broadcaster RTL Group that has merged with magazine publisher Gruner + Jahr and includes broadcasters RTL Germany and Netherlands, book publisher PRH, music publisher BMG, media-related and outsourcing services Arvato, Bertelsmann Printing Group, Bertelsmann Education Group, and Bertelsmann Investments.

Bertelsmann is a privately held partnership limited by shares and ultimately controlled by the Mohn family. Three foundations (Bertelsmann Stiftung, Reinhard Mohn Stiftung, and BVG-Stiftung) indirectly hold 80.9% of Bertelsmann, with the remaining 19.1% held indirectly by the Mohn family.

Our Base-Case Scenario

Assumptions

- Eurozone real GDP to increase by 3.3% in 2022 and 2.8% in 2023; U.S. real GDP to expand by 3.2% in 2022 and 2.1% in 2023.
- Bertelsmann's organic revenue growth of about 5.3% in 2022, and 4.4% in 2023. This reflects the solid growth dynamics in its core businesses such as outsourcing services Arvato, publishing house PRH, and music publisher BMG which should help reduce the effects of a secular decline in Bertelsmann Printing Group's rotogravure and offset markets.
- We assume the acquisition of S&S will close by the end of 2022 and incorporate it in our 2023 forecast, assuming incremental revenues of €0.9 billion and a pro forma EBITDA contribution of about €160 million. We expect the integration of S&S to provide cost synergies and a healthy pipeline of new book titles that will support ongoing growth in publishing and the group's profitability.
- Within RTL Group, we expect modest growth at linear TV broadcasters RTL Deutschland, RTL Netherlands, and M6 (which we continue consolidating) and solid growth at Fremantle that will benefit from the strong global demand for content.
- We have not yet factored into our base case the proposed combination of M6 with TF1 as the deal awaits regulatory approval and the ultimate operating perimeter of the combined group post-merger remains uncertain.
- Adjusted EBITDA margin of 15.0%-15.5% in 2022 and 15.0%-16.5% in 2023, compared with 15.5% in 2021. This reflects our expectation of sustained organic growth, synergies, and cost efficiencies across different segments, that will be partly offset by cost inflation and investments in its content production and streaming business.
- Capex of €750 million in 2022 and up to €950 million in 2022 and 2023. These discretionary initiatives may be in the form of growth capex or music library acquisitions at the BMG level.
- Acquisitions of about €2.3 billion in 2022, including the $2.2 billion (€1.8 billion) acquisition of U.S. publisher S&S that could be approved by the end of 2022. In 2023 we assume spending on acquisitions of up to €650 million.
- Asset disposals of €300 million in 2022 from the sale of RTL Belgium and RTL Croatia.
- Annual working capital outflows of about €100 million.
- Dividends of about €480 million in 2022, slightly up from €410 million paid in 2021, and €430 million going forward.

Key metrics

Bertelsmann SE & Co. KGaA--Key Metrics*

	--Fiscal year ended Dec. 31--				
Mil. €	**2020a**	**2021a**	**2022f**	**2023f**	**2024f**
Revenue	17,289	18,696	19,700-20,200	20,700-21,500	22,200-22,700
EBITDA	2,608	2,906	2,950-3,100	3,200-3,350	3,400-3,600
EBITDA margin (%)	15.1	15.5	15.0-15.5	15.0-16.0	15.0-16.5
Free operating cash flow (FOCF)	2,096	782	900-1,200	1,000-1,250	1,150-1,350
Debt to EBITDA (x)	1.8	1.1	1.7-2.0	1.7-2.0	1.7-2.0
FOCF to debt (%)	44.2	24.2	15-25	20-25	20-25
DCF to debt (%)	28.0	10.9	c.10	10-15	c.15

*All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast. FOCF--Free operating cash flow. DCF--Discretionary cash flow.

Liquidity

We view Bertelsmann's liquidity as strong because we expect sources of liquidity will exceed uses by about 1.9x over the next 12 months. The group benefits from sufficient committed credit facilities, a large cash balance, and our expectation of continued positive free cash flow generation. We also consider that Bertelsmann has a strong relationship with banks and high standing in the credit markets.

Principal liquidity sources

- Our assumption of unrestricted cash on balance of €4.5 billion as of March 31, 2022;
- Fully undrawn €1.2 billion revolving credit facility (RCF) due in 2026;
- Our forecast of cash funds from operations of €1.6 billion-€1.8 billion; and
- €300 million proceeds from the RTL Belgium and RTL Croatia disposals.

Principal liquidity uses

- Debt maturities of about €695 million;
- Seasonal and structural working capital outflow of up to €250 million;
- Capex of approximately €750 million;
- Dividends of about €430 million; and
- Contracted acquisitions of €1.8 billion, considering the acquisition of S&S that we assume could close by the end of 2022.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors have an overall neutral influence on our credit rating analysis of Bertelsmann. We factor in management's good track record of strategic planning and execution, including effective monitoring and managing of social risks that media companies are facing.

Issue Ratings - Subordination Risk Analysis

Capital structure

Almost all debt of the group is unsecured and is issued at the Bertelsmann SE & Co. KGaA level. All senior notes rank pari passu and are senior to the €413 million debt-like profit participation notes and the group's €1.3 billion hybrid capital, which is also issued at the parent level.

Analytical conclusions

There is no structural or contractual subordination and we therefore rate the senior unsecured debt at 'BBB', the same level as our ICR on Bertelsmann. The hybrid capital is rated 'BB+', two notches below our ICR, due to:

- Its subordination in the capital structure; and
- The payment flexibility, reflecting that the deferral of interest on the notes is optional.

Ratings Score Snapshot

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Issuer credit rating	BBB/Stable/A-2
Business risk:	Satisfactory
Country risk	Very low
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	bbb+
Modifiers:	
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-1 notch)
Liquidity	Strong (no impact)

Ratings Score Snapshot (cont.)

Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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 | 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- U.S., Canadian, And European Telecom, Media, And Cable Majors Ranking: January 2022, Jan. 10, 2022
- Bertelsmann SE & Co. KGaA, Aug. 31, 2021

Ratings List

Ratings Affirmed	
Bertelsmann SE & Co. KGaA	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
Junior Subordinated	BB+

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