EF1+

INSTRUMENT RATING

Neu CP

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RATING ACTION AND RATIONALE

- EthiFinance Ratings has upgraded its short-term rating for the NEU CP instrument of Sonepar (of up to €1.5bn) to EF1+ (from EF1).
- This rating upgrade is driven by the confirmed strong business profile of Sonepar, being the world's largest B2B distributor of electrical products, solutions and services, and its global presence, with a strong local footprint and distribution network, as well as a diversified product offering and limited customer concentration. Moreover, the excellent current financial profile of Sonepar with solid cash flow generation, and an EthiFinance Ratings-adjusted net leverage ratio of 0.9x at end-2022, has also led us to make positive revisions to our credit metrics projections. Finally, the ESG company score, as the group has been reducing its carbon footprint, has also contributed to the upgrade of the rating of Sonepar.
- However, the rating is constrained by the industry risk assessment that derives from the group's exposure to the construction and renovation end-markets for residential and commercial buildings, which are subject to some degree of cyclicality.
- In line with our methodology, the retail industry has medium ESG risks (heatmap score of between 2 and 3.5), which is neutral on our industry assessment. Meanwhile, our assessment of the company's ESG policy is slightly positive (company ESG score of between 1 and 1.5). This results in a positive adjustment based on company's ESG considerations.

ISSUER DESCRIPTION

Family-owned Sonepar is the world's largest B2B distributor of electrical products, solutions, and related services, a fragmented market where the group holds a c.15% share globally (according to the company). The group's product offering (generally marketed under the manufacturers' brands) includes the following main segments: i) Infrastructure & Industrial Automation (38% of 2022 sales), which includes equipment for coupling and circuit protection, energy conversion and storage, sensors, actuators and consumption devices; ii) Cables & Wires (20%), including raceways, mouldings and cable trays; iii) Lighting (13%): lighting sources, interior & exterior lighting systems; and iv) Building Automation & Construction (9%), where products are essentially designed for the utilities industry. The majority of customers are installers (62% of sales in FY22), which act as intermediaries to end-users. They are usually construction firms in the residential and commercial building markets or specialist installers. Other customers are end-users in various industries (including parts manufacturers, public facilities and infrastructures), sourcing their products directly from Sonepar. The group has a global presence across 42 countries with c. 2,400 branches, 170 distribution centres, and 44.3k employees.

Over 2022, Sonepar generated €32.4bn of revenues, with an EthiFinance Ratings-adjusted EBITDA of €3.0bn, equivalent to a 9.2% margin, and a net adjusted leverage ratio of 0.9x.

FUNDAMENTALS

BUSINESS PROFILE

INDUSTRY RISK ASSESSMENT

- **Long-term growth drivers supported by rising energy needs and demand for electrical appliances**

The industry is anticipating positive long-term trends on the back of rising energy needs and demand for electrical appliances. This paves the way for further growth in all regions where the group is present, including in emerging markets where B2B electrical product distribution has had a low penetration rate so far. We expect Sonepar to benefit from these trends, especially in fragmented markets where the group is already present, and is well positioned to drive market consolidation.

- **Exposure to residential and commercial buildings end-markets comes with a certain cyclicality**

The group's sales are subject to some degree of cyclicality due to the group's exposure to the construction and renovation end-markets for residential and commercial buildings.

- **Significant size and CapEx required are effective barriers to entry**

The barriers to entry have been relatively low but are increasing significantly due to the major capex required in the fields of digitalization & logistics which small players cannot afford. Size is an important factor allowing stronger bargaining power vis a vis suppliers, better absorption of fixed costs, and the capacity to deploy large capex. These all lead to good price positioning, and superior services for customers.

COMPANY'S COMPETITIVE POSITIONING

- **World's largest B2B distributor of electrical products, solutions and services**

Sonepar is the world's largest B2B distributor of electrical products, solutions, and related services, a fragmented market where the group holds a c.15% share globally (according to the company). It benefits from its large scale, operating in four continents, with the bulk of sales being generated in Europe and North America (both contributing to c. 89% of 2022 revenues), where the group has leading market positions.

Sonepar has gone a long way to digitalizing its operations - and on this front the group is ahead of peers, which is expected to bring further efficiency gains and support margins. In 2022, digital sales accounted for 31.1% of total revenues (vs 25.2% reported by Rexel, its main competitor). This includes online sales (web and mobile) and “system to system” sales. This is a key factor, as intense competition results in low operating margins, making scale a major driver for profitability.

- **Sonepar has historically outperformed its direct competitors**

Sonepar has displayed resilience both in terms of operating margins, and cash generation during past economic downturns, outperforming its main peers over the past few years. It has consistently achieved a high level of free cash-flow, a positive factor that we expect to continue over the medium term.

- **Global presence with a diversified product portfolio and limited customer concentration**

The rating of Sonepar is supported by its strong local footprint and distribution network, which is reflected in the high numbers of branches (2,400), distribution centers (100), and brands (170) operated by Sonepar globally. The business is essentially local and, accordingly, transactional FX effects are marginal.

The group benefits from a diversified product offering in various segments. Moreover, the group has been recently focusing on developing its renewable energy product offer, which reached €2.2bn in FY22 (c. 5% of sales vs c. 3% in FY21).

Customer concentration is limited. Top 10 clients for each key country represent only a modest share of that country's sales (around 5-15%). Concentration could be more important for segments which serve specific industries, but these activities have limited scope.

GOVERNANCE

- **Shareholders**

The group was founded in 1969 by Henri Coisne and his brothers. Sonepar is still a family group owned by founding families (Coisne & Lambert) via the holding company Colam Entreprendre as well as other vehicles, bringing together over 400 shareholders from the two legacy families. The remaining capital was held by employees and management at end-2022. Some members of the family are present in the Corporate Board.

- **Stable and prudent financial policy with an excellent track-record**

The group has an excellent track record for growth combined with a very prudent financial strategy. The group's EBIT has almost tripled from 2016 to 2022 while our net adjusted leverage has gradually decreased from 2.5x to 0.9x. The financial policy involves (i) a reasonable indebtedness with a net reported leverage below 2.50x over the past 10 years, and (ii) limited shareholder distributions as most earnings are reinvested to support growth.

Sonepar has built in substantial financial flexibility. M&A is clearly a key component of its development strategy, which could periodically lead to some releveraging. However, we are reassured by Sonepar's good track record for integrating companies, and adhering to its disciplined financial policy. Over the past fourteen years the group completed, and successfully integrated over 140 small-to-medium-size deals (representing over €10bn of acquired sales). This was supported by its policy to involve local management in the acquisition and integration processes.

- **ESG policy**

Sonepar ESG's strategy is centered on three core pillars: (i) helping customers reduced their impact, mainly through the launch of its “Green Offer”. This consists of a methodology and environmental label enabling customers to measure the ecological footprint of products and help them chose the most sustainable ones; ii) training all of its associates, through its Energy Transition Academy, in order to promote best practices and be able to properly advise customers; and iii) reducing its own environmental footprint. Concerning the last item, Sonepar has committed to reduce, by 2030, its scope 1 and 2 emissions (buildings and fleet) by 46.2% (-12.6% in 2022 vs 2019 baseline). In addition, it aims to reduce its scope 3 emissions from purchase, use, end of life, and transportation of products from suppliers to Sonepar's customers by 13.5% (-3.7% in 2022 vs 2019 baseline). Moreover, in December 2022, the group joined the Science Based Targets initiative (SBTi) and pledged to set carbon reduction targets in line with the Paris Agreement to limit global warming to 1.5°C. The SBTi target validation team validated Sonepar's scope 1 and 2 targets and determined that they were consistent with a 1.5°C trajectory.

FINANCIAL PROFILE

RESULTS AND PROBITABILITY

Over 2022, Sonepar posted a strong growth in revenues of 22.9% yoy to €32.4bn. Electrical sales increased by 27.8% yoy to €31.4bn, of which 3.2% was related to higher volume growth, 15.3% to price inflation (11.6% from non-cable products), 5.0% to a positive FX impact and 2.9% to M&A activity. Overall, the group reported revenue growth in all its geographic divisions, particularly in North America (+29.5% yoy) and Western Europe & South America (+22.1% yoy).

In terms of profitability, the EthiFinance Ratings-adjusted EBITDA increased by 34.8% to c. €3.0bn, equivalent to a margin of 9.2% (vs 8.4% in FY21). Therefore, despite inflationary pressures, the group managed to improve its profitability, by mainly passing price increases to customers, as well as through cost reductions, which are also a result of its investment efforts into supply chain automatization and developing its digital platform.

CASH FLOW AND LEVERAGE

Free cash-flow (after dividends and M&A) was largely positive in 2022 (€433m vs €801m in FY21) despite a significant working capital cash outflow (-€1.1bn vs -€465m in FY21). This mostly resulted from an inventory build-up in order to face supply chain disruptions, as well as from higher capex (1.3% of sales vs 1.0% historically).

Sonepar has low leverage with an Ethifinance Rating's net adjusted debt/EBITDA ratio 0.9x at YE22 (vs 1.0x at YE21), which included IFRS 16 lease liabilities. We expect our adjusted leverage to remain close to 1.0x going forward, with moderate-to-medium acquisition expenditures and a significant capex (€2.5bn between 2021 and 2026). These are crucial to the modernization and automation of its supply chain (automated picking and cable cutting), and to continue developing its digital platform.

SOLVENCY

As of end-December 2022, Sonepar's consolidated gross debt amounted to c. €3.3bn, mostly related to private placements (€1.4bn at end-2022), on-balance sheet factoring in France (€150m), securitization programs in France and in the US (respectively €150m and $150m drawn at end-2022), and commercial papers (€89m outstanding at end-2022). The remaining debt mostly consisted of IFRS 16 lease liabilities. Our adjusted gross debt amounted to c. €3.8bn, and included €450m of adjustments related to the company's pension obligations (€232m at end-2022) as well as other financial liabilities (€217m et end-2022), primarily consisting of payables on company acquisitions and put options granted to non-controlling interests. Nearly all financing, mostly denominated in EUR and USD, has been raised at the level of the parent company Sonepar S.A.S. Also, at end-2022, the group had access to c. €2.1bn of undrawn committed revolving credit facilities, including a €1.1bn sustainability-linked RCF issued in December 2022, in addition to a cash position of €1.2bn.

LIQUIDITY

We assess the liquidity profile of Sonepar as "Superior", reflecting its strong refinancing profile and its high liquidity availability. Sonepar has a significant amount of cash on balance sheet, large undrawn committed credit lines, a long-term debt maturity profile, and a capacity to generate strong free cash-flow after dividends.

MODIFIERS

- **Country risk**

Taking into account Sonepar's excellent geographic diversification, no specific country risk has been identified.

- **Controversies**

Over the course of our review, we found no notable controversies.

CREDIT METRICS EXPECTED EVOLUTION (CMEE)

- **Stable CMEE**

Our Stable CMEE reflects our view that credit metrics should remain strong and broadly unchanged over the next twelve months.

MAIN FINANCIAL FIGURES

Main financial figures. Millions of €.				
	2020	2021	2022	22vs21
Revenues	22 744	26 366	32 408	22.9%
EBITDA adj.	1 563	2 222	2 996	34.8%
EBITDA Margin	6.9%	8.4%	9.2%	0.8pp
EBIT adj.	1 064	1 726	2 461	42.6%
EBIT Margin	4.7%	6.5%	7.6%	1.05pp
EBT	966	1 638	2 353	43.7%
Total Assets	14 596	17 118	19 424	13.5%
Equity	5 943	6 864	8 360	21.8%
Total Financial Debt	3 692	3 747	3 794	1.3%
Net Financial Debt	2 207	2 117	2 567	21.3%
Equity/TFD	161.0%	183.2%	220.3%	37.2pp
NFD/EBITDA	1.4x	1.0x	0.9x	-0.1x
Funds From Operations	1 221	1 834	2 316	26.3%
FFO/NFD	55.3%	86.6%	90.2%	3.6pp
EBITDA/Interest	15.9x	25.3x	27.7x	2.5x

RATING SENSITIVITY

Factors that may (individually or collectively) impact the rating:

- **Positive factors (↑).**

Sonepar already has the highest short-term rating.

- **Negative factors (↓).**

A downgrade to EF1 may come from a sustained deterioration of credit metrics, should margins fall or should the group adopt a more aggressive financial policy, for example in the event of a large debt-funded M&A deal. An EthiFinance Ratings-adjusted net leverage ratio above 1.7x, on a sustainable basis, could lead to a downgrade of our short-term rating to EF1. Moreover, a deterioration of the CMEE to “Negative” would also imply a rating downgrade.

REGULATORY DISCLOSURES

LEI: 969500VEVOWR22R2YR86

Initiation report: No

Rating initiation: EF1 for the NEU CP instrument rating on November 28, 2022

Last rating action: Initiation at EF1 for the NEU CP instrument rating on November 28, 2022

Rating nature: Solicited, public, short-term NEU CP instrument rating

With rated entity or related third party participation: Yes. This rating report was published after having been reviewed by the issuer.

With access to internal documents: Yes

With access to management: Yes

Ancillary services provided to the entity: In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.

Name of the rating committee chair: Guillermo CRUZ, Chief rating officer

Material sources used to support the rating decision:

- Consolidated financial statements 2020, 2021, 2022, 1H2023
- Discussions with Sonepar management & Group Presentation

Limitation of the Rating action:

- EthiFinance Ratings believes the quality and quantity of information available on the rated entity is sufficient to provide a rating.
- EthiFinance Ratings has no obligation to audit or verify the accuracy of data provided.

Our methodologies used for this rating are available at:

https://files.qivalio.net/documents/methodologies/CRA_190_V3_Corporate%20Methodology_2023-10-06.pdf

https://files.qivalio.net/documents/methodologies/CRA_191.Corporate_Rating_Methodology_Short_Term-202303.pdf

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