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CCC – Inks Deal To Sell CCC Germany, Buy Stake In HR Group

Recommendation: buy | target price: PLN 272.00 | current price: PLN 189.80

CCC PW; CCCP.WA | Retail, Poland

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CCC disclosed on Saturday that it had a conditional agreement in order to negotiate (1) the sale of a 100% stake in CCC Germany for a total price of 1 euro (ex. cash and inventory) to a subsidiary of HR Group Holding S.à.r.l. (HRG), (2) the purchase of a 30.5% stake in HRG for EUR 25.9m (of which EUR 5.8m payable in cash and the balance a shareholder loan of EUR 20.1m), (3) the extension of credit not exceeding EUR 35m to cover the costs of closures of non-performing CCC Germany stores and EUR 3.8m to cover other future integration costs, and (5) the conditions for exercising a call option for the remaining shares in HRG and put options with an estimated value of EUR 4.5m for HRG shares held by the other shareholders. The parties want to close the deal by the end of March 2019, and no later than by 30 June 2019.

According to our calculations, CCC is paying 9.2x 2018 EV/EBITDA for the HRG shares (based on HRG's LTM EBITDA for 9M'18) and 7.1x the 2019E ratio (assuming 30% growth in HRG's EBITDA combined with flat growth in net debt), multiples which are lower than CCC's current multiples of 18.4x and 10.5x, respectively. The divestment of CCC Germany in our view will result in the recognition of a much lower segmental EBITDA loss next year, projected at PLN 17m, versus a loss of PLN 60m anticipated this year. As a result, the total payment that CCC is making to HRG at approximately PLN 278m (PLN 6.7 per share) will be more than offset by a PLN 428m boost to CCC's valuation (PLN 10.4/share, with 2019E Equity Value/EBITDA at 10x), generated by offloading the loss-making German business. What is more, CCC and HRG (via a subsidiary operating the "Reno" chain of 280+ footwear stores based in Germany) agreed on cross-supply of their respective footwear lines starting from the 2019 autumn/winter season, a potential source of long-term cost advantage. On the whole, the deal looks good for CCC, however there is some risk that the restructuring of CCC Germany (store closures and rebranding) will take more time.

- **HRG is the second-largest mid-range footwear retailer in Germany.** Its business model is based on two pillars: (1) Retail, represented by 363 stores, which accounts for 61% of total sales, and (2) Wholesale, represented by 2,000+ partner locations, making up for the remaining 39%. The majority of the retail stores are based in Germany (accounting for 81% of total retail sales), and the rest are located in Austria and Switzerland. As part of a restructuring exercise over the last two years, HRG closed 100 loss-making stores.

HRG 2018-2019E Financials

(millions)	EUR	2018E PLN	2019E PLN
Revenue	370.3	1589.1	
Gross profit	181.4	778.7	
margin	49%	49%	
EBITDA	16.7	71.5	93.0
margin	4.5%	4.5%	
Net debt	69.3	297.4	297.4
Equity Value	84.8	363.8	363.8
Enterprise Value*	154.1	661.2	661.2
EV/EBITDA**		9.2	7.1

Source: CCC. Dom Maklerski mBanku; *assuming no change in debt; **assuming a EUR 20.1m shareholder loan is part of the payment for shares

- **HRG's LTM revenue as of 30 September 2018 was EUR 370.3m.** On a sales area of 182,0000 square meters, this implies average monthly revenue per square meter of PLN 589 versus PLN 566 generated in the same period by CCC. The LTM gross margin in September was 49%, and the EBITDA margin was 4.5%. **HRG's budget assumes EBITDA growth of 30% in 2019** not including synergy benefits from the CCC deal. This would imply a 2019 EBITDA target of EUR 21.7m after EUR 16.7m expected in 2018. HRG's net debt at 30 September stood at EUR 69.6m, of which EUR 55.6m bank borrowings, and the rest a shareholder loan and debt incurred by the subsidiary S4S.

- The **term sheet** between CCC and HRG discusses (1) the sale of a 100% stake in CCC Germany for a total price of 1 euro (ex. cash and inventory), (2) the purchase of a 30.55% stake in HRG for EUR 25.9m (of which EUR 5.8m payable in cash and the balance a shareholder loan of EUR 20.1m), and (3) the extension of credit not exceeding EUR 35m to cover the costs of closures of non-performing CCC Germany (the actual costs are not expected to exceed EUR 30m) and integration costs to the tune of EUR 3.8m. CCC also purchased a call option for the remaining shares in HRG exercisable within 24 months from closing based on IRR. HRG's ownership after the deal (with the EUR 20.1m loan extended by CCC converted to equity) will be divided between Capiton, the current controlling shareholder, with a 52.8% stake, CCC with 30.5%, and HRG's managers, holding a combined 16.7%.

Costs of HRG deals to CCC

(millions)	EUR	PLN
Shares	5.8	24.9
Shareholder loan (as payment for preferred shares)	20.1	86.3
Funding for CCC Germany restructuring*	35.0	150.2
Costs of post-merger integration**	3.8	16.3
Total	64.7	277.7
Total costs per CCC share		6.74

Source: CCC; *CCC assumes that the amount actually lent will not exceed EUR 30m; **The funding is capped at EUR 6.5m

Positive impact of HRG deals on CCC's Equity Value

(PLN m)	2019E*
EBITDA	780.1
Net debt	858.8
EV/EBITDA	11.1x
Enterprise Value	8 660
Equity Value	7 801
Equity Value/EBITDA	10.0x
Positive impact on EBITDA**	42.8
Equity value growth	427.8
Equity value growth per share (PLN)	10.4
Costs per share (PLN)	6.7

Source: CCC, *Estimates by Dom Maklerski mBanku; **Assuming an annual loss of PLN 60m from CCC Germany

- **After the sale, CCC is expected to recognize an EBITDA loss attributable to CCC Germany of an estimated PLN 17m in 2019, a big improvement on 2018, when the German business is expected to generate an EBITDA loss of PLN 60m** (after an operating profit of PLN 5m anticipated in the fourth quarter). Assuming the deal is closed as hoped by the end of March 2019, we expect from then on CCC Germany will be disclosed on CCC's financial statements as "discontinued operations." **By reducing next year's EBITDA loss by PLN 43m with the sale of CCC Germany, according to our calculations CCC is poised for an equity value boost of PLN 428m, i.e. PLN 10.4 per share (with Equity Value/EBITDA at 10x), representing added value which more than offsets the costs of the whole transaction, estimated at PLN 6.7 per share.**

List of abbreviations and ratios contained in the report.
EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
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HOLD – we expect that the rate of return from an investment will range from –5% to +5%
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