GBB-Rating

A-

negative

Rating Committee: 07/01/2021

GRENKE AG (consolidated group)

Rating result

Strengths/Opportunities:

- Material criticisms of the short seller have been invalidated
- Restructuring of franchise business is a crucial step towards enhanced transparency
- Findings are being rigorously addressed and remedied. Measures have been initiated quickly and in some cases already implemented
- Granular portfolio, broad risk diversification
- Capital base remains very solid
- Lean processes thanks to highly developed standardization and automation

Weaknesses/Threats:

- Final assessment of special audits by the supervisory authority and disclosure of outcomes still awaited
- Management/personnel capacities constrained by audits and dealing with their findings
- Implications for cost structure remain unknown
- Adverse effect on reputation and access to the capital market
- Economic burden arising from effects of the COVID-19 pandemic (including on new business)
- Significant portion of business volume in countries with a difficult economic and/or political landscape
- Forecast of global rise in insolvencies

Financial data:

(Amounts in kEUR)	2020
Change in embedded value	- 34,989
Ordinary comprehensive income	125,172*
Economic result	90,183
Total assets	7,331,781
Net profitability	1.2 %
Modified equity ratio	20.6 %

* before extraordinary costs

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In September 2020 Viceroy Research LLC made serious allegations against GRENKE AG which triggered the initiation of several (special) audits to clarify the issues raised. Material criticisms, such as concerns about the substance of the company's leasing operations for example, have been invalidated. GRENKE AG is successively assimilating and resolving the findings. Some of the measures that were initiated early have already been implemented, while others are expected to be largely completed by the end of the current financial year. A final assessment by the supervisory authority is still awaited.

Especially in view of a regressive financial profile, the rating of GRENKE AG (consolidated group) has been lowered by one notch to A-. The earnings position, in particular, is under pressure due to the COVID -19 pandemic. Giving consideration to a market climate that will remain difficult this year as well as the progress that still needs to be made in the Company's governance and risk & compliance management to restore investor confidence, the outlook remains negative. The ongoing measures that are seeking to address these issues and the awaited final assessment of the special audits by the supervisory authority are among the reasons for the rating remaining on watch. The economic viability of the business model continues to be ranked highly.

A subsidiary belonging to GRENKE AG, namely GRENKE Bank AG, is a credit institution which, by purchasing lease receivables, plays a key role in the refinancing strategy of the GRENKE consolidated group. As of October 8, 2020, the credit quality of GRENKE Bank AG is likewise high.

In view of the extensive audits, publication of the consolidated financial statements for 2020 of GRENKE AG, which have been audited and provided with an unqualified opinion, was delayed until May 21, 2021. For the first time, all the franchise companies were fully consolidated and adjusted with retroactive effect from 2019. The realignment of the franchise business also includes the takeover, by no later than the end of 2022, of the companies that currently do not belong to the group. This move will increase the transparency of transactions with related parties. Net profit for 2020 stood at €88m, which is much less than the €133m posted for the previous year. The downturn is attributable to a decline in new business, an increase in provisions for risks (from €137m to €202m), and significant auditing and consulting expenses. In the current year, GRENKE anticipates a further decline in net profit to around €50m to €70m, new leasing business in the amount of €1.7bn to €2.0bn (€2.0bn in 2020), and a stable equity ratio of more than 16 %. Figures for the first quarter of

Summary:

Rating criteria	Rating
Financial profile	adequate
Business profile	
- Market	adequate
- Organization	adequate
- Risk profile	adequate

(strong > adequate > acceptable > unsatisfactory > weak)

Rating history:

Rating	Outlook	Date
A-	**negative**	**07/01/2021**
A	negative	10/08/2020
A	stable	03/26/2020
A	stable	10/31/2019
A	stable	11/05/2018

Rating scale:

Rating	Rating categories
AAA	highest financial standing
AA+ / AA / AA-	very high financial standing
A+ / A / A-	high financial standing
BBB+ / BBB / BBB-	good financial standing
BB+ / BB / BB-	satisfactory financial standing
B+ / B / B-	financial standing scarcely adequate
CCC+ / CCC / CCC-	financial standing no longer adequate
CC / C	inadequate financial standing
D	moratorium / insolvency proceedings

2021 are below those reported in the corresponding period of 2020, when the COVID-19 pandemic was yet to exert a significant influence. GRENKE expects business to pick up in the second half of 2021.

Its still highly granular portfolio and broad risk diversification are to be seen in a favorable light. By focusing on small-ticket business that generates a high contribution margin, GRENKE AG raised its contribution margin 2 from 17.0 % in 2019 to 18.4 % in 2020 and 19.5 % as of March 31, 2021. As is typical of its business model, the share of non-performing receivables is relatively high. In view of the significant portion of business volume generated in countries with a difficult economic and/or political landscape, developments require further monitoring.

Although the sharp rise in cash and cash equivalents increases financial independence, it also imposes a burden on profitability. Attention is drawn to the constraints imposed on management/personnel capacities by activities following on from the (special) audits. It remains to be seen whether any structural cost implications will materialize.

Rating-sensitive factors

Factors capable of stabilizing the rating result include a final assessment of the supervisory authority confirming the invalidity of material criticisms, as well as the restoring of investor confidence and a sustained substantial improvement in the economic climate. The rating result reflects an assumption that the reported capital position will persist.

Among the factors that would impose a burden on the rating result are remedies for the audit findings that are inadequate or too slow, a significant weakening of credit quality, an appreciable downturn in profits or new business, and a lasting impairment of funding opportunities/terms and conditions.

Unexpected economic and/or legally relevant negative outcomes arising from the supervisory authority's assessment could likewise weigh upon the rating result. In view of the high degree of process automation, general consideration is to be given to the company's elevated dependence on functioning IT systems and the availability of suitable skilled (IT) employees. The persistence of the COVID-19 pandemic continues to feed a highly uncertain economic outlook. Against this backdrop, the future course of the pandemic and the possible impairment of economic activity are further factors that could place a burden on the rating result.

Regulatory disclosure requirements

Name and function of analysts:

- Christina Weymann, Lead Rating Analyst, Senior Manager GBB-Rating, Cologne
- Kerstin Kittlitz, Rating Analyst, Manager GBB-Rating, Cologne

Company address:

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Members of the rating committee:

- Harald Erven, Senior Manager GBB-Rating, Cologne
- Klaus Foro, Manager GBB-Rating, Cologne
- Thomas Sauter, Junior Manager GBB-Rating, Cologne
- Carlo Pflitsch, Junior Manager GBB-Rating, Cologne

Date	Rating Committee	Notification	Issue
First rating	10/01/2014	10/01/2014	10/06/2014
Current rating	07/01/2021	07/01/2021	07/02/2021

Validity:

- Rating: 12 months
- Outlook: 24 months

Subsequent rating changes after notification to the rated entity:

- none

Major sources of information for the rating:

- Annual report as at 12/31/2020
- Quarterly statement for the 1st quarter 2021
- Answers provided by the company to a detailed questionnaire
- Management calls on 03/01/2021 and 05/27/2021
- Further disclosures and company specific information

Statement about the quality of information available (including potential restrictions):

- The quality and extent of information (interviews and documents) were suitable to obtain a comprehensive picture of the company and to assign an objective, transparent and professional credit rating

Applicable rating methodology, rating type and release:

- Solicited Rating
- Methodology for Rating Leasing 2.3.04
- https://gbb-rating.eu/en/ratings/methodik/Pages/default.aspx

Meaning of the rating category:

- https://gbb-rating.eu/en/ratings/ratingskala/Pages/default.aspx

Business relationship:

- Besides the rating mandate there are further business relationships with GRENKE BANK AG

Legal remarks

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Future events are uncertain. Ratings are based on predictions of these and thus inevitably rely upon estimates. Therefore, they solely represent statements of opinion rather than statements of fact or investment advice.

Credit ratings are performed with proficiency and due professional care. Ratings are based on the data and information provided by the applicant. This information is used in reaching an opinion about the future viability as well as the strengths and weaknesses of the rated company as of the date of rating issuance.

GBB-Rating puts focus on sustainability and is a signatory of the UN Global Compact since 2018. We support the 10 principles of the UN Global Compact relating to human rights, labor standards, the environment and anti-corruption.

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