Ceconomy AG
Germany, Retail

SCOPE BBB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2019/20**	**2020/21**	**2021/22E**	**2022/23E**
Scope-adjusted EBITDA/interest cover	20.1x	20.9x	17.8x	16.5x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	1.6x	1.5x	2.7x	2.6x
Funds from operations/SaD	59%	54%	33%	30%
Free operating cash flow/SaD	39%	-4%	-14%	4%

Rating rationale

We expect pressure on the group's profitability margins in 2021/22 due to high inflation and supply chain bottlenecks. This is despite management's significant efforts to decrease costs and our expectation they will be passed on to customers to a certain extent. These adverse factors come at an unfavourable time as Ceconomy is still transitioning its business models toward more flexible and lean operations in all businesses. For example, the group has a clear strategic goal to increase online sales and omni-channel deployment in order to enhance its capacity to maintain high online sales. This target is despite the end of the pandemic, which should gradually decrease Ceconomy's online penetration. The group continues to count on its high market positioning across Europe and broad product diversification to achieve these ambitions. While we expect profitability to decrease, Ceconomy still benefits from relatively low leverage, which will partially mitigate the impact of the deterioration in profitability on credit metrics in the coming years.

Outlook and rating-change drivers

The Outlook is Stable and incorporates a decrease in Ceconomy's Scope-adjusted EBITDA margin towards 4%. This translates into SaD/Scope-adjusted EBITDA surpassing 2.5x in BY 2021/22 before reverting to lower levels in the following years, as we expect a certain normalisation of the macro economic environment. The Outlook also assumes no M&A or significant debt issuance in the coming years.

A Positive rating action could be triggered by an improved business risk assessment, for example, through better operating margins than expected or by keeping SaD/Scope-adjusted EBITDA below 2x on a sustained basis.

A Negative rating action could result from sustainable SaD/Scope-adjusted EBITDA well above 2.5x following 2021/22, as it would indicate that the negative macro-conditions have deeper lasting effects than the ones that we are currently forecasting.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
24.05.2022	Affirmation	BBB-/Stable
24.06.2021	Affirmation	BBB-/Stable
16.09.2020	Confirmation	BBB-/Stable

Ratings & Outlook

Issuer	BBB-/Stable
Short-term debt	S-2
Senior unsecured debt	BBB-

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Related Methodology(ies) and Related Research

Corporate Rating Methodology; July 2021

Retail and Wholesale Rating Methodology; April 2022

ESG considerations for the credit ratings of retail corporates; November 2021

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Europe’s leading consumer electronics retailer in terms of size and market shares • High diversification in terms of geographical outreach and product range • Strong balance sheet with limited debt and long maturities • High interest cover due to low net cost of debt	• Expected pressure on business due to rising inflation in Europe • Group business model in transition leading to low profitability base • Net cash flow expected to be under pressure due to negative net working capital in 2021/22

Positive rating-change drivers	Negative rating-change drivers
• Keep leverage below 2x on a sustained basis • Improved business risk profile	• Sustainable SaD/Scope-adjusted EBITDA well above 2.5x following 2021/22

Corporate profile

Ceconomy is Europe’s leading consumer electronics retailer with about EUR 21bn of annual revenues and close to 45,000 full-time equivalents. Ceconomy’s activities are widely spread across Europe. The group holds market leader positions in eight countries (being either number one or number two) but has an overall geographical outreach to 13 countries, totalling 1,018 stores at end-October 2021. The group has four historical shareholders: Haniel, Meridian Stiftung, freenet AG and Beisheim. By the end of fiscal year 2022, the existing MediaMarktSaturn shareholder, Convergenta Invest GmbH, will become Ceconomy’s largest shareholder, with voting rights of close to 26%.

Financial overview

				Scope estimates		
Scope credit ratios	**2019/20**	**2020/21**	**LTM H1 2021/22**	**2021/22E**	**2022/23E**	**2023/24E**
Scope-adjusted EBITDA/interest cover	20.1x	20.9x	18.2x	17.8x	16.5x	17.6x
SaD/Scope-adjusted EBITDA	1.6x	1.5x	2.3x	2.7x	2.6x	2.4x
Funds from operations/SaD	59%	54%	31%	33%	30%	32%
Free operating cash flow/SaD	39%	-4%	7%	-14%	4%	5%
Scope-adjusted EBITDA in EUR m						
EBITDA	991	1,103	957	963	950	1,000
Other items[1]	-5	4	-	-4	-	-
Scope-adjusted EBITDA	**986**	**1,107**	**957**	**959**	**950**	**1,000**
Funds from operations in EUR m						
Scope-adjusted EBITDA	986	1,107	957	959	950	1,000
less: (net) cash interest paid	-45	-48	-47	-49	-52	-52
less: cash tax paid per cash flow statement	17	-104	-159	22	-121	-155
Change in provisions	-53	-48	-65	-101	-37	-30
Funds from operations	**905**	**907**	**686**	**831**	**740**	**763**
Free operating cash flow in EUR m						
Funds from operations	905	907	686	831	740	763
Change in working capital	314	-354	91	-436	140	190
less: capital expenditure (net)	-92	-122	-142	-250	-300	-350
less: operating lease payments	-530	-503	-487	-503	-486	-473
Free operating cash flow	**597**	**-72**	**148**	**-358**	**93**	**130**
Net cash interest paid in EUR m						
Net cash interest per cash flow statement	45	48	47	49	52	52
Change in other items	4	5	6	5	5	5
Net cash interest paid	**49**	**53**	**53**	**54**	**57**	**57**
Scope-adjusted debt in EUR m						
Reported gross financial debt	2,422	2,867	2,641	2,690	2,640	2,540
less: adjusted cash and cash equivalents adjusted from restricted cash	-1,384	-1,482	-711	-444	-453	-449
add: pension adjustment	496	295	293	295	295	295
Scope-adjusted debt	**1,534**	**1,680**	**2,223**	**2,541**	**2,482**	**2,386**

[1] Includes 'gains from the disposal of fixed assets and gains from reversal of impairment losses' and 'net impairments on operating financial assets and contract assets'

Table of Content

Environmental, social and governance (ESG) profile[2]

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

ESG profile: adequate

Governance plays an important role in the group's management. The last years have seen significant management turnover, indicating a clear instability in long-term decision making. We now expect these issues to have been resolved.

Ceconomy's home market has a country retail strength of 'high'. As such, we expect ESG considerations to form a major part of the group's business decisions due to higher investor scrutiny and greater customer awareness of environmental and social matters. Reputational risk is a major social criterion for retailers. For example, a product or type of labour management that has a negative social impact may prompt consumer boycotts, affecting sales, margins and inventory value. We do not see risk for Ceconomy in this area. Discretionary retailers are under increasing pressure to ensure the sustainability of their products in terms of durability and repairability. A strong commitment in this regard is likely to improve brand value.

Lastly, the environmental footprint of a company's brick-and-mortar shops will remain fundamental to its development. This is especially the case for Ceconomy due to its historically large 'core' shops. Ceconomy will have to continue balancing the challenges of improving the energy efficiency of its hypermarkets and increasing the flexibility of its space to incorporate additional distribution channels (e.g. click and collect) while maintaining a high-quality shopping experience.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB-

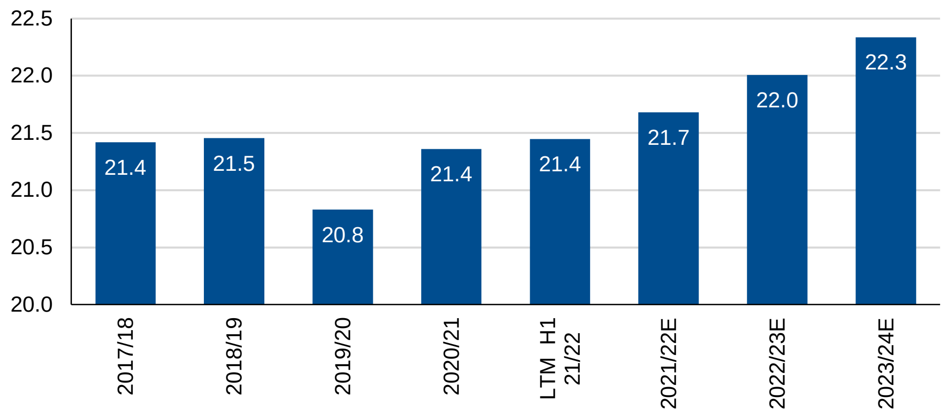
Industry risk profile: BB

Based on its products sold (mainly electronic goods), Ceconomy is a discretionary retailer. This leads to an industry risk profile of BB. Although the group has operations within services, these activities are too limited to warrant a blended approach to Ceconomy's business risk profile.

High market position...

Ceconomy continues to benefit from its European dominance in terms of market position. Its vast deployment across 13 European countries makes Ceconomy the largest physical electronic goods retailer in Europe. The market remains clustered. Strong physical players each have their catchment areas: Fnac Darty mainly in France, Dixon Carphone in the UK and Scandinavia, and Ceconomy in the DACH region and southern and eastern Europe.

Figure 1: Evolution of the revenue of the group in EUR bn



Sources: Ceconomy, Scope estimates

...in a competitive market

The group assesses that it is either the number one or number two in eight of its countries of operations (number one in six). It does, however, face strong competition from Amazon and other physical retailers such as Dutch Coolblue and Euronics affiliates. We believe the group's strong omnichannel positioning (32.5% of online sales over total sales with 43% in click and collect at BY 2020/21) will continue to support its market position, allowing it to remain Europe's largest consumer electronics retailer. Ceconomy estimates that the markets in operation see 25% of the volume of the consumer electronics to be online (data as of BY 2018/19) and that the volume could reach 33% by 2022/23. The group aims to accelerate the deployment of its online sales and pick-up possibilities, highlighted by their promise to deliver in shops within 30 minutes. These deployments will be supported by the development of large, automated warehouses in most countries, such as the German warehouse in Göttingen, set up in the current business year.

Germany is the main market

With close to 50% of both revenue and EBIT (latter estimated by us) generated in Germany, the group's performance is strongly correlated to its home market. Competition is likely to be relatively fierce because e-commerce penetration is high and electronic goods are estimated to be the main items purchased by households on the internet[3]. While this heavy dependency on a single market would normally be negative, the group's positioning in Germany is 'iconic', with very strong brand awareness across the nation. We consequently expect limited substitution with comparable competitors.

[3] Source: ecommercedb

Pressure on the market

While we expect Ceconomy's market share dominance to continue in the coming year, we expect the overall market to shrink slightly due to pressure on consumer spending (inflation) and on product ranges (logistics bottlenecks). The former is likely to impact consumers' discretionary spending and could decrease the revenues generated from 'spontaneous' purchases. The latter could delay the arrival of some highly sought-after products.

Potential mitigation

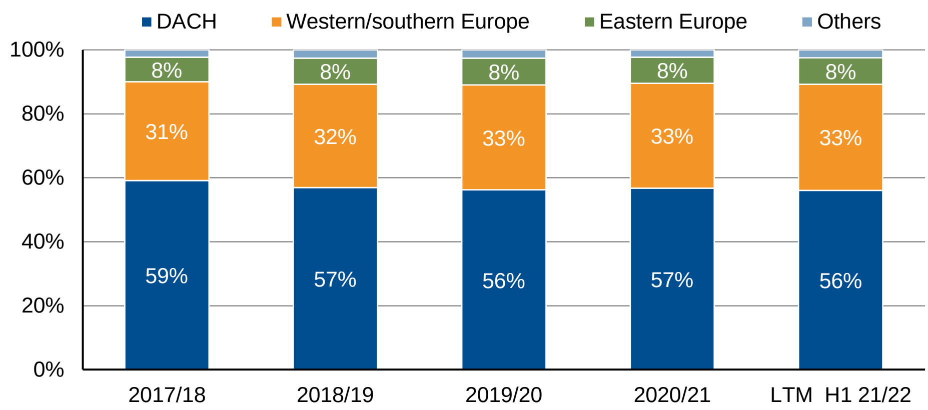
These pressures are, however, likely to be somewhat mitigated by the following:

Strong omnichannel positioning. Customers shopping via omnichannels tend to have a 50% higher ticket than single-channel shoppers[4]. The group's 'promise' to provide a pick-up option within 30 minutes after the online order has been placed should also reinforce sales.

'New pool of income' (Services & Solutions and Marketplace). While both services' contributions to sales are currently low, their recent deployments in Ceconomy's main countries of operation should increase long-term customers loyalty (for Services & Solutions) and passively benefit from transactions made on the online platform (Marketplace).

Reworking of stores. The group is considerably reworking its portfolio network. While the overall number of stores has remained roughly stable since the end of 2020, at over 1,000 stores, the group's selling area has decreased (from 2,784 thousand sqm at end-October 2018 to 2,591 thousand sqm at end-October 2021). This decrease in sellable area should not shrink the customer catchment area (90% of brick-and-mortar customers as well as 71% of the countries' populations live within 25km of the stores). Ceconomy aims to cut the size of its core format stores (from 2,500 sqm historically to 1,750 sqm) and to enhance the shopping experience via its recent experimental 'lighthouse' concept stores (currently in Milan and Rotterdam) – to be rolled out in new locations shortly. These are expected to give customers the opportunity to try out and test different products in the shops. The group believes that these stores will generate higher sales and EBIT.

Figure 2: Geographical outreach per European region



Sources: Ceconomy, Scope

High geographical outreach

Ceconomy is supported by high overall diversification. The group is one of the few European non-food retailers which has developed a large footprint across multiple regions of the continent. However, this broad diversification does not alter the fact that

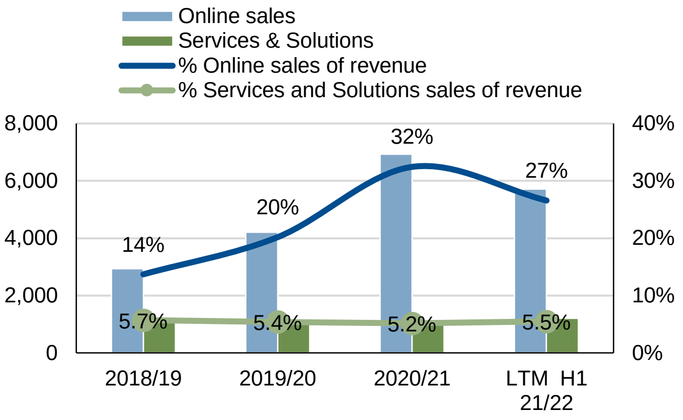
[4] Source: PwC Strategy&

Germany represents the majority of the group's sales: 46% at 2020/21 and 49% at 2019/20. Italy and Spain are the group's second largest markets, with close to 10% of total sales generated in each, respectively. Given the relatively high resilience of the German economy, we see Ceconomy's overreliance on this country as a smaller risk than it would be for other European countries.

Strong development of channel diversification

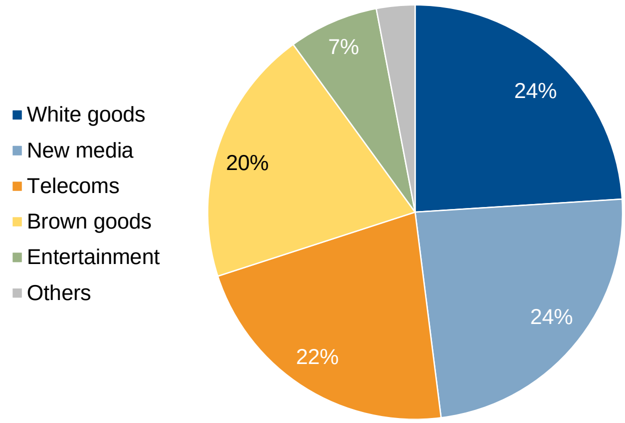
Ceconomy's online sales have grown, benefiting from purchases shifting to this platform during the Covid-19 outbreak when shops were fully/partially closed. This provided strong tailwinds for a group which had historically low online penetration due to low investment in this channel. The group has now almost caught up with the international average for the sub-sector. We expect the development of this channel to accelerate in the coming years, despite less momentum in BY 2022/2023 due to the lifting of restrictions in shops, thanks to Ceconomy's heavy investments in warehouses and pick-up offers, supported by high demand as 75% of customers are estimated to use the omni-channel approach. The group has successfully launched its 'omnichannel spine' initiative to connect IT, logistic and orders more efficiently in the Netherlands. Its roll-out to other countries is expected in the coming years.

Figure 3: Services & Solutions and online sales



Sources: Ceconomy, Scope

Figure 4: Split of products in terms of sales (BY 2020/21)



Sources: Ceconomy, Scope

Good product diversification

Product diversification is good, benefitting from a strong presence in goods classified by our sectorial methodology as 'household products' (white goods) and 'consumer electronics' (brown goods, new media[5], telecoms and others[6]). While new products are expected to increase Ceconomy's product range (especially with the scaling up of the marketplace), we expect that Ceconomy will continue to generate the lion's share of its revenues from the two above-mentioned categories. In addition to pure retailing, the group has also launched complementary services to extend its range of offers. Ceconomy provides a wide range of services, which fosters customer loyalty (e.g. repair services, pre-installed and ready to use products, the replacement of existing hardware, telecoms contracts, warranties and consumer finance). This division currently represents 5.2% of total sales (BY 2020/21), which has been stable over the last few years.

Profitability burdens business risk profile

The main constraint to Ceconomy's business risk profile is its relatively low profitability compared to retail sector peers. The group's Scope-adjusted EBITDA margin has been oscillating around levels below 5% over the last few years, with an improvement to 5.2% in BY 2020/21.

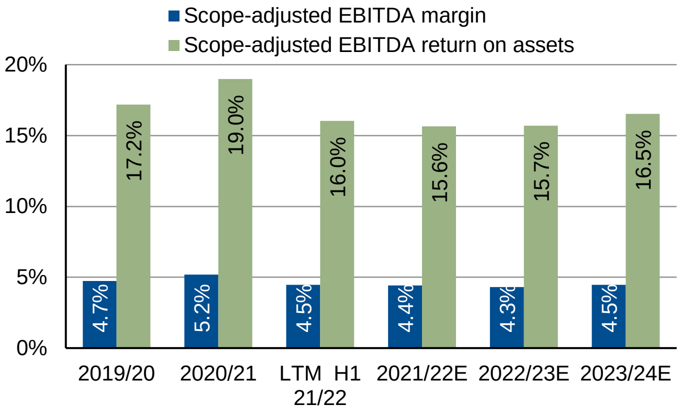
[5] Including computer, hardware, computer accessories and smart home products
[6] Mainly including photo products

This low profitability is due to the following:

Legacy non-optimised structure: Following its spin-off from Metro in 2017, the group inherited relatively heavy operational expenditure, with a clear separation of headquarters between MediaMarkt and Saturn, decentralised inventories/procurement between the two brands and distinct selling, general and administrative expenses cost centres. While considerable efforts have been made over the last few years to unify the brand, the remaining structure continues to weigh negatively on operational expenditure.

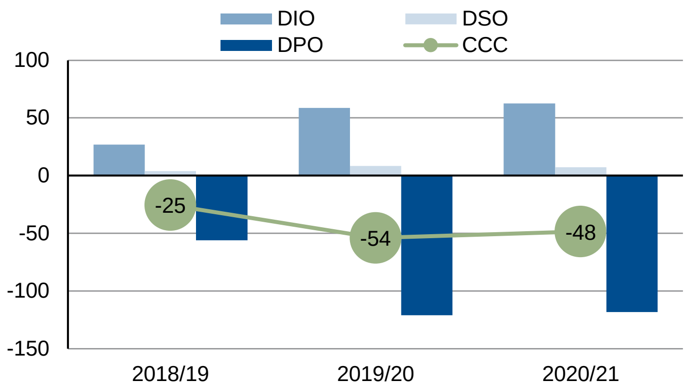
Online sales: Despite high demand, online sales remain a source of losses for most retailers. Ceconomy is no exception and its ambition to integrate online sales even further is likely to put additional pressures on its weak margins. Nonetheless, the development of automated warehouses and pick-up rates in each country of operation should slightly alleviate the negative impacts of this channel.

Figure 5: Evolution of profitability ratios



Sources: Ceconomy, Scope estimates

Figure 6: Development of the cash conversion cycle[7]



Sources: Ceconomy, Scope

Potential mitigation sources

The group has launched significant efforts and initiatives to improve profitability.

High-profitability business. The deployment of the 'Marketplace' and 'Services & Solutions' activities should have a long-term positive effect on the group's margins as both businesses are profitability accretive. The group aims to generate a gross merchandise volume of close to EUR 100m by BY 2021/22 – and over EUR 1bn within the next two years (versus EUR 30m gross merchandise volume BY 2020/21) – which would considerably increase margins. Ceconomy also wants to modify its shops to generate higher income. Historically, the majority of the sellable area has been used for shelves but the group aims to decrease this significantly, with the rest being used by shop-in-shops, testing and consumer experiences (the 'lighthouse' concept store) or the development of services.

The new 'Operating Model' (2020) is tailored to significantly decrease overall operational expenditure. Ceconomy has reduced the weight of operational expenditure by 0.5% versus pre-Covid levels. The group states that it has achieved its EUR 100m saving targets and implemented two-thirds of planned store closures. In addition to the store optimisation initiative, the group expects to renegotiate its leases more aggressively, decrease its sellable areas (on average by 12% of stock keeping unit per stores vs BY 2018/19) and renegotiate rents (average leases are close to three years).

[7] CCC corresponds to cash conversion cycle; DIO to days inventory outstanding; DSO to days supplier outstanding; and DPO to days payable outstanding

Pressure from inflation and supply bottlenecks

However, we expect intense pressure on profitability in the coming year, mainly driven by the high inflation, which is expected to continue (above 7% in Germany as of May 2022) and potential supply bottlenecks, illustrated by the stranded logistics ships in Chinese harbours. These two strong headwinds are likely to: i) put pressure on product availability and costs (which is negative for the gross margin); ii) raise operational costs (negatively affecting EBITDA); and iii) lead to a potential change in consumer purchasing behaviour, with customers less likely to go for larger tickets and avoiding spontaneous purchases (negatively impacting sales and EBITDA).

In H1 2021/22, management reiterated its aim to protect group margins and to pass increased costs on to customers. Management also plans one-off actions to decrease prices if they become uncompetitive.

Deterioration of both profitability ratios

While the impact of these negative effects remains difficult to assess, we expect Ceconomy's Scope-adjusted EBITDA margin to decrease to levels slightly below 4.5%. Given the normalisation of online sales, however, we expect the development of Services & Solutions in shops to surge in the coming year as footfall in shops recovers, which would have a positive effect on group margins.

We also expect the return on assets to deteriorate, given our assumption of lower EBITDA alongside the increase in inventories, despite our expectation of decreased leases, which would improve the ratio. Increasing the stock level in this context is a strategic priority for the group in order to: i) avoid the risk of price rises in the coming months; ii) ensure the ready availability of products, to prevent customers using another retailer. The inventory could be decreased earlier if supply bottlenecks are resolved earlier in the coming quarter.

Financial risk profile: BBB

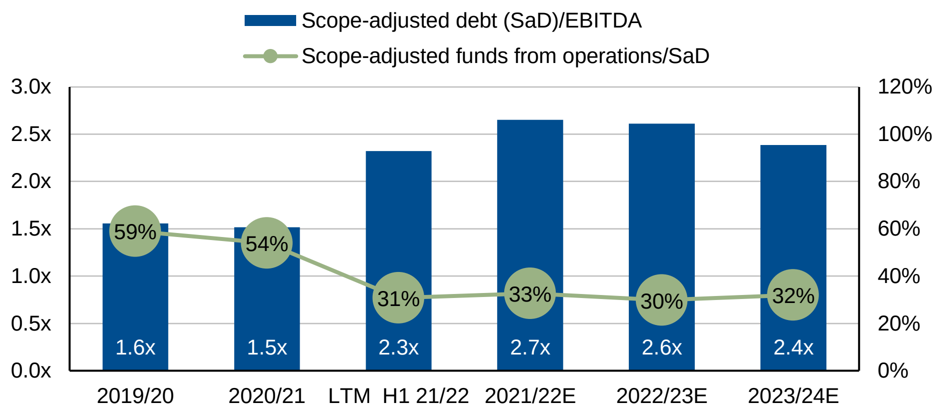
Financial context

While we expect profitability to decrease, affecting the group's cash generation, the balance sheet is robust. Ceconomy's financing structure as of May 2022 consists of a EUR 500m bond (maturing in 2026), a EUR 500m commercial paper programme and a EUR 1,060m ESG-linked revolving credit facility. The overall maturity schedule is relatively flat as the bond will mature in 2026 and the revolving credit facilities will mature between 2024/25 and 2025/26, depending on the use of extension options.

Low leverage but under pressure

Leverage is low overall. Over the last few years, the group has benefitted from comfortable levels of SaD/Scope-adjusted EBITDA close to 1.5x and funds from operations/SaD consistently above 45%. Given our forecasts of stable gross financial debt in the coming years (excluding EUR 151m of convertible bonds mainly linked to the Convergenta transaction), the evolution of EBITDA and funds from operations will determine leverage. We expect overall leverage to weaken slightly to SaD/Scope-adjusted EBITDA above 2.5x and funds from operations/SaD of 30%.

Figure 7: Leverage

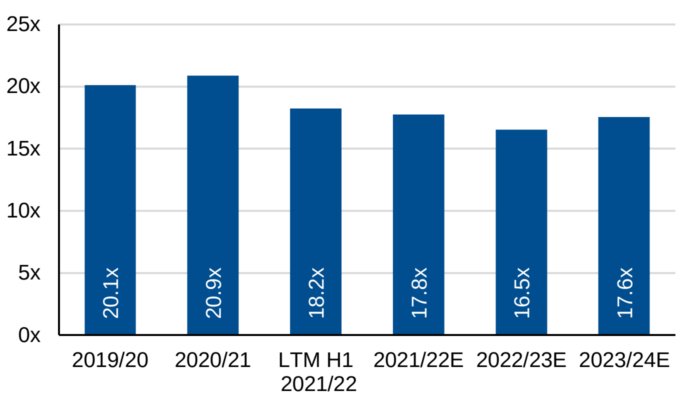


Sources: Ceconomy, Scope estimates

High interest cover

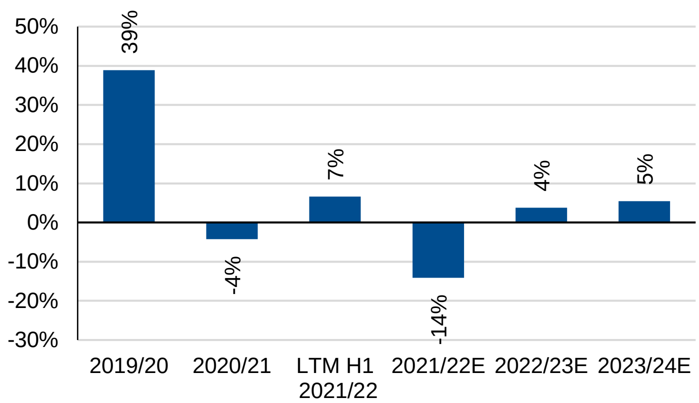
Ceconomy continues to benefit from a large buffer in terms of interest cover. We expect its financial risk profile to remain supported by the ratio. While we expect interest expenses to remain stable in the coming years, the absence of any significant debt issuance or re-financing should limit the deterioration of interest cover in the coming years. Although we expect this ratio to be weakened by the decrease in EBITDA, we nonetheless expect it to remain at comfortable levels in the coming years.

Figure 8: Interest cover



Sources: Ceconomy, Scope estimates

Figure 9: Cash flow cover



Sources: Ceconomy, Scope estimates

Cash flow cover expected to be negative in 2021/22E

We expect cash flow cover to remain under pressure in the coming years. While we expect that the group will continue to optimise its selling areas by disposing of less profitable shops (potentially leading to cash inflows in capex), capex is likely to remain high due to the investments needed to complete the group’s transition towards its new business model. Net working capital might become under pressure than in previous years due to the need to increase inventories to relatively high levels to secure existing prices (not affected by the increased prices from inflation in the coming months) and also to ensure the availability of products if supply bottlenecks persist in the short term. We expect both factors to be the main negative drivers of free operating cash flow in the coming years. We consequently anticipate that cash flow cover will decrease towards a negative level in 2021/22, followed by a recovery based on our assumption of a normalisation of net working capital.

Adequate liquidity

Given the overall absence of short-term debt repayments for the next years, liquidity continues to be adequate. Pressure on the cash level, linked to lower cash flow generation, remains possible but is not expected to affect Ceconomy's ability to repay its short-term debt. We expect the ESG-linked revolving credit facility of EUR 1,060m to serve as a strong buffer should the company need seasonal financing.

Balance in EUR m	2021/22E	2022/23E
Unrestricted cash (t-1)	1,482	444
Open committed credit lines (t-1)	1,060	1,060
Free operating cash flow	-358	93
Short-term debt (t-1)	242	-
Coverage	>2x	No short-term debt

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

We affirm the BBB- rating assigned to senior unsecured debt.

Short-term debt rating: S-2

We affirm the S-2 rating assigned to short-term debt. We consider both internally and externally provided liquidity cover to be better than adequate. The group's banking relationships and its standing in capital markets are good.

Appendix: Peer comparison (as at last reporting date)

	Ceconomy AG	Fnac Darty SA	Vörösko Kft	Otto GmbH & Co. KG
Home market	Germany	France	Hungary	Germany
Status	Public	Public	Public	Non-public
Business risk profile	**BBB-**	**BB+**	**BB-**	*
Country retail strength	High	High	High-medium	High
Market position	Strong with international market shares	Strong	Strong	Strong
Revenue size (in EUR bn)	21.4	8.0	0.2	14.8
Consumer good category	Discretionary	Discretionary	Discretionary	Discretionary
Online diversification**	High	High	High	High
Geographical exposure	No countries >50% sales	Immediate neighbours	One country	No countries >70% sales
Product diversification	2 categories	2 categories	2 categories	> 2 categories
Profitability assessment	Moderate	Strong	Moderate	Good
Financial risk profile ***	**BBB**	**A-**	**BB+**	*
SaD/Scope-adjusted EBITDA	1.9x	1.6x	1.9x	1.6x
FFO/SaD	49%	50%	61%	66%
EBITDA interest expense	19.6x	12.1x	8.7x	5.8x
FOCF/SaD	7%	11%	3%	24%
Liquidity	>2x	>2x	No short-term debt	>2x
Issuer rating	**BBB-**	**BBB**	**BB**	*
Outlook	**Stable**	**Stable**	**Stable**	*

* Available on ScopeOne

** 'SCD' stands for 'Single channel distributor'

*** (average Y-1; Y; Y+1)

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