31 May 2023

Corporates

Ceconomy AG
Federal Republic of Germany, Retail

BBB- Negative

Key metrics

			Scope estimates	
Scope credit ratios	**2020/21**	**2021/22**	**2022/23E**	**2023/24E**
Scope-adjusted EBITDA/interest cover	21.3x	15.5x	11.4x	11.8x
Scope-adjusted debt/EBITDA	1.5x	2.4x	2.9x	2.6x
Scope-adjusted funds from operations/debt	54%	32%	30%	34%
Scope-adjusted free operating cash flow/debt	-4%	-14%	0%	6%

Rating rationale

We expect the persisting inflation and lower demand for consumer electronics to continue pressuring EBITDA margins in 2022/2023. This is despite management's significant efforts to decrease costs and move towards a more efficient structure, reflected in the recent disposal of unprofitable Swedish and Portuguese branches. Ceconomy continues to pursue its target of increasing online sales and creating a lean omnichannel structure to fight competition from online giant retailers; however, as for most retailers, online business generates comparably lower profits, contributing to the low EBITDA margins. The group continues to benefit from its strong market share, Europe-wide outreach, and diversified product range, helping its competitive position. The absence of newly issued debt and relatively low leverage partially balances the negative trend in the operating result and keeps financial metrics at still comfortable levels.

Outlook and rating-change drivers

The Outlook is Negative and incorporates a decrease in Ceconomy's Scope-adjusted EBITDA margin to below 4%. This translates into Scope-adjusted debt/EBITDA surpassing 2.5x in FY 2023 and FY 2024 before reverting to below 2.5x in the following years, as we expect a certain normalisation of the macroeconomic environment. The Outlook also assumes no M&A or significant debt issuance in the coming years.

A Positive rating action (including a reversal of the Outlook to Stable) could be triggered by an improved Scope-adjusted debt/EBITDA ratio of below 2.5x. This could be due to an early rollout of the restructuring plan or a higher-than-expected rebound of the demand for consumer electronics.

A Negative rating action could result from Scope-adjusted debt/EBITDA being sustained above 2.5x for a continued period of time, as it would indicate that the negative macroeconomic conditions have longer lasting effects than we are currently forecasting.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
19 Apr 2023	Outlook change	BBB-/Negative
24 May 2022	Affirmation	BBB-/Stable
24 Jun 2021	Affirmation	BBB-/Stable

Ratings & Outlook

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

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Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

Retail and Wholesale Rating Methodology; April 2023

Retailing bankruptcy risk grows in Europe: business failures to rise after slowdown in 2021-2022

ESG considerations for the credit rating of retail corporates, November 2021

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Europe's leading consumer electronics retailer in terms of size and market share • High geographical and product diversification • Strong balance sheet with limited debt and long maturities • High interest cover due to low net cost of debt	• Expected pressure on the business due to persisting inflation in Europe • Group business model in transition, leading to low profitability base.

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA sustained below 2.5x	• Scope-adjusted debt/EBITDA above 2.5x for a continued period

Corporate profile

Ceconomy is Europe's leading consumer electronics retailer with ca. EUR 22bn in annual revenues and 44,000 full-time employees. The Group holds a leading market position in nine European countries but is present in 11 countries (after the announced disposal of the Swedish and Portuguese operations) with 1,024 stores at FYE 2022. The group has four historical shareholders: Haniel, Meridian Stiftung, Freenet AG and Beisheim, and at FYE 2022, the existing MediaMarktSaturn shareholder, Convergenta Invest GmbH, became Ceconomy's largest shareholder, with voting rights of 29%.

Financial overview

				Scope estimates		
Scope credit ratios	**2019/20**	**2020/21**	**2021/22**	**2022/23E**	**2023/24E**	**2024/25E**
Scope-adjusted EBITDA/interest cover	20.5x	21.3x	15.5x	11.4x	11.8x	12.4x
Scope-adjusted debt/EBITDA	1.6x	1.5x	2.4x	2.9x	2.6x	2.4x
Scope-adjusted funds from operations/debt	59%	54%	32%	30%	34%	37%
Scope-adjusted free operating cash flow/debt	39%	-4%	-14%	0%	6%	7%
Scope-adjusted EBITDA in EUR m						
EBITDA	991	1,103	944	789	812	854
Other items[1]	-5	4	3	-	-	-
Scope-adjusted EBITDA	**986**	**1,107**	**947**	**789**	**812**	**854**
Funds from operations in EUR m						
Scope-adjusted EBITDA	986	1,107	947	789	812	854
less: (net) cash interest paid	-48	-52	-61	-69	-69	-69
less: cash tax paid per cash flow statement	17	-104	-134	-	-4	-34
Change in provisions	-53	-48	-36	-40	-10	-10
Funds from operations (FFO)	**902**	**903**	**716**	**680**	**729**	**741**
Free operating cash flow in EUR m						
Funds from operations	902	903	716	680	729	741
Change in working capital	314	-354	-361	-56	19	-6
less: capital expenditure (net)	-92	-122	-166	-150	-150	-150
less: lease payments	-530	-503	-498	-483	-469	-455
Free operating cash flow (FOCF)	**594**	**-76**	**-309**	**-9**	**129**	**130**
Net cash interest paid in EUR m						
Net cash interest per cash flow statement	-45	-48	-57	-64	-64	-64
Change in other items[2]	-3	-4	-4	-5	-5	-5
Net cash interest paid	**-48**	**-52**	**-61**	**-69**	**-69**	**-69**
Scope-adjusted debt in EUR m						
Reported gross financial debt	2,422	2,867	2,772	2,691	2,691	2,641
less: cash and cash equivalents net from restricted cash	-1,384	-1,482	-719	-625	-749	-826
add: pension adjustment	496	295	210	210	210	210
Scope-adjusted debt	**1,534**	**1,680**	**2,263**	**2,276**	**2,152**	**2,025**

[1] Net impairment on operating financial assets.
[2] Interest on pension

Table of Content

Environmental, social and governance (ESG) profile[3]

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

As Europe's largest consumer electronics retailer, ESG plays an important role in Ceconomy's strategy.

The last years have seen significant management turnover, indicating a clear instability in long-term decision making. Going forward, we expect the corporate governance risk to decline, driven by the new ownership structure (with Convergenta as major shareholder) and the appointment of the new CFO, who started in February 2023, both expected to bring continuity and stability and redefine the company's long-term strategy.

In many countries, consumer behaviour can be widely influenced by a company's reputation and responsibility towards the environment, the employees and society. In this regard, we believe Ceconomy has no issues or reputational risk. Furthermore, the group is committed to offer products that are usable longer and sustainably packaged. For large brick-and-mortar businesses like Ceconomy, the major challenge remains the environmental footprint and continuing to improve energy efficiency while keeping the right number of stores, an efficient logistics structure, and a high-quality shopping experience.

[3] 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: BB+

Industry risk profile: BB

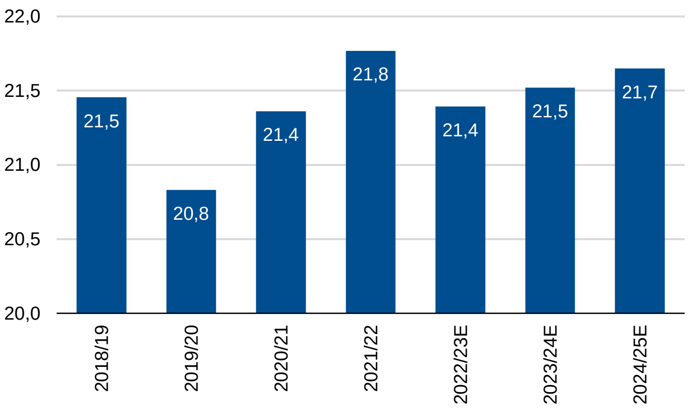
Ceconomy is a discretionary retailer, an industry that we consider as having low entry barriers, medium cyclicality and low substitution risk, which translates to a BB industry risk profile.

Strong market share in major European markets

The issuer continues to benefit from its presence in 11 European countries with a leading position in DACH (Germany, Austria, Switzerland, Hungary), southern and eastern Europe, limiting risk of potential substitution by competitors.

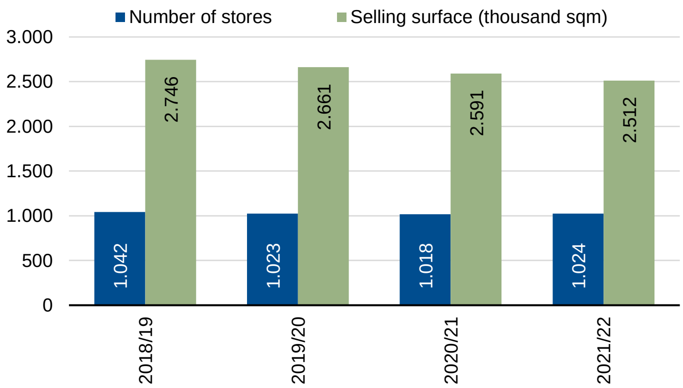
As reflected in the announced disposal of the Swedish operations (expected to be closed in summer 2023) and the confirmed sale of the Portuguese stores to Fnac Darty, we anticipate that the group will focus on consolidating and reinforcing its position in its key markets while keeping capex and costs under control. In the highly competitive European market, the future success will highly depend on improving the customer experience, and especially fulfilling the expectation of high product availability and fast delivery at home. This will drive Ceconomy to centre its strategy on improving the logistic and supply channels.

Figure 1: Revenue evolution (EUR bn)



Sources: Ceconomy, Scope estimates

Figure 2: Number of stores and selling surface over years



Sources: Ceconomy, Scope

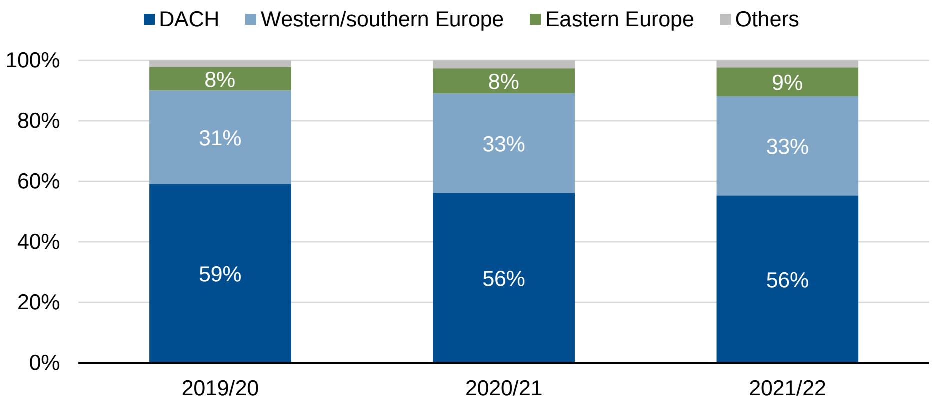
Germany is main market …

With about 45% of revenue generated in Germany, the group's performance is strongly correlated to its home market. We deem the position of the group in Germany to be solid and, despite fierce competition, to remain stable, supported by strong brand awareness and consumer experience.

… but geographical outreach is strong

Ceconomy is one of the few consumer electronics retailers that developed a broad geographical footprint, and, despite the recent disposal of Swedish and Portuguese operations, we do not expect the group to significantly cut back its geographical diversification going forward. The strong geographical diversification minimizes the exposure to the macro-economic and consumer trends of its home market.

Figure 3: Geographical diversification by sales (%)



Sources: Ceconomy, Scope

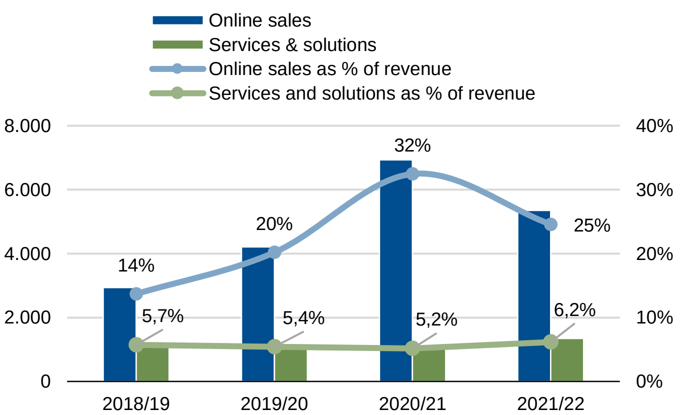
High competition drove improved channel diversification

Online sales have largely grown for Ceconomy, benefitting from the pandemic which shifted costumer purchases from brick and mortar to virtual. Despite declining from around 32% in FY 2020/21 to around 25% in FY 2021/22 in sales contribution, in line with the general post-pandemic drop in online shopping, we believe the online channel is still strong and allows the group to compete with large online platforms in its main markets, supported by the recent improvement in its click and collect options (e.g. orders ready for pick up in 30 minutes in Q1 2022/23).

Good product diversification

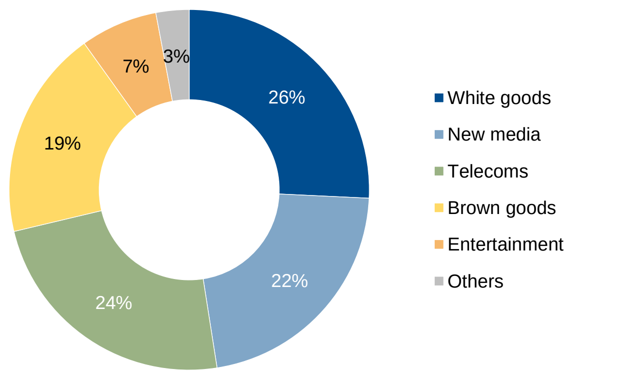
Product assortment benefits from a robust presence in two categories of goods, classified in our methodology as 'household products' (white goods) and 'consumer electronics' (brown goods, new media[4], telecom and others[5]). While new products are expected to expand the issuer's offering radius (especially the marketplace recently launched in three countries), we expect that Ceconomy will continue generating the lion's share of its revenues from the two aforementioned categories. In addition to pure retailing, the group provides complementary services which foster customer loyalty (e.g. repair, installation, replacement of existing hardware, telecom contracts, warranties and consumer finance). The service division represented 6% of total sales in FY 2021/2022.

Figure 4: Evolution of online sales and services and solutions sales



Sources: Ceconomy, Scope

Figure 5: Product diversification by revenues 2021/2022 (%)



Sources: Ceconomy, Scope

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

Profitability constrains the business risk profile

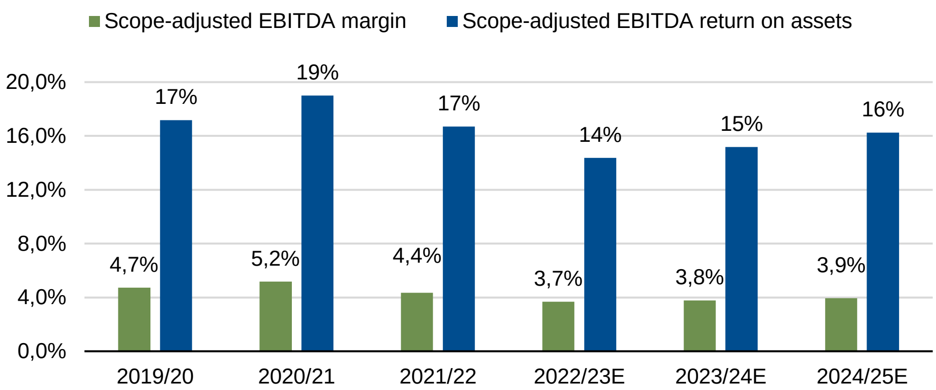
Ceconomy has relatively low profitability compared to retail sector peers. While the Scope-adjusted EBITDA margin increased to 5.2% in FY 2020/2021, it decreased back to 4.4% in FY 2021/2022. We believe the low profitability is explained by: i) an operational expenditure structure (only for Germany) hindered by partly separate functions for MediaMarkt and Saturn, decentralised inventories/procurement and separate cost centres; ii) inflationary pressure; and iii) lower than average margins from online sales: as for most retailers, despite the high demand, the online business is generating low profits for Ceconomy. We expect that Ceconomy's objective to further develop the online distribution channel will further pressure margins but will be partially mitigated by the automated warehouses and pick-up solutions offered in every country.

… end expected to remain low in the near future

Given the persisting inflationary pressure and the impact on consumer purchasing behaviour (less willing to spontaneous purchases), we anticipate the Scope-adjusted EBITDA margin to remain low in upcoming years at around/below 4%.

Nevertheless, in the long term we expect that the several strategic initiatives recently put in place, will improve the group's profitability. Among those, the disposal of the Swedish operations and then agreeing to sell the Portuguese operations to Fnac Darty, both loss-making, are expected to lower operational expenditure in the future. The implementation of new services, (Marketplace, Retail Media and Services & Solutions) is seen as a potential key driver to increase profit margins for the retailer.

Figure 6: Profitability margins over years



Sources: Ceconomy, Scope estimates

Financial risk profile: BBB-

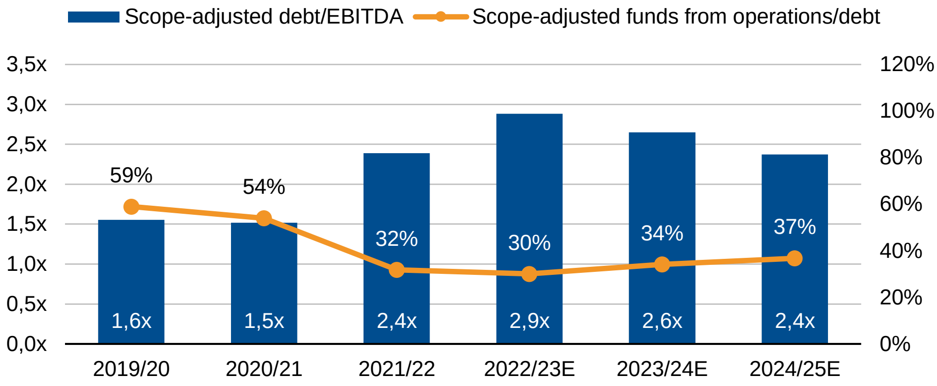
While we expect profitability to decrease, affecting the group's cash generation, the balance sheet still remains robust.

Leverage under pressure due to persisting inflation

Decreasing cash in FY 2022 has led to a deterioration of the leverage, measured by the Scope-adjusted debt/EBITDA ratio, increasing to 2.5x from 1.5x in the prior year.

In the future we anticipate the leverage to remain under pressure in view of the persisting inflation pressuring the costs and EBITDA and from net cash flow expected close to zero, before recovering from FY 2025.

Figure 7: Leverage



Sources: Ceconomy, Scope estimates

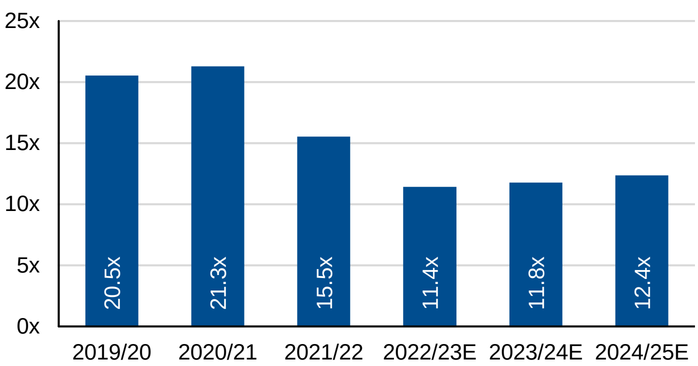
Strong interest cover

The strong debt protection, measured by the Scope-adjusted EBITDA interest cover, is the major support to the financial risk profile. Although we expect the ratio to be drawn down by the weakening EBITDA, the absence of any significant debt issuance and refinancing should keep interest expenses stable, supporting the ratio to stay at a more than comfortable level.

Cash flows to return positive

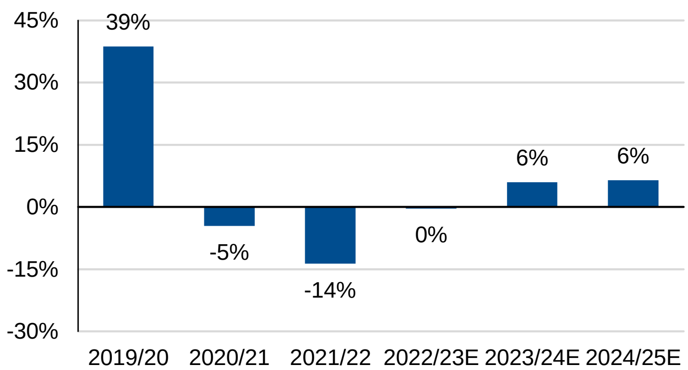
Cash flow cover was negative in FY 2021/2022, pressured by high net working capital and increasing capex. The need to secure purchases at existing prices and ensure availability of products at times of supply bottlenecks, was the driver of negative FOCF. Improvement of the inventory and overall supply chain is expected to have more focus going forward, and we anticipate that Ceconomy will pursue a leaner inventory management (faster turnaround of inventory to facilitate the transition to omni-channel infrastructure), gradually increasing the FOCF.

Figure 8: Scope-adjusted EBITDA interest cover



Sources: Ceconomy, Scope

Figure 9: Cash flow cover (Scope-adjusted FOCF/debt)



Sources: Ceconomy, Scope

Adequate liquidity

Given the overall absence of short-term debt repayment for the next years, liquidity continues to be adequate. The group's current financing structure constitutes as at April 2023 of a EUR 500m bond (maturing in 2026), a EUR 500m commercial paper programme, promissory notes (accounting for EUR 122m with the first EUR 50m maturing in 2024) and a EUR 1,060m ESG-linked RCF. The group also issued last year a convertible bond of EUR 151m with maturity in 2027 to finance the Convergenta transaction.

Potential pressure on the cash level linked to lower cash flow generation remains possible but is not expected to affect the ability of the group to repay its short-term debt. The presence of an ESG-linked RCF of EUR 1,060m is expected to serve as a buffer should the company need seasonal financing.

Balance in EUR m	2021/22	2022/23E	2023/24E
Unrestricted cash (t-1)	1,482	719	625
Open committed credit lines (t-1)	1,061	1,060	1,060
FOCF	-309	-9	129
Short-term debt (t-1)	240	81	-
Coverage	**>200%**	**>200%**	**>200%**

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

Ceconomy currently has a EUR 500m senior unsecured bond maturing in 2026 with a 1.75% annual coupon. We affirm the BBB- rating of the 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 more than adequate. The group's banking relationships and its standing in capital markets are good.

Appendix: Peer comparison

	Ceconomy AG	Fnac Darty SA	Vöroskö Kft	Otto GmbH & Co. KG
	BBB-/Stable	BBB/Negative	BB/Stable	*
Last reporting date	30 September 2022	31 December 2022	30 June 2022	31 December 2021
Business risk profile				
Country retail strength	High	High	High-medium	High
Market position	Strong with international market share	Strong	Strong	Strong
Revenue size (in EUR m)	21,768	7,949	230	16,060
Consumer good category	Discretionary	Discretionary	Discretionary	Discretionary
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	Moderate
Financial risk profile				
Scope-adjusted EBITDA/interest cover	15.3x	10.4x	10.4x	17.5x
Scope-adjusted debt/EBITDA	2.4x	2.2x	2.6x	2.0x
Scope-adjusted FFO/debt	32%	35%	34%	50%
Scope-adjusted FOCF/debt	-13%	-6%	-54%	17%

* Subscription ratings available on ScopeOne

Sources: Public information, Scope

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