MOODY'S

Rating Action: Moody's downgrades Ceconomy to Ba3; continuing review for further downgrade

22 Nov 2022

Senior unsecured notes downgraded to B1 from Ba3

Paris, November 22, 2022 -- Moody's Investors Service ("Moody's") has today downgraded to Ba3 from Ba2 the corporate family rating (CFR) of CECONOMY AG ("Ceconomy" or "the company") and its probability of default rating (PDR) to Ba3-PD from Ba2-PD. Moody's has also downgraded Ceconomy's senior unsecured notes to B1 from Ba3. The outlook remains unchanged at ratings under review. Concurrently, Moody's affirmed the NP rating of the company's commercial paper program.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

Today's rating action reflects Moody's expectation that, given the overall weak macroeconomic outlook for Europe and weak consumer sentiment, Ceconomy is unlikely to meaningfully recover its earnings and cash flows in the coming quarters. Moody's believes that given the company's very low margins and negative free cash flows (FCF) in the last two years (fiscals 2021 and 2022, ending 30 September), a rating level in the mid-to-high Ba range is no longer tenable.

Moody's significantly cut its 2023 economic growth forecasts and raised inflation projections for a number of countries in Europe. Moody's now expects a deeper GDP contraction in Europe in 2023, including in Ceconomy's major markets such as Germany and Italy, followed by weak recoveries in 2024. In Germany, which is Ceconomy's main market, Moody's anticipates an economic contraction of 1.9% in 2023, compared to only 0.4% previously. There are significant downside risks to these forecasts. Economic outcomes could be significantly worse in a situation of acute energy shortages that would lead to significant rationing.

European consumer sentiment is under severe pressure and with persistent inflation Moody's expects European consumers to trade down or to rein their discretionary spending in the next 12-18 months. Moody's expects inflation, which, coupled with rising energy costs are likely to weigh negatively on trading in the next few quarters. Weaker consumer demand coupled with rising operational costs will likely translate into continued weak profitability in the next 12-18 months. As a result Moody's expects the company's EBIT margin (as adjusted by Moody's) will be at or below 1% in fiscal 2023 (year ending 30 September 2023), which will likely translate into very limited FCF in the absence of major working capital reversal.

Moody's acknowledges that management has articulated a plan to improve margins and financial flexibility, especially through increased sales of high margin Services & Solutions activities (5.7% of sales in the first 9 months of fiscal 2022), cost and capital spending reductions, increased logistic efficiency and active stock management. However, the rating agency considers that Ceconomy's financial profile is not likely to improve meaningfully given the history of suppressed margins over the past five years, the implementation time needed for the contemplated improvements, as well as deteriorating macro environment and overall consumer demand Moody's anticipates in the next 12-18 months.

Ceconomy's weaker earnings in 2022, higher inventory levels and some one-off cash payments (Convergenta transaction, pension contribution, buy back of minorities shares from store manager and some reversal of Covid-related tax deferrals) translated into a significant negative FCF generation in the last 12 months to 30 June 2022 (€727 million, Moody's-adjusted). Ceconomy's liquidity is adequate for now, supported by a full availability under its committed revolving credit facility (RCF) of €1.06 billion. The company has no major debt refinancing, with only €30 million of short-term commercial paper due over the next 12 months. Having said that, the absolute amount of trade payables, which usually peaks at €8 billion at the end of each calendar year, is very material in the context of the company's overall liquidity profile and weak FCF generation. Moody's believes that a negative shift in supplier's payment terms (which could be prompted by deterioration of macro conditions later in 2023) represents a key risk which may result in material working capital swings during the coming fiscal year and liquidity deterioration.

STRUCTURAL CONSIDERATIONS

The downgrade of the senior unsecured notes to B1 from Ba3 reflects the downgrade of the CFR. The company's senior unsecured bond is rated one-notch below the CFR, reflecting the presence of large non-debt liabilities, including sizeable trade claims (€4.9 billion at end-June 2022) and short-term lease liabilities, both located at the operating subsidiary level. The magnitude of these non-debt liabilities creates structural subordination for debt at the holding company level, including the senior unsecured notes, which do not benefit from upstream guarantees. Ceconomy's capital structure also includes around €122 million of promissory notes and the €1.06 billion syndicated RCF.

RATIONALE FOR THE REVIEW FOR FURTHER DOWNGRADE

The continuing review will focus on the company's ability to noticeably improve profitability and cash flows during the first quarter of fiscal 2023 and on the levers that the company has at its disposal to strengthen cash flows and liquidity in the short-term. The review will include an assessment of the company's liquidity profile that remains reliant on internally generated cash flows and is very vulnerable to working capital swings, as well as access to a covenanted RCF.

Moody's had placed Ceconomy's ratings on review for downgrade on 20 September 2022 (https://www.moodys.com/research/--PR_469518).

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A rating upgrade is unlikely considering the rating is on review for further downgrade. Upward pressure could arise over time if (1) Ceconomy demonstrates a sustainable margin enhancement with Moody's-adjusted EBIT margin of around 3% to give the company sufficient buffer against external pressures; (2) the company's Moody's-adjusted (gross) debt/EBITDA remains sustainably below 3.5x; (3) FCF turns materially positive on a sustained basis and (4) liquidity headroom materially improves. Moody's would also expect Ceconomy to maintain prudent financial policies.

The ratings could be downgraded if Moody's concludes that the company is unlikely to improve profitability on a sustainable basis such that FCF will not turn positive in fiscal year 2023. Liquidity will need to be strong enough to have a sufficient buffer to sustain material working capital movements throughout the year, while a draw down on its RCF or signs that creditor terms are becoming less favourable would suggest a weakening in liquidity. Moody's estimates the company would need to improve EBIT margin to at least 2.0-2.5%, maintain the interest cover at 3x or above (Moody's-adjusted EBIT to interest expense) and Moody's gross adjusted leverage below 4.0x to support the Ba3 rating.

LIST OF AFFECTED RATINGS

Downgrades:

..Issuer: CECONOMY AG

.... Probability of Default Rating, Downgraded to Ba3-PD from Ba2-PD; Placed Under Review for further Downgrade

.... LT Corporate Family Rating, Downgraded to Ba3 from Ba2; Placed Under Review for further Downgrade

....Senior Unsecured Regular Bond/Debenture, Downgraded to B1 from Ba3; Placed Under Review for further Downgrade

Affirmations:

..Issuer: CECONOMY AG

....Senior Unsecured Commercial Paper, Affirmed NP

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Retail published in November 2021 and available at https://ratings.moodys.com/api/rmc-documents/356421. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Düsseldorf, Germany, Ceconomy is Europe's largest consumer electronics retailer, operating two brands — MediaMarkt and Saturn. The company recorded €21.8 billion of revenue in fiscal 2022. It is listed on the Frankfurt Stock Exchange and had a market capitalisation of around €1.1 billion as of 22 November 2022. The company has five anchor shareholders: Convergenta, Franz Haniel & Cie. GmbH (Haniel, Baa3 stable), Meridian Stiftung, freenet AG and Beisheim.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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