MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Ceconomy to Ba2; ratings placed on review for downgrade

20 Sep 2022

Senior unsecured notes downgraded to Ba3 from Ba1

Paris, September 20, 2022 -- Moody's Investors Service ("Moody's") downgraded CECONOMY AG's ("Ceconomy" or "the company") corporate family rating (CFR) to Ba2 from Ba1 and its probability of default rating (PDR) to Ba2-PD from Ba1-PD. Concurrently Moody's has downgraded Ceconomy's senior unsecured notes to Ba3 from Ba1. Moody's affirmed the NP rating of the company's commercial paper program. Simultaneously, Moody's placed the CFR, the PDR and senior unsecured notes rating on review for downgrade. The outlook has been changed to ratings under review from stable.

"The downgrade was driven by the increasingly challenging economic environment, with already strong evidence of high inflation affecting consumer spending, as well as rising operational costs, which will further pressure Ceconomy's weak margins. This will lead to material negative free cash flow generation in 2022, which will in turn weaken the company's liquidity" says Guillaume Leglise, a Moody's Vice President-Senior Analyst and lead analyst for Ceconomy. "The review will focus on the company's ability to sustainably improve profitability and generate positive free cash flow from 2023, such that this strengthens liquidity - important in light of the company's significant working capital swings throughout the year", adds Mr Leglise.

RATINGS RATIONALE

Today's downgrade was driven by the company's weak trading performance to date in 2022, leading to the company's significant downward revision to its profit guidance for the fiscal year ending 30 September 2022 (fiscal 2022), and now, in addition to this, the materially weaker consumer sentiment in Ceconomy's main markets (primarily Germany) and rising operational costs (staff, transportation and energy costs). These pressures will continue to weaken the company's EBIT generation, and in particular, are likely to contribute to a significant deterioration in the company's free cash flow (FCF) generation during 2022 and potentially in 2023, which is now placing material negative pressure on the company's liquidity.

Ceconomy now expects to report an EBIT (as adjusted by the company) between €150 and €210 million for fiscal 2022, which is contrary to the company's previous guidance of a very clear increase from the €237 million generated last year, and much lower than the EBIT that Moody's previously forecasted of over €300 million.

Moody's anticipates that this deterioration in profitability will contribute to a materially negative FCF of well over €500 million in 2022, potentially more depending on working capital movements. In the 12 months to June 2022 Ceconomy's FCF (Moody's adjusted) was negative at around €727 million. Given continuing economic pressures, there is significant uncertainty that the company can improve margins in 2023 such that FCF can turn positive next year. Ceconomy's underlying earnings and margins are structurally weak, owing among other factors to a dense store network and a large workforce.

Moody's recognizes the company's commitment to improving margins through initiatives aimed at rationalizing the company's cost base and combating inflation, and appreciates that profit and cash flows in 2022 were also impacted by a cyber attack and stores closures due to covid. Ceconomy also has a strong market position as Europe's largest electronics retailer with geographically well-diversified operations and a strong distribution network, which could support a turnaround, or at the very least curtail the cash burn. But the fact that margins remain under pressure highlights the company's sensitivity to external events beyond management's control. Moody's now forecasts that the company's EBIT might not improve in fiscal 2023, reflecting an EBIT margin below 1%, which is very weak compared to similarly-rated peers in the retail industry. The company's Moody's-adjusted EBIT margins was 1.0% in the 12 months to June 2022.

For now, Ceconomy's liquidity remains adequate with an available cash balance of €451 million and full availability under its €1.06 billion committed bank facilities as at end-June 2022. The company has no major debt refinancing, with only €50 million of short-term commercial paper due over the next 12 months. But, strong liquidity is especially important for Ceconomy in view of the company's material working capital swings during the year and its sizeable trade payables balance, where there is the risk that these begin to unwind if creditor terms become less favourable or the topline shrinks due to a more aggressive rationalization of its stores than the company currently plans. Furthermore, trade payables usually peak at around €8 billion at the end of December, the first quarter of the fiscal year, which is the company's key trading period. These begin to unwind at the beginning of each calendar year, and if trading performance during Christmas is weak in comparison to what has been planned by the company itself, pressure on liquidity could exacerbate.

Governance was one of the key drivers of today's rating action in accordance with Moody's ESG framework. Moody's believes that the deterioration in liquidity as well as the limited track record in being able to reliably forecast earnings and cash flow effects despite some external events being beyond management's control, translates into a Governance Issuer Profile Score of G-4 (highly negative), and a Credit Impact Score of CIS-4 (highly negative).

Ceconomy's on-balance sheet leverage was around 3.5x at the end of June 2022 (Moody's-adjusted, including leases). Moody's believes that the company does not have the ability to carry high levels of debt given its structurally weak profitability, which is persistently translating to negative cash flows and now liquidity pressures.

STRUCTURAL CONSIDERATIONS

The downgrade of the senior unsecured notes to Ba3 from Ba1 reflects the downgrade of the CFR as well as 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 c. €1.1 billion syndicated bank facilities.

In addition, assets owned by Ceconomy, notably its 24% stake in FNAC DARTY SA (Fnac, Ba2 Stable), previously provided some mitigation to structural subordination. However, Moody's views the protection for the senior unsecured notes as weaker than in the past given the decline in the value of Fnac's stake, worth only around €200 million as of today.

RATIONALE FOR THE REVIEW

The rationale for placing the rating on review for further downgrade reflects the uncertainty regarding the company's ability to improve profitability and cash flows through 2023 and how liquidity will likely develop over the next few quarters. The review will focus on the levers that the company has at its disposal to strengthen cash flows and liquidity in the short-term, especially if it appears likely that trading during the Christmas period will be less strong than forecast. The review period will allow Moody's to assess how consumer sentiment has affected the company's last quarter of 2022 and sentiment going into the key Christmas period amid inflationary pressures.

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 the company is unlikely to improve profitability on a sustainable basis such that FCF will not turn positive from fiscal year 2023, and that this in turn means that liquidity does not improve over the next 12-18 months. 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 liquidity is weaker. Sufficient cash flow will be subject to a number of factors including adequate working capital management, but Moody's estimates that the company may need to sustainably improve EBIT margins to over 2.5%. Other drivers of negative rating action could include interest cover remaining below 3x (Moody's-adjusted EBIT to interest expense) and Moody's gross adjusted leverage approaching 4.0x.

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 €21.7 billion of revenue since the 12 months ended on 30 June 2022. It is listed on the Frankfurt Stock Exchange and had a market capitalisation of around €760 million as of September 2022. The company has five anchor shareholders: Convergenta, Haniel, 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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At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on https://ratings.moodys.com.

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