Research Update:

Germany-Based Electronics Retailer Ceconomy AG Assigned 'BB-' Rating; Outlook Stable

April 13, 2023

Rating Action Overview

- Ceconomy AG is the largest consumer electronics retailer in Europe, enjoying the leading position in the majority of the 13 markets it operates in. The group reported €21.8 billion in sales and €851 million in S&P Global Ratings-adjusted EBITDA in fiscal 2022 (year ended Sept. 30).
- Lower-than-average profitability and persistently negative free operating cash flow (FOCF) after leases are affected by a high amount of lease payments that constrain the rating, while the turnaround program is susceptible to execution risk amid inflationary pressure on consumer disposable income.
- We assigned our 'BB-' long-term issuer credit rating to Ceconomy and our 'BB-' issue rating on the company's €500 million senior unsecured bond due 2026.
- The stable outlook indicates that we expect Ceconomy will continue improving its operating profitability and cash generation; adhere to a conservative financial policy; and post EBITDA margins of 3.5%-4.0%, adjusted leverage of about 3.0x, and positive FOCF after leases over the next 12-24 months.

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Rating Action Rationale

Our 'BB-' rating is underpinned by Ceconomy's prudent financial policy. Reflecting this is S&P Global Ratings-adjusted leverage of 3.0x in fiscal 2022, adequate liquidity, and the absence of regular dividend payments since the demerger from Metro AG in 2017. We understand the group will continue its prudent financial policy and as of today see limited headroom for dividend payments due to volatile business conditions.

Ceconomy's leading position is underpinned by meaningful scale and its omnichannel setup. The group is the largest European electronics retailer, with 1,024 stores and operations in 13 markets (leading positions in eight). It benefits from its large scale, with revenue of €21.8 billion in fiscal 2022, and its brand equity in key markets like Germany, where it was founded. The group has a No. 1 or 2 position in its four largest markets: Germany (45% of revenue), Italy (11%), Spain

(11%) and the Netherlands (7%). The omnichannel model helped mitigate the pressure other brick-and-mortar retailers felt during the pandemic. The group quickly increased online sales (including click and collect) to 32% in fiscal 2021, at the height of the pandemic, from 14% in fiscal 2019, retaining revenue of €20.8 billion-€21.8 billion in the past three years. We understand that the omnichannel flexibility positions Ceconomy well to react quickly to changes in consumer habits and behaviors, and online's share of revenue will not materially change over the forecast period.

We see the group's geographic diversity as credit supportive, because it reduces earnings volatility. Economic patterns, COVID-19-related restrictions, and reactions to geopolitical conflicts have varied across markets in which Ceconomy operates. While the DACH segment--which consists of Germany, Austria, Switzerland, and Hungary--saw company-adjusted EBITDA decline 35% over the past two years to €484 million in fiscal 2022 from a peak of €744 million in fiscal 2020, adjusted EBITDA of the group's other segments combined increased 37% to €396 million. Mostly mature DACH markets remain the largest contributor to the group's earnings.

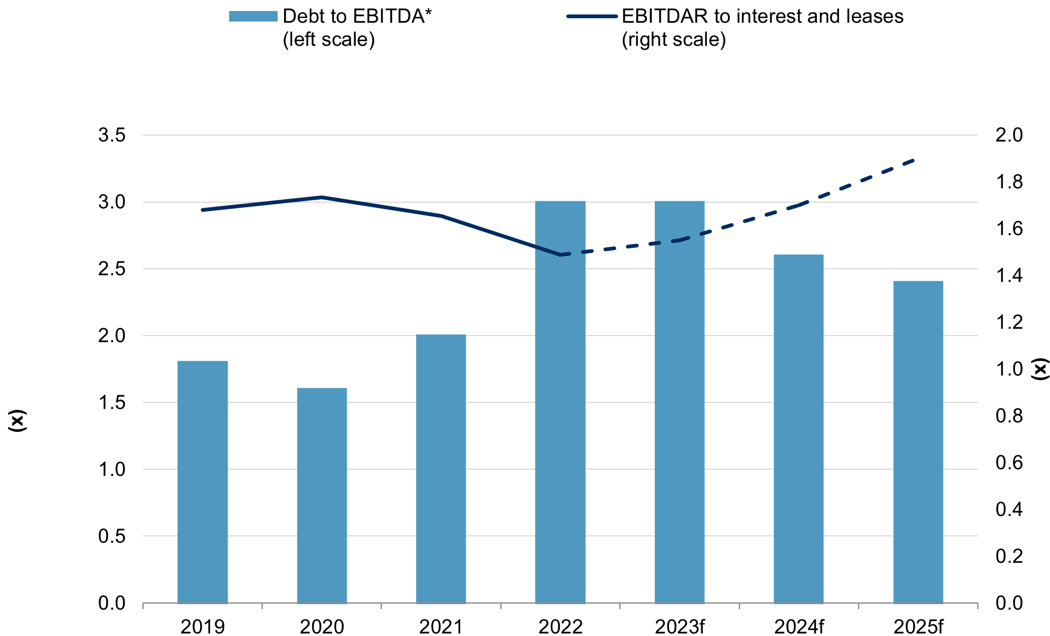
Ceconomy aims to improve customer retention and margins through its "experience electronics" strategy. The group had more than 2.2 billion customer contacts in fiscal 2022, and it aims to improve retention by offering options to repair, trade in, or recycle electronic products and raise the share of high-margin services and solutions (6.2% of sales). We think Ceconomy can improve margins through promoting own-label products, partnering with manufacturers to leverage advertising, and its "lighthouse" strategy, a space-as-a-service model that focuses on increasing rental income.

The execution of Ceconomy's turnaround plan is clouded by competition and economic uncertainty. We view the consumer electronics market as value-driven and highly dependent on discretionary spending. The high price transparency online and in stores constrains gross margins. We see limited barriers of entry for the online segment, which results in fierce competition from pure online retailers like Otto in Germany or Amazon across Europe. Combined with global supply chain disruptions and rapid increases in logistics costs, Ceconomy's S&P Global Ratings-adjusted EBITDA margins decreased to 3.9% in fiscal 2022 from 4.8% in fiscal 2019. We expect a recovery of margins in its key markets to above 4% in 2024 and about 4.5% in 2025. This is supported by its cost-efficiency measures to reduce headquarter costs, digitize processes and align stock-keeping units (SKUs) and marketing campaigns between Saturn and MediaMarkt in Germany. The margin-accreditive "experience electronics" strategy complements the program. Nevertheless, we see execution risk because higher inflation-driven fixed costs, potentially a slower recovery of consumer confidence, or worsening economic situation weighing on discretionary spending could offset cost savings.

The group leases most of its real estate, resulting in hefty lease liabilities and cash payments. Given this, we see the company's efforts in raising the efficiency of operations of utmost importance in improving its cash generation and credit metrics. The group's lease liabilities of about €2 billion in 2022 constituted 77% of S&P Global Ratings-adjusted debt, while total cash outflows on leases stood at €520 million. We therefore consider FOCF after leases and the EBITDAR coverage ratio (EBITDAR to cash interest plus rents) as key factors in our assessment of the group's financial risk. As part of its initiatives to align and reduce SKUs across stores and adapt to the higher share of online sales, the group continuously reduces store space. While large parts of the rental contracts are linked to inflation, the group's average lease term is relatively short, and the overall trading space is set to decline. This should lead to lease outflows decreasing

€15 million-€20 million from fiscal 2024 onward. In our base-case scenario, we expect the EBITDAR coverage ratio will rise from its low level of 1.5x in 2023 and approach 2.0x over the next 24 months.

S&P Global Ratings-adjusted leverage will remain below 3.0x, but lease liabilities will weaken coverage ratio



*S&P Global Ratings adjusted. Years are fiscal years ending September. Source: S&P Global Ratings. Forecast reflects the midpoint of our guided range.
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We expect costs to rise and working capital to stabilize in fiscal 2023, leading to leverage of about 3.0x We expect like-for-like growth of 1.5%-2.0% on continuous high inflation and low consumer sentiment. S&P Global Ratings-adjusted EBITDA should decrease to €800 million-€850 million (3.5%-3.7% margin) in fiscal 2023 from €851 million (3.9%) in fiscal 2022, because higher wages, energy costs, and continued restructuring will offset the easing of supply chain costs. In line with the overall sector, we saw Ceconomy's first-quarter fiscal 2023 inventory normalize, which came at the cost of a slightly lower gross profit margin. The normalization should support the group's operating cash flow by €50 million-€75 million. From fiscal 2024, we expect limited impact on operating cash flow. Combined with higher capital expenditure (capex), S&P Global Ratings-adjusted debt should only fall slightly, leading to leverage of about 3.0x in fiscal 2023 and 2.5x in fiscal 2024, when benefits from operating-efficiency measures should materialize.

Outlook

The stable outlook indicates that we expect Ceconomy will retain adjusted leverage of about 3.0x and S&P Global Ratings-adjusted EBITDA margins at 3.5%-3.7% in fiscal 2023. We expect that FOCF after leases will turn positive and reach about €100 million-€150 million in 2023, mainly with significant improvement in the group's working capital.

Downside scenario

We could lower the rating on Ceconomy if the group's operating performance and earnings weaken, translating into any of the following metrics:

- The S&P Global Ratings-adjusted EBITDA margin dropping below 4% for a prolonged period;
- An EBITDAR coverage ratio remaining at about 1.5x;
- FOCF after leases remaining negative for a prolonged time; or
- Adjusted debt to EBITDA approaching 3.5x.

This could stem from higher-than-expected margin erosion amid fierce price competition in its end markets, inability to stabilize working capital, or Ceconomy falling substantially short of realizing profit accretion from its current strategy. A downgrade could also arise from a more aggressive financial policy than we anticipate, resulting in erosion of the group's large cash cushion and credit metrics.

Upside scenario

We could raise the rating on Ceconomy if the group's operating performance and cash generation sustainably improve, translating into:

- Meaningful and growing FOCF after leases;
- The S&P Global Ratings-adjusted EBITDA margin approaching 5%;
- An EBITDAR coverage ratio exceeding 2.0x; and
- Adjusted debt to EBITDA well below 3.0x.

This could stem from the successful execution of the group's strategy leading to stronger competitiveness and profitability, along with more robust consumer discretionary spending than we anticipate.

Company Description

Ceconomy is Europe's largest electronics retailer, generating €21.8 billion revenue and €851 million of S&P Global Ratings-adjusted EBITDA in fiscal 2022. The group operates under two brands:

- MediaMarkt, which was founded in 1979 and operates across Europe with 892 stores and 37,000 employees, including 267 stores and 11,000 employees in Germany; and
- Saturn, which was founded in 1961 and operates only in Germany, with 132 stores and 5,600

employees.

As of fiscal 2022, the group operates in three key regions: DACH (representing 55.3% of sales), Western/Southern Europe (32.9%), and Eastern Europe and other (11.8%). The group held a 24.2% minority stake in Fnac Darty, which is valued at about €220 million based on its market capitalization as of March 31, 2023.

The group is majority privately owned. Its key shareholders are Convergenta (29.0%) with its ultimate beneficiary being the Kellerhals family (founders of MediaMarkt), Haniel (16.7%), Meridian Stiftung (11.1%), and freenet AG (6.7%). The residual 36.5% are free float, which include the two shareholders of Prof. Otto Beisheim Foundations (with 4.8%) and Exor Financial Investments (4.2%).

Our Base-Case Scenario

Assumptions

- A stagnation in real GDP in Germany in 2023 and growth of 0.9% in 2024 after 1.8% growth in 2022. We expect real GDP growth for the eurozone of 0.3% in 2023 and 1.0% in 2024.
- Inflation to remain elevated, at 6.7% in Germany in 2023 and 5.9% in the eurozone after 8.7% and 8.4%, respectively, in 2022. We expect inflation normalizing toward 2.9% in Germany and 2.7% in the eurozone in 2024.
- Real volume decline for consumer electronics at least in 2023 and nominal growth of 1%-3%, which follows our expectations of higher discounts in first-half calendar 2023 to manage working capital throughout the industry, low consumer confidence, and discretionary income.
- Revenue growth in line with the market at nominal rates of 1.5%-2.0% in 2023 and 2024. Reported growth will be slower at 0.5%-1.0%, due to the divestment of its Swedish business, which the company expects to close by fiscal year-end 2023. In 2022, the business generated about €500 million in revenue and achieved break-even EBITDA.
- The S&P Global Ratings-adjusted EBITDA margin contracting to 3.5%-3.7% in fiscal 2023 from 3.9% in fiscal 2022 due to inflationary pressure on labor, logistics, and energy costs, and initial costs from the new restructuring program. In fiscal 2024, we expect margins to recover to above 4%, supported by a streamlining of the organization that we expect to result in lower SKUs and aligned product offerings that should stabilize gross profit margin. In addition, some benefits from restructuring, changes in product mix, and combined marketing initiatives could improve margins toward 4.5% in fiscal 2025.
- Positive working capital changes of €50 million-€75 million in fiscal 2023 and a neutral contribution thereafter due to product mix and a higher share of services.
- Annual capex of €250 million-€300 million in fiscal years 2023 and 2024, reflecting increase in capex levels of 1.3%-1.5% of sales, from below 1% in fiscal years 2021 and 2022.
- No dividends or material acquisitions beside the divestment of the Swedish business.

Key metrics

Key Metrics--Ceconomy AG

	--Fiscal year ends Sept. 30--						
(Mil. €)	2019a	2020a	2021a	2022a	2023f	2024f	2025f
Sales	21,455	20,831	21,361	21,768	21,600-22,100	21,700-22,200	22,100-22,600
EBITDA	1,037	1,013	935	851	800-850	920-970	990-1,040
EBITDA margin (%)	4.8	4.9	4.4	3.9	3.5-3.7	4.1-4.3	4.3-4.6
FFO	718	976	769	643	620-720	720-820	770-870
Reported FOCF after lease payments	(103)	496	(242)	(542)	100-150	0-50	0-50
Debt*	1,843	1,572	1,827	2,511	2,200-2,600	2,200-2,600	2,100-2,500
Debt to EBITDA (x)	1.8	1.6	2.0	3.0	2.9-3.1	2.5-2.7	2.3-2.5
FFO to debt (%)	39	62.1	42.1	25.6	27-32	30-35	33-38
EBITDAR to interest and leases (x)	1.7	1.7	1.7	1.5	1.4-1.6	1.6-1.8	1.7-1.9

All figures adjusted by S&P Global Ratings. *2022 year-end debt consists of financial debt of €812 million, with key adjustments being €1.96 billion in leases, €264 million in pensions, €189 million of factoring, and €1.4 billion surplus cash. FOCF--Free operating cash flow. FFO--Funds from operations. DCF--Discretionary cash flow. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Ceconomy's liquidity as adequate. We estimate that cash sources will cover liquidity uses by more than 2.0x over the 12 months starting Jan. 1, 2023, and remain above 1.5x over the subsequent 12 months even if EBITDA declines by 30%. However, the group is exposed to a high seasonality and structurally high intra-year seasonality of earnings and, particularly, working capital. In our opinion, the peak's magnitude accounts payable position of €7.3 billion at the end of first-quarter fiscal 2023 could expose the group to unexpected deterioration in liquidity if challenging trading conditions hampered full price sales or a substantial share of payment terms were to change unexpectedly, for example, for regulatory reasons.

Ceconomy has a two-tranche ESG-linked revolving credit facility (RCF), with a total volume of €1.06 billion. The €353 million RCF is due in May 2025 and can be extended to May 2026, while the €707 million RCF is due in May 2026 and can be extended to May 2028.

We estimate that principal liquidity sources include:

- About €2.58 billion in unrestricted cash and equivalents at Dec. 31, 2022;
- Available €353 million RCF due in 2025 and €707 million due in 2026;
- Cash funds from operations of €300 million-€350 million net of lease payments; and
- Normalized working capital, leading to a slight inflow.

Principal liquidity uses include:

- Short-term debt maturities of approximately €100 million, including €83 million of commercial paper at Dec. 31, 2022;
- Annual seasonal working capital swings (intrayear) of €1.5 billion from the first quarter of the fiscal year; and
- Capex of €250 million-€300 million.

Covenants

The €1.06 billion ESG-linked RCF facility has a maintenance covenant that is tested in March and September of each year, and we estimate the group has significant headroom under it.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

Environmental factors are a neutral consideration in our credit rating analysis of Ceconomy. The company publishes an annual sustainability report. In fiscal 2022, Ceconomy committed to participate in the Science Based Target initiative (SBTi) and is formulating and implementing additional climate targets. We see topics around the circular economy incorporated in the group's business strategy that can support higher customer retention.

Social factors are also a neutral consideration. Ceconomy is one of Europe's largest retail employers, with 50,148 employees. In Germany (20,686 employees), 80.46% of employees have a collective bargaining agreement. We anticipate that record high inflation in Germany (10.9% in fiscal 2022) will increase personnel costs, and these will continue to rise due to high inflation and a tight labor market, in particular in the DACH region.

Governance factors are also a neutral consideration. The company's corporation and legal bodies (the management board, supervisory board, and general assembly) are governed by German stock corporation law. Of the supervisory body, 50% is composed of elected employee representatives. We estimate that the buyout of minority shareholders at the local store level and the Convergenta transaction simplified Ceconomy's governance structure and improved transparency. The company's main shareholder is the Kellerhals Family, with a 29% share.

Issue Ratings - Recovery Analysis

Key analytical factors

- We rate the group's €500 million unsecured bond maturing in 2026 'BB-', in line with the issuer credit rating.
- The recovery rating on these instruments is '3', indicating our expectation of meaningful recovery prospects (50%-70%; rounded estimate: 65%) in the event of default. This is supported by relatively limited financial debt and lack of priority ranking facilities.
- The financial debt, comprising promissory notes, the €151 convertible bond, €500 million notes

(rated 'BB-'), and bank RCFs, is solely issued by Ceconomy and ranks pari passu. Guarantor coverage for the rated notes consists of entities that contribute more than 80% of group revenue.

- In our hypothetical default scenario, we assume intense competition in the European electronics retail market along with a severe economic downturn leading to deterioration in the group's margins and operating performance.
- We value Ceconomy as a going concern, underpinned by the company's strong position in European electronics and home appliances retail market, with an omnichannel presence, a strong store network, and solid brand equity in its key markets.

Simulated default assumptions

- Year of default: 2027
- Jurisdiction: Germany

Simplified waterfall

- Emergence EBITDA: €280 million (capex represents 1.0% of average sales for the past three years; cyclicality adjustment of 5%, in line with the industry subsegment)
- EBITDA multiple: 5.0x
- Gross enterprise value: €1.21 billion
- Net recovery value for waterfall after administrative expenses (5%): €1.15 billion
- Estimated senior unsecured debt claims: €1.73 billion
- --Recovery range: 50%-70% (rounded estimate: 65%)
- --Recovery rating: 3

All debt amounts include six months' prepetition interest. Debt claims include the €1.06 billion RCF, which we assumed 85% drawn at default.

Ratings Score Snapshot

Issuer Credit Rating	BB-/Stable/--
Business risk:	Fair
Country risk	Low
Industry risk	Intermediate
Competitive position	Fair
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)

Issuer Credit Rating	**BB-/Stable/--**
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bb-

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

New Rating	
Ceconomy AG	
Issuer Credit Rating	BB-/Stable/--
Senior Secured	BB-
Recovery Rating	3(65%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at

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