FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Ceconomy AG at 'BB'; Outlook Stable

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Fitch Ratings - Milan - 20 Nov 2024: Fitch Ratings has affirmed Ceconomy AG's Long-Term Issuer Default Rating (IDR) at 'BB' with Stable Outlook.

The affirmation reflects continued satisfactory trading performance in FY24 (financial year end September), with sequential profit recovery over FY23-FY24 after a very weak FY22. The Stable Outlook reflects our expectation that, after its leverage peaked in FY22 at a level that was inconsistent with the rating, the restoration of profitability and the return to positive cash flow generation in FY23 are sustainable and should support gradual deleveraging to EBITDAR net leverage of close to 4.0x in FY24-FY25.

The rating also reflects Ceconomy's large-scale, well-diversified product offering, omnichannel capabilities, and its pan-European footprint. Rating constraints are low operating margins in a competitive market, a history of volatile free cash flow (FCF) and tight EBITDAR fixed charge cover.

KEY RATING DRIVERS

Recovery from Low Profitability: Ceconomy operates in the largely commoditised mass market of appliances and consumer-electronics retailing, which is exposed to intense competition, limited customer loyalty and high online market penetration.

After falling to below 2% in FY22, its EBITDA margin remains weak but should continue its recovery towards 2.5% by FY26. We forecast EBITDA to rise towards EUR600 million by FY27 from EUR364 million in FY23. This will be aided by cost-efficiency measures, a shift of the product mix to private label and increasing contribution of the services and solutions business and media services. We also expect demand drivers to improve in its core markets in FY25, due to consumer confidence recovery and replacement-cycle dynamics.

Leading European Consumer-Electronics Retailer: Ceconomy is the largest consumer-electronics retailer in Europe, but we place its business profile at between the 'BBB' and

'BB' categories due to a fiercely competitive and volatile market. It benefits from a strong brand name, sizeable operations with a pan-European footprint, and a well-diversified product offering with adequate omnichannel capabilities.

Online sales, which accounted for 22% of total sales in FY23 and are gradually growing, help Ceconomy defend its market share against intense online competition. Overall, the company has successfully gained market share in FY24. However, trading is mostly driven by its core market of Germany, where demand remains subdued.

Diversification Offsets Macroeconomic Challenges: Ceconomy's geographic diversification offset weak sales during FY23-FY24 in Germany, where consumers were tightening spending on major non-discretionary items, with the strength of the Turkish, Dutch and Spanish markets. For FY24 we estimate that spending on electronics and appliances has remained stagnant in Europe, but a resumption of replacement cycles for small appliances and phones plus innovation in personal computers and other items should now start to lift demand.

Working Capital Stabilising: Following a partial normalisation of trade working capital (TWC) in FY23 that reversed some of the heavy outflows of close to EUR800 million in FY21-FY22, we expect further inflows in FY24 before they turn neutral in FY25-FY27. Store-related investments remain focused on renovation and are limited to the opening of small formats and only few new large flagships. Ceconomy is investing in the redesign of its logistics model. We expect these higher-than-historical cash requirements for capex to be covered by internal cash flow.

FCF Recovery: Barring a resumption of dividend payments - which management has ruled out until it has delivered on its strategic plan in FY26 - we expect Ceconomy to generate consistently neutral to mildly positive FCF. Our view of sustained positive FCF is an important rating consideration, given the importance of well-managed TWC against the company's investment needs and structurally low EBITDA margins.

Execution Risks: In its biggest markets, Ceconomy is shifting from a reliance on third-party distributors and stocking products in the warehouses of each of its stores to one large nationwide hub, complemented by smaller regional ones. We see some execution risks due to the magnitude of the transformation but, if successful, it will lead to more agile management of inventories. This will enable Ceconomy to operate with lower stocks and, once the automation of logistics operations is also completely implemented, to lower operating costs.

Leverage Recovery Since FY23: The weak FY22 performance, combined with two years of inflated WC, led to a jump in EBITDAR net leverage to 4.8x, before it fell in FY23 to

4.5x, which was close to the 4.0x negative sensitivity. We see scope for further improvements in FY24, potentially reaching 4.0x in FY25. These levels place Ceconomy's financial structure score in the mid-to-low end of the 'BB' rating category.

Tight Fixed-Charge Coverage: We see weak EBITDAR fixed-charge coverage remaining below 2.0x, which corresponds to a low 'B' level. This is balanced by its actively managed leased store network, mitigating the impact of inflation indexation, and leading to broadly flat lease payments and modest cash debt service. However, tightening fixed-charge coverage ratios would signal less effective property management and could put ratings under pressure.

Adequately Managed Property Portfolio: Fitch recognises Ceconomy's active management of its operating leases, which provides financial flexibility, given the short-term nature of leases as well as the inclusion of early termination clauses, usually linked to store-based profitability metrics. Fitch uses a lower estimated 7x lease multiple (than the standard 8x) when computing Ceconomy's lease-adjusted debt metrics to reflect that a proportion of its leases are turnover-based.

DERIVATION SUMMARY

Ceconomy's 'BB'/Stable combines the 'BBB' traits of its sizeable operations, market position and product offering, with 'B' levels of operating profitability and credit metrics. We also regard as a rating constraint the highly commoditised consumer electronics markets in which Ceconomy operates, with exposure to demand volatility and growing competing online penetration. We consequently view Ceconomy's credit profile as being in line with that of the consumer electronics retail sub-sector.

Ceconomy's closest Fitch-rated peer is FNAC Darty SA (BB+/Stable). FNAC is almost three times smaller by revenue but has slightly stronger profitability due to its greater focus on premium segments, editorial products and subscription services, and a demonstrated ability to pass on price increases and protect margins. FNAC's EBITDA margin at around 4% is double that of Ceconomy's currently, which explains the one-notch rating differential, although we expect the margin to gradually improve towards 3%.

Compared with Kingfisher plc (BBB/Stable), the largest DIY group in UK and Poland, Ceconomy has similarly strong positions in its respective markets, combined with scale and good diversification. Ceconomy's financial policy of a maximum 2.5x net debt (including leases)/ EBITDAR and well-managed leased property portfolio are positive for its credit profile, although this is offset by considerably lower profitability, weaker coverage metrics and around 2 turns higher leverage versus Kingfisher's. This is reflected in the three-notch rating differential.

Similarly-rated Pepco Group N.V (BB/Stable), a European value retailer with leading positions in CEE markets, is smaller in scale but has higher EBITDA margin (13%) than Ceconomy. Pepco has slightly better coverage metrics and similar leverage to Ceconomy's.

Relative to Spanish department store El Corte Ingles S.A. (ECI, BBB-/Stable), Ceconomy is larger, more geographically diversified (ECI generates 95% of sales in Spain) and better positioned in its online service offering. ECI, however, has a more premium service offering, with prime-city store locations and customer loyalty, as well as higher own-brand sales, which translate into higher EBITDA margin (6.6%) than Ceconomy. The two-notch rating differential is further explained by lower leverage and stronger coverage metrics for ECI.

Compared with another direct peer in the consumer-electronics space, UK retailer Currys plc, Ceconomy is around 2x larger in absolute sales, reflecting operations across multiple European countries. Its gross profit and EBITDA margins are similar to Currys' at around 18% and 2%-3%, respectively.

KEY ASSUMPTIONS

- Low single-digit revenue growth over FY25-FY27 from company-reported EUR22.4 billion in FY24

- Fitch-defined EBITDA margin to improve to 2.3% in FY25 (1.7% in FY23) and gradually expanding to 3% in FY27

- Leases at 2.4%-2.5% of sales to FY27

- TWC inflow of around EUR116 million in FY24 followed by a normalisation with a marginally positive cash impact over FY25-FY27

- Capex at around EUR275 million a year, corresponding to around 1.2% of sales to FY27

- No dividend payments over FY24-FY25. Dividend payments of EUR50 million in FY26 and EUR75 million in FY27

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, lead to Negative Rating Action/Downgrade

- Decline in profitability and like-for-like sales, for example, due to increased competition or a poor business mix, with EBITDA margin remaining below 2%

- EBITDAR fixed-charge coverage below 1.6x

- EBITDAR net leverage consistently above 4.0x

- Mostly negative FCF

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Improved profitability and like-for-like sales, for example, due to a strengthened competitive position or an improved business mix, with Fitch-defined EBITDA margin sustained above 2.5%

- EBITDAR net leverage consistently below 3.5x

- EBITDAR fixed-charge coverage above 1.8x

- Neutral to marginally positive FCF generation and improved cash flow conversion leading to lower year-on-year trade WC volatility

LIQUIDITY AND DEBT STRUCTURE

We estimate Ceconomy's readily available cash balance at around EUR1 billion at FYE24, which is adequate for its limited debt service requirements in the absence of material contractual debt maturities until FY26-FY27. We project low single-digit FCF margins, which should help keep the cash balance broadly stable, unless distributed to shareholders.

Ceconomy has access to an undrawn committed revolving credit facility (RCF) of EUR1.06 billion due in 2026, as well as a EUR500 million commercial paper programme to support short-term financing needs (EUR115million utilised as of June 2024), although we do not include the latter in our liquidity calculation. In July 2024, Ceconomy demonstrated its access to capital markets by issuing EUR500 million notes (6.25%, due 2029) to refinance its EUR500 million notes maturing in FY26, a portion of which (EUR144 million) remains due in 2026 after the tender.

We do not restrict the cash balance for WC purposes, as we view its cash position in the fourth quarter of its financial year as a fair representation of the average annual level, despite large WC swings during the year, particularly around the first and third quarters.

Our assessment considers that the favourable WC swing between the fourth and first quarters tends to be larger than the cash-absorbing WC swing between the second and third quarters.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING	RECOVERY	PRIOR
Ceconomy AG	LT IDR BB Rating Outlook Stable Affirmed		BB Rating Outlook Stable
senior unsecured	LT BB Affirmed	RR4	BB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Ceconomy AG	EU Issued, UK Endorsed

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