Ceconomy AG
Germany, Retail

Corporate profile

Ceconomy is the European market leader in consumer electronics retail, with about EUR 21bn of revenue generated in FY 2020 (fiscal year ending September). The group has two established brands, Media Markt and Saturn, after demerging from Metro Group in 2017. Ceconomy has a broad presence in Europe with more than 1,000 stores and leads the market in six of its 15 countries of operation. The group's network of physical stores, combined with its online platform, allows it to record about six million customer contacts per day.

Key metrics

			Scope estimates	
Scope credit ratios	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
EBITDA/interest cover (x)	9	19	15	16
Scope-adjusted debt (SaD)/EBITDA (x)	1.8	1.6	2.0	1.7
Scope-adjusted FFO/SaD (%)	40	61	39	46
FOCF/SaD (%)	-4	30	-9	15

Key metrics

Rating rationale

Scope Ratings has affirmed its BBB-/Stable issuer rating to German consumer electronics retailer Ceconomy AG. Scope has also assigned a BBB- senior unsecured debt category rating and a BBB- rating for its issued EUR 500m senior unsecured bond maturing in 2026. The short-term rating is S-2.

The rating action reflects Ceconomy's resilient financial performance over the last 18 months given the unfolding coronavirus crisis. Some quarters were stronger than others, depending on the degree to which lockdowns affected the store network. Overall though, Ceconomy benefited greatly from its 'hybrid' status as a multi-channel electronics retailer, affording consumers additional flexibility during the crisis. The implications of the coronavirus crisis for the group's business risk profile have little impact on its ratings in our view. At the same time, Ceconomy's financial risk profile, including its liquidity situation, was strongly supported by management's credit-friendly approach. This was confirmed by the mainly equity funded and non-cash nature of the minority buyout of Convergenta's 21.62% stake in Media Markt Saturn Retail Group.

With regard to Ceconomy's **business risk profile**, we believe that the group's performance has been resilient, given that a large percentage of its total store network was shut down at times, especially in Germany and the Netherlands. The group was able to significantly grow the share of its online business (almost half of group sales in the second quarter), which greatly mitigated and at times even overcompensated for the loss of physical shop sales. However, this was probably driven by the one-off effect generated by cocooning and the initial home office effect. Thus, Ceconomy was able to generate a significant online presence in the crisis from a rather low basis of about 10% of group sales just two years ago. Management guidance is cautious for the remainder of the year, given a weaker second quarter and still limited visibility. However, we believe that this former weakness has been addressed by a much-improved online market share, which may prove sustainable. Thus, while Ceconomy's overall business risk profile did not change materially during the crisis, the increase in online market shares is positive.

Ratings & Outlook

Corporate rating	BBB-/Stable
Short-term rating	S-2
Senior unsecured rating	BBB-

Analysts

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Related Methodology

Corporate Rating Methodology: February 2020

Rating Methodology: Retail and Wholesale Corporates March 2021

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Contrary to our previous base case, Ceconomy's **financial risk profile** did not deteriorate in fiscal 2020 compared to the previous year but actually improved. This was driven by: i) a much less negative impact from the coronavirus crisis than initially expected; and ii) management's swift implementation of a stringent cash preservation policy after the crisis broke out. Businesswise, the trends described above stabilised top-line performance. Credit metrics were also greatly helped by a positive swing of about EUR 700m from working capital changes compared to fiscal 2019. This was achieved despite significant inventory expansion driven by the sharp rise in online business. Free operating cash flow (FOCF) generation of EUR 479m in fiscal 2020 was mainly triggered by the strong business conditions in the fourth quarter of the year, which increased payables significantly at the end of fiscal 2020. As this was clearly a one-off factor, it reversed strongly in the first half of fiscal 2021 in combination with a pay back of suppliers' bills after a temporary extension of payment terms in the first quarter of the current year. The resulting cash outflow of EUR 852m in the first half of the current year led to an according deterioration in credit metrics. Scope-adjusted debt (SaD)/EBITDA increased to 2.2x on a last twelve months' basis, from the level of 1.6x reached in fiscal 2020.

Outlook and rating change drivers

The Stable Outlook reflects our expectations that Ceconomy's financial risk profile will not deteriorate significantly in fiscal 2021 and that the working capital-led deterioration at the half-year stage will come to an end in the second half of the year. Specifically, current credit metrics continue to reflect the BBB category, as indicated by Scope-adjusted funds from operations/SaD of 35%-40% and a SaD/EBITDA ratio of below 2.5x.

A positive rating could be triggered by an improved business risk assessment. This could, for example, be achieved through better operating margins and free cash flow via successful restructuring measures and by keeping SaD/EBITDA below 2x on a sustained basis.

A negative rating action could result from a more aggressive financial policy or a sustained, negative deviation from ratios commensurate with the present ratings, as expressed by leverage exceeding 2.5x.

Rating drivers

Positive rating drivers	Negative rating drivers
• Europe's leading consumer electronics retailer • Diversified product range encompassing white and brown goods as well as communication equipment • Conservative financial policy and investment grade ratings commitment • Continueds strong balance sheet	• Company in transition to achieve profitability • Lowest operating margins among peers • Strong competition from Amazon

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Successful execution of restructuring programme and emergence from coronavirus crisis • Leverage below 2x on a sustained basis	• Potential M&A eroding credit metrics • Inability to maintain at least funds from operations/SaD of 35% and • SaD/EBITDA of 2.5x

Financial overview

			Scope estimates	
Scope credit ratios	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
EBITDA/interest cover (x)	9	19	15	16
Scope-adjusted debt (SaD)/EBITDA (x)	1.8	1.6	2.0	1.7
Scope-adjusted funds from operations/SaD (%)	40	61	39	46
Free operating cash flow/SaD (%)	-4	30	-9	15
Scope-adjusted EBITDA in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
EBITDA	465	991	1,075	1,200
Operating lease payments in respective year	589	0	0	0
Other	**0**	**0**	**0**	**0**
Scope-adjusted EBITDA	1,054	991	1,075	1,200
Scope-adjusted funds from operations in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
EBITDA	465	991	1,075	1,200
less: (net) cash interest as per cash flow statement	-14	-45	-75	-75
less: cash tax paid as per cash flow statement	-152	17	-150	-170
add: depreciation component, operating leases	485	0	0	0
Scope-adjusted funds from operations	774	959	844	947
Scope-adjusted debt in EUR m	**2018/19**	**2019/20**	**2020/21E**	**2021/22E**
Reported gross financial debt	302	2,422	2,641	2,666
less: cash and cash equivalents	-1,132	-1,484	-1,100	-1,247
add: cash not accessible	100	100	100	100
add: pension adjustment	574	544	519	522
add: operating lease obligations	2,094	0	0	0
Other	0	0	0	0
Scope-adjusted debt	**1,939**	**1,582**	**2,160**	**2,041**

Business risk profile

European market leader

Ceconomy is Europe's leading consumer electronics retailer, with about EUR 21bn of revenues. The group has over 1,000 stores in 15 European countries, in six of which it is market leader.

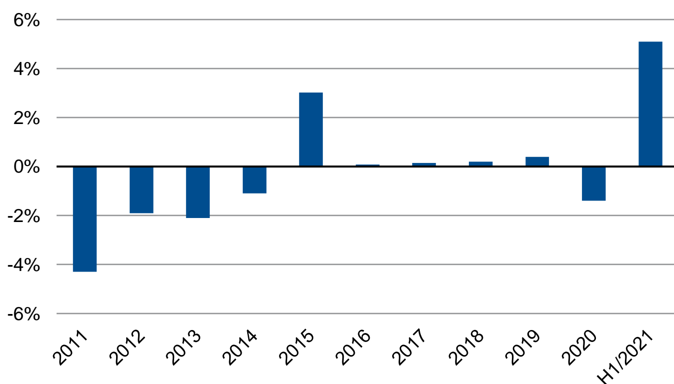
After 2014, same store, comparable ('like-for-like') growth rates generally recovered for the group's two established sales channels Saturn and Media Markt (see Figure 1 below). Ceconomy had a number of years with almost no same-store growth on a local currency basis. This changed when the effects of the coronavirus crisis accelerated growth rates, despite the total closure of most of the group's store networks for several months. As a multi-channel electronics retailer, Ceconomy benefited from its 'hybrid' status (physical shops and online channel), which gave consumers additional flexibility during the crisis. This was confirmed by the consumer preference to mix the two channels, i.e. to order online and pick up the goods purchased in the shops.

Ceconomy also benefitted from two demand trends triggered by the crisis, namely cocooning (upgrading the 'home experience' in times of hardship/inability to travel) and the necessity to invest in home office equipment as most companies sent employees home. Ceconomy thus appears to have taken advantage of its recently upgraded online platform and significantly expanded its online business. Just two years ago the online business accounted for under 10% of group sales. At the end of the second quarter of fiscal 2021, online sales accounted for 49% of group sales (37% for the first six months of the year overall, up from about 30% for the first quarter). This more than compensated for the negative trends in the group's stationary business due to the lockdowns. According to management, Ceconomy's online growth has outperformed the underlying German online market by far in the past quarters, resulting in significant market share gains in Germany.

Ceconomy thus appears to have entered a phase in which the online business is expanding faster than the shop business is declining, to the benefit of overall sales. We expect some of this growth to normalise again as the two coronavirus-driven effects described above are very likely to have had a one-off character. We nevertheless believe there is a good chance that Ceconomy will retain some of its significant online market share gains as customers get used to this form of shopping.

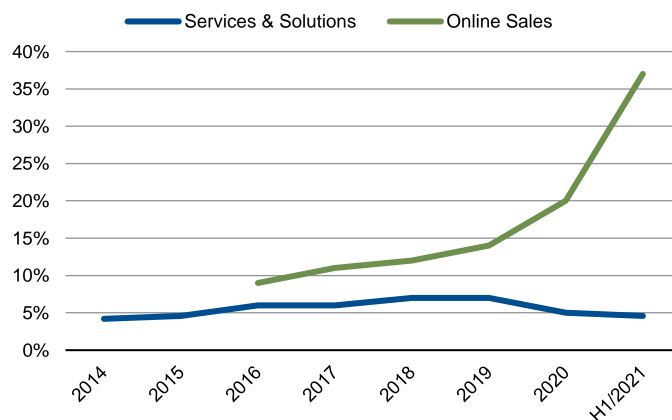
Based on the group's unchanged leading market position in Europe overall, Ceconomy's market share continues to be the strongest driver for its business risk profile from a ratings perspective.

Figure 1: 'Like-for-like' growth rates picking up



Source: Scope estimates

Figure 2: Online sales taking off



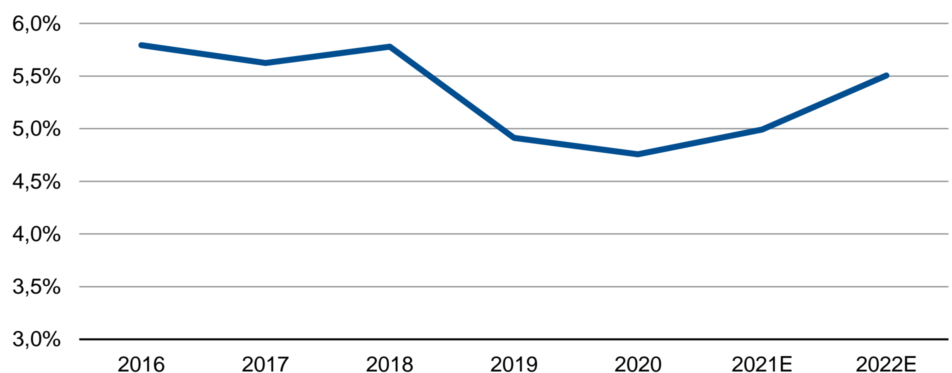
Source: Scope estimates

Profitability still lagging

Convergenta transaction will allow easier decision making Compared with peers, Ceconomy continues to have low operating margins, which is surprising at first glance given the company's size and market shares. This low profitability is mainly because the group still reflects the former, independently built standalone brands Media Markt and Saturn. These were initially designed to attract different customer groups with different product assortments. The largely decentralised profile was still maintained under Metro ownership (until 2017). It was also difficult to change until recently as the founding Kellerhals family (which owns a strong minority position in the operating company Media Markt Saturn Retail Group via its investment company Convergenta) opposed efforts to concentrate the main functions. Particularly, both operating companies have had their own procurement and overhead functions so far. New management has finally been able to replace overhead functions by management functions (see paragraph below on the Convergenta transaction). We believe this should eventually have a positive bearing on profitability in combination with the group's transformation strategy ("first choice", which is about efficiency, value proposition and growth orientation), moving profitability more in line with peers like FNACDarty, whose EBITDA margin is 7%-8% (although this is also supported by FNACDarty's pricing protection in its book retail business).

Profitability levels in the last two years were profoundly shaped by the coronavirus crisis and the parallel expansion of the online business, which initially had a negative effect on profitability due to transport and packaging expenses. However, we believe that prospects for higher profitability are good, depending on no further lockdowns and progress on the group transformation. As this development is probably still one to two years in the future, profitability remains the weakest contributor to the group's overall business risk assessment. Group EBIT in fiscal 2020 was burdened by the additional impairment of Ceconomy's stake in FNACDarty. This effect is likely to reverse in the current financial year as it was already written up again in the first half of fiscal 2021 due to the participation's rising share price.

Figure 3: Profitability not improved yet



Source: Annual reports, Scope adjustments

Convergenta transaction will allow easier decision making

In May 2021, Ceconomy announced an agreement with Convergenta with regard to the future structure of the group. This followed a long-standing disagreement between the parties on the subject and frequent court battles. The essence of the agreement is the shift of Convergenta's stake from the operating level to the group level, which will make it much easier to execute operating decisions. In addition, the removal of sizeable minorities at the operating level will also free up synergies such as the usage of existing tax loss carry-forwards as well as the deductibility of Ceconomy's holding costs for tax reasons. However, we believe the main benefit will be centralised procurement for both Business risk profile assessed at BBB- Improving credit metrics in 2020

Normalisation in first half of fiscal 2021

brands and the availability of a central German warehouse in Goettingen, which should be provided in fiscal 2022.

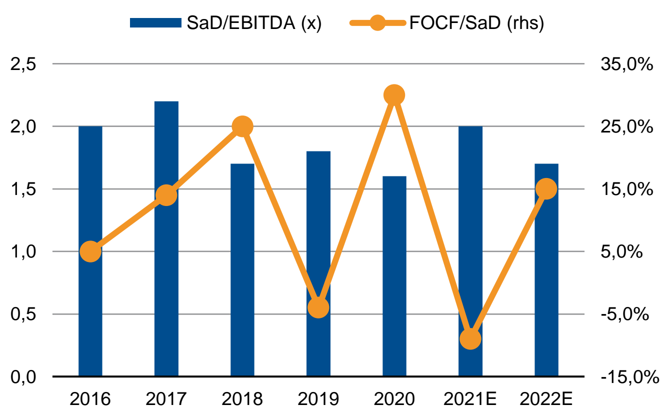
We continue to assess Ceconomy's business risk profile at BBB-. This includes industry risk of BB and our competitive positioning analysis of BBB-. The latter incorporates Ceconomy's strong market shares and good diversification, offset by below-par operating margins.

Financial risk profile

Contrary to our expectations, Ceconomy produced very good credit metrics in 2020. This was driven by: i) a much less negative impact from the coronavirus crisis than initially expected; and ii) management's swift implementation of a stringent cash preservation policy after the crisis broke out. Group sales fell by about 3% in fiscal 2020 and EBITDA gave way by about 6% in a year-on-year comparison. However, this negative effect on credit metrics was clearly overcompensated by a sharp fall in SaD generated by cost savings and a strong release of working capital. Working capital changes contributed more than EUR 450m to FOCF in 2020 as Ceconomy benefited from the strong demand at the end of the previous year. This was also achieved despite a significant increase in the group's inventory to make products available for the much-increased internet business.

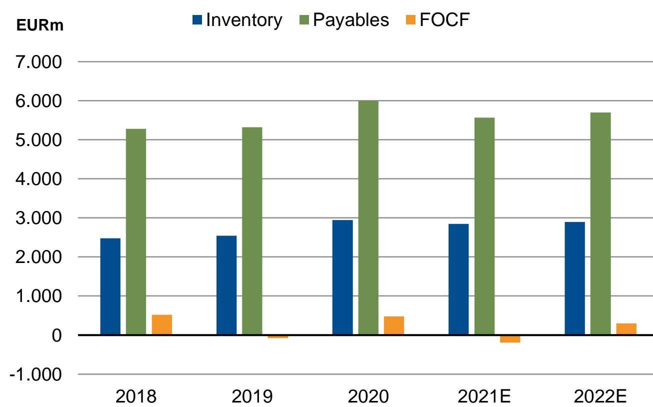
As a consequence, credit metrics improved strongly in fiscal 2020, even surpassing the pre-Covid-19 levels reached in fiscal 2019 (compare to Figure 4 below).

Figure 4: Leverage under control



Source: Scope estimates

Figure 5: Working capital expansion in 2020



Source: Scope

The first half of fiscal 2021 was a mixed bag as regards performance. The first quarter of the year (Christmas quarter 2020) was very strong operationally (+11.7% like-for-like growth) driven by a strong online business and consumers cocooning to compensate for the inability to travel. The second quarter was much weaker (-4.6% comparable growth) due to continued shop closures, especially in Germany and the Netherlands, which together account for about half of the total Ceconomy store network.

EBITDA and operating cash flow were broadly satisfactory given the prevailing trading conditions. However, FOCF in particular suffered significantly from a hugely negative cash absorption from working capital. This was primarily led by the asset side: i) inventories kept increasing reflecting the rising online business; and ii) payables normalised after the strong demand in the previous year's fourth quarter and from suppliers' pay-back following temporarily extended payment terms in the first quarter of the current year. This drove the FOCF/SaD ratio deeply into the red in the first half of the present year, based on a negative EUR 852m contribution from working capital. This very

negative but unavoidable effect was 'digested' fairly easily as Ceconomy's cash balances were strong enough to absorb the resulting cash outflow in the second quarter. Based on a rolling twelve months' performance, key credit metrics deteriorated somewhat including the first half of fiscal 2021, compared to the levels reached in fiscal 2020. Leverage as expressed by SaD/EBITDA reached 2.2x, up from 1.6x in fiscal 2020. However, given the one-off nature we expect working capital and thus free cash flow effects to normalise over the remainder of the year.

For the full year of fiscal 2021 we expect the following trends:

- Group revenues of about EUR 21.5bn, up by about 3.4% year-on-year
- Slightly expanding EBITDA of EUR 1.05bn, up by about 8%
- Group profitability remaining well below historical levels, reflecting the expected transition towards becoming a more centralised organisation
- Dividend to remain at zero for fiscal 2021
- No further acquisitions
- FOCF remaining negative in fiscal 2021 and returning to positive territory in the following year

Convergenta transaction is supportive

We view the agreement with Convergenta as creditor friendly. This is driven by its equity focus and non-cash attributes. The key features of the transaction are new equity and a convertible bond. The upfront cash contribution is rather small at EUR 80m, to be paid in the second half of fiscal 2021 and only accounting for about 15% of the total transaction value of EUR 815m. Both new equity and the convertible bond are contributed 'in kind' and do not incorporate cash payments. The operational benefits to the group of the transaction are twofold: i) the use of existing tax loss carry-forwards at Ceconomy (total of EUR 1.2bn, plus the deductibility of Ceconomy's holding costs for tax reasons, which was not the case before); and ii) an easier decision making process at the operating level with regard to efficiency-enhancing measures such as streamlining the two units Media Markt and Saturn, formerly operated independently, with regard to developing common procurement, administrative and logistics concepts.

Convergenta will receive the convertible bond and has the option to either convert it into equity after five years or receive a cash payment of EUR 151m from Ceconomy at maturity. Both equity and the convertible bond have not been provided due to individual shareholders' opposition at Ceconomy's annual general meeting, which needs to be resolved first. This should not constitute a major delay though, in our view. We expect resolution in the second half of 2021.

Adequate liquidity

Ceconomy's liquidity profile still benefits from its completely undrawn syndicated credit facility of EUR 2.68bn in total, including the EUR 1.7bn KfW loan signed in May 2020, granted as part of the coronavirus support measures in Germany. In addition, a new revolving credit facility of EUR 1.06bn was put in place in May 2021, replacing the existing EUR 2.68bn RCF (including the KfW part) after its termination which is solely at Ceconomy's discretion. While the group's end of half-year cash balances were greatly diminished in comparison to the end of fiscal 2020, Ceconomy's short-term maturities remained low at about EUR 800m (and still below cash at hand).

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