

EuroRating has downgraded the credit rating for the company Pepco Group N.V. to 'BB' from 'BB+'

Warsaw, 21 December 2023 – The EuroRating credit rating agency has downgraded the credit rating assigned to the company Pepco Group N.V. (Poland) to 'BB' from 'BB+'. The rating outlook has been confirmed as stable.

RATING ACTION RATIONALE

The credit rating of Pepco Group N.V. was downgraded primarily due to the deterioration of its financing structure, a weakened liquidity position and a decline in the financial performance of the company.

EuroRating points out that the development of the Pepco Group's store chain is increasingly financed through debt. At the end of the fiscal year 2022/2023, the proportion of equity in total liabilities dropped to 25%, as opposed to 30% at the end of March 2022 (excluding lease liabilities and lease assets, this was 34% and 42%, respectively). The amount of interest-bearing liabilities is on an upward trend, and after taking into account cash held by the Pepco Group, the net debt by the end of September 2023 has reached its highest point in three years, nearly PLN 400 million.

Taking into account the presently low level of equity financing ratio, EuroRating identifies as risk factors the substantial nominal value of intangible assets and their considerable contribution to the total assets of the Pepco Group, exceeding 45% (excluding leasing, goodwill and other intangible assets are still making up over 25% of the total balance sheet assets).

EuroRating also considers the decline in the company's liquidity position in recent quarters. The current liquidity ratio has declined to a low level of 0.93 as of the end of September 2023 (1.12 excluding leasing), from 1.10 a year ago (1.41 without leasing). The quick liquidity ratio indicates a significantly low level, decreasing to 0.29 (0.35 without leasing), compared to 0.41 (0.53) a year ago. The agency emphasizes that this is partly due to a substantial increase in inventory levels.

The rating downgrade was also influenced by the company's weakened profitability in the financial year 2022/2023. Despite a 17% increase in sales revenue, the operating profit declined by 18%, and the net profit (influenced by a more than 50% increase in the net financial costs) dropped by 41%. This resulted in a decrease in the operating margin to 4% (compared to 5.8% in the previous year) and the net margin to a merely 1.8% (compared to 3.6% in the previous year).

Among the negative factors considered when evaluating the credit risk of Pepco Group, the agency currently also includes financial challenges faced by the company's main shareholder, Steinhoff International. Due to insolvency, Steinhoff International is currently undergoing debt restructuring. Part of this process includes plans to sell Pepco Group shares to a new shareholder within the next

few years. While Pepco Group's operations are currently unaffected by the absence of a stable and financially credible strategic investor, this lack of support could pose a potential risk in situations where external assistance may be needed.

STABLE RATING OUTLOOK

The stable rating outlook means that, according to the current EuroRating's estimates, the rating assigned to the company should most likely remain unchanged in the horizon of the next 12 months.

MAIN FACTORS THAT COULD LEAD TO A RATING CHANGE

The most significant potential factors that could (individually or collectively) lead to a positive rating action (change of the rating outlook to positive and/or rating upgrade) include: a substantial increase in the equity share in liabilities (particularly after adjusting for intangible assets); a substantial improvement in financial performance; a reduction in financial debt and/or a decrease in the net debt to EBITDA ratio; an increase in generated cash flows from operating activities and free cash flows; improvement of liquidity position; and the acquisition of a new credible strategic investor.

The most significant potential factors that could (individually or collectively) lead to a downgrade of Pepco Group current credit rating (and/or to a change of the rating outlook to negative): possible further deterioration of financial performance (especially the generation of losses; a significant decline in the value of generated cash flows from operating activities and/or the generation of negative free cash flows; potential further substantial increase in financial debt; further decrease in the equity share in liabilities (particularly after adjusting for intangible assets and leasing); and further worsening of the company's liquidity position.

BEST/WORST RATING SCENARIO

The full range of best- and worst-case scenarios for all rating categories spans from 'AAA' to 'D'. Historical long-term statistics on rating migrations (changes between individual rating classes) for entities rated by EuroRating are published in the report on rating statistics, available at: <https://www.eurorating.com/en/ratings/statistics> (annexes No. 6-9).

REGULATORY DISCLOSURES

Information on the EuroRating credit rating agency

EuroRating is a fully independent international credit rating agency operating since 2007, specializing in assessing the credit risk of enterprises and financial institutions.

EuroRating Sp. z o.o. is formally registered by the European Securities and Markets Authority (ESMA) as a credit rating agency authorized to issue public credit ratings throughout the European Union (in accordance with the Regulation of the European Parliament and of the Council No. 1060/2009 on credit rating agencies) and is under direct supervision of ESMA.

EuroRating holds the ECAI (External Credit Assessment Institution) status in the European Union, pursuant to the Regulation of the European Parliament and of the Council No. 575/2013 on prudential requirements for credit institutions and investment firms (CRR Directive). The credit ratings (including unsolicited ratings) assigned by EuroRating are valid throughout the European Union and can be used for regulatory purposes under EU legislation by all financial institutions or any other entities and are entirely equal to credit ratings issued by other credit rating agencies registered by ESMA.

Methodology

The presented credit rating for the company Pepco Group N.V. is an issuer credit rating – it is a general assessment of the creditworthiness of the assessed entity and concerns the credit risk of its senior, unsecured and unsubordinated financial obligations.

The presented credit rating has been assigned in accordance with the Regulation (EC) No. 1060/2009 of the European Parliament and of the Council on credit rating agencies.

The methodology used in this rating was "Credit rating methodology for non-financial corporations" published in June 2023 and available at: <https://www.eurorating.com/en/ratings/methodology/credit-risk-assessment-methodology>

The rating scale of the EuroRating credit rating agency as well as detailed rating definitions are published at: <https://www.eurorating.com/en/ratings/rating-scale>

Historical default statistics for entities assessed by EuroRating are published in the report on rating statistics, available at: <https://www.eurorating.com/en/ratings/statistics>

EuroRating's definition of default as well as definitions of rating notations can be found in the agency's website at: <https://www.eurorating.com/en/ratings/methodology/definition-of-default>

Credit ratings assigned by the EuroRating credit rating agency are not solely estimates of the probability of default of a rated entity, but represent a total estimated assessment of a risk of loss (i.e. the ultimate loss of part or all of the receivables along with any interest) by the creditors of the rated entity in the event of its default. Ratings assigned by EuroRating therefore express a combination of the estimated probability of default of the rated entity and the estimated level of loss of receivables by its creditors in the event of an actual default (Loss Given Default).

Public status of the credit rating / terms of use

The presented credit rating for the company Pepco Group N.V. is a public rating. The date of the first publication of the rating, the current rating level and the full rating history are published free of charge on the European Rating Platform provided by ESMA (https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_radar), as well as on the EuroRating's website in the section "Credit ratings", in the relevant tab on the rated entity/security.

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Solicitation status

The rating assigned to the company Pepco Group N.V. was not solicited by the rated entity or any related third parties. The rated entity did not participate in the rating process, the agency had no access to internal documents or the management of the rated entity, and the analytical process was based on publicly available information. The main sources of information used in the rating process were: interim financial statements, presentations and reports of the rated entity, as well as publications in the media about the economy, the industries in which the company operates and about the rated entity itself. The information on the assigned credit rating was presented to the rated entity in advance. The rating was issued without any changes resulting from this disclosure.

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Disclaimer

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