S&P Global
Ratings

RatingsDirect®

Research Update:

ELO Outlook Revised To Negative On Underperformance And French Retail Structural Challenges; Affirmed At 'BBB-/A-3'

November 2, 2023

Rating Action Overview

- ELO (Auchan Holding), owner of Auchan Retail and New Immo Holding (NIH), reported weaker-than-expected results in the first half of 2023, and we expect operating performance will remain challenged over the next 12 months due to the economic environment, driving S&P Global Ratings-adjusted debt to EBITDA (excluding Russian operations) close to 3.5x.
- We believe Auchan Retail's structural weaknesses in its core French market, characterized by declining market share and very low EBITDA margin, pose long-term challenges to the group's profitability and cash-flow generation.
- Various unfavorable macroeconomic and geopolitical developments, including the Russia-Ukraine war, inflationary environment, and raising interest rates, are impacting ELO's profitability, cash-flow generation, and business prospects, absorbing the rating headroom.
- ELO has a strong balance sheet, with meaningful real-estate assets, including New Immo Holding's (NIH's) €7.4 billion portfolio, and a track-record of repaying debt through asset disposals, although high interest rates and declining real estate valuations could make disposals more difficult over the next 24 months.
- We therefore revised our outlook on ELO to negative from stable, and affirmed the 'BBB-' long-term and 'A-3' short-term issuer credit ratings on the company, as well the 'BBB-' issue rating on ELO's rated debt.
- The negative outlook reflects that the challenging economic environment, characterized by weak consumer demand, higher interest rates, and declining valuations, combined with Auchan Retail's structural challenges in France, could constrain ELO's performance, credit metrics, and business profile over the next 24 months.

PRIMARY CREDIT ANALYST

Eugenio Manzoli
Madrid
+ 33 1 40 75 25 53
eugenio.manzoli
@spglobal.com

SECONDARY CONTACTS

Mickael Vidal
Paris
+ 33 14 420 6658
mickael.vidal
@spglobal.com

Kathleen Allard
Paris
+ 33 14 420 6657
kathleen.allard
@spglobal.com

Alphee Roumens
Paris
+33 144206706
alphee.roumens
@spglobal.com

Rating Action Rationale

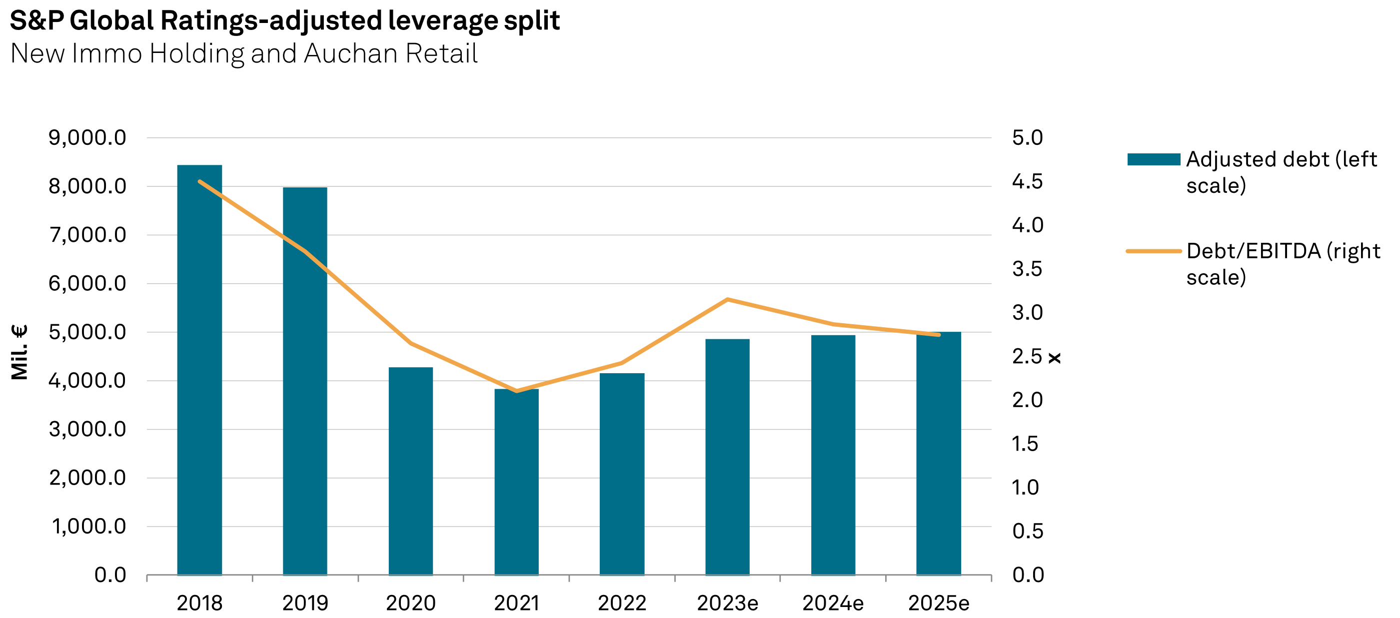
We project operating underperformance of Auchan Retail will drive ELO's S&P Global Ratings-adjusted leverage (excluding Russia) close to 3.5x in 2023. In the first six months of 2023, ELO reported sales of €15.8 billion, about 1.2% higher than 2022, or about 4.8% higher when excluding fuel. However, reported EBITDA declined to €545 million, about 12% lower than in first-half 2022, which was already 10% below first-half 2021. The group's reported EBITDA margin was 3.5%, compared with 4.0% in first-half 2022, and 4.7% in first-half 2021. That said, we understand a significant portion of the EBITDA drop was concentrated in Russia and Ukraine, due to the difficult operating environment. Excluding these two countries, EBITDA would have declined 3%, although from an already low first-half 2022 base. We expect operating conditions will remain challenging over the next six-12 months, as purchasing power concerns and higher energy costs, together with ELO's structural challenges in the French market, will continue to weight on the company's volumes and profitability. As such, we have revised downward our base case, and we now expect adjusted EBITDA will decline to about €1.5 billion in 2023, from €1.7 billion in 2022. This, together with an increase in net debt, will bring S&P Global Ratings-adjusted leverage excluding Russia close to 3.5x, our downgrade trigger. Given the market circumstances, we also believe that ELO will be unable to reduce its reported net financial leverage to 1.5x on Dec. 31, from 2.49x as of June 30, as communicated in July.

Weakness in the core French retail market poses long-term challenges to the group's profitability and cash-flow generation. Excluding Russia and Ukraine, the main drag on ELO's profitability and cash generation remains its core French retail operations, which still represent about half of the group's revenue and one fourth of its EBITDA. In our base-case, we expect Auchan Retail's reported EBITDA in France will drop by 5.0%-10.0% in 2023, after having dropped by 26.2% in 2022 and by 8.3% in 2021. We estimate this implies an EBITDA margin below 3.0% in 2022-2023, which translates in negative free operating cash flow (FOCF) generation. Although management is confident it can address the poor profitability of the French retail operations in the medium term, by investing in prices and in the attractiveness of hypermarkets, we believe this constitutes a major challenge for the group and the rating. French retail activities have been suffering from years of progressive market share erosion in a highly competitive environment, below-average profitability, and unpredictable performance, not aligned with other food retailers we rate. We believe Auchan Retail's competitive position in France is challenged by its dependence on large hypermarkets, which we estimate account for more than two-thirds of its revenue, and particularly by its significant nonfood exposure. Although the inflationary environment should support traffic in hypermarkets, given it is a price-driven format, ELO has been losing market share consistently over the last five years. We believe this is the result of fierce competition from discounters and market leader Leclerc, as well as the growth of specialized players such as Grand Frais in the fresh food segment, or Action in the non-food segment. So far, the various initiatives that the group has put in place to improve the attractiveness and the profitability of its French operations have not reflected in a durable improvement in the metrics. That said, we note that Auchan Retail's geographic diversification offers some natural hedge to underperformance in France. We expect Auchan Retail will continue to report satisfactory results in other regions, such as Spain and Portugal, where like-for-like revenue rose 5.2% in 2022, and in Central and Eastern Europe, where like-for-like revenue grew 5.8%.

Real estate subsidiary NIH helps ELO's profitability, but the macroeconomic environment is not supportive. We forecast NIH's adjusted EBITDA will reach around €400 million over 2023-2024, corresponding to an operating margin of 62%-63%, supporting ELO's performance and business diversity. NIH's revenue and profitability strongly recovered after the drop due to COVID-19-related restrictions in 2020-2021. We expect its rental income to continue growing by 3%-5% on a like-for-like basis over 2023-2024, before slowing in 2025, as most of its leases are indexed to inflation. Despite the material rise in interest rates, we project a decline of only about 5.0% of the company's portfolio value over the next 24 months (currently at about €7.4 billion), after a 0.7% decrease in the first half of the year. This is because the rise in yields should be partly compensated by robust cash-flow generation. Moreover, NIH's yields are already somewhat higher than those of some peers in the office or residential sectors (7.82% discount rate in France, 9.01% in Western Europe, and 11.79% in Eastern Europe). That said, higher interest rates could still pose additional challenges over the next 12-24 months, including increasing cost of funding and difficult execution on asset disposals. We assume slightly less than €150 million disposals over 2023-2024 overall, and €100 million over 2025 in our base case. We note that NIH would likely continue investing in its development pipeline over the coming several years and we assume around €600 million capital spending (capex) over 2023-2024, and €200 million in 2025. That said, we believe NIH will remain committed to self-financing its growth investments. As a result, we expect NIH's investment strategy will not drive any significant reduction or increase in ELO's net debt.

ELO's financial leverage remains lower than in 2018-2019, benefitting from a record of conservative financial policy and a strong balance-sheet. We forecast ELO's S&P Global Ratings-adjusted leverage (including Russia) will increase to 3.1x in 2023, from 2.4x in 2022 and 2.1x in 2021. Excluding Russia, this corresponds to an estimated leverage of 3.4x in 2023, up from 2.8x in 2022 and 2.4x in 2021. Despite the increase, the current level remains below 2018 and 2019, when adjusted leverage fluctuated between 3.7x-4.5x. In recent years, ELO went through a substantial deleveraging, with our adjusted debt declining to €4.1 billion in 2022, from a peak of €8.4 billion in 2018, as the group delivered its ambitious disposal plan. We believe ELO has a record of conservative financial policy, and could cut dividends or investments, if needed, to preserve its credit metrics. Given its strong asset base, including NIH's €7.4 billion portfolio and Auchan Retail's ownership of a significant portion of its stores, we believe the group may also execute additional disposals to reduce its financial debt. That said, to preserve the investment-grade rating, we believe net debt reduction must also come from positive FOCF generation and from the restoration of a sound retail business in France, and not only from asset disposals that often entail EBITDA reduction or higher lease payments.

Chart 1



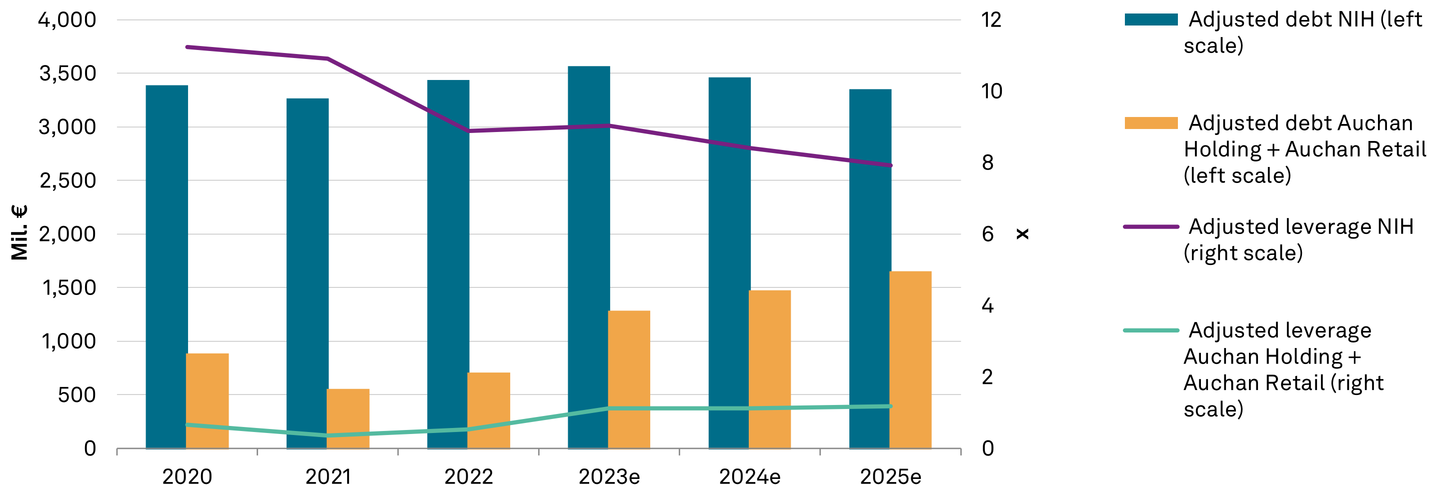
e--Estimate. Source : S&P Global Ratings

ELO's financial debt mostly benefits NIH, while Auchan Retail has no significant financial debt but struggles to generate positive FOCF. In 2022, NIH accounted for about 22% of ELO's consolidated adjusted EBITDA, but for about 85% of its €4.1 billion adjusted debt. Consequently, in 2022 NIH had an adjusted leverage of 8.9x, while the holding company and Auchan Retail had a leverage of only 0.5x, mostly constituted of lease obligations and a net cash position. We think this gives Auchan Retail more flexibility to eventually invest in prices and absorb a challenging trading period, especially in France. That said, due to its low operating margin and high investment needs, we forecast Auchan Retail's FOCF after leases will be negative in 2023, similar to 2022, and only moderately positive from 2024. From a financial standpoint, and in line with our rating approach for real estate companies, NIH can bear a much more leveraged capital structure relative to its EBITDA than regular corporate entities. This high leverage is offset by the high level of real estate assets on the books and the predictability of the related rental income mostly generated through fixed and indexed leases--a characteristic we reflect in our methodology for real estate companies, which have less stringent financial triggers compared with other corporates. Under our financial matrix framework for real estate entities, NIH's weighted-average credit metrics correspond to an intermediate financial risk profile. Therefore, we believe that ELO's credit quality is stronger than what its consolidated credit metrics suggest under our corporate rating methodology, justifying a one-notch uplift from the 'bb+' anchor. Considering its hybrid nature, combining both retail and real estate businesses, we will monitor the consolidated group and the creditworthiness of its two core businesses on a stand-alone basis under each methodology.

Chart 2

S&P Global Ratings-adjusted leverage split

New Immo Holding and Auchan Retail



e--Estimate. Source : S&P Global Ratings

Cash flow will remain weak in 2023-2025, due to subdued profitability, high capex, and increasing interest expenses, hampering organic deleveraging. In 2022, ELO's FOCF after leases was negative at about €400 million, mostly due to a working capital outflow of about €310 million and NIH's acquisition of the V2 shopping center for about €300 million, which the company reports as capex. This translated into an equivalent increase in the company's reported net debt, to €2.58 billion from €2.18 billion, with the proceeds from disposals being entirely absorbed by the €200 million dividend. We expect the group's FOCF after leases will remain negative in 2023, and close to neutral in 2024, as the group will maintain high annual capex of €1.0 billion-€1.1 billion, after a period of reduced investment during the pandemic. Accounting for an annual €100 million-€200 million dividend, expected €100 million-€200 million of annual disposals, and the announced acquisitions, we project adjusted debt will increase in 2023-2024. We also note that ELO will need to refinance €750 million-€850 million of debt coming to maturity each year, starting from the first trimester of 2025. We expect the interest rate on the new debt will range 6%-7%, in line with the recent bond issuance, and significantly above the existing debt, representing an additional constraint on the group's cash-flow generation.

We consider leverage excluding Russia as more representative of the group's ability to repay its debt under the current circumstances. Although the group does not intend to leave Russia for now, we consider ELO's adjusted leverage excluding EBITDA from Russia as a metric that better reflects the group's current creditworthiness. This is because, under the current circumstances, including the sanctions, we believe the group cannot rely on the cash flows generated in Russia to service its debt. By removing our estimate of Russian EBITDA for 2022, we estimate ELO's adjusted leverage increases by about 0.4x.

Outlook

The negative outlook reflects that the challenging economic environment, characterized by weak consumer demand, higher interest rates, and declining valuations, combined with Auchan Retail's structural challenges in France, could constrain ELO's performance, credit metrics and business profile over the next 24 months.

Downside scenario

We could lower the rating if, over the next 12-24 months ELO continues to underperform our base case. In particular, we could lower the rating if:

- We see not sign of recovery in the performance of the French retail operations, such that retail EBITDA continues to decline, and consequently ELO is unable to generate sizable FOCF after leases;
- ELO's adjusted leverage exceeds 3.5x (excluding Russia) on the back of deteriorating operating performance or continuous increase in net financial debt; or
- The real estate operations' creditworthiness deteriorates more than we anticipate because of the challenging economic conditions.

Upside scenario

We could revise the outlook to stable if operating performance improves, such that adjusted leverage (excluding Russia) remains well below 3.5x and funds from operations (FFO) to debt above 20%, which should primarily be driven by an improvement in profitability and cash-flow generation of the French retail operations, or by significant debt repayments.

Company Description

ELO is the sole owner of Auchan Retail and NIH and it reported €33.5 billion of sales in 2022. NIH is rated 'BBB-/A-3', with a stable outlook; the stand-alone credit profile is 'bbb' (see the full analysis "New Immo Holding," published Dec. 16, 2022, on RatingsDirect).

Auchan Retail operates hypermarkets and supermarkets in 11 countries. It is the fifth-largest retailer in France, with sizable operations in both Eastern and Western Europe and a notable presence in Spain, Russia, Poland, Portugal, and Romania. The group owns and operates shopping centers through NIH in 12 countries. ELO also holds a 49.9% stake in Oney Bank, with the remaining 50.1% being owned by BPCE (one of France's largest banks) since 2019. The Mulliez family owns about 97% of ELO through Association Familiale Mulliez (AFM), while the remainder is owned by eligible employees. AFM is also the owner, among others, of Decathlon (sportswear and equipment) and Adeo (DIY and home improvement).

Our Base-Case Scenario

Assumptions

- French real GDP growth to slow to 0.8% in 2023 and 1.0%-1.5% in 2024-2025. Eurozone real GDP growth to slow to 0.5% in 2023 and 1.0%-1.5% in 2024-2025. Inflation to remain elevated in 2023, at 5.6% in France and the eurozone, before progressively slowing.
- Inflation and economic uncertainty continuing to pose risks to European food retailers' volumes and profitability in 2023-2024, with the hit depending on the specific retailer's market share, product offering, price positioning and pricing power with customers and suppliers, and ability to achieve cost efficiency measures. In particular, the nonfood segment of hypermarkets is likely to face a squeeze in discretionary spending. We expect pressures on volumes and profits as well on the grocery part of the business, as consumers shift toward less expensive food categories and baskets, weighing on the operating margin, which is inherently thinner on these products.
- The group's revenue to increase by 1.5%-2.5% in 2023-2024, despite the still significant food price inflation, due to sales contraction in Russia and difficult trading conditions in France, where we expect volumes will continue to contract while the group may invest in its price positioning by passing cost increases to customers gradually. We expect 4.0%-8.0% annual revenue growth in Iberia, driven by the recent acquisitions and stronger performance, and 4.0%-7.0% growth in Central and Eastern Europe excluding Russia.
- Auchan Retail's gross margin to stabilize at 23.0%-23.5% in 2023-2024, up from 22.5% in 2022. Last year the group's investment into prices over the first half drove a significant deterioration in gross margin.
- NIH's adjusted EBITDA margin of 62.0%-63.0% in 2023-2024, versus 66.3% in 2022, with adjusted EBITDA trending above €400 million.
- ELO's adjusted EBITDA margin to decline to 4.5% in 2023, from 5.1% in 2022 and 5.8% in 2021, before gradually recovering from 2024.
- Neutral working capital variations in 2023-2024.
- Annual gross capex of €1.0 billion-€1.2 billion per year, including about €400 million capex for NIH in 2023 and about €200 million in 2024. We believe investment is critical for ELO's efforts to remain competitive after some years of reduced investments in the context of COVID-19. Capex includes part of the transformation charges relating to automated and digital investment.
- Total acquisition outflow of about €350 million in 2023, including the acquisition of 217 stores from DIA in Spain, already paid out in the first half. In 2024, we expect acquisition outflow of €50 million-€100 million, mostly related to the acquisition of DIA's network in Portugal.
- We assume about €150 million of disposals per year in 2023-2024, including some real estate assets and the sale of Hungarian operations. From 2025, we expect annual real estate disposal of €100 million per year. Although we acknowledge the group has an asset-rich balance sheet and could dispose significantly more assets, the high interest rate environment and declining real estate valuations could make asset sales more challenging over the next 24 months. We also believe that some disposals will drive a reduction in EBITDA, resulting in a mixed effect on adjusted leverage.
- Annual dividend of €100 million-€200 million.
- Buybacks related to employee shareholdings of up to €30 million each year French real GDP growth to slow to 0.2% in 2023 and 1.5%-1.6% in 2024-2025.

- We assume the group will refinance upcoming debt maturities at an interest rate of 6.0%-7.0% over 2024-2025.

Key metrics

ELO -- Key forecast ratios

	--Fiscal year ends Dec. 31--					
Mil. €	2020a	2021a	2022a	2023f	2024f	2025f
Revenues	32,117	31,088	33,485	34,098	34,839	35,224
EBITDA	1,608	1,809	1,703	1,534	1,717	1,815
EBITDA margin	5.0	5.8	5.1	4.5	4.9	5.2
Capital expenditure	685	814	1,127	1,239	1,054	1,064
Reported FOCF, after finance lease payments	1,351	321	(391)	(226)	38	59
Debt/EBITDA (x)	2.6	2.1	2.4	3.1	2.8	2.6
FFO/debt (%)	22.7	35.7	31.5	25.1	27.1	27.8
DCF/debt (%)	7.1	(7.8)	(9.1)	(2.5)	3.3	2.0
New Immo Holding - Debt/EBITDA (x)	11.2	10.9	8.9	9.0	8.4	7.9
Auchan Retail* - Debt/EBITDA (x)	0.7	0.4	0.5	1.1	1.1	1.2
EBITDA - excluding Russia	N/A	N/A	1,400-1,500	1,350-1,450	1,500-1,600	1,600-1,700
Debt/EBITDA - excluding Russia	N/A	N/A	2.8	3.4	3.2	3.0

Note: Adjusted figures by S&P Global Ratings. A--Actual. f--Forecast. N/A--Not applicable. *Retail adjusted leverage is estimated by netting NIH's debt and EBITDA from ELO's consolidated figures.

Liquidity

We assess ELO's liquidity as adequate based on our expectation that its sources of liquidity will exceed its uses by over 1.2x over the 12 months started July 1, 2023.

Principal liquidity sources:

- €1.4 billion cash and cash equivalents;
- €1.6 billion of available committed credit lines;
- About €1.0 billion of FFO forecast over the next 12 months (net of lease depreciation); and
- €750 million of proceeds from the bond issuance in September.

Principal liquidity uses:

- Current financial debt as of June 30, 2023, of €1.3 billion (assuming no refinancing);
- Total annual capex of up to €1.1 billion (including growth and maintenance);
- Extra seasonal working capital requirements of up to €400 million (considering that June is one

of the lowest point in cash);

- Annual dividend of €100 million-€200 million;
- Total outflows for acquisitions of about €100 million; and
- About €30 million of share repurchases as part of the employee incentive program.

Covenants

Some credit lines bear a maintenance financial covenant (debt to EBITDA at a maximum of 3.5x, as defined in the debt documentation, at the end of each fiscal year). We expect ELO will maintain sufficient headroom under its covenants.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Negative/A-3
Business risk:	Satisfactory
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Positive (+1 notch)
Stand-alone credit profile:	bbb-

Related Criteria

- 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: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- 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

Ratings Affirmed; Outlook Action

	To	From
ELO		
Issuer Credit Rating	BBB-/Negative/A-3	BBB-/Stable/A-3
Senior Unsecured	BBB-	BBB-
Commercial Paper	A-3	A-3
Auchan Coordination Services S.A.		
Issuer Credit Rating	--/--/A-3	--/--/A-3