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Research Update:

Auchan Holding Outlook Revised To Stable On Restored Credit Metrics; 'BBB-' Rating Affirmed

November 16, 2020

Rating Action Overview

- Auchan Holding disposed of its 36.18% stake in its Chinese subsidiary Sun-Art to Alibaba for a total cash consideration of €3.064 billion.
- The group intends to use the disposal proceeds to restore its financial capacity and focus on turning around its Western European retail operations. Although the disposal will enable a reduction in the group's S&P Global Ratings-adjusted leverage to about 3.3x in fiscal-year 2020, in our view it weakens its business risk profile because its Chinese retail operations displayed a stronger growth profile and higher operating margins than its European business.
- We have revised our outlook on Auchan to stable from negative and affirmed the ratings.
- The stable outlook reflects our expectation that the group's S&P Global Ratings-adjusted financial leverage will remain below 3.5x at all times, largely due to the current transaction and its planned €2 billion additional asset disposals, thereby enabling the group to execute its transformation plan aimed at restoring the profitability of its core European retail operations.

PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

Solene Van Eetvelde
Paris
+ 33 14 420 6684
solene.van.eetvelde
@spglobal.com

Rating Action Rationale

The disposal of Sun-Art will enable the group to deleverage more quickly. Auchan disposed of Sun-Art for a €3,064 million cash consideration. Considering the cash sitting in the Chinese business of about €1.7 billion as of fiscal year-end 2019, this results in about €1.3 billion in net cash proceeds, which are already sitting on Auchan's books. We understand that this amount will primarily be dedicated to debt repayment, though part of it will likely also be used to reinvest in the group's core operations. This disposal will materially contribute to the group's deleveraging effort. We now expect S&P Global Ratings-adjusted leverage of about 3.3x in fiscal-year 2020, down from the 3.8x-4.0x we initially anticipated in our updated base case of September 2020, which led us to assign a negative outlook. We understand that this disposal comes in addition to the €2 billion debt-reduction plan announced in August 2020, which indicates to us the group's capacity to maintain adjusted leverage no higher than 3.5x in fiscal years 2021 and 2022. This is despite our expectation of a declining adjusted EBITDA margin in 2021 due to the impact of one-off charges associated with the transformation plan and a still-difficult market environment that is weighing on both the real estate and retail operations.

The increased weight of Ceetrus in the group's earnings somewhat affects our assessment of the group's financial and business risk profiles. With the exit from China, Ceetrus' weight in the overall group will increase to 33% of its 2019's pre-IFRS 16 EBITDA (pro forma for the Chinese disposal) compared with less than 20% from China. This mechanical rebalancing will also increase the weight of Ceetrus' financial and business risk profiles in the overall rating, including its specificities as a real estate company.

- From a financial standpoint, and in line with our real estate criteria, Ceetrus--like other real estate entities--has a much more leveraged capital structure relative to its EBITDA generation than regular corporate entities do. This is offset by the high levels of real estate assets it holds on its books and the quality of the related rental incomes. For instance, in fiscal-year 2019, Ceetrus reported €3.2 billion of gross debt, €432 million of EBITDA, and real estate assets worth more than €8 billion. Our adjusted leverage for Ceetrus is therefore at about 7.6x, while its debt-to-debt-plus-equity ratio is just 45%. Under our financial matrix framework for real estate entities, this corresponds to an intermediate financial risk profile, one category stronger than what Auchan's consolidated leverage indicates under our standard corporate financial matrix. On the other hand, if we excluded Ceetrus from Auchan, we estimate that the leverage of the retail operations stand-alone (and pro forma for the Chinese transaction) would be in a stronger category than what the consolidated Auchan leverage of 3.3x suggests. In sum, the greater weight of the inherently more leveraged Ceetrus mechanically deteriorates the group's consolidated ratios and contributes to a consolidated leverage north of 3.0x, which corresponds to a significant leverage under the corporate methodology. However, a significant part of the consolidated debt is supported by a real estate asset that allows for higher leverage. Therefore, we believe that Auchan's credit quality is stronger than what its consolidated credit metrics suggest under our issuer credit rating methodology, justifying a one-notch uplift against our 'bb+' anchor. Considering the hybrid nature of Auchan, combining both retail and real estate businesses, we will monitor not only the consolidated group but also the creditworthiness of its two core businesses on a stand-alone basis under each methodology.
- From an operational standpoint, Auchan will benefit from the diversification brought by its real estate operations, though these are challenged by the current sanitary situation. We believe that Ceetrus, currently rated 'BBB', benefits from a well-diversified tenant base, with its 10 largest tenants contributing only 13% of revenues. It also has a well geographically diversified revenue base with France contributing 52%, other Western European countries accounting for 32%, and the remainder from Eastern European countries. However, a strong majority--about 75%--of its total real estate portfolio comprises dominant shopping centers clustered around Auchan's hypermarkets. For that reason, Ceetrus' performance is closely associated with that of Auchan Retail. In addition, we believe that the measures taken by governments to fight the pandemic, particularly lockdowns, could lead to structural challenges for real estate operators operating malls, as it could change consumer behavior toward these formats and profoundly affect the retail landscape. In fiscal-year 2020, we anticipate EBITDA of about €150 million-€180 million lower than in fiscal-year 2019, with a recovery to 2019's level only by 2023. Hence, while Ceetrus contributed very positively historically to the group's adjusted margin, it will be less so in 2020 and 2021, weighing on our overall credit metrics for the wider Auchan Holding group.

The Chinese disposal weakens the business risk profile of the group's retail operations and further heightens the stakes associated with the transformation plan. With this disposal, Auchan will cease controlling its best-performing retail asset, with leading positions in the

Chinese grocery market and relatively high EBITDA margins (nearly 10%, pro forma of IFRS 16). The group's remaining retail operations will now be focused on Europe (including Russia), where it does not hold leading positions and is exposed to challenged formats (hypermarkets in particular). In France, while Auchan somewhat restored its profitability in the last 18 months, it is still losing market share to competition, as per Kantar Worldpanel (the fifth-largest market player and a market share below 10%), questioning the sustainability of its price positioning and competitiveness--and hence its profitability. In Russia, now the group's second-largest market, revenues, market share, and profitability have substantially dropped in recent years, and the turnaround is longer than we anticipated. While the group's other markets are more resilient, in particular Portugal and Spain, it is not a market leader either (no.5 in Spain as per Kantar).

More fundamentally, Auchan's retail operations rely largely on destination formats and particularly hypermarkets. Although in some markets this format benefitted from a spike in consumption with the sanitary crisis, it has nevertheless been profoundly challenged in recent years by the rise of proximity formats and online retail, which has notably contributed to pressuring earnings on the non-food side. In France, to date, hypermarkets remain the largest format of consumption in revenue terms with about €105 billion in sales as per Euromonitor data. Yet, it is also the most exposed to price competition. Hypermarkets are typically the preferred shopping destination for large-ticket items and therefore price plays a critical role in their attractiveness. Auchan does not particularly stand out as a best-in-class player on that front, at least in its largest market France (over half of revenues under the new perimeter), which casts doubts over its capacity to sustainably grow profitability. Beyond the price consideration, hypermarkets also face the challenge of specialized fresh food retailers capturing a growing portion of the traffic and of new customer habits favoring online purchasing. While the group CEO's transformation plan aims precisely at addressing these challenges and rejuvenating this format of consumption, we believe this plan entails significant execution risk.

The long-term credit quality of the group will ultimately depend on its capacity to successfully reposition its business operations and the evolution of its financial policy such that cash flow generation improves structurally and durably. With the disposal of Sun-Art, Auchan Holding will enable a faster and greater deleveraging than we had initially anticipated, notably as our current forecast does not incorporate the further €2 billion of disposals the group envisages it will execute in 2021 and 2022. In the short term, these disposals will permit the group to restore its credit ratios while also enabling it to restore its investment capacities--which we deem critical for its turnaround strategy. Ultimately, our long-term view on the credit quality of Auchan Holding will depend on its capacity to generate material and sustainable free operating cash flows (FOCF) before disposals. In addition, we expect that shareholders will pursue a conservative financial policy such that any shareholder remuneration will not translate into the group releveraging.

Following the disposal, Auchan's business risk profile will be repositioned around more mature geographies faced with high operational challenges both to its retail and real estate businesses. Therefore, due to these increased operational risks and despite the higher debt capacity of the real estate business, we believe that the wider group has less financial flexibility than previously.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety

Outlook

The stable outlook reflects our anticipation that despite challenging operating trends both in the retail and real estate businesses, the group will succeed in maintaining consolidated S&P Global Ratings-adjusted leverage below 3.5x and FFO to debt well in excess of 20% at all times.

The outlook also reflects our anticipation that the group will use the proceeds of the disposal from China to manage credit metrics while reinvesting in its core European Retail operations to reinforce its competitive positioning. This should translate into positive like-for-like and pre-exceptional profitability growth and improved cash-flow generation.

Downside scenario

We could lower the rating if:

- The group's retail operations were to deteriorate materially in the next 24 months due to a weakening of its business position, translating into negative like-for-like growth and a lack of success in restoring profitability and material positive FOCF generation before asset disposals;
- The real estate business' performance and credit ratios were to deteriorate further than we anticipate because of COVID-19 and challenging retail conditions; or
- Consolidated leverage exceeds 3.5x on an S&P Global Ratings-adjusted consolidated basis or FFO to debt deteriorates to below 20% as a result of delays in asset disposals and the return to a more aggressive financial policy.

Upside scenario

We could revise the outlook to positive if the group was able to sustain its business risk profile in the face of current structural pressures and its deleveraging efforts were sustained such that its debt to EBITDA were to decrease sustainably below 3.0x. This would be due to continuing asset disposals but also to a sustainable improvement of the group's profitability and organic FOCF generation indicating a durable improvement in the group's credit quality.

Company Description

Pro forma the China disposal, we expect the group to report about €32 billion-€33 billion of sales in fiscal 2020. The company operates hypermarkets and convenience stores 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 Russia, Ukraine, Poland, and Spain. The company also owns and operates shopping centers through Ceetrus in 12 countries.

Auchan also holds a 49.3% stake in Oney Bank. Auchan had sold remaining stake to BPCE (one of France's largest banks) in 2019. Auchan still leverages Oney Bank to offer consumer credit to its customer base. In the medium term, assuming Oney benefits from the support of BPCE, we believe this transaction will likely increase the overall value of Oney Bank.

The Mulliez family owns about 97% of Auchan through Association Familiale Mulliez (AFM), while the remainder is owned by eligible employees.

Our Base-Case Scenario

- Real GPD contracting in France by 8%-10% in 2020 before recovering by about 6%-8% in 2021.
- EU GDP shrinking by 7%-8% in 2020 before increasing by about 6% in 2021. However, given the evolving situation with regard to COVID-19, we expect GDP growth will be somewhat volatile against our base case.
- A continuing challenging market in France, with intensifying price competition in 2021 as a result of the recessionary context. The increased penetration of discounters and the renewed push from independents for market-share gains will exert pressure on prices, only moderately compensated for by increased food demand due to COVID-19.
- Following a boom of online sales due to the pandemic, we expect a structural increase in online sales, which is also likely to weigh on margins because physical retailers have to reshuffle their supply chains, ensure last-mile delivery, and maintain their store network.
- Modest improvements in gross margin will continue, spurred by the same efforts to improve supply-chain efficiency and limit breakage costs seen in 2019 and the first half of 2020, combined with the benefits from the purchasing alliance with Casino, Metro, and DIA. Other cost-saving measures--including closures of loss-making stores in France--should also help to restore profitability.
- One-offs associated with the restructuring plan of €400 million-€500 million, down from the €700 million-€800 million we had anticipated for the next three years. While the company may provision most of the one-offs as early as this year, most of the cash outflow would be effective in 2021, which is what we have accounted for in our forecast.
- Real estate arm Ceetrus' profitability dropping by about €150 million-€180 million for the full year due to lockdowns in various countries. We also expect more subdued profitability in future years, considering the exposure of its galleries to nonfood retail and in particular the apparel sector, which has been badly affected by the pandemic.
- One-off costs associated with COVID-19 (employee bonuses, higher sanitary costs, etc.) weighing on the group's consolidated EBITDA generation.
- A continued absolute revenue decline in Russia related to store closures and the ongoing restructuring, with like-for-like sales only picking up in 2021 due to a redefined commercial strategy and footprint. We believe the group's intention to target more premium positioning should help improve margins in the near future, though in the short term restructuring costs related to network optimization should offset the positive effect on margins.
- The group's S&P Global Ratings-adjusted EBITDA margin dropping to about 4.5% in 2020 and 2021 from 5.6% in 2019, largely due to the effect of the deconsolidation of China, which contributed significantly to the group's overall profitability.
- We also expect the group's transformation plan to pick up pace, and that efficiency gains will be to a large extent offset by a portion of the one-off costs related to business transformation, a more price competitive market, and COVID-19-related costs.
- Excluding one-offs related to the transformation plan, an adjusted EBITDA margin of about 4.8%-5.3% over the next two years.
- About €160 million in working capital outflows in 2020, in line with management's expectation, followed by neutral working capital effects on FOCF from 2021.

- Annual gross capex of €1.0 billion-€1.1 billion in 2020 because we believe investments are critical for Auchan's effort to remain competitive with its digital capabilities. Capex includes a portion of the transformation charges that will relate to automated and digital investments. However, the group's expansion plans for convenience formats have been toned down and will be essentially through new franchisees, limiting capex for this expansion. Equally, Ceetrus' earnings will be dampened by COVID-19 but we have not assumed for now a reduction in real estate capex.
- Outflows of about €130 million and €100 million in 2020 and 2021, respectively, related to the recapitalization of operations in Italy disposed of in 2019.
- No dividend distributions to Auchan's direct shareholders in 2020 and 2021, offset by share buybacks in relation to employee shareholdings of €100 million each during the same period.
- No disposals over the next 24 months, in the absence of clearly identified assets.

Based on these assumptions, we arrive at the following adjusted credit measures:

- Adjusted debt to EBITDA of 3.3x-3.4x, incorporating our expectations of one-offs, with adjusted FFO to debt of about 20%-25% in 2020 and 2021.
- Excluding the €3 billion proceeds from China, we expect negative cash flow generation of €200 million-€250 million in fiscal 2020.

Liquidity

Auchan's liquidity should improve following the completion of the transaction, translating into a liquidity ratio over 2x. However, considering we still expect weak to negative discretionary cash flow generation (excluding the proceeds from China) and expect the group to redeem part of its outstanding financial debt, we still view the liquidity as adequate. The amounts below are an estimate for the 12 months starting from July 1, 2020, of the group's accessible cash, excluding the Chinese operations and our expectation of its contribution to FFO, working capital, and capex, among others.

Principal liquidity sources include:

- Cash of €1.7 billion accessible and available for debt repayment;
- About €2.6 billion of available credit lines;
- About €1.0 billion-€1.1 billion in reported FFO forecast over the next 12 months (net of lease depreciation); and
- €3,064 million of proceeds related to the disposal of Chinese subsidiary Sun-Art.

Principal liquidity uses include:

- Short- and long-term debt of €1.2 billion (including commercial paper used to fund working capital needs);
- About €120 million-€130 million of cash related to the disposal of the Italian subsidiary;
- Annual capex of about €1 billion (including growth capex and capex related to the transformation plan);
- Working capital outflows of about €160 million in 2020, along with seasonal working capital requirements of about €1.2 billion; and

- Share buybacks of €100 million 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), but Auchan has sufficient headroom.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 2020, Auchan's capital structure consists of about €8.1 billion of issued bonds and bank debt, essentially borrowed by the group's parent company, Auchan Holding. Ceetrus reported €3275 million of debt on its books in fiscal-year 2019 but about 46% of it composed of intra-company loans with Auchan Holding. The debt borrowed by Auchan Holding is not guaranteed by its two subsidiaries, Auchan Retail and Ceetrus, but it is onlent to these two companies through long-term senior unsecured intercompany loans. There are no cross-default or cross-acceleration clauses between the debt borrowed at Auchan Holding and that at the Ceetrus level.

Analytical conclusions

Auchan's capital structure consists of senior unsecured debt, primarily comprising bonds and notes. We rate Auchan's debt 'BBB-', in line with the issuer credit rating, because there are no significant elements of subordination risk in the capital structure.

As of June 2020, real estate subsidiary Ceetrus has taken some third-party debt on its own books. However, the amounts raised are not significant, totaling about €1.5 billion. The debt comprises a bond, a private placement, and a corporate and asset financings. We understand that Ceetrus' intention is to rely less on intracompany funding and more on external funding, which could ultimately reinforce subordination risk, an aspect we will monitor. However, the portion of priority debt outstanding at the subsidiary levels is still below the thresholds that could trigger subordination risks.

Ratings Score Snapshot

Issuer credit rating: BBB-/Stable/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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Positive (+1 notch)

Related Criteria

- 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

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

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

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 https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.