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Research Update:

French Retailer Auchan And Subsidiary Banque Accord Outlooks To Negative On Weaker Profitability; Ratings Affirmed

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Overview

- French retailer Groupe Auchan S.A.'s profitability materially weakened in its core markets in Western Europe in 2014.
- If the group is unable to restore its profitability levels in the region while maintaining sound operating performance and maintaining profitability in emerging markets over the next 24 months, our view of its business risk profile could fall to the lower end of our "strong" category.
- We are revising to negative our outlook on Auchan and its subsidiary Banque Accord, and affirming our 'A-/A-2' ratings on both entities.
- The negative outlook reflects our view that the group may find it difficult to quickly restore positive like-for-like revenues and sound profitability levels in Western Europe, which could lead us to consider that Auchan's business risk profile has deteriorated.

Rating Action

On April 30, 2015, Standard & Poor's Ratings Services revised to negative from stable its outlook on France-based retailer Groupe Auchan S.A. and its core banking subsidiary, Banque Accord. At the same time, we affirmed our 'A-/A-2' long- and short-term corporate credit ratings on Auchan and our 'A-/A-2' counterparty credit ratings on Banque Accord.

Rationale

The outlook revision mainly indicates that, in our view, the substantial EBITDA margin contraction Auchan experienced in the key Western European region in 2014 could be the start of a prolonged weakening of its business risk profile if competition remains strong and pricing remains under pressure in these markets.

We revised our outlook on Banque Accord because we equalize our ratings on the bank with those on Auchan.

Auchan's reported 2014 revenues fell 2.2% in France and 6% in Western Europe. Its Standard & Poor's-adjusted EBITDA margin fell 90 basis points year-on-year to 5.6% in 2014. We attribute this to falling prices in France, the continuing effects of the weak Italian economy on private consumption, and strong price-focused competition in Spain.

In our view, Auchan's Western European operations--combined with those in Eastern Europe--are critical to our assessment of the group's financial risk profile and credit quality because it has much greater access to cash and cash flows generated in these regions than to those in Russia and China. Although its operations in China and Russia are very important to our analysis, we give them less weight in assessing the financial risk profile. For example, if we were to exclude cash and cash flows in China to which Auchan does not have direct and discretionary access due to its 36% ownership, its credit metrics would look substantially weaker, likely at the bottom of our "intermediate" financial risk category. In the case of Russia, although it has more access to cash in the subsidiary there because it fully owns the subsidiary, we think Auchan's ability to upstream cash from Russia would depend on the amount of dividends its subsidiary could pay in any given year.

Although we think the group's EBITDA margin should stabilize and gradually improve from its 2014 level over the next 24 months, we anticipate that it could prove difficult to restore the previous margin levels in Western Europe during this period. We expect consumers to remain price-focused and unlikely to substantially increase their food purchases while economic and employment prospects in France, Italy, and Spain remain weak over the next 12-24 months. Instead, we assume that Auchan will achieve a moderate margin improvement in Western Europe (and on a groupwide basis) because of margin benefits achieved through the purchasing agreements that the group has signed in France, Italy, and Spain. It also signed a purchasing agreement with German diversified retailer Metro AG, which covers the international operations of both groups. We also forecast that pricing and the competitive environment in France will stabilize in 2015.

Weaker profitability had a limited impact on the group's credit metrics in 2014 if we consider China's operations proportionally consolidated at 51%. Essentially, this is because of a significant €572 million reduction in the group's net financial debt. Auchan's real estate subsidiary, Immochan, sold seven assets in 2014 in France, Italy, Spain, Portugal, and Russia. As a result, Standard & Poor's adjusted debt-to-EBITDA and funds from operations (FFO)- to-debt ratios remained broadly stable at 2.1x in 2014 (2.0x in 2013) and 38.1% (38.8%), respectively.

We continue to analyze Auchan's financial risk profile on a proportional basis to better reflect our view of its limited access to cash originating from China, even though it changed its International Financial Reporting Standards (IFRS) reporting in 2014 to include 100% of its Chinese operations, versus 51% previously. Our financial risk profile assessment also takes into account the pronounced financial flexibility provided by Immochan's estimated €7 billion assets under management.

Under our base case, we forecast that Auchan will continue to report credit ratios in line with the current rating and our assessment of its business risk at the higher end of the "strong" category--that is, adjusted FFO to debt in excess of 35% and adjusted debt to EBITDA close to 2x. Auchan's relatively weak free cash flow and discretionary cash flow-to-debt ratios continue to constrain its financial risk profile as the group pursues the remodeling of its stores in Western Europe and expands its network in China and Russia.

In our approach to rating Auchan, we combine our views of its "strong" business risk profile and "intermediate" financial risk profile to derive an anchor of either 'a-' or 'bbb+'. We apply the higher anchor of 'a-' to Auchan to account for the relative strength of Auchan's business risk profile within the "strong" category.

In our base case, we assume:

- A subdued economic recovery in the eurozone (European Economic and Monetary Union), with real GDP growth of about 1.1% in France, 2.2% in Spain, and a meagre 0.4% in Italy in 2015, and limited improvement thereafter.
- Reported revenue growth of 1%-3% in 2015, accelerating to 4%-6% in 2016, based on growth in China and a return to growth in France.
- An increase in capital expenditures over the next two years.

Based on these assumptions, we arrive at the following credit ratios, based on proportional consolidation of Auchan's Chinese operations:

- An adjusted EBITDA margin gradually improving to about 6% in 2016.
- Adjusted FFO-to-debt ratio close to 40%.
- An adjusted debt-to-EBITDA ratio of about 2x.

Liquidity

We view Auchan's liquidity as "adequate" under our criteria and calculate that liquidity sources will likely exceed liquidity needs by more than 1.2x over the next 12 months. We take into account the potential exercise of the put option relating to Sun Art in our assessment. The amounts below reflect reported accounts that consolidate 100% of Sun Art, despite Auchan owning only 36% of the economic interest. However, we consider that our assessment broadly reflects actual cash flow circulation, as we estimate that operations in China and Russia, where the group has limited access to cash and cash flows, do not generate meaningful amounts of free operating cash flow.

We anticipate the company will have the following principal liquidity sources over the next 12 months:

- €2 billion of surplus cash, excluding €300 million-€400 million we consider to be tied to operations;
- €2.8 billion of undrawn credit lines expiring in more than 12 months; and
- €2.4 billion of reported FFO forecast over the next 12 months.

We anticipate the company will have the following principal liquidity uses over the next 12 months:

- €0.6 billion of short-term debt, excluding the debt related to banking activities;
- €1.2 billion of working capital seasonality;
- Close to 4% of sales to capital expenditures, mainly owing to expansion

in emerging markets;
- €0.2 billion of dividends; and
- €0.2 billion of acquisitions.

Some credit lines bear a financial covenant (debt to EBITDA at a maximum of 3.5x), but Auchan had significant covenant headroom at year-end 2014.

Outlook

The negative outlook on Auchan reflects our opinion that the group may find it difficult to quickly restore positive like-for-like revenues and sound profitability levels in Western Europe following the marked EBITDA contraction it experienced in the region in 2014. This could lead us to consider that Auchan's business risk profile has deteriorated.

The negative outlook also reflects our assumption that local currency revenue growth will remain positive in Russia and China, that EBITDA margins will remain broadly stable in 2015, and that the group's financial policy will remain prudent despite a high level of investment in emerging markets. In particular, we would expect the group to mostly mitigate any negative financial impact on credit metrics if its partner in China exercised its put option. We do not expect it to do so in 2016, which is the first year that it could exercise this put option.

Under our base case, we anticipate that credit metrics will weaken somewhat in 2015. However, we expect that credit metrics will remain commensurate with an 'A-' rating--namely an adjusted FFO-to-debt ratio in excess of 35% and an adjusted debt-to-EBITDA ratio lower than 2.5x, measured on a proportional basis.

The negative outlook on Banque Accord mirrors that on its parent.

Downside scenario

We could lower the ratings if the group fails to restore persistent revenue growth and strong EBITDA growth in Western Europe over the next two years. We currently apply the higher of two possible anchors because we consider that Auchan's business risk profile is at the higher end of the "strong" category. If we revise our view of where Auchan's business risk profile sits within the range, we could revise the anchor to 'bbb+' from 'a-', which would cause us to lower the rating. We could also lower the ratings on Auchan if deteriorating performances or a more aggressive financial policy weakened credit ratios below the levels we regard as commensurate with the current rating.

Upside scenario

We could revise the outlook to stable if Auchan restored its adjusted EBITDA margin to historical levels of about 6.5% over the next 24 months, especially if it achieved this by restoring profitability at its Western European operations. An outlook revision would also hinge on operations in China and Russia continuing to grow on a local currency basis with broadly stable or increasing profitability. In addition, we would expect credit metrics to remain commensurate with the current ratings and financial policy to remain prudent in terms of acquisitions and shareholder remuneration.

Ratings Score Snapshot

Corporate Credit Rating: A-/Negative/A-2

Business risk: Strong
- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: a-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparative rating analysis: Neutral (no impact)

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers, Jan. 2, 2014
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Retail And Restaurants Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Groupe Auchan S.A.		

Corporate Credit Rating	A-/Negative/A-2	A-/Stable/A-2
Banque Accord		
Counterparty Credit Rating	A-/Negative/A-2	A-/Stable/A-2

Ratings Affirmed

Auchan Coordination Services S.A.	
Corporate Credit Rating	--/--/A-2
Banque Accord	
Certificate Of Deposit	A-/A-2
Groupe Auchan S.A.	
Senior Unsecured	A-
Commercial Paper	A-2

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