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Summary:

Groupe Auchan S.A.

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Credit Rating: A/Stable/A-1

Rationale

The ratings on French food retailer Groupe Auchan S.A. reflect its well-established positions in the regulated French and southern European markets, underpinned by its expertise in the hypermarket format. Although barriers to entry protect Auchan's core French market, the group is exposed to intense competition and buying power erosion.

Auchan is the fourth-largest food retailer in France, with a market share of about 12%. Operating 124 hypermarkets in France at the end of 2010, Auchan has a strong position in this segment, fueled by high recognition of the Auchan banner; a focus on large stores that average more than 9,000 square meters; and almost nationwide coverage. Auchan has developed firm expertise in hypermarkets, which generate about 80% of group sales and more than two thirds of group EBITDA. Faced with intense competition and consumers trading down in its Western European home markets, the group has successfully expanded in growth markets, such as Asia where it had 202 hypermarkets at the end of 2010, and Central and Eastern Europe, where it has 97 hypermarkets. A local joint venture partner, RT Mart, runs 143 of the hypermarkets in Asia.

Key business and profitability developments

Sales and revenue progression in developing markets (more than 25% of group sales) continued to outweigh ongoing difficult trading conditions in Auchan's Western European markets (almost 75% of group sales) over 2010. Western Europe's sales and EBITDA progression during the year was hindered by austerity measures, growing by 2.3% and 1.7% only. Against this, developing market sales grew by almost 23% and EBITDA by more than 26%, fuelled by ongoing expansion. This, on top of 1.3% like-for-like growth, contributed 3.6 percentage points to the group's sales progression of 7.3% including tax. We see these two-speed sales dynamics--marginally positive growth in Western Europe and expansion-driven double-digit growth in developing markets--as continuing drivers for the group's sales trends in 2011. We do not factor in gains in profitability in our key scenario as we think that Auchan's operations predominantly focus on volume growth, and as ongoing austerity and expectations of rising inflation might continue to hold back consumer spending especially in Western European markets. Reported group EBITDA margins were flat at 5.9% in 2010, supported by the transfer of a €57 million tax component (CVEA) from above the EBITDA line to income tax. This accounted for about 10 basis points in group profitability in 2010.

Auchan's business strategy is focused on volume generation, and its positioning in the low-price hypermarket format provides a degree of resilience. The group benefits from a positive price image. Overall, Auchan's share of private label products was about 36% in 2010 and should gradually rise further over time. The prices of the group's first-price private-label product range are comparable with those of hard-discount formats, consequently positioning Auchan well to meet customers' growing focus on low prices. In addition, while Immochan, the group's real estate operation, has contributed to Auchan's softening financial profile over time, we consider the group's real estate ownership and development activities a diversifying and strategically supportive factor for Auchan's retail operations.

Key cash flow and capital-structure developments

Thanks to another year of cutbacks in capital expenditure, as reflected in a ratio of capital expenditure to sales of about 3%, and conservative shareholder remuneration, Auchan's financial metrics were way ahead of what we consider adequate for the current ratings at the end of 2010. Adjusted funds from operations (FFO) to debt was above 45% and adjusted debt to EBITDA below 2.0x. As we expect rising but still controlled investments, and an unchanged shareholder remuneration policy in 2011, we believe that even under more adverse trading conditions, the group's financial metrics should remain ahead of what we consider as a minimum under the ratings, i.e. 30%-35% and 2.0x-2.5x. While adjusted free operating cash flow might become negative during the year ahead, we think the group is in a position to generate positive discretionary cash flow on a reported basis.

Auchan's financials reflect a balanced approach between its strategic prerogatives of volume growth and expansion, and a financial policy that enables the group to maintain an adequate financial profile for the current rating levels. Therefore, while we believe that the group's capital expenditure is set to rise again over time, Auchan's disciplined financial policy, supported by the financial flexibility derived from its asset base, should enable the group to sustain a financial profile commensurate with the current ratings.

Liquidity

The short-term rating is 'A-1'. We view Auchan's liquidity as adequate. The group's policy is to have undrawn, long-term committed facilities available at all times to fund seasonal peaks, plus one week of turnover. Auchan benefits from significantly diversified funding sources. At the end of 2010, the group's sources of liquidity essentially consisted of €1.9 billion of cash and cash equivalents plus the undrawn portion of committed long-term bank lines, which stood at €4 billion at that time. We consider Auchan's liquidity sufficient to cover its reported consolidated short-term debt (including Banque Accord) of €2.8 billion (2009: €3 billion), annual working capital swings of €1.2 billion, and potential shortfalls of operating cash flow against capital expenditure. Auchan posted such shortfalls in three of the past five years but we expect positive cash flow going forward. A few bank lines bear financial covenants, but Auchan has significant headroom. The group's debt maturity profile is fairly balanced, with €434 million and €275 million of bonds coming due in 2011 and 2012.

Auchan's substantial real estate holdings, especially the shopping malls around its hypermarkets, support the group's liquidity. The shopping malls' net asset value stood at €2.7 billion at the end of 2010, while management valued these assets at €6.4 billion.

Outlook

The stable outlook reflects our view that, based on a balanced financial policy, the group is in a position to maintain financial metrics at least adequate for current ratings despite a potentially difficult trading environment in some of its markets and ongoing capital-intensive development activities. In addition, we believe that Auchan's operations should benefit over time from the development of its growing international presence, mainly in Eastern Europe and China, and from the development of its real estate activities (shopping centers), which now contribute more to the group's earnings than its supermarkets. The minimum levels we consider adequate for the current ratings are adjusted FFO to debt in the 30%-35% range and adjusted debt to EBITDA of 2.0x-2.5x.

We could lower the ratings if Auchan's financial measures slide below this FFO-to-debt range, or if they move above the debt-to-EBITDA range. An upgrade would hinge on enhanced diversity of its business operations, as reflected in improving and broadening contributions from the group's supermarket operations, as well as from the non-French

Western European operations. Ratings upside could also unfold if management commits to permanently sustain the levels of financial metrics achieved in 2010.

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