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**Research Update:**

# French Retailer Groupe Auchan SA Outlook To Negative On Weakening Financial Measures; 'A/A-1' Ratings Affirmed

**Primary Credit Analyst:**

Nicolas Baudouin, Paris (33) 1-4420-6672; nicolas\_baudouin@standardandpoors.com

**Secondary Credit Analyst:**

Marketa Horkova, London (44) 20-7176-3743; marketa\_horkova@standardandpoors.com

## Table Of Contents

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Rationale

Outlook

Ratings List

## Research Update:

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## Rationale

On March 24, 2009, Standard & Poor's Ratings Services revised its outlook to negative from stable on French food retailer Groupe Auchan SA following the group's weakening financial measures and despite its robust 2008 trading performance. At the same time, we affirmed the 'A/A-1' long- and short-term corporate credit ratings on the group.

We also revised the outlook to negative from stable on Banque Accord, Auchan's financing arm, while affirming the 'A/A-1' long- and short-term counterparty credit ratings on the bank. The ratings on Banque Accord are equalized with those on Auchan owing to the bank's core status within the group.

The ratings reflect Auchan's well-established positions in the tightly regulated French and Southern European markets (about 50% and 30%, respectively, of 2008 sales), underpinned by its expertise in the hypermarket format and its conservative financial policy. The group's core French market is protected by strong barriers to entry but exposed to intense competition and buying power erosion.

Auchan is the joint third-largest food retailer in France, with a market share of about 12% in 2008, stable versus 2007. Auchan has a strong position in France in hypermarkets, fuelled by high recognition of the Auchan banner; a focus on large stores averaging more than 9,000 sq. m.; and almost nationwide coverage. Auchan has developed firm expertise in hypermarkets, a format that the group is successfully expanding in emerging markets, particularly China and Russia. Hypermarkets are, however, more exposed to down trading than other retail formats owing to the higher share of nonfood in their offering. Still, the group's French hypermarkets posted a 1.6% EBITDA increase in 2008, attesting to a better performance than at domestic competitors, especially industry leader Carrefour S.A.

The erosion of buying power in Auchan's three largest markets--France, Spain, and Italy--is a concern. But Auchan's positioning in the low-price hypermarket format provides a degree of resilience. The group also benefits from a positive price image. Ten percent to 15% of hypermarket floor space is entirely dedicated to discount products. The prices of the group's first-price private-label product range are comparable to those of hard-discount formats, consequently positioning Auchan well to meet customers' growing focus on low prices.

The group is renovating its French Atac supermarkets through the attractive "Simply Market" banner. Auchan has so far converted 50% of Atac and could suffer sales erosion until the conversion program is completed.

Auchan reported robust 2008 trading, with strong resilience in retailing

and marked organic growth in real estate activities. Reported consolidated 2008 EBITDA advanced a significant 9.2%, with the EBITDA margin widening to 5.7% versus 5.6% in 2007, a noteworthy performance given the tough market conditions in retail.

We note that Auchan's financial profile has gradually deteriorated since 2006. Free cash flows turned negative as of 2007 on increased capital expenditures. As a result, reported net debt (excluding Banque Accord's gross debt) materially increased to about €2.8 billion at year-end 2008 against €2.1 billion one year earlier. This has led to gradual deterioration in financial measures, leaving little headroom beyond our minimum ratio guideline commensurate with the ratings. Adjusted funds from operations (FFO) to debt stood at 33% at end-December 2008, slightly above our minimum guideline of 30%. But the EBITDAR-fixed charge coverage ratio decreased to 4.4x, just below our 4.5x guideline.

## **Liquidity**

The short-term rating is 'A-1'. Auchan's liquidity is 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 year-end 2008, the group's reported consolidated short-term debt (including Banque Accord) of €3.5 billion was fully covered by a cash balance of €2.3 billion plus the undrawn portion of committed long-term bank lines, which stood at €2.8 billion at year-end 2008, including €600 million for Banque Accord. A few bank lines bear financial covenants, but Auchan has significant headroom.

Liquidity is also supported by the group's substantial real estate holdings, especially the shopping malls around its hypermarkets, which are currently worth €5.2 billion.

## **Outlook**

The negative outlook reflects the gradual weakening of the group's financial profile. Based on year-end 2008 financial metrics, Auchan has limited headroom for further debt leveraging. We could lower the ratings if Auchan's financial measures deteriorate in 2009 from their currently stretched level. Although Standard & Poor's anticipates that Auchan's solid operational performance should help to maintain adjusted FFO to debt above 30% in 2009, EBITDAR-fixed charge coverage could still fall below our 4.5x guideline on increased rental charges owing to the group's substantial organic growth.

We expect growth in Auchan's international operations, mainly Eastern Europe and China, to offset hurdles that it stands to face in 2009 in its mature markets. In addition, we believe Auchan is set to continue to benefit from the successful development of its real estate activities (shopping centers), which now contribute more to the group's earnings than its supermarkets.

We could revise the outlook to stable if Auchan's financial measures show resilience in 2009.

## Ratings List

Ratings Affirmed; Outlook Action

	To	From
Groupe Auchan SA		
Corporate Credit Rating	A/Negative/A-1	A/Stable/A-1
Senior Unsecured	A	A
Banque Accord		
Counterparty Credit Rating	A/Negative/A-1	A/Stable/A-1
Certificate Of Deposit	A/A-1	A/A-1
Senior Unsecured	A	A
Auchan Finances SNC		
Corporate Credit Rating	--/--/A-1	--/--/A-1
Commercial Paper	A-1	A-1

### Additional Contact:

Industrial Ratings Europe;CorporateFinanceEurope@standardandpoors.com

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