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# Research

## Research Update:

# French Automaker Renault Upgraded To 'BBB-' On Strong Credit Ratios; Outlook Stable

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## Overview

- We believe that French car manufacturer Renault should sustain funds from operations (FFO) to debt of more than 45% over the next 24 months.
- We are raising our long- and short-term ratings on Renault to 'BBB-/A-3' from 'BB+/B'.
- The stable outlook reflects our view that Renault will continue to improve its profitability--despite an uncertain outlook in emerging markets--and will maintain positive free operating cash flow (FOCF) over the coming two years.

## Rating Action

On April 22, 2015, Standard & Poor's Ratings Services raised its long- and short-term corporate credit ratings on French automotive manufacturer Renault S.A. to 'BBB-/A-3' from 'BB+/B'. The outlook is stable.

At the same time, we have withdrawn our 'B' short-term corporate credit rating on Cofiren Renault et Cie, since this entity no longer exists.

## Rationale

The upgrade reflects our view that Renault will maintain strong credit ratios in the next two years and gradually improve the profitability of its core automotive division, which now contributes about half of the group's reported EBIT.

Renault has markedly improved its financial profile in recent years. We believe that it will sustain an adjusted FFO-to-debt ratio of more than 45% over the next two years. Between 2010--when we raised the company's long-term rating to 'BB+'--and 2014, FFO to debt climbed to 55% from 38%, thanks to asset disposals and earnings growth. Additionally, the automotive division had a €1.3 billion net cash position on a reported basis at year-end 2014. We expect Renault will continue to generate positive FOCF in 2015 and 2016, owing to sustained recovery of the Western European car market, capital expenditures in line with historical trends, and stable working capital cash outflows. We also assume that the company will maintain a disciplined approach toward shareholder remuneration and acquisitions.

We believe that Renault's profitability will continue to improve, despite the weakness of the Russian and Latin American economies. In our base-case

scenario, we forecast that the reported margin of the automotive division will continue to rise, on track with management's target of achieving at least 5% by 2017. We see risk arising from emerging markets, but we believe that Renault enjoys several cushions, notably the weakness of the euro and the future benefits of ongoing cost-cutting measures. Regarding Russia, we expect the high share of Russian production and possible market share gains to partly offset the negative impact on earnings of falling car sales.

Under our base case, we assume:

- Real GDP growth of 3.6% in 2015 and 3.8% in 2016 globally. In the EU we expect 1.5% in 2015 and 1.8% in 2016; in Latin America 3.5% and 4%; and in Russia -2.3% and 1.9%.
- An increase in light vehicle sales of 3.1% in 2015 and 0.8% in 2016 globally, of which 4.6% and 3.7% in Western Europe; -7.7% and 4.9% in Latin America; and -35.3% and -0.1% in Russia.
- Stable revenues in 2015, followed by a 3% increase in 2016.
- A gradual increase in the profitability of the automotive division, thanks to additional productivity gains.
- A prudent financial policy over the next two years, with stable investment trends, a gradual increase in dividends, and no large debt-financed acquisitions.

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

- Renault's adjusted EBITDA margin will rise to about 8%-10% in 2016, from 7.6% in 2014.
- The reported operating margin of Renault's automotive division will structurally improve and the consolidated operating margin will continue to rise toward 5%, from 3.9% in 2014.
- Adjusted FFO to debt will remain comfortably above 45% over the next two years.

### Liquidity

The short-term rating on Renault is 'A-3'. We now view Renault's liquidity as "strong" under our criteria, compared with "adequate" previously, as we believe that its ratio of sources to uses of liquidity will exceed 1.5x in the next 24 months.

As of Dec. 31, 2014, we calculate that sources of liquidity amounted to €16 billion for the next 12 months, comprising:

- €9.7 billion of cash and cash equivalents held in the automotive division on June 30, 2014, after applying a 15% haircut;
- €2.9 billion in undrawn committed credit lines maturing in more than 12 months at the automotive division; and
- Our forecast of about €3.4 billion of reported FFO, excluding the contribution of Renault's captive finance subsidiary, RCI Banque, over the next 12 months.

At the same time, we estimate liquidity sources at €6.5 billion for the 12 months started Dec. 31, 2014, comprising:

- €3.2 billion of debt in the automotive division maturing in less than one

year;
- About €2.7 billion of capital expenditures; and
- About €0.6 billion of dividends.

The undrawn credit facilities have no financial covenants. We note that Renault also reported €25.7 billion of short-term liabilities related to RCI Banque at year-end 2014. We expect this subsidiary will have sufficient liquidity to cover its funding needs.

## Outlook

The stable outlook reflects our view that Renault's automotive division will continue to improve its profitability, despite an uncertain outlook in emerging markets, and that Renault will maintain positive FOCF over the coming two years. We also expect that financial policy will remain prudent. We believe that revenues will grow moderately in the next 24 months and that the adjusted EBITDA margin will rise to about 8%-10% by 2017.

### Downside scenario

We could lower the ratings if Renault was unable to maintain an adjusted FFO-to-debt ratio above 45%. This could happen if earnings declined sharply, possibly because of an unexpected downturn of the European market or large losses in Latin America or Russia. Debt-financed acquisitions or an increase in shareholder remuneration could also lead to a negative rating action.

### Upside scenario

We could raise our ratings on Renault if its management was committed to sustaining an adjusted FFO-to-debt ratio of more than 60% and if FOCF generation improved substantially. In that case, we would revise our financial risk profile assessment to "minimal" from "modest." Such a scenario could unfold if, for instance, the profitability of the automotive division rose above our expectations, thanks to productivity gains and a sharper recovery of the European car market.

## Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/A-3

Business risk: Fair
- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: bbb-

Modifiers
- Diversification: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

Upgraded; Ratings Withdrawn

| | To | From |
|---|---|---|
| Renault S.A. | | |
| Corporate Credit Rating | BBB-/Stable/A-3 | BB+/Positive/B |
| Senior Unsecured | BBB- | BB+ |
| Senior Unsecured | cnA- | cnBBB+ |
| Recovery Rating | NR | 3 |
| Commercial Paper | A-3 | B |
| Cofiren Renault et Cie | | |
| Corporate Credit Rating | --/--/NR | --/--/B |

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