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Research

Research Update:

French Automaker Renault Outlook Revised To Positive On Stronger Earnings And Less Debt; 'BBB-/A-3' Ratings Affirmed

Primary Credit Analyst:
Vincent Gusdorf, CFA, Paris (33) 1-4420-6667; vincent.gusdorf@standardandpoors.com

Secondary Contact:
Alex P Herbert, London (44) 20-7176-3616; alex.herbert@standardandpoors.com

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Overview

- Rising earnings and declining debt should enable Renault to sustain stronger-than-expected credit ratios.
- We are therefore revising our outlook on Renault to positive from stable and affirming the 'BBB-/A-3' ratings.
- The positive outlook on Renault reflects our opinion that a conservative financial policy will support credit metrics, and that the profitability of its automotive operations will continue to improve on the back of additional productivity gains and new car launches.

Rating Action

On April 19, 2016, Standard & Poor's Ratings Services revised its outlook on French automotive manufacturer Renault S.A. to positive from stable. At the same time, we affirmed our 'BBB-' long-term and 'A-3' short-term corporate credit ratings on the company.

Rationale

The outlook revision reflects our view that Renault will sustain higher-than-expected credit ratios over the next two years and that its business risk profile will continue to improve.

Shrinking debt and an expanding earnings base should fuel a marked improvement in Renault's credit ratios in the coming years. Renault has increased its EBITDA by €0.7 billion and reduced its debt by €0.5 billion over the past two years. As a result, its funds from operations (FFO) to debt has risen to 120% from 76% between 2013 and 2015, and we believe that it should exceed 100% in the coming years. We also forecast that Renault will sustain healthy cash flow generation, with a free operating cash flow (FOCF)-to-debt ratio of about 50%.

We think that the sale of Nissan shares should more than offset cash outflows coming from a possible recapitalization of the Russian subsidiary AvtoVAZ. Although the cost of this operation is currently difficult to assess, Renault's management indicated that it would not exceed a few hundred million euros. At the same time, we calculate that Nissan's share buyback program should generate about €1 billion of proceeds for Renault, as it intends to sell some of its shares to maintain its 43.4% stake.

We've also taken into account our belief that Renault's business risk profile is strengthening. Its Standard & Poor's adjusted EBITDA margin rose to 8.8% in 2015 from 7.6% in 2014, thanks mostly to an increase of the automotive division's profitability. Although Renault benefited from a supportive operating environment last year, notably the significant rebound of the European car market and favorable exchange rates, we think that the improvement in profitability is also structural. In particular, we note that the Monozukuri cost-cutting program generated €1.4 billion of savings over the past two years. For the next couple of years, we believe that profitability will continue to improve, albeit more gradually as additional productivity gains become increasingly difficult to achieve. Still, the pipeline of new vehicles is supportive, with 10 new vehicles to be launched in 2016.

Our base-case scenario relies on the following assumptions:

- An annual increase in car sales of about 2%-3% annually over the next two years. We expect the recovery of the European market to continue, supported by mild economic conditions, with a real GDP growth of 2% in 2016 and 1.9% in 2017. This should more than offset the poor performance of Russia (real GDP growth of 0.3% in 2016 and 1.8% in 2017) and Brazil (negative 3% in 2016 and 1% in 2017). We also expect sound performances in India owing to a good product mix. Furthermore, China, from which Renault is almost absent, and Iran, provide upside potential.
- Annual revenue growth should reach about 3%-5% over the next two years, driven by a supportive pipeline of new vehicles and rising sales to partners.
- A gradual increase in the profitability of the automotive division thanks to additional productivity gains.
- A stabilization of working capital.
- A moderate increase in capex to about 7% of revenues to finance investments in China and new projects.
- A prudent financial policy over the next two years, with stable investment trends, a gradual increase in dividends, and no large debt-financed acquisition.
- A €1 billion cash inflow coming from the sale of Nissan shares, as part of its share buyback program.
- A moderate cash outflow related to the recapitalization of the Russian subsidiary AvtoVAZ.

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

- An adjusted EBITDA margin of moving gradually to 9%-10% in the next two years.
- An FFO-to-debt ratio above 100%.
- A debt-to-EBITDA ratio of less than 1x.
- An FOCF-to-debt ratio of about 50%.

Liquidity

The short-term rating on Renault is 'A-3'. We view Renault's liquidity as strong, based on our estimate that its ratio of liquidity sources to uses will

exceed 2x in the next 24 months. The company's well-established relationships with its banks and its prudent risk management also underpin our assessment, among others supporting factors.

We calculate that sources of liquidity amount to about €18 billion for the 12 months started Dec. 31, 2015, comprising:

- €9.7 billion of cash and cash equivalents held in the automotive division, after applying a 15% haircut;
- €3.3 billion in undrawn bilateral committed credit lines maturing in more than 12 months at the automotive division;
- About €4.4 billion of reported FFO, excluding the contribution of RCI Banque, forecast over the next 12 months; and
- About €1 billion of proceeds from the sale of Nissan shares.

For the same time period, we estimate €8 billion in liquidity sources, comprising:

- €4.2 billion in automotive debt maturing in less than one year;
- About €3.3 billion of capex; and
- About €0.8 billion of dividends.

The undrawn credit facilities have no financial covenants. We note that the sales financing division RCI Banque had €15.4 billion of debt maturing over the next 12 months at year-end 2015. We expect this subsidiary will have sufficient liquidity to cover its funding needs.

Outlook

The positive outlook on Renault reflects our opinion that a conservative financial policy will support strong credit metrics and that the profitability of its automotive operations will continue to improve on the back of additional productivity gains and new car launches. As a result, we expect Renault's Standard & Poor's adjusted EBITDA margin to rise to about 9%-10% by 2017.

Upside scenario

We may raise our ratings on Renault over the next 12-18 months if the company builds a track record of strong credit ratios and good profitability levels. This would require that Renault maintain FFO to debt well above 60%, with only a limited increase in shareholder remuneration and no large debt-financed acquisitions. An upgrade would also require that profitability remained on an upward trend and that the strength of the European market mitigated the decline of the markets in Brazil and Russia.

Downside scenario

We could revise the outlook to stable if Renault's profitability started to decline. Such a scenario could unfold if, for instance, the European market unexpectedly deteriorated or if the company was unable to contain costs. We would also revise the outlook to stable if FFO to debt fell below 60%, possibly because of a debt-financed acquisition or an increase in shareholder remuneration.

Ratings Score Snapshot

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

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

Financial risk: Minimal
- Cash flow/Leverage: Minimal

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

- Standard & Poor's National And Regional Scale Mapping Tables, Jan. 19, 2016
- The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers , Dec. 14, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Renault S.A.		
Corporate Credit Rating	BBB-/Positive/A-3	BBB-/Stable/A-3
Senior Unsecured	BBB-	BBB-
Commercial Paper	A-3	A-3

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.