S&P Global
Ratings

Research

Research Update:

French Car Manufacturer Renault Upgraded To 'BBB/A-2'; Outlook Stable

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Overview

- We forecast that Renault will maintain its EBITDA margin at 9%-10% and its free operating cash flow-to-debt ratio at well above 40% over the next two years, while temporarily stepping up its capital expenditures and research and development spending to meet toughening regulatory requirements.
- We are therefore raising our ratings on Renault to 'BBB/A-2' from 'BBB-/A-3'.
- The stable outlook reflects our expectation that Renault will keep its EBITDA margin at 9%-10% over the next two years, supported by volume growth and a continued focus on cost discipline.

Rating Action

On Nov. 17, 2017, S&P Global Ratings raised its long- and short-term corporate credit ratings on France-based car manufacturer Renault S.A. to 'BBB/A-2' from 'BBB-/A-3'. The outlook is stable.

At the same time, we raised our issue ratings on Renault's senior unsecured debt to 'BBB' from 'BBB-'.

Rationale

The upgrade reflects our forecast that Renault will sustain its EBITDA margin at 9%-10% over the next two years, despite a short spike in its costs as it gears up for toughening emission standards in the coming years.

Renault's thin automotive EBITDA margin and margin volatility had been a drag on the rating. However, over the past three years, the company has demonstrated continued profitability improvement, posting an S&P Global Ratings-adjusted EBITDA margin of about 10% in 2016, up from 8.8% the previous year. We consider this level to be at the upper end of the average category for the auto original equipment market (OEM) sector.

Renault should sustain its EBITDA margin at 9%-10% over the next two years, thanks to continued revenue growth, cost discipline, and dividends received from associates.

We forecast steady growth of 2.0%-3.5% in car sales in Europe, supported by mild economic conditions. With a portfolio of recent models, including the

Clio, Megane, and Talisman, and its successful launches of SUVs such as the Captur and the Duster, we think Renault can grow at least as fast as the market and maintain its market position within the top three carmakers in Europe. Other markets, such as Russia and Latin America, provide further growth potential thanks to the slow recovery expected in these markets.

Moreover, we expect Renault will pursue its focus on cost reduction and productivity gains, where the alliance with Nissan benefits the company. With about 3 million cars sold in 2016, Renault is a small car manufacturer compared with auto OEMs such as Volkswagen (10.3 million) or even Fiat Chrysler (4.7 million). For a mass-market player focused mostly on the competitive A&B segments (mini and small cars, per the European Commission's classification), size is critical. The company can therefore count on the purchasing synergies coming from its joint efforts with Nissan to reduce costs. We see further cost benefits over the coming years, through the increased number of cars produced on shared platforms, the increased proportion of common components, and productivity gains.

We also anticipate that Nissan will maintain its dividend payments to Renault. In our calculation of Renault's adjusted EBITDA, we add the dividends received from associates Nissan and Daimler, with the former being the main contributor. In 2016, Renault received a cash dividend of €728 million from Nissan.

The high level of investments in research and development (R&D) required over the next two to three years to meet toughening regulatory standards on emissions will constrain Renault's profitability. Consequently, we estimate stability in its EBITDA margin, rather than continued improvement. By 2021, car manufacturers in Europe must decrease their carbon dioxide (Co2) emissions of their fleets to 95 grams per kilometer (g/km) to avoid fines. Renault's fleet Co2 emissions are currently at 110g/km. The steady but slow decrease in demand for diesel cars in Europe following concerns about the level of their nitrogen oxide (NOx) emissions further exacerbates the challenge to meet Co2 targets. This is because diesel engines perform better than gas engines on Co2 emissions. As part of its new strategic plan "Drive the Future," Renault has announced that it aims, together with Nissan, to develop a portfolio of 20 models of electrified vehicles by 2022, of which eight will be full electric models. Although Renault plans to spend around €18 billion on R&D over the next six years, it should also benefit to some extent from Nissan's spending (the budget for the alliance is about €50 billion over the same period). Renault already produces four electric vehicles and holds a leading position in the small but growing segment of small electric cars in Europe with its ZOE model.

Since December 2016, Renault fully consolidates its Russian subsidiary Avtovaz. We see the Russian market as particularly volatile and remain cautious about the recent pace of recovery there. At the end of June 2017, Avtovaz reported operating profit of €3 million and revenues of about €1.2 billion, translating into a dilution of Renault's operating margin. In our forecasts, we expect Avtovaz will report positive operating margins over the

next two years but at levels lower than Renault's.

In our analysis of Renault, we deconsolidate the contribution of its financing arm, RCI Banque, to focus on the automotive segment. Still, we acknowledge that RCI Banque improves loyalty to Renault's brands.

Renault's financial risk profile offers flexibility for modest operational setbacks. Assuming sales growth of 10%-11% in 2017, with a stabilization of the EBITDA margin at 9%-10% and capital expenditures (capex) of €3.8 billion-€4.0 billion, we arrive at a ratio of free operating cash flow (FOCF) to debt of about 150% in 2017, versus about 86% in 2016. We generally consider an FOCF-to-debt ratio of above 40% as commensurate with the current rating category.

Renault's intention to increase shareholder returns should not weaken its financial risk profile, given the existing headroom. More specifically, by 2022, Renault plans to distribute 100% of the dividends received from its associates--Nissan and Daimler--plus 15% of its net profits, excluding associates' contributions. This compares with a full pass through of dividends received and about 7% of net profits, excluding associates' contributions, currently. We expect that Renault will gradually increase dividends in accordance with its new stated financial policy, but at the same time, we think that the company will maintain its leverage and free cash flow ratios at or above current levels.

The French investigation of diesel emission levels for European car manufacturers, including Renault, still represents a legal risk for the company. In our base case, we exclude any additional costs or cash outflow related to the investigation because the magnitude of a potential fine remains uncertain at this stage. We think that Renault could accommodate a limited fine given the headroom in its leverage ratios.

In our base case for Renault, we assume:

- An annual increase in global car sales of 2%-3% annually over the next two years. In Europe, where Renault generates about 55% of its sales; we expect car unit sales will grow by 2.0%-3.5%, supported by mild economic conditions. This is directionally consistent with our expectations of real GDP growth of 1.6% in 2017 and 1.5% in 2018 in Europe.
- Annual revenue growth of about 10% in 2017 and approximately 5% in 2018, mainly driven by increasing volumes in Europe and international markets, such as Russia and Brazil, and rising sales to partners.
- A stabilization of the automotive EBITDA margin in 2017 at about 10% as volume growth and additional productivity gains offset raw material price increases and full consolidation of Russian subsidiary Avtovaz for the first year, with a thinner EBITDA margin than the Renault group. In 2018, we expect that the rise in R&D to meet regulatory requirements in terms of Co2 and NOx emissions will constrain EBITDA margin progression.
- An increase in capex to €3.8 billion-€4 billion in 2017 and 2018 from €3.1 billion in 2016, to support volume growth and more stringent regulatory requirements.

- Dividends of €1.0 billion in 2017 and €1.2 billion in 2018.
- No large debt-financed acquisition.
- No provision or cash outflow related to the French investigation of diesel car emission levels.

Based on these assumptions, we arrive at the following credit measures over the next two years:
- An annual EBITDA margin at 9%-10%, versus 10.2% in 2016;
- Debt to EBITDA remaining below 1x;
- Funds from operations (FFO) to debt above 300%, up from 186% the previous year; and
- FOCF to debt above 150% versus 86% in 2016.

Liquidity

The short-term rating on Renault is 'A-2'. Our view of Renault's strong liquidity primarily reflects the company's well-established relationships with banks, its prudent risk management, and our belief that the ratio of sources to uses of liquidity will exceed 1.5x in the 24 months started July 1, 2017.

On June 30, 2017, we calculate that Renault's sources of liquidity amount to about €19 billion for the following 12 months, comprising:
- €10.7 billion of cash and cash equivalents in the automotive division, after removing €1.5 billion that we consider as not immediately available for debt repayment;
- €3.4 billion in undrawn bilateral committed credit lines maturing in more than 12 months at the automotive division; and
- About €5 billion of forecast reported FFO (excluding RCI Banque's contribution).

On the same date, we estimate liquidity sources at about €10 billion for the next 12 months, comprising:
- About €4.8 billion in automotive debt maturing in less than one year;
- About €0.5 billion of working capital outflow;
- Approximately €3.9 billion of capex; and
- About €1 billion of dividends and €200 million of share buybacks.

The undrawn credit facilities have no financial covenants. We note that at midyear 2017 RCI Banque had about €23 billion in financial liabilities maturing over the next 12 months. We expect this subsidiary will have sufficient liquidity to cover its funding needs.

Outlook

The stable outlook reflects our expectation that over the next two years Renault will maintain its leadership position in the European market for small cars while further developing its presence in international markets, such as Brazil and Russia, We also anticipate it will pursue its cost discipline; and make the necessary investments to prepare for tougher regulatory standards and increased electrification. Numerically, this should translate into an annual

EBITDA margin of 9%-10%.

Downside scenario

We could downgrade Renault if we saw that it started to lose market share in Europe or faced tougher market conditions, leading to a failure to maintain its EBITDA margin at 9%-10% for a sustained period. A negative rating action could also occur if Renault had to pay material fines in relation to the investigation of diesel car emissions or due to a breach of Co2 targets. Lastly, a more aggressive financial policy, characterized by large debt-financed acquisitions or increased shareholder returns, could also lead us to consider a negative rating action.

Upside scenario

Although unlikely in the next 12-24 months, we could raise our ratings on Renault if it markedly reduced the concentration of its revenues and profits from European markets and consistently maintained its EBITDA margin at above 10%. An upgrade would also hinge on Renault maintaining FFO to debt and FOCF to debt above 60% and 40%, respectively.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

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

Financial risk: Minimal
- Cash flow/Leverage: Minimal

Anchor: bbb

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

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017

- Criteria - Corporates - General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Renault S.A.		
Corporate Credit Rating	BBB/Stable/A-2	BBB-/Positive/A-3
Senior Unsecured	BBB	BBB-
Commercial Paper	A-2	A-3

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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.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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.