S&P Global
Ratings

Research

Research Update:

Renault S.A. Downgraded To 'BBB-' On Tougher Market Conditions; Outlook Negative

October 25, 2019

Rating Action Overview

- France-based carmaker Renault S.A. has lowered its guidance for sales, operating margins, and cash flow for the full-year 2019 due to more difficult market conditions than it anticipated in the second half of the year.
- We see the prospects for a swift recovery over the next two years as dim, due to our expectations of low growth in global car sales, increasing regulatory costs to meet stricter exhaust emission standards, and lower dividends from Nissan Motor Co. Ltd.
- We are therefore lowering to 'BBB-' from 'BBB' our long-term issuer credit rating on Renault and our issue ratings on the company's unsecured notes and revolving credit facility. We are also lowering our short-term rating on Renault to 'A-3' from 'A-2'.
- The negative outlook reflects our view of Renault's reduced flexibility to withstand a further weakening in demand, and operational missteps in the ramp-up phase of its new model launches, including the Clio, the Captur, and the new Zoe.
- The negative outlook also reflects uncertainty around the increased uptake of Renault's electric models due to increasing competition, potentially leading to regulatory fines for noncompliance with the EU's carbon dioxide emissions target.

PRIMARY CREDIT ANALYST

Margaux Pery
Paris
(33)1-4420-7335
margaux.pery
@spglobal.com

SECONDARY CONTACT

Anna Stegert
Frankfurt
(49) 69-33-999-128
anna.stegert
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Rating Action Rationale

Renault's EBITDA margin will likely fall toward 6% in 2019, highlighting the company's challenges in adjusting its cost base to declining revenues. Renault's sales were down by about 5% in the first nine months of 2019, reflecting lower sales to partners, unfavorable foreign-exchange rates, and weaker demand in most of the company's markets. In the first nine months of 2019, total sales volumes in Europe fell by 1.6%, in Russia by 2.0%, in Turkey by 36.9%, and in Argentina by 46.9%. We expect that global demand for cars will remain weak in the fourth quarter of the year. Overall, we forecast that the company's car sales will decline by 4%-5% in 2019. At the same time, Renault is facing increasing regulatory costs that it cannot fully pass onto its customers. We believe that Renault's position in the small and entry-level automotive division

places it at a disadvantage in passing through increasing regulatory costs to its consumers on existing car models. Renault ranks at the lower end of what we consider average profitability (6%-10%) for carmakers, with our expectation of Renault's S&P Global Ratings-adjusted EBITDA margin at about 6.0%-6.5% in 2019, down from 7.8% in 2018 and 9.5% in 2017.

Research and development (R&D) costs and capital expenditure (capex) constrain Renault's free cash flow from the automotive division. Renault, like other car manufacturers, is incurring increasing investments in R&D and capex to ensure the attractiveness of its models, improve the efficiency of its cars, and meet regulatory requirements. The carmaker does not have much flexibility to cut these investments, even though market demand is weakening. In the first half of 2019, Renault reported negative free cash flow from the automotive division of €716 million. For the second year in a row, Renault's ability to generate positive free cash flow from the automotive division for the full year will rely on large inflows of working capital in the last quarter. This is inconsistent with the 'BBB' long-term rating, as we would typically expect free operating cash flow (FOCF) to sales to stay comfortably above 2%-3%.

The launch of new car models in the second half of 2019 and in 2020 should support Renault's sales in the next couple of years, but is unlikely to lead to a meaningful recovery in the EBITDA margin. In Europe, where Renault derives about 50% of its sales, we assume no growth in 2020 and 2021. (See "Global Auto Sales Will Stay In The Slow Lane For At Least The Next Two Years," published Sept. 17, 2019, on RatingsDirect). However, we believe that the launch of new versions of Renault's bestselling models, Clio and Captur, together with the continuing appeal of the entry-level models under the Dacia brand, particularly the new Duster, should allow the company to continue to slightly outperform the European market. Moreover, Renault has increased its prices on the Clio V in line with its new pricing policy. We expect that Renault will continue to focus on the perceived quality and content of its vehicles to support higher prices. Nevertheless, we consider that increasing regulatory costs--which are difficult to pass onto customers outside new model introductions--and the ongoing shift in the sales mix toward electric models will likely limit the chances of a meaningful recovery in the company's EBITDA margin by 2021. We assume that Renault's EBITDA margin will hover around 7% by 2021.

Declining diesel car sales and electrification will constrain operating margin expansion, at least until electric cars reach a high share of total volumes. In Europe, consumers continue to move away from diesel cars in favor of gasoline-powered cars following scandals over nitrogen oxide emissions and the announcement of future sales bans by big European cities. This change in the sales mix continues to be unfavorable for Renault. Moreover, gasoline engines emit more carbon dioxide (CO2) than diesel engines, which makes it harder for carmakers to meet the EU's 2021 CO2 emissions targets of 95g per kilometer (/km) without further increasing their share of electric cars.

Renault has four electric models in its portfolio, two passenger cars and two light commercial vehicles. Overall, we perceive the company to be in a relatively good position to reach the EU's CO2 emissions target by 2020-2021. In the ramp-up phase, we assume that Renault's operating profits will be constrained by the lower-margin contribution from its electric cars until they reach volumes that allow for efficient coverage of overhead costs.

We also assume that dividend payments from Nissan Motor Co. Ltd. (Nissan) will stay at Japanese yen (¥) 40 per share for the next two-to-three years, below levels in recent years. We add back dividends received from Nissan and other equity affiliates to our calculation of Renault's EBITDA and FOCF. While dividends received from affiliates have increased over the past few years to reach €828 million in 2018, we now assume than Nissan will maintain its dividends at ¥40 per

share due to the operating challenges it faces in its key markets of the U.S., China, and Europe. (For more information, see "Nissan Motor Ratings Placed On CreditWatch Negative On Prospect Of Weaker Earnings," published Oct. 18, 2019). This would translate into a dividend to Renault of about €585 million annually from €765 million that we assume for 2019.

Future synergies from Renault's business alliance rely on increased cooperation between the partners. The alliance between Renault, Nissan, and Mitsubishi Corp. remains a supportive factor for our ratings on Renault. This is because the alliance provides Renault with cost benefits related to the alliance's joint purchasing, manufacturing, and engineering functions. All new car models will be produced on common platforms in order to minimize R&D and manufacturing costs through increased commonality of components. We caution that successive changes in Nissan's and Renault's management could have slowed decisions at the alliance, with possible delays in achieving additional synergies in the tougher market environment.

We assume that Renault would adjust its financial policy to protect its strong balance sheet. At the end of 2018, Renault's adjusted debt was low and amounted to €713 million, excluding debt from the captive finance arm RCI Banque S.A., including adjustments of €0.5 billion for operating leases, €1 billion for pension liabilities, and €2.1 billion for receivables securitization, and netting large cash balances of €11.2 billion. In a scenario of more difficult market conditions, we assume that Renault will adjust its dividend policy to protect its liquidity position and mitigate any increase in adjusted net debt.

An investigation into diesel car emissions in France is still ongoing. A negative outcome from the ongoing investigation would represent an event risk that we have not factored in our base case. Renault has not booked any provisions and denies any wrongdoing. The likelihood and magnitude of a fine remain uncertain.

Outlook

The negative outlook indicates a one-in-three chance of us lowering the ratings in the next 18-24 months. The outlook also reflects our view of Renault's reduced flexibility to withstand a further weakening in demand, and operational missteps in the ramp-up phase of its new model launches, including the Clio, the Captur, and the new Zoe. The negative outlook also reflects uncertainty around the increased uptake of Renault's electric models due to increasing competition, potentially leading to regulatory fines for noncompliance with the EU's CO2 emissions target.

Downside scenario

We could downgrade Renault if tougher market conditions prevent it from maintaining an EBITDA margin above 6% for a sustained period, alongside FOCF to sales of at least 1%. We could also downgrade Renault if it pays material fines in relation to the investigation of diesel car emissions, or due to a breach of the EU's 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

We could revise our outlook to stable if Renault mitigates low volume growth and increasingly stringent regulatory standards through better cost discipline and successful new car launches.

This would translate into the adjusted EBITDA margin stabilizing at above 6% and FOCF to sales of sustainably above 1%. It would also hinge on Renault maintaining funds from operations (FFO) to debt above 60% and FOCF to debt comfortably above 25%.

Company Description

France-based Renault is the third-largest automaker in Europe, behind Volkswagen AG and PSA Group in terms of the number of cars sold. The company sells cars under six brands: Renault, Dacia, Lada, Renault Samsung Motors, Alpine, and Jinbei & Huasong.

Renault formed an alliance with Nissan in 1999 and holds about 43% of the shares in the venture. Renault's main shareholders are the French state (15%), Nissan (non-voting share of 15%), and Daimler AG (3.1%), while the remainder of its shares are free floating.

Our Base-Case Scenario

Under our base case scenario, we assume:

- A slowdown in global GDP growth to about 3.2%-3.3% in 2019 and 2020 from 3.8% in 2018. In Europe, we assume GDP growth of 1.4% in 2019 and 1.6% in 2020, down from 2.3% in 2018; in Russia, 1.3%-1.8% down from 2.3%; and in Asia-Pacific, 5.0% down from 5.5%.
- A slowdown in the growth of global light vehicle volumes due to weakening economic conditions. We expect global sales to fall by 2%-3% in 2019 and to stabilize in 2020 and 2021, with sales growth in Europe of between 0% and -2% in 2019 and 0% in 2020 and 2021.
- A drop in Renault's automotive division revenue by approximately 4%-5% in 2019, rebounding by about 2%-3% in 2020, supported by new model launches and a new pricing policy.
- A decline in the EBITDA margin to about 6.0%-6.5% in 2019 from 7.8% in 2018, due to lower volumes in most markets and continued cost inflation that is not fully offset by management's pricing initiatives. The EBITDA margin should improve toward 6.5%-7.0% in 2020 on slightly higher volumes and continued cost discipline.
- A capex peak in 2019 to support the development of next-generation technologies. We anticipate capex of €4.7 billion in 2019 and €4.2 billion in 2020, compared with €4.4 billion in 2018.
- A dividend of around €1.1 billion in 2019 and €0.9 billion in 2020, in accordance with Renault's policy to distribute 100% of the dividends it receives from its associates--Nissan and Daimler--plus a percentage of its net profits (excluding associates' contributions); and
- No material acquisitions or disposals.

These assumptions lead to the following credit measures:

- FOCF to sales declining to below 1% in 2019, and increasing to about 1.0%-1.5% in 2020 and 2021.
- FFO to debt and debt to EBITDA remaining above 60% and below 1x, respectively.
- FOCF to debt declining to below 25% in 2019 and recovering to above 25% in 2020 and 2021.

Liquidity

Our short-term rating on Renault is 'A-3'. Our strong assessment of the company's liquidity primarily reflects its well-established relationships with its banks, its prudent risk management, and our belief that its liquidity sources will exceed its uses by 1.5x over the 24 months from July 1, 2019.

Principal liquidity sources:

- €12.0 billion of cash and cash equivalents in the automotive division, after deducting €0.5 billion that we consider as not immediately available to repay debt;
- About €3.0 billion in undrawn committed credit lines maturing in more than 12 months at the automotive division; and
- Our forecast of about €4.6 billion of reported FFO, excluding RCI Banque's contribution.

Principal liquidity uses:

- About €1.8 billion of automotive debt maturing in less than one year;
- About €1 billion of intra-year working capital outflows;
- Approximately €4.5 billion of annual capex; and
- About €1 billion of annual dividends.

Covenants

The undrawn credit facilities do not include any financial maintenance covenants.

Environmental, Social, And Governance

We see the environmental and social factors for Renault as broadly in line with those of its peers. Renault's Zoe model ranks among the best-selling electric car brands in Europe. Nevertheless, Renault has high exposure to Europe, which accounted for about 49% of sales in 2018. In order to meet the EU's 2021 CO2 emission target of 93g/km for its average car fleet in Europe, compared with 112g/km in 2018, Renault is stepping up its efforts to electrify its portfolio. This will constrain, at least temporarily, Renault's operating profitability and free cash flow generation due to the associated R&D costs and capex. Renault acknowledges that its electric cars generate operating margins below the group average, but indicates that they are profitable in terms of variable costs. By the end of 2022, the company expects to generate an operating margin in Europe at the group average.

Thanks to its cooperation with Nissan and Mitsubishi, Renault expects benefits for R&D and production costs. The cost benefits will mainly come from the use of a common platform for electric vehicles. This is a key consideration because Renault is a mass-market manufacturer focused on small and entry-level cars, and runs a risk of not being able to pass on extra costs onto consumers.

Social factors do not play a major role in our credit assessment, but we monitor the risks of product liability issues linked to road and vehicle safety.

Renault has strengthened its governance with the appointment of Jean-Dominique Sénard as

chairman, but still needs to finalize the appointment of the CEO following the dismissal of Thierry Bolloré in October 2019. Previously, both the chairman and CEO positions were concentrated in the sole person of Carlos Ghosn. The management instability since Carlos Ghosn's arrest adds uncertainty to the execution of the company's strategy. Our assessment of Renault's governance does not constrain our ratings, but it is low compared to other investment-grade companies, mainly reflecting the lower quality of Renault's accounting disclosure.

Issue Ratings - Subordination Risk Analysis

Capital structure

- Renault's capital structure consists of senior unsecured debt issued at the parent company, Renault S.A.

Analytical conclusions

- We rate Renault's debt 'BBB-', the same level as our long-term issuer credit rating, because no significant elements of subordination risk are present in its capital structure. This approach is also supported by the company's low leverage and our assessment of its financial risk profile as minimal.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Negative/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/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

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

Downgraded

	To	From
Renault S.A.		
Issuer Credit Rating	BBB-/Negative/A-3	BBB/Negative/A-2
Renault S.A.		
Senior Unsecured	BBB-	BBB
Commercial Paper	A-3	A-2

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 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.