FitchRatings

13 Nov 2019 | Rating Changed Outlook to Negative

Fitch Revises Renault's Outlook to Negative; Affirms at 'BBB'

Fitch Ratings-Barcelona-13 November 2019:

Fitch Ratings has revised the Outlook on Renault SA's Long-Term Issuer Default Rating (IDR) to Negative from Stable and affirmed the IDR at 'BBB'.

The Negative Outlook reflects the combination of deteriorating profitability and cash generation coming from an adverse economic environment and fundamental issues that Fitch believes could burden free cash flow (FCF) for a prolonged period, to levels not commensurate with the rating.

The rating already incorporates a cyclical weakening of sales and profitability, unfavourable foreign exchange dynamics and specific operational issues with product launches such as those recently reported by the group. However, we believe that these pressures will be exacerbated by sustained investment to meet emissions regulation and new mobility trends, further uncertainty regarding the operational and strategic management of the alliance with Nissan Motor Co., Ltd. (WD) and lower dividends received from the latter.

Key Rating Drivers

Negative FCF: We expect FCF to be negative in 2019 and 2020, in the range of minus 2.5%-minus 1.0%, after being consistently positive since 2009. We expect the negative impact of weaker underlying funds from operations (FFO) to be compounded by capex remaining between 7.5% and 8.5% of automotive sales and a lower dividend contribution from Nissan in 2019-2020. However, lower pass-through payments from Nissan's declining dividends could be partially offset by increased dividends received from Renault's financial services subsidiary and a cut in Renault's total dividend payments.

Working capital movements in late 2019 and 2020 could be a further burden but they remain particularly unpredictable in the context of uncertain production schedules and customer reaction to new products offered to improve emissions.

Weakening Profitability: We project profitability to come under pressure, with the group EBIT margin declining to below 5% in 2019-2020, from 6.3% in 2018 and 6.6% in 2017. This should be driven by cyclical weakness in some key markets, a slower than expected reduction in R&D,

adverse currency movements and recent product launch issues. This should be partly offset by a robust product pipeline in 2020 and accelerating cost-savings efforts. Furthermore, the group expects to improve synergies with Nissan but we think that this could take longer than expected in a context of mending relationships within the alliance.

We also believe that the market environment will remain extremely unfavourable in the next 12-18 months as competitors adjust their product plans and pricing strategies, especially in the context of new emission regulations. This could put further pressure on demand and prices.

Leverage Metrics Still Resilient: Despite renewed pressure on FCF, we do not expect FFO adjusted net leverage to go above 1.5x in the next two to three years. Net financial debt has fallen substantially since 2009 as a result of positive FCF and asset sales, while earnings and FFO rebounded. Net FFO adjusted leverage has declined continuously since end-2009, from more than 5.5x to 0.9x at end-2018, providing the group with some flexibility for the sector's next cyclical downturn.

Difficult Compliance with Emissions Targets: The rating has so far incorporated our assumptions that Renault was well positioned with regards to the shift to electric powertrains and compliance with 2020/2021 emissions targets in Europe. The Renault-Nissan alliance's decision to invest early in electric vehicles (EVs) has provided the group with a competitive advantage from their multi-year experience in manufacturing EVs and managing the overall supply chain and after-sale service.

However, we believe that substantial additional investments, including in hybrid powertrains, which Renault has so far largely overlooked, are still required to meet these targets. We also understand from the company's comments that it is struggling to pass on the cost of emissions technology to customers. We view the Dacia brand as a particular challenge with regards to emissions compliance.

Disruptive Management Changes: The departure of CEO and chairman Carlos Ghosn has started a period of turbulence at the senior management level. A new chairman has been appointed but Carlos Ghosn's internal replacement as CEO was ousted after a few months in the job and his successor has not yet been chosen. Various other senior managers have also left the company. We do not expect a fundamental alteration of Renault's strategy under a new CEO, but we believe that some financial targets could be adjusted.

We also believe that the difficulty to replace top management could remain quite distracting across the group as it diverts board's and management's time and attention from other important operational issues, particularly at a time of major sector shifts and industry consolidation.

Strained Alliance: While Renault's scale remains modest on a standalone basis, compared with

large international peers such as Volkswagen AG (BBB+), Toyota Motor Corporation (A+) and Ford Motor Company (Ford, BBB/Negative), it can derive material synergies from its alliance with Nissan, recently complemented by Mitsubishi Motors (NR). This is an important advantage in the context of new powertrains and autonomous driving technologies but which we believe has not been leveraged to its full potential. Investigations into Carlos Ghosn, which led to his departure, have triggered some turmoil between the two partners and disrupted several joint-projects. In light of its weaker performance, we also expect a smaller dividends stream from Nissan, constraining Renault's diversified source of cash in the past few years.

Nonetheless, we believe that the nomination of a new CEO at Nissan and soon at Renault, as well as the announcement of a likely merger between Fiat Chrysler Automotive N.V. (FCA, BBB-) and Peugeot S.A. (PSA, BBB-), bringing a potential transaction between Renault and FCA to an end, will create a renewed sense of urgency at Renault and Nissan to resume joint discussions and projects.

European Volume Manufacturer: The group derives the majority of its revenue from the less profitable mass-market small- and medium-sized car segments, where competition is fiercest and price pressure is strongest. Renault's sales also retain a bias towards Europe. However, the success of the entry range has been pivotal in compensating for the sales decline of the core Renault models and bolstering group profitability and geographical diversification. We also expect the latter to increase as international markets should outperform Europe, leading the group to derive more than 50% of its revenue from outside Europe in the medium-term.

Derivation Summary

Renault compares well with global automotive manufacturers at the 'BBB' level. On a standalone basis, Renault is smaller than General Motors Company (GM, BBB), Ford and Hyundai Motor Company (BBB+), but Renault's alliance with Nissan, extended to Mitsubishi, provides it with a capacity for substantial economies of scale and synergies, although we believe that these have not yet delivered their full potential.

Renault's brand positioning is moderately weaker than US peers. Nonetheless, we believe Renault's relative position should incorporate Dacia and Renault, the former not having a high brand value and leading market shares, but enhancing product and geographic diversification as well as healthily contributing to profitability. Compared with Hyundai and Kia Motors Corporation (BBB+), we see a much closer comparison in terms of competitive position and brand positioning.

However, we expect Renault's automotive operating and FCF margins to be lower than GM's and slightly weaker than Ford's. In addition, FFO adjusted net leverage are expected to be higher than GM's and broadly similar to Ford. No Country Ceiling, parent/subsidiary or operating environment

aspects impact the rating.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Single-digit decline in global light vehicle volumes in 2019 and 2020, and very low-single-digit growth over the medium term;

- Industrial operations revenue declining by 5% in 2019, and recovering moderately by low-single digits in 2020-2022;

- Automotive operating margin (including Avtovaz) declining to less than 3% in 2019-2020, before gradually improving to 4% in 2022. Group margin failing to around 5% in 2019 and 2020, before gradually recovering to 6% through to 2022;

- Capex on average at about 7.5% of industrial sales between 2019 and 2022, peaking above 8.5% in 2019;

- Dividend payment of around EUR1 billion in 2019 declining to between EUR0.5 billion and EUR0.7 billion over 2020-2022; and

- No material acquisitions or disposals.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Group operating margin remaining above 5% on a sustained basis (2018: 6.3%, 2019E: 4.9%).

- FCF margin comfortably above 2% on a sustained basis (2018: 0%, 2019E: -2.5%).

- Cash flow from operations (CFO)/lease-adjusted debt above 60% (2018: 33%, 2019E: 24%).

- FFO adjusted net leverage below 0.5x (2018: 0.9x, 2019E: 1.3x).

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Group operating margin falling below 3% on a sustained basis.

- FCF margin below 1% on a sustained basis.

- CFO/lease adjusted debt below 30%.

- FFO adjusted net leverage increasing above 1.5x.

- Material negative changes to the benefits derived from the alliance with Nissan.

Liquidity and Debt Structure

Healthy Liquidity: Liquidity is ample, including EUR11.4 billion of readily available cash and liquid investments for industrial operations at end-2018, according to Fitch's adjustments for minimum operational cash of about EUR1.4 billion and not readily available financial assets. In addition, undrawn committed credit lines of EUR3.5 billion are available at the automotive division. This is more than sufficient to cover reported short-term debt of EUR3 billion excluding derivatives liabilities as at end-2018. Renault is maintaining a prudent financial policy, including a reported net cash position and availability under revolving credit lines of at least 20% of revenue.

Diversified Debt Structure: The debt structure reported by the Renault group is diversified and consists mainly of euro- and yen-denominated unsecured bonds. The notes' maturities are well-spread from July 2020 to October 2027. The group has also raised debt through bank credit lines, including at the level of its subsidiaries. For its short-term financial needs, the group has direct access to EUR3.5billion of undrawn revolving credit facilities and has recourse to a EUR1.5 billion euro commercial paper programme, EUR1.2 billion used at end-June 2019. It can also use account receivables factoring (several receivables securitisation programmes in different countries) to fund its working capital needs.

Summary of Financial Adjustments

Summary of Financial Statement Adjustments - Fitch adjusts leverage metrics for financial services operations. Fitch calculated a target debt-to-equity ratio of 5x for Renault Banque, below the actual ratio of 8.9x at end-2018. Fitch has assumed that Renault makes a EUR3.3 billion equity injection into Renault Banque, to bring its debt-to-equity ratio down to 5x.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3, meaning that ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

Renault has an ESG Relevance Score of 4 for GHG Emissions & Air Quality as Renault is facing stringent emission regulation, notably in Europe, which is its main market. Investments in lower emission are a key driver of the group's strategy and cash generation and this is therefore relevant to the rating in conjunction with other factors.

Renault has an ESG Relevance Score of 4 for Governance Structure, reflecting the complex shareholding structure, including the partial ownership of the French State and cross-shareholdings with Nissan. The complicated relationship has been illustrated recently by the developments surrounding merger discussions between Renault and FCA, which ultimately failed.

Renault SA; Long Term Issuer Default Rating; Affirmed; BBB; RO:Neg
----senior unsecured; Long Term Rating; Affirmed; BBB

Contacts:
Primary Rating Analyst
Emmanuel Bulle,
Senior Director
+34 93 323 8411
Fitch Ratings Espana. S.A.U.
Av. Diagonal 601
Barcelona 08028

Secondary Rating Analyst
Aurelien Jacquot, CFA
Associate Director
+33 1 44 29 91 37

Committee Chairperson
Richard Barrow,
Senior Director
+44 20 3530 1256

Media Relations: Adrian Simpson, London, Tel: +44 20 3530 1010, Email: adrian.simpson@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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