FitchRatings

Fitch Downgrades Renault to 'BB+'; Outlook Negative

Fitch Ratings - Barcelona - 27 March 2020:

Fitch Ratings has downgraded Renault SA's Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'BB+' from 'BBB-'. The Outlook on the IDR is Negative.

The downgrade reflects our view that the COVID-19 pandemic will weigh on Renault's earnings and cash flow in 2020 and materially hinder or delay the recovery in the group's credit metrics assumed in our February 2020 review. Fitch's current base case includes a significant global economic downturn through 2Q20 that will significantly affect new vehicle sales in 1H20. We expect a rebound in sales over 2H20 and into 2021 but to a lower level than previously assumed.

The Negative Outlook reflects the risk of further deterioration in Renault's credit profile if confinement measures and production stoppages related to COVID-19 are prolonged, further stressing Renault's operations and liquidity. The Negative Outlook also reflects the risk of a protracted weakened economic environment and its potential effect on new vehicle sales, particularly in Europe. A weaker-than- expected rebound in sales further impairing Renault's financial performance could lead to another downgrade.

Key Rating Drivers

Delayed Recovery: The pandemic is compounding Renault's challenges that first surfaced in 2019. Our previous rating case assumed a gradual improvement of the financial profile by end-2022, including recovery of free cash flow (FCF) to positive territory, operating margin to 5% from a trough of just above 3% in 2020 and funds from operations (FFO)-adjusted net leverage to below 1.5x from 1.7x in 2020. Our current base case incorporates weaker operating and FCF margins and higher leverage in 2020-2022.

Fall in Revenue: We expect car sales to plummet in Europe in 1H20 as a result of extended confinement measures in the largest automotive markets, further intensifying existing sales pressures due to the sector's cyclical downturn that started before the outbreak. Emergency measures and lockdown decisions in several countries have led to a sharp decline in dealership visits and widespread postponements of new vehicle purchases, bringing new vehicle sales to a halt for several weeks.

European Sales Hardest-hit: Renault derives about half of its unit sales and about two thirds of its revenue from Europe. We estimate that an 80% yoy sales decline in Europe could represent for the group more than EUR500 million in lost revenue per week. Other regions where Renault is active have so far been less affected by the outbreak, except for South Korea, but will also record lower sales. Renault does not have operations in the US and its presence in China is not material.

Profitability Hit: The fall in revenue will strongly impair fixed cost absorption and have a material effect on operating margins at least in 1H20. We believe that Renault's industrial operating margin could become negative in 2020, down from 2.7% in 2019 and 4.4% in 2018 but the magnitude of the impact will depend on the duration and extent of the production stoppages and sales decline. Profitability recovery will depend on the success of the ongoing cost-saving initiatives and restructuring measures to be announced later in the year.

Working Capital Absorption: The automotive industry typically displays negative working capital, including shorter-term receivables than payables. A sudden fall in sales causes a rapid decline in trade receivables

while payables are still due for a further two-to-three months. Factory shutdowns across Europe will curb inventory pile-up and shrink receivables but we expect a significant cash outflow from working capital developments in the next couple of months from sharply lower payables.

Working Capital Release Uncertain: We expect a recovery in sales to trigger a symmetric inflow of working capital, similar to what happened in 2009, but the timeline is hard to predict at this point and could extend into 2021. It will depend on upcoming demand and potential government decisions to spur demand and steer financial relationships between various companies in the supply chain.

Further Pressure on FCF: Our previous assumption of negative FCF in 2020 is compounded by the risk of worse-than-expected funds from operations (FFO) in 1H20. Working capital developments will be pivotal to FCF but are difficult to project. We also forecast a cut in capex and dividends to preserve cash but expect investments to remain driven by the need to meet stringent emission regulation. Furthermore, we expect a cut in dividends up-streamed from Nissan for longer than previously forecast as Nissan also faces significant pressure on its financial profile.

Upcoming Restructuring Measures: Renault has identified significant savings worth about EUR2 billion, or about 20% of its total fixed costs, in the next three years from non-core asset sales and the alignment of its global production footprint to its revised expectations for the automotive market and its own sales. It said that it will detail the cost and timeframe of its programme in May 2020 but the pandemic could change the agenda and scope of the plan. We are also cautious that renewed synergies with Nissan could take longer than expected to accrue from relationships on the mend and from heavy resistance from some stakeholders to cost-cutting.

Difficult Compliance with Emission Targets: Despite its advantage of being an early entrant on the electric vehicle (EV) market, Renault still has to fill a material gap to its 2020 CO2 targets to avoid heavy fines. To meet these targets, we expect acceleration of EV sales, but potentially at a loss, as well as substantial additional investments, including in hybrid powertrains, which Renault has so far largely overlooked. Furthermore, we expect COVID-19-related measures to disrupt EV production and availability in 2020 and hinder some crucial model development.

Regulation Potentially on Hold: The evolution of the product mix is difficult to forecast and the immediate sales recovery could be focused on smaller, more fuel-efficient models supporting Renault's average CO2 emissions. Likewise, regulatory response is hard to anticipate at this point. European regulators have so far taken a hard stance towards lowering fuel emissions but exceptional circumstances may warrant special derogations for carmakers, depending on the duration and magnitude of the crisis.

Disruptive Management Changes: The departure of CEO and Chairman Carlos Ghosn has opened up a period of turbulence at senior management level. A new Chairman was appointed in early 2019, who focused on stabilising the relationship between Renault and Nissan. A new CEO has also been chosen in early 2020 but will join the group only in July 2020, after the restructuring plan has been announced. Various other senior managers have also left the company. We expect the new management team to bring some balance to the group but this could be drawn-out.

Strained Alliance: While Renault's scale remains modest on a standalone basis, compared with large international peers such as Volkswagen and Toyota, it can derive material synergies from its alliance with Nissan, which was completed by Mitsubishi recently. This is an important advantage for new powertrains and autonomous driving technologies but which we believe has not been leveraged to its full potential. Investigations into Carlos Ghosn have triggered some turmoil between the two partners and disrupted several joint projects. Nonetheless, we believe that the new management at Nissan and Renault will bring stability, having agreed to coordinate strategies and name leaders for regions and technologies.

Effect from ESG Factors: Renault has an ESG Relevance Score of 4 for GHG Emissions & Air Quality and Governance Structure. The group 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. The Governance Structure score reflects the complex shareholding structure, including the partial

ownership of the French State and cross-shareholdings with Nissan. The complicated relationship was recently illustrated by the developments surrounding merger discussions between Renault and FCA, which ultimately failed.

Derivation Summary

On a standalone basis, Renault is smaller than General Motors Company (GM, BBB/Stable), Ford Motor Company (BBB-/Negative) and Hyundai Motor Company (BBB+/Stable), but Renault's alliance with Nissan, extended to Mitsubishi Motors, provides it with a capacity for substantial economies of scale and synergies, although we believe that these synergies 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, which despite not having a high brand value and leading market shares, enhances product and geographic diversification and is a healthy contribution to profitability. Compared with Hyundai and Kia Motors Corporation (BBB+/Stable), we see a much closer comparison in competitiveness and brand positioning.

Renault's financial profile has deteriorated compared with 'BBB' global automotive manufacturers. Renault's automotive operating and FCF margins are now expected to be lower than GM's, Ford's, PSA's and FCA's. In addition, FFO-adjusted net leverage is also expected to be higher than these peers'. 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

-High single-digit decline in global light vehicle volumes in 2020, some recovery in 2021 and very low single-digit growth over the medium term;

-Industrial operations revenue declining 9% to 10% in 2020, and recovering gradually through to 2023;

-Automotive operating margin (including Avtovaz) turning negative in 2020 and 1% to 1.5% in 2021, before improving toward 3% in 2022. Group margin falling below 2% in 2020 and 4% in 2021, before recovering to approximately 5% in 2022;

-Capex on average at about 7.1% of industrial sales between 2020 and 2023, after peaking at 9.6% in 2019;

-Dividend payment of around EUR0.3 billion in 2020 and none in 2021; and

-No material acquisitions or disposals.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action, although an upgrade is unlikely until the global environment has normalised.

- Group operating margin recovering to 3% (2019: 4.8%, 2020E: 1.5%).

- FCF margin recovering to 1% (2019: -1.8%, 2020E: -5.5%).

- Cash flow from operations (CFO)/lease-adjusted debt above 30% (2019: 30%, 2020E: 11%).

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

- Increasing risk of deteriorating liquidity.

- Group operating margin below 2%.

- FCF margin remaining negative by 2022.

- CFO/lease-adjusted debt below 20%.

- FFO-adjusted net leverage above 2x (2019: 1.3x, 2020E: 2.6x).

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

Liquidity and Debt Structure

Working Capital to Affect Liquidity: We expect negative working capital developments in 2Q20 to strain liquidity. Renault had EUR9.9 billion in trade payables at its automotive operations at end-2019, which were partly covered by EUR1.3 billion in trade receivables. Further coverage was provided by EUR13.5 billion of reported cash and cash equivalents and financial assets for industrial operations at end-2019, before Fitch's adjustments for minimum operational cash of about EUR1.3 billion and not readily available financial assets. In addition, undrawn committed credit lines of EUR3.5 billion are available at the automotive division. Renault has a record of 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 at Renault 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 recourse to a EUR2.5 billion euro commercial paper programme, of which EUR0.6 billion was used at end-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

Fitch adjusts leverage metrics for financial services operations.

Fitch calculated a target debt-to-equity ratio of 5x for Renault Banque (RCI Banque), below the actual ratio of 8.8x at end-2019.

Fitch assumed that Renault makes a EUR3.5 billion equity injection into RCI Banque, to bring its debt-to-equity ratio down to 5x.

ESG Considerations

Renault: Governance Structure: 4, GHG Emissions & Air Quality: 4

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.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Renault SA	LT IDR BB+ ⛔ Downgrade	BBB- ⛔
senior unsecured	LT BB+ Downgrade	BBB-

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)

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