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## Research Update:

# Swiss Travel Retailer Dufry AG 'BB' Ratings Affirmed; Outlook Stable; Recovery Rating Revised To '3'

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## Overview

- We have revised our assumptions for the recovery analysis of Swiss travel retailer Dufry AG. In particular, we raised our estimate of the company's EBITDA on emergence due to the contribution from its World Duty Free acquisition. This, together with partial repayment of existing debt, led us to increase our valuation of Dufry, leading to a higher expectation of recovery for senior unsecured debtholders.
- We are revising the recovery rating on the senior unsecured debt (comprising a Swiss franc 900 million revolving credit facility, €500 million notes due 2022, and €700 million notes due 2023) to '3' from '4'.
- The recovery rating is supported by the limited prior-ranking liabilities but constrained by the significant amount of unsecured debt. Our rounded estimate of the recovery expectation for the unsecured debt is 55%.
- We are also affirming our 'BB' corporate credit and issue ratings on Dufry.
- The stable outlook reflects our expectation that in the near term, Dufry's leverage metrics should improve and we could see a track record of strong cash flow generation.

## Rating Action

On March 31, 2017, S&P Global Ratings affirmed its 'BB' long-term corporate credit rating on Swiss travel retailer Dufry AG. The outlook remains stable. At the same time, we affirmed our 'BB' long-term issue rating on the senior unsecured debt facilities.

We also revised to '3' from '4' our recovery ratings on the senior unsecured debt--comprising a Swiss franc (CHF) 900 million revolving credit facility (RCF), €500 million notes due 2022, and €700 million notes due 2023--indicating our expectation of meaningful (50%-70%; rounded estimate: 55%) recovery in the event of payment default.

## Rationale

The affirmation reflects Dufry's position as the world's leading travel retailer. Following the acquisition of competitors The Nuance Group in 2014 and World Duty Free (WDF) in 2015, Dufry expanded its market share in the airport retail industry to about 25% from about 10% previously. The world's

No. 2 travel retailer is LS Travel Retail (Lagardère group), which only has about 8% of the market share.

Dufry's large size results in a strong negotiating position with its suppliers. It also means the company is better placed to compete for new and up-for-renewal concession contracts. The long duration for most of its concessions provides fairly good visibility and implies limited risk of shortfalls in revenues and profits from unexpected concession terminations.

We expect Dufry's business risk profile to remain satisfactory as we anticipate modest improvement in its EBITDA margins after the WDF acquisition. Synergies expected from the deal are in line, and Dufry has seen a positive turnaround, especially in the past two quarters. We are, however, still applying a one-notch negative adjustment under our comparative rating analysis as we are yet to observe a track record of improved performance, measured by improved EBITDA and cash flow generation. We expect the group to improve its EBITDA margins to a historical level of about 13%-15% and generate strong free cash flow.

We expect Dufry to deleverage and therefore continue to forecast that our core leverage ratios of funds from operations (FFO) to debt and debt to EBITDA will remain in our significant category in 2017 and 2018.

We revised our recovery rating on Dufry's debt to '3' from '4' due to the WDF acquisition, as we believe that its emergence EBITDA would be higher than our previous forecast. Dufry has also repaid around CHF200 million of debt, which led to less debt outstanding at the point of default. We continue to value the company as a going concern, supported by its global leadership position in the travel retail market and significant geographic and portfolio diversity.
Other factors in our assessment:

- The recovery rating of '3' on Dufry's senior unsecured debt (comprising a CHF900 million RCF, €500 million notes due 2022, and €700 million notes due 2023) is based on the indicative recovery prospects of 55% under our EBITDA multiple valuation approach. We affirmed the issue rating at 'BB', in line with the corporate credit rating.
- The enterprise value to EBITDA multiple of 6.0x (against the anchor multiple of 5.0x for the retail and restaurant industry) reflects Dufry's global leadership position in the travel retail market, significant geographic and portfolio diversity, and increased exposure to the high growth emerging market after the WDF acquisition. The multiple is also in line with the company's satisfactory business risk profile and compared with other retail peers. Indicative recovery prospects improved to 55% (compared with 45% in February 2017).
- We assumed the 2022 default year in line with the five-year guideline for 'BB' rated companies. The next significant maturity is in 2019 when senior unsecured term facilities of CHF1.6 billion mature, which we assume would be rolled over on similar terms.

## Liquidity

We assess Dufry's liquidity as adequate. Our view is supported by our expectation that over the coming 12 months, liquidity sources should be around three times higher than uses. Our assessment is supported by Dufry's generally sound relationships with banks and its solid standing in credit markets.

Dufry's principal liquidity sources total around CHF1.7 billion-CHF1.8 billion for the next 12 months and include:
- Cash and equivalents of around CHF400 million-CHF450 million;
- Undrawn credit lines of over CHF500 million; and
- FFO of around CHF700 million.

Principal liquidity uses over the same period are over CHF400 million:
- Seasonal working capital swing of around CHF100 million;
- Working capital outflows of less than CHF50 million;
- Capital expenditures of CHF250 million-CHF300 million; and
- Dividend payments of over CHF50 million.

## Outlook

The stable outlook reflects our expectation that in the near term, Dufry's leverage metrics should improve on the back of higher cash flow generation and the smooth integration of WDF. We expect underlying revenue growth to be around 2%-4% and our adjusted EBITDA to improve modestly. This should result in discretionary cash flow material enough for the group to reduce leverage such that it remains between 3.0x and 4.0x on an adjusted basis. We would expect the company to have adequate headroom under its covenants at all times.

### Upside scenario

We could raise our ratings if company's operations perform better than we anticipate, leading to a modest improvement in EBITDA margins after the WDF acquisition, leading to significant deleveraging of its balance sheet. Specifically, we could raise our ratings should our adjusted FFO-to-debt ratio rise sustainably above 20% and free operating cash flow (FOCF) to debt to above 15%. We also expect a smooth integration of WDF with no disruptions of the operational business or unexpected restructuring needs. We believe Dufry's liquidity is adequate and estimate sufficient headroom under the company's financial covenants.

### Downside scenario

We could lower our ratings if deleveraging is slower than we currently anticipate, in particular, if FFO to debt remains below 20% and FOCF to debt below 10%. This may be the result of either a slower underlying business, for example, as a result of a general slowdown in air traffic, or disruptions for the integration process of WDF. The latter could also involve additional restructuring costs. Although not in our base case, the rating may also be lowered if management embarks on new, significant transformational acquisitions. We could also revise our outlook should liquidity become less than adequate, primarily because of tightening covenant headroom.

## Ratings Score Snapshot

Corporate Credit Rating: BB/Stable/--

Business risk: Satisfactory
- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bb+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

## Recovery Analysis

### Simulated default and valuation assumptions
- Year of default: 2022
- Jurisdiction: Switzerland

### Simplified waterfall
- EBITDA at emergence: CHF478 million
- Minimum capital expenditure at 2.5% of historical three-year annual average revenues, based on the company's average minimum capital expenditure requirement trend.
- Standard cyclicality adjustment of +5% for the retail and restaurants industry.
- Operational adjustment of 25% to reflect the inherent growth in EBITDA post-acquisition.
- Implied enterprise value multiple: 6.0x; an EBITDA multiple of 6.0x (versus an anchor multiple of 5x for the retail and restaurant industry) reflects Dufry's global leadership position in travel retail market, significant geographic and portfolio diversity, and its increased exposure to the high growth emerging market after the acquisition.
- Gross enterprise value at default: CHF2,856 million.
- Net enterprise value after administrative costs (5%): CHF 2,722 million.
- Priority claims: CHF 75 million.

- Estimated senior unsecured debt claims: CHF 4,602 million. (1)
- Value available for senior secured claims: CHF 2,647 million
- Recovery expectations: 50%-70% (rounded estimate: 55%)

(1) All debt amounts include six months' prepetition interest. Includes CHF900 million RCF assumed 85% drawn.

## Related Criteria

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 07, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Retail And Restaurants Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, 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

Ratings Affirmed

| | | |
|---|---|---|
| Dufry AG | | |
| Corporate Credit Rating | BB/Stable/-- | |

Ratings Affirmed; Recovery Rating Revised

| | | |
|---|---|---|
| Dufry Finance | | |
| Dufry International AG | | |
| Senior Unsecured | BB | BB |
| Recovery Rating | 3(55%) | 4(45%) |

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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.globalcreditportal.com and at spcapitaliq.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.