S&P Global
Ratings

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Summary:
Dufry AG

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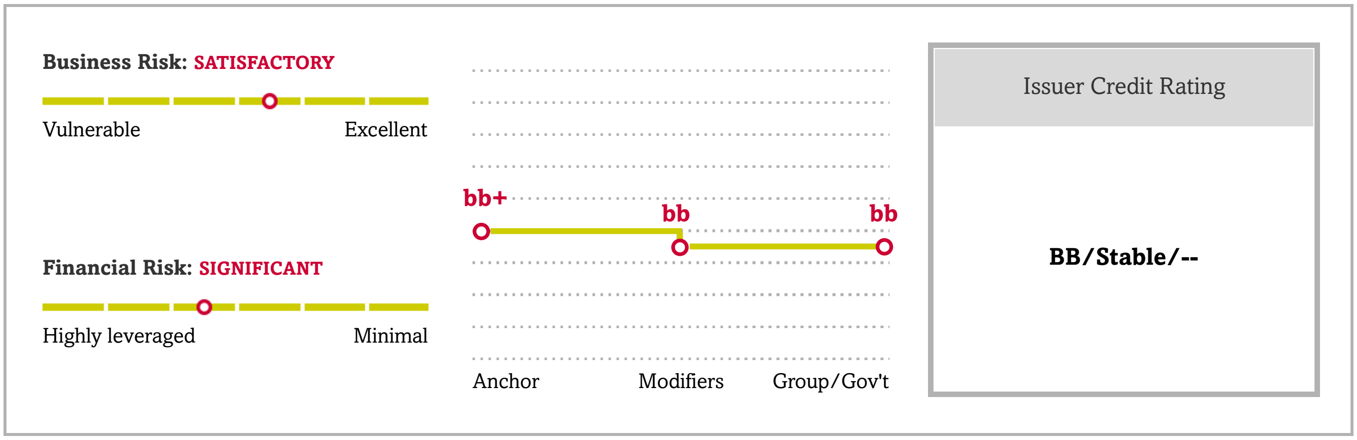

Credit Highlights

Scale and synergy benefits to help maintain stable EBITDA margin.

Since the acquisitions of Nuance Group and World Duty Free (WDF), Dufry has gained a strong global footprint of over 2,300 stores across 65 countries, giving it bargaining clout with suppliers as reflected in the improvement in EBITDA margins to about 12.5%-13.0% over 2018-2020.

Reducing leverage on the back of strong cash flow generation.

With improving EBITDA margin and limited capital expenditure (capex) requirement (Swiss franc [CHF]250 million to CHF300 million each year), we expect Dufry to generate CHF400 million-CHF 450 million in free operating cash flow (FOCF) each year. This would help the group improve its credit metrics and we expect leverage at around 3.2x-3.0x and funds from operations (FFO) to debt at 23%-26% over 2018-2019.

Impact of IFRS 16 likely to be credit neutral.

In the recent full-year numbers, management has indicated that adoption of International Financial Reporting Standard (IFRS) 16 from 2019 would result in recognition of about CHF4 billion-CHF5 billion as liabilities and additional yearly amortization expense of less than CHF1 billion. We do not adjust for such contracts under operating leases, which tends to understate Dufry's adjusted debt and EBITDA. We do not expect these to materially alter the group's credit profile as we now expect debt to EBITDA to be 3.0x and decreasing thereafter to about 2.7x and FFO to debt to be 23%-26% over 2018-2019.

Outlook: Stable

The stable outlook reflects our expectation that over the next 12 months, Dufry's leverage metrics should continue to improve on the back of higher cash flow generation as a result of smooth integration of WDF. We expect the group will maintain underlying revenue growth at 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 around 3.0x and reduces to 2.9x on an adjusted basis from 2019. We would expect the company to have adequate headroom under its covenants at all times.

Upside scenario

We could raise our ratings on Dufry if the group continues to successfully mitigate the competitive pressure on its margins and strengthen its adjusted credit metrics sustainably such that its EBITDA margins return to the historical 14%-15% level, alongside significant deleveraging of its balance sheet. We consider an adjusted FFO-to-debt ratio rise sustainably above 20% and free operating cash flow (FOCF) to debt to above 15% as commensurate with a higher rating, absent any material weakening of profitability or transformational acquisition. However, with the application of IFRS 16 from 2019, Dufry's adjusted debt and EBITDA absolute amounts are expected to change. However, with the application of IFRS 16 from 2019, we do not expect this to materially alter the group's credit profile. We would consider an upgrade only if we saw a fundamental sustainable improvement in business, which should be reflected in the group's profitability, cash generation, and payback measures.

Downside scenario

Although not likely in the next 12 months due to good operating performance, 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 slowdown in underlying business due to for example, a general slowdown in air traffic, political uncertainty, or disruptions faced by the travel retail sector. Although not in our base case, we could also lower the rating 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.

Our Base-Case Scenario

Assumptions

- World real GDP growth of 3.8% in 2018 and 3.6% in 2019, with international passenger traffic expected to increase by about 7% in 2018.
- Revenue growth of about 4%-5% per year over 2018-2019 supported by passenger growth and an increase in sales area/concessions.
- S&P Global Ratings-adjusted EBITDA margin to moderate and stabilize at around 12.5%-13.0% as restructuring expenses dwindle and synergies from the WDF acquisition start contributing to the group's profitability. We expect these to be partially offset by foreign exchange fluctuations.
- Strong reported FOCF of CHF400 million-CHF 450 million would help Dufry to reduce leverage more quickly. We expect debt to EBITDA to progressively reduce to 3.2x in 2018 and to around 2.7x in 2019, from 3.6x in 2017.
- Capex of about CHF250 million-CHF 300 million per year, focused on concession network expansion and refurbishments of existing concessions.
- Proceeds from the February 2018 IPO of Hudson of CHF667 million to be used for the CHF400 million share buyback program and CHF200 million dividends to shareholders. We anticipate that management would continue distributing about CHF200 million of dividends each year from 2019.
- Small bolt-on acquisitions of CHF50 million-CHF100 million each year.

Key Metrics

	2017A	2018E	2019E
Adjusted EBITDA margin (%)	12.9	12-13	12-13
Debt to EBITDA (x)	3.6	3.0–3.3	2.7–2.9
FFO to debt (%)	20.8	22-25	24-28
FOCF to debt (%)	6	11-13	12-14

A--Actual. E--Estimate. FFO--Funds from operations. FOCF--Free operating cash flow.

Base-case projections

Credit ratio improvements should continue over the next 12–24 months.

With no material transformational acquisition anticipated and strong FOCF generation of about CHF400 million-CHF450 million, we expect S&P Global Ratings-adjusted debt to EBITDA to improve to about 3.0x-3.3x in 2018 and 2.7x-2.9x in 2019, from 3.6x in 2017.

Unexpected distributions to shareholders could significantly increase adjusted debt.
While management plans to distribute CHF200 million of dividends in 2019, any material deviation either via dividends or share buybacks could materially impact adjusted debt and subsequently credit ratios.

Company Description

Switzerland-based Dufry is a leader in travel retail with a global airport retail market share of around 20%. It has a footprint of more than 2,300 shops in 65 countries throughout the U.S., Europe, the Middle East, Asia, South America, Africa, and Australia. Dufry operates both duty-free and duty-paid segments of travel retail through channels such as airports; border downtown and hotel shops; railway stations; and cruise liners and seaports. Consumer products such as perfumes and cosmetics, wine and spirits, luxury goods, tobacco products, and electronics and confectionery are sold through these outlets. In 2017, Dufry reported total turnover of CHF8.4 billion and EBITDA of CHF1.0 billion.

Dufry is listed on the Swiss Stock Exchange in Zurich. As of Nov. 30, 2018, major investors include groups Travel Retail Investments (16.5%), Richemont (7.5%), Qatar Holding LLC (6.7%), Franklin Resources (5.1%), GIC (3.1%) and free float (61.2%).

Business Risk: Satisfactory

In a highly fragmented and niche market of travel retail, Dufry is considered a market leader reflecting a global market share of about 20%--more than twice that of its nearest competitor Lagardere Group, with an 8% global travel retail market share. Dufry is present across both duty-free and duty-paid travel shopping, which account for 62% and 38% of its 2017 revenues, respectively. Though the group has a wide footprint of over 2,300 concessions, given its presence in travel retail, it has a relatively short window to make a strong impression on customers and close a sale, which results in a low level of customer stickiness compared with other segments.

While the group's stores are present in prominent high footfall locations across major airports, concessions that generate about 8%-10% of its annual revenues are up for renewals each year, which puts pressure on Dufry to win these concessions. Often, these concessions are re-negotiated at higher rents than earlier contracts, resulting in increasing costs for the group. However, its strong brand identity and large scale give Dufry an advantage while competing for new and up-for-renewal concessions. That said, the long tenure of concessions also provides fairly good visibility and implies limited risk of shortfall in revenues and profits from unexpected concession terminations.

Dufry's retail business is underpinned by factors that influence the global travel industry, as over 90% of its concessions are present in airports and the rest in cruise lines and seaports, railway stations, border town and hotel shops etc. As such, any major external events such as terrorist attacks, changes in airline passenger traffic, or subdued spending on travel and leisure activities would directly hit operations. However, with a presence in major airports across the world, Dufry is poised to take advantage of any changes in passenger traffic flows. Its broad geographic presence largely helps the group mitigate the impact of external shocks.

Group gross margins have largely been stable over the years, at between 58% and 60%. With its increased scale, the group has negotiated better purchasing terms with its suppliers, as demonstrated by its gross margin improving to about 60% for the rolling 12 months ending September 2018, compared with 59.3% a year ago. In the past, its acquisitions of Nuance Group in 2014 and WDF in 2015 resulted in its S&P Global Ratings-adjusted EBITDA margin diluting to about 10.8% in 2015 from a peak of 14.4% in 2012 before improving to about 12.9% in 2017. With the expected reduction in restructuring and integration costs and benefits of synergies and increased scale of operations, we expect the EBITDA margin to improve to about 13.0% in 2018 and to about 13.5% in 2019. However, this primarily depends on the group not undertaking any margin-dilutive acquisitions during this period.

Peer comparison

We compare Dufry to leisure industry peers--such as TUI AG and Expedia Group Inc.--as well as peers in the non-food retail industry--such as Fnac Darty SA and Sally Beauty Holdings, Inc. Both Dufry and Expedia have similar business risk profiles as they are leading players in their respective businesses, with a broad geographic spread. Their leading positions provide these companies purchasing scale and help generate higher-than-industry-average EBITDA margins. However, lower adjusted debt at Expedia reflects its better credit metrics and current rating.

TUI, Fnac, and Sally Beauty have a weaker business risk assessment than Dufry due to their geographic concentration and focus on narrow business lines. They are all also facing strong competitive pressures from industry disruptors, especially online travel agencies, in the case of TUI, and pure-play online retailers in case of Fnac and Sally Beauty resulting in margin pressures on these companies. Sally Beauty's adjusted EBITDA margin is higher than Dufry because of inclusion of operating lease adjustment.

While almost all of Dufry's peers have operating leases as a component of their adjusted debt. In the past we did not adjust for such contracts under operating leases. This has largely understated Dufry's adjusted debt and EBITDA.

Financial Risk: Significant

In the past, Dufry undertook several large debt-funded acquisitions that boosted inorganic growth for the group and levered up the balance sheet. Its adjusted debt to EBITDA increased from 3.6x in 2013 to about 6.2x in 2015. Since its last acquisition of WDF in 2015, management has shifted its focus to integrating acquired businesses and improving its cash flows, which has resulted in its debt to EBITDA improving to 3.6x by end-2017.

As the acquisition synergies start contributing to group EBITDA along with gains from increased purchasing scale, we expect adjusted EBITDA margin to stabilize at about 12.5%-13.0% over 2018-2019. We expect the group to incur annual capex of about CHF250 million-CHF300 million, which will primarily be focused expansion through new concessions and refurbishments of existing ones.

We expect group credit metrics to progressively improve on the back of strong free operating cash flow generation of about CHF400 million-CHF450 million each year in 2018-2019. During 2018, management used proceeds of CHF667 million from IPO of its American subsidiary Hudson Group to buy back CHF400 million of shares and pay a special dividend of CHF200 million to its shareholders.

Liquidity: Adequate

We assess Dufry's liquidity as adequate. Our view is supported by our expectation that over the coming 12 months, liquidity sources should be about 1.5x uses. Our assessment is supported by Dufry's generally sound relationships with banks and its solid standing in credit markets. We estimate that Dufry would have comfortable headroom under its financial covenants over the next 12 months.

Principal Liquidity Sources	Principal Liquidity Uses
Dufry's principal liquidity sources total around CHF2.0 billion for the next 12 months and include: • Cash and equivalents of around CHF525 million; • Undrawn credit lines of over CHF700 million; and • FFO of around CHF750 million-CHF 800 million.	Dufry's principal liquidity uses total around CHF1.3 billion for the next 12 months and include: • Debt maturities of around CHF600 million; • Working capital outflows including seasonal working capital swing of about CHF 150 million-CHF 200 million; • Capex of about CHF-250 million-CHF-300 million. • Bolt-on acquisitions of about CHF100 million. • Dividends of about CHF200 million-CHF 220 million.

Covenant Analysis

The CHF 1.3 billion revolving credit facility (RCF) and the term loan requires the company to maintain a maximum leverage of 4.0x and minimum interest coverage of 3.5x. We expect the group to maintain comfortable covenant headroom over the next 12 months.

Other Credit Considerations

Dufry is highly exposed to emerging markets and subsequently to foreign exchange volatility related to these countries' currencies. Also, given the strong cash flow generation, acquisitive growth strategy, and shareholder-friendly past, we believe that unexpected releveraging or use of cash is possible. We therefore apply a one-notch downward adjustment to the anchor under our comparable rating analysis modifier to derive the long-term rating.

Ratings Score Snapshot

Issuer 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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Related Criteria

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 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

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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