Research Update:

Travel Retailer Dufry 'B+' Rating Removed From CreditWatch Negative And Affirmed; Outlook Negative

March 30, 2021

Rating Action Overview

- Switzerland-based travel retailer Dufry AG has recently placed a new Swiss franc (CHF) 500 million convertible bonds issue, boosting liquidity amid continued travel disruption and global COVID-19 vaccination efforts.
- We consider Dufry's recent capital market transactions and the trading level of its financial instruments to be indicative of the favorable capital market conditions for refinancing the group's €1.6 billion equivalent facilities, due 2021 and 2022, ahead of maturity.
- We therefore affirmed our 'B+' long-term issuer credit rating on Dufry and its senior unsecured debt and removed all ratings from CreditWatch with negative implications, where they were placed on March 18, 2020.
- The negative outlook indicates the risk of slower-than-anticipated travel retail recovery, which, despite Dufry having sustainably reduced its cost base, could stall improvement in the group's credit metrics over the next 12-24 months, namely S&P Global Ratings-adjusted funds from operations (FFO) to debt falling short of 10% or persistently negative adjusted free operating cash flow (FOCF) after full concession fee payments.

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Rating Action Rationale

Dufry repeatedly tapped debt and equity capital markets since the start of the pandemic, and we view current monetary conditions as supportive for the refinancing of the 2022 maturities and extending covenant holiday beyond June 2021. Dufry's closest bullet maturity is Nov. 3, 2022, when the $700 million and €500 million term loans are due, together comprising CHF1.1 billion equivalent as of Dec. 31, 2020. The CHF390 million facility due May 2021 is fully undrawn and can be extended to May 2022. We understand that the group is in discussions with the bank syndicate to address the refinancing and extend the covenant holiday which expires after June 30, 2021. We consider the successful placement of the CHF 500 million convertible bonds and a total of over CHF600 million bank debt and CHF1.4 billion equity raised since the beginning of the pandemic as indicative of the group's sound standing in capital markets. We therefore anticipate that amid current benign monetary conditions, Dufry should be able to refinance its 2022 maturities well ahead of time.

If not amended, Dufry's covenants kick in from Sept. 30, 2021. Although not tested until Sept. 30, 2021, Dufry's bank facilities contain two maintenance financial covenants: leverage at maximum 5x net debt to company-adjusted operating cash flow (AOCF)--due to revert to 4.5x from March 31, 2022-- and interest coverage at minimum 3x AOCF to interest expense. Our base case estimates the AOCF will still fall short of the covenant threshold level in second-half 2021. While we do not expect banks to accelerate the group's capital structure repayment, we believe this puts pressure on Dufry to either extend the covenant holiday or to address the refinancing of its 2022 maturities in the next few months. In the meantime, we anticipate that the group will comfortably meet the requirement to maintain at least a CHF300 million liquidity cushion, while on a covenant holiday.

Tightly managed costs and cash spending will allow the group to improve its credit metrics sooner than top line and restore positive FOCF after full concession payments by end-2022. We forecast that the group's revenue will trail the evolution of passenger traffic with considerable growth likely from fourth-quarter 2021 and will still be about 20% lower than the 2019 level by the end of 2022. This follows the 70% year-over-year revenue decline in 2020 in constant currency, as compared with the 66% plunge in global passenger traffic as per the International Air Transport Association. We estimate that Dufry will take until 2024 to return to 2019's revenue level. Since March 2020, the group has introduced a series of initiatives to support earnings and cash flow and agreed a number of measures with its suppliers and concession partners. As part of its reorganization, Dufry switched to centralized management of operating expenses and capital expenditure (capex), and will control overall spending to match the top-line recovery. The durable benefits arising from this include a reduction in personnel and general expenses, change in terms of some of the concession contracts, and focused capex budget. The group intends to keep dividends suspended until cash flow generation reliably resumes. We estimate that FOCF after full concession fee payments will be about CHF200 million–CHF400 million negative in 2021 (after CHF1.0 billion negative in 2020), changing to CHF150 million-CHF250 million positive in 2022, and will continue expanding thereafter. We forecast adjusted EBITDA of about CHF550 million-CHF600 million in 2021 rising to CHF1.5 billion-CHF1.6 billion in 2022. This will support adjusted funds from operations (FFO) to debt recovering to 12%-14% by end 2022, compared with negligible 1%-2% in 2020 and 2021, and still below the 2019 level of 23%.

International travel restrictions will continue to hinder air passenger traffic and travel retail recovery. Our estimate for global traffic and revenue in 2021 is unchanged at 40%-60% of 2019 levels. The global average is boosted by regions where domestic traffic makes up a greater share of the total than in Europe, or where the pandemic is less severe and restrictions less strict. The impact on domestic traffic, while severe, has been far less than that on international travel. In 2022, we still expect European and global traffic to recover to 70%-80% of 2019 levels, rising to 2019 levels by 2024 (see "As COVID-19 Cases Increase, Global Air Traffic Recovery Slows," published on Nov. 12, 2020). In the longer term, growth in the sector is likely to be slower than the 4%-5% per year we saw over the past couple of decades. The pandemic has accelerated moves toward working from home and the use of digital technology, which could have a lasting effect on demand for business travel. Companies are also likely to rethink their cost-saving efforts to support a green agenda, further depressing demand.

We anticipate that Dufry will maintain its position as one of the strongest travel retail operators globally, but consider the industry to be susceptible to a permanent loss of earnings in the pandemic's aftermath. Historically, travel retail recovered faster than air passenger traffic following the event-driven temporary disruptions to air travel; for instance, the terror attacks of Sept. 11, 2001, or the SARS epidemic of 2003. With its broad geographic footprint in 65 countries across six continents including higher-growth emerging markets, considerable diversity of the product mix, and recently launched store and e-commerce operations in Hainan (China), Dufry is poised to benefit from such recovery. However, we see a risk that consumer preferences and shopping behavior may change more profoundly as a result of the COVID-19 pandemic, due to disposable income squeezed by a global recession in 2020 and the acceleration of underlying retail industry trends such as e-commerce gaining an irreversibly higher share of wallet. This could delay earnings recovery for the travel retail industry as a whole and challenge its ability to achieve historical levels of profitability. So far, as for many of its competitors, e-commerce has not been a strategic priority for Dufry, and should the group decide to develop a meaningful online presence in multiple markets it would require significant investment, posing execution risk and delaying deleveraging. Moreover, Dufry's largest product group--beauty and perfumery products--is subject to discretionary demand and is one of the most exposed to the risk of the switch to e-commerce. Perfumes and cosmetics account for about one-third of the group's turnover, more than 10 percentage points higher than the next-largest group, and if the turnover or profitability were to lag historical patterns, it could hit the group's earnings disproportionally. That said, this is not part of our central forecast at the moment, and we maintain our view of Dufry's business model as one of the more robust among European retailers, reflecting its leadership position in airport retail (20% global market share pre-pandemic), its diversity, and its flexibility in adjusting cost base and preserving cash flow.

The air passenger traffic and travel retail path to recovery depends on the pandemic's evolution and its economic effects. S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The negative outlook indicates risks of slower-than-anticipated travel retail recovery, which could stall the improvement in the group's credit metrics over the next 12-24 months, notwithstanding the sustainable costs reduction Dufry has already implemented. At the same time, we believe that lax monetary policies implemented by central banks have led to favorable capital market condition, which should allow the group to sufficiently extend its covenant holidays currently expiring after June 30, 2021, and refinance its facilities due 2021 and 2022 well ahead of maturity dates.

Downside scenario

We could downgrade Dufry if:

- The group failed to address its 2022 maturities and the covenant holiday expiration in June 2021 well ahead of time;
- The prospects of raising adjusted FFO to debt to 10% seemed unlikely in the next 12-24 months;
- FOCF after minimum annual guarantees (MAG) payments remained persistently negative;
- The group's liquidity or covenant headroom were to weaken; or
- Passenger spending at airports failed to recover swiftly once air traffic resumed, thereby bringing into question the long-term resilience of the travel retail business.

This could occur if the pandemic-related economic weakness and travel disruption extended longer than we anticipate, or--combined with consumers changing their shopping habits--hit the retail travel industry harder than we estimate.

Upside scenario

We could revise the outlook to stable over the next 12-24 months if air passenger traffic and travel retail saw consistent recovery progress, allowing the group to drastically improve its earnings such that:

- Adjusted FFO to debt trends to 10% by end of 2022;
- Adjusted FOCF is consistently positive and on track to exceed the concession MAGs by end of 2022; and
- Dufry is on track to restore its profitability, cash generation, and credit metrics to historical levels over the medium term.

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 in both the 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, wines and spirits, luxury goods, tobacco products, and electronics and confectionery are sold through these outlets. In 2020, Dufry reported total turnover of CHF2.6 billion and adjusted EBITDA of CHF334 million (CHF8.8 billion and CHF2.2 billion, respectively, in 2019).

Dufry is listed on the Swiss Stock Exchange in Zurich. As of March 29, 2021, its market capitalization was CHF4.9 billion.

Our Base-Case Scenario

- Global air passenger numbers of 40%-60% of 2019 level in 2021, 70%-80% of 2019 in 2022, rising to 2019 levels by 2024.
- We expect domestic and short-haul air travel to recover more quickly than intercontinental traffic, given the severe border restrictions hindering intercontinental traffic.
- We expect the group's revenue to decline at a similar rate to passenger traffic by up to 50% from 2019's level in 2021, and remain about 20% below the 2019 base in 2022.
- Revenue of about CHF4.0 billion-CHF4.7 billion in 2021 and CHF6.8 billion-CHF7.2 billion in 2022, assuming that mass immunizations proceed as expected, and continued recovery in both passenger traffic and travel retail.
- S&P Global Ratings-adjusted EBITDA margin of 13%-15% in 2021 followed by 21%-23% in 2022, as the group expands its top line and benefits from its cost-saving measures.
- Capex of about CHF130 million in 2021 and CHF200 million-CHF220 million in 2022, compared with CHF119 million in 2020 and CHF253 million in 2019, focused on projects that cannot be delayed without long-term detrimental effects on earnings.
- No dividends over the forecast horizon.

Based on the assumptions, we forecast the following key metrics:

Dufry AG--Key Metrics

	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021e	2022f	2023f
(Mil. CHF)					
Revenue	8,849	2,561	4,000-4,700	6,800-7,200	7,500-7,800
Revenue versus 2019 (%)			~50	~80	~85-90
EBITDA	2,234	334	550-600	1,500-1,600	1,700-1,850
EBITDA margin (%)	25	13	13-15	21-23	22-25
AOCF	960	(406)	(100)-(120)	500-600	550-750
FOCF after full concession payments	388	(994)	(300)-(400)	150-200	175-300
Debt	7,704	8,889	9,000-9,300	8,500-9,000	8,200-8,800
Debt to EBITDA (x)	3.4	26.6	>10	5.0-6.0	4.5-5.0
FFO to debt (%)	22.9	1.4	1.5-5.0	10.0-15.0	12.0-18.0

Note: All figures adjusted by S&P Global Ratings except AOCF. Debt includes CHF5.4 billion International Financial Reporting Standard 16 liabilities. AOCF--Adjusted operating cash flow as per Dufry's definition. a--Actual. CHF--Swiss franc. e--Estimate. f--Forecast. FFO--Funds from operations. FOCF--Free operating cash flow.

Liquidity

Our adequate assessment reflects our estimate that Dufry will keep the required CHF300 million liquidity cushion for monthly tests until September 2021. However, we consider that the group could breach at least one of its maintenance covenants applicable from September 2021 unless its cash generation substantially improves. We forecast that, over the coming 12 months, Dufry's liquidity sources should exceed uses by about 2.8x. Our assessment is supported by Dufry's solid standing in the credit markets and generally sound relationships with banks. We think that the group's well-established relationship with the bank syndicate will allow it to agree a temporary covenant relief in good time, or otherwise renegotiate the covenant schedule.

We anticipate the following principal liquidity sources over the 12 months to Dec. 31, 2021:

- Cash on balance sheet of about CHF324 million net of estimated CHF36 million, held by subsidiaries operating in countries with exchange controls or other legal restrictions on money transfer;
- About CHF1.0 billion availability under the committed €1.3 billion revolving credit facility (RCF); and
- About CHF500 million proceeds from the convertible notes issue.

We anticipate the following principal liquidity uses over the same period:

- Forecast cash FFO after MAG payments of about CHF350 million-CHF450 million negative;
- Working capital requirements of up to CHF120 million, largely seasonal;
- Capex of about CHF130 million.

Issue Ratings - Recovery Analysis

Key analytical factors

- We rate the senior unsecured notes issued by Dufry One BV, the fully owned financial subsidiary of Dufry, at 'B+', in line with the issuer credit rating on Dufry.
- The notes comprise the €800 million 2.5% issue due in October 2024 and a €750 million 2.0% issue due in February 2027, and are guaranteed by the parent, Dufry AG. The recovery rating on both instruments is '3' indicating our expectation of meaningful recovery (50%-70%; rounded estimate: 50%) in a hypothetical default.
- The recovery rating is supported by the limited prior ranking liabilities but constrained by the significant amount of unsecured debt. Our recovery expectation for the unsecured debt is around 50%.
- In our hypothetical default scenario, we assume negative regulatory changes and reduced airport travel following a natural disaster or terrorist event, combined with an economic recession in Europe.
- We value the business as a going concern given Dufry's leading market position in the duty-free travel retail market and its diverse global footprint.

Simulated default assumptions

- Year of default: 2025
- Jurisdiction: Switzerland

Simplified waterfall

- EBITDA at emergence: CHF490 million (we apply operational adjustment reflecting significant geographic and portfolio diversity and cost flexibility)
- Implied enterprise value multiple: 6.0x
- Gross enterprise value at default: CHF2.9 billion
- Net enterprise value after administrative costs (5%): CHF2.8 billion
- Estimated priority claims: CHF197 million
- Estimated senior unsecured claim: CHF4.9 billion *
- Value available for senior secured claims: CHF2.6 billion
- Recovery rating: '3' (50%-70%; rounded estimate: 50%)

*All debt amounts include six months of prepetition interest.

Includes €1.3 billion RCF assumed to be drawn at 85% and CHF390 million facility assumed to be refinanced and drawn at 85%.

Ratings Score Snapshot

Issuer Credit Rating: B+/Negative/--

Business risk: Satisfactory

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

Financial risk: Highly Leveraged

- Cash flow/Leverage: Highly Leveraged

Anchor: b+

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 Ratings Analysis: Neutral (No impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Europe's 2021 Air Passenger Traffic Likely To Stall At 30%-50% Of 2019 Level, Feb. 18, 2021
- Industry Top Trends 2021: Retail and Restaurants, Dec. 10, 2020
- SLIDES: EMEA Retail & Restaurants: Industry Overview, Credit Trends, And Outlook, Oct. 16, 2020
- Travel Retailer Dufry Downgraded To 'B+' On Longer Than Expected Global Travel Disruption; Still On CreditWatch Negative, Oct. 1, 2020

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Dufry AG		
Issuer Credit Rating	B+/Negative/--	B+/Watch Neg/--
Dufry One B.V.		
Senior Unsecured	B+	B+/Watch Neg
Recovery Rating	3(50%)	3(50%)

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. A description of each of

S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.