

Research Update:

Travel Retailer Dufry 'B+' Ratings On CreditWatch Positive On Autogrill Acquisition Announcement

July 20, 2022

Rating Action Overview

- Switzerland-based travel retailer Dufry AG has announced the acquisition of a 50.3% majority stake in Italy-based travel concession catering provider Autogrill SpA from its owner, Edizione, via a share swap transaction. The acquisition is expected to complete in the first quarter (Q1) of 2023, subject to regulatory requirements.
- Dufry expects to complete the two-step transaction by Q2 2023, which would also require Dufry to launch the mandatory tender offer (MTO) for the remaining 49.7% shares in Autogrill, offering the shareholders to be paid either in Dufry AG shares or in cash. Dufry will finance the cash consideration with an as-yet-undecided mix of debt and equity.
- We think that a sustainable improvement in Dufry's credit metrics will depend on the final capital structure, the trading performance of the combined group, and the path to recovery for air travel.
- We therefore placed our 'B+' long-term issuer credit rating on Dufry and on its senior unsecured debt on CreditWatch with positive implications.
- The CreditWatch placement indicates that we could upgrade Dufry on completion of transaction if, over the next 12-24 months, we expect a sustainable improvement in credit metrics on a combined basis. For an upgrade we would look for adjusted funds from operations (FFO) to debt exceeding 12%, debt to EBITDA less than 5x, and positive free operating cash flow (FOCF) after full concession fee payments, with liquidity at least adequate.

PRIMARY CREDIT ANALYST

Abigail Klimovich, CFA
London
+ 44 20 7176 3554
abigail.klimovich
@spglobal.com

SECONDARY CONTACTS

Raam Ratnam, CFA, CPA
London
+ 44 20 7176 7462
raam.ratnam
@spglobal.com

Mickael Vidal
Paris
+ 33 14 420 6658
mickael.vidal
@spglobal.com

Rating Action Rationale

The proposed transaction has a sound business rationale but there are some risks, in our opinion. The near-term integration of the ambitiously sized acquisition, related execution risks, and a potential for raising additional debt as part of funding the cash component could stall the group's deleveraging at a time of continued volatility and disruption in the travel retail industry.

The acquisition will likely enhance Dufry's economies of scale in the long-term but add constraints to the short-term performance. Combined, Dufry and Autogrill will be able to offer a more comprehensive commercial package in negotiations with airport authorities and benefit from significantly greater scale in their relationship with shared suppliers (mostly of not-for-resale goods and services). Dufry will gain through adding complementary site locations across the U.S. and a sizeable food service proposition to its product mix, thereby reducing cyclicity, as well as expanding in the domestic air travel segment, particularly in the U.S., which is currently experiencing the strongest recovery in air passenger traffic. On the other hand, the transaction would not reduce the group's exposure to the travel retail industry, which is generally highly susceptible to the event risk and is still recovering from the extreme stress to its earnings and cash flows hit by the COVID-19 pandemic. Recently heightened prospects of discretionary spending volatility could further exacerbate the uncertainty in achieving near-term earnings and cash flow expansion targets for travel retailers.

Dufry's positive track record in integrating acquisitions and in raising capital across varied venues supports the rating. We acknowledge execution risks related to the ambitious acquisition of a company half Dufry's size, but we note that the management guidance does not rely on substantial earnings uplift from synergies. The Swiss franc (CHF) 85 million synergies and CHF100 million one-off costs are relatively low compared to the size of the transaction. We also take into account Dufry's extensive track record of acquisitive growth and successful integration of large acquisitions, particularly that of World Duty Free from Edizione in 2015. Dufry also had a stronger-than-anticipated performance in 2021 and has shown conservative and proactive management of its capital structure and liquidity through the pandemic.

Top-line expansion in travel retail relies on a recovery in air travel, which we still forecast to only approach 2019 levels by the end of 2024. We have recently revised up our European airline forecast for 2022 to 60%-70% of 2019 levels (see "European Aviation Is Set For A Strong Summer Before Brewing Macro Headwinds Blow In," published on June 8, 2022) from 50%-65%, but a full return to 2019 levels is still remote. Moreover, while the pent-up demand is propelling summer demand for flights, the recovery momentum is susceptible to unfavorable macro fundamentals and could lose momentum towards the end of 2022. As passenger traffic recovers across all regions and revenue generation evens out across the locations, we consider that on a pro forma combined basis, Dufry will achieve annual revenues of about CHF10.7 billion–CHF11.5 billion in 2022 and CHF12.0 billion–CHF13.0 billion in 2023, compared with our estimate of CHF7.0 billion in 2021.

Although Autogrill's business is less cyclical, its operating profitability is lower than Dufry's, which on a combined basis is likely to compound the pressure on operating margins Dufry faces over the next 12-24 months. In our base case, we forecast the group's top line to recover to about three-quarters of the 2019 level by end-2022. At the same time, we note the potential pressure on margins and, particularly, cash flows from rapidly rising energy and personnel costs and phasing-out of the reliefs on concession fee payments granted during the height of the pandemic disruption. Dufry's S&P Global Ratings-adjusted EBITDA margin was 32% in 2021 on a stand-alone basis and 25% on a pro forma combined basis, which we forecast to decline in our base case to 19%-20% in 2022 and only moderately expand to about 21% by end-2024.

Even if the cash consideration payable to the minority shareholders of Autogrill is fully debt-financed, the improvement in credit metrics would still be possible due to the change in geographical footprint and product mix. In our base case, the credit ratios would moderately

improve compared with our previous forecast for Dufry stand-alone even if it fully funds the cash consideration with debt. On a pro forma combined basis, in 2021 adjusted debt would have been CHF10.4 billion, debt to EBITDA 5.8x and FFO to debt 13% (for Dufry stand-alone adjusted debt was CHF7.0 billion, debt to EBITDA 5.6x, and FFO to debt 15%). On a pro forma basis, we forecast a decline in leverage to about 4x and FFO to debt of 15%-19% in 2023. At the same time, we think the group's ability to generate free operating cash flow sufficient to comfortably cover its concession payments in full will be constrained over the next two years. Our estimate of FOCF after leases is neutral to positive CHF50 million in 2023.

CreditWatch

The CreditWatch placement indicates that we could upgrade Dufry on completion of the transaction. We will review the ratings and could resolve the CreditWatch after the first step of the transaction is completed, both companies release the 2022 annual results, and the final capital structure is confirmed.

In order to resolve the CreditWatch, we will assess the trading conditions and the operating performance prospects for both companies, the sustainability of Dufry's credit metrics on a combined basis, and its liquidity.

We consider S&P Global Ratings-adjusted FFO to debt of over 12%, debt to EBITDA of less than 5x, and sizeable positive FOCF after full concession fee payments as commensurate with a higher rating. An upgrade would also rely on our assessment on the combined group's adequate liquidity and comfortable covenant headroom.

Any positive rating action will be predicated on Dufry maintaining a consistent financial policy supportive of the stronger performance and credit ratios.

Company Description

Switzerland-based Dufry is a leader in travel retail with a global airport retail market share of around 20% (pre-pandemic). It has a footprint of more than 2,300 shops in 66 countries throughout the U.S., EMEA, 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 2021, Dufry reported total turnover of CHF3.9 billion and adjusted EBITDA of CHF1.2 billion (CHF8.8 billion and CHF2.2 billion, respectively, in 2019).

Autogrill is a provider of food and beverage concession catering services for travelers. It has a presence in more than 30 countries, with approximately 3,300 points of sale and a network of about 830 locations.

North America contributed 48% of sales in 2021 (50% in 2019) and Europe contributed 44% (36% in 2019), with the remainder coming from other international operations (14% in 2019). In 2021, airports contributed 57% of revenue (67% in 2019), motorways 36% (25% in 2019), and other channels such as railway stations 7% (8% in 2019). In 2021, Autogrill reported total turnover of €3.1 billion and adjusted EBITDA of €515 million.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, 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
- 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
- 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

- European Aviation Is Set For A Strong Summer Before Brewing Macro Headwinds Blow In, June 8, 2022

Ratings List

Ratings Affirmed; CreditWatch Action

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

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