Research Update:

French Automaker Renault Outlook Revised To Stable On Increased Operating Resilience; 'BB+/B' Ratings Affirmed

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PRIMARY CREDIT ANALYST

Vittoria Ferraris
Milan
+ 390272111207
vittoria.ferraris
@spglobal.com

SECONDARY CONTACT

Lukas Paul
Frankfurt
+ 49 693 399 9132
lukas.paul
@spglobal.com

ADDITIONAL CONTACT

Corporate and IFR EMEA
RatingsCorpIFREMEA
@spglobal.com

Rating Action Overview

- Renault overperformed its guidance and our forecast of the profitability of its auto operations and free operating cash flows (FOCF) in 2022, despite the disruptive impact of chip shortages across the auto industry and the termination of its key operations in Russia after the Russia-Ukraine war began.
- We think this, supported by Renault's measures to reduce the cash breakeven per unit produced, other cost savings, and proactive management of its model mix and pricing, will enable Renault to maintain improved profitability and cash flow amid more difficult industry conditions in 2023.
- We are therefore revising our outlook on Renault to stable from negative while affirming our 'BB+' long-term and 'B' short-term ratings.
- The stable outlook reflects our expectation that Renault can withstand a mild recession in Europe while maintaining adjusted EBITDA margin above 6% and positive FOCF to sales.

Rating Action Rationale

For the second year in a row, Renault posted solid operating performance in a market battered by supply shortages. As expected, the termination of Renault's Russian operations had a limited impact on the upward trajectory of its credit profile. We view the group's restructuring as completed, with Renault ready to face the challenge of establishing itself as a cost competitive leader of electric vehicles (EV) in Europe. In Europe, Renault competes with larger competitors like Volkswagen (VW), Stellantis, Hyundai, and, most likely, new Chinese entrants.

Renault has beat its 2022 guidance and outperformed our base case. Following the publication of Renault's 2022 results, we have reviewed our base case for the group. We now expect Renault to post adjusted EBITDA margins in the 7.0%-8.0% range compared with 6.3% in 2021 and our previous projection of about 7% for 2022. We also estimate adjusted FOCF at about €1 billion,

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versus negative FOCF in 2021 and our previous expectation this year of €300 million-€500 million. Changes in the product and price mix were primary drivers of operating performance last year. The pricing environment will be less favorable in 2023-2024. We consider that Renault's large order backlog at year-end 2022 should offset declining demand amid a mild recession in Europe for most of this year, while its operations could be more exposed in 2024. There was a progressive increase of sales--in the C segment and higher--for the Renault brand to 39% of total sales in 2022 and we believe there is additional room for improvement. This should continue to support revenue in 2023, thanks to the contribution of Megane E-Tech and Austral for the whole year and the revision of the Clio model. Cost pressure from energy, logistics, wages, and selected raw materials (mainly EV related) could remain high and pressure margins in the mature and highly regulated European market over the next two years. It is unclear at this stage whether the deconsolidation of Renault's powertrain business into its joint venture with Geely, planned for midyear 2023, will have a material impact on the auto segment's operating margins, this year or next.

Renault's EV strategy will need diligent execution to build a robust market position amid tough competition. EV sales in the market were fairly stable in 2022 versus previous years, according to the EV Volumes database. Bestsellers among the battery electric (BEV) and plug-in hybrid electric (PHEV) vehicles include SUV A Dacia Spring (the cheapest EV in Europe), Car B ZOE, Car C Megane E-Tech (competing with VW's ID.3), and Car A Twingo. There will be no major BEV or PHEV launches in 2023. On a global scale, Renault is behind VW, Stellantis, and Volvo Cars in the transition to electric mobility. Its acceleration will come with key model launches like that of R5 (replacing the ZOE), R4, and Scenic only in 2024 under Ampère, the group's forthcoming EV and software company. Ampère's capacity to establish a solid position in the competitive and highly regulated European EV market is key to its credit profile. We therefore factor in execution risks we associate with this strategic development, leading to a negative adjustment under our comparable ratings analysis.

Revival of the Renault-Nissan Alliance provides opportunities outside Europe and greater financial flexibility for Renault. The alliance's agreement confirms that cooperation between the two automakers will remain confined to specific projects in Latin America, India, and Europe. In our view, this ends the uncertainty regarding the alliance in recent years and clarifies that the groups' strategies will be independent to a large extent. We already take this into account in our rating analysis. Under the proposed settlement, the alliance's cross shareholding will be limited to 15% and additional Nissan shares (28.4%) will be transferred to a French trust where the voting rights will be neutralized but the economic rights will remain in Renault's control. This is likely to result in stronger financial flexibility at Renault. Looking ahead, Renault's creditworthiness will depend heavily on the execution of its ambitious business plan, which involves, among other things, the IPO of Ampère. We understand Ampère is fully funded but that proceeds from a potential IPO would allow the company to accelerate its development. The opportunity to sell Nissan shares thus provides additional financial headroom to Renault's plan. At current equity prices, these shares represent €3.5 billion-€4.0 billion, or the equivalent of about one-third of the gross debt allocated to Renault's industrial operations. Considering the complexity of Renault's industrial plan and the emerging economic and market risks, we expect the group will aim to optimize capital allocation. We add a discounted value of Nissan shares transferred to the Trust to Renault's available cash.

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We have reassessed our view of the group's governance, which we now regard as neutral to the ratings. Over the last few years, Renault has faced a variety of headwinds on top of industrywide supply bottlenecks. These include challenges of reviving the Alliance, a complicated group overhaul in relatively tough market conditions, and the termination of its Russian operations. The latter resulted in a loss of approximately 500,000 vehicles and about €2.3 billion of value lost. Notwithstanding the difficult environment, the group delivered a profound industrial transformation and rapid deleveraging. We recognize this effort through our positive reassessment of management and governance.

Outlook

The stable outlook reflects our belief that Renault may withstand a mild recession in Europe without a major deterioration of its credit metrics or liquidity, thanks to significant improvements in its management of pricing, model mix, and costs implemented over the last two years.

Downside scenario

We could lower the ratings if we observed a material weakening of Renault's competitive position in Europe, possibly combined with a more severe erosion of auto market conditions, resulting in adjusted EBITDA margins falling below 6% and negative adjusted FOCF. This scenario, although currently not likely in our view, could materialize as a result of increased competitive pressure in Europe from new entrants in the EV space, in combination with material missteps in the deployment of the B and C segment EV models that Renault expects to launch from 2024.

Upside scenario

Although not expected in the short term, we could raise the rating if Renault establishes a durable and competitive EV position against intense competition from incumbent and potentially new players in the highly regulated European market, supported by competitive model launches and the development of a reliable EV supply chain. We would also expect Renault to achieve adjusted EBITDA margins in the 8.0%-10.0% range and adjusted FOCF approaching 2% of automotive revenue, in addition to an adjusted net cash position.

Company Description

France-based Renault is the fourth-largest automaker in Europe by number of cars sold, behind VW, Stellantis, and Hyundai-Kia. In May 2022, the group announced that it had sold 100% of its holding in Renault Russia to the city of Moscow and its 67.69% stake in AvtoVAZ to NAMI for a symbolic sum of Russian ruble (RUB) 1. Renault has retained a six-year option to buy back its stake in AvtoVAZ from NAMI. As a result, Europe accounts for about two-thirds of Renault's geographic presence.

The company sells passenger cars and light commercial vehicles under four brands: Renault, Dacia, Renault Korea Motors, and Alpine. Based on full-year 2022 sales, its best-selling models include Megane, Dacia Sandero, Dacia Duster, Arkana, Clio, Captur, and Renault Kwid (in India). Renault formed an alliance with Nissan in 1999 and holds about 43% of the shares in that venture. Renault's main shareholders are the French government (15%) and Nissan (non-voting share of 15%), while the remainder of its shares are free floating. Renault fully owns RCI Banque S.A.,

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which runs the group's captive finance business.

Our Base-Case Scenario

Assumptions

- No impact of the transition to the third stage of the "Renaulution" plan, since additional detail is needed. We don't expect the contribution of Renault's internal combustion engines and hybrid powertrain business to the newly created joint venture with Geely to significantly affect its credit metrics over 2023-2024. This is because we assume the relative impact on the margin from lower research and development expenses and on cash flow from lower consolidated capital expenditure will be offset by higher capital intensity at Ampere.
- Overall, likely margin pressure over 2023 and 2024, since we forecast only marginal residual headroom to trim fixed costs further and cost pressure from energy, logistics, and specific raw materials. More importantly, we expect the pricing environment to soften from 2023 with the deterioration of economic conditions in Europe, where the group sells the bulk of its production.
- Low single-digit volume recovery (3%-4%) in 2023 and 2024.
- EBITDA margins of 7.0%-8.0% throughout 2023-2024 as a result of ongoing cost pressure on logistics, energy, and specific EV raw materials.
- Break-even automotive working capital in 2023 and 2024 in line with that in 2022.
- Reported capital expenditure (including capitalized development costs) of around €3 billion per year.
- No acquisitions through 2023-2024 and no sale of Nissan shares.
- Dividend payments to resume from 2023, totaling €150 million including minority shareholders, based on 2022 earnings.
- Dividends paid out by RCI of €500 million from 2023, down from €800 million in 2022 and €1 billion in 2021.
- Cash restructuring charges of €600 million in 2023 and 2024.

Key metrics*

Bil. €	2020a**	2021a**	2022e	2023f	2024f
Revenue	40.3	38.7	43.2	42-43	44-46
Revenue growth year on year (%)	(22.6)	7.3	11.0	5.0-6.0	5.0-6.0
EBITDA	0.5	2.7	3.4	3.0-3.5	3.0-4.0
EBITDA margin (%)	1.3	6.3	7.9	7-8.0	7-8.0
Funds from operations (FFO)	(0.2)	2.3	2.9	>3.0	>3.0
FFO/Debt (%)	N.M.	47	>100	>100	>100
Capital expenditure	2.8	1.9	1.2	1.5-2.0	1.5-2.0
Free operating cash flow	(4.4)	(0.2)	1.0	1.0-1.5	1.0-2.0
Dividend payout	0	0.1	0.1	0.3	0.3

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Bil. €	2020a**	2021a**	2022e	2023f	2024f
Debt to EBITDA (x)	11	1.8	0.5	0.2	0.0

*All figures adjusted by S&P Global Ratings. **Not yet restated for the termination of the Russian operations. a--Actual. e--Estimate. f--Forecast. N.M.--Not meaningful.

Liquidity

We assess Renault's liquidity as strong, based on our forecast of the ratio of sources to uses for the industrial division of about 3.0x over the next 12 months and about 2.7x for the subsequent 12 months. The assessment is also supported by the group's well-established banking relationships. At the same time, we expect liquidity to remain high given the current uncertainty on the extent of recession.

The industrial division's principal liquidity sources for the 24 months from Dec. 31, 2022, comprise:

- Cash and marketable securities of €13.7 billion, excluding restricted cash that we estimate at approximately €500 million;
- Undrawn bank lines worth €3.4 billion maturing in more than one year; and
- Automotive funds from operations slightly below €3 billion.

The group's principal liquidity uses on the same date included:

- Short-term debt of €3.2 billion in the industrial division;
- Working capital swings of up to €1 billion, considering likely supply shortages (including seasonal working capital requirements);
- Capital expenditure (including capitalized development costs) of €2.5 billion-€3.0 billion per year in the next two years; and
- Dividend payout of €150 million including minority shareholders.

Covenants

We are unaware of covenants on either facilities or other financial agreements.

Environmental, Social, And Governance

ESG credit indicators: To E-3, S-2, G-2; From E-3, S-2, G-3

Renault has material exposure to environmental factors due to its large share of volume sales in Europe. Outside the region, around 70% of the group's sales are subject to Corporate Average Fuel Economy-type regulations. Together with its Alliance partners, Nissan and Mitsubishi, Renault met the 2021 carbon dioxide (CO_2) emissions target of around 109 grams per kilometer (as defined under the Worldwide Harmonised Light Vehicles Test Procedure) for its average car fleet in Europe.

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We do not expect the company to have particular difficulties complying with CO_2 regulation over 2022-2025 because the share of EV in the group's sales is set to rapidly increase to more than 30% in 2025 (including BEVs, PHEVs, and fuel cell electric vehicles) from 10%-11% as of Dec. 31, 2022. The shift is likely to constrain profitability at least until the full EV line-up transitions to more cost-efficient EV platforms that are developed and shared within the Alliance. Renault acknowledges that its EVs generate operating margins below the group average. Ampère is targeting breakeven in 2025 and, in the long term, its operations should be consistent with the targeted 8% group operating margin.

Social factors do not play a major role in our credit assessment for Renault, but we monitor the risks of product liability issues linked to road and vehicle safety.

We believe governance at Renault has benefitted from the recent management change. In our view, management has succeeded in realigning all stakeholders' interests to the exclusive benefit of the company. The early delivery on an ambitious restructuring plan also derives in our view from the cohesion on an ambitious albeit compelling project. This leads us to think that governance no longer has a moderately negative impact on credit quality. Hence we revised the governance score to G-2 from G-3.

Issue Ratings--Recovery Analysis

Key analytical factors

- The rating on Renault's unsecured debt is 'BB+', with a '3' recovery rating. The recovery rating is constrained by priority liabilities, including factoring and debt at operating companies. We expect about 65% recovery in the event of a payment default.
- In our hypothetical default scenario, we contemplate a default in 2028 as the company faces a severe market downturn, aggressive competition from new and existing competitors, in particular in EVs, and a loss of market share as a result.
- We believe that if the company were to default, it would still have a viable business model because of continued demand for its light and commercial vehicles, its established network of dealerships, and strong brand awareness. For this reason, we expect the company would reorganize.

Simulated default assumptions

- Simulated year of default: 2028
- Jurisdiction: France
- EBITDA at emergence: €2.2 billion
- -Maintenance capital expenditure assumed at 3% of sales
- --Cyclicality adjustment factor of 15%
- --No operational adjustment
- EBITDA multiple: 5.5x

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Simplified waterfall

- Net enterprise value (after 5% administrative costs): €11.3 billion
- Priority claims: €3.5 billion
- Total value available to unsecured claims: €7.8 billion
- Senior unsecured debt claims: €11.4 billion
- --Recovery expectations: 50%-70%; rounded estimate 65%

Ratings Score Snapshot

Issuer Credit Rating	BB+/Stable/B
Business risk:	Fair
Country risk	Intermediate
Industry risk	Moderately high
Competitive position	Fair
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Strong
Management and governance	Satisfactory
Comparable rating analysis	Negative
Stand-alone credit profile:	bb+
Group credit profile	bb+

Related Criteria

- 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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

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- Criteria | Corporates | General: Corporate Methodology, 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

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Renault S.A.		
Issuer Credit Rating	BB+/Stable/B	BB+/Negative/B
Ratings Affirmed; Recovery Revised		
Renault S.A.		
Senior Unsecured	BB+	BB+
Recovery Rating	3(65%)	3(55%)
Commercial Paper	B	B

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