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## Research Update:

# French Rail Operator SNCF Mobilites 'AA-/A-1+' Ratings Affirmed After Rail Reform Approved; Outlook Stable

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## Research Update:

# French Rail Operator SNCF Mobilites 'AA-/A-1+' Ratings Affirmed After Rail Reform Approved; Outlook Stable

## Overview

- A new rail reform package has been recently approved by the French Parliament, announcing the creation of an integrated railway group.
- Pending details on the future governance of the group, we continue to assess the likelihood of extraordinary support provided by the state to the French incumbent provider of passenger rail services, SNCF Mobilites, as extremely high because we expect the government to maintain very tight control and supervision over the company's strategy and financial standing.
- Although we expect the consolidated group to have higher financial leverage than SNCF Mobilites' current credit metrics, the effect on the company's credit quality could be offset by higher stability of cash flows and lower operational risk.
- We are therefore affirming our 'AA-/A-1+' long-term and short-term issuer credit rating on SNCF Mobilites.
- The stable outlook reflects that on France and our unchanged view on the likelihood of extraordinary support from the state. It also reflects our expectation that the consolidation of the company within the integrated group should not materially weaken its credit quality.

## Rating Action

On June 29, 2018, S&P Global Ratings affirmed its 'AA-/A-1+' long- and short-term issuer credit ratings on French rail operator SNCF Mobilites. The outlook is stable.

At the same time, we also affirmed our 'AA-' issue rating on SNCF Mobilites' debt.

## Rationale

The affirmation reflects our view that the terms of the new rail pact law, approved by the French Parliament on June 14, 2018, should not materially modify our view on the likelihood of extraordinary support that SNCF Mobilites may receive from the state over the next two years. We therefore continue to incorporate a six-notch uplift to the company's stand-alone credit profile

(SACP) of 'bbb-'.

The rail reform package recently approved announces the creation of an integrated French rail group composed of public limited-liability companies ("société anonyme"), with a fully state-owned and -controlled holding company, as a "société nationale à capitaux publics," which in turn will fully own French railway infrastructure manager SNCF Réseau and SNCF Mobilités. Under the new law, the state is not able to dispose of its shares in the future holding company, and the latter cannot dispose of its shares in SNCF Réseau or SNCF Mobilités. Both entities will therefore lose their current state agency status ("Établissement Public Industriel et Commercial"; EPIC) and will no longer be directly owned by the state. The reform, which will become effective on Jan. 1, 2020, also includes the end of the current special civil-servant status for new employees joining the group.

We note that the new law includes some key elements of the reform but remains quite generic on the terms of its application, such as the technicalities of SNCF Réseau's €35 billion debt takeover, the financial trajectory of the two companies, and the future governance of the unified rail group.

We anticipate future government acts (through ordinances and decrees) will clarify the mechanics of the reform in the coming 12 months.

According to the information available so far, we expect the government to maintain very tight control and supervision over SNCF Mobilites' strategy and financial standing after 2020. Although the current EPIC status makes the French government ultimately responsible for company's obligations, including financial debt, in our view the transformation into a limited-liability company per se doesn't prevent SNCF Mobilites from maintaining an integral link with the state. Under the terms of the reform, the capital of the holding company is not accessible to shareholders other than the French state and the capital of SNCF Réseau and Mobilites is not accessible to shareholders other than the holding company. Furthermore, we understand that the transformation to a limited-liability company will not undermine the ability of SNCF Mobilites to access state emergency financial support mechanisms such as emergency loans from the Treasury or the purchase of the company's bonds and commercial paper by the state's public debt fund (Caisse de la Dette Publique; CDP).

At the same time, the company maintains a very important role for the French government, in our view. Although under the terms of the reform the ownership and management of train stations will be transferred to SNCF Réseau, SNCF Mobilites will remain the country's incumbent provider of passenger rail services and main railway freight operator. The introduction of competition in the sector, as envisaged by the EU's Fourth Rail Package, might diminish the company's role for the government going forward. However, we expect this process to be gradual and not to have a material impact over the next two years.

Although we expect the consolidated group to have higher financial leverage

than SNCF Mobilites' current credit metrics, the effect on the company's credit quality could be offset by higher stability of cash flows and lower operational risk driven by the integration of transportation and infrastructure business.

Pending more clarity on the future financial trajectory of the company and of the group, we continue to assess the SACP at 'bbb-', supported by the company's dominant position in the French rail passenger and freight market, being one of the largest employers in the country and the second-largest rail group in Europe behind Deutsche Bahn. However, compared with peers, the SACP is somewhat constrained by more volatile profitability due to continued increases in access charges and high labor costs, as well as the impact of labor strikes over recent years.

The SACP also reflects our expectation that the company will be able to maintain its adjusted funds from operations (FFO) to debt at about 15% over the next two years, despite the negative impact of recent labor strikes and the need to raise new financial debt to co-finance the company's investment plan.

Our base-case scenario incorporates the following assumptions:

- A decline of total revenues by about 1% in 2018, due to the impact of labor strikes, followed by revenue growth of about 2%-3% in 2019 as a rebound effect.
- The adjusted EBITDA margin to remain at about 10% over 2018-2019, although the current reform could require additional operating efficiency, resulting in somewhat higher margins.
- Annual capital expenditure (capex) of about €2.4 billion over 2018 and 2019, in line with the past forecasts.
- Annual dividends of about €150 million-€180 million.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt of about 13%-15% over 2018-2019;
- Debt to EBITDA of about 5x over 2018-2019.

### **Liquidity**

We have revised our assessment of SNCF's liquidity to strong from adequate. This reflects the abundant liquidity available, which includes a €1.3 billion undrawn and committed liquidity facilities, but also the ability of the company to swiftly access emergency public funding in the event of difficult market access. Given its role within the French economy, we believe the company benefits from solid relationships with banks and high standing in credit markets.

We estimate liquidity sources in the 12 months to March 31, 2019 to be about

€8.7 billion, including:

- About €5.8 billion of unrestricted cash and cash equivalents;
- Availability of €1.3 billion under multiple credit lines maturing over 2019; and
- Forecast unadjusted cash flows from operations of €1.7 billion.

We estimate SNCF Mobilités' liquidity needs over the same period to be about €5.7 billion, comprising:

- Debt maturities of about €2.8 billion, including some short-term debt, which we think will be largely refinanced;
- Capex, net of capital subsidies, of about €2.5 billion;
- Working capital uses of about €150 million; and
- Dividends of about €180 million.

The company's financial documentation does not include any financial covenants.

## **Outlook**

The stable outlook reflects that on France and our unchanged view on the likelihood of extraordinary support from the state. It also reflects that higher financial leverage of the consolidated group could be offset by higher stability of cash flows and lower operational risk, driven by the integration of transportation and infrastructure business.

### **Downside scenario**

We could take a negative rating action on SNCF Mobilites if the consolidation of the company within the new rail group resulted in a deterioration of its stand-alone credit profile by at least two notches, to 'bb' or below, all other things being equal. In our view, this could result if the group's financial leverage is not sufficiently compensated by lower operational risk and stability of cash flows. We could also take a negative rating action if the future governance of the group in our view weakened the link with or the importance of the company for the state, weakening our view on the likelihood of extraordinary support.

Although unlikely at this stage, a negative rating action on the sovereign could also result in a similar action on SNCF Mobilites.

### **Upside scenario**

We could raise the ratings on SNCF Mobilités if we raised the ratings on France.

We consider SNCF Mobilités as a government-related entity. As a result, if

neither the sovereign rating nor our assessment of the likelihood of extraordinary support changes, raising our long-term issuer credit rating on SNCF Mobilités by one notch would depend on an upward revision of the SACP to 'a+' (five notches higher than the current SACP). We see this scenario as highly unlikely, also considering that the company will become part of a group with higher financial leverage.

## Ratings Score Snapshot

Issuer Credit Rating: AA-/Stable/A-1+

Business risk: Satisfactory

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

Financial risk: Intermediate

- Cash flow/leverage: Intermediate

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bbb-

- Sovereign rating: AA/Stable/A-1
- Likelihood of government support: Extremely high (+6 notches from SACP)

## Issue Ratings--Recovery Analysis

SNCF Mobilites' capital structure consisted of about €20.6 billion as of Dec. 31, 2017. The amount of debt included within the subsidiaries, such as Keolis and Eurostar, is limited (less than 10% of company's total debt).

Therefore, we rate SNCF Mobilites' debt 'AA-', at the same level as the issuer credit rating, because no significant elements of subordination risk are present within its capital structure.

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: 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

SNCF Mobilites

Issuer Credit Rating	AA-/Stable/A-1+
Senior Unsecured	AA-
Commercial Paper	A-1+

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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action

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