FitchRatings

Fitch Upgrades SNCF SA to 'AA-'; Outlook Negative

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Fitch Ratings - Paris - [publication date will be automatically inserted]
Fitch Ratings has upgraded societe nationale SNCF SA's (SNCF SA) Long-Term Issuer Default Rating (IDR) to 'AA-' from 'A+'; Outlook 'Negative'.

The upgrade reflects, in Fitch's view, the increased social and political implications of default driven by SNCF SA's key role in the government's infrastructure and green transition strategies, as well as the increased political implications of a default to the French government and the EU's push towards more sustainable mobility solutions. We also raised the Standalone Credit Profile to 'bbb+' from 'bbb', reflecting an improving financial profile.

KEY RATING DRIVERS

Status, Ownership and Control: 'Very Strong'

Fitch views the 100% State ownership and the legal provision preventing the State from selling its shares as supportive of SNCF SA's ratings. This is because it illustrates the State's ongoing involvement in the railway group and offsets its commercial law status and associated bankruptcy risk. The State exercises strong control over SNCF SA's operational and financing activities through its control of the company's board of directors as well as through the Ministries of Transport and Finance.

SNCF SA's private-law nature does not entail an automatic transfer of liabilities to the sponsor, but Fitch considers that the proximity of SNCF SA's infrastructure activities to government functions and the public service nature of mass transportation would imply a liability transfer to the state in case of need.

Support Track Record: 'Strong'

The State's commitment to support the national railway group is highlighted by the 2020's EUR4.05 billion equity injection into the group to offset Covid-19-related losses, as well as the EUR35 billion debt relief dedicated to the infrastructure manager SNCF Reseau (AA/Negative). Fitch also believes that the proximity with the State and regular monitoring by the State Shareholding Agency would make timely support likely. This factor's assessment is capped at 'Strong' due to EU regulation on State aid as a material share of SNCF SA's businesses is now fully exposed to competition.

Socio-Political Implications of Default: 'Strong'

The reassessment of the Key Risk Factor to 'Strong' from 'Moderate' is driven by our view that SNCF SA will play a key role in the government's infrastructure and green transition strategies. Fitch believes the political implications of a default would be significant as SNCF SA is central to the government's and the EU's push towards more sustainable mobility solutions. With more than 210,000 employees in France alone, the French State relies on SNCF's commercial activities as a countercyclical investment vehicle, as a major source of employment for the country and as a means to enable poorer French citizen to travel across the country at an affordable rate.

Financial Implications of Default: 'Strong'

In Fitch's view, a default by SNCF SA on its financial obligations would lead to contagion risk and impact the availability and cost of funding for other French government-related entities (GRE). SNCF SA is a large issuer in domestic and international capital markets through its EUR15 billion EMTN programme, its EUR5 billion European commercial paper (ECP) programme and its EUR3 billion French CP (NeuCP) programme.

Standalone Credit Profile

Fitch assess SNCF SA's Standalone Credit Profile (SCP) at the lower of its competitive activities (bbb+) and the infrastructure manager SNCF Reseau (bbb+) to capture the European ban on cross-subsidising between the businesses.

As both entities have the same SCP, we will analyse SNCF SA's commercial activities' credit profile, due to the less intense link it has with the State compared to SNCF Reseau. Its commercial activities reflect the following factors.

Revenue Defensibility 'Midrange'

This assessment reflects SNCF SA's very strong market position in France, from which the company derives about two-thirds of its revenue, as well as passenger and freight demand's correlation with the business cycle. It also factors in the supportive regulatory regime for public service contracts (PSC) with regional authorities compensating SNCF SA for the transport services provided through a stable history of operating grants.

At end-2021, 61% of SNCF SA's competitive activities' operating revenue came from passenger transportation. This included 34% from proximity trains under PSC with French regions, which bear most of the traffic risk and cover most of the costs, and 16% from high-speed trains, which is a commercial activity fully funded by the sale of tickets.

Freight transportation and logistics make up 36% of SNCF SA's revenue, mostly through its subsidiary, Geodis. Geodis derives most of its revenue from international markets. This activity is cyclical, linked to global trade flows, but is also characterised by a flexible cost structure, which limits EBITDA fluctuations. Despite the apparent recent economic struggles, H1 2022 performance has remained robust for Geodis, up +34% year-on-year.

Operating Risk 'Midrange'

The assessment for operating costs reflects the limited volatility and flexibility of SNCF SA's competitive activities' main cost items. Staff costs represent the main expense at 41% of operating costs, a stable share over the past five years. Flexibility for this item is limited by the share of special-status employees ('cheminots' status). The second-largest single cost item (14% of total costs) is the access charge paid mostly to SNCF Reseau to use the tracks. The annual increase of the access charge on the high-speed train and freight access is capped at the inflation rate. As such, SNCF SA has some visibility over the trajectory of its expenses. The access charge usually takes a couple of years to adjust, as such it is likely to remain low relative to current inflation levels, but to then compensate in 2024-25.

Financial Profile 'Midrange'

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In our rating-case scenario, we expect SNCF SA's competitive activities to exhibit a leverage ratio (net adjusted debt / EBITDA) of about 4.0x in 2025-2026 (2021: 4.2x), and coverage ratio (EBITDA / gross interest) of about 3.6x. We expect a sharp improvement in the EBITDA in 2022, at above EUR2.9 billion, thanks to a very sharp increase in turnover. Our rating-case scenario assumes 2022 to be a peak, and we factor in the return to a more normal level of EBITDA and EBITDA margin. We also factor in the likelihood of an economic downturn in 2023, combined with a high pressure on operating margins.

We expect the capital balance to remain at a sustained level in the coming years, at EUR1.5 billion on average. In our scenario, net adjusted debt on competitive activities would remain stable, slightly below EUR10 billion (end-2021: EUR9.5 billion) as SNCF SA should be able to self-financing its capex through its own cash-flows.

Derivation Summary

Fitch views SNCF SA as a GRE of France and rates it one notch below the sovereign. This reflects a score of 35 points under our GRE criteria. The SCP is 'bbb+' and at more than four notches away from the sovereign rating, it does not affect the IDR.

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KEY ASSUMPTIONS

Our rating case is based on the following assumptions:

- Operating revenue growth on average of 3.5% per year in 2022-2026

- Operating expenditure growth on average of 3.8% per year in 2022-2026

- Capital balance of around -EUR1.5 billion per year in 2022-2026

-Apparent cost of debt of 2.8% in 2022-2026.

Issuer Profile

SNCF SA is the holding company and sole debt issuing entity of the French national integrated railway group. Fully owned by the French State, it was created on 1 January 2020 to regroup the infrastructure manager SNCF Reseau and the operator SNCF Mobilites.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Weaker Support Factors: A downgrade could result from a weakening of the links between the French State and SNCF SA, or a weakening of SNCF SA's importance to the French State, which Fitch views as unlikely at the moment. Furthermore, all else being equal, a downgrade of the sovereign would be reflected in the ratings of SNCF SA.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of the sovereign would be reflected in SNCF SA's ratings.

Stronger Support Factors: An upgrade could result from a strengthening of the links between the French State and SNCF SA, or from an improvement of SNCF SA's SCP to 'a-' for both underlying entities. As such, the Outlook would be revised to 'Stable' from 'Negative' if SNCF SA's competitive activities' net leverage remains sustainably below 4.0x and SNCF Reseau's sustainably below 8.0x.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

SNCF SA's ratings are credit-linked to those of France.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

RATING ACTIONS

ENTITY	RATING			PRIOR
societe nationale SNCF SA	LT IDR	AA-	Upgrade	A+
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	AA-	Upgrade	A+
	LC ST IDR	F1+	Affirmed	F1+
senior unsecured	LT	AA-	Upgrade	A+
senior unsecured	ST	F1+	Affirmed	F1+

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FITCH RATINGS ANALYSTS

Andreane Soucaze
Analyst
Primary Rating Analyst
+33 1 44 29 91 78
andreane.soucaze@fitchratings.com
Fitch Ratings Ireland Ltd
28 avenue Victor Hugo
Paris 75116

Ekaterina Kozlova
Senior Analyst
Secondary Rating Analyst
+33 1 44 29 92 74

ekaterina.kozlova@fitchratings.com

Konstantin Anglichanov
Senior Director
Committee Chairperson
+49 69 768076 123
konstantin.anglichanov@fitchratings.com

Media relations
Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Government-Related Entities Rating Criteria (pub.30-Sep-2020)
Public Sector, Revenue-Supported Entities Rating Criteria (pub.01-Sep-2021)(includes rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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