Research Update:

Société Nationale SNCF Outlook Revised To Stable From Negative On Expected Deleveraging; 'AA-' Affirmed

June 16, 2022

Rating Action Overview

- We forecast a solid recovery in long distance and high-speed passenger traffic volumes in 2022 for French rail group Société Nationale SNCF SA (SNCF), with revenue for the segment rebounding to about 85%-90% of 2019 levels this year, versus 60% in 2021, and approaching 100% in 2023.
- This, combined with the expected boost in logistics revenue, partial hedges against cost increases, and the cost savings plan, should mitigate effects from the current inflationary environment and maintain funds from operations (FFO) to debt above 9% on average in 2022-2024, from about 6% in 2021, which we view as commensurate with the 'bbb-' stand-alone credit profile (SACP).
- We believe that significant support from the French state, including the last tranche of debt relief (€10 billion in 2022 out of €35 billion in total) and a €4.1 billion capital injection received in response to the COVID-19 pandemic, will result in expected deleveraging.
- We therefore revised our outlook on SNCF to stable from negative and affirmed our 'AA-/A-1+' long- and short-term issuer credit ratings and our 'AA-' issue ratings on its senior unsecured debt.
- The stable outlook mirrors that on France and reflects our view that SNCF will maintain FFO to debt well above 6% over 2022-2024 despite near-term pressure on profitability due to higher energy and labor-union-protected personnel costs.

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Rating Action Rationale

We expect SNCF will keep FFO to debt above 9% on average in 2022-2024, from about 6% in 2021, supported by a material recovery in long-distance passenger traffic and higher logistics revenue. After promising recent traffic trends and solid bookings for summer 2022, we assume revenue for the long distance and high-speed passenger segment will rebound to about 85%-90%

of 2019 levels in 2022, compared with about 60% in 2021, and approach 100% in 2023. In our view, remote working could continue to weigh on business traffic but leisure traffic is steadily recovering to pre-pandemic levels. Although we anticipate the logistics segment could continue to expand in 2022, following an about 30% increase in 2021, we expect normalization starting 2023 as logistics chain disruptions start to ease. Given the lower profitability of the logistics segment compared to passenger transportation (9.7% reported EBITDA margin in 2019 for freight transport and logistics solutions provider Geodis compared with 14.8% for SNCF Voyageurs), under our base case, we forecast S&P Global Ratings-adjusted EBITDA of about €5.3 billion-€5.5 billion in 2022 from €4.5 billion in 2021 on a consolidated basis, or about 95% of 2019 levels, followed by €5.6 billion-€5.8 billion in 2023, which is close to pre-pandemic levels. Nevertheless, we will continue to closely monitor the pace of recovery in long-distance passenger traffic volumes as well as the evolution of operating costs as traffic resumes in the context of a weaker macroeconomic environment. A significant deviation from our current forecasts could pressure our investment-grade SACP for SNCF.

We believe that the significant support from the government together with nonstrategic asset disposals will enable the deleveraging targeted by the company. The last phase of the state debt relief announced as part of the rail reform in January 2020 was completed in January 2022--€10 billion, following €25 billion in 2020. The mirror-debt mechanism in place is to support the large legacy debt repayment at SNCF Reseau (AA/Stable/A-1+), the manager of the rail infrastructure in France and a fully owned nontransferable subsidiary to SNCF. The government extraordinary support also includes a €4.1 billion capital injection (of which €1.6 billion was paid in 2021) to SNCF as part of a rail sector package included in the France Relance plan in response to the COVID-19 pandemic. In our adjusted debt metrics, we factor the €10 billion additional debt relief resulting in a positive adjustment to our calculation of the group's debt, and we reflect S&P Global Ratings-adjusted capital expenditure (capex) net of the investment grants of €1.8 billion in 2022 and €0.6 billion in 2023 to be received by SNCF Réseau as part of the France Relance plan. The group also completed the sale of nonstrategic railcar and tanker leasing firm Ermewa in October 2021, leading to a €3.2 billion reduction in reported net debt (reflecting €2.1 billion of cash proceeds and €1.1 billion of debt, which was previously consolidated at Ermewa). We do not factor any other disposal in our base case at this stage, although we acknowledge the group's strategy to dispose of noncore assets might result in more divestments. All these factors, plus SNCF's financial commitment toward positive group free cash flow in 2022, support our expected deleveraging trajectory with S&P Global Ratings-adjusted financial leverage improving to 6.5x-7.0x over 2022-2024 from 10.2x in 2021. This is not far from the company's target of reported net debt to EBITDA of below 6x by 2023, which would be supported by traffic recovery and flexibility to delay or reduce capex expenditure (capex) as part of the implementation of cost savings measures considering the current inflationary environment. We assume high capex totaling €4.0 billion-€4.5 billion in 2022, followed by €4.5 billion-€5.5 billion in 2023-2024, net of investment grants received from the state.

We believe that SNCF's partial hedges against cost increases as well as the cost-savings plan will help mitigate current inflationary pressures. In our view, SNCF's credit metrics will be somewhat protected from cost base inflation over the next 12 months, having already agreed salary increases with its labor unions for 2022, lower than our forecast inflation rate of 5.1% for the year, and established hedges at above 90% for traction energy, which will limit the effects of rising electricity and fuel costs. Moreover, the group will be partly protected by index-linked clauses that allow for the pass through of inflation on its regulated activities (including regional

transportation and Keolis) as well as Geodis for energy costs. It can also set its own prices in the long-distance train segment supported by its strong competitive position in France. Therefore, in our 2022 base case, we assume a limited potential EBITDA hit. From 2023, we assume inflationary pressures could delay EBITDA recovery more than we previously expected with personnel expenses, absent other agreements, likely to keep up with inflation and the hedges on energy costs to ease off, although we believe there is sufficient credit metric headroom to accommodate the potential decline. This should be partly mitigated by still important hedges in place at above 80% for traction energy in 2023, as well as some energy costs being at fixed prices thanks to the Accès Régulé à l'Electricité Nucléaire Historique (ARENH) mechanism.

Outlook

The stable outlook on SNCF mirrors that on France (unsolicited AA/Stable/A-1+) and reflects our opinion that the group retains an extremely high likelihood of extraordinary support from the sovereign and will achieve deleveraging commitments promoted by the rail reform. It also reflects the material recovery in passenger traffic volumes expected in 2022 following the loosening of pandemic-related restrictions as well as the partial hedges against cost increases, and cost-saving initiatives, which will contain earnings pressures from the current inflationary environment.

We expect the group's adjusted FFO to debt to remain above 9% on average for 2022-2024, supported by the debt relief mechanism from the state, with the last tranche of €10 billion effective since January 2022 and a €4.1 billion capital injection received in response to the COVID-19 pandemic.

Downside scenario

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

We would consider a multi-notch downgrade if we believe that SNCF Group's link with or role for the state have weakened. This could stem from reductions of state controls over the company and its strategy, or if the group's public service role for the government weakens.

All else being equal, a negative rating action could also result if we revise down the SACP to 'bb'. This could materialize, for example, if the group cannot maintain FFO to debt well above 6% over 2022-2024. It could also be due to SNCF not achieving its key reform goals in terms of performance improvement and sustainable financial equilibrium, or if competition materializes more aggressively than we currently anticipate.

We could revise down the SACP by one notch if the group cannot strengthen its FFO to debt to above 9% on average over 2022-2024. This would not prompt us to lower the rating on the group provided the likelihood of support from the state is the same, however.

Upside scenario

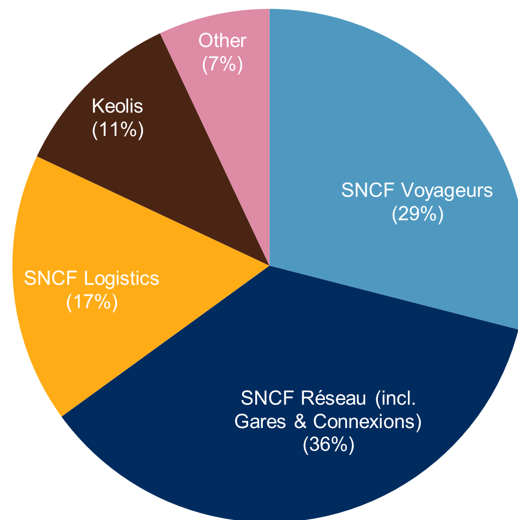
We currently see a positive rating action on SNCF as highly unlikely, since it would depend on an upgrade of France or a higher assessment of the likelihood of extraordinary support. Absent any of these factors, to raise our long-term issuer credit rating by one notch, we would need to revise up the SACP to 'a+' (five notches higher than the current SACP).

Company Description

SNCF is the holding company of French integrated rail and transportation services provider SNCF Group. Fully owned by the French government, the group is France's incumbent provider of passenger rail services through its 100%-owned subsidiary SNCF Voyageurs (29% of total gross profit in 2019), and the monopolistic rail infrastructure and train station manager in France through its 100%-owned subsidiary SNCF Réseau (36%, including its subsidiary Gares&Connexions). The company also owns rail freight, logistics, and mass-transit transportation activities respectively through Geodis, SNCF Fret, logistics subsidiaries (17% of total gross profit), and Keolis (11%).

Chart 1

SNCF's Gross Profit Distribution By Activity In 2019
About one-third of gross profit driven by SNCF Voyageurs' activity pre-pandemic



Source: SNCF 2019 annual report.
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Our Base-Case Scenario

Assumptions

- French GDP growth of 2.7% in 2022 and about 1.8%-1.9% over 2023-2024.
- French consumer price index growth of 5.1% in 2022, 2.5% in 2023, and 2.1% in 2024.

- Voyages SNCF and Intercités segment revenue remains at 85%-90% of 2019 levels in 2022, compared with about 60% in 2021, and approaches 100% in 2023.
- Group revenue growth of about 7%-9% in 2022, spurred by a recovery in passenger volumes, and flat to slightly negative in 2023 since we assume some normalization in the logistics and freight segment. From 2024, we expect revenue growth broadly in line with French GDP.
- EBITDA margins remain below 2019 levels in 2022 and 2023 at about 14.0%-14.5% and 15.0%-15.5%. As traffic normalizes and inflationary pressures start to ease from 2024, we project margins of about 15.5%-16.0%.
- Consolidated capex, net of capital subsidies, of about €4.0 billion-€4.5 billion in 2022 and €4.5 billion-€5.0 billion per year thereafter, benefitting from the receipt of €1.76 billion in 2022 and €0.65 billion in 2023 as part of the France Relance plan.
- Debt relief of €10 billion in 2022, resulting in a positive adjustment to our calculation of the group's debt.

Key metrics

SNCF SA--Key Metrics*

	--Fiscal year ended Dec. 31--					
Mil. €	**2019a**	**2020a**	**2021a**	**2022e**	**2023f**	**2024f**
Revenue	35,120	29,975	34,752	37,400-37,600	37,100-37,300	37,800-38,000
EBITDA margin (%)	16.2	6	12.8	14.0-14.5	15.0-15.5	15.5-16.0
Funds from operations (FFO)	3,073	-416	2,652	3,500-3,700	3,600-3,800	3,700-3,900
Capital expenditure*	5,043	3,929	3,357	4,000-4,500	4,500-5,000	4,500-5,000
Debt**	70,297	46,151	45,170	35,000-36,000	38,000-39,000	39,500-40,500
Debt to EBITDA (x)	12.4	25.5	10.2	About 6.5	6.5-7.0	6.5-7.0
FFO to debt (%)	4.4	-0.9	5.9	About 10	9.5-10	9.5-10

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. *Capex is presented net of investment grants from the state. **S&P Global Ratings-adjusted debt is about €10 billion lower in 2022e than 2021a reflecting the €10 billion additional debt relief finalized in Januray 2022.

Liquidity

We assess SNCF's liquidity as adequate, based on our expectation that sources will cover uses by more than 1.2x over the 12 months to Dec. 31, 2022. In addition to the large amount of liquidity available, which could point to a stronger assessment if SNCF (group holding company since January 2020) continues to show a solid track record, our assessment is supported by its high standing in credit markets, given its key role and strong links with the French government, solid relationships with banks, and ability to swiftly access emergency central government funding in the event of difficult market access.

We estimate the following liquidity sources for the 12 months to Dec. 31, 2022:

- About €10 billion of unrestricted cash and cash equivalents (inflated by €2.1 billion of proceeds from the Ermewa sale);

- An undrawn revolving credit facility of €3.5 billion, committed until 2024, and about €800 million of other committed lines;
- Positive FFO of about €1.7 billion; and
- The state's contribution of about €3 billion to cover debt service under a €35 billion debt-relief mechanism in place since Jan. 1, 2020.

We estimate the following liquidity uses over the same period:

- Debt maturities of about €3.2 billion-€3.3 billion;
- Capex of about €4.2 billion, net of investment grants; and
- Working capital outflows of €150 million;

Covenants

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

Environmental, Social, And Governance

ESG credit indicators: E-1, S-2, G-2

Environmental factors are a positive consideration in our credit rating analysis of SNCF, since the entity plays a vital role in France's strong carbon-reduction policies. This is evidenced by the recent ban on short-haul domestic flights in favor of rail. Also, the group's goal to reduce its greenhouse gas emissions from transportation services by 30% in 2030 over 2015 supports the country's climate agenda. Social factors are an overall neutral consideration. This balances the key social mandate of the group and the strong support received by the French government (€35 billion of debt relief in 2020-2022 approved as part of the rail reform) versus negative effects from the pandemic and exposure to social conflicts. The COVID-19 pandemic hit SNCF's revenue hard, but the impact was softened by a capital injection of €4.1 billion (about 14% of annual revenue) from the government in 2020. That said, strikes have historically hurt the company's cash flow. Opposition to reforms led to a 24-day strike and €500 million in lost revenue in 2016. This was followed by a 39-day strike and €700 million-€800 million in lost revenue in 2018.

Issue Ratings - Subordination Risk Analysis

Capital structure

SNCF is the holding company of SNCF Group and the sole issuer for the group after June 2020. Its total external consolidated debt (about €69 billion as of Dec. 31, 2021) notably includes SNCF Réseau's large external debt of about €47 billion, which benefits from the €10 billion second phase of state debt relief on Jan. 1, 2022. Other subsidiaries have limited external debt (about €2.5 billion), including Keolis, logistics companies, and Eurostar.

Analytical conclusions

We equalize our issue rating on SNCF's debt with the issuer credit rating, even though we anticipate that the priority debt ratio will be higher than 50% over the next few years, notably because of SNCF Réseau's legacy debt.

We expect SNCF Réseau's external debt will progressively reduce below 50% after the €35 billion debt relief is completed and refinancing needs will remain covered by holding company SNCF SA.

Ratings Score Snapshot

Issuer Credit Rating	**AA-/Stable/A-1+**
Business risk:	Strong
Country risk	Low
Industry risk	Low
Competitive position	Strong
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bbb-
Related government rating	Unsolicited AA/Stable/A-1+
Likelihood of government support	Extremely high (+6 notches from SACP)

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
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- 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
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Societe nationale SNCF		
Issuer Credit Rating	AA-/Stable/A-1+	AA-/Negative/A-1+
Senior Unsecured	AA-	
Commercial Paper	A-1+	

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; or Stockholm (46) 8-440-5914

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