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Research Update:

French Rail Company SNCF SA 'AA-/A-1+' Ratings On Watch Negative Amid Uncertainty Of COVID-19 Impact And State Support

July 7, 2020

Rating Action Overview

- We forecast that passenger traffic for Société Nationale SNCF SA will decline by 30% on long distance routes and by 20% on regional services in 2020, due to COVID-19-related travel restrictions.
- The group, which generated S&P Global Ratings-adjusted EBITDA of €5.7 billion in 2019, has a large, mainly fixed cost base, so the passenger decline could lead funds from operations (FFO) to debt to weaken to 6% on average in 2021-2022 without state support, instead of the 10% we previously anticipated.
- Although we expect the French government to provide extraordinary support to SNCF SA to mitigate the COVID-19 impact, the extent, timing, and mechanism of such support is uncertain.
- We are therefore placing our 'AA-/A-1+' long- and short-term ratings on SNCF SA and our 'AA-' ratings on SNCF SA's senior unsecured debt on CreditWatch with negative implications.
- The CreditWatch indicates that we could lower the ratings by one notch if the group's stand-alone credit profile (SACP) deteriorates to 'bb', with average FFO to debt dropping toward 6% in 2021-2022 combined with an uncertain traffic recovery and state support; or by more than one notch if in our view there is no longer an extremely high likelihood of government support for SNCF SA.

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Rating Action Rationale

The CreditWatch placement reflects uncertainty regarding the group's future credit metrics and the extent, timing, and mechanism of state support for SNCF SA to address the COVID-19 impact. Rail traffic has decreased across Europe due to travel restrictions and measures adopted by governments to contain the spread of the coronavirus. We assume that, like its European peers, SNCF will see a passenger traffic decline of about 30% on long distance routes and 20% on regional services in 2020. Given the group's largely fixed cost base, we expect this to result in a 70%-75% drop in EBITDA in 2020 to €1 billion-€1.5 billion, followed by a two-year recovery. In the absence of state support and assuming a gradual recovery of rail traffic, we anticipate SNCF's reported EBITDA could remain suppressed at 35%-40% below the 2019 level in 2021 before recovering to pre-pandemic levels in 2022. We anticipate the additional debt issued by the group (about €4 billion between March and June 2020), combined with lower EBITDA, will delay the group's expected deleveraging, with financial leverage (S&P Global Ratings adjusted debt to EBITDA) increasing to 10x-11x on average in 2021-2022 from the 6x-7x we previously forecast. While we expect the French government to provide extraordinary support to the rail group in response to the pandemic, which could improve our current forecasts, we have no information on the amount, timing, or mechanism of such support. At the same time, we will need to assess whether such extraordinary relief will continue to underpin our view of an extremely high likelihood of support for SNCF SA from the French government.

In the absence of state support, and despite the €35 billion debt relief approved by the government last year, we expect FFO to debt to drop to 6% on average in 2021-2022. Our adjusted metrics incorporate the large debt-relief measures the French government approved last year as part of its rail reform: €25 billion on Jan. 1, 2020, and €10 billion on Jan. 1, 2022. This package is intended to mitigate the large legacy debt accumulated by SNCF Réseau (AA/Stable/A-1+), the SNCF group's rail infrastructure manager, which reported €51.9 billion in debt as of Dec. 31, 2019. As a result, we consider average credit metrics for 2021-2022 to be more representative of the group's future credit quality than the 2019 ratios: S&P Global Ratings-adjusted FFO to debt of 4.4%, reflecting about €70 billion in S&P Global Ratings-adjusted debt. That said, we expect the unprecedented traffic decline will have a cumulative effect over the next few years, with FFO to debt reducing to about 6% on average in 2021-2022 excluding government support. In our view, this could also require a revision of the targets agreed with the government, such as neutral free cash flow generation for the group in 2022 and reported net debt to EBITDA below 5x by 2022. This would depend on the extent of the passenger decline, pace of recovery, and capital expenditure (capex) plan. For the time being, we assume annual capex will decline to €4 billion-€4.5 billion in 2020, net of investment grants, from the €5 billion-€5.2 billion previously expected. We expect most of the operating cost savings to relate to temporary layoffs backed by the government (staff accounted for 49% of SNCF's total operating costs in 2019).

Environmental strings attached to Air France's state-aid package could benefit rail services, although it's still unclear how quickly traffic will recover. We expect private vehicles to be the preferred option for travelers in the current context, but it is difficult to predict long-term behavioral changes as a result of the pandemic, due for example to increased reliance on remote working and fewer business trips. That said, in the case of SNCF group, we consider that environmental conditions attached to Air France's state-aid package require the French flagship carrier to cut short-haul flights, which could stimulate demand for SNCF's long-distance rail services. We see an important role for rail transportation to help with the EU's net-zero emissions targets by 2050. Also, requirements for social-distancing measures on trains in France have been lifted, while the number of services is returning to pre-pandemic levels. As for SNCF's European rail peers, we forecast an approximate 35% drop in revenue on long-distance routes in France and a 20% drop in revenue on regional services in 2020. We expect regional services to be relatively less affected because about two-thirds of that revenue is paid by regions and are fixed. The same largely applies to SNCF's subsidiary Keolis, which operates in local transportation worldwide, while other segments--Geodis, the logistics business, and rail freight--are more sensitive to the global macroeconomic environment. We estimate that long-distance passenger traffic operated by subsidiaries like TGV and Eurostar/Thalys have been the worst affected and recovery prospects remain uncertain.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety

CreditWatch

The CreditWatch indicates that we could lower the rating on SNCF SA by one notch over the next few months if the group cannot withstand the impact of COVID-19 pandemic, leading to a deterioration of its SACP by two notches to 'bb'. This could materialize, for example, if the group, while maintaining its business strengths, cannot keep FFO to debt well above 6% on average in 2021-2022 amid uncertainty about the traffic recovery and the amount, timing, and mechanism of state support.

We could lower the rating by more than one notch if we believed that SNCF SA's link with or role for the state had weakened. This could materialize if in our view the extent and mechanism of state support is not aligned with our opinion of an extremely high likelihood of support.

We intend to resolve the CreditWatch once we have visibility over the amount, timing, and mechanism of extraordinary state support to SNCF SA from the French government.

Company Description

SNCF SA is the holding company of French integrated rail and transportation services 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 Voyageur (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% of total gross profit in 2019, including its subsidiary Gares&Connexions). The company also owns rail freight, logistics, and mass-transit transportation activities, respectively through Geodis, SNCF Fret, logistic subsidiaries (17% of total gross profit) and Keolis (11% of gross profit).

Liquidity

We assess SNCF SA's liquidity as adequate. This reflects that, despite the forecast EBITDA drop in 2020, we expect sources will cover uses by more than 1.2x over the 12 months to March 31, 2021. Given its key role and strong links with the French government, we believe the group benefits from a high standing in credit markets, solid relationships with banks, and ability to swiftly access emergency central government funding in the event of difficult market access.

We estimate liquidity sources in the 12 months to March 31, 2021 include:

- About €4.57 billion of unrestricted cash and cash equivalents;
- An undrawn revolving credit facility of €3.5 billion, committed until 2024;
- Proceeds of new bond issuances completed in second-quarter 2020 of about €4 billion;
- The state's contribution of about €2.5 billion to cover debt service under a €25 billon debt-relief mechanism in place since Jan. 1, 2020.

We estimate the following liquidity uses over the same period:

- Debt maturities of about €4.2 billion;
- Capex of about €4 billion, net of investment grants;
- Negative FFO of about €800 million;
- Working capital of €150 million-€200 million; and
- Annual dividends to the French government of about 60% of net profit, to be reinjected as grants to support SNCF Réseau's investment.

Covenants

SNCF SA doesn't have any financial covenant in its financial documentation. Nevertheless, some subsidiaries such as Keolis and Eurostar have external debt, which includes certain financial covenants. We do not anticipate an acceleration of such debt and estimate that SNCF SA has sufficient liquidity if needed.

Issue Ratings--Subordination Risk Analysis

Capital structure

SNCF SA is the holding company of SNCF group and the sole issuer for the group after June 2020. Its total external consolidated debt (about €68 billion as of Dec. 31, 2019) notably includes SNCF Réseau's large external debt of about €54 billion, which benefits from €25 billion of debt relief on Jan. 1, 2020, and €10 billion on Jan. 1, 2022. Other subsidiaries have limited external debt (about €2.8 billion), including Keolis, logistic companies, and Eurostar.

Analytical conclusions

We equalize our issue rating on SNCF SA's debt at the level of 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 the amount of 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 the holding company, SNCF SA.

Related Criteria

- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch Action

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