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Strikes Dent French Retailers' Earnings For The Second Year In A Row

February 26, 2020

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Key Takeaways

- In what is already a tough market, strikes and social unrest disrupted French retailers' key festive trading season for the second year in a row.
- Changing consumption trends in favor of convenience and proximity stores pose structural challenges to the hypermarkets that still dominate the French retail landscape.
- Weak trading in fourth-quarter 2019 will lead to further margin pressure, as retailers are already having to invest in prices and transform their business models to stay competitive.
- Disposals lend some support to French retailers' credit metrics, but for several, credit quality continues to weaken.

Public sector strikes and protests against pension reforms have added to French retailers' woes in what are already difficult market conditions. The strikes followed on the heels of the gilets jaunes ("yellow vest") protests for economic justice, which lasted for more than a year. According to data firm Nielsen, the latest strikes adversely affected the French fast-moving consumer goods sector in the fourth quarter of 2019 even compared with the same period in 2018, which marked the start of the yellow vest movement.

Last year was therefore the second consecutive year when trading in December--the most important month of the year for retailers--was disrupted due to social unrest in France. S&P Global Ratings expects that the decline in consumption in December will have a significantly negative effect on the retailers' full-year operating results.

At the same time, the French retail market is highly competitive, with almost all retailers investing heavily to reduce prices. This has resulted in a topline decline for many retailers, with only a few reporting meaningful like-for-like sales growth. In addition, French consumers' shopping behavior and expectations continue to evolve rapidly. Consumers' price-sensitivity and desire for convenience have increased, as has their demand for fresh foods and organic produce. All the major French retailers are aiming to differentiate their offerings, with several spending heavily to restructure and transform their customer proposition.

These Strikes Hit Discretionary Spending Harder Than The Yellow Vest Movement Did

The recent strikes have affected Paris and other city centers more than the social disturbances in 2018, and they will likely take a bigger chunk out of retailers' earnings. This is particularly true for discretionary spending, suggesting a greater impact on retail segments such as nonfood and luxury goods. French consumer electronics and editorial products retailer Fnac-Darty has estimated that it lost about €70 million in revenues due to the social unrest in France in December. The Fnac brand was most affected due to its strong presence in city centers, particularly Paris, and due to lost sales in the important gifting category. Transport issues created operational challenges for the movement of goods and employees, as well as customers. According to the group, footfall in its Parisian stores dipped 16% compared with 2018, versus an average normative decline of between 2% and 3%. In the 2019 Christmas period, sales declined by €35 million more than they did due to the yellow vest movement in 2018.

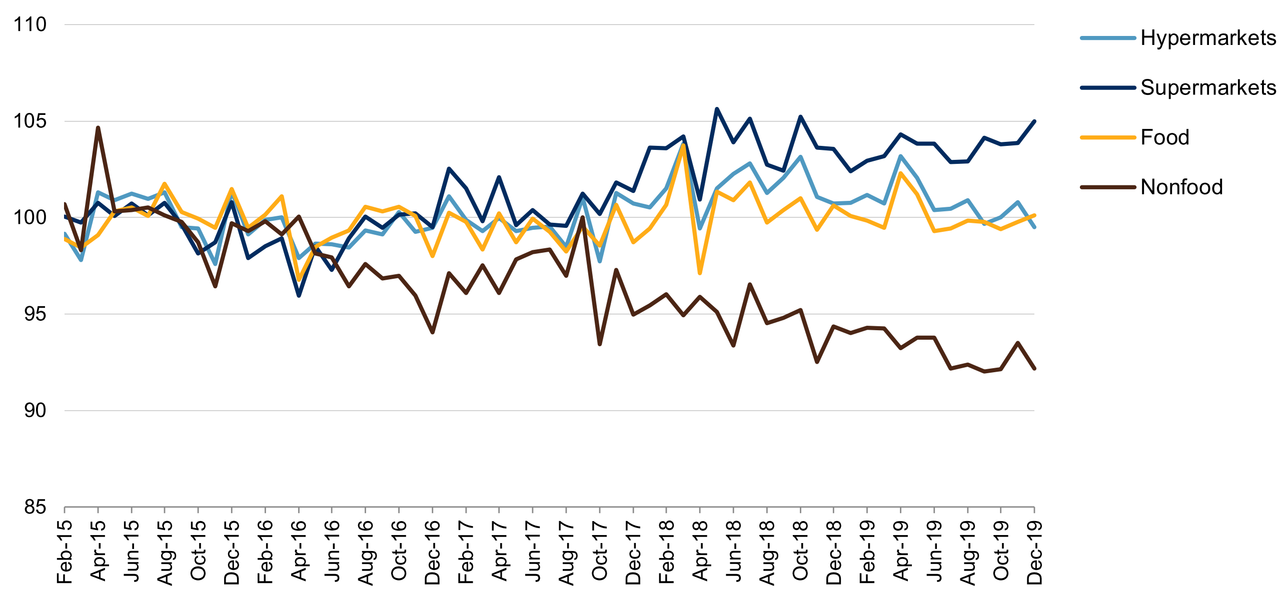
Fnac-Darty expects turnover in the fourth quarter in France to be broadly stable in like-for-like terms thanks to good performance on Black Friday, notably from sales of household electronics. Yet, despite cost controls and the positive contribution from acquisitions, the strikes had clear repercussions on its 2019 sales and margins. The group's gross margin on continuing activities was down by about 20 basis points versus 2018. While this is the cumulative effect of several factors, the loss in Christmas sales volumes due to the strikes, together with an unfavorable mix on books and other products, will shave about 15 basis points off the yearly gross margin. However, Fnac-Darty's preliminary numbers on profitability and cash flow suggest that performance is broadly in line with our base case and highlight the group's capacity to adapt its cost base swiftly to less favorable market conditions.

That said, in our view, not all retailers will be able to limit the effect of revenue loss from strikes on their overall financial performance. We expect smaller retailers that depend on discretionary spending, like Novartex, the parent of French apparel and footwear retailer Vivarte, to feel the effects of the tough social environment in France, as the strikes severely affected transport to stores in city centers. In view of Novartex's high operational leverage, if these factors were to lead to even a small drop in revenues, the company's cash flow generation would take a pronounced hit, thereby depleting liquidity.

As many of the rated French retailers in the apparel and other nonfood segments have yet to report their 2019 financial results, we do not have full visibility on their performance during the festive season and the all-important fourth quarter. Yet, French nonfood retailers were reeling from widespread competition even before the strikes. While almost all major retailers in France have developed their own e-commerce and mobile channels, Amazon continues to grow and dominate the nonfood retail market, with its share of nonstore sales now estimated at 15% in France, based on Euromonitor data.

Chart 1

Turnover In Large-Scale Food Retail Is On A Declining Trend



Source: INSEE and S&P Global Ratings.

Food Retailers Also Had A Weak Fourth Quarter, With Hypermarkets Underperforming The Most

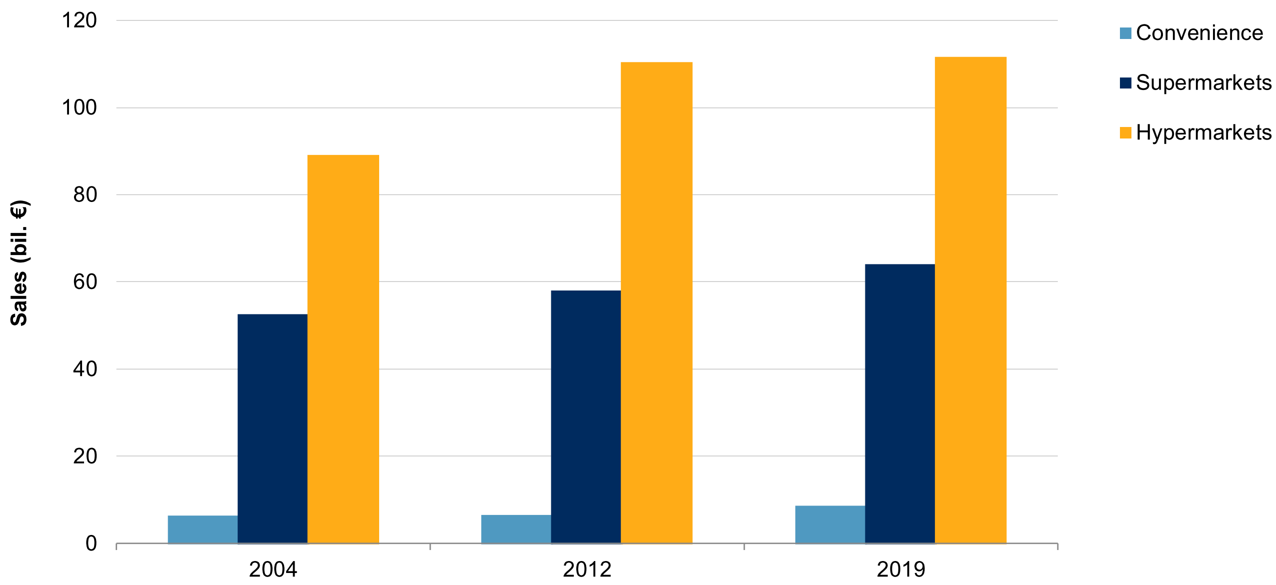
Over the fourth quarter of 2019, the turnover in large food retail decreased 0.7% compared with the fourth quarter of 2018, according to the National Institute of Statistics and Economic Studies, INSEE. Over that period, sales of food products declined by 0.6% and nonfood products by 1.5%.

More critically, the data reflect the underperformance in hypermarkets, where turnover declined by 1.5% compared with the fourth quarter of 2018, and by 0.3% compared with the third quarter of 2019. Supermarkets, conversely, remained broadly stable relative to the same quarter in 2018, and grew by 0.9% in the third quarter of 2019.

Overall, these results are consistent with the trend in recent years, whereby discounters, supermarket operators, and specialized food retailers have gained market share at the expense of large integrated food retailers. Fast-changing consumer trends also contribute to reduced footfall in hypermarkets, with customers now preferring smaller baskets and more regular trips at their neighborhood stores, over shopping in bulk less frequently. That said, the hypermarket segment still has materially larger sales volumes than the supermarket, convenience, and discount segments, and therefore remains important.

Chart 2

Hypermarkets Still Have The Largest Sales Volumes



Source: Euromonitor, S&P Global Ratings.

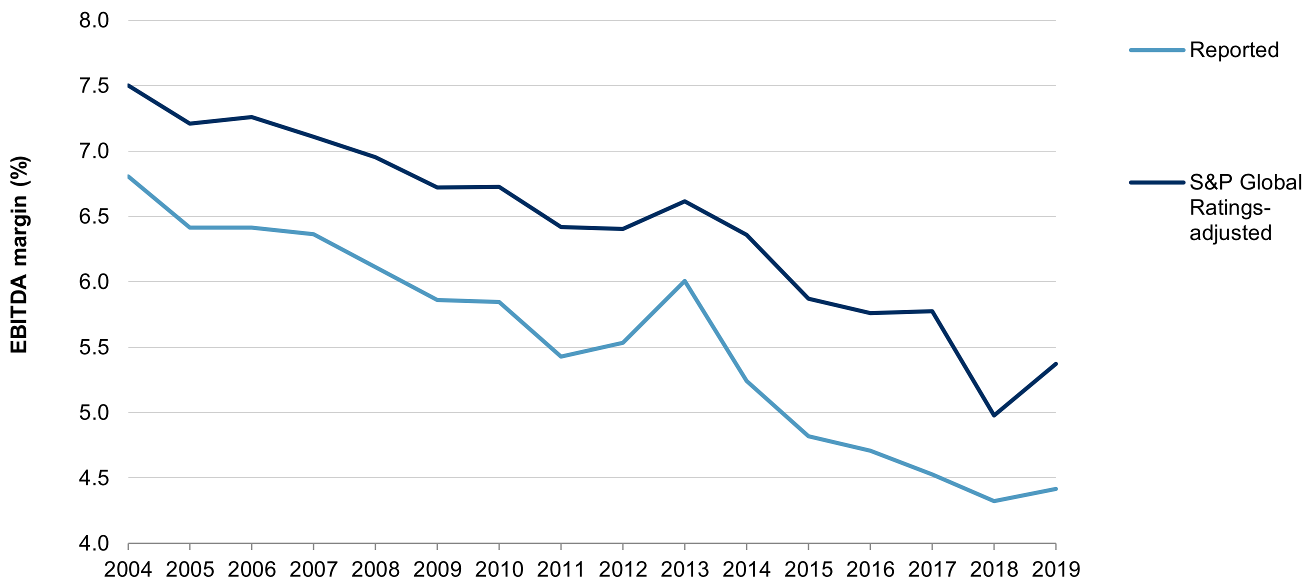
As anticipated, the recent strikes have not helped matters. Carrefour has not quantified the impact of the strikes in its preliminary figures for 2019, but its like-for-like sales in France were down by 0.9% in the fourth quarter. The decline was primarily due to the significant impact of the December strikes on hypermarket sales and a sharp 7.7% drop in sales of nonfood items, which was not offset by moderate growth of 0.4% in food. Carrefour's hypermarket sales were down by 3.4% on a like-for-like basis in the fourth quarter of 2019.

In addition to the strikes, hypermarket sales of festive products suffered from the effects of the new law in France imposing a minimum gross margin of 10% for each food item and capping promotions by food retailers. The performance of hypermarkets also suffered measures taken to improve the competitiveness of the segment. These included investments to lower prices, the introduction of cheaper own-brand products, the reduction of under-productive nonfood areas, and the discontinuation of certain product categories.

Casino's full-year 2019 net sales growth of 4.2% on an organic and 2.2% on a same-store basis was driven by its Latin American business. In France, Casino could only achieve stable same-store net sales, with organic growth declining by 0.8%. For the fourth quarter, both its organic and same-store sales were down by 1.6% and 0.6%, respectively. The Géant hypermarkets reported a 0.7% decrease in sales on a same-store basis for the fourth quarter. Sales in Casino's nonfood categories at its hypermarkets were also down, by 4.2%, with food sales down by 0.5%. In our view, a lot of this decline could be due to the disruption caused by the strikes across Paris as Casino is comparatively less exposed to hypermarkets than Auchan and Carrefour.

Chart 3

French Food Retailers' Profitability Has Seen A Structural Decline



Source: S&P Global Ratings.

Of all the rated French grocers, we believe Auchan is characterized by less diversification in terms of store formats than Carrefour or Casino, with an overreliance on destination stores rather than proximity or convenience stores. In our view, destination stores, either out-of-town supermarkets or hypermarkets, are more price-sensitive given that the consumer is less captive and typically has recourse to this type of store for larger baskets. Auchan, which operates some of the biggest hypermarkets, still has a material portion of its hypermarkets dedicated to nonfood, a segment where competition is even more pronounced given the presence of specialized retailers and online pure players. We note that the new management's strategy has evolved since Mr. Bonte, a member of the Mulliez family, was appointed chairman. For instance, Auchan is exploring the possibility of partnering with other Mulliez-controlled entities to operate some of the nonfood sections in large hypermarkets. Aside from the exit of the Italian operations, a major step for the group, it has also announced its intention to sell or close 21 nonperforming or poor-performing stores in France.

Carrefour is also materially exposed to the challenged hypermarket format in France, with hypermarkets accounting for 54% of sales in 2018. It has reduced the underproductive sales area of its hypermarkets by 110,000 square meters out of a target of 350,000 by 2022, excluding China. It has also expanded its omnichannel capabilities and growth formats by opening drive and cash-and-carry outlets, and 836 new convenience stores out of a target of 2,700 by 2022, excluding China. Carrefour has also achieved more than half of its targeted 15% reduction in its product assortments by 2020, particularly in the nonfood segment. Comparatively, Casino's business model benefits from higher format diversity and lower exposure to hypermarkets. Casino's premium and convenience store formats in France--where it has a leading position--are less exposed to pricing pressure, in our opinion. We also expect Casino to pursue its strategy to shift away from hypermarkets, keeping in its portfolio only the most profitable ones and either disposing of or closing nonstrategic or nonperforming ones.

Despite The Strikes, Consumption Will Continue To Benefit From Supportive Economic Conditions

The French economy remains largely supportive of household consumption. We are likely to scale back our French GDP growth expectations of 1.3% in 2020, as a result of the coronavirus and strikes at the start of the year. That said, we expect the economy to remain resilient thanks to strong domestic demand and the labor market being in its best shape since the financial crisis. Fiscal easing and a more domestically oriented economy will help France outperform the eurozone. As such, households and firms are set to benefit from additional reductions in fiscal pressure, at least until 2022. A further rise in job creation, alongside rising wages and average inflation of 1.3% over the next four years, will support households' purchasing power and therefore their spending.

Confidence among French consumers is close to its 2016-2017 high as consumers benefited from a significant fiscal boost last year and are more optimistic about their future job prospects and personal finances in the near term.

Disposals Have Improved Retailers' Credit Metrics, But Increased Their Dependence On France

Many of the large rated French retailers, notably Carrefour, Auchan, and Casino, have undertaken significant disposals to reduce pressure on their credit metrics. On the flipside, these disposals have put more emphasis on the retailers' operating performance and earnings in their difficult home market.

Carrefour announced asset disposals of about €1 billion over 2018-2019, including 80% of its Chinese subsidiary and 100% of Cargo Property Assets. This follows an IPO of Carrefour's Brazilian hypermarket subsidiary Atacadao in 2017, which generated about €1.2 billion of proceeds that management primarily used to repay debt. Carrefour is making good progress on its five-year transformation plan, with limited setbacks so far. The group is also starting to reap the benefits of its cost-saving initiatives, but is reinvesting the savings in its price competitiveness.

Auchan has also taken steps to mitigate its poor operating performance and restore its credit ratios. In March 2019, it announced a more conservative financial policy, with reduced capital expenditure and no dividends to immediate shareholders. Later that year, Auchan completed the partial disposal of Oney Bank to French banking group BPCE. Auchan has taken several other broad measures to preserve its credit quality and financial leverage. These include:

- The disposal of its retail operations in Italy;
- The closure or disposal of 21 stores in France;
- A pilot of shop-in-shop concepts with other Mulliez-owned businesses, such as Decathlon, Leroy-Merlin, and Boulanger;
- A decision to centralize the Chinese operations under RT-Mart; and
- A partnership with Sunning in China to operate the consumer electronics business.

Auchan is targeting a reported EBITDA margin of 6% for 2022, which translates into about €1.1 billion of cost savings against 2018 spending. This suggests that more restructuring measures are yet to be announced.

Casino has confirmed plans for €2.5 billion of disposals in France by the end of the first quarter of 2020. Of these, Casino has commitments for €2.1 billion, with a cumulative total target of €4.5 billion by the end of the first quarter of 2021. The group continues to dispose of loss-making stores under the Géant hypermarket and Casino supermarket brands, and plans to sell the Leader Price brand. It has classified these stores as discontinued operations in its 2019 full-year report.

Furthermore, Casino has secured €1.8 billion in new financing and a new credit line in France maturing in October 2023, which has extended the average maturity of its credit lines from to 3.6 from 1.6 years. Casino has consolidated its operations in Latin America within its Brazilian subsidiary GPA, which now owns 96.6% of retail group Éxito.

Even smaller French retailers like Novartex have undertaken disposals to improve their financial positions. Novartex was able to add about €200 million to its cash following the divesture of Besson, its shoe brand, in 2019. We believe that the group is likely to make further disposals in the coming years.

A Continued Focus On Costs And A Tangible Improvement In Operating Performance Will Be Key To Preserving Credit Quality

Despite the support from the disposal proceeds, French retailers' adjusted debt remains high. Pressure on earnings and restructuring costs, combined with continued investments in business transformation, make it difficult for the retailers to reduce their leverage sustainably. We have downgraded all of the three large retailers--Carrefour, Auchan and Casino--over the past 12 months, in large part due to operating weakness in France.

The majority of the rated retailers in France have ratings in the 'B' category, and so the recent weak trading results only increase their vulnerability to further setbacks in earnings and cash flow. Three retailers--Auchan, Casino, and Novartex--have negative outlooks, and are most likely to see negative rating actions.

Auchan. Of its French peers, Auchan is the most exposed to the extremely competitive French food retail market. The group may need to adapt its business model to enhance its hypermarket operations and preserve its market position and profitability. We see execution risks in both the scope of its transformation plan and the speed of its implementation.

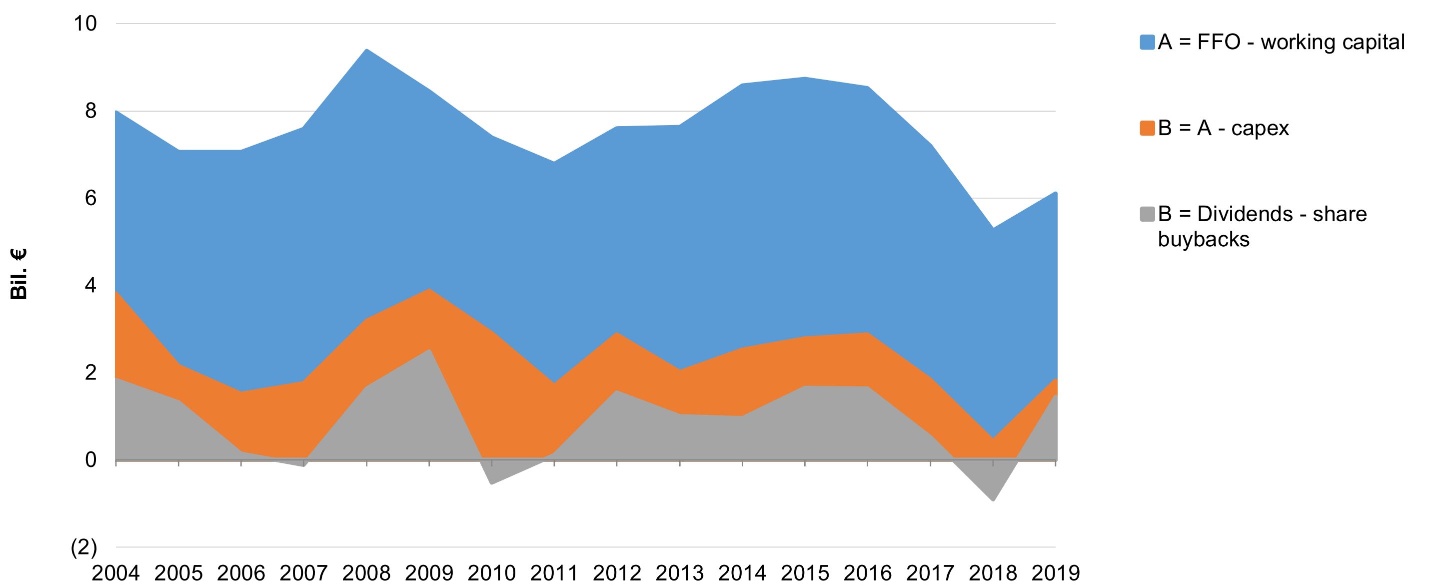
Casino. The negative outlook on Casino mainly reflects the ongoing uncertainty arising from the safeguard procedure affecting Casino's parent companies, which could hurt Casino's credit standing indirectly.

Novartex. Novartex (Vivarte) is vulnerable despite a recent upgrade following the completion of a distressed debt exchange and refinancing that stabilized its liquidity position. The negative outlook reflects our view that the ongoing tough social environment in France and intense competition in the fashion retail market could suppress Novartex's cash generation, constrain its liquidity, and threaten its long-term solvency.

For all the French retailers, their weak topline performance will weaken their margins and cash flow, diminishing the ratings headroom that for many is already low. Because of the difficulty in growing sales, the success of transformation programs, cost management, and cash-preservation initiatives--which almost all of the retailers are pursuing--will be key to maintain margins, cash flow, and credit quality. We should have more visibility on these aspects from our analysis of the retailers' detailed financial results, which should be available over the next few weeks.

Chart 4

French Retailers' Cash Flow Generation Has Eroded Since 2016



FFO--Funds from operations. Source: S&P Global Ratings.

French Retailers, Strongest To Weakest

The following table ranks the retailers we rate in France from strongest to weakest. We rank companies by rating, outlook, stand-alone credit profile (SACP), business risk profile, financial risk profile, and liquidity assessment. Investment-grade companies are ranked by business risk profile, then financial risk profile. Speculative-grade companies are ordered by financial risk profile, then business risk profile. For retailers in France, our business risk assessments are identical to the corresponding competitive positions. If not distinguished by these factors, companies are then listed in alphabetical order.

In line with our corporate rating methodology, the rating may differ from the SACP, where government, group, or rating-above-the-sovereign considerations apply. Where the SACP differs from the anchor, we have applied one or more modifiers, which may include one for liquidity. We've noted the anchor and active modifiers for each company for informational purposes only.

For more detailed analysis, please refer to company-specific pages on RatingsDirect. For our sector outlooks and analysis, please refer to the commentaries listed in the Related Research section below.

Table 1

French Retailers Rated By Global Ratings, From Strongest To Weakest

Company	ICR	Outlook	Business risk	Cash flow and leverage	Anchor	Modifiers (active)	Liquidity
Carrefour S.A.	BBB	Stable	[2] Strong	[3] Intermediate	bbb+	Comparable ratings analysis: Negative (-1 notch)	Strong
Auchan Holding	BBB-	Negative	[3] Satisfactory	[4] Significant	bb+	Comparable ratings analysis: Positive (+1 notch)	Adequate
FNAC Darty SA	BB+	Stable	[4] Fair	[3] Intermediate	bb+	--	Adequate
Mobilux 2 S.A.S. (BUT)	B	Positive	[5] Weak	[5] Aggressive	b+	Comparable ratings analysis: Negative (-1 notch)	Adequate
Picard Groupe S.A.S.	B	Stable	[4] Fair	[6] Highly leveraged	b	--	Adequate
THOM Europe S.A.S.	B	Stable	[4] Fair	[6] Highly leveraged	b	--	Adequate
Casino Guichard - Perrachon S.A.	B	Negative	[3] Satisfactory	[5] Aggressive	bb	Management & governance: Weak (-1 notch); Comparable ratings analysis: Negative (-1 notch); Group influence: Negative (-1)	Adequate
BURGER KING France SAS	B-	Stable	[5] Weak	[6] Highly leveraged	b-	--	Adequate
Novartex (Vivarte)	B-	Negative	[6] Vulnerable	[5] Aggressive (was [6])	b	Management & governance: Weak (-1 notch)	Less than adequate

ICR--Long-term foreign currency issuer credit rating. N/A--Not applicable.
Note: Decathlon S.A. is not included in the table above, as it only has a short-term rating of 'A-2'.

Related Research

- Coronavirus Impact: Key Takeaways From Our Articles, Feb. 20, 2020
- ESG Industry Report Card: Retail, Feb. 11, 2020
- Inside Credit: The Health Of Branded European Consumer Goods Companies Isn't Immune To The New Coronavirus, Feb. 3, 2020
- U.K. Retailers: Disappointed By Their Christmas Presents, Jan. 21, 2020
- A Poor Third Quarter Revealed U.S. Retailers' Vulnerability To Consumer Sentiment, Jan. 9, 2020
- Economic Research: Eurozone Economic Outlook: Consumers Won't Give Up In 2020, Nov. 28, 2019

This report does not constitute a rating action.