MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's assigns first-time Baa2 rating to Esselunga S.p.A.; negative outlook

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London, 09 October 2017 -- Moody's Investors Service has today assigned a first-time Baa2 long-term issuer rating to Esselunga S.p.A. ("Esselunga"). Concurrently, Moody's has assigned a Baa2 senior unsecured rating to Esselunga's proposed senior unsecured bonds of up to EUR 1 billion. The outlook on the ratings is negative.

"The Baa2 long-term issuer rating reflects Esselunga's well-established position as Italy's fourth-largest grocery retailer position and its defensive business profile" says Ernesto Bisagno, a Moody's Vice President - Senior Credit Officer and lead analyst for Esselunga. "The rating also reflects the strong financial metrics offsetting the lack of international diversification", adds Mr Bisagno.

RATINGS RATIONALE

Esselunga's Baa2 long-term issuer rating reflects the company's (1) defensive business profile and low seasonality; (2) well-established position as Italy's fourth-largest grocery retailer; (3) exposure to some of the wealthiest parts of Italy; (4) strong track record in generating stable, above-average returns for the sector, with a Moody's-adjusted EBIT margin of 6.1% in 2016; (5) relatively low level of adjusted debt and conservative financial policy; (6) expectation that free cash flow (FCF) generation (after capital spending and dividends) will remain marginally positive despite the material investment programme.

The rating also reflects the company's (1) lack of international diversification and hence reliance on the economic conditions in Italy, although Moody's notes the company's resilient performance during the financial crisis; (2) relatively smaller size and higher geographical concentration than other rated European retailers.

Moody's expects macroeconomic conditions to be supportive of Esselunga's operating performance, also in light of the company's exposure to some of the wealthiest parts of Italy. However, the lack of diversification outside Italy could impair growth and leaves Esselunga exposed to the volatility in the domestic economy.

Moody's anticipates leverage (Moody's adjusted gross debt to EBITDA) at December 2017 to be 2.3x. The calculation includes around EUR 1.3 billion of debt of which almost EUR 900 million funding the acquisition of the 67.5% stake in Villata Partecipazioni S.p.A. ("Villata Partecipazioni"), and EUR 417 million of adjustments for operating leases and pensions. In addition, the rating agency notes the existence of EUR 300 million of debt at the level of the holding company Supermarkets Italiani SpA (Supermarkets) and the significant minority stake of 32.5% in Villata Partecipazioni. While the EUR 300 million debt is not factored in Moody's credit metrics, the holding company Supermarkets largely relies on dividend payments from Esselunga to service the debt. Positively, this is mitigated by the conservative financial policy with management focused on maintaining a level of reported net debt to EBITDA below 1.5x.

Moody's anticipates Esselunga to continue to grow its sales each year in the low-to-mid single digit range (as a combination of positive organic growth and contribution from its new stores) and maintain relatively stable margins, supporting steady operating cash flow generation.

Moody's expects FCF generation to be broadly neutral in 2018, owing to discretionary capex plan and working capital needs due to changing value-added tax payables, and to improve in 2019-20 at EUR 50 million- EUR 100 million each year. As a result, Moody's expects leverage to decline marginally towards 2.2x by 2019, with the decline driven by a combination of higher EBITDA and stable gross debt. On a reported net debt to EBITDA calculation, that would be equal to 1.3x in 2019, down to 1.1x in 2020, within the company's targets to maintain reported net leverage below 1.5x.

LIQUIDITY ANALYSIS

Moody's views Esselunga's liquidity profile as good, underpinned by the existing cash in excess of EUR 200 million and limited refinancing needs until their bilateral revolving credit facilities of EUR 300 million mature in August 2022. Moody's understands that those facilities do not contain any material restrictive covenants.

The liquidity assessment assumes that the company will complete the refinancing of the EUR 900 million facility on the capital markets. In addition, Moody's liquidity analysis takes into account the expectation that FCF will be neutral in 2018 and marginally positive in 2019, and factors in modest seasonality and limited working capital volatility over quarters.

RATIONALE FOR THE NEGATIVE OUTLOOK

Metrics are comfortable for the rating category so the negative outlook instead reflects the business concentration in Italy and mirrors the negative outlook on Italy. If the sovereign was downgraded we do not see Esselunga as being absolutely constrained by Italy's rating and might consider positioning the rating above the sovereign if justified by an expectation of sufficiently strong and resilient performance. However in view of the domestic concentration we would not expect the rating to be positioned more than one notch above Italy, even if performance and metrics are very strong.

WHAT COULD CHANGE THE RATING UP/DOWN

An upgrade to Baa1 is now considered unlikely at this point. However, upward rating pressure would reflect a combination of: (1) continued improvement in the company's financial profile, resulting in adjusted (gross) debt/EBITDA to trend below 2x and retained cash flow ("RCF")/net debt above 30% on a sustained basis; (2) simplification of the financial structure in particular with regard to the existence of debt at Supermarkets level. Any potential upgrade would also be considered in the context of the prevailing macroeconomic conditions and the Government of Italy's rating.

Conversely, negative pressure on the rating could materialize if (1) Esselunga's credit metrics deteriorated with adjusted (gross) debt/EBITDA trending above 2.5x and retained cash flow/net debt below 20% on a sustained basis. Any potential downgrade to the Government of Italy's rating could also exert negative pressure on Esselunga's rating.

The principal methodology used in these ratings was Retail Industry published in October 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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