MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Esselunga to Ba1 from Baa2; stable outlook

25 Mar 2020

Milan, March 25, 2020 -- Moody's Investors Service, ("Moody's") has today downgraded to Ba1 from Baa2 the ratings on the senior unsecured debt instrument ratings issued by Esselunga S.p.A. ("Esselunga"), a leading Italian food retailer.

Concurrently, Moody's has withdrawn Esselunga's Baa2 issuer rating and subsequently assigned the company a Ba1 corporate family rating (CFR), a Ba1-PD probability of default rating (PDR), and a Ba1 instrument rating to the €1 billion bonds in line with the rating agency's practice for corporates with non-investment grade ratings. The outlook is stable.

The rating action follows the announcement that Marina and Giuliana Caprotti ("majority shareholders"), who currently hold 70% of the share capital of Supermarkets Italiani S.p.A. ("SI"), the vehicle which in turn fully owns Esselunga, reached an agreement to purchase the remaining 30% share capital owned by Violetta and Giuseppe Caprotti for €1,830 million.

This rating action concludes the ratings review process that began on 17 January 2019, when the proposed transaction was initially announced.

A newly incorporated company named Superit Finco S.p.A. ("Superit Finco"), fully owned by the majority shareholders, will buy 30% of the shares in SI. The transaction is expected to close in April and will be funded through a combination of (1) €100 million equity injection from the majority shareholders; (2) €435 million from the sale of the majority shareholders' 32.5% interest in La Villata S.p.A. ("La Villata"), the real estate company that owns most of Esselunga's stores, to a financial investor; (3) €550 million bridge facility with a maximum 15 months maturity to be repaid using Esselunga's existing cash; and (4) €762 million acquisition facility with a maturity of seven years. The new debt facilities have been raised by Superit Finco.

Following the transaction, Esselunga will be merged with both Superit Finco and SI and, as a consequence, will assume the obligations under the new debt facilities.

"The downgrade to Ba1 from Baa2 reflects the significant debt and resulting higher leverage that Esselunga will incur to facilitate the acquisition of the 30% stake by its majority shareholders. The transaction comes at a time of increased uncertainty given the difficult retail environment and the weakened economic conditions owing to the coronavirus outbreak In Italy, and mainly in the Lombardy region, Esselunga's core market," says Ernesto Bisagno, a Moody's Vice President - Senior Credit Officer and lead analyst for Esselunga.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The rating action reflects Moody's expectation that Esselunga's leverage pro forma for the transaction will increase to around 4.3x at December 2020 from around 2.5x pre-transaction. This material increase also reflects a change in financial policy with has led to a more aggressive balance sheet management. However, the limited cash equity contribution of €100 million is partially mitigated by the fact that the majority shareholders funded the transaction through the disposal of their minority stake in La Villata. Moody's understands that the 32.5% equity stake bought by the financial investor has been converted from ordinary to preferred shares. These preferred shares, despite being deeply subordinated at La Villata level, do not receive any equity credit at Esselunga level as the instrument is issued by a subsidiary, and therefore in a distressed scenario would be closer to La Villata's assets.

Over 2020-21, Moody's expects Esselunga to continue to grow its sales through the contribution from its new stores and stronger online sales, more than offsetting weak organic growth. However, the rating agency continues to anticipate an increase in operating costs, which, combined with the competitive retail environment, could exert pressure on the company's margins. The rating agency cautions that the unprecedented situation owing to the coronavirus outbreak leaves its forecasts exposed to increased uncertainty.

Moody's expects operating cash flow to remain stable or modestly decline depending on the company's ability to continue to improve working capital, to offset higher interest paid. Moody's assumes around €20 million dividends each year mainly related to the remuneration paid to the financial investor who has bought the 32.5% stake in La Villata. With capital expenditure of around €400 million each year, the rating agency expects Esselunga to continue to generate positive free cash flow (FCF) of around €100 million - €150 million annually. However, the largest part of the capital expenditure is discretionary, which gives Esselunga additional levers to preserve cash flows, albeit temporarily, in case operating performance deteriorates.

Moody's expects adjusted leverage to increase towards 4.3x in 2020-21. However, the company could use any excess cash to prepay part of the new acquisition financing which could support an improvement in credit metrics in 2021.

The leverage calculation at fiscal year-end 2020 is based on total adjusted gross debt of €3 billion which includes (1) €1 billion legacy bonds at Esselunga level, (2) €762 million new acquisition facility, (3) €435 million preferred shares issued at La Villata level; (4) around €720 million of lease obligations (including both finance and operating leases); and (5) approximately €100 million of pension liabilities. Currently, there is also €300 million of debt at the level of SI that is not factored in Moody's credit metrics, as the company indicated this debt will be repaid in 2020.

Despite the weakened credit metrics, the Ba1 rating reflects (1) Esselunga's defensive business profile and low seasonality; (2) its well-established position as Italy's fourth-largest grocery retailer; (3) the company's exposure to some of the wealthiest parts of Italy; (4) its strong track record of generating stable, above-average returns for the sector; and (5) expectation that the company's free cash flow (FCF) generation (after capital spending and dividends) will remain positive despite the material investment programme.

The rating also reflects (1) Esselunga's lack of international diversification and, hence, reliance on economic conditions in Italy, despite the company's resilient performance during the financial crisis; (2) its modest size and higher geographical concentration compared with most other European retailers that Moody's rates; and (3) the competitive retail environment, which continues to exert pressure on its margins.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATIONS

Following the transaction, Esselunga will be fully owned by Marina and Giuliana Caprotti. Despite being privately held, and notwithstanding the lack of explicit commitment to a leverage target, the controlling shareholders had historically maintained a conservative financial policy with no appetite for material shareholder distributions. However, the transaction suggests a shift in financial policy which points to a higher leverage tolerance, due to the fact that a material portion of the purchase price has been funded with debt.

Moody's also regards the coronavirus outbreak as a social risk under the ESG framework, given the substantial implications for public health and safety. This is particularly relevant for Esselunga as the company derives around 66% of its earnings in Lombardy, which so far has been the region most affected by the outbreak. The exposure to coronavirus is mitigated by the fact that the company provides fundamental services and, for now, the food supply chain remains protected by the Italian government despite having imposed the nationwide lockdown on all the non-essential activities.

LIQUIDITY

Liquidity is good but will weaken as a result of the transaction. Cash at 31 December 2019 stood at €1.1 billion and is expected to decline towards €400 million at December 2020, as Esselunga will repay the €550 million bridge facility and the €300 million outstanding debt at SI, partially offset by positive FCF of approximately €100 million - €150 million. In addition, the company has access to committed bilateral revolving credit facilities of €300 million maturing in August 2022, currently fully undrawn. There are limited refinancing needs, given the two €500 million bonds outstanding mature in October 2023 and October 2027, while the new acquisition financing will mature in January 2027.

STRUCTURAL CONSIDERATIONS

Esselunga's capital structure includes both bank debt and bonds, and as a result, Moody's has assumed a 50% family recovery rate, resulting in a PDR of Ba1-PD. The €1 billion bonds are rated Ba1, in line with the CFR, as the vast majority of debt as sitting at Esselunga's level, and the bonds rank pari passu.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Esselunga's performance is likely to be fairly resilient to the unprecedented economic and social challenges caused by the coronavirus outbreak, and that leverage will remain at around 4.3x over 2020-21, barring any debt reduction.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward rating pressure would require an improvement in operating performance with growing revenues and EBITDA which, combined with a more prudent financial policy, would result in an improvement in the company's financial profile. Quantitatively, that would require (1) adjusted (gross) debt/ EBITDA to reduce towards 3.75x, and (2) retained cash flow/net debt above 25%.

Downward pressure would be exerted on Esselunga's ratings if (1) the company's operating performance weakens leading to a Moody's adjusted (gross) debt/EBITDA ratio above 4.5x; (2) free cash flow generation turns negative; or (3) liquidity deteriorates.

LIST OF AFFECTED RATINGS

..Issuer: Esselunga S.p.A.

Downgrade:

....Senior Unsecured Regular Bond/Debenture, Downgraded to Ba1 from Baa2

Assignments:

....Probability of Default Rating, Assigned Ba1-PD

....Corporate Family Rating, Assigned Ba1

Withdrawal:

.... Issuer Rating, Withdrawn , previously rated Baa2

Outlook Action:

....Outlook, Changed To Stable From Rating Under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Retail Industry published in May 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

COMPANY PROFILE

Esselunga is a leading food retailer in Italy. In 2019, the company reported revenues of €8.1 billion and EBITDA of €717 million. The company distributes its products through integrated multichannel capabilities, which included, as of 31 December 2019, a network of 158 food retail stores, an e-commerce platform and other sales channels, including 93 cafe bars under the Bar Atlantic brand and 38 perfumeries through the EsserBella brand sales channel.

REGULATORY DISCLOSURES

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The rating has been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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