MOODY'S
INVESTORS SERVICE

## CREDIT OPINION

8 May 2018

Update

Rate this Research

**RATINGS**

**Dufry AG**

| | |
|---|---|
| Domicile | Switzerland |
| Long Term Rating | Ba2 |
| Type | LT Corporate Family Ratings - Dom Curr |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*

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# Dufry AG

## Update on Key Credit Factors

### Summary Rating Rationale

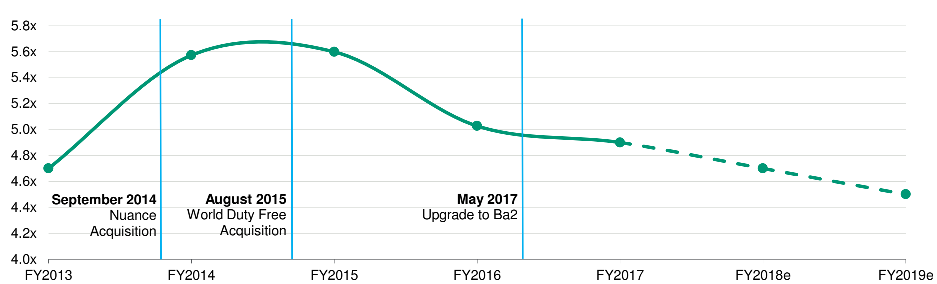
Dufry AG's (Dufry) Ba2 Corporate Family Rating (CFR) reflects its (1) leading market position with over 20% global market share of the airport travel retail spending according to the company; (2) strong geographical footprint; (3) track record and know-how in operating a travel retail business; (4) expectation of steady earnings growth and free cash flow over 2018-19; (5) long term positive organic sales growth in line with growth of passenger air traffic

The rating is constrained by the (1) high leverage reflecting Dufry's past acquisitions combined with high concession costs; (2) cyclical nature of the company's travel retail business, which is tied to international passenger traffic, and exposed to discretionary items (e.g., perfumes and cosmetics, confectionary and luxury goods) and; (3) risks associated with the renewal of concession contracts as well as to certain event risks that would have implications on global travel behaviour.

We expect steady organic growth at around 4.0%-5.0% in 2018-19, in line with the low end of the 5%-7% range, as guided by Dufry's management. We expect profitability to continue to improve with reported EBITDA margin (according the management definition) to increase towards 13.0% in the medium term, in line with the company's guidance.

Despite the positive free cash flow, we expect gross adjusted debt to continue to increase modestly as a result of higher concession costs going forward, that we capitalize as debt in our adjusted ratios. Relatively higher level of adjusted debt will be offset by of higher EBITDA and therefore Moody's expects leverage (adjusted gross debt to EBITDA) to continue to decrease towards 4.5x over 2018-19, as shown in the exhibit 1.

Exhibit 1
**Dufry's leverage to decline towards 4.5x by 2019**
**Adjusted (gross) debt/EBITDA**




*Source: Moody's Investors Service estimates*

## Credit Strengths

» Leading travel retail operator

» Broad geographical diversification

» Improved profitability and positive free cash flow generation

» Expectation of long term positive organic growth in the industry

## Credit Challenges

» High gross leverage reflecting Dufry's past acquisitions and concession costs

» Cyclical nature of the business with revenues tied to passengers' spending

» High proportion of sales related to discretionary categories (e.g. perfumes and cosmetics)

» Exposure to event risk and risks associated with the renewal of concession contracts

## Rating Outlook

The stable outlook reflects our expectation that Dufry's credit metrics will continue to improve modestly, driven by stronger EBITDA and positive free cash flow generation thanks to the steady organic growth. The stable outlook also reflects Moody's expectations that management will remain focused on deleveraging towards 2.5x-3.0x on a reported basis, a level that would more firmly support the Ba2 rating.

## Factors that Could Lead to an Upgrade

An upgrade is unlikely in the near term given the high adjusted leverage. However, upward pressure on the ratings would reflect further deleveraging below 4.0x (adjusted gross debt to EBITDA), combined with positive organic growth and additional margins strengthening in line with Dufry's strategy.

## Factors that Could Lead to a Downgrade

Conversely, downward pressure on the rating would reflect operational weakness combined with negative organic growth. Quantitatively, downward pressure could be exerted on the ratings as a combination of leverage not returning towards 4.5x in the next 12-18 months and adjusted RCF / net debt declining below 15%.

## Key Indicators

Exhibit 2

**KEY INDICATORS [1]**

**Dufry AG**

| | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 12/31/2017 | Moody's 12-18 Month Forward View |
|---|---|---|---|---|---|---|
| Revenue (CHFBillion) | CHF 3.6 | CHF 4.2 | CHF 6.1 | CHF 7.8 | CHF 8.4 | CHF8.7-9.1 |
| EBIT / Interest Expense | 1.6x | 1.3x | 1.0x | 1.1x | 1.2x | 1.3x-1.4x |
| RCF / Net Debt | 15.4% | 12.5% | 12.2% | 14.4% | 15.5% | 15%-16% |
| Debt / EBITDA | 4.7x | 5.6x | 5.6x | 5.0x | 4.9x | 4.5x-4.7x |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
*Source: Moody's Financial Metrics™*

## Company Profile

Headquartered in Basel Switzerland, with 2017 reported sales and EBITDA of CHF8.4 billion/CHF1 billion, Dufry is the leading global travel retailer covering 64 countries and over 390 locations, operating around 2,200 shops in airports, border downtown and hotel shops, railway stations, cruise liners and seaports. The acquisition of WDF in 2015, the second largest operator in the travel retail industry, further consolidated Dufry's leading position in the travel retail market. DFS Group (LVMH Group, unrated) and Lotte Duty Free (unrated) are the second and third players respectively with a much lower revenue.

Dufry's network includes general travel retail shops, 'walk-through' shops, brand boutiques, news agents and convenience stores with a product offer spanning perfumes & cosmetics, wines & spirits, tobacco, watches & jewellery, and accessories.

In February 2018, the company completed the IPO of 43% in its US subsidiary in Hudson Limited for $714 million. With an EBITDA of $172 million at December 2017, Hudson accounts for around 17% of Dufry total EBITDA. Following the transaction, we expect that earnings to non controlling shareholders increased to about CHF 70 million. We do not expect significant dividends to be paid to Hudson's shareholders in 2018.

Dufry is listed on SWX Swiss Exchange with a market capitalization of around CHF7.2 billion and a free float of 80.5% as of April 2018.

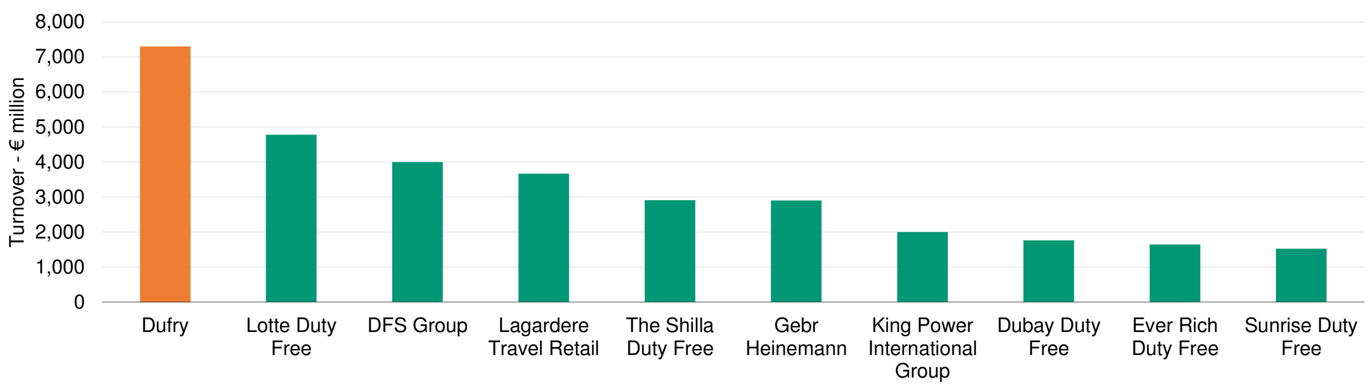
## Detailed Rating Considerations

### Leader in the travel retail industry with broad geographic diversification but exposure to discretionary categories

With total revenues of CHF8.4 billion, Dufry is the global leader in the travel retail industry with above 20% market share as of December 2016, as shown in the exhibit 3.

Exhibit 3

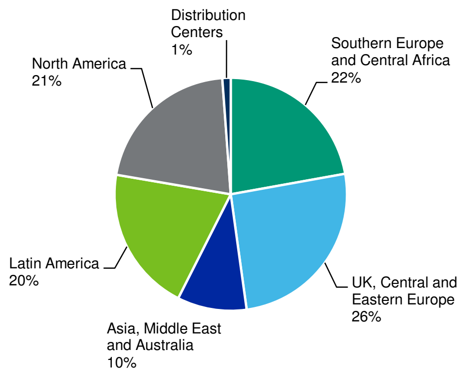
**2016 Turnover of Top 10 Travel Retailers**




*Source: The Moodie Davitt Report, July/August 2017.*

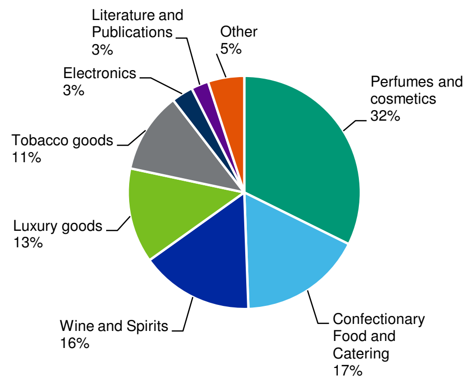
The company operates over 2,200 shops in airports (91% of sales), border downtown and hotel shops (3%), railway stations (3%), cruise liners and seaports (3%). Dufry has a global footprint with operations in 64 countries and over 390 locations, and with its largest business region, UK, Central and Eastern Europe accounting for less than 30% of total sales as shown in exhibit 4. Through the acquisition of WDF the company improved its geographical reach by increasing presence in Europe whilst decreasing presence in emerging markets. Overall, its good geographic diversification should help cushion any severe contraction in sales in any category or in any region.

Exhibit 4
**Dufry is well diversified geographically, turnover split by geography for 2017…**




*Source: Company information*

Exhibit 5
**… and is well diversified by product offering, revenue by category for 2017**




*Source: Company information*

Moreover, the company reduced its reliance on single contracts with the company's largest concession with the Heathrow airport currently accounting for around 7% of total sales and the top 10 contract for less than 35%.

The company's stores sell a wide assortment of products including perfumes, cosmetics, confectionary, wines and spirits, tobacco, and accessories. However, the company is exposed to certain discretionary product categories with perfumes and cosmetics, confectionary and luxury goods categories accounting for around 62% of total sales as exhibit 5 shows.

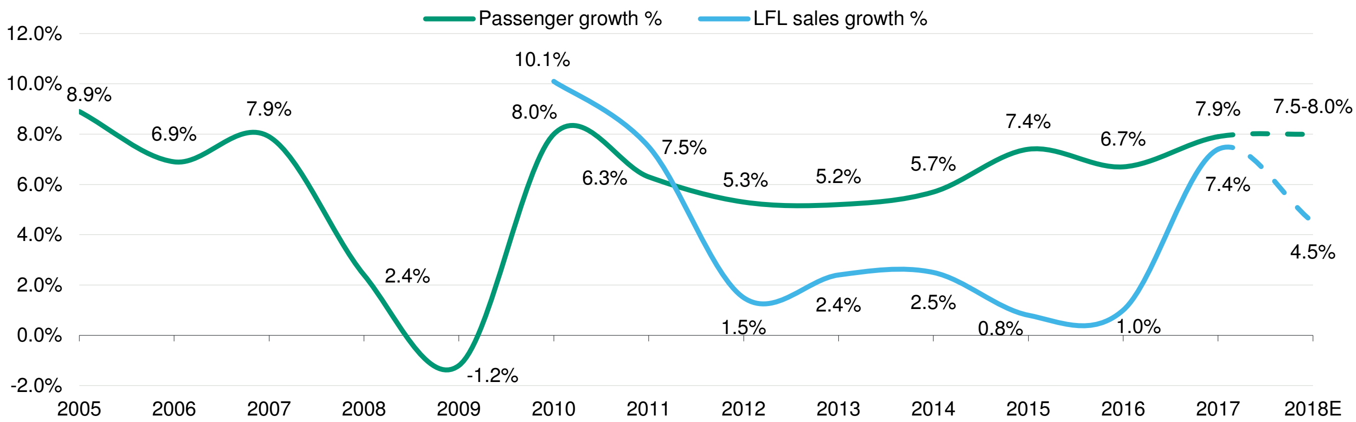
Dufry's diversified revenue base mitigates exposure to disruptions related to adverse local or regional economic or political events and the renewal of concession contracts in key markets. Positively, the company has a strong track record with approximately 80%-90% retention rate for expired contracts. The average life of the existing concessions is eight years. The acquisition of WDF further enhanced the combined group's geographical footprint, providing it with a balanced geographic portfolio that holds strong positions in mature and emerging markets. WDF's portfolio strengthened Dufry's position in Europe and North America and expanded the geographical footprint in the Middle East and Asia.

### Revenue highly correlated to international passenger flows but expectation of long term positive organic growth

Dufry's travel retail operations are correlated to international passenger flows, and are, therefore, subject to a degree of cyclicality. Positively, total passenger flows have continued to grow steadily at around 5% per annum and only in 2009 was there a decline, with volumes falling 1.5%, according to the IATA, as shown in the exhibit 6.

Exhibit 6

**Passenger Flows have been historically resilient - Dufry weaker sales growth over 2012-15 reflected higher exposure to emerging markets**
**Passenger Growth over 2005-2017, Dufry organic sales over 2010-2017**




*Source: IATA, Dufry reports*

Despite the resilient passenger growth over the years, in 2015 Dufry reported negative like for like growth of -5.3% (+0.8% including WDF) due to the negative impact from Brazil and Russia as a combination of lower volumes of passengers traveling outbound and decreased passengers spending. In the first half of 2016 the negative impact from Brazil and Russia continued but the second half saw performance improvements which filtered into 2017, resulting in Dufry's organic growth of 7.4% for fiscal 2017, due to the recovery in Russia and Brazil and a stable contribution from the North American and Europe.

We expect organic growth to remains steady at around 4.0%-5.0% in 2018-19. Our forecast for Dufry's organic growth reflects three factors: (1) steady passenger flows through the airports in which Dufry's concessions operate; (2) resilient passenger spending including Russia and Brazil, where macroeconomic conditions have improved, boosting travelers' disposable income (we forecast GDP growth in Brazil of around 2.5% in 2018 and 2019 and 1.6% and 1.5% in 2017 and 2018 respectively in Russia) and; (3) new commercial space and Dufry's refurbishment programme to increase sales.

## Good profitability compared to other speciality retailers

With an EBITDA margin (Moody's reported including concession costs) of 11.8% at December 2017, Dufry's profitability is stronger than rated UK department stores Debenhams Plc (B1 stable 8.1%), and French specialty retailer FNAC Darty SA (Ba2 stable 3.4%); and ranks better than Dixons Carphone Plc (unrated 5.8%), and French travel retailer Lagardère Travel Retail (unrated 6.4%).

Although Dufry's profitability continue to benefit from higher-return emerging markets, the acquisitions of WDF had a negative impact on margins given the higher exposure to developed markets (more than 60% of EBITDA in 2016 compared to 47% before WDF acquisition).

Positively, the company's concession-based business model is considered to be more flexible than that of a traditional retailer because concession fees are mostly variable, whereas rents tend to be mostly a fixed charge. Therefore, operating margins are less likely to be eroded as sharply if footfall and sales slowed-down.

## Strong 2017 results driven by improved organic growth

More in general, Dufry reported strong 2017 results ahead of Moody's expectations with organic growth of 7.4% driven by (1) improved market conditions in all the geographies; (2) increase in retail space (+30,000 sqm opened in 2017 bring the total space to 437,000 sqm); and (3) contribution from the refurnishment program (32,000 sqm refurnished in 2017).

Operating cash flow was stable at CHF524 million in 2017 (CHF505 million in 2016) with the increase in profits offset by higher working capital needs mainly reflecting one off inventories needs related with new openings in Southern Europe and in Latin America. With stable capex at CHF 205 million and no dividends, free cash flow was around CHF150 million in 2017 and reported net debt declined to CHF3.7 billion at December 2017 (CHF3.8 billion in 2016).

As a result adjusted gross debt to EBITDA marginally improved to 4.9x (5.0x in 2016). However, despite the positive free cash flow, gross adjusted debt continued to increase to CHF15.9 billion (CHF 15 billion in 2016) as a result of higher concession costs, that we capitalize as debt in our adjusted ratios.

### Credit metrics to improve modestly over 2018-19

We expect organic growth to be around 2017 to 4.0%-5.0% in 2018-19, in line with the low end of Dufry's guidance of 5.0%-7.0%. This is an improvement from 2015-16, but is below the rate of 2017, which was higher given that the first half of 2016 was particularly weak.

We expect profitability to continue to improve as a combination of better operating leverage driven by higher revenues and increased efficiencies. The latter reflects the implementation of the new business model announced last year, which aims to standardize and unify processes and share best practices, leading to additional efficiencies. Management has also reaffirmed its guidance of reported EBITDA margin to increase towards 13.0% in the mid-term (by 2018 in the previous guidance) from current 12%.

We expect operating cash flow to improve in 2018 due to more favourable working capital dynamics (see comment above). We model dividends of at least CHF 200 million each year, in line with the company guidance provided in April, and modest level of capex at 3%-3.5% of total sales. As a result, we expect a positive free cash flow of free cash flow available for debt reduction to around CHF 200 - CHF 250 million each year. In addition, part of the $714 million proceeds from the Hudson IPO, net of the CHF400 million share buyback will be available for debt reduction. We assume management to continue to focus on deleverage and target a net leverage between 2.5x-3.0x (3.6x at December 2017).

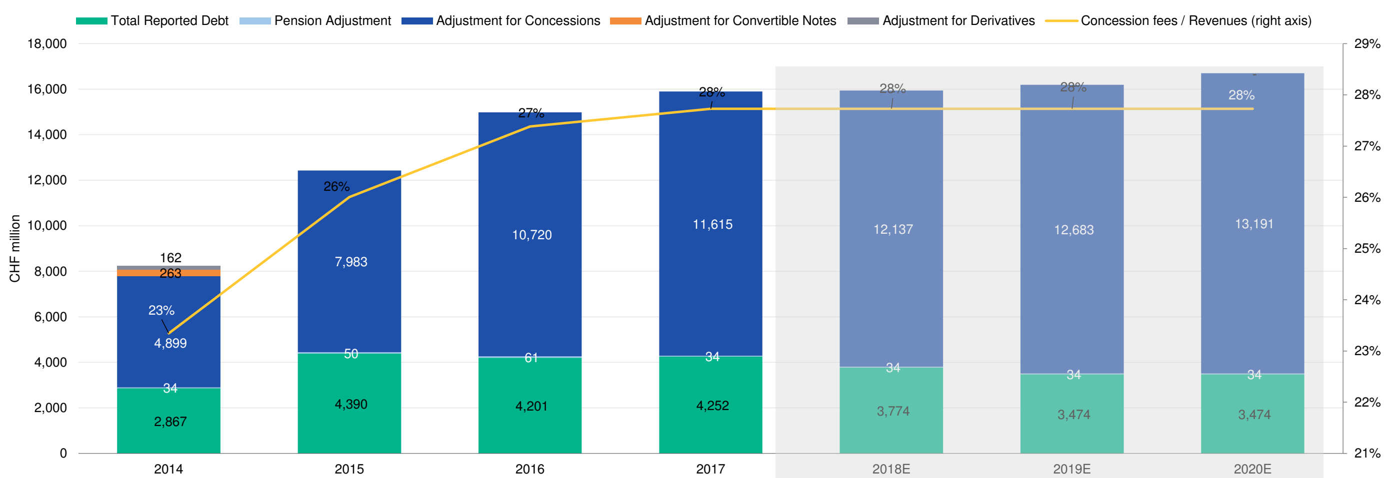
Despite the positive free cash flow, we expect gross adjusted debt to continue to increase modestly as a result of higher concession costs going forward, that we capitalize as debt in our adjusted ratios. Relatively higher level of adjusted debt will be offset by of higher EBITDA and therefore Moody's expects leverage (adjusted gross debt to EBITDA) to continue to decrease towards 4.5x over 2018-19, our trigger to support the Ba2 rating.

Positively, we note that Dufry mostly operates under concessions with variable payments based upon the revenues of each shop which provides Dufry a more flexible debt structure when compared to the typical retailer. However, some concessions also include a fixed fee component called "MAG" which would be payable to the airport operator regardless of the amount of sales generated from the shop.

Exhibit 7

**Adjusted Gross Debt To Increase Despite Positive Free Cash Flow Generation**

**Evolution of adjusted debt 2017-19**



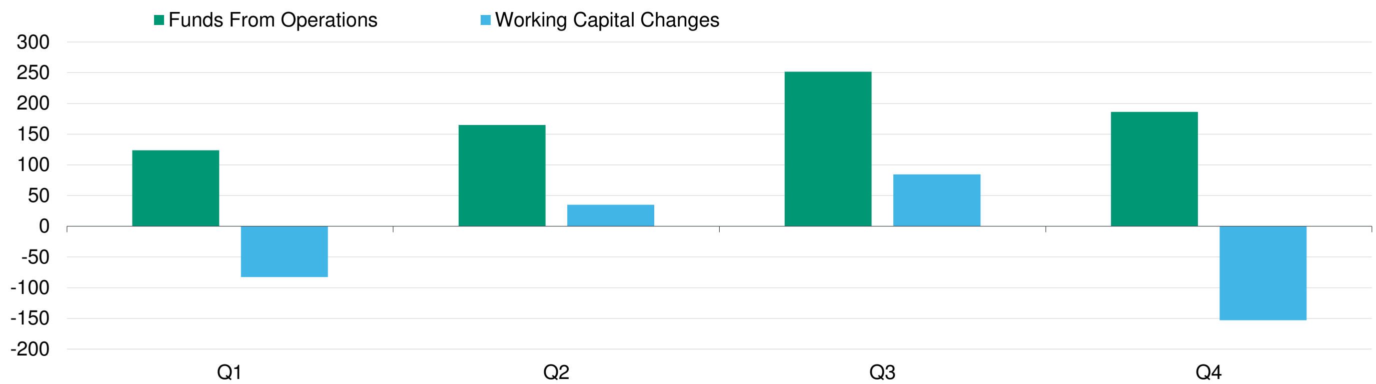

*Source: Moody's Financial Metrics and Moody's Investors Service estimates*

## Liquidity Analysis

Dufry's liquidity is good, underpinned by cash balances of CHF565 million (December 2017), an undrawn €1.3 billion revolving credit facility (RCF) maturing in November 2022 (CHF 715 million undrawn at fiscal 2017); and our expectation of ongoing positive free cash flow generation. We note that the first quarter is seasonally the weakest for the company with Dufry having its strongest season of turnover and EBITDA between July and September corresponding to the summer time in the northern hemisphere.

Dufry has managed its liquidity and debt maturity proflie well with the refinancing activities which took place in 2017 including (1) the refinancing of its €500 million 2022 senior notes being replaced with €800 million senior notes and (2) refinancing of its main bank credit facilities of CHF3.4 billion extending the maturities to 2022 from 2019. We continue to assume that Dufry will address its refinancing needs in a timely manner, or in any case, at least 12 months in advance.

Exhibit 8
**Q3 is the strongest quarter**
**3-years average cash flow by quarter**




Notes: Both figures are as reported
*Source: Moody's Financial Metrics*

The main financial covenants are with better conditions following the company's recent refinancing, include a max net debt/ Adj. EBITDA threshold of 4.00x (compared to 3.75x previously). We expect the company to maintain sufficient headroom under its covenants.

## Structural Considerations

Dufry's Ba2 senior unsecured instrument ratings are in line with the corporate family rating (CFR). This reflects the lack of significant subordination with all the obligations benefiting from a guarantee from Dufry AG, Dufry Financial Services B.V. and the subsidiaries that collectively represent 100% of the consolidated net assets and EBITDA of the company. the IPO These instruments rank behind a small amount of secured debt which is not material to create subordination, located at the operating subsidiaries' level. Following the IPO completed in February, Hudson Limited is not included among the guarantors.

## Rating Methodology and Scorecard Factors

Indicated Rating from the grid is Ba2 in line with the actual rating assigned.

Exhibit 9

## Credit Metrics to strengthen over the next 12-18 months

| Rating Factors | | | | |
|---|---|---|---|---|
| Dufry AG | | | | |
| Retail Industry Grid [1][2] | Current FY 12/31/2017 | | Moody's 12-18 Month Forward View As of 4/20/2018 [3] | |
| **Factor 1 : Scale (10%)** | **Measure** | **Score** | **Measure** | **Score** |
| a) Revenue (USD Billion) | $8.5 | Ba | $8.9 - $9.3 | Ba |
| **Factor 2 : Business Profile (30%)** | | | | |
| a) Stability of Product | Ba | Ba | Ba | Ba |
| b) Execution and Competitive Position | Baa | Baa | Baa | Baa |
| **Factor 3 : Leverage and Coverage (45%)** | | | | |
| a) EBIT / Interest Expense | 1.2x | B | 1.3x-1.4x | B |
| b) RCF / Net Debt | 15.5% | Ba | 15% - 16% | Ba |
| c) Debt / EBITDA | 4.9x | B | 4.5x - 4.7x | B |
| **Factor 4 : Financial Policy (15%)** | | | | |
| a) Financial Policy | Ba | Ba | Ba | Ba |
| **Rating:** | | | | |
| a) Indicated Rating from Grid | | Ba2 | | Ba2 |
| b) Actual Rating Assigned | | | | Ba2 |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 31/12/2017; Source: Moody's Financial Metrics. [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
*Source: Moody's Financial Metrics*

Exhibit 10

## Moody's adjustments to Dufry's debt

| (in CHF Millions) | FYE Dec-12 | FYE Dec-13 | FYE Dec-14 | FYE Dec-15 | FYE Dec-16 | FYE Dec-17 |
|---|---|---|---|---|---|---|
| As Reported Debt | 1,385 | 2,000 | 2,867 | 4,390 | 4,201 | 4,252 |
| Pensions | 21 | 9 | 34 | 50 | 61 | 34 |
| Operating Leases | 3,300 | 3,937 | 4,899 | 7,983 | 10,720 | 11,615 |
| Hybrid Securities | 0 | 0 | 263 | 0 | 0 | 0 |
| Non-Standard Adjustments | 0 | 0 | 162 | 0 | 0 | 0 |
| Moody's-Adjusted Debt | 4,705 | 5,945 | 8,225 | 12,424 | 14,982 | 15,900 |

*Source: Moody's Financial Metrics*

Exhibit 11

## Moody's adjustments to Dufry's EBITDA

| (in CHF Millions) | FYE Dec-12 | FYE Dec-13 | FYE Dec-14 | FYE Dec-15 | FYE Dec-16 | FYE Dec-17 |
|---|---|---|---|---|---|---|
| As Reported EBITDA | 443.5 | 467.0 | 495.7 | 570.6 | 825.1 | 991.8 |
| Pensions | 0.5 | -0.5 | -11.9 | -1.7 | 1.3 | -19.8 |
| Operating Leases | 659.9 | 787.3 | 979.7 | 1,596.6 | 2,143.9 | 2,322.9 |
| Unusual | 10.6 | 9.6 | 14.7 | 57.6 | 13.9 | -75.0 |
| Non-Standard Adjustments | 0.0 | 0.0 | -2.3 | -4.0 | -3.9 | 1.6 |
| Moody's-Adjusted EBITDA | 1,114.5 | 1,263.4 | 1,475.9 | 2,219.1 | 2,980.3 | 3,221.5 |

*Source: Moody's Financial Metrics*

Exhibit 12
## Moody's rated peers

| | Dufry AG | | | FNAC DARTY SA | | | Nordstrom, Inc. | | | Macy's, Inc. | | | Debenhams plc | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Ba2 Stable | | | Ba2 Stable | | | Baa1 Stable | | | Baa3 Stable | | | B1 Stable | | |
| (in US millions) | FYE Dec-16 | FYE Dec-17 | LTM Dec-17 | FYE Dec-15 | FYE Dec-16 | LTM Jun-17 | FYE Jan-17 | FYE Feb-18 | LTM Feb-18 | FYE Jan-17 | FYE Feb-18 | LTM Feb-18 | FYE Aug-15 | FYE Sep-16 | LTM Sep-17 |
| Revenue | $7,948 | $8,512 | $8,512 | $4,151 | $5,941 | $7,646 | $14,757 | $15,478 | $15,478 | $25,778 | $24,837 | $24,837 | $3,608 | $3,373 | $2,956 |
| EBITDA | $3,026 | $3,273 | $3,273 | $284 | $413 | $470 | $1,838 | $1,857 | $1,857 | $3,232 | $3,381 | $3,381 | $697 | $662 | $562 |
| Total Debt | $14,741 | $16,316 | $16,316 | $758 | $1,911 | $2,065 | $4,982 | $5,213 | $5,213 | $10,430 | $9,283 | $9,283 | $3,823 | $3,396 | $3,280 |
| Cash & Cash Equiv. | $405 | $532 | $532 | $592 | $691 | $410 | $1,007 | $1,181 | $1,181 | $1,297 | $1,455 | $1,455 | $50 | $75 | $52 |
| EBITDA Margin | 38.1% | 38.5% | 38.5% | 6.8% | 7.0% | 6.1% | 12.5% | 12.0% | 12.0% | 12.5% | 13.6% | 13.6% | 19.3% | 19.6% | 19.0% |
| EBIT / Int. Exp. | 1.1x | 1.2x | 1.2x | 2.2x | 1.8x | 2.2x | 4.8x | 4.3x | 4.3x | 3.7x | 4.7x | 4.7x | 1.8x | 1.9x | 1.8x |
| Debt / EBITDA | 5.0x | 4.9x | 4.9x | 2.7x | 4.9x | 4.2x | 2.7x | 2.8x | 2.8x | 3.2x | 2.7x | 2.7x | 5.6x | 5.5x | 5.7x |
| RCF / Net Debt | 14.4% | 15.5% | 15.5% | 111.2% | 20.3% | 20.3% | 26.3% | 24.9% | 24.9% | 18.6% | 21.0% | 21.0% | 10.5% | 11.0% | 10.2% |
| FCF / Debt | 1.2% | 1.1% | 1.1% | 11.6% | 7.0% | 6.0% | 11.2% | 8.2% | 8.2% | 5.3% | 8.7% | 8.7% | 2.1% | 2.2% | 0.6% |

*Moody's Financial Metrics*

## Ratings

Exhibit 13

| Category | Moody's Rating |
|---|---|
| **DUFRY AG** | |
| Outlook | Stable |
| Corporate Family Rating -Dom Curr | Ba2 |
| **DUFRY ONE B.V.** | |
| Outlook | No Outlook |
| Bkd Senior Unsecured -Dom Curr | Ba2/LGD4 |
| **DUFRY FINANCE S.C.A.** | |
| Outlook | Stable |
| Bkd Senior Unsecured -Dom Curr | Ba2/LGD4 |

*Source: Moody's Investors Service*

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