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Research Update:

Dufry AG Upgraded To 'BB' On Successful Autogrill Acquisition; Outlook Stable

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Rating Action Overview

- Dufry AG has completed its mandatory tender offer (MTO) to acquire the remaining 49.3% of shares in Autogrill, resulting in a minimal cash settlement.
- We expect Dufry will continue to demonstrate sound operating performance as it progresses with the integration of Autogrill and the industry continues to recover from the COVID-19 pandemic, such that credit metrics should strengthen in the near term.
- We therefore raised our long-term issuer credit and issue ratings on Dufry and its senior unsecured debt to 'BB' from 'BB-'.
- The stable outlook reflects our expectation that Dufry will integrate Autogrill smoothly such that leverage will reach 3.7x and funds from operations (FFO) to debt 21% in 2023, with potential further improvements toward 3.0x and 25% in 2024, while generating meaningfully positive free operating cash flow (FOCF) after full concession payments.

Rating Action Rationale

Dufry completed the acquisition of Autogrill with a minimal cash payment. The MTO for the acquisition of the remaining 49.7% of Autogrill shares has now been completed, with 45.9% of the shares tendered through this process. So far only 1.7% of Autogrill shares have been tendered for cash (€6.33 for each Autogrill share), which represents about €40 million, while 44.2% were tendered for Dufry shares (0.1583 newly-issued Dufry shares for each Autogrill share). We view this outcome positively given the relatively low cash payment, which Dufry has sufficient liquidity to finance without raising additional debt. Post MTO, Dufry's ownership of Autogrill reached 96.4% considering the ordinary shares already held by Dufry and the treasury shares owned by Autogrill. Dufry can therefore initiate the squeeze-out procedure (95% threshold crossed), which will result in it gaining full ownership and delisting Autogrill by the end of July.

The group reported a solid start to the year and we expect this positive momentum to continue. In first-quarter 2023, the combined group reported revenue growth of 113.4% versus first-quarter 2022 to Swiss franc (CHF) 2,359.3 million due in part to the start of the full consolidation of Autogrill from February and the negative effects of COVID-19-related mobility restrictions in 2022. On an organic basis and excluding the business combination benefits, this corresponds to 51.5% growth year on year. We anticipate the positive momentum will continue this year driven by a continued air passenger traffic recovery, particularly in Europe where it has been slower than in the U.S. S&P Global Ratings expects European air passenger traffic to return to pre-pandemic levels in 2024, up from 85%-90% of 2019 levels in 2023 (see "European Air Travel Defies Economic Pressures On Robust Demand," published June 7, 2023, on RatingsDirect). The International Air Transport Association also recently reported that in May 2023 global air traffic reached 96.1% of pre-pandemic levels (May 2019), driven by domestic traffic, which has now exceeded pre-pandemic levels. International traffic reached 90.8% of pre-pandemic levels, with North American airlines exceeding them.

We expect Dufry's credit metrics to improve in the near term on the business combination and continued recovery. In our view, consolidated revenue could reach CHF12.1 billion in 2023 and improve toward CHF13 billion in 2024 as the Autogrill integration progresses and the group benefits from the air travel recovery. We forecast EBITDA margins will decline to about 19% in 2023 compared to 23% on a stand-alone basis in 2022. This is due to one-off integration costs while the business is returning to 100% of its operations (from 80% last year) as well as rising personnel costs. EBITDA margins are expected to improve from 2024 after the integration of Autogrill is completed and the realization of cost synergies. In turn, we forecast leverage will reach 3.7x in 2023, in line with 2022, and improve toward 3.0x in 2024 on earnings growth.

FOCF after concession payments is expected to weaken to CHF180 million in 2023 compared to €356 million for Dufry stand-alone in 2022. This is partly due to normalized capital expenditure (capex) investments post-pandemic. We view cash flow as somewhat constrained relative to the group's total gross financial debt (about CHF3.8 billion) but expect it will strengthen from 2024 as the group completes the integration of Autogrill and its earnings base increases. Therefore, we forecast adjusted FFO to debt should reach about 21% in 2023 and improve toward 25% in 2024, versus 23% for Dufry stand-alone in 2022, and adjusted FOCF to debt at about 17% in 2023 and improving toward 19% in 2024, versus 19% in 2022.

Dufry's combination with Autogrill has a sound business rationale, but the main risks remain. Combined, Dufry and Autogrill can offer a more comprehensive commercial package in negotiations with airport authorities and benefit from significantly greater scale in their relationships with shared suppliers. Dufry will benefit through adding complementary site locations across the U.S. and a sizeable food service proposition to its product mix, thereby reducing cyclicality, as well as by expanding in the domestic air travel segment--particularly in the U.S. where we see air passenger traffic has already recovered to pre-pandemic levels. That said, the transaction does not reduce the group's exposure to the travel retail industry, which is often highly susceptible to event risk and is still recovering from the extreme stress to its earnings and cash flows from the COVID-19 pandemic. Also, we see Autogrill's operating profitability as lower than Dufry's, which is likely to compound the short-term pressure on operating margins and cash flow we expect Dufry might continue to face. In our view, this is a risk given the business' high operating leverage (personnel expenses are about 20% of revenue and total concession fees slightly more than 25%) and need to generate sufficient operating cash flow to comfortably cover its concession payments.

Outlook

The stable outlook reflects our expectation that Dufry will continue to demonstrate sound operating performance as it completes the integration of Autogrill and the industry recovers from the pandemic, such that credit metrics should strengthen in the near term.

Upside scenario

We could raise our ratings when the group's operations recover to pre-pandemic levels, and if it successfully completes the integration of Autogrill with no unexpected restructuring needs or other material disruptions to the operational business. This would lead to a significant reduction in leverage toward 3.0x with our adjusted FFO to debt rising sustainably above 25% and FOCF to debt toward 20%.

Any positive rating action will depend on Dufry generating plentiful FOCF after full concession payments and maintaining a consistent financial policy supportive of the stronger performance and credit ratios.

Downside scenario

We could lower our ratings if the group's operating performance is hampered by slower underlying business, which could be because of a general slowdown in air traffic or prolonged changes in consumer preferences that result in reduced spending on travel retail. A downgrade could also follow if there is disruption to the Autogrill integration process, such as additional integration or restructuring costs. We could take a negative rating action if adjusted leverage increases beyond 4.0x, adjusted FFO to debt deteriorates below 20% and FOCF to debt below 10%, or FOCF after full concession payments turns negative.

Although not in our base case, we may also lower the rating if management embarks on new, significant transformational acquisitions leading to a deterioration in credit metrics.

Company Description

Switzerland-based Dufry (stand-alone) is a leader in travel retail with a global airport retail market share of about 20% (pre-pandemic). It has a footprint of more than 2,300 shops in 66 countries throughout the U.S., Europe, the Middle East, Africa, South America, and Australia. Dufry operates in both the duty-free and duty-paid segments of travel retail through channels such as airports, border town and hotel shops, railway stations, and cruise liners and seaports. Consumer products such as perfumes and cosmetics, wines and spirits, luxury goods, tobacco products, and electronics and confectionery are sold through these outlets. In 2022, Dufry reported total turnover of CHF6.9 billion and adjusted EBITDA of CHF1.6 billion (CHF8.8 billion and CHF2.2 billion, respectively, in 2019).

Autogrill is a provider of food and beverage concession catering services for travelers. It has a presence in more than 30 countries, with approximately 3,300 points of sale and a network of about 830 locations. In 2022, Autogrill reported total turnover of €4.1 billion and adjusted EBITDA of €619 million.

On a combined and pro-forma basis, the Americas contributed 47% of sales in 2022 and Europe contributed 47%, with the remainder from Asia-Pacific. In 2022, airports contributed 82% of revenue, motorways 10%, and other channels--including railway stations, cruises, borders, downtowns, and hotels--8%.

Our Base-Case Scenario

Assumptions

- In 2023, air passenger traffic reaches 85%-95% of 2019 levels in Europe and is back to pre-pandemic levels in North America.
- Revenue growth of about CHF12 billion in 2023, up 76% compared to 2022 in light of the Autogrill acquisition. We expect revenue growth of 7% in 2024 as the group also benefits from the continued recovery of passenger air traffic post-pandemic.
- EBITDA margins decline to about 19% in 2023 compared to 23% in 2022, This is due to one-off integration costs while the business is returning to 100% of its operations (from 80% last year) as well as rising personnel costs. We also note Autogrill is a lower-margin business due to its product mix, so its integration will provide lower margins on a consolidated basis. EBITDA margins are expected to increase from 2024, after the integration is completed and cost synergies are realized.
- Capex of about CHF550 million-CHF600 million per year as the group invests in its digital transformation and strengthens its global footprint. This is significantly higher than in previous years because the group reduced investments to preserve liquidity during the pandemic. We also note Autogrill has a higher average capex than Dufry stand-alone given the nature of the food and beverage activity. This is about 4.5% of revenue.
- No material acquisitions or dividend distributions over the forecast period

Key metrics

Dufry AG--Key Metrics

Mil. CHF	2019a	2022a	2023f	2024f
Revenue	8,849	6,878	12,115	12,963
EBITDA	2,234	1,612	2,269	2,777
EBITDA margin	25	23	19	21
FOCF after full concession payments	388	356	179	276
Debt	7,704	5,993	8,428	8,695
Debt to EBITDA	3.4	3.7	3.7	3.1
FFO to debt (%)	22.9	22.9	21.4	25.9
FOCF to debt (%)	8.8	19.0	17.2	19.0

CHF--Swiss franc. FFO--Funds from operations. FOCF--Free operating cash flow. a--Actual. f--Forecast. Note: 2019 and 2022 are standalone; 2023 and 2024 are the combined group (Dufry plus Autogrill)

Liquidity

We assess Dufry's liquidity on a combined basis as adequate. We forecast that, over the coming 12 months, Dufry's liquidity sources should exceed uses about 2.5x. Although we consider that Dufry has well-established and solid relationships with banks, we see limited likelihood that it would be able to withstand high-impact, low-probability events without refinancing.

We anticipate the following principal liquidity sources over the next 12 months from April 1, 2023:

- Cash and liquid investments of CHF1,048 million, net of 10% restricted cash;
- Availability under the revolving credit facility (RCF) of CHF1,680 million (total size of the RCF is CHF2,085 million)
- A subsequent RCF accordion increase of CHF578 million
- Forecast cash FFO after leases of about CHF766.8 million.

We anticipate the following principal liquidity uses over the same period:

- Seasonal working capital requirements of up to CHF200 million;
- Repayment of Autogrill debt of about CHF560 million, in June 2023;
- Capex of CHF560 million; and
- Cash settlements for part of the Autogrill shares acquired through the MTO of about CHF40 million-CHF130 million (depending on the outcome of the squeeze-out).

Covenants

The RCF and the term loans require Dufry to maintain a maximum leverage of 4.5x (the threshold will be 5.0x in second-quarter 2023 testing since it was temporarily increased in light of the pandemic) and a minimum interest coverage of 3.0x. We expect the group will maintain healthy covenant headroom of above 15% over the next 12 months.

Issue Ratings - Recovery Analysis

Key analytical factors

- We rate the senior unsecured notes issued by Dufry One B.V., the fully owned financial subsidiary of Dufry, at 'BB', in line with the issuer credit rating on Dufry.
- The notes are guaranteed by the parent, Dufry AG, and its selected subsidiaries and comprise: a €800 million, 2.5% bond due in October 2024; a CHF300 million, 3.625% bond due in April 2026; a €750 million, 2.0% bond due in February 2027; and a €725 million, 3.375% bond due in April 2028.
- The recovery rating on all instruments is '3' indicating our expectation of meaningful recovery (50%-70%; rounded estimate: 65%) in a hypothetical default.
- The recovery rating is supported by the limited prior ranking liabilities but constrained by the significant amount of unsecured debt. We view the equity financing of the Autogrill acquisition

as supportive of recovery prospects.

- In our hypothetical default scenario, we assume negative regulatory changes and reduced airport travel following a natural disaster or terrorist event, combined with an economic recession in Europe and North America.
- We value the business as a going concern given the combined group's leading market position in the duty-free travel retail market and its diverse global footprint.

Simulated default assumptions

- Year of default: 2028
- Jurisdiction: Switzerland

Simplified waterfall

- EBITDA at emergence: CHF596 million
- Implied enterprise value multiple: 6.0x
- Gross enterprise value at default: CHF3.575 billion
- Net enterprise value after administrative costs (5%): CHF3.396 billion
- Estimated priority claims: CHF127 million
- Estimated senior unsecured claim: CHF5.026 billion *
- Value available for senior secured claims: CHF3.269 billion
- Recovery rating: '3' (50%-70%; rounded estimate: 65%)

*All debt amounts include six months of prepetition interest. The €2.247 billion RCF is assumed to be 85% drawn and 2024 maturities are assumed to be refinanced on similar terms.

Ratings Score Snapshot

Issuer Credit Rating	BB/Stable/--
Business risk:	Satisfactory
Country risk	Intermediate
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb+
Modifiers:	
Diversification/Portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Negative

Issuer Credit Rating	BB/Stable/--
Liquidity	Adequate
Management and governance	Neutral
Comparable rating analysis	Neutral
Stand-alone credit profile:	bb

ESG credit indicators: E-2, S-3, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- 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 | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; Outlook Action

	To	From
Dufry AG		
Issuer Credit Rating	BB/Stable/--	BB-/Watch Pos/--
Dufry One B.V.		
Senior Unsecured	BB	BB-/Watch Pos
Recovery Rating	3(65%)	3(50%)