Research Update:

Avolta AG Upgraded To 'BB+' On Strong Operating Performance And Integration of Autogrill; Outlook Stable

April 3, 2024

Rating Action Overview

- Avolta reported strong operating performance in 2023 on the back of sound passenger traffic recovery, beating our base-case expectations for revenue, earnings, and cash flow. Avolta also tightened its financial policy parameters.
- The group completed the combination of Dufry and Autogrill ahead of plan, and we see a strengthening of its business model thanks to significant improvements in its scale, geographic diversification and product mix over the past few years.
- We therefore raised our long-term issuer credit and issue ratings on Avolta and its senior unsecured debt to 'BB+' from 'BB'.
- The stable outlook reflects our expectations that Avolta will continue to demonstrate sound operating performance on the back of continued traffic recovery and successful execution of its strategy. We expect credit metrics will strengthen over the coming 12-18 months, with S&P Global Ratings-adjusted debt to EBITDA reaching well below 4.0x and robust free operating cash flow after full concession payments while maintaining a consistent financial policy supportive of the stronger performance and credit ratios.

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Rating Action Rationale

Avolta reported sound operating performance in 2023 on the back of strong passenger traffic recovery and the successful integration of Autogrill. Revenues reached Swiss franc (CHF) 12.8 billion in 2023 compared with CHF6.9 billion for Dufry stand alone in 2022. On a pro forma combined basis, this represents organic growth of close to 22%. Our adjusted EBITDA show an increase to CHF2.5 billion from CHF1.6 billion for Dufry in 2022. Core EBITDA (which management defines as after full concession payments) reached CHF1.1 billion in 2023 versus about CHF941 million on a pro forma basis in 2022. These results surpassed our base-case expectations and demonstrate the sound execution of the group's strategy while air travel continued to recover from

the pandemic disruption.

Now that the integration of Autogrill is completed, the group plans to achieve CHF85 million in synergies one year ahead of plan and lower integration costs than expected. Overall, we see a strengthening in Avolta's business risk profile over the past few years, considering the substantial improvements in scale, geographic footprint, and product diversification. We think the group has built a solid competitive edge and can offer more comprehensive commercial package in negotiation with airport authorities and benefit from significantly greater scale in their relationships with shared suppliers. We view the recent win of the AENA concession contracts in Spain and the new negotiated terms as a demonstration of its business strength.

Avolta generated strong free operating cash flow (FOCF) and markedly reduced financial leverage in 2023. FOCF after concession payments rose to CHF396 million, from CHF356 million for Dufry on a stand-alone basis in 2022. This is higher than our previous expectation of CHF180 million, and the improvement stems from sound core EBITDA and tight control over capital expenditure (capex), which was slightly lower than historical levels (3.4% revenue in 2023). Net financial leverage (management definition based on core EBITDA and net financial debt) improved to 2.6x in 2023 versus 4.8x for Dufry stand alone and 3.0x on a pro forma basis in 2022.

That said, S&P Global Ratings-adjusted credit metrics for 2023 are weaker than anticipated because of a pronounced increase in lease liabilities corresponding to minimum guaranteed payments (MAGs). Adjusted funds from operations (FFO) to debt and adjusted debt to EBITDA reached 17.3% and 4.2x, respectively, in 2023, versus 20.9% and 3.7x for Dufry stand alone in 2022. The 12-year extension of AENA contracts with fixed payment terms weighed on these ratios. That said, these contracts are credit positive, in our view, given they extend the group's commercial footprint in Spain by 30% compared with previous contract and will likely be accretive to Avolta's profitability and cash flow under the negotiated terms. We forecast lease liabilities should remain at least stable in the medium term since we understand no sizable contracts are due for renewal in the next few years. We note, however, that fluctuations in lease liabilities are inherent for the business model and will likely drive volatility in our adjusted credit metrics around the expected range.

We expect credit metrics to strengthen over the coming 12-18 months on continued traffic recovery and supportive prudent financial policy. The continued positive momentum should stem from the ongoing recovery in passenger traffic; levels were still 12% below those in 2019 and are likely to fully recover by 2024 and continue to rise in the following years thanks to growth in leisure and international traffic. This should support continued earnings growth, prompting us to forecast S&P Global Ratings-adjusted debt to EBITDA improving to 3.8x (net financial leverage to 2.0x) and FFO to debt to 21% while FOCF after full concession payment stays strong at about CHF450 million in 2024.

Avolta announced it would resume dividend distribution with a new capital allocation policy returning one-third of equity free cash flow to shareholder and two-thirds for deleveraging balance sheet and strategic business development. The group aims to reduce and maintain net financial leverage at 1.5x-2.0x with flexibility up to 2.5x. We view its financial policy as prudent and more conservative than its pre-pandemic approach and expect this will sustain expected credit metrics improvements in the medium term.

Outlook

The stable outlook reflects our expectations that Avolta will deliver strong credit metrics on the back of continued sound operating performance thanks to air traffic recovery and solid execution of its group strategy. We also assume Avolta, while pursuing its prudent financial policy targets, will reduce S&P Global Ratings–adjusted debt to EBITDA to less than 4.0x by the end of 2024. In particular, we forecast Avolta's return to its target reported net leverage of 1.5x-2.0x (equivalent to adjusted leverage of 3.2x-3.8x) in the next 12 months, and the ratio should remain within that range absent material acquisitions.

Downside scenario

We could take a negative rating action if, by the end of 2024, S&P Global Ratings-adjusted leverage exceeds 4.0x in conjunction with reported net leverage exceeding 2.0x, while cash flow is weaker than in our forecast. Over the next 12-24 months, we could downgrade Avolta if leverage is persistently higher than our expectation of 3.2x-3.8x adjusted and 1.5x–2.0x net reported, or if discretionary cash flow after all concession payments and dividends turns negative for a prolonged period. This could occur if the company deviates from its financial policy or if its operating performance sharply deteriorates because of general slowdown in air traffic or prolonged changes in consumer preferences that result in reduced spending on travel retail.

Upside scenario

We could raise our ratings if credit metrics strengthen sustainably with adjusted leverage staying well below 3.0x at all times and the company generates strong FOCF after all concession payments sufficient to fully cover dividends and preserve its net reported leverage within the target range even in case of material acquisitions or operating setbacks. This would also hinge on the company maintaining a track record of strict adherence to its stated financial policy once regular dividend payments resume and maintaining a robust competitive position and profitability.

Company Description

Avolta is a leading travel retailer and operator of food and beverages space with over 5,100 outlets in airports, motorways, seaports, railway stations, downtown areas, border crossings, cruise liners and ferries, and hotels, spanning 73 countries.

In 2023, Avolta reported total turnover of CHF12.8 billion and S&P Global Ratings-adjusted EBITDA of CHF2.5 billion. Europe contributed 51% of sales, North America 32%, and Latin America 13%, with the remainder from Asia-Pacific. Airports contributed 82% of revenue, motorways 10%, and other channels 8%.

Our Base-Case Scenario

Assumptions

- We expect GDP growth of 2.5% in the U.S. and 1.7% in Europe in fiscal 2024. For fiscal 2025, we expect GDP will rise by 1.5% in the U.S. and 2.1% in Europe.

- Air passenger traffic to return to pre-pandemic levels in 2024.
- Revenue growth of about 6% in 2024 and 2025 from CHF12.8 billion in 2023, driven by organic growth on continued air travel recovery and sustained sound passenger spend.
- EBITDA margins to improve to about 20.0% in 2024 and 20.2% in 2025 from 19.6% in 2023, on realized cost synergies and continued tight cost control offsetting concession fees increase.
- Capital expenditure of about CHF540 million in 2024 and CHF575 million in 2025, up from CHF441 million in 2023, in line with management's guidance of capex of 4% of revenues
- Lease liabilities that account for about CHF7.8 billion of our adjusted debt calculation, remains broadly stable in our forecast horizon.
- No material acquisition expected for the forecast period.
- Annual dividend of about CHF110 million in 2024, growing thereafter in line with company's plan to pay one-third of EFCF (equity free cash flow) to shareholders.

Key metrics

Avolta AG--Key Metrics

Mil. CHF	2022a	2023a	2024f	2025f
Revenue	6,878	12,790	13,557	14,370
EBITDA	1,612	2,513	2,704	2,899
EBITDA margin (%)	23.4	19.6	19.9	20.2
FOCF after full concession payments	344	396	448	443
Debt	5,948	10,664	10,408	10,295
Debt to EBITDA	3.7	4.2	3.8	3.6
FFO to debt (%)	20.9	17.3	20.8	22.2
FOCF to debt (%)	19.1	13.5	15.2	16.2

CHF--Swiss franc. FFO--Funds from operations, FOCF--Free operating cash flow. a—actual. F--forecast. Note: 2022 are stand alone and 2023, 2024, 2025 are the combined group i.e Avolta (Dufry and Autogrill).

Liquidity

We assess Avolta's liquidity as adequate. We forecast that, over the coming 12 months, Avolta's liquidity sources should exceed uses about 1.5x. Although we consider that Avolta 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 2024:

- Cash and liquid investments of CHF714.6 million;
- Undrawn bank lines of CHF2.4 billion; and
- Forecast cash FFO after leases of about CHF1.0 billion.

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

- Non-seasonal working capital outflow of CHF40 million;
- Mainly seasonal working capital requirements of up to CHF150 million;
- Capex of up to CHF542 million;
- CHF100 million liquidity usage for acquisitions;
- CHF110 million for dividends; and
- Debt maturity of CHF743 million.

Covenants

The RCF and the term loans require Avolta to maintain a maximum leverage of 4.5x 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 Avolta, at 'BB+', in line with the issuer credit rating on Avolta.
- The notes are guaranteed by the parent, Avolta 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.
- 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 the US.
- We value the business as a going concern given Avolta's leading market position in the duty-free travel retail market and its diverse global footprint.

Simulated default assumptions

- Year of default: 2029
- Jurisdiction: Switzerland

Simplified waterfall

- EBITDA at emergence: CHF581.8 million

- Implied enterprise value multiple: 6.0x
- Gross enterprise value (EV) at default: CHF3.49 billion
- Net EV after admin. costs (5%): CHF3.3 billion
- Estimated senior unsecured claim: CHF4.9 billion*
- Value available for senior secured claims: CHF3.2 billion
- Recovery rating: '3' (50%-70%; rounded estimate: 65%)

*All debt amounts include six months of prepetition interest. Includes €2.75 billion RCF assumed to be drawn at 85%.

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	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bb+

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded

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

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