S&P Global Ratings

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Metro AG

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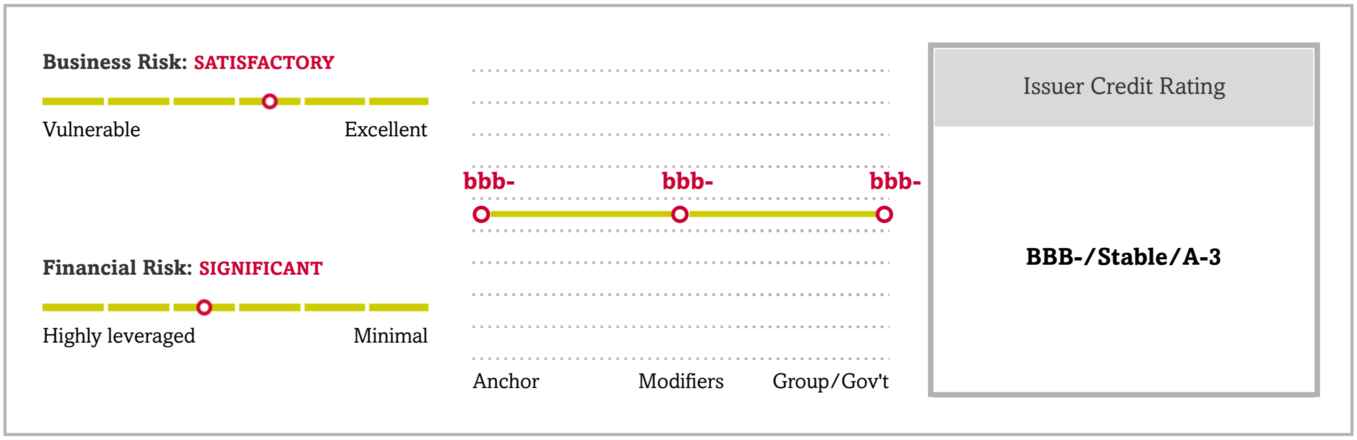

Credit Highlights

Overview

Key Strengths	Key Risks
Europe's largest wholesale and foodservice operator (No. 2 worldwide).	After consecutive quarters of like-for-like sales decline (Q3 and Q4), the Real retail business in Germany has been a drag on the overall business and its disposal is planned this year
High degree of geographic, product, and service diversification with meaningful operations outside Europe.	Weak free operating cash flow (FOCF) generation.
Strong customer base for the hotel, restaurant, and catering (HoReCa) channel, which is more focused on quality and service and more loyal than typical retail customers.	Capital intensive business which further constrains free operating cash flows.
Substantial real estate ownership, providing financial flexibility.	Limited headroom under its credit metrics to withstand weakness in operating performance.

Weak Russian operations along with unfavorable foreign exchange trends put a strain on already low rating headroom. Metro's Russian operations were very weak in the fiscal year ended Sept. 30, 2018 (fiscal 2018), affected by both a 7% like-for-like decline and devaluation of the Russian ruble by about 10.4%. We expect some moderate benefits of the turn-around strategy being implemented in Russia to flow from fiscal 2019, mostly offset by continued weakness of the ruble. We expect the EBIT margin in Russia to compress further to about 5.5%-6% over the next two years from 7.6% reported in fiscal 2018 as the group operations undergo change in Russia and foreign exchange volatility weighs on its performance.

High capital expenditure, including a focus on digital initiatives, is resulting in weak FOCF. Over the past few years, the group has been focusing on increasing its Food Service Delivery (FSD) business and investing in associated digital initiatives (€114 million in fiscal 2018), alongside consistent investments in store remodeling, real estate development, and omnichannel capabilities. As a result, we expect the group payback ratios to remain weak, in particular we forecast S&P Global Ratings-adjusted FOCF to debt will remain below 10%.

Timely execution of real estate transactions is crucial for cash flows. Metro AG has been generating annual EBITDA of over €100 million from real estate transactions and these continue to form a major part of its business strategy. As such, timely execution of the group's proposed real estate transactions is crucial, given that the group intends to substantially ramp up its real estate activity in the coming year, expecting gains of €250 million-€300 million in fiscal 2019 versus €128 million in fiscal 2018. These transactions are critical for the group's cash generation profile especially as there is an upcoming €500 million bond maturing in March 2019.

Outlook: Stable

The stable outlook reflects our view that Metro should be able to maintain its market position in its core wholesale food business, gradually increase its revenue by 2020 by about 0.5%-1.0% on the back of modest like-for-like sales growth, with adjusted EBITDA margins to remain flat at around 6%

We expect that management will be able to secure improvements in operating performance, gain efficiencies, and drive margin stability in 2019 on the back of cost-saving initiatives, more focus on its ailing Russian business, and reinvestments in the business. We factor in the disposal of Real, which we expect to be supportive for the rating. Carving out Real, which is accounted for as discontinued operations, we expect the company will maintain adjusted funds from operations (FFO)-to-debt of around 21%-22% and adjusted debt-to-EBITDA of around 3.0x-3.4x over the next two years, while the FOCF-to-debt ratio would remain weak, due to ongoing investments in store remodeling and digital investments. Accordingly, given the current low headroom for the rating category under the FFO and cash flow ratios, our stable outlook is predicated on sustainable improvement in operating margins and, more importantly, meaningful FOCF generation on the back of management's targeted plans to improve cash generation.

Downside scenario

We would consider a negative rating action if we see weak operating performance in core markets due to highly competitive trading conditions or if we see any negative surprise in any of the core or non-core markets having a meaningful negative EBITDA or cash flow impact. In such a scenario, we could see deterioration of Metro's revenue, continued pressure on FOCF, and/or weakness in the group's operating margins relative to our base case. This could translate into the adjusted debt-to-EBITDA ratio increasing toward 3.5x and FFO to debt falling below 20% and further weakness in FOCF. Further, an increase in the dividend payout ratio despite weaknesses in cash flow generation and credit metrics could also put pressure on the ratings.

Upside scenario

Due to the high level of adjusted debt and the relative weakness in FOCF, we consider an upgrade unlikely over the next two years. Metro continues to invest on its real estate and omnichannel strategies, which will likely curtail any meaningful improvement in the group's credit metrics in the short term.

However, we could consider a positive rating action if the proceeds from Metro's real estate disposals and or cuts in capex and shareholder remuneration reduced leverage significantly, such that the adjusted debt-to-EBITDA ratio fell below 3.0x. This should also be accompanied by a positive sustainable improvement in cash flow generation for the group such that the adjusted FFO-to-debt ratio strengthened significantly toward 30% and FOCF to debt remained comfortably over 15%.

Our Base-Case Scenario

Assumptions

- 2018 Real GDP growth of 1.6% in Germany, France, and the eurozone in 2019 and about 1.4%-1.6% in 2020 in these regions. We expect inflation of 1.5%-1.8% in 2019 and 2020 in these countries, which will have a negative impact on consumer spending.
- Revenues to decline by 0%-0.5% in 2019 and grow by about 0%-0.5% in 2020, due to weak Russian operations coupled with the negative impact of currency fluctuations, offset by organic growth.
- Margins to remain under pressure due to unfavorable foreign exchange impacts and increasing competition, but supported by lower restructuring costs and about €200 million of real estate gains.
- Annual capital expenditure of €600 million, in line with management's guidance.
- Stable dividends in 2019 and 2020 in line with the historical payout ratios.

Key Metrics

	2018A	2019E	2020E
EBITDA margin (%)	6.0	6.0-6.4	5.8-6.2
Debt/EBITDA (x)	3.3	3.2-3.4	3.3-3.4
FFO/debt (%)	20.8	20.5-21.0	20.0-20.5
FOCF/debt (%)	9.4	5.0-8.0	7.0-9.0
DCF/debt (%)	5.0	1.0-3.0	3.5-5.5

A--Actual. E—Estimate. FFO--Funds from operations. FOCF--Free operating cash flow. DCF--Discretionary cash flow.

Base-Case Projections

Metro's margins are low compared with its peers and credit metrics are offset by real estate gains

Metro's adjusted EBITDA margins are low compared with other retailers such as REWE and Ahold, but better than pure play HoReCa operators such as Sysco. Given its diversified base and low competition, we expect adjusted margins to be stable at around 6%. Cash generation should also be supported by its property division where the group has a healthy ownership ratio of 55% for Metro Wholesale stand-alone, versus47% for fiscal 2017 (METRO and REAL consolidated) and we expect annual real estate gains of €200 million or more. In our base case, we expect the core ratios to continue to be marginally weaker than our earlier forecast while we see interest coverage ratios to be slightly stronger than earlier, given the repayment of bonds maturing in March 2019. We expect EBITDA to broadly remain flat over the forecast period as the group balances a shortfall in retail operations with real estate disposals. We expect debt to reduce progressively, which is likely to result in moderate deleveraging.

Company Description

Germany-based Metro AG is Europe's largest wholesale and Food service operator and the second-largest in the world. It has strong business-to-business operations under its wholesale business in 35 countries across the world, targeting hotels, restaurants, catering companies, and trading companies. The group also has active real estate operations through which it buys land parcels, develops and sells them after a few years, thus realizing value appreciation in the process.

For fiscal 2018, Metro group reported revenues of €29.5 billion and EBITDA of €1.4 billion. Metro's store network comprises 769 locations. The company registered €128 million of gains from the sale of real estate during the year.

Its hypermarket business, Real, has been put up for sale and as such is considered as a discontinued operation in the group's financial reporting from fiscal 2018.

Business Risk: Satisfactory

The rating is supported by Metro's resilient position as Europe's largest wholesale and foodservice operator (No. 2 worldwide) and its revenue and profit diversity, built on localized business models. The retail environment across Europe is facing substantial challenges and we see pressures on account of significant market competition and also from changing consumer behavior.

Metro benefits from a high degree of geographic, product, and service diversification. It has a large and diverse revenue base that encompasses over 35 countries across Europe and Asia, with over 21 million buying customers. Metro (excluding Real) generates more than 80% of its sales and 90% of EBITDA outside Germany and is well established in several Western European countries, with operations in Russia, China, and other emerging countries such as Turkey and Pakistan, which are all positioned as growth territories.

We view positively Metro's recurring revenue base (with over 20% of recurring customers generating more than three-quarters of its sales) and high average basket size spend, as this also underlines the strength of its market position. Although the group serves several customer segments including smaller retail chains, wholesale, commercial establishments, and service providers, it has a strong presence in the HoReCa segment (comprising hotels, restaurants, bars, cafes, pubs, coffee shops and fast food providers, caterers, and canteen operators). This segment accounts for nearly 45% of its business. Metro has strong brand recognition based on serving customers that do not want to compromise on product quality and service standards due to consistent need for the timely supply of goods and produce. However, even after the sale of its hypermarket business, Metro has a still meaningful but decreasing sale share of private customers--primarily customers that are non-HoReCa, such as services, companies, and offices--exposing the group to challenges in the retail environment and changing customer behavior.

Although subject to continued competition and execution considerations, we believe that Metro's future growth potential stems from its strong food service distribution platform, warehouse operations, new customized offers, and further market penetration in the newer international operations. Operating efficiency is supported by strong bargaining power with suppliers and inventory management.

Despite its large scale of operations and diversity, Metro's adjusted EBITDA margin is at the lower end of the 5%-10% range that we regard as average in the food retail sector. We expect overall results for fiscal 2019 to be subdued at 6.0%-6.4% EBITDA margins, reflecting reduced headroom within the rating. That said, at a group level, Russia contributes about 10% of group sales.

While Metro AG is primarily a wholesale and food services business, it also benefits from its fairly resilient and well-invested property operations. Metro's property division supports the group with a healthy ownership ratio of 55% for Metro Wholesale stand-alone, versus 47% for fiscal 2017 (METRO and REAL consolidated).

Peer comparison

Table 1

Metro AG -- Peer Comparison

Industry Sector: Supermarkets						
	Metro AG	**Sysco Corp.**	**Esselunga SpA**	**Marks & Spencer PLC**	**REWE Group**	**Carrefour S.A.**
Rating as of Jan. 18, 2019	BBB-/Stable/A-3	BBB+/Stable/A-2	BBB-/Watch Neg/--	BBB-/Negative/A-3	BBB-/Stable/A-3	BBB+/Negative/A-2
Fiscal year ended:	Sep. 30, 2018	June 30, 2018	Dec. 31, 2017	March 31, 2018	Dec. 31, 2017	Dec. 31, 2017
(Mil. €)						
Revenues	29,476.0	50,333.3	7,594.7	12,187.4	49,424.3	79,591.0
EBITDA	1,781.5	2,807.4	702.7	1,548.1	3,725.6	4,222.5
Funds from operations (FFO)	1,228.8	2,136.5	579.6	1,155.0	2,915.2	3,326.5
Net income from cont. oper.	454.0	1,226.3	298.9	29.3	346.3	(532)
Cash flow from operations	1,010.8	2,164.5	541.8	983.9	2,721.5	3,213.5
Capital expenditures	454.0	587.4	454.1	388.9	1,879.0	2,379.0
Free operating cash flow	556.8	1,577.1	87.7	594.9	842.5	834.5
Discretionary cash flow	293.8	958.2	87.7	249.3	656.3	542.5
Cash and short-term investments	1,298.0	473.4	500.8	252.2	653.4	3,504.0
Debt	5,905.8	7,630.5	1,596.9	4,749.3	11,320.2	8,510.1
Equity	3,227.5	2,180.9	2,819.8	3,365.4	6,174.6	11,315.0
Adjusted ratios						
EBITDA margin (%)	6.0	5.6	9.3	12.7	7.5	5.3
Return on capital (%)	11.0	20.2	10.5	5.2	8.6	8.1
EBITDA interest coverage (x)	5.1	7.7	10.2	5.0	5.8	7.6

Table 1

Metro AG -- Peer Comparison (cont.)

Industry Sector: Supermarkets

	Metro AG	Sysco Corp.	Esselunga SpA	Marks & Spencer PLC	REWE Group	Carrefour S.A.
FFO cash int. cov. (X)	11.2	9.6	25.2	11.4	56.3	12.1
Debt/EBITDA (x)	3.3	2.7	2.3	3.1	3.0	2.0
FFO/debt (%)	20.8	28.0	36.3	24.3	25.8	39.1
Cash flow from operations/debt (%)	17.1	28.3	33.9	20.7	24.0	37.8
Free operating cash flow/debt (%)	9.4	20.6	5.5	12.5	7.4	9.8
Discretionary cash flow/debt (%)	5.0	12.5	5.5	5.2	5.8	6.4

Sysco is the largest distributor of food and related products primarily to the North American food service industry (restaurants, health care and educational facilities, lodging establishments and other customers). Unlike Metro, it has a very strong private label penetration (about 46% versus less than 20% for Metro) and e-commerce platform (about 40% of sales versus METRO Wholesale's sales share of FSD of 18% in fiscal 2018. However, due to its presence in emerging markets and overlap of business to consumer business in some countries, Metro's EBITDA margin is higher than that of Sysco.

We note that Sysco's cash flows are stronger than Metro's, but its higher quantum of dividend distributions result in its discretionary cash flow to debt ratio being similar to that of Metro. FFO to debt are also at a similar level, but in case of Sysco we expect the metric to improve gradually, while we expect that it will remain marginally above 20% in the case of Metro.

REWE is a Germany-based food retailer and travel operator with over 10,800 stores in 11 countries, generating revenue of €50 billion. It is supported by its leading market positions, consistent merchandising strategy and good geographic diversity, and constrained by intense competition and pricing pressures, a low e-commerce presence, and low private label penetration. REWE operates at a higher scale than Metro--about 1.3x in terms of revenue and about 1.6x for EBITDA. REWE's profitability has been moderately volatile due to operating lease adjustments, EBITDA from REWE's partners, and increasing exposure to volatile travel segment and online expansion.

Financial Risk: Significant

Our assessment of financial risk mainly reflects Metro's high lease and pensions-adjusted leverage and relatively weak FOCF generation.

Despite adjusted debt to EBITDA of 3.3x for fiscal 2018, the remaining ratios--FFO to debt (20.8%), FOCF to debt (9.4%), and discretionary cash flow to debt (5.0%)--reflect reduced headroom at the current rating level. Accordingly, we note that there is very limited scope for business underperformance in the future years.

Overall, we expect to see Metro's credit ratios to remain broadly stable for fiscal 2019, due to weakness in retail margin compensated by gains from real estate. Various strategic and operational measures implemented by management to expand the business and generate cost efficiencies are likely to be offset by weakness in the group's Russian operations. That said, given the extremely high competition in all its markets, future margin improvement hinges on quick ramp-up of its digital and FSD business, tempered to some extent by execution risks, in our view.

Financial summary

Table 2

Metro AG Financial Summary

Industry Sector: Supermarkets					
	--Fiscal year ended Sept. 30--				
(Mil. €)	**2018***	**2017***	**2016**	**2015**	**2014**
Revenues	29,476.0	29,903.0	36,549.0	37,496.0	38,970.0
EBITDA	1,781.5	2,001.0	2,226.5	2,230.5	2,371.0
FFO	1,228.8	1,440.0	1,556.1	1,448.6	1,405.7
Net income from continuing operations	454.0	359.0	506.0	254.0	40.0
Cash flow from operations	1,010.8	1,024.0	1,358.1	1,386.6	1,202.7
Capital expenditures	454.0	452.0	592.0	705.0	571.0
Free operating cash flow	556.8	572.0	766.1	681.6	631.7
Discretionary cash flow	293.8	540.0	424.1	372.6	621.7
Cash and short-term investments	1,298.0	1,559.0	1,599.0	3,436.0	1,512.0
Debt	5,905.8	6,498.6	7,486.2	8,353.9	10,537.2
Equity	3,227.5	3,263.3	2,949.1	2,698.0	826.8
Adjusted ratios					
EBITDA margin (%)	6.0	6.7	6.1	5.9	6.1
Return on capital (%)	11.0	11.5	10.9	10.2	11.9
EBITDA interest coverage (x)	5.1	5.1	4.2	3.9	3.6
FFO cash interest coverage (x)	11.2	11.2	7.6	7.0	5.2
Debt/EBITDA (x)	3.3	3.2	3.4	3.7	4.4
FFO/debt (%)	20.8	22.2	20.8	17.3	13.3
Cash flow from operations/debt (%)	17.1	15.8	18.1	16.6	11.4
Free operating cash flow/debt (%)	9.4	8.8	10.2	8.2	6.0
Discretionary cash flow/debt (%)	5.0	8.3	5.7	4.5	5.9

*Continued operations only. FFO--Funds from operations.

Liquidity: Adequate

We assess Metro's liquidity as adequate. We expect its sources of liquidity to be around 2.21x over the next 12 months. We do not assess Metro's liquidity as strong because we believe that the group would not be able to withstand high-impact, low-probability events without refinancing. Though it has significant cash balances, these would not be sufficient to manage upcoming maturities along with a high-impact event.

We do not expect sources of liquidity to be lower than uses even if EBITDA were to decline by 15% during this period.

Our liquidity assessment is also based on our expectation that the group will maintain good access to different financing sources and adequate headroom under its covenants.

Principal Liquidity Sources	Principal Liquidity Uses
Over the 12 months to Oct. 1, 2019: • Cash on balance sheet of about €1.3 billion; • Committed and undrawn credit facilities of about €2.0 billion available until 2024; and • Cash FFO of about €715 million.	Over the 12 months to Oct. 1, 2019: • Debt maturities of about €500 million-€600 million; • Working capital requirements of €250 million, covering seasonal swings and the year-end position; • Capital expenditure of about €600 million; • Dividends of about €250 million-€270 million; and • Small bolt-on acquisitions of about €10 million.

Debt maturities

- Fiscal 2019: €500 million
- Fiscal 2020: €125 million
- Fiscal 2021: none
- Fiscal 2022: €629 million
- Fiscal 2023 and beyond: €1,200 million

This excludes finance leases and liabilities to banks.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Sept. 30, 2018, Metro AG's capital structure consists of €3.3 billion of unsecured debt and €13 million of secured debt issued at parent level.

Analytical conclusions

We rate Metro's debt 'BBB-', mirroring the issuer credit rating, because no significant elements of subordination risk are present in the group capital structure.

Reconciliation

Table 3

Reconciliation Of Metro AG Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Sep. 30, 2018--						
Metro AG reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	4,010.0	3,090.0	1,371.0	824.0	147.0	1,371.0	874.0
S&P Global Ratings' adjustments							
Interest expense (reported)	--	--	--	--	--	(147.0)	--
Interest income (reported)	--	--	--	--	--	29.0	--
Current tax expense (reported)	--	--	--	--	--	(231.0)	--
Operating leases	2,728.7	--	417.5	188.5	188.5	229.0	229.0
Postretirement benefit obligations/deferred compensation	293.0	96.5	12.0	12.0	11.0	(3.2)	20.8
Surplus cash	(1,203.8)	--	--	--	--	--	--
Asset retirement obligations	13.9	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	29.0	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(113.0)
Non-controlling Interest/Minority interest	--	41.0	--	--	--	--	--
Debt - Put options on minority stakes	64.0	--	--	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	--	(14.0)	(14.0)	--	(14.0)	--
EBITDA - Business Divestments	--	--	(5.0)	(5.0)	--	(5.0)	--
EBIT - Income (expense) of unconsolidated companies	--	--	--	14.0	--	--	--
Total adjustments	1,895.8	137.5	410.5	224.5	199.5	(142.2)	136.8
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	5,905.8	3,227.5	1,781.5	1,048.5	346.5	1,228.8	1,010.8

Ratings Score Snapshot

Issuer Credit Rating

BBB-/Stable/A-3

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:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Retail And Restaurants Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of January 18, 2019)

Metro AG	
Issuer Credit Rating	BBB-/Stable/A-3
Issuer Credit Ratings History	
26-Jun-2017	BBB-/Stable/A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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