S&P Global Ratings

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Research Update:

Metro Outlook Revised To Stable From Negative On Robust Earnings And Disposal-Driven Deleveraging; 'BBB-/A-3' Affirmed

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Rating Action Overview

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- Food wholesaler Metro AG has increased reported sales by 20%, driven by inflation and better-than-anticipated volume increases, leading to leverage of 2.7x (3.2x excluding Russia) in fiscal 2022 (ended Sept. 30, 2022).
- Although S&P Global Ratings-adjusted EBITDA is expected to remain stable due to an unfavorable context in 2023, the group's anticipated disposal-driven deleveraging will allow it to keep leverage in check over the next two years, with debt to EBITDA ranging 2.4x-2.8x despite anticipated negative free operating cash flow (FOCF) after leases due to an increase in growth capital expenditure (capex).
- We therefore revised the outlook on Metro AG to stable from negative and affirmed the 'BBB-/A-3' long- and short-term issuer credit ratings.
- The stable outlook reflects our expectation that Metro will be able to mitigate the current inflationary cost pressures and volatile macroeconomic environment and maintain S&P Global Ratings-adjusted leverage below 3.5x, while maintaining a conservative financial policy with a company-defined net leverage target of about 2.5x by 2025 (translating to 3.0x S&P Global Ratings-adjusted leverage), from 2.3x in fiscal 2022, and financing its sCore growth strategy with internal cashflows.

Rating Action Rationale

S&P Global Ratings expects that Metro AG can maintain S&P Global Ratings-adjusted leverage of well below 3.0x in fiscal 2023 despite the challenging macroeconomic environment. Metro's group S&P Global Ratings-adjusted debt to EBITDA of 2.7x in fiscal 2022, versus our projection of 3.4x-3.6x, reflects the company's strong sales and S&P Global Ratings-adjusted EBITDA recovery to €29.8 billion (20% growth compared with 2021) and €1.4 billion (21.4% growth) respectively. We understand that the sales growth incorporates moderate volume growth and is strongly supported by the high inflation in the eurozone, which reached 10.9% at Sept. 30, 2022, when Metro's fiscal year ends. Metro has guided that company-adjusted operating EBITDA could decline €75 million-€225 million in fiscal 2023 from the high of €1,389 million seen in fiscal 2022. We expect a contraction of about €150 million driven by the first quarter cyberattack on the company and higher labor and energy costs, but supported by continued price increases and expansion of the food service distribution (FSD) business, leading to like-for-like revenue growth of about 5% (broadly flat on a reported basis due to disposals) in fiscal 2023. At the same time, S&P Global Ratings-adjusted EBITDA, which includes restructuring expenses and disposal gains on real estate, will stagnate at about €1.4 billion in fiscals 2023 and 2024 because we expect operational EBITDA to partially recover but lower real estate disposal gains of about €50 million-€75 million from about €210 million in 2023.

Fiscal 2023 credit metrics are expected to be supported by sizeable disposal proceeds, improving S&P Global Ratings-adjusted leverage by 0.4x-0.6x. Three sizeable transactions are expected to improve S&P Global Ratings-adjusted debt by €700 million-€900 million. In first-quarter 2023, the group concluded the sale of parts of the Metro Campus in Düsseldorf with overall real estate disposal gains of €207 million and proceeds of €278 million.

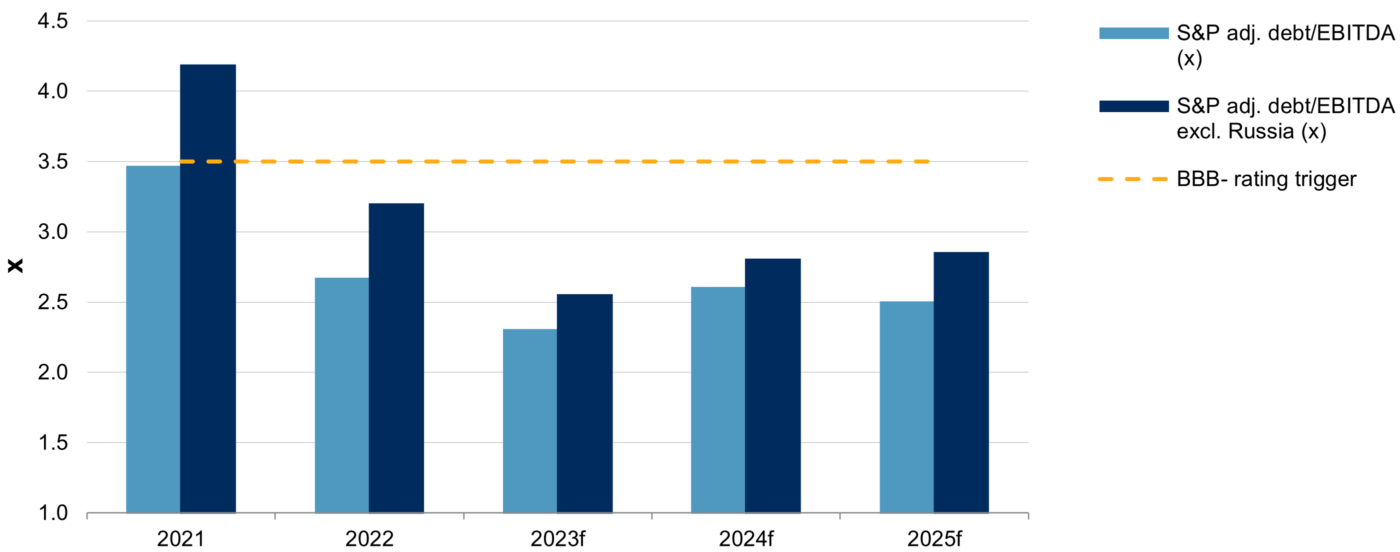
The company also expects the closing of the sale of the India business to Reliance Retail Ventures Ltd., a majority owned entity of Reliance Industries Ltd. (BBB+/Stable/--) in first-half calendar 2023. The transaction has an equity value of approximately €300 million and will also include the local financial and lease liabilities. Overall, we expect this will reduce net debt by about €300 million-€400 million from a combination of proceeds and liabilities. The operating EBITDA impact is expected to be limited. In fiscal 2022, Metro operated 31 stores in India and generated €926 million of revenue, with company-adjusted EBITDA in the low-double-digit millions of euros.

In addition, the group has exercised its option to sell its 20% stake in WM (HK) Holding Ltd., an entity in which Metro AG retains a 20% stake after it sold its operations in China to Wumei in 2020. We expect cash proceeds of more than €200 million, which reflects the estimated book value of the put option and assets categorized as held for sale. Metro has a licensing agreement with Wumei that will end in April 2023.

Metro's Russian operations create a key source of uncertainty but the group is actively managing the risk. At Sept. 30, 2022, Metro operated 93 stores in Russia, where it generated revenue of €2.9 billion (9.8% of the group's total) and company-defined EBITDA (of €231 million; 16.6%) for fiscal 2022. For now, the group has stated no plan to leave the country. We understand the Russian subsidiary had no financial debt and €68 million of cash on the balance sheet at Dec. 31, 2022, which we believe is adequate to operate the usual cash flow-positive business. We understand more than 90% of Metro's sales are food items that are locally sourced and therefore expect limited constraints on its supply chain, as announced in our June report (see "Ratings On Three European Retailers Exposed To Russia Affirmed; One Outlook Revised To Negative," published June 20, 2022, on RatingsDirect). We treat cash sitting in Russia as restricted and complement our ratio analysis by excluding from our adjusted leverage ratio the Russian contribution, so as to quantify the potential effects of an exit from Russia without financial compensation. This ratio is about 0.5x higher at 3.2x compared with 2.7x for the overall group in fiscal 2022 (see chart). Compared to our last publication in June 2022, the company has shown it can repatriate cash sitting in the Russian subsidiary, as evidenced by the reduction to €68 million at Dec. 31, 2022, from €119 million at Sept. 30, 2022.

Metro's Leverage Should Remain Below 3.5x, Excluding Russia, For the Next 12-24 Months

Fiscal year ending Sept. 30



f--Forecast. Source: S&P Global Ratings. Values reflect mid-point of guided range.

FOCF after leases will remain negative in 2023 and 2024 due to an acceleration of sCore investments. Overall, S&P Global Ratings-reported FOCF after leases is expected to remain negative by about €150 million in fiscal 2023 and about €50 million in fiscal 2024, as the company accelerates investments in its sCore strategy. The latter will lead to capex of above €600 million (more than 2% of sales) in the next two years from €414 million (1.4%) in fiscal 2022. The company aims to finance its growth investments with internally generated cashflows that also include disposal proceeds (company-defined free cash flow). Under the company definition of free cash flow, we expect Metro to be positive in fiscal 2023 and break even in fiscal 2024. From 2024, Metro should start to reap the first benefits of the sCore strategy, which aims to boost topline to €40 billion by 2030 and absolute EBITDA to €2 billion, a goal we deem quite ambitious. This EBITDA growth will help mitigate the negative effects on leverage of the FOCF burn we expect until 2025.

The restaurant sector has proven more resilient than anticipated in the context of prevailing inflation, but we expect some short-term pressure will likely weigh on Metro's earnings. We believe the robust fiscal 2022 results indicate strong pent-up demand that we expect to normalize over 2023, on the back of continuing high inflation that will hit consumer purchasing power. Although the hotel, restaurant, and catering (HoReCa) segment, Metro's main revenue stream, is benefitting from a relatively well-off customer base, we don't see it as immune to inflationary pressures and expect a challenging year to come in terms of volume growth, just as Metro AG is investing operating expenditure to fund the development of its sCore strategy. That said, Metro has already exceeded pre-pandemic sales and should benefit from a restaurant industry that resumes the slightly positive growth trends seen pre-pandemic, on the back of increasing eating-out habits. We also expect Metro to consolidate its market positions on the back of high investments, which should help it maintain positive growth in a somewhat mature market.

We expect Metro will pay dividends from fiscal 2024 after two years of no shareholder renumeration. Metro has set financial leverage targets that are in line with our expectations for an investment-grade rating. The group achieved company defined net leverage of 2.3x (0.4x difference to S&P Global Ratings-adjusted metrics of 2.7x) in fiscal 2022, which aligns with its 2025 guidance to keep leverage below 2.5x. Given the sizeable disposal gains in 2023, we expect the group to pay a dividend in line with its policy of 45%-55% of reported net income. We note that this would be the first time since fiscal 2021 that a dividend is paid. The group was loss-making during the height of the COVID-19 pandemic and in fiscal 2022 due to impairments and noncash expenses related to the Russia-Ukraine war. We expect a dividend of about €150 million for 2024 and about €100 million thereafter. In light of our assessment of negative FOCF after leases in the next two years and the reinstatement of dividend payments, S&P Global Ratings-adjusted debt will increase, if not offset with exceptional cash inflows from real estate disposals or portfolio adjustments.

Although the shareholder structure remains a concern, it currently does not affect Metro's creditworthiness. We lack clear visibility on EPGC's (Metro's 45.62% shareholder at Nov. 1, 2022) potential plans for Metro, but do not factor a full takeover in our base-case scenario. Following the annual general meeting, EPGC has four of the 20 board seats, which is not sufficient to influence decisions on dividends or determine the group's strategy. Therefore, we do not regard the current stake or funding raised at the EPGC level to be constraining factors. Furthermore, we understand the main shareholders are well aligned on the strategy deployed by the current management team.

Outlook

The stable outlook reflects our assumption that Metro's credit metrics for fiscal 2023 will improve, supported by sizeable disposals proceeds but constrained by weaker operating performance. As a result, we expect S&P Global Ratings-adjusted leverage will reduce to 2.2x-2.4x in fiscal 2023 and remain at about 2.4x-2.8x in fiscal 2024. In our adjusted debt calculation, we exclude the cash held at the Russian subsidiary. Excluding the Russian subsidiary's EBITDA contribution from the group's results would increase S&P Global Ratings-adjusted leverage to 2.4x-2.7x in fiscal 2023 and 2.6x-3.0x in fiscal 2024.

Upside scenario

We could consider a positive rating action if:

- The group can sustainably generate positive reported FOCF after leases;
- S&P Global Ratings-adjusted debt to EBITDA falls sustainably below 3.0x;
- Adjusted funds from operations (FFO) to debt approaches 30%;
- Metro accelerates its sCore strategy, characterized by continued organic sales and EBITDA growth; and
- The company maintains a conservative financial policy.

Any positive rating action would also require us to either have a clear view on Metro's operations in Russia or the company demonstrates that it can maintain the required metrics excluding its operations in Russia.

Downside scenario

We could consider a negative rating action if:

- S&P Global Ratings-adjusted debt to EBITDA exceeds 3.5x for a prolonged period;
- Adjusted FFO to debt decreases below 20%;
- There is operating underperformance, notably a material deviation from our base case for adjusted EBITDA, and the group does not take financial policy measures to mitigate the hit to credit metrics; or
- The financial policy becomes more aggressive.

Company Description

Germany-based Metro AG is Europe's largest food wholesale and food delivery operator. It has strong business-to-business operations in 22 countries, with clients in three main groups: Hotels, restaurants, and caterers; independent retailers (traders); and other services. The food service distribution business made up 21% of group sales and is operated through 567 out-of-store facilities and 64 dedicated depots. Metro runs only the delivery business in nine countries.

The group also has active real estate operations through which it buys land and then develops and sells it after a few years, creating and realizing value in the process. For fiscal 2022, Metro reported revenue of €29.8 billion and S&P Global Ratings-adjusted EBITDA of €1.4 billion. The company's store network comprised 661 locations at the end of fiscal 2022.

EPGC is Metro's largest shareholder, at about 46% ownership, while family offices Meridian Foundation and Beisheim Holding pooled their interest and together hold about 24%; the rest is in free float.

Our Base-Case Scenario

Assumptions

- Real GDP stagnating in the eurozone in 2023 and expanding 1.4% in 2024.
- Consumer price index growth in the eurozone of about 5.7% in 2023 and 2.5% in 2024.
- Reported sales to be broadly flat in fiscal 2023, which is a result of the sale of Metro's Belgian business in fiscal 2022 and Indian business in fiscal 2023. On a like-for-like basis, we expect 5% revenue growth in 2023 on the back of high inflation and a slight volume decline. We expect revenue to remain at about €30.0 billion-€30.5 billion until fiscal 2025.
- Group-adjusted EBITDA margins of 4.5%-4.7% in fiscals 2023 and 2024, compared with 4.7% in fiscal 2022. We believe that margins in fiscal 2023 will be hit by an increase in energy and labor costs, as well as the cyberattack in first-quarter 2023, and supported by earnings of about €210 million from real estate development disposal gains. In the following years, we assume disposal gains reduce to about €50 million.
- Capex of more than €600 million in fiscal 2023 (2% of sales) and thereafter remaining at about 2% of sales.

- Asset disposal proceeds in excess of €500 million in fiscal 2023, as a result of the sale of the Metro Campus in Düsseldorf, the Wumei option, and Metro's India business. We also expect lower financial and lease liabilities from the divestment, bringing an overall reduction in S&P Global Ratings-adjusted debt to €700 million-€900 million in 2023. From 2024, we estimate annual asset disposal proceeds of about €75 million.
- No dividends in fiscal 2023 but about €150 million in fiscal 2024, in line with management's policy of a payout of 45%-55% of last year's reported earnings per share, which will be hit by high disposal gains. After 2024, we expect dividends of about €100 million.
- Acquisitions of €100 million per year, mainly in the European food service segment, after €128 million in fiscal 2022.
- Net debt at the group level is negatively affected by cash allocated in Russia (€119 million at Sept. 30, 2022). We note this reduced to €68 million by Dec. 31, 2022.

Key metrics

Metro AG--Key Metrics

	--Fiscal year ends Sept. 30--				
(Mil. €)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Sales	24,765	29,754	29,500-30,000	29,600-30,100	30,000-30,500
EBITDA	1,146	1,391	1,400	1,350-1,400	1,375-1,425
FFO	890	1,021	1,000-1,100	1,000-1,100	1,000-1,100
Reported FOCF after lease payments	287	(89)	(200)-(100)	(100)-0	(100)-0
Debt*	3,969	3,706	3,000-3,300	3,300-3,600	3,400-3,700
Debt to EBITDA (x)	3.5	2.7	2.2x-2.4x	2.4x-2.8x	2.4x-2.6x
FFO to debt (%)	22.4	27.5	30-35	25-30	28-31
DCF to debt (%)	10.7	9.1	6-8	5-8	6-8
Revenue (excl. Russia)	22391	26850	26,900-27,600	27,100-27,800	27,600-28,300
EBITDA (excl. Russia)	949	1160	1,220-1,250	1,130-1,260	1,230-1,260
Debt to EBITDA (excl. Russia)**	4.3	3.2	2.4-2.7	2.6-3.0	2.7-3.0
FFO (excl. Russia)***	734	825	850-970	860-980	860-980
FFO to debt (excl. Russia)	17	21	26-32	24-30	23-29

All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. DCF--Discretionary cash flow. FFO--Funds from operations. FOCF--Free operating cash flow. *Debt excludes cash accrued in Russia in the forecast 2022f-2023f; as of Sept. 30, 2022, €119 million. **Excludes company-adjusted EBITDA from the Russian segment. ***Russia FFO estimated based on EBITDA, expectation of limited local debt and tax rate in Russia. Impact in the forecast period is solely from deconsolidation of Russian EBITDA and FFO since cash is already excluded in the consolidated forecast

Liquidity

We assess Metro's liquidity as strong. We expect the company's liquidity sources will be above 1.5x its liquidity uses over the next 12 months and above 1.0x over the next 24 months. We do not expect sources of liquidity will drop below uses, even if EBITDA declines 30% more than we foresee during this period. However, we think that the group would not be able to withstand high-impact, low-probability events, such as a sovereign debt crisis, without some refinancing needs. Although it has significant cash balances, these would not be sufficient to manage historically significant intra-year working capital requirements and related drawings on facilities in such a scenario. We also base our liquidity assessment on our expectation that the group will maintain good access to different financing sources and at least adequate headroom under its covenants.

In December 2022, the group signed a new five-year revolving credit facility (RCF) totaling €1 billion.

We expect principal liquidity sources over the 12 months from Jan. 1, 2023, will include:

- Unrestricted cash on the balance sheet of about €900 million;
- Committed and undrawn long-term credit facilities with at least 12 months remaining to maturity of €1.7 billion; (consisting of a €1 billion undrawn RCF due December 2027 and €728 million of undrawn bilateral facilities);
- Proceeds from the sale of its India business and exercise of the Wumei put option of up to €450 million; and
- Reported FFO of €800 million-€900 million

We expect principal liquidity uses over the same period will include:

- Debt maturities of €1,058 million, consisting of the €500 million bond due March 2023 and short-term financing instruments and lease liabilities;
- Seasonal working capital swings of €500 million;
- Neutral or slightly negative working capital outflows of up to €50 million;
- Capex of about €600 million; and
- No dividends.

Environmental, Social, And Governance

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

ESG factors have an overall neutral influence on our credit rating analysis of Metro. More generally, we believe the HoReCa sector will remain sensitive to health and safety issues, and will monitor developments and their respective effects on Metro closely.

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

Issuer Credit Rating	**BBB-/Stable/A-3**
Cash flow/leverage	Significant
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)

Related Criteria

- 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: 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: Methodology: Industry Risk, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Industry Top Trends 2023: Retail And Restaurants, Jan. 23, 2023

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Metro AG		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3
Senior Unsecured	BBB-	BBB-
Commercial Paper	A-3	A-3

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914