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Research Update:

Grupo Famsa S.A.B. de C.V. 'B' Global Scale And 'mxBBB-' National Scale Ratings Affirmed, Outlook Still Negative

Primary Credit Analyst:
Juan Camilo Alvarez, Mexico City + 52 55 5081 4479; juan.camilo.alvarez@spglobal.com

Secondary Contact:
Laura Martinez, Mexico City (52) 55-5081-4425; laura.martinez@spglobal.com

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Research Update:

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Overview

- Mexico-based retailer GFamsa has continued to implement initiatives to improve its capital structure and liquidity including an asset monetization plan and debt refinancing.
- However, the recovery of the company's operating performance has taken longer than expected, resulting in weak credit metrics, low cash flow generation, and a tight liquidity.
- We're affirming our 'B' global scale and 'mxBBB-' national scale corporate credit and issue-level ratings on the company.
- The negative outlook on GFamsa reflects the possibility of a downgrade in the next three months if the company fails to execute a liability management plan to gradually extend its debt maturity profile and address potential refinancing risks. A downgrade could also occur before the end of 2018 if GFamsa's initiatives to strengthen its operating and financial performance are not sufficient to improve credit metrics and liquidity, or if the company doesn't develop a feasible plan to address its debt maturity on its senior unsecured notes due May 2020.

Rating Action

On May 25, 2018, S&P Global Ratings affirmed its 'B' global scale and 'mxBBB-' national scale corporate credit ratings on Grupo Famsa, S.A.B. de C.V. (GFamsa). We also affirmed our 'B' issue-level rating on GFamsa's debt. Our recovery rating of '3', which indicates our expectation of meaningful (50%-90%; rounded estimate 65%) recovery prospects for the bondholders in the event of a payment default, remains unchanged. The outlook remains negative.

Rationale

Since early 2017, GFamsa has implemented several initiatives to improve its operating and financial performance, and strengthen its capital structure and liquidity. These included the reinforcement of its sales force, the closing of underperforming stores, the reduction of staff, the partial refinancing of its senior unsecured bond due 2020, and some debt reduction through the proceeds of its asset monetization plan. Moreover, the company is currently working on a couple of refinancing options that should occur before the end of the second quarter of this year. Nevertheless, these efforts haven't sufficiently improved GFamsa's operating and financial performance, and in our view, the company continues to face several challenges that could undermine the recovery of its growth prospects. Additionally, failure to refinance its debt and continue asset sales could raise refinancing risk and liquidity pressures, triggering a downgrade.

In our view, fierce competition, Mexico's volatile macroeconomic conditions in light of the upcoming presidential elections, the uncertainty around the North America Free Trade Agreement (NAFTA), and the potential downside risks in consumption due to high interest rates are weighing on the company's top-line growth, EBITDA, and cash flow generation. However, GFamsa continues to have a strong presence in northern Mexico, its captive finance division, Banco Ahorro Famsa S.A. Institucion de Banca Multiple, maintains a solid performance, and adjusted EBITDA margins remain above those of of the company's peers, which we expect at around 19% for the next two years.

During the past 12 months, GFamsa reduced its debt by around MXN620 million through the proceeds from the asset monetization plan. We also expect the company to divest assets during 2018 for additional MXN800 million to further reduce its debt. However, we continue to expect GFamsa's debt-to-EBITDA ratio to remain significantly above 5.0x and its EBITDA interest coverage ratio below 2.0x in the next 12 months. All of our ratios are adjusted by operating leases, pensions, and captive finance operations. The company carries substantial operating leases that pressure its leverage metrics, because almost half of the adjusted debt is derived from this adjustment. Even though GFamsa has hedged its coupon payments for May and November 2018, the company continues to have a significant exposure to the volatility of the dollar-denominated debt.

Our base-case scenario assumes the following factors:

- GDP growth and CPI in Mexico of about 2.4% and 4.1%, respectively, in 2018 and 2.5% and 3.2% in 2019, which could pressure consumption trends. U.S. GDP growth and CPI of about 2.9% and 2.3%, respectively, in 2018 and 2.6% and 1.9% in 2019. The same stores sale (SSS) growth to slip to the mid-single digit area from high-single digits in 2017.
- Year-end exchange rate of MXN19 per $1 in 2018 and MXN19.25 per $1 in 2019. However, given the volatile macroeconomic conditions, potential currency fluctuations could raise GFamsa's debt and cost of imported goods.
- Revenue growth at 3.3% in 2018 and 3.1% in 2019, reflecting price increases but also a fierce competition in Mexico.
- Cost structure improvements in the next two years, reflecting the implementation of operating efficiencies and manpower reduction.
- Working capital needs of around MXN1.2 billion annually in 2018 and 2019.
- Capital expenditures (capex) of about MXN150 million in 2018 only for stores' renovations and MXN200 million in 2019 for several store openings.

- No dividend payments.
- MXN800 million from the asset monetization plan during 2018 to reduce debt by around MXN500 million.
- Adjusted debt to drop to between MXN18.0 billion and MXN18.3 billion in the next two years.

Based on these assumptions, we arrive at the following credit metrics for 2018 and 2019:

- EBITDA margins around 19%;
- Debt to EBITDA significantly above 5.0x; and
- EBITDA interest coverage below 2.0x.

Liquidity

GFamsa's liquidity is less than adequate, under our criteria. We expect sources to uses of cash to remain below 1.2x in the next 12 months, reflecting intensive working capital requirements and significant short-term debt maturities. We also include qualitative factors in our liquidity analysis, as seen the company's good access to domestic capital markets and credit lines from Mexican banks. Nonetheless, we expect that under stressed economic conditions and tight credit availability, the company's refinancing sources could be limited. Funding and liquidity at the captive finance division are neutral to the overall liquidity assessment for GFamsa. The division's funding sources are fully composed of deposits without exposure to margin calls and other forms of early termination. Moreover, the division doesn't have significant borrower concentration.

Principal Liquidity Sources:

- Cash and cash equivalents of MXN1.2 billion as of March 31, 2018; and
- Funds from operations of about MXN1.5 billion for the next 12 months.

Principal Liquidity Uses:

- Debt amortization of MXN2.7 billion for the next 12 months as of March 31, 2018;
- Working capital requirements of MXN2.2 billion for the next 12 months (including peak in intra-year working capital); and
- Capex of about MXN163 million for the next 12 months.

We expect GFamsa's liquidity to improve through the asset monetization and other refinancing alternatives in the next 12 months. As of March 31 2018, GFamsa's financial covenants are of incurrence, with which the company was in compliance.

Outlook

The negative outlook on GFamsa reflects the possibility of a downgrade in the next three months if the company fails to execute a liability management plan to gradually extend its debt maturity profile and address potential refinancing risks. A downgrade could also occur before the end of 2018 if GFamsa's initiatives to strengthen its operating and financial performance are insufficient to improve credit metrics and liquidity, or if the company doesn't develop a feasible plan to address its debt maturity on its senior unsecured notes due May 2020.

Upside scenario

We could revise the outlook to stable in the next 6-12 months if the company successfully completes its liability management plan and refinances its senior unsecured notes due 2020. Moreover, this would require improved operating and financial performance, capital structure, and liquidity position.

Ratings Score Snapshot

Corporate Credit Rating:
Global Scale B/Negative/--
National Scale mxBBB-/Negative/--

Business risk: Fair
- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Highly Leveraged
- Cash flow/Leverage: Highly Leveraged

Anchor: b
Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Negative (-1 notch)
- Liquidity: Less than adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)
- Captive finance risk position: Neutral (no impact)

Stand-alone credit profile: b

Issue Ratings--Recovery Analysis

Key analytical factors

- The global scale issue-level rating on GFamsa's senior unsecured notes is 'B'. The recovery rating is '3', indicating our expectation for meaningful (50%-90%; rounded estimate of 65%) recovery prospect in the event of a payment default.
- In an event of default, the senior unsecured notes would rank pari-passu in right and order of payment with all the existing unsecured debt instruments in GFamsa's current capital structure except for factoring loans that are priority claims and other first lien debt.
- Our simulated default scenario assumes a payment default in 2020, due to a sustained and deep economic downturn in Mexico that would translate into a significantly reduced demand for branded durable products, and pricing pressures.
- We have valued GFamsa on a going concern basis given our belief that it would continue to have a viable business model in an event of default.

Simulated default assumptions

- Simulated year of default: 2020
- EBITDA at emergence: about MXN1.22 billion
- Implied enterprise value multiple: 5.0x
- Jurisdiction: Mexico

Simplified waterfall

- Gross enterprise value at default: about MXN6.1 billion
- Administrative costs: about MXN300 million
- Net enterprise value at default: about MXN5.8 billion
- Priority claims and first lien debt: about MXN600 million
- Collateral value available to unsecured creditors: MXN5.2 billion
- Total claims ranking pari-passu with senior unsecured notes: MXN7.9 billion*
- Recovery expectations: 50%-90% (rounded estimate of 65%)

* Notes: All debt amounts include six months of prepetition interest.

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Recovery: Methodology For Applying Recovery Ratings To National Scale Issue Ratings, Sept. 22, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Retail And Restaurants Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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

Ratings List

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Ratings Affirmed

Grupo Famsa S.A.B. de C.V.
 Corporate Credit Rating
   Global Scale                          B/Negative/--
   CaVal (Mexico) National Scale         mxBBB-/Negative/--

 Senior Unsecured
   Global Scale                          B
   Recovery Rating                       3(65%)
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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. 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.