



Fitch Downgrades Famsa's IDRs to 'RD' on Exchange Completion; Subsequently Upgrades them to 'CCC-'

Fitch Ratings - Mexico City - 18 December 2019:

Fitch Ratings has downgraded Grupo Famsa, S.A.B. de C.V. (Famsa)'s Long-Term Local Currency, Foreign Currency Issuer Default Ratings (IDRs) and the national long-term rating to 'RD' from 'C' on the completion of Famsa's exchange offer. Fitch considers the debt exchange, which closed on Dec. 10, 2019, as a distressed debt exchange (DDE) under Fitch's DDE criteria. Subsequently, Fitch has reassessed and upgraded the IDRs and the national long-term rating to 'CCC-' post completion of the exchange. A full list of rating actions follows at the end of this release.

The 'CCC-' ratings reflect the fact that Famsa has not completely eliminated the refinancing risk for the untendered USD59.1 million notes due in June 1st 2020 and there still are credit concerns of high debt burden and weak FCF generation. The ratings also reflect Famsa's high execution risk in the company's strategy, amid a very competitive market and expectations of soft consumer demand.

Fitch has also assigned a 'CCC-/RR4' rating to Famsa's USD80.9 million 9.75% senior notes due 2024 which were issued arising from the exchange offer.

The rating on Famsa's outstanding untendered USD59.1 million 7.25% senior unsecured notes due June 1, 2020 has been upgraded to 'CC'/RR5', reflecting the lower recovery prospects and lower levels of creditor protection as the exchange's percentage of acceptance eliminated restrictive covenants and certain events of default included in the 2020 senior notes indenture. Fitch has also withdrawn the rating of Famsa's untendered 2020 unsecured notes that were partially exchanged for the new 2024 notes.

RATING ACTIONS

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Grupo Famsa, S.A.B. de C.V.	LT IDR CCC- Upgrade		C
	LT IDR RD Downgrade		C
	LC LT IDR CCC- Upgrade		C
	LC LT IDR RD Downgrade		C
	Natl LT RD(mex) Downgrade		C(mex)
	Natl LT CCC-(mex) Upgrade		C(mex)

	Natl ST RD(mex) Downgrade		C(mex)
	Natl ST C(mex) Upgrade		RD(mex)
senior unsecured	LT WD Withdrawn		C
senior unsecured	LT CC Upgrade	RR5	C
senior unsecured	LT CCC- New Rating	RR4	
senior unsecured	Natl ST C(mex) Affirmed		C(mex)

The rating for the 2020 senior notes was withdrawn with the following reason: Bonds Were Exchanged

Key Rating Drivers

Exchange Offering Completed: With the exchange completed, Famsa managed to restructure a portion of its short-term maturities. As per Fitch's DDE Criteria, Famsa's IDR was lowered to 'Restricted Default' (RD) on completion of its debt restructuring. The exchange enabled a reduction of the outstanding 2020 notes to USD59.1 million from the previous USD140 million (originally USD250 million issuance), and extending the maturity of the tendered notes to 2024 with the issuance of new secured notes. The new 2024 notes have as collateral the shares of Famsa Inc. and its subsidiaries.

Leverage Still High: While the exchange partially improves Famsa's liquidity, its leverage (estimated at above 7.0x on an adjusted debt to EBITDAR basis, calculated pre-IFRS 16) remains high for a non-food retailer operating in a challenging competitive environment, given its persistent negative FCF generation and BAF constant capital requirements. As the debt restructuring did not involve a principal reduction or additional equity, it is critical that the company improve its operational performance.

Derivation Summary

Famsa is one of the main retailers in Mexico, offering durable goods and consumer services primarily to the middle and lower-middle segments of the Mexican population. Connected with the retail operations, Famsa also offers financial services to the customers who opt to purchase its products on credit, many of whom do not typically have access to other forms of financing. However, the company's heightened liquidity risk, high leverage and recurring negative FCF had place Famsa's rating in 'CCC-', post debt exchange.

Famsa is less geographically diversified than Grupo Elektra S.A.B. de C.V. (BB+/Stable) and Grupo Unicomer Company Limited (BB-/Positive), but it is well positioned in its influence area of northern Mexico. The company

also has smaller scale in number of stores than Grupo Elektra and Grupo Unicomer, with 401 stores compared with more than 1,000.

From a financial risk profile view, the company has similar adjusted leverage than J.C. Penney (JCP, CCC+) and Rite Aid (B-/Stable) with ratios above the 7.0x (calculated pre-IFRS 16). The three companies present neutral to negative FCF, but JCP and Rite Aid have stronger liquidity position than Famsa's. On the other hand, Famsa operates in Mexico and the prospects for the Mexican retail industry are stronger than in the U.S.

Compared with Latin American peers, the company maintains a weaker financial position than Elektra and Unicomer. Famsa's operating margins are lower than Unicomer's, while Elektra has the best operating margins of the three companies.

Key Assumptions

Fitch's Key Assumptions Within the Rating Case for the Issuer

- Consolidated revenues grow an average of 5.1% annually in 2019–2022;
- Average EBITDA margin of 7.7% during 2019–2022;
- Revenue growth from the U.S. division recovers to 1% in 2019 and around 6% in 2020–2022;
- Consolidated debt, excluding bank deposits and operating leases, of MXN9.1 billion on average for 2019–2020;
- BAF issues MXN500 million of subordinated bonds in 2019;
- The company completes the exchange offering and refinance the remaining balance of the existing 2020 notes;
- Average annual capex of MXN233 million in 2019–2022;
- No dividend payments for 2019–2022;
- Famsa collects Mr. Garza's guarantee in 2019 via real estate assets to be located on BAF's balance sheet.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action:

While Fitch does not expect positive rating actions in the short-term, other factors that might improve the company's credit profile over the medium term would be:

- A successful refinancing of the remaining 2020 senior unsecured notes;
- Significant improvement in liquidity, measured by FCF trending toward neutral;
- coverage ratio measured as EBITDAR/interest paid + rents increasing above 1.4x;
- consolidated total gross debt/EBITDA, excluding bank deposits, below 6.0x on a sustained basis;

- continued strengthening of the consolidated credit portfolio's quality.

Developments That May, Individually or Collectively, Lead to Negative Rating Action:

- Failure to refinance the 2020 senior unsecured notes' untendered balance;
- Liquidity erosion, driven by continuing negative FCF;
- EBITDAR / interest paid + rents not recovering above 1.2x by FY21;
- Consolidated gross debt/EBITDA, excluding bank deposits, consistently above 7.0x.

Liquidity and Debt Structure

Liquidity Risk not Fully Eliminated: Famsa's liquidity will continue to be pressured in the short-term despite the conclusion of the debt exchange offer, as the untendered amount of the 2020 notes (USD59.1 million) still have to be paid on June 1, 2020. The company is working on several options to refinance those remaining 2020 notes, which is expected to culminate during the 1Q20, but currently there is uncertainty on how Famsa will serve this maturity.

The company's has been paying its short-term local Certificados Bursatiles maturities, which together with the conclusion of the exchange offering, have reduced short term debt by around 41% on a proforma basis compared to September 2019. In addition to the 2020 notes, Famsa faces other short-term maturities during the first half of 2020, related mainly to bank amortizations and some short-term Certificados Bursatiles.

Fitch expects Famsa to continue presenting negative FCF in the near future, so any consumer downturn or failure in the execution of the operational strategy could weaken Famsa's financial profile and increase its refinancing risks, despite the cash flow relief from the reduced short-term debt.

RECOVERY ANALYSIS

For issuers with Issuer Default Ratings (IDRs) of 'B+' and below, Fitch performs a recovery analysis for each class of obligations of the issuer. The issue rating is derived from the IDR and the relevant Recovery Rating (RR) and notching, based on the going concern enterprise value of a distressed scenario or the company's liquidation value.

The recovery analysis assumes that Famsa would be considered a going-concern in bankruptcy and that the company would be reorganized rather than liquidated. We have assumed a 10% administrative claim.

Fitch's recovery analysis for Famsa places a going concern value under a distressed scenario of approximately MXN3.8 billion; based on a going-concern EBITDA of MXN0.8 billion and a 4.5x multiple. The going concern value is higher than the liquidation value, which Fitch estimates at about MXN1.8 billion.

The going-concern EBITDA estimate reflects Fitch's view of a sustainable, post-reorganization EBITDA level upon which we base the valuation of the company. The MXN0.8 billion going-concern EBITDA assumption reflects a 30% discount from average annual EBITDA generation in the last four years. The discount reflects deterioration of U.S. operations and, at the same time, a significant consumer contraction in Mexico. The 4.5x multiple reflect the weakened business model and high degree of execution risks under challenging market conditions.

The liquidation value considers no value for cash due to the assumption that cash dissipates during or before the bankruptcy. Fitch applied a 100% discount on the credit portfolio, given that most of it is allocated within

BAF, which is a regulated entity and has another liquidation process. Fitch has also applied a 50% discount on inventory and PPE as a proxy for the liquidation value of those assets.

For the new USD80.9 million Secured Notes due 2024, Famsa's waterfall results in a 61% recovery corresponding to a Recovery Rating of 'RR3'. However, according to Fitch's 'Country-Specific Treatment of Recovery Ratings Criteria', published in April 2018, the Recovery Rating for Mexican corporate issuers is capped at 'RR4', constraining the upward notching of issue ratings in countries with a less reliable legal environment. Therefore, the Recovery Rating for Famsa's 2024 new senior notes is 'RR4'. The waterfall also indicates a ranked recovery for the 2020 senior notes in the 'RR5' band indicating a 'CC' instrument rating.

Summary of Financial Adjustments

Gains on fixed asset sales were deducted from the operating income. Financial Statements were adjusted to revert IFRS 16 effect.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

Famsa has an ESG Relevance Score of 5 for Management Strategy due to the number of operational restructures that have occurred due to challenges the company has faced in implementing its strategy, which has a negative impact on the credit profile and is highly relevant to the rating in conjunction with other factors.

Famsa has an ESG Relevance Score of 4 for Governance Structure due to board effectiveness and ownership concentration, which has an unfavorable impact on the credit profile and is relevant to the rating in conjunction with other factors.

Famsa has an ESG Relevance Score of 4 for Group Structure given that the company presents a below average transparency of related-party transactions. This has a negative impact on the credit profile and is relevant to the rating in conjunction with other factors.

Famsa has an ESG Relevance Score of 5 for Financial Transparency due to a track record of material differences from audited financial statements and the company's reported figures. This has a negative impact on the credit profile and is highly relevant to the rating in conjunction with other factors.

Additional information is available on www.fitchratings.com

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Applicable Criteria

National Scale Ratings Criteria (pub. 18 Jul 2018)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)
Corporate Rating Criteria (pub. 19 Feb 2019)
Distressed Debt Exchange Rating Criteria (pub. 06 Aug 2019)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)

Additional Disclosures

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