

Research Update:

France-Based Aerospace Propulsion Manufacturer Safran SA Assigned 'BBB+' Rating; Outlook Stable

February 25, 2021

Rating Action Overview

- We are assigning our 'BBB+' long-term issuer credit rating to Safran SA, a France-based leading tier 1 manufacturer of aerospace propulsion systems, aircraft equipment, and aircraft interiors.
- The 'BBB+' rating primarily reflects Safran's strong balance sheet, conservative financial policy, and strong cash generation profile, supported by relatively resilient profit margins; as well as its significant exposure to the commercial aerospace sector that is undergoing a significant downturn due to the COVID-19 pandemic.
- Despite the pandemic and thanks to management's swift actions to preserve profitability and cash flow, we forecast that the company will maintain EBITDA margins of above 15% over 2021-2022 and generate free operating cash flow (FOCF) of close to €1 billion in 2021 and €1.0 billion-€1.5 billion in 2022, compared with about €1.4 billion in 2020 and about €2.3 billion in 2019.
- The stable outlook reflects our expectation that Safran's cost-cutting measures and discipline on investments will translate into funds from operations (FFO) to debt of at least 40% and FOCF to debt at above 20% in 2021, despite air traffic demand not recovering to 2019 levels until at least 2024.

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Rating Action Rationale

Safran is well positioned to steer through the worst aerospace downturn in the industry's history, thanks to its strong balance sheet and strong cash generation profile, and supported by resilient profit margins. In our global air passenger traffic forecast (for more information, see "Industry Top Trends 2021: Aerospace and Defense: Pandemic Will Pressure Commercial Aerospace Through At Least 2021," published Dec. 10, 2020, on RatingsDirect), we expect air passenger traffic to decline 40%-60% in 2021 compared with 2019 levels, and foresee a gradual recovery to pre-pandemic levels only by 2024. Safran's customers, such as airlines, are reducing their fleets to cope with the lower demand, while aircraft original equipment manufacturers Airbus and Boeing have cut their production rates by 30%-50% on most models, with the deepest cuts to

wide-body production. Safran, however, is present on narrow-body airplane platforms that service domestic and regional air travel and are expected to recover more quickly than wide-body aircraft and international air traffic. This contrasts quite strongly with key peer Rolls-Royce PLC, which is only present on wide-body aircraft.

For Safran, the pandemic's effects will translate into lower engine sales and subdued demand for aftermarket services compared with the industry peak in 2019. The company's propulsion division is its main profit source, thanks to its larger share of higher-margin service (repairs and spare parts) revenue. In 2020, services revenue accounted for about 61% of propulsion engines revenue; this was 44% for the group overall. Therefore, the recovery in aftermarket activities will be key to restoring higher operating profits. In 2020, Safran's sales declined by about 33% primarily due to the slump in air traffic and airplane demand that affected all divisions. Nevertheless, the company maintained an S&P Global Ratings-adjusted EBITDA margin at about 14% in 2020 versus about 18% in 2019, and we expect that Safran's EBITDA margin will stay above 15% for the 2021-2022 period, toward the higher end of the average (10%-18%) range for the aerospace sector. This reflects the company's agility in reducing operating costs through layoffs (with a 21% workforce reduction in 2020, including temporary staff) and the flexible work agreement negotiated with French unions that is in effect until the end of 2021. The resilience in earnings despite the weak demand, coupled with a strict discipline on capital expenditure (capex), should support strong FOCF.

With a low debt-to-EBITDA ratio of about 1.3x and a solid FOCF-to-debt ratio of about 38% in 2019, Safran exhibited a strong balance sheet before the pandemic, reflecting the company's strong cash generation profile and conservative financial policy. This also contrasted strongly against some aerospace peers (such as Boeing, Spirit Aero, and Rolls-Royce) who, when the pandemic first hit, were already grappling with engineering challenges and pressured profitability, weaker cash flow, and rising debt levels. We expect the group's debt-to-EBITDA ratio to gradually decline below 1.5x by 2022 from a peak of 2.0x in 2020 due to the pandemic.

Thanks to its positioning on narrow-body aircraft and the young age of its installed engine fleet, Safran is well positioned to ride out the downturn. Through its 50-50 joint venture with General Electric, Safran is the market leader for propulsion engines in short- and medium-range aircraft ahead of its American competitor Pratt & Whitney (part of Raytheon Technologies Corp. [RTC]). We believe that domestic air travel is likely to recover before international, so narrow-body production could begin to increase in late 2021 if demand warrants. As air travel increases, aircraft will require more repairs and spare parts. The retirement of older aircraft could hinder recovery in higher-margin spare parts sales. This is because those older aircraft generally require more maintenance and, when scrapped, will be a source of used parts that compete with new ones. Nevertheless, we think the company is less likely to feel the effects, thanks to the young age of its CFM56-5B/7B installed fleet. In 2020, about 50% of these engines had not gone through their first shop visits yet which usually occur after six-to-seven years of service. For these reasons, we have modeled a marked recovery in aftermarket services in 2022 that should support FOCF of €1.0 billion-€1.5 billion in 2022. We also believe that Safran's lower reliance on fly-by-the-hour contracts compared with that of some peers such as Rolls-Royce is an advantage in downturns, because its cash flow profile is somewhat less affected by sudden fall in the number of flying hours.

Safran's positive discretionary cash flow will support deleveraging such that by 2022, its credit metrics will get closer to 2019 levels.

After suspending the dividend payment of about €1 billion in 2020, Safran's management will propose a dividend payment of €184 million in 2021. For 2022, we assume that the company will make dividend payments with a payout ratio of about 40%. We have not included any acquisitions in our base-case scenario because we believe management will focus on deleveraging its balance sheet toward 2019 levels.

Safran's limited diversification outside the commercial aerospace sector is a constraining factor for our assessment of the group's business risk profile relative to that of peers.

About 75% of the company's activities relate to commercial aerospace, a sector that is heavily affected by the COVID-19 pandemic. Defense and helicopters related operations make up the remaining 25%. Within commercial aerospace, Safran offers a very broad range of products covering extensive functions of an aircraft (such as engines, nacelles, brakes, wheels, fluid systems, cabins, seats, lavatories). However, we think that Safran lags the diversity of peers such as Thales, RTC, or BAE Systems, and which are likely to demonstrate more resilient revenue, EBITDA and cash flow in 2020-2021. For instance, France-based engineering company Thales covers diverse end markets, including transportation, commercial aerospace, defense and digital security. U.S.-based RTC was formed from the merger between UTC technologies and Raytheon; it is one of the largest aerospace and defense companies. Its revenue profile is more balanced than Safran's, with 55%-65% of sales correlated to commercial aerospace and 35%-45% of sales related to defense. Finally, although BAE Systems is a pure defense player, it exhibits a large diversity of programs being on air, marine, and field platforms. In our base-case scenario for 2020, we expect revenue for Thales to drop by just 7%-7.5%; while RTC's sales declined by about 23% organically compared with the 33% drop for Safran.

Outlook

The stable outlook reflects our expectation that Safran's cost-cutting measures and discipline on investments will translate into an adjusted FFO-to-debt ratio of at least 40% and an adjusted FOCF-to-debt ratio of above 20% in 2021 despite air traffic demand remaining low (40%-60% below 2019 levels). We also factor in a marked recovery of those ratios to above 60% and 30%, respectively, in 2022.

Downside scenario

We could lower our ratings if we were to expect that Safran failed to sustain the following key credit metrics:

- Adjusted FFO to debt above 45%
- Adjusted FOCF to debt above 20%

This could occur in case of operating missteps or if Safran cannot reduce its costs to match slower than expected recovery in air traffic. Although not expected, it could also result from a more aggressive financial policy.

Upside scenario

We could raise our ratings on Safran if the company sustainably strengthens its credit metrics,

such that:

- Adjusted FFO to debt stays above 60%; and
- Adjusted FOCF to debt is consistently higher than 40%.

This would also require that Safran maintains EBITDA margin of 16%-18% as well as a conservative financial policy.

Company Description

Safran is a global tier-1 aerospace and defense group focused on the design, manufacture, sale, and servicing of aircraft and helicopters systems. Its main business is aerospace propulsion (46.5% of 2020 revenue) as a leading engine manufacturer and aftermarket services provider for commercial single aisle aircrafts, helicopters, and military aircrafts. The aircraft equipment, defense, and aerosystems division (41.8%) provides a broad range of products such as landing gears, wheels, brakes, nacelles, wiring, avionics, and fluid systems. The aircraft interiors division (11.7%) provides cabin interiors, seats, lavatories, water and waste systems, and in-flight entertainment.

Safran is headquartered in France. It generated revenue of about €16.5 billion in 2020. The company is listed on the Euronext stock exchange. As of December 2020, the French state held about 11% of Safran's shares, employees held about 7% of shares, and the rest was free float.

Our Base-Case Scenario

- Global passenger air traffic (as measured by revenue passenger kilometers) down by 60%-80% in 2020; and to continue to lag 2019 levels in 2021 and 2022 by 40%-60% and 20%-30%, respectively.
- Safran's sales down 3%-6% in 2021 driven by low production rates from Airbus and Boeing, combined with the end of production of CFM56 engines. We see limited prospects for recovery in repairs and spare-parts revenue as airlines continue to optimize fleet management.
- Revenue growth of 10%-13% in 2022 driven by pent-up demand in all segments. We see faster recovery prospects from the propulsion engines division as opposed to aircraft equipment and interiors division due to the larger exposure to wide-body airplane production within the aircraft equipment and interiors division.
- EBITDA margin recovery in 2021 from cost-cutting measures, improving further in 2022 from the growth of profitable aftermarket sales. We deduct capitalized development costs from our adjusted EBITDA figures, which we expect will be around €300 million over 2021-2022 from €279 million in 2020 and €325 million in 2019. We assume no material restructuring costs in 2021 and 2022.
- Annual capex of €500 million-€600 million in 2021-2022 excluding capitalized R&D, compared with €800 million in 2019.
- Working capital outflow of €500 million-€600 million in 2021 reflecting the decrease in advance payments linked to the Rafale program and to the LEAP, followed by a ramp-up in activity from 2022 translating into higher inventories.
- Dividend payment of €184 million in 2021 after the dividend suspension in 2020. Dividend payout of 40% in 2022.

- No share buybacks, material acquisitions, or material disposals in our base-case scenario.

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Key metrics

Safran SA--Key Metrics*

(Bil. €)	--Fiscal year ended Dec. 31--				
	2018a	2019a	2020a	2021e	2022f
Revenues	21.3	24.6	16.5	15.5-16.0	17.0-18.0
EBITDA	3.0	4.5	2.3	2.3-2.5	2.5-3.0
Funds from operations	2.4	3.5	2.1	1.8-2.0	2.0-2.5
Capital expenditure	1.0	0.8	0.5	0.5	0.6
Free operating cash flow	1.7	2.3	1.4	0.8-1.0	1.0-1.5
Discretionary cash flow (after dividends and SBB)	0.5	0.2	1.4	0.6-0.8	0.5-1.0
Debt	5.7	6.0	4.6	3.8-4.0	3.3-3.8
Debt to EBITDA (x)	1.9	1.3	2.0	1.6-1.8	1.0-1.5
FFO to debt (%)	40.9	58.1	45.0	43.0-45.0	65.0-70.0
FOCF to debt (%)	29.9	38.4	29.4	21.0-23.0	35.0-40.0

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We expect Safran will maintain a strong liquidity profile and that sources of liquidity will exceed uses by more than 1.5x over the 12 months from Dec. 31, 2020, and by more than 1.0x in the following 12 months. We also expect liquidity sources to exceed uses, even if EBITDA unexpectedly fell 30% below our base-case forecast.

Safran maintains well-established bank relationships and access to debt capital markets, as demonstrated by the signing of a €3 billion bridge facility in April 2020, now reduced to €1.4 billion. From 2021 to 2024, the company has about €2.4 billion of debt due (excluding commercial paper), including a €500 million bond maturing in June 2021, a \$540 million U.S. private placement due in 2022, OCEANE of €700 million in 2023, and a U.S. private placement of \$505 million in 2024. We consider Safran's debt maturity profile manageable.

Principal liquidity sources for the 12 months started Jan. 1, 2021, are:

- Cash of about €3.5 billion, excluding about €260 million of cash considered not readily

accessible

- Available credit lines of €3.9 billion including an undrawn revolving credit facility of €2.52 billion maturing in December 2022 and an undrawn bridge facility of €1.4 billion maturing in April 2022
- Forecast FFO of €2.1 billion-€2.3 billion (before capitalized R&D)

Principal liquidity uses for the same period are:

- About €2.5 billion of debt maturing (including commercial paper).
- €500 million-€600 million of working capital needs,
- Capex of about €800 million including capitalized development costs.
- €184 million in annual dividend payments.

Covenants

There are no financial maintenance covenants under the revolving credit facility agreement and the bridge facility. The U.S. Private Placement agreement includes one maintenance covenant stipulating that net debt to EBITDA must remain below 2.5x. We expect at least 30% headroom under this covenant in our base-case forecast. As of Dec. 31, 2020, Safran's net debt to EBITDA ratio stood at about 1.06x.

Government Influence

Under our criteria for rating government-related entities, we view Safran as having limited importance to its 11% shareholder, France. This assessment reflects our view that the French government is primarily interested in the company's critical operations and employment and to a lesser extent by its credit standing. We likewise view the link between Safran and the French government as limited. This is because the French government occupies only two seats out of 18 at the company's board of directors and acts just as any other minority shareholder. As a result, we assess the likelihood of extraordinary government support as low and do not add any uplift for government support to Safran's 'bbb+' stand-alone credit profile.

Environmental, Social, And Governance(ESG)

We consider Safran's ESG factors broadly in line with those of its peers and the overall industry. The company faces long-term environmental risks related to greenhouse gas emissions. It can meet current regulations with existing technology and is developing, with GE, the successor of the LEAP engine with an aim to reduce fuel consumption by at least 15%. As a major supplier of aircraft engines to the civil aerospace sector, Safran is exposed to some social risks, mainly involving product safety. A serious design flaw or manufacturing defect, especially if it causes a fatal accident, could expose the company to significant legal liabilities, costs to fix the problem, and possibly order cancellations or lost sales. Safran has no history of significant engineering issues related to engines. We view the group's management and governance as satisfactory. This reflects the group's demonstrated willingness and capacity to adhere to its public financial targets and gradually improve its credit metrics. It also reflects management's clear strategic planning process, transparent communication with investors, and good depth and breadth. On the other hand, the group is exposed to the global aerospace downturn owing to the pandemic.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/--

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers:

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

- Likelihood of government support: Low

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- 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, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Industry Top Trends 2021: Aerospace and Defense, Dec. 10, 2020
- Airbus SE, Nov. 12, 2020
- Raytheon Technologies Corp. Nov. 6, 2020
- Rolls-Royce PLC Downgraded To 'BB-' And Placed On CreditWatch Negative, Sept. 11, 2020

Ratings List

New Rating

Safran SA

Issuer Credit Rating BBB+/Stable/--

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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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