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Research Update:

French Nuclear Company Orano Upgraded To 'BB+' On Improved Liquidity And Capital Structure; Outlook Stable

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Overview

- Orano has reported EBITDA of close to €1 billion for 2017, despite challenging industry conditions, and its recent restructuring and capital increases have improved its liquidity and capital structure.
- We think Orano will continue to focus on cost-cutting and generate moderately positive free operating cash flow, enabling it to reduce net debt in 2018-2020.
- Consequently, we are upgrading Orano to 'BB+' from 'BB'.
- The stable outlook reflects our view that Orano will be able to reduce adjusted debt to EBITDA to below 5.5x in 2019-2020 despite challenging industry conditions, supported by its sizeable, long-term order backlog.

Rating Action

On April 5, 2018, S&P Global Ratings raised its long-term issuer credit rating on France-based nuclear services group Orano to 'BB+' from 'BB'. The outlook is stable.

We also raised our ratings on Orano's senior unsecured bonds to 'BB+' from 'BB'. Although we expect substantial recovery (70%-90%; rounded estimate 85%) on the bonds in the event of a default, the recovery rating is capped at '3' due to the bonds' unsecured nature and issuance by a company rated in the 'BB' category.

Rationale

The upgrade follows the finalization of Orano's restructuring, with the sale of Areva NP's assets to Electricité de France (EDF) in December 2017, the completion of two equity increases in February 2018, cumulative cost savings of about €480 million yearly since 2014, and the company's track record of operating as a stand-alone entity since mid-2017. We expect the S&P Global Ratings-adjusted debt-to-EBITDA ratio will average 5.0x-5.5x in 2018-2020 and decrease thereafter, despite challenging industry conditions characterized by low and volatile spot prices due to uncertainty about the pace of the recovery in demand for uranium products globally. This is supported by the company's long-term contract profile, which limits its exposure to spot prices in the near term; management's new cost-savings plan through 2020; and the company's commitment to reduce net debt after 2018. We also anticipate the company will generate moderately positive free operating cash flow (FOCF) from 2018 onward. We continue to believe that there is a high likelihood of Orano receiving support from the French government, which is reflected in a three-notch uplift in the rating above the company's stand-alone credit profile.

After our adjustments, we calculate that debt to EBITDA was 4.8x in 2017, which demonstrates the resilience of the company's business, supported by long-term contracts in its mining, enrichment, and back-end divisions. We expect that this ratio could deteriorate to about 6x in 2018, due to one-time effects linked to the industrial transition at the Comurhex I site to Comurhex II, as well as expenses related to the Voluntary Departure Plan. We factor in, however, that after a temporary increase in 2018, leverage will decrease in 2019 and 2020 on the back of EBITDA recovery and moderately positive discretionary cash flow, supported in particular by favorable working capital movements related to advance payments in the back-end segment as well as some destocking in the front-end segment.

Orano's restructuring was completed after two Japanese shareholders, Japan Nuclear Fuel Ltd. and Mitsubishi Heavy Industries, contributed additional equity totaling €500 million in February 2018, after NEW NP (now Framatome) was sold to EDF. Although the full completion of the capital increases and restructuring was in line with our expectations, we believe this enhances Orano's credit profile because it further improves its liquidity position and capital structure. It has also removed residual risks related to AREVA SA.

Orano was originally created by France-headquartered nuclear services provider AREVA to focus on the key nuclear cycle activities, encompassing AREVA's former mining, uranium conversion and enrichment, and back-end activities (such as recycling, dismantling, logistics, and other downstream services). At year-end 2017, Orano's revenues totaled €3.9 billion and the S&P Global Ratings-adjusted EBITDA figure was €1.0 billion. We view these activities as providing Orano with stable cash flows, backed by long-term contracts, supporting our view of Orano's satisfactory business risk profile.

We also take into account Orano's strong global market positions, fully invested asset base with high-quality mining sites and reserves, and asset and geographic diversification. We believe that the sector's high capital intensity, long-term customer relationships, technological know-how, and security and safety considerations create important barriers to entry. The main constraints are the difficult low-price conditions in the nuclear industry and challenging operating environment, which we think will persist since utility clients remain under pressure to contain capital and operating expenditures, with new builds being delayed and sometimes becoming less likely as some governments decide to reduce the nuclear part of the energy mix.

Orano's highly leveraged financial risk profile reflects its high adjusted debt, which largely comprises bonds. We anticipate adjusted debt to EBITDA of about 6x in 2018, 5.5x-6.0x in 2019, and about 5x in 2020 (after 4.8x in

2017). We also anticipate moderately positive FOCF and discretionary cash flows from 2018, which should enable the company to gradually reduce debt.

In our debt calculation, we take into account about €1.8 billion of debt adjustments related to pension-related liabilities and asset-retirement obligations. We view Orano's credit ratios, including leverage and only limited FOCF generation (excluding capital injection), as comparatively weaker than those of peers in the same rating category, which is reflected in our negative view of Orano under our comparable ratings analysis.

In our base case, we assume:

- Reported EBITDA (that is, before our adjustments) of about €750 million in 2018, €750 million to €850 million in 2019, and €900 million-€1 billion in 2020, after €946 million in 2017. The assumed decline in 2018 reflects weaker mining and front-end segment EBITDA, due to a decline in volumes and pressure on pricing, as well as the impact of restructuring expenses. Growth in 2019, and notably in 2020, will likely stem from lower restructuring expenses, the end of the industrial transition at the Comurhex I site to Comurhex II, as well as new contracts and an increase in demand globally;
- The impact of current weak spot prices in uranium and uranium enrichment markets will be largely mitigated by long-term contracts with fixed prices and, to a lesser extent, cost-cutting;
- Significant restructuring expenses in 2018-2019 (although lower than in 2017 when they totaled about €100 million) tied to the company's cost-cutting activities, taking into consideration its recently announced new program, which aims to achieve recurring cash gains of €250 million annually from 2020. We include these expenses in our EBITDA and funds from operations calculations;
- High recurring capital expenditure requirements of about €600 million-€700 million per year on average in 2018-2019;
- Substantial positive working capital movements in 2018-2019; and
- No dividends.

At this point we don't factor in any impact in our base case from the French Multi-Year Energy Program (Programmation Pluriannuelle de l'Energie; PPE). France will decide by the end of this year how many nuclear reactors it wants to close in order to reduce the share of nuclear operations in power generation.

We consider Orano to be a government-related entity (GRE). The French government owns 90% of Orano (including a direct stake of 45.2% and an indirect stake through AREVA SA and Atomic Energy Commission). We view the government as committed to ensuring that any potential liquidity pressure will be addressed in a timely manner, as demonstrated by its recent commitment to provide new equity and intermediate funding to Orano.

We view Orano as a GRE with a high likelihood of receiving government support because of its:

- Important role as France's leading nuclear services provider to the country's largest power producer. Orano ensures supplies of uranium and enriched uranium for France, which generates about 75% of its electricity from nuclear plants; and
- Very strong link with the French government. The group's ties with the government are reinforced by the politically sensitive nature of its enrichment and back-end recycling activities, as well as its strategic importance to France's energy policies. As a commercial enterprise, Orano operates autonomously. The French government closely follows Orano's performance and must authorize strategic investments and acquisitions. Orano also has to provide its analysis of events and answer questions from specific parliamentary committees.

Liquidity

We now assess Orano's liquidity as strong. This is supported by our estimate that the company's liquidity sources will cover uses by more than 1.5x in the 24 months started Jan. 1, 2018. We also take into account the company's prudent liquidity management and solid bank relationships.

Orano's sources of liquidity in the 12 months started Jan. 1, 2018, include:

- Our estimate of about €1.9 million of unrestricted cash on the balance sheet;
- €500 million in proceeds from Japanese investors in relation to the capital increases completed in February 2018; and
- Moderately positive FOCF of about €100 million.

These sources compare with the following uses of liquidity:

- About €120 million of short-term debt maturing in 2018 and about €750 million in relation to a bond due in November 2019;
- €100 million-€200 million in relation to nuclear end-of-life-cycle top-up payments; and
- Some moderate intrayear working capital swings that we don't expect to exceed €200 million.

We note there are no covenants in the debt documentation.

Outlook

The stable outlook reflects our view that Orano's focus on improving its cost position and its FOCF generation will enable it to reduce adjusted debt to EBITDA to below 5.5x in 2019-2020 despite challenging industry conditions, supported by its sizeable, long-term order backlog.

Downside scenario

We could lower the rating if debt to EBITDA increased materially above 6x in 2018 or if we didn't expect deleveraging in 2019-2020, so that the ratio stayed at about 6x on average. This could be the case if the currently weak market environment affected Orano's performance more than we currently expect, despite its long-term contract structure, or if it faced major, unexpected operational or quality issues, or if the revision of the French PPE resulted in a significant negative impact for Orano.

Upside scenario

We do not contemplate an upgrade in the next 18 months, given our view that challenging industry conditions will limit EBITDA improvements and deleveraging. We would, however, consider an upgrade over time if we forecast our adjusted debt to EBITDA will be sustainably and comfortably between 4.0x and 5.0x, in conjunction with positive FOCF of at least €200 million. This would require better market conditions, including stronger demand for uranium and uranium enrichment that in turn would likely require an increase in global nuclear power production.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/--

Business risk: Satisfactory
- Country Risk: Low
- Industry risk: Intermediate
- Competitive position: Satisfactory

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

Anchor: b+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (+1 notch)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: b+

- Sovereign rating: Unsolicited AA
- Likelihood of government support: High (+3 notches from SACP)

Issue Ratings--Recovery Analysis

Key analytical factors

- The issue ratings on Orano's various senior unsecured obligations are 'BB+'. We cap the recovery rating at '3' according to our methodology for unsecured financial instruments of companies rated in the 'BB' category. This is because we assume, based on empirical analysis, that the size and ranking of debt and non-debt claims will change before the hypothetical default for companies at this rating level. We expect recovery for noteholders at 85% in the event of a payment default. The ratings are supported by the company's robust asset base and minor prior-ranking debt claims, but constrained by the substantial amount of pari passu unsecured debt.
- Under our hypothetical default scenario for Orano, we assume a combination of loss of key customers and a prolonged downturn in the industry, leading to lower pricing and operational issues.
- We value Orano as a going concern, given its market-leading position and diversified product offering.

Simulated default assumptions

- Year of default: 2023
- Jurisdiction: France

Simplified waterfall

- Gross recovery value: €4.263 billion
- Net recovery value after admin. expenses (5%): €4.050 billion
- Prior-ranking claims: €346 million* mainly related to the Georges Besse II plant
- Remaining recovery value: €3.704 billion
- Senior unsecured debt claims: €4.178 billion*
- Recovery range: 70%-90% (rounded estimate 85%)
- Recovery rating: 3

*All debt amounts include six months of prepetition interest. Assuming some refinancing of the debt.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- 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 - Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Orano		
Issuer Credit Rating	BB+/Stable/--	BB/Positive/--
Senior Unsecured	BB+	BB
Recovery Rating	3(65%)	3(65%)

Additional Contact:
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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 the 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.