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Research Update:

Orano Outlook Revised To Negative From Stable On Weaker Adjusted Leverage Forecast; 'BB+' Rating Affirmed

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Rating Action Overview

- On March 1, 2019, France-based nuclear services group Orano published weak results for the rating in 2018, with an anticipated decline in EBITDA and an increase in its asset retirement obligation (ARO) liabilities.
- While we continue to view the company's ability to generate positive free cash flow in 2018 and in the coming years as a key consideration for the current rating, the volatile nature of the nuclear liabilities may hinder its ability to deleverage.
- Consequently, we revised our outlook to negative from stable and affirmed our 'BB+' issuer credit rating on Orano.
- The negative outlook reflects the possibility we could lower the rating by one notch over the coming 12-24 months if the company cannot demonstrate clear deleveraging, with adjusted debt to EBITDA of 5.5x by 2020.

Rating Action Rationale

The outlook revision reflects the possibility we could lower the rating by one notch over the coming 12-24 months if Orano experienced weaker-than expected EBITDA with an increase in its overall liabilities, maintaining adjusted debt to EBITDA above 6x in 2019 and above 5.5x in 2020. As of December 2018, the company's adjusted debt to EBITDA peaked at 6.4x, and under our current base-case scenario we see only modest improvement in 2019. A future potential rating action would also be subject to the company's ability to generate positive free operating cash flow (FOCF), while supporting a reduction in net reported debt.

In 2018, Orano posted an adjusted EBITDA of €741 million (within our previous expectation of about €700 million-€800 million), down about €70 million from 2017. In addition, the company's guidance called for stable revenues in 2019 and an EBITDA margin between 20% and 23%, translating to EBITDA of €725 million-€825 million. The weak 2018 EBITDA reflects generally weak nuclear industry conditions, the backlog structure, and other operational issues (such as the effect of the Comurhex transition and, to a lesser extent, restructuring expenses). In our view, industry conditions won't likely improve over the short term, and the company's ability to mitigate the pressure will be subject to further execution of its cost-cutting program and limiting operational issues.

Orano carried a relatively high adjusted debt burden of about €4.7 billion as of Dec. 31, 2018. The debt includes the following:

- Net financial debt of about €2.4 billion.
- ARO of €1.1 billion.
- Pension liabilities of €1.1 billion.
- Other relatively minor items.

In 2018, the company generated positive free operating cash flow and received a €500 million equity injection that reduced its net financial debt by about €750 million. Under our base case, we expect the company to continue to deleverage by about €100 million-€200 million annually in each of the coming two years, mainly driven by material working capital inflow.

On the other hand, Orano's ARO net obligations (linked to decommissioning of the nuclear facilities) rose by about €600 million in 2018. In our view, the company's need to match the liabilities (which are subject to future uncertain costs, regulatory changes, and more) by getting parallel returns from its investment portfolio is an ongoing challenge. In our view, ongoing deviations between the liabilities and the assets could put some pressure on our satisfactory business risk assessment.

Outlook

The negative outlook reflects the possibility we could lower the rating by one notch over the coming 12-24 months if the company cannot demonstrate clear deleveraging, with adjusted debt to EBITDA at about 6x on average. This would be the case, if adjusted debt to EBITDA remained above 6x in 2019, without a clear deleveraging path to 5.5x or better in 2020.

A future potential rating action would also be subject to the company's ability to generate positive FOCF

Under our base-case scenario, we assume adjusted EBITDA of €650 million-€750 million in 2019, translating to adjusted debt to EBITDA of 6.2x-7.0x, improving to 5.5x-6.0x by the end of 2020.

Downside scenario

In our view, a negative rating action could be triggered by one or more of the following:

- Lower-than-expected EBITDA and FOCF, for example, as a result of a continued weak market environment.
- An increase in the company's AROs and/or pension obligations, which are

not temporary.

While we don't expect any change in the relationship with the French government, a change in our perception of the likelihood of government support could lead to a lower rating.

Upside scenario

A stable outlook would be linked primarily to the company's ability to generate a positive FOCF in the coming 12-24 months, with a material reduction in its financial debt, and at the same time better stability of its other obligations.

Company Description

Orano (formerly New AREVA Holding) offers products and services for the entire nuclear fuel cycle, from raw materials to waste processing. Its activities, ranging from mining to decommissioning and including conversion, enrichment, recycling, logistics, and engineering, contribute to the production of low-carbon electricity. It has about 16,000 employees worldwide and is headquartered in Courbevoie, France. At year-end 2018, Orano's revenues totaled €3.7 billion, with S&P Global Ratings-adjusted EBITDA of €741 million.

Orano operates mainly through three business divisions:

- Mining (31% of sales in 2018): This operates from three countries (Canada, Niger, and Kazakhstan). The main activities comprise mineral exploration, mining project development, construction, extraction and sales of uranium ore, and site rehabilitation.
- Front end (23% of sales in 2018): This combines all of the operations required to convert natural uranium into enriched uranium to be used in nuclear fuel assemblies designed to generate electricity. Customers are primarily nuclear power plant operators.
- Back end (45% of sales in 2018): This includes treating and recycling used fuel for reuse in the reactor, developing storage systems, organizing the transportation of radioactive materials, and cleaning up and dismantling nuclear facilities.

Our Base-Case Scenario

The nuclear industry has been suffering over the past few years from lower demand, some overcapacity and weak prices. In addition we see some uncertainty regarding size and timing for large new contracts, mostly in Asia.

The difficult market environment for nuclear activities is illustrated by Orano's backlog, which did decline by about 5% at the end of 2018 to €31.8 billion compared with €33.6 billion a year before. However, that is equivalent to almost nine years of annual revenue, therefore we consider that it still provides good visibility on cash flows over the next few years as it limits the company's exposure to spot prices in the near term, including uranium spot prices. That said, a further decline in the backlog will allude to ongoing pressure on the business over the medium and long term.

Under our base-case scenario, we project that Orano's adjusted EBITDA will be between €700 million and €800 million in 2019, compared to an adjusted EBITDA of €760 million in 2018. We note the company's guidance for a decline of up to €100 million in its reported EBITDA in 2019. Looking into 2020, we expect EBITDA to recover to about €750 million-€850 million.

The following assumptions underpin our base case:

- Uranium, enrichment and conversion spot market prices to gradually improve from current levels over the next two years, but to remain historically relatively weak. However, there has been an uptick in uranium and conversion prices over the past year or so and a rebound in enrichment prices in recent months.
- The end of the industrial transition at the Comurhex I site to Comurhex II, and to a lesser extent restructuring expenses to affect 2019 EBITDA. This should be offset by new contracts globally, and, to a lesser extent, cost savings.
- Successful implementation of the company's cost-cutting initiatives, which aim to achieve recurring cash gains of €250 million annually from 2020 onward.
- Mixed trends in profitability, with EBITDA margin in mining to decline below 50% in 2019, while that of front-end segment to increase above 20% and back-end above 10% in 2019.
- High recurring capital expenditure requirements of about €600 million per year on average in 2019-2020.
- Substantial positive working capital movements in 2019-2020 related to advance payments in the back-end segment, as well as some destocking in the front-end segment.
- No dividends.

Under the assumption of no material changes in the company's current other liabilities (as of Dec. 31, 2018, of about €2.3 billion), we calculate the following the following credit measures:

- Adjusted debt to EBITDA of about 6x in 2019 and 5.5x-6.0x in 2020 (after 6.4x in 2018).
- Discretionary cash flow of at least €200 million annually in 2019-2020.

Government-related entity

The French government influence remains critical for Orano's creditworthiness. We continue to believe it's highly likely Orano would receive support from the French government, which is reflected in a three-notch uplift in the rating above the company's stand-alone credit profile (SACP). We consider Orano to be a government-related entity (GRE). The French government owns directly and indirectly 90% of Orano. 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.
- 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 and 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.

We don't factor in any impact in our base case from the recently proposed French Multi-Year Energy Plan (Programmation Pluriannuelle de l'Energie; PPE), which notably sets a roadmap for ambitious growth in renewables and reduced nuclear energy in the energy mix to 50% by 2035 from about 75% today. While this might hurt Orano's activities and financial performance over time, we think implications would be very long term and the plan is flexible, which allows for security of supply and to integrate neighbors' evolving mix, with no preset closures due before 2027.

Liquidity

We 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, 2019. We considered the company's prudent liquidity management and solid bank relationships.

We understand that under certain circumstances, the company may need to balance its end-of-cycle liabilities deficit with cash at the end of up to a three-year period. At this stage, we are not aware of a requirement to make such deposits in the coming years.

Principal liquidity sources in the 12 months started Jan. 1, 2019:

- Our estimate of about €2.0 million of unrestricted cash on the balance sheet, including about half made up of highly liquid marketable securities;
- €940 available under a syndicated credit revolving facility (including an

additional commitment of €100 million received in March 2019) maturing in July 2021 (plus two one-year extensions); and

- FOCF of about €200 million including positive working capital movements of several hundred millions.

Principal liquidity uses in the 12 months started Jan. 1, 2019:

- €750 million debt related to a bond due in November 2019; and
- Some moderate intrayear working capital swings that we don't expect to exceed €200 million.

Covenants

There are no covenants in the debt documentation.

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, but constrained by the substantial amount of pari passu unsecured debt.
- Under our hypothetical default scenario for Orano, we assume a combination of a loss of key customers and a prolonged downturn in the industry lead to lower pricing and operational issues.
- We value Orano as a going concern, given its market-leading position and diversified product offerings.
- In our calculations we exclude any end of lifecycle obligations.

Simulated default assumptions

- Year of default: 2024
- Jurisdiction: France

Simplified waterfall

- Gross recovery value: €4.8 billion
- Net recovery value after administrative expenses (5%): €4.6 billion
- Remaining recovery value: €4.5 billion
- Senior unsecured debt claims: €4.2 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.

Ratings Score Snapshot

Issuer credit rating: BB+/Negative/--

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)

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 | General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, 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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- France's New Energy Plan: Implications For The Power Market And EDF's Credit Quality, Dec. 5 2018

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Orano		
Issuer Credit Rating	BB+/Negative/--	BB+/Stable/--

Ratings Affirmed; Recovery Ratings Unchanged

Orano		
Senior Unsecured	BB+	BB+
Recovery Rating	3(65%)	3(65%)

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. 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.