Credit FAQ:

Is The Renault-Nissan-Mitsubishi Alliance Stalling?

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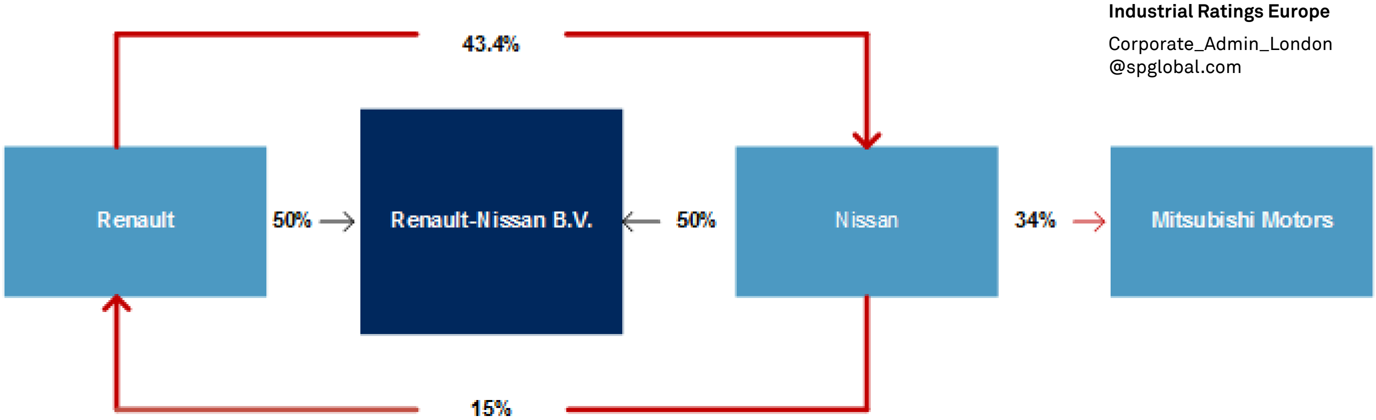
The Renault, Nissan, and Mitsubishi Motors alliance has announced the creation of a new board to try to ease tensions that followed the arrest of Carlos Ghosn, its former chairman, on alleged financial misconduct in November 2018. The members of the new board are the CEOs of the three carmakers as well as the newly appointed Renault chairman Jean-Dominique Senard.

Below, we address questions we've received from market participants regarding possible rating implications of potential changes in the alliance shareholding structure.

France-based Renault and Japan-based Nissan formed a strategic alliance in 1999 when Nissan had already been struggling to restructure its operations for several years, both in the Japanese market and in the U.S. Since then, the companies have increased cross-shareholdings in each other, and Renault now owns 43.4% of Nissan while Nissan holds 15% of Renault. In 2016, Mitsubishi joined the alliance when Nissan bought a 34% stake in the company. The alliance was managed through Renault-Nissan B.V., a jointly owned Renault and Nissan company based in Amsterdam, the Netherlands (see chart 1). This will now change when the new governance is formally put in place in the coming weeks.

Shareholding Structure For Renault-Nissan-Mitsubishi Motors



Frequently Asked Questions

How do the cross-shareholdings between Nissan and Renault affect their ratings?

Currently, we view the rating relationships between Renault, Nissan, and Mitsubishi as delinked. As a result, we don't factor into our ratings on each company any possibility of extraordinary financial support from fellow alliance members.

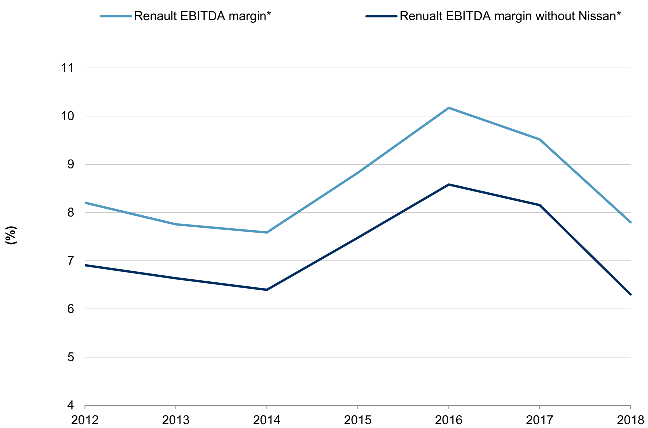
This is because, in our opinion, Renault and Nissan don't form a group because they are operationally and financially autonomous. Although Renault holds a controlling stake in Nissan, only a minority three out of nine members of Nissan's Board of Directors are from Renault. The "stability covenant" that Renault and Nissan signed in 2015 establishes the non-interference by Renault in Nissan's governance. In case of a breach of this agreement, Nissan would be allowed to increase its ownership in Renault without giving advance notice. Such a move could invalidate Renault's voting rights as a Nissan shareholder under Japanese law. Lastly, we believe Nissan independently determines its dividend policy based on its own financial performance and spending priorities. This was demonstrated in 2008 when Nissan suspended cash dividends during the global financial crisis at the time Renault most needed liquidity. These factors lead us to consider that Nissan has a high degree of autonomy under the current shareholding structure despite Renault's 43% stake in Nissan.

In the alliance's current form, we view members' joint activities as rather opportunistic. Activities target joint commercial and financial benefits, but don't offer the full strategic benefits that could be realized from a full merger of the three companies. We therefore base our current rating approach on the assumption that each company's management and capital structure will remain independent.

We do, nevertheless, include in our calculation of Renault's EBITDA margin and free operating cash flow the dividends it receives from Nissan, which supports the current rating. When excluding the dividends received, Renault's EBITDA margin would have been about 1.0-1.5 percentage points lower between 2012 and 2018 (see chart 2). The dividends also comprised a substantial portion of Renault's free operating cash flow over the past six years (see chart 3).

Chart 2

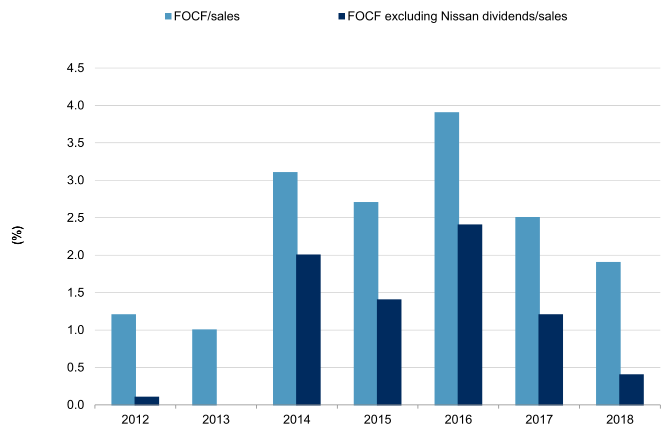
Alliance With Nissan Has Boosted Renault's EBITDA Margins



*S&P-adjusted.

Chart 3

Nissan Dividends Have Boosted Renault's Free Operating Cash Flow To Sales



Do you expect Renault Nissan, and Mitsubishi will deepen or weaken the alliance?

Given that Renault, Nissan, and Mitsubishi are mass-market producers with a high fixed-cost base, a larger scale can provide cost benefits. In this context, with increasing R&D and capex needed to extend electrification to the group's product line-up and development of autonomous driving features, we believe that a break-up of the alliance would be detrimental to the alliance's members. Since Carlos Ghosn's arrest in November last year, all three partners have confirmed their intention to maintain the alliance.

To reach their 2022 objectives, alliance members would have to step up their level of operational cooperation. For instance, the number of vehicles manufactured on common platforms is set to increase to about two-thirds by 2022 compared to about 20% in 2016. Similarly, the members plan to increase the rate of common powertrains over unit sales towards 75% by 2022. Overall, alliance members target synergies of around €10 billion by 2022 compared to about €5.7 billion in 2017. The synergies correspond to a mix of cost reductions, avoidance of costs and capex, and increased sales.

Although we consider that continuation of the alliance represents an efficient option for Renault, Nissan, and Mitsubishi given the ongoing change in engine mix and the costly development of connected and autonomous cars, we nevertheless believe that the speed of decision-making could slow down, at least until the new governance at Nissan has been established. Notably, decisions between partners are reached by consensus, and projects are only approved if they are beneficial to all partners. We think that, in a more challenging environment, it might become more difficult for the alliance to extend the scope of its activities while at the same time ensuring that decisions benefit all companies. For instance, this year, Renault has launched its own cost-savings program on a stand-alone basis.

On the other hand, we believe that a severe underperformance by both Nissan and Renault over the next two years could reduce potential resistance to a closer operational collaboration. Neither

Renault or Nissan have particularly outperformed their other mass-market producer peers such as Peugeot, FCA, Hyundai or Honda in terms of their automotive operating margins. Whether full integration would be more defensive in light of the imminent market and geopolitical challenges for the industry remains to be seen. But Renault's main shareholder, the French state, is reportedly pushing for a full merger scenario. The increasingly challenging outlook for the global automotive industry could test the alliance's agility to adjust: we believe it is easier to achieve mutual benefits in expansionary times.

Chart 4

Renault's Adjusted Automotive Operating Margins Compared To Peers

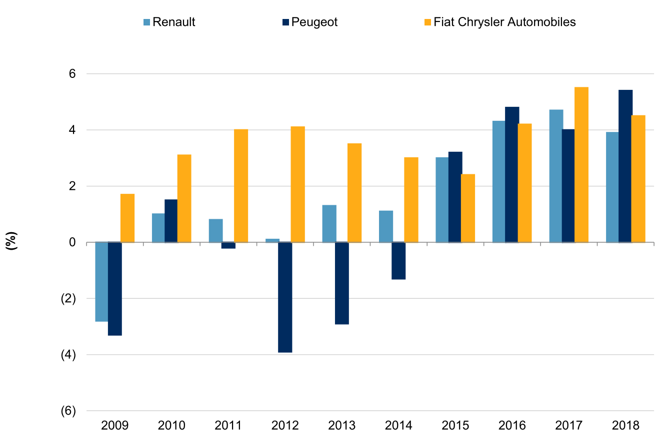
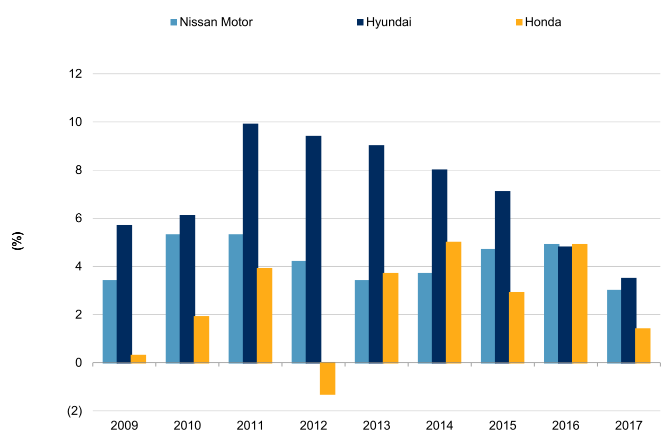


Chart 5

Nissan's Automotive Operating Margins Compared To Peers



What would be the rating implications of a change in the cross-shareholding structure?

Nissan is reportedly looking for a rebalancing of powers with its partner Renault. This could require a change in the current cross-shareholding structure, and this could have negative credit implications for Renault if it was to reduce its stake in Nissan. We have considered three possible scenarios.

In the first scenario, we assume Renault maintains its current stake in Nissan at 43% but Nissan increases its stake in Renault from 15% to 25%. For the sake of rebalancing the cross-shareholdings, Nissan would need to spend an amount exceeding €1.5 billion for the transaction. Given that Nissan had a net cash position of more than €10 billion as of December 2018, we consider that Nissan would still be able to maintain a strong financial standing under this scenario.

This first scenario would not trigger any change in the amount of dividends paid by Nissan given that Renault would maintain its current shareholding unchanged, assuming that Nissan would maintain its current dividend policy. This scenario is therefore equivalent to our current base case for Renault and we would not anticipate any rating impact for Renault if Nissan increases its stake to 25%.

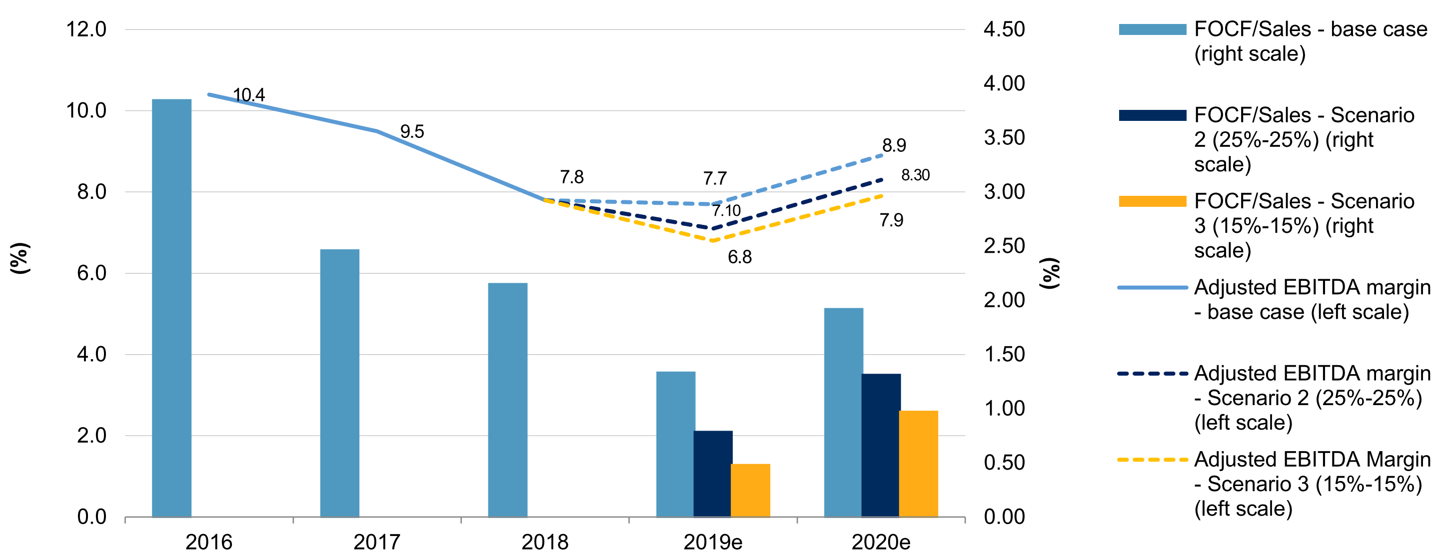
A second scenario assumes Renault reduces its stake from 43% to 25% and Nissan increases its stake from 15% to 25%. Taking into account Nissan's current market capitalization, Renault would receive about €5.3 billion of cash for the sale of 18% of Nissan's shares. We assume that Renault would use 50% of proceeds for a special dividend to shareholders, while keeping the rest on the balance sheet.

In a third scenario, we assumed that Renault reduced its stake from 43% to 15% to equalize it with Nissan's current 15% stake in Renault. Taking into account Nissan's current market capitalization, Renault would receive about €8.2 billion of cash for the sale of 28% of Nissan's shares. We assume that Renault would use 50% of proceeds for a special dividend to shareholders while keeping the rest in the balance sheet.

In scenarios two and three, the decrease in Renault's shareholding would result in a lower dividend for Renault from Nissan. This would weigh on Renault's adjusted EBITDA margins and free operating cash flow generation, only partly offset by a stronger balance sheet, depending on how it used the proceeds. This would likely trigger negative implications for our business risk profile assessment and consequently the rating on the French automaker, all else being equal.

Chart 6

Renault's EBITDA Margin And FOCF/Sales Under Different Scenarios*



*S&P-adjusted. e--Estimate.

Related Research

- Nissan Motor Downgraded to 'A-' On Weak Prospect Of Recovery In Earnings; Outlook Stable, Feb. 21, 2019
- Renault Outlook Revised To Negative On Weaker Operating Profit Margin And Free Cash Flow; 'BBB/A-2' Ratings Affirmed, Feb. 20, 2019

This report does not constitute a rating action.