Moody's
INVESTORS SERVICE

Rating Action: Moody's changes outlook on DIA's Baa3 ratings to positive; affirms ratings

Global Credit Research - 17 Jun 2015

London, 17 June 2015 -- Moody's Investors Service has today changed to positive from stable the outlook of Distribuidora Internacional de Alimentacion, S.A.'s (DIA) Baa3 long-term issuer rating and Baa3 senior unsecured rating. Concurrently, Moody's has affirmed both ratings. DIA's short term (P)P-3 rating remains unchanged.

"Our decision to change the outlook to positive reflects the reduction in adjusted debt, following revisions to the way we capitalize operating leases," says Sven Reinke, a Moody's Vice President -- Senior Analyst and lead analyst for DIA. "While DIA's key credit ratios could get weaker in 2015, absent any material acquisition, we expect DIA's financial metrics to improve in 2016 potentially to a level commensurate with a Baa2 rating."

The updated approach for standard adjustments for operating leases is explained in the cross-sector rating methodology "Financial Statement Adjustments in the Analysis of Non-Financial Corporations", published on 15 June 2015.

RATINGS RATIONALE

Today's rating action reflects significant improvements to DIA's key credit metrics following changes to Moody's approach for making standard adjustments to operating leases. For example, DIA's lease adjusted gross debt/EBITDA ratio was 2.6x and its retained cash flow/net debt ratio was 32.4% in 2014 when considering the revised methodology. Moody's notes that DIA's financial ratios would have improved slightly without the impact of the lease methodology changes, largely owing to its stable operating performance and disposal of the French operations.

DIA's Baa3 rating is supported by the resilience of its food retail operations, its expertise with city centre stores and discount price positioning, and its good market position in Iberia. The company's growing franchise in Brazil, Argentina and China and its cost efficient business model together with the extensive use of franchises, has resulted in solid profitability.

The rating agency expects that DIA's key credit ratios will deteriorate somewhat in 2015 driven by (1) the impact of recent acquisitions that are initially margin dilutive, (2) the cash outflow for the acquisition of 144 Eroski stores that occurs in the second quarter of 2015 as well as (3) the EUR200 million share buy-back programme announced in February 2015.

While the acquisition of EL Arbol and the 144 Eroski stores fits into DIA's strategy to further grow and improve its market position in Spain where the company has very profitable operations in part owing to its scale and efficient logistics, it diverges slightly from DIA's discount focus. EL Arbol is a supermarket format with a different proposition than DIA's discount formats as it has a large fresh food offer. With the El Arbol acquisition, DIA aims to acquire know-how in the fresh fish and meat categories. DIA has indeed applied some of the knowledge gained when it remodelled 6 "DIA Maxi III" stores in Q1 2015 -- DIA aims to remodel more than 100 DIA Maxi stores in line with the new concept through 2015.

The rating is constrained by DIA's smaller market positions in certain areas where it operates, and weak like-for-like sales in Iberia since 2013, although this did not prevent some margin progression in the region. The company is committed to growing shareholder value and its shareholder policy includes dividend payments and share buybacks. Moody's nevertheless expects that DIA will maintain a low reported net deb/'adjusted' EBITDA ratio (as calculated by the company), which is supportive of an investment-grade financial profile (this ratio was 1.1x as of 31 March 2015). DIA intends to continue to participate in the consolidation of the Spanish supermarket sector, which creates some event risks potential for the rating.

RATIONALE FOR THE POSITIVE OUTLOOK

The positive outlook reflects Moody's expectations that DIA will improve its operational performance in 2016 following some deterioration in the current year, mostly on the back of a successful integration of El Arbol and the 144 Eroski stores, further expansion in emerging markets and a gradual turnaround in like-for-like sales growth in

Iberia. Its financial profile would also benefit from a balanced approach between creating shareholder value and maintaining an adequate financial structure such that its net debt/EBITDA ratio (as calculated by the company) does not deviate materially from the level that the company has achieved historically (between 1.0x and 1.5x).

WHAT COULD CHANGE THE RATING UP/DOWN

Moody's could upgrade DIA's rating if the company were to continue successfully executing its strategy such that it further improves its market position in Iberia and in emerging markets and sustains its solid profitability. In addition, a successful integration of the two recent acquisitions is a prerequisite for a potential upgrade. Quantitatively, an upgrade would require the company's:

• adjusted debt/EBITDA metric to be sustainably below 3.0x

• adjusted retained cash flow/net debt increases to remain in the low-to-mid 20s in percentage terms (with Moody's standard adjustments).

DIA's rating could be lowered if there were an erosion in the company's market shares in its key markets and/or if its operating margins deteriorate, as a result, for example, of continued negative like-for-like sales performance in Iberia, more intense competition or operational difficulties in emerging markets. An aggressive shareholder return policy and/or a large debt-funded acquisition could also create downward pressure on the rating. Quantitatively, Moody's could downgrade the rating if DIA's

• adjusted debt/EBITDA increases above 4.0x

• adjusted retained cash flow/net debt were to fall below 15% (with Moody's standard adjustments), for a prolonged period of time.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Retail Industry published in June 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Headquartered in Madrid, Spain, DIA is one of the world's largest discount food supermarket chains. It principally operates through two discount formats, DIA Market and DIA Maxi, complemented by the Spanish regional supermarket chain El Arbol following the acquisition in October 2014, its new Spanish supermarket format "La Plaza" which DIA recently introduced and a network of Clarel stores specialised in household and personal care products. The company has operations in Iberia, Brazil, Argentina and China. In 2014, DIA generated net sales of EUR8.0 billion.

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