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Peugeot: back in the race

Jon Brager, Senior Credit Analyst at Hermes, comments on Peugeot H1 2014 results:

Today the French auto company announced its first group operating profit in two and a half years. The 1H rise of €477mn beat analyst estimates and marked a rebound from a loss of €65mn a year ago. This was driven primarily by cost cutting and a modest recovery in European auto demand as its joint venture with DongFeng Automotive spurred greater production in China.

Peugeot's balance sheet also strengthened during 1H after the French Government and Dongfeng acquired 14% stakes, resulting in a €3.0bn capital injection. This has diminished net debt from €4.8bn to €467mn, while net leverage has also shrunk from 2.6x in December 2013 to 0.2x. In further upbeat news, free cash flow increased significantly in the past year to €1.2bn, partly due to a higher EBITDA but also a €1.1bn fall in net working capital. Finally, €10.9bn in cash at 30 June provided an ample liquidity cushion.

The company is on track to reach its long-term targets – to generate positive group operating free cash flow by 2016 and an automotive operating margin of 2% in 2018 – which are conservative in comparison to those of some competitors. The only change to its 2014 guidance is an expected halving of auto sales in Russia to 5% due to deteriorating economic conditions and a weak rouble.

Peugeot has substantially improved its credit quality in the past year. Balance-sheet improvement provided the biggest boost, but increasing profitability shows that cost cuts have helped its bottom line and its expansion into China indicates decent growth prospects. But challenges remain: the company still has too much excess capacity in Europe and it underinvested in R&D and capex during its run of years with a weak balance sheet.

To compete with Ford, Renault, VW and Asian auto groups, Peugeot must invest heavily in the coming years simply to maintain market share. Demand for technologically advanced cars with electric or hybrid engines, wireless connectivity and even driverless capability is outpacing traditional vehicles. Developing these types of vehicles requires years of R&D and billions of dollars: bondholders would be wise to ask how the company will fund these essential investments.

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Notes to Editors:

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