Research

Research Update:

Swedish Truck Manufacturer Scania Downgraded To 'BBB+' On Similar Action On Parent; Outlook Negative

Primary Credit Analyst:
Per Karlsson, Stockholm (46) 8-440-5927; per.karlsson@standardandpoors.com

Secondary Contact:
Alex P Herbert, London (44) 20-7176-3616; alex.herbert@standardandpoors.com

Table Of Contents

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Overview

- On Dec. 1, 2015, we lowered our rating on Volkswagen AG (VW), Scania AB's parent, to 'BBB+'.
- Scania is a highly strategic entity within the VW group, in our view, implying that it cannot carry a higher rating than its owner.
- We are therefore downgrading Scania to 'BBB+', the same level as its parent.
- The outlook is negative, reflecting that on its parent. If we downgrade VW, we would take the same action on Scania.

Rating Action

On Dec. 2, 2015, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Sweden-based heavy truck manufacturer Scania AB (publ.) to 'BBB+' from 'A-'. The outlook is negative.

Additionally, we affirmed our 'A-2' short-term corporate credit rating and 'K-1' Nordic rating on Scania.

At the same time, we removed our global and regional scale ratings on Scania from CreditWatch negative where we placed them on Sept. 25, 2015, and Oct. 13, 2015, respectively (see "Swedish Heavy Truck Manufacturer Scania 'A-' Rating Placed On Watch Negative After Similar Action On Parent, Volkswagen" and " Swedish Heavy Truck Manufacturer Scania 'K-1' Nordic Scale Rating Put On Watch Neg; 'A-' Ratings Remain On Watch Neg," published on RatingsDirect).

We also lowered our long-term ratings on Scania's debt instruments to 'BBB+' from 'A-'.

Rationale

The downgrade follows a similar rating action on Scania's owner, Volkswagen AG (VW) on Dec. 1, 2015 (see "German Automaker Volkswagen Downgraded To 'BBB+' from 'A-' On Adverse Emissions Impacts; Outlook Negative"). We consider Scania a highly strategic entity within the VW group, reflecting Scania's virtually integral status to the group's current identity and future strategy. Under our criteria, our long-term credit ratings on highly strategic subsidiaries cannot be higher rated than the group credit profile (GCP). As such, our ratings on

Scania are capped by our assessment of VW's GCP as 'BBB+'. We continue to assess Scania's stand-alone credit profile (SACP) as 'a-'.

We still assess Scania's business risk profile as satisfactory, reflecting the company's leading market positions in Europe and Latin America in the manufacturing of heavy trucks and buses. Scania is one of the largest heavy-truck producers globally, behind Daimler AG and AB Volvo. It has a market-leading position in South America, notably in Brazil. A key operational strength is the company's advanced modular production system in the truck industry, which means that Scania uses the lowest number of individual parts for different vehicle specifications. This allows Scania to tailor vehicles to individual customers' needs, but still benefit from economies of scale. Furthermore, Scania has an up-to-date product range and offers a wide range of bus and coach products from chassis to fully built vehicles. These benefits translate into very strong profitability metrics, when compared with those of its peers. In recent quarters, revenue from services has increased (up 8% in 2014, and about 20% of total revenue), which we believe should be generally positive for earnings stability. We expect operating margins will be no lower than 4%-5% at the bottom of the cycle, reflecting Scania's focus on the owner-operator market (lower need for discounting) and efficiency resulting from the modular production system.

We continue to assess Scania's financial risk profile as minimal, which takes into account the company's conservative financial policy, robust credit ratios, and prudent liquidity. Furthermore, Scania has a strong ability to generate positive free operating cash flow (FOCF) through the cycle, and cash flows have been steady for a number of years with positive FOCF generation through the cycle. Since 2010, Scania's adjusted debt has been close to zero. We expect Scania's credit ratios will remain very robust over the next few years, but do not exclude the possibility of the company gradually building up debt, however limited. In 2015, we expect annual capital expenditures (capex) of Swedish krona (SEK) 6 billion-SEK7 billion (€650 million-€755 million) in our base case. Nevertheless, we expect credit ratios, such as funds from operations (FFO) to debt and debt to EBITDA, will remain in line with Scania's current minimal financial risk profile on a stand-alone basis. While we notice that dividends have not been paid in recent years, in our forecast we assume dividends in line with the company's policy at 50% of net income going forward.

In our base case, we assume:

- Moderate growth in the eurozone of 1.6% in 2015 improving to 1.9% in 2016.
- Revenue increase in both 2015 and 2016 in the low- to mid-single-digit percentage range, reflecting our view of a mixed truck market, with good demand in Europe following replacement needs and the improving economic situation, but weak market in Brazil.
- Dividends in line with the company's policy 50% of net income, although we note that no dividends have been paid in 2015.
- Capex of SEK6 billion-SEK7 billion (excluding customer finance operations) in 2015 and 2016, reflecting our view that ongoing investment in the development of a new truck cabin will push spending up, compared

with previous periods.

Based on these assumptions, we arrive at the following credit measures:
- Standard & Poor's-adjusted EBITDA margin of 9%-10% over 2015-2016.
- Standard & Poor's-adjusted EBITDA of about SEK8.5 billion-SEK9.0 billion over 2015-2016.
- Still limited debt, implying credit ratios such as FFO to debt and debt to EBITDA will remain in the minimal financial risk category.

Liquidity

We assess Scania's liquidity as strong, based on our projections that the company's ratio of potential sources of liquidity to uses will exceed 1.5x in each of the next two years.

We assess that principal liquidity sources include:
- Cash and liquid assets of SEK13 billion as of Sept. 30, 2015.
- About SEK38 billion in undrawn fully committed credit facilities, including a three-year €1 billion revolving credit facility signed by Scania CV AB and VW in July 2015.
- Our expectation of FFO of SEK9 billion-SEK10 billion annually in 2015 and 2016.

We assess that principal liquidity uses include:
- A total of SEK26 billion, including debt maturing in the next 12 months. Most of these outgoings are tied to Scania's financial services operations, but because we expect they will be matched by inflows from the same operations, we remove them from our calculations. This could change, however, if for any reason a material duration mismatch were to occur.
- Annual capex of SEK6 billion-SEK7 billion.

Outlook

The negative outlook on Scania reflects that on its parent, VW group. If we downgrade VW, the same action would follow on Scania, since we cap our rating on the company at the level of VW.

Downside scenario

Downside rating potential is predominantly tied to the rating on VW. We could also lower the rating on Scania if we assess that its SACP deteriorated to below that of VW.

Upside scenario

Rating upside is linked to Volkswagen. If we revise our outlook on Volkswagens to stable, we would perform the same on Scania.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Negative/A-2

Business risk: Satisfactory
- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Strong

Financial risk: Minimal
- Cash flow/Leverage: Minimal

Anchor: a-

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

Stand-alone credit profile: a-

Entity status within group: Highly strategic

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Standard & Poor's National and Regional Scale Mapping Tables, Sept. 30, 2014
- National and Regional Scale Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Related Research

- German Automaker Volkswagen Downgraded To 'BBB+' from 'A-' On Adverse Emissions Impacts; Outlook Negative, Dec. 1, 2015

Ratings List

Downgraded; CreditWatch Action; Ratings Affirmed

	To	From
Scania AB (publ.)		
Corporate Credit Rating	BBB+/Negative/A-2	A-/Watch Neg/A-2
South Africa National Scale	zaAAA/--/zaA-1	zaAAA/--/zaA-1
Nordic Regional Scale	--/--/K-1	--/Watch Neg/K-1
Scania CV AB		
Commercial Paper*	K-1	K-1/Watch Neg
Senior Unsecured*	BBB+	A-/Watch Neg

*Guaranteed by Scania AB (publ.)

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

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