

Research

Research Update:

Sweden-Based Truck and Bus Maker Scania (publ.) Outlook Revised To Stable; 'A-/A-2' Ratings Affirmed

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Overview

- Swedish truck and bus maker Scania (publ.) is now fully owned by German auto manufacturer Volkswagen AG.
- We are changing Scania's group status to "highly strategic" from "strategically important."
- We are revising the outlook on Scania to stable from positive, and are affirming our 'A-/A-2' ratings.
- The stable outlook reflects our view that Scania will continue to be a "highly strategic" entity of Volkswagen.

Rating Action

On Sept. 22, 2014, Standard & Poor's Ratings Services revised its outlook to stable from positive on Sweden-based truck and bus manufacturer Scania (publ.) AB. At the same time, we affirmed our 'A-' long-term and 'A-2' short-term corporate credit ratings.

We also affirmed the 'zaAA+' long-term and 'zaA-1' short-term South Africa national scale ratings and the 'K-1' Nordic regional scale short-term rating on Scania.

Rationale

The outlook revision follows our review of Scania's group status within Volkswagen AG (VW; A/Stable/A-1). VW acquired the last shares in Scania in the second quarter of 2014, so we now assess Scania's group status in VW as "highly strategic," versus "strategically important" in our previous assessment. This implies our view that Scania is almost integral to VW's current identity and future strategy. We believe the group would support Scania under almost all foreseeable circumstances. Under our criteria, we assess our long-term credit ratings on "highly strategic" subsidiaries at one notch below the group credit profile or in line with the company's stand-alone credit profile (SACP). As we continue to assess Scania's SACP at 'a-', we currently don't see the potential for the rating to move in line with VW and are therefore revising our outlook to stable from positive.

In our view, Scania fulfils our criteria to be classified as a "highly strategic" entity within the VW group. We believe VW is unlikely to sell

Scania over the long term, and we think that Scania will play an important role in VW's heavy truck operations. We view Scania as very successful in its line of operation and expect the company's performance will continue to be in the upper end of heavy truck makers. Scania's truck and bus businesses benefit from leading market positions, up-to-date product lines, and the highest degree of component commonality in the global truck industry. Furthermore, even though Scania maintains its own name, we believe the company's image is closely linked to the VW brand and reputation. In the larger VW group, however, Scania does not qualify as a material entity of the consolidated group nor is it, for now, fully integrated. As a result, at this stage, Scania does not qualify as a "core" entity under our criteria. A revision of Scania's group status to "core" would at least require the completion of several integration steps that the group may now contemplate either in terms of platform sharing, common use of modular approach, joint research and development and procurement, or pension management and intra-group funding.

We continue to assess Scania's business risk profile as "satisfactory." Our view reflects 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 top-tier position in South America, notably in Brazil. In our opinion, a key operational strength is the company's advanced modular production system in the truck industry, meaning 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 lines and offers a wide range of bus and coach products from chassis to fully built buses. These benefits translate into very high profitability measures compared with peers. For full year 2013, operating profit stood at 8.1%, and we don't expect any major deviation from this ratio in 2014 and 2015. We don't project that the operating margin will fall below 4%-5% at the bottom of the cycle, also reflecting Scania's focus on the owner-operator market and the efficiency resulting from the modular concept.

We continue to regard Scania's financial risk profile as "minimal." Our view takes into account the company's conservative financial policy, robust credit ratios, and prudent liquidity goals. We don't anticipate any changes in the company's financial management now that VW is the full owner. Also, we take comfort that VW continues to have control via the board of directors. We expect Scania's credit ratios will remain robust in the coming years, but we assume a gradual, yet limited, debt build-up. This follows mainly increased capital expenditures for the development of a new cabin. In 2014 and 2015, we expect capital expenditures of about Swedish krona (SEK)6 billion-SEK7 billion (€650 million-€760 million) in our base case. Nevertheless, we expect that credit ratios, such as funds from operations (FFO) to debt and debt to EBITDA, will remain well in line with Scania's current "minimal" financial risk profile on a stand-alone basis.

Under our base case, we assume:

- 1.0% GDP growth for the eurozone (European Economic and Monetary Union)

in 2014, 2.7% in South America, and 5.4% in Asia-Pacific.

- No growth in revenues in 2014 and only low-single-digit growth in 2015, reflecting increasing declining market situation in South America and price pressure in the market European market, on which we expect reasonable growth, however.
- Capital expenditure of about SEK6 billion-SEK7 billion (excluding customer finance operations) in 2014, reflecting our view that the ongoing investment in a new truck cabin will push spending up, compared with previous periods.

Based on these assumptions, we arrive at the following credit measures:

- Operating margin 7%-8%.
- FFO to debt well above 100%.
- Debt to EBITDA below 0.5x.

Liquidity

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

We calculate the following principal liquidity sources:

- Cash and liquid assets of SEK8.5 billion at June 31, 2014;
- In total about SEK28 billion in undrawn fully committed credit facilities, the main ones due 2016 and 2018; and
- Our expectation of FFO of more than SEK7 billion annually in 2014 and 2015.

To our knowledge, the bank lines are not subject to financial covenants or rating triggers

We calculate the following principal liquidity uses:

- We expect near-term liquidity uses totaling SEK16.5 billion, comprising debt maturing in the coming 12 months. The majority of these are tied to the financial service operations. We also expect them to be well matched by inflow from the financial service and therefore remove them from our calculation. This may change, however, if for any reason there were to be any material mismatch in duration.
- Capital expenditures of about SEK6 billion-SEK7 billion; and
- Annual dividends of about SEK3 billion. However, we notice that dividends were cancelled in 2014.

In its financial services unit, Scania pursues a policy of having dedicated financing that covers estimated funding needs during the subsequent year.

Outlook

The stable outlook reflects our view that Scania will continue to be a "highly strategic" entity within VW group. Therefore, the rating is likely to be one notch lower than VW, or in line with Scania's SACP, over our rating horizon for 2014-2015.

Upside scenario

We could raise the rating on Scania if we raised the rating on VW to 'A+'. Over time, if we have clear evidence Scania is becoming more integrated in the group, we could consider a review of the group status. If we were to view Scania as core in the group, we could consider a positive rating action.

Downside scenario

Downside rating potential is predominantly tied to the rating on the VW group, and it would likely only occur if the rating on VW were to fall below 'A-', or any negative change in the group status were to occur. We don't think this is likely.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/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)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings 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, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- 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
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Swedish Truck And Bus Maker Scania Outlook Revised To Pos On Similar Action On Parent Volkswagen; Affirmed At 'A-/A-2', Sept. 10, 2012

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Scania (publ.) AB Corporate Credit Rating	A-/Stable/A-2	A-/Positive/A-2

Ratings Affirmed

Scania (publ.) AB Counterparty Credit Rating Nordic Regional Scale South Africa National Scale	--/--/K-1 zaAA+/--/zaA-1
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Scania CV AB Senior Unsecured* Commercial Paper*	A- K-1
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*Guaranteed by Scania (public.) AB.

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