

Research

Scania AB (publ.)

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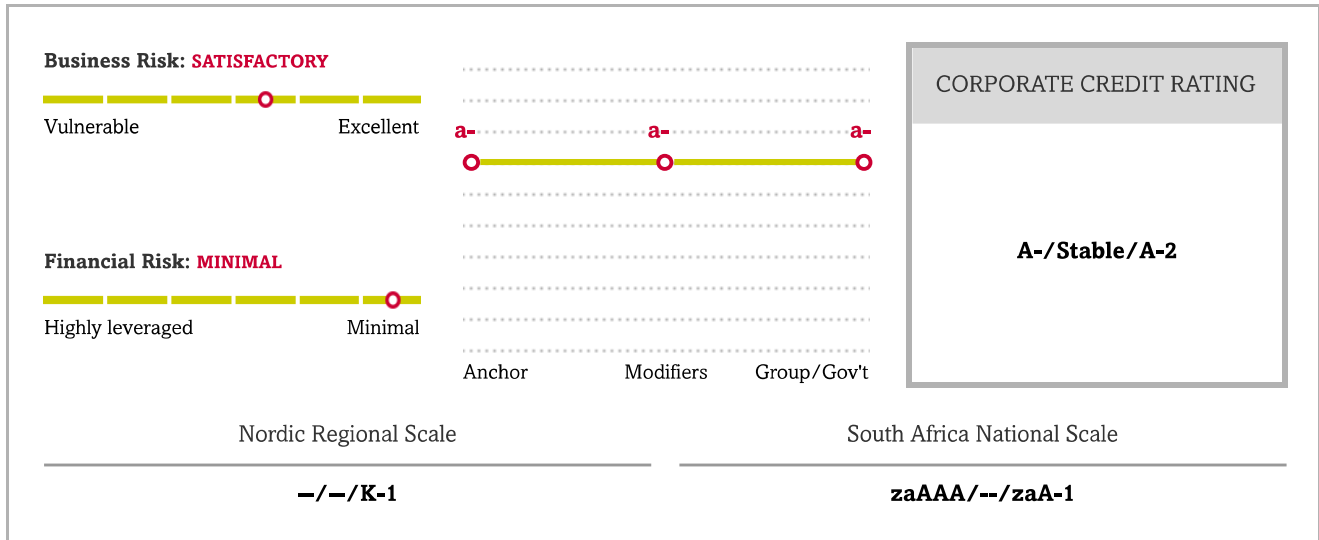
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Scania AB (publ.)



Rationale

Business Risk: Satisfactory

- Leading market positions in Europe and South America in the manufacture of heavy trucks and buses.
- An up-to-date product range and the highest degree of component commonality in the global truck industry.
- Operations in industries characterized by high volatility and capital intensity.

Financial Risk

- A conservative financial policy and a modest financial risk profile.
- Very strong profitability within peer group, and good financial flexibility.

Outlook:

The stable outlook on Scania AB (publ.) reflects our view that the company will remain a "highly strategic" entity within the Volkswagen (VW) group. Under our criteria, the rating on Scania is likely to remain one notch lower than the group credit profile or in line with the company's own stand-alone credit profile over the 2014-2015 rating horizon.

Downside scenario

Downside rating potential is predominantly tied to the rating on parent Volkswagen AG (A/Stable/A-1). A downgrade would likely only occur if the long-term rating on the parent were to fall below 'A-'. We could also lower the rating on Scania to reflect any negative change in the company's status within the group. However, we think such an event unlikely.

Upside scenario

We could raise the rating on Scania if we were to raise the long-term rating on the parent to 'A+'. Over time, if we have clear evidence that Scania is becoming more integrated within the group, we could consider a review of its group status. If we were to view Scania as "core" to the group, we could consider a positive rating action.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> 1% GDP growth in the eurozone (European Economic and Monetary Union) in 2014, 2.7% in South America, and 5.4% in Asia-Pacific. We forecast a low to mid-single digit percentage increase in revenues in both 2014 and 2015, reflecting higher prices due to new engines and increased service revenues. This takes into account declining market conditions in South America. Capital expenditure (capex) of Swedish krona (SEK) 6 billion-SEK7 billion (excluding customer finance operations) in 2014, reflecting our view that ongoing investment in the development of a new truck cabin will push spending up, compared with previous periods. 	2013A	2014F	2015F	
	Operating margin (%)	8.1	8-8.5	7.5-8
	FFO to debt (%)	N.M.	Above 100	Above 100
	Debt to EBITDA (x)	N.M.	Below 0.5	Below 0.5
A—Actual. F—Forecast. FFO—Funds from operations.				

Company Description

Scania, based in Södertälje, Sweden, is one of the world's leading heavy-truck and bus manufacturers. Although the group's divisions encompass buses, the truck operations dominate Scania's business. Despite strong growth in South America in recent years, Europe remains the group's major market. Scania is fully owned by Volkswagen AG.

Business Risk: Satisfactory

Our assessment of Scania's business risk profile as "satisfactory" reflects the company's leading market positions in Europe and Latin America in the manufacture of heavy trucks and buses. Scania ranks as 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 the company's peers. For full year 2013 Scania's operating margin stood at 8.1% and we expect no major deviation from this ratio in 2014 and 2015. 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 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.

S&P Base-Case Operating Scenario

- Our base-case scenario includes modest 1% growth in the eurozone in 2014, improving moderately to 1.5% in 2015.
- We forecast a low to mid-single digit percentage increase in revenues in both 2014 and 2015, reflecting higher prices due to new engines and increased service revenues.
- Overall, we assume low single digit percentage growth in truck deliveries to 65,000-70,000 units in 2014, improving moderately thereafter. We assume only a limited impact from foreign exchange movements over the period.
- For 2014 and 2015, we forecast adjusted consolidated capex of SEK6 billion-SEK7 billion. This is based on our expectation that the company's investment in developing a new cabin will increase capex compared with previous periods.
- Our base case does not incorporate any meaningful acquisition-related outflows in 2014 or 2015.

Peer Comparison

Table 1

Scania AB (publ.) -- Peer Comparison				
	Scania AB (publ.)	AB Volvo	Daimler AG	PACCAR Inc.
Rating as of Dec. 4, 2014	A-/Stable/A-2	BBB/Negative/A-2	A-/Stable/A-2	A+/Stable/A-1
--Average of past three fiscal years--				
(Mil. \$)				
Revenues	12,850.6	43,176.6	132,674.3	15,742.2
EBITDA	1,728.5	3,953.6	13,345.9	1,720.1
Funds from operations (FFO)	1,350.5	2,936.7	11,034.0	1,335.8
Net income from cont. oper.	1,120.6	1,621.0	8,273.7	1,108.4
Cash flow from operations	1,265.8	2,419.6	10,173.2	1,162.8

Table 1

Scania AB (publ.) -- Peer Comparison (cont.)				
Capital expenditures	670.7	1,604.7	6,430.2	445.3
Free operating cash flow	595.1	814.9	3,743.0	717.5
Discretionary cash flow	(1.6)	(67.6)	366.2	280.9
Cash and short-term investments	422.4	1,553.9	(1,912.5)	708.3
Debt	53.3	5,788.7	9,818.8	0.0
Equity	4,499.5	10,126.8	42,452.9	3,577.7
Adjusted ratios				
EBITDA margin (%)	13.5	9.2	10.1	10.9
Return on capital (%)	30.8	15.5	23.3	46.3
EBITDA interest coverage (x)	26.4	6.7	11.5	59.2
FFO cash int. cov. (X)	30.2	7.4	19.1	8.3
Debt/EBITDA (x)	0.0	1.5	0.7	0.0
FFO/debt (%)	2,580.9	51.0	112.5	N.M.
Cash flow from operations/debt (%)	2,416.9	42.3	103.6	N.M.
Free operating cash flow/debt (%)	1,145.9	14.6	38.1	N.M.
Discretionary cash flow/debt (%)	11.7	(0.5)	3.6	N.M.

Financial Risk: Minimal

S&P Base-Case Cash Flow And Capital Structure Scenario

Our assessment of Scania's financial risk profile as "minimal" takes into account the company's conservative financial policy, robust credit ratios, and prudent liquidity goals. 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 to remain very robust over the next few years, do not exclude the possibility of a gradual debt built up, however limited. This follows increased capex on the development of a new truck cabin. In 2014 and 2015 we expect annual capex of SEK6 billion-SEK7 billion in our base case. Nevertheless we expect credit ratios such as funds from operations (FFO) to debt and debt to EBITDA to remain in line with Scania's current "minimal" financial risk profile on a stand-alone basis.

Financial summary

Table 2

Scania AB (publ.) -- Financial Summary					
--Fiscal year ended Dec. 31--					
	2013	2012	2011	2010	2009
(Mil. SEK)					
Revenues	86,847.0	79,603.0	87,686.0	78,168.0	62,074.0

Table 2

Scania AB (publ.) -- Financial Summary (cont.)					
EBITDA	10,039.5	9,852.5	14,459.5	15,061.0	5,413.5
Funds from operations (FFO)	7,543.6	7,826.7	11,482.8	10,995.3	3,486.8
Net income from continuing operations	6,201.0	6,646.0	9,422.0	9,103.0	1,129.0
Cash flow from operations	7,771.6	6,871.7	10,502.8	14,440.3	8,432.8
Capital expenditures	4,975.0	4,328.0	3,921.0	2,921.0	3,430.0
Free operating cash flow	2,796.6	2,543.7	6,581.8	11,519.3	5,002.8
Discretionary cash flow	(1,003.4)	(1,456.3)	2,581.8	10,719.3	3,002.8
Cash and short-term investments	2,402.3	3,011.8	2,949.0	2,467.0	1,786.8
Debt	44.2	996.2	0.0	860.5	11,324.9
Equity	31,043.9	28,607.9	29,249.6	25,572.7	18,278.3
Adjusted ratios					
EBITDA margin (%)	11.6	12.4	16.5	19.3	8.7
Return on capital (%)	24.6	25.5	43.0	43.0	7.7
EBITDA interest coverage (x)	25.4	20.5	34.2	24.2	4.8
FFO cash int. cov. (x)	18.1	37.9	43.1	21.0	4.9
Debt/EBITDA (x)	0.0	0.1	0.0	0.1	2.1
FFO/debt (%)	17,062.3	785.6	N.M.	1,277.7	30.8
Cash flow from operations/debt (%)	17,578.0	689.8	N.M.	1,678.1	74.5
Free operating cash flow/debt (%)	6,325.4	255.3	N.M.	1,338.6	44.2
Discretionary cash flow/debt (%)	(2,269.5)	(146.2)	N.M.	1,245.7	26.5

SEK--Swedish krona. N.M.--Not meaningful.

Liquidity: Strong

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.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • Cash and liquid assets of SEK8.5 billion as at June 31, 2014. • About SEK28 billion in undrawn fully committed credit facilities, with the main facilities due in 2016 and 2018. • FFO of more than SEK7 billion annually in 2014 and 2015 (our expectation). 	<ul style="list-style-type: none"> • Near-term liquidity uses total SEK16.5 billion, and include debt maturing in the next 12 months. Most of these outgoings are tied to the company's financial services operations. Because we expect these outflows to be well matched by inflows from the financial services operations, we remove them from our calculations. This could change, however, if for any reason a material mismatch in duration were to occur. • Annual capex of SEK6 billion-SEK7 billion. • Annual dividends of about SEK3 billion. We note that dividends were cancelled in 2014. <p>To our knowledge, Scania's bank lines are not subject to financial covenants or rating triggers. In its financial services unit, Scania pursues a policy of dedicated financing that covers estimated funding needs during the subsequent year.</p>

Other Modifiers

No modifiers affect the rating.

Group Influence

We view Scania as a highly strategic entity of the VW group. This implies that Scania is virtually integral to the group's current identity and future strategy. We believe the group would support Scania under almost all circumstances. Under our criteria, our long-term credit ratings on "highly strategic" subsidiaries are one notch below the group credit profile or in line with the company's own stand-alone credit profile.

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)
- **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

Reconciliation**Table 3**

Reconciliation Of Scania AB (publ.) Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. SEK)										
--Fiscal year ended Dec. 31, 2013--										
Scania AB (publ.) reported amounts										
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
Reported	43,833.0	37,055.0	91,341.0	13,196.0	8,455.0	58.0	13,196.0	9,352.0	3,800.0	29,740.0
Standard & Poor's adjustments										
Interest expense (reported)	--	--	--	--	--	--	(58.0)	--	--	--
Interest income (reported)	--	--	--	--	--	--	438.0	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(2,553.0)	--	--	--
Operating leases	1,513.1	--	--	505.5	110.4	110.4	395.1	395.1	--	--
Postretirement benefit obligations/deferred compensation	4,660.0	39.8	--	7.0	7.0	227.0	(205.5)	(51.5)	--	--
Surplus cash	(7,206.8)	--	--	--	--	--	--	--	--	--
Capitalized development costs	--	--	--	(1,123.0)	(830.0)	--	(1,123.0)	(1,123.0)	--	(1,123.0)
Dividends received from equity investments	--	--	--	6.0	--	--	6.0	--	--	--
Captive finance operations	(42,755.1)	(6,107.9)	(4,494.0)	(2,531.0)	(616.2)	--	(2,531.0)	(801.0)	--	(23,642.0)

Table 3

Reconciliation Of Scania AB (publ.) Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. SEK) (cont.)										
Non-operating income (expense)	--	--	--	--	438.0	--	--	--	--	--
Non-controlling Interest/Minority interest	--	57.0	--	--	--	--	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	--	--	(21.0)	(21.0)	--	(21.0)	--	--	--
EBIT - Income (expense) of unconsolidated companies	--	--	--	--	21.0	--	--	--	--	--
Total adjustments	(43,788.8)	(6,011.1)	(4,494.0)	(3,156.5)	(890.8)	337.4	(5,652.4)	(1,580.4)	-	(24,765.0)
Standard & Poor's adjusted amounts										
	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	44.2	31,043.9	86,847.0	10,039.5	7,564.2	395.4	7,543.6	7,771.6	3,800.0	4,975.0

SEK--Swedish krona.

Related Criteria And Research

- 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
- Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of December 4, 2014)

Scania AB (publ.)

Corporate Credit Rating

A-/Stable/A-2

Nordic Regional Scale

--/--/K-1

Ratings Detail (As Of December 4, 2014) (cont.)

<i>South Africa National Scale</i>	zaAAA/-/zaA-1
Senior Unsecured	A-
Corporate Credit Ratings History	
22-Sep-2014	A-/Stable/A-2
10-Sep-2012	A-/Positive/A-2
04-Aug-2011	A-/Stable/A-2
06-Dec-2012 <i>Nordic Regional Scale</i>	--/--/K-1
06-Oct-2014 <i>South Africa National Scale</i>	zaAAA/-/zaA-1
31-Aug-2009	zaAA+/-/zaA-1
23-Jul-2009	zaAA+/Watch Neg/zaA-1
Related Entities	
LeasePlan Corporation N.V.	
Issuer Credit Rating	BBB+/Watch Neg/A-2
Commercial Paper	
<i>Foreign Currency</i>	A-2/Watch Neg
Senior Unsecured	A-2/Watch Neg
Senior Unsecured	BBB+/Watch Neg
Short-Term Debt	A-2/Watch Neg
Volkswagen AG	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	A-1
<i>Canada National Scale Commercial Paper</i>	A-1(MID)
Junior Subordinated	BBB+
Preferred Stock	BBB+
Senior Unsecured	
<i>Greater China Regional Scale</i>	cnAAA
Senior Unsecured	A
Short-Term Debt	A-1
Volkswagen Bank GmbH	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	
<i>Local Currency</i>	A-1
Senior Unsecured	A
Volkswagen Financial Services AG	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	A-1
<i>CaVal (Mexico) National Scale</i>	mxA-1+
Senior Secured	
<i>CaVal (Mexico) National Scale</i>	mxAAA
Senior Unsecured	
<i>CaVal (Mexico) National Scale</i>	mxAAA
Senior Unsecured	A
Senior Unsecured	BBB-
Short-Term Debt	A-1

Ratings Detail (As Of December 4, 2014) (cont.)**Volkswagen Finans Sverige AB**

Issuer Credit Rating

Nordic Regional Scale

--/--/K-1

Volkswagen Group Services S.A.

Issuer Credit Rating

A/Stable/A-1

Commercial Paper

Local Currency

A-1

Volkswagen Insurance Co. Ltd.

Financial Strength Rating

Local Currency

A/Stable/--

Issuer Credit Rating

Local Currency

A/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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