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Summary:
Scania (publ.) AB

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Summary:

Scania (publ.) AB

Credit Rating: A-/Watch Neg/A-2

Rationale

The ratings on Sweden-based truck and bus manufacturer Scania (publ.) AB (Scania) reflect the group's strong business profile and modest financial risk. The ratings are supported by Scania's outstanding profitability in the global truck industry, which is not expected to fall below an operating margin of 4% to 5% at the bottom of the cycle. The group'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.

Scania's results for the first quarter of 2009 showed a sharp decline in profitability due to a considerable drop in unit sales. EBIT was down drastically compared with the peak-of-the-cycle margins in the years 2006-2008, although Scania managed to achieve a positive EBIT margin of 3.2% in its industrial unit, mostly supported by the service business. Free operating cash flow (FOCF) in industrial operations was positive at Swedish krona (SEK) 0.8 billion due to a reduction of working capital, notably inventory.

The outlook for Scania's markets continues to be bleak. We expect Scania's operating profit to contract sharply in 2009 compared with 2008, although we expect the group to show a slightly positive EBIT and positive FOCF in its industrial unit.

In 2008, Scania's credit protection measures, such as funds from operations to debt of 46% and debt to EBITDA of 0.9x, were commensurate with the rating. However, the combination of the rapidly weakening business conditions has made Scania vulnerable to the downturn.

Short-term credit factors

The short-term rating is 'A-2'. Standard & Poor's Ratings Services considers Scania's liquidity and financial flexibility to be adequate. It is enhanced by two committed revolving credit facilities (RCF) of €1 billion each. In early 2008, Scania upsized its old €500 RCF to €1.0 billion. This new facility is due in January 2013 with a two-year renewal option. The second RCF is due in May 2012. In total, Scania has access to committed unutilized credit facilities of SEK36.5 billion. Committed facilities were received from a broad variety of banks. For its financial services unit, Scania pursues the policy of dedicated financing that covers the estimated demand for funding during the subsequent year. The bank lines are not subject to financial covenants or rating triggers. The company's liquidity position is underpinned by access to medium-term note and commercial paper programs. In addition, in its industrial unit the company reported cash and short-term investments of SEK5.9 billion as of March 31, 2009. Short-term maturities in the industrial unit are covered with existing financial flexibility. We expect Scania to report a positive FOCF in 2009.

CreditWatch

On May 8, 2009, Standard & Poor's placed its 'A-' long-term and the 'K-1' short-term Nordic national scale rating on Scania on CreditWatch with negative implications, reflecting our concern about the potential impact on Scania's

credit quality as a result of the restructuring at Volkswagen AG (VW; A-/Watch Neg/A-2).

Our CreditWatch listing on Scania, of which VW owns 46% of the capital and 71% of the voting shares, is based on Standard & Poor's parent-subsiary rating criteria and reflects the possibility that we could lower our opinion of Scania's credit quality as a result of the VW group's restructuring. This could result from a change in Scania's financial or business profile if it becomes directly involved in the VW group's restructuring. We could also downgrade Scania if we perceive, under our parent-subsiary rating criteria, that Scania will remain subject to group risk through VW's exercise of its voting power or through other means of influence, in the absence of offsetting protective measures and incentives. At this stage, we expect that in such a case our rating on Scania will unlikely be higher than that on Volkswagen.

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