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Research Update:

Swedish Truck Manufacturer Scania 'BBB+/A-2' Ratings Affirmed Following Dividend Payment; Outlook Negative

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Overview

- On Dec. 18, 2015, Scania announced a Swedish krona (SEK) 9.6 billion payment to its owner Volkswagen AG (VW) representing three years of dividends, and we cannot rule out further distributions.
- In our view, the dividend indicates a more aggressive financial policy, leading us to revise our assessment of Scania's stand-alone credit profile to 'bbb+' from 'a-'.
- We are, however, affirming our 'BBB+/A-2' ratings on Scania.
- The negative outlook reflects that on VW, indicating that we would downgrade Scania if we took the same action on VW.

Rating Action

On Dec. 22, 2015, Standard & Poor's Ratings Services affirmed its 'BBB+/A-2' long- and short-term corporate credit ratings on Sweden-based heavy truck manufacturer Scania AB (publ.). The outlook remains negative.

At the same time, we affirmed our 'K-1' short-term Nordic regional scale rating and 'zaAAA/zaA-1' long- and short-term South Africa national scale ratings on Scania.

Rationale

The affirmation follows Scania's declaration on Dec. 18, 2015, of a SEK9.6 billion dividend to Volkswagen AG (VW), its 100% owner. The group states the dividend is in line with its profit distribution policy, but we view it as a fairly aggressive payment. We also believe the funding of the dividend increases uncertainties about Scania's future debt level, which is likely to be influenced by its parent's financial situation. At this stage, we expect that Scania will pay similar amounts to VW in the coming years, in line with its stated policy of distributing 50% of net income as a dividend. However, we also see combining the distribution for three fiscal years into one substantial outflow as evidence of a moderate change in financial policy that could imply a further increase in debt in the future. We note that, prior to this distribution, Scania had about SEK16 billion in retained earnings that can be freely distributed. We are therefore revising our financial policy modifier to negative from neutral, resulting in a stand-alone credit profile (SACP) assessment of 'bbb+', compared with 'a-' earlier.

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We continue to 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 rating on highly strategic subsidiaries cannot be higher than the group credit profile (GCP). As such, our ratings on Scania are capped by our assessment of VW's GCP at 'bbb+'.

We 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. 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, which implies a lower need for discounts, and efficiency resulting from the modular production system.

We continue to assess Scania's financial risk profile as minimal. Scania has a strong ability to generate positive free operating cash flow (FOCF) through the cycle, with a track record of positive FOCF generation for several years. We do not assume further dividend payouts during 2016 following the SEK9.6 billion to VW, expected in the first quarter of next year. We assume dividends will stay in line with the company's policy of 50% of net income from 2017 onward. However, the dividend to be paid in 2016 represents the sum of shareholder remunerations for three consecutive fiscal years, 2013 to 2015. No dividend was paid in 2013 and 2014. In our forecast, adjusted funds from operations (FFO) to debt will be about 60% at year-end 2016, before improving in subsequent years. We expect Scania's credit ratios to remain strong over the next few years, but at lower levels than in our previous base case.

In our base case for Scania, we assume:

- Moderate growth in the eurozone of 1.6% in 2015, improving to 1.8% in 2016.
- A revenue increase for 2015 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 conditions in Brazil.
- No dividend payouts in 2015, but SEK9.6 billion in the first quarter of 2016.
- Capital expenditure of about SEK6 billion (excluding customer finance operations) in 2015, 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:

- A Standard & Poor's-adjusted EBITDA margin of 8.5%-9.5% over 2015-2016.
- Standard & Poor's-adjusted EBITDA of about SEK8.5 billion-SEK9.0 billion in 2015.
- An increase in adjusted debt to about SEK6 billion-SEK6.5 billion at year-end 2015 to finance the upcoming dividend payout. However, we expect 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 the next 12-24 months.

We expect that principal liquidity sources will include:

- Cash and liquid assets of SEK13 billion as of Sept. 30, 2015.
- About SEK29 billion in undrawn fully committed credit facilities, including a three-year €1 billion revolving credit facility made available to Scania CV AB by VW, signed in July 2015.
- Our expectation of FFO of SEK9 billion-SEK10 billion annually in 2016 and 2017.
- A new SEK9.6 billion term loan from VW to cover the dividend payment.

We calculate the principal liquidity as:

- Outflows totaling SEK21 billion, including debt maturing in the next 12 months. Most of these outflows are tied to Scania's financial services operations.
- About SEK9.6 billion in dividends in 2016.
- Annual capital expenditure of SEK5 billion-SEK7 billion.

Outlook

The negative outlook on Scania reflects that on the parent company, VW. If we downgrade VW, we would downgrade Scania, since we cap our rating on Scania at the rating on VW.

Downside scenario

Downside rating potential is predominantly tied to the rating on VW. We could also lower the rating on Scania if, in our view, Scania's SACP had deteriorated to below that of VW. This would most likely result from further distributions to VW from Scania, without offsetting measures.

Upside scenario

Rating upside is linked to VW. If we revise our outlook on VW to stable, we would take the same action 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)
Liquidity: Strong (no impact)
Financial policy: Negative (-1 notch)
Management and governance: Satisfactory (no impact)
Comparable ratings analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

Related Criteria And Research

Related Criteria

- Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Standard & Poor’s National And Regional Scale Mapping Tables, Sept. 30, 2014
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

Ratings Affirmed

Scania AB (publ.)

Corporate Credit Rating	BBB+/Negative/A-2
Nordic Regional Scale	--/--/K-1
South Africa National Scale	zaAAA/--/zaA-1
Scania CV AB	
Senior Unsecured*	BBB+
Commercial Paper	K-1

*Guarantor: Scania AB (publ.)

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