Standard & Poor's Research

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Summary:
Scania (publ.) AB

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Summary:
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Credit Rating: A-/Negative/A-2

Rationale

The ratings on Sweden-based truck and bus manufacturer Scania (publ.) AB reflect the group's satisfactory business profile and modest financial risk, according to Standard & Poor's Ratings Services' criteria. The ratings are supported by Scania's very strong profitability in the global truck industry. However, they also reflect the strong cyclicality of the group's operating earnings. 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.

We apply our parent-subsidiary criteria in our assessment of Scania's credit quality because of the relationship between Scania and its parent, Germany-based Volkswagen AG (VW; A-/Negative/A-2). VW owns 71% of the voting rights in Scania and 46% of the capital. Consequently Scania is fully consolidated. Although VW's economic interest in Scania is smaller than previously, its voting power is sufficient for it to exert a significant influence over Scania's business risk profile, strategy, and, more importantly, its financial risk profile. VW views Scania as a group brand within its portfolio. Furthermore, we regard other investors as less able to influence Scania, given the small proportion of voting rights in the hands of minority shareholders.

We have raised Scania's stand-alone credit profile to 'a-' from 'bbb+'. The corporate credit ratings and outlook are capped by those on the parent.

Key business and profitability developments

Scania's results in 2010 and for the first quarter of 2011 showed a continuous improvement in profitability following a significant rise in unit sales. The EBIT margin of the industrial operations increased significantly to 16.1% in 2010 from 4.2% previously. This is higher than the peak-of-the-cycle margins of 2006-2008 (the industrial operations' EBIT margins were 13.6% in 2008, 13.8% in 2007, and 11.7% in 2006). The considerable margin expansion was mainly supported by better capacity utilization, cost reductions, and stronger sales in Brazil, partly because of tax incentives and interest-rate subsidies. Emerging markets contributed about one-half of the group's revenues in 2010. European demand grew significantly towards the end of the year and has continued to do so in 2011.

European order intake in the fourth quarter of 2010 and the first quarter of 2011 suggests that Scania will have solid results in 2011. Consequently, capacity utilization in Europe should improve. Accordingly, we expect Scania's industrial operations to continue to generate an EBIT margin of about 15%.

Key cash flow and capital-structure developments

In 2010, free operating cash flow (FOCF) in the industrial operations was positive at Swedish krona (SEK) 11.4 billion. The customer finance portfolio declined by about SEK4.3 billion over the same period. Consequently, together with the effect of a stronger Swedish krona against major currencies, Scania's debt decreased by about SEK12.0 billion compared with December 2009. Credit metrics, such as funds from operations (FFO) to debt and debt to EBITDA, improved markedly from the weaker levels of 2009. With a continued solid performance in the first quarter of 2011, Scania currently has a net cash position of SEK9.0 billion. In view of the solid cash flow generation and our expectation of continued solid operating results, we envisage a further improvement in Scania's credit-protection measures in 2011.

Liquidity

The short-term rating is 'A-2'. We consider Scania's liquidity and financial flexibility to be "strong". As of March 31, 2011, the company's industrial unit reported liquidity sources consisting of:

- Cash and liquid assets of SEK 7.2 billion (of which we consider 6.4 billion as excess cash).
- Two committed revolving credit facilities of €1 billion each. One facility is due in January 2013 and the second in May 2016. To our knowledge, the bank lines are not subject to financial covenants or rating triggers. However, the documentation for the facilities contains a material adverse change clause.
- Two additional committed lines totaling SEK10.0 billion, due in 2016 and 2017.
- Our expectation of FFO of about SEK13 billion in 2011 and onward.

This compares with the following near-term expected liquidity uses:

- Debt maturities of about SEK12 billion in 2012.
- Total shareholder returns of about SEK4 billion.

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

Outlook

The negative outlook on Scania reflects the negative outlook on VW.

Scania's stand-alone credit profile could be negatively affected by a negative rating action on VW, or through the influence of VW in terms strategic business decisions, and the upcoming integration of the truck units of VW, MAN, and Scania.

We could revise the outlook on Scania to stable if we revise the outlook on VW to stable.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Key Credit Factors: Business and Financial Risks In The Automaker Industry, Sept. 25, 2008
- Principles Of Corporate And Government Ratings, June 26, 2007
- Captive Finance Operations, April 17, 2007

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