

Research Update:

Scania AB Outlook Revised To Negative On TRATON's Agreement To Take Full Ownership Of Navistar; 'BBB' Rating Affirmed

October 22, 2020

Rating Action Overview

- Scania's parent, TRATON SE, recently reached an agreement in principle to acquire the 83.2% of U.S. truck maker Navistar it does not own for about €3.1 billion.
- We continue to believe Scania is comparatively stronger than TRATON on a stand-alone basis, with superior industrial business adjusted EBITDA margins expected at about 8% in 2020 from about 13.5% in 2019, and a likely continued net cash position at the industrial business for the following two years.
- At the same time, we see Scania as pivotal for TRATON's strategy to gradually integrate the brands it manages, which caps our rating on Scania with that on TRATON (currently BBB/Negative/--).
- We are therefore affirming the 'BBB/A-2' long- and short-term issuer credit ratings, 'K-2' short-term Nordic regional scale rating, and 'zaAAA/zaA-1+' South Africa national scale ratings on Scania.
- The negative outlook reflects that on TRATON, for which Scania is a core subsidiary, and the potential for a one-notch downgrade should TRATON's stand-alone credit profile (SACP) weaken below 'bbb' and at the same time we take a negative rating action on its majority owner Volkswagen AG (BBB+/Negative/A-2).

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Rating Action Rationale

The negative outlook reflects that on TRATON, Scania's parent company. We have revised our outlook on Scania to negative to reflect the same action on its sole shareholder TRATON (see "German Truck Manufacturer TRATON Outlook Revised To Negative On Plans To Takeover Navistar; 'BBB' Ratings Affirmed," published Oct. 22, 2020, on RatingsDirect).

The 'BBB' long-term rating on Scania is capped by that on TRATON. We consider Scania to be a core subsidiary for TRATON, reflecting the 100% ownership of Scania's share capital and Scania's pivotal role for TRATON's future strategies and growth ambitions. We therefore equalize our rating on Scania with that on TRATON, notwithstanding its solid 'bbb+' SACP.

Scania's margins are superior to TRATON's, and we believe they will show resilience, even in the current pandemic, while its industrial business also has an adjusted debt-free balance sheet.

For 2020, absent a second recession linked to the COVID-19 pandemic, we believe Scania's sales could drop by about 18%, while we expect its adjusted EBITDA margin under the industrial business could reach about 8%, from 13.5% recorded in 2019. Scania's adjusted EBITDA margin is almost 2x higher than that we expect for TRATON in 2020 (before potential restructuring costs on MAN's rightsizing from TRATON's EBITDA in 2020). We also forecast Scania's industrial business adjusted free operating cash flow will be about Swedish krona (SEK) 3 billion in 2020, from SEK11 billion in 2019. This will continue to support its strong balance sheet, which should mean the group will remain in a net adjusted cash position.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-year 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The negative outlook on Scania reflects that on TRATON.

Downside scenario

We could downgrade Scania if we were to downgrade TRATON's majority owner Volkswagen AG (BBB+/Negative/A-2) and, at the same time, we lowered our assessment of TRATON's SACP to 'bbb-' or below.

Upside scenario

We could revise our outlook to stable following a similar action on TRATON.

Company Description

Based in Södertälje, Sweden, Scania is one of the world's leading heavy truck and bus manufacturers. Although it also produces buses, truck operations dominate the business. German original equipment manufacturer TRATON, controls all of Scania's share capital.

Over 2019, Scania's industrial business revenue reached about SEK148 billion and it sold 91,680 trucks and 7,777 buses. Industrial business adjusted EBITDA margin rose to 13.5% last year, from 10.5% in 2018, when excluding the depreciation of assets under operating lease. Scania's industrial business enjoys a debt-free capital structure, and we calculate that its financial service business has about a 9.3x reported debt to equity ratio, which is in line with its financial policy

remaining below 10x.

We consider Scania to be a core subsidiary for TRATON, reflecting the 100% ownership of Scania's share capital. This also points to Scania's pivotal role for TRATON in developing the group's long-term growth strategy, aimed at strengthening its market reach, operating profit margins, and consolidated leverage metrics following the recent initial public offering.

Although still in the early stages, TRATON's integration of its businesses and brands over the coming 12-18 months will likely continue as per its strategy to become a global truck champion. This, over the medium term, would result in a more harmonized group structure with integrated shared services and support functions, including but not limited to treasury, research and development, and purchasing.

At the same time, we expect the group to have a rigorous approach to brand management, increasing Scania's brand awareness. As such, we continue to expect Scania will retain its access to debt capital markets to fund its financial service business, which is essential to supporting commercial vehicle sales over the medium term.

Issue Ratings – Subordination Risk Analysis

Capital structure

Scania's capital structure consists of senior unsecured debt issued at its financing subsidiary, Scania CV AB.

Analytical conclusions

The debt is rated 'BBB', in line with the long term issuer credit rating on Scania, since there are no significant elements of subordination risk in the capital structure. This is also supported by the company's low leverage.

Ratings Score Snapshot

Issuer 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)

- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Negative (-1 notch)
- Captive finance: Neutral (no impact)

Stand-alone credit profile: bbb+

- Estimated group credit profile: bbb
- Entity status within group: Core (-1 notch from its SACP)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- German Truck Manufacturer TRATON Outlook Revised To Negative On Plans To Takeover Navistar; 'BBB' Ratings Affirmed, Oct. 22, 2020

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Scania AB (publ.)		
Issuer Credit Rating	BBB/Negative/A-2	BBB/Stable/A-2
Nordic Regional Scale	--/--/K-2	--/--/K-2
South Africa National Scale	zaAAA/--/zaA-1+	zaAAA/--/zaA-1+
Scania CV AB		
Senior Unsecured	BBB	BBB
Commercial Paper	K-2	K-2

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