

Rating Action: Moody's assigns a Baa1 rating to TRATON SE, Outlook negative

17 Jun 2020

Frankfurt am Main, June 17, 2020 -- Moody's Investors Service, ("Moody's") has assigned a Baa1 long-term issuer rating to Traton SE (TRATON). The outlook is negative.

RATINGS RATIONALE

Traton SE's Baa1 rating reflects (i) the group's strong market positions in Europe and South America in the heavy-duty truck segment, (ii) the expectation of profitability improvements driven by a sizable synergy potential between the group brands that might be realized over a longer-term time horizon (given the long product life cycles in the truck industry) as well as (iii) a solid liquidity profile. In addition, the rating reflects the company's commitment to preserve a capital structure in line with the requirements for a solid investment grade rating. We expect the group's net debt to EBITDA to remain below 2.0x on a stand-alone basis (i.e. excluding any impact from the pending acquisition of Navistar International Corp. (B2 negative)) even in a scenario of weaker operating performance in 2020 because of a continued focus on debt repayment and supported by stringent financial policies.

Furthermore, TRATON's rating benefit from the ownership and assumed support from its main shareholder Volkswagen Aktiengesellschaft (A3 negative), which is committed to remain a major shareholder going forward.

The rating also incorporate the cyclical nature of truck market demand, which is likely to weigh on operating performance at least in 2020 as indicated by weak order intake in Europe over the last few quarters and the group's focus on medium- and heavy-duty trucks and buses with no other diversifying business operations. We note that the group's operating profitability is weaker than that of some key peers, but we consider the group's clear objective of better integrating its MAN and Scania activities, which should help to gradually strengthen its operating margins towards the high single digits in percentage terms (i.e. EBITA margin as defined by Moody's).

The truck market downturn brought on by the coronavirus will cause a pronounced weakening in TRATON's credit metrics. We expect that during 2020, TRATON's Moody's-adjusted EBITA margin could fall to around 3%, compared with 7.6% in 2019. However, the company should be able to restore its metrics to appropriate levels by 2022 because it has ample liquidity to bridge a prolonged downturn.

We anticipate that the demand for new trucks will be further reduced over the coming months in a market that was already weakening as evident from declining order intakes in recent quarters.

OUTLOOK

The negative outlook reflects the potentially severe impact that the coronavirus could have on TRATON's operating performance and credit metrics into 2021.

Moody's forecasts for the global truck sector a 25% decline in unit shipments during 2020, with a steep year-over-year contraction in the second and third quarters followed by a modest rebound in the fourth quarter. We expect 2021 industry unit sales to rebound and grow by about 10-15%. However, future demand for vehicles could be weaker than our current estimates, the already competitive environment in the auto sector could intensify further, and TRATON could encounter greater headwinds than currently anticipated in the recovery of its credit metrics.

ESG RISKS

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The truck manufacturing industry is considered as one of the sectors most affected by the shock given its sensitivity to market demand and sentiment. The vulnerability of TRATON's

products to a potentially steep downturn in demand heightens the importance of a healthy liquidity profile.

Concerning governance risk, TRATON is part of the Volkswagen Group and has to adhere to the strict governance rules of the Group which is supervised by the US regulator following the diesel issue.

LIQUIDITY

TRATON's liquidity position allows it to fund sizable cash requirements that might arise under a potentially extended downturn in the global truck market as a result of the coronavirus pandemic. As of 31 March 2020, the group's sources of cash included cash and marketable securities of around €3.4 billion as well as €1.8 billion available under Scania's revolving credit facility, of which €0.55 billion will be maturing in 2021 and €1.25 billion in 2023. Large upcoming debt repayments are due to a significant degree from group's financial services segment included in our liquidity analysis. Given the self-liquidating and amortizing nature of credit contracts in the financial services division, TRATON's liquidity is considered appropriate.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

TRATON's ratings could be downgraded in case of (1) inability to realise identified synergies within the Group's truck brands resulting in profitability below expectations, (2) EBITA margin sustainably below 6%, (3) rising leverage (Debt/EBITDA) sustainably above 2.0x, (4) a weakening liquidity profile as well as (5) a negative Free Cash Flow generation.

Although an upgrade within the next 24 months is not likely, Moody's would consider upgrading the rating in case of (1) improving the longer-term returns for the MAN and VWCO truck brands; (2) EBITA margin of around 8% through the cycle; (3) positive Free Cash Flow on a sustainable basis; (4) Debt/EBITDA consistently below 1.5x; as well as (5) evidence of a track record of conservative financial policy and a strong liquidity profile.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Manufacturing Methodology published in March 2020 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1206079. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Munich, Germany, Traton SE (TRATON) is one of the world's largest manufacturer of medium- and heavy-duty trucks and buses sold under its strong brands Scania, MAN and VWCO. Moreover, TRATON offers customer financing solutions through its Scania financial services business.

During the year 2019, TRATON's Industrial business (excl. financial services) generated revenues of €26 billion and a company-adjusted operating profit of €1.7 billion. TRATON is listed on the Frankfurt and Stockholm stock exchange since its IPO in June 2019, with Volkswagen AG remaining its major shareholder with around 89.7% of TRATON's shares.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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