S&P Global
Ratings

RatingsDirect®

Research Update:

German Truck Manufacturer TRATON Outlook Revised To Negative On Plans To Takeover Navistar; 'BBB' Ratings Affirmed

October 22, 2020

PRIMARY CREDIT ANALYST

Marta Bevilacqua
Milan
+ (39)0272111298
marta.bevilacqua
@spglobal.com

SECONDARY CONTACT

Vittoria Ferraris
Milan
(39) 02-72111-207
vittoria.ferraris
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Rating Action Overview

- TRATON has agreed in principle to acquire the remaining 83.2% of U.S. truck maker Navistar's share capital that it does not yet own for about €3.1 billion or $44.50 per share.
- If the deal closes, it will significantly impair TRATON's already strained financial performance, which is under pressure from weaker revenue and cash flow in 2020 related to the COVID-19 pandemic, as well as a recently announced comprehensive realignment plan at its subsidiary MAN.
- Despite our expectation of weaker credit metrics on a stand-alone basis, the rating on TRATON remains supported by its status as a highly strategic subsidiary of Volkswagen AG (VW; BBB+/Negative/A-2).
- We are therefore revising our outlook on TRATON to negative from stable, and affirming our 'BBB' long-term issuer credit rating.
- The negative outlook reflects the risk that we could lower our rating on TRATON by one notch if we revised downward our assessment of its stand-alone credit profile (SACP) below 'bbb', and at the same time lowered our rating on VW to 'BBB', given that TRATON is a highly strategic subsidiary for VW.

Rating Action Rationale

TRATON's planned debt-financed takeover of the remainder of Navistar will put the group's financial performance under substantial strain. TRATON, which currently owns 16.8% of Navistar, has reached an agreement in principle to acquire the remaining share capital of Navistar at a price of $44.50 per share; this translates to a total acquisition price of €3.1 billion, when excluding transaction costs. This agreement in principle is subject to TRATON's finalization of a due diligence on Navistar. Moreover, it is subject to both TRATON and Navistar concluding a formal merger agreement, and approval by the respective boards of directors and shareholders.

Additionally, it is subject to customary antitrust authorities' approval.

If the deal closes, this will further burden TRATON's already meaningfully leveraged credit metrics. On an S&P Global Ratings-adjusted basis as of end-July 2020, Navistar's gross debt (excluding its financial services) was $4.6 billion, and it held cash of $1.6 billion. This resulted in adjusted gross debt to EBITDA on a 12-month rolling basis of 8.8x, compared with 4.6x at end-October 2019. We understand that the financing will be provided by VW with an intercompany loan to TRATON, we forecast that the group's adjusted debt will more than double from current levels.

Unlocking access to the North American truck market could improve TRATON's margin in the long run. This transaction will provide TRATON access to the large North American market, a geographic area where the company is not currently present. We expect that in the long run TRATON's operating profit margins could benefit from the rich profit pool that characterizes the U.S. market. We however see the transaction as neutral from a business risk perspective in the short to medium term, since it adds additional complexity to TRATON's operations, which as of today are significantly strained by MAN's weak operating performance and ongoing restructuring plans. In addition, we expect meaningful synergies to accrue only over the medium to long term. As of end-October 2020, Navistar reached sales of $11 billion and adjusted EBITDA of $1 billion under its industrial business, resulting in an adjusted EBITDA margin of 9.4%, comparable to TRATON's EBITDA margin of 9% for 2019.

TRATON's industrial business credit metrics on a stand-alone basis have been deeply impaired by the COVID-19 pandemic and MAN's marked underperformance. For 2020, absent a second wave of COVID-19, we believe TRATON's sales could drop by about 15%, while we expect its EBITDA margin under the industrial business could decrease to about 4% (excluding any provisions or one-off costs related to the recently announced restructuring program at MAN) from 9% in 2019. In addition, the group's debt metrics will be significantly below our thresholds for the current 'bbb' SACP. We expect adjusted fund from operations (FFO) to debt to fall to about 20% in 2020 (excluding for the moment any MAN restructuring provisions from our EBITDA)--from about 200% in 2019. For 2020, we now expect adjusted free operation cash flow (FOCF) for the industrial business of about €200 million compared with €564 million in 2019. Additionally, recovery prospects remain largely uncertain for 2021. Earlier in September MAN announced its intention to lay off up to 9,500 workers, as well as plant closures. MAN is currently negotiating the terms of this restructuring with the unions. Given the extent of the restructuring, which we previously did not incorporate in our base case, we believe it could drain cash from TRATON in the near future, derailing steep deleverage we previously envisaged.

We consider TRATON a highly strategic subsidiary of VW, reflecting its strong ties with the parent and our expectation that VW's stake in the company will not decrease below 75% in the foreseeable future. We believe that VW regards TRATON as a strategic asset. In 2019, TRATON contributed about 17% of VW's consolidated top line. Moreover, TRATON has access to VW's purchasing platforms and both MAN's and VWCO's financial services are offered through VW's captive operations. Furthermore, VW has granted TRATON a permanent €3 billion revolving credit facility. As long as we view TRATON as a highly strategic subsidiary for VW, our long-term rating on TRATON will remain at maximum one notch below that on VW. This would remain the case even if we revise downward our SACP on TRATON to 'bbb-' or below, provided VW retains a 'BBB+' long-term issuer credit rating. Our rating on TRATON could equal, but not exceed, the rating on VW if its SACP is at least equal to the rating on VW, although this is currently not the case.

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-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 TRATON reflects that on VW as well as the weak positioning of its 'bbb' SACP, given the pandemic as well as the several open projects TRATON has that could materially weaken its cash generation, including the potential debt-funded takeover of Navistar.

Downside scenario

We could lower our rating on TRATON if we revise our assessment of its SACP below 'bbb' and, at the same time, we lower our rating on VW to 'BBB' from 'BBB+'.

We could revise our assessment of TRATON's SACP down by one notch, if it does not achieve S&P Global Ratings-adjusted FFO to debt of at least 60% for its industrial business 12 months after closing of the envisaged Navistar acquisition. We could consider revising our SACP assessment downward by two notches, if we expect that TRATON will fail to achieve FFO to debt above 45% 12 months after closing.

If the transaction with Navistar does not go ahead, we could still revise our assessment of TRATON's SACP downward if its S&P Global Ratings-adjusted FFO to debt is not above 60% by the end of 2021.

Upside scenario

Ratings upside is fairly remote. However, we could revise the outlook to stable, if we take a similar action on Volkswagen. Given that our rating on TRATON is currently 'BBB' and our rating on VW is 'BBB+', we could also revise the outlook to stable, if the Navistar acquisition does not materialize and TRATON's operating performance improves such that its EBITDA margin increases above 9%. This would be on the back of meaningful progress under the integration of brands it manages. At the same time, we would expect the group to maintain an adjusted FFO-to-debt ratio overtime well above 60%.

Company Description

TRATON was founded in 2015 as the commercial vehicle arm of VW. The company sells trucks and buses under the Scania, MAN, and VWCO brands, and is market leader in Europe and Brazil in the heavy duty truck segment (over 15 tons) with a market share of about 33% and 38%, respectively. It is mainly active in Europe and South America, with a footprint in 17 countries and 29 production and assembly sites.

TRATON recorded revenue of more than €26 billion and an adjusted EBITDA margin of 9% under its industrial business in 2019. The company sells its new vehicles supported by either Scania's financial business operations (for the Scania brand) or VW's financial services (for MAN and VWCO).

TRATON is controlled by VW, which owns 89.7% of its share capital after a June 2019 IPO. It is listed on the Frankfurt Stock Exchange and the Nasdaq Stockholm. As of Oct. 19, 2020, its market capitalization was about €9.0 billion.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Negative/--

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Captive finance: Neutral (no impact)
- Comparable ratings analysis: Negative (-1 notch)

Stand-alone credit profile: bbb

- Group credit profile: bbb+
- Entity status within group: Highly strategic (no impact)

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 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

Ratings List

Ratings Affirmed; /Outlook Action

	To	From
TRATON SE		
Issuer Credit Rating	BBB/Negative/--	BBB/Stable/--