Research Update:

TRATON SE 'BBB/A-2' Ratings Affirmed Following Implementation Of New Captive Finance Criteria; Off UCO, Outlook Stable

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Rating Action Overview

- S&P Global Ratings has completed our ratings review of Germany-based global truck manufacturer TRATON SE and its subsidiaries under our new criteria for issuers with captive finance operations (see "The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers," published Oct. 23, 2023). The review entails the effects of our new captive criteria on TRATON's stand-alone assessment.
- Currently TRATON's financial services division has a meaningful exposure to residual value (RV) risk from its operating leasing business, representing more than 30% of its consolidated portfolio, but we anticipate this ratio will materially diminish in the next two years as MAN and Navistar will start offering financial services directly under TRATON's groupwide financial services.
- We continue to consider TRATON a highly strategic subsidiary of Volkswagen AG (VW; BBB+/Stable/A-2), which has a stake of close to 90%, owing to its continued strong operational and financial ties with its parent; as such our rating is primarily based on VW's likely support for TRATON.
- We therefore affirmed our 'BBB/A-2' issuer credit ratings on TRATON SE and Scania. Moreover, we also affirmed our K-2 Nordic scale rating on Scania, as well as the ZaAAA/zaA-1+ South African national scale ratings. At the same time, we affirmed our 'BBB' issue ratings on the group's senior unsecured debt, removing all issuer and issue ratings from under criteria observation (UCO).
- The stable outlook mirrors that on VW, as long as VW owns more than 75% of TRATON.

Rating Action Rationale

Our rating reflects TRATON's ongoing strong ties with its parent, VW. 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% for the foreseeable future. We believe VW regards TRATON as an important strategic asset and there are close operational links between TRATON and VW. In 2022, TRATON contributed about 14.4% of VW's consolidated top line. Moreover, TRATON has access to VW's purchasing platforms. In addition, VW granted TRATON an acquisition facility to support the purchase of Navistar, which has now been fully refinanced with external debt. VW further grants an uncommitted line of €4 billion to TRATON. Therefore, as long as we view TRATON as highly strategic to the VW group, we will rate it up to one notch below VW, all else being equal. Should VW's stake in TRATON fall below 75%, we could reconsider TRATON's group status and the implications for our long-term rating.

We anticipate that as soon as both MAN and Navistar portfolios will ramp up the share of consolidated leased assets will diminish. The share of operating lease assets on a consolidated basis for TRATON amounts to more than 30% of what we deem TRATON's total earning assets from captive finance operations. Currently, TRATON carries on its balance sheet the financial services activities of Scania, but it does not have fully centralized captive finance operations for the other brands. In particular, loans and finance leases for MAN and VW Truck & Buses are for the most part directly offered by VW Financial Services. As of the end of Sept. 30, 2023, TRATON's consolidated operating lease assets reached €6.2 billion, including operating lease contracts offered by TRATON Financial Services, VW Financial Services, and external banks, and we understand that about half of this amount pertains to MAN. However, as part of its strategic initiative to establish a uniform financial services business for trucks, TRATON will steadily increase its directly managed loan and finance lease business by underwriting the new business. We expect this will reduce the share of operating lease assets at TRATON well below 25% within the next two years, and concurrently its exposure to residual value risk.

TRATON's future capitalization of its centralized captive finance operations will become clearer in the next 12-24 months. As part of the reorganization of TRATON's Financial Services activities, which the company expects to conclude by 2025, TRATON will be the single provider of financial services for new contracts under the MAN and VW Truck & Bus (VWTB) brands. In addition, on Oct. 5, 2023, Navistar started providing financial services to its clients directly. For the time being, TRATON hasn't disclosed its key milestones for establishing a groupwide financial services business, or its funding needs, so our stand-alone credit profile for TRATON does not include a full assessment of any possible impact on leverage or liquidity, if any, of establishing a new business. For example, we're uncertain about the company's leverage tolerance at the financial services once the full roll out of the portfolio takes place. However, we anticipate the company will largely mirror the funding structure at Scania for all of its portfolio. As of year-end 2022, TRATON's captive operations had a debt-to-equity ratio of 5.5x following the consolidation of Navistar, and we expect it to remain below 10x. We will reflect the effects of the new financial services organization as soon as the company discloses its structure, funding strategy, capitalization targets, and related matters.

TRATON's liquidity is adequate, but with limited headroom. Following the implementation of the new captive finance criteria, we assess TRATON's liquidity jointly for the industrial and captive finance operations. On Sept. 30, 2023, the TRATON group had about €20.7 billion financial debt coming due, of which €8 billion is due over the next 12 months. Although we believe these maturities are covered by our expected funds from operations (FFO), group cash, and revolving credit facilities (RCFs), as well as the portfolio run-off of TRATON's financial services assets, liquidity coverage could weaken in an industry downturn or other scenarios of weaker operational performance.

Bright short-term outlook, although for 2024 clouds are mounting, owing to materially diminishing order intake. TRATON recently raised its operating return sales guidance to 8%-9% for TRATON operations, up from 7.5%-8.5%. At the same time, in the first nine months of 2023, orders were down by 26% of compared to the same period a year ago to 189,611 units. We hereby expect units sold to decrease to 290,000-310,00 units in 2024, compared to our expectation of 325,000-335,000 units in 2023 and 305,485 units recorded in 2022. There is some divergence in the order intake trend for TRATON's key brands. Scania reported orders increasing by 6% in the first nine months to 61,781, while MAN incoming orders decreased by 20% to 65,838 units, with one of the reasons being the geographic concentration on MAN in Germany, particularly hit by an economic slowdown.

That said, overall we anticipate sales will decrease by 6% in 2024. At the same time, the downside risk is material in our view and will largely depend on the order intake received in in Q4 2023 for the group. However, we expect TRATON's operating flexibility to be more resilient in 2024, when the group will benefit in full from the restructuring at MAN, and reap some synergies from the deployment of its common base engine to Navistar. This is why for the time being we anticipate the company's S&P Global Ratings-adjusted EBITDA margin to decrease just by about 30 basis points (bps) if compared to the 2023 level of about 10%. TRATON's stand-alone assessment is 'bb+' and we could consider improving it by one category when its FFO to debt reaches 45% even at the bottom of the cycle.

Outlook

The stable outlook on TRATON mirrors that on VW, so long as VW owns more than 75% of TRATON.

Downside scenario

We could lower our rating on TRATON following a similar action on VW. However, we view a downgrade as unlikely, given VW's solid headroom under the 'BBB+' rating.

Upside scenario

We could take a positive rating action on TRATON following a positive rating action on VW.

Company Description

TRATON was founded in 2015 as the commercial vehicle arm of VW. It sells trucks and buses under the Scania, MAN, Navistar, and VW Truck & Buses brands. TRATON is the market leader in South America for heavy-duty trucks (class 8), with a market share of about 34%, and retains the No. 2 position in Europe, with a market share of 21%. The company is active mainly in Germany, the U.S., and Brazil, with a presence in 16 other countries via 28 production and assembly sites. TRATON gained material exposure to the North American heavy-duty vehicle market through its July 2021 acquisition of Navistar, which gave it the No. 4 position in the U.S. heavy-duty truck market in 2022.

In 2022, TRATON recorded S&P Global Ratings-adjusted revenue of €39.0 billion and an adjusted

EBITDA margin of 6.9% under its industrial business.

TRATON is controlled by VW, which has owned about 90% of its share capital since an IPO in June 2019. It is listed on the Frankfurt stock exchange and the Nasdaq Stockholm. As of Nov. 10, 2023, the company's market capitalization was about €9.4 billion.

Our Base-Case Scenario

Assumptions

- Real GDP growth in the eurozone of 0.9% in 2024, up from 0.6% in 2023, but considerably below the 3.4% growth in 2022, further recovering to 1.5% in 2025. In the U.S., we expect real GDP growth of 1.3% in 2024, after 2.3% in 2023 and 2.1% in 2022, before slightly improving to 1.4% in 2025. In China, we expect real GDP growth of 4.4% in 2024, after 4.8% in 2023 and 3.0% in 2022, followed by 5.0% in 2025.
- Units sold ranging from 325,000-335,000 in 2023, and 290,000-310,000 in 2024, compared with 305,485 in 2022. We think the group will catch up to lost deliveries in 2023, especially related to production idling at MAN. Meanwhile Scania will benefit from the new engine, which promises fuel savings of up to 8% compared with the former model, and Navistar started delivering the new powertrain to North American customers from the second half of 2023, which promises to improve fuel efficiency by 15% compared with its predecessor.
- Revenue for the industrial business ranging from €44 billion-€46 billion in 2023, up from €39 billion in 2022, owing to both higher units sold and price increases, and €40 billion-€45 billion in 2024, driven by lower expected new vehicle sales.
- S&P Global Ratings-adjusted EBITDA margin increasing to 9.2%-10.2% in 2023-2024 considering a boost from Scania's sales of its new engine, and a somewhat better contribution from MAN. We anticipate the full cost benefits from MAN realignment will be fully visible in 2024. MAN targets a reported 8% return on sales on its manufacturing activities by end-2024, compared with 0.0% in 2022 and 6.8% in the first six months of 2023. Overall, TRATON targets a consolidated company's adjusted return on sales of 9%.
- Working capital outflow in the industrial business of about €900 million in 2023 and €500 million in 2024.
- S&P Global Ratings-adjusted capital expenditures (capex) of about €1.8 billion per year in 2023-2024, compared with €1.3 billion in 2022. The increase in capex relates mainly to investments towards electrification and Scania's new plant in China.
- Dividend payments of about €350 million in 2023 and €700 million-€750 million in 2024.
- Acquisition costs of about €300 million in 2023 due to the ramp up of joint ventures, and €100 million thereafter.
- No material disposals.

Key metrics

TRATON SE--Forecast summary

	--Fiscal year ended Dec. 31--					
(Mil. €)	2019a	2020a	2021a	2022a	2023e	2024f
Revenue	26,444	22,156	29,656	39,041	45,093	42,420
EBITDA	2,379	899	1,865	2,694	4,490	4,122
Funds from operations (FFO)	1,833	405	1,124	1,649	3,040	2,814
Capital expenditure (capex)	1,025	1,029	1,128	1,307	1,802	1,802
Free operating cash flow (FOCF)	643	669	716	-963	1,471	1,664
Dividends	3,250	501	135	250	350	723
Discretionary cash flow (DCF)	-3,716	168	581	-1,213	1,121	941
Debt	854	2,087	9,111	9,809	9,173	8,696
Cash and short-term investments (reported)	5,091	3,819	2,228	1,512	2,178	2,687
Adjusted ratios						
Debt/EBITDA (x)	0.4	2.3	4.9	3.6	2.0	2.1
FFO/debt (%)	214.6	19.4	12.3	16.8	33.1	32.4
Annual revenue growth (%)	5.9	(16.2)	33.9	31.6	15.5	(5.9)
EBITDA margin (%)	9.0	4.1	6.3	6.9	10.0	9.7

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess TRATON's liquidity as adequate, and our short-term rating on TRATON is 'A-2'. We project the group's ratio of liquidity sources to uses will be about 1.3x for the 12 months from Sept. 30, 2023. Following the implementation of the criteria, we perform our liquidity analysis for TRATON on a joint basis, which looks at industrial and captive operations in combination.

Principal liquidity sources as of Sept. 30, 2023, for the next 12 months include:

- Accessible cash and equivalents of about €2.0 billion for the group (industrial and captive finance operations) as of Sept. 30, 2023.
- €4.5 billion of undrawn committed lines maturing in 2026.
- Reported cash FFO of €4.0 billion-€5.0 billion over the next 12 months.
- Net portfolio run-off of captive finance assets of about €4 billion, as further broken down below.

Principal liquidity uses as of Sept. 30, 2023, for the next 12 months include:

- Debt maturities for the group of about €8 billion
- Working capital outflows in the industrial business of about €0.5 billion, with seasonal swings of up to €0.5 billion.
- Reported capex (including capitalized development costs) of €2.3 billion-€2.8 billion.
- Dividend payments of €700 million-€750 million in the next 12 months.

Our estimated inflow from TRATON's portfolio run-off, and portfolio reinvestment can be broken down as follows:

- Gross portfolio run-off: Inflows from contractual repayments of loans and finance principal, totaling about €5 billion over the next 12 months;
- Net portfolio run-off: We net these amounts with our assumption of €1 billion of portfolio investments, which we assume TRATON would undertake from own funds during periods of constrained debt market access. These estimates are based on an imputed debt-to-equity ratio that we apply to the gross portfolio run-off plus depreciation of leased assets.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Sept. 30, 2023, TRATON's consolidated financial debt totaled about €21 billion, excluding €1.2 billion of leasing.

Analytical conclusions

We continue to rate TRATON's senior unsecured debt and the €12 billion euro medium-term notes program 'BBB'. We also continue to rate Scania's 7 billion EMTN program at 'BBB' in line with its parent rating.

The priority debt ratio is about 41% (38% as of the end of June 2023) and sensitive to some swings in issuances, but we still think the amount of priority debt will decrease, with new issuances at the parent level.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/A-2

Business risk: Satisfactory

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

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bb+

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)

- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)
- Captive Finance: Neutral (no impact)

Stand-alone credit profile: bb+

Group credit profile: bbb+

Entity status within group: Highly strategic (-1 notch from group credit profile)

Related Criteria

- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Oct. 23, 2023
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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 And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

- Volkswagen 'BBB+/A-2' Ratings Off UCO; Affirmed Following Implementation Of New Captive Finance Criteria; Outlook Stable, Nov. 1, 2023
- Ratings On Six Issuers With Captive Finance Operations Placed Under Criteria Observation After Criteria Revision, Oct. 23, 2023
- Daimler Truck Holding AG, Oct. 12, 2023
- Global Heavy-Duty Truck Sales Gain Momentum Amid Mounting Risks, Oct. 3, 2023

- Tear Sheet: AB Volvo, July 31, 2023
- Tear Sheet: Daimler Truck Holding AG, July 31, 2023
- Tear Sheet: TRATON SE, June 16, 2023
- Tear Sheet: PACCAR Inc., June 8, 2023
- Research Update: Daimler Truck Holding AG Outlook Revised To Positive On Improving Margins And Cash Flow; Affirmed At 'BBB+/A-2', May 26, 2023
- Research Update: Sweden-Based Truck Manufacturer AB Volvo Upgraded To 'A' On Improving Margins And Cash Flow Expectations; Outlook Stable, May 15, 2023
- Bulletin: German Truck Manufacturer TRATON Sees Positive Route Ahead For 2023, March 9, 2023

Ratings List

Ratings Affirmed	
TRATON SE	
Issuer Credit Rating	BBB/Stable/A-2
Scania AB (publ.)	
Issuer Credit Rating	BBB/Stable/A-2
Nordic Regional Scale	--/--/K-2
South Africa National Scale	zaAAA/--/zaA-1+
Scania CV AB	
TRATON Finance Luxembourg S.A.	
Senior Unsecured	BBB