Scope Hamburg downgrades issuer rating of Grammer AG to BB/Stable from BB+/under review for changes in methodologies due to changes in methodologies

The downgrade reflects a change in Scope Hamburg's assessment of Grammer's credit quality following the introduction of changed rating methodologies at Scope Hamburg on 2 May 2022

The latest information on the rating, including rating reports and related methodologies, is available on this **LINK**.

Rating action

Scope Hamburg GmbH (Scope) has downgraded the issuer rating of Grammer AG to BB/Stable from BB+/under review for changes in methodologies. The downgrade follows a review of the issuer rating after the introduction of changed rating methodologies at Scope Hamburg on 2 May 2022. Simultaneously, Scope Hamburg has assigned a S-3 short-term debt rating.

Rating rationale

Grammer's issuer rating mainly benefits from our assessment of the business risk profile and is held back by a weaker financial risk profile.

Grammer's business risk profile is assessed at "BB+" and is supported by the diversified business into two core segments, Automotive and Commercial Vehicles (CV) each of the two segments exhibiting different business cycles and prospects for sustainable growth. Grammer benefits from a largely future-oriented product portfolio which only would need minor adjustments to market (vehicle interior) trends which in turn limits capital expenditures and transformation risks currently facing the auto supplier industry. While software will become market differentiating on the manufacturer side in the future, changes in the interior segment are influenced by technology and process trends in particular, in addition to end customer preferences. Grammer enjoys market-leading position in its two core segments and partly operates in niche markets such as components for off-road vehicles. In its core segments, Grammer is among the top 5 suppliers in the respective industry. The business risk assessment is limited by the cyclicality inherent in Grammer's end-markets and a business concentration in Europe and North America. In addition, bargaining power vis-à-vis the automotive original equipment manufacturers (OEMs) is rather low and the sector is subject to price and competitive pressures. Suppliers' weak negotiation positions towards OEMs limits the ability to pass on rising raw materials prices and other input price inflation such as energy and transportation costs. In the CV segment, we believe Grammer to have stronger negotiation power as a result of a higher degree of customisation of products and predominance of small-to-medium sized series productions. Overall, Grammer's operating profitability, as measured by Scope-adjusted EBITDA margin is rather weak and subject to significant risks of volatility. We do not view the years 2020 and 2021, affected by either the COVID-19 crisis or price increases in key raw materials to be representative of Grammer's long-term profitability levels. However, we see still some pressure on EBITDA margins in the next two years. With an expected normalisation of produced volumes and fewer disruptions in the supply chains, we expect a gradual improvement of operating profitability and forecast the EBITDA margin to move to levels of around 7%-9% in 2022 and 2023, about the level achieved by Grammer in preceding years.

Furthermore, the issuer rating likewise captures a financial risk profile assessment of “BB-“. Key for this assessment is the projected improvement of Grammer’s key financial credit metrics that are currently weak for the rating. The elevated debt levels that resulted from the pandemic and simultaneous weakening of profitability had a disproportionate effect on key credit metrics, notably in 2020 and 2021. In line with the expected improvement of operating profitability (EBITDA), we foresee Scope-adjusted debt (SaD)/EBITDA to move towards 3.0x in 2023 while funds from operations (FFO) to SaD should improve to about 20%-25%. Cash flow cover, as defined by free operating cash flow (FOCF) to SaD is the weakest element of our financial risk profile assessment. Liquidity is adequate and primarily supported by available unused committed credit lines and unrestricted cash with minor positive FOCF expected and low financial maturities to be served relative to available financial flexibility.

On the supplementary rating drivers we currently view neutral the key shareholder Ningbo Jingfeng. The key shareholder has not received dividend payments from Grammer and likewise provided further shareholder funds in the form of a loan during the COVID-19 pandemic.

No driver of this credit rating action is considered an ESG-relevant factor.

Outlook and rating-change drivers

The stable outlook reflects our expectation that the SaD/EBITDA ratio will move towards 3.0x in 2023. In addition, we expect that automotive OEMs and Grammer will be able to find suitable cooperative solutions to adequately compensate for inflation-related cost increases.

A positive rating action could we warranted if, contrary to our expectations, the economic recovery is faster and the deleveraging is outpaced by a significant improvement in operating margins and free cash flows, leading to stronger credit metrics than envisaged at this stage. We would view an improvement of leverage (SaD/EBITDA) to levels of below 3.0x on a sustained basis to be indicative for any such situation.

A negative rating action could be warranted if the financial risk profile was to deteriorate leading to credit metrics such as SaD/EBITDA above 4.0x on a sustained basis. This could be triggered by an inability of Grammer to pass on escalated input costs or may result from an unexpected volume weakness in the automotive and CV end-markets.

Long-term and short-term debt ratings

GRAMMER short-term rating of S-3 reflects Grammer's view on the company's good liquidity including the cover of financial maturities with internal liquidity sources but likewise through the combination of internal and external liquidity sources both leading to an assessment of better-than-adequate according to the applicable methodology. Grammer also benefits from good standing in public and private debt markets, and well-established banking relationships as evidenced by a broad mix of committed long-term credit lines from leading banks.

Stress testing & cash flow analysis

No stress testing was performed. Scope Hamburg performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlook: (Corporate Rating Methodology, 6 July 2021), Corporates – Rating Methodology: European Automotive Suppliers (14 January 2022).

Scope Ratings GmbH, Scope Ratings UK Limited and Scope Hamburg GmbH apply the same methodologies/models and key rating assumptions for their credit rating services.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in ‘Basic Principles for Assigning Credit Ratings and Other Services 2 May 2022’, published on **https://scopehamburg.com/seiten/Principles_20220608.pdf**. Historical default rates of the entities rated by Scope Hamburg can be viewed in the ‘Credit Rating Transition and Default Study Feb. 2021’ at **https://scopehamburg.com/seiten/Validation_Update_31Dec21.pdf**.

Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Hamburg's definitions of default and Credit Rating notations can be found at https://scopehamburg.com/seiten/Principles_20220608.pdf. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity and Scope Hamburg's internal sources.

Scope Hamburg considers the quality of information available to Scope Hamburg on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Hamburg considers to be reliable and accurate. Scope Hamburg does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Hamburg GmbH, Ferdinandstraße 29-33, D-20095 Hamburg, Tel +49 40 524724-170.

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The Credit Ratings/Outlook were first released by Scope Hamburg or its predecessor on 21 July 2016. The Credit Ratings/Outlook were last updated on 2 May 2022.

Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

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