Scope Hamburg confirms issuer rating of ‘BBB-‘ for German truck & trailer supplier SAF-Holland SE and changes the outlook to negative

The rating reflects the expected impact of SAF Holland’s acquisition of the Swedish brake manufacturer HALDEX AB (Haldex) which is expected to result in a weakening of credit metrics.

Rating action

Scope Hamburg GmbH (Scope) has confirmed the issuer rating of ‘BBB-‘ for German truck & trailer supplier SAF-Holland SE and changed the outlook to negative from ‘BBB-‘/ under review for a possible downgrade.

Rating rationale

Following up on the latest rating action from 15 June 2022, Scope has confirmed the ‘BBB-‘ issuer rating for SAF-Holland SE and changed the outlook to negative.

In our view, the takeover of Haldex leaves the business risk profile assessment of SAF Holland unchanged at ‘BBB-‘. The combined business group operates in the same sector and customer end markets with a complementary product portfolio that is well equipped to address the future megatrends of the commercial vehicle industry. Both entities have good market positions as suppliers of chassis-related components for trailers, trucks, and buses. SAF and Haldex operate in consolidated markets with oligopolistic structures and command #1 or #2 market positions in key geographical regions (North America and EMEA) for their “high end” products and components. We view this market position as defendable. Further supporting our view of the business risk profile (‘BBB-‘) is a good and increasing share of more resilient and profitable aftermarket and spare parts business representing around 30 % of the combined group’s sales in the future. Haldex generates 50 % (around EUR 220m) of its sales in the more cyclically stable and higher-margin aftermarket business which should have a stabilising effect on profitability in the future. In view of a very fragmented global trailer market, the business combination shows a lower customer concentration than typically observed for suppliers to the commercial vehicle industry. We assess the integration risk as low to medium overall due to the complementary product portfolio, the sector competencies and the experience of SAF-Holland to integrate companies.

SAF has launched its “Forward 2.0” program in 2020 to address complexity costs in its product portfolio with a planned reduction of variants from over 11k to 5k while increasing the degree of modularization of product lines. During the COVID-19-Pandemic, the efficiency enhancement programmes were pushed on the SAF-Holland side and also Haldex launched a “global cost reduction program”.

This combined should help SAF and Haldex to improve its operating efficiency and profitability going forward.

The key driver for a substantial improvement of profit margins, however, would rest on a turnaround of the EMEA region’s profitability.

Limiting factors for the business risk assessment are the inherent substantial cyclicality risks that drive demand in global commercial vehicle markets (truck/trailers), low operating profit margins (combined Scope-adjusted EBITDA margins expected between 9% and 10% in the medium term), and no significant presence in the large Asian markets such as China or India representing only about 10% of the combined entities’ sales.

In our view, the closing of transaction includes a material financial impact on SAF’s financial risk profile (FRP) and we have lowered the FRP assessment to ‘BBB-‘ from our previous SAF-Holland stand alone assessment (excluding Haldex effect) of ‘BBB’. For 2022, Scope expects a combined group revenue of around EUR 1.8bn as a result of the rebounding demand for commercial vehicles and trailer components, notably in the North-American and APAC region. In our pro-forma scenario the profit margin (SaEBITDA margin) should improve to levels of close to 9.5 % in the same period.

With completion of the transaction, the pro-forma SaD/EBITDA of the combined entities is expected to be around 3.6x and FFO/SaD towards 20 % post-closing. Our calculation includes the purchase price of around EUR 300m and the net debt position of Haldex of around EUR 100m including the pension deficit of Haldex. We classify this development as temporary and expect SaD/EBITDA and FFO/SaD to gradually move back towards 2.5x and 35% by 2024, due to the current strong order books and the structurally increasing aftermarket business that supporting the resilience of the business model to cyclical fluctuations.

The free operating cashflow (FOCF) development has been volatile in the past due to smaller acquisitions, plant consolidation in the Americas region and impacts from the corona crisis. Accordingly, cash flow coverage (FOCF/SaD) has tended to be a weaker ratio of SAF (stand alone) in the past. From 2023 onward we expect a more stable development after the integration of Haldex. In our view the combined entity will benefit from an improving cash flow quality due to the increasing share of the higher margin aftermarket business and efforts from SAF’s “Cash is King” net working capital optimization program. We also expect a reduction of inventories as recently there has been an increasing relaxation of supply chains issues. As a result, safety buffers for steel, for example, are very likely reduced. Gradually, we expect a development of cash flow cover towards 15 % (2021: 0%; 2020: 39%) in the medium term which supports our FRP assessment at ‘BBB-‘ overall.

Liquidity is adequate. As of 30 June 2022, SAF had available EUR 173m of unrestricted cash and EUR 250m under the new committed syndicated credit facility with maturity in 2027. This syndicated credit line can be up-sized by EUR 100m and contains financial maintenance covenants.

In March 2020, SAF placed promissory notes ("Schuldschein") with different maturities and a volume of EUR 250m leading to a staggered maturity profile in the next years. In connection with the offer extended to the shareholders of Haldex AB for the purchase of all outstanding shares, SAF signed a new loan agreement that provides two annuity loans offering a total credit volume of EUR 300m. The next larger financial maturities (EUR 161m) from promissory notes are due in March 2023. Overall, SAF has a manageable maturity profile and a solid financing base in the medium term.

Supplementary rating drivers are neutral for the issuer rating. We view the financial policy as moderate. SAF has a long-term oriented dividend policy of distributing 40%-50% of net income which is rather at the upper end and higher of what the auto/truck maker/suppliers normally have as dividend payout targets (more in the range of 20%-40%) but still not an shareholder remuneration target that we would classify as aggressive. This is also documented by the waiving of dividend payments during the corona-crisis.

In our analysis no driver is considered as ESG-related factor and given that any such ESG-related factor is not viewed in existence, there is no substantial impact on the overall assessment on credit risks emanating from ESG-related factors. We note, however, that companies such as SAF and Haldex operating in the automotive supplier sector are exposed to the need for improved resource management including reduction of greenhouse gas emissions, either for their end-products or in the production process.

Outlook and rating-change drivers

The negative outlook reflects the risk that SAF Holland might not be able to restore credit metrics commensurate with the 'BBB-' rating within 12 to 18 month from closing of the transaction. This may be the result of a significant weakening of economic conditions (e.g. triggered by energy shortages or remaining inflationary pressures) and unexpected volume weakness, inadequate dividend payments or unexpected post-merger integration risks to materialize.

A positive rating action could be warranted if, contrary to our expectations, the deleveraging is outpaced by a significant improvement in operating margins and free cash flows, leading to stronger credit metrics than we envisage at this stage. We would view an improvement of leverage (SaD/ EBITDA) to levels sustainably below 2.0x and FFO/SaD sustainably above 45% as indicative for any such situation.

A negative rating action is possible if SAF's leverage (SaD/EBITDA) sustainably remains at levels above 3.0x as this would trigger a lowering of the financial risk profile assessment. Likewise, a weakening liquidity profile could result in a downgrade of the issuer rating.

Long-term and short-term debt ratings

No senior unsecured debt category ratings for long-term financial instruments were assigned. Instrument rating to individual long-term financing instruments were likewise not assigned.

No short-term rating was assigned.

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, 15 July 2022), 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 8 June 2022', published on **https://scopehamburg.com/seiten/SH_Basic_Principles_July_2022.pdf**
Historical default rates of the entities rated by Scope Hamburg can be viewed in the 'Credit Rating Transition and Default Study July 2022' at **https://scopehamburg.com/seiten/Default_Study_2022_Scope_Hamburg.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/SH_Basic_Principles_July_2022.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 (Issuer) and Scope Hamburg's internal sources.

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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 60 77 81200

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The Credit Ratings/Outlook were first released by Scope Hamburg or its predecessor on 24 September 2012. The Credit Ratings/Outlook were last updated on 15 June 2022.

Potential conflicts

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