EULER HERMES

Summary of

Rating Report

SAF-HOLLAND S.A.

8 April 2014

EULER HERMES

Rating rationale

Rating of 8 April 2014	
Company Rating:	**BBB**
Outlook:	**Stable**

Subject of rating:

SAF-HOLLAND S.A. develops, produces and markets axle and suspension systems, tractor and trailer couplings, kingpins and landing gear for the truck and trailer industry. Its core markets are Europe and North America. With over 3,000 employees, the company generated sales of € 857.0 million in 2013.

Strengths:

- Large market share in Europe and North America
- Long-standing business relations with commercial vehicle OEMs
- Service networks in the core markets

Weaknesses:

- Exposure to the cyclical commercial vehicle industry
- Weak presence in the emerging markets

Opportunities:

- Growing road haulage volumes
- More stringent statutory safety requirements
- Improvement in earnings potential in the *Trailer Systems* segment
- Expansion of *Aftermarket* business

Threats:

- Highly cyclical exposure
- Increasingly intense competition
- Rising commodity prices

Euler Hermes Rating confirms the BBB rating for SAF-HOLLAND S.A. We expect the rating to remain stable over the next twelve months.

The primary rationale for the rating is the company's stable earnings potential thanks to expanding spare parts and service business as well as the favourable capital structure and its financial flexibility. In addition, we assess the company's large share of the market in Europe and North America favourably. In 2013, the company's successful business performance continued, with sustained earnings stability resulting in further improvements to its capital structure. With the enlargement of its global production capabilities and service network, SAF-HOLLAND has been able to additionally reinforce its good market position in the *Trailer Systems* and *Powered Vehicle Systems* segments. In view of the growth in order intake in these segments, we expect a continued increase in market penetration for the main products and the steady performance of the less cyclical *Aftermarket* business with its broader margins.

We see opportunities in the worldwide increase in transportation volumes, improved earnings potential in the *Trailer Systems* segment as well as further expansion in spare-parts business. In this connection, SAF-HOLLAND is seeking to stand apart more distinctly from the competition by means of innovations and regional technology transfers in response to mounting price and competitive pressure in the sector, to improve established relations with commercial vehicle OEMs and final customers and to reinforce its long-term profitability.

We consider the main threat to the company to lie in its exposure to the cyclical commercial vehicle sector. Only limited use can be made of the growth potential offered by the emerging markets at the moment due to the company's weak presence in these regions.

Threats include heavy cyclical exposure, increases in commodity and energy prices, currency fluctuations, the mounting price and innovation pressure being exerted by OEMs, heightened competition and possible material sourcing shortfalls.

Key financials*	2011	2012	2013
EBITDA margin	8.5	8.3	8.0
Return on capital employed (ROCE)	17.1	17.2	16.9
Equity ratio	28.0	32.6	38.4
Debt to equity ratio	56.3	49.1	41.6
Total liabilities / EBITDA	4.7	4.3	4.1
Net financial liabilities / EBITDA	2.3	2.0	1.8
EBIT interest coverage	2.6	3.9	5.3
EBITDA interest coverage	3.7	5.6	7.1

* adjusted in accordance with EHRG's analysis principles.

Company

SAF-HOLLAND S.A. (SAF-HOLLAND) specialises in developing, producing and marketing high-quality systems and components for tractors (*Powered Vehicle Systems*) and trailers (*Trailer Systems*). In addition, its activities include related service and spare-parts business (*Aftermarket*). In 2013, the company generated consolidated sales of € 857.0 million with an average of 3,106 employees in the *Powered Vehicle Systems* (16.9 % of sales), *Trailer Systems* (56.7% of sales) and *Aftermarket* (26.4 % of sales) segments. SAF-HOLLAND has approximately 9,000 service stations around the world and a total of 16 production facilities including in the United States, Canada, Germany, Australia, China and India. Its most important sell-side markets are Europe, which contributes 52.3% to sales, and North America with 39.6% of sales.

In the ***Trailer Systems* segment**, SAF-HOLLAND holds a leading market position in axle and suspension systems, landing gear and kingpins. It supplies major customers such as Krone and Kögel as well as numerous smaller regional operators and producers of special-purpose vehicles. The *Trailer Systems* segment reported sales of € 485.7 million and adjusted EBIT of € 10.6 million (EBIT margin: 2.2%) in 2013. Local competitors in axle and suspension system business include BPW in Europe, Hendrickson in North America and FUWA in China.

The ***Powered Vehicle Systems* segment** reported sales of € 144.7 million and adjusted EBIT of € 12.4 million (EBIT margin: 8.6%) from business in trailer couplings and suspension systems. In contrast to the *Trailer Systems* segment, the *Powered Vehicle Systems* segment is characterised by a greater sell-side concentration and the dominant position of the OEMs over the suppliers. The largest customers in this segment are Paccar, Oshkosh, Daimler, Volvo and Navistar. The main competitors globally are Jost, Fontaine in North America and FUWA in China.

SAF-HOLLAND's ***Aftermarket* segment** is responsible for supplying the transport industry with spare parts. Here, the customer structure is fragmented, ranging from final customers (fleet operators) to spare parts traders and garages. A dense service network has been established in the core markets of Europe and North America and is substantially broader than those of its competitors. The *Aftermarket* segment reported sales of € 226.7 million and adjusted operating earnings of € 36.3 million (EBIT margin: 16.0%) in 2013.

SAF-HOLLAND S.A. was established on 21 December 2005 following the merger of the SAF Group and the HOLLAND Group. The organisational merger of the two subgroups SAF and HOLLAND was completed in 2007. Further milestones in the company's history include the use of disc brake technology in trailers and the acquisition of a European producer of coupling products (Georg Fischer Verkehrstechnik) and a US producer of lading gear (Austin-Westran) in 2008. At the end of 2013, it acquired a majority stake in Corpco, a Chinese producer of air suspension systems for buses.

SAF-HOLLAND S.A. has been listed on the stock market since 2007. The stock is mostly free float. The members of the Management Board and the Board of Directors held around 4.2% of the company's stock as of 31 December 2013. The Management Board comprises Mr. Detlef Borghardt (CEO), Mr. Wilfried Trepels (CFO) and the heads of the three segments *Powered Vehicle Systems* (Jack Gisinger), *Trailer Systems* (Steffen Schewerda) and *Aftermarket* (Alexander Geis).

Rating history	24.09.2012	04.09.2013	08.04.2014		
Notation/outlook	BBB- / stable	BBB / stable	BBB / stable		

Financial analysis

Earnings potential and profitability

Contrary to the company's consolidated financial statements, our analysis classifies income from the disposal of assets (2011-2013), income from claims for damages (2013) and the reversal of impairments on intangible assets (2011-2012) as extraordinary items. Similarly, restructuring expense (2011-2013) and impairments of goodwill and intangible assets (2012) are also included in extraordinary expense.

Structural income statement*	**2011**		**2012**		**2013**		**Change year on year (%)**	
	T€	**%**	**T€**	**%**	**T€**	**%**	**2012**	**2013**
Sales	831,317	100.0	859,578	100.0	857,018	100.0	3.4	-0.3
Total revenues	831,317	100.0	859,578	100.0	857,018	100.0	3.4	-0.3
Cost of materials	551,497	66.3	566,683	65.9	563,411	65.7	2.8	-0.6
Gross profit	279,820	33.7	292,895	34.1	293,607	34.3	4.7	0.2
Other operating income	768	0.1	1,161	0.1	1,598	0.2	-49.5	37.6
Personnel expenses	147,597	17.8	159,433	18.5	154,344	18.0	8.0	-3.2
Other operating expenditure	61,973	7.5	63,565	7.4	72,011	8.4	2.6	13.3
EBITDA	71,018	8.5	71,058	8.3	68,850	8.0	-2.1	-3.1
Depreciation/amortisation	20,676	2.5	20,884	2.4	17,876	2.1	1.0	-14.4
EBIT	50,342	6.1	50,174	5.8	50,974	5.9	-3.3	1.6
Net finance expense	-24,019	-2.9	-29,572	-3.4	-17,957	-2.1	23.1	-39.3
Of which interest expenditure	*19,009*	*2.3*	*12,736*	*1.5*	*9,703*	*1.1*	*-33.0*	*-23.8*
Profit from ordinary business activities	26,323	3.2	20,602	2.4	33,017	3.9	-26.0	60.3
Net exceptional income/expense	322	0.0	-4,627	-0.5	-1,574	-0.2	-1,537.0	-66.0
Earnings before taxes (EBT)	26,645	3.2	15,975	1.9	31,443	3.7	-43.3	96.8
Consolidated net profit for the year	26,619	3.2	7,418	0.9	24,365	2.8	-73.6	228.5

* The income statement was derived from the reported cost-of-sales method.

In the wake of the financial and economic crisis, consolidated sales tumbled by 47.5% in 2009 due to a sharp decline in demand and high inventories in the commercial vehicle industry. Of this decline, the *Trailer Systems* segment accounted for over 90%. In response to the negative experience gained with high inventories, requirements-oriented production was implemented in the following years. The economic recovery and the effects of unleashed pent-up demand in the transport industry caused revenues to surge by 50.4% in 2010 and 31.7% in 2011. Demand softened in 2012 and 2013 slightly as the pent-up demand subsided and the outlook for the economy clouded over. Last year, currency-translation losses (US dollar) of € 12.7 million were sustained. **Consolidated sales** dropped by € 2.6 million to € 857.0 million. Despite the negative currency effects, sales in the group's largest segment *Trailer Systems* rose by € 12.2 million to € 485.7 million. The *Aftermarket* segment, which plays a crucial role for the group's earnings potential, saw a slight € 1.9 million decline in sales to € 226.6 million. This reflected the growing market penetration of the group products, additions to the dealer network and the availability of new logistics centres. By contrast, *Powered Vehicle Systems* segment sales dropped by € 12.9 million to € 144.7 million due to currency-translation-related declines of € 3.9 million and particularly also the uncertainty surrounding the US budget deficit. Consolidated sales by segment were as follows in 2013: *Trailer Systems* 56.7 % (2012: 55.1 %; 2011: 56.9 %), *Powered Vehicle Systems* 16.9 % (2012: 18.3 %; 2011: 18.5 %) and *Aftermarket* 26.4 % (2012: 26.6 %, 2011: 24.6 %).

Regionally, sales were dominated by *North America* and *Europe* in 2013. Sales in *North America* contracted by 7.6% (by 4.5% before currency conversion) to € 339.1 million, causing the share in total sales to contract slightly to 39.5% (previous year 42.7%). Sales in *Europe* benefited from a slight improvement in demand, rising by 3.0% to € 447.9 million. Accounting for 52.3% (previous year 50.6%) of total sales, *Europe* is SAF-HOLLAND's **largest market**. *Other countries*, which include the BRIC nations, achieved a 21.5% increase in sales to € 70.0 million, with the share in total sales widening to 8.2% (previous year 6.7%).

With respect to the **customer structure**, the largest customer accounted for around 5.9% of total sales last year (previous year 6.5%), with the top ten customers contributing around 35.6% (previous year 38.3%). However, this dependence must be seen in the light of the scope which the final customer has for selecting the components for a trailer.

The improvement of a total of 60 basis points in the **gross margin** from 2011 to 2013 was due to declining commodity prices (e.g. steel) on the one hand and a shift in sales in favour of the *Aftermarket* segment on the other. The above-average growth in the *Trailer Systems* segment had the opposite effect in the year under review. With its low real net output ratio, the *Trailer Systems* segment generates relatively small gross margins, meaning that the dynamic growth of this segment in 2010 (+87.0%), 2011 (+47.0%) and 2013 (+3.7%) has increasingly diluted gross profit at the group level. By the same token, the disproportionately strong growth in the *Trailer Systems* segment indicates growing market penetration of the group's products, resulting in heightened future demand for spare parts (*Aftermarket* segment). Accordingly, the dilution of the gross margin is the main reason for the strategic corporate decision to substantially step up spare-parts business with its wider margins.

Personnel expenses were reduced substantially in response to the financial crisis via layoffs, reduced working hours and management salary waivers. In the wake of the dynamic economic recovery in the ensuing years, personnel expenses rose again. In 2013, personnel expenses dropped to € 154.3 due to currency effects of € 2.9 million and capitalized development work of € 3.1 million arising from the consolidation of SAP systems. The business-induced increase in **other operating expenses** was disproportionately large compared with sales, causing the corresponding ratio to widen to 8.4%. This is due to increased warranty provisions in 2013 caused by the above-average production output in 2007 and 2008. As the reasons for these warranty claims were eliminated years ago, SAF-HOLLAND expects this source of strain to recede from the 2nd half of 2014 at the latest.

EBIT after analysis-related adjustments rose slightly to € 51.0 million in 2013 despite the increased warranty provisions (approx. € 2.0 million) and negative transaction effects. With adjusted EBIT of € 36.3 million (previous year € 31.8 million), the ***Aftermarket* segment** was the most **important** and **most stable earnings mainstay** in the Group. The adjusted EBIT margin widened to 16.0% (previous year 13.9%). The *Power Vehicle Systems* segment had to fill the gap left by a major contract and make up for negative transaction effects, as a result of which operating earnings dropped to € 12.4 million (previous year € 14.7 million). The adjusted EBIT margin contracted to 8.6% (previous year 9.3%). In the *Trailer Systems* segment, operating earnings dropped to € 10.6 million (previous year € 11.7 million) particularly as a result of increased warranty provisions and heightened selling and development expenses. The adjusted EBIT margin shrank to 2.2% (previous year 2.5%).

Interest expense on interest-bearing loans and other borrowings was lowered in the previous year due to a reduction in financial liabilities and a contraction in the interest margins. At the same time, the non-recurring effects which had arisen in 2012 in connection with the funding (€ 9.3 million) and settlement of interest-rate hedges (€ 3.0 million) were eliminated. All told, **net finance expense** fell by € 11.6 million to € 17.9 million. Lower restructuring expenses and higher income from compensation claim recoveries and the disposal of assets caused the extraordinary loss to shrink to € 1.6 million (previous year € 4.6 million). Against this backdrop, **earnings before tax** doubled to € 31.4 million.

Earnings potential (%)	**2011**	**2012**	**2013**
EBITDA margin	8.5	8.3	8.0
Total return on capital	9.9	7.3	9.3
ROCE	17.1	17.2	16.9
Cash flow ROI	15.5	15.6	15.0

During the analysed period, the income and profitability ratios remained at a satisfactory level. The increase in the total return on capital to a satisfactory level in 2013 was chiefly due to the improvement in net finance expense. The return on capital employed remained satisfactory during the analysed period.

In the first two months of 2014, consolidated sales increased by € 15.4 million (up 11.2%) over the previous year to € 153.4 million in line with expectations. In this respect, the *Trailer Systems* segment in particular grew, performing better than expected and posting a sizeable increase in sales to € 92.1 million (previous year € 80.2 million). There was an increase in sales in the *Powered Vehicle Systems* (up € 0.2 million to € 24.6 million) and *Aftermarket* (up € 3.1 million to € 36.6 million) segments despite the negative currency effects. Consolidated EBIT rose to € 10.8 million (previous year € 8.9 million) thanks to improved margin quality and more favourable volume effects. The EBIT margin came to 7.1% (previous year 6.5%). With adjusted EBIT of € 6.4 million (previous year € 5.3 million), the *Aftermarket* segment remained the **most important source of earnings**. In addition, the *Trailer Systems* segment made a substantially improved contribution to operating earnings, which rose to € 3.1 million (previous year € 1.3 million). At the same time, the *Power Vehicle Systems* segment sustained a decline to € 1.7 million (previous year € 2.3 million). The adjusted EBIT margin widened to 3.4% (previous year 1.7%) in the *Trailer Systems* segment but narrowed to 6.8% (previous year 9.4%) in the *Power Vehicle Systems* segment.

SAF-HOLLAND S.A.'s earning potential and profitability remained stable in 2013, generally achieving a satisfactory level. The most important underpinnings for this are the growing earnings contributions by the *Aftermarket* segment, which was able to more than make up for the slightly weaker earnings potential in the *Powered Vehicle Systems* and *Trailer Systems* segments.

Capital structure and debt

Contrary to the consolidated financial statements, we have netted deferred income tax assets with deferred income tax liabilities (2011-2013) and deducted net retained profit from equity (2011-2012) for the purposes of our analysis. In addition, we have reduced the value of the intangible assets by 25.0% for reasons of caution and lowered reported equity accordingly (2011-2013).

Structural balance sheet	31.12.2011		31.12.2012		31.12.2013		Change year on year (%)	
	T€	%	T€	%	T€	%	2012	2013
Assets	458,360	100.0	454,709	100.0	458,975	100.0	-0.8	0.9
Non-current assets	249,661	54.5	248,073	54.6	251,705	54.8	-0.6	1.5
of which intangible assets	*139,821*	*30.5*	*139,091*	*30.6*	*138,392*	*30.2*	*-0.5*	*-0.5*
Current assets	208,699	45.5	206,636	45.4	207,270	45.2	-1.0	0.3
of which inventories	*90,400*	*19.7*	*88,163*	*19.4*	*100,223*	*21.8*	*-2.5*	*13.7*
of which trade receivables	*95,352*	*20.8*	*87,319*	*19.2*	*76,088*	*16.6*	*-8.4*	*-12.9*
of which cash and cash equivalents	*15,345*	*3.3*	*18,579*	*4.1*	*23,856*	*5.2*	*21.1*	*28.4*
Equity and liabilities	458,360	100.0	454,709	100.0	458,975	100.0	-0.8	0.9
Equity	128,033	27.9	148,120	32.6	176,056	38.4	15.7	18.9
Non-current liabilities	208,178	45.4	197,965	43.5	166,575	36.3	-4.9	-15.9
Current liabilities	122,149	26.6	108,624	23.9	116,344	25.3	-11.1	7.1
Financial liabilities	*180,907*	*39.5*	*161,407*	*35.5*	*149,305*	*32.5*	*-10.8*	*-7.5*

During the period covered by the analysis, adjusted total assets remained virtually constant, standing at € 459.0 million in 2013. Reported **current assets** were more or less stable. The increase in inventories in 2013 reflected rising market expectations and increased order receipts towards the end of the year. At the same time, trade receivables dropped as a result of increased factoring volumes (€ 18.7 million). There was virtually no change in **non-current assets** during the analysed period. **Intangible assets** are of material importance in this connection, accounting for 30.2% of total assets after the analysis-related adjustment of 25%. The intangible assets chiefly comprise goodwill and customer lists acquired in connection with the “SAF” and “HOLLAND” subgroups in 2006. We assume that this item has a recoverable value after the adjustment made and in the light of the sustained favourable underlying conditions and the medium-term outlook for growth.

Economic capital after analysis-related adjustments widened to € 176.3 million in 2013, chiefly underpinned by the capital market transactions in March 2011 (gross issue proceeds: € 139.4 million) and November 2012 (gross issue proceeds: € 21.6 million) and the net earnings recorded for the year. This resulted in an increase of € 159.4 million in the **share premium** to € 265.8 million. The **equity ratio** after analysis-related adjustments climbed by 580 basis points to 38.4% (previous year 32.6%). At the same time, **financial liabilities** dropped by a total of € 12.1 million. The decline in financial liabilities and retirement benefit provisions was the main reason for the reported drop in non-current liabilities.

In connection with **restructuring of funding** in October 2012, an agreement was reached with the syndicate banks to adjust the existing loan arrangements, resulting in improved terms and more favourable interest margins in the previous year. A key element of these restructuring efforts was the issue of a five-year bond of € 75.0 million (maturing in April 2018). The current loan agreements expire in October 2017 and entail credit facilities totalling € 188.2 million (see section on internal financing potential and financial flexibility). The non-current liabilities also include retirement benefit provisions of € 25.4 million. In this connection, there are off-balance-sheet gaps of € 23.6 million due to interest and yield shortfalls as of 31 December 2013 (previous year € 39.2 million). With respect to current liabilities, trade payables declined by € 8.6 million to € 79.3 million for closing-day reasons.

	31.12.2011	31.12.2012	31.12.2013
Capital structure (%)			
Equity ratio	28.0	32.6	38.4
Debt to equity ratio	56.3	49.1	41.6
Deleveraging potential			
Total liabilities / EBITDA	4.7	4.3	4.1
Net financial liabilities / EBITDA	2.3	2.0	1.8
Interest coverage ratios			
EBIT interest coverage	2.6	3.9	5.3
EBITDA interest coverage	3.7	5.6	7.1

Restructuring of equity and liability as a result of the capital market transactions in 2011 (equity issue) and 2012 (equity and bond issue) in tandem with stable earnings potential resulted in an improvement in the capital structure, which reached a generally good level. Against the backdrop of the improved capital structure and stable earnings potential, deleveraging potential and interest coverage ratios were good and highly satisfactory, respectively.

As of 28 February 2014, SAF-HOLLAND S.A.'s non-adjusted total assets stood at € 573.9 million, equivalent to an increase of € 37.5 million over the annual financial statements for 2013. In particular, there was an increase in trade receivables (up 21.0 million), trade payables (up € 14.5 million) and inventories (up € 11.0 million) due to first-time consolidation effects and the increased volume of business. This resulted in an increase of € 17.5 million in average net working capital. Cash and cash equivalents dropped by € 11.0 million chiefly as a result of acquisition-related purchase price payments (Corpco). Non-adjusted equity came to € 227.5 million, up on the year-end figure of € 222.2 million. Financial liabilities climbed marginally by € 8.0 million to € 157.3 million.

Thanks to the capital market transactions and the net profits achieved, SAF-HOLLAND S.A. exhibits a good capital structure as of the end of the analysed period. Deleveraging potential and interest coverage ratios were generally good or highly satisfactory.

Internal financial potential and financial flexibility

Cash flow (T€)	2011	2012	2013
Cash flow from operating activities	41,098	53,993	53,962
Cash flow from investing activities	-12,109	-21,333	-23,522
Free cash flow (total)	28,989	32,660	30,440
Cash flow from financing activities	-22,344	-29,253	-24,857

Cash flow from operating activities widened in 2012 particularly as a result of reduced net working capital. The stable earnings potential ensured a **stable cash flow from operating activities, which remained at a comfortable level** in 2013. In this connection, net working capital benefited from increased factoring volumes of € 18.7 million (previous year € 7.8 million). This positive effect was tempered by increased income taxes. Cash flow from investing activities climbed due to heightened replacement and extension spending. Last year, the increased capital spending particularly related to spending of € 0.8 million on the integration of local SAP systems as well as closure-related losses of € 0.9 million. Cash flow from financing activities benefited from two equity issues in 2011-2012 of € 143.7 million (2011) and € 21.7 million (2012) as well as the placement of a bond with a value of € 75.0 million (2012). The proceeds from these issues were chiefly used to settle financial liabilities. Non-recurring transaction costs in connection with the funding activities, payments for the settlement of interest-rate hedges and the settlement of financial liabilities together resulted in a net cash outflow from financing activities. In the previous year, the net cash outflow from financing activities had chiefly been driven by a further reduction in financial liabilities and interest payments made.

SAF-HOLLAND S.A. has syndicated loans and facilities of € 188.2 million available to it; of these, a sum of € 67.3 million had been drawn as of 31 December 2013. In this connection, it should be noted that semi-annual repayments of € 3.9 million each are due in March and September. These loan agreements expire on 5 October 2017. As of the end of December, unused facilities of € 120.9 million were available. Including cash and cash equivalents, total liquidity stood at around € 144.8 million as of 31 December 2013. In addition, the company is able to utilise a factoring facility of € 25.0 million, of which a sum of € 18.7 million had been utilized as of 31 December 2013. Given the existing facilities and liquidity, SAF-HOLLAND currently exhibits good financial flexibility.

Last year, SAF-HOLLAND S.A. was able to additionally improve its internal financing potential thanks to stable earnings potential and reduced net working capital. The facilities available to the company and the cash held in addition to the strategic liquidity reserve provide good financial flexibility. In addition, improved terms and conditions have been secured for the medium term following the renewal of the funding agreements with the syndicate banks.

Market conditions

The business performance of **producers and suppliers of components and parts for heavy-duty tractors and (semi) trailers** is highly dependent on the production and call-down volumes of truck and trailer OEMs in the Tier 1 market. Moreover, demand is influenced by the financing possibilities available (leasing) and the individual preferences of the final customers (e.g. fleet managers). The sector is highly cyclical, something which is reflected in volatile call-down quantities. Demand for commercial vehicles is primarily driven by macroeconomic conditions, economic expectations and corresponding changes in global transport volumes. The market is characterised by oligopolistic structures. A small number of specialists offer a small number of OEMs individualised components, modules and systems tailored to meet their customers' requirements. In this connection, high-quality, product-specific tools are used, with components suppliers developing new processes for a given product in some cases. The distribution of market share is very largely stable particularly in Western Europe and the United States as the business relations between OEMs and components suppliers generally continue throughout the entire life cycle (up to 15 years) of a vehicle generation. To date, the commercial vehicle markets in the emerging markets (e.g. China and India) have been largely dominated by local companies and brands due partly to high import duties and product ranges which are more specifically tailored to the requirements of the individual market. Regional potential in the after-sales market chiefly arises from the age structure of the commercial vehicle fleets and the corresponding demand for replacement parts and spares.

Following the recession in 2009, the market was driven by the effects of unleashed pent-up demand in 2010 and partially also 2011. In 2012, a downswing in Europe and South America as well as slower growth in China triggered a global 6.7% drop in production output in the commercial vehicle industry. Brazil experienced an unexpectedly sharp 40.5% drop in commercial vehicle production (GTAI 2012, OICA 2013) due to a macroeconomic slowdown as well as the pull-forward effects which had arisen in 2011 ahead of the introduction of more stringent emission standards in 2012. Global sales of commercial vehicles rose by 5.3% in the first half of 2013 (compared with the first half of 2012). At the same time, sales volumes contracted by 7.1% in Europe and by 10.2% in Germany as a result of reduced transport volumes. Spurred by the pull-forward effects ahead of the Euro 6 emission rules taking effect as of 1 January 2014, truck sales were substantially stronger in the second half of the year. As a result, the overall EU market for commercial vehicles climbed by a total of 8.3% (Germany 0.2%). On the other hand, trailer business contracted by a slight 0.6% in 2013 particularly as a result of short-term budget reallocations in favour of tractors in connection with the aforementioned pull-forward effects.

Production of middle/heavy commercial vehicles (in thousands of units)*	**2011**	**2012**	**2013**	**2014e**	**2015e**	**2016e**	**CAGR (%) 2011-2013**	**CAGR (%) 2014-2016**
Europe	649	619	575	632	707	725	-5.9	8.1
North America	451	496	477	537	592	575	3.1	6.6
South America	284	197	265	283	292	293	1.9	3.4
Asia	2,142	1,977	2,071	2,106	2,266	2,348	-1.5	4.3
Rest of the world	3	3	3	3	4	4	0.0	11.1
Total	**3,529**	**3,293**	**3,391**	**3,561**	**3,861**	**3,945**	**-1.9**	**5.2**
Trailer production (core SAF markets) (in thousands of units)								**CAGR (%) 2014-2016**
United States**	N/A	232	234	240	230	215		-5.3
Europe***	N/A	244	248	280	284	306		4.6
Total	**N/A**	**476**	**482**	**520**	**514**	**521**		**-0.7**

Sources: *IHS Automotive Global Production Summary (01/2014), own calculations / ** FTR Associates (03/2014)/*** CLEAR Int. (06/2013)

We expect production figures to rise in all regions in the **short to medium term**. The highest growth rates are forecast for Brazil due to government subsidies as well as heavy infrastructure spending in connection with the 2014 Football World Cup and the Olympic Games in 2016 among other things. In the medium term, we also expect to see a recovery and rising transport volumes in the Eurozone. Given the age structure and rising average age of the European commercial vehicle fleet, we see heightened sales potential as a result of modernisation and replacement spending in the medium term. Previously, Russia in particular had been seen as a future growth market for German OEMs as the market share of heavy commercial vehicles is forecast to widen to around 80% by 2020 (2010: 30.0%) on the basis of a market volume of 120,000 new registrations in 2013 (heavy-duty trucks) in the middle to high price segment. However, given the sustained border conflicts with Ukraine and the possible impact of economic sanctions, we now see heightened risks for the continuation of the market transformation process.

We assume that sales of tractors and trailers in the mid to high price segment in the emerging markets and Eastern Europe will continue to rise in the medium to long term particularly as a result of an improved infrastructure and changing customer preferences. In our view, German OEMs will enlarge their foreign production capacities as part of their localisation strategies in order to benefit more fully from the aforementioned opportunities for growth. Generally speaking, we assume that growth in the individual segments and markets will be exposed to pronounced macroeconomic volatility. Looking ahead, the components industry continues to face the challenge of responding flexibly and swiftly to fluctuations in sales.

In our view, the steady rise in road haulage volumes will also force the commercial vehicle industry to take steps to reduce CO_2 emissions in the future. Accordingly, we assume that statutory restrictions will become gradually more stringent in the key markets in the medium to long term in the interests of reduced strain on the environment. Depending on the nature of the rules, the significance of integrated vehicle concepts could rise, something which would have a corresponding impact on the business models of tractor and trailer OEMs and/or prompt them to see strategic partnerships and joint ventures to a greater extent. Given the fragmented market structure, however, we think that, as in the past, further technical developments will tend to take the form of small evolutionary steps in the medium to long term. In particular, we see medium to long-term potential in the greater use of telematics applications (“green telematics”) in heavy-duty trucks to optimise response and fuel consumption. Potential for reducing fuel consumption and for implementing technical modifications can be derived from an analysis of automatic vehicle reports on driving, braking and consumption trends. This would, for example, also permit greater utilisation of tractors and trailers, which would in turn result in more frequent replacements of parts which are subject to wear and tear, thus generating additional impetus for the aftermarket. We see further trends in the form of weight reduction (materials, design), reduced maintenance requirements, robust handling, modular structures (e.g. axles and braking systems), standardisation (e.g. wheel connections), and heightened road safety. Moreover, suppliers of high-quality components and systems have an opportunity of developing product characteristics giving them a competitive edge due, among other things, to the growing structural complexity of the products and rising demands of just-in-time delivery and quality. In our view, components suppliers in the commercial vehicle industry with global production networks and a bespoke product range enjoy a competitive edge.

Risks particularly arise from a possible economic slowdown, particularly in Europe. There are also currency-translation and sourcing risks. The main materials used, namely steel and aluminium, are also subject to cyclical price fluctuation. Moreover, shortfalls may occur with deliveries of special steels in the event of higher demand due to the dependence on specialist suppliers. We assume that closer partnerships among OEMs and modularisation will heighten price and competitive pressure on components suppliers.

We consider the medium to long-term outlook for growth in the commercial vehicle and trailer industry to be favourable due to the steady global rise in freight volumes. In our view, growth in the individual segments and markets will not be continuous but will be exposed to pronounced macroeconomic volatility. We see risks in a possible economic slowdown, increasingly intense competition and volatile exchange rates and commodity prices.

Strategy and planning

Strategic orientation

Business segment	Markets/customers
Trailer Systems ▪ Development of new axle and suspension systems ▪ Greater differentiation via innovative new materials, electronics and niche products ***Powered Vehicle Systems*** ▪ Development of new axle and suspension systems ▪ Increased share of market for trailer couplings ***Aftermarket*** ▪ Additions to distribution and service network and expansion of spare parts business ▪ Enlargement of range of spare parts through the introduction of secondary brands ("Sauer Quality Parts")	▪ Reinforcement and expansion of market share in core markets in Europe and North America ▪ Expansion of market position in the emerging markets
Organisation	**Financials**
▪ Cost-cutting and productivity enhancements ▪ Ongoing optimisation of the sourcing processes ▪ Ongoing optimisation of the production and logistics processes ▪ Examination of acquisition candidates	▪ Increase in sales of an annual average 8.6% from 2013 to 2016 to € 1,098 million. ▪ Improvement in EBIT margin ▪ Increase in equity ratio and reduction in financial liabilities and interest expense

SAF-HOLLAND is positioning itself as a leading supplier of high-quality system solutions and components for the commercial vehicle industry. With this strategic alignment, it is seeking technology and quality leadership in its core European and North American markets. In particular, it wants to hold and broaden its leading market position as a provider of high-quality products and services in the ***Trailer Systems***, ***Powered Vehicle Systems*** and ***Aftermarket*** segments. For this purpose, SAF-HOLLAND coordinates a global network of subsidiaries and alliance partners to address the strategically important spare-parts and service business on a comprehensive basis and to expand it selectively. In addition, it is seeking to build up a leading market position in new product segments, particularly those which offer synergistic effects within the range as a whole or make use of opportunities arising from market consolidation or heightened regulatory requirements.

SAF-HOLLAND S.A.'s core skills in the ***Trailer Systems* segment** include the development of axle and suspension systems as well as welding, painting and assembling. The modular structure of the axle and suspension systems allows the company to flexibly address different customer requirements and to offer special products for niche markets. Given the already very large share of the European market for axle and suspension systems which it holds (2013: 36-40%), SAF-HOLLAND plans to particularly make use of the opportunities for growth in **North America** and the emerging markets, in which it currently holds only a small share of the market and has only limited production capacities. The company's share of the US market is to be substantially widened to 30.0% in the medium term (2013: approx. 22.0%) through the establishment of its own axle production activities and the utilisation of experience gained in Europe with the integration of axle production with disk brake technology (technology transfer). In this connection, SAF-HOLLAND particularly wants to benefit from a structural change in the US trailer market, which will be triggered by the more stringent requirements with respect to braking performance as of 2013. This rule stipulates a roughly 30.0% cut in the maximum braking distance. This requirement will spur demand for disk brakes as these offer superior braking performance and generate less heat compared with drum brakes. On the other hand, additional demand for both braking systems (drum and disk brakes) is expected as the more stringent rules are likely to result in shorter maintenance intervals. Against this background, SAF-HOLLAND has already widened its North American production capacity from 40,000 to 80,000 axles a year. SAF-HOLLAND is well positioned to benefit from the expected structural change in North America thanks to European skills in disk brake technology and the sustained extensions to production capacity.

In addition to structural growth opportunities in North America, the *Trailer Systems* segment is to expand in **Europe** chiefly for **market-related reasons**. This assumption is being confirmed by commercial vehicle OEMs' current order intake figures. As of 2015, additional **impetus for growth** will be generated through the development of a new central axle and suspension system in Europe (to be unveiled at IAA 2014). Alongside other measures, the planned market launch of this system aims to boost the low earnings potential (EBIT) in the *Trailer Systems* segment by around € 30.0 million by 2016. The planned cost cuts are to be primarily achieved by consolidating facilities in Germany and North America and by increasing efficiency in the production process, e.g. in the ball bearing system segment. In response to the heavy pressure on prices and costs being imposed by OEMs, SAF-HOLLAND wants to continuously review its production skills and internal sourcing levels and keep quality costs and productivity at a competitive level. To this end, substantial improvements are being planned for the internal production process and are to be implemented as part of the plant consolidation activities scheduled for 2014 and 2015. By outsourcing logistics processes, the company plans to reduce product turnaround times and adopt a 3-shift system. This will help to improve production capacity and flexibility so that fluctuation in demand can be addressed more effectively in the future.

Future developments in the *Trailer Systems* segment in the core European and North American markets will continue to focus on weight reduction, heightened modularisation and the growing integration of electrical and electronic components. In addition, local development and production capacities are to be expanded, special products for niche commercial vehicle markets developed and strategic partnerships forged with international trailer OEMs.

In the ***Powered Vehicle Systems*** **segment**, SAF-HOLLAND S.A.'s core skills are defined as entailing trailer coupling and suspension systems as well as welding, painting and assembling. The market for suspension systems for tractors is dominated mainly by the large component suppliers and OEMs. SAF-HOLLAND should be able to generate additional growth impetus in the Northern American market particularly with the launch of a newly developed suspension system. The company holds a large share of the North American market for trailer coupling systems (approx. 51.0%) as this is the former HOLLAND's domestic market. Further potential for growth in this segment is to be tapped by boosting selling activities targeted at fleet customers and OEMs together with a selective broadening of business activities. The *Powered Vehicle Systems* segment is to be reinforced through the **acquisition and consolidation** of Corpco, a Chinese producer of air suspension systems for buses.

SAF-HOLLAND S.A.'s ***Aftermarket*** segment boasts the world's largest service network, thus ensuring a high degree of customer proximity as a core skill. With the large network of fleet operators, garages and spare parts dealers, SAF-HOLLAND is able to arrange repairs for its customers at short notice and deliver the necessary spare parts. It has more than 9,000 service partners around the world, which gives it a lead over its competitors. With the steadily growing market penetration of SAF-HOLLAND products, demand for spare parts is expected to widen in the future. At the same time, the service network is to be extended in all key regions, resulting in a positive effect for the network. The successful start-up of a new spare parts distribution centre for the South American market marks a recent step in the implementation of this expansion strategy. This year, at least one further distribution centre is to be established for the Asian market. In addition, SAF-HOLLAND will have direct access to 100 service stations in China through the **acquisition of Corpco**. As well as this, the regional marketing activities are to be boosted and the range of training and skills development offerings broadened. The **range of spare parts** is to be enlarged with the introduction of "A2" secondary brands ("Sauer Quality Parts"). These parts will be particularly targeted at markets with a high proportion of tractors and trailers of an advanced age. In this way, SAF-HOLLAND wants to offer its customers spare parts which are more appropriate for the life cycle of the products. Secondary-market products are covered by the statutory guarantee rather than the substantially longer six-year guarantee offered on the company's premium products. With this secondary-brand strategy, SAF-HOLLAND is particularly seeking to address the markets of the Middle East to benefit from the later life cycle phase of the products in use there and to avert potential substitution risks. We consider the expansion of the relatively **stable Aftermarket business with its wide margins** to constitute an important step towards boosting earnings potential and reducing exposure to the cyclical Tier 1 market.

In addition to widening its share in the core markets of Europe and North America, SAF-HOLLAND also wants to strengthen its position in the emerging markets. This year, its presence in **China** is to be stepped up, particularly through the acquisition of Corpco. The product range acquired is to be improved and selectively marketed in other BRIC nations as well. To this end, it wants to revise its original plans of tailoring its range more closely to the less stringent quality and safety requirements of these markets. Accordingly, SAF-HOLLAND plans to increasingly offer higher-quality products in selected market segments in the BRIC nations and thus leverage its core skills. In this connection, for example, a suspension system designed for the US market is to be marketed in China. Given the intense competition and lower quality requirements in the emerging markets, we see heightened risks for these expansion plans.

In our view, SAF-HOLLAND S.A. has a systematic strategy differentiated by product segment and region which takes due account of the opportunities and risks arising in the market environment, its own market position and the available resources and skills. The risks to SAF-HOLLAND's business performance comprise the aforementioned market uncertainty as well as mounting competitive pressure, possible quality problems leading to impaired customer confidence and product liability and development risks.

Execution of the rating

The rating request was submitted by SAF-HOLLAND S.A. (client) on 5 May 2014. The company was visited on 20 March 2014. This rating report was presented to the client on 8 April 2014, meaning that the rating process has now been concluded. The notation proposal and the report on which it was based were reviewed by the Rating Committee on 8 April 2014 and approved in their current form. If this rating is not made public, the rating refers to this date. If the rating assessment is published on the rating agency's website (www.eulerhermes-rating.com), it will be followed by a subsequent one-year monitoring process. During this period, the company and the environment in which it operates remain under observation. The rated company is subject to unrestricted disclosure obligations during this period. Any change in the rating agency's assessment will result in a change in the published rating, meaning that the rating as shown on the internet represents the current rating assessment at all times. Continued publication after the expiry of the monitoring period is contingent upon a follow-up rating being conducted.

The client is solely and exclusively liable for any errors or omissions in the documents and information supplied openly and willingly in response to our requests for information. The client has reviewed the rating report and confirms that all of the information which it contains is correct and complete in all significant respects, that no major aspects have been concealed and that any forward-looking statements which it may include are based on plausible, verifiable and current data and have been prepared by the client with the diligence of a prudent businessman. However, the client cannot be held liable if actual results differ from the forward-looking statements, in particular the projections, presented in this document. Changes in the economic environment and unforeseen events may impair the validity of the forward-looking statements and projections.

The rating report may not be construed as constituting a recommendation to participate in certain facilities. All recipients of the information should conduct their own independent analyses, credit assessments and other reviews and evaluations which are customary and necessary to reach a final decision about the participation in certain facilities. It should be noted that the summaries of contracts, legislation and other documents included in the report are no replacement for examination of the corresponding full texts. As of the date on which this information is published, it is not possible to guarantee that the information has not changed since being collected and that all information provided is still valid. The client is under no obligation to update the information.

The publication of this rating report may be prohibited by law in certain jurisdictions. The client therefore requests that any persons who gain possession of this information enquire about and comply with any such restrictions. The client does not assume any liability of any kind towards anyone with respect to the dissemination of this rating report in any jurisdiction whatsoever.

The client's management has submitted to Euler Hermes Rating GmbH a written letter of representation.

We have prepared this report to the best of our abilities and knowledge.

Euler Hermes Rating GmbH

Hamburg, 8 April 2014

Analysts

Torsten Schellscheidt, Senior Analyst and Project Manager
Jörg Walbaum, Senior Analyst

Rating Committee

Gundel Bergknecht, senior analyst
Holger Ludewig, senior analyst

Principal sources of information

- Consolidated financial statements for 2011, 2012, 2013
- Extracts from internal reports
  (e.g. business performance in 2013, analysis of bank liabilities etc.)
- Market analyses
- Strategy paper and corporate planning
- Documents on corporate structure
- Conversations with management

Rating method

Issuer rating, company rating manual of Euler Hermes Rating GmbH, March 2012 version

Appendix 1: Rating notations

category	explanation
AAA	AAA rated companies demonstrate an excellent credit quality. Such companies are characterized by an extremely positive future outlook and are viewed as being “first class” business partners. Although the various security elements can certainly change, such changes – to the extent this can be assessed - are highly unlikely to adversely affect the fundamentally strong position of such companies.
AA	AA rated companies demonstrate very high quality with respect to future security. Along with the AAA rated companies, this group forms the socalled “quality class.” Security margins may, however, be comparatively thinner, the solidity of the security elements may fluctuate more or individual assessment components may indicate a greater long-term risk than is the case for AAA rated companies.
A	A rated companies demonstrate high quality with respect to future security. They show many favourable features which secure their future. Nevertheless, there may be isolated factors which reveal a slightly in-creased susceptibility to the worsening of circum-stances and general economic conditions in the future.
BBB	BBB rated companies demonstrate reasonable quality with respect to future security. Compared to A rated companies, however, it is more likely that worsening of general economic conditions could weaken the capability of fulfilling financial obligations.
BB	BB rated companies still have structures adequate to secure their future. Yet they are subject to greater insecurities. Negative business developments or changes in the general financial and economic conditions can make it impossible for them to fulfil their financial obligations in a suitable manner.
B	B rated companies lack the usual structures to secure their future. Negative business developments or changes in the general financial and economic conditions will most likely make it impossible for them to fulfil their financial obligations in a suitable manner.
CCC	CCC rated companies have structures which greatly endanger the security of their future. Capital service is in jeopardy. Such a company is dependent on a favourable development of general economic conditions if it is to be able to meet its financial obligations in the long term.
CC	Companies receiving a CC rating have very little security for their future. Capital service is in great jeopardy.
C	C rated companies have the least future security of all. The basic conditions enabling such debtors to fulfil their financial obligations are extremely poor. Default is imminent.
D	Companies with a D rating are already in default of payment or have filed for bankruptcy. The D rating is irrelevant for the future; it documents solely the bankruptcy of the company.
SD	If an issuer defaults with respect to a certain financial liability or class of liabilities but is still able to honour its payment obligations under other financial liabilities or classes of liabilities within the requisite period, it is assigned SD (selective default) status.
NR	A debtor or an issuer not rated by Euler Hermes Rating is classified as NR (Not Rated).
PLUS (+) MINUS (-)	Rating notations from AA to CCC may be complemented by a PLUS (+) or MINUS (-) if required, in order to show their relative position within the respective rating category.