S&P Global
Ratings

Research

Scania AB (publ.)

Primary Credit Analyst:
Per Karlsson, Stockholm (46) 8-440-5927; per.karlsson@spglobal.com

Secondary Contact:
Alex P Herbert, London (44) 20-7176-3616; alex.herbert@spglobal.com

Table Of Contents

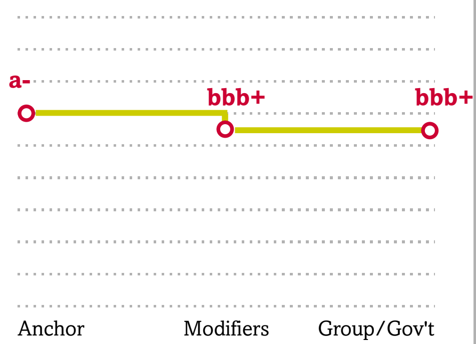
Scania AB (publ.)

Business Risk: SATISFACTORY

Vulnerable — Excellent

Financial Risk: MINIMAL

Highly leveraged — Minimal



CORPORATE CREDIT RATING
BBB+/Negative/A-2

Nordic Regional Scale	South Africa National Scale
--/--/K-1	**zaAAA/--/zaA-1**

Rationale

Business Risk: Satisfactory	Financial Risk: Minimal
• Leading positions in Europe and South America as a manufacturer of heavy trucks and buses. • An up-to-date product range and the highest degree of component commonality in the global truck industry. • Likelihood of high profitability ratios over the economic cycle. • Operations in industries characterized by high volatility and capital intensity.	• A conservative financial policy and robust credit metrics. • Strong liquidity and the ability to generate solid free cash flow. • Our expectation of continued strong credit ratios, with funds from operations (FFO) to debt above 100% in 2016 and 2017.

Outlook: Negative

The negative outlook on Swedish commercial vehicle manufacturer Scania AB (publ.) reflects that on the parent company, German automaker Volkswagen AG (VW). If we downgrade VW, we would downgrade Scania, since we cap our rating on Scania at the level of the rating on VW.

Downside scenario

Downside rating potential is predominantly tied to the rating on VW. However, we could also lower the rating on Scania if, in our view, Scania's stand-alone credit profile (SACP) deteriorated below VW's SACP. This would most likely result from Scania making further dividend distributions to VW without offsetting measures.

Upside scenario

If we revise our outlook on VW to stable, we would take the same action on Scania.

Our Base-Case Scenario

Assumptions

- Global GDP of 3% in 2016 and 4% in 2017, including about 2% per year in Western Europe and 0.9% in South America.
- Mid-single-digit percentage increases in revenues in 2016 and 2017, reflecting higher volumes. This predominantly reflects our expectations of continued strong demand for trucks in Europe, partly offset by continued weak market conditions in South America. We believe that the need to replace vehicles is driving demand in Europe, rather than the economic situation, which continues to be weak.
- Retention of a market share of around 17% in Europe.
- Capex of Swedish krona (SEK) 6 billion-SEK7 billion (excluding the customer finance operations) in 2016.
- An annual dividend of 50% of net income, in accordance with Scania's financial policy. Scania made a significant dividend payout to VW in financial 2015. We assume that the dividend will come from the industrial unit, although that may not be the case.
- No material acquisitions.
- No material disposals.

Key Metrics

	2015	2016E	2017E
Operating margin (%)	7.6	8.0-8.6	8.0-8.6
FFO to debt (%)	263	Above 100	Above 100
Debt to EBITDA (x)	0.1	Below 0.5	Below 0.5

*S&P Global Ratings-adjusted. A--Actual. E--Estimated.

Company Description

Scania, based in Södertälje, Sweden, is one of the world's leading heavy-truck and bus manufacturers. Although Scania's divisions encompass buses, the truck operations dominate the business. Scania is fully controlled by VW.

Business Risk: Satisfactory

Our assessment of Scania's business risk is supported by the company's leading positions in Europe and Latin America as a manufacturer of heavy trucks and buses. Scania ranks as one of the largest heavy-truck producers globally, behind Daimler AG and AB Volvo. It has a market-leading position in South America, notably in Brazil, although demand there has weakened considerably during 2016, and for the first half-year, order bookings were down by 32%.

A key operational strength is Scania's advanced modular production system in the truck industry, which means that the company uses the lowest number of individual parts for different vehicle specifications. This allows Scania to tailor vehicles to individual customers' needs, but still benefit from economies of scale.

That said, Scania lacks product diversity compared to its competitors such as Volvo and Daimler. Relatively high fixed costs, increasing development costs, and declining volumes in non-European markets have weakened Scania's profitability metrics and undermined its operating efficiency.

For the full-year 2015, Scania's operating margin stood at 7.6%, but we expect an improvement of around 50-100 basis points from 2017. In recent quarters, revenue from services has increased--by 3% in the first half of 2016, constituting about 20% of total revenue. We believe this should be generally positive for earnings stability.

We expect operating margins of no lower than 4%-5% at the bottom of the cycle, reflecting Scania's focus on the owner-operator market, where there is less need for discounting, and efficiency resulting from the modular production system.

Our Base-Case Operating Scenario

- A continuation of mixed industry conditions in 2016 and 2017, driven by weak market conditions in Latin America, but offset by a healthy truck market in Europe.
- High volumes in 2016, reflecting the order book of close to 20,000 trucks. We understand that production is close to full capacity in Europe.
- Operating margins in 2016 and 2017 of about 7.5%-8.5%, adjusting for a SEK3.8 million provision in the second quarter of 2016 related to the European Commission's competition investigation.
- Low- to mid-single-digit percentage growth in truck deliveries to 72,000-77,000 trucks and components in 2016, improving moderately thereafter.
- Adjusted consolidated capex of SEK6 billion-SEK7 billion for 2016 and 2017, excluding the customer finance operations.

Peer comparison

Table 1

Scania AB (publ.) Peer Comparison

	Scania AB (publ.)	AB Volvo	PACCAR Inc.	Daimler AG	Navistar International Corp.
(Mil. $)	--Average of past three fiscal years--				
Revenues	12,177.3	37,180.3	17,228.2	140,716.9	10,421.7
EBITDA	1,209.3	2,972.1	2,086.4	15,366.6	388.3
Funds from operations (FFO)	920.4	2,227.1	1,283.9	13,055.4	(35.1)
Net income from continuing operations	845.5	870.7	1,378.0	9,001.5	(555.3)
Cash flow from operations	1,212.9	1,941.0	2,351.1	11,974.1	43.6
Capital expenditures	742.0	1,102.6	361.3	6,570.9	247.0
Free operating cash flow	471.0	838.4	1,989.8	5,403.2	(203.4)
Discretionary cash flow	273.7	14.5	1,460.6	2,117.7	(203.4)
Cash and short-term investments	1,460.0	3,926.6	3,163.9	20,726.6	1,252.7
Debt	108.8	4,770.2	0.0	699.1	6,252.2
Equity	4,344.0	10,087.2	4,622.2	48,097.2	(5,142)
Adjusted ratios					
EBITDA margin (%)	9.8	8.0	12.1	11.0	3.7
Return on capital (%)	22.3	10.8	40.1	24.8	4.6
EBITDA interest coverage (x)	22.4	7.0	13.6	17.5	1.1
FFO cash interest coverage (x)	14.5	9.7	11.1	30.3	1.3
Debt/EBITDA (x)	0.1	1.6	0.0	0.0	16.1
FFO/debt (%)	747.3	48.7	N.M.	1,897.3	(0.6)
Cash flow from operations/debt (%)	1,012.4	42.6	N.M.	1,732.9	0.7
Free operating cash flow/debt (%)	392.7	19.4	N.M.	789.7	(3.3)
Discretionary cash flow/debt (%)	252.7	1.8	N.M.	315.7	(3.3)

N.M.--Not meaningful.

Financial Risk: Minimal

Our assessment of Scania's financial risk takes into account the company's robust credit ratios and strong liquidity. Furthermore, Scania has a strong ability to generate positive free operating cash flow (FOCF) through the cycle. Cash flows have been steady for a number of years, with positive FOCF generation through the cycle.

We expect Scania's credit ratios to remain robust over the next few years, and expect only limited debt built-up. This follows relatively limited capex expectations, although the company will incur the cost of the continued development of various parts. Scania has already borne the cost of a new truck that it launched in August 2016. In 2016 and 2017, we expect annual capex of SEK6 billion-SEK7 billion in our base case. We therefore expect credit ratios such as FFO to debt and debt to EBITDA to remain strong on a stand-alone basis.

We view Scania's declaration of a SEK9.6 billion dividend paid to VW in arrears late in 2015 as fairly aggressive. It highlights to us the risk that VW will continue to affect Scania's financial risk profile. At this stage, we expect that

Scania will pay 50% of its net income as a dividend to VW in line with its stated policy.

We exclude the reported gross debt of the financial services division from reported group debt in order to calculate our adjusted debt figures for Scania. On this basis, S&P Global Ratings-adjusted debt was SEK5.1 billion as at June 30, 2016. The main analytical adjustments to total reported gross debt of SEK56.9 billion are to deduct SEK56.5 billion of financial services debt and SEK6.5 billion of surplus cash. We add SEK5.9 billion for pensions and SEK1.5 billion for operating leases to arrive to the adjusted debt number.

To finance its captive assets, Scania has incurred significant debt obligations. These stood at SEK56.5 billion on June 30, 2016. Leverage in the captive finance operations (that is, reported debt to equity) is around 8x, and we expect it to remain well below 12x. We expect finance receivables in the captive finance division to continue to broadly match assets. On June 30, 2016, the group had captive finance receivables and operating lease assets of about SEK47.5 billion. We regard the asset quality of the receivables (which are primarily vehicle-financing term loans) to be excellent, based on annual net losses of less than 1% in recent years.

We continue to consider Scania as a highly strategic entity within the VW group, reflecting Scania's virtually integral status to the group's current identity and future strategy. Our long-term credit rating on highly strategic subsidiaries cannot be higher than the group credit profile (GCP). As such, our ratings on Scania are capped by our assessment of VW's GCP at 'bbb+'.

Financial summary

Table 2

Scania AB (publ.) Financial Summary					
	--Fiscal year ended Dec. 31--				
(Mil. SEK)	**2015**	**2014**	**2013**	**2012**	**2011**
Revenues	94,897.0	92,051.0	86,847.0	79,603.0	87,686.0
EBITDA	7,976.0	8,687.5	10,039.5	9,852.5	14,459.5
Funds from operations (FFO)	5,826.6	6,693.0	7,759.3	9,735.8	13,197.2
Net income from continuing operations	6,764.0	6,019.0	6,201.0	6,646.0	9,422.0
Cash flow from operations	10,389.8	9,312.2	7,771.6	6,871.7	10,502.8
Capital expenditures	6,698.0	5,144.0	4,975.0	4,328.0	3,921.0
Free operating cash flow	3,691.8	4,168.2	2,796.6	2,543.7	6,581.8
Discretionary cash flow	3,691.8	4,168.2	(1,003.4)	(1,456.3)	2,581.8
Cash and short-term investments	12,508.0	10,966.0	9,609.0	12,047.0	11,796.0
Debt	2,211.1	502.6	0.0	996.2	0.0
Equity	32,176.0	33,002.4	32,121.8	28,607.9	29,249.6
Adjusted ratios					
EBITDA margin (%)	8.4	9.4	11.6	12.4	16.5
Return on capital (%)	21.8	21.3	23.8	25.1	42.7
EBITDA interest coverage (x)	23.1	19.1	25.4	(6.9)	(11.2)
FFO cash interest coverage (x)	14.3	11.7	18.6	37.9	43.1
Debt/EBITDA (x)	0.3	0.1	0.0	0.1	0.0
FFO/debt (%)	263.5	1,331.8	N.M.	977.3	N.M.
Cash flow from operations/debt (%)	469.9	1,853.0	N.M.	689.8	N.M.

Table 2

Scania AB (publ.) Financial Summary (cont.)					
	--Fiscal year ended Dec. 31--				
(Mil. SEK)	**2015**	**2014**	**2013**	**2012**	**2011**
Free operating cash flow/debt (%)	167.0	829.4	N.M.	255.3	N.M.
Discretionary cash flow/debt (%)	167.0	829.4	N.M.	(146.2)	N.M.

N.M.--Not meaningful.

Liquidity: Strong

We assess Scania's liquidity as strong, based on our projection that the company's ratio of potential sources of liquidity to uses will exceed 1.5x in 2016 and 2017. In our view, management has a proactive approach to financing, and we believe that liquidity would remain sufficient to cover uses even if EBITDA fell by 30%. Other supportive factors include Scania's solid relationships with its banks, and its likely ability to absorb high-impact, low-probability events without refinancing.

Principal Liquidity Sources

- Cash and liquid assets of SEK7.8 billion as at June 30, 2016.
- About SEK29 billion in undrawn fully committed credit facilities, with maturities beyond 2017.
- Our expectation of FFO of more than SEK12 billion annually in 2016 and 2017.

Principal Liquidity Uses

- Near-term liquidity uses total SEK30.8 billion and include debt maturing in the next 12 months.
- Most of these outgoings are tied to the company's financial services operations. Because we expect these outflows to be well matched by inflows from the financial services operations, we remove them from our calculations. This could change, however, if for any reason a material mismatch in duration were to occur.
- Working capital of SEK1.2 billion
- Annual capex of SEK6 billion-SEK7 billion.
- Annual dividends of about 50% of net income.

Reconciliation

Table 3

Reconciliation Of Scania AB (publ.) Reported Amounts With S&P Global Ratings' Adjusted Amounts									
	--Fiscal year ended Dec. 31, 2015--								
Scania AB (publ.) reported amounts									
(Mil. SEK)	**Debt**	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Capital expenditures**
Reported	54,942.0	37,790.0	100,414.0	12,902.0	9,641.0	(20.0)	12,902.0	13,094.0	40,719.0

Table 3

Reconciliation Of Scania AB (publ.) Reported Amounts With S&P Global Ratings' Adjusted Amounts (cont.)

S&P Global Ratings' adjustments									
Interest expense (reported)	--	--	--	--	--	--	20.0	--	--
Interest income (reported)	--	--	--	--	--	--	359.0	--	--
Current tax expense (reported)	--	--	--	--	--	--	(2,461.0)	--	--
Operating leases	1,547.1	--	--	569.0	108.6	108.6	460.4	460.4	--
Postretirement benefit obligations/deferred compensation	5,928.0	--	--	(3.0)	(3.0)	256.0	(190.6)	(242.6)	--
Surplus cash	(9,381.0)	--	--	--	--	--	--	--	--
Capitalized development costs	--	--	--	(1,863.0)	(1,470.0)	--	(1,863.0)	(1,863.0)	(1,863.0)
Dividends received from equity investments	--	--	--	79.0	--	--	79.0	--	--
Captive finance operations	(50,825.0)	(5,661.0)	(5,517.0)	(3,662.0)	(1,040.0)	--	(3,433.2)	(1,059.0)	(32,158.0)
Non-operating income (expense)	--	--	--	--	359.0	--	--	--	--
Non-controlling interest/minority interest	--	47.0	--	--	--	--	--	--	--
EBITDA--income (expense) of unconsolidated companies	--	--	--	(46.0)	(46.0)	--	(46.0)	--	--
EBIT--income (expense) of unconsolidated companies	--	--	--	--	46.0	--	--	--	--
Total adjustments	(52,730.9)	(5,614.0)	(5,517.0)	(4,926.0)	(2,045.4)	364.6	(7,075.4)	(2,704.2)	(34,021.0)
S&P Global Ratings' adjusted amounts									
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditures**
Adjusted	2,211.1	32,176.0	94,897.0	7,976.0	7,595.6	344.6	5,826.6	10,389.8	6,698.0

Ratings Score Snapshot

Corporate Credit Rating

BBB+/Negative/A-2

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Moderately high

- **Competitive position:** Strong

Financial risk: Minimal

- **Cash flow/Leverage:** Minimal

Anchor: a-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Negative (-1 notch)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb+

- **Group credit profile:** bbb+
- **Entity status within group:** Highly strategic

Related Criteria And Research

Related Criteria

- The Impact of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Volkswagen AG, Sept. 29, 2016

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	**a/a-**	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of October 28, 2016)

Scania AB (publ.)		
Corporate Credit Rating		BBB+/Negative/A-2
Nordic Regional Scale		--/--/K-1
South Africa National Scale		zaAAA/--/zaA-1
Corporate Credit Ratings History		
02-Dec-2015		BBB+/Negative/A-2
25-Sep-2015		A-/Watch Neg/A-2
22-Sep-2014		A-/Stable/A-2
10-Sep-2012		A-/Positive/A-2
02-Dec-2015	*Nordic Regional Scale*	--/--/K-1
13-Oct-2015		--/Watch Neg/K-1
06-Dec-2012		--/--/K-1
06-Oct-2014	*South Africa National Scale*	zaAAA/--/zaA-1
31-Aug-2009		zaAA+/--/zaA-1
23-Jul-2009		zaAA+/Watch Neg/zaA-1
Related Entities		
Banco Volkswagen S.A.		
Issuer Credit Rating		
Brazil National Scale		brAA-/Negative/--
LeasePlan Corporation N.V.		
Issuer Credit Rating		BBB-/Stable/A-3
Senior Unsecured		A-3
Senior Unsecured		BBB-
Volkswagen AG		
Issuer Credit Rating		BBB+/Negative/A-2
Volkswagen Bank GmbH		
Issuer Credit Rating		A-/Negative/A-2
Commercial Paper		
Local Currency		A-2
Senior Unsecured		A-
Volkswagen Financial Services AG		
Issuer Credit Rating		BBB+/Negative/A-2

Ratings Detail (As Of October 28, 2016) (cont.)	
Senior Unsecured	BBB+
Volkswagen Finans Sverige AB	
Issuer Credit Rating	
Nordic Regional Scale	--/--/K-1
Volkswagen Group Services S.A.	
Issuer Credit Rating	BBB+/Negative/A-2
Commercial Paper	
Local Currency	A-2
Volkswagen Insurance Co. Ltd.	
Financial Strength Rating	
Local Currency	BBB+/Negative/--
Issuer Credit Rating	
Local Currency	BBB+/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com