Credit Rating Announcement

18 April 2023

Scope assigns BBB-/Stable first-time issuer rating to SAF-HOLLAND

The rating is supported by strong market positions, a broad customer base and the high aftermarket exposure. Moderate profitability and volatile free cash flow cover are rating constraints.

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

Rating action

Scope Ratings GmbH (Scope) has assigned a first-time BBB-/Stable issuer rating to SAF-HOLLAND SE.

Rating rationale

The BBB- issuer rating is based on the BBB- business risk profile and BBB- financial risk profile assessments for SAF-HOLLAND, a leading international manufacturer of chassis-related system components for trailers, trucks and buses. Specialised brake systems were recently added to the product portfolio following the takeover of Swedish braking system specialist Haldex AB. The takeover received its final merger control clearance on 21 February 2023 and was finalised with the completion of the squeeze-out of all remaining outstanding Haldex shares on 28 February 2023.

The main support for SAF-HOLLAND's competitive position is the company's global or regional leadership in oligopolistic markets protected by high entry barriers, with top three market positions for key products and systems in North America, Europe, the Middle East and Africa. The combined group will be well positioned to meet the needs of the global commercial vehicle sector thanks to the increased complementary product portfolio after the Haldex merger. Furthermore, the combined group owns one of the largest spare parts and service networks in Europe and North America, which constitutes a significant barrier to market entry.

SAF HOLLAND's diversification has improved thanks to the integration of Haldex. The product range will be enlarged by the addition of foundation brakes, air controls and electromechanical braking systems, thus covering a wider scope of chassis-related components and cementing the group as a one-stop solution provider. The integration will also further strengthen the exposure to the highly profitable and resilient aftermarket business to around 34%, as Haldex generates over 50% aftermarket sales (versus 27% for SAF-HOLLAND).

SAF-HOLLAND has a global outreach, generating around 50% of its revenues in Europe, the Middle East and Africa and 40% in North and South America. However, the group remains underrepresented in large

Asian markets such as China and India, with the Asia-Pacific accounting for only 10% of the group's revenues.

Key restraining factors for the business risk assessment are the cyclicality in global commercial vehicle markets (trucks/trailers/buses) and the group's relatively modest operating profitability with combined Scope-adjusted EBITDA margins expected at around 10% in the coming years.

Scope assesses the financial risk profile at BBB-, supported by the expected leverage of 2-3x and the interest coverage of above 5x, but constrained by a relatively weak cash flow cover as measured by the Scope-adjusted free operating cash flow/debt ratio.

Due to the volatility of free operating cash flow in the past few years, cash flow cover has been weak for SAF-HOLLAND as a standalone entity, averaging 8% over 2018-2021. Weak cash generation turned the metric negative in 2021 before it recovered to 17% in 2022, driven by a noticeable reduction in net working capital. Scope expects cash flow cover at 10-15% over the forecast period.

During 2022, Scope-adjusted debt increased to EUR 559m from EUR 249m due to the acquisition of Haldex, financed predominantly by debt. Leverage, as measured by Scope-adjusted debt/EBITDA, increased to around 3.9x in 2022 compared to an average of 2.9x over 2018-2021. This ratio was significantly inflated as Haldex was yet to be consolidated and therefore did not contribute to the group's EBITDA in 2022. Scope-adjusted debt/EBITDA for the combined group is expected at 2.9x in 2023E and estimated to gradually decrease towards 2x by 2025. Meanwhile, Scope-adjusted funds from operations/debt reached 25% in 2022 versus an average of 29% over 2018-2021. This metric is expected to move towards 35% by 2025.

EBITDA interest cover was historically strong, averaging around 12.5x during 2018-2021, Rising interest rates are expected to lead to a deterioration towards 5.5x in 2023 followed by a recovery towards 7x in 2025.

Liquidity is adequate, supported by available liquidity sources including cash balances and a EUR 250m undrawn committed credit line that cover upcoming maturities comfortably.

Supplementary rating drivers are neutral for the issuer rating. This is despite the shareholder-friendly dividend policy, with the 40-50% pay-out ratio at the upper range for most automotive players (25%-40%). However, this policy has been relatively stable and proved flexible as evidenced by the cancellation of dividends payments during the Covid-19 crisis. Lastly, no material acquisition is expected following the Haldex deal. Management has indicated the intention to deleverage and reduce reported net debt/EBITDA ratio to below 2x by 2024.

Scope has not identified company-specific ESG factors that could have a significant impact on credit risk. The agency notes, however, that ESG factors relevant for automotive suppliers like SAF-HOLLAND include the need to reduce the environmental impact of products or production, improve resource management (optimised use of energy and natural resources), and enhance supply chain oversight in terms of social standards and responsible sourcing.

Outlook and rating-change drivers

The Stable Outlook reflects Scope's expectation that the combined group will be able to withstand moderate fluctuations in the cyclical global commercial vehicle market thanks to the higher share of aftermarket business, further strengthened by cross-selling, cost savings and pricing opportunities brought in by the merger with Haldex. Furthermore, the Outlook reflects Scope's anticipation of Scope-adjusted debt/EBITDA improving thanks to a gradual deleveraging.

A positive rating action could be warranted if SAF-HOLLAND managed to reduce leverage as measured by Scope-adjusted debt/EBITDA towards 2x while improving free cash flow generation after the merger with Haldex. This could be achieved thanks to higher profitability through the Haldex integration combined with enhanced free cash flow generation through capex discipline and net working capital optimisation.

Scope may consider a negative rating action if leverage, as measured by Scope-adjusted debt/EBITDA, remained above 3x. A negative rating action could also be triggered by a sustained deterioration in free cash flow generation or if profitability deteriorated due to much weaker business conditions, an unforeseen revenue decline or unexpected execution risks related to the merger with Haldex.

Stress testing & cash flow analysis

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

Methodology

The methodologies used for the Credit Rating and/or Outlook, (General Corporate Rating Methodology, 15 July 2022; European Automotive Suppliers Rating Methodology, 6 February 2023), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. 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 Rating was 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 Rating: public domain, the Rated Entity and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings 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 Rating and/or Outlook and the principal grounds on which the Credit Rating and/or Outlook are based. Following that review, the Credit Rating was not amended before being issued.

Regulatory disclosures

The Credit Rating and/or Outlook is issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Rating and/or Outlook is UK-endorsed.
Lead analyst: Ivan Castro Campos, Director
Person responsible for approval of the Credit Rating: Thomas Faeh, Executive Director
The Credit Rating/Outlook was first released by Scope Ratings on 18 April 2023.

Potential conflicts

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