Voith GmbH & Co. KGaA Germany, Capital Goods

SCOPE BBB STABLE

Corporate profile

Founded in 1867, Voith GmbH & Co. KGaA is a 100% family-owned company in the mechanical engineering sector, headquartered in Heidenheim/Brenz, Germany. Voith's operating business is split into four group divisions. Voith Hydro (a fully consolidated joint venture of Voith and Siemens which was founded in April 2000 and in which Voith holds a majority 65% of all shares and voting rights) covers the entire life cycle and all components of large and small hydropower plants. Voith Paper serves the paper market for all types of paper – newspaper, board and packaging paper, tissue paper as well as specialty papers such as bank notes – with new machines, rebuilds of entire production facilities, partial rebuilds, services and spare parts as well as fabric and roll-cover products. Voith Turbo can be subdivided into mobility and industry subdivisions. The mobility subdivision produces drive components and solutions as well as braking systems for the commercial vehicle industry (in particular trucks and buses), the railway industry and the marine segment. The industry subdivision produces various couplings, hydraulic systems and components, high-duty universal shafts, turbo gear units, actuators and control systems for steam and gas turbines. The company is currently establishing a fourth reporting division, Voith Digital Ventures, focussing on the development of new digital business solutions. Voith has more than 19,900 employees. For the business year 2017/18, the company reported revenues of EUR 4.2bn and EBITDA of EUR 268m.

Key metrics

			Scope estimates	
Scope credit ratios	2016-17	2017-18	2018-19F	2019-20F
EBITDA/interest cover (x)	5.8x	11.2x	9.8x	9.9x
Scope-adjusted debt (SaD)/EBITDA	1.6x	1.7x	2.0x	2.3x
Scope-adjusted FFO/SaD	33%	38%	38%	33%
FOCF/SaD	6%	-13%	-1%	0%

Rating rationale

In its annual review Scope Ratings affirms its BBB issuer rating for Voith GmbH & Co. KGaA. Scope also affirms its Stable Outlook. The S-2 short-term rating remains unchanged.

In FY 2017-18 Voith's order intake of EUR 4,285m was slightly below the previous year's level of EUR 4,368m mainly due to the marked decline in the Voith Hydro division (EUR 856m in FY 2017-18 vs. EUR 1,180m previously). Voith has attributed this to project postponements. We do not expect incoming orders to recover any time soon and have adjusted our expectation for the Voith Hydro division downwards. In contrast, the order intake in the Voith Paper segment was very strong at EUR 1,995m (EUR 1,813m previously) supported by strong demand for paper machines, in particular for board and packaging paper as well as tissue paper. However, we understood that Voith is expecting the order intake in FY 2017-18E to level out again. The order intake of EUR 1,378m in the Turbo division was rather flat YoY compared to EUR 1,344m in the previous year.

Ratings & Outlook

Corporate ratings	BBB/Stable
Short-term rating	S-2/Stable

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Related methodology

Corporate Methodology, January 2018

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Bloomberg: SCOP

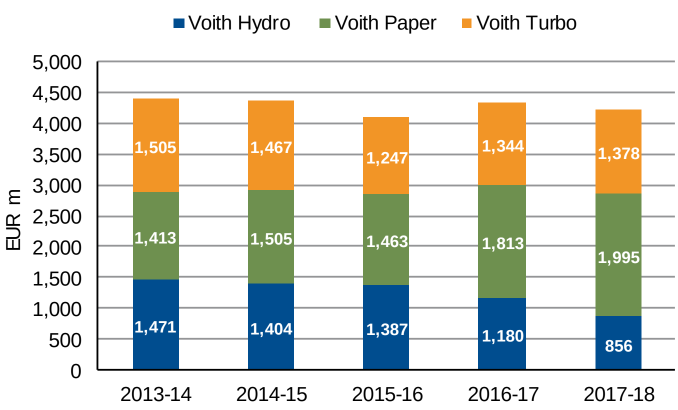
Given weak incoming orders in the Hydro division, the company's order backlog of EUR 5,172m at end-September 2018 was slightly below the previous fiscal year's level of EUR 5,193m. Voith's revenues of EUR 4,209m decreased slightly (-0.4% YoY) because higher revenues in Voith Paper (+14.3% YoY) and Voith Turbo (+1.5% YoY) could not offset the sharp decline in the Voith Hydro division (-20.1% YoY). Voith also benefited from higher revenues in the new Voith Digital Ventures division, which has tripled its revenues from EUR 13m in FY 2016-17 to EUR 40m in FY 2017-18 mainly due to the acquisition of the digital services provider Ray Sono. In FY 2018-19F we expect revenues to increase to about EUR 4,270m (+1.5% YoY) mainly driven by the consolidation of Voith Robotics and FlowLink Systems for a full fiscal year for the first time. Revenues in the other divisions are expected to remain roughly stable. In 2019-20F, we expect revenues to increase to around EUR 4,400m driven by acquisitions.

Voith's profitability measured by its EBITDA margin has decreased to 6.4% for the third year in succession. As in previous years, profitability was impacted by:

- An increase in personnel expenses due to collectively bargained pay rises as well as an increasing headcount of more qualified and more highly paid employees in the Voith Digital Ventures division.
- The higher cost of materials, in particular due to the increased sale of material-intensive paper machines in the Paper division.

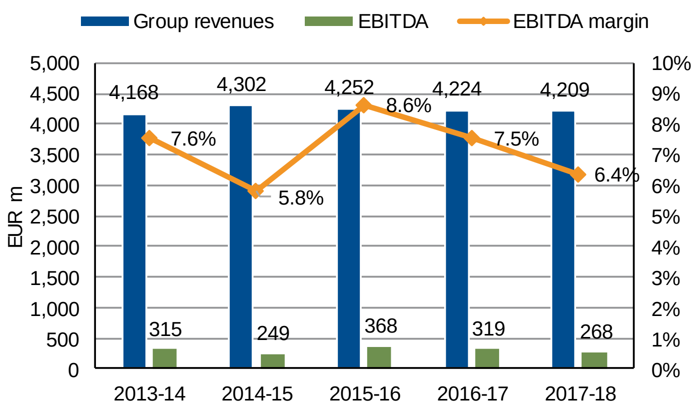
We expect the ratio of cost of materials to total output to decrease slightly, driven by higher aftermarket sales in the Paper division and increasing revenues in the less material-intensive Voith Digital Ventures division. Having said that, we expect this decrease to be eaten up by a further rise in personnel expenses given the company's intention of expanding its Digital Ventures business. We have adjusted our EBITDA margin expectation down to the 6%-7% range, from 7%-8% previously.

Figure 1: **Trend in incoming orders by division**



Source: Voith, Scope

Figure 2: **Voith's revenue and EBITDA**



Source: Voith, Scope

Funds from operations of EUR 162m have been rather flat YoY as lower profits have been offset by lower cash interest (minus EUR 17m in FY 2017-18 vs. minus EUR 53m previously) as a result of the redemption of the corporate bond at the end of the 2016/17 fiscal year and lower cash taxes (minus EUR 70m in FY 2017-18 vs. minus EUR 93m previously). Operating cash flow (OCF) dropped by around EUR 100m to EUR 31m mainly due to the use of warranty provisions and contract-specific provisions. In FY 2018-19, we expect OCF to be impacted by payments to pension plans of EUR 15m. Due to the decreased OCF, free cash flow (FCF) turned negative and amounted to minus EUR 57m. We expect FCF to be around zero in FY 2018-19F.

We have changed Voith's financial risk profile from BBB- to BBB as we now have more clarity with regard to its financial policy. We understand that Voith has abandoned its plan to build up a fifth mainstay by making a substantial acquisition. Instead, the company now intends to make smaller acquisitions that complement its existing activities. We expect Voith to spend EUR 150-200m on acquisitions over the next two fiscal years. This removes the risk of a sudden deterioration in credit metrics which impacted our previous assessment. Voith's net leverage has increased to 1.7x driven by lower Scope-adjusted EBITDA. We expect the company's SaD/EBITDA ratio to deteriorate into the 2.0-2.5x range, which is still commensurate with the current rating. Furthermore, in view of the anticipated lower EBITDA and higher capex, we expect FCF/SaD to remain below 5% in the foreseeable future.

Voith's cash on the balance sheet has decreased by EUR 240m to EUR 342m at end-September 2018 (EUR 582m at end-September 2017) due to negative FCF and debt repayments. Having said that, we still consider Voith's liquidity to be more than adequate.

Principal cash sources at end-September 2018 comprised:

- Cash on the balance sheet of EUR 342m. According to Voith, approx. EUR 168m of its liquidity (mainly liquidity at the level of its affiliated companies), is trapped and has been deducted from liquidity.
- Liquid investments of EUR 618m (mainly time deposits).
- Syndicated revolving credit facility in the amount of EUR 550m due in 2023 at the level of the parent company and undrawn at FY-end 2018. We expect the revolving credit facility to remain mostly undrawn.
- We expect OCF of around EUR 120m in 2018-19F and around EUR 140m in 2019-20F.

We expect the following cash uses:

- Capex of EUR 120m in FY 2018-19F and EUR 135m in FY 2019-20F.
- Acquisition-related cash payouts of EUR 80m in FY 2018-19F and EUR 90m in FY 2018-19F.
- Dividend payment of EUR 30m in FY 2018-19F and FY 2019-20F.
- Debt maturities according to Voith's debt maturity profile: debt payments of around EUR 70m in FY 2018-19F and EUR 147m in 2019-20F.

All things considered, Voith's liquidity amply covers its maturities in FYs 2018-19F and 2019-20F. We therefore affirm its S-2 short term rating.

Outlook

We affirm the Stable Outlook based on our expectation that the company's SaD-to-EBITDA ratio will not exceed 3.0x (a level commensurate with a BBB rating category) and that its FCF-to-net-debt ratio will remain below 10%.

We may upgrade the rating if: i) Voith's SaD-to-EBITDA ratio remains below 2.0x and its FCF-to-net-debt ratio improves to above 10% on a sustainable basis. A negative rating action could result if the company's SaD-to-EBITDA ratio increased above 3.0x on a sustainable basis, e.g. due to a deterioration in profitability.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leading market positions in hydro and paper • Diversification with regard to end-markets and products • Broad geographic footprint both group- and segmentwise • Very strong liquidity position with EUR 792m at FY-end 2017-18 • More clarity with regard to financial policy	• Relatively low and decreasing profitability over the past years due to increasing personnel expenses and higher material costs • Expected low FCF in FYs 2018-19F and 2019-20F • Low cash flow-based credit metrics

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA and FCF/SaD sustainably below 2x and above 10%, respectively	• SaD/EBITDA increasing towards 3.0x, for instance because of a deterioration in profitability

Financial overview

			Scope estimates	
Scope credit ratios	**2016-17**	**2017-18**	**2018-19F**	**2019-20F**
EBITDA/interest cover (x)	5.8x	11.2x	9.8x	9.9x
SaD/EBITDA	1.6x	1.7x	2.0x	2.3x
Scope-adjusted FFO/SaD	33%	38%	38%	33%
FOCF/SaD	6%	-13%	-1%	0%
Scope-adjusted EBITDA in EUR m	**2016-17**	**2017-18**	**2018-19F**	**2019-20F**
EBITDA	319	268	268	271
Operating lease payment in respective year	40	51	51	51
Other	-13	-13	-13	-13
Scope-adjusted EBITDA	346	307	306	309
Scope funds from operations in EUR m	**2016-17**	**2017-18**	**2018-19F**	**2019-20F**
EBITDA	319	268	268	271
less: (net) cash interest as per cash flow statement	-41	-6	-10	-10
less: pension interest	-13	-16	-16	-16
less: cash tax paid as per cash flow statement	-93	-70	-57	-54
add: depreciation component operating leases	34	46	46	46
Other items	-22	-30	-2	-1
Scope funds from operations	184	193	228	236
Scope-adjusted debt in EUR m	**2016-17**	**2017-18**	**2018-19F**	**2019-20F**
Reported gross financial debt	634	451	455	422
less: cash, cash equivalents	-1,184	-960	-854	-706
Cash not accessible	228	168	168	168
add: pension adjustment	777	744	729	729
add: operating lease obligations	105	107	107	107
Scope-adjusted debt	560	510	605	720

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