Voith GmbH & Co. KGaA
Germany, Capital Goods

SCOPE BB+ 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, Voith Paper, Voith Turbo and Voith Digital Ventures. Voith has around 21,000 employees. The company reported revenues of EUR 4.3bn for the 2020-21 business year (FY 2020-21).

Key metrics

			Scope estimates	
Scope credit ratios	2019-20	2020-21[1]	2021-22E	2022-23E
EBITDA/interest cover (x)	11.5x	11.8x	13.2x	14.8x
Scope-adjusted debt (SaD)/EBITDA	5.5x	3.7x	3.9x	3.4x
Scope-adjusted funds from operations/SaD	11%	20%	20%	23%
Free operating cash flow/SaD	12%	5%	5%	7%

Rating rationale

Scope Ratings GmbH has downgraded the issuer rating on Voith GmbH & Co. KGaA to BB+ and changed the Outlook from Negative to Stable. The short-term rating has been downgraded to S-3.

The rating action mainly reflects the deterioration in the financial risk profile (unchanged at BB-) over the last years, the still low profitability, and the upcoming Voith Hydro transaction, which will burden credit metrics in FY 2021-22.

Between FY 2016-17 and FY 2018-19, the financial risk profile benefited from high liquidity supported by the KUKA share sale proceeds but was negatively impacted by the high multiple paid in the BTG, Toscotec and ELIN Motoren acquisitions. Scope-adjusted debt (SaD) increased to EUR 928m at the end of FY 2020-21 from EUR 560m at the end of FY 2016-17 due to higher M&A. However, the comparability of SaD to previous years' figures is distorted by our application of a lower net pension obligation adjustment since FY 2020-21, at two-thirds rather than the full amount previously. In FY 2020-21, SaD/Scope-adjusted EBITDA (SaD/SaEBITDA) was 3.7x. The improvement from 5.5x in FY 2019-20 (2018-19: 2.4x) was mainly driven by decreased SaD by around EUR 370m, a result of a reduction in trapped cash after cash was repatriated from China and the lower pension adjustment. We expect SaD/SaEBITDA to increase to around 4.0x in FY 2021-22, burdened particularly by the upcoming acquisition of the remaining stake in Voith Hydro from joint venture partner Siemens Energy. We expect SaD/SaEBITDA in FY 2022-23 at around 3.5x, based on no material M&A activity and a SaEBITDA of around EUR 300m.

The unchanged BBB rated business risk profile continues to be supported by Voith's market positioning and diversification but constrained mainly by the still low profitability in a peer group context.

[1] Adjustment for two-thirds of the net pension obligation in SaD from FY 2020/21 onwards as opposed to the full amount previously.

Ratings & Outlook

Corporate rating BB+/Stable

Short-term rating S-3

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Related Methodologies

Corporate Rating Methodology, July 2021

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We note positively the sharp rise in new orders by around EUR 1bn or 24% YoY, mainly reflecting strong investment activity in Voith Paper. The order backlog was at an all-time high, at EUR 6.2bn at the end of FY 2020-21.

Liquidity reserves are 'adequate' given the short-term debt coverage at more than 100%.

Outlook and rating-change drivers

The change in Outlook from Negative to Stable reflects our expectation of increased revenues in FY 2021-22 based on the record-high order backlog at FY 2020-21. The Stable Outlook also reflects the expectation of no other material M&A apart from the Voith Hydro transaction.

A rating upgrade may be warranted if the SaEBITDA margin improved substantially to around 8%, resulting in SaD/SaEBITDA reducing to below 3.0x.

A negative rating action is possible if the rating base case did not materialise, for example, through a failure to improve SaEBITDA in the near future or launch new capital allocation measures, resulting in a SaD/SaEBITDA of above 4.0x on sustained basis.

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 by group and segment • Still sound liquidity position with accessible cash on the balance sheet of EUR 511m at FY 2020-21 and around EUR 730m in two undrawn revolving credit facilities	• Low profitability in a peer group context • Deterioration in credit metrics after recent M&A transactions • Low free operating cash flow expected

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Sustainably higher SaEBITDA margin (i.e. around 8%) resulting in SaD/SaEBITDA of below 3.0x	• Failure to improve SaEBITDA in the near future or launch new capital allocation measures, resulting in SaD/SaEBITDA exceeding 4.0x for a long period

Financial overview

			Scope estimates	
Scope credit ratios	**2019-20**	**2020-21[2]**	**2021-22E**	**2022-23E**
EBITDA/interest cover (x)	11.5x	11.8x	13.2x	14.8x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	5.5x	3.7x	3.9x	3.4x
Scope-adjusted funds from operations/SaD	11%	20%	20%	23%
Free operating cash flow/SaD	12%	5%	5%	7%
Scope-adjusted EBITDA in EUR m	**2019-20**	**2020-21[2]**	**2021-22E**	**2022-23E**
EBITDA	229	259	270	302
Operating lease payments in respective year				
Other	8	-6	-6	-6
Scope-adjusted EBITDA	237	253	264	296
Scope-adjusted funds from operations in EUR m	**2019-20**	**2020-21[2]**	**2021-22E**	**2022-23E**
EBITDA	229	259	270	302
less: (net) cash interest as per cash flow statement	-11	-11	-10	-10
less: pension interest	-9	-10	-10	-10
less: cash tax paid as per cash flow statement	-51	-57	-39	-53
add: depreciation component, operating leases				
Other items	-12	6	-1	-1
Scope-adjusted funds from operations	146	186	210	228
Scope-adjusted debt in EUR m	**2019-20**	**2020-21[2]**	**2021-22E**	**2022-23E**
Reported gross financial debt	908	788	908	870
less: cash and cash equivalents	-704	-563	-581	-571
add: cash not accessible	238	148	148	148
add: pension adjustment	859	555	555	555
add: operating lease obligations				
Scope-adjusted debt	1,300	928	1,030	1,002

[2]Adjustment for two-thirds of the net pension obligation in SaD from FY 2020/21 onwards as opposed to the full amount previously.

Business risk profile: BBB

Unchanged BBB rated business risk profile

The business risk profile, still rated at BBB, continues to be supported by Voith's market positioning and diversification.

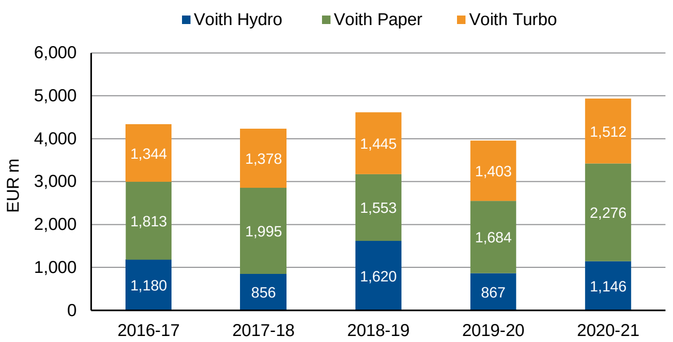
Relatively low profitability still main constraint

The still low profitability in a peer group context continues to be the main constraint for the business risk profile. The SaEBITDA margin improved slightly to 5.9% in FY 2020-21 (5.7% in FY 2019-20), reflecting a reduction in the other operating result (mainly due to a decline in expenses from additions to provisions) and headcount (which dampened the impact in relation to revenues of the higher overall personnel costs). These cost savings, however, were absorbed by the higher cost for materials, compounded for Voith by the reduced revenue share of services (which typically have lower materials costs), particularly in Voith Hydro. SaEBITDA increased to EUR 253m in FY 2020-21 against EUR 237m from the period before. SaEBITDA and its margin benefited from higher revenues (+2.1% YoY to EUR 4.3bn) due to the full-year effect (around EUR 160m) of an acquisition made in the previous year.

Sharp rise in new orders and order backlog at an all-time high

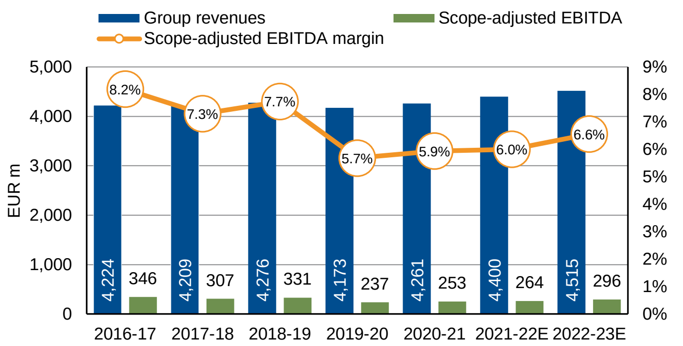
We note positively the sharp rise in new orders, by around EUR 1bn or 24% YoY. This was largely due to Voith Paper (around EUR 590m or +35% YoY), reflecting the strong investment in its new lines and the rebuild of its paper packaging production to keep up with the boom in online business. Voith Hydro increased orders by EUR 280m or 32% YoY. Voith Turbo (+EUR 109m or 8% YoY) benefited from the full-year effect of the previous year's acquisition. The order backlog with EUR 6.2bn at the end of FY 2020-21 was at an all-time high.

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



Source: Voith, Scope

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



Source: Voith, Scope

Revenues expected at around EUR 4.4bn (+3% YoY) in FY 2021-22

However, the high order backlog will only slowly translate into revenue growth, due to the long project times customary in the large-scale plant business. We expect the continuing global supply chains interruptions to have a negative impact on Voith's revenues. That said, we continue to expect revenues to grow, largely driven by Voith Paper, in FY 2021-22 to around EUR 4.4bn (+3% YoY) and in FY 2022-23 to around EUR 4.5bn (+3% YoY).

The following factors should support profitability in FY 2021-22:

- Scale effects in Voith Paper projects
- Cost savings from Boost Project (launched in November 2020 in Germany), mainly from a reduction in personnel expenses that is expected to more than offset the collectively bargained wage increases
- Completion of the site closure and relocation from Sonthofen to Crailsheim (VT Industries will especially benefit), through an end to relocation costs and the improved economies of scale through the reallocation of small-scale production to the large hub

SaEBITDA margin expected at 6.0% in FY 2021-22 and 6.6% in FY 2022-23

The higher revenue contribution from the high-margin small-hydro business is expected to be another supporting factor. Rises in material prices are likely to offset cost savings, though it is very uncertain to what extent. We expect a SaEBITDA margin of 6.0% in FY 2021-22 and 6.6% in FY 2022-23.

Environment is positive ESG factor

Environmental considerations are a positive ESG factor. Voith is a leader in the global hydro equipment sector and benefits from the trend towards renewables. Voith Hydro accounted for 22% of Voith's revenues in FY 2020-21. Further, Voith acts as a supplier rather than a main contractor, which reduces environment-related litigation risk.

Financial risk profile: BB-

Unchanged BB- rated financial risk profile

The unchanged BB- rated financial risk continues to reflect the deterioration in credit metrics over the last years and the expectation of SaD/SaEBITDA remaining between 3.5-4.0x in FY 2021-22 and FY 2022-23.

3.7x SaD/SaEBITDA in FY 2020-21 an improvement against 5.5x in FY 2019-20 due to lower trapped cash and pension gap adjustment

Between FY 2016-17 and FY 2018-19, the financial risk profile benefited from high liquidity supported by the KUKA share sale proceeds but was negatively impacted by the high multiple paid in the BTG, Toscotec and ELIN Motoren acquisitions. SaD increased to EUR 928m at the end of FY 2020-21 from EUR 560m at the end of FY 2016-17, mainly due to the EUR 400m of Schuldschein issued with terms of five, seven and 10 years. The comparability to previous years' figures is, however, distorted by our application of a lower net pension obligation adjustment since FY 2020-21, at two-thirds from the full amount previously. The reason is that pension assets have exceeded annual pension payments by threefold for several years, and we consider this sustainable. In FY 2020-21, SaD/SaEBITDA was 3.7x. The improvement from 5.5x in FY 2019-20 (2018-19: 2.4x) was mainly driven by decreased SaD by around EUR 370m, a result of a reduction in trapped cash after cash was repatriated from China and the lower pension adjustment.

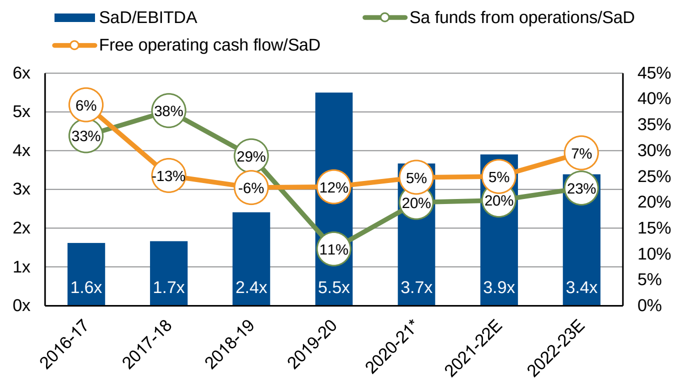
Lower EBITDA also weighed on credit metrics

In addition to the impact from higher M&A-driven indebtedness, credit metrics suffered from lower EBITDA, reflecting lower revenues, higher restructuring costs, higher materials prices and an unfavourable product mix.

SaD/SaEBITDA expected at around 4.0x in FY 2021-22, burdened by Voith Hydro transaction

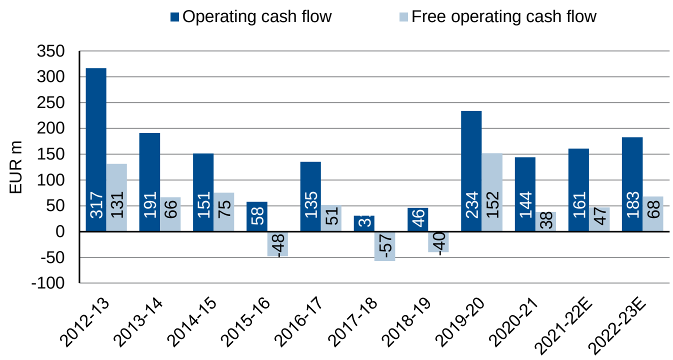
In our base case, we expect SaD/SaEBITDA to increase to around 4.0x in FY 2021-22, burdened particularly by the Voith Hydro transaction. We expect SaD/SaEBITDA in FY 2022-23 at around 3.5x, based on no material M&A activity and a SaEBITDA of around EUR 300m.

Figure 3: **Key credit metrics, 2015-16 to 2022-23E**



*Adjustment for two-thirds of the net pension obligation in SaD from FY 2020/21 onwards as opposed to the full amount previously; Source: Voith, Scope

Figure 4: **10-year trend in cash flow**



Source: Voith, Scope

EUR 788m in total financial debt as at September 2021

Voith's total financial debt as at September 2021 was EUR 788m, comprising mainly note loans (EUR 459m), lease liabilities (EUR 98m), bank loans (EUR 88m), and other loans and borrowings (EUR 142m for obligations from the classification of non-controlling interests in limited partnerships based on termination rights of holders of non-controlling interests and put options).

Undrawn EUR 550m revolving credit facility due in April 2025

After second options were exercised, the existing syndicated euro loan of EUR 550m was extended to April 2025. This loan was undrawn at end-September 2021 and is available as a strategic liquidity reserve. According to Voith, no financial covenants were arranged.

Undrawn EUR 176m revolving credit facility due in June 2024

In addition, Voith has a syndicated revolving loan of RMB 1,400bn (around EUR 176m) for working capital financing in China, available in that country until June 2024 and unutilised at end-September 2021.

Adjustments to SaD

The SaD calculation adjusted for i) pensions of EUR 555m (two-thirds of the net pension obligation in SaD since FY 2020-21 as opposed to the full amount previously); and ii) restricted cash of EUR 148m (cash held in countries with currency controls, in particular, India and Brazil).

Figure 5: Composition of external financing at end-September 2021

Debt instrument	Currency	Amount (EUR m)	Outstanding (EUR m)	Maturity	Issuer	Leverage
Bilateral committed credit facilities	EUR	375	0	2-3 years	Voith GmbH	0.0x
Syndicated revolving credit facility	EUR	550	0	Apr 2025	Voith GmbH	0.0x
Syndicated revolving credit facility	RMB	1,400	0	Jun 2024	Various Asian subsidiaries but guaranteed by Voith GmbH	0.0x
New EIB credit facility	EUR	100	0	5-8 years	Voith GmbH	0.0x
Schuldschein, seven years	EUR		38	Nov 2022	Voith GmbH	0.2x
Schuldschein, 10 years	EUR		21	Nov 2025	Voith GmbH	0.1x
New Schuldschein, five years	EUR		200	Feb 2025	Voith GmbH	0.8x
New Schuldschein, seven years	EUR		160	Feb 2027	Voith GmbH	0.6x
New Schuldschein, 10 years	EUR		40	Feb 2030	Voith GmbH	0.2x
Bank loans	EUR		88	Various	Voith GmbH	0.3x
Leases	EUR		98		Voith GmbH	0.4x
Debt at parent level (EUR m)			**645**			**2.5x**
Other debt	EUR		142		Various subsidiaries	0.6x
Senior unsecured debt (EUR m)			**142**			**0.6x**
Total debt (EUR m)			**788**			**3.1x**
Adjustments for:						
Pensions (2/3 of total amount)*			555			2.2x
Scope-adjusted gross debt (EUR m)			**1,343**			**5.3x**
Unrestricted liquidity			-415			-1.6x
Scope-adjusted debt (EUR m)			**928**			**3.7x**

*In accordance with Scope's methodology; Source: Voith, Scope

Acquisition of 35% stake in Voith Hydro to increase indebtedness

We expect SaD to increase by during FY 2021-22 to around EUR 1.0bn, mainly driven by the acquisition of 35% stake in Voith Hydro.

Volatile free operating cash flow

Free operating cash flow proved rather volatile. In FY 2020-21, operating cash flow decreased to EUR 144m, reflecting higher net working capital due to higher volumes of work in progress. Free operating cash flow decreased to EUR 38m in FY 2021-22 after EUR 152m previously. In addition to the impact from lower operating cash flow, free operating cash flow also reduced through the higher net capex of around EUR 106m after EUR 83m previously. We estimate free operating cash flow at around EUR 50m in FY 2021-22 (including net capex of around EUR 115m) and around EUR 70m in FY 2022-23.

Adequate liquidity

Voith's liquidity reserves are 'adequate' given the short-term debt coverage of more than 100%.

Cash sources

Principal liquidity sources at end-September 2021 comprised: i) a cash balance of EUR 511m (around EUR 148m of which is trapped cash); ii) liquid investments of EUR 51m (mainly time deposits); iii) an unused syndicated revolving credit facility of EUR 550m due in April 2025; and iv) an unused syndicated revolving credit facility of RMB 1,400bn (around EUR 180m) to finance working capital in China. Furthermore, we expect free operating cash flow of around EUR 50m in FY 2021-22 and around EUR 70m in FY 2022-23.

Cash uses

Expected cash uses include: i) the Voith Hydro acquisition (no other material M&A activity in FY 2022-23); ii) dividend payments of EUR 30m in FY 2020-21 and FY 2021-22; and iii) debt maturities of around EUR 38m in FY 2022-23 (no maturities in FY 2021-22).

We have not considered it in our liquidity analysis but in July 2020 Voith has credit facilities of EUR 375m with terms of two to three years.

Long-term and short-term debt ratings

Voith currently has no outstanding long-term debt instruments to be rated.

One notch down for short-term rating

In line with the issuer rating, we lower the short-term rating from currently S-2 to S-3.

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