Franz Haniel & Cie. GmbH
Germany, Investment Holdings

SCOPE BBB- STABLE

Corporate profile

Franz Haniel & Cie. GmbH (Haniel) is an investment holding company. Haniel manages a diversified portfolio and pursues a long-term investment strategy as a value developer with no operating activities of its own. The holding company focuses on the receipt of recurring dividend payments from its different shareholdings, in addition to value creation. Additional cash flows can be generated by the (partial) sale of stakes in shareholdings and other assets. The current portfolio comprises controlling stakes in CWS-boco, ELG, TAKKT, BekaertDeslee, ROVEMA, Optimar and minority positions in CECONOMY and METRO.

Key metrics

			Scope estimates	
Scope credit ratios	**2016**	**2017**	**2018F**	**2019F**
Total cost coverage (x)	1.1	1.5	1.3	1.5
LTV (Scope-adjusted debt/portfolio's market value)	15%	17%	<25%	<25%
Liquidity	>200%	>200%	>200%	>200%

Rating rationale

Scope Ratings affirms its issuer ratings of BBB- on Germany-based Franz Haniel & Cie. GmbH and its financing subsidiary Haniel Finance Deutschland GmbH. The rating Outlook remains Stable. The short-term rating is affirmed at S-2. Senior unsecured debt is affirmed at BBB-.

The rating affirmation reflects Scope's continued view on Haniel's consistent execution of its investment strategy which has resulted in increased portfolio diversification and more robust income streams from ventures in little-correlated industries without burdening the company's indebtedness. Scope's ratings reflect the holding's strengthened full cost coverage from recurring cash flows (1.5x in 2017) as a result of improved dividend streams from shareholdings as well as sharp cost reductions and continuously low market value gearing. Our rating case incorporates full cost coverage by a factor of 1.3x and a loan-to-value (LTV) of below 25%. Cost coverage is robust: Scope calculates that Haniel's dividend projections could fall short by around 20% before reaching the important 1.0x threshold. Moreover, Haniel retains debt headroom for further portfolio rebalancing, if opportunities arise, before reaching its communicated maximum debt level of EUR 1bn (also accounting for financial assets). Nevertheless, the limited fungibility of the overall investment portfolio, with a high share of non-listed shareholdings, and lasting concentration risks from core dividend-paying entities remain rating constraints.

Scope maintains the Stable rating Outlook. While Scope expects that Haniel's total cost coverage can be kept at around 1.3x over the next 2.5 years even including a more conservative stance on dividend streams from CECONOMY, which would trigger a positive rating action, we remain conservative until we have further guidance on this. A rating upgrade could be warranted if our expectations regarding total cost coverage of above 1.3x are met on a sustainable basis, and if concentration risks in the portfolio are reduced as expected. A negative rating action could result if the holding company exceeds its communicated net debt target, without offsetting this through additional dividend streams from new investee companies, or if total cost coverage is expected to deteriorate to a level below 1.0x.

Ratings & Outlook

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

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Related methodology

ROVEMA deal in line with Scope's rating case, Nov 2017

Rating report 2017, July 2017

Scope affirms BBB-/Stable rating of Haniel, Feb 2017

Reduced asset and dividend concentration from METRO demerger, Sep 2016

Initial rating report, February 2016

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Rating drivers

Positive rating drivers	Negative rating drivers
• Buy-and-hold investment approach with primary focus on recurring dividend streams • Portfolio companies which are largely market leaders in their respective industries and with well-established business models in mature markets • Ongoing rebalancing of investment portfolio in line with investment strategy, bolstered by current liquidity, good access to unused, committed credit lines and further debt headroom • Balanced industry allocation in the investment portfolio, which contains uncorrelated exposure to non-cyclical and cyclical industries • Strong geographical diversification across revenue streams in the investment portfolio • Commitment to keeping net debt up to EUR 1bn over the medium-to-long term, even after new investments • Total cost coverage sustainably above 1.0x and expected to stand at around 1.3x over the next few years • Strong liquidity and limited short-term refinancing needs, allowing for substantial acquisitions	• Number of shareholdings remains limited (eight) resulting in high concentration risks within shareholdings in terms of dividend and net asset value concentration • Limited asset liquidity due to large share of unlisted subsidiaries which may not be sold immediately if liquidity is urgently needed. This is partly offset by the buy-and-hold investment approach and Haniel's comfortable liquidity position • Increased focus on SMEs resulting in stronger earnings volatility, partly offset by improved diversification • Volatile leverage (LTV) stemming from market volatility • Uncertainties around future dividend payments at CECONOMY

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Expected total cost coverage to remain above 1.3x on a sustained basis	• Total cost coverage to drop below 1.0x on a sustained basis • Breach of the company's net debt target of EUR 1bn if not justified by equivalent dividend income

Financial overview

			Scope estimates	
Scope credit ratios	**2016**	**2017**	**2018E**	**2019E**
Total cost coverage (from recurring income)	1.1	1.5	1.3	1.3
Total cost coverage without dividend payments (recurring)	1.7	2.5	2.4	2.7
LTV (Scope-adjusted debt/portfolio's market value)	15%	17%	Depending on new investments and market developments (<25%)	
Liquidity	>200%	>200%	110-200%	>200%
Cash flows (EUR m)	**2016**	**2017**	**2018E**	**2019E**
Recurring cash inflows (dividends)	159	174	163	159
Non-discretionary cash outflows (incl. net interest payments)	142	119	129	118
Balance sheet/indebtedness (EUR m)	**2016**	**2017**	**2018E**	**2019E**
Scope-adjusted debt (incl. pension adjustments)	1,011	1,137	~1,000	~1,000
Net asset value	5,581	5,712	n/a	n/a

Business risk profile

Consistent execution of buy-and-build investment strategy

From Scope's perspective, over the past 1.5 years, Haniel has achieved comprehensive portfolio rebalancing despite the very competitive environment for companies which match Haniel's investment criteria. Following the integration of Rentokil Initial's continental European business activities (in the areas of hygiene, workwear and cleanroom services) into CWS-boco in H1 2017, Haniel has further developed its investment portfolio through the acquisition of two new 'satellite investments' ROMEVA and Optimar. Scope regards these two transactions as further evidence of the holding's continuous portfolio development in line with its 'Mittelstandsinitiative' investment strategy limited to SMEs, particularly as appealing deals are hard to find given the current fierce competition in tenders and the resulting premium valuations. With regard to credit risk, this type of portfolio rebalancing, together with the broader foundation of relatively small, dividend- or interest-paying companies, addresses one of Haniel's major credit weaknesses in terms of limited portfolio diversification.

Loosened investment criteria lead to accelerated execution

Scope observes that Haniel's investment criteria have loosened somewhat. While the holding's investment filter remains focussed on mature European SMEs, Haniel is now also looking at small, capital-light ventures in a broader array of industries such as business services or engineering. Scope links this approach to the acceleration in deal execution over the last 1.5 years in contrast to the investment drought of 2008-2015.

Most recent portfolio additions

ROVEMA is a German turnkey provider of packaging machines and systems which are used for dosing, vertical form filling and sealing, cartooning and final packaging in different consumer staple areas (powdered, chunky, frozen and liquid products). The company, with annual revenues of more than EUR 100m, was established over 60 years ago and operates on a global scale (approx. 40% of revenues generated outside of Europe). ROMEVA is likely to contribute to Haniel's dividend profile through a profit and loss transfer agreement.

Optimar is a Norwegian manufacturer of automated fish handling systems. The company, with an annual turnover of more than EUR 100m, develops, produces and installs solutions for use on ships, on land and for aquaculture across more than 30 countries. Along with its acquisition, Haniel has provided a shareholder loan to the new portfolio company which will improve Haniel's cost base through interest receipts.

Credit-supportive mix of industries

Although the two new portfolio additions, ROVEMA and Optimar, are fairly small investments (<5% of portfolio market value), they add further diversification in terms of industry exposure and geographical outreach. Scope considers both investments to be comparatively low risk due to their established niche positions in growth markets. While the two ventures supply machinery, they are attached to the processing and packaging of foods and other consumer staples. Secondly, the two ventures are complementary to the existing investment portfolio with little expected correlation to other shareholdings. As a result, Scope expects small but robust cash flow contributions from the two new ventures, either in the form of dividends (ROVEMA) or interest payments on shareholder loans (Optimar).

Further reduction of concentration risks in net asset value and dividend streams

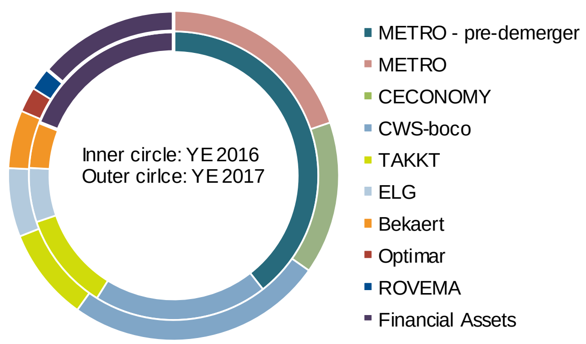
Scope acknowledges Haniel's ongoing portfolio rebalancing with regard to reduced concentration risks associated with portfolio market value and dividend/interest streams. Following the new investments, but also the demerger of METRO in 2017, and a portfolio now comprising eight shareholdings, Haniel's largest investment now makes up around 25% of the overall portfolio (as per 31 Dec 2017) as compared to 40% when Scope initially rated Haniel in 2016. However, Scope notes that the portfolio may change quickly, particularly due to sizable share price movements of Haniel's larger shareholdings (e.g. CECONOMY and METRO have lost about one third of their market capitalisation since the beginning of the year, primarily on market concerns over their Russia exposure).

Largest dividend-paying portfolio company expected to contribute around 35%

More importantly, Scope points out that dividend streams are growing increasingly resilient to potential earnings disruptions at one of Haniel's portfolio companies, with CWS-boco incl. the acquired parts of Rentokil Initial expected to become the largest dividend-paying entity. As displayed in Figure 2, Scope's rating case reflects a concentration for the largest dividend payer of around 35% over the next 2.5 years. This level can be expected to fall further if Haniel exploits its remaining financing headroom for additional ventures.

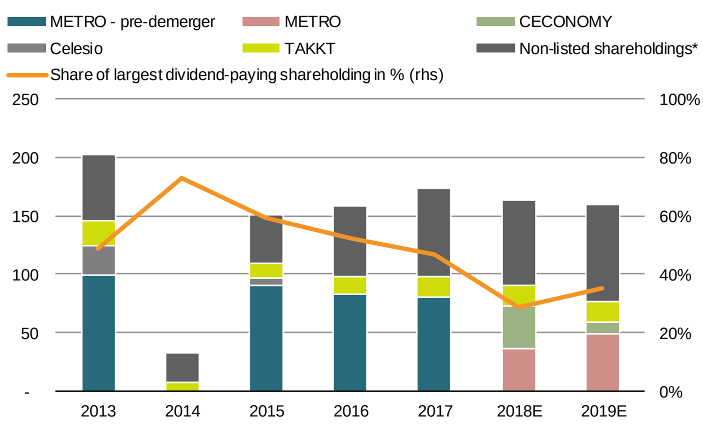
Major uncertainties now rank around the future dividend payments of CECONOMY following large envisaged impairments for the current business year. While the portfolio company has guided to pay out 45%-55% of normalised EPS, Scope takes a conservative stance which leads to increasing concentration risks from the largest dividend-paying shareholding towards 40% in the next years.

Figure 1: Reduced asset concentration



Source: Haniel, Scope

Figure 2: Dividend concentration*



* CWS-boco, ELG, TAKKT, Bekaert, ROVEMA, Optimar

Source: Haniel, Scope estimates

Portfolio liquidity/fungibility remains one of Haniel's credit weaknesses

While Scope recognises that Haniel is not reliant on asset disposals for full cost coverage, the investment holding's portfolio liquidity remains one of Haniel's credit weaknesses, particularly in times of economic turmoil. As the acquisition of the two new portfolio companies, ROVEMA and Optimar, was financed with cash and the disposal of financial assets, publicly traded liquid assets remain limited (less than 50% of market portfolio value as of 31 December 2017). However, Scope maintains its view that risks arising from this lack of direct portfolio liquidity are largely offset by i) Scope's expectations on the solid total cost coverage, ii) the substantial leeway to Haniel's communicated debt ceiling and iii) the holding's good access to various external financing channels (commercial paper, credit lines), if needed.

Portfolio companies operate on a global scale

Scope regards Haniel's aggregated geographical diversification within its current shareholdings to be strong (revenue exposure of portfolio companies in 2017: 65% Europe, 32% Americas, 2% Asia), thereby providing some protection of income streams against regional economic developments. In particular Haniel's core dividend payers METRO, CWS-boco and TAKKT act on a global scale, thereby reducing dividend volatility risks.

Financial risk profile

Scope's view on Haniel's financial risk profile has become more positive due to the holding's improved cash inflow and cost profile. While the company's leverage – measured as the LTV – remains vulnerable to major value disruptions in Haniel's core assets, we believe that total cost coverage is likely to stand at around 1.3x on a sustainable basis, despite higher anticipated dividend distributions to Haniel's shareholders, continued share buybacks and higher uncertainties around future dividend streams from CECONOMY.

Improved full cost coverage sustainably around 1.3x

As displayed in Figure 3, Scope's rating case now reflects a sustained full cost coverage at the holding level of around 1.3x, which is the result of:

(1) improved dividend contributions from major portfolio companies;

(2) Scope's reflection on increased uncertainties regarding dividend contributions from CECONOMY in 2019/2020;

(3) a reduced cost base, predominantly through improved net interest payments as a result of the cash-financed repayment of the EUR 250m bond in February 2017 (interest savings of approx. EUR 15m per annum from 2018 onwards) as well as the most recent refinancing of the EUR 200m bond in February 2018 (interest savings of approx. EUR 13m per annum from 2019 onwards);

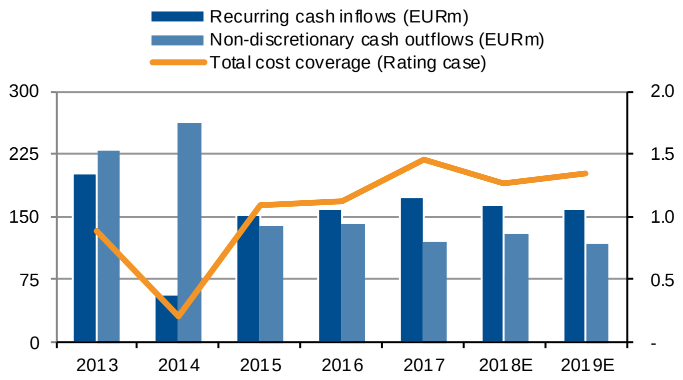
(4) robust interest income from shareholder loans to different portfolio companies; and

(5) no further cost burden from the 'Kalksandstein' payments.

Shortfall of 20% on dividend receipts could be absorbed

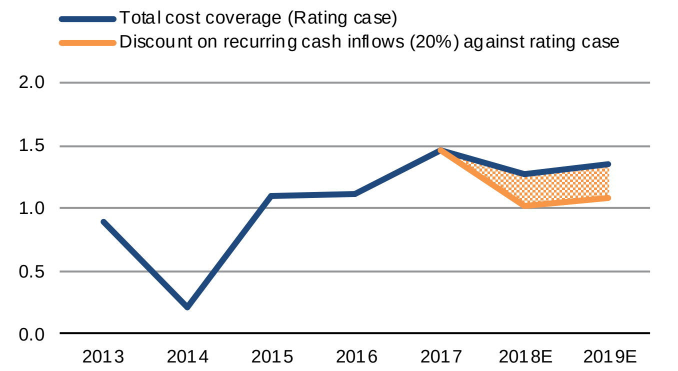
Scope calculates that expected dividend income at the holding level could fall short by 20% before threatening full cost coverage (total cost cover = 1.0x) against our rating case. Given the continuously supportive environment for Haniel's core dividend-paying investments, Scope is confident that Haniel should have sufficient headroom against a situation without full cost coverage as in 2013/14 when METRO AG did not pay out any dividends.

Figure 3: Total cost coverage



Source: Haniel, Scope estimates

Figure 4: Total cost coverage to potential downside on projected recurring cash inflows of up to 20%



Source: Scope estimates

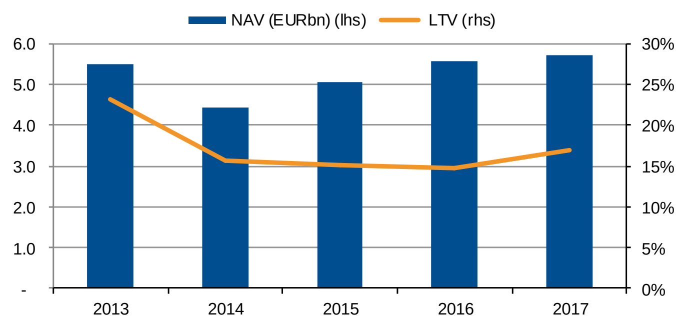
Most recent share price developments at CECONOMY and METRO demonstrate LTV volatility

Scope notes that the most recent portfolio additions have been financed through asset swaps (cash and financial assets) without any major debt funding. Haniel's LTV (Scope-adjusted debt/net asset value) stood at a comfortable 17% at YE 2017 (see Figure 5). However, Scope acknowledges that Haniel's leverage remains volatile in nature. In light of the most recent share price movements of CECONOMY and METRO, LTV may increase rapidly due to adverse market sentiment in general, or for specific core assets in the investment portfolio. Consequently, the holding's current leverage is expected to stand between 20-25%. Scope's sensitivity analysis indicates that Haniel's portfolio market value would need to decrease by 30% in order to surpass an LTV threshold of 25%.

Further debt potential of EUR 800m before debt target is reached

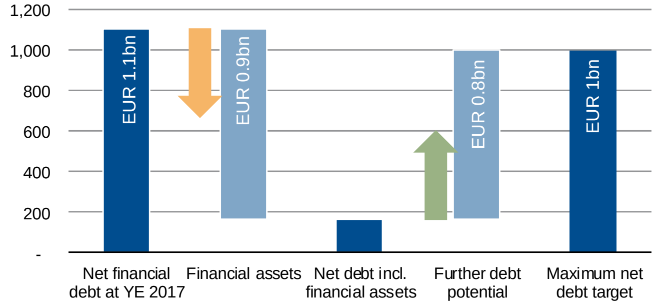
Haniel's communicated net debt ceiling of EUR 1bn affords the company further potential to raise additional debt. Whereas net financial debt already reached EUR 1.1bn at YE 2017, Scope calculates additional debt potential of another EUR 800m (see Figure 6), thereby reflecting Haniel's financial assets (financial assets including short-to-medium term shareholder loans to portfolio companies). As Haniel is likely to screen the market for further portfolio additions and execute other relatively small deals, particularly towards 2020 when additional debt potential could be released from the conversion of the exchangeable bond, we believe that in the short term the holding will focus more on integrating its most recent portfolio additions.

Figure 5: Development of net asset value and LTV



Source: Haniel, Scope

Figure 6: Potential for additional debt before reaching the maximum net debt target



Source: Haniel, Scope

Robust liquidity profile

Scope continues to assess Haniel's liquidity profile as robust. Liquidity ratios stand above 110% on a sustainable basis. Following the latest repayment of the EUR 200m corporate bond in February 2018, the company only bears the burden of i) its exchangeable bond, ii) drawn debt from its credit facilities and commercial paper programme and iii) shareholder loans, totalling around EUR 950m. Given the company's headroom on its financial debt, the access to various undrawn, committed credit lines with a volume of more than EUR 650m at YE 2017 and positive expected discretionary cash flows, Haniel is expected to comfortably cover upcoming debt maturities over the next 2.5 years.

S-2 short-term rating driven by robust liquidity and good access to funding

In light of the expected full total cost coverage, Haniel's good standing in the public and private debt capital markets and well-established banking relationships – evidenced in part by the broad mix of committed long-term credit lines from different banks – Scope affirms the S-2 short-term rating for the holding's EUR 500m commercial paper programme.

Outlook

Stable Outlook maintained

While Scope expects that Haniel's total cost coverage can be kept at around 1.3x over the next 2.5 years even including a more conservative stance on dividend streams from CECONOMY, which would trigger a positive rating action, we remain conservative until we have further guidance on this.

A rating upgrade could be warranted if our expectations regarding total cost coverage of above 1.3x are met on a sustainable basis, and if concentration risks in the portfolio are reduced as expected.

A negative rating action could result if the holding company exceeds its communicated net debt target, without offsetting this through additional dividend streams from new investee companies, or if total cost coverage is expected to deteriorate to a level below 1.0x.

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