

# RatingsDirect®

---

## Research Update:

# Alfa Laval Upgraded To 'A-' On Strong And Resilient Financial And Operational Performance; Outlook Stable

### Primary Credit Analyst:

Michael Andersson, Stockholm +46 8 440 59 30; michael.andersson@standardandpoors.com

### Secondary Contact:

Anna Stegert, Frankfurt (49) 69-33-999-128; anna.stegert@standardandpoors.com

## Table Of Contents

---

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

## Research Update:

# Alfa Laval Upgraded To 'A-' On Strong And Resilient Financial And Operational Performance; Outlook Stable

## Overview

- We think Swedish industrial machinery manufacturer Alfa Laval has shown strong, resilient operating and financial performance over several years.
- Strong, stable cash flow generation has helped Alfa Laval maintain financial and business risk profiles above its targets, despite shareholder distributions and acquisitions.
- We are raising our rating on Alfa Laval to 'A-' from 'BBB+'.
- The stable outlook reflects our expectations that the company will continue to show strong credit metrics over the coming two years, despite continued soft demand.

## Rating Action

On May 8, 2013, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Sweden-based industrial machinery manufacturer Alfa Laval AB to 'A-' from 'BBB+'. The outlook is stable.

## Rationale

We raised the rating because of the resilience of Alfa Laval's operating performance and strong credit metrics even in times of significant market downturns, relative to its rated peers. We anticipate that the company will maintain its solid cash flow performance and moderate financial policy, balancing expected ongoing acquisitions and shareholder distributions to sustain credit measures commensurate with the rating.

We also believe that Alfa Laval, with its three core product areas of heat exchange, separation, and fluid handling, is very well positioned in areas of future potential growth, such as energy, process, sanitary, marine, pharmaceutical, and food.

We consider that Alfa Laval's late-cycle profile, strong market position, good pricing power, and good cost flexibility will allow the company to maintain a stable performance. We also expect acquisitions to continue at about Swedish krona (SEK) 1.5 billion-SEK2 billion per year, but not to materially hit the financial risk profile.

Our current base-case scenario assumes a slight decrease in sales because of

continuing soft end markets on the back of slow economic conditions throughout 2013, especially in Europe. However, according to our macroeconomic base case, we expect Europe to return to growth in 2014, with the Americas and China strengthening even further, all of which should clearly benefit Alfa Laval's end markets.

We do expect some decrease in the EBITDA margin in 2013, which was slightly more than 18% in 2012, owing to weaker sales and a slight change of product mix. However, we also see 2013 as a trough year, because the reported gross margin is stable at 37%, and we think the operating margin will improve again in 2014 as sales growth returns. In view of all these factors, we expect funds from operations (FFO) to debt to remain around our target ratio of 50%, thanks to the company's strong cash generating ability and disciplined approach to acquisitions.

The rating reflects our view of the company's "strong" business risk profile and "modest" financial risk profile. Support for the rating comes from the group's leading market positions, good cost flexibility, strong profitability, a high share of stable aftermarket sales, and a fairly diverse earnings base. In addition, Alfa Laval enjoys strong, stable cash generation and, in our view, demonstrates good liquidity management. Offsetting these strengths is the group's exposure to demand cyclicalities and meaningful competition and what we see as a shareholder-friendly financial policy.

## **Liquidity**

We consider Alfa Laval's liquidity position to be "strong", with a sources-over-uses ratio of more than 2x. On March 31, 2012, the company's liquidity sources consisted of:

- Cash and liquid assets of about SEK1.7 billion, of which we consider about SEK700 million to be excess cash.
- A five-year multicurrency revolving credit facility of \$420 million and €301 million (equivalent to SEK5.2 billion, of which SEK3.5 billion was unutilized). The facility matures in April 2016, and includes two one-year extension options.
- Our expectation of annual FFO of about SEK4 billion in 2013 and thereafter.

This compares with the following near-term expected cash calls:

- \$25 million maturing in December 2013 and €100 million maturing in 2014.
- Our base-case assumptions of potential acquisitions of SEK1.5 billion-SEK2 billion in 2013 and thereafter.
- At the group's annual general meeting (AGM) on April 23, 2013, the board of directors was authorized to buy back up to 5% of the total number of outstanding shares before the next AGM in 2014. The board might not fully use this mandate if the group identifies suitable acquisition targets in the period.

## Outlook

The stable outlook reflects our expectation that Alfa Laval will continue to balance investments, acquisitions, and shareholder payouts to maintain adequate cash flow protection ratios for the 'A-' rating. We expect a continued strong operating performance in the coming two years, despite continuing soft end markets.

At the current rating level, we expect adjusted FFO to debt of about 50%, adjusted debt to EBITDA of less than 2.0x, and free operating cash flow to debt of more than 20%. In the case of a larger acquisition, we would expect the company to return to rating-commensurate metrics in 12-24 months.

We see limited potential for a further upgrade, given the combination of business and financial risk. However, we would consider raising the rating if the company demonstrated a sustained, strong financial performance exceeding the current rating requirements, as well as further strengthening of the business risk profile, for example coming from even stronger diversification.

Conversely, we would consider lowering the rating if Alfa Laval were to adopt significantly more aggressive financial behavior that led to credit ratios outside our expectations, notably on the back of large debt-funded acquisitions or aggressive shareholder returns. These two aspects are the main factors with the greatest likelihood of negatively affecting the rating, although we consider the chances of them happening to be only moderately likely.

## Related Criteria And Research

- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Key Credit Factors: Criteria For Rating The Global Capital Goods Industry, April 28, 2011
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

## Ratings List

Upgraded

	To	From
Alfa Laval AB Corporate Credit Rating	A-/Stable/--	BBB+/Positive/--

**Additional Contact:**

*Research Update: Alfa Laval Upgraded To 'A-' On Strong And Resilient Financial And Operational Performance;  
Outlook Stable*

Industrial Ratings Europe; Corporate\_Admin\_London@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2013 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription) and [www.spcapitaliq.com](http://www.spcapitaliq.com) (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

**McGRAW-HILL**