

Research Update:

Sweden-Based Capital Goods Company Alfa Laval AB Outlook Revised To Negative From Stable; 'BBB+' Ratings Affirmed

April 1, 2020

Rating Action Overview

- We believe that COVID-19, coupled with subdued oil prices and volatility in the shipping industry could dent the demand for Sweden based capital goods company Alfa Laval AB's products, exerting negative pressure on top line and profit margins in 2020.
- Although the company is taking extraordinary measures to cope with harsh market conditions cutting costs by 1 billion Swedish krone (SEK) on a rolling-12-month basis and halting expansionary capex for 2020, we still see the risk that funds from operations (FFO) to debt for 2020 could materially decline compared with 2019, where it stood at 50%.
- We are revising our outlook to negative from stable and affirming our 'BBB+' long-term issuer credit rating on Alfa Laval.
- The negative outlook reflects the potential for a lower rating over the next few quarters if sales and EBITDA decline more significantly than we expect, most likely due to the adverse economic impact from COVID-19 and lower prospects for recovery, resulting in adjusted FFO to debt below 40% or adjusted EBITDA margins falling below 18% by the end of 2020 without prospects for near-term recovery.

PRIMARY CREDIT ANALYST

Mikaela Hillman
Stockholm
+ 46 84 40 5917
mikaela.hillman
@spglobal.com

SECONDARY CONTACT

Marta Bevilacqua
Milan
+ (39)0272111298
marta.bevilacqua
@spglobal.com

Rating Action Rationale

The rating action reflects the probability that weak global macroeconomic conditions sparked by the COVID-19 pandemic coupled with subdued oil prices and volatility in the shipping industry could meaningfully dent demand for Alfa Laval's products over the near-to-medium term. This could cause credit ratios to deteriorate, including adjusted FFO to debt falling below 40% or EBITDA margins falling below 18% in 2020. In 2019, the company reached FFO/debt of about 50% and EBITDA margin of 19%. We positively acknowledge that Alfa Laval has already initiated a defensive strategy to preserve margins and cash flow aiming at reducing costs by SEK1 billion in 2020. It also halted all expansionary capex.

Marine and energy represents about 60% of sales, but only 10%-15% of Alfa Laval's total sales are directly exposed to the oil price decrease and the volatility of shipping market, and activities pertaining to the energy and shipping divisions should be more resilient. However the degree of demand drop would depend on how the company's end markets and clients will be affected by the COVID-19 amid weaker macroeconomic scenario. At this stage, we estimate that Alfa Laval's revenues could decline by 10%-20% in 2020 in our base case.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The negative outlook reflects an increasing risk of a downgrade over the next few quarters depending on how the COVID-19 outbreak and its medium-term effect would affect Alfa Laval's EBITDA margins and credit metrics, and should there be no near-term prospect of a recovery in 2021.

Downside scenario

We could lower the rating if credit ratios materially depart from our expectations, including FFO to debt below 40% for 2020. We could also lower the rating if the company's profitability deteriorates materially from historical levels, specifically if its EBITDA margins dropped significantly below 18% without near-term prospects for recovery. This could stem from further substantial restructuring expenses, or from weaker end markets, resulting in declining sales volume and order intake, in the absence of sufficient counterbalancing measures from the company.

Upside scenario

We could revise the outlook to stable if Alfa Laval's adjusted FFO-to-debt ratio for 2020 reaches at least 45% and its EBITDA margins remains above 18%.

Company Description

Alfa Laval is a leading global supplier of products and solutions for heat transfer, separation, and fluid handling. As of end-2019, the company reported revenue of SEK46.5 billion (€4.2 billion), an increase of slightly more than 14% against 2018. Alfa Laval reported an adjusted EBITDA margin of 19% for 2019, virtually unchanged from 2018 and in line with its historical trend of 18.0%-21.0%.

The company's main products are:

- Heat exchangers used for example heating and cooling applications, representing more than 30% of market share and 40% of its revenue in 2019;

- Separators and decanters to separate liquids from other liquids or solids, representing 25%-30% of market share and 17% revenue in 2019; and
- Fluid handling equipment, including pumps, valves, fittings or tank equipment for sanitary applications as well as for marine and offshore pumping, representing 10%-12% market share and 22% of consolidated revenue in 2019.

The products are used in a wide range of industrial applications for the heating, cooling, separation, and transportation of products such as oil, water, chemicals, beverages, food, pharmaceuticals, and starch.

Alfa Laval first listed on the Stockholm Stock Exchange in 1901, where it remained for 90 years, until Tetra Pak bought the company in 1991. It returned to the stock exchange on May 17, 2002. As of Dec. 31, 2019, Tetra Laval B.V., ultimately owned by Tetra Pak, controls 29.1% of Alfa Laval's capital. Free float as of the same date represents about 50% of shares outstanding. The company's market capitalization was about SEK73.6 billion (€6.7 billion) as of March 27, 2020.

Issue Ratings--Subordination Risk Analysis

Capital structure

Alfa Laval's capital structure consists of senior unsecured debt issued at its financing subsidiary, Alfa Laval Treasury International AB.

Analytical conclusions

We rate Alfa Laval's debt 'BBB+', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Negative/A-2

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers

- Diversification - Portfolio Effect: Neutral (No impact)
- Capital Structure: Neutral (No impact)
- Financial Policy: Neutral (No impact)

- Liquidity: Strong (No impact)
- Management and Governance: Satisfactory (No impact)
- Comparable Ratings Analysis: Neutral (No impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria | Corporates | Industrials: Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch Action

	To	From
Alfa Laval AB		
Issuer Credit Rating	BBB+/Negative/--	BBB+/Stable/--
Senior Unsecured	BBB+	BBB+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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.

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