

### Research Update:

## MAN SE Long-Term Rating Lowered To 'BBB+' On More Volatile Earnings And Lower Industry Profitability; Outlook Stable

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## Overview

- MAN's volumes of commercial vehicles sold deteriorated significantly more than we expected in 2009 and the outlook for the European truck market remains moderate.
- Primarily because of higher earnings volatility in the truck industry, we are lowering our long-term corporate credit rating on MAN to 'BBB+' and removing it from CreditWatch with negative implications.
- The outlook is stable, reflecting our view that MAN will be able to improve its debt protection measures.

## Rating Action

On April 7, 2010, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Germany-based diversified industrial company MAN SE to 'BBB+' from 'A-' and removed it from CreditWatch, where it was placed with negative implications on Dec. 3, 2009. The 'A-2' short-term rating is affirmed. The outlook is stable.

## Rationale

The rating action follows MAN's weaker commercial vehicle sales in 2009 than we previously expected, our view of the weak outlook for the European truck market, and our lower assessment of MAN's business risk profile, which we now consider satisfactory compared with strong previously.

In 2009, MAN reported sharply lower operating profits, with an operating margin before depreciation (excluding investment income) of 2.3%, after 9.8% in 2008. This also compares with peak-of-the-cycle margins of 10%-11% achieved in 2007-2008.

The negative margin development is mostly attributable to significantly lower volumes and low capacity utilization in the truck division. Order intake for trucks (in unit terms) was down 48% in 2009, reflecting low levels of industrial production, which in turn implies low freight volumes and low truck utilization in customers' fleets. Although the performance of MAN's Power Engineering unit (diesel and turbo) was solid in 2009, we believe cash flow contributions from these late-cycle product divisions are likely to decline in 2010 and beyond. MAN does, however, expect these divisions to report operating margins in 2010 above the 8.5% through-the-cycle target.

Our lower assessment of MAN's business risk to satisfactory reflects our view of the unexpectedly strong cyclical nature of operating earnings in the truck division, which exceeded our expectations materially. We have always reflected cyclical earnings swings in our business risk assessment for the commercial vehicles industry. However, in 2009 we observed that truck makers' earnings volatility could be much more pronounced than we have so far incorporated into our analysis. As a result of the significant drop in market volumes, MAN's operating profits in the truck division disappeared in 2009 from levels of about €1.0 billion in 2008. This potential risk of more significant earnings swings in MAN's major division was the key reason for our lowered business risk assessment.

We view MAN's improved diversification through a significantly increased footprint in Brazil and the joint venture in China as positive, but we are still cautious about whether they will translate into a sustainably improved operating margin or lower earnings volatility in the future.

We expect orders in the European truck industry to show only moderate improvements in 2010. Our ratings on MAN include our assumption of mid-single-digit growth of the European truck market in 2010. We think that the European truck market has a considerable overcapacity, which creates price risks for new vehicles. Furthermore, given that we expect a considerable number of vehicles will come off lease in 2010, we see a risk of price pressure for used and new vehicles.

For 2010, MAN expects sales and operating profit at similar levels to 2009. We also assume that the company's operating profits will be stable, mostly supported by the €700 million cost-reduction program completed in 2009 but moderate declines in profitability at the Power Engineering (diesel and turbo) unit. For the commercial vehicles division, we expect a positive operating margin, mostly due to lower under-absorption of fixed costs and benefits from the cost-reduction program. We believe the group will achieve a mid-single-digit EBIT margin in 2010.

Our CreditWatch placement of the rating on MAN with negative implications last December followed the resignation of key management members and investigations due to bribery allegations, as well as our review of MAN's business risk and financial risk profiles in view of the negative developments in the commercial vehicle markets. After the resignations in December 2009, MAN quickly appointed a new CEO and CFO, which we consider removed the uncertainty about MAN's strategic and business execution. Furthermore, investigations by public prosecution authorities were concluded in December 2009 with the payment of a €151 million fine. We have lowered our assessment of MAN's governance from conservative to moderate to reflect these negative corporate governance and risk control failures, but we believe that MAN took adequate measures to mitigate the risk of such events reoccurring in the future.

## Liquidity

We consider MAN's liquidity to be strong, underpinned by cash and marketable securities of about €0.6 billion in its industrial unit as of Dec. 31, 2009. The group has availability under a €2.0 billion variable-rate revolving credit facility (RCF), which was granted by a consortium of 25 banks and expires in December 2011. We understand that this RCF has a change-of-control clause but no financial covenants or ratings triggers. This facility was unused as of Dec. 31, 2009. The group's liquidity position is also supported by an undrawn committed €300 million credit facility from the European Investment Bank, due in 2015, and bilateral credit lines of about €0.5 billion with different banks. The bilateral credit lines are mostly due in 2010.

In 2010, MAN's capacity to serve its outstanding debt should be supported by free operating cash flow generation. On Dec. 31, 2009, short-term maturities in its industrial unit consisted of a €0.2 billion bond due in December 2010. MAN's funding sources considerably exceed upcoming debt maturities in the medium term. MAN's debt maturities in its financial services division are matched with the underlying assets.

In March 2009, MAN drew down €1.5 billion on a €2.0 billion syndicated bank facility that was arranged in conjunction with the acquisition of the Volkswagen truck business. In mid-May 2009 the €1.5 billion drawdown was paid off with a €1.5 billion bond placement. The remaining availability under MAN's €5.0 billion EMTN program is €3.5 billion. We understand that bank lines are not subject to financial covenants, rating triggers, or material adverse change clauses.

MAN's decision to reduce dividend payments for 2009, following a dividend reduction in 2009 is likewise instrumental to preserve liquidity, in our view.

## Outlook

The stable outlook reflects our view that MAN will improve its group operating margin in the industrial division to a mid-single-digit level in 2010 and markedly improve its debt protection measures. This is based on our expectations of an increase in production by MAN and a moderate recovery of the truck market in Europe.

To remain commensurate with the ratings, we would expect the industrial business to generate funds from operations of about 40% of industrial debt and industrial debt to EBITDA to be no higher than 2.0x. We believe that MAN would be able to exceed these ratios comfortably in a cyclical upturn. In a cyclical downturn, we believe it could recover to these levels within 18-24 months.

We could lower the ratings if the company increases its industrial debt leverage beyond these levels or if its liquidity situation deteriorates. Our view on the group's business risk profile limits upside ratings potential in the short term assuming no major change to MAN's business model and business

mix.

## Related Research

- Principles Of Corporate And Government Ratings, June 26, 2007
- Key Credit Factors: Business And Financial Risks In The Automaker Industry, Sept. 25, 2008
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009

## Ratings List

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
MAN SE		
Corporate Credit Rating	BBB+/Stable/A-2	A-/Watch Neg/A-2
Senior Unsecured (2 issues)	BBB+	A-/Watch Neg

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