Research Update:

Thyssenkrupp Outlook Revised To Positive On Expected Cash Inflow From Sale Of Elevator Business

March 4, 2020

PRIMARY CREDIT ANALYST

Tobias Buechler, CFA
Frankfurt
(49) 69-33-999-136
tobias.buechler
@spglobal.com

SECONDARY CONTACT

Tuomas E Ekholm, CFA
Frankfurt
(49) 69-33-999-123
tuomas.ekholm
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Rating Action Overview

- Thyssenkrupp AG (tk) has agreed to sell its elevator business for €17.2 billion to financial investors Advent International, Cinven, and RAG-Stiftung. The transaction is scheduled to close within fiscal year 2020. The elevator business has been the group's most profitable business segment, and its sale will result in lower margins and more volatile cash flows for the remaining group.
- We are therefore reassessing the business risk profile for the remaining group as fair, reflecting as well its reduced product offering and geographic footprint.
- We view the transaction as credit positive. Factors weighing on the current rating include consistently negative free operating cash flow (FOCF) generation, limited visibility of the group's strategic direction, and execution risk of the sale not going through.
- Therefore, we are affirming the ratings on tk and its issues at 'BB-' and revising the outlook to positive from developing.
- The positive outlook reflects that we will likely raise the rating over the next six to 12 months if the transaction closes as planned and tk receives sale proceeds, FOCF generation improves, and we gain clarity on the remaining group's new strategic direction and capital allocation.

Rating Action Rationale

Sale proceeds of €17.2 billion are higher than previously anticipated. We assume that the transaction will close soon because the new owners (Advent, Cinven, and RAG) are financial investors and we expect no objection from antitrust authorities. We expect the transaction will be completed before the end of thyssenkrupp AG's (tk's) 2020 fiscal year (ending Sept. 30, 2020). We also understand that with the sale a locked box mechanism as of Sept. 30, 2019, was agreed on. We understand further that the value appreciation of assets in the books will not trigger any meaningful tax payments. We estimate limited synergy losses and limited transaction and

separation costs because the segment was operating independently from the other segments.

tk will use the proceeds to repay financial debt and to restructure its remaining operations. We estimate that most of the proceeds from the disposal of elevators will be used or set aside to retire maturing financial debt. We also understand that tk will start to fund a contractual trust agreement (CTA), which will match to a large extend the liabilities and cash outflows relating to its pension obligations. We expect that tk will fund the CTA soon after it receives the proceeds, including the investment of €1.25 billion in the sold elevator business. We estimate a positive three-digit million effect on operating cash flow annually, as cash outflows for pension obligations and interest payment will be reduced along with the retirement of debt. This will compensate to a large extend the loss of positive cash flow generation from the elevator business.

The remaining group will be less profitable and have more volatile cash flows. In recent years, the sold Elevator Technology segment generated about 20% of the tk's revenue and more than 60% of the group's EBIT, diluting the margin profile by about 200 basis points, leaving our expectation for EBITDA of about 4% well below what we consider as average. After the sale, the remaining group will heavily depend on its steel operations (Steel Europe and Material Services). By nature, steel production and steel distribution operations are more volatile and have only a limited service share, leading to more volatile cash flow generation. Therefore, because the remaining group will have a lower capacity to carry debt, we now assess the business risk as fair.

Ongoing negative free cash flow and limited visibility of the remaining group's transformation strategy will weigh on the rating. The remaining group's weaker profitability and more volatile cash flows, coupled with the slowdown tk is experiencing in some of its end markets (including the auto industry) will continue to weigh on the rating. tk could underperform our base case if the coronavirus continues to hurt global supply chains and demand. We now expect tk to report S&P Global Ratings-adjusted €1.7 billion-€1.9 billion of negative free operating cash flow (FOCF) generation in fiscal 2020. With these measures, we expect an improvement to between negative €500 million and negative €300 million in fiscal 2021. We view tk's inability to generate positive FOCF as a key rating constraint and as limiting its upside now. For a higher rating, we would need to have a better understanding on the group's new strategic direction and asset allocation.

Management remains committed to reducing debt on the balance sheet, restructuring the business, and attaining an investment-grade credit rating. The management team stated its intention to improve the credit rating to investment-grade level over the medium term. We therefore assume that management will not take any shareholder-friendly measures such as paying out an extraordinary dividend or initiating a share buyback program. We expect management will initiate measures to smooth its high intrayear working capital swings.

Outlook

The positive outlook encompasses the confirmed sale of tk's elevator business for more than €17 billion, the vast proceeds of which will be applied to reduce debt and turn the group to a net cash position. The positive outlook reflects that we will likely raise the rating over the next six to 12 months if the transaction closes as planned and tk receives sale proceeds, FOCF generation improves, and we gain clarity on the remaining group's new strategic direction and capital allocation.

Upside scenario

We could raise the rating over the next six to 12 months if we are confident the transaction will be executed on time and we receive clarity on the strategy of the remaining operations in the group, including the allocation of the funds that are not used to restructure the group's balance sheet. We would also look for structural improvements in free cash flow generation and no weakening of our expectation of FOCF generation in fiscals 2020 and 2021.

Downside scenario

Ratings downside over the 12-month outlook horizon would likely materialize if the transaction does not close over the next 12 months, is canceled, or its operating performance does not improve according to our base-case expectations. Should the transaction not materialize, tk would be unable to offset its negative free cash flow of 2020 and 2021 with the proceeds, which could lead to funds from operations (FFO) to debt falling below 12% by 2021, which is not in line with a 'BB-' rating.

Company Description

Tk is a Germany-based diversified industrial conglomerate with active operations in about 80 countries. In February 2020, it publicly announced the sale of its Elevator Technology business division for €17.2 billion. At current, the group structure comprises seven segments:

- Automotive Technology: Development and production of high-tech components and development of automated production systems for the auto industry.
- Industrial Components: Manufacture of mechanical components for general engineering and the construction equipment sector.
- Elevator Technology (sold to Advent, Cinven, and RAG): Development, production, installation, maintenance, and modernization of passenger and freight elevators, escalators, moving walkways, and stair and platform lifts.
- Plant Technology: Construction of plants for the chemical, cement, and minerals industries.
- Marine Systems: System supplier for submarines and surface vessels, as well as for maritime electronics and security technology.
- Materials Services: Stainless steel production and global materials distribution.
- Steel Europe: Production of flat-rolled carbon steel for the auto industry and other sectors.

The group generated about €42 billion in revenues in fiscal 2019.

Our Base-Case Scenario

- Weaker macroeconomic conditions will continue to hamper the group's performance in 2020 and 2021. Most importantly, we expect weaker demand from the auto sector will continue to pressure its divisions with high auto exposure, namely its Steel Europe, Materials Services, and Automotive Technologies divisions. These are the group's three largest divisions by top line (excluding Elevator Technologies), and they are currently posting very weak operating margins, which we expect to persist through 2020 and only gradually improve in 2021.

- Marine systems and Plant Technology divisions currently post operating margins of zero and below. We expect margins for both divisions will improve through 2020 and 2021. In particular, Plant Technology' growing order book should help to cover the fixed costs of the business and improve its cash flow profile.
- Restructuring efforts for the underperforming business will continue, depressing cash outflow and EBITDA in fiscal 2020. Positive effects should materialize in fiscal 2021.
- Receipt of €17.2 billion from the sale of its elevator business in the second half of fiscal 2020. Most of the proceeds will be reserved to retire its financial debt and build up a CTA to cover its pension obligation going forward.
- Top line of about €32 billion in fiscal 2020 on a pro forma basis, excluding Elevator Technologies. Stagnating topline in fiscal 2021, and EBITDA of less than €1 billion in fiscal 2020, and about €1.4 billion in fiscal 2021, including our assumption of €500 million-€700 million of restructuring expenses per year, leading to modest EBITDA margins of 3%-5%.
- Annual capital expenditures (capex) of about €1.7 billion-€1.8 billion, the payout of a steel cartel fine imposed on tk (already paid in first-quarter fiscal year 2020), and transaction-related costs in fiscal 2020.

Based on the above, we arrive at the following key credit metrics:

- Net cash position in fiscals 2020 and 2021 after receiving sale proceeds.
- Negative free cash flow of €1.7 billion-€1.9 billion for fiscal 2020, improving to between negative €500 million and negative €300 million in fiscal 2021.

Liquidity

We view tk's liquidity as adequate, based on our projection that sources will exceed potential uses by more than 1.2x over the 12 months from Dec. 31, 2019. We also believe that tk's net sources will remain positive even if forecast EBITDA declines more than 15%. Our liquidity score of adequate is also supported by tk's prudent financial risk management and its well-established relationship with banks.

Our short-term rating on tk is 'B', reflecting the long-term issuer credit rating and our assessment of the group's liquidity.

Principal liquidity sources:

- Cash balances of €2.1 billion;
- Availability of €2 billion under company's main committed credit line maturing in March 2021;
- Availability of €1 billion under various other committed lines; and
- Positive FFO of about €1.2 billion-€1.3 billion over the next 12 months.

Principal liquidity uses:

- €2.6 billion of short-term debt maturities in next 12 months; including €750 million 1.75% note due in November 2020
- Annual capex of about €1.7 billion;
- No dividend payments; and

- No material intrayear working capital outflows swings, reflecting the group's peak end of first-quarter fiscal 2020.

From the current outstanding bonds, a €750 million 1.75% note is due in November 2020, and a €850 2.75% note is due in March 2021. We expect tk will retire these maturities with the cash proceeds.

Covenants

We estimate adequate headroom under its gearing covenant for its undrawn €2 billion facility, also considering the sale of the Elevator business.

Issue Ratings - Recovery Analysis

Key analytical factors

- We perform the recovery analysis on the existing capital structure, as the planned sale of its Elevator business is not closed yet.
- We rate tk's various senior unsecured notes and the €2.0 billion senior revolving credit facility 'BB-'; the recovery rating on these debt instruments is '3'.
- Our recovery expectations are in the upper half of the 50%-70% range (rounded estimate: 65%).
- Under our hypothetical scenario, a default would follow the planned sale of the Elevator business not materializing, leaving the current debt structure in place; persistent weakness in the industries in which tk operates; and operating setbacks leading to deteriorating financial performance, permanent negative free cash flow, and an inability to refinance key obligations.
- We value tk as a going concern, given the significant market positions of several of its core divisions.
- Nevertheless, we believe that many parts of the company could be broken up and sold separately, and they would provide significant value to creditors in a break-up scenario.

Simulated default assumptions

- Year of default: 2024
- EBITDA at emergence: €1.7 billion (we assume maintenance capex at 2% of revenue; cyclical adjustment of 5%, which is standard for the sector; and operational adjustment of 40%)
- Implied enterprise value multiple: 6.0x
- Jurisdiction: Germany

Simplified waterfall

- Gross recovery value: €10.5 billion

- Net recovery value for waterfall after administrative expenses (5%) and pension consideration: €6.4 billion
- First priority claims: €0.4 billion
- Value available for senior unsecured claims: €6 billion
- Senior unsecured claims: €9 billion
- --Recovery range: 50%-70% (rounded estimate: 65%)

All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Positive/--

Business risk: Fair

- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria | Corporates | Industrials: Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Industrials: Key Credit Factors For The Auto Suppliers Industry, 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/Outlook Action

	To	From
thyssenkrupp AG		
Issuer Credit Rating	BB-/Positive/B	BB-/Developing/B
Senior Unsecured	BB-	
Recovery Rating	3(65%)	
Commercial Paper	B	

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/sourceId/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.

Copyright © 2020 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. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

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 acknowledgment 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 acknowledgment 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 non-public 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 (free of charge), and www.ratingsdirect.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.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.