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Research Update:

Siemens AG Outlook Revised To Stable On Strong Performance; 'A+' Rating Affirmed

April 26, 2021

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Rating Action Overview

- Germany-based Siemens AG posted stronger-than-expected operating performance in 2020. For first-quarter fiscal 2021 (quarter ended Dec. 31, 2020), revenue was up 7% and free operating cash flow (FOCF) reached €800 million compared to negative FOCF for the same period in FY2020.
- We anticipate performance will continue improving over the next 24 months, on the back of the expected recovery of its end markets and the overall economy, and given its increasing order backlog.
- Although Siemens' financing of the Varian Medical Systems (VMS) acquisition relied on about €2 billion less equity than we estimated, this was more than offset by better cash flow and additional pension funding.
- We therefore revised our outlook on Siemens to stable from negative, and affirmed our 'A+/A-1+' long- and short-term ratings on the company.
- The stable outlook reflects our view that Siemens' operating performance will improve such that its S&P Global Ratings-adjusted EBITDA margin increases to more than 15% and funds from operation (FFO) to debt recovers to more than 50% by FY2022.

Rating Action Rationale

Siemens' operating performance and cash generation are stronger than we previously estimated, and we expect they will continue improving at least over the next 24 months. In first-quarter FY2021, its industrial businesses increased revenue 7% year over year to €13.3 billion, thanks to solid performance from its high-margin divisions, Siemens Healthineers (SHS) and Digital Industries, on the back of strong recovery in Germany and China. On a reported basis, the group's EBITDA margin rose to 17.4% in first-quarter FY2021 from 13.9% for the same period last year. The higher profitability translated into positive FOCF of €801 million compared with negative €135 million in first-quarter FY2020, which if sustained in coming years would demonstrate the benefits of the group's transformation, given that first-quarter FOCF has generally been negative. We expect the positive trend in performance will continue, supported by the expected dynamic recovery in economic activity fueled by global stimulus packages and the group's healthy book-to-bill ratio of 1.13x bringing the order backlog to €70 billion at the end of first-quarter FY2021. For FY2021, we expect revenue will increase about 7% to €60 billion, and that its S&P Global Ratings-adjusted EBITDA margin will increase to 15.5%-16.0%.

The VMS acquisition increased the group's adjusted debt considerably more than we anticipated, but this is more than offset by stronger operating cash flow generation and pension funding. SHS successfully closed the acquisition of global radiation therapy market leader VMS for $16.4 billion in cash, but funded the transaction with less equity than we previously estimated (about 35% versus our estimate of 50%). The group financed the acquisition with a mix of capital increases at SHS, in which Siemens AG did not participate, and the issuance of new debt at Siemens AG to be transferred to SHS via intragroup loans. During the past six months, SHS placed 128 million new shares, collecting €5.1 billion in cash. The capital increase diluted Siemens' SHS ownership to 75.4% from 85%. To replace its bridge facility, Siemens issued $10 billion notes in March and for the remainder used the cash on its balance sheet.

Although the financing relying on about €2 billion less equity than we estimated, we now expect a more muted contraction in credit metrics in FY2021. This is due to the group's strong operating performance and cash flow generation, the pension funding with Bentley shares reducing the group's pension deficit, and about €1.85 billion in expected cash inflow from the sale of Flender. We now expect an S&P Global Ratings-adjusted debt to EBITDA for full FY2021 on pro forma basis to be 2x, including FFO to debt of about 40%-43%, compared to our previous estimate of 2.3x and 34%-36%, respective. We forecast that leverage will recover to about 1.5x and FFO to debt to more than 50% in FY2022.

Completion of the VMS acquisition marks a further step in Siemens' Vision 2020+ strategy to achieve a higher-margin and less-volatile earnings profile. The acquisition fits well with the strategy of steering its industrial portfolio toward higher-growth segments with high technological barriers, less cyclicality, and higher margins. The shift in strategy has been underlined by the spin-off of Siemens Energy; multiple acquisitions including Corindus Vascular Robotics, Mendix Group, and Mentor Graphics; and continuous investments in its own product-lifecycle-management software and cloud services. Additionally, the recent sale of Flender (mechanical and electric drive systems) for an enterprise value of about €2 billion further confirms the shift in strategy. In our view, Siemens' execution of its strategy and the increasing contribution from SHS have strengthened the group's business profile. We estimate the group's profitability will further improve, with S&P Global Ratings-adjusted EBITDA margins reaching 15.5%-16.0% in FY2021 and about 17% in FY2022.

In light of the group's successful transformation through implementing and continuing its Vision2020+ strategy, which resulted in resilient performance during the recessionary environment in 2020, a better margin profile, and lower cash flow volatility, we have revised our management and governance assessment to strong.

We expect that Siemens will remain the majority shareholder of SHS over the long term. Despite the lower-than-anticipated dilution of its stake in SHS to 75.4% instead of 72%, we view as positive that Siemens' management has no intention to give up control over the long term. We don't expect any further dilution or sell down of its stake over the next two to three years. We estimate that Siemens will continue to fully consolidate SHS, which we believe is the best representation of the group's business, economic, and financial ties.

Siemens' track record of strong credit metrics and commitment to an 'A+' rating and conservative financial policy continue to support the rating. We understand that management remains committed to it financial policy and our 'A+' rating. We therefore estimate that the group will refrain from any further large-scale debt-funded acquisitions over the next two years. We also expect that shareholder remunerations, in particular share buybacks, will be carefully matched with free cash flow generation to ensure its deleveraging and achieve an FFO-to-debt ratio of at least 45% by FY2022. The conservative financial policy is underlined by the group's track record of strong credit metrics over the past 10 years, during which FFO to debt remained above 60%. We view the decline to below our threshold in FY2021 as temporary and resulting from the group's repositioning (Siemens Energy spin-off and the VMS acquisition).

Outlook

The stable outlook reflects our view that Siemens' operating performance will continue to improve over the next 24 months, on the back of the expected recovery of its end markets and the overall economy. In particular, we expect positive dynamics from its high-margin Digital Industries division and SHS will support the group's profitability, translating into S&P Global Ratings-adjusted EBITDA margins exceeding 15% and FFO to debt of more than 50% by FY2022.

Furthermore, we expect that Siemens will use FOCF generation to deleverage its balance sheet and balance shareholder remuneration and acquisitions in line with its conservative financial policy, which supports the rating.

Downside scenario

We could lower the rating on Siemens if its credit metrics fall below our expectations, such that FFO to debt does not reach at least 45% by FY2022 and its EBITDA margin falls below 15%. Such a development could occur if Siemens' FOCF generation does not materialize as expected--for example if the economy fell back into a recession due to a resurgence of COVID-19, leading to moderated order intake, or if the development of the group's highest-margin divisions, SHS and Digital Industries, lag our expectations, including the realization of synergies and earnings contributions from VMS.

We could also lower the rating if we observe a change in Siemens' financial policy or commitment to maintain the current rating--for example via higher-than-currently-expected shareholder remuneration or an unwillingness reduce its share buybacks in case of weaker-than-anticipated cash generation, resulting in FFO to debt taking longer than FY2022 to recover to more than 45%. We could also lower the rating if the group gives up control of SHS, which is the most stable of its operating divisions given the strong margins and steady cash flow.

Upside scenario

We could raise the rating as a result of a revenue increase and EBITDA margins rising toward 20%, as well as continuous growth of the group's highest-margin divisions, SHS and Digital Industries. An upgrade could also result from a more conservative financial policy, which could lead to FFO to debt remaining permanently above 60%.

Company Description

Siemens AG, founded in 1847, is one of the world's leading electronic engineering and manufacturing companies. With its focus on electrification, automation, and digitalization, Siemens provides hardware and software, as well as expertise to companies from a wide range of industries.

The company's principal divisions are split into Digital Industries, Smart Infrastructure, Mobility, and Healthineers.

Our Base-Case Scenario

Assumptions

- We expect a rebound in the global economy in 2021 after a very weak 2020, with GDP growth of 4.2% for the eurozone, 6.4% in North America, and 6.7% in Asia-Pacific. We foresee a slowdown in 2022 to 4.4% for the eurozone, 3.0% for North America, and 4.7% for Asia-Pacific.
- We fully included the VMS acquisition from FY2021 on a pro forma basis.
- We excluded Flender from FY2021, since the sale closed in March 2021. We estimate improving operating performance will result in revenue growth of about 7% in FY2021, mainly due to improving conditions for Siemens' business and the full contribution from VMS on a pro forma basis of about €2.8 billion, partially offset by the elimination of the Flender contribution. We expect the contribution from portfolio companies will decline over the years. We expect improving conditions in the coming quarters to continue particularly for their short-cycle business. The order backlog of about €70 billion at the end of first-quarter FY2021 also provides revenue visibility. For FY2022, we expect further revenue growth of about 3% on the back of the global economic recovery.
- We expect adjusted EBITDA margins will improve to 15.5%-16.0% in FY2021 and about 17.0%-17.5% in FY2022, from 13.8% in FY2020, driven by improving volumes, exclusion of the weaker-margin energy business, margin expansion in Digital Industries and SHS, synergies from VMS, and several cost-cutting measures. We also expect a gradual reduction in other corporate costs, such as reconciliation and adjustments to consolidated financial statements, will to benefit profits.
- Capital expenditure (capex) of about 3% of revenue over the next two years.
- A dividend payout ratio of 40%-60% of net income according to Siemens' financial policy.
- Cash inflows of about €1.85 billion in FY2021 from the sale proceeds of Flender.
- VMS acquisition calculated at €14.6 billion (acquisition closed on April 15, 2021). No material acquisitions over the next 24 months besides VMS.
- Inflow of about €2.34 billion in FY2021 from the issuance of 53 million SHS shares to finance the VMS acquisition. The issuance was completed in March 2021.
- Share buyback program with a volume of about €1 billion per year.
- No changes in financial policy. We expect the group will adjust future acquisition-related spending or share buybacks to its annual cash generation and its leverage targets.

Key metrics

Key Metrics--Siemens AG

(Bil. €)	FY2020a	FY2021f*	Change in FY2021f since previous base case§	FY2022f	Change in FY2022f since previous base case§
Sales	56.5	60.0-60.5	3	61.5-62.5	1.5
Growth (%)	(34.4)	6-7	N/A	2.5-3.5	N/A
EBITDA	7.8	9.3-9.7	0.6	10.3-10.8	0.1
Margin (%)	13.8	15.5-16.0	0.2-0.3	17.0-17.5	0
FFO to debt (%)	47.6	40-43	6-7	50<	N.M.
Debt to EBITDA (x)	1.6	1.9-2.1	(0.3)	About 1.5	N.M.

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. FFO--Funds from operations. FY--Fiscal year ending September 30. N/A--Not applicable. N.M.--Not meaningful. *Acquisitions included on pro forma basis. §Previous base case is from Aug. 4, 2020, when we revised the outlook to negative.

Liquidity

The short-term rating is 'A-1+', derived from our long-term issuer credit rating and liquidity assessment. We regard Siemens' liquidity as exceptional, with an expectation that liquidity sources will continuously exceed uses by 2x over the next 24 months. We further view Siemens' bank relationships as well established, its credit market standing as high, and its financial risk management as very prudent.

We estimate that principal liquidity sources include over the next 24 months:

- Reported cash and cash equivalents not reserved to finance the VMS acquisition of about €10 billion on Dec. 31, 2020.
- A total of €7.0 billion unused under the €7.0 billion committed revolving credit facilities (RCFs), maturing in 2025. €2.0 billion unused of its subsidiary's credit facility maturing in 2024.
- Positive FFO of €9.0 billion-€9.5 billion per year over the next 24 months
- Net proceeds of about €1.85 billion from the sale of the Flender business .

For the same period, we estimate that principal liquidity uses include:

- Short-term debt maturities of about €6.6 billion over the next 12 months, and about €6.0 billion in 2021.
- Annual capex of about €1.5 billion-€2.0 billion.
- Our assumption of discretionary dividend payments within the group's targeted payout range of 40%-60% of net income.

In our liquidity analysis, we have not included any reserved cash or cash outflow related to the VMS acquisition, which closed in March 2021.

Ratings Score Snapshot

Issuer Credit Rating: A+/Stable/A-1+

Business risk: Strong

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

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: a+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Exceptional (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a+

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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

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Ratings Affirmed; Outlook Action		
	To	**From**
RISICOM Rueckversicherung AG		
Issuer Credit Rating	A+/Stable/--	A+/Negative/--
Financial Strength Rating	A+/Stable/--	A+/Negative/--
Siemens AG		
Siemens Financial Services GmbH		
Issuer Credit Rating	A+/Stable/A-1+	A+/Negative/A-1+
Ratings Affirmed		
Siemens AG		
Siemens Capital Co. LLC		
Commercial Paper	A-1+	A-1+
Siemens Financieringsmaatschappij N.V.		
Senior Unsecured	A+	A+
Commercial Paper	A-1+	A-1+

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.