Research Update:

Siemens AG Upgraded To 'AA-' On Successful Portfolio Transformation And Conservative Financial Policy; Outlook Stable

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PRIMARY CREDIT ANALYST

Tobias Buechler, CFA
Frankfurt
+ 49 693 399 9136
tobias.buechler
@spglobal.com

SECONDARY CONTACT

Maria Vinokur
Madrid
+ 44 20 7176 3727
maria.vinokur
@spglobal.com

Rating Action Overview

- Germany-based Siemens AG continues to successfully transform its industrial portfolio by focusing on high margin businesses that have leading market positions and benefit from secular trends like digitalization and decarbonization, while also divesting its lower margin or more volatile businesses.
- The successful transformation has led to a structural improvement and higher resilience in profitability and cash flow generation, with S&P Global Ratings-adjusted EBITDA margins exceeding 17% and free operating cash flow (FOCF) of more than €8 billion in fiscal 2023 (ending Sept. 30, 2023).
- In addition, despite some notable divestments and spin-offs, the group has maintained its significant scale and higher degree of diversification compared with its main capital goods peers in the 'A' rating category.
- The group aims to maintain significant headroom under its debt to EBITDA threshold under its conservative financial policy, resulting in very strong credit metrics with funds from operations (FFO) to debt exceeding 60% in 17 of the last 20 years.
- We therefore raised our long-term rating on Siemens AG to 'AA-' from 'A+'. We also affirmed our 'A-1+' short-term rating on the company.
- The stable outlook reflects our view that Siemens' operating performance will remain solid, such that the S&P Global Ratings-adjusted EBITDA margin remains at or above 17% and FFO to debt remains above 45% with generally very significant headroom.

Rating Action Rationale

The successful industrial portfolio transformation resulted in a higher EBITDA margin, more cash generated, and a less volatile earnings profile. Over the past years, Siemens has successfully executed its strategy to steer its industrial portfolio toward higher-growth

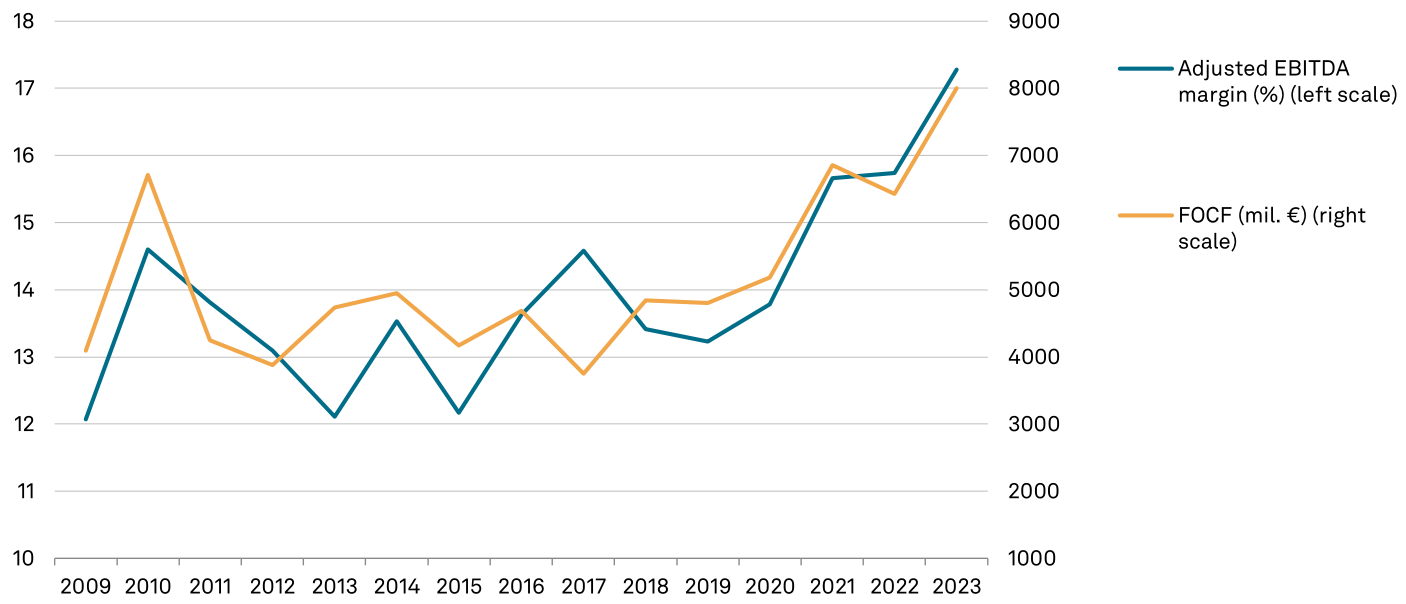
businesses with high technological barriers, leading market positions, less cyclicality, strong long-term demand characteristics, and attractive margin profiles. The group is also focusing on leading market positions as a systems provider rather than a component supplier, continuously making investments in its own product-lifecycle-management software and cloud services, and has increased the share of high margin software revenues, as evidenced by the mentor graphics acquisition. The implemented transition to software as a service (SAAS) will increase the software contribution further as well as boosting the share of recurring revenues (about 23% of revenues within its digital industries [DI] segment in fiscal 2023).

Among many bolt-on acquisitions including Corindus Vascular Robotics and Mendix Group, two o Siemens' key portfolio adjustments are the spin-off of Siemens Energy in 2020, and the acquisition of the very profitable global radiation therapy market leader Varian Medical Systems (VMS), completed in 2021, to strengthen Siemens Healthineers (SHS), its 75.4%-owned health care subsidiary. The spin-off of Siemens Energy resulted in the deconsolidation of €27 billion of revenues and reduced the group's exposure to long-term project execution risks materially. Since then, Siemens has further reduced its stake to about 17% (as of Dec. 31, 2023).

As a result, the S&P Global Ratings EBITDA margin has steadily improved and reached 17.3% in fiscal 2023 compared with 12.0%-14.6% between 2009 and 2020. In our base case, we estimate the group's profitability will further improve, with adjusted EBITDA margins reaching 17.5%-18.0% in fiscal 2024 and more than 18% in fiscal 2025 as a result of higher revenues, better pricing, and productivity gains. In particular, we expect positive dynamics from its smart infrastructure and mobility sectors to support the group's revenue growth and margin expansion. FOCF is likely to remain strong as well, at about €7 billion in fiscal 2024 compared with €8 billion in fiscal 2023. We expect a further increase in fiscal 2025 to about €7.5 billion. Given the more moderate revenue growth and continued normalization of supply chains, we estimate that working capital requirements will start to ease in fiscal 2024 and continue in fiscal 2025.

Chart 1

Higher margins and higher cash flows



FOCF--Free operating cash flow. Source: S&P Global Ratings.

Siemens has a relatively high degree of diversification and large scale within the capital goods industry. Despite the significant disposals and spin-offs losing more than €30 billion of revenue since 2020, the group has maintained a large scale within the capital goods industry--generating revenues of close to €80 billion. This is thanks to its balanced, long-term focus on capital allocation, investing into research and development (R&D; 8% of revenues), growth capital expenditure (capex), and acquisitions.

Siemens maintains an unmatched diversified global industrial portfolio, with operations across multiple end markets, including building technologies, mobility, digitalization, and automation. Its portfolio also includes activities unrelated to the industrial investment cycle, particularly health care. The group's applications across short-cycle and long-cycle segments and increasing share of recurring revenue give it a resilient business mix, which ensures some earnings stability during the economic cycle. This was notable during the recessionary environment in 2020 and in the current, rather muted, economic environment.

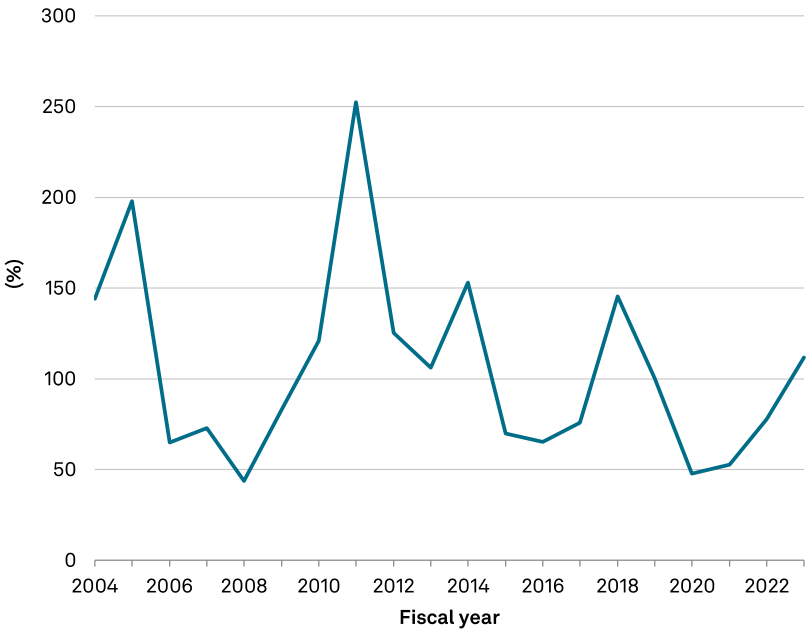
The majority holding in SHS (75.4%) reflects the diversification benefits Siemens enjoys from the less cyclical and generally highly profitable health care operations. SHS is fully consolidated and is listed--a fungible stake could be monetized or used to fund acquisitions, like VMS, to protect credit metrics. Siemens' shareholding has a current value of about €46.5 billion.

Siemens' track record of very strong credit metrics and a conservative financial policy support the upgrade. The conservative financial policy aims to maintain a reported net debt to EBITDA ratio of up to 1.5x (by Siemens' definition), which fits well with S&P Global Ratings-adjusted FFO to debt of more than 45%, where the company usually maintains large headroom with FFO to debt of more than 60%. Over the past two decades, FFO to debt was only below 45% during the financial crisis of 2008, and below 60% in 2020 and 2021, due to the effects of the spin-off of Siemens Energy, the Varian acquisition, and the pandemic. We understand that management remains committed to its conservative financial policy, with its leverage target acting as a ceiling meaning it builds headroom before executing larger acquisitions. As well, we expect shareholder remunerations, in particular buybacks, will be carefully matched with FOCF to ensure achieving an FFO to debt ratio of comfortably above 45% over the next 24 months.

In our base case for fiscals 2024-2025, we expect credit metrics to remain very strong with debt to EBITDA of well below 1.0x and FFO to debt well above 60%. For fiscal 2023, adjusted debt-to-EBITDA was 0.6x, compared with 1.0x for fiscal 2022.

Chart 2

FFO to debt



Source: S&P Global Ratings.

Outlook

The stable outlook reflects our view that Siemens'; operating performance will continue to improve over the next 24 months, on the back of healthy secular demand in its end markets, despite some challenges in the wider economy. We expect adjusted EBITDA margins to remain between 17%-19% over the next 24 months, while maintaining strong credit metrics with funds from operations (FFO) to debt well above 45%. We anticipate Siemens will continue to maintain comfortable headroom under our rating threshold during normal operating circumstances, as well as to balance shareholder remuneration and acquisitions, in line with its conservative financial policy.

Downside scenario

We could lower the rating on Siemens if its credit metrics fall below our expectations, such that FFO to debt declines below 45% and its EBITDA margin structurally falls below 17%.

We could also lower the rating if:

- Siemens' FOCF generation does not materialize as expected--for example, if the economy falls back into a prolonged recession, leading to a notable decline in order intake, or if development in the group's highest-margin divisions, SHS and DI, lags our expectations.
- We observe notable market share losses or lower competitiveness, resulting in slower revenue growth compared with GDP or its main peers in capital goods industry.
- We observe a change in Siemens' financial policy or commitment to maintain the current rating--for example, via less-balanced shareholder renumerations versus internal and external growth investments or an unwillingness to reduce share buybacks in case of weaker-than-anticipated cash generation.
- The group relinquishes control of SHS, which is the most stable of its operating divisions and has strong margins and steady cash flow.

Upside scenario

A positive rating action is very limited, in our view. We could raise the rating if EBITDA margins increase well beyond 20% or the group further substantially improves its business diversification into low volatile business, while at the same time its conservative financial became more conservative leading to FFO to debt remaining permanently above 60%.

Company Description

Siemens AG, founded in 1847 and headquartered in Germany, is one of the world's leading electronic engineering and manufacturing companies. In the fiscal year to Sept. 30, 2023, the group recorded S&P Global Ratings-adjusted revenue of €77 billion and adjusted EBITDA of more than €13 billion.

It operates through three fully owned segments: DI; smart infrastructure; and mobility. In addition, it consolidates two segments: SHS (75% owned) and Siemens Financial Services (100% owned).

- DI offers automation systems and software for factories; numerical control systems; motors,

drives, and inverters; and integrated automation systems for machine tools and production machines. It also offers process control systems; machine-to-machine communication products; sensors and radio frequency identification systems; software for production and product life cycle management; software for the simulation and testing of mechatronic systems; and cloud-based industrial internet of things (IoT) operating systems.

- Smart infrastructure offers products, systems, solutions, services, and software to support the sustainable transition in energy generation from fossil and renewable sources; sustainable buildings and communities; and buildings, electrification, and electrical products.
- Mobility provides passenger and freight transportation, such as vehicles, trams and light rail, and commuter trains, as well as trains and passenger coaches; locomotives for freight or passenger transport as well as solutions for automated transportation; products and solutions for rail automation; electrification products; and intermodal solutions.
- SHS develops, manufactures, and sells various diagnostic and therapeutic products and services; and provides clinical consulting services.
- Siemens Financial Services offers leasing, lending, and working capital financing solutions and equipment, project, and structured financing solutions.

We view the group's captive finance operations as neutral in terms of the group's credit profile. This reflects the historically low loss rates and leverage of these operations.

In September 2020, Siemens completed the spinoff of its energy business, Siemens Energy AG (oil and gas, conventional power generation, power transmission, and renewable energies) to a separately managed publicly listed company. As of Dec. 31, 2023, Siemens directly and indirectly held a stake of about 17% in Siemens Energy.

Our Base-Case Scenario

Assumptions

- Globally, we expect real economic growth to slow from 3.3% in 2023 to 3.0% in 2024 and a rebound to 3.3% in 2025. For the eurozone, we expect GDP growth of about 0.8% in 2024 and 1.5% in 2025, after growth of 0.6% in 2023. In China, we forecast GDP growth will reduce to 4.6% in 2024 and 4.8% in 2025 from 5.4% in 2023. In the U.S., we forecast GDP growth to decelerate to about 1.5% in 2024 and 1.4% in 2025 from 2.4% in 2023.
- We forecast revenue growth of 4%-6% in fiscals 2024 and 2025, based on the strong order book growth seen over the past 12 months. The order backlog position of about €111 billion at the end of fiscal 2023 provides good revenue visibility.
- We expect adjusted EBITDA margins to be 17.5%-18.5% over fiscals 2024 and 2025, compared with 17.3% in fiscal 2023. In our view, this is mainly because of the normalization of inflationary environment even though the company is prone to the weaker macroeconomic environment, combined with the increase in R&D expenses caused by the company's focus on software and digital technologies. The tighter margins are offset by modest volume improvements, margin expansion in DI and SHS, and the effect of various cost-cutting measures. Profits are also likely to benefit from a gradual reduction in other corporate costs.
- Capex of about 2.7%-2.9% of revenue over the next two years.
- Working capital outflows of up to €1 billion for fiscals 2024 and 2025 to support growth.

- Dividend distribution (including to minorities) of about €4.2 billion in fiscal 2024 (increase of 45 cent per share to €4.70 from €4.25). For fiscal 2025, we estimate dividend distributions including minorities will increase further, to about €4.6 billion.
- Acquisition budget of about €2.5 billion per year.
- Cash outflow of up to €3.0 billion per year toward share repurchases under the new share buyback program, which has a volume of €6 billion, to be executed over the next five years.

Key metrics

Siemens AG--Key metrics*

	--Fiscal year ended Sept. 30--						
Mil.€	**2019a**	**2020a**	**2021a**	**2022a**	**2023a**	**2024e**	**2025f**
Revenue	86,072	56,472	61,602	71,345	77,301	80,000-82,000	84,000-86,000
EBITDA	11,389	7,784	9,644	11,228	13,357	14,000-14,500	15,000-15,500
Funds from operations (FFO)	8,224	5,898	7,139	8,853	10,239.80	11,500-12,000	12,500-13,000
Capital expenditure	2,167	1,112	1,431	1,758	1,885	2,000-2,200	2,000-2,200
Free operating cash flow (FOCF)	4,804	5,180	6,855	6,429	8,003	~7,000	~7,500
Dividends	3,306	3,382	3,089	3,569	3,751	~4,200	~4,600
Share Repurchases	1,407	1,517	547	1,870	1288	<3,000	<3,000
Acquisitions	958	1727	14391	2207	407	2,500	2,500
Debt	8,219	12,389	13,570	11,372	9154	12,500-13,500	13,500 - 14,500
Debt to EBITDA (x)	0.7	1.6	1.4	1.0	0.7	<1	<1
FFO to debt (%)	100.1	47.6	52.6	77.8	111.9	~100	~100
FOCF to debt (%)	58.4	41.8	50.5	56.5	87.4	55-65	55-65
Annual Revenue growth (%)	4.7	(34.4)	9.1	15.8	8.3	4-6	4-6
EBITDA margin (%)	13.2	13.8	15.7	15.7	17.3	17.5-18.0	18.0-18.5

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

The short-term rating is 'A-1+', derived from the long-term rating on Siemens AG. We regard Siemens' liquidity as exceptional, with an expectation that liquidity sources will continuously exceed uses by 2x over the next 24 months from the end of September 2023. 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:

- Reported cash and cash equivalents of about €11.3billion at the end of September 2023.
- A total of €7.5 billion unused committed credit lines, including €450 million of revolving credit facility maturing in September 2024 and remaining €7 billion maturing in February 2026.
- Positive FFO of about €11.0 billion-€12.0 billion per year over the next 24 months.

- Net payments received from captive portfolio run off of about €5 billion in fiscal 2024 and more than €3.5 in fiscal 2025.

We estimate that the principal liquidity uses include:

- Short-term debt maturities of about €9.1 billion in fiscal 2024 and about €5.6 billion in fiscal 2025.
- Annual capex of about €2.2 billion-€2.4 billion.
- Working capital outflow of about €1 billion per year.
- Dividend payment of about €4.2 billion in fiscal 2024 and about €4.6 billion in fiscal 2025.

Covenants

The capital structure does not contain any covenants.

Environmental, Social, And Governance

Governance factors are a positive consideration in our credit rating analysis of Siemens. This is because the company adheres to the highest standard of disclosure, and management is committed to long-term, sustainable organic growth. We also view positively the group's forward-looking strategic planning processes and ability to execute on its strategy.

Environmental and social factors are an overall neutral consideration in our credit rating analysis. That said, Siemens is likely to benefit from the current sustainability trends through its smart infrastructure segment, providing energy saving infrastructure and services for buildings, and through its mobility segment, benefiting from government investments into less carbon-intense railway transportation infrastructure, and from its software offering (digital twin) to design energy-efficient production lines and products.

Sustainability is one of Siemens' core organizational values. The company has aligned its internal targets with the U.N.'s Sustainable Development Goals 2030. As a part of its environmental agenda, Siemens pledges its operations will be carbon neutral by 2030, by reducing in-house CO2 emissions.

Also, Siemens targets net zero operations by 2030, waste-to-landfill reduction by 50% by 2025, and zero landfill waste by 2030. Through its health care segment, the group benefits from the aging population and advancements in medical systems and treatments.

Issue Ratings - Subordination Risk Analysis

Capital structure

Siemens' outstanding debt consists largely of senior unsecured obligations issued by the group's financing entities.

Analytical conclusions

We rate Siemens' senior unsecured debt 'AA-', in line with the issuer credit rating, because no

significant elements of subordination risk are present in the capital structure and adjusted debt to EBITDA is well below 2x.

Ratings Score Snapshot

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

Business risk: Strong

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

Financial risk: Modest

- Cash flow/leverage: Modest

Anchor: a+

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Exceptional (no impact)
- Management and governance: Positive (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: aa-

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Oct. 23, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 And Assumptions: Liquidity Descriptors For Global

Corporate Issuers, Dec. 16, 2014

- 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Upgraded		
Siemens AG		
Siemens Financial Services GmbH		
Issuer Credit Rating	AA-/Stable/A-1+	A+/Stable/A-1+
Ratings Affirmed		
Siemens Servicios Comerciales S.A. de C.V. Sofom E.N.R.		
Issuer Credit Rating	A-/Stable/--	A-/Stable/--
Ratings Affirmed		
Siemens AG		
Siemens Capital Co. LLC		
Siemens Financieringsmaatschappij N.V.		
Commercial Paper	A-1+	A-1+
Upgraded		
Siemens AG		
Siemens Financieringsmaatschappij N.V.		
Senior Unsecured	AA-	A+
Upgraded		
	To	**From**
RISICOM Rueckversicherung AG		
Issuer Credit Rating		
Financial Strength Rating		
Local Currency	AA-/Stable/--	A+/Stable/--