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Danfoss A/S

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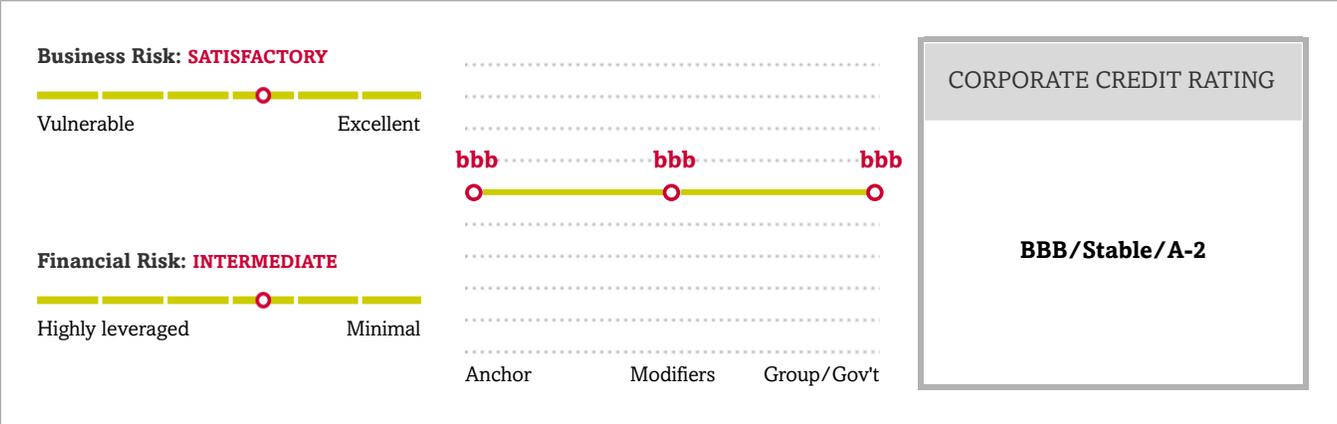
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Danfoss A/S



Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
<ul style="list-style-type: none"> • Leading market positions in electrical and mechanical components in a number of industry segments. • Good degree of customer, end market, and geographic diversity. • Good cost position, resulting in high operating margins, which are at the upper end of the 11%-18% range that we view as average in the capital goods sector. • Exposure to cyclical demand. • Competition in pricing and product performance. 	<ul style="list-style-type: none"> • Track record of robust cash flow generation. • Strong liquidity and well-spread debt maturity profile. • Growth-oriented strategy, with a number of acquisitions over recent years. • Limited access to equity, owing to status as a privately-held company.

Outlook: Stable

The stable outlook on Denmark-headquartered capital goods company Danfoss A/S reflects S&P Global Ratings' expectation that the company will maintain adjusted funds from operations (FFO) to debt comfortably above 30%, adjusted debt to EBITDA of less than 3x, and positive free operating cash flow (FOCF), in line with the current rating. Our base case assumes the company will deliver adjusted FFO to debt in the range of 40%-45% over 2016 and 2017. We factor in our assumption that Danfoss will continue to report a stable operating performance, leading to solid operating cash flows that we assume the company will apply to reduce debt over the coming years.

Upside scenario

Given Danfoss' strong cash flow generation, we see some potential for a one-notch upgrade over the medium term. A positive rating action would likely depend on Danfoss' ability to sustain adjusted FFO to debt exceeding 45% and adjusted debt to EBITDA at below 2x, combined with a more conservative financial policy and leverage tolerance compared to the company's current commitment.

Downside scenario

We could consider a negative rating action if there was a significant deterioration in Danfoss' credit metrics due to a weakening operating performance or an aggressive debt-financed acquisition, resulting in adjusted FFO to debt below 30% on a sustained basis.

Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> • Low organic revenue growth of about 2%, benefiting from Danfoss' diverse end-market and geographic exposure despite the current weak global macroeconomic environment. Low commodity prices are affecting the company's agriculture, marine, oil and gas, and mining end-markets, resulting in relatively weaker growth in its power solutions (globally) and drives divisions, to an extent. On the other hand, the downturn in Russia and the weak ruble are affecting the company's heating segment. These are offset by relatively better prospects in its cooling (North America) and drives (North America and Europe) divisions. • Profitability to remain stable thanks to ongoing efficiency improvement measures. Adjusted EBITDA margins to remain about 17%. • Capital expenditure (capex) to sales roughly in line with historical levels at about 3.5% of revenues. • Annual dividend payouts of around Danish krone (DKK) 1 billion. • Payouts for bolt-on acquisitions of DKK1 billion per year. 				
		2015A	2016E	2017E
	EBITDA margin (%)*	16.6	16.0-17.0	16.0-17.0
	FFO to debt (%)*	42.5	40.0-45.0	40.0-45.0
Debt to EBITDA (x)*	1.9	1.5-2.0	1.5-2.0	
	<p>*Margins and ratios include our debt adjustments for operating leases and postretirement obligations. A--Actual. E—Estimate.</p>			

Company Description

Danfoss is a leading producer of electrical and mechanical components in a number of industry segments. With revenues of about DKK38 billion (about €5.1 billion) in 2015, Danfoss is a mid-sized European capital goods company.

Danfoss operates with four segments:

- Danfoss Power Solutions: Hydraulic systems and components for off-highway mobile equipment manufacturers. End markets include cyclical end markets such as agriculture, construction and material handling, and specialty equipment.
- Danfoss Cooling: Components for the air conditioning and refrigeration industry.
- Danfoss Drives: Development and production of low-voltage drives and power modules. End markets are fairly diverse, comprising several industrial sectors, including heating, ventilation, air conditioning, mining, lifts and elevators, food and beverage, automotive, and wind.
- Danfoss Heating: Heating components for residential and commercial heating and district energy for cities.

Danfoss is a privately-held company and controlled by the Bitten and Mads Clausen Foundation that together with the Clausen family, holds 94.9% of voting shares.

Business Risk: Satisfactory

Danfoss' satisfactory business risk profile is supported by the company's leading market positions for electrical and mechanical components in a number of industry segments. We also view positively the company's good degree of customer end-market diversification and its fairly good geographic diversification. In 2015, Danfoss generated about 52% of its revenues outside Europe.

Other positive factors are Danfoss' good profitability, with adjusted EBITDA margins that averaged about 17% over the past three years, thereby positioning Danfoss at the upper end of the 11%-18% range that we view as average in the capital goods sector.

Those strengths are tempered by Danfoss' exposure to cyclical demand in a number of its segments. The power solutions segment showed the most significant decline in the 2008-2009 global financial downturn, with demand being dependent on fairly cyclical end markets. The other segments also showed volatility, but to varying degrees. We understand that the cooling and heating segments are also somewhat dependent on inventory stocking cycles, which exaggerates underlying cyclicalities. However, heating has shown the least cyclicalities among Danfoss' businesses in the past. Danfoss is exposed to pricing competition in a number of its segments.

Base-Case Operating Scenario

- A continued focus on efficiency improvements, coupled with low organic volume growth and disciplined pricing policies, which should allow Danfoss to show stable adjusted EBITDA margins of about 16%-17% over 2016-2017, compared with 16.6% in 2015.

Peer comparison

Table 1

Danfoss A/S -- Peer Comparison						
Industry Sector: Diversified						
	Danfoss A/S		SKF AB	Sandvik AB	Metso Corp.	Alfa Laval AB
Rating as of June 13, 2016	BBB/Stable/A-2		BBB/Negative/--	BBB/Negative/A-2	BBB/Stable/A-2	BBB+/Negative/--
--Fiscal year ended Dec. 31, 2015--						
(Mil. Mix curr.)	Dkr	kr	kr	€	kr	
Revenues	38,031.0		75,997.0	85,845.0	2,977.0	39,746.0
EBITDA	6,314.0		10,340.5	13,300.5	411.2	7,935.0
Funds from operations (FFO)	4,997.9		7,097.7	8,903.0	285.0	5,871.0
Net income from cont. oper.	2,381.0		3,880.0	3,496.0	442.0	3,839.0
Cash flow from operations	5,053.9		8,108.6	11,749.0	400.8	5,927.0
Capital expenditures	1,300.0		2,299.0	4,308.0	46.0	674.0
Free operating cash flow	3,753.9		5,809.6	7,441.0	354.8	5,253.0
Discretionary cash flow	3,012.9		3,204.6	3,048.0	137.8	3,557.0
Cash and short-term investments	319.0		7,218.0	6,376.0	657.0	2,897.0

Table 1

Danfoss A/S -- Peer Comparison (cont.)					
Industry Sector: Diversified					
	Danfoss A/S	SKF AB	Sandvik AB	Metso Corp.	Alfa Laval AB
Debt	11,755.1	29,222.1	36,810.2	414.6	15,602.0
Equity	15,424.0	26,282.0	34,343.1	1,444.0	18,423.0
Adjusted ratios					
EBITDA margin (%)	16.6	13.6	15.5	13.8	20.0
Return on capital (%)	14.4	12.5	10.1	16.0	15.8
EBITDA interest coverage (x)	15.7	8.6	4.7	6.9	15.0
FFO cash int. cov. (X)	18.9	10.6	6.2	12.3	20.2
Debt/EBITDA (x)	1.9	2.8	2.8	1.0	2.0
FFO/debt (%)	42.5	24.3	24.2	68.7	37.6
Cash flow from operations/debt (%)	43.0	27.7	31.9	96.7	38.0
Free operating cash flow/debt (%)	31.9	19.9	20.2	85.6	33.7
Discretionary cash flow/debt (%)	25.6	11.0	8.3	33.2	22.8

Financial Risk: Intermediate

We assess Danfoss' financial risk profile as intermediate, reflecting its robust adjusted FOCF generation over the past five years, with consistently positive adjusted FOCF ranging between DKK2 billion and DKK3.8 billion per year.

We anticipate that Danfoss will continue to generate solid FOCF, which should help the company to deleverage. We also note Danfoss' commitment to maintain a 'BBB' rating, and we anticipate that the company will consider potential future acquisitions carefully in light of expected earnings and cash flow generation prospects.

The strengths of Danfoss' financial risk profile are somewhat moderated by the company's focus on expansionary growth that led to a number of acquisitions over recent years. We also consider Danfoss' access to equity as limited owing to its status as a privately held company. This is somewhat balanced by shareholder remuneration levels--with dividend payouts to Danfoss shareholders of no more than 30% of net income in addition to minority dividends--which are lower than most of Danfoss' public Scandinavian peers.

Base-Case Cash Flow And Capital Structure

- Strong operating performance supporting robust FOCF generation of DKK3.0 billion-DKK 3.5 billion, and deleveraging over the next two years.
- Adjusted FFO to debt at about 40%-45% and adjusted debt to EBITDA of about 1.5x-2.0x over the coming two years.

Financial summary

Table 2

Danfoss A/S -- Financial Summary

Industry Sector: Diversified

	--Fiscal year ended Dec. 31--				
	2015	2014	2013	2012	2011
Rating history	BBB/Stable/A-2	BBB/Stable/A-2	-/-/-	-/-/-	-/-/-
(Mil. DKK)					
Revenues	38,031.0	34,375.0	33,628.0	34,007.0	33,904.0
EBITDA	6,314.0	6,135.0	5,679.5	6,049.5	5,552.5
Funds from operations (FFO)	4,997.9	4,758.6	4,200.7	4,846.3	4,305.6
Net income from continuing operations	2,381.0	2,104.0	2,037.0	1,998.0	1,871.0
Cash flow from operations	5,053.9	4,689.6	4,776.7	4,524.3	3,617.6
Capital expenditures	1,300.0	1,224.0	1,183.0	1,175.0	1,257.0
Free operating cash flow	3,753.9	3,465.6	3,593.7	3,349.3	2,360.6
Discretionary cash flow	3,012.9	2,518.6	2,999.7	2,814.3	2,156.6
Cash and short-term investments	319.0	716.0	737.0	888.0	829.0
Debt	11,755.1	14,258.4	6,702.5	6,294.4	7,848.8
Equity	15,424.0	13,242.0	11,443.0	14,193.0	12,597.0
Adjusted ratios					
EBITDA margin (%)	16.6	17.8	16.9	17.8	16.4
Return on capital (%)	14.4	16.1	18.0	16.3	16.2
EBITDA interest coverage (x)	15.7	20.1	17.4	14.2	12.0
FFO cash int. cov. (x)	18.9	23.0	17.3	9.9	8.6
Debt/EBITDA (x)	1.9	2.3	1.2	1.0	1.4
FFO/debt (%)	42.5	33.4	62.7	77.0	54.9
Cash flow from operations/debt (%)	43.0	32.9	71.3	71.9	46.1
Free operating cash flow/debt (%)	31.9	24.3	53.6	53.2	30.1
Discretionary cash flow/debt (%)	25.6	17.7	44.8	44.7	27.5

DKK--Danish krone.

Liquidity: Strong

We assess Danfoss' liquidity as strong. We expect sources of liquidity to exceed uses by at least 1.5x over the 12 months from March 31, 2016. We also expect that liquidity sources would exceed uses even if EBITDA declined by 30%. We view Danfoss' bank relationships as well established, its credit market standing as high, and its risk management as very prudent. The company does not have any financial covenants.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • About DKK500 million of total cash as of March 31, 2016; • About DKK7.2 billion available under a number of long-term committed credit lines as of March 31, 2016; and • Cash FFO generation of more than DKK4 billion per year over 2016-2017. 	<ul style="list-style-type: none"> • Seasonal working capital outflows of DKK500 million-DKK1 billion; • Capex of roughly DKK1.3 billion-DKK1.4 billion annually; and • Dividend payouts of DKK1 billion annually.

Debt maturities

- 2016: DKK0.7 billion
- 2017: DKK1.8 billion
- 2018: 0
- 2019: DKK0.8 billion
- 2020: DKK0.9 billion
- Thereafter: DKK5.6 billion

Covenant Analysis

Danfoss has no financial maintenance covenants with which it needs to comply.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

Business risk: Satisfactory

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

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

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 rating analysis:** Neutral (no impact)

Reconciliation

Table 3

Reconciliation Of Danfoss A/S Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. DKK)							
--Fiscal year ended Dec. 31, 2015--							
Danfoss A/S reported amounts							
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations
Reported	10,076.0	14,700.0	6,023.0	4,097.0	297.0	6,023.0	4,667.0
S&P Global Ratings adjustments							
Interest expense (reported)	--	--	--	--	--	(297.0)	--
Interest income (reported)	--	--	--	--	--	65.0	--
Current tax expense (reported)	--	--	--	--	--	(954.0)	--
Operating leases	973.4	--	391.0	75.3	75.3	315.7	315.7
Postretirement benefit obligations/deferred compensation	831.8	--	--	--	31.0	(54.8)	71.3
Surplus cash	(148.0)	--	--	--	--	--	--
Capitalized development costs	--	--	--	17.0	--	--	--
Dividends received from equity investments	--	--	5.0	--	--	5.0	--
Non-operating income (expense)	--	--	--	65.0	--	--	--
Non-controlling Interest/Minority interest	--	724.0	--	--	--	--	--
Debt - Other	22.0	--	--	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	--	(67.0)	(67.0)	--	(67.0)	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	(38.0)	(38.0)	--	(38.0)	--
EBIT - Income (expense) of unconsolidated companies	--	--	--	67.0	--	--	--
Total adjustments	1,679.1	724.0	291.0	119.3	106.3	(1,025.1)	386.9
S&P Global Ratings adjusted amounts							
	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations
Adjusted	11755.1	15424.0	6314.0	4216.3	403.3	4997.9	5053.9

DKK--Danish krone.

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 15, 2016)

Danfoss A/S

Corporate Credit Rating BBB/Stable/A-2

Senior Unsecured BBB

Corporate Credit Ratings History

10-Nov-2014 BBB/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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