S&P Global Ratings

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Research Update:

Sweden-Based Capital Goods Company Indutrade Assigned 'BBB-' Rating; Outlook Stable

March 29, 2021

Rating Action Overview

- Indutrade AB is a Swedish industrial and technology group that acquires and develops niche companies within the capital goods industry. The group currently consists of more than 200 companies, and it generated revenue of about Swedish krona (SEK) 19.2 billion (€1.9 billion) in 2020 with an S&P Global Ratings-adjusted EBITDA margin of 16.3%.
- Indutrade's decentralized business model, alongside its solid product and end-market diversification, , gives it resilient profitability and free cash flow generation over the cycle.
- We expect Indutrade to continue growing inorganically, utilizing its free cash flow primarily for acquisitions and to a lesser extent for shareholder distributions.
- We are assigning Indutrade our 'BBB-' rating.
- The stable outlook reflects our expectation that Indutrade will sustain its profitability, with EBITDA margin at about 16%, while generating free operating cash flow (FOCF) of about SEK2 billion annually, and adjusted funds from operations (FFO) to debt comfortably above 30% over time.

PRIMARY CREDIT ANALYST

Mikaela Hillman
Stockholm
+ 46 84 40 5917
mikaela.hillman
@spglobal.com

SECONDARY CONTACT

Marta Bevilacqua
Milan
+ (39)0272111298
marta.bevilacqua
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Rating Action Rationale

Indutrade's track record of stable earnings, good cash generation profile, and sound financial flexibility underpin the group's credit quality. The group has a track record of resilient profitability. It reported an EBITDA-margin of 14.0%-15.0% in 2014-2017, improving to above 15.4% over the past three years. As a result, its FOCF exceeded SEK1 billion a year, on average, over the past five years. The resilience of Indutrade's business model stems from its wide range of products and end-market diversity, supported by its large portfolio of niche companies. Although treasury functions and risk management are fully centralized, a key factor for Indutrade's operating profit resilience and sound FOCF generation is embedded in its decentralized operational structure, which makes the group agile and closer to clients' needs. Indutrade has historically held a good leverage position, despite leaning on FOCF to drive acquisition-led growth. This resulted in adjusted leverage of 1.9x-2.3x, and FFO to debt consistently above 30% over

2014-2019. We view positively the group's ability to reduce debt over 2020, when adjusted debt to EBITDA improved to about 1.6x and FFO to debt improved to approximately 50.5%, despite the operating challenges caused by the pandemic.

Indutrade is agile and adapts to customers' needs thanks to its highly decentralized operating model. The group expanded by an average 14% a year over 2014-2019, and slightly more than 50% of this growth was through acquisitions. The group's consolidated sales reached SEK19.2 billion (€1.9 billion) in 2020, up 4.4% from 2019. Indutrade acquires companies with the aim of developing them over time. It offers, with its centralized treasury, the financing infrastructure for a balanced growth. The group maintains the identities of the companies, without rebranding or merging. Indutrade promotes an entrepreneurial model by which each of its more than 200 subsidiaries is directly responsible for its own operations and results. We expect the group will stick to its growth strategy, acquiring relatively small size niche players (that typically report annual revenue between SEK50 million and SEK300 million or €5 million-€30 million). For 2021 and 2022, we expect the group's acquisition spending to reach up to SEK1.5 billion-SEK2 billion per year.

Indutrade's EBITDA margin should remain stable at around 16% in 2021-2022, underpinned by end-market diversity and a high volume of repeat sales. Indutrade is relatively small size and has a limited geographical reach compared with bigger capital goods companies such as Danfoss, Alfa Laval, or Sandvik. That said, its margin stability has been remarkable over the years. This is because each entity it operates represents a fairly small share of the wider group. The largest company in the group accounts for no more than 3% of sales. Additionally, the group focuses on critical components (e.g., filters, seals, gaskets, etc.) used in customers' production processes, where production uptime is the main driver. About 75% of sales is maintenance-, repair-, or operations-driven, rather than powered by capital expenditure (capex) or projects. Unit prices per piece sold are usually low, compared with the cost of the customer's downtime, which also supports repeated sales. Finally, the main end-markets are infrastructure/construction (20% of sales), engineering (16%), medical technology/pharmaceutical (15%), process industry (8%), and energy (8%). Although some of the company's end markets are cyclical and affected by global economic conditions, the diversity of its companies, from both an end-market and product perspective, protects it against any one company dragging down profitability and cash flow for an extended time.

Centralized treasury and risk management, combined with cash pools, allow the group to route resources where needed. While at the operating level each single subsidiary runs as a self-standing entity, Indutrade's treasury functions are centralized at the parent company level and about 98% of consolidated debt sits at the parent. Indutrade's efficient cash management is supported by a number of cash pools that allow the company to have immediate access to cash if needed. That said, the cash held at the parent is typically very low (zero at year-end 2020). This is because the company typically finances its cash outlays through commercial paper and bank overdraft facilities--as soon as the cash becomes available, it's dedicated to debt repayment. We understand that about 35% of the group's profits are outside efficient cash pools. If needed, these would require manual transfers of cash. At the same time, we note that Indutrade benefits from its fully available revolving credit facilities (RCFs), which cover almost the full amount of its debt. The short-term debt typically accounts for about one-third of total debt outstanding. In our view, this compares negatively with other investment-grade companies in the capital goods industry, where we typically see larger shares of cash on hand and longer average debt maturity profiles.

Indutrade managed to improve its credit metrics over the pandemic thanks to strong earnings and FOCF, combined with dividend cancellation and somewhat lower acquisition spending. Last year was characterized by a difficult operating environment because of the pandemic. However, the variety of Indutrade's companies helped the group achieve and increase its order intake by 5% to SEK19.6 billion, of which 2% was organic growth. Sales rose 4% to SEK19.2 billion, fueled by acquisitions, and were stable on an organic basis. FFO to debt reached 50.5% at the end of 2020, up from 35.9% in 2019. This was thanks to strong FOCF of about SEK 2.4 billion, up from SEK1.5 billion in 2019. Improvements also stemmed from the dividend cancellation and somewhat lower acquisition spending, of SEK1.0 billion compared with SEK1.5 billion in 2019. We view as positive the discretionary nature of cash flow deployment, which can be adjusted to reduce leverage in downcycles. We expect Indutrade will be able to generate FOCF of about SEK2 billion per year in 2021-2022, supported by solid earnings and its light capex model, typically 2% of sales, and relatively low research and development spending.

We continue to expect Indutrade will utilize its FOCF for acquisitions and shareholders' remuneration while maintaining its FFO to debt above 30%. Indutrade is targeting 10% profitable growth per year, including acquisitions. As such, we except acquisition spending to reach SEK1.5 billion-SEK2.0 billion per year in 2021-2022. Shareholder distributions will reach about SEK655 million in 2021 (about 39% of 2020 net income), and we forecast it will remain about 40% of 2021 annual profits in 2022 (in line with the financial policy of distributing 30%-50% of previous year's net income). Even though we forecast some debt buildup, we expect it to be balanced, and that the group's credit ratios will remain comfortably in line with the rating, including FFO to debt well above 30%.

Outlook

The stable outlook reflects our expectation that Indutrade will keep delivering profitable growth during the next 24 months while maintaining a balanced approach toward organic and external growth through relatively small acquisitions, showing FFO to debt well above 30%. In addition, we expect the company to continue to raise the share of subsidiaries that are part of its cash pooling system toward 80% in the next two years, from currently about 65%.

Under our base case for 2021 and 2022, we forecast a stable adjusted EBITDA margin at about 16%. This will translate into FFO to debt of about 40%-45%, incorporating cash acquisition spending of about SEK1.5 billion-SEK2 billion per year.

Downside scenario

We could consider lowering the rating if there was a significant deterioration in Indutrade's credit metrics due to weakening operating performance or more-aggressive debt-financed acquisitions, resulting in adjusted FFO to debt falling below 30% on a sustained basis. We could also consider a negative rating action if Indutrade were to experience operating difficulties for a prolonged period of time, resulting in more volatile EBITDA margins or deteriorating EBITDA margins below 13% and annual FOCF below SEK1 billion, without short-term prospects of recovery. Although this is not expected, a failure to continue to upstream free cash flows from subsidiaries to the parent level, a lack of progress in increasing the span of its cash pooling system across the group, or an overly short-term capital structure could also result in a downgrade.

Upside scenario

We see limited prospects for a higher rating over the next 12-24 months. This reflects Indutrade's smaller scale and geographical concentration compared with larger global capital goods companies. We do not anticipate credit ratios sustainably at levels meriting a higher rating over the next 12-24 months, given the company's aspiration to grow 10% annually (including acquisitions).

Company Description

Sweden-based Indutrade AB is an industrial group that acquires and develops leading niche companies, primarily within the capital goods industry. It has evolved into a group of over 200 companies, with revenue of about SEK19.2billion (€1.9 billion) and EBITDA of SEK3.2billion EBITDA (€320 million) in 2020. It is primarily involved in the manufacturing and sale of components, as well as the customization, combination, and installation of products from various suppliers. Its customers are spread over 30 countries, but with a focus on Western Europe. Its leading markets are Sweden (24% of sales), the U.K. and Ireland (11%), Finland (11%), and Benelux (11%).

The group has been listed on the Stockholm Stock Exchange since 2005. The largest owner is L E Lundbergforetagen, which held 26.71% of shares and votes as per Dec. 31, 2020. The group's market capitalization stood at SEK 76.4 billion as of March 22, 2020.

Our Base-Case Scenario

Because the economic impact of COVID-19 is proving longer-lasting and more-intense than expected, we have revised our macroeconomic forecasts six times over 2019. We now anticipate that global GDP fell 3.7% in 2020, and will rebound to 4.9% growth in 2021. The longest economic expansion on record ended with the sharpest contraction in economic activity since World War II. Eurozone GDP will likely fall 7.2% in 2020, but we expect a solid rebound in 2021, with 4.8% growth (see "The Eurozone Can Still Rebound In 2021 After Lighter Lockdowns," published Dec. 1, 2020, on RatingsDirect).

As vaccine rollouts in several countries continue, S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic and its economic effects. Widespread immunization, which certain countries might achieve by midyear, will help pave the way for a return to more normal levels of social and economic activity. We use this assumption about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Although we think that Indutrade's niche end-markets and somewhat concentrated geographies will be protected from the sharp fall in GDP, as demonstrated by its good performance in 2020, we still expect uncertainties around COVID-19 containment measures, which are not included in our base-case scenario.

Assumptions

- Revenue growth of about 6%-11% in 2021, with revenue rising to about SEK20.3 billion–SEK21.3 billion, up from SEK19.2 billion in 2020, supported by continued recovery in demand for companies negatively impacted by the pandemic, and of which half will derive from acquisitions. For 2022, we forecast revenue growth of 10%-14%, with continued support from GDP growth and driven by our assumption of somewhat higher acquisitions.

- Sustained profitability and good cost management. We do not anticipate any material restructuring costs that could materially affect our adjusted EBITDA in 2021 or 2022.
- Adjusted EBITDA margins normalizing at about 16.0% in 2021 and 2022, from 16.3% in 2020 and 15.6 % in 2019.
- Some buildup of working capital, of about SEK100 million-SEK300 million in 2021-2022, driven by increasing volumes.
- Capex to remain at about 2% of sales going forward, about SEK400 million-SEK500 million over 2021-2022, compared with about SEK427 million in 2020.
- Dividend payment of SEK655 million in 2020, corresponding to 39% of 2020 net income, and remaining at about 40% of 2021 profit in 2022.
- Acquisition spending of about SEK1.5 billion-SEK2.0 in 2021 and 2022. This compares with SEK1.0 billion in 2020 and SEK1.5 billion in 2019.

Key metrics

Table 1

Indutrade AB Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. SEK)	**2018a**	**2019a**	**2020a**	**2021f**	**2022f**
Revenue	16,848	18,411	19,217	20,300-21,300	22,800-23,800
EBITDA	2,600	2,881	3,165	3,200-3,400	3,650-3,950
Funds from operations (FFO)	2,039	2,272	2,565	2,500-2,700	2,800-3,000
Free operating cash flow (FOCF)	1,239	1,499	2,353	1,900-2,300	2,000-2,400
Debt/EBITDA (x)	1.9	2.2	1.6	1.6-2.0	1.6-2.0
FFO/debt (%)	41.6	35.9	50.5	42.0-46.0	41.0-45.0

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

Liquidity

We view Indutrade's liquidity position as adequate, with sources of cash at about 2.0x of uses for the next 12 months from Dec. 31, 2020, supported by its access to SEK4.25 billion of undrawn RCFs. We expect liquidity sources would continue to exceed uses, even if EBITDA were to decline by 15%. We expect Indutrade would be able to absorb high-impact, low-probability events, with limited need for refinancing, supported by its ability to adjust acquisition spending. We also believe that the company has solid banking relationships and note that it has ample covenant headroom. The liquidity assessment further incorporates Indutrade's acquisitive growth strategy, which increases the share of short-term funding from time to time, and we believe that it could occasionally make use of the RCFs to fund acquisitions.

Principal liquidity sources for the 12 months started Jan. 1, 2021 include:

- Our assessment of cash immediately available of about SEK500 million;
- Undrawn RCF of SEK3.5 billion maturing in May 2025, and another SEK750 million undrawn RCF maturing in April 2023; and
- Cash FFO of SEK2.3-SEK2.7 billion.

Principal liquidity uses for the same period include:

- Contracted debt maturities of about SEK0.7 billion in the next 12 months, equaling outstanding commercial paper as of Dec. 31, 2020. That said, we estimate peak commercial paper usage at about SEK1.5 billion over the coming 12 months;
- Working capital outflow of about SEK100 million, and seasonal swings of up to SEK300 million;
- Capex of SEK400 million-SEK500 million;
- Dividends of SEK677 million;
- Estimated earn-out payments (contracted as per Dec. 31, 2020) amounting to about SEK50 million – SEK100 million in 2021; and
- Estimated acquisition payments (contracted as per Dec. 31, 2020) of SEK200 million–SEK400 million to be paid in 2021.

Covenants

Indutrade is subject to two financial covenants under its RCFs, tested quarterly. The covenants stipulate equity to total assets above 25% and interest coverage above 3x. The covenant headroom is ample.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

- Country risk: Very low
- 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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)

- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- 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
- 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

New Rating	
Indutrade AB	
Issuer Credit Rating	BBB-/Stable/--

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.