S&P Global
Ratings

# Research

## Summary:
# Heraeus Holding GmbH

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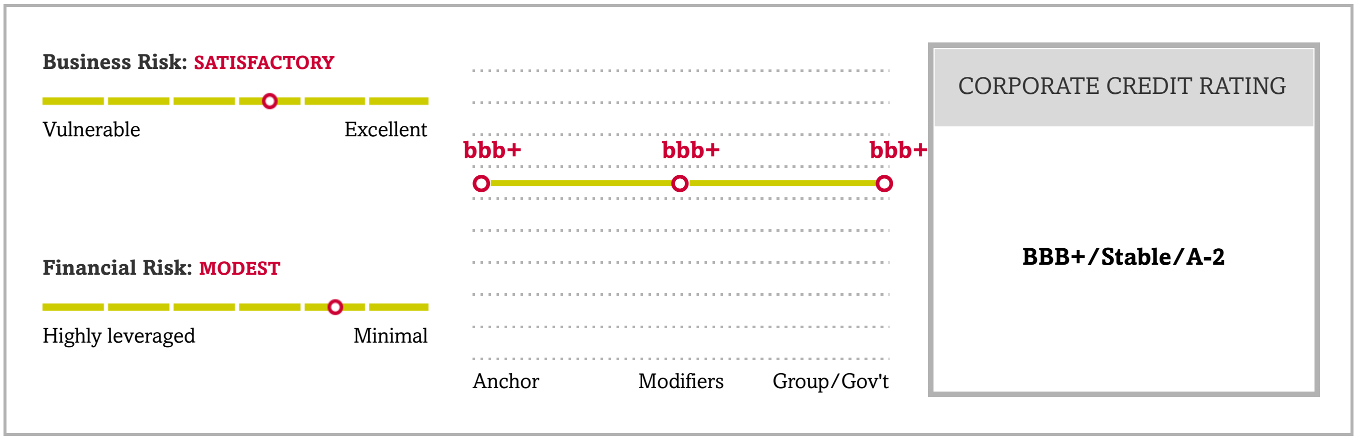
Summary:

# Heraeus Holding GmbH




## Rationale

| Business Risk: Satisfactory | Financial Risk: Modest |
| --- | --- |
| • Leading market positions in most of its core businesses.<br>• Significant proportion of earnings from end markets with stable demand.<br>• Good diversity by region, product, and customer base, reducing volatility in earnings.<br>• Material cyclicality in certain industrial end markets coupled with risk of rapid technological change.<br>• Relatively small industrial business reducing economies of scale, and ongoing need for cost optimization across segments. | • Conservative financial policy and balance-sheet structure.<br>• Strong liquidity and high cash balances.<br>• Modest free cash flow generation.<br>• Restricted access to equity, owing to its status as a family-owned company. |

**Outlook: Stable**

The stable outlook on Germany-based precious metals and technology company Heraeus Holding GmbH reflects S&P Global Ratings' belief that Heraeus will preserve its modest financial risk profile. We also anticipate that the company will continue to manage its portfolio of businesses to improve profitability as well as actively seek acquisition and divestment opportunities. We believe that the group will balance investments, dividends, and acquisitions in line with its financial risk profile over the long term.

We expect Heraeus will maintain credit metrics in line with our target ranges for the current ratings, including funds from operations (FFO) to adjusted debt comfortably at least in our modest financial risk category FFO to Debt threshold of 45% to 60%.

### Downside scenario

Ratings downside could result if Heraeus' credit metrics fell below our expectations for the current rating. This would likely stem from a substantial increase in investments, most likely in the form of a large acquisition, causing cash balances to deteriorate. Weaker-than-expected operating performance would also strain the ratings.

### Upside scenario

An upgrade looks unlikely over the outlook horizon of two years. We could consider raising the rating on Heraeus if it demonstrates significant and continuous strengthening of the portfolio, including improvement in financial and operational performance of businesses and increased scale of the portfolio without material weakening of key credit metrics.

## Our Base-Case Scenario

**Assumptions**

- For 2017, low-mid-single-digit revenue decline (excluding precious metals).
- We expect S&P Global Ratings-adjusted EBITDA margins to be stable at about 20%-22% relating to industrial business only in 2017 and 2018.
- Capital expenditures (capex) of about €200 million-€220 million annually in 2017 and 2018.
- A moderate dividend payout of €30 million-€40 million annually over the next two years.

**Key Metrics**

| | 2016 | 2017f | 2018f |
|---|---|---|---|
| EBITDA margin (%) | 21.7 | 21-22 | 21-22 |
| FFO to debt (%) | >100 | >100 | >100 |
| Debt/EBITDA | 0 | 0-0.5 | 0-0.5 |

FFO--Funds from operations. f--S&P Global Ratings' forecast.

## Business Risk: Satisfactory

Heraeus Group is a German specialty manufacturer focusing on precious metals, medical components, quartz glass products, sensors, specialty light sources, and products and services used in electronics, chemicals, and photovoltaics applications. The group is family-owned and reported €2 billion of non-precious-metal-related revenues in 2016 with approximately 12,000 employees. The group holds about 6,000 patents for its specialty products. The recent acquisition of precious metal refiner Argor enables Heraeus to further expand its refining presence in Europe and Latin America, gaining a leading position in the industrial precious metal processing and trading business, including becoming the second-largest gold refiner globally.

We assess Heraeus' business risk profile as satisfactory, incorporating our view of the risk for the global capital goods industry; good regional, customer, and product diversification of the group's sales; and leading niche market positions in its core businesses. Heraeus sells about 40% of its products to manufacturers based in Asia, and the rest to lower-risk countries and regions such as Germany, the U.S., and countries in western and southern Europe. The group derives a significant proportion of its earnings from end markets with relatively stable demand patterns for specialty products, which mitigates exposure to cyclical demand in other end markets.

The group is managed as a holding with central administration and finance functions. Business segments share few synergies and operate with a high degree of independence. This reduces the overall margin potential for the group, in our view, but provides group stability through product and end market diversification.

Under our base-case scenario, we expect Heraeus' adjusted EBITDA margins will be fairly stable at about 20%-22%, underpinned by its cost-cutting and efficiency improvement programs across various business segments. Our adjusted margins reflect the industrial business only and do not take into account any of the precious metals trading revenue or related costs.

## Financial Risk: Modest

We assess Heraeus' financial risk profile as modest, based on its robust balance sheet and strong credit metrics and financial flexibility. At the end of 2016, the group reported cash and equivalents of more than €1 billion. After the closing of the Argor acquisition in April and July 2017 bond maturity of €250 million, the cash position of the group remains very comfortable.

These strengths are partly offset by the group's track record of moderate free cash flow generation, working capital needs, its restricted access to the equity market as a family-owned company, as well as significant pension obligations compared to its financial debt, which we include in our calculation of adjusted debt.

In our base-case scenario, we assume that Heraeus should be able to generate annual S&P Global Ratings-adjusted FFO of about €340 million-€360 million in 2017 and 2018. We expect Heraeus' credit protection ratios to remain strong for the rating, with FFO to debt in excess of 100% and close to zero adjusted debt. We believe that the company will continue to use its financial flexibility to pursue bolt-on (as well as potential larger) acquisitions to strengthen the portfolio of businesses, and therefore do not see the net cash position as likely to last over the long term.

We do not include precious metal loans in our ratio calculations, as these do not constitute an on-or off-balance-sheet commitments for the purchase or use of long-life assets (such as lease obligations) or businesses where the benefits of ownership are accruing to the company.

## Liquidity: Strong

We view Heraeus' liquidity position as strong. We estimate that the group's ratio of sources of liquidity to uses will comfortably exceed 1.5x for next 24 months, and that the group meets our quantitative and qualitative criteria factors for the strong liquidity assessment, including management's long-term commitment to a comfortable liquidity cushion.

| Principal Liquidity Sources | Principal Liquidity Uses |
|---|---|
| • About €500 million of cash and equivalents assumed at the parent company level, after the closing of the Argor acquisition and bond repayment, excluding cash that we consider not available for debt service at all times across emerging markets subsidiaries.<br>• Access to an undrawn €300 million committed credit facility maturing in December 2020. To our knowledge, this instrument is not subject to financial maintenance covenants.<br>• Annual FFO of €300 million-€325 million in 2016 and 2017. | • No meaningful maturities over the next two years.<br>• Capex of about €200 million-€220 million annually.<br>• Assumed cash dividends of €30 million-€40 million annually over the next two years.<br>• Bolt-on acquisition of approximately €25 million annually. |

## Ratings Score Snapshot

### Corporate Credit Rating

BBB+/Stable/A-2

### Business risk: Satisfactory

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

### Financial risk: Modest

- **Cash flow/Leverage:** Modest

### 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)

## Related Criteria

- 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

**Business And Financial Risk Matrix**

| | Financial Risk Profile | | | | | |
|---|---|---|---|---|---|---|
| **Business 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- |

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