



## Rating Action: Moody's upgrades Continental AG to Baa3 with stable outlook

Global Credit Research - 19 Sep 2013

### Approximately EUR4.2 billion of rated debt affected

Frankfurt am Main, September 19, 2013 -- Moody's Investors Service has today assigned a Baa3 issuer rating to Continental AG (Conti). Concurrently Moody's has upgraded Continental AG's and its rated subsidiaries Conti-Gummi Finance BV and Continental Rubber of America Corporation's senior unsecured ratings to Baa3/(P)Baa3. At the same time Moody's has withdrawn Conti's Ba1 corporate family rating (CFR) and its Ba1-PD probability of default rating (PDR).

The outlook on all ratings is stable.

"The upgrade to Baa3 was prompted by a further slight weakening in the link with Schaeffler AG (Schaeffler) following Schaeffler's recent reduction in its stake in Conti to 46% from 49.99% as well as the ratings upgrade of Schaeffler to Ba3 from B1 as a result of its improved leverage following the stake sale," says Falk Frey, a Moody's Senior Vice President and lead analyst for Continental. "The upgrade is also supported by our expectation that the company's operating performance and cash flow generation in the current year will be close to last year's levels and will improve from 2014 as well as a continued strong positive free cash flow generation in coming years resulting in further improvements to Continental's leverage ratio and continued strong credit metrics," adds Mr. Frey.

#### Upgrades:

..Issuer: Conti-Gummi Finance BV

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)Baa3 from (P)Ba1

....Senior Unsecured Regular Bond/Debenture Oct 15, 2018, Upgraded to Baa3 from Ba1

....Senior Unsecured Regular Bond/Debenture Jan 15, 2016, Upgraded to Baa3 from Ba1

....Senior Unsecured Regular Bond/Debenture Mar 20, 2017, Upgraded to Baa3 from Ba1

..Issuer: Continental AG

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)Baa3 from (P)Ba1

....Senior Unsecured Regular Bond/Debenture Sep 9, 2020, Upgraded to Baa3 from Ba1

....Senior Unsecured Regular Bond/Debenture Jul 16, 2018, Upgraded to Baa3 from Ba1

..Issuer: Continental Rubber of America Corporation

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)Baa3 from (P)Ba1

....Senior Unsecured Regular Bond/Debenture Sep 15, 2019, Upgraded to Baa3 from Ba1

#### Assignments:

..Issuer: Continental AG

.... Issuer Rating, Assigned Baa3

#### Outlook Actions:

..Issuer: Conti-Gummi Finance BV

....Outlook, Remains Stable

..Issuer: Continental AG

....Outlook, Remains Stable

..Issuer: Continental Rubber of America Corporation

....Outlook, Remains Stable

## Withdrawals:

..Issuer: Conti-Gummi Finance BV

....Senior Unsecured Regular Bond/Debenture Oct 15, 2018, Withdrawn , previously rated a range of LGD3, 48 %

....Senior Unsecured Regular Bond/Debenture Jan 15, 2016, Withdrawn , previously rated a range of LGD3, 48 %

....Senior Unsecured Regular Bond/Debenture Mar 20, 2017, Withdrawn , previously rated a range of LGD3, 48 %

..Issuer: Continental AG

.... Probability of Default Rating, Withdrawn , previously rated Ba1-PD

.... Corporate Family Rating, Withdrawn , previously rated Ba1

....Senior Unsecured Regular Bond/Debenture Sep 9, 2020, Withdrawn , previously rated a range of LGD3, 48 %

....Senior Unsecured Regular Bond/Debenture Jul 16, 2018, Withdrawn , previously rated a range of LGD3, 48 %

..Issuer: Continental Rubber of America Corporation

....Senior Unsecured Regular Bond/Debenture Sep 15, 2019, Withdrawn , previously rated a range of LGD3, 48 %

## RATINGS RATIONALE

The rating action follows the announcement of Conti's major shareholder Schaeffler AG of the placement of another 3.9% of its shares in Conti with the cash received and additional cash flows to be applied to reduce its debt by nearly EUR1.3 billion. This has prompted Moodys to upgrade Schaeffler's corporate family ratings to Ba3 from B1. The upgrade of Schaeffler together with the company's reduction of its shareholding in Conti to 46% have triggered the upgrade of Conti back to investment grade level.

Throughout this year, Continental has exhibited strong credit metrics that are commensurate with investment-grade rating levels on a standalone basis, such as Moody's adjusted debt/EBITDA of 2.2x per end of March 2013. However, the rating is constrained by the uncertainty associated with the possible form and pace of a potential combination of Continental and its major shareholder, Schaeffler, which reportedly has a high debt level following its investment in Continental. At the same time, Moody's considers that such a transaction is unlikely over the medium term, given Schaeffler's gradual reduction in its shareholding in Continental over the past four years, to 49.9% currently from 89% in 2009. Given that it now appears unlikely that a combination will take place in the medium term, and that the form of such a combination could be less drastic than previously indicated, this, in Moody's view, justifies the three notches difference in the two companies' issuer rating/CFR.

At this time, Moody's expects the potential risk to noteholders from any action initiated by Schaeffler will be mitigated primarily by financial covenants in Continental's bond and loan documentation that restrict the company's ability to (1) dispose of its rubber activities and (2) merge with entities of the Schaeffler group, unless certain interest coverage and leverage tests are met with regard to metrics pro forma for the respective transactions.

Nonetheless, Moody's does not anticipate any change in Schaeffler's position to have an impact on Continental's dividend payout and thus debt repayment capacity.

## RATIONALE FOR STABLE OUTLOOK

The stable rating outlook incorporates Moody's expectation that (1) Continental will continue to generate positive free cash flow (FCF) in the coming years and use this to reduce debt; and (2) the company's operating performance and cash flow generation in the current year will be close to last year's levels and will improve from 2014, mainly driven by stronger growth in revenues and the continued turnaround in the powertrain division. Overall, this should lead to further improvements to Continental's leverage ratio.

## WHAT COULD CHANGE THE RATING UP/DOWN

Moody's might consider to upgrade the ratings to Baa2 should Conti be able to (1) demonstrate a sustainable Moody's adjusted free cash flow generation of around EUR1.0 billion p.a. that would be applied to (2) a further debt reduction leading to a decline in Moody's leverage (Debt/EBITDA) of constantly below 1.5x; (3) achieve an EBIT margin (as defined by Moody's) sustainably above 10% (per March 2013: 9.3%). An upgrade would also require a track record of more resilient results through a downturn compared to results in 2009 as well as Conti to demonstrate a conservative financial policy regarding the balance between debtholders and shareholders interest especially when it comes to dividends and M&A activity.

The ratings could be downgraded to Ba1 in case of (1) an increase in leverage (Debt/EBITDA) above 2.25x; (2) a FCF / Debt ratio falling below 4%; (3) a decline in the company's reported adjusted EBIT margin below 8% as well as (4) a deterioration in Conti's liquidity profile. Moreover, downward rating pressure could also arise if (5) Continental were to re-leverage as a result of a combination with Schaeffler or if the linkage to Schaeffler would appear as

increasing again. Also a downgrade of Schaeffler's CFR could result in a downgrade of Continental's rating as both credits are linked.

#### LIQUIDITY

As of 30 June 2013, Continental's liquidity needs for the next 12 months consisted of debt maturities as well as cash outflows for capital expenditure, working capital, dividend payments and day-to-day needs. These requirements were covered by the company's sizable cash position (around EUR1.6 billion as of 30 June 2013), and its EUR3.0 billion revolving credit facility, with conditionality language and covenants with ample headroom.

#### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was the Global Automotive Supplier Industry published in May 2013. Other methodologies used include Loss Given Default for Speculative-Grade Non-Financial Companies in the U.S., Canada and EMEA published in June 2009. Please see the Credit Policy page on [www.moody.com](http://www.moody.com) for a copy of these methodologies.

Headquartered in Hanover, Germany, Continental AG is one of the world's top automotive suppliers in the areas of brake systems, systems and components for powertrains and chassis, instrumentation, infotainment solutions, vehicle electronics and technical elastomers. It is also the world's fourth-largest manufacturer of passenger and commercial vehicle tyres. In 2012, Continental generated consolidated sales of approximately EUR32.7 billion.

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