

Consolidated financial statements in credit analysis
May 2024

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Key features of credit analysis

Financial metrics and qualitative factors

What are credit ratings?



- Probabilistic opinions about the future
- Assessment of the relative likelihood of an issuer to meet its financial obligations over the medium term
- Based on an assessment of the information gathered
- Based on the rating agency's experience in rating other securities and issuers



- Statements of absolute fact
- A guarantee of securities performance
- A recommendation to buy, sell or hold a security
- Price indicators
- Liquidity indicators

Key rating drivers for corporates: an overview



Moody's rating methodology

Published rating methodologies ensure a **consistent approach**



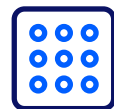
Methodology scorecards provide **transparency for issuers and investors** to understand the rating outcome



All financial ratios are adjusted using **Moody's Global Standard Adjustments**



Methodologies include a **rating scorecard**: a summary of the main qualitative and quantitative factors considered



It is **not an exhaustive treatment** of all factors reflected in Moody's ratings: the indicated outcome from the scorecard can and does often differ from the actual rating assigned



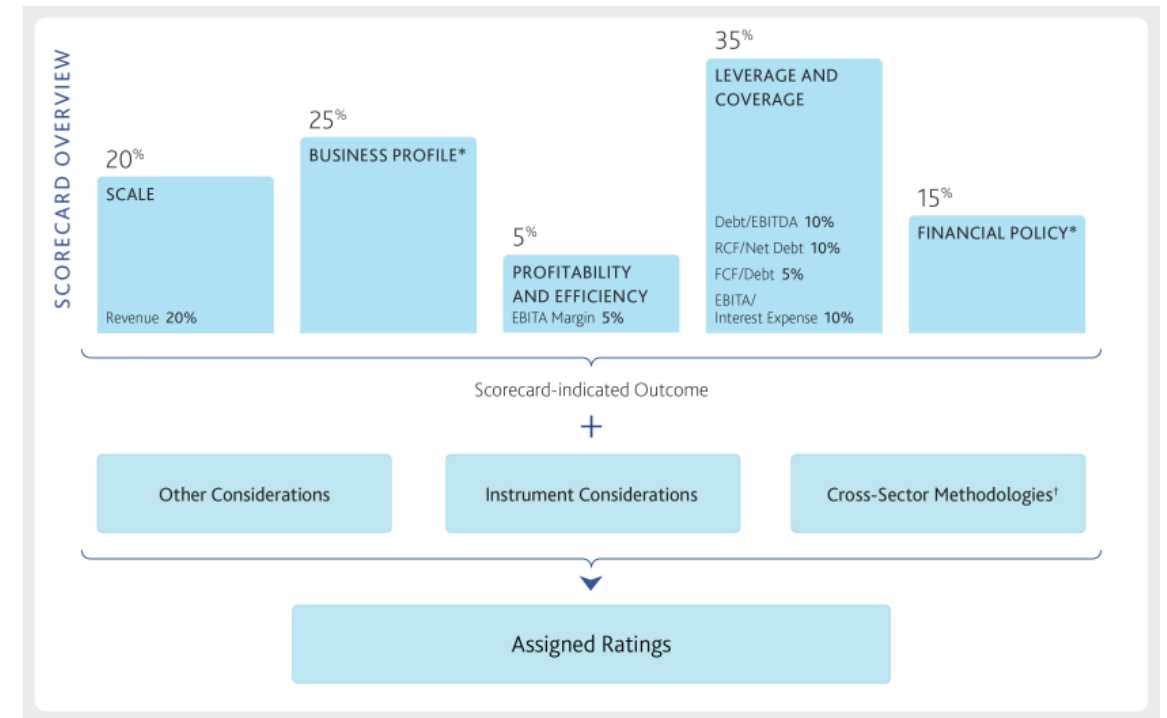
Rating assignments/changes are made by rating committees, taking into account a wide range of factors, which are not restricted to credit metrics or the methodology



Rating methodology factors for manufacturing

- The scorecard summarizes the key credit factors of the Manufacturing sector
- However, the final, assigned rating will take into account other considerations and can therefore deviate from the scorecard-indicated outcome

Illustration of the manufacturing methodology framework



* This factor has no sub-factors.
† Some of the methodological considerations described in one or more cross-sector rating methodologies may be relevant to ratings in this sector. A link to a list of our sector and cross-sector methodologies can be found in the "Moody's related publications" section
Source: Moody's Ratings. Manufacturing rating methodology, dd. 10 September 2021.

Which ratios do we focus on and why?

→ Profitability ratios

- EBITDA, EBITA and EBIT margins
- Industry specific, examples: EBIT / Avg Assets, ROA, EBIT / Throughput barrels

→ Leverage ratios

- Gross Debt / EBITDA
- Net Debt / EBITDA could be an additional consideration, but not always

→ Coverage ratios

- Interest coverage (EBITDA / Interest expense, EBITA / Interest, EBIT interest)
- Cash flow coverage (Free Cash flow / Debt, Retained Cash flow / Debt)

All ratios will be adjusted according to our methodologies

Why the need for adjustments?



Better capture the underlying economics



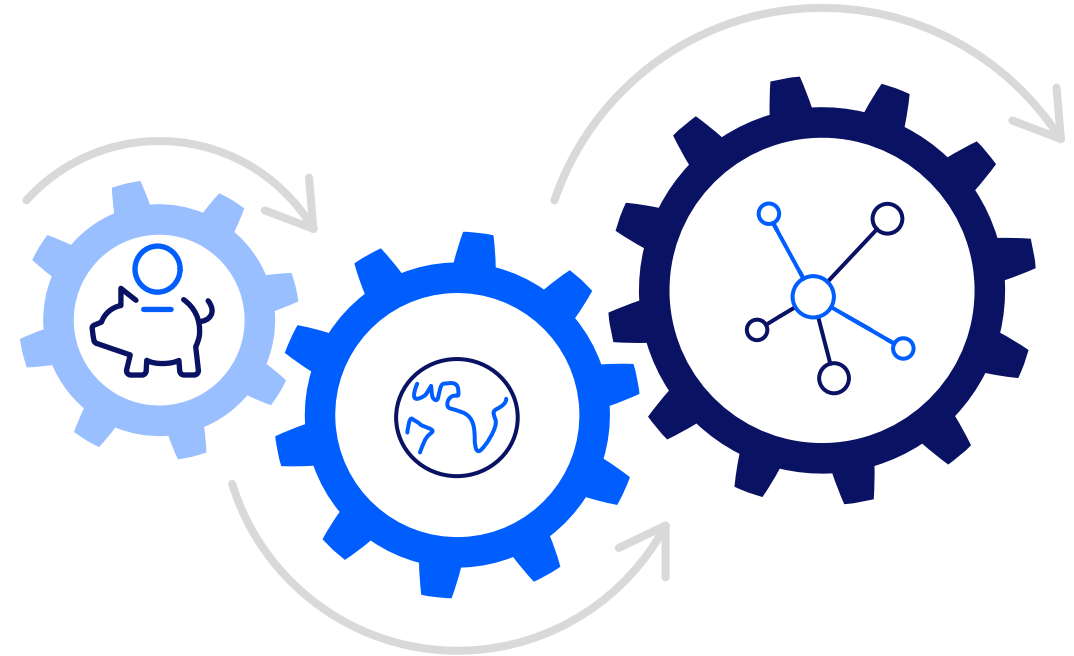
Improve comparability (GAAP vs IFRS)



Segregate unusual and non-recurring items



Use estimates and assumptions that are more prudent



Moody's major adjustments

Create a comparable basis



Biggest problem area:

- Pension accounting
- Different rules for different GAAPs
- Lease accounting



Other examples:

- Securitizations and factoring
- Restructuring
- Put options
- Third party financial guarantees
- Capitalized interest
- Capitalized development costs
- Hybrid securities

EBITDA – Moody’s definition

Financial statement line item

Revenue

Less: Cost of goods sold

Less: Selling, general & administrative expenses

Add: Depreciation, amortisation & impairment

Add: Share of JV’s and associates’ net income

Add: Finance income

Moody’s-reported EBITDA

Understanding free cash flow

→ What is free cash flow (FCF)?

- the cash a company generates through its operations, minus the cost of expenditures on assets. In other words, free cash flow (FCF) is the cash left over after a company pays for its operating expenses and capital expenditures (CapEx).

→ Formula

$$\text{FCF} = \text{Operating Cash Flow} - \text{Capital Expenditures}$$

→ Importance of FCF

- One of the critical measures in company's analysis, because it shows how efficient a company is at generating cash.
- Equity investors use FCF to assess whether a company has enough cash, after funding operations and capital expenditures, to reward shareholders through dividends and buybacks.
- Debt investors also use FCF to assess how much cash is left for the company to meet its debt obligations.

→ Example

$$\text{Merck's FCF} = 853 - 79 - 572 = \text{€}202 \text{ million}$$

€ million	Q1 2023	Q1 2022
Profit after tax	800	884
Depreciation/amortization/impairment losses/reversals of impairment losses	456	430
Changes in inventories	-323	-186
Changes in trade accounts receivable	-116	-343
Changes in trade accounts payable/refund liabilities	215	207
Changes in provisions	-8	107
Changes in other assets and liabilities	-187	-234
Neutralization of gains/losses on disposals of assets	-	-27
Other non-cash income and expenses	17	3
Operating cash flow	853	840
Payments for investments in intangible assets	-79	-68
Payments from the disposal of intangible assets	4	21
Payments for investments in property, plant and equipment	-572	-430
Payments from the disposal of property, plant and equipment	10	17
Payments for investments in financial assets	-22	-24
Payments for acquisitions less acquired cash and net cash equivalents	-	-695
Proceeds from the disposal of other financial assets	225	87
Payments from disposal of non-financial assets	-897	-100
Proceeds from the disposal of non-financial assets	100	100
Payments from other divestments	-	4
Investing cash flow	-1,231	-1,089
Dividend payments to Merck KGaA shareholders	-	-
Dividend payments to non-controlling interests	-	-10
Dividend payments to E. Merck KG	-90	-91
Payments from new borrowings from E. Merck KG	-	-
Repayments of financial debt to E. Merck KG	-1	-406
Payments from the issuance of bonds	-	-
Repayments of bonds	-	-883
Changes in other current and non-current financial debt	216	1,074
Financing cash flow	124	-315
Changes in cash and cash equivalents	-254	-564
Changes in cash and cash equivalents due to currency translation	-16	4
Cash and cash equivalents at the beginning of the reporting period	1,854	1,899
Changes in cash and cash equivalents due to reclassification to assets held for sale	-	-
Cash and cash equivalents as of March 31 (consolidated balance sheet)	1,584	1,339

Source: Merck Group's interim report Q1 2023

Different types of FCF

Hypothetical example

FCF to firm		FCF to equity		Levered FCF		Moody's-defined FCF	
EBITDA	1,000	EBITDA	1,000	EBITDA	1,000	EBITDA	1,000
- Tax paid	-184	- Tax paid	-184	- Tax paid	-184	- Tax paid	-184
- Interest paid	-315	- Interest paid	-315	- Interest paid	-315	- Interest paid	-315
+/- WC	138	+/- WC	138	+/- WC	138	+/- WC	138
- CAPEX	-500	- CAPEX	-500	- CAPEX	-500	- CAPEX	-500
		+ debt issued	800	- debt repaid	-300	- Dividends	-180
		- debt repaid	-300				
FCF to firm	139	FCF to Equity	639	Levered FCF	-161	Moody's-defined FCF	-41

Operating cash flows



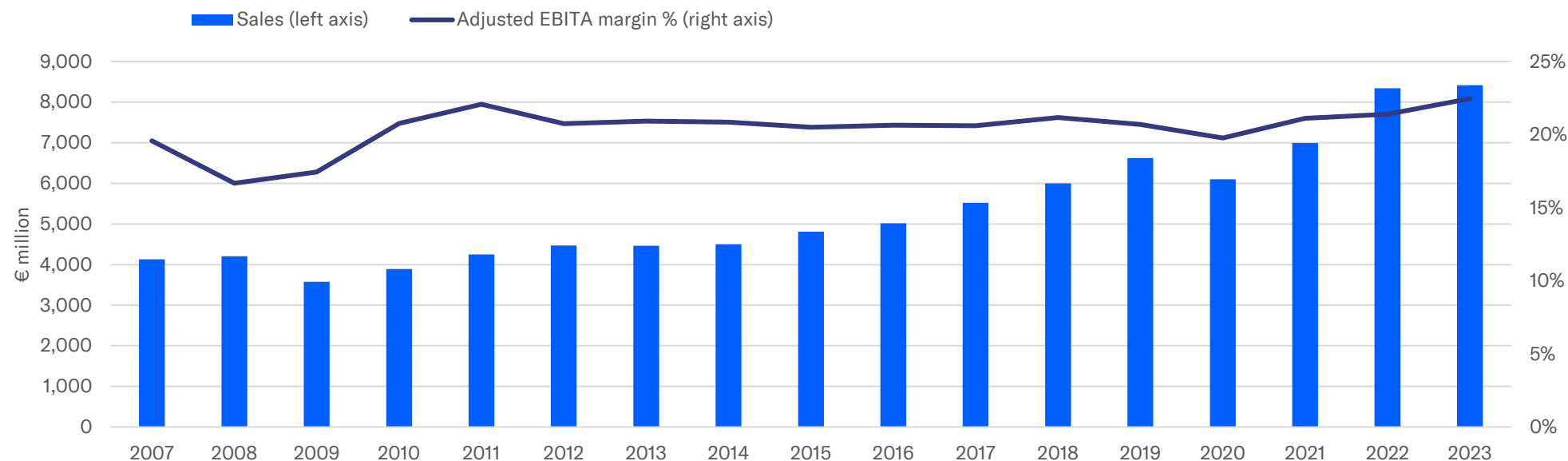
Active growth through M&A

Legrand France S. A. case study

M&A complements organic growth

Legrand increased its scale through M&A in a highly fragmented market

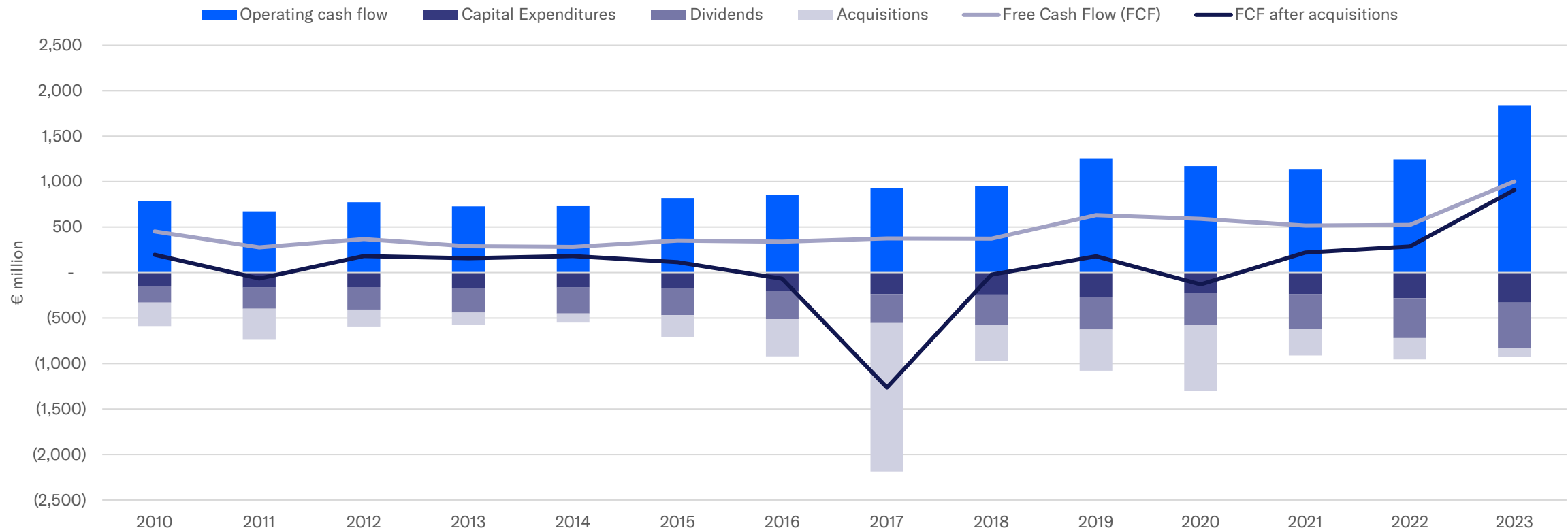
- Legrand operates in a highly fragmented industry for low-voltage products.
- The total addressable market ~€120 billion is served by almost 3,000 small or medium-sized companies.
- Between 2010 and 2022, Legrand made ~60 acquisitions, spending on average ~€0.4 billion per year.
- These acquisitions were largely bolt-ons, with a notable acquisition of Milestone in 2017 for \$950 million.
- The company's acquisition strategy is focused on companies with relatively low integration risk.



Source: Moody's Financial Metrics™

M&A is an attractive alternative to capex

Not captured in FCF

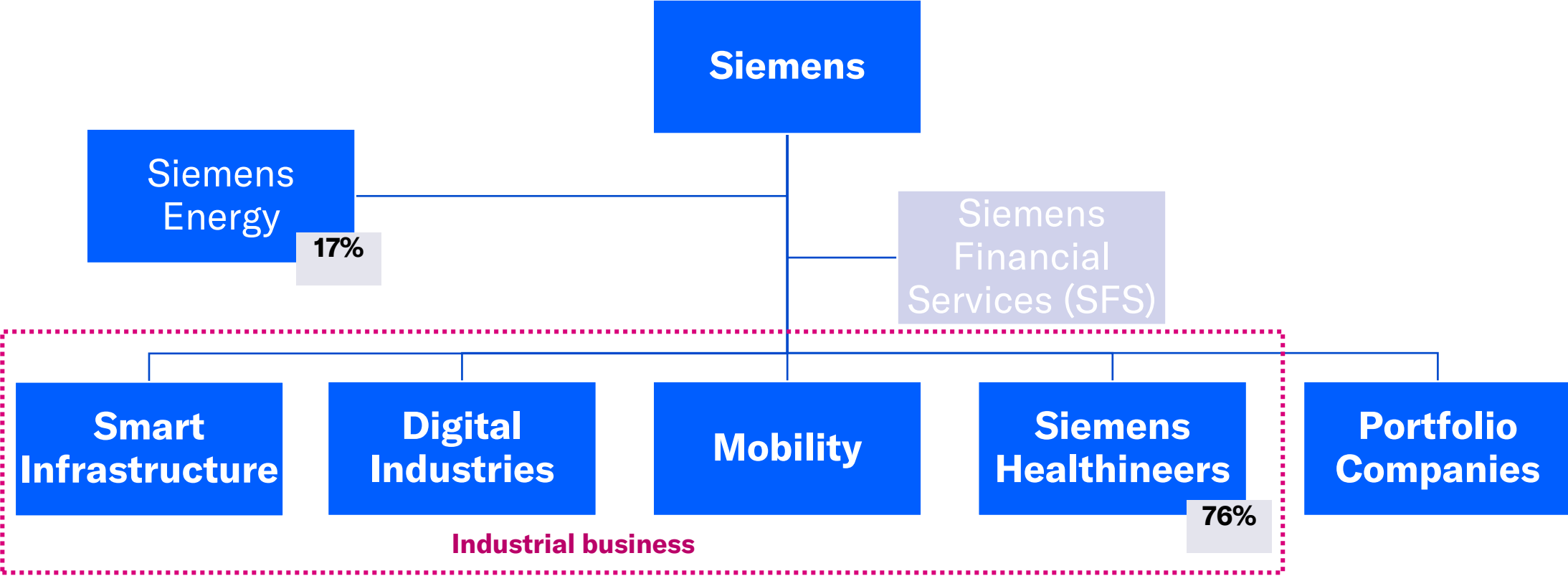


Source: Moody's Financial Metrics™



Analysis of parts of a group
Siemens Aktiengesellschaft case study

Siemens - simplified business structure



As of 31 March 2024

Captive finance operations add complexity to the analysis and are sizeable

(in € millions)	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
Reported pre-tax income	8,050	6,933	5,502	7,496	7,154	11,201
Add back interest expense	1,089	965	814	644	689	1,373
Add back D&A	3,414	2,342	3,105	3,075	3,561	3,608
Reported EBITDA	12,553	10,240	9,421	11,215	11,404	16,182
SFS Adjustment [1]	(912)	(959)	(1,023)	(1,029)	(1,135)	(1,723)
Operating Lease Adjustment	1,249	1,208				
Pension Adjustment	153	50	(3)	2	(17)	(9)
Unusual items	(1,633)	63	(1,252)	(672)	974	(2,204)
Adjusted EBITDA	11,410	10,602	7,143	9,516	11,226	12,246

[1] SFS adjustment is an estimate of SFS's EBITDA (pretax income plus interest expense plus depreciation and amortisation) included in Siemens reported EBITDA, as defined by Moody's.

Source: Moody's Financial Metrics™

Source: Moody's credit opinion on Siemens Aktiengesellschaft, dd. 15 January 2024

Captive finance operations add complexity to the analysis and particularly material to debt

(in € millions)	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
Total Unadjusted Debt	33,662	38,191	44,567	48,700	50,636	46,596
Pension Adjustments [1]	7,084	9,296	5,967	2,494	1,979	1,142
Operating Lease Adjustments [2]	3,747	3,624	-	-	-	-
Other Standard Adjustments [3]	(23,267)	(25,588)	(24,802)	(27,531)	(30,827)	(29,377)
Total Adjusted Debt	21,226	25,523	25,732	23,663	21,788	18,361

[1] Pension liability, excluding other post-employment benefits liability.

[2] The operating lease adjustment was changed with the implementation of IFRS 16. Since financial 2020, we use a reported finance lease liability on the balance sheet.

[3] Includes primarily the deconsolidation of SFS' debt.

Source: Moody's Financial Metrics™

Source: Moody's credit opinion on Siemens Aktiengesellschaft, dd. 15 January 2024

SFS deconsolidated from financial metrics of Siemens

But assessed qualitatively

- Deconsolidation due to the need for comparability with pure industrial companies
- Impact of the captive finance operations assessed qualitatively:
 - SFS does not engage in asset trading, subprime mortgages or consumer lending.
 - Debt financing solutions with limits that depend on rating categories, unsecured positions accepted only in exceptional cases
 - Well diversified portfolio, funding with matching maturity and currency
 - Relatively low credit defaults, even amid the coronavirus pandemic
 - Ongoing shift to smaller projects, reduces SFS' risk profile, but also profitability

Source: Moody's credit opinion on Siemens Aktiengesellschaft, dd. 15 January 2024

SFS is not a major drag on Siemens' Aa3 rating

Methodology scorecard for Siemens

The methodology scorecard indicates an Aa2 outcome for financial year 2023 and in our 12-18-month forward view, which is one notch higher than actual Aa3 rating assigned.

- The metrics are unlikely to be sustained because Siemens operates well below its net leverage ceiling.
- Additionally, the application of capital call and liquidity call in our Captive Finance Subsidiaries of Nonfinancial Corporations methodology typically leads to up to one-to-two notches downward adjustment to the scorecard-indicated outcome based on industrial operations' metrics.

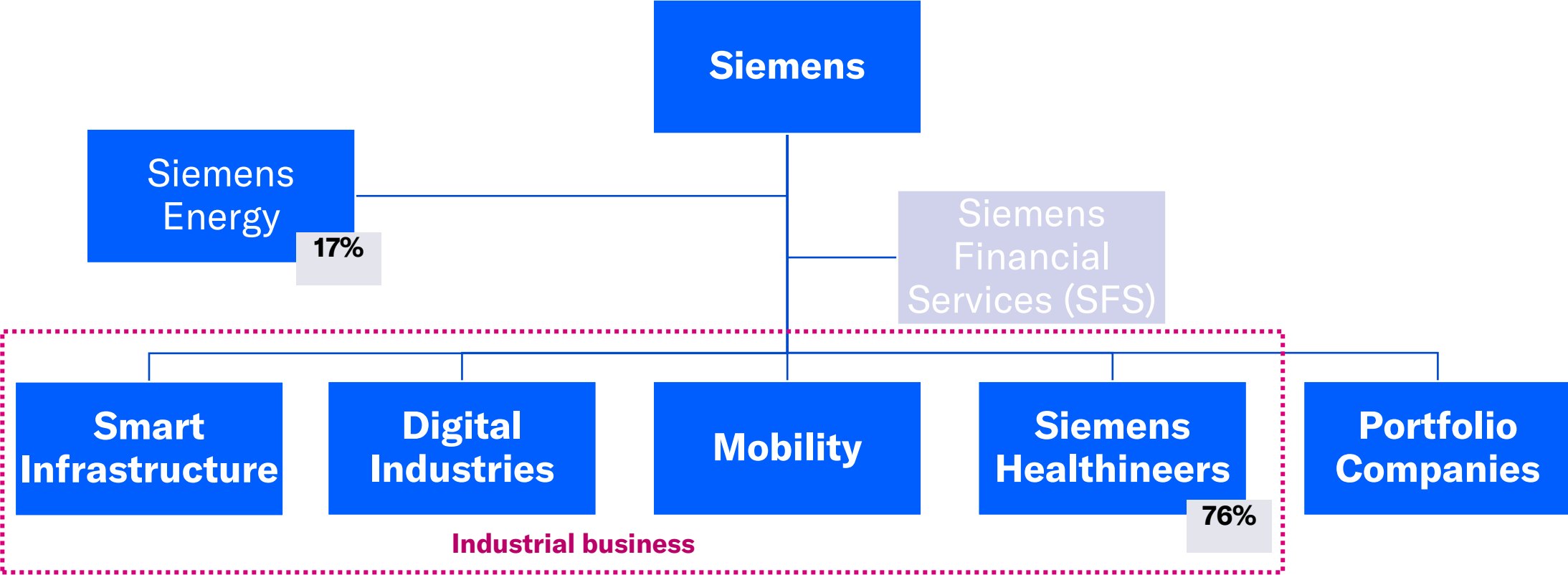
Manufacturing Industry Scorecard	Financial 2023		Moody's 12-18 Month Forward View As of 12/14/2023 [1]	
	Measure	Score	Measure	Score
Factor 1 : Scale (20%)				
a) Revenue (\$ Billion)	\$82.5	Aaa	\$85 - \$87	Aaa
Factor 2 : Business Profile (25%)				
a) Business Profile	Aa	Aa	Aa	Aa
Factor 3 : Profitability and Efficiency (5%)				
a) EBITA Margin	13.1%	Baa	14% - 15%	Baa
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	1.5x	A	1.3x - 1.5x	A
b) Retained Cash Flow / Net Debt	71.4%	Aaa	60% - 80%	Aaa
c) Free Cash Flow / Debt	18.9%	A	7% - 12%	Ba
d) EBITA / Interest Expense	26.6x	Aaa	30x - 35x	Aaa
Factor 5 : Financial Policy (15%)				
a) Financial Policy	A	A	A	A
Rating:				
a) Scorecard-Indicated Outcome		Aa2		Aa2
b) Actual Rating Assigned				Aa3

Source: Moody's credit opinion on Siemens Aktiengesellschaft, dd. 15 January 2024



Large minority stakes considerations Siemens Aktiengesellschaft case study

Siemens - simplified business structure

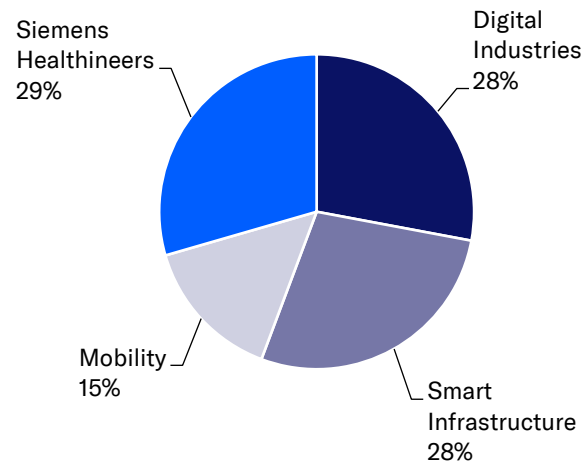


As of 31 March 2024

Siemens Healthineers (SHL) carries a 24% minority stake

SHL brings a number of credit strengths

- Accounting for ~30% of Siemens' Industrial business revenue
- SHL adds stability to Siemens' topline as ~40% of its revenue is recurring
- SHL is listed, its market capitalization was €64.5 billion as of 20 May 2024, providing Siemens with a source of liquidity to finance future growth (including through M&A)

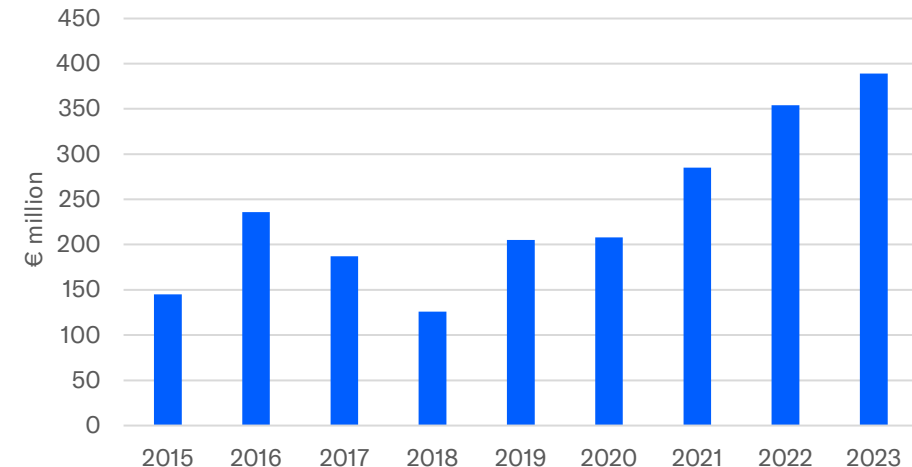


Source: Siemens

But also cash leakage

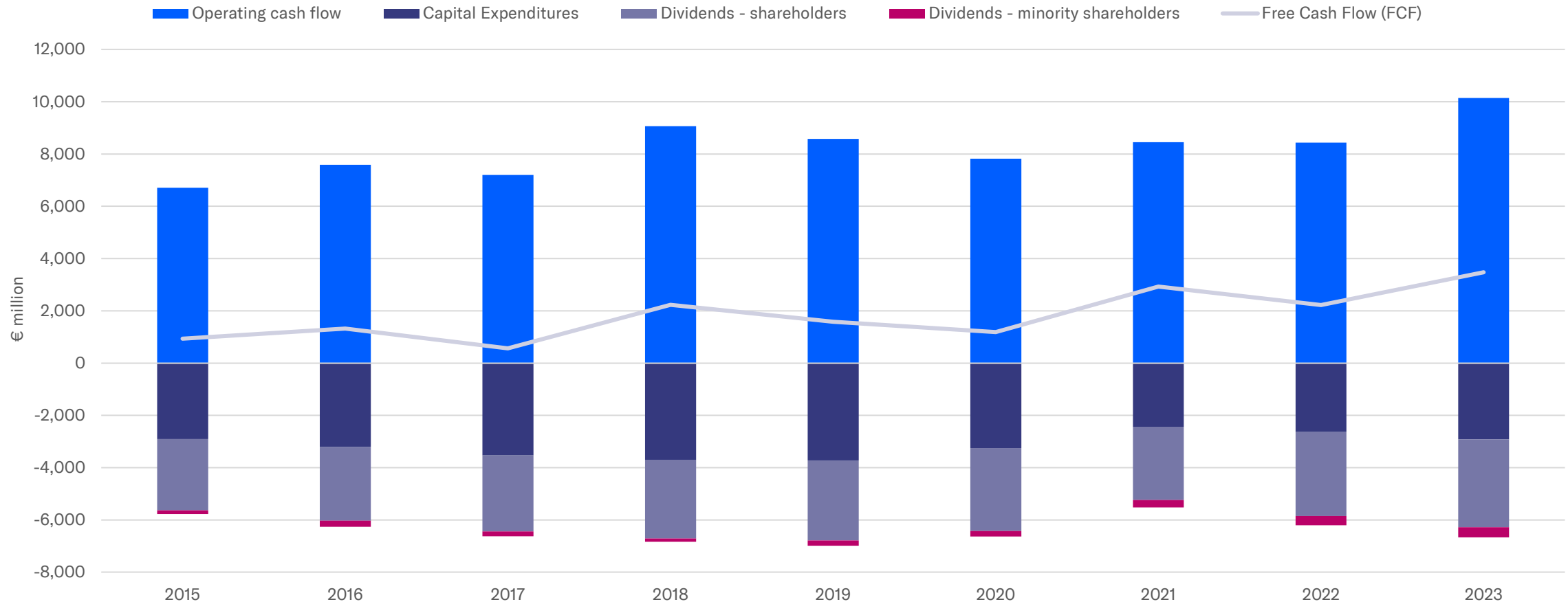
- Dividends to minority shareholders increased since the IPO of SHL in 2018

Dividends to minority shareholders



Source: Moody's Financial Metrics™

SHL's cash leakage is contained by Siemens' strong cash flows



Source: Moody's Financial Metrics™



JVs impact on credit analysis Financial metrics and beyond

ArcelorMittal's credit metrics are impacted by its JVs

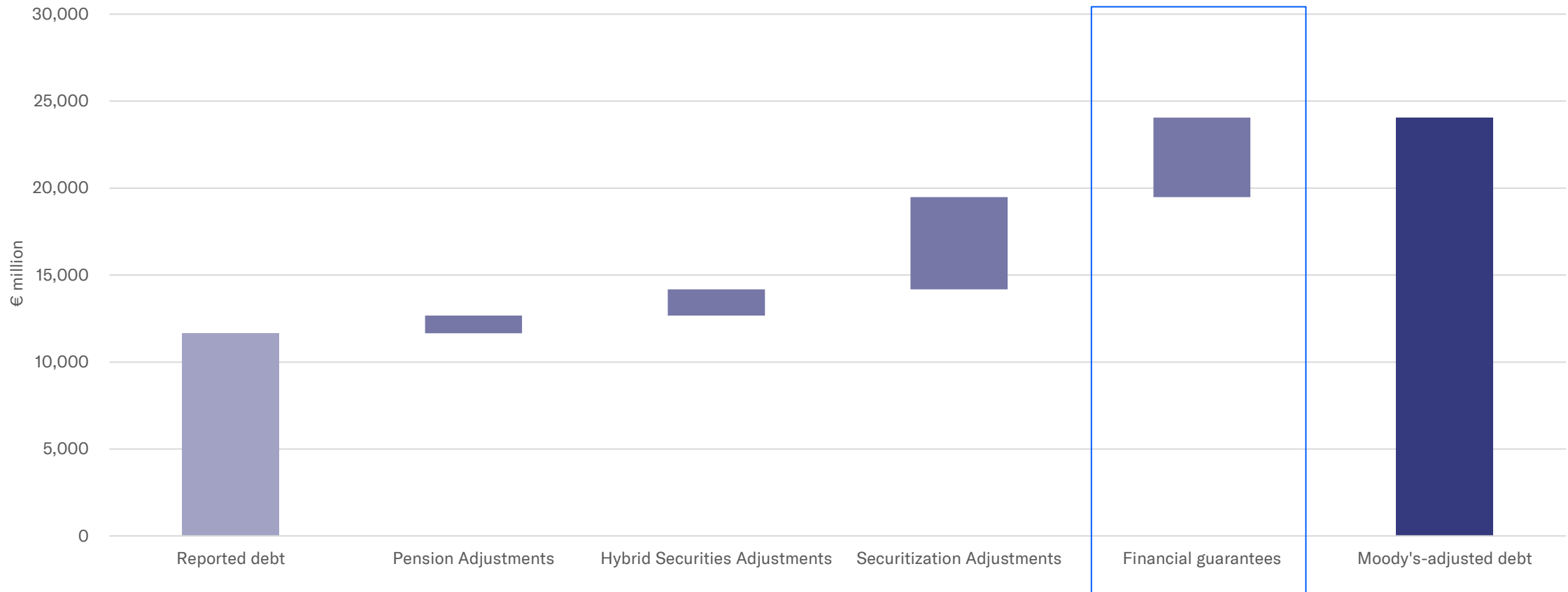
Equity income is used as a proxy of dividends



For the year that ended 31 December 2022
Source: Moody's Financial Metrics™

ArcelorMittal's credit metrics are impacted by its JVs

Financial guarantees for JV's increase debt



As of 31 December 2022
Source: Moody's Financial Metrics™

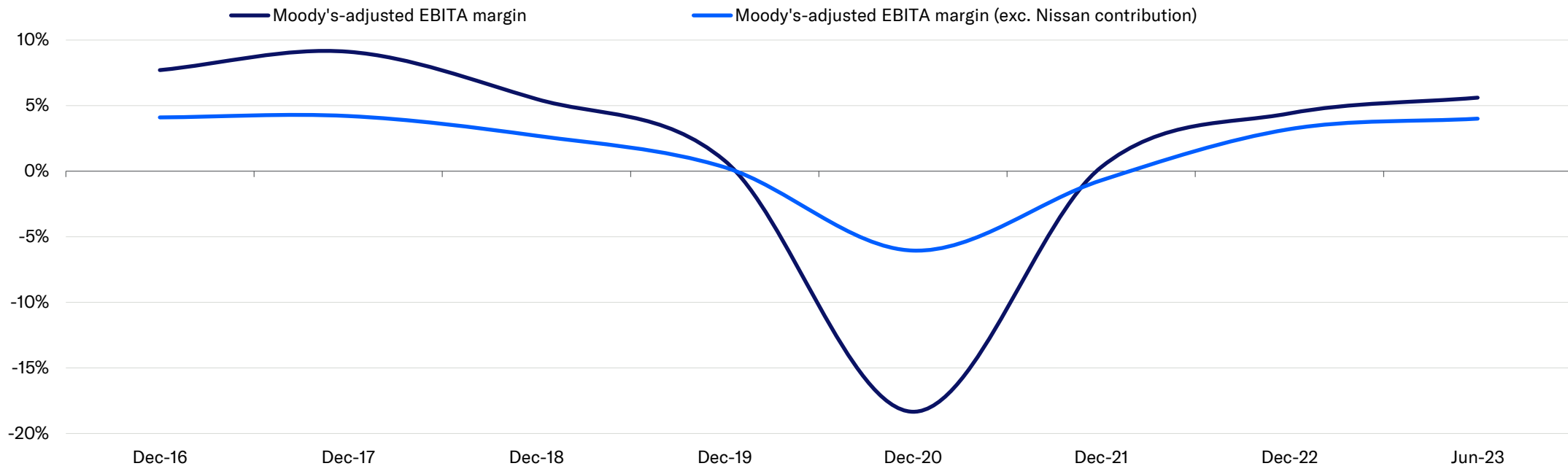
Siemens' need to support Siemens Energy is credit negative

- Siemens spun-off Siemens Energy (SE) through an IPO in September 2020 reducing its stake to 35%
- SE has been incurring substantial losses, driven mainly by quality issues with its wind turbines
- As of end-2023, Siemens' stake in SE reduced to 17%, however, Siemens still supported SE in Q1 2024 by:
 - purchasing a stake in SE's subsidiary, Siemens Ltd. India, for around €2.1 billion
 - agreeing on €1 billion in indirect financial measures, allowing third parties to provide guarantees to SE
- Credit implications on Siemens are not material, but the need for support could indicate Siemens may continue to assist SE for reputational reasons.
- This support may continue even if Siemens is not legally required to and despite its strategy to disentangle from SE, particularly if SE's performance and credit quality continue to deteriorate.

Source: Moody's credit opinion on Siemens Aktiengesellschaft, dd. 15 January 2024

Nissan's stake contributes to Renault's credit quality

- Renault owns 43.4% stake in Nissan (equity accounted)
- Historically, contribution from Nissan has been a supportive factor for Renault's credit metrics
 - It accounted for more than half of Renault's reported EBITA (Moody's definition) on average
 - In recent years, however, Nissan's operating performance has weakened at a similar pace as Renault's.
- The alliance with Nissan and Mitsubishi offers material synergies; but further progress needed
- New alliance agreement envisages reduction of Renault's stake in Nissan to 15%, with proceeds potentially to be used for debt repayment



Appendix



Daimler Trucks AG's financial metrics

Key indicators - Manufacturing sector

Financial metric	LTM-March 2023 As Reported [1]	LTM-March 2023 As Adjusted [2]
EBITA margin	8.3%	7.9%
Debt / EBITDA	0.1x	0.3x
Retained Cash Flow / Net Debt	(63.3%)	(58.7%)
Free Cash Flow / Debt	381.2%	142.8%
EBITA / Interest expense	20.3x	18.6x

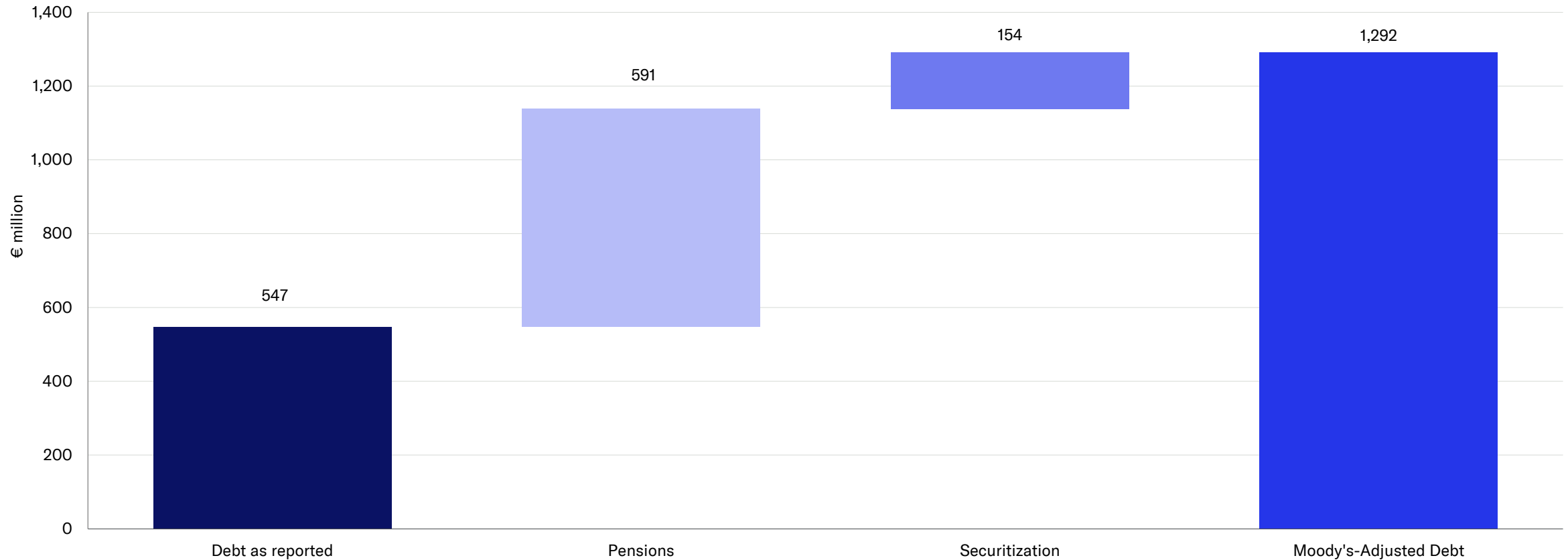
[1] As defined by Moody's Ratings

[2] All ratios incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics™

Impact of Moody's adjustments - Pensions

Pension liabilities have the biggest impact on Daimler Trucks' debt



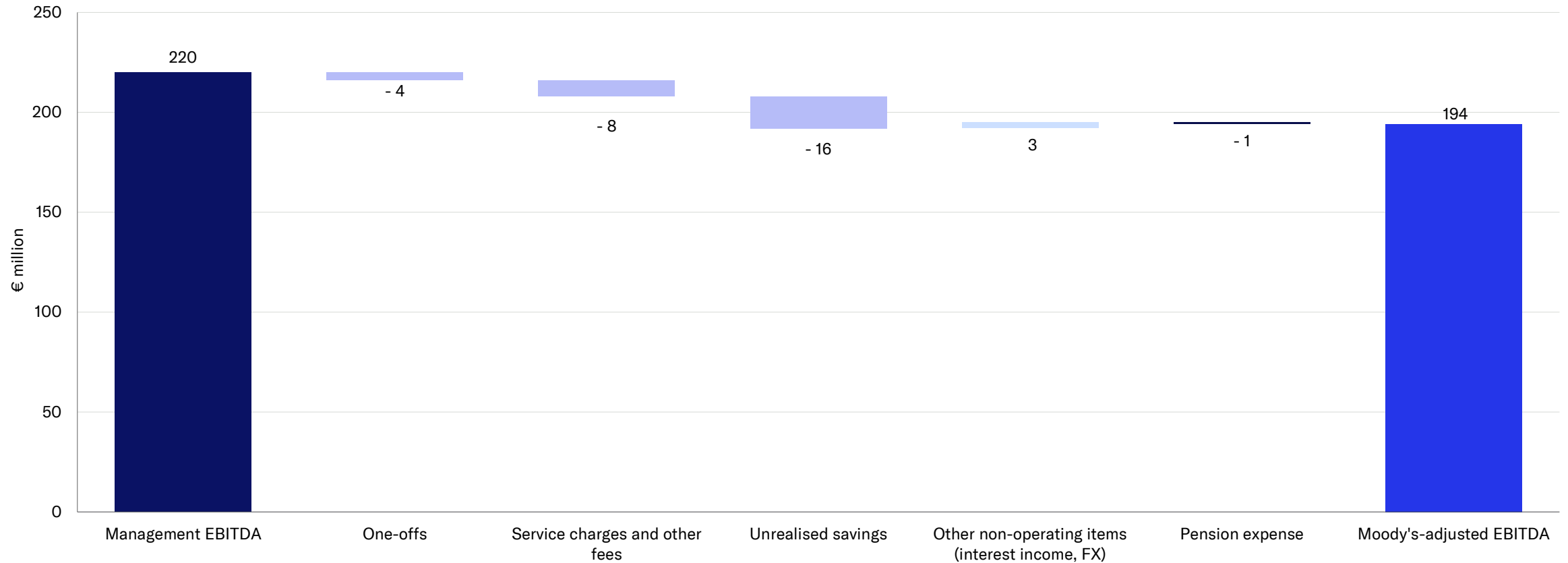
Source: Moody's Financial Metrics™

Other common adjustments affecting debt

- Leases (for non-IFRS reporters)
- Hybrids (hybrid bonds, shareholder loans)
- Securitisation / Factoring
- Third party financial guarantees
- Earn-outs, put options and deferred consideration

Impact of Moody's adjustments on EBITDA

HY issuers tend to have many normalisation adjustments



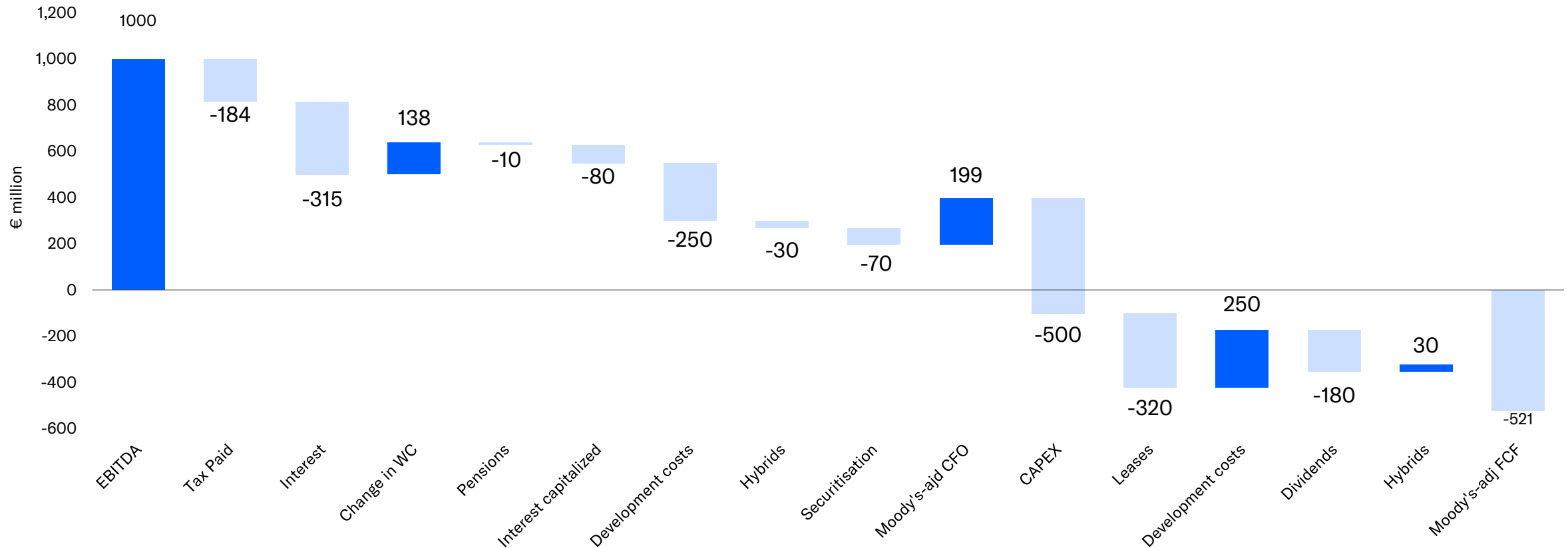
Source: Moody's Financial Metrics™

Other common adjustments affecting EBITDA

- Pensions
- Leases (for non-IFRS reporters)
- Unwinding of discounts
- Development costs

Moody's-adjusted FCF calculation

Hypothetical example of FCF reconciliation for an IFRS reporter



The list of adjustments is not exhaustive

Thank you

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