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Research Update:

AEG Power Solutions Downgraded To 'CCC+' On Weak Earnings And Delays In Customer Payments; Outlook Negative

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Overview

- 3W Power, the parent holding company of Netherlands-based power solutions provider AEG Power Solutions B.V., has reported weaker earnings for 2012 than we anticipated. In addition, the company is experiencing a payment delay from a major European customer, and has delayed the release of its detailed year-end financial statements.
- We estimate that AEG Power Solutions' credit ratios at year-end 2012 and over the coming year will be commensurate with a 'CCC+' rating.
- We are therefore lowering our long-term corporate credit rating on AEG Power Solutions to 'CCC+' from 'B-'.
- The negative outlook reflects our view that there is a one-in-three chance of a further downgrade if AEG Power Solutions fails to collect the material payment from its major customer or if its earnings and cash position continue to deteriorate.

Rating Action

On March 27, 2013, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Netherlands-based power solutions provider AEG Power Solutions B.V. to 'CCC+' from 'B-'. The outlook is negative.

Rationale

The downgrade follows a combination of unfavorable factors that have negatively affected AEG Power Solutions' operating performance. Preliminary results for 2012 are weaker than we forecast in our base case, with €18 million of reported EBITDA being materially lower than our projection of more than €30 million. In addition, cash outflow for the year was about €40 million, more than double our forecast of negative free operating cash flow of €16 million. This level of earnings and cash generation resulted in weaker credit ratios than we anticipated. We are therefore revising our assessment of AEG Power Solutions' financial risk profile to "highly leveraged" from "aggressive." The company has also delayed the release of its detailed year-end financial statements.

In addition, AEG Power Solutions has reported that as of Dec. 31, 2012, it has not received a due payment from a major customer that has centralized its procurement through a Cypriot subsidiary. As of Dec. 31, 2012, this customer represented 37.5% of AEG Power Solutions' €124.5 million of receivables (the related past due amount has been fully reserved for in the accounts and totaled €8.5 million). In our opinion, and as management has acknowledged, a failure to collect a material payment could pose a significant financial difficulty for AEG Power Solutions. If such a situation were to occur, AEG Power Solutions' credit quality could deteriorate further, in our opinion, and this could result in us taking a negative rating action.

Having said that, management expects to collect the outstanding amount in full from the aforementioned major customer and to maintain its strong business relationship with this customer. However, in our opinion, even if AEG Power Solutions resolves this issue in accordance with the agreed timetable, we anticipate that the company's earnings in 2013 will be largely in line with 2012 and as such, will not be sufficient to restore its credit metrics to a level that we see as commensurate with our previous 'B-' rating.

We base our view on the book-to-bill ratio in AEG Power Solutions' renewable energy solutions and energy efficiency solutions segments reaching about 1x in 2012, reflecting a limited capacity to increase revenues in the coming 12 months. We consider that the positive effect of cost-base streamlining efforts that the company has been undertaking in the course of 2012 and 2013 to date will not be enough to fully offset the under-absorption of fixed costs and a decline in the share of high-margin power controllers in the company's product mix.

In our base-case credit scenario, we estimate that in 2013, AEG Power Solutions will generate reported EBITDA comparable with the €18 million it posted in 2012, including a similar level of restructuring spending to 2012. We estimate, however, that AEG Power Solutions will be able to restore cash generation as it advances toward the completion of large framework contracts and fulfills smaller-scale orders that demand less working capital financing. If Standard & Poor's-adjusted debt remains at the same level as on Dec. 31, 2012 (€122 million excluding excess cash), this will result in debt to EBITDA in excess of 10x and funds from operations (FFO) to debt of materially less than 10%.

At the same time, we see a risk that cash flow generation could come under more pressure should AEG Power Solutions face further delays in collecting payments from its customers. Although this is not our base-case assumption, such risks could materialize because the company's emerging market customers have operations in countries with weaker financial institutions and less mature financial systems than Western European markets.

Liquidity

We continue to assess AEG Power Solutions' liquidity as "adequate" under our criteria. In our assessment, we take into account the following factors:

- As of Dec. 31, 2012, the company's primary sources of liquidity consisted of cash balances of about €43 million and access to short-term lines of credit and factoring facilities that we understand can be rolled over

annually.
- AEG Power Solutions has no meaningful near-term maturities before 2015, when its €100 million 9.25% notes are due.
- The company does not have any covenants governing its debt instruments.
- AEG Power Solutions relies on advanced payments from its customers for orders undertaken. The amount of such advanced payments is volatile and depends on the order intake and related contract terms.
- We anticipate that AEG Power Solutions will generate positive FFO in the next 24 months.

These sources should cover estimated uses (such as working capital investment and capital expenditures) by at least 1.2x over the next 12 months.

We see the main risks to AEG Power Solutions' liquidity position coming from working capital financing. Should the company face more payment delays, we could revise our classification of the company's liquidity position downward.

Outlook

The negative outlook reflects our view that there is a one-in-three chance that we could take a negative rating action over the next 12 months if AEG Power Solutions fails to collect material payments from its major customer or if its earnings and cash position continue to deteriorate.

Downside risks to AEG Power Solutions' performance in 2013 could result in the company's credit quality deteriorating further and liquidity ceasing to qualify as "adequate" under our criteria. We could, for instance, take a negative rating action if we foresee that cash flow generation will fail to materially improve from the negative €40 million in 2012.

We could revise the outlook to stable if AEG Power Solutions' business position strengthens over the near term. A stable order intake, a strong contract base, steady revenues, and operating profitability at least in line with the level in 2012 would be important factors for an outlook revision. An outlook revision would also likely depend on FFO to debt being about 10%, alongside neutral to moderately positive free operating cash flow.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal.
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, And CC Ratings, Oct. 1, 2012
- Key Credit Factors: Criteria For Rating The Global Capital Goods Industry, April 28, 2011
- Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

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Downgraded
                                        To                 From
AEG Power Solutions B.V.
 Corporate Credit Rating                CCC+/Negative/--   B-/Negative/--
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