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Summary:
Scania (publ.) AB

Primary Credit Analyst:
Werner Staeblein, Frankfurt (49) 69-33-999-130; werner_staeblein@standardandpoors.com

Secondary Credit Analysts:
Maria Bissinger, Frankfurt (49) 69-33-999-120; maria_bissinger@standardandpoors.com
Andreas Zsiga, Stockholm (46) 8-440-5936; andreas_zsiga@standardandpoors.com

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Summary:

Scania (publ.) AB

Credit Rating: A-/Stable/A-2

Rationale

The ratings on Sweden-based truck and bus manufacturer Scania (publ.) AB reflect the group's strong business profile and modest financial risk. The ratings are supported by Scania's outstanding profitability in the global truck industry. Standard & Poor's Ratings Services expects the company to maintain an operating margin of at least 4% to 5% at the bottom of the business cycle. The group's truck and bus businesses benefit from leading market positions, up-to-date product lines, and the highest degree of component commonality in the global truck industry.

In March 2008, Volkswagen AG (VW; A-/Stable/A-2) acquired an additional 30.62% of voting power in Scania, increasing its holding to 68.60% of voting power and 37.8% of share capital. Subject to expected changes in the board composition to reflect the new shareholding structure, VW has now effectively taken control of Scania. We factored in the relationship with VW into our ratings assessment of Scania, but the ratings on Scania will not automatically match those on VW.

The ratings continue to benefit from Scania's strong cash flow generation and stable capital structure, together with its adequate financial flexibility. The ratings are constrained by the high capital intensity and severe cyclicality of the commercial vehicle industry, as well as the volatile and difficult global bus industry, although conditions have been improving.

Scania's results for the first quarter of 2008 showed a continuation of the strong earnings performance seen over the past two years. The group's EBIT margin in the first quarter was 16.4%, compared with 15.9% in the first quarter of 2007, 14.4% for full-year 2007, and 12.4% in 2006. The company continues to benefit from high capacity utilization as a result of increased production volumes, a favorable pricing environment, and increasing high-margin service revenues. EBIT in industrial operations was 15.6% in first-quarter 2008 compared with 15.2% for the same period of 2007, 13.8% for full-year 2007, and 11.7% in 2006. The company has affirmed its medium-term goal of a 12%-15% EBIT margin between 2007 and 2009, while at same time achieving average sales growth of about 10%.

Given the favorable demand situation, we expect Scania to maintain its overall high profitability in 2008. Capacity bottlenecks and strong market demand should allow for a favorable pricing environment and the recovery of higher raw material costs through price increases.

Liquidity

Standard & Poor's considers Scania's liquidity and financial flexibility to be strong, enhanced by two committed revolving credit facilities (RCF) totaling €2 billion. In early 2008, Scania negotiated an increase of its old €500 million RCF to €1.0 billion. This new facility is due in January 2013 and has a two-year renewal option. The second €1 billion RCF is due in May 2012.

The company's bank lines are not subject to financial covenants or rating triggers. Access to medium-term note and commercial paper programs supports the company's liquidity position. In addition, Scania reported cash and short-term investments of Swedish krona 4.1 billion on March 31, 2008. Positive free cash flows throughout the cycle, supported by credit lines, should provide ample leeway for Scania to cover short-term debt maturities.

Outlook

The stable outlook reflects Scania's industry-leading profitability and its ability to generate free cash flows throughout the cycle, which limits downside risk. In line with the company's historical practice, we expect it to continue its predominantly organic growth strategy. We have therefore not factored major acquisitions into the ratings. The industry's tough competitive environment and cyclical demand restrict upside ratings potential, however.

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com