

### Research Update:

## Netherlands-Based AEG Power Solutions B.V. Assigned Preliminary 'B-' Corporate Credit Rating; Outlook Stable

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## Research Update:

# Netherlands-Based AEG Power Solutions B.V. Assigned Preliminary 'B-' Corporate Credit Rating; Outlook Stable

## Overview

- We are assigning a preliminary 'B-' corporate credit rating to Netherlands-based AEG Power Solutions B.V. (AEG) subject to a successful issuance of €125 million unsecured notes (unrated).
- The rating reflects our view that AEG has a "vulnerable" business risk profile and "highly leveraged" financial risk profile.
- The outlook is stable because we expect that AEG will benefit from the current upturn in the economy from 2011 and improve its sales and profitability.

## Rating Action

On Nov. 11, 2010, Standard & Poor's Ratings Services assigned its preliminary 'B-' corporate credit rating to Netherlands-based AEG Power Solutions B.V. The outlook is stable.

## Rationale

The preliminary rating is subject to AEG successfully issuing €125 million in unsecured notes (unrated) and reflects our view that the company will have a highly leveraged financial risk profile on completion of this proposed issuance and a "vulnerable" business risk profile, according to our classifications. We consider AEG's business risk profile to be characterized by volatile and late-cyclical demand, low planning certainty, high customer concentration, and strong dependence on suppliers. Furthermore, we consider that AEG's business plan relies significantly on a rebound in the solar energy market for future growth and profitability generation. In our view, these factors offset positive ratings factors, which we consider include AEG's good geographic diversification of revenues and a low capital intensity of the business.

We expect the company's revenue to grow by about 15% in 2011. Nevertheless, we believe AEG will have a high rate of cash burn over the next two years, owing to its weak operating cash flow generation ability as a result of moderate profitability and still moderate sales volumes given the company's size. In addition, we view the company's financial policy as aggressive in terms of its expansion plans, which we estimate are likely to result in total debt to EBITDA of between 5x-6x by the end of 2011. We view this leverage as highly vulnerable given the volatility of this business, as has been exemplified by

significant swings in profitability, order intake, and sales historically. The preliminary ratings also reflect our expectation that AEG's liquidity will benefit if it successfully issues the €125 million notes.

AEG is a global provider of highly engineered custom and standard power-system solutions for a broad range of applications with a particular focus on the solar industry. It manufactures devices used in the application of polysilicon manufacturing and solar inverters for industrial and commercial applications. Typical customers are engineering and procuring firms. The company also provides custom and standard power-system solutions for UPS and telecom applications to the industrial sector, including oil and gas, transportation, power generation, power transmission and distribution, and process manufacturing. AEG operates in two business segments: Renewable Energy Solutions, and Energy Efficiency Solutions. AEG has a fairly concentrated customer base, somewhat offset by good geographic diversity, which enables it to generate more than half of its revenues from outside Europe. AEG's products require a fair degree of customization and technological specialization. Furthermore, its business is highly dependent on customers' capital spending and commodity price movements, especially for polysilicon.

The global economic downturn affected demand for AEG's products and revenues in 2010 and we expect full-year sales to decrease more than 20%. We expect the company's operating margins (before depreciation and amortization) to remain weak in 2010 and 2011, before rebounding to an acceptable level of 10%-12%. Standard & Poor's notes that the company attributes significant importance to the growth of the photovoltaic industry and to investments in new polysilicon production capacity for its profitability and the success of its growth strategy.

We view AEG's financial risk profile as highly leveraged. Pro forma for the new debt issuance, we expect that its total debt to EBITDA will be weak. We believe that AEG's credit metrics would likely improve in the next few quarters to reach between 5x-6x by the end of 2011, amid a gradual recovery in its end markets. Our ratings do not incorporate larger bolt-on acquisitions above €20 million.

### **Liquidity**

We view AEG's liquidity as adequate on a pro forma basis. Pro forma for the new €125 million debt issue maturing 2010, we understand that primary sources of the company's liquidity will include unrestricted cash balances of about €40 million and access to short-term lines of credit, which we understand are expected to be rolled over at maturity. There are no meaningful near-term maturities because its new debt would mature in 2015. Prior to the new debt issuance, we view the company's debt profile is moderate. As of Sept. 30, 2010, the company had about €24 million of short-term debt and €1 million of long-term debt outstanding. Although AEG's current lines of credit do not contain any financial covenants, we understand that the unsecured notes would be governed by a minimum interest coverage ratio. AEG's annual interest payments should average €15 million and we will continue to monitor

developments related to covenant compliance in the future. AEG's maintenance capital expenditure is relatively low at about €5 million annually. Working capital requirements have not been high historically. However, we expect the company to have a high cash-burn rate over the next two years as a result of increased business activity. Another source of liquidity is the advanced payments that the company receives upfront for orders undertaken. We do not expect the company to generate free operating cash flows in 2011. We believe AEG would use cash primarily to fund its working capital needs, capital expenditure, and bolt-on acquisitions.

## Outlook

The outlook on AEG is stable. We expect that the company will benefit from the current upturn in the economy from 2011 and show clearly improving profitability on the back of a larger number of contracts. We believe that this should support the company's rebound in sales and profitability and credit metrics over the next two years. We expect AEG's currently negative free operating cash flow to turn positive from 2013 at the latest, and to remain moderate in 2012. To stay commensurate with the current rating we would expect that AEG's debt to EBITDA will be about 5x-6x and that it will maintain an adequate liquidity. However, the company's earnings remain highly vulnerable to weakening economic conditions and we could lower the ratings if economic conditions weakened and/or debt-financed activities adversely affected liquidity and subsequently credit measures.

While we do not see any immediate rating upside, we would consider raising the ratings if AEG's business position strengthened over the medium term, demonstrated by a materially increased contract base, higher operating profitability, and a more conservative financial policy.

## Related Criteria And Research

- Principles Of Corporate And Government Ratings, June 26, 2007.
- Business Risk/Financial Risk Matrix Expanded, published May 27, 2009.
- Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010.

## Ratings List

New Rating; CreditWatch/Outlook Action

AEG Power Solutions B.V.  
Corporate Credit Rating

B-(prelim)/Stable/--

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