MOODY'S RATINGS

Rating Action: **Moody's Ratings assigns first-time Baa1 LT issuer rating to Danfoss; outlook stable**

06 May 2025

Stockholm, May 06, 2025 -- Moody's Ratings (Moody's) has today assigned first-time foreign and local currency Baa1 long-term issuer ratings to Danfoss A/S ("Danfoss" or "the company"), a global diversified manufacturer of industrial products and applications based in Nordborg, Denmark.

At the same time, we also assigned a (P)Baa1 rating to Danfoss' €2.5 billion senior unsecured Euro Medium Term Note (EMTN) Programme and (P)Baa1 backed senior unsecured EMTN programme ratings to Danfoss Finance I B.V. and Danfoss Finance II B.V. and Baa1 backed senior unsecured ratings to Danfoss Finance I B.V. and Danfoss Finance II B.V. for debt issued under the programme. The outlook on all entities is stable.

"Danfoss' first-time Baa1 rating reflects the company's strong track record of consistently generating a double-digit EBITA margin and positive free cash flow while at the same time growing the business organically and through acquisitions, accompanied by a conservative financial policy" says Daniel Harlid, a Moody's Ratings VP - senior credit officer and lead analyst for Danfoss.

RATINGS RATIONALE

Danfoss' Baa1 long-term issuer rating and stable outlook is supported by its market-leading positions within hydraulics systems and components, heating and cooling solutions and electrical drives. Furthermore, the rating reflects the company's track record of a stable and high profitability level through the cycle. This includes an EBITA margin that has hovered at around 12%-13% in each but one year since at least 2014. The assigned rating is also underpinned by Danfoss' conservative financial policy as evidenced by a commitment to a company net leverage below 2.0x and its long term track record of abiding by its financial policy. The conservative financial policy is also underpinned by a history of maintaining a low dividend payout ratio not exceeding 30% during the last ten years. The Baa1 rating is further supported by the company's very diversified revenue exposure, both on a geographic, end-market and customer level. This also applies to its own highly decentralized operating model, where each of its 16 divisions has its own factories and its own supply chain.

Part of Danfoss' strategy is to grow through acquisitions, which since 2016 has contributed to around half of the company's annual sales growth. This includes the acquisition of Eaton Corporation's (A3 Positive) hydraulics business in August 2021 for an enterprise value of €2.7 billion, the largest transaction in the company's history, adding around €1.8 billion of revenue on a full year basis. We note that as a result of using a high share of new debt in the funding mix, the acquisition increased the Moody's-adjusted debt / EBITDA ratio to 2.0x in 2022 from 1.4x in 2020. Notwithstanding the risk of debt-funded acquisitions going forward, we take comfort in Danfoss' conservative financial policy which stipulates: (1) Maintain a capital and financing structure over the cycle that is compatible with a Baa1 credit rating; (2) maintaining a net debt / EBITDA ratio at a maximum of 2.0x, which would be allowed to be exceeded following significant acquisitions and (3) a dividend distributions of up to 30% of net profit.

We recognize that the company's weak performance in 2024, driving its reported EBITA margin to 9% (the lowest on record over the last 10 years) was largely attributable to a challenging market environment for the US agriculture sector as well as the global EV market. Although we understand the outlook for these two key sectors have yet to improve, partly as a result of high uncertainties around the imposed tariffs by the current US administration, we do not expect further profitability erosion. The reason is the company's current restructuring program that in 2024 rendered €185 million of restructuring costs, which mainly related to employee terminations (equivalent to 6.5% of employee expenses in 2024). As such, the assigned Baa1 rating is based on somewhat improved profitability in 2025 coupled with low single digit organic growth.

LIQUIDITY

We view Danfoss' liquidity as excellent. As of 31 December 2024, liquidity sources included the company's cash balance of €339 million as well as €1.2 billion of revolving credit facilities with no material adverse clauses (MAC) but with financial covenants (all undrawn). We understand the company's policy is to have liquid reserves (cash and undrawn facilities) of at least 7.5% of net sales at any time. In terms of cash uses, working capital swings follow the typical seasonal patterns of the capital goods industry with outflows during the first half of the year followed by a material inflow during the fourth quarter. We note as positive the company's track record of positive free cash flow generation each year since at least 2016, which we expect to continue during the next three years.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects our expectation that Danfoss will increase its Moody's-adjusted EBITA margin to around 10% - 11% during the next twelve months, which will result in a Moody's-adjusted debt / EBITDA ratio of around 1.9x and a Moody's-adjusted free cash flow / debt ratio of around 12.5% - 15.5%.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Positive ratings pressure could be the result of Danfoss increasing its scale or further diversified its revenue exposure. In addition, this would be accompanied by (i) a Moody's-adjusted debt / EBITDA ratio decreasing below 1.5x, (ii) a structurally higher Moody's-adjusted EBITA margin and (iii) a more conservative financial policy.

Conversely, negative ratings pressure could be the result of (i) a Moody's-adjusted debt / EBITDA ratio exceeding 2.5x on a sustained basis, (ii) a Moody's-adjusted EBITA margin sustainably below 10%, (iii) a Moody's-adjusted retained cash flow / net debt ratio decreasing below 20% or (iv) signs of a more aggressive financial policy.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Manufacturing published in September 2021 and available at https://ratings.moodys.com/rmc-documents/74970. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Based in Nordborg, Denmark, Danfoss is a global diversified manufacturing company that designs and manufactures products and solutions to enhance energy efficiency, machine productivity, and electrification. It designs, manufactures and sells a range of products and solutions for refrigeration, heating, air conditioning, motor control and off-highway machinery applications. In 2024, the company reported revenue of €9.7 billion and EBITA of $870 million. The company is privately held by the Bitten & Mads Clausen's Foundation and the Clausen family, which together control 100% of the votes and 96.6% of the capital.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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