MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms MTU's Baa3 LT Issuer rating, outlook stable

17 Mar 2022

Frankfurt am Main, March 17, 2022 -- Moody's Investors Service ("Moody's") has today affirmed MTU Aero Engines AG's (MTU or the company) long-term issuer rating at Baa3. Concurrently the agency has affirmed the company's Baa3 rating of EUR500 million senior unsecured fixed rate notes due 2025. The outlook has been changed to stable from negative.

RATINGS RATIONALE

The rating affirmation and change in outlook to stable reflects (i) the significant recovery in MTU's credit profile since the worst of the pandemic, (ii) the solid medium term outlook for the company supported by its focus on narrow body engines, (iii) a very limited exposure to the Russian and Ukrainian markets, (iv) a strong liquidity profile and commitment to a prudent financial policy in line with our requirements for an investment grade rating.

MTU's credit profile has significantly improved since the worst of the pandemic. MTU's credit metrics improved materially over the last 18 months with Debt/EBITDA dropping from 5.0x at YE2020 to below 4.0x expected at YE2021 (2.0x in 2019). Furthermore, Moody's notes that MTU continued to generate positive free cash flows. The recovery in metrics was led by a recovery in MRO activity supported by MTU's focus on narrow body aircraft and freighter exposure as well as by a very gradual improvement in the Original Equipment business both for new engines and spare parts. MTU's gross leverage is inflated by a significant cash buffer of €722 million compared to €140 million pre-pandemic, which has provided MTU with a good liquidity cushion to withstand the operating performance volatility. Net debt / EBITDA is expected at around 2.5x in 2021 versus 3.3x in 2020 and 1.9x in 2019. MTU's gross leverage ratio is still somewhat outside of our downgrade trigger of 3.0x but is expected to improve further over the next 12 to 18 months and is also mitigated by the company's high cash buffer (both in absolute terms and in comparison to pre-pandemic).

MTU has presented a strong short to medium term outlook to the market during its November 2021 investor day. Both the short and medium term outlook were confirmed at the company's FY results call in March 2022. For 2022, MTU expects revenue and EBIT growth of more than 20% supported by all business divisions but especially by the MRO business, which is expected to grow by mid to high twenties. For the period 2021-2024 MTU expects revenue growth of low to mid-teens and an EBIT exceeding pre-pandemic levels in 2024. MTU has also guided to a strong cash conversion. MTU's recovery expectations are aligned with Moody's view that passenger traffic will recover in the short term supported by strong pent up demand and gradually easing travel restrictions. MTU's focus on narrow body engines both for its Original Equipment and MRO business as well as its strong market presence for freighter aircraft should support the company's path.

MTU has very limited exposure to Russia and Ukraine. Its revenue and EBITDA exposure is minimal (below 5%). MTU sources some of its titanium from Russia but has a lower share of supply from Russia than certain peers. MTU's titanium consumption for 2022 is covered by buffer inventory. The company has no production assets in Russia and would only be hit if the conflict spreads to Poland where MTU has a sizeable MRO facility. Moody's expects that MTU will be able to mitigate rising raw material prices through passing on most of these costs to end customers through contractual arrangements or negotiations albeit potentially with some time lag.

MTU has significantly strengthened its liquidity management during the pandemic. MTU is now carrying €722 million of cash on balance sheet (~20% of group revenue) after having issued €500 million senior unsecured bond during the pandemic. In addition the company has access to a €600 million undrawn RCF. Pre-pandemic MTU had €140 million of cash on balance sheet or 3% of group revenue. MTU is committed to maintaining its investment grade rating. The low to middle end of their net leverage public guidance of 0.5x to 1.5x would map with our downgrade trigger of debt /EBITDA of 2.5x to 3.0x (~1x adjustment from pension + ~1x of cash on balance sheet) although MTU carries more cash on balance sheet than pre-pandemic. As a result of the more conservative liquidity management MTU has adopted we have revised our financial policy score to Baa from Ba. Governance is therefore seen as a driver of today's rating action.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook on the ratings reflects our expectation that MTU's credit metrics will continue to improve supported by a recovery in demand for its original equipment and MRO services to position the metrics more solidly into its Baa3 rating category over the next 12 to 18 months. The stable outlook also factors in that MTU will maintain a prudent financial policy in line with its public net leverage commitment and will maintain a strong liquidity profile.

LIQUIDITY

MTU's liquidity position is strong. The company had €722 million of cash and marketable securities on balance sheet at 31st December 2021 and €600 million availability under a €600 million revolving credit facility with comfortable covenant headroom at year-end 2021. This compares to a cash position of €140 million before the pandemic. MTU has a well spread maturity profile with the first large maturity in 2025 when its €500 million senior unsecured bond issued in 2020 comes due.

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

Positive rating pressure is unlikely in the short term. Longer term a gross leverage as measured by Moody's-adjusted debt/EBITDA below 2.5x and retained cash flow (RCF)/net debt above 35% as well as sustained positive FCF generation, with FCF/debt in the high-single digits in percentage terms could lead to positive rating pressure.

Negative rating pressure would build if leverage (Moody's-adjusted debt/EBITDA) would stay sustainably above 3.0x. A drop in RCF/Net debt below 25% on a sustainable basis and materially negative FCF generation could lead to negative pressure on the current rating. A deterioration in the group's liquidity profile would also exert negative pressure on the rating.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Aerospace and Defense published in October 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1287887 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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 at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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Stanislas Duquesnoy
Senior Vice President
Corporate Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Christian Hendker, CFA
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454