S&P Global
Ratings

Research

Research Update:

Sweden-Based Medical Equipment Manufacturer Elekta AB Assigned 'BBB-' Rating; Outlook Stable

October 26, 2021

Rating Action Overview

- Elekta AB is a global leader in radiotherapy solutions for cancer and neurological diseases treatment and generated revenue of about Swedish krona (SEK) 13.8 billion and S&P Global Ratings-adjusted EBITDA margin of 18% during the fiscal year ending April 30, 2021.
- We positively view the group's ability to introduce new innovative treatment solutions cementing its strong No.2 position in a market that is effectively a duopoly, as well its high share of recurring service revenue over the life of the installed equipment providing cashflow visibility.
- We assigned our 'BBB-' ratings to Elekta AB and the group's senior unsecured notes.
- The stable outlook reflects our view that Elekta will continue to deliver solid operating performance and cash flow, supported by its strong market position, revenue growth, stable EBITDA margins, and free cash flow. We also consider that the company will continue its conservative balance sheet management, leading to S&P Global Ratings-adjusted debt to EBITDA below 2x over the next 24 months.

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Rating Action Rationale

We expect Elekta's technology leadership in radiotherapy solutions, as well as its resilient business model, to lead to healthy revenue and cash flow over the next 24 months. Elekta is the second-largest player in radiotherapy solutions for cancer treatment and neurological diseases with a global market share of approximately 40%. Elekta is solely focused on radiotherapy equipment, and its investment in product innovation and technology has yielded solid revenue growth, maintenance of its market position, and healthy cash flow over the past years. We expect the group to continue to expand with an annual sales growth rate of 5%-10% over our forecast horizon, mirroring the expected market demand. We view market share development in Elekta's specialized field as stable thanks to the high value and long life of the equipment. As a result, clinicians generally prefer not to switch vendors, provided that vendors continue to invest in research and development (R&D) and develop innovative solutions, including software, which continue to improve value for both practitioners and patients. Elekta invests heavily in R&D (it reported annual R&D investments of about 10%-12% of revenue), enabling the company to remain competitive in the marketplace and retain its market share, with late gains in the share of new installations stemming from the company's introduction of innovative technologies, notably the product platform Unity. Elekta's global installed base of radiotherapy machines ranks second only to Varian Medical Systems (Siemens Healthineers) at approximately 4,750 units versus about 8,854 units of Varian in the fiscal year ended April 30, 2021. We also note that Elekta's revenue is split between solutions (sale of radiotherapy equipment and software) and services (maintenance, software updates, logistics, and training). The latter services are typically provided during the 10 to fifteen years following the sale of the equipment. Service sales through maintenance contracts for the installed equipment are a highly visible and recurring source of revenue and constituted 41% of total sales in the fiscal year ended April 30, 2021. Service revenue further carries a significantly higher operating margin than the equipment sales and shows low cashflow volatility.

Elekta's small scale and lack of diversification in terms of product offering constrain the rating. Elekta's largest market is Europe, Middle East, and Africa, accounting for about 37% of revenue, followed by Asia-Pacific (35%), and North and South America (28%). We view this diversification as positive, in particular because Elekta has strong presence in all main health care markets. In addition, as part of its strategy, Elekta aims to expand its presence in emerging markets that present higher revenue growth opportunities, whereas the group's presence in developed markets remains a source of predictable revenue. Elekta's main downside relative to peers in the high technology healthcare equipment space is its small size. While Elekta's revenue, as adjusted by S&P Global Ratings, was $1.6 billion and adjusted EBITDA stood at $288 million the last fiscal year, rated medical technology peers such as Hologic, Illumina, and Teleflex have S&P Global Ratings-adjusted revenue of $2.5 billion-$4.0 billion and adjusted EBITDA at $0.7 billion-$1.6 billion. Additionally, groups manufacturing high-end equipment like Elekta, such as Siemens Healthineers and Philips, have a significantly larger scale of operations. Elekta's operating margins (S&P Global Ratings-adjusted EBITDA margin of 18%) are lower than the industry average for medical equipment, but comparable with those of other players producing similar types of high-value equipment. We view scale as an important factor because larger groups are better positioned to leverage their R&D spending across product lines and develop complementary services like software and artificial intelligence (AI) solutions, which are an integral part of the solution offering and will continue to gain importance in the marketplace. That said, Elekta has demonstrated its ability to innovate, introduce new products, and successfully compete in its focused market, which will mitigate the disadvantages of the group's smaller scale through development and operational partnerships. Nevertheless, we view a smaller player like Elekta to be potentially more exposed to unforeseen negative events, such as an unsuccessful introduction of a new product line or introduction of a more technological advanced solution by a competitor.

We believe the radiotherapy treatment market presents good growth opportunities driven by demographic trends, and barriers to entry remain high. The global radiotherapy solutions market amounts to $7 billion and will likely expand at a 6%-8% annual compound annual growth rate in the next years. The market is concentrated because developing radiotherapy treatment solutions is technologically complex and costly. The high barriers to entry with high technological complexity of products requiring significant R&D investments, as well as complex regulatory pathways, limit the number of potential new competitors. Currently the market is dominated by two players, Varian and Elekta, with a combined market share of more than 90%. Demographic trends, including rising cancer cases and prevalence and ageing of the population, combined with the cost-efficient nature of radiotherapy treatment, will be the main drivers for the long-term demand of radiotherapy solutions. Radiotherapy solutions are recommended for more than 50% of cancer patients and are often combined with surgery, chemotherapy, or immunotherapy solutions. Therefore, we view these treatments as complementary to each other and currently do not see a near-term risk of a sudden technological disruption. Moreover, the radiotherapy market is still largely underpenetrated in many geographies, especially in developing economies, presenting a growth opportunity for the market leaders.

We view low adjusted leverage and stable cash generation as key credit strengths. We view Elekta's financial profile as a key strength to its credit quality, thanks to the company's low leverage, strong liquidity position, and considerable free cash flow. Despite cancer patients' radiotherapy treatment frequency being negatively affected by anti-COVID-19 measures, such as hospitals being forced to delay the radiotherapy sessions, Elekta's equipment sales remained high and operating performance resilient for the fiscal year ended April 30, 2021. This underlines the stable nature of Elekta's business model. We expect future revenue and EBITDA growth to be driven by increasing Unity platform roll-out and digital solutions market penetration, as well as servicing the existing installed base. We further expect Elekta's continuous investments in R&D to secure its competitiveness in a technologically highly advanced market. We forecast Elekta's capital expenditure (capex) to increase over the next 24 months as the company invests in machinery and equipment to meet heightening demand for equipment installations.

Elekta's financial policy and dividend policy will remain key factors to shaping its credit metrics. Elekta's capital allocation decisions will be a key factor influencing credit metrics over the next 12-24 months. Although we have not included any large acquisitions in our forecasts for the next years, we acknowledge that the company has a historical track record of mergers and acquisitions (M&A) and we believe it could pursue a larger debt-funded acquisition that could weaken our adjusted leverage temporarily to above 2x should an attractive M&A opportunity present itself. In addition to this, we view Elekta's dividend policy of distributing more than 50% of net income as dividends to shareholders as relatively shareholder friendly. Nevertheless, we think the group will likely engage in smaller bolt-on acquisitions over the next 24 months, balance investments, shareholder distributions, and M&A with its cash generation and keep S&P Global Ratings-adjusted leverage below 2.0x.

Outlook

The stable outlook reflects our view that Elekta will continue to deliver solid operating performance and cash flow, supported by its strong market position, revenue growth, stable EBITDA margins, and free cash flow. We also expect the group to continue its conservative balance sheet management leading to S&P Global Ratings-adjusted leverage below 2x over the next 24 months.

Upside scenario

We could consider upgrading Elekta if the company demonstrates S&P Global Ratings-adjusted-leverage consistently below 1.5x debt to EBITDA through the cycle, while maintaining S&P Global Ratings-adjusted EBITDA margins consistently near 20%. At the same time, we would expect Elekta's strategy to lead to an increase in scale, diversification, and quality of revenue in terms of solution offerings, sales mix, and share of software and service revenue.

Downside scenario

We could lower the rating on Elekta if S&P Global Ratings-adjusted-leverage is consistently above 2x fueled by large debt-funded acquisitions or material increases in discretionary spending, or as a result of investment need or operational decisions to support the group's development that affects margins or capex. We could also lower the rating if Elekta's operating performance weakens due to deterioration in its competitive position, which currently is not a part of our base case.

Company Description

Elekta is a global leader in radiotherapy solutions to cure cancer and neurological diseases, offering advanced solutions and delivering efficient radiotherapy treatments to more than 2 million patients every year. Elekta's equipment is used in more than 7,000 hospitals offering value-creating innovative treatment solutions and AI-supported service supported by Elekta's global service network. Currently, Elekta has more than 4,500 employees globally across 40 different sites.

Table 1

Elekta AB--Peer Comparison

Industry Sector: Healthcare Equipment

Fiscal year ended	--April 30, 2021--	--Sept. 30, 2020--	--Dec. 31, 2020--	
	Elekta AB (publ)	**Hologic Inc.**	**Illumina Inc.**	**Teleflex Inc.**
Ratings as of Oct. 25, 2021	BBB-/Stable/--	BB+/Stable/--	BBB/Stable/--	BB+/Stable/--
(Mil. $)				
Revenue	1,627.5	3,776.4	3,239.0	2,537.2
EBITDA	288.3	1,628.8	1,110.0	694.4
Funds from operations (FFO)	203.9	1,251.6	958.1	533.1
Interest expense	27.7	118.4	81.9	71.1
Cash interest paid	29.4	111.3	32.9	84.2
Cash flow from operations	221.8	922.3	1,131.1	463.2
Capital expenditure	20.0	156.4	189.0	90.7
Free operating cash flow (FOCF)	201.9	765.9	942.1	372.5
Discretionary cash flow (DCF)	120.5	98.0	115.1	309.3
Cash and short-term investments	521.6	701.0	3,472.0	375.9
Debt	293.7	2,536.6	0.0	2,405.7
Equity	969.2	2,707.3	4,694.0	3,336.5
Adjusted ratios				
EBITDA margin (%)	17.7	43.1	34.3	27.4
Return on capital (%)	17.1	22.6	15.6	7.6
EBITDA interest coverage (x)	10.4	13.8	13.6	9.8
FFO cash interest coverage (x)	7.9	12.2	30.1	7.3

Table 1

Elekta AB--Peer Comparison (cont.)

Debt/EBITDA (x)	1.0	1.6	0.0	3.5
FFO/debt (%)	69.4	49.3	N.M	22.2
Cash flow from operations/debt (%)	75.5	36.4	N.M	19.3
FOCF/debt (%)	68.7	30.2	N.M	15.5
DCF/debt (%)	41.0	3.9	N.M	12.9

N.M.--Not meaningful.

Our Base-Case Scenario

Assumptions

- Global GDP will return to growth by year-end 2021, with the eurozone GDP growing by 5.1%, North American GDP by 5.7%, and Asia-Pacific GDP by 6.7%.
- The radiotherapy treatment market to expand 6%-8% globally, broken down by emerging markets (8%-10%) and developed economies (2%-4%).
- Revenue to rise 7%-9% annually for the next two years, slightly above market growth, reflecting the introduction of innovative products, solid revenue generation from the installed base, and expansion into new countries.
- S&P Global Ratings-adjusted EBITDA margin broadly stable at around 18%-19%.
- S&P Global Ratings-adjusted leverage below 1.5x and slowly declining over the next 24 months, reflecting deleveraging trends.
- Continued structurally negative working capital in the medium term, reflecting payment flows structure.
- Annual capex of 8%-9% of revenue.
- Dividends to common shareholders to remain high, at about 50%-70% of net income.

Key Metrics

Table 2

Elekta AB--Key Metrics*

	--Fiscal year ends April 30--				
Mil. SEK	**2020a**	**2021a**	**2022e**	**2023f**	**2024f**
Revenue	14,601.0	13,763.0	14,931.4	16,308.3	17,123.7
EBITDA	2,400.0	2,438.0	2,651.5	2,993.2	3,176.5
Funds from operations (FFO)	1,931.0	1,724.0	2,002.7	2,275.3	2,452.3
Cash flow from operations (OCF)	469.0	1,876.0	1,651.7	2,392.3	2,470.3
Capex	207.0	169.0	625.0	675.0	742.0

Table 2

Elekta AB--Key Metrics* (cont.)

	--Fiscal year ends April 30--				
Mil. SEK	**2020a**	**2021a**	**2022e**	**2023f**	**2024f**
Free operating cash flow (FOCF)	262.0	1,707.0	1,026.7	1,717.3	1,728.3
Dividends	688.0	688.0	795.3	1,043.8	1,182.0
Discretionary cash flow (DCF)	(426)	1,019.0	231.4	673.4	546.4
Debt	3,770.0	2,483.4	2,846.8	2,878.4	3,024.4
Annual revenue growth (%)	7.7	(5.7)	8.5	9.2	5.0
EBITDA margin (%)	16.4	17.7	17.8	18.4	18.6
Debt/EBITDA (x)	1.6	1.0	1.1	1.0	1.0
FFO/debt (%)	51.2	69.4	70.3	79.0	81.1
FFO cash interest coverage (x)	10.3	7.9	16.5	18.5	19.9
EBITDA interest coverage (x)	11.1	10.4	20.3	22.9	24.3
OCF/debt (%)	12.4	75.5	58.0	83.1	81.7
FOCF/debt (%)	6.9	68.7	36.1	59.7	57.1
DCF/debt (%)	(11.3)	41.0	8.1	23.4	18.1

*All figures adjusted by S&P Global Ratings. SEK--Swedish krona. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Elekta's liquidity as strong, assuming the following:

- Liquidity sources to uses for the upcoming 12 months of 1.5x or more, and remaining above 1.0x over the subsequent 12 months.
- Sources remaining higher than uses, even if forecast EBITDA declines by 30%.
- Sufficient covenant headroom for forecast EBITDA to decline by 30% without the group breaching coverage tests, and debt at least 25% below covenant limits.
- The likely ability to absorb high-impact, low-probability events without refinancing.
- Well-established, solid relationships with banks.
- Generally prudent risk management.

Sources of liquidity over the next 12-24 months include:

- Cash on the balance sheet of about SEK4.4 billion as of May 1, 2021.
- Undrawn revolving credit facility (RCF) of about SEK2.0 billion maturing in 2024.
- Positive FFO of about SEK2.5 billion in 2022.

Uses of liquidity include:

- Working capital requirement of about SEK350 million in the next 12 months and working capital inflows of about SEK100 million in 2023.

- Debt maturing in the next 12 months in the amount of SEK1.8 billion. In addition to this, within 24 months, SEK500 million of debt will mature.
- Annual capex of about SEK1.3 billion in the next 12 months.
- Dividends of about SEK800 million in the next 12 months.

Covenants

The company has ample headroom under its RCF covenant.

Environmental, Social, And Governance

ESG factors have an overall neutral influence on our credit rating analysis of Elekta. We view Elekta as well positioned to face any risks arising from ESG issues within the health care equipment subsector. We do not believe the company is more or less exposed to these risks than the overall subsector. We note radiotherapy treatment solutions do have an important role in health care because the number of cancer patients has risen due to demographic trends and heightening demand for these therapies in emerging markets. Also, Elekta's governance is satisfactory, in our view, and the framework in place enables the company to successfully implement its strategy and maintain profitable growth through innovation.

Issue Ratings - Subordination Risk Analysis

We align the issue level ratings on the senior unsecured notes with the 'BBB-' issuer credit rating on Elekta. Considering the low leverage of the group and the fact that there is no secured debt we know of in the group's debt structure, we do not see a meaningful risk of subordination to unsecured notes.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Fair

- Country risk: Low risk
- Industry risk: Low risk
- Competitive position: Fair

Financial risk: Minimal

- Cash flow/Leverage: Minimal

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

New Rating; Outlook Action	
Elekta AB (publ)	
Issuer Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.