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Ratings

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Research Update:

U.S.-Based Auto Supplier Autoliv Outlook Revised To Negative On $210 Million Fine

Primary Credit Analyst:
Per Karlsson, Stockholm (46) 8-440-5927; per.karlsson@spglobal.com

Secondary Contact:
Mikaela Hillman, Stockholm + 46 84 40 5917; mikaela.hillman@spglobal.com

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Overview

- Autoliv has announced its intention to accrue $210 million in fourth-quarter 2018 for a likely fine relating to an ongoing EU investigation, and at the same time, we now expect the car industry to face a slowdown in demand over 2019.
- We see an increased risk that Autoliv's credit ratios may not improve in line with our expectations, for example if industry conditions worsen more than we currently expect.
- We are therefore revising our outlook on Autoliv to negative from stable and affirming our 'A-/A-2' and 'K-1' ratings.
- The negative outlook indicates that we could lower the ratings if funds from operations to debt fails to exceed 60% and the debt-to-EBITDA ratio remains above 1.5x in the second half of 2019.

Rating Action

On Dec. 10, 2018, S&P Global Ratings revised its outlook on U.S.-based auto supplier Autoliv Inc. and its subsidiary Autoliv ASP Inc. to negative from stable. At the same time, we affirmed our 'A-' long-term and 'A-2' short-term issuer credit ratings on both entities.

We also affirmed our 'K-1' Nordic national scale rating and 'A-' issue rating on Autoliv's senior unsecured debt, issued by core subsidiaries Autoliv AB and Autoliv ASP Inc.

Rationale

Autoliv has announced that it will accrue $210 million for a possible fine relating to an ongoing EU investigation, in fourth-quarter 2018. The investigation relates to possible anti-competitive behavior among suppliers of occupant safety systems in the EU and has been ongoing since 2011. It is still unclear when the fine will be paid, but in our forecast we have added the $210 million as an adjustment to debt. The fine comes at a time when Autoliv's credit ratios are already in the lower range for the rating, as a consequence of Autoliv's $1 billion recapitalization of Veoneer, an entity that was spun off from Autoliv in the second quarter of 2018. In the third quarter of 2018, FFO to debt stood at about 49%. We still expect ratios will improve in 2019, but we think the improvement will be slower than previously assumed. This also

takes into account the effect of a less-supportive market environment than previously. Over the past few months, the market has been characterized by lower sales growth and looming geopolitical risks from a potential no-deal Brexit, as well as escalating trade tensions between Europe and the U.S., which, all-in-all, are likely to slow demand for cars in 2019 (see also " Industry Top Trends 2019 Autos," published Nov. 14, 2018, on RatingsDirect). We still believe that Autoliv's good geographic diversification should protect sales somewhat from trade tariffs--with about 30%-37% of its revenues in each of Asia and the Americas, and around 1,300 models and 100 car brands in total. However, we see an increased risk that volumes could affect profitability and cash flow generation.

Nevertheless, we continue to forecast an improvement in FFO to debt to about 60%-65% in 2019, from 49% at the end of third-quarter 2018. We view this to be in line with the rating, but the company will have no headroom for any deviations. We continue to assume a strong improvement of free operating cash flow in 2019, to about $650 million-$750 million (somewhat revised downward from $700 million-$800 million previously), because we expect that capital expenditure will decrease to about $450 million-$500 million in 2019, from about $600 million in 2017 and 2018. This is because the remaining operation (the passive Safety segment, or Veoneer) requires proportionally less investments. While Autoliv marginally departed from its historically very conservative financial policy of net debt to EBITDA in the 0.5x-1.5x range, we believe that management remains committed to its financial policy, including a commitment to lower gearing within a relatively short period.

Autoliv's business risk profile will remain supported by its leading market position. With a market share of about 40%, Autoliv is the leading operator in automotive safety. We see Autoliv as a premium supplier, with a reputation as a quality provider. Its geographic diversity is good, with about 40%, 30%, and 30% of sales in Asia, America, and Europe, respectively, supplying all key car manufacturers.

In our base case, we assume:

- Real GDP growth in 2018 and 2019 of 2.2% and 1.7% in Europe, 2.8% and 2.2% in North America, and 6.5% and 6.2% in China.
- A revenue increase, excluding Veoneer, in 2019, but we have softened somewhat our expectation to mid-single digits, compared with 3% in 2017 and 9.9% in 2016. We anticipate that the growth will be the combined effect of recent years' order intake, light-vehicle production, and contents per car. Since 2015, Autoliv has been winning more than 50% of all available orders globally, which compares favorably with its market share of about 40%. As the lead time from order to start of production is around 18-36 months, we expect this to become more visible 2019--this is a major part of our forecast revenue assumption. Another driver is light vehicle production; we now assume gradually lower light-vehicle growth of 1%-2% in Asia in 2018-2019, and relatively flat in Europe and North America.
- We continue to expect EBITDA margins for the remaining passive safety

business to improve to about 15% in 2019, up from 12.8% in 2017 for the combined group, as the electronic business which had lower margins has been spun off.

- Capital expenditures of $600 million-$650 million in 2018, including in the electronics business for the first half of the year, before moderating to $450 million-$500 million in 2019.
- Working capital outflows of about $100-200 million annually, in light of the continued revenue growth, with some seasonality over the year. This is an upward revision from our previous expectations, in light of the $300 million working capital outflow in the first nine month 2018. In 2019, however, we expect a more moderate figure.
- Acquisition spending of up to about $150 million-$200 million per year.
- Normal annual dividends of $220 million-$230 million in 2018-2020.

Based on these assumptions, we arrive at the following (pro forma) credit measures:

- Debt to EBITDA of about 1.2x-1.5x in 2019.
- FFO to debt of 60%-65% in 2019.

Liquidity

We view Autoliv's liquidity as strong, since we project the ratio of sources to uses of liquidity will be comfortably around 1.7x for the coming 12 months. In this figure, we assume that the fine of $210 million will be paid out within the 12 months, although the timing is still unclear.

In our view, management has a proactive approach to financing, and we believe that Autoliv's liquidity would remain sufficient to cover uses even if EBITDA dropped by 30%. Other supportive factors include Autoliv's solid relationships with banks, high standing in credit markets as demonstrated by the bond issue earlier in 2018, and its likely ability to absorb high-impact, low-probability events without refinancing.

Principal liquidity sources as of Sept. 30, 2018, include:

- Reported $534 million of cash and cash equivalents.
- An undrawn revolving credit facility of $1.1 billion maturing in July 2023.
- Our expectation of about $1 billion in cash FFO.

Principal liquidity uses as of the same date, include:

- Short-term debt of $537 million.
- A year-on-year working capital increase of about $100 million-$200 million.
- Capital expenditures of $450 million-$500 million in the next 12 months.
- Potential fine payment of $210 million.

- Annual dividend about $200-$250 million.

There are no maintenance covenants.

Outlook

The negative outlook on Autoliv reflects our view that, as a consequence of the spin-off and accrued EU fine, the company's credit metrics will be weak during 2019 and the softer market conditions might further delay the expected improvement. As a result, the company has little headroom under the rating, and any unexpected operational difficulty could delay the recovery of credit metrics. In our base-case scenario, we project its EBITDA margin will exceed 15% in 2019, and improve further in 2020. We would expect Autoliv's credit ratios will improve quarter on quarter and FFO to debt to be higher than 60% at year-end 2019, at the latest, to be in line with the current rating.

Downside scenario

We could lower the ratings if Autoliv's credit ratios remain below our expectations, with FFO to debt remaining lower than 60% and debt to EBITDA higher than 1.5x. This could be the result of a more subdued operating environment that we currently expect, without Autoliv offsetting the potential impact by paying lower shareholder distributions, or Autoliv's EBITDA margin not improving in line with our base-case projections. We could also consider a downgrade if Autoliv made a sizable debt-funded acquisition that significantly increased leverage.

Upside scenario

We could revise the outlook back to stable if Autoliv's credit ratios show a clear path of improvement, with FFO to debt and debt to EBITDA sustainably above 60% and below 1.5x, respectively. We think that is unlikely before the second half of 2019. We would also expect the EBITDA margin to be in line with our expectations of about 15%.

Issue Ratings--Recovery Analysis

Capital structure

Autoliv's capital structure consists of senior unsecured debt issued at the parent company Autoliv Inc. and by the core subsidiaries Autoliv AB and Autoliv ASP Inc.

Analytical conclusions

The debt is rated 'A-', the same as the issuer credit rating, since no significant elements of subordination risk are present in the capital structure. This is also supported by the company's low leverage.

Ratings Score Snapshot

Issuer Credit Rating: A-/Negative/A-2

Business risk: Satisfactory
- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Strong

Financial risk: Minimal
- Cash flow/Leverage: Minimal

Anchor: a-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Auto Suppliers Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors

For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Autoliv Inc.		
Autoliv ASP Inc.		
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2

Ratings Affirmed

Autoliv Inc.	
Issuer Credit Rating	
Nordic Regional Scale	--/--/K-1
Autoliv Inc.	
Senior Unsecured	A-
Autoliv AB	
Senior Unsecured	A-
Autoliv ASP Inc.	
Senior Unsecured	A-
Commercial Paper	A-2

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

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