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Research Update:

U.S.-Based Auto Supplier Autoliv Outlook Revised To Negative On Cash Injection In Veoneer; 'A-/A-2' Ratings Affirmed

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Research Update:

U.S.-Based Auto Supplier Autoliv Outlook Revised To Negative On Cash Injection In Veoneer; 'A-/A-2' Ratings Affirmed

Overview

- Autoliv has announced its intention to transfer of up to $1.2 billion in cash to capitalize a new entity, Veoneer, as part of a planned spin-off.
- As a result, we expect Autoliv's credit ratios will be weaker than commensurate for the rating for the coming quarters.
- 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 within the coming two years.

Rating Action

On April 27, 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 its intention to transfer of up to $1.2 billion to capitalize Veoneer, a new entity created from a spin-off of its electronics business, to capitalize the new entity. To fund the capital injection, Autoliv intends to raise the majority of the amount through debt financing and the remainder from its cash on hand.

We consider the spin-off to be shareholder friendly, since we view it and the transfer as equal to a dividend payment. We note that Autoliv will depart from its historically very conservative financial policy in some quarters of net debt to EBITDA in the 0.5x-1.5x range. However, we do not expect a similar transaction in the near or medium term. Therefore, in our base case, we project that Autoliv will restore its credit ratios within the next 12-18 months, thanks to its strong cash flow generation. We forecast Autoliv's funds from operations (FFO) to debt will fall below 50% after the spin-off, compared with 114% at year-end 2017, and free operating cash flow will total $350 million-$450 million in 2018, and $700 million-$800 million in 2019. In our base case, FFO to debt recovers to above 60% and debt to EBITDA to below 1.5x within the next 12-18 months, which we believe is in line with the rating. During this time, the company will have no headroom under the rating, however. This means any unexpected operational difficulty or material cash outflow could delay the recovery of credit metrics. In our forecast, we assume a strong improvement of free operating cash flow in 2018-2019, thanks to increased profitability without the electronics business. We also expect that capital expenditures will decrease to about $400 million in 2019, from about $600 million in 2017 and 2018, since the Passive Safety segment requires proportionally less investments.

Following the spin-off, Autoliv's diversification will decrease, since that business represents about 20% of the revenue base. The size, product offering, and scope of Autoliv's remaining businesses will therefore become narrower, which we see as a negative factor. We also believe that the electronics operations have high growth potential over the medium term, which could have supported a stronger business risk profile over that period. Autoliv's remaining operations would be concentrated in the Passive Safety segment only. Nevertheless, 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.

By contrast, many of its peers still operate in several segments and, in our view, even before the spin-off, Autoliv was smaller in size and product diversity than companies like Continental and Schaeffler.

We expect this reduction in diversification to be offset by higher and more stable profitability for the remaining operations, and we forecast an S&P Global Ratings-adjusted EBITDA margin in Passive Safety of 15%-16% in 2018-2019. This is because the electronics business, which will be spun off, reported a lower EBITDA margin of around 6.6% in 2017, well below the 14.2% reported by Passive Safety. We believe profitability in the electronics business will remain hampered by higher investments in research and development (R&D). This is in contrast to our expectations for Autoliv's remaining operations, where we project spending will decrease in the coming years, thereby improving its cash flow profile after the split.

In our base case, we assume:

- Real GDP growth in 2018 and 2019 of 2.2% and 2.0% in Europe, 2.8% and 2.2% in North America, and 6.5% and 6.3% in China.
- Revenues will decline by about 10% in 2018, reflecting the spin-off, before increasing by 8%-12%. We believe revenues will be driven by

light-vehicle production and contents per car. We assume light-vehicle sales growth in Asia will be 2%-4% in 2018-2019, and relatively flat in Europe and North America. We therefore assume topline growth will be supported by higher contents per vehicle, of about 3% yearly. This growth will mainly come from new passive safety systems such as active seatbelts, knee airbags, far-side impact airbags along with improved protection for pedestrians and rear-seat occupants like bag-in-belt in Western Europe, North America, Japan, and South Korea.

- EBITDA margins in passive safety of 15%-16%.
- Capital expenditures of $600 million-$650 million in 2018, including in the electronics business for the first half of the year, before moderating to about $400 million in 2019.
- Moderate working capital outflows of about $60 million annually, based on continued revenue growth.
- Acquisition spending of $150 million-$200 million per year in 2018 and 2019.
- Normal annual dividends of $220 million-$230 million in 2018-2020.

We have not included any settlement or provision following the EU's ongoing investigation of Autoliv.

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

- Debt to EBITDA of about 1.3x-1.7x in 2018, improving to 0.7x-1.1x in 2019.
- FFO to debt of 48%-53% in 2018, improving to 78%-82% in 2019.

Liquidity

We view Autoliv's liquidity as strong, since we project the ratio of sources to uses of liquidity will be comfortably at around 3.6x in 2018 after the transaction. At the same time, we think that the potential EU fine and midsize acquisition could be a drag on cash in the near future, although they are unlikely to change our view of Autoliv's liquidity.

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, and its likely ability to absorb high-impact, low-probability events without refinancing.

Principal liquidity sources as of Jan. 1, 2018, include:

- Reported $959 million of cash and cash equivalents.
- An undrawn revolving credit facility of $1.1 billion maturing in July 2022 that can be extended by an additional year.
- Our expectation of about $1 billion in cash FFO.

Principal liquidity uses as of the same date, include:

- No material short-term debt.
- A year-on-year working capital increase of about $60 million, in light of continued growth.
- Capital expenditures of $600 million-$650 million in the next 12 months.

There are no maintenance covenants.

Outlook

The negative outlook on Autoliv reflects our view that, as a consequence of the spin-off, the company's credit metrics will be weak for the next 12-18 months. 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 the first year after the spin-off, and improve further in the second year. 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 ratio higher than 1.5x. This could be the result of a substantial EU fine, 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 currently see limited headroom for an upgrade. We would consider raising the rating if Autoliv's scale and diversification of operations were to materially increase, while its EBITDA margin stays above 15%. Given the planned spin-off, we see such a scenario as unlikely.

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)

Issue Ratings--Subordination Risk Analysis

Capital structure

Autoliv's capital structure consists of senior unsecured debt issued by 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.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- 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: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions,

Nov. 19, 2013

- Criteria - Corporates - Industrials: Key Credit Factors For The Auto Suppliers Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology - November 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Outlook Action; Ratings Affirmed

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

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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. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the 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.