S&P Global Ratings

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Autoliv Inc.

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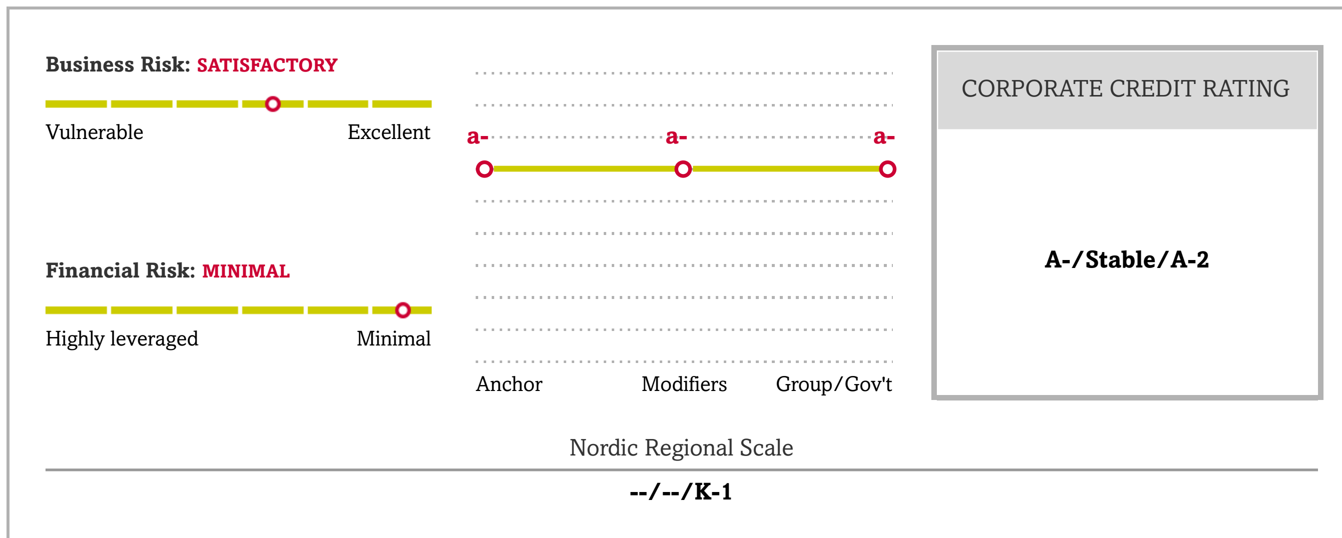
Autoliv Inc.



Rationale

Business Risk: Satisfactory	Financial Risk: Minimal
• Leading position in automotive passenger safety systems, with a market share of 38%. We expect Autoliv's market share to increase further over 2018 and 2019. • Good sales diversity across all major original equipment manufacturers (OEMs) and major geographic markets, as well as a diverse and cost-focused production footprint. • Exposure to the cyclical and competitive light vehicle component market, implying constant cost pressure and volatility in profitability metrics from time to time. • We expect the combined effect from increasing revenue, improving margin, and declining investment needs will result in an upswing in free operating cash flow (FOCF) during 2018-2020 to around $750 million-$850 million. • Limited product diversity and no meaningful presence in the aftermarket.	• Credit metrics in 2018 are forecast to be less strong than in the past, with funds from operations (FFO) to debt of 51%-56%, but improving to 80%-84% in 2019 thanks to the group's strong free operating cash flow profile. • A prudent financial policy, with a long track record of keeping net debt to EBITDA below 1.5x, which we forecast the company will exceed only temporarily during 2018. • Strong liquidity profile, with projected cash sources to cash needs around 3.6x in 2018. • Risk of material cash outflows coming from an investigation by the European Commission's antitrust authority, however potential amount and timeframe is highly unclear. .

Outlook: Stable

The stable outlook on Autoliv reflects our view that, as a consequence of the spin-off, the company's credit metrics will be less strong for the next 12 months but recover, and be in line with the rating within the next year. In our base-case scenario, we project Autoliv's 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% within one year, 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 in 2019. This could be the result of an 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. Even a relatively small fine of around a couple of hundred million U.S. dollars could put pressure on the rating if it comes in 2018, before Autoliv has restored its credit ratios, which we expect in 2019. 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 increase materially, while its EBITDA margin stayed above 15%. Given the planned spin-off, we see such a scenario as unlikely.

Our Base-Case Scenario

Assumptions

- 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.
- We expect that Autoliv will spin-off Veoneer, a new entity created from its electronics business, in the third quarter of 2018, and capitalize the new entity with $1 billion of equity.
- We forecast that revenues, excluding Veoneer, will increase by 8%-10% in 2018 and 8%-12% in 2019, compared with 3% in 2017 and 9.9% in 2016. We anticipate that the accelerated growth will be the combined effect of an increased 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 38%. As the lead time from order to start of production is around 18-36 months, we expect this to become visible over 2018 and 2019--this is a major part of our forecast revenue assumption. Another driver is the light vehicle production. We assume light-vehicle growth of 2%-4% in Asia in 2018-2019, and relatively flat in Europe and North America. Furthermore, we 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, and far-side impact airbags, along with improved protection for pedestrians and rear-seat occupants like the bag-in-belt in Western Europe, North America, Japan, and South Korea.
- EBITDA margins for the remaining passive safety to improve to 15%-16%, up from 12.8% in 2017 for the combined group.
- Capital expenditures of $600 million-$650 million in 2018, including in the electronics business for the first half of the year, before moderating to $400 million-$500 million in 2019.
- Moderate working capital outflows of about $60 million annually, in light of the continued revenue growth, with some seasonality over the year.
- Acquisition spending of $150 million-$200 million per year in 2018 and 2019.

Key Metrics

	2017A	2018F	2019F
EBITDA margin (%)*	12.8	15-16	15.5-16.5
Debt/EBITDA (x)*	0.7	1.3-1.6	0.7-1.1
FFO/debt (%)*	113.9	50-54	78-82

A--Actual. E--Estimate. *Adjusted by S&P Global Ratings.

- Annual dividends of $220 million-$230 million in 2018-2020.

Company Description

Incorporated in the U.S., but headquartered in Stockholm, Autoliv Inc. is the world's largest supplier of automotive occupant restraint systems. The company develops, markets, and manufactures integrated safety systems. It has two divisions:

- Passive safety (78% of sales in 2017), which includes airbags, seat belts, steering wheels, and seat components and
- Electronics (22% of sales) that includes safety electronics hardware and software in the areas of safety and drive assist.

In December 2017, management announced its intention to spin off the electronic business, to be called Veoneer Inc., during the third quarter of 2018. Management intends to capitalize the entity with $1.0 billion.

Business Risk: Satisfactory

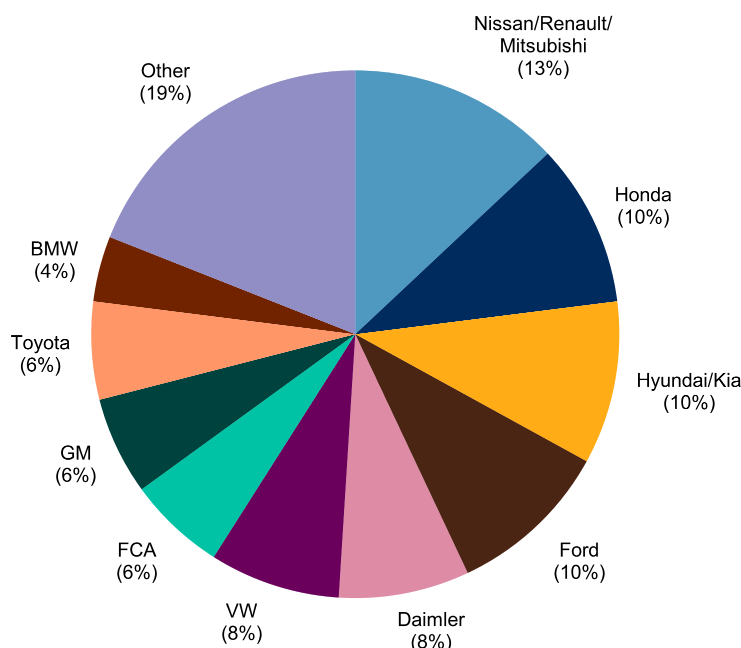
Strong market shares in automotive safety, along with good geographic and customer diversity, support Autoliv's business profile. At year-end 2017, Autoliv's market share stood at about 38%, which in our view makes Autoliv the market leader in passive safety operations. ZF Friedrichshafen (BBB-/Stable/--) and Takata Corp are the main competitors, which in the past held one-fifth and one-sixth of the market, respectively. In the near term, however, we expect Autoliv's market share to increase into to the 45%-50% range. This reflects Autoliv winning more than 50% of all of available orders in the market between 2015 and 2017, which further supports the business risk profile as it indicates Autoliv's strong position in market for safety products. Part of the high order intake follows major recalls of products by Takata Corp. that also led to the company's bankruptcy filing during 2017. In November 2017, Takata was acquired by KSS Holdings (B+/Watch Dev/--). We therefore expect Autoliv's market share will come down gradually to about 40%, but only over the medium term.

Autoliv has a reputation as a quality provider, as indicated by its relatively high share (around 20%) of total sales to premium car brands while, at the same time, the premium car brand share of global light vehicle production is approximately 10%. We believe this is an important factor for Autoliv's business risk, as safety awareness and safety issues tend to constantly increase, and a reputation for quality products is therefore key to securing contracts with OEMs. This is also why we believe that the passive safety market will continue to grow somewhat faster in general than underlying light vehicle production (i.e., increases in content per car). Another important indicator is Autoliv's relatively low share of recalls, Autoliv has been involved in less than 2% of passive-related recalls over the last eight years, which we believe is low compared with the industry average. Still, should a major quality issue arise, it could become a detriment, as was the case for Takata.

Autoliv is one of the most geographically diversified auto suppliers, with about 30%-37% of of its revenues in each of Asia, the Americas, and Europe. Though the product offering is narrow compared with other auto suppliers that have larger product types, Autoliv delivers products for around 1,300 models and 100 car brands in total. Finally, it enjoys a relatively wide customer base (see chart 1). Its top five customers represented 51% of sales and the 10 largest represented 81%, in line with the automotive industry in general.

Chart 1

Autoliv Sales By Manufacturer



Source: Autoliv.

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These strengths are partly offset by the company's relatively small size, its limited product diversity, and its historically volatile EBITDA margin, such as during the financial crisis. The company is smaller than many lower-rated auto suppliers, such as Continental and Valeo, and has the same rating as Michelin. It is also a pure player in safety solutions, while many of its peers operate in several segments. In contrast to many peers in the auto supplier industry, Autoliv derives no sales from aftermarket services, which is due to its product offering. Products are activated in a car crash and not re-used. Following the spin-off, Autoliv's diversification will decrease, since that business represents about 22% 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.

For 2018, we expect Autoliv's EBITDA margin to increase to around 15%-16% from 12.8% in 2017. 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 the passive safety division. We also expect that the investments in research development and application engineering (RD&E) have peaked and will be lower also as a consequence of the spin-off. Investments has also been higher to support the increased order intake under 2015-2017, to be able to increase production, and consequently margins in 2018 and particularly 2019 should benefit from lower spending. Net RD&E expenditure increased to $741 million in 2017 (7.1% of sales) from $524 million in 2015 (5.7% of sales). The expansion of production capacity in the form of new lines and buildings to meet product launches was largely completed during this period. Like all other auto suppliers, Autoliv is exposed to extensive price pressure from OEMs, amounting to 2%-4% annually during 2015-2017 according to the company. For the 2018-2020 period, we take into account that the price pressure should soften somewhat, given the changes in the competitive situation with Takata Corp., but will nevertheless remain and increase further over the medium to long term.

Peer comparison

Table 1

Autoliv Inc. -- Peer Comparison

Industry Sector: Automotive - Parts Producers & Suppliers

	Autoliv Inc.	**Valeo S.A.**	**Continental AG**	**Compagnie Generale des Etablissements Michelin S.C.A.**
Rating as of May 14, 2018	A-/Negative/A-2	BBB/Stable/A-2	BBB+/Stable/A-2	A-/Stable/A-2
	--Average of past three fiscal years--			
(Mil. $)				
Revenues	9,875.3	18,501.4	46,083.4	23,819.3
EBITDA	1,234.2	1,914.8	7,142.3	4,456.9
Funds from operations (FFO)	924.2	1,475.2	5,607.2	3,299.7
Net income from cont. oper.	483.7	944.0	3,167.9	1,692.9
Cash flow from operations	854.0	1,555.4	5,639.1	3,270.6
Capital expenditures	517.9	1,060.5	2,851.2	1,933.4
Free operating cash flow	336.1	494.9	2,787.9	1,337.2
Discretionary cash flow	133.1	202.7	1,887.7	754.7
Cash and short-term investments	1,173.2	2,429.4	2,081.3	1,797.8
Debt	803.7	2,983.7	8,308.4	5,571.1
Equity	3,854.6	4,894.5	16,490.7	11,791.5
Adjusted ratios				
EBITDA margin (%)	12.5	10.3	15.5	18.7
Return on capital (%)	18.2	15.8	19.9	15.7
EBITDA interest coverage (x)	15.1	11.4	21.5	10.7
FFO cash interest coverage (x)	15.6	20.9	34.0	11.3
Debt/EBITDA (x)	0.7	1.6	1.2	1.2
FFO/debt (%)	115.0	49.4	67.5	59.2
Cash flow from operations/debt (%)	106.3	52.1	67.9	58.7

Table 1

Autoliv Inc. -- Peer Comparison (cont.)				
Free operating cash flow/debt (%)	41.8	16.6	33.6	24.0
Discretionary cash flow/debt (%)	16.6	6.8	22.7	13.5

Financial Risk: Minimal

We base our assessment of Autoliv's financial risk profile on its strong balance sheet, strong liquidity, sound discretionary cash flow generation through the cycle, and financial flexibility provided by cash generation and the discretionary nature of shareholder distribution levels, notably share buybacks.

Autoliv has enjoyed very strong credit ratios since 2010, as the company strictly and prudently adhered to its conservative financial policy to keep debt to EBITDA in the 0.5x-1.5x range. Despite sizable annual dividend payments of around $200 million and more or less yearly share buybacks (most recently, $157 million in the second quarter of 2017), reported net debt to EBITDA has often been below 0.5x since the policy was introduced in 2013. However, following the company's intention to transfer up to $1.0 billion to capitalize Veoneer, we expect a material debt increase in 2018. Reported debt stood at about $600 million at the end of the first quarter of 2018, which implies that the transaction will lead to significantly higher adjusted debt and weaker credit ratios in the remainder of 2018 and the first quarter of 2019. We consider the spin-off to be shareholder-friendly in general, since we view it and the transfer as equivalent to a dividend payment. While Autoliv will depart from its financial policy for a short period, we take comfort from our projections that it will restore its credit ratios within the next 12 months, thanks to its strong cash flow generation and also since the starting debt level was very low.

We forecast that Autoliv's funds from operations (FFO) to debt will fall just below 50% after the spin-off, compared with 114% at year-end 2017. As we also forecast strong free operating cash flow of $250 million-$400 million in 2018 increasing to around $700 million-$800 million in 2019, we expect debt to recover to above 60% and debt to EBITDA to below 1.5x within the next 12-18 months (see chart 2). This is also thanks to lower capital expenditure, which we anticipate will be around $400 million-$500 million in 2019 (the first full year without Veoneer) and thereafter, compared with about $600 million in 2016 and 2017. We have assumed only smaller bolt-on acquisitions during this time, and discretionary cash flow to debt of 30%-40% in 2019. In our base case, we have not included any settlement or provision following the EU's investigation of Autoliv, which has been ongoing since 2011.

The debt maturity profile is relative spread out, with no large debt maturities, reflecting Autoliv's prudent refinancing policy requiring long-term facilities with an average maturity of at least three years (drawn or undrawn) corresponding to 150% of total net debt. We believe Autoliv enjoys continued good access to bank and capital markets and that management has prudent financial funding policies in place.

Financial summary

Table 2

Autoliv Inc. -- Financial Summary					
Industry Sector: Automotive - Parts Producers & Suppliers					
	--Fiscal year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
Rating history	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2
(Mil. $)					
Revenues	10,382.6	10,073.6	9,169.6	9,240.5	8,803.4
EBITDA	1,325.4	1,282.6	1,094.7	1,154.3	1,109.5
Funds from operations (FFO)	1,049.7	944.2	778.7	857.6	847.2
Net income from continuing operations	427.1	567.1	456.8	467.8	485.8
Cash flow from operations	938.7	899.8	723.5	796.9	879.4
Capital expenditures	580.1	507.9	465.8	456.0	385.6
Free operating cash flow	358.6	391.9	257.7	340.9	493.8
Discretionary cash flow	149.8	187.4	62.0	141.1	299.5
Cash and short-term investments	959.5	1,226.7	1,333.5	1,529.0	1,118.3
Debt	921.5	816.1	673.7	496.7	0.0
Equity	4,169.4	3,926.4	3,468.1	3,442.1	4,000.4
Adjusted ratios					
EBITDA margin (%)	12.8	12.7	11.9	12.5	12.6
Return on capital (%)	17.0	19.5	18.4	20.7	20.2
EBITDA interest coverage (x)	16.3	15.8	13.3	14.2	21.5
FFO cash int. cov. (x)	17.7	16.0	13.0	16.5	27.2
Debt/EBITDA (x)	0.7	0.6	0.6	0.4	0.0
FFO/debt (%)	113.9	115.7	115.6	172.7	N.M.
Cash flow from operations/debt (%)	101.9	110.3	107.4	160.4	N.M.
Free operating cash flow/debt (%)	38.9	48.0	38.3	68.6	N.M.
Discretionary cash flow/debt (%)	16.3	23.0	9.2	28.4	N.M.

N.M.--Not meaningful.

Liquidity: Strong

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 (assuming the $800 million bridge facility is refinanced on a timely basis, which we expect management to address shortly). Excluding such refinancing, the sources-to-uses ratio stands at around 2.2x. At the same time, we think that the potential EU fine and midsize acquisitions 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 liquidity management, as indicated by a well-spread debt maturity schedule and ample committed credit facilities.

We expect that Autoliv's liquidity would remain sufficient to cover uses even if EBITDA dropped by 30% for any

reason, which was the case in 2009. Other supportive factors include Autoliv's solid relationships with banks and high standing in credit markets. We believe it is likely that Autoliv would manage to absorb high-impact, low-probability events without refinancing, such as a situation that would trigger a major product recall.

Principal Liquidity Sources	Principal Liquidity Uses
• Reported $793 million of cash and cash equivalents. • An undrawn revolving credit facility (RCF) of $1.1 billion maturing in July 2022 that can be extended by an additional one year. • Our expectation of about $1 billion in cash FFO.	• No material short-term debt. • A year-on-year working capital increase of $100 million-$200 million, in light of continued growth. • Capital expenditure of $600 million-$650 million in the next 12 months. • Dividends of $200 million-$240 million. • Transfer to Veoneer of $1 billion at the end of June 2018.

Debt maturities

Table 3

Autoliv Debt Maturities At Year-End 2017	
2018	17.5
2019	268.7
2020	0
2021	286.0
2022	0
Thereafter	767.0
Total	1,341

Covenant Analysis

Autoliv is not subject to any financial covenants, such as performance-related restrictions, in any of its significant long-term borrowings or commitments.

Ratings Score Snapshot

Corporate Credit Rating

A-/Stable/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 rating analysis:** Neutral (no impact)

Issue Ratings--Subordination Risk Analysis

Capital structure

Autoliv's capital structure consists of $1.3 billion of debt outstanding at year end 2017. Of this $60 million is unsecured U.S. private placement notes issued in 2007, and $1.25 billion unsecured U.S. private placement notes issued in April 2014 by Autoliv ASP Inc. and guaranteed by Autoliv Inc. The 2014 notes have an average interest rate of 3.84%, and consist of four tranches with different maturities, ranging from five to 12 years, in amounts of around $185 million-$297 million each.

Analytical conclusions

The debt is rated 'A-', the same as the issuer credit rating. The notes are issue by Autoliv ASP, a U.S.-based entity in which also domestic revenues are reported, typically constituting around 30%-40% of the total group. We thereby notice there are some elements of subordination risk present in the capital structure, but do not view them as significant, meaning any lender would not be significantly disadvantaged compared with others. This is also supported by the group's low leverage and our view of the issuer Autoliv ASP as a core subsidiary of Autoliv, meaning we expect them to be supported by Autoliv under all circumstances.

Reconciliation

Table 4

Reconciliation Of Autoliv Inc. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. $)

	--Fiscal year ended Dec. 31, 2017--						
Autoliv Inc. reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	1,341.4	4,035.1	1,265.4	605.3	61.2	1,265.4	935.9
S&P Global Ratings adjustments							
Interest expense (reported)	--	--	--	--	--	(61.2)	--

Table 4

Reconciliation Of Autoliv Inc. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. $) (cont.)							
Interest income (reported)	--	--	--	--	--	7.4	--
Current tax expense (reported)	--	--	--	--	--	(246.2)	--
Trade receivables securitizations	134.0	--	--	--	2.6	(2.6)	-21
Operating leases	125.4	--	44.0	8.1	8.1	35.9	35.9
Postretirement benefit obligations/deferred compensation	196.2	--	7.5	7.5	9.2	1.5	(12.1)
Surplus cash	(889.5)	--	--	--	--	--	--
Share-based compensation expense	--	--	8.5	--	--	8.5	--
Non-operating income (expense)	--	--	--	(21.6)	--	--	--
Non-controlling Interest/Minority interest	--	134.3	--	--	--	--	--
Debt - Contingent considerations	14.0	--	--	--	--	--	--
D&A - Impairment charges/(reversals)	--	--	--	234.2	--	--	--
FFO - Other	--	--	--	--	--	41.0	--
Total adjustments	(419.9)	134.3	60.0	228.2	19.9	(215.7)	2.8
S&P Global Ratings adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	921.5	4,169.4	1,325.4	833.5	81.1	1,049.7	938.7

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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- U.S.-Based Auto Supplier Autoliv Outlook Revised To Negative On Cash Injection In Veoneer; 'A-/A-2' Ratings Affirmed, April 27, 2018

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	**a/a-**	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 12, 2018)

Autoliv Inc.		
Corporate Credit Rating		A-/Stable/A-2
Nordic Regional Scale		--/--/K-1
Corporate Credit Ratings History		
30-May-2018		A-/Stable/A-2
27-Apr-2018		A-/Negative/A-2
09-Dec-2013		A-/Stable/A-2
26-Nov-2013		BBB+/Watch Pos/A-2
29-Oct-2010	*Nordic Regional Scale*	--/--/K-1
26-Nov-2009		--/--/K-2
19-Feb-2009		--/--/K-3
Related Entities		
Autoliv ASP Inc.		
Issuer Credit Rating		A-/Stable/A-2
Commercial Paper		
Local Currency		A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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