Research Update:

Auto Supplier Autoliv Outlook Revised To Positive On Solid Growth And Cash Flow Prospects; 'BBB/A-2' Ratings Affirmed

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Rating Action Overview

- We now expect Autoliv Inc. will show stronger earnings and cash flows in 2021-2022, based on its outperformance in second-half 2020 versus our base case, prospects for the auto market's recovery, increasing content per car, and the company's strict cost discipline.
- Although the pace of the market's recovery remains uncertain, we now expect Autoliv's funds from operations (FFO) to debt will increase beyond 60%, and believe its free operating cash flow (FOCF) to debt could rise sustainably above 25% by 2022.
- We are therefore revising our outlook on Autoliv to positive from stable, while affirming our 'BBB/A-2' long- and short-term ratings on the company and its senior unsecured debt, and our 'K-2' Nordic regional scale short-term rating.
- The positive outlook indicates that we could raise our ratings if Autoliv's FFO to debt and FOCF to debt ratios improve and remain comfortably above 45% and 25%, respectively, by 2022, supported by its financial policy.

Rating Action Rationale

Autoliv's strong free cash flow generation in 2020 helped preserve credit metrics and liquidity. Autoliv's earnings weakened in 2020 due to the COVID-19-related fall in car demand. Revenue declined by around 13% in 2020 to $7.4 billion and our adjusted EBITDA margin declined to about 11% from 13.3% in 2019. However, against this backdrop, Autoliv demonstrated very good cash management, generating sizeable FOCF of about $550 million in 2020, up from $232 million (including antitrust fine payments of $203 million) in 2019. Autoliv's FOCF benefited from two main factors: disciplined capital expenditure (capex), which was cut by nearly 30% from about $480 million in 2019; and tight working capital management, leading to a large cash inflow of about $277 million without materially increasing the use of accounts receivables factoring. Overall, this boosted the company's adjusted FOCF-to-debt ratio to about 30% in 2020 compared with 10% in

2019. Strong FOCF also helped reduce leverage, supporting adjusted FFO to debt of about 35% at year-end 2020, according to our estimates, only moderately down from about 39% in 2019.

We believe Autoliv can outpace auto production growth, thereby supporting sustainable deleveraging and increasingly resilient free cash flow over 2021-2022 if the industry recovers as expected. We forecast Autoliv's revenue will increase organically by 15%-17% in 2021, and by a further 8%-10% in 2022. This growth would stem from an expected rebound in auto production after the pandemic-related trough in 2020, and from the company's continued growth at a faster rate than overall production levels. In 2020, Autoliv's organic revenue declined 12%, but still outperformed global light vehicle production by about 5 percentage points (pps). Management aims to outpace light vehicle production by 4 pps–5 pps annually in the coming years. In our view, outperformance is primarily fueled by higher content per vehicle, since successive generations of car models are equipped with more and richer safety features. This creates additional demand for Autoliv's key passive safety products, including various types of airbags, advanced seatbelts, and steering wheels. Combined with benefits from restructuring initiatives and ongoing cost efficiency measures, we expect this to translate into higher profitability and, in turn, stronger credit metrics. In our base case, we expect Autoliv's FFO to debt to exceed 60% from 2021, and strengthen further in 2022. That said, we think structural improvements in our adjusted FOCF figure will follow with a certain time lag because capex will return to normal and there's no tailwind from working capital this year. We forecast a moderate decrease in adjusted FOCF to €375 million-€425 million, and FOCF to debt of 23%-27% in 2021 before a potential increase to more than 30% from 2022. Moreover, we continue to see significant uncertainty regarding the speed of recovery of auto production in the next two years, which could lead to deviations from our base case. This is primarily due to the potential economic impact of the COVID-19 pandemic and its implications for consumer spending and car demand. However, it also reflects supply chain issues, exemplified by the recent shortage of semiconductor chips, which could impede light vehicle production growth, particularly in the first half of 2021. We currently estimate that the shortage could dent global light vehicle production by 3%-5% this year.

The group's financial policy is creditor friendly, but a quick ramp of shareholder distributions could slow leverage reduction. Autoliv remains committed to a net leverage ratio target of 0.5x-1.5x, as defined by the company, which translates into our adjusted debt to EBITDA metric being 0.2x–0.4x higher. We think the policy reduces event risks pertaining to shareholder returns or acquisitions and, having paid $54 million in the first quarter of 2020, Autoliv scrapped dividend payments for the rest of the year in an effort to limit the buildup of leverage and preserve cash. Although we assume shareholder payouts will resume at €150 million-€250 million later in 2021, and more than €300 million in 2022, in our base case, we foresee Autoliv's financial policy leverage declining to about 1x during 2021–2022. That said, once challenges stemming from the pandemic ease further, the company could use the flexibility afforded by its policy to scale up distributions. This would delay the improvement in credit metrics that we project in our base case. Autoliv's leverage target is for the long term, and its leverage was above the target since the spin-off and recapitalization of Veoneer in mid-2018.

Outlook

The positive outlook reflects that, despite uncertainty regarding the auto market's recovery, we expect Autoliv to deliver robust revenue growth and increased profit margins in 2021 and 2022, backed by a sizeable order book and disciplined cost management. This could support steady and sustainable improvements in credit metrics to levels commensurate with a 'BBB+' rating.

Upside scenario

We could raise the rating on Autoliv during the next two years if the market's recovery, combined with disciplined cost and cash management, resulted in a sustained improvement in credit metrics, with FFO to debt and FOCF to debt sustainably exceeding 45% and 25%, respectively. An upgrade also depends on Autoliv's strict adherence to its financial policy, which requires leverage to return to within the company's target range on a sustained basis.

Downside scenario

We could revise the outlook to stable if the auto market recovery stalled or cost and cash management became looser, resulting in a weaker recovery of FFO to debt and FOCF to debt than we anticipate in our base case. Although not expected at this stage, any significant increase in shareholder returns that weakens compliance with Autoliv's stated financial policy could also lead to us to revise the outlook to stable.

Company Description

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

- Airbag products (65% of sales in 2020); and
- Seatbelt products (35% of sales in 2020).

In 2020, the company's sales were split across Asia (41%), the Americas (31%) and Europe (28%).

Our Base-Case Scenario

Assumptions

- A 4.8% rebound of eurozone GDP growth in 2021 and 3.9% in 2022, after an expected contraction of 7.2% in 2020. U.S. GDP to recoup most of the lost ground from 2020 in 2021 with expected growth of 4.2%, and 3.0% in 2022 after an estimated contraction of 3.9% in 2020. China's GDP growth for 2020 to remain positive at around 2%, with a further 7% expansion forecast in 2021 and 5% in 2022.
- Growth of global light vehicle sales of 7%-9% in 2021 and 6%-8% in 2022, after a decline of about 14% in 2020.
- Organic revenue growth for Autoliv of 15%-17% in 2021 and 8%-10% in 2022, after a drop of 12% in 2020, amid improving macroeconomic conditions and recovery of market demand combined with increasing content per vehicle and modest market share gains. In 2021, we assume additional exchange rate effects of about 5 pps, for total reported revenue growth of 20%-22%.
- The EBITDA margin improving to 14%-15% in 2021 and 15%-16% in 2022, after about 11% in

2020, supported by operating leverage and continued cost efficiency measures.

- Working capital outflows of $20 million-$40 million in 2021, slightly increasing in 2022, partly reversing working capital-related cash inflows of $277 million in 2020.
- Capex of $500 million-$550 million in 2021 and $500 million-$600 million in 2022, at 5%-6% of sales, following lower capex in 2020 of $340 million-$350 million as Autoliv reduced spending to preserve liquidity.
- Dividend payments of $150 million-$250 million in 2021 after a pause from the second quarter of 2020, and expectations of dividends rising to more than €300 million in 2022.

Key metrics

Autoliv Inc. Key Metrics*

	--Fiscal year ended Dec. 31--				
Mil. $	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
Revenue	8,678.0	8,548.0	7,447.0	8,900-9,100	9,800-10,000
EBITDA	14.9	13.3	10.9	14-15	15-16
Capital expenditure	560.0	483.0	340-350	500-550	500-600
Free operating cash flow (FOCF)	145.0	232.0	545-555	390-420	520-580
Debt to EBITDA (x)	1.9	2.0	2.1-2.3	1.0-1.5	0.8-1.2
Funds from operations to debt (%)	41.6	38.8	34-36	55-65	70-80
FOCF to debt (%)	6.0	10.4	29-31	20-30	30-40

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

Liquidity

The short-term global scale rating is 'A-2', and the Nordic regional scale rating is 'K-2'. We view Autoliv's liquidity as strong because we project the ratio of sources to uses of liquidity will be about 2.0x for the next 12 months and between 1.5x and 2.0x for the following 12 months. Autoliv's liquidity remains sufficient to cover uses even if EBITDA dropped by 30%. Factors supporting our view of Autoliv's liquidity are the company's solid relationships with banks and high standing in credit markets, illustrated by successful refinancing activities in the last three years, its covenant-lite debt structure, and likely ability to absorb high-impact, low-probability events without refinancing, given its ample cash holdings and limited near-term maturities.

Principal liquidity sources

As of Dec. 31, 2020, for the following 12 months include:

- Cash and cash equivalents, after deducting inaccessible cash, of about $1.1 billion.
- Undrawn bank lines maturing in July 2023 of $1.1 billion.
- Positive cash FFO of $850 million-$1,000 million.

Principal liquidity uses

Over the same period, these include:

- Debt maturities of about $300 million.
- Working capital outflows of $20 million-$40 million in 2021, and about $400 million peak outflows related to intrayear working capital swings.
- Capex of $500 million-$550 million.
- Dividends, expected to resume in 2021, of $150 million-$250 million for the year.

Covenants

Autoliv's credit documentation does not contain any financial maintenance covenants.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Positive/A-2

Business risk: Satisfactory

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

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: Neutral (no impact)

Related Criteria

- 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

- 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
- Criteria | Corporates | General: Corporate Methodology, 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, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

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