S&P Global
Ratings

RatingsDirect®

Research Update:

U.S.-Incorporated Auto Supplier Autoliv Inc. Downgraded to 'BBB+'; Outlook Negative

September 26, 2019

PRIMARY CREDIT ANALYST

Per Karlsson
Stockholm
(46) 8-440-5927
per.karlsson
@spglobal.com

SECONDARY CONTACT

Vittoria Ferraris
Milan
(39) 02-72111-207
vittoria.ferraris
@spglobal.com

Rating Action Overview

- As a result of weaker market conditions, U.S.-incorporated auto supplier Autoliv Inc. posted weaker-than-expected funds from operation (FFO) to debt of about 35% for first-half 2019.
- We anticipate Autoliv's credit ratios will fall short of our previous expectations for 2019 and 2020, and now forecast FFO to debt and debt to EBITDA of about 45% and 1.8x respectively for 2019.
- Therefore, we are downgrading Autoliv and its subsidiary Autoliv ASP Inc. to 'BBB+' from 'A-'.
- The negative outlook reflects the risk that, due to tougher market conditions, Autoliv's FFO to debt could remain under 45% over the next to two years, which would be below our expectations.

Rating Action Rationale

The downgrade reflects our expectations that weaker market conditions will cause U.S.-incorporated and Sweden-headquartered auto supplier Autoliv Inc.'s funds from operations (FFO) to debt to improve only to about 45% for full-year 2019, compared with our previous forecast of over 60%.

Autoliv's S&P Global Ratings-adjusted FFO to debt and adjusted debt to EBITDA in first-half 2019 were about 35% and 2.3x respectively. During this period, the light vehicle production market, to which Autoliv is exposed, declined by about 7%, implying weaker earnings for the company than anticipated. Autoliv's EBITDA stood at $1.1 billion and its adjusted EBITDA margin was 13.9% at June 30, 2019.

Economic conditions have worsened in recent months because of the ongoing trade war between the U.S. and China, resulting in a downturn in global trade. We expect the risk of a no-deal Brexit and the higher probability of a recession in the U.S. will further dampen consumer confidence and, consequently, auto sale prospects in the next two years. We have therefore recently revised downward our assumption for autosales in 2019, assuming a 2%-3% drop for the full year. Because Autoliv's revenue growth partly depends on volumes, we see a risk that the current tougher environment and potential higher cost pressure could make it more difficult for the company to improve its financial profile. We have therefore revised our forecast, and now expect FFO to debt of about 45% for full year 2019 and 55% 2020. This compares unfavorably with our previous forecast with FFO to debt above 60% at year-end 2019. Credit ratios have been in the lower range for the rating since June 2018, a consequence of Autoliv's $1 billion recapitalization of Veoneer, which was spun off from Autoliv, and a $203 million fine related to anti-competitive behavior.

More positively, we note that Autoliv has increased its market share to about 40% in 2018 from 38% the year before. In our view, Autoliv has, in recent years, enforced its leading market position within the passive safety segment. However, the company remains less diversified than some other auto suppliers such Valeo S.A. (BBB/Negative/A-2) and Continental AG (BBB+/Stable/A-2). Since 2016, Autoliv has won more than 50% of all contracts in the market, and we anticipate Autoliv will continue to strengthen its market position in the coming years. Long lead times for new contracts, high launch costs that affected operating performance in 2019, and disproportional negative volume effect on mature models contributed to profitability slightly below our expectations for first-half 2019. Thanks to a more mature product portfolio and management's cost-cutting initiatives, including a 5% headcount reduction, we expect profitability will gradually improve to about 14%-15% for full-year 2019. We continue to believe Autoliv's good geographic diversification should somewhat protect sales from trade tariffs, with 30%-37% of revenue coming from each of Asia and the Americas, and about 1,300 models in total.

Despite the downgrade, we continue to assume Autoliv's free operating cash flow (FOCF) will improve in 2019 and 2020 to about $400 million-$450 million per year. However, this is still less than our previous expectation of $650 million. Our forecast assumes a relatively supportive improvement in working capital in second-half 2019. We expect FOCF to debt and discretionary cash flow to debt of 20%-25% in the coming years, well below the last five-year average levels of 50%. While Autoliv has departed from its historically very conservative financial policy of maintaining net debt to EBITDA of 0.5x-1.5x, we believe management remains committed to its current financial policy, including a commitment to lower leverage. We therefore expect management will strengthen its balance sheet, but that the timing and success of recovery remains uncertain and contingent upon more favorable market conditions in 2020 and 2021. We have not observed any indications of lower dividends payments, which could have resulted in a quicker balance sheet improvement, which to some extent softens management's commitment. We continue to expect about $220 million in dividend payments per year.

Outlook

The negative outlook on Autoliv reflects the risk that tougher market conditions could prevent the company's financial risk profile improving in line with our revised forecasts.

However, we continue to expect Autoliv's credit ratios will improve, in particular FFO to debt to over 45% and FOCF to debt over 25% in 2020. This factors into our assumption that the company will increase its annual revenue by 1%-4% over the next two years, and its profitability will gradually improve to 14%-15%, allowing healthy annual cash flow after dividends of about $200 million.

Downside scenario

We could lower the rating if we forecast FFO to debt below 45%, or FOCF to debt below 25% on a prolonged basis. This could occur if light-vehicle production declines sharply, leading to lower profitability, through a large debt-financed acquisition, or a material increase in shareholder returns.

Upside scenario

We would likely revise the outlook back to stable if Autoliv manages its balance sheet in such way that FFO to debt reaches 45% and FOCF exceeds 25%. We could consider an upgrade if Autoliv significantly strengthens its balance sheet, implying permanently stronger credit ratios of FFO to debt well above 60% and FOCF to debt higher than 40%. A positive rating action would also depend on the company's continued firm commitment to sustaining strong financial risk profile. An upgrade would also require supportive operating conditions and a track record of an EBITDA margin above 15%.

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 including airbags, seatbelts, steering wheels, and seat components.

Our Base-Case Scenario

- Global light vehicle volume growth in 2019 of negative 2%-3%, primarily due to weaker sales in China, and zero or very small growth in 2020, with a return to growth in China offsetting still-declining volumes drop expected in the U.S.
- Group revenue growth of 0%-2% in 2019 and 3%-5% in 2020. We anticipate this will be the combined effect of recent years' order intake, and increased contents per car. Since 2015, Autoliv has won more than 50% of all available orders globally, which compares favorably with its market share of about 40%. As the lead time from ordering to the start of production is about 18-36 months, we expect market share and revenue will increase gradually.
- We continue to expect EBITDA margins will improve to about 15% in 2020, up slightly from 14.9% in 2018, because we expect lower ramp up costs and that products will reach a more mature stage in the product life. This is to some extent offset by continued general price pressure, which has historically been about 2%-4% annually.
- Capital expenditures (capex) of $450 million-$550 million in 2019 and 2020.
- Working capital outflows of about $100 million-$200 million annually, in light of continued revenue growth, with some seasonality over the year.
- Only potential small bolt acquisitions of up to about $150 million-$200 million per year, if any.
- Normal annual dividends of $200 million-$220 million in 2019-2020.

Liquidity

We view Autoliv's liquidity as strong, since we project the ratio of sources to uses of liquidity will be about 1.9x for the coming 12 months. In our view, management has a proactive approach to financing, and we believe that Autoliv's liquidity will 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 refinancing both in 2018 and 2019, and its likely ability to absorb high-impact, low-probability events without refinancing.

Principal liquidity sources as of June 30, 2019, include:

- Reported $406 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 $366 million.
- A year-on-year working capital increase of about $100 million-$200 million, but with some intrayear swings.
- Capex of $450 million-$550 million in the next 12 months.
- Annual dividends of about $200 million-$220 million.

Covenants

There are no maintenance covenants.

Issue Ratings - Subordination Risk Analysis

Capital structure

Autoliv's capital structure consists of senior unsecured debt issued at Autoliv and by its core subsidiaries Autoliv AB and

Autoliv ASP Inc.

Analytical conclusions

The debt is rated 'BBB+', the same as the issuer credit rating, since no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

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

Business risk: Satisfactory

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

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

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

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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 | Industrials: Key Credit Factors For The Auto Suppliers Industry, Nov. 19, 2013
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

	To	From
Autoliv Inc.		
Autoliv ASP Inc.		
Issuer Credit Rating	BBB+/Negative/A-2	A-/Negative/A-2
Senior Unsecured	BBB+	A-
Autoliv AB		
Senior Unsecured	BBB+	A-
Ratings Affirmed		
Autoliv Inc.		

Nordic Regional Scale	--/--/K-1
Autoliv ASP Inc.	
Commercial Paper	A-2

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 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.