S&P Global
Ratings

RatingsDirect®

Research Update:

Autoliv Inc. Ratings Lowered To 'BBB' On COVID-19 Impact; Outlook Stable

May 28, 2020

PRIMARY CREDIT ANALYST

Eric Tanguy
Paris
(33) 1-4420-6715
eric.tanguy
@spglobal.com

SECONDARY CONTACT

Marta Bevilacqua
Milan
+ (39)0272111298
marta.bevilacqua
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Rating Action Overview

- The COVID-19 pandemic has caused a downturn of historic proportions for the global auto industry.
- We believe that this will materially weaken the earnings and cash flow of U.S.-incorporated Autoliv Inc., as for many other auto suppliers this year, particularly over the second quarter of 2020.
- We anticipate that Autoliv's revenues will decline by about 15% this year, from about $8.5 billion in 2019, and that its S&P Global Ratings-adjusted EBITDA margin will weaken to slightly less than 10% in 2020 from 13.3% in 2019, resulting in funds from operations (FFO) to debt of around 25%, down from 38.8% at year-end 2019.
- We forecast that Autoliv's credit ratios, which were already slightly weak for the rating in 2019, will fall short of our expectations for a 'BBB+' rating at year-end 2020, with earnings disruptions likely to continue until the first half of 2021.
- We are therefore downgrading Autoliv and its subsidiary Autoliv ASP Inc. to 'BBB' from 'BBB+'. At the same time, we are lowering our issue ratings on the company's senior unsecured debt to 'BBB' from 'BBB+', and our Nordic scale rating to 'K-2' from 'K-1'. We are affirming the short-term issuer credit rating at 'A-2'.
- The stable outlook reflects the fact that in the face of the extremely challenging market conditions, Autoliv has the flexibility to maintain credit ratios commensurate with its new 'BBB' rating over the next to two years, such as FFO to debt in the 30%-45% range and adjusted debt to EBITDA of less than 2x through the generation of positive free operating cash flow from next year.

Rating Action Rationale

Autoliv's operating performance will be weak in 2020, reflecting a severe drop in global light-vehicle production volumes. Global economic conditions have worsened materially in recent months because of the COVID-19 pandemic. The impact on the auto industry is likely to prove severe, with production shutdowns in place across Europe and North America during the second quarter of 2020. In the wake of the pandemic, we forecast that light-vehicle sales will decline by 15% in 2020 (see "COVID-19 Will Batter Global Auto Sales And Credit Quality," published March 23, 2020).

The fall in the global production of light vehicles in 2020 could even reach -20% this year, with China at around -15% and Europe and North America closer to -25%. These falls are more severe than those we observed during the 2008-2009 recession.

For full-year 2020, we consider that the prospects for auto demand are bleak due to long lockdowns, health concerns when visiting vehicle showrooms and dealerships, and travel restrictions between or within countries, some of which may not be completely lifted by the summer. Europe will further grapple with demanding CO2 emissions targets and ongoing trade discussions between the U.K. and the EU following the U.K.'s exit from the EU. In 2021, depressed economic conditions could dampen consumer confidence and should cloud the prospects for a rapid and full recovery in auto sales volumes. These medium-term headwinds should be partly offset by a possible shift in daily commutes from public transport to light vehicles, and the introduction of new incentives to accelerate the transition to electrified powertrain, and possibly of some "cash-for-clunker" vehicle-exchange schemes. This should enable a rebound in auto sales in 2021, but from a historically low base of less than 80 million units in 2020.

Because Autoliv's revenue base depends on production volumes, we believe that the tough environment will weaken the company's earnings over the coming 12 months at least. We note that, on April 2, 2020, Autoliv withdrew its 2020 guidance to be able to assess the full effects of the pandemic on its operations.

We expect the industry trends to translate into a revenue drop of about 15% for Autoliv in 2020, from about $8.6 billion at the end of 2019. Autoliv's S&P Global Ratings-adjusted EBITDA stood at $1.1 billion in 2019, while its adjusted EBITDA margin was 13.3%. We foresee the margin falling to slightly less than 10% in 2020, which is above the historical low of 8% reported for the fiscal year ended Dec. 31, 2009. We expect the EBITDA margin to return to the full-year 2019 level in 2021.

Inherent strengths in Autoliv's product offering and measures to protect earnings should limit the downfall. The company is smaller and has less product diversity than its direct competitor ZF Friedrichshafen AG, or other European auto suppliers such as Continental AG and Valeo S.A. However, Autoliv's leading position within the passive safety segment (primarily airbags, seatbelts, and steering wheels) remains solid, at 50% of the new order intake on these products in 2019.

We foresee Autoliv's sales for full-year 2020 outperforming global production declines, as they did during the first quarter of 2020, when sizable capacity had already been shut down in China. Original equipment manufacturers' medium-term strategy to improve the safety features in their cars remains fundamentally unchanged to comply with ever more demanding government regulations.

We continue to believe that Autoliv's good geographic diversification should partly protect its sales from possible new trade tariffs, with 29%-37% of revenue coming from each of Europe, the Americas, and Asia.

Autoliv's cost structure is quite flexible for an auto supplier, since about 70% of its cost base comprises labor costs and components that can be adjusted over time. The company is taking active measures to try to protect its margins. After reducing the workweek, it has furloughed personnel in many countries to adapt to substantially lower demand, accelerated its cost-saving initiatives, and implemented a 20% cut in the compensation of its executive officers and board members.

Still, we expect Autoliv to face substantial cost pressure this year, not so much to implement the protection measures for its personnel, but primarily because of its need to right-size its operations across countries on a more permanent basis.

A challenging market environment will weigh on Autoliv's credit metrics in 2020, and we only expect a recovery in 2021. Weaker earnings and cash generation will put pressure on the company's credit metrics. We forecast that Autoliv's funds from operations (FFO) to debt will be about 25% and its debt to EBITDA 3.0x for 2020, and average 40% and 2.0x, respectively, over our forecast horizon to 2022. Tighter capital expenditure (capex) and improved working capital during the first half of 2020 should help buoy credit metrics this year.

We consider that Autoliv's credit ratios had already been at the low end of our ranges for the 'BBB+' rating since June 2018. This was a consequence of Autoliv's $1 billion recapitalization of Veoneer, which it spun off in 2018, and the payment in 2019 of a $203 million EU fine related to prior anti-competitive behavior.

Free operating cash flow (FOCF) will benefit from lower capex and working capital investments and limited dividends. We foresee Autoliv's FOCF falling toward $100 million in 2020, a sharp reduction from the below-average $232 million that the company reported for fiscal 2019.

While Autoliv has departed from its historically very conservative financial policy of maintaining net debt to EBITDA in the 0.5x-1.5x range, we believe that management remains committed to its medium-term financial policy. This includes a commitment to lower leverage over time, once operational issues are fully addressed. We note that after the payment of a $54 million partial dividend during the first quarter of 2020, the company has suspended all future dividends for now.

We expect that management will strengthen the balance sheet, but that the timing and success of a recovery remains uncertain and contingent on much more favorable market conditions from 2021.

We do not see any liquidity risk for Autoliv, owing to a sizable cash balance and manageable debt maturities. Following the first quarter of 2020, the company fully drew on its $1.1 billion revolving credit facility (RCF) maturing in June 2023, resulting in a considerable cash balance of about $1.5 billion. With its plans to scale back capex and cancellation of dividend payments, we believe that Autoliv will be able to weather the next 12 months with liquidity being a limited constraint.

In terms of debt maturities, Autoliv has about $318 million maturing in the next 12 months, including commercial paper to be rolled over, and $275 million in the subsequent 12 months. We also note that the company's debt structure has no financial covenants.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety.

Outlook

The stable outlook reflects the fact that in the face of the extremely challenging market conditions, Autoliv has the flexibility to maintain credit ratios commensurate with its new 'BBB' rating over the next to two years, such as FFO to debt in the 30%-45% range and adjusted debt to EBITDA of less than 2x through the generation of limited but positive FOCF from next year. Over our forecast horizon, we expect Autoliv's FFO to debt at the higher end of the 30%-45% range and FOCF to debt hovering around 15%.

Downside scenario

We could lower the ratings if we anticipate that Autoliv's FFO to debt will be sustainably below 30% or if its FOCF to debt remains below 10% for full-year 2021. This could occur if challenging conditions in the auto sector require the company to undertake an extensive and lasting restructuring, or because of a sizable debt-financed acquisition, a material increase in shareholder returns, or looser adherence to the current financial policy.

Upside scenario

Unless we see clear signs of an upturn in the medium-term prospects for the global auto industry, the likelihood of an upgrade is low. We could consider an upgrade if Autoliv significantly strengthens its balance sheet, implying permanently stronger credit ratios of FFO to debt sustainably above 45% and FOCF to debt higher than 25%. A positive rating action would also depend on the company's continued firm commitment to sustaining a stronger financial risk profile.

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 (66% of sales in 2019); and
- Seatbelt products (34% of sales in 2019).

In 2019, the company's top five customers measured by revenue were the Renault/Nissan/Mitsubishi Alliance (16%), Volkswagen (10%), Honda (10%), Fiat Chrysler Automobiles (8%), and Hyundai/Kia (8%).

Our Base-Case Scenario

Assumptions

- A contraction in U.S. and eurozone GDP of -5.2% and -7.3%, respectively, in 2020, with modest growth of 1.2% in China.
- Translation of the current recessionary economic backdrop into a 15% drop in revenues in 2020, to $7.3 billion from $8.5 billion in 2019, recovering in 2021 by about 10% to about $8.1 billion.
- A slight contraction in the adjusted EBITDA margin to below 10% in 2020 from 13.3% in 2019, before improving to about 13% in 2021.
- Negative trade working capital of $40 million-$60 million in 2020 and of $90 million-$110 million in 2021.

- Lower capex in the range of $400 million-$450 million in 2020 and 2021, compared with $483 million in 2019.
- No further dividend payments in 2020, thereby totaling $54 million this year, and dividends of around $200 million in 2021, assuming that the company's earnings do recover.

Key metrics

- FFO to debt of about 25% in 2020, improving toward 40% in 2021.
- FOCF to debt of 5% at the end of 2020, and of around 15% in 2021.

Liquidity

We view Autoliv's liquidity as strong. The short-term rating is 'A-2', while the Nordic national scale rating is 'K-2'. We project that the ratio of sources to uses of liquidity will be about 2.0x for the coming 12 months and 1.7x over the following 24 months. In our view, Autoliv's liquidity will remain sufficient to cover uses even if EBITDA dropped by 30%. The company fully drew on its $1.1 billion RCF to secure its liquidity position over the coming year.

Supportive factors include Autoliv's solid relationships with banks and its high standing in the credit markets evident from a refinancing both in 2018 and 2019, its covenant-lite debt structure, and its likely ability to absorb high-impact, low-probability events without refinancing.

Autoliv's principal liquidity sources as of March 31, 2020--adjusted for the RCF drawn on April 2, 2020--include:

- Cash and cash equivalents of about $1.5 billion.
- Our expectation of cash FFO in the range of $550 million-$600 million for fiscal 2021, improving to $800 million-$900 million over the following 24 months.

Principal liquidity uses as of the same date include:

- Debt maturities of $318.8 million over the next year and $275 million in the subsequent 12 months.
- A year-on-year working capital increase of about $50 million-$100 million, but with some intrayear swings of up to $200 million.
- Capex of $400 million-$450 million annually.
- No further dividend payouts in 2020, and dividends of about $200 million in 2021.

Covenants

There are no maintenance covenants.

Issue Ratings--Subordination Risk Analysis

Capital structure

The capital structure consists of senior unsecured debt issued by Autoliv Inc. and by its core operating subsidiaries, Autoliv AB and Autoliv ASP Inc.

Analytical conclusions

The issue rating on the debt is 'BBB', the same as the issuer credit rating, with no significant elements of subordination risk present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/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 | 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
- General Criteria: Understanding S&P Global Ratings' Rating Definitions, June 3, 2009

Related Research

- COVID-19 Will Batter Global Auto Sales And Credit Quality, March 23, 2020

Ratings List

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

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

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.