S&P Global Ratings

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Summary:

Autoliv Inc.

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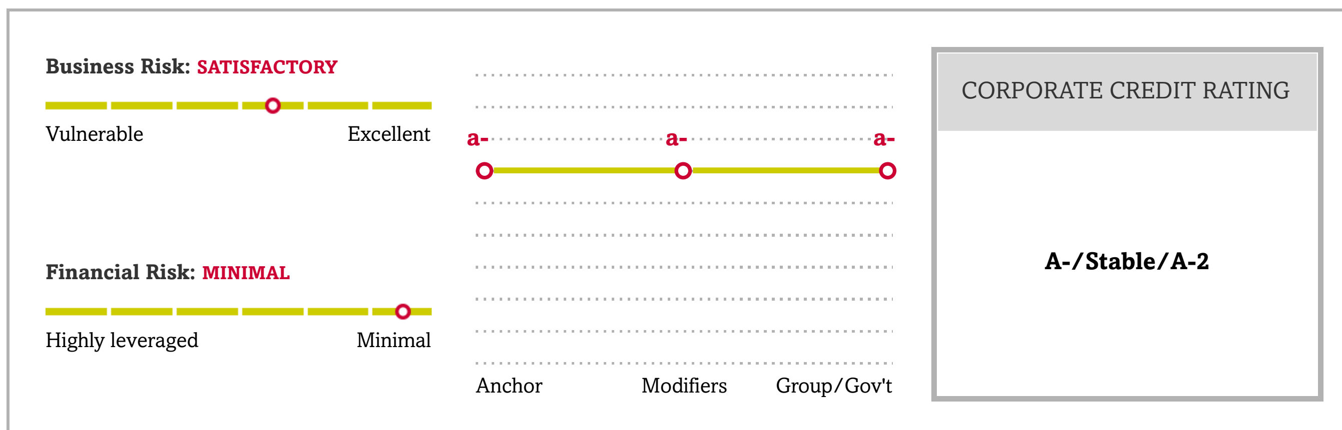

Rationale

Business Risk: Satisfactory	Financial Risk: Minimal
• Leading global position in automotive passenger safety systems. • Balanced geographic exposure. • Good customer diversification. • Diverse and cost-focused production footprint. • Cyclical and competitive light vehicle component market, especially for active safety products. • Limited product diversity and no meaningful presence in aftermarket. • Volatile profitability through the downturn.	• Sustained financial leeway under the credit metrics. • Solid track record of free operating cash flow (FOCF) generation. • Substantial shareholder remuneration, albeit slower share buybacks than previously. • Risk of cash outflows resulting from legal investigations. • Potential for midsize acquisitions. • Robust liquidity.

Outlook: Stable

The stable outlook on U.S.-based Autoliv Inc. reflects S&P Global Ratings' view that the company will sustain stable profitability and healthy FOCF generation in excess of US$200 million. The outlook also factors in continued dividend distribution of about US$220 million per year and a pause in share buybacks. Also, we assume that midsize acquisitions and a potential antitrust investigation settlement will not hamper the company's ability to sustain a funds from operations (FFO)-to-debt ratio of more than 60% and a debt-to-EBITDA ratio of less than 1.5x.

Downside scenario

We could take a negative rating action if Autoliv posted credit ratios below our expectations for the current rating. This could happen if the company paid a substantial fine, without offsetting these outflows by lower shareholder distributions. We could also consider a negative rating action 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 achieved a track record of substantially stronger and more stable profitability metrics.

Our Base-Case Scenario

Assumptions

- Real GDP growth in 2016 and 2017 of 1.6% and 1.4%, respectively, in the EU, 1.5% and 2.4% in NAFTA (USA, Canada, and Mexico), and 6.6% and 6.4% in China.
- Light vehicle production growth in 2016 and 2017 of 3.5% and 0.6%, respectively, in Europe, 3% and 1% in NAFTA, and 5% and 1% in Asia.
- Strong 10% revenue growth in 2016 to more than US$10 billion, supported by robust organic growth in Europe and Asia and recently completed acquisitions, but partly offset by depreciation of currencies in emerging countries. We expect revenues to grow at about 3%-5% in 2017. In the first nine months of 2016, revenues increased by 12.3%, including 9.5% organic growth, 4.6% growth from acquisitions, and a negative 1.8% foreign exchange impact.
- Higher capital expenditures (capex) in the 5%-6% range as a percentage of revenues to accommodate growth embedded in the order intake.
- We assume higher working capital requirements in 2016 due to strong growth. For the first nine months of the year, Autoliv reported a high US$140 million outflow that we expect to partially reverse in the fourth quarter.
- We model US$150 million for acquisitions per year starting from 2017. In 2016, we include roughly US$270 million for the joint venture with Nissin Kogyo in Japan (ANBS).
- About US$200 million-US$220 million per year for dividend distribution in 2016 and 2017.
- We don't include share buybacks in our base case. We note, however, that the company could purchase up to 4.4 million of its shares under the existing program.

Key Metrics

	2015a	2016f	2017f
EBITDA margin (%)	11.9	11.5-12.0	12.0-12.2
FFO/debt (%)	115	95-100	90-100
Debt/EBITDA (x)	0.6	0.8	0.8

a--Actual. f--Forecast.

Business Risk: Satisfactory

Leading market position in automotive safety as global No. 1 supplier of passive safety products, which include seatbelts, airbags, steering wheels, and electronics products. The company estimates its global market share at about 39%. We note that the active safety market, which includes radars, night vision and camera vision systems, and which

accounted for 7% of Autoliv's sales in 2015, is more fragmented and, therefore, more competitive. Nevertheless, the company was able to capture significant growth in active safety applications and we expect it to double its sales over three years from 2013 to 2016 to more than US$700 million.

Our assessment is also supported by Autoliv's balanced geographic presence in terms of sales and industrial footprint. The company sells its products in Europe, the Americas, and Asia, which all account for roughly a third of revenues. In that respect, Autoliv is better diversified than many other European auto suppliers that typically have greater focus on Europe.

We also note that Autoliv serves a wide array of customers that includes all major global original equipment manufacturers (OEMs). In 2015, the company derived 52% of its revenues from the five largest OEM clients, which include GM (12%), Ford (12%), and Renault/Nissan (10%).

We think that Autoliv is less diversified product-wise given its focus on safety products. The scale of its operations compared to some European peers, such as Continental, Michelin, Schaeffler, or Valeo, is also smaller. We also note that its profitability is somewhat at the lower end compared with that of peers, as measured by our adjusted EBITDA margin of 11.9% in 2015. Moreover, the company has exhibited more volatility in its earnings during the 2008-2009 financial crisis. However, the company has since worked on reducing material costs and the number of suppliers and achieving labor productivity improvements, notably through moving some of its factories to low-cost emerging markets.

We think that growth of Autoliv's revenues over the longer term is supported by continued growing light vehicle production, mainly driven by emerging markets. In that respect, we positively view the company's presence in China, where it generates 17% of its revenues. Having said that, we expect that sales of light vehicles in China will slowdown in 2017 to about 1% from about 6% expected for 2016. Furthermore, rising safety concerns globally, including increasing safety standards in emerging markets, shall enable Autoliv to increase value content by car. We also note that Autoliv recently signed a joint venture agreement with Volvo Cars to develop autonomous driving technology, which we see as one of the auto industry's key growth areas for the future. The first products are expected to be delivered by 2019.

Financial Risk: Minimal

As of end 2015 and under our base-case expectations for 2016 and 2017, we see adequate financial leeway under Autoliv's credit metrics. We think that revenue growth prompted by good order intakes will support operating cash flow generation, albeit require somewhat higher investment to accommodate higher volumes. Autoliv has been consistently generating FOCF and we expect it to continue to post FOCF in the US$200 million-US$300 million range, despite higher capex.

We think that the financial leeway that the company currently enjoys could be thwarted by potential antitrust investigation settlement, for which the timing still remains unknown. We also think that the company could continue doing midsize acquisitions, such as MACOM in 2015 in the U.S. (for US$138.5 million, including a US$25 million earn-out provision) and the ANBS joint venture in Japan in 2016 for about US$263 million. We think that more sizable

debt-funded acquisitions could put pressure on credit metrics without any offsetting measures.

We note the company's prudent financial management and public leverage target of about 1.0x net debt to EBITDA in the long-term. As such, we think that Autoliv will focus on cash flow generation and put on hold its share buyback program, under which it purchased roughly US$870 million of shares from 2013 to 2015. The company significantly reduced its dividend distribution in 2009-2010 and made no share buybacks between 2009 and 2012.

Liquidity: Strong

The short-term corporate credit rating is 'A-2' and the short-term Nordic regional scale rating is 'K-1'. We view Autoliv's liquidity as strong. This reflects our view that the ratio of sources to uses of liquidity should comfortably exceed 1.5x 2016 and 2017. At the same time, we think that the potential EU fine and a midsize acquisition could be a drag on cash in the near future, although this should not undermine our view of strong 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	Principal Liquidity Uses
• Reported US$1.182 billion of cash and cash equivalents as on Sept. 30, 2016. We deduct about US$70 million from cash balances because we deem this amount not immediately available. • An undrawn revolving credit facility (RCF) of US$1.1 billion that the company successfully refinanced this summer with maturity in July 2021 that can be extended by up to two more years. • Our expectation about US$900 million in FFO (unadjusted).	• About US$73 million of short-term debt. • Year-on-year working capital increase in light of solid growth. • Capex exceeding US$500 million in the next 12 months. • We model €150 million spending on acquisitions per year.

Covenant Analysis

There are no maintenance covenants in the RCF or in any of Autoliv's other credit lines.

Ratings Score Snapshot

Corporate Credit Rating

A-/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Low

- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

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)

Related Criteria And Research

Related Criteria

- Use Of CreditWatch And Outlooks - September 14, 2009
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Industry Risk - November 19, 2013 Delete Criteria
- Country Risk Assessment Methodology And Assumptions - November 19, 2013
- S&P Global Ratings' National And Regional Scale Mapping Tables - June 01, 2016
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Key Credit Factors For The Auto Suppliers Industry - November 19, 2013
- Ratios And Adjustments - November 19, 2013
- Group Rating Methodology - November 19, 2013
- Corporate Methodology - November 19, 2013
- 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- National And Regional Scale Credit Ratings - September 22, 2014

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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-

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