Standard & Poor's Research

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Summary:
Autoliv Inc.

Primary Credit Analyst:
Robert E Richards, Frankfurt (49) 69-33-999-200; rob_richards@standardandpoors.com

Secondary Credit Analyst:
Michael Andersson, Stockholm +46 8 440 59 30; michael_andersson@standardandpoors.com

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Credit Rating: BBB+/Stable/A-2

Rationale

The ratings on Autoliv Inc., the parent company of the Sweden-based Autoliv group, reflect Standard & Poor's Ratings Services' view of the company's leading market position in auto safety products, principally seat belts and air bags. Supplying all leading automotive original equipment manufacturers (OEMs) worldwide, Autoliv enjoys a more diverse and stronger customer and geographic mix than is typical for the auto safety products industry. These strengths are offset by the close correlation of safety system demand to cyclical new auto sales and recurring pricing pressure from OEMs. This reflects our assessment of Autoliv's business risk profile as "satisfactory." The company has cyclical profitability but generally positive free operating cash flow, leading to our view of its "intermediate" financial risk profile. This also reflects financial policies that indicate higher future borrowings, notwithstanding particularly strong credit metrics and liquidity achieved during the industry's recovery from a severe downturn in 2009.

Autoliv benefits from consumers' and regulators' increased focus on automobile safety in both advanced and emerging automobile markets. We believe this is likely to support higher growth than the underlying auto unit sales. Passive safety systems, including seat belt and airbag systems, are becoming more sophisticated and account for a higher proportion of auto content in developed markets. We believe consumers' growing safety consciousness and new regulatory standards will also support relatively robust demand in rapidly expanding, increasingly prosperous emerging markets.

Management's strategy of shifting production to locations with lower and more flexible costs has boosted profitability. We believe this will somewhat mitigate the pressure on profit margins from large OEM customers and volatile raw material costs.

We believe Autoliv has the capacity to generate free cash flow, except during severe industry downturns. This gives the company potential to support a reasonable level of acquisitions and return cash to shareholders. We believe management has demonstrated its commitment to a flexible dividend policy and sound financial profile, which could mitigate deterioration of the financial profile in future auto industry downturns.

S&P base-case operating scenario

Autoliv reported a healthy 11.5% EBIT margin for the 12 months ended Sept. 30, 2011, up from the corresponding period in 2010, but down from a very robust 12.7% for the calendar year 2010. The EBIT margin is also significantly higher than the historical average of high single digits (7%-10%). In our opinion, strong profitability over the past two years has stemmed from a substantial cyclical rebound in global demand for automotive occupant restraints, increasing interest in safety systems in expanding emerging markets, and cost-cutting during the 2009 recession. We expect profitability to weaken in 2012, owing to cooling demand amid an increasingly uncertain economic outlook, likely OEM pricing pressure, and potentially higher raw material costs. While we do not expect Autoliv to achieve its 2011 margins through the cycle, we believe its shift of capacity and employment to lower-cost markets and fixed cost-cutting have increased its resilience should a downturn materialize. Rapidly increasing sales of active safety systems will likely only account for a small proportion of total sales in the near term, in our view.

S&P base-case cash flow and capital-structure scenario

Cash generation during 2010 and the first three quarters of 2011 was strong and substantially better than the weak levels posted during the 2009 downturn. For the 12 months to Sept. 30, 2011, Autoliv's funds from operations (FFO) to debt, after our adjustments, was 143% and adjusted debt to EBITDA only 0.6x (after netting cash in excess of $100 million from debt). We believe this should allow the company to deal with various challenges in 2012. These may include weaker auto demand in Europe and other markets and uncertainty regarding costs of the European Commission and U.S. Justice Department investigations into possible anticompetitive practices at Autoliv and some of its competitors. We believe Autoliv should be able to cover even sizable penalties, shareholder payouts, and midsize acquisitions while remaining within its financial policies. The company's financial targets, for instance, include a maximum debt-to-EBITDA ratio of significantly less than 3x, and we consider Autoliv able to meet at least $1 billion of mandatory or discretionary payouts that might materialize in 2012. We base this assessment on our anticipation that Autoliv will generate about $1.1 billion in EBITDA and $0.5 billion of adjusted free operating cash flow (FOCF) annually in 2011 and 2012.

Liquidity

The short-term rating on Autoliv is 'A-2'. We assess the company's liquidity and financial flexibility as "strong," as defined in our criteria. On Sept. 30, 2011, liquidity sources consisted of $631 million in cash and short-term investments and full availability under a $1.1 billion committed credit facility maturing in April 2016. This compares with $222 million in short-term debt on the same date. A separate €225 million five-year loan commitment from the European Investment Bank (EIB; AAA/Watch Neg/A-1+), which expires in December 2012 if not utilized, and $306 million of bank lines were also undrawn.

Although we anticipate that Autoliv will generate less FOCF in 2011 and 2012 than the $720 million it achieved in 2010, FOCF and available liquidity sources are sufficient to meet annual dividend payments and other likely requirements. The company has a Swedish krona (SEK) 7.0 billion (about $1.02 billion) and a $1 billion U.S. commercial paper (CP) program.

We understand that none of Autoliv's revolving facilities are subject to financial covenants.

Outlook

The stable outlook reflects our view that Autoliv's robust operating performance and currently strong financial metrics will enable it to weather potential slowdowns in Europe and some other markets as well as possible fines stemming from the European Commission or the U.S. Justice Department investigations, even if fines were to reach guideline or statutory maximums. The outlook also reflects our expectation that the company will remain committed to balancing investments, dividends, and acquisitions in line with an "intermediate" financial profile. At the current rating level, we see headroom to accommodate acquisitions and special shareholder payments of several hundred million dollars or more, depending on what the payment is for.

We would consider raising the rating if Autoliv demonstrated sustainably stronger and more stable profitability or commitment to a modest financial risk profile. We believe Autoliv could maintain its current credit measures, which exceed what we consider commensurate with the 'BBB+' rating, absent much higher shareholder payouts. These metrics include FFO to debt of about 40%, debt to EBITDA of about 2.5x, and FOCF to debt of 15%-20%.

A combination of adverse market conditions, legal penalties, very generous dividend payouts, or share buybacks would likely weaken the company's credit measures to below what we see as rating-commensurate, leading to a negative rating action.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

Additional Contact:
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com