MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's confirms Valeo's Baa3/P-3 ratings; outlook negative

**11 Jun 2020**

Frankfurt am Main, June 11, 2020 -- Moody's Investors Service, ("Moody's") has today confirmed the Baa3 long-term issuer rating and senior unsecured ratings as well as the P-3 commercial paper rating of the French automotive parts supplier Valeo S.A. (Valeo). The outlook on the ratings changed to negative from ratings under review.

This rating action concludes a review for possible downgrade that began on March 26, 2020.

"The confirmation of Valeo's ratings reflects the expectation that the company will swiftly recover from the negative impact of the global coronavirus outbreak on credit metrics in 2020.", said Matthias Heck, a Moody's Vice President -- Senior Credit Officer and Lead Analyst for Valeo. "Valeo's margins and leverage will, however, still be weak for a Baa3 in 2021 and the negative outlook indicates the risk of a downgrade if the global auto market does not recover as expected or Valeo fails to achieve its expected outperformance of at least 500 basis points.", added Mr. Heck.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The confirmation of Valeo's Baa3 issuer rating reflects Moody's expectation that Valeo remains profitable in a very difficult year 2020 (in terms of Moody's adjusted EBITA) and recovers margins towards our expected range of 4.5% - 5.5% in 2021, and be comfortably within the range in 2022. This expectation is supported by (i) Valeo's track record of continued outperformance of its revenues versus global light vehicle production (600 basis points achieved in 2019), which Moody's expects to continue over the next two years at least, and (ii) the company's actions to mitigate the negative impact of the global coronavirus outbreak by cost reduction and variabilization and capex reduction, and (iii) the company's commitment to an investment grade rating, evidenced by a material cut in dividend payments. At the same time, we note that the group's profitability has been under pressure already before the Corona crisis and hence we believe that a turnaround back to historic levels requires a firm grip on the group's cost base in combination with no material underperformance of automotive demand against our expectation.

Moody's forecasts for the global automotive sector a 20% decline in unit sales in 2020, with a steep year-over year contraction in the first three quarters followed a modest rebound in the fourth quarter. We expect 2021 industry unit sales to rebound and grow by approximately 11%. However, future demand for vehicles could be weaker than our current estimates, the already competitive environment in the auto sector could intensify further, and Valeo could encounter greater headwinds than currently anticipated.

The widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The global automotive industry is one of the sectors that will be most severely impacted by the outbreak. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Valeo's Baa3 rating reflects as positives its: (a) size and scale as a Tier 1 automotive supplier with revenues of around €19 billion in 2019; (b) long-standing relationships with the global original equipment manufacturers (OEMs); (c) high product diversity operating across four core reporting segments; (d) positive exposure to the long-term forces affecting the automotive industry; (e) high rate of innovation, which underpins future revenue growth (products launched within the last 3 years accounting for over 47% of order intake in 2019); and (f) overall balanced financial policy with a commitment to an investment grade rating, and strong liquidity.

The rating also reflects as negatives its: (a) exposure to the cyclicality of automotive production which faces continued headwinds in 2020; (b) exposure to volatile raw material costs; and (c) low profitability, with an EBITA margin (Moody's adjusted) of 3.9% per December 2019 albeit close to the level that is average for the industry, (d) high R&D expenses, (e) slightly elevated leverage (3.7x debt/EBITDA Moody's adjusted, at December 2019).

## RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook reflects (i) the negative impact that the global coronavirus outbreak will have on Valeo's operating performance and credit metrics at least into 2021, (ii) continued challenges in the automotive industry, such as electrification and disruptive technologies, which require ongoing high amounts of R&D spending and limit free cash flow generation.

In this environment, it might be difficult for Valeo to improve credit metrics by the end of 2021 to levels, which Moody's expects for the Baa3, including EBITA margins (Moody's adjusted) of at least 4.5% (3.9% at December 2019), leverage of a maximum of 3.5x debt/EBITDA (Moody's adjusted; 3.7x at December 2019) and a maximum of 2.5x net debt/EBITDA (2.7x at December 2019).

## LIQUIDITY

Moody's considers Valeo's liquidity position to be strong. This reflects a combination of: (a) cash on the balance sheet of €1.8 billion at the end of December 2019; (b) annual funds from operations (FFO) of around €1.7 billion; and (c) full availability under the company's committed credit lines of €1.12 billion. While those lines contain a financial covenant (<3.5x consolidated net debt/consolidated EBITDA), we anticipate that headroom against it will remain ample (1.1x at December 2019). In addition, On April 14, 2020, Valeo announced additional €1 billion credit lines with its main banking partners. None of these lines have been drawn. These cash sources, totaling to more than €4.5 billion, should comfortably exceed cash uses for dividends and short-term debt maturities (together less than €0.5 billion), working cash needs (€0.5 billion), and short-term working capital swings and capex (together less than €2.0 billion).

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Negative rating pressure could arise if there is a rising likelihood that Valeo will not be able to improve metrics towards levels more appropriate with a Baa3 rating beyond 2020, such as that its EBITA margin were to remain below 4.5%, the company failed to reduce adjusted leverage below 2.5x net debt/EBITDA and/or 3.5x gross debt/EBITDA, or RCF/net debt declined to below 20%. Materially negative free cash flow generation would also put negative pressure on the ratings.

Positive rating pressure could arise if Valeo achieved on a sustainable basis an adjusted EBITA margin of at least 5.5%, Moody's adjusted net debt/EBITDA of below 2.0x (debt/EBITDA below 3.0x) and an adjusted RCF/net debt ratio of above 30%. An upgrade would also require sustainable positive free cash flows and continuation of a balanced financial policy.

## LIST OF AFFECTED RATINGS:

..Issuer: Valeo S.A.

Confirmations, Previously Placed On Review For Downgrade:

.... Commercial Paper, Confirmed at P-3

.... LT Issuer Rating, Confirmed at Baa3

....Senior Unsecured Medium-Term Note Program, Confirmed at (P)Baa3

....Senior Unsecured Regular Bond/Debenture, Confirmed at Baa3

Outlook Actions:

....Outlook, Changed To Negative From Ratings Under Review

## PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Automotive Supplier Methodology published in January 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1170606 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

## COMPANY PROFILE

Headquartered in Paris, Valeo S.A. is one of the leading global suppliers of automotive components for new cars and light vehicles (original equipment or OE) and the aftermarket (around 10% of group revenues). In 2019, Valeo generated revenues of €19.5 billion. Valeo has four business divisions: (i) Comfort and Driving Assistance Systems (19% of 2019 group revenues); (ii) Powertrain Systems (26%); (iii) Thermal Systems (24%); and (iv) Visibility Systems (31%). The group's product range consists of clutches, electrical systems, switching and driver interface modules; sensors for driving assistance; air-conditioning systems and modules; heating and cooling products; filters; windshield wipers; and lighting systems.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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