

Rating Action: Moody's changes outlook on Valeo's ratings to negative; affirms Baa2/P-2 ratings

02 Nov 2018

Frankfurt am Main, November 02, 2018 -- Moody's Investors Service ("Moody's") has today changed the outlook on the ratings of Valeo S.A. (Valeo) to negative from stable. Concurrently, the agency has affirmed the company's long-term issuer rating and senior unsecured ratings at Baa2 as well as its commercial paper rating at P-2.

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

"The change in outlook is driven by the recent deterioration of market conditions in Europe and China, and its negative implications on Valeo's credit metrics," said Matthias Heck, a Moody's Vice President -- Senior Credit Officer and Lead Analyst for Valeo. "The negative outlook reflects the challenges for Valeo to maintain EBITA margins (Moody's adjusted) above 5.5%, and de-lever below 3x debt/EBITDA and 2x net debt/EBITDA (Moody's adjusted) within the next 12-18 months; levels which are required for a Baa2 rating," added Mr. Heck.

RATINGS RATIONALE

The negative outlook reflects Moody's expectation that Valeo's EBITA margins (Moody's adjusted) will decline towards 4.5% at the end of 2018 (6.2% at June 2018). Despite some expected improvements in 2019 from a strong order book, it might be challenging for Valeo to achieve EBITA margins of at least 5.5%, which Moody's expects for a Baa2 rating, in a softening industry environment. The negative outlook also reflects the expectation that the company's financial leverage, measured as debt/EBITDA, will exceed 3.5x in 2018 (3.4x at June 2018), and that it will be challenging to de-lever to less than 3x in 2019, which Moody's requires for the Baa2.

On October 25, 2018, Valeo reduced its expectations for revenues and profits for 2018, reflecting the negative impact of the new emission testing standard WLTP in Europe as well as more challenging market conditions in China. The company now expects to achieve a sales growth of 6% at constant exchange rates, compared to the previous expectation of 9%, and an operating margin of 6.2%-6.5%, down from "slightly below 7.8%". As a result, Moody's expects that EBITA margin (Moody's adjusted) will fall well below the level of at least 5.5% expected for a Baa2 rating in 2018. In Moody's view, it will also be challenging to improve margins towards this level in 2019, given the operational headwinds.

Valeo's adjusted gross leverage was 3.4x as per LTM June 2018, while its net leverage was 2.1x. Given the weakening operating environment and reduced profitability, we estimate gross and net leverage to increase slightly towards year-end 2018. Despite some expected deleveraging due to profit growth next year, resulting from high capex and R&D spending over the last year and a good order book, Moody's expects leverage to stay elevated, positioning the rating very weakly on a 12-18 month forward view.

Valeo also revised its guidance for free cash flows in 2018. Based on its own definition (free cash flows before dividends) and after already initiated cost cutting and capex reduction, the company now expects to generate €120-€150 million in 2018, compared to €278 million generated 2017. After dividends paid of around €300 million, 2018 will be the second consecutive year of negative free cash flows, and it might also be challenging to return to positive free cash flows in 2019. Assuming a stable business portfolio and capital structure, positive free cash flows are required to reduce net financial debt.

RATIONALE FOR THE RATING AFFIRMATION

The affirmation at Baa2 reflects the group's (1) size and scale as a Tier 1 automotive supplier with revenue of around €19 billion in the last twelve months to June 2018 period; (2) long-standing relationships with the global original equipment manufacturers (OEMs); (3) high product diversity operating across four core reporting segments; (4) positive exposure to the long-term forces affecting the automotive industry; (5) high rate of innovation which underpins future revenue growth; (6) increasing aftermarket sales; (7) strong liquidity, supported by continuously high cash balance.

However, the Baa2 rating also reflects Valeo's (1) exposure to the cyclical nature of automotive production; (2) exposure to disruptive trends in the industry, but the group's product portfolio partly offsets this; (3) exposure to volatile raw material costs; (4) low profitability, with an EBITA margin (Moody's adjusted) of 6.2% per June 2018 albeit at a level that is average for the industry; (5) high R&D expenses.

WHAT COULD CHANGE THE RATING UP/DOWN

Positive rating pressure could arise if Valeo achieved on a sustainable basis an adjusted EBITA margin in the high single-digits in percentage terms, Moody's adjusted net debt/EBITDA of below 1.5x and an adjusted RCF/net debt ratio of above 40%. A further improvement in adjusted free cash flow generation and continuation of a balanced financial policy would also put positive pressure on the ratings.

Negative rating pressure could arise if EBITA margins dropped below 5.5%, the company failed to reduce adjusted leverage below 2.0x net debt/EBITDA and/or 3.0x gross debt/EBITDA, or RCF/net debt declined to below 35%. Materially negative free cash flow generation would also put negative pressure on the ratings.

LIST OF AFFECTED RATINGS

..Issuer: Valeo S.A.

Affirmations:

...LT Issuer Rating, Affirmed Baa2

... Commercial Paper, Affirmed P-2

...Subordinate Medium-Term Note Program, Affirmed (P)Baa3

...Senior Unsecured Medium-Term Note Program, Affirmed (P)Baa2

...Senior Unsecured Regular Bond/Debenture, Affirmed Baa2

Outlook Actions:

...Outlook, Changed To Negative From Stable

The principal methodology used in these ratings was Global Automotive Supplier Industry published in June 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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