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Bulletin:

French Auto Supplier Valeo's Recent Cut In Profit Guidance Reduces Headroom Under 'BBB' Rating

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PARIS (S&P Global Ratings) Oct. 31, 2018--S&P Global Ratings said today that French auto supplier Valeo S.A. (BBB/Stable/A-2) has limited headroom at the current rating level following the group's revision of its profit guidance for 2018.

On Oct. 26, Valeo released its nine-month sales figures and revised downward its operating profit and cash flow forecasts for the full-year 2018. It now expects a more consistent decline of its operating profit margin to 6.2%-6.5% down from 7.8% in 2017, as opposed to moderate margin contraction against the prior year. Free cash flow guidance was essentially halved to €120 million-€150 million versus earlier expectations of replicating 2017 performance when the group generated €278 million.

Weak retail sales in China, distortions linked to delayed certification of vehicles under the new Worldwide Harmonized Light-Duty Vehicle Test Procedure, factory disruptions, and increasing raw material prices are driving the profitability decline at Valeo.

Under our revised forecast, we see funds from operations (FFO) to debt in 2018 declining to about 30%, or even slightly below, which we deem low for the current ratings. Because we acknowledge the nonrecurring nature of some extraordinary costs and we do not expect to see permanent weakness of the Chinese market, at least at this stage, we expect FFO to debt will recover to about 35% in 2019. At this level, leverage ratios remain in line with the current rating on Valeo, although headroom for operational setbacks and room for significant acquisitions or continued share buybacks is now limited. The reduced headroom could become a concern in a more uncertain industry environment should we see continued deceleration of global economic growth or new trade restrictions as a consequence of a disruptive Brexit.

This report does not constitute a rating action.