Rating Action: Moody's downgrades Valeo to Baa3, from Baa2; outlook stable

22 Mar 2019

Frankfurt am Main, March 22, 2019 -- Moody's Investors Service ("Moody's") has today downgraded the long-term issuer rating and senior unsecured ratings of Valeo S.A. (Valeo) to Baa3, from Baa2. Concurrently, it downgraded the company's commercial paper rating to Prime-3 (P-3) from P-2. The outlook has been changed to stable from negative.

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

"The downgrade of Valeo's ratings is driven by the continued deterioration of the global automotive industry environment, 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 stable outlook reflects the expectation that Valeo will be able to maintain EBITA margins (Moody's adjusted) above 4.5%, and de-lever to below 3.5x debt/EBITDA and 2.5x net debt/EBITDA (Moody's adjusted) within the next 12-18 months; levels which are required for a Baa3 rating." added Mr. Heck.

RATINGS RATIONALE

RATIONALE FOR DOWNGRADE

The downgrade to Baa3 reflects Moody's expectation that Valeo's EBITA margins (Moody's adjusted) will decline towards 4.5% at the end of 2019 (5.1% at December 2018, down from 6.5% in 2017), which is below the level of at least 5.5% required for the previous Baa2 rating. The downgrade also reflects the expectation that the company's financial leverage, measured as debt/EBITDA (Moody's adjusted), will remain at around the level of 3.7x (as of December 2018) also in 2019, which is no longer commensurate with a Baa2.

On 11 March 2019, Moody's changed its global automotive manufacturing outlook to negative from stable. The change was driven by ongoing weakness of global light vehicle sales, which started to decline at the end of 2018, and are expected to weaken further during the first half of 2019. Including a slight recovery in the second half of 2019, Moody's expects global light vehicle sales to grow only marginally by 0.5% in 2019 and 0.8% in 2020. The negative sector outlook also reflects heightened political risks, including the looming possibility of higher US import tariffs and the risk of a no-deal Brexit from the European Union. These factors could also negatively affect automotive suppliers such as Valeo.

As a result of the more challenging market environment, Valeo's EBITA margin (Moody's adjusted) declined to 5.1% in 2018, down from 6.5% in 2017. At the end of 2018, Valeo's adjusted gross leverage increased to 3.7x (Moody's adjusted debt/EBITDA), from 3.2x at the end of 2017. Concurrently, the net leverage increased to 2.4x, from 1.9x.

On February 21, 2019, Valeo announced the roll-out of a new programme to reduce costs by more than EUR100 million and capital expenditure by more than EUR100 million. Assuming also a difficult automotive sector environment in 2019, Valeo expects to continue to outperform the market thanks to EUR800 million additional product launches in 2019 (EUR19.3 billion in 2018), whilst its operating margin (defined by the company) will be in a range of 5.8%-6.5%, compared to 6.3% in 2018. As a result, Moody's expects that Valeo's EBITA margin (Moody's adjusted) will fall towards 4.5% in 2019 before recovering towards at least 5% in 2020.

In 2018, Valeo's free cash flows amounted to minus EUR222 million, after payment of EUR324 million dividends, as per Moody's definition. For 2019, Valeo expects higher free cash flow generation compared to 2018. With the proposed unchanged dividend, however, Moody's expects free cash flows to remain negative also in 2019. Absent of positive free cash flows, Moody's expects for 2019, that Valeo's gross and net leverage to remain at around 2018 levels, before further improved free cash flows and earnings improvements will reduce gross leverage to below 3.5x in 2020.

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 2018; (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 53% of orders in 2018); 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 cyclical nature of automotive production which faces continued headwinds in 2019; (b) exposure to volatile raw material costs; and (c) low profitability, albeit close to the level that is average for the industry, (d) high R&D expenses, (e) slightly elevated leverage.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects the expectation that Valeo will be able to maintain EBITA margins (Moody's adjusted) above 4.5%, and de-lever to below 3.5x debt/EBITDA and 2.5x net debt/EBITDA (Moody's adjusted) within the next 12-18 months. The outlook includes the assumption of a weak first half of 2019, followed by a market recovery and benefits of new model launched in the second half of 2019. The stable outlook also reflects Valeo's commitment to an investment grade rating and actions that could be taken to defend it if needed.

WHAT COULD CHANGE THE RATING UP/DOWN

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.

Negative rating pressure could arise if EBITA margins dropped 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.

LIST OF AFFECTED RATINGS

..Issuer: Valeo S.A.

Downgrades:

.... LT Issuer Rating, Downgraded to Baa3 from Baa2

.... Commercial Paper, Downgraded to P-3 from P-2

....Subordinate Medium-Term Note Program, Downgraded to (P)Ba1 from (P)Baa3

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Baa3 from (P)Baa2

....Senior Unsecured Regular Bond/Debenture, Downgraded to Baa3 from Baa2

Outlook Actions:

....Outlook, Changed To Stable From Negative

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.

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 2018, Valeo generated revenues of €19.3 billion. Valeo has four business divisions: (i) Comfort and Driving Assistance Systems (19% of 2018 group revenues); (ii) Powertrain Systems (26%); (iii) Thermal Systems (26%); and (iv) Visibility Systems (29%). 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.

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