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Research Update:

France-Based Auto Supplier Faurecia S.A. Assigned 'BB+' Long-Term Credit Ratings; Outlook Stable

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France-Based Auto Supplier Faurecia S.A. Assigned 'BB+' Long-Term Credit Ratings; Outlook Stable

Overview

- We are assigning our 'BB+' long-term corporate credit ratings to France-based tier 1 auto supplier Faurecia S.A.
- Faurecia designs, manufactures, and assembles auto components, including seating systems, cockpits, door panels, and emissions control systems.
- The stable outlook reflects our view that Faurecia will gradually improve its profitability, with an S&P Global Ratings-adjusted EBITDA margin widening toward 9% in 2018 and funds from operations to adjusted debt within the 35%-40% range.

Rating Action

On Jan. 31, 2018, S&P Global Ratings assigned its 'BB+' long-term corporate credit rating to France-based auto supplier Faurecia S.A. The outlook is stable.

We also assigned our 'BB+' issue rating to Faurecia's €500 million 3.125% senior unsecured notes due 2022, its €700 million 3.625% senior unsecured notes due 2023, and its €1.2 billion revolving credit facility (RCF) maturing in June 2021. The '3' recovery rating on this debt reflects our expectation of meaningful recovery prospects of 60% in the event of a hypothetical default.

Rationale

Our rating on Faurecia reflects our expectation that the company will sustain its credit metrics at current levels while investing to reposition its portfolio toward higher value-added products and rebalance its geographic mix with increased presence in Asia. These strategic goals should fuel a wider EBITDA margin and stronger free cash flow generation, assuming a continued focus on cost control and accretive acquisitions, barring major changes in the current benign economic environment.

With about €15.6 billion of value-added sales reported in 2016 (excluding catalytic converter monolith sales), Faurecia is a large tier 1 automotive supplier providing major carmakers such as Volkswagen, Ford, Renault-Nissan, Peugeot, BMW, and Daimler with seating systems, interior components, and emissions control systems. Faurecia's top-three customers account for 45% to 50% of total sales, but the company runs about 870 active programs, none of which exceeded 3% of sales.

In 2016, Faurecia derived about €6.6 billion of sales from its seating division, competing with market leaders Adient plc and Lear Corp. Faurecia manufactures and assembles frames and mechanisms for auto seating but also provides complete seating solutions to auto original equipment manufacturers (OEMs). The interiors segment is Faurecia's second-largest segment by revenues, generating €4.8 billion in 2016. Faurecia holds leading market positions, along with Yanfeng Global Automotive Interior Systems Co. Ltd. and ahead of Grupo Antolin Irausa SA. Clean mobility is Faurecia's third division, with €4.2 billion of value-added revenues. Along with Tenneco Inc., Faurecia holds leading market positions in emissions control systems.

The demand for Faurecia's products ultimately relies on numbers of new car sales. The auto market is highly cyclical because consumers' disposable income or their ability to access affordable financing solutions fluctuate with economic cycles. Over the next 12-18 months, we forecast continued growth of global car production levels, albeit at a slower pace than in the past two years, especially in the U.S. and Europe.

We regard Faurecia's EBITDA margin (which we expect to be about 8% in 2017) (as adjusted by S&P Global Ratings, after capitalized research and development [R&D] costs and restructuring costs) to be below average in the sector, which reflects the competitive nature of the auto industry, with carmakers imposing recurring price-downs during the life of programs. It also incorporates the somewhat commoditized nature of Faurecia's products. Lastly, we believe that the EBITDA margin is hampered by the need for further cost optimization, which the company has already started to implement. We forecast that the EBITDA margin will move toward 9% in 2018, supported by revenue growth combined with rationalization of costs (R&D, manufacturing costs, and selling, general, and administrative costs).

Faurecia's concept "cockpit of the future" requires the company to develop new capabilities, such as connectivity, artificial intelligence, and adaptive security. In 2017, Faurecia acquired stakes in Parrot and Jiangxi Coagent, specializing in connectivity and infotainment. We assume that Faurecia will favor bolt-on acquisitions or joint ventures to optimize time and investments in developing such capabilities. We have therefore included in our base case annual spending of €300 million-€350 million for acquisitions.

The ongoing trend of electrification, accompanied by a decline in new diesel cars sales, should be neutral to Faurecia because seating systems and interiors components are indifferent to the powertrain mix. Moreover, the increased scrutiny on emission controls by regulatory bodies (in China, Europe, or the U.S.) should support growth of Faurecia's emissions control systems (retrofit and new cars).

Historically, Faurecia's free cash flow generation has been volatile and weak, but it started to pick up in the last couple of years. The better free cash flow generation resulted from higher EBITDA and from improved cash conversion through greater discipline regarding working capital changes and capital expenditures (capex).

Overall, we expect credit metrics will remain broadly stable in the short term and strengthen to higher levels in the medium term, assuming acquisitions become accretive, capex is maintained at current levels, and dividends remain unchanged, with a payout ratio of about 25%.

In our base case, we assume:
- Real global GDP growth of 3.7% in 2017, and 3.8% annually in 2018 and 2019. We expect real GDP will grow at 1.8% and 1.7%, respectively, in 2018 and 2019 in Western Europe, and at 2.5% in 2018 and 1.9% in 2019 in countries belonging to the North American Free Trade Agreement. In China, we expect GDP growth of 6.5% in 2018 and 6.3% in 2019.
- An increase of 1.9% in global automotive production, on the back of moderate growth in European markets, stable to positive trends in China, and despite some softness in the U.S. This is directionally consistent with our GDP growth assumptions.
- Value-added sales (VAS) growth in 2018 and 2019, supported by a strong order backlog and accretive acquisitions. VAS corresponded to total sales minus monolith sales, under which Faurecia will be considered as an agent under International Financial Reporting Standards (IFRS) 15. Although the company started to report revenue under VAS in 2017, its first audited accounts to report VAS will be in 2018.
- A gradual increase in EBITDA margins based on VAS moving toward 9.0%-9.5% in 2018 and 2019 (versus 8.0%-8.5%, which we expect for 2017) primarily on the back of revenue growth, a freeze in R&D costs, and continued rationalization of the industrial footprint, with higher loading factors and common platforms.
- Modest working capital outflow.
- Stable capex of about €650 million annually, excluding capitalized R&D costs.
- Dividend of €200 million-€250 million per year, in line with the company's guidance of a payout ratio of about 25%.
- Annual acquisition spending of €300 million-€350 million, mostly to access new technologies in connectivity, infotainment, adaptive safety, and well-being, and to expand the company's presence in Asia.

Based on these assumptions, we arrive at the following credit measures for Faurecia in 2017 and 2018:
- Funds from operations (FFO) to debt of 35%-40%, broadly stable compared with the 2016 figure of 39%.
- Debt to EBITDA of 1.5x-2.0x, compared with 1.8x in 2016.
- Free operating cash flow (FOCF) to debt of 15%-20%, compared with around 10% in 2016.

As of Dec. 31, 2016, our adjustments to reported debt included around €352 million for operating leases, €259 million related to the pension deficit, €1.0 billion for off-balance-sheet receivables securitization, and about €1.2 billion of surplus cash (after we deduct about €400 million of cash not readily available).

Liquidity

We assess Faurecia's liquidity as strong. In our projections, we expect that the ratio of liquidity sources to uses will exceed 1.5x for the next two years. We also expect sources of liquidity will exceed uses in the same period, even if forecast EBITDA would unexpectedly decline by 30%.

Principal liquidity sources for the 12 months started July 1, 2017:

- About €1.1 billion of cash on balance sheet on June 30, 2017, excluding cash we consider as not readily available for debt repayment.
- €1.2 billion available under the company's undrawn revolving credit facility maturing in June 2021.
- About €1.5 billion of FFO.

Principal liquidity uses over the same period:

- About €1.1 billion of capex.
- Dividends of €200 million-€250 million.
- Intrayear seasonal working capital of €800 million-€1 billion.

Outlook

The stable outlook reflects our expectation that, over the next 12-18 months, Faurecia will further increase its sales in Asia and more than offset flat growth expectations in Europe and North America. Volume growth, together with the rationalization of its industrial footprint, should lead to a gradual improvement in the company's adjusted EBITDA margin toward 9% and a ratio of FOCF to debt increasing to more than 15%. We also expect FFO to adjusted debt in the 35%-40% range.

Upside scenario

We could upgrade Faurecia if it increased its FFO-to-debt ratio sustainably above 40% and its FOCF-to-debt ratio sustainably above 20%. This could result from the company's successful implementation of its strategy to grow the share of technological content of its product offering while moderating R&D costs and capex. An upgrade would also hinge on management's commitment to maintaining credit metrics at these levels.

Downside scenario

We could lower our rating on Faurecia if it fails to improve its EBITDA margin due to operational setbacks or weaker-than-expected new car sales leading to an FFO-to-debt ratio below 30% and an FOCF-to-debt ratio below 15% for a prolonged period. A more aggressive financial policy, characterized by large debt financed acquisitions or shareholder returns, could also lead to a negative rating action.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Satisfactory
- Country risk: Low risk
- Industry risk: Moderately high risk
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/leverage: Intermediate

Anchor: bbb-

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Negative (-1 notch)

Other Considerations

Peugeot S.A. (PSA) is Faurecia's main shareholder. Although its ownership has decreased in the recent years from above 50% to about 46% currently, PSA still owns the majority of Faurecia's voting rights (currently at 62%).

We recognize the measures taken by PSA and Faurecia to support Faurecia's position as a stand-alone entity, including a board of directors with a majority of independent members, autonomous funding arrangements with no cross-default provisions, and separate financial statements. This results in the rating on Faurecia being at the same level as our assessment of its 'bb+' stand-alone credit profile. The group credit profile on PSA does not currently constrain our rating on Faurecia.

Issue Rating--Recovery Analysis

Key analytical factors

- We have assigned our 'BB+' issue rating with a recovery rating of '3' to Faurecia's senior unsecured notes of €500 million due 2022 and €700 million due 2023, and to its €1.2 billion RCF. Indicative recovery prospects are mainly constrained by factoring liabilities of around €1.2 billion, which we consider as priority liabilities in our payment waterfall. The recovery rating of '3' on this debt reflects our expectation of meaningful (50%-70%, rounded estimate: 60%) recovery

prospects in the event of a hypothetical default.
- In our hypothetical default scenario for Faurecia, a cyclical downturn in the industry, combined with intensified competition, would negatively affect production volumes and prices and would cause the company's operating performance to deteriorate markedly and EBITDA and cash flow generation to decline sharply.
- We value Faurecia as a going concern, given its global industrial footprint and longstanding relationships with auto OEMs.

Simulated default assumptions

- Year of default: 2022
- Jurisdiction: France

Simplified waterfall

- Emergence EBITDA: €578 million (maintenance capex is assumed to be 2% of revenue; cyclical adjustment of 10%, standard for the sector)
- Multiple: 5x
- Gross recovery value: €2,890 mil.
- Net recovery value after administrative expenses (5%): €2,745 mil.
- Priority claims: €1,227 mil.
- Value available for senior unsecured claims: €1,518 mil.
- Senior unsecured claims: €2,468 mil.*
- --Recovery expectations: 50%-70% (rounded estimate: 60%)

*All debt amounts include six months' prepetition interest

Related Criteria

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Auto Suppliers Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

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Faurecia S.A.
 Corporate Credit Rating                 BB+/Stable/--
 Senior Unsecured                        BB+
   Recovery Rating                       3(60%)
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Additional Contact:
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.