MOODY'S
RATINGS

Rating Action: Moody's Ratings downgrades Valeo's ratings to Ba1 from Baa3; outlook negative

26 Sep 2024

Frankfurt am Main, September 26, 2024 -- Moody's Ratings (Moody's) has today downgraded the senior unsecured ratings of French auto parts supplier Valeo S.E. ("Valeo" or "group") to Ba1 from Baa3. Concurrently, we have withdrawn Valeo's long-term issuer rating (previously Baa3) and assigned a Ba1 long term corporate family rating (CFR) and Ba1-PD probability of default rating (PDR) to the group. We also downgraded the rating of Valeo's senior unsecured Medium- Term Note Program to (P)Ba1, from (P)Baa3 and the short-term commercial paper rating to Not Prime (NP) from Prime-3 (P-3). The outlook remains negative.

"The downgrade of Valeo's ratings is driven by a weaker automotive market environment than we had anticipated at the beginning of this year, with lower and more volatile car production and lasting sluggish consumer sentiment", says Goetz Grossmann, Moody's Ratings lead analyst for Valeo. "While we recognize Valeo's continued efforts to improve profitability levels, profitability and credit metrics remain below our requirements for the previous rating category with limited prospects for improvements amid the challenging market environment, as reflected in the negative outlook. The Ba1 rating continues to be supported, however, by Valeo's substantial cash position and very good liquidity, depending on a continued ability to generate positive free cash flows", continues Mr. Grossmann.

RATINGS RATIONALE

The downgrade of Valeo's ratings reflects the recently slowing automotive market environment, illustrated by stagnant global light vehicle production in the first half of 2024 (H1 2024), lackluster consumer sentiment, especially in the battery electric vehicle (BEV) segment, and increased uncertainty as to improving production in the forthcoming quarters. As a result, we believe that Valeo's credit metrics will take longer to recover and are unlikely to reach adequate levels for the Ba1 rating category before 2025. Our revised forecast mainly assumes lower volumes, constraining topline and profit growth in 2024 and 2025. Given our lower earnings projections, we expect Valeo's leverage to remain high for its Ba1 rating over the next 12-18 months.

Assuming no debt repayments in 2024 and 2025, the group's Moody's adjusted gross debt to EBITDA will likely persist around the current level (5.1x for the last 12 months (LTM) ended June 2024) but should reduce towards 3.5x in 2025, a level just in line with our defined 3.0x-3.5x range for a Ba1 rating. That said, we continue to acknowledge Valeo's substantial cash position (€3 billion as of June-end 2024), which supports its liquidity and much lower net leverage.

The downgrade further mirrors Valeo's sustained slim profitability, which has been lagging behind our expectations for several quarters. We expect the group's Moody's adjusted EBITA margin to weaken to 2.2% in 2024 from 2.7% in 2023 (2.3% as of LTM June 2024), driven by increased restructuring costs, production inefficiencies due to erratic order call off and delivery schedules at customers, as well as still-high research and development (R&D) costs. In 2025, we expect Valeo's EBITA margin to visibly improve and to meet our at least 3.5% guidance for a Ba1 rating along the execution of existing orders with better embedded margins, lower restructuring and reduced (capitalized) R&D expenditures. Despite the improving profitability, however, we expect the group's Moody's adjusted free cash flow (FCF) to remain constrained at around break-even in 2025, due to restructuring cash needs, lower working capital reductions and assumed slightly growing dividend payments.

Slowing economic growth, weakened industry conditions and consumer sentiment and an increasingly competitive landscape in China pose significant challenges for the auto supplier industry. As such, we consider that downside risks to our forecasts are currently high.

Credit challenges that continue to constrain the rating relate to Valeo's exposure to the cyclicality of automotive production; low profitability, also when compared with rated industry peers; continued sizeable R&D investments that weigh on profits and cash flows; a significant amount of trade payables utilized under a reverse factoring program available to suppliers, which we qualitatively capture in our leverage assessment for Valeo; and execution risk around ongoing restructuring.

Factors supporting Valeo's rating include the group's positive exposure to current trends in the automotive industry as to electrification, tightening safety standards that fuel demand for advanced driver assistance systems (ADAS), where Valeo holds a leading market position, and the group's high level of innovation. The rating also positively reflects Valeo's substantial size with around €22 billion of group revenue as of LTM June 2024, its good geographical and product diversification; conservative financial policy, focused on reducing the reported net leverage ratio to 1.0x by 2025 (from 1.5x at June-end 2024); and its excellent liquidity.

LIQUIDITY

We regard Valeo's liquidity as very good. As of 30 June 2024, the group had access to around €3 billion of cash and cash equivalents and €1.6 billion available under its revolving credit facility agreements (average maturity of 2.4 years at June-end 2024).

Valeo's short-term debt maturities of around €1.9 billion as of 30 June 2024 consisted mainly of a €600 million senior unsecured bond due in June 2025, €700 million of commercial paper debt, Schuldschein and various other bank debt.

Over the next 12 months, we expect Valeo's funds from operations (FFO) to exceed €2 billion and a continued reduction in working capital that, together, should almost cover capital spending of around €2.5 billion (including capitalized development costs). Other cash uses comprise lease and dividend payments that are included in Moody's adjusted FCF, which we expect to be modestly negative over the next 12-18 months.

ESG CONSIDERATIONS

As to governance considerations, the rating action reflects Valeo's sustained high leverage, which exceeded our expectations for the previous Baa3 rating for several quarters and will continue to constrain Valeo's rating over the next 12-18 months.

RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook reflects Valeo's weak credit metrics at present, also in the context of a recently worsened market environment and very limited visibility into improving business conditions over next year. We, therefore, believe it will be challenging for Valeo to strengthen its EBITA margin to well above 3.5% and reduce its leverage to below 3.5x gross debt/EBITDA by year end 2025.

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

We would consider to downgrade the ratings, if Valeo's (1) EBITA margin remained below 3.5% throughout 2025, (2) leverage continued to exceed 3.5x gross debt/EBITDA, (3) retained cash flow (RCF) to net debt weakened to below 15%, (4) FCF remained negative beyond 2024 – all on a Moody's adjusted and sustainable basis. Moreover, a substantial weakening in Valeo's currently very good liquidity would lead to negative rating pressure.

We might consider an upgrade of Valeo's rating, if its (1) EBITA margin improved to at least 4.5%, (2) leverage was reduced to below 3.0x gross debt/EBITDA, (3) retained cash flow (RCF) to net debt remained well above 20%, (4) FCF turned positive – all on a Moody's adjusted and sustainable basis.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Automotive Suppliers published in May 2021 and available at https://ratings.moodys.com/rmc-documents/72204 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Paris, Valeo S.E. is one of the leading global suppliers of automotive components for new light vehicles (original equipment) and the aftermarket (11% of group revenue in H1 2024). In the 12 months through June 2024, Valeo generated revenue of around €22 billion and reported EBITDA of over €2.7 billion (12.4% margin). Valeo has three business divisions: POWER (powertrain and thermal solutions for all powertrain architectures), accounting for 51% of group revenue in H1 2024, BRAIN (ADAS, electrical/electronic architectures, software; 23%), and LIGHT (exterior and interior lighting and signaling systems; 26%). The group's product range consists of systems for advanced driving assistance (software, sensors, computing units), exterior and interior lighting modules, wiper and sensor cleaning systems, electric machines and power electronics for hybrid and electric vehicles, transmission systems, and temperature management systems (air conditioning, battery thermal management, engine cooling).

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 on https://ratings.moodys.com/rating-definitions .

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At least one ESG consideration was material to the credit rating action(s) announced and described above. Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1355824 .

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Goetz Grossmann, CFA
Vice President - Senior Analyst
Corporate Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Christian Hendker, CFA
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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