



ISSUER RATING

Long-Term

Outlook

Stable



ISSUER RATING

Short-Term

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RATING ACTION AND RATIONALE

- EthiFinance Ratings has reaffirmed Valeo SE's long-term rating at BBB- with a Stable outlook. EthiFinance Ratings has also reaffirmed Valeo's short-term rating of EF2.
- Our ratings are supported by Valeo's competitive position with respect to automotive trends, through a variety of highly technological products (LIDAR, ADAS, and autonomous driving technology). In addition, the group in 2022 took full ownership of the JV with Siemens, Valeo Siemens eAutomotive (VSeA), which is dedicated to high voltage powertrain. VSeA is expected to support growth in revenues, on the back of a strong and expanding orderbook. Valeo's good geographic and client diversification also support the ratings, as the group has a global reach and works with most OEMs through 184 plants across the world. Our ratings also factor in improving credit metrics over the medium term. The EthiFinance Ratings-adjusted net leverage ratio is expected to decrease to 2.3x by 2025 after a peak of 3.1x in 2023 (3.0x at end-2022), owing to the acquisition of VSeA. We assess positively management's reaffirmed commitment to deleveraging the group.
- However, our ratings are constrained by still rather average credit metrics, not entirely commensurate with an investment grade rating. The group was hit hard by the pandemic and the chip shortage, which weighed on credit metrics for FY20, FY21, and FY22. In addition, credit metrics have been affected by the full acquisition of VSeA in 2022, and are expected to remain so in 2023 during the ramp-up of that company.
- In line with our updated methodology, the automobile components industry has medium-to-high ESG risks (heatmap score of between 3.5 and 4) given its impact on the environment. Our assessment of the company's ESG policy is advanced (company ESG score of between 0 and 1), which counts positively for our financial assessment and therefore more than offsets the negative impact resulting from our industry assessment.

ISSUER DESCRIPTION

Valeo is a top-tier French automotive supplier for original equipment manufacturers (c.84% of FY22 revenues) and offers after-market & miscellaneous services (c.16% of FY22 revenues) worldwide. It is renowned for being one of the top-tier innovators and experts in comfort and advanced driving assistance systems (ADAS). Valeo designs, manufactures, and sells auto parts, integrated systems, and modules through its four divisions with the goal of enhancing intuitive, safer, and cleaner mobility (LIDARs, RADARs, EV components).

For FY22, the group exceeded €20bn in total revenues for the first time while reporting EBITDA of €2.4bn, equivalent to a 12% margin (vs 13% in FY21). At end-December 2022, the EthiFinance Ratings-adjusted net leverage ratio was 3.0x and the group had 109,900 employees spread across 183 plants and 65 R&D centres in 29 different countries.

FUNDAMENTALS

BUSINESS RISK PROFILE

INDUSTRY RISK ASSESSMENT

- A market expected to grow while transitioning to EVs after two years of turmoil, despite a continuing risk of volatility**

One of the significant trends in the automotive parts industry is the shift towards electric vehicles (EVs) and hybrid vehicles, which require different types of components and technology from traditional internal combustion engine (ICE) vehicles. Within the scope of tackling climate issues, manufacturers are increasingly aware of the pressure for change being applied by regulators worldwide. In addition, multiple challenges have shaped the pattern of the entire industry since the Covid-19 outbreak, including: (i) the disruptions to global supply chains, then (ii) the electronic components shortage that hit in 2021 and continued in early 2022, and finally (iii) the increase in raw materials prices in 2022 in the aftermath of the onset of the war between Ukraine and Russia. Nevertheless, the industry has recovered. Global light vehicle production is expected to increase by 3.6% in 2023, a trend which we expect to continue in 2024 and 2025, characterized by growing market share for electrics vehicles.

- Rather strong barriers to entry for the automotive components industry**

The auto parts industry is highly competitive. It relies on significant capital investment in specialized equipment and facilities as well as in research and development in order to stay ahead of competitors and meet changing customer needs. From a regulatory standpoint, automotive components manufacturers must comply with a wide range of regulations around product safety, environmental standards, and other factors. Meeting these requirements can be costly and time-consuming, which amount to significant obstacles for potential new entrants.

COMPANY'S COMPETITIVE POSITIONING

- **Valeo's global presence and ambitions in the electrical engine market**

With operations in over 29 countries, Valeo has a significant global presence and a solid foothold in several of the world's most important automotive markets. The EMEA region accounted for c. 45% of FY22 revenues, followed by Asia Pacific (33%), and North America (19%). In terms of activities, Valeo also has exposure to long-term disruptive trends affecting the auto industry, such as the electrification of the powertrain, the shift towards hybrid and fully electric vehicles, and advances in autonomous driving. This allows it to better understand the needs and preferences of different markets and to tailor its products and solutions accordingly, giving it a competitive edge over its rivals. The recent integration of VSeA is actually a perfect example of Valeo's aspirations to exploit the increasing demand for car electrification and connectivity components.

- **Significant investments in R&D**

Valeo invests heavily in R&D, with over 20,000 engineers and around 33k patents within its portfolio (the company is the leading French patent applicant). These investments reflect Valeo's ongoing aspiration to develop a wide range of innovative technology that improves vehicle performance, safety, and efficiency. In this regard, the company benefits financially from a tax credit received from the French state and competitive financing for its R&D expenditures from the European Investment Bank (EIB). However, these significant R&D investments weigh on its EBIT margin, which is lower than most of its peers.

- **Sustainability commitment**

The company is dedicated to reducing its environmental impact by developing eco-friendly technology and processes. It hopes to achieve carbon neutrality by 2050. Valeo's efforts in 2022 to cut emissions (Scope 1,2 & 3) and enhance governance policies have resulted in an improvement in our ESG score for the company. Should Valeo meet its sustainability goals for the foreseeable future, it will be better positioned to address the changing needs of customers who are becoming more environmentally-sensitive.

GOVERNANCE

- **Management has a satisfactory track record despite the Covid turmoil, and a stable ownership structure characterized by the participation of the French state**

Despite several challenges encountered during 2022 - such as high inflation (French CPI at 5.9% yoy at YE22), the shortage of electronic components and the consequences of the lockdown in China and the war in Ukraine, management achieved its guidance, mainly through highly profitable order intake. It has also set ambitions in the field of electrification as reflected by the acquisition of the remaining stake in VSeA. From a governance standpoint, the presence of the French state as a stable shareholder through BPI france (c.5.2%) and the reorganisation in early 2022 - with a separation of the CEO and chairman positions - are two positive aspects.

FINANCIAL RISK PROFILE

CASHFLOW AND LEVERAGE

- **A rather high adjusted net leverage ratio, which is expected to improve gradually alongside FCF by 2025**

As of 31 December 2022, the EthiFinance Ratings-adjusted net leverage ratio was 3.0x (2.9x at YE21), which is at the high end of the range for an investment grade company. The acquisition of the remaining stake in the JV with Siemens resulted in a net cash outflow of €350m. Combined with the consolidation of VseA's net debt and a reduction in financial assets for €354m, this led to an increase of around €900m in reported net debt at end-2022. The increase in our net adjusted leverage ratio (that excludes financial assets) was limited by the decrease in pension obligations (-€268m), owing to the increase in interest rates in 2022. EthiFinance Ratings-adjusted FCF is expected to improve significantly from 2024 onwards, on the back of a strong order book (expected but not guaranteed sales) from the newly-acquired company and favourable EBITDA margins expected for the Powertrain Systems division post-acquisition.

In the meantime, we expect another tough year in terms of financial performance in 2023 (EBITDA margin, FCF) as the group will digest its recent acquisition in the context of high inflation and depressed economic activity. This will result in contrasting developments in credit metrics, with some slightly improving (such as the FFO/NFD ratio) and some slightly deteriorating (The interest coverage ratio and the adjusted net leverage ratio). Indeed, the interest coverage ratio has decreased from 13.8x in FY21 to 9.2x in FY22 due to (i) significantly higher gross debt (€7.4 bn in FY22 from €5.9bn in FY21); and (ii) a higher cost of financing in both variable and fixed rates (EURIBOR 6 months was at 2.72% at end-2022 and is expected to rise further in 2023).

SOLVENCY AND LIQUIDITY PROFILE

• An Average solvency profile

As of YE22, Valeo's gross debt stood at €7.3bn, mostly made up of €3.8bn of bonds (EMTN programs), €1.1bn of NEU CP debt, €0.9bn of Schuldschein debt, and €0.6bn of lease debt. The group also had €1.8bn of undrawn committed credit lines with an average maturity of 3 years. The EthiFinance adjusted equity/debt ratio is expected to decrease to 53.7% for 2023 - which is lower than most of its peers in the auto components industry - before recovering to c.75% by 2025.

• A Superior liquidity assessment

We assess the company's liquidity profile as "Superior" since Valeo can pay off all of its forthcoming debt maturities without receiving new funding for more than two years. The company can also secure financing rather easily given its financial profile. Yet, its currently robust liquidity is susceptible to significant fluctuations in cash flow, which could force Valeo to seek financing in unfavourable debt markets.

CREDIT METRICS EXPECTED EVOLUTION (CMEE)

• CMEE : Stable

We have a Stable CMEE as we expect contrasting developments in credit metrics in the next twelve months, on the back of the integration of VSeA as well as adverse market conditions (inflation, higher interest rates).

MAIN FINANCIAL FIGURES AND FORECASTS

Main financial figures. €m.						
	2021	2022	2023E	2024E	2025E	22vs21
Turnover	17,262	20,037	22,041	24,024	25,946	13.8%
EBITDA (Adjusted)*	1,722	1,744	1,767	2,046	2,261	1.3%
EBITDA Margin	10.0%	8.7%	8.0%	8.5%	8.7%	-1.3pp
EBIT	650	543	500	665	770	-19.7%
EBIT Margin	3.8%	2.7%	2.3%	2.8%	3.0%	-1.1pp
Interest expenses	(125)	(189)	(250)	(249)	(241)	33.9%
EBT (Adjusted)	525	354	250	416	528	-48.3%
Total Assets	18,835	22,029	21,999	21,960	22,121	14.5%
Equity (Adjusted)	4,491	4,612	4,674	4,849	5,082	2.6%
Total Financial Debt (Adjusted)**	7,347	8,581	8,187	7,448	6,889	14.4%
Net Financial Debt	4,932	5,252	5,449	5,238	5,104	6.1%
Equity/TFD	61.1%	53.7%	57.1%	65.1%	73.8%	-7.4pp
NFD/EBITDA	2.9x	3.0x	3.1x	2.6x	2.3x	0.1x
Funds From Operations	1,889	1,518	2,139	2,451	2,700	-24.4%
FFO/NFD	38.3%	28.9%	39.2%	46.8%	52.9%	-9.4pp
EBITDA/Interest	13.8x	9.2x	7.1x	8.2x	9.4x	-4.5x

Adjusted EBITDA is adjusted for capitalized R&D

Total adjusted debt is mainly adjusted for factoring and pensions obligations

RATING SNAPSHOT

CREDIT RATING	
Business Risk Profile	BBB-
<i>Industry Risk Assessment</i>	<i>BB</i>
<i>Competitive Positioning</i>	<i>BBB</i>
<i>Governance</i>	<i>BBB</i>
Industry' ESG	Negative
Financial Risk Profile	BBB
<i>Cash flow and leverage</i>	<i>BBB</i>
<i>Solvency</i>	<i>BB</i>
Company's ESG	Positive
Anchor Rating	BBB-
<i>Modifiers</i>	-
Final Rating	BBB-

RATING SENSITIVITY

- **List of ratings:**
 - **LT corporate rating:** BBB-
 - **ST corporate rating:** EF2

- **Positive factors which could influence the ratings (↑)**

A long-term rating upgrade could occur in the near future should Valeo's profitability, credit metrics and financial policy improve on a sustainable basis. Such an upgrade may derive from EthiFinance Ratings-adjusted net leverage ratio dropping below 2.0x over time as a result of a continuous deleveraging strategy, along with an equity/TFD ratio over 80%.

A short-term rating upgrade would derive from an upgrade in the long-term rating along with a Stable or Positive CMEE.

- **Negative factors which could influence the ratings (↓)**

Should the EBITDA margin decline as a result of unfavourable market conditions, resulting in a deterioration of credit metrics, notably an EthiFinance Ratings-adjusted net leverage ratio above 3.5x on a sustainable basis, we may opt to downgrade our long-term rating. A downgrade could also result from a more aggressive financial policy such as debt-funded M&A or a considerably higher pay-out ratio.

A downgrade of our short-term rating would derive from a downgrade of the LT rating combined with a deterioration of the liquidity assessment from 'Superior' to 'Adequate', and/or a change to a Negative CMEE.

REGULATORY INFORMATION

17/04/2023

LEI: 5493006IH2N2WMIBB742

Initiation report: No

Rating initiation: 29 November 2022 at BBB- for the long-term rating and EF2 for the short-term rating

Last rating action: Initiated at BBB- and EF2 on November 29, 2022

Rating nature: Unsolicited long-term and short-term corporate ratings (this report is paid for by investors, not the issuer)

With rated entity or related third-party participation: Yes- The report was published after having been reviewed by the issuer.

With access to internal documents: No

With access to management: No

Ancillary services with the rated entity: No

Name of the rating committee chair: Marc Pierron, Senior Director

Material sources used to support the rating decision:

- Annual reports 2019, 2020, 2021, 2022
- Half-year reports 2021, 2022
- Investor presentations and press releases 1H21, FY21, 1H22, FY22

Limitation of the Rating action:

- EthiFinance Ratings believes that the quality and quantity of information available on the rated entity is sufficient to provide a rating
- EthiFinance Ratings has no obligation to audit the data provided

Principal methodologies used for these ratings:

https://files.EthiFinance.com/documents/methodologies/CRA_190_V3.CorporateRatingMethodology_Long_Term.pdf

https://files.EthiFinance.com/documents/methodologies/CRA_191.Corporate_Rating_Methodology_Short_Term.pdf

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