

Research Update:

# lochpe-Maxion S.A. And Its Proposed Senior Unsecured Notes Rated 'BB-' (Recovery Rating: 3); Outlook Negative

April 22, 2021

## Rating Action Overview

- We expect Brazil-based auto supplier lochpe-Maxion S.A.'s (lochpe or lochpe-Maxion) operations to continue rebounding globally in 2021 after a significant hit last year due to the pandemic. We forecast lochpe's revenues to grow about 20% in 2021, reflecting demand recovery in North America, advanced vaccination programs, and favorable momentum for commercial vehicles in all regions where the company operates.
- However, the negative outlook on the company still reflects the uncertainties about the auto industry's recovery given the effects of the COVID-19 pandemic, global economic downturn, and disruptions in the industry's supply chain that could delay the rise in the company's cash generation and pressure credit metrics.
- On April 22, 2021, S&P Global Ratings assigned its 'BB-' global scale issuer credit rating on lochpe. We also assigned our 'BB-' issue-level rating to the company's seven-year senior unsecured notes to be jointly issued by lochpe-Maxion Austria GmbH and Maxion Wheels de Mexico, S. de R.L. de C.V. lochpe guarantees the proposed issuance. We also assigned our '3' recovery rating to the proposed notes, which indicates a substantial recovery (65%) in the event of default.
- In addition, we affirmed our 'brAA+' national scale issuer and issue-level ratings on lochpe. The '4' recovery rating on the senior unsecured debentures remains unchanged.

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## Rating Action Rationale

**The ratings reflect lochpe's leading position in the global steel wheel market.** The ratings also reflect the company's significant position the global aluminum wheels and structuring components markets that supports its commercial relationships with the main original equipment manufacturers (OEMs) and its high bargaining power with suppliers. The company operates in a highly competitive industry marked by cyclical demand, capital intensity, and pricing pressures. In

this sense, we believe that lochpe is well positioned geographically, with plants in 14 countries, providing a strategic advantage to better serve customers and to maintain close relationships with suppliers. However, the company still faces the risks inherent in the auto parts industry that in addition to the abovementioned factors, also features commodity-like products and constant negotiations with OEMs and suppliers. In addition, lochpe's product concentration--wheels represented about 80% of product sales in 2020--limits the rating.

**The shortage of semiconductors in the industry is disrupting the global auto production and may slow down lochpe's recovery.** Given the sharp decrease in auto sales and production during the first and second quarters of 2020 because of lockdowns to contain the spread of COVID-19, automakers slashed orders of semiconductors. In response, semiconductor chip makers shifted production to meet other surging orders of technology products such as smartphones, laptops, and tablets. The auto industry now faces a supply imbalance caused by a shortage of semiconductors while industry players have resumed production to deal with pent-up demand. Many automakers have recently stopped production in all regions, and we believe the shortage will affect the entire supply chain while lochpe will possibly have to stop production as well. Therefore, lochpe's cash generation would be delayed and profitability would weaken in the next few quarters.

**Debt refinancing will enable lochpe to focus on demand recovery.** The company raised R\$865 million in new credit lines from Banco Nacional de Desenvolvimento Econômico e Social (BNDES; BB-/Stable/--) and R\$75 million from Banco de Desenvolvimento de Minas Gerais (BDMG; B/Stable/--) in the first quarter of 2021. It's now seeking an international bond issuance of at least \$300 million to refinance upcoming maturities. We believe this amount will provide some liquidity cushion for lochpe so that it can continue focusing in resuming operations and cash generation in 2021-2022. We believe that industry headwinds could delay recovery, but the situation may normalize during the second or third quarters of 2021. We consider that pent-up demand could be high in the second half of this year as vaccination programs advance worldwide.

**Sales of commercial vehicles to remain stronger than light vehicles, which rely more on consumer confidence and better economic prospects.** lochpe has geographically diversified operations. As of December 2020, revenue breakdown by region was as follows: Europe (39.3%), North America (29.7%), South America (22.1%), and Asia and others (8.9%). Given its global footprint, the company has experienced diverging effects from the pandemic on its operations, and the same will occur in its recovery. Since June 2020, the auto industry has been gradually recovering, given strong demand in Europe, South America, and North America for commercial vehicles. Despite a significant demand for new vehicles in South America, we believe that the region may take relatively longer to recover, given our forecast of its weak economy, limited support to the industry from regional governments, and lower pace of vaccination.

**Free operating cash flow (FOCF) will remain pressured due to foreign exchange (FX) rates and working capital.** We view the auto industry as capital intensive, and lochpe has been investing to keep its operations efficient and to expand production. In 2020, the company delayed some projects and focused on health and safety measures for its employees. Therefore, we believe the company will shift its investments to increase operating efficiency in 2021. It recently announced the closure of its U.S. plant in Akron, Ohio to adjust to idle capacity. We forecast capital expenditures (capex) and high working capital needs to pressure FOCF in 2021. We also expect lochpe's cash flows to improve gradually in the next few years and to return to historical levels by 2022. We forecast FOCF to debt of about 0.5% in 2021 and 5%-10% in 2022.

## Outlook

The negative outlook on lochpe incorporates the auto industry's supply shortage of semiconductors, which is mostly affecting the light vehicles segment, to which lochpe has higher exposure (about 65% of revenues in 2020). In our opinion, the stoppage of several carmakers' plants will affect the entire supply chain and could delay lochpe's cash flows from improving in 2021. Still, we forecast lochpe to resume generating cash in the next few quarters because of pent-up demand in all regions, but especially in North America with the rapid pace of vaccination and the company's cost-cutting initiatives. We forecast lochpe's debt to EBITDA close to 4x and FOCF to debt of about 0.5x in 2021.

## Downside scenario

We could lower the ratings in the next 6-12 months if the company's cash flows and leverage don't adhere to our base-case expectations. In this scenario, we would see debt to EBITDA consistently above 5x and a shortfall in FOCF. We could also lower the ratings if lochpe fails to refinance the upcoming short-term debt, weakening its liquidity.

## Upside scenario

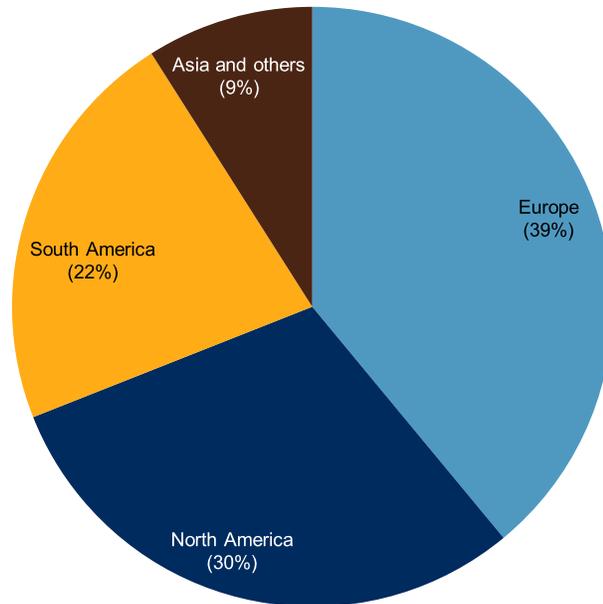
We could revise the outlook to stable in the next 6-12 months if the industry's supply shortage of chips diminishes and demand improves, while lochpe's debt to EBITDA falls below 4x by 2021. In addition, the company would maintain adequate liquidity cushion through refinancing of upcoming debt maturities.

## Company Description

Founded in 1918, lochpe is a global manufacturer of steel wheels for light and commercial vehicles, and agricultural machinery. It also manufactures aluminum wheels for light vehicles and produces side rails, cross members, and full frames for commercial vehicles and structural components for light vehicles. lochpe currently has 32 manufacturing facilities across 14 countries. The company operates its core business through Maxion Wheels and Maxion Structural Components in the auto segment and through AmstedMaxion producing railway equipment in Brazil and internationally.

lochpe's main shareholders are the founder's family, loschpe, with 14.7% of total shares, followed by Alaska Investimentos Ltda. (13.3%; not rated), Fundo de Investimento em Ações WPA EST IE (10.1%; not rated), [Compass Group Diversified Holdings LLC; B+/Stable/-- ] (6.3%), and the remaining are free float.

### Iochpe's Revenue Breakdown By Country



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### Our Base-Case Scenario

- Average exchange rate of about R\$5.50 per \$1 in 2021-2023.
- Brazil's inflation rate of 5.3% in 2021, 4.0% in 2022, and 3.3% in 2023.
- Brazil's GDP growth of 3.4% in 2021 and 2.5% in 2022-2023.
- Brazil's basic interest rate of 3.4% in 2021, 4.8% in 2022, and 5.5% in 2023.
- North America's inflation of 2.7% in 2021 and 2.2% in 2022-2023.
- North America's GDP growth of 6.3% in 2021, 3.0% in 2022, and 2.0% in 2023.
- EU's inflation of 2.7% in 2021 and 2.2% in 2022-2023.
- EU's GDP growth of 4.0%-4.5% in 2021-2022 and 2.3% in 2023.
- Asia-Pacific's inflation of 2.0% in 2020-2023.
- Asia-Pacific's GDP growth of 6.7% in 2021 and 4.7%-5.0% in 2022-2023.
- Net revenue of about R\$10.7 billion in 2021, R\$11.5 billion in 2022, and R\$12.2 billion in 2023.
- Volumes to recover this year due to pent-up demand for passenger cars and continued strong demand for commercial vehicles in all regions of the company's operations. We believe Brazil

will take longer to recover than EU and the U.S. because of the government's limited fiscal support to the auto industry. Also, our forecast incorporates a faster recovery in commercial vehicles given an aging global fleet serving the e-commerce shipping, construction, and agriculture segments during the pandemic.

- Recovery in light vehicles, which depend more on consumer spending, will take longer to return to pre-pandemic levels. In addition, we expect a recovery in India and capacity expansion in Thailand to support the company's volume in Asia in the next few years.
- Gradual EBITDA margin recovery starting in 2021 due to cost-cutting initiatives such as layoffs and the Akron plant closure, even amid higher production costs from higher demand.
- Capex of about R\$360 million in 2021, R\$420 million in 2022, and R\$490 million in 2023 for expanding capacity at the plant in Thailand and technology projects to make operations more efficient and develop new products.
- Dividend payout at 37% of previous year's net income, and R\$90 million – R\$100 million annually to minority shareholders of Turkish and Indian operations.
- Debt refinancing in the next two years.

### lochpe-Maxion S.A. -- Key Metrics\*

	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021e	2022f	2023f
EBITDA margin (%)	10.4	4.7	9-10	9.5-10.5	10.5-11.5
Debt to EBITDA (x)	2.7	9.6	3.5-4.5	3.0-4.0	2.5-3.5
FFO to debt (%)	25.9	3.9	10-20	15-25	20-30
FOCF to debt (%)	6.1	-5.6	0-5	5-10	5-10
EBITDA interest coverage (x)	6	2	3.0-4.0	3.5-4.5	4.0-5.0

\*All figures adjusted by S&P Global Ratings. Debt is adjusted by postretirement benefit obligation. a--Actual. e--Estimate. f--Forecast.

### Liquidity

lochpe's liquidity is adequate, in our view. We expect sources of cash to exceed uses by more than 1.2x for the next 12 months, and sources minus uses to remain positive even if EBITDA were to decline by 15% from our forecast. We believe lochpe has well-established and solid relationships with banks, but hasn't demonstrated prudent financial risk management given high short-term debt in the past two years. Given the recent credit line from BNDES and BDMG and the proposed bond issuance, we expect smooth debt amortization in 2021 and 2022.

Principal liquidity sources:

- Cash position of R\$1.6 billion as of Dec. 31, 2020;
- Funds from operations (FFO) of about R\$665 million in 2021; and
- New credit line of about R\$865 million from BNDES and R\$75 million from BDMG available for disbursement for 24 months.

Principal liquidity uses:

- Short-term debt of R\$1.9 billion as of Dec. 31, 2020;
- Working capital needs of about R\$290 million in 2021; and
- Capex of R\$360 million in 2021.

## **Covenants**

lochpe recently obtained a waiver on its financial covenant of net debt to EBITDA of below 3.5x for the next two measuring periods in 2021. The company will pay a fee of about R\$20 million and the covenant will require net debt to EBITDA to be below 5.25x in June and 4.75x in December. In addition, during the waiver period, lochpe will have to comply with a covenant of accessible cash over short-term debt of more than 0.5x. As of Dec. 31, 2020, the ratio was 0.84x, which we expect to improve as soon as the company refinances its short-term debt.

## **Issue Ratings - Recovery Analysis**

The '4' recovery rating on lochpe's senior unsecured debentures remains unchanged, with a recovery expectation of 30%. In addition, we assigned the '3' recovery rating, with recovery expectation of 65%, to the company's proposed senior unsecured notes to be jointly issued by lochpe-Maxion Austria and Maxion Wheels de Mexico, because this debt would rank superior in the event of default versus the debt at the parent's level.

## **Key analytical factors**

- We assess recovery prospects using a simulated default scenario, with an EBITDA multiple valuation approach.
- Our simulated default scenario assumes a payment default in 2025 because of a severe global economic slowdown, sharply lower consumer discretionary income, and higher competition in the markets where lochpe operates, all of which would reduce its cash flows.
- We analyze recovery prospects under a going concern basis and use a 5x multiple to our projected emergence EBITDA, because we believe the company would likely be restructured instead of being liquidated in the event of default, given its strong position among auto suppliers and its solid operations that should generate consistent cash flows.
- In such a scenario, we estimate that EBITDA would decline 30% from our forecast 2021 EBITDA of about R\$1 billion and wouldn't sufficiently cover the company's maintenance capex and interest expenses, triggering a payment default.

## **Simulated default assumptions**

- Simulated year of default: 2025
- Emergence EBITDA: R\$730 million
- EBITDA multiple: 5x
- Estimated gross enterprise value (EV): R\$3.6 billion

## Simplified waterfall

- Consolidated net EV after 5% administrative costs: R\$3.5 billion
- Net EV of its subsidiaries (approximately 75% of EBITDA): R\$2.6 billion
- Unsecured debt of the subsidiaries: R\$2.7 billion (bank loans and the proposed senior notes)
- Net EV of lochpe-Maxion (the parent company; approximately 25% of EBITDA): R\$864 million
- Unsecured debt: R\$2.5 billion (bank loans and debentures at the level of the parent, and the remaining portion of R\$100 million from its subsidiaries that were not covered by its designated EV)

\*All debt amounts include six months of prepetition interest.

## Ratings Score Snapshot

Issuer Credit Rating:

Global scale: BB-/Negative/--

National scale: brAA+/Negative/--

Business risk: Fair

- Country risk: Intermediate risk
- Industry risk: Moderately high risk
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb-

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- 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
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### New Ratings

#### lochpe-Maxion S.A.

Issuer Credit Rating	BB-/Negative/--
lochpe-Maxion Austria GmbH	
Senior Unsecured	BB-
Recovery Rating	3(65%)

### Ratings Affirmed

#### lochpe-Maxion S.A.

Issuer Credit Rating	
Brazil National Scale	brAA+/Negative/--

#### lochpe-Maxion S.A.

Senior Unsecured	brAA+
Recovery Rating	4(30%)

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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