FitchRatings

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Fitch Assigns 'BB-' First Time Rating to Iochpe-Maxion; Outlook Stable

Fitch Ratings - Chicago - 22 Apr 2021: Fitch Ratings has assigned first time Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) of 'BB-' to Iochpe-Maxion S.A. (Iochpe) and to its proposed benchmark sized unsecured notes to be issued by Iochpe's wholly owned subsidiaries Iochpe-Maxion Austria GmbH and Maxion Wheels de Mexico, S. de R.L. de C.V. The notes will be unconditionally and irrevocably guaranteed by Iochpe. Proceeds will be used primarily to refinance existing debt at the issuer level or their subsidiaries and general corporate purposes. In addition, Fitch has assigned Iochpe a National Scale Rating of 'A+(bra)'. The Rating Outlook is Stable.

The ratings reflect Iochpe's customer and regional diversification as a large global wheels producer and as an important producer of side rails and commercial vehicle frames in the Americas as well as the competitive nature of the wheels industry. They also reflect Iocphe's more volatile cash flow profile and expectations of net debt/EBITDA declining to the 2.5x range over the next two-three years mainly through recovering EBITDA and positive FCF generation.

Key Rating Drivers

Global Presence: Iochpe is exposed to the markets of Europe, North America, South America and to lesser extent Asia. Consolidated revenue in 2020 was generated in Europe 39%, North America 30%, South America (mostly Brazil) 22%, and 9% from other markets, mainly India, Thailand and South Africa. The company has important manufacturing presence in low-cost countries such as Mexico and Turkey, which serve the large markets of the U.S. and Europe, as well as Brazil where vehicle production has become more domestically focused. Iochpe is gradually expanding its wheel manufacturing capacity in India and expects to benefit from long-term growth in this market while seeking to gain new business in its more established markets.

Large Wheels Producer: Iochpe is the world's largest wheel manufacturer in unit volumes. The company is the leading global supplier of steel wheels for light and commercial vehicles and one of the top 10 suppliers of aluminum wheels. It operates in 14 countries through 32 factories which allows it operational flexibility to compete for business in multiple regions. Iochpe estimates its global market share of steel wheels at 16.8% in light vehicles and 15.0% in commercial vehicles. In aluminum wheels the company estimates its market share at 3.4%. The company is also a leading supplier of side rails in North America and South America and of chassis in South America.

Competitive Industry: Competition in the wheels industry is intense. The company's competitors have varying degrees of specialization and end-market or geographic diversification, including a limited number of competitors with more established brand names and greater financial resources. Price is an important consideration for OEMs, and wheels imports into Europe or U.S. have at times increased as a result of global overcapacity.

Weak Operating Performance: Iochpe's operating EBITDA declined to USD104 million in 2020 from USD266 million in 2019 driven by the decline in global vehicle sales. Fitch is projecting Iochpe's EBITDA to rise to around USD200 million (BRL1.1 billion) in 2021 and USD230 million in 2022 given prospects for global vehicle production recovering and cost reductions implemented in 2020.

FCF Positive Over Next 2-3 Years: Fitch forecasts positive FCF in 2021-2022 of around USD50 million as cash flow generation recovers while dividends and to lesser extent capex are scaled back. No dividend payments are expected to occur in 2021 due to the net income loss that occurred the prior year. For 2022 and beyond, our rating case incorporates dividend payment assumptions within a range of 35%-40% of the prior year net income.

Leverage Should Trend Down: Iochpe's net debt to EBITDA leverage spiked to 7.0x in 2020 from 2.5x in 2019. We forecast this ratio to decline to 3.2x in 2021 and to 2.8x in 2022 as global vehicle production gradually recovers to normalized levels. The company's expansion of its India aluminum wheel plant, which is ramping up, should also contribute to EBITDA recovery to a lesser extent.

FCF Affected During Pandemic: Iochpe consumed USD72 million of cash in 2020 or 0.4x projected 2021 EBITDA. Consolidated revenue declined 33% in U.S. dollars last year as global light vehicle sales declined more than 15%. Total vehicle production in Brazil, where the company generated 27% of its sales in 2019 declined 32% in 2020. A depreciation of the Brazilian real by more than 20% also contributed to weak results in this country. In North America and Europe production was down slightly more than 20% during the year. These regions represented approximately 69% of revenues in 2020 compared with 64% in 2019.

Derivation Summary

Iochpe's ratings compare with capital goods supplier Meritor's (BB-/Stable) whose product lines are focused primarily on driveline components and brakes for commercial vehicles, off-highway equipment and trailers. Meritor's commercial truck drivetrain systems are more complex relative to wheels. Meritor revenues and EBITDA are about 50% larger than Iochpe's. Similar to Iochpe, Meritor generally retains a top-three market position in most of its product segments.

Both entities face heavy competition in their main products. Iochpe's exposure to commercial vehicles is around 40% while Meritor's cash flow profile is more concentrated in commercial vehicles, and sales to this end market are more volatile than the light vehicle market. Fitch estimates roughly a quarter of Meritor's sales comes from the aftermarket, which is more stable. This compares with Iochpe's exposure to aftermarket sales at less than 5% of consolidated revenue.

From a geography standpoint Iochpe is more diversified with Europe being its largest revenue contributor at around to 40% followed by North America at roughly 30%. This compares with Meritor's exposure to North America at around 65% and Europe at around 20%. However, Iochpe's approximate exposure of 20% to South America, which mainly comprises Brazil, has been more volatile. Meritor's gross leverage, expected over the next two years in the 3x-4x range, is similar to Iochpe.

Tupy's (BB/Stable) stronger credit profile reflects its portfolio of products with high-value added structural components, such as iron casted cylinder heads and engine blocks. The cylinder head and engine block industry is more concentrated than the wheels industry. Tupy's ratings also reflect its track record of disciplined liquidity management with ample cash coverage as well as its very conservative financial policies with net adjusted leverage historically maintained at around 1.5x despite industry cyclicality. Tupy generates 90% of its revenues from commercial vehicles and off-road, mainly in the external market, with 67% of revenues from North America, 17% from Brazil and 16% Europe/RoW.

Key Assumptions

--Consolidated volumes recover at approximately 15% pace in 2021 and climb at a low-mid single digit pace in 2022 and 2023;

--EBITDA of around BRL1.0 billion in 2021; BRL1.1 billion in 2022 and BRL1.3 billion in 2023;

--Capex averages approximately BRL450 million per year;

--Dividends between 35%-40% of prior year net income;

--BRL:USD of approximately 5.3 in 2021 and 5.0 in 2022;

--Short-term maturities decline as they are refinanced or paid with cash.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Operational improvements that enables Iochpe to reach net leverage solidly below 2.0x, sustainably;

--New business gains that lead to meaningful expectations of stronger cash flow generation across the cycle;

--A record of positive FCF generation;

--FFO net leverage below 2.5x

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Deterioration of EBITDA margins, leading to expectations of net leverage consistently above 3.0x;

--Weakening Liquidity measured by the cash to short-term debt ratio persistently below 1x;

--Material acquisitions that impair the company's deleveraging process.

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Liquidity and Debt Structure

Improving Liquidity: Iochpe's liquidity is adequate supported by cash and access to funding. Cash balance as of year-end 2020 was BRL1.6 billion compared with one-year maturities of BRL 1.9 billion. The company received seven-year loans from Brazilian development banks in February 2021 for a combined total amount of BRL940 million. The company expects to use the proceeds to refinance short-term debt maturing mostly during 1H21. The international notes issuance would be used to refinance near-term debt maturities.

Iochpe's cash to short-term debt ratio was improving prior to the pandemic, reaching 1x in 2019 compared with 0.5x in 2018 this ratio was at 0.8x as of YE20 and should improve pro forma with the bank debt raised in February, which does not require amortizations for the first three years as well as with the proceeds of the notes issuance.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Iochpe-Maxion Austria GmbH					
• senior unsecured	LT	BB-	New Rating		
Iochpe-Maxion S.A.	LT IDR	BB-	New Rating		
	LC LT IDR	BB-	New Rating		

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Natl LT	A+(bra)	New Rating		
Maxion Wheels de Mexico, S. de R.L. de C.V.					
• senior unsecured	LT	BB-	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊡	

Applicable Criteria

Corporate Rating Criteria (pub.21 Dec 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub.22 Dec 2020)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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