S&P Global Ratings

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Research Update:

Iochpe-Maxion S.A. Upgraded To 'BB' On Expected Lower Leverage And Solid Free Cash Flow; Outlook Stable

March 4, 2024

Rating Action Overview

- With the rebound of the trucks market in 2024 and the consistent demand for light vehicles in Brazil with easing interest rates and greater credit availability, we expect Iochpe-Maxion S.A. will post solid net revenue growth and EBITDA generation this year.
- With that, we expect profitability improvements with EBITDA margin above 10% and leverage reduction with debt to EBITDA between 2.0x-2.5x in the next two years. Moreover, we believe Iochpe will continue with solid free operating cash flow (FOCF) allowing for some debt reduction in the coming years and FOCF to debt between 20%-25% in the next two years.
- On March 4, 2024, S&P Global Ratings raised its global scale issuer credit rating on Iochpe-Maxion S.A. to 'BB' from 'BB-' and the national scale rating to 'brAAA' from 'brAA+'. We also raised our issue-level ratings on the company's senior unsecured notes to 'BB' from 'BB-' and on the senior unsecured debentures to 'brAAA' from 'brAA+'.
- The stable outlook reflects our expectation of continued solid cash flows, low leverage, and comfortable liquidity in the next few years.

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Rating Action Rationale

The upgrade reflects our view that Iochpe will benefit from the rebound of trucks production and sales domestically, supporting higher revenues and cash generation in 2024. The Brazilian national association for automakers (ANFAVEA) forecasts the production of heavy vehicles in Brazil will expand around 30% and sales will increase about 14% in 2024, compared with 2023, mostly driven by stronger trucks volumes.

In our view, the better trucks market post technology shift supported by the solid agricultural prospects and logistics demand, along with steady production and sales of light vehicles, will support stronger results in the Brazilian operations. We expect an annual increase in revenues of 6%-6.5%% compared with 2023.

We expect the improvements of the domestic operations to balance the somewhat uncertain automotive markets abroad due to the still-elevated interest rates in North America and Europe, and credit constraints. Such markets should present revenue growth of about 2% in 2024 versus 2023 mostly from inventory restocking after good sales volumes last year and from the backlog of electrical and hybrid vehicles with more developed regulations toward lower carbon emissions.

EBITDA margin will gradually return to historical levels above 10% in the coming years. We expect margins to gradually improve over 2024, reaching 10% versus about 8.3% in 2023, from higher volumes and lower inflation in Brazil compensating the relatively stable prices.

Pressured profitability in 2023 was caused by lower volumes, specifically of commercial vehicles in Brazil, and weaker prices globally because of a reduction in raw material costs directly affecting sales price.

Additionally, we believe Iochpe will continue working on advanced engineering, digitalization, and innovation, enabling stronger operating efficiencies.

We expect lower leverage with debt to EBITDA around 2.5x in 2024 and 2.0x in 2025. We forecast solid operating cash flows rising from about Brazilian real (R$) 1.3 billion in 2024 to about R$1.8 billion in 2026, from volumes recovery and its broad geographic diversification. The company has been taking some actions to improve cash generation. It will continue anticipating receivables, which we forecast at around R$350 million quarterly, and will decrease working capital needs.

We expect the company to fund working capital and capital expenditure (capex) with operating cash flow generation, resulting in solid FOCF of over R$800 million in 2024, near R$950 million in 2025, and above R$1.1 billion in 2026. Such FOCF should also enable the company to reduce gross debt in the coming years.

Liability management will continue in the next few years. We believe Iochpe will continue to have good access to debt markets and maintain strong relationship with banks issuing long-term debt at lower costs.

In September 2023, it issued debentures of R$700 million due in 2028 and by the end of the year signed R$400 million with the Brazilian development bank (BNDES)--already addressing part of its 2024 short-term needs, which we estimate at about R$1.6 billion.

We expect the company to maintain a smooth debt maturity profile with weighted average maturity of debt above four years and a comfortable liquidity position. Additionally, the company has a revolving credit facility of R$500 million due in April 2025, enabling greater liquidity cushion to support future investments.

Outlook

The stable outlook reflects our expectation that Iochpe will improve profitability and cash generation in the next quarters from rising volumes of commercial vehicles domestically, balancing the moderate growth in other regions amid the continued high interest rates and credit affordability. We expect EBITDA margin of 10%, debt to EBITDA of about 2.5x, and FOCF to debt around 20% in 2024.

Downside scenario

A negative rating action is unlikely in the short to medium term. But it could occur if the company fails to improve profitability and reduce leverage because of tougher global industry dynamics, with lower demand and higher inflation weighing on costs and expenses. Moreover, this could result from the continued elevated interest rates globally affecting credit availability and families' income. In this scenario, we would see deteriorated debt to EBITDA consistently close to 3.5x and negative free cash flow.

Upside scenario

A positive rating action is also unlikely in the next 12-18 months, as in our view it will depend on the company delivering comfortable liquidity cushion and less volatile credit metrics through the cycles. In this scenario, we would have to see debt to EBITDA trending to 2.0x and FOCF to debt above 15%.

Company Description

Founded in 1918, Iochpe is a global manufacturer of steel wheels for light and commercial vehicles and agricultural machinery. It also manufactures aluminum wheels for light vehicles; side rails, crossmembers, and full frames for commercial vehicles; and structural components for light and commercial vehicles.

Iochpe currently has 33 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, which produces railway equipment in Brazil and other countries.

We estimate revenue from Brazil represented about 25%-30% of consolidated revenues in 2023, while North America represented almost 30%, Europe about 35%, and Asia 9%.

Our Base-Case Scenario

Assumptions

- Average foreign exchange (FX) rate of R$5.15 per US$1 in 2024, R$5.25 per US$1 in 2025, and R$5.30 per US$1 in 2026
- Brazil's inflation rate of 3.5%-3.7% in 2024-2026
- Brazil's GDP growth of 1.5% in 2024 and 2% in 2025-2026
- Brazil's average basic interest rate of 9.9% in 2024 and 9% in 2025-2026
- U.S. inflation of 2.8% in 2024, 2.0% in 2025, and 2.4% in 2026
- U.S. GDP growth of 2.4% in 2024 and 1.5% in 2025-2026
- EU's inflation of 6.1% in 2024, 4.0% in 2025, and 3.0% in 2026
- EU's GDP growth of 1.3% in 2024 and 2% in 2025-2026
- Higher volumes from commercial vehicles in Brazil in 2024, after a weak 2023, from solid agricultural prospects and greater industrial activities increasing logistics demand, and light vehicles benefiting from the reducing interest rates domestically
- In North America, volumes coming mostly from commercial vehicles with infrastructure

incentives in the U.S. and moderate growth for light vehicles production and sales amid elevated interest rates and credit constraints in 2024. In the following years, we expect improved light vehicles sales/production with better economic perspectives and increasing share of electric vehicles (EVs), while commercial vehicles remain solid.

- In Europe, a relatively weak 2024 amid interest rate distress affecting consumer spending but gradual improvement over the subsequent years with the increasing backlog of hybrid and EVs
- Gradually decreasing interest expenses at the pace the company pays down debt and decreasing interest rates globally
- Capex of about R$550 million in 2024-2025 and R$700 million in 2026, of which 50% for maintenance of operations and 50% for expansion of production. The expansion in capex is related to Turkey's new facility for aluminum wheels for heavy vehicles and a capacity increase in the structural components plant in North America.
- Dividend payout at 37% of previous year's net income (in line with company's bylaws) and R$50 million–R$100 million annually to minority shareholders of Turkish and Indian operations

Iochpe-Maxion S.A.--Forecast summary

Industry sector: Automotive--parts producers and suppliers

	--Fiscal year ended Dec. 31--								
Mil. R$	**2019a**	**2020a**	**2021a**	**2022a**	**2023f**	**2024e**	**2025f**	**2026f**	**2027f**
Revenue	10,016.4	8,760.6	13,688.4	16,947.9	14,948.2	15,649.6	17,091.6	18,426.1	19,155.7
EBITDA (reported)	1,095.8	372.1	1,841.3	1,736.9	1,238.2	1,567.6	1,832.2	2,069.0	2,202.8
Plus/(less): Other	(52.4)	41.4	(289.8)	(80.5)	(0.0)	--	--	--	--
EBITDA	1,043.5	413.6	1,551.5	1,656.4	1,238.2	1,567.6	1,832.2	2,069.0	2,202.8
Less: Cash interest paid	(174.1)	(163.5)	(282.4)	(443.2)	(564.2)	(465.3)	(399.8)	(374.0)	(344.9)
Less: Cash taxes paid	(132.4)	(94.6)	(205.6)	(254.7)	(209.3)	(99.3)	(140.1)	(184.7)	(222.9)
Funds from operations (FFO)	736.9	155.6	1,063.4	958.4	464.7	1,003.0	1,292.3	1,510.3	1,635.1
EBIT	610.8	(159.8)	1,026.9	1,257.0	912.5	1,216.0	1,448.4	1,650.1	1,782.3
Interest expense	172.6	204.6	292.9	528.4	563.6	552.4	424.2	373.9	344.8
Cash flow from operations (CFO)	657.7	113.2	1,019.6	1,878.7	1,115.8	1,358.2	1,486.0	1,848.9	1,965.9
Capital expenditure (capex)	483.6	335.8	485.0	488.6	500.0	550.0	540.0	700.0	700.0
Free operating cash flow (FOCF)	174.1	(222.6)	534.5	1,390.0	615.8	808.2	946.0	1,148.9	1,265.9
Dividends	108.7	146.2	165.6	235.5	149.5	38.9	117.6	231.9	317.2
Share repurchases (reported)	3.0	--	--	12.6	14.1	--	--	--	--
Discretionary cash flow (DCF)	62.4	(368.8)	368.9	1,141.9	452.2	769.2	828.4	917.0	948.7
Debt (reported)	3,061.6	5,120.4	5,532.2	6,477.0	6,765.2	6,056.1	5,693.0	4,960.2	4,560.7
Plus: Lease liabilities debt	73.5	--	53.0	47.2	66.1	68.5	71.0	73.5	76.1

Iochpe-Maxion S.A.--Forecast summary (cont.)

Industry sector: Automotive--parts producers and suppliers

	--Fiscal year ended Dec. 31--								
Mil. R$	**2019a**	**2020a**	**2021a**	**2022a**	**2023f**	**2024e**	**2025f**	**2026f**	**2027f**
Plus: Pension and other postretirement debt	335.4	456.3	407.1	305.1	305.1	305.1	305.1	305.1	305.1
Less: Accessible cash and liquid Investments	(646.1)	(1,605.4)	(1,088.1)	(2,287.1)	(2,966.9)	(2,458.6)	(2,558.7)	(2,461.7)	(2,779.3)
Debt	2,849.2	3,982.5	4,904.2	4,542.3	4,659.5	3,971.1	3,860.4	3,227.1	2,512.7
Cash and short-term investments (reported)	646.1	1,605.4	1,088.1	2,287.1	2,966.9	2,458.6	2,558.7	2,461.7	2,779.3
Adjusted ratios									
Debt/EBITDA (x)	2.7	9.6	3.2	2.7	3.8	2.5	2.1	1.6	1.1
FFO/debt (%)	25.9	3.9	21.7	21.1	10.0	25.3	33.5	46.8	65.1
EBITDA interest coverage (x)	6.0	2.0	5.3	3.1	2.2	2.8	4.3	5.5	6.4
CFO/debt (%)	23.1	2.8	20.8	41.4	23.9	34.2	38.5	57.3	78.2
FOCF/debt (%)	6.1	(5.6)	10.9	30.6	13.2	20.4	24.5	35.6	50.4
DCF/debt (%)	2.2	(9.3)	7.5	25.1	9.7	19.4	21.5	28.4	37.8
EBITDA margin (%)	10.4	4.7	11.3	9.8	8.3	10.0	10.7	11.2	11.5

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

Iochpe's liquidity is adequate, in our view. We expect Iochpe's sources of cash to exceed uses by about 1.8x in the next 12 months, and sources minus uses to remain positive even if EBITDA were to decline 15%-30% from our current forecast.

We believe Iochpe has a sound relationship with banks, proven by its long relationship with large Brazilian banks and BNDES, and satisfactory standing in the domestic credit market with a track record of issuing debentures locally.

We expect Iochpe will maintain a comfortable cash position in the coming years, and we believe it will continue anticipating part of its receivables, improving working capital generation. Moreover, Iochpe's revolving credit facility of R$500 million due in April 2025 provides greater liquidity comfort.

Principal liquidity sources as of Dec. 31, 2023:

- Estimated cash position of about R$3 billion
- Undrawn committed credit lines of R$500 million, maturing in April 2025
- Forecast funds from operations of about R$1.1 billion in 2024

Principal liquidity uses as of Dec. 31, 2023:

- Estimated short-term debt of R$1.6 billion
- Seasonal working capital needs of about R$300 million in 2024
- Capex of about R$550 million in 2024
- Dividend payment of about R$40 million in 2024

Covenants

The company cannot incur additional debt or distribute dividends above 37% if net debt to EBITDA is above 3.5x. This incurrence covenant is present on the 11th and 12th debentures and sustainability-linked notes. The company has no acceleration financial covenant.

We forecast the company will demonstrate a cushion of more than 30% on the covenant by the end of 2024, and over 50% in the subsequent year on increasing cash generation. We believe the covenant calculation in 2023 was tighter because of the relatively weak EBITDA generation.

Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of Iochpe. This is because the global automotive industry is significantly exposed to environmental risks, given that electrification and the transition to carbon dioxide-neutral mobility are disruptive forces that will shape the industry.

In Europe and North America, regulatory rules are well advanced for light vehicles, but those for heavy vehicles will be implemented in the long term. Given significant exposure to both regions and to light vehicles, Iochpe has been working on weight-reduction technology to meet original equipment manufacturers' needs.

Nevertheless, the company is the global leader in wheel manufacturing, which is less vulnerable to the global regulatory push. Also, Iochpe is on track to reduce the intensity of its greenhouse gas emissions (scopes 1 and 2) 30% by 2025 from the 2019 level of 0.0003900028 tons of carbon dioxide per kilogram produced, and to be carbon neutral by 2040.

Issue Ratings - Recovery Analysis

Key analytical factors

- The recovery rating on Iochpe's senior unsecured debentures is '4', with a recovery expectation of 35%. The recovery rating on company's senior unsecured notes is '3', with a recovery expectation of 65%. The higher recovery expectation on the senior notes issued by Iochpe-Maxion Austria GmbH and Maxion Wheels de Mexico reflect our view that this debt would rank superior in the event of default versus the debt at the parent level.
- We assess recovery prospects using a simulated default scenario, with an EBITDA multiple valuation approach.
- Our simulated default scenario assumes a payment default in 2029 because of a severe global

economic slowdown, sharply lower consumer discretionary income, and higher competition in the markets where Iochpe operates, all of which would reduce its cash flow.

- 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 flow.
- In such a scenario, we estimate that EBITDA would decline about 40% from our forecasted 2024 EBITDA and wouldn't sufficiently cover the company's maintenance capex and interest expenses, triggering a payment default.

Simulated default assumptions

- Simulated year of default: 2029
- Emergence EBITDA: R$987 million
- EBITDA multiple: 5x
- Estimated gross enterprise value (EV): R$4.9 billion
- Jurisdiction: Brazil

Simplified waterfall

- Consolidated net EV after 5% administrative costs: R$4.7 billion
- Net EV of its subsidiaries (approximately 70% of EBITDA): R$3.2 billion
- Unsecured debt of the subsidiaries: R$3 billion
- Net EV of Iochpe-Maxion (the parent company; approximately 30% of EBITDA): R$1.4 billion
- Secured debt: R$808 million (Finame)
- Unsecured debt: R$2.4 billion (bank loans and debentures at the parent level).
- --Recovery expectations of senior unsecured notes: 65% (jurisdiction cap)
- --Recovery expectations of debentures: 35%

*All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating:

- Global scale: BB/Stable/--
- National scale: brAAA/Stable/--

Business risk: Fair

- Country risk: Low risk
- Industry risk: Moderately high risk

- Competitive position: Fair

Financial risk: Significant

- Cash flow/Leverage: Significant

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: Neutral (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Iochpe-Maxion S.A.		
Issuer Credit Rating	BB/Stable/--	BB-/Positive/--
Brazil National Scale	brAAA/Stable/--	brAA+/Positive/--

Upgraded

	To	From
Iochpe-Maxion S.A.		
Senior Unsecured	brAAA	brAA+
Recovery Rating	4(35%)	
Iochpe-Maxion Austria GmbH		
Senior Unsecured	BB	BB-
Recovery Rating	3(65%)	

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.