Research Update:

Iochpe-Maxion S.A. Outlook Revised To Positive From Negative On Improved Profitability And Leverage; Ratings Affirmed

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Rating Action Overview

- Brazil-based auto supplier Iochpe-Maxion S.A. (Iochpe) has been delivering solid operational improvements with higher revenues and profitability than we previously expected, leading to a rapid leverage reduction.
- We now expect the company to post debt to EBITDA close to 3.0x by the end of this year and 2.0x-2.5x in 2022.
- As a result, on Aug. 19, 2021, S&P Global Ratings revised its outlook on Iochpe to positive from negative and affirmed our global scale 'BB-' and national scale 'brAA+' issuer credit and issue-level ratings.
- We also affirmed our recovery ratings of '3' (65%) on company's senior unsecured notes and of '4' (30%) on company's debentures.
- The positive outlook on both rating scales reflects the possibility of an upgrade in the next 6-12 months if the company delivers stronger cash flow and comfortable liquidity.

Rating Action Rationale

Already solid results in the first half of 2021 despite the industry volatility due to the semiconductor shortage. Iochpe has delivered stronger results than we expected in the past two quarters, benefiting from demand rebound with higher vehicles production globally and from its cost restructuring measures implemented last year. We think the company's broad geographic diversification and higher growth in sales for commercial vehicles could mitigate the likely volatile demand from automakers because the demand-supply imbalance of semiconductors should last for the next few quarters. With higher capacity utilization this year and an optimized cost structure, we expect Iochpe to keep its EBITDA margin around 11%, similar to what was registered in the first half of 2021 and aligned with pre-pandemic levels. In our view, the company will be able to continue increasing prices to pass through higher input costs.

Credit metrics rapidly returning to pre-pandemic levels. In our opinion, we're near the worst of the semiconductor supply shortage. Assuming that, we now believe Iochpe can deliver much stronger revenues and EBITDA. As a result, even assuming relatively stable debt, we now forecast debt to EBITDA of about 3.0x and funds from operations (FFO) to debt at 20%-25% in 2021, compared with our previous forecast of about 4.0x and 15%, respectively. For 2022, we think solid global demand prospects will support stronger cash flow and leverage reduction to 2.0x-2.5x.

Stronger free operating cash flow (FOCF) and improving liquidity cushion would likely lead to an upgrade. Despite the higher revenues and improved profitability, we still forecast negative FOCF this year with higher capital expenditure (capex) disbursements in the second half (totaling over R$450 million this year) and Iochpe will likely carry higher inventory levels for a few more months. Management decided to increase inventories in the first half of the year due to the market's volatility. Assuming the monetization of these inventories in 2022 and continued industry growth, we believe the company could post much stronger FOCF next year that would be aligned with a higher rating. In addition, Iochpe was successful in issuing its inaugural senior notes this May, raising $400 million and extending its debt maturity profile. We expect the company to maintain an active liability management strategy over the next quarters, improving its liquidity cushion.

Outlook

The positive outlook reflects our view that Iochpe will be able to maintain adequate profitability, as it's done in the first half of 2021, thanks to its good geographic and product diversification and its cost efficiency measures implemented last year, which should mitigate the risks related to the semiconductor shortage. It also incorporates our view that Iochpe will continually improve liquidity, refinancing debt to extend its maturity profile.

Upside scenario

We could raise the ratings in the next 6-12 months if we see stronger cash flow in the next few quarters, allowing the company to post debt to EBITDA close to or below 3x at the end of 2021 and close to 2.5x in 2022. We would also expect FOCF to debt near or above 10% next year.

Downside scenario

We could revise the outlook to stable in the next 12 months if the company's cash flows and leverage are weaker than our base-case expectations in the next several quarters. This would likely be a result of a stoppage of several carmaker plants affecting the supply chain. In this scenario, we would expect Iochpe to post debt to EBITDA consistently close to 4x and negative FOCF.

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 and produces side rails, crossmembers, and full frames for commercial vehicles and structural components for light vehicles. Iochpe 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, which produces railway equipment in Brazil and internationally.

Iochpe's main shareholders are the founder's family, Ioschpe, with 14.7% of total shares, followed by Alaska Investimentos Ltda. (12.1%; not rated), Fundo de Investimento em Ações WPA EST IE (8.4%; not rated), Vokin – VKN Administração de Recursos Ltda (5.01%; not rated), and the remaining are free float.

Our Base-Case Scenario

- Average foreign exchange (FX) rate of R$5.30 per $1 in 2021, R$5.35 per $1 in 2022, and R$5.43 per $1 in 2023.
- Brazil's inflation rate of 7.0% in 2021, 4.4% in 2022, and 3.5% in 2023.
- Brazil's GDP growth of 4.7% in 2021, 2.1% in 2022, and 2.2% in 2022.
- Brazil's basic interest rate of 4.41% in 2021, 6.94% in 2022, and 7.00% in 2023.
- North America's inflation of 3.6% in 2021, 2.4% in 2022, and 2.5% in 2023.
- North America's GDP growth of 6.6% in 2021, 3.6% in 2022, and 2.5% in 2023.
- EU's inflation of 2.9% in 2021 and 2.3% in 2022-2023.
- EU's GDP growth of 4.0%-4.6% in 2021-2022 and 2.4% in 2023.
- Asia-Pacific's inflation close to 2.0% in 2021-2023.
- Asia-Pacific's GDP growth of 6.7% in 2021 and 4.7%-5.0% in 2022-2023.
- Net revenue of about R$14 billion in 2021, R$15 billion in 2022, and R$16 billion in 2023.
- Volumes to continue recovering due to pent-up demand for passenger cars and continued strong demand for commercial vehicles in all regions of the company's operations. 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.
- 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.
- Capex of about R$470 million in 2021, R$520 million in 2022, and R$650 million in 2023 for capacity expansion and technology projects to make operations more efficient and develop new products.
- Dividend payout from 2022 on, 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 for part of the company's maturities over the next few years, assuming Iochpe will use part of its free cash flows to reduce gross debt in 2022 and 2023.

Based on these assumptions, we arrive at the following credit metrics for the next few years:

- Debt to EBITDA of about 3.0x in 2021 and close to 2.0x-2.5x in 2022 and 2023, compared with 9.6 in 2020;
- FFO to debt of 20%-25% in 2021 and 30%-40% in 2022 and 2023, compared with 3.9% in 2020; and
- Negative FOCF in 2021, and then FOCF to debt at 10%-20% in 2022 and 2023.

Liquidity

Iochpe'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 Iochpe has well-established and solid relationships with banks and has recently diversified its funding mix and extended its debt maturity profile with the senior notes issuance, which could reduce risks of the somewhat limited liquidity cushion that we saw in the past two years.

Principal liquidity sources:

- Cash position of R$1.35 billion as of June 30, 2021;
- Forecasted FFO of about R$1.2 billion in the next 12 months; and
- Undrawn bank loan with BNDES of R$620 million available for disbursement until 2023.

Principal liquidity uses:

- Short-term debt of R$1.8 billion as of June 30, 2021;
- Working capital needs of about R$500 million in the next 12 months;
- Maintenance capex of R$100 million in the next 12 months; and
- Dividend distribution of about R$140 million in the next 12 months.

Covenants

Earlier this year, Iochpe obtained a waiver on its financial covenant of net debt to EBITDA below 3.5x for the June and December 2021 measuring periods. The new covenant requires net debt to EBITDA below 5.25x in June and 4.75x in December. In addition, during the waiver period, if net debt to EBITDA is above 3.5x, Iochpe will have to comply with a covenant of accessible cash over short-term debt of more than 0.5x. We expect the company will maintain a comfortable covenant cushion.

Issue Ratings - Recovery Analysis

We affirmed the '4' recovery rating on Iochpe's senior unsecured debentures, with a recovery expectation of 30% and the '3' recovery rating on company's senior unsecured notes, with 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.

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 Iochpe 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 about 50% from our forecast 2021 EBITDA of about R$1.6 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$735 million
- EBITDA multiple: 5x
- Estimated gross enterprise value (EV): R$3.67 billion
- Jurisdiction: Brazil

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$2.9 billion
- Net EV of Iochpe-Maxion (the parent company; approximately 25% of EBITDA): R$870 million
- Secured debt: R$257 million
- Unsecured debt: R$1.77 billion (bank loans and debentures at the parent level, and the rest of the R$250 million from its subsidiaries that weren't covered by its designated EV).
- Recovery expectations of senior unsecured notes: 65% (jurisdiction cap)
- Recovery expectations of debentures: 30%

*All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating:

Global scale: BB-/Positive/--

National scale: brAA+/Positive/--

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 | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 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: Ratings Above The Sovereign--Corporate And Government Ratings: 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

Ratings Affirmed; CreditWatch/Outlook Action

	To	From

Iochpe-Maxion S.A.		
Issuer Credit Rating	BB-/Positive/--	BB-/Negative/--
Brazil National Scale	brAA+/Positive/--	brAA+/Negative/--
Ratings Affirmed;		
Iochpe-Maxion S.A.		
Senior Unsecured	brAA+	
Recovery Rating	4(30%)	
Iochpe-Maxion Austria GmbH		
Senior Unsecured	BB-	
Recovery Rating	3(65%)	
Maxion Wheels de Mexico, S. de R.L. de C.V.		
Senior Unsecured	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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.