Tear Sheet:

Iochpe-Maxion S.A.

May 31, 2023

Primary contact

Fabiana Gobbi
Sao Paulo
55-11-3039-9733
fabiana.gobbi
@spglobal.com

Secondary contact

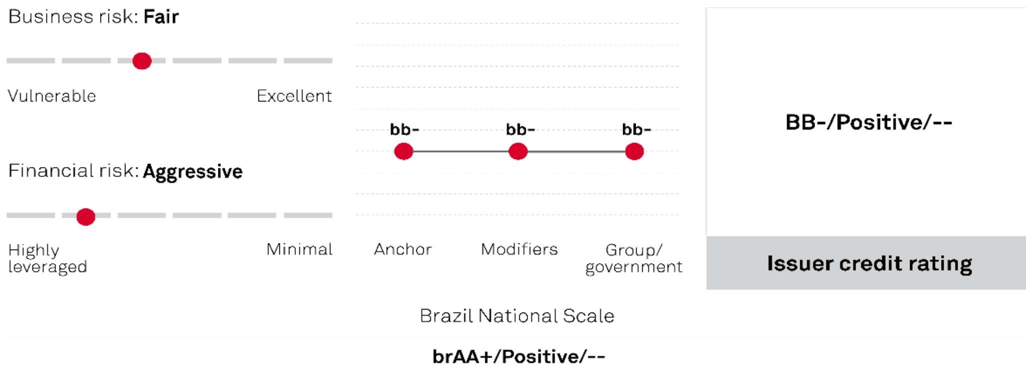
Luisa Vilhena
Sao Paulo
55-11-3039-9727
luisa.vilhena
@spglobal.com

We expect lower volumes in Brazil will be compensated by stronger operations in Europe and North America in 2023. Iochpe-Maxion S.A.'s sales of wheels and structural components for commercial vehicles in Brazil in 2023 will be much lower than a year before, primarily given the changes in engine technology requirements for trucks (Euro6) taking place this year, which caused a significant pre-buy movement of trucks in 2022 with the expectation of substantial price increases this year. Prices of trucks in Brazil with the new technology jumped 20%-25%, slashing the company's sales volumes in 2023. According to ANFAVEA, total production of trucks in Brazil for 2023 should decrease around 20% compared with 2022. On the other hand, Iochpe's volumes in North America and Europe grew 13.8% and 12.6%, respectively, in the first quarter of 2023. This was mostly because of infrastructure projects in the U.S. and the increasing shift toward electric vehicles in Europe.

Margin pressures in the past quarters should reverse in the next few quarters. We now expect Iochpe to post EBITDA margin of 9.0%-9.5% in 2023, down from our previous expectation of above 10%. Since the third quarter 2022, Iochpe's margins have dropped to below 8% because of a mismatch between sales prices and costly inventory. The decrease in raw material prices (steel and aluminum) reduces the prices of Iochpe's products, while it takes about 60 days for the company to clear its costlier inventory. We believe the worst is already behind, as raw material prices are stabilizing, and inventory turnover at Iochpe is reaching the end.

Iochpe to continue reducing leverage in the next few years. We expect debt to EBITDA of about 3.0x in 2023 and to fall to 2.5x in 2024. We believe the company will continue reducing debt through internal cash flows, as seen in the repurchase of its ninth and 10th debentures that were initially due in 2024 and 2025, respectively. We expect gross debt reduction of R$600 million in 2023 from 2022. With a lower interest burden and forecasted drop interest rates in 2024 and 2025, we expect funds from operations (FFO) to debt at about 20% in 2023, and 25%-35% in 2024 and 2025. Moreover, our forecast indicates Iochpe's operating cash flows will be enough to cover working capital and capital expenditures, as well as dividend payments in the next few years.

Ratings Score Snapshot



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 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 other countries. Iochpe's main shareholders are the founder's family, with 14.8% of total shares, followed by Alaska Investimentos Ltda. (10.8%), Vokin – VKN Administração de Recursos Ltda. (7.7%), Fundo de Investimento em Ações WPA EST IE (7.2%), BlackRock Inc. (5.3%), and the remainder is free floating.

Outlook

The positive outlook reflects our view that Iochpe's margins will recover in the next few quarters, as it clears more expensive inventory that caused a mismatch with sales prices in the last two quarters. As a result, we expect EBITDA margin of 9.0%-9.5% for 2023. The company's wide geographic diversification with solid results expected at its North American and European operations this year should offset the impact of Brazil's weaker demand for commercial vehicles. The outlook also incorporates our view that Iochpe will continue to improve its liquidity, extending its maturity profile and paying down debt.

Downside scenario

We could revise the outlook to stable in the next 12 months if the company's profitability and cash flows weaken, leading to higher leverage than our base-case expectations. This would likely be a result of tougher industry dynamics with further auto manufacturing stoppages around the globe, lower demand, higher inflationary pressures on costs and expenses, and greater energy costs in Europe. In this scenario, we expect Iochpe to post debt to EBITDA consistently close to 3.5x and negative free operating cash flows (FOCF).

Upside scenario

We could raise the ratings in the next 6-12 months if profitability rises and cash flows strengthen, with North American and European operations' results compensating for weaker results in Brazil amid lower interest expenses due to debt reduction. In this scenario, we expect debt to EBITDA of about 2.5x in 2023 and close to 2.0x in 2024, and FOCF to debt of 10%-15%.

Key Metrics

Iochpe-Maxion S.A.--Key Metrics*

Mil. R$	2021a	2022a	2023e	2024f	2025f
Revenue	13,688.4	16,947.9	16,000-16,300	17,000-17,500	18,500-19,000
EBITDA	1,551.5	1,656.4	1,400-1,600	1,600-1,800	2,000-2,200
EBITDA margin (%)	11.3	9.8	9-10	10-11	10-11
Funds from operations (FFO)	1,063.4	958.4	900-1,000	1,150-1,250	1,500-1,600
Capital expenditure	485	488.6	420-480	500-550	600-650
Free operating cash flow (FOCF)	534.5	1,390.0	250-350	500-600	700-800
Debt, adjusted	4,904.2	4,542.3	4,300-4,600	4,300-4,600	4,300-4,600
Debt to EBITDA (x)	3.2	2.7	3.0-3.5	2.0-3.0	2.0-2.5
FFO to debt (%)	21.7	21.1	20-25	25-30	30-35
FOCF to debt (%)	10.9	30.6	5-10	10-15	15-20
EBITDA interest coverage (x)	5.3	3.1	2.5-3.0	3.5-4.0	5.0-5.5

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Financial Summary

Iochpe-Maxion S.A.--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	R$	R$	R$	R$	R$	R$
Revenues	7,488	9,616	10,016	8,761	13,688	16,948
EBITDA	874	1,100	1,043	414	1,551	1,656
Funds from operations (FFO)	553	745	737	156	1,063	958
Interest expense	215	192	173	205	293	528
Cash interest paid	225	179	174	163	282	443
Operating cash flow (OCF)	315	640	658	113	1,020	1,879
Capital expenditure	237	471	484	336	485	489
Free operating cash flow (FOCF)	78	169	174	(223)	535	1,390

Iochpe-Maxion S.A.--Financial Summary

Discretionary cash flow (DCF)	63	120	62	(369)	369	1,142
Cash and short-term investments	543	487	646	1,605	1,088	2,287
Gross available cash	543	487	646	1,605	1,088	2,287
Debt	2,653	2,746	2,849	3,983	4,904	4,542
Common equity	2,631	3,199	3,497	3,803	4,398	4,293
Adjusted ratios						
EBITDA margin (%)	11.7	11.4	10.4	4.7	11.3	9.8
Return on capital (%)	7.9	11.8	9.9	(2.3)	12.0	13.9
EBITDA interest coverage (x)	4.1	5.7	6.0	2.0	5.3	3.1
FFO cash interest coverage (x)	3.5	5.2	5.2	2.0	4.8	3.2
Debt/EBITDA (x)	3.0	2.5	2.7	9.6	3.2	2.7
FFO/debt (%)	20.9	27.1	25.9	3.9	21.7	21.1
OCF/debt (%)	11.9	23.3	23.1	2.8	20.8	41.4
FOCF/debt (%)	2.9	6.2	6.1	(5.6)	10.9	30.6
DCF/debt (%)	2.4	4.4	2.2	(9.3)	7.5	25.1

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	**E-3**	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

Environmental	Social	Governance
- Climate transition risks	- N/A	- N/A

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Environmental factors are a moderately 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 CO2-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 significant exposure to light vehicles, Iochpe has been working in 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 has a target to reduce greenhouse gas emissions intensity (Scopes 1 and 2) by 30% by 2025 from the 2019 level of 0.0003900028 tons of CO2 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'. We now see a recovery expectation improving to 35% from 30% with expected lower debt levels. 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 2027 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 40% from our forecasted EBITDA in 2023 and wouldn't sufficiently cover the company's maintenance capex and interest expenses, triggering a payment default.

Simulated default assumptions

- Simulated year of default: 2027
- Emergence EBITDA: R$925 million
- EBITDA multiple: 5x
- Estimated gross enterprise value (EV): R$4.6 billion
- Jurisdiction: Brazil

Simplified waterfall

- Consolidated net EV after 5% administrative costs: R$4.4 billion
- Net EV of its subsidiaries (approximately 70% of EBITDA): R$3.0 billion
- Unsecured debt of the subsidiaries: R$3.6 billion
- Net EV of Iochpe-Maxion (the parent company; approximately 30% of EBITDA): R$1.3 billion
- Secured debt: R$381.5 million
- Unsecured debt: R$2.6 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

Rating Component Scores

Foreign currency issuer credit rating	**BB-/Positive/--**
Local currency issuer credit rating	**BB-/Positive/--**
Business risk	**Fair**
Country risk	Intermediate
Industry risk	Moderately High
Competitive position	Fair
Financial risk	**Aggressive**
Cash flow/leverage	Aggressive
Anchor	**bb-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, 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