S&P Global
Ratings

Autoflash EMEA: Car Makers And Suppliers See Past Economic Roadblocks

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This report does not constitute a rating action

Key Takeaways

- The auto market outlook for 2023 is better than previously expected, though new orders are weakening in some regions (notably Europe) and the impact of higher interest rates and potentially weaker labor markets should be felt in the second half of 2023 and 2024.
- Original equipment manufacturers should be able to mitigate this year's pressure on margins from weaker pricing with model-mix based strategies and product launches, though the risk of margin contraction will be greater in 2024.
- Auto suppliers' positive production momentum should support upward revisions to guidance, with easing supply-side constraints signaling an end to a two-year catchup period. Inflation remains their main concern.

S&P Global Ratings expects 2023 will be a generally solid year for the European auto manufacturers that we rate. For the bulk of issuers, rating headroom should be sufficient to absorb uncertainties related to the anticipated softening in demand, which we expect will result from weakening economies, sticky inflation, and high interest rates.

Original equipment manufacturers (OEMs) should take advantage of the differential between the weakening economies' already-evident deflationary impact on raw materials (particularly steel but also lithium, cobalt, and nickel), and the more gradual decline in net pricing, due to weaker demand and strong competition. The capacity to optimize production costs (and variable costs in particular) before pricing pressure intensifies should be supported by large order books with locked-in prices. New product launches and management of the model mix will mitigate margin pressure in 2023 for many OEMs, partly offsetting the dilutive effect of an increasing EV penetration. This has led us to soften our view on the deterioration of margins this year, with more noticeable margin contraction delayed to 2024.

In particular, the first half of 2023 should thus be sound. We will be watching new orders and inventory movements over April-June to gauge the magnitude of the decrease in pent-up demand and for clues about the second half of this year.

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Table 1

EMEA light vehicle OEMs: Good rating headroom

	Ratings	2022 versus our base case	2023 company guidance versus 2022	Headwinds	Tailwinds	Rating headroom
BMW	A/Stable/A-1	In line	Ahead of prior base case	Volumes, EV dilution, capex	Mix, pricing	
Mercedes	A-/Positive/A-2	In line	Cautious	Volumes, EV dilution	Mix, pricing	
VW	BBB+/Stable/A-2	EBITDA underperform, FOCF underperform	FOCF improving, margin range cautious	Capex, China, mix	Volumes, pricing	
Stellantis	BBB/Stable/A-2	In line	In line	Capex, R&D, M&A	Pricing, WC	
Volvo Car	BB+/Stable/--	Underperform	Profit improving	EV dilution (including Polestar)	Large EU order book	
Renault	BB+/Stable/B	EBITDA outperform, FOCF outperform	Improving	No new EV launches	Large order book	
Jaguar Land Rover*	B+/Stable/--	FY2023: outperform	S&P Global Ratings' base case for FY2024: volumes up >10%, margins improving	R&D, capex for EVs	Volume, mix, WC	

Ratings as of April 19, 2023. *Fiscal year to end-March 2023. FOCF--Free operating cash flow. EV--Electric vehicle. Capex--Capital expenditure. R&D--research and development. M&A--mergers and acquisitions. WC--Working capital. Source: S&P Global Ratings.

Accelerating light vehicle production supports auto supplier positivity

Auto suppliers have less ratings headroom than OEMs, primarily due to the severe supply chain disruptions and challenging cost inflation pass-through conditions of the past two years. Those conditions eroded credit metrics, with few exceptions, while many suppliers were also forced to manage a complex portfolio-transition linked to an accelerated move to electric mobility and higher electronics and software content.

While uncertainty is high with regards to the economic scenario and the resilience of the current production upturn, auto suppliers generally have a positive view on 2023, which we share. Most hope to benefit from new cost indexation mechanisms negotiated with clients. Cost pass-through agreements do not generally include labor cost inflation, which is expected to remain high in 2023, so recovery of those costs will depend on successful negotiations with OEMs. With few exceptions, suppliers struggled with working capital management last year, as they purposedly decided to overstock to support production continuity for their customers and mitigate the risk of supply shortages. With the normalization of supply chains expected in 2023, suppliers are guiding a reversal in working capital dynamics that will benefit cash flow generation after investments. The easing of supply chain bottlenecks should also support suppliers' ability to benefit from efficiency gains.

Tailwinds for 2023 include accelerating light vehicle production which we expect to increase about 2%-3% globally, after an increase of about 3% in the first quarter of 2023 (source: S&P Global Mobility). We consider a widespread upward revision of earnings guidance this year to be a possibility, particularly because 2023 budgets were prepared in October-November 2022, when

recessionary concerns were stronger. The market views China as this year's potential game changer, despite a weak first quarter, though that is not part of our base case, for now. Our view remains that seasonality will play out differently compared to the past two years, delivering a clearly stronger first half compared with the second half.

Table 2

Selected EMEA auto suppliers: Guidance could be lifted

	Ratings	2022 versus our base case	2023 company guidance versus 2022	Headwinds	Tailwinds	Rating headroom
Michelin	A-/Stable/A-2	EBITDA in line, FOCF underperform	Profit in line FOCF improving	Inflation	LV production, WC, China rebound	
Continental	BBB/Stable/A-2	EBITDA in line, FOCF underperform	Improving	Inflation	LV production	
Pirelli	BBB-/Stable/--	EBITDA in line, FOCF outperform	Profit marginally lower, FOCF marginally lower.	Inflation	Price, product mix	
Schaeffler	BB+/Stable/--	EBITDA in line, FOCF in line	In line or improving	Inflation, restructuring costs	LV production	
Valeo	BB+/Stable/B	EBITDA in line, FOCF in line	Profit in line, FOCF better	Inflation, supply shortages	LV production, China rebound, faster VSea integration	
ZF	BB+/Stable/--	EBITDA underperform, FOCF underperform	Improving	Inflation	LV production, truck market recovery	
Faurecia	BB/Negative/--	EBITDA in line, FOCF outperform	Profit improving, FOCF in line	Inflation	LV production, faster integration of Hella, China rebound	
Gestamp	BB/Stable/--	EBITDA in line, FOCF outperform	Profit in line, FOCF in line	Inflation	LV production	
Garrett Motion Inc	B+/Stable/--	EBITDA underperform, FOCF in line	Profit and FOCF improving	Inflation	LV production, FX	

Ratings as of April 19, 2023. FOCF--Free operating cash flow. LV--Light vehicle. FX--Foreign exchange. WC--Working capital.
Source: S&P Global Ratings

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