MITEC Automotive AG
Germany, Automotive suppliers

BB- STABLE
Corporate Bond Rating

Corporate Profile

Founded in 1990, MITEC Automotive AG is a German auto supplier operating in the field of automobile propulsion technology, which aims to reduce noise emissions and vibrations, as well as enhance powertrain efficiency. MITEC's product portfolio comprises auto parts such as balancer systems, gear wheels and bevel gear sets, along with adjustable oil pumps and camshaft timing devices. The company operates production sites in Germany, China and the USA.

Rating

Corporate Rating:	BB-
Outlook:	Stable
Corporate Bond Rating:	BB-
Outlook:	Stable
Sector:	Automotive suppliers
Monitoring:	Monitored

Analysts

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Rating Rational

Scope Ratings has assigned a BB- Corporate Issuer Credit Rating (CICR) to MITEC Automotive AG ("MITEC"). Concurrently, Scope assigned a BB- rating to MITEC's Corporate Bond (7.75% 03/2017). Both rating outlooks are Stable.

The BB- rating is supported by MITEC's strong market position as a small tier 1 supplier in the growth market for balancer systems, as well as by a well-diversified geographical spread and ample order backlog.

Negative rating factors include MITEC's still relatively small size, with a turnover of EUR 137m in 2013, and its relatively limited product offering, in which 75% of total revenues are derived from the sales of MITEC's core product, balancer systems. Although MITEC's adjusted EBITDA margin stood at 6.5% in 2013, down from 17.5% in 2010 due to the postponement of substantial orders from a core customer, Scope expects it to improve to about 11% in 2016, as MITEC's sizable order backlog materialises. Driven by cash flows buoyed by the order backlog, Scope expects MITEC to reduce its high ND/EBITDA to 4.5x in 2016 (2013: 8.7x). For the same reason, Scope assumes that MITEC's EBITDA Fixed Charge Cover will improve to 3.3x in 2016 (2013: 1.4x).

Outlook

The outlooks on the CICR and bond rating are Stable. A positive rating action on the CICR and the bond rating might occur if, on the one hand, the company's order backlog materializes as expected and the resulting cash flow is used to reduce the high leverage and, on the other, customer diversification improves.

Rating Drivers

Positive	Negative
Strong positioning in the market of balancer systems	High cyclical exposure and vulnerability to external shocks and potential changes in the regulatory environment with a negative impact on MITEC
Ample order backlog providing business stability and visibility on future cash flows	Small-scale tier 1 supplier competing with financially stronger large companies in its niche market
Solid geographical diversification	Strong customer concentration combined with a deterioration in the customer structure
Reasonable interest coverage despite high leverage	Almost a single-product supplier associated with high project concentration
Sufficient liquidity and limited risks in debt structure	High leverage combined with a bullet maturity profile
	Capital intense business with large pre-financing requirements

Rating Change Drivers

The following might impact the rating in the future:

Positive
Strong cash flow generation as order backlog materialises
Significant improvement in debt protection measures
Reduction of reliance on top customers

Negative
Material order cancellation and loss of revenues with impact on margins and cash flow generation
Economic slump evidenced by sharply declining OEM production levels significantly effecting MITEC's operating performance

Financial overview

	2010	2011	2012	2013	2014E	2015E	2016E
P & L Statement (EURm)							
Revenue	136.8	143.2	137.9	137.7	145.2	168.2	177.0
EBITDA (adj.)	24.3	20.4	16.5	9.1	11.4	18.3	19.2
EBIT	12.1	8.9	4.8	-2.6	-0.9	6.8	8.6
Interest expense	-5.2	-4.6	-6.9	-6.6	-6.3	-6.2	-5.9
Net interest income (NII)	-5.1	-4.5	-6.7	-6.4	-6.3	-6.2	-5.9
Total Financial Debt	76.4	69.5	106.3	94.7	106.2	96.9	92.8
Cash & marketable securities	2.0	1.0	25.9	15.7	14.9	7.1	6.3
Net Debt	74.4	68.5	80.4	79.0	91.3	89.8	86.5
Cash Flow Statement (EURm)							
Funds flow from Operations (FFO)	18.7	15.2	15.0	5.0	6.6	13.2	13.8
Operating Cash Flow (CFO)	19.4	15.4	-5.4	11.1	5.3	9.5	12.4
Free Cash Flow (FCF)	11.1	8.4	-10.7	2.6	-10.6	3.1	4.9
CAPEX	-8.3	-7.0	-5.4	-8.6	-16.0	-6.4	-7.4
Change in Working Capital	-2.5	-0.8	9.0	-5.0	1.2	3.8	1.4
Financial ratios							
EBITDA (adj.) Margin	17.5%	14.1%	11.7%	6.5%	7.9%	10.8%	10.8%
EBIT Margin	8.8%	6.2%	3.5%	-1.9%	-0.6%	4.0%	4.9%
Total Debt / EBITDA (adj.)	3.1x	3.4x	6.4x	10.4x	9.3x	5.3x	4.8x
Net Debt / EBITDA (adj.)	3.1x	3.4x	4.9x	8.7x	8.0x	4.9x	4.5x
FFO Fixed Charge Cover	4.6x	4.4x	3.2x	1.8x	2.1x	3.1x	3.4x
EBITDA (adj.) Fixed Charge Cover	4.7x	4.5x	2.5x	1.4x	1.8x	2.9x	3.3x
FCF margin	8.1%	5.8%	-7.8%	1.9%	-7.3%	1.8%	2.8%
Liquidity	41.4%	32.4%	65.1%	50.8%	39.5%	31.4%	34.9%

Source: MITEC, Scope estimates

Business Risk Profile

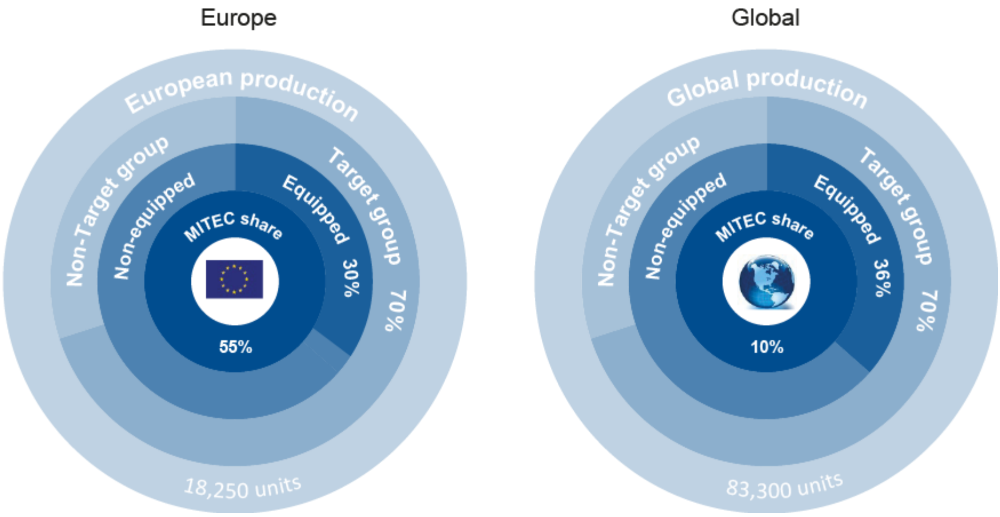
Market Drivers and Positioning

Tier 1 supplier with strong market share in the niche market for balancer systems

Specialising in automobile propulsion technology, MITEC is a tier 1 auto component supplier with established customer relationships with 6 of the Top 20 original equipment manufacturers (OEMs). Scope considers MITEC to be well positioned as the European leader in the balancer systems niche market. The global market share of balancer systems is considered to be approximately 10%.

However, the market for tier 1 suppliers is very fragmented and dominated by several large international players. Scope notes that although MITEC specialises in the niche market for balancer systems, some of the companies it competes with possess significantly more financial strength and market impact.

Figure 1 – Strong Share in the Market for Balancer Systems in 2013



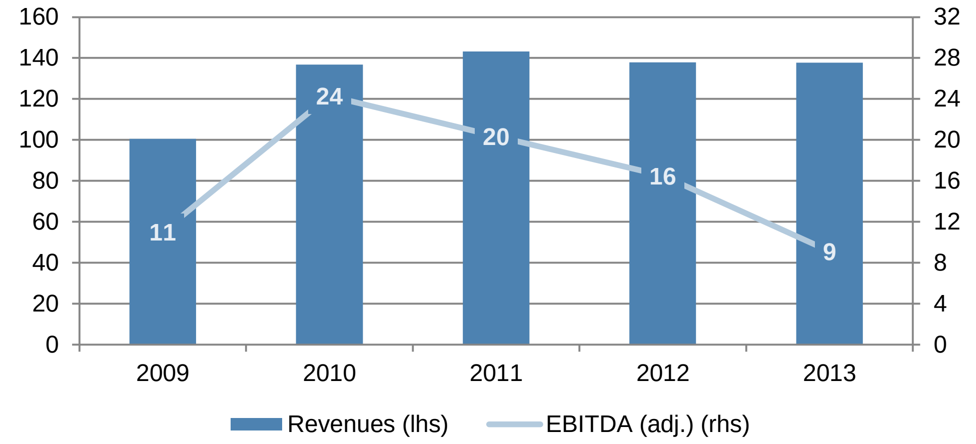
Source: MITEC estimates based upon IHS, Scope

Comparatively small size renders it vulnerable to the highly cyclical and competitive nature of the industry

MITEC's ratings reflect the highly cyclical and fiercely competitive nature of the automotive supplier industry. The sector's cash flow generation is directly impacted by changes in demand patterns for automobiles. In addition, the high level of competition within the industry and strong bargaining power of OEMs are seen as a permanent challenge to the margins and cash flows of automotive suppliers.

Due to its comparatively small size MITEC is vulnerable to significant order cancellations or postponements. As OEMs increasingly shift the "ramp-up" risk toward suppliers, the company is heavily dependent on its customers. Alternative short-term agreements cannot compensate for the volumes lost on order cancellations as such orders are awarded with long lead times. Due to the high percentage of fixed costs in the industry (~50% of total costs on average in 2013 for MITEC) order cancellations, such as the EUR 10.6m order cancellations in 2014 significantly affect the company's EBITDA margin and FFO.

Figure 2 – Volatility of Revenues and EBITDA (in EURm)

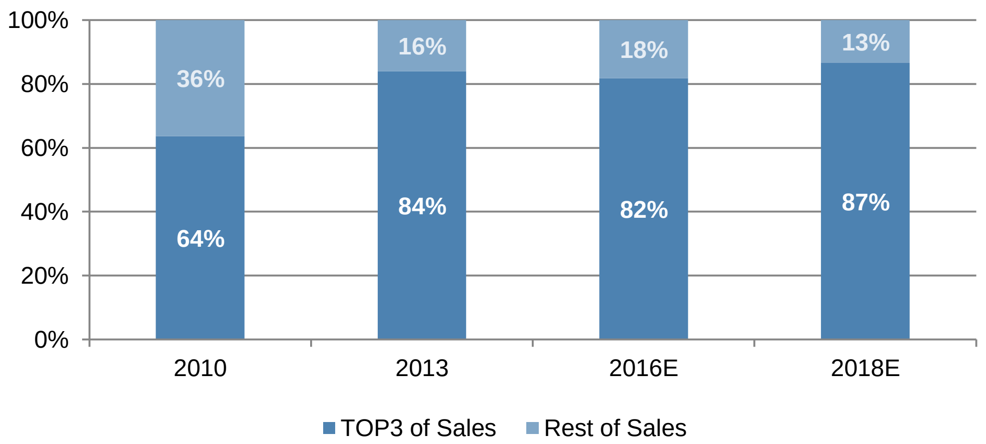


Source: MITEC, Scope

Customer diversification bears concentration risks

From Scope's perspective the macro-economic risks MITEC is exposed to are amplified by the strong customer concentration of its business. The largest three customers account for a high 84% of 2013 sales. Given the order backlog to 2018, Scope expects this customer concentration to remain high, but with an increasing bias towards OEMs with weaker financial profiles. Scope sees this as a negative rating driver.

Figure 3 – Customer Concentration 2010 to 2018E

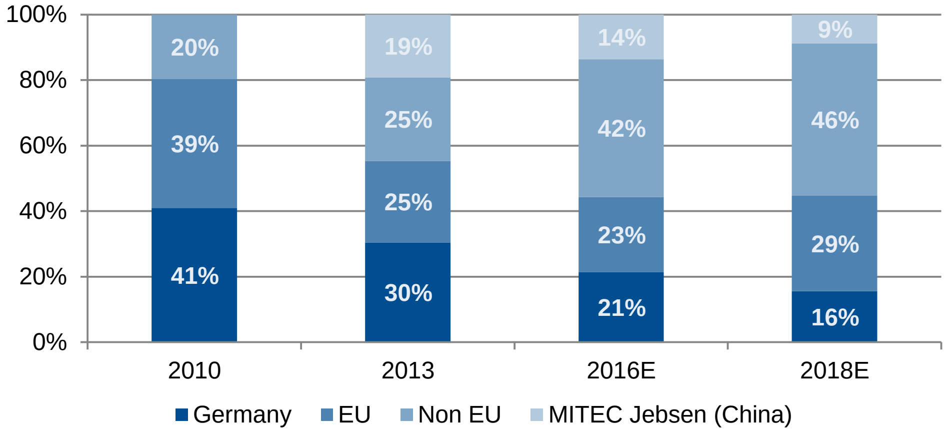


Source: MITEC, Scope

Strong geographical diversification – expected to improve further

In 2013, 55% of MITEC's revenues were generated in Europe; 19% through its Chinese joint venture and the remaining 26% in the rest of the world, predominantly with US automotive manufacturers. Going forward, MITEC is expected to steadily diversify its revenue base and reduce its dependence on European automotive manufacturers. Scope anticipates that sales from Europe will account for about 45% by 2018.

Figure 4 – Geographical Diversification 2010 to 2018E



Source: MITEC, Scope

Solid sales growth expected – helped by environmental regulations and sector trends

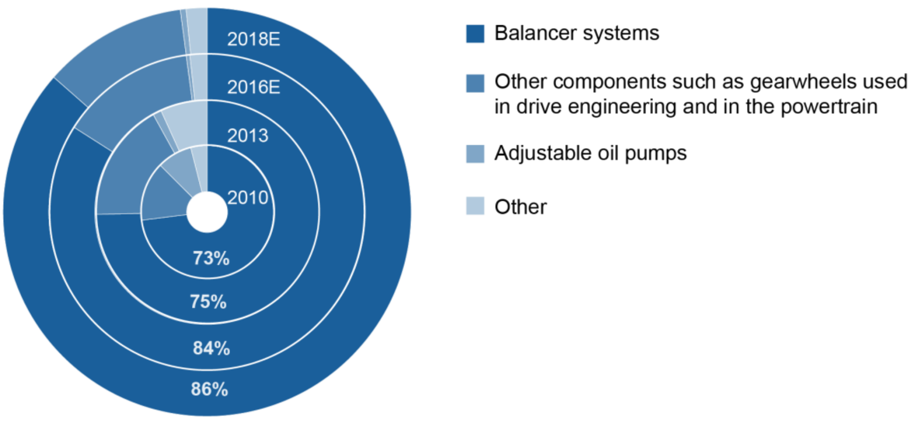
Scope believes that the trend towards stricter CO2 emission rules in the automotive industry is beneficial to MITEC. The requirements for reduced emissions have in particular led to the current moves to (i) improve engine efficiency and fuel economy by internal combustion engine ("ICE") downsizing and (ii) to a general hybridization of the powertrain.

From Scope's perspective, both trends will drive future demand for MITEC's entire product range. Furthermore, Scope expects global vehicle production to continue to shift towards smaller passenger vehicles, thus boosting the share of the A to C car segment. This is expected to increase MITEC's existing target group for its core division balancer systems in the mid-term and underscores the sustainability of the business model.

Very limited product diversification

MITEC's very limited product diversification is a constraining factor for the ratings. Nearly 75% of the company's 2013 sales are attributable to the core division, balancer systems. Taking into account MITEC's existing order backlog Scope expects balancer systems to account for 87% of sales in 2018, leaving the company even more vulnerable to external shocks.

Figure 5 – Product Diversification 2010 to 2018E



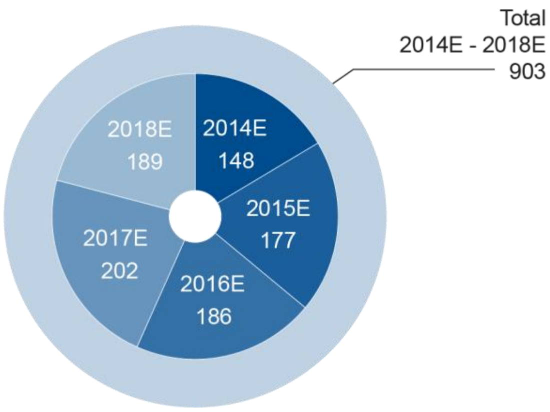
Source: MITEC, Scope

Ample order book provides cash flow visibility

The company's long-term order backlog for 2014E-2018E totals EUR 900m, which represents 6.5x MITEC's 2013 sales. Setting aside execution risks, Scope considers the company's booked business to be a reliable indicator of the stability of future revenues and cash flows and thus views it as a positive rating driver. In addition, Scope believes that the visibility on the company's future cash flows more than offsets the lack of aftersales business for MITEC.

Nonetheless, Scope notes the risks associated with the shift of customers towards debtors with a lower credit quality and with the ramp-up of new projects for new customers. As a result, order cancellations or adjustments as in previous business years may continue to occur.

Figure 6 – Order Book Extending to 2018 (in EURm)



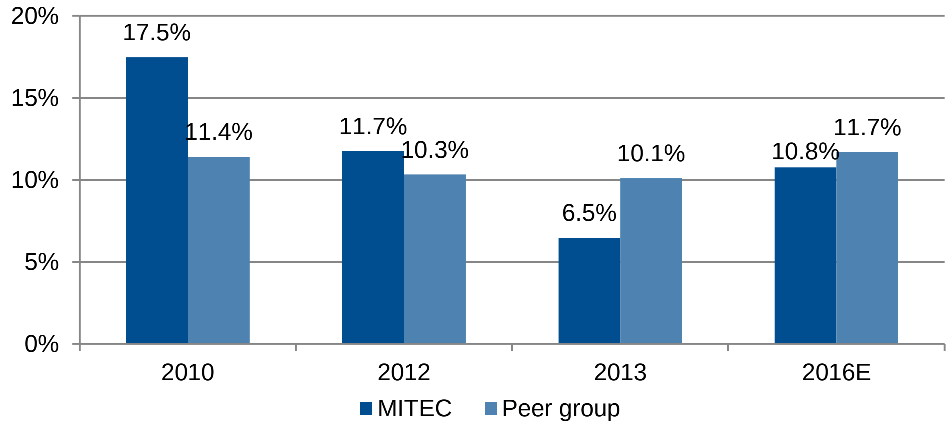
Source: MITEC, Scope

EBITDA margin in line with sector average and set to improve

MITEC's adjusted EBITDA margin declined from 17.5% in 2010 to 6.5% in 2013, owing to significant delays in order deliveries from a core customer and the associated high pre-financing costs. Excluding this one-time drop in the company's EBITDA margin in 2013, MITEC's profitability is in line with the industry average.

Once the order backlog materialises, Scope expects MITEC's EBITDA margin to improve to about 11% in 2016, in line with forecast sector developments for European automotive suppliers (estimated margins of about 12% in 2016 according to Bloomberg).

Figure 7 – EBITDA margin: MITEC vs. peer group



Source: MITEC, Scope, Bloomberg European Auto Parts Peers

Financial Risk Profile

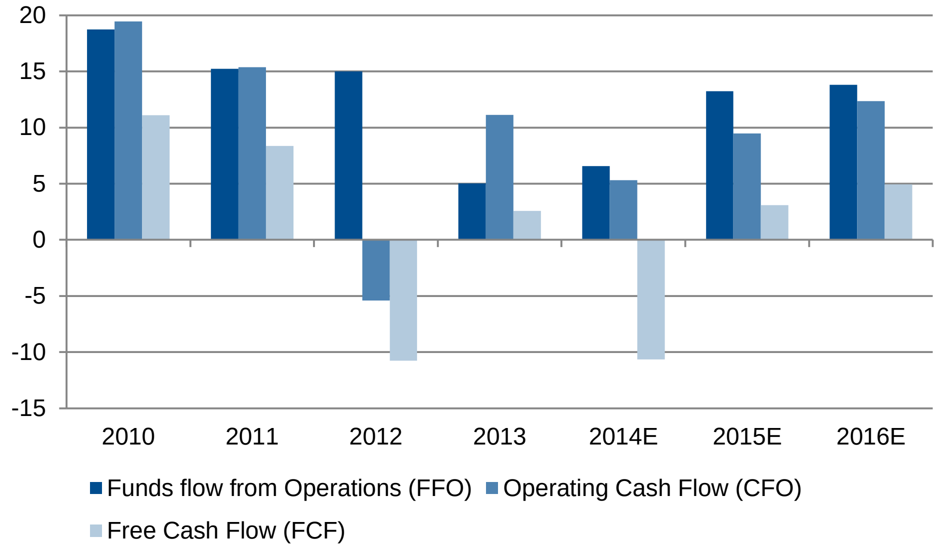
MITEC's BB- rating reflects Scope's anticipations of its financial situation going forward with improved margins and a deleveraging compared to the current financial situation.

Cash flow and EBITDA margin development

MITEC's FFO dropped from EUR 15m to EUR 5m due to the deterioration in the company's EBITDA margin to 6.5% as a result of postponed orders in 2013. However, funds from operations have been positive, enabling the company to cover its investment needs through the operating business. Free Cash Flows in 2012 and 2013 were largely burdened by high pre-financing requirements for new product lines, because every new order requires tailor-made equipment.

Although execution risks remain, Scope expects MITEC to return to a double-digit EBITDA margin of about 11% by 2016, once the orders in the order book materialise. This is roughly in line with the sector average of European automotive suppliers according to Bloomberg. While the company is expected to finance its CAPEX needs via its cash positions and external financing in 2014, Scope assumes that MITEC's operating business will be strengthened and Free Cash Flows will become positive in 2015 and 2016. These expectations have been positively factored into the ratings.

Figure 8 – Development of Cash Flows (in EURm)



Source: MITEC, Scope estimates

Current high leverage expected to decrease

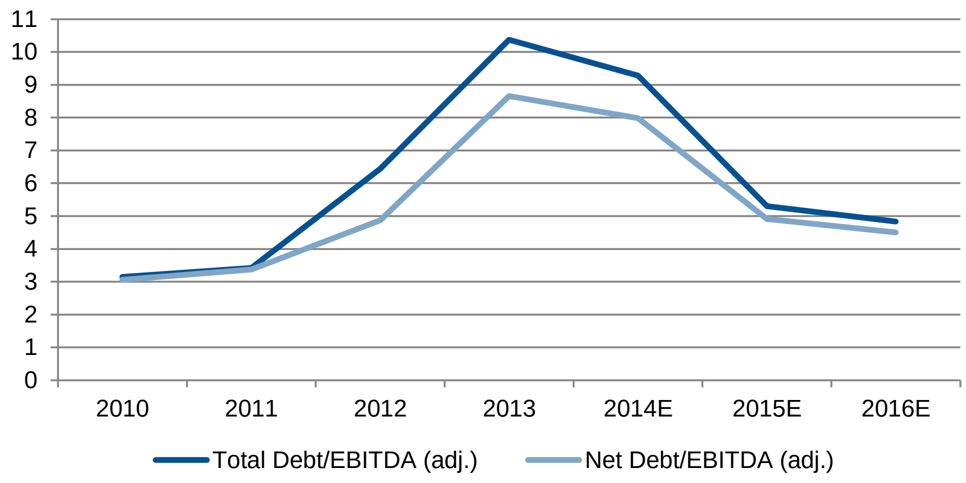
At present, MITEC is highly leveraged. ND/EBITDA stood at 8.7x in 2013 (2012: 4.9x). The yoy increase in leverage was driven by a significant drop in EBITDA from EUR 16.5m to EUR 9.1m, due to the above-mentioned order postponement. Scope notes that MITEC's leverage is significantly higher than that of its peer group of European tier 1 automotive suppliers. The latter stood at 1.8x in 2013.

Scope expects the company's leverage to decrease to a ND/EBITDA of 4.5x by 2016 as a result of the anticipated improvement in the company's EBITDA and a stable level of interest-bearing debt. This is factored into the rating.

Moderate interest coverage despite high leverage

Despite the company's high leverage, Scope sees MITEC's FFO Fixed Charge Coverage still at a comfortable level of 1.8x in 2013. With margins and cash flows improving Scope expects the company's FFO Fixed Charge Cover to increase to 2.1x in 2014 and 3.4x by 2016. Scope therefore considers that MITEC has enough buffer to comfortably cover its interest payments going forward.

Figure 9 – Development of Financial Leverage

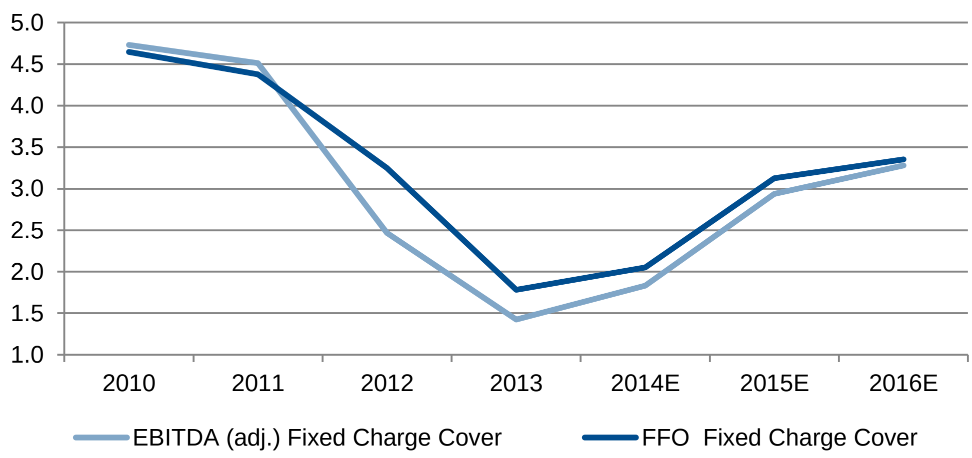


Source: MITEC, Scope estimates

Sufficient interest coverage and deleveraging even under a stress case scenario

According to Scope's calculations, even after applying a conservative safety discount of 20% on sales generated from MITEC's order book, MITEC is still expected to generate EBITDA of over EUR 10m in 2016, thus improving its ND/EBITDA to 6.1x in 2016 and the EBITDA Fixed Charge Cover to 2.6x.

Figure 10 – Development of Fixed Charge Coverage



Source: MITEC, Scope estimates

Debt structure

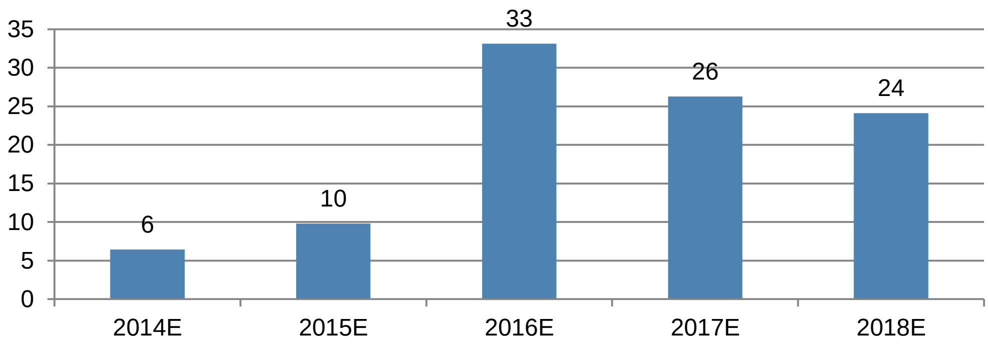
MITEC's interest-bearing debt amounted to EUR 101.7m in June 2014, mainly comprising EUR 71.9m senior secured debt and MITEC's EUR 25m senior unsecured corporate bond. Substantial refinancing is required for EUR 33m bank debt in December 2016 and for the EUR 25m Corporate Bond in March 2017. The remaining debt positions are either revolving credit lines or amortising debt.

Figure 11 – Financial Debt as of June 2014 (in EURm)

	Amount outstanding
Senior Secured Debt	71.9
Senior Unsecured Corporate Bond	25.0
Other financial Debt	4.8
Total financial Debt	**101.7**

Source: MITEC, Scope

Figure 12 – Maturity schedule (in EURm)



Source: MITEC, Scope estimates

Sufficient liquidity and limited refinancing risks

Scope considers MITEC's liquidity profile to be solid. Cash and marketable securities available of EUR 15.7m at 2013 comfortably cover the 2014 debt maturities amounting to EUR 6.5m. In addition, MITEC has access to EUR 2m in undrawn committed bank facilities. While Scope believes that MITEC's liquidity and Free Cash Flows of EUR 18m in total would be sufficient to cover maturing debt of EUR 9.8m in 2015, refinancing would be required to guarantee the EUR 33m bank debt in 2016 and the EUR 25m corporate bond in 2017.

Given the order backlog and the company's expected solid financial performance, Scope believes that risks arising either from refinancing/prolonging the bank debt facility by MITEC's house banks in December 2016 or from refinancing the EUR 25m corporate bond in March 2017 are limited.

Corporate Rating BB-

Incorporating the explicated rating drivers for MITEC, Scope assigns a BB- Corporate Issuer Credit Rating.

Corporate Bond Rating

Subordination of to EUR 72m of senior secured debt

MITEC AG issued a EUR 25.0m corporate bond in March 2012. Given the absence of a security package, MITEC's corporate bond is structurally subordinated to the secured debt issued by MITEC AG and its US-American subsidiary MITEC Powertrain Inc., which amounted to EUR 72m in June 2014. The latter debt positions are secured by pledges over (i) easements of the production sites in Thuringia/Germany and in Ohio/USA, (2) inventories and receivables, (3) machinery equipment and (4) intangibles.

Senior unsecured corporate bond rating of BB- aligned with the CICR

Taking into account the structural subordination of the senior unsecured corporate bond and Scope's calculations of a distressed enterprise value under the going concern assumption, the Recovery Rating of the bond is presumed to be "Average".

The Corporate Bond Rating is thus aligned with MITEC's BB- Corporate Issuer Credit Rating.

Outlook

Outlooks: Stable

The outlooks for the CICR and bond rating are Stable. A positive rating action on the CICR and the bond rating might occur if, on the one hand, the company's order backlog materialises as expected and the resulting cash flow is used to reduce the high leverage and, on the other, customer diversification improves.

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings GmbH, Berlin, District Court for Berlin (Charlottenburg) HRB 145472, Director: Florian Schoeller.

Rating prepared by	**Rating committee responsible for approval of the rating**
Sebastian Zank, Lead Analyst	Dr. Britta Holt, Committee Chair

Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings but for a fee based on a mandate of the rated entity.

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Key sources of Information for the rating

☒ Website of the rated entity	☒ Annual reports/semi-annual reports of the rated entity
☒ Valuation reports, other opinions	☒ Detailed information provided on request
☒ Current performance record	☒ Data provided by external data providers
☒ Annual financial statements	☒ External market reports
☒ Interview with the rated entity	☒ Press reports/other public information

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating report by the rated entity prior to publication / Modification of the report after the examination

The rated entity has been given the opportunity to examine the report prior to publication. Following that examination, the report was not modified.

Methodology

The rating methodology applied is the refined Corporate Rating Methodology which was placed on call for comments on 9 July 2014. This methodology is available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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Competent supervisory authority

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