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Ratings

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Southwire Co. LLC

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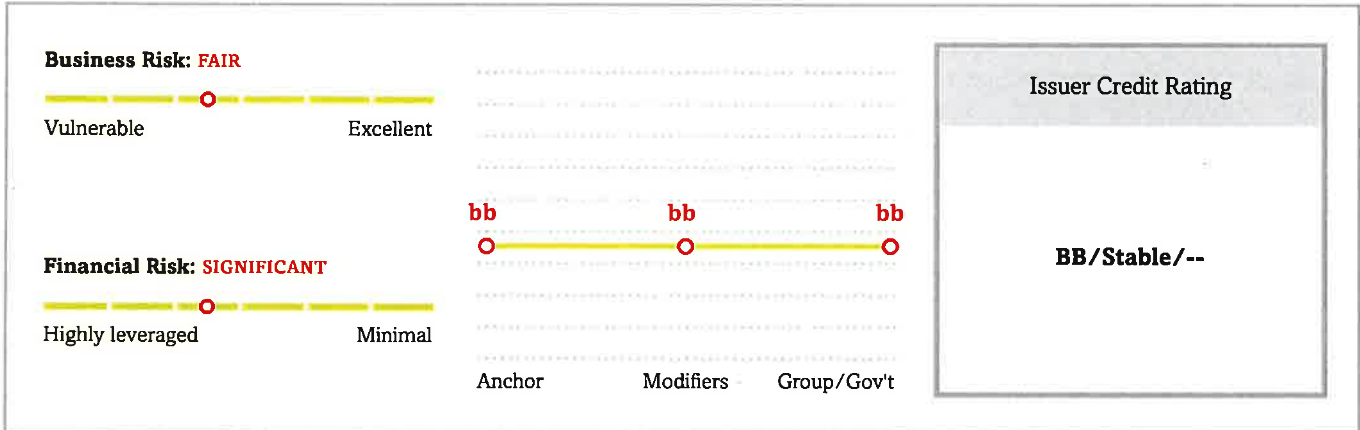


Credit Highlights

Overview

Key Strengths	Key Risks
Market leader in the North American wire and cable manufacturing industry.	Limited geographic diversity, with the majority of revenues derived in the U.S.
Relatively moderate debt leverage in the 2x-3x range.	Cyclical end markets and volatile metals prices can affect profitability and working capital during periods of sudden variations.
Cash balances on hand and revolving borrowing capacity provide ample liquidity.	Average EBITDA margins compared to other rated metals processing firms.

S&P Global Ratings views Southwire Co. LLC as the leading player in the U.S. wire and cable space, with a market share of over 30%. We believe the company will maintain its leading domestic position as it invests in further automation and efficiencies of its producing lines and continues to penetrate the profitable tool and component solutions business. We think these initiatives will allow Southwire to improve its adjusted EBITDA margin back to its historical levels of 6%-7% from about 5.5% in 2018.

Southwire's operating track record and prudent financial policies are supportive of adjusted debt to EBITDA in the 2x-3x range. Despite some margin pressures caused by higher distribution and transportation costs in 2018, we think the company's healthy production levels and utilization rates of about 90% provide cash flow visibility. In our view, a balanced capital allocation with moderate shareholder-friendly activities ($20 million annual dividends) also support relatively stable credit metrics.

Southwire's margins and credit metrics will remain exposed to cyclical end markets and cost inflation. While we forecast the company will generate more solid operating income in 2019, we believe it remains exposed to competitive pressures or volatile costs (namely raw materials and distribution). We estimate a 10% increase in Southwire's unit costs would, all else being equal, result in adjusted debt to EBITDA approaching 3x. A downturn in construction markets from our current growth assumption of 1% to 2% could also pressure volumes and margins, leading to a similar debt leverage increase.

Outlook: Stable

The stable outlook reflects our view that Southwire's earnings generation will improve in 2019 on the back of more favorable operating costs and relatively healthy end-market demand. While the company's margins trended slightly below our expectations in 2018, credit metrics remain commensurate with its rating. We forecast adjusted debt to EBITDA to remain in the mid-2x area and funds from operations (FFO) to debt of about 35% over the next 12 months.

Downside scenario

We view a negative rating action as unlikely over the next 12 months given our relatively supportive outlook for U.S. construction markets and GDP growth. However, we could lower our ratings on Southwire if market conditions deteriorated or competitive pressures weighed on EBITDA, resulting in adjusted debt to EBITDA approaching 4x or FFO to debt approaching 20%. A more aggressive financial policy that raises leverage toward those thresholds--whether due to additional acquisitions or larger dividends--could also result in a downgrade.

Upside scenario

We view an upgrade over the next 12 months as equally unlikely absent a transformational change in which Southwire became a more diverse company able to withstand differing sector and economic conditions or managed to grow profit margins materially from current levels. However, we could raise our ratings if the company achieved such growth and lessened the volatility in its cash flows while maintaining adjusted FFO to debt above 45% and debt to EBITDA below 2x.

Our Base-Case Scenario

Assumptions

- U.S real GDP to grow by 2.3% in 2019 and 1.8% in 2020.
- U.S. residential and nonresidential construction to grow at 0.5% and 1.7% in 2019, respectively, and 1.7% and 3.0% in 2020, respectively.
- Volumes sold close to 2.1 billion pounds in 2019 and growing at a 3% annual rate thereafter.
- Copper prices of $6,100/metric ton (mt) in 2019 and 6,300/mt in 2020.
- Aluminum prices of $2,100/mt for 2019 and 2020.
- Relatively steady volumes and metal prices to result in revenue growth of about 3% in 2019 and 2020.
- Improving operating costs and continuing ability to pass on raw material price fluctuations leading to improving adjusted EBITDA margin of about 6% in 2019 and 6.5% in 2020.
- Annual working capital outflow of $30 million to $50 million as the company continues to grow.
- Capital expenditures (capex) of about $120 million in 2019 and $175 million in 2020, mainly to further modernize producing facilities.
- Tuck-in acquisitions of about $100 million annually, centered on the tool and component solutions market.
- Stable dividends of close to $20 million in each of 2019 and 2020.

Key Metrics

	2018E	2019E	2020E
Debt-to-EBITDA	2.5x	2x-3x	2x-2.5x
FFO-to-debt	30%	30%-40%	35%-40%
EBITDA margin	5.5%	5.5%-6.5%	6%-7%

A--Actual. E--Estimate

Base-Case Projections

We expect relatively favorable end-market demand to support steady sales volumes at slightly above 2 billion pounds. Such levels, combined with broadly stable metal prices, should translate into revenue growth of about 3% in each of the next two years. We do not anticipate the General Cable–Prysmian transaction to cause lost volumes or more aggressive pricing that would affect Southwire's top and bottom lines. We believe the merged entity will work toward margin improvements (an area where General Cable was lagging its peers) rather than chasing volumes.

We expect adjusted EBITDA margins to improve near 6% in 2019 as operating costs stabilize. Higher than expected distribution and operational costs (warehouse transfer, freight) have somewhat pressured margins in 2018. Some of these issues were one-time events that we believe the company will resolve with the final ramp-up of its new enterprise resource planning (ERP) systems and the consolidation of its facilities. Such measures should lead to adjusted EBITDA margins getting closer to their historical levels of 6%-7%.

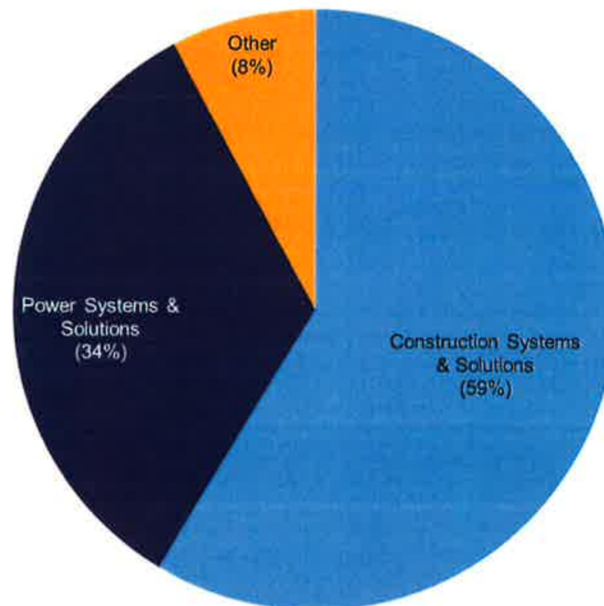
We forecast higher free operating cash flow of about $100 million in the next two years. More modest working capital outflows and increasing EBITDA generation should lead to this improvement (Southwire was free-cash-flow-neutral in 2018). We estimate the company will generate sufficient earnings to fund a higher capital expenditure program focused on processes automation and other add-on acquisitions.

Company Description

Southwire manufactures copper and aluminum wires, cables, and related products for residential and nonresidential construction, energy, infrastructure, and original equipment manufacturing (OEM) markets in North America, with annual production of about 2 billion pounds. It provides aluminum building wires, automotive cables, branch circuit cables, copper building wires, data com and low voltage electronics wires, feeder cables, flexible cords, flexible conduits, industrial portable cords and cables, telecom cables, well pump and low voltage irrigation cables, and whip products. Southwire also markets its technology for proprietary rod mills to metal fabricators worldwide. The company was founded in 1937 and is headquartered in Carrollton, Ga.

Chart 1

Southwire Co. LLC Sales By Segment ($ Mil.)



Year-to-date Sept. 30, 2018.

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Business Risk: Fair

Our view of Southwire's business primarily includes its relatively large size (No. 3 globally in terms of total revenues) and market leadership in the North American wire and cable processing and distribution industry (estimated market share of over 30%). The company also benefits from healthy utilization rates (over 90% historically), strong and established customer relationships, and a broad product portfolio.

Southwire's acquisition strategy (about $55 million spent in 2018) aims to partially mitigate its concentrated end-market exposure, while also expanding its product and customer base. We believe Southwire's growing tool and power component solutions business could contribute to higher operating margins in the medium term, mainly through an improved value proposition platform and some bundle effects.

Cyclical construction markets (residential and nonresidential) account for slightly more than 50% of the company's total revenues, while its energy and OEM and infrastructure segments account for nearly 30%. In addition, Southwire's limited geographic diversity, with about 95% of total revenues derived in the U.S., and average profitability metrics (adjusted EBITDA margins of 5% to 7%) relative to other metal processing companies that manufacture commodity-like products, constrain our business risk assessment.

Southwire's products are largely composed of copper and aluminum, which increases the volatility of profits and working capital during periods of rapidly changing metals prices. Operating margins could also be affected by slower end-market demand or higher than expected competitive pressures. At this point, we do not believe the acquisition of General Cable Corp. by Prysmian Group (No. 1 player globally, not rated) will result in more aggressive market behaviors as we expect the merged entity to focus on margin improvement rather than growing its volumes at all costs.

Peer comparison

We compare Southwire with France-based Nexans S.A. (BB/Negative/-- as of Feb. 16, 2019), the second largest cable manufacturer in the world. Although Nexans is slightly bigger than Southwire in terms of size (net sales over €6 billion), Nexans faced higher margin pressures over the past 12 months (project delays, higher input costs), with adjusted EBITDA margins expected to drop in the 4%-5% area in 2019. Our expectation that adjusted FFO to debt could decrease below 20% led us to revise the outlook to negative in December 2018.

We also compare Southwire with copper wire producer International Wire Group Holdings Inc. (B/Negative/-- as of Feb. 16, 2019) and steel rope and wire manufacturer WireCo WorldGroup Inc. (B/Negative/-- as of Feb. 16, 2019). The lower issuer credit ratings primarily reflect smaller and more concentrated operations (Southwire's revenues are more than 8 times those of International Wire and WireCo), lower utilization rates, and higher debt leverage (adjusted debt to EBITDA over 5x). The negative outlooks are the result of increasing competitive pressures and higher raw materials weighing on operating margins.

Financial Risk: Significant

We expect Southwire to generate adjusted debt to EBITDA in the mid 2x area and FFO to debt of about 35% over the next 12 months, which is slightly weaker than our previous expectations. Such levels remain commensurate with the current rating, and our expectation for improving operating margins should further support credit metrics in 2019 and 2020.

Our assessment incorporates Southwire's exposure to cyclical end markets as well as a degree of volatility in its material and operational costs. More specifically, we estimate that a 10% increase in its total cost per pound, all else being equal, could result in adjusted debt to EBITDA increasing close to 3x. While currently not envisioned, this scenario could result from higher than expected distribution costs or a sudden increase in copper prices that cannot be directly passed onto customers.

With the exception of a somewhat late refinancing in 2018, we view Southwire's financial policies as relatively prudent, balancing out growth strategy and deleveraging. More favorable operating margins and lower working capital requirements ($30 million to $50 million) should allow the company to further invest in the modernization of its facilities while completing tuck-in acquisitions in 2019. Moderate dividend payout of about $20 million per year should also be supportive of debt leverage remaining in the 2x to 3x area.

Liquidity: Adequate

We continue to view Southwire's liquidity to be adequate, based on the following observations and estimates:

- Our expectation that liquidity sources should exceed uses by more than 3x over the next 12 months;
- Positive liquidity sources minus uses, even if forecast EBITDA declines by an unanticipated 50%; and
- Sufficient covenant headroom for forecast EBITDA to decline by 50% without the company breaching its springing financial covenant.

Our view of Southwire's liquidity is limited by certain qualitative factors such as its infrequent capital markets activity and the absence of bond or credit default swap (CDS) trading data to indicate a high standing in credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash of approximately $153 million as of Sept. 30 , 2018; • Availability of approximately $595 million (net of outstanding borrowings and letters of credit) under the company's $1 billion asset-backed lending (ABL) facility over the next 12 months; and • Cash FFO of $250 million-$300 million in 2019.	• Capital spending of close to $120 million over the next 12 months; • Peak seasonal working capital needs of roughly $125 million annually; • Total working capital outflow of $30 million to $50 million in 2019; • Annual amortization of $5 million required under the term loan; and • Annual dividend payment to shareholders of about $20 million.

Debt Maturities

The company does not face near-term repayment obligations as its $1 billion ABL facility and $500 million secured term loan mature in 2023 and 2025, respectively.

Year	Amount$ mil.	Description
2019	5	Term loan amortization
2020	5	Term loan amortization
2021	5	Term loan amortization
2022	5	Term loan amortization
2023	1,005	ABL facility ($365 million drawn as of Sept. 30, 2018); Term loan amortization
Thereafter	472.5	Term loan maturing in May 2025

Covenant Analysis

We don't expect any covenant issues over the next 12 months given our expectation for Southwire's EBITDA generation and revolving facility availability. The ABL facility is governed by a springing 1x fixed charge coverage ratio if availability falls below the greater of $100 million or 10% of the aggregate borrowing base. In addition, its $500 million secured term loan is subject to a prepayment clause that states that the company must prepay the loan with a principal amount equal to 50% of excess cash flow as long as consolidated secured debt to consolidated EBITDA is greater than 2x. If this ratio drops below 2x but remains higher than 1.5x, this percentage shall be reduced to 25%. If this ratio falls further to 1.5x or less, the company has the option to prepay this principal amount.

Issue Ratings--Recovery Analysis

Key analytical factors

- We assess recovery prospects on the basis of a gross reorganization value for Southwire of approximately $961 million, reflecting about $178 million of emergence EBITDA and a 5.5x multiple. The $175 million emergence EBITDA incorporates our recovery assumptions for minimum capital expenditures at 1.5% of sales (based on

historical results) and our standard 15% cyclicality adjustment for issuers in the metals and mining downstream sector. We also incorporate a 25% operational adjustment given our view that the difference between its three-year average EBITDA of approximately $330 million and its emergence EBITDA of roughly $140 million is higher than the typical decline for similarly rated companies. Meanwhile, the 5.5x multiple is in line with the multiples we assign to other companies in the metals and mining downstream sector.

- The company derives about 95% of its EBITDA in the U.S. with the remaining 5% coming from Canada. As such, we assume Southwire's obligor/non-obligor split is 95%/5%.
- We also continue to assume that Southwire's $1 billion ABL facility will be drawn up to 60%, less outstanding letters of credit, which results in about $566 million ($510 million in the U.S. and $56 million in Canada) in principal and interest outstanding, at default.

Simulated default assumptions

Our simulated default scenario contemplates a default in 2023 amid a sharp decline in volumes because of weakening demand across the company's end markets, substitution for alternative materials, or market share loss to larger competitors. As a result, weakened cash flows from lower throughput would be inadequate to fund debt service with available cash. Eventually, the company's liquidity and capital resources become strained to the point where it cannot continue to operate or service its debt obligations absent a reorganization or restructuring.

- Year of default: 2024
- Emergence EBITDA: $178 million
- EBITDA multiple: 5.5x
- Gross recovery value: $980 million

Simplified waterfall

- Net recovery value for waterfall after admin. expenses (5%): $931 million
- Obligor/non-obligor valuation split: 95%/5%
- Estimated priority claims (ABL borrowings): $566 million
- Remaining recovery value: $374 million
- Senior secured term loan claim: $483 million
- --Recovery range: 70%-90% (rounded estimate: 75%)
- --Recovery rating: '2'

Note: Estimated claim amounts generally include approximately six months' accrued but unpaid interest.

Ratings Score Snapshot

Issuer Credit Rating

BB/Stable/--

Business risk: Fair

- **Country risk:** Very low
- **Industry risk:** Moderately high
- **Competitive position:** Fair

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Downstream Industry, Dec. 20, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment 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 And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	**bb**	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of February 28, 2019)

Southwire Company LLC	
Issuer Credit Rating	BB/Stable/--
Senior Secured	BB+
Issuer Credit Ratings History	
26-Apr-2018	BB/Stable/--
21-Feb-2018	BB/Negative/--
23-Jan-2014	BB/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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