Veoneer Inc. (VNE)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Price ($) (5/26/20)</th>
<th>10.78</th>
</tr>
</thead>
<tbody>
<tr>
<td>52WK H-L ($)</td>
<td>19 - 5</td>
</tr>
<tr>
<td>Market Cap (mil)</td>
<td>1,202</td>
</tr>
<tr>
<td>Shares Out (mil)</td>
<td>111.5</td>
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<tr>
<td>Float (mil)</td>
<td>111.1</td>
</tr>
<tr>
<td>Avg. Daily Vol (mil)</td>
<td>0.71</td>
</tr>
<tr>
<td>Dividend ($)</td>
<td>0.00</td>
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<tr>
<td>Yield (%)</td>
<td>0.0</td>
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</table>

Rating: Neutral
Speculative Risk: FY Dec

<table>
<thead>
<tr>
<th>2019A</th>
<th>2020E</th>
<th>2021E</th>
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<tbody>
<tr>
<td>Q1</td>
<td>(1.57)A</td>
<td>(2.09)A</td>
</tr>
<tr>
<td>Q2</td>
<td>(1.39)A</td>
<td>(1.76)E</td>
</tr>
<tr>
<td>Q3</td>
<td>(1.20)A</td>
<td>(0.81)E</td>
</tr>
<tr>
<td>Q4</td>
<td>(0.87)A</td>
<td>(0.24)E</td>
</tr>
<tr>
<td>Total</td>
<td>(4.32)A</td>
<td>(4.00)E</td>
</tr>
</tbody>
</table>

| Price Target ($) | 9 |
| L-Term Rev. Gr Rate Est: 15% |
| L-Term EPS Gr Rate Est: 10.0% |
| Debt/Cap: 0.0% |
| ROE: 0.0% |
| FY P/E | 2021A |
| | 2020E |
| | 2021E |
| NM | NM | NM |

<table>
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<tr>
<th>2021A</th>
<th>2020E</th>
<th>2021E</th>
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<tbody>
<tr>
<td>Dec</td>
<td>Revenue (Mil)</td>
<td>1,901.0</td>
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<tr>
<td></td>
<td>% Growth</td>
<td>(14.7)%</td>
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<tr>
<td></td>
<td>Operating Margin</td>
<td>-24.1%</td>
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Company Description

Veoneer, Inc. is a leading global supplier in the automotive safety electronics market, with a presence in three key product categories: restraint control systems, active safety, and brake systems. The company previously operated as the Electronics segment of Autoliv, Inc. and was established in 2018 following a distribution of shares (“spin-off”) to existing shareholders of Autoliv, Inc. Veoneer is listed on the NYSE under the ticker “VNE.” The company is headquartered in Stockholm, Sweden.

Revenue Profile

*As of December 2019

Investment Thesis

Automotive safety electronics pure-play. Veoneer is a pure-play on the automotive safety electronics market, with exposure to restraint control systems, active safety, and brake systems. Combined, these markets are expected to grow 10% annually through 2025.


- Based on the timing between program award and launch and how new business scales over time, we anticipate the higher level of order intake to drive an acceleration in Veoneer revenues later in 2020 (mid-teens growth) and continuing through 2022 (20%+ growth).
- The current order book is also shaping up well to deliver 2022 revenue targets, supporting a mid-teens rate of overall revenue growth and 25-30% rate of active safety revenue growth during 2021-22.

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Leading player in Active Safety. Veoneer is a leading player in the fast-growing active safety market and we believe this business is likely a key reason investors own Veoneer’s stock. With $708 million in revenue in 2019, Veoneer is a top five player in the active safety market (as the company defines it).
- The active safety market is expected to increase in size by more than five-fold between 2017 and 2025, growing from $4.8 billion to approximately $24.5 billion (23% CAGR).

Exiting the Zenuity JV should improve cash position. Veoneer is currently in the process of dissolving Zenuity, its 50-50 joint venture partnership between Veoneer and Volvo Cars focused on developing the software stack for autonomous driving.
- While the objective of Zenuity was to provide several benefits to Veoneer, including long-term attractive economics (additional JV income through the sale of autonomous driving software stacks) and the opportunity for Veoneer to purchase the Zenuity software stack to integrate with its own hardware and sensor fusion capabilities when supplying an autonomous driving solution to its OEM customers, Veoneer now believe a go-it-alone approach is more financially advantageous.
- Veoneer expects the partnership to be dissolved by Q3-20, with the dissolution of the partnership providing the potential for $30-40 million in annualized cash savings once the transaction is complete.

Identifiable drivers of margin expansion. Given global economic conditions, Veoneer has not yet updated long-term margin targets, but the company does expect to see improved profitability in 2020, given the sale of the money-losing brake business and the dissolution of the Zenuity joint venture. We expect margin expansion to be driven by normalizing RD&E spending and operating leverage on additional volume.

Valuation. Our $9 price target is based 0.7x Cal-2022E EV/Sales, the median valuation of the post-spin trading range, discounted by 20%. As a recovery scenario emerges, we believe investors will begin to value auto stocks on mid-cycle EBITDA.

Risks & Caveats

Automotive industry. The global automotive industry is cyclical and highly impacted by economic activity. Cyclical declines in volume have the potential to negatively impact revenue and earnings and can result in meaningful losses and/or cash outflows until volumes recover.

Customer concentration. While the automotive industry is highly concentrated to begin with (top 5 OEMs comprised ~50% of global light vehicle production), Veoneer has an even higher customer concentration than the industry average. Veoneer’s top five customers – Honda, Daimler, Ford, Hyundai/Kia, and Renault-Nissan-Mitsubishi – accounted for 67% of consolidated sales in 2019. GM, Fiat Chrysler, and BMW are also meaningful customers, representing 6%, 5%, and 4% of 2019 sales, respectively. The loss of a key customer or a key program with any large customer could materially impact revenue.

Competitive markets. Tier 1 auto supply markets are notoriously fragmented, making the market highly competitive. In addition to competition from traditional tier 1 auto suppliers, Veoneer also faces increasing competition – particularly in the active safety market – from tier 2 suppliers and from non-traditional players who have entered the market in pursuit of autonomous driving solutions.
- Restraint control systems. While Veoneer has the leading market position in the restraint control business, it has just 25% market share and four sizable competitors (Bosch, Continental, Denso, and ZF), making competition in the space intense.
- Active safety. Veoneer estimates it has 15% of its addressable market in active safety, but that business is also highly fragmented, facing competition from both traditional tier 1 auto suppliers (Aptiv, Bosch, Continental, Denso, Magna, Valeo, ZF) as well as competition from newer, disruptive entrants from the tech space (Apple, Google, Intel/Mobileye, NVIDIA, Qualcomm, and Uber). Given the large amount of investment dollars flowing into the space, we expect competition in the active safety market to remain fierce.

Pace of technology adoption. Veoneer’s revenue and margin targets are highly contingent on a pace of technology adoption consistent with the company’s internal forecasts. However, the pace of technology adoption is highly uncertain – and any variation from Veoneer’s assumptions is likely to impact vehicle content, and subsequently, company revenues.

Regulatory environment. Changes in the regulatory environment may negatively impact the pace of technology adoption. If countries/regions are slower to regulate active safety features or incorporate these features as part of standard vehicle ratings, the pace of technology adoption may develop slower than anticipated, resulting in slower growth in content per vehicle.

Sub-scale operations. The spin-off of Veoneer from Autoliv may result in a loss of purchasing power for Veoneer, putting the company at a potential cost disadvantage relative to its larger peers, generally housed within the business/operations of a larger auto supplier.

Raw materials. Veoneer’s largest commodity exposures include electrical components, non-ferrous metals, and ferrous metals for brake systems. Raw material purchases are governed by contractual (but lagged) commodity pass-through agreements, which sometimes create a timing mismatch between the increase in costs and the increase in revenue.

Warranty costs. Veoneer provides warranties for its products. If recall expenses and other warranty costs are running higher than previous loss experience/management’s anticipated reserve, this could materially impact earnings. Higher warranty experience or an inability to effectively react to recalls could also result in a loss of key customers.
**Currency.** Veoneer generates approximately 65% of its revenue outside of the U.S., exposing the company to both translational and transactional currency risk. Gross transactional currency exposure was $1.0 billion in 2019, while net exposure was approximately $900 million. The largest net exposures include: 1) sale of EUR vs. SEK, 2) purchase of USD vs. SEK, 3) purchase of USD vs. KRW, 4) sale of USD vs. RMB, and 5) purchase of USD vs. EUR. These five currency pairs comprised approximately 82% of Veoneer’s net transactional currency exposure in 2019.

**Cash burn.** Given investments in RD&E and a high level of order intake in the near term, we do not expect Veoneer to generate positive cash flow until 2022. Because the will not be cash flow positive until that time, we see risk that the company may need to raise high-cost debt, forego attractive acquisition opportunities, or potentially become insolvent – all potential risks to the business.

**Acquisitions.** Given the aforementioned cash burn anticipated through 2022, we believe Veoneer’s appetite for acquisitions may be limited. However, to the extent the company does pursue acquisitions, we believe smaller, technology-oriented acquisitions are more likely, which may represent another source of potential pressure on cash flow if these companies are “pre-revenue.”
Appendix - Important Disclosures and Analyst Certification

Approved on 27 May 2020 12:47EDT/ Published on 27 May 2020 12:52EDT.

Rating and Price Target History for: Veoneer Inc. (VNE) as of 05-26-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of VNE.

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