

Lear Corp (LEA)

Beat & Raise Quarter; Buy 4.75% Senior Nts

■ **Citi's Take** — Lear reported strong 2Q results and raised its FY14 guidance for revenue, core operating earnings, and free cash flow. Revenues of \$4.6bn (+11.5% y-o-y) outpaced our and Street's \$4.4bn expectations owing to top-line expansion in both Seating (+12% y-o-y) and Electrical (+9% y-o-y). Adjusted EBITDA expanded 20% y-o-y to \$353mm and beat our \$328mm estimates owing to strong electrical adj. operating margins (+280bp y-o-y to 12.5%) and a 20bp sequential improvement in seating margins (-10bp y-o-y to 5.7%). During the quarter, Lear returned \$172mm to shareholders through repurchases and dividends (the company has \$594mm of share repurchase authorization remaining, which expires in April 2016). FCF for the quarter of \$137mm expanded \$77mm y-o-y owing to EBITDA expansion and a \$36mm reduction in capital expenditures. Net leverage remained low at 0.2x (vs. 0.1x during 1Q14). Looking ahead, we expect Lear to be focused on shareholder friendly actions as well as tuck-in acquisitions, as mgmt. noted "no transformational acquisitions are needed or planned". Nonetheless, Lear itself could be a potential M&A target.

■ **Credit Implications** — We maintain our buy recommendation on LEA 4.75% senior notes (2023), along with Neutral on the yield-to-call 8.125% senior notes (2020) and longer-dated 5.375% senior notes (2024). Recall, a number of industry participants have highlighted LEA as a potential M&A target owing to its attractive position in the supplier space and with an EV of ~\$8bn. Per our note from July 17 (see [link](#)), we offer a quick summary of the covenants below. Importantly, the 4.75% notes include a change of control covenant that does not require a ratings downgrade (unlike the 5.375% notes which appear more issuer-friendly).

- **LEA 5.375% (2024):** Change of Control at 101% requires rating downgrade; no restriction on RP; unlimited unsecured debt capacity and ~\$3.25bn secured debt capacity; equity claw until Mar 2017; next call Mar 2019.
- **LEA 4.750% (2023):** Change of Control at 101% does not require a ratings downgrade; no RP restrictions; unlimited unsecured debt capacity and ~\$3.25bn secured debt capacity; equity claw available until Jan 2016; next call: Jan 2018.
- **LEA 8.125% (2020):** Change of Control at 101% does not require ratings downgrade; RP capacity available up to 3.75x leverage ratio (subject to other tests); current unsecured debt capacity governed by 2x coverage test (\$500mm general basket); equity claw expired Mar 2013; next call date: Mar 2015.

■ **Conference Call Info** — July 25 @ 9AM ET; Dial-in: (800) 789-4751. No PW.

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Figure 1. LEA Trading Levels

Coupon	Description	Citi	Maturity	Ratings	Amount	Current Prices				Next Call Data	
		Rating		(Moody's/S&P)		Outst.	Bid	YTW (%)	Z-Spr (bp)	YTW Date	Date
LEAR CORP (LEA) - Marketweight											
8.125%	Sr Nts	Neutral (2)	3/15/2020	Ba2(P)/BB(S)	\$245	107.125	3.03%	264	3/15/2015	3/15/2015	104.06
4.750%	Sr Nts	Buy (1)	1/15/2023	Ba2(P)/BB(S)	\$500	99.500	4.82%	243	1/15/2023	1/15/2018	102.38
5.375%	Sr Nts	Neutral (2)	3/15/2024	Ba2(P)/BB(S)	\$325	102.250	5.02%	275	3/15/2022	3/15/2019	102.69

Source: Citi Research

Appendix A-1

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Data current as of 30 Jun 2014	Rating		
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Lear Corp (LEA) — Issuer Portfolio Weighting and Issue Rating History

High Yield Credit Research

Analyst: Manish A. Somaiya

Issuer		Issue				
Weighting	Date	Coupon	Description	Maturity	Rating	Date
MW	05-Oct-12	7.875%	Sr Nts	15-Mar-18	Sell (3)	05-Oct-12
					Neutral (2)	17-Jun-13
		8.125%	Sr Nts	15-Mar-20	Sell (3)	05-Oct-12
					Neutral (2)	17-Jun-13
		4.750%	Sr Nts	15-Jan-23	Neutral (2)	05-Feb-13
					Buy (1)	21-Oct-13
		5.375%	Sr Nts	15-Mar-24	Neutral (2)	25-Apr-14

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