COOPER-STANDARD HOLDINGS INC. (CPS)

EQUITY: UNDERWEIGHT
13% SENIOR SECURED NOTES DUE 06/24: OVERWEIGHT

REVENUE COMPRESSION; HIGH LEVERAGE; STRICT COVENANTS

2/9/2022

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THESIS

We are initiating an underweight rating on the equity of Cooper Standard Automotive, and simultaneously initiating an overweight rating on their 13% Senior Secured Notes due 6/24. The significant headwinds on the company's earnings power coupled with its overleveraged capital structure set the stage for a collapse in its equity value, while the notes are protected by a strong tangible asset base and can generate significant yield regardless of the company's outlook. This strategic positioning in both poles of the capital structure serves to mitigate risk and benefit from different the yield profiles.

KEY DRIVERS

Compression of profits from both the revenue side and the costs side. Production volumes of OEMs have been adversely affected by the chip shortage, and this is likely to continue, albeit to a lessening extent, in the short to medium term. As OEMs cannot produce to the full extent to meet demand, revenues for Cooper Standard will be artificially compressed too. On the costs side, inflation has begun to cause an increase in labor and raw material costs which shrink the margins of the firm. This too, is likely to burden the company in the short to medium term.

Overleveraged capital structure causing default risk. Cooper Standard's leverage well surpasses its peers and presents a huge burden on the firm's cash flows in the near future. Compressed free cash flows and large coupon payments, coupled with the looming maturity of a large principal payment for the term loan, cause significant liquidity risk going forward.

Tight covenants and a strong tangible asset base protect the notes' value. The notes trade at a discount to par yet are positioned to recover the full principal amount even in the event of a liquidation. The covenants in the credit documents protect against value leakage from additional debt and outlines a priority lien on the largest source of collateral in the firm. These factors provide downside protection and ensure that the highly appealing double digit yield is attained.

COUPON RATE: 13.00%

CURRENT PRICE: $95

CURRENT YIELD: 13.68%

(As of 2/9/22)

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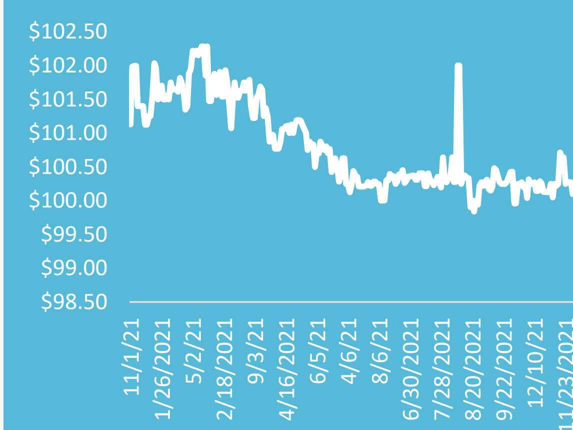
Summary

Tenor	2.5 yrs.
Current Price	95
EBITDA/Interest Expense	0.73x
Debt/EBITDA	22.38x
Current Stock Price:	$19.46
Target Stock Price:	$9.66

Senior Secured Note Price Chart



COMPANY OVERVIEW

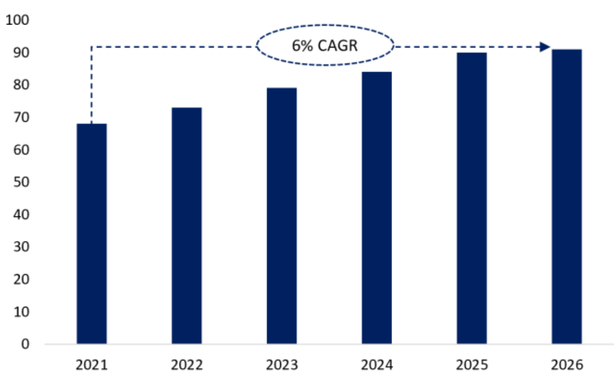
Cooper-Standard Holdings Inc. (NYSE: CPS) is a manufacturer of sealing, fuel and brake delivery, and fluid transfer systems. Their products are primarily used in passenger vehicles and light trucks that are manufactured by global automotive original equipment manufacturers ("OEMs") and replacement markets. The Company has approximately 25,000 employees, with 121 facilities in 21 countries. Their business model can be summarized as purchasing raw or unfinished materials and using them to produce car parts which they then sell to OEMs. A key thing to note is that sales to the large North American OEMs such as Chrysler and Ford Motor Company make up the majority of Cooper Standard's revenue.

EARNINGS POWER HEADWINDS

OEM Production Volumes

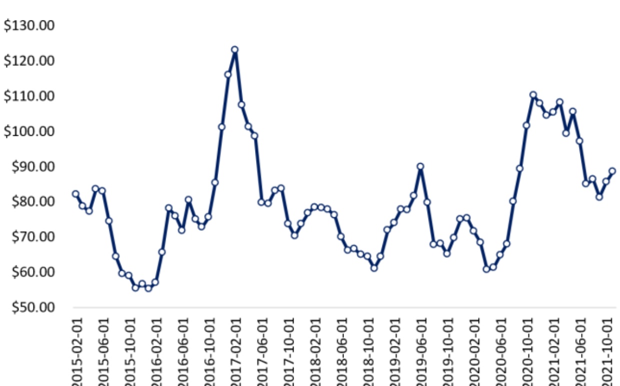
Chip shortage caused in 2020-2021 by COVID-19 pandemic and supply chain disruption have negatively affected revenues of CPS. Analysts expect to see recovery in global light vehicle production by 2026 with CAGR of 6%. During the next four years positive revenue recovery trend can be expected.

Figure 1: Global Light Vehicle Production, mln. units



Margin Compression

Figure 2: Global price of Rubber, U.S. Cents per Pound



Increasing inflation leads to increasing costs, and while management states that historically they have been able to pass on close to half of this to the customer, management has currently begun expressing doubts in the firm's ability to pass even 40% on. This puts significant pressure on margins.

CAPITAL STRUCTURE

Figure 2: Capital Structure of CPS

	Principal	Market	Cumulative Leverage				Interest	Trading
USD in millions	Amount	Amount	Principal	Market	Maturity	Rate	Payment	Price [5]
ABL Facility [1]	0	0	0	0	Mar-25			N/A
$340m Term Loan Facility due 2023	340	284	7.23x	6.05x	Nov-23	L + 200	9	83.6
$250m Senior Senior Secured Notes due 2024	250	238	12.55x	11.10x	Jun-24	13.00%	33	95
Finance Leases [2]	26	26	13.12x	11.66x				N/A
Other Borrowings [3]	35	35	13.87x	12.42x				N/A
Total Secured Debt	**$ 652**	**$ 584**	**13.87x**	**12.42x**			**42**	
5.625% Senior Notes due 2026	400	253	22.38x	17.80x	Nov-26	5.63%	23	63.2
Total Debt	**$ 1,052**	**$ 836**	**22.38x**	**17.80x**			**64**	
Less Cash and Equivalents [4]	(253)	(253)						
Net Debt	**$ 799**	**$ 583**	**16.99x**	**12.41x**				
Market Capitalization (as of 2/9/2022)	331	331						
Plus: Unfunded Pension & Postretirement Obligations	191	191						
Plus: Environmental Contingencies	10	10						
Plus: Non Controlling Interests [4]	13	13						
Total Enterprise Value	**$ 1,345**	**$ 1,129**	**28.62x**	**24.03x**				
Memo Item: LTM Adj. EBITDA	*$ 47*							

1 - Maximum borrowings of $180m available depending on size of borrowing base. Grid pricing of 1.5%-2.0% depending on average quarterly availability. LIBOR floor of 0.75%. Sublimits on letters of credit and swingline loans of $100m and $25m. Incremental borrowings of $100m available subject to consent of additional lenders. Maturity springs forward to 91 days prior to term loan in the case of no refinancing.
2 - Weighted average discount rate of 5.8%.
3 - Comprised of borrowings under local bank lines payable within one year.
4 - Not reflective of events subsequent to Q3, namely the repurchase of non-controlling interests in South Korea.
5 - Pricing as of 2/9/2022.

While there is a great deal to unpack in this capital structure, the two focus areas revolve around the sheer amount of leverage (as described by Debt or Net Debt divided by LTM Adjusted EBITDA) and the $340 million dollar maturity coming due soon.

Leverage

While the LTM operating profit two years prior was over $150 million, it has plummeted to under negative $100 million now. This has been reflected in the EBITDA, and so the leverage metrics have ballooned to unsustainable levels. Below is a breakdown of debt levels of Cooper Standard's peers, which illustrates how much debt the company should ideally be carrying.

Figure 3: Debt Capacity

Company	Credit Rating	Interest Spread on Revolver	Interest Spread on Term Loan	Weighted Average Interest Rate on Unsecured	2020 Total Secured Debt / LTM EBITDA	2020 Total Debt / LTM EBITDA	2020 Net Debt / LTM EBITDA	2020 Total Debt / Market Cap	2020 EBITDA Interest Coverage Ratio
American Axle & Manufacturing Holdings, I	BB-	4.6%	4.6%	6.4%	1.5x	3.4x	2.9x	3.4x	0.5x
Dana Incorporated	BB+	4.0%	2.4%	5.1%	0.3x	3.3x	3.0x	0.8x	3.5x
Martinrea International Inc.	BB	2.3%	2.1%	N/A	1.4x	3.6x	3.1x	1.8x	7.3x
Mentor, Inc.	BB-	4.3%	4.3%	4.7%	0.4x	3.2x	2.9x	0.6x	7.5x
Modine Manufacturing Company	BB-	1.5%	1.5%	5.9%	1.3x	3.1x	2.7x	0.8x	4.8x
	Median	**4.0%**	**2.4%**	**5.5%**	**1.3x**	**3.3x**	**2.9x**	**0.8x**	**4.8x**
	Min	1.5%	1.5%	4.7%	0.3x	3.1x	2.7x	0.6x	0.5x
	Max	4.6%	4.6%	6.4%	1.5x	3.6x	3.1x	3.4x	7.5x
	25th	2.3%	2.1%	5.0%	0.4x	3.2x	2.9x	0.8x	3.5x
	75th	4.3%	4.3%	6.0%	1.4x	3.4x	3.0x	1.8x	7.3x
	Mean	**3.3%**	**3.0%**	**5.5%**	**1.0x**	**3.3x**	**2.9x**	**1.5x**	**4.7x**
	St Dev	1.4%	1.4%	0.8%	0.6x	0.2x	0.2x	1.2x	2.9x

Clearly, Cooper Standard is significantly overleveraged, and our projections show that next year's EBITDA levels will not be much higher than now, meaning that the company would have to survive for two years or more to organically return to sustainable levels of leverage. This means there is a high likelihood of a reorganization being pursued. In such a scenario, equity would recover a fraction of its value, or be wiped completely.

Impending Maturity

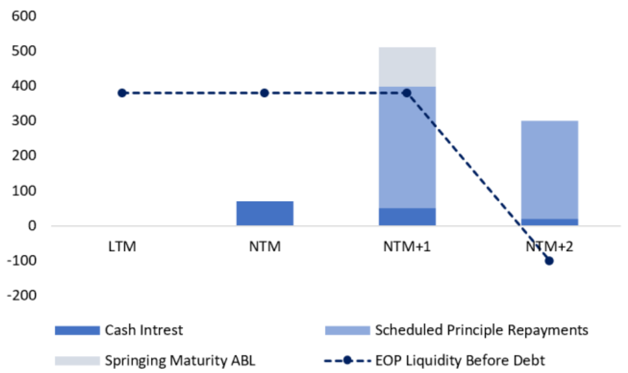
These issues are exacerbated by the impending term loan maturity totaling $340 million. Coming due in under 2 years, the failure to refinance these notes would almost certainly mean a bankruptcy or restructuring will take place. This is because the firm does not have sufficient liquidity to make the full payment, keeping in mind the springer attached to the ABL Facility.

Figure 4: Current Liquidity

RCF Commitments	180
Less: Borrowing base restrictions	*(33)*
Less: Letters of Credit	*(5)*
Less: FCCR covenant restrictions	*(15)*
Plus: Cash and Cash Equivalents	*253*
Total Liquidity	**380**

Although $380 million seems enough to cover the $340 million of outstanding debt, a deeper look shows that the ABL Facility accounts for $127 million of that. Since the springer would trigger that to mature even before the TL, the only realistic liquidity available to make the principal payment would be cash. The firm's cash reserves currently sit at the level of $253 million, and there's a high chance that there will be erosion from further negative free cash flows. So, a bankruptcy or restructuring procedure seems imminent.

Figure 5: Projected Liquidity



COVENANT RESTRICTIONS

Additional debt capacity is virtually non-existent under current covenant restrictions, as the 13% notes coming in as a rescue financing of sorts used up prior capacity. Besides that, the fixed charge coverage ratio (FCCR) must satisfy a minimum of 1x, and the ratio currently sits at the level of -0.65x. However, this is only tested if the ABL availability falls below $45 million.

Moving onto collateral protection, the undrawn ABL has a priority lien on most short-term assets and a junior lien on most long-term assets, and vice versa for the Term Loan and 13% Senior Secured Notes, which share the same collateral. Transfers to unrestricted subsidiaries may be permitted, subject to certain limitations. The maximum value leakage seems to be just under $150 million at current conditions. All said, the 13% Senior Secured Notes are well protected by collateral and other restrictions, and the company itself is walking a fine line bordering very close to a technical default.

VALUATION

Figure 6: DCF Price Target & Sensitivity Table

		Weighted Average Cost of Capital (WACC):				
		8.0%	9.0%	**10.0%**	11.0%	12.0%
Terminal EV / EBITDA Multiple	4.40 x	15.9	15.7	**15.5**	15.3	15.1
	4.20 x	13.0	12.8	**12.6**	12.4	12.2
	4.00 x	**10.1**	**9.9**	**9.7**	**9.5**	**9.3**
	3.80 x	7.2	7.0	**6.8**	6.6	6.4
	3.60 x	4.3	4.1	**3.9**	3.7	3.5

The Brief summary of assumptions and caveating this by saying this is the value if the firm is assumed to survive without a reorganization, which is not a safe assumption to make. As for the projections, revenue growth assumptions were selected from the higher end of light vehicle production growth projections, and they surpass the CAGR displayed in Figure 1. Furthermore, operating margin recoveries were factored into calculations of future cash flows and EBITDA figures. Even so, the base case price target the model suggests is just under $10 per share, putting it at nearly a 50% discount to its trading price of $19.46. At the higher end, the model still suggests a value which is a considerable discount to its current trading price, though there is still risk to the upside, as a complete recovery could put the EV/EBITDA multiple even higher than 5.0x. That said, given the leverage and underperformance of CPS versus its peers, we believe the above range is justified.

Figure 7: Hypothetical Recovery Waterfall in a Reorganization

Net Distributable Value (Implied EV)				$980	$1,280
Distributable Proceeds by Claimant Class					
1. First Lien Priority Claims (Including LOC)	652	100%	100%	$652	$652
Net Proceeds Remaining after Class 1				*$328*	*$628*
2. General Unsecured Claims					
Plus: Senior Note Claims	*400*				
Plus: Trade Claims & Other Accrued	*336*				
Plus: Pension & Postretirement Obligations	*191*				
Total	927	35%	68%	$328	$628
Net Proceeds Remaining after Class 2				*$0*	*$0*
3. Remaining Value to Equity Interests				$0	$0

Figure 8 addresses what the worst-case recovery for the 13% Senior Secured Notes could be, while Figure 7 demonstrates how quickly the firm's equity could lose value in a potential reorganization. Although these do not represent all the total claims, as pension and other such claims were left out of the General Unsecured Claims class for simplicity. These brief analyses show that even without those other claims senior to the equity of Cooper Standard likely stands to lose immense value in the case of a reorganization.

Figure 8: Liquidation Valuation

Liquidation process	Book Value	Recovery Estimate % Low	Recovery Estimate % High	Recovery Estimate $ Low	Recovery Estimate $ High
(USD in millions)					
Gross Distributable Value					
Current Assets					
Unrestricted Cash at Conversion	253	100%	100%	$253	$253
Tooling receivable	98	0%	5%	$0	$5
Accounts receivable	309	40%	60%	$124	$185
Inventories	198	65%	75%	$129	$149
Prepaid expenses	30	27%	47%	$8	$14
Income tax receivable and refundable credits	83	0%	20%	$0	$17
Other Current Assets	101	97%	97%	$98	$98
Total Current Assets	**1072**	**57%**	**67%**	**$611**	**$720**
Non Current Assets					
Property, plant and equipment 1	809	55%	70%	$445	$566
Operating lease ROU assets	103	0%	0%	$0	$0
Goodwill	143	0%	0%	$0	$0
Intangible assets	62	0%	15%	$0	$9
Other assets	131	5%	10%	$7	$13
Total Non Current Assets	**1247**	**36%**	**45%**	**$445**	**$566**
Gross Distributable Value	**2319**	**46%**	**55%**	**$1,056**	**$1,287**
1 - Some of PP&E was recorded at orderly liquidation value on B/S, so it was assigned high recovery rates.					
Less: Liquidation Adjustments					
Wind Down Costs				($162)	($209)
Professional Fees				($46)	($70)
Ch. 7 Trustee Fees				($46)	($46)
Total Liquidation Adjustments				**($255)**	**($325)**
Net Distributable Value				**$801**	**$962**

Figure 9: Liquidation Waterfall

Distributable Proceeds by Claimant Class					
1. First Lien Priority Claims (Including LOC)	630	100%	100%	$630	$630
Net Proceeds Remaining after Class 1				*$171*	*$332*
2. General Unsecured Claims					
Plus: Senior Note Claims	*400*				
Plus: Trade Claims & Other Accrued	*546*				
Plus: Pension & Postretirement Obligations	*191*				
Plus: Lease Rejection Claims & Other	*64*				
Total	1,201	14%	28%	$171	$332
Net Proceeds Remaining after Class 2				*$0*	*$0*
3. Remaining Value to Equity Interests				$0	$0

The recovery assumptions for the assets on Cooper Standard's balance sheet were taken from past bankruptcy filings of auto parts companies. The hypothetical liquidation analyses from disclosures statements in Garrett Motion Inc., APC Automotive Technologies LLC, and Cooper Standard's own Chapter 11 filings were used as reference. One key difference occurs, though, in the PP&E line item, since the recovery assumptions were considerably higher than ones in our precedents. This is because the bulk of Cooper Standard's PP&E is already recorded on its balance sheet at the value of their orderly liquidation. The overall implications of this analysis are that the senior secured tranche can expect a full recovery in a liquidation scenario, supporting the downside protection thesis for the 13% Senior Secured Notes in the absolute worst case scenario.

RISKS & MITIGATION

First, there is potential for an extremely swift recovery in semiconductor production capacity causing a large spike in revenues lifting share prices. While the short position makes losses potentially infinite, this risk can be mitigated by a stop loss for $24, which is the expected share price for a very, very bullish recovery scenario.

Second, asset strippage among the senior secured tranche could leave the notes unprotected in the case of a credit event. Such legal maneuvers involving transfers to unrestricted subsidiaries are hard to completely prevent even with well written covenants, and these could damage the recovery prospects of the notes considerably. This, however, would likely only be a problem in a near-bankruptcy situation, meaning the short position on the equities would have yielded a handsome return to mitigate any losses.

CONCLUSION

Short to mid headwinds on Cooper Standard's earnings power and its overleveraged capital structure are markers of further decline in its equity value. Placing a short on CPS equity while also buying its 13% Senior Secured Notes due 2024 with a healthy YTW and even better downside protection via liens on tangible assets would create a well-hedged strategy to deliver significant profits to the investor.