

Rating Action: Moody's changes VW's outlook to stable and affirms A3 rating

Global Credit Research - 20 Mar 2018

Frankfurt am Main, March 20, 2018 -- Moody's Investors Service, ("Moody's") has today affirmed the A3 long term issuer ratings and Prime-2 short term Commercial Paper ratings of Volkswagen Aktiengesellschaft (VW) and its rated subsidiaries, where applicable, and changed the outlook to stable from negative.

For a list of all affected ratings, please refer to the end of this press release.

"The change in VW's outlook to stable reflects the company's strong operating performance trend in 2016 and 2017 which was much better than anticipated, despite the diesel issue that had occurred in September 2015, and thus offsetting the higher than expected provisioning for the diesel settlements," said Falk Frey, a Senior Vice President and Analyst for Volkswagen AG. Moody's expects a continued strong operating performance in the current year providing an additional cushion for possible additional costs resulting for the remaining diesel fixes, lawsuits and litigation issues which should however be limited to low/mid-single digit billion Euros," Frey added.

RATINGS RATIONALE

For 2017, VW reported the delivery of 10.7 million vehicles (+4.3%) to customers resulting in a 6.2% increase in group revenues of EUR230.7 billion primarily driven by solid unit sales and strong performance of the Financial Services division albeit offset by negative FX effects. Operating profit before special items grew by almost 17% to EUR17.0 billion from EUR14.6 billion in 2016 which was mainly a result of improvements in product costs, stronger volumes and positive mix effects. Including the special items (related solely to the diesel charges issue) of EUR3.2 billion (EUR6.4 billion in 2016), operating profit was EUR13.8 million. Despite high cash outflows resulting from the issue, net liquidity of the Automotive division remained strong totaling to EUR22.4 billion as at year-end 2017 compared to EUR27.2 billion in 2016.

These reported numbers translate into Moody's adjusted metrics of an EBITA margin of 8.3% for 2017 (2016: 7.0%) and gross debt/EBITDA of 1.9x (2016: 2.0x).

For the current year, Moody's anticipates VW to improve its operating performance albeit at a slower pace given continuously increasing competition in the industry, FX volatility as well as uncertainty around the potential impact of the diesel issue. Based on significantly lower expected cash outflows related to the diesel issue Moody's anticipates a positive free cash flow generation (after EUR4-5 billion diesel related cash outflows) and a strengthening of the company's credit metrics with EBITA margin of at least 7.0% and debt/EBITDA slightly below 2.0x.

LIQUIDITY

In our theoretical scenario of no access to the capital markets for its manufacturing and financial services activities, VW had a coverage of more than 12 months of its corporate needs as of 31 December 2017. The group's liquidity profile in 2017 was negatively impacted by significant remediation costs, fines and legal costs associated with the emissions crisis which altogether resulted in cash outflows of around EUR16 billion in the year.

With the overall provision totaling to around EUR26 billion, the bulk of the payments was already made in 2016-2017 and approximately EUR4 billion is anticipated to be spent in 2018. As such, we expect to see an improvement in the group's liquidity position, which will be supported by cash on balance sheet (excluding time deposits and restricted cash) and short-term marketable securities (after a 20% haircut) of more than EUR32 billion (31 December 2017) as well as our expectation of solid cash flow generation in the next 12 months. In addition, VW has access to a significant amount of undrawn long-term committed credit facilities. In our analysis, we have also assumed that around EUR30 billion of short term deposits from private and institutional customers at the VW Bank subsidiary will be relatively sticky.

RATING OUTLOOK

The stable outlook reflects Moody's view that the US Department of Justice criminal investigation, EU compensation as well as shareholders lawsuits do not present major financial risks to VW in the next 12-18 months or that associated financial risks would be manageable within the limit of the existing provision for the remediation of the diesel emissions issue.

The stable outlook further reflects Moody's expectation that VW's business setup has the capacity to contend with the long-term cyclicalities within the global passenger vehicle markets and its challenging landscape as a result of heavy investment requirements for (1) alternative propulsion technologies; (2) driverless vehicles; (3) the shift of production capacities towards alternative fuel vehicles; (4) connectivity as well as (5) regulations relating to vehicle safety, emissions and fuel economy.

WHAT COULD CHANGE THE RATINGS DOWN/UP

Upward pressure on the ratings could occur if VW (1) continues to at least protect its market share in the major markets where it operates, especially in Western Europe and in China, regardless of potential changes in global macro-economic conditions; and (2) significantly grows its competitive position for the Volkswagen Passenger Cars brand and in the US market. VW would also need to deliver a more consistent earnings pattern across its commercial vehicle brands as a result of the successful execution of its long-term plan for the division. A further upgrade would also depend on the implementation of more stringent corporate governance structures.

Quantitatively, an upgrade of the ratings would require sustained robust cash flow generation, despite elevated capital expenditure, supported by Moody's-adjusted EBITA margins sustainably above 7%. This means a (1) free cash flow/debt ratio at around 10%; and (2) EBITA/interest expense above 7x (all ratios including Moody's adjustments).

The ratings could come under pressure if Moody's notes (1) an erosion in VW's market shares in its core markets; (2) deterioration in the company's operational performance as a result, for example, of weaker earnings of its premium brands or of its commercial vehicle division; or (3) an inability to enhance the Volkswagen Passenger Cars profitability to a level sustainably more competitive and (4) severe pressure on the company's liquidity profile as a result of fines and legal costs.

Quantitatively, a downgrade could occur if (1) VW's Moody's-adjusted EBITA margin drops below 7%; (2) its free cash flow/debt ratio deteriorates below the mid-single digit range in percentage terms for a prolonged period of time as a result of an operational weakness or more aggressive financial policies; and (3) EBITA/Interest Expense decreases below 5x from LTM September 2017 of 7.9x (all ratios as adjusted by Moody's).

LIST OF AFFECTED RATINGS

Issuer: Volkswagen Aktiengesellschaft

..Affirmations:

....Long-term Issuer Rating, affirmed A3

....Commercial Paper, affirmed P-2

....Senior Unsecured Medium-Term Note Program, affirmed (P)A3

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: MAN SE

..Affirmations:

....Long-term Issuer Rating, affirmed A3

....Short-term Issuer Rating, affirmed P-2

....Senior Unsecured Medium-Term Note Program, affirmed (P)A3

..Outlook Action:

...Outlook changed to Stable from Negative

Issuer: Porsche Holding Gesellschaft m.b.H.

..Affirmation:

...Backed Commercial Paper, affirmed P-2

..No Outlook assigned

Issuer: VW Credit, Inc.

..Affirmations:

...Backed Senior Unsecured Regular Bond/Debenture, affirmed A3

...Backed Senior Unsecured Medium-Term Note Program, affirmed (P)A3

...Backed Other Short Term, affirmed (P)P-2

...Backed Commercial Paper, affirmed P-2

..Outlook Action:

...Outlook changed to Stable from Negative

Issuer: Volkswagen Group Canada, Inc.

..Affirmation:

...Backed Commercial Paper, affirmed P-2

..No Outlook assigned

Issuer: VW Credit Canada, Inc.

..Affirmations:

...Backed Commercial Paper, affirmed P-2

...Backed Senior Unsecured Regular Bond/Debenture, affirmed A3

...Backed Senior Unsecured Medium-Term Note Program, affirmed (P)A3

...Backed Other Short Term, affirmed (P)P-2

..Outlook Action:

...Outlook changed to Stable from Negative

Issuer: Volkswagen Group of America, Inc.

..Affirmations:

...Backed Commercial Paper, affirmed P-2

..No Outlook assigned

Issuer: Volkswagen Group of America Finance, LLC

..Affirmations:

...Backed Commercial Paper, affirmed P-2

...Backed Senior Unsecured Regular Bond/Debenture, affirmed A3

..Outlook Action:

...Outlook changed to Stable from Negative

Issuer: Volkswagen International Belgium S.A.

..Affirmations:

...Commercial Paper, affirmed P-2

..No Outlook assigned

Issuer: Volkswagen International Finance N.V.

..Affirmations:

...Backed Junior Subordinated Regular Bond/Debenture, affirmed Baa2

...Backed Commercial Paper, affirmed P-2

...Backed Senior Unsecured Medium-Term Note Program, affirmed (P)A3

...Backed Other Short Term, affirmed (P)P-2

...Backed Senior Unsecured Regular Bond/Debenture, affirmed A3

..Outlook Action:

...Outlook changed to Stable from Negative

Issuer: Volkswagen International Luxembourg S.A

..Affirmation:

...Backed Commercial Paper, affirmed P-2

..No Outlook assigned

The principal methodology used in these ratings was Automobile Manufacturer Industry published in June 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Wolfsburg, Germany, Volkswagen Aktiengesellschaft is the world's largest car and truck manufacturer in terms of unit sales. VW manufactures mass-market and premium vehicles under the Volkswagen Passenger Cars, SKODA, SEAT, Audi, Bentley, Lamborghini, Bugatti and Porsche brands, as well as commercial vehicles under the Volkswagen Commercial Vehicles, MAN and Scania brands. In addition, VW has a 100% stake in premium motorcycle manufacturer Ducati. VW also provides the full range of banking, leasing, insurance and mobility services.

In 2017, VW delivered 10.7 million vehicles to its customers (10.3 in 2016) and reported revenues of almost EUR231 billion and an operating profit before special items of EUR17 billion.

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