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DBRS Morningstar Confirms Volkswagen AG at A (low); Trend Remains Stable

Industry Group: Corporate Finance

Sub-Industry: Autos & Auto Suppliers

Region: Canada

DBRS Limited (DBRS Morningstar) confirmed Volkswagen AG's (VW or the Company) Issuer Rating at A (low) with a Stable trend. DBRS Morningstar also confirmed the Senior Unsecured Debt and Commercial Paper ratings of VW Credit Canada, Inc. at A (low) and R-1 (low), respectively, both with Stable trends. The rating confirmations reflect the Company's solid business risk assessment as a leading global automotive original equipment manufacturer of substantial scale with a highly diversified brand portfolio (that notably includes several strong premium automotive brands). Moreover, VW's financial performance has remained resilient despite extended disruptions in automotive production and volumes, initially attributable to the global progression of Coronavirus Disease (COVID-19) and, subsequently, to the semiconductor shortage. Notwithstanding challenges across certain markets (notably including China) and sizable investment requirements for the foreseeable future, DBRS Morningstar expects VW's financial risk assessment (FRA) to remain strong in the context of the currently assigned ratings. Despite the above, DBRS Morningstar notes that certain environmental, social, and governance (ESG) risk factors continue to negatively affect the ratings.

The 2022 financial performance of VW's Automotive division improved over already solid 2021 results. While volumes remained curtailed as a result of the semiconductor shortage (and other supply base challenges), this was more than offset by a firmer product mix (that reflected the deliberate allocation of available semiconductors to the production of higher-margin vehicles) and strong pricing (facilitated by pent-up demand). Higher product development costs and other cost increases represented additional partial offsets. Moreover, profitability of the Company's Financial Services business, while moderately decreasing year over year (YOY) from 2021 record levels, remained very favourable with the segment continuing to benefit from strong demand for used vehicles, thereby benefitting residual value performance. Accordingly, VW's 2022 annual consolidated profit increased YOY, exceeding EUR 22 billion. Earnings continued to trend positively in H1 2023 amid volume growth (reflecting the progressive improvement in the semiconductor shortage) and ongoing strong pricing. The Company also meaningfully bolstered its liquidity position in September 2022 through the initial public offering and sale of an approximate 25% stake in Porsche AG (Porsche); (the divestiture generated proceeds of around EUR 16 billion, partly offset by the payment of a special dividend of approximately EUR 6.5 billion in January 2023). For the 2023 full year, amid ongoing improvements in the semiconductor shortage and associated volume growth, VW is projecting consolidated revenues to be higher in the range of 10% to 15% YOY, with the operating margin likely in the range of 7.5% to 8.5% (absent special items). DBRS Morningstar deems the Company's outlook to be attainable. While DBRS Morningstar acknowledges various headwinds, including softening consumer sentiment stemming from inflationary pressures, rising interest rates, and geopolitical tensions, these are estimated to be considerably offset by remaining pent-up demand.

Going forward, reflecting tightening emissions legislation worldwide, the Company is targeting a leadership position in the automotive industry's transition away from internal combustion engines (ICEs) and toward battery electric vehicles. Additionally, VW is seeking to further transform itself into a major provider of new mobility services. While these objectives are projected to entail substantial financial outlays over the next several years in the form of requisite capital spending and anticipated merger and acquisition activity, DBRS Morningstar expects these to be considerably covered by the Company's legacy ICE business' ongoing free cash flow generation; VW benefits further from its strong presence in the premium automotive segment, which is projected to outgrow the automotive industry as a whole while typically

generating considerably stronger margins relative to mainstream brands. DBRS Morningstar notes further that the Company maintains several additional options to further bolster its liquidity position, including the sale of further equity stakes in Porsche or the TRATON GROUP, and/or other potential divestitures of noncore assets.

Consistent with the Stable trends, DBRS Morningstar expects the ratings to remain constant over the near to medium term, and DBRS Morningstar notes that VW's FRA provides some cushion against unexpected challenges at the current rating level, rendering a downgrade rather unlikely. Conversely, an upgrade is not anticipated over the aforementioned time horizon given the cost headwinds facing the automotive industry amid the substantial financial outlays projected to be incurred by the Company in pursuit of its strategic objectives.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Environmental Factors

DBRS Morningstar considered that the Environmental factor related to carbon and greenhouse gas costs represents a relevant negative factor as VW, consistent with its automotive peers, is facing a fundamental transformation process in line with the implementation of ever more stringent emission and fuel consumption regulations across several jurisdictions. Accordingly, the Company is undergoing substantial investments associated with the electrification of its model portfolio, including the further development of modular toolkits for its volume, premium, and sports brands. Similarly, VW is investing in the gradual conversion of its locations for the production of electric vehicles and in the creation of battery manufacturing capacity with the aim of establishing a battery supply chain under its own control.

Social Factors

DBRS Morningstar considered that the Social factor related to product governance represents a significant negative factor in connection with VW's diesel issue, which dates back to 2015 and initially spanned 482,000 vehicles in the United States, only to quickly increase to 11 million units globally.

This Social factor has been changed from the prior rating disclosure. DBRS Morningstar notes that this factor was previously deemed to have a significant negative effect on the ratings, with associated costs in the form of vehicle refits, fines, and provisions for legal claims exceeding EUR 30 billion. However, with the considerable majority of such charges now likely behind the Company, the effect of this factor has been revised to relevant.

Governance Factors

DBRS Morningstar considered that the Governance factor related to corporate/transaction governance, specifically with respect to VW's shareholder structure and distribution of voting rights, represents a relevant negative factor. As of 2022 year-end, Porsche Automobil Holding SE, Stuttgart held 53.3% of voting rights. The State of Lower Saxony (the second-largest shareholder) held 20.0% of the voting rights, with Qatar Holding LLC holding 17.0% of voting rights. Accordingly, external shareholders have very few voting rights; these amounted to 9.7% as of 2022 year end. Similarly, VW's supervisory board is composed primarily of shareholders and worker representatives, with only a nominal proportion of independent members; this potentially limits the board's ability to oversee risks.

The combination of the ESG factors cited above negatively affects the ratings.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>.



Notes:

All figures are in euros unless otherwise noted.

DBRS Morningstar applied the following principal methodologies:

-- Global Methodology for Rating Companies in the Automotive Manufacturing and Supplier Industries (October 14, 2022; <https://www.dbrsmorningstar.com/research/404042>)

-- DBRS Morningstar Global Criteria: Guarantees and Other Forms of Support (March 28, 2023; <https://www.dbrsmorningstar.com/research/411694>)

The following methodologies have also been applied:

-- DBRS Morningstar Global Criteria: Commercial Paper Liquidity Support for Nonbank Issuers (February 24, 2023; <https://www.dbrsmorningstar.com/research/410196>)

-- DBRS Morningstar Global Criteria: Preferred Share and Hybrid Security Criteria for Corporate Issuers (October 20, 2022; <https://www.dbrsmorningstar.com/research/404248>)

The credit rating methodologies used in the analysis of this transaction can be found at: <https://www.dbrsmorningstar.com/about/methodologies>.

A description of how DBRS Morningstar analyzes corporate finance transactions and how the methodologies are collectively applied can be found at: <https://www.dbrsmorningstar.com/research/397223>.

The related regulatory disclosures pursuant to the National Instrument 25-101 *Designated Rating Organizations* are hereby incorporated by reference and can be found by clicking on the link under Related Documents or by contacting us at info@dbrsmorningstar.com.

The rating was initiated at the request of the rated entity.

The rated entity or its related entities did participate in the rating process for this rating action.

DBRS Morningstar had access to the accounts, management and other relevant internal documents of the rated entity or its related entities in connection with this rating action.

This is a solicited credit rating.

This credit rating is endorsed by DBRS Ratings Limited for use in the United Kingdom, and by DBRS Ratings GmbH for use in the European Union, respectively. The following additional regulatory disclosures apply to endorsed credit ratings:

The last rating action took place on August 10, 2022, when DBRS Morningstar confirmed Volkswagen AG's rating at A (low) with the trend remaining Stable.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar trends and ratings are under regular surveillance.



For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://registers.esma.europa.eu/cerep-publication>. For further information on DBRS Morningstar historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see <https://data.fca.org.uk/#/ceres/craStats>.

Lead Analyst: Robert Streda, Senior Vice President, Diversified Industries
Rating Committee Chair: Tom Currie, Managing Director, Credit Ratings, Global Fundamental Ratings
Initial Rating Dates: Volkswagen AG – May 16, 2001; VW Credit Canada Inc. – April 24, 2000

DBRS Morningstar will publish a full report shortly that will provide additional analytical detail on this rating action. If you are interested in receiving this report, contact us at info@dbrsmorningstar.com.

Information regarding DBRS Morningstar ratings, including definitions, policies, and methodologies, is available on www.dbrsmorningstar.com or contact us at info@dbrsmorningstar.com.

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Issuer	Debt	Rating Action	Rating	Trend
Volkswagen AG	Issuer Rating	Confirmed	A (low)	Stable
* VW Credit Canada Inc.	Senior Unsecured Debt	Confirmed	A (low)	Stable
* VW Credit Canada Inc.	Commercial Paper	Confirmed	R-1 (low)	Stable

* Guaranteed by Volkswagen AG

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