FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Volkswagen at 'A-'; Outlook Stable

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Fitch Ratings - Barcelona - 14 Aug 2024: Fitch Ratings has affirmed Volkswagen AG's (VW) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook.

The affirmation reflects our expectation that VW's profitability and cash flow generation will remain in line with its rating sensitivities despite significant provisions and other restructuring items, and rising investments driven by electrification and software transition. Challenges regarding the competitive landscape in China and footprint optimisation for certain brands are embedded in our medium-term EBIT margin forecast of 7% - 8%. We also forecast a free cash flow (FCF) margin of around 2% on a sustainable basis, despite the hefty EUR165 billion-EUR170 billion investment programme currently under way, which is in line with the rating.

The ratings also reflect a strong and sizeable brand portfolio, good geographic diversification and a product range covering almost all car and commercial-vehicle segments. We assess VW's capital structure as strong for its rating and aligned with other high investment-grade auto original equipment manufacturers (OEMs).

KEY RATING DRIVERS

Robust Underlying Profit Margins: Fitch expect VW's underlying operating margins to reach close to 7% in 2024, despite waning vehicle demand and a competitive pricing landscape in its principal markets. Cost-control measures have contributed to short-term profitability resiliency.

We believe the group is well positioned to reach its target of 8%-10% EBIT margin by 2027, with uplift potential from the model revamp, a more efficient cost base following recent severance programmes in Europe, and partnerships with Xpeng in China and Rivian in the US, which improve the cost advantage of its BEV (battery electric vehicle) line-up. VW's underlying EBIT margin of between 7% - 8% is well in line with the 'a' category median on Fitch's Navigator tool.

Growth Prospects From New Models: We forecast VW's industrial revenue to grow at close to 4% per year beyond 2024, outpacing our volume growth expectations, which are 1.5% yoy over 2025-2027. Fitch believes the year-to-date good order book and model changeover, particularly for the premium and luxury segments that are characterised by resilient pricing relative to the broad market, will support VW in capturing market share and delivering solid topline growth. We also view the cooperation with Rivian as positive to strengthen VW's foothold in the US and accelerate its Scout electric vehicle (EV) revival.

Capital Investment to Peak in 2024: The capex/revenue ratio is expected to peak in 2024, reaching 9.7% and trending toward 9% by 2027 in our rating case. This is lower than our previous assumption of around 10% in the medium term and gives the FCF margin expectations a boost. Our assumptions reflect VW's revised capex plan, in response to slower EV uptake, down to EUR165 billion-EUR170 billion from EUR180 billion over the five years to 2027. We believe VW's electrification evolution will not be impaired by the scaling back and the 'in-region-for-region' approach via local partnerships should meaningfully improve EV cost competitiveness and reinforce the product-offensive strategy.

Chinese Competition Lingers: Fitch does not expect a significant shift in the competitive landscape in the Chinese market, as demand continues fluctuating on the back of macro-economic trends and government policies. Luxury brands are following overall demand in the market, but the mass market and BEV space remains difficult and complex for European players. We do not forecast European OEMs, including VW, to recover market share loses in the past three years, but expect some stabilisation of market share following consolidation among smaller pureplay Chinese new energy vehicle players.

Resilient FCF Generation: We forecast VW's FCF margin will remain sustainably above its 2% rating sensitivity after 2024, despite our assumptions of lower cash flow contributions from the Chinese JVs and VW Financial Services. FCF in 2024 will be eroded by restructuring costs announced in 2Q24. Fitch has incorporated EUR1 billion cash outflow dedicated to the restructuring initiatives, with EUR750 million in 2024 and the remainder in 2025. We have not forecast additional outflows relating to the announced restructuring beyond 2025.

Robust Capital Structure: We expect VW's capital structure to remain in line with higher-rated peers and commensurate with the 'a' rating median in our Navigator tool, despite historical swings in FCF generation. Profitability should benefit from cost control as well as favourable pricing and product mix. However, cash flow generation will continue to be used for large investments, which we believe will be financed by FCF generation, potential portfolio realignment and key partnerships with no major impact on leverage metrics.

Strong Business Profile: VW's ratings are supported by its unparalleled product portfolio in the auto and heavy-truck segments. The ratings also reflect the company's broad diversification, leading market share and unrivalled potential for cost savings and economies of scale. The group's size enables an industrial strategy of platform consolidation and yields significant potential for economies of scale and synergies across its broad brand portfolio. However, the group's complex structure has not allowed these potential synergies to fully accrue to operating profit.

EU Tariffs Neutral to Ratings: The tariffs imposed by the European Commission on imported Chinese EVs are unlikely to materially affect the competitive landscape in Europe in the short term, given the slowdown in EV uptake. However, retaliatory action from China, particularly with broader measures covering other types of vehicles or even other industrial sectors, would affect German automakers the most. The impact of potential broader measures could weigh on German automakers' margins and cash flow generation. However, we expect existing headroom to help absorb these pressures without ratings being affected.

DERIVATION SUMMARY

VW's rating benefits from the group's solid business profile and resilient financial profile. It is the largest car manufacturer by deliveries in Europe and is vying globally for the top spot against Toyota Motor Corporation (A+/Stable), Hyundai Motor Company (A-/Stable), General Motors Company (BBB/Stable) and the global alliance between Renault SA (NR), Nissan Motor Co., Ltd. (BBB-/Stable) and Mitsubishi Motors Corporation.

VW is one of the most diversified auto manufacturer in the world, in line with Toyota, with substantial product and geographic exposure as well as production diversification. The group's individual brands have lower value than other premium manufacturers, such as BMW and Mercedes-Benz Group AG (A/Stable), as well as other large and recognised global manufacturers, including Honda Motor Co., Ltd (A/Stable) and Toyota, but the group owns several brands with a strong image and value.

VW's Fitch-adjusted industrial operating margin of 7-8% exceeds 6%, the 'a' rating category median on our auto navigator, but lags that of other German car manufacturers. Profitability benefits from the high operating margins of its premium and sports brands; Audi and Porsche. FCF generation is robust, aided by dividends from its Chinese JVs and easing outflow from a reduction in settlement payments related to the diesel emissions scandal disputes.

KEY ASSUMPTIONS

- Topline growth by low single digit over the forecast period

- Fitch-adjusted EBIT margin gradually trending toward 8% by 2027 from 7% in 2023

- Neutral to slightly negative working capital broadly in line with volume growth assumption

- Capex, including capitalised research and development, at 9.7% of revenues in 2024, before gradually declining to 9% in 2027

- Dividend payout ratio at roughly 30%

- Cash flow impact of severance programmes totaling EUR1 billion, with EUR750 million in 2024 and the remainder in 2025

- EUR6 billion M&A expenses earmarked for 2024, including EUR2 billion for the Rivian JV

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Tighter corporate governance practices

-- FCF margin sustainably above 3.0%

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- FCF margin dropping below 2% for a sustained period

-- Industrial operating margin remaining below 6%

-- Significant deterioration in key credit metrics, including net debt/EBITDA of 1x

LIQUIDITY AND DEBT STRUCTURE

Ample Liquidity: VW's industrial business has a consistent record of strong liquidity and a net cash position. It reported EUR21.8 billion in cash and equivalents and EUR23.2 billion in marketable securities at end-June 2024. Fitch restricts around EUR6.7 billion, or around 2.5% of annual sales, as reported cash, and considers 70% of the reported marketable securities as cash like. The 2024 year-end cash and cash equivalents will be burdened by EUR6 billion cash expenses, with EUR4 billion earmarked for M&A and EUR2 billion for the Rivian JV.

Solid Capital Market Access: VW's liquidity profile is supported by an undrawn EUR10 billion syndicated credit line maturing in December 2026. VW had EUR21 billion in bilateral and syndicated credit lines, with only EUR0.3 billion drawn at end 2023. VW has a solid record of capital market access, even under stressed conditions, and benefits from diversified funding sources.

ISSUER PROFILE

Volkswagen is among the largest global car and commercial vehicle manufacturers, with group sales of EUR322 billion and around 9.4 million vehicles delivered in 2023. The product offering spans volume (VW, Skoda, Seat), premium (Audi), sport (Porsche, Lamborghini) and luxury (Bentley) cars, motorcycles (Ducati), commercial vehicles (VW, Scania, MAN and Navistar), engines and turbochargers. The financial services division combines dealer and customer financing, leasing, banking and insurance activities, fleet management and mobility offerings.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

VW has an ESG Relevance Score of '4' for Governance Structure due to a lack of independence and diversity at the supervisory board level, potential conflicts of interest with board members and a 20% blocking minority in voting resolutions. This has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

VW has an ESG Relevance Score of '4' for GHG Emissions & Air Quality due to stringent emission regulations, notably in Europe and China, which are its main markets.

Investments in lower emissions are a key driver of the group's strategy and cash generation, which has a negative impact on the credit profile and is relevant to the rating in conjunction with other factors.

The PAG IPO will likely increase VW's already complex governance structure given the creation of ordinary and non-voting preferred shares in PAG. VW's governance structure and limited board independence is embedded in Fitch's rating assessment of VW.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
VW Credit Canada, Inc.				
senior unsecured	LT	A-	Affirmed	A-
Volkswagen Group of America Finance, LLC				
senior unsecured	LT	A-	Affirmed	A-
Volkswagen International Finance NV				
senior unsecured	LT	A-	Affirmed	A-
subordinated	LT	BBB	Affirmed	BBB

Volkswagen AG	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
	ST IDR	F1	Affirmed	F1

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Volkswagen AG	EU Issued, UK Endorsed
Volkswagen Group of America Finance, LLC	EU Issued, UK Endorsed
Volkswagen International Finance NV	EU Issued, UK Endorsed
VW Credit Canada, Inc.	EU Issued, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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