MOODY'S

Rating Action: Moody's affirms Volkswagen's A3/P-2 ratings; outlook stable

21 Jul 2023

Frankfurt am Main, July 21, 2023 -- Moody's Investors Service (Moody's) has today affirmed the ratings of Volkswagen Aktiengesellschaft (Volkswagen, VW or the group), including the group's long-term issuer rating of A3 and its short-term Prime-2 (P-2) commercial paper rating. The outlook remains stable.

"The rating affirmation balances the company's strengths as one of the world's two largest automotive manufacturers and its moderate leverage, with the overall challenges in the automotive industry, especially its high cyclicality and the transformational trends towards electrification and autonomous driving technologies," said Matthias Heck, a Moody's Vice President -- Senior Credit Officer and Lead Analyst for Volkswagen. "The stable outlook reflects the continued recovery of global light vehicle sales, and the expectation that Volkswagen will be able to maintain leverage and margins commensurate with the A3 in 2023 and 2024," added Mr. Heck. "We expect that the relatively low profitability of the brand group "Core" will improve to a more competitive level, supporting a more balanced profit generation within the group", Mr. Heck continues.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The rating affirmation reflects Volkswagen's (1) robust portfolio of highly recognizable brands (including Volkswagen, Audi and Porsche) and established market positions in Western Europe and China; (2) its generally successful and frequent model launches; (3) its geographical diversification and good product offering that help shield the group's earnings and cash flow from local or regional demand cycles, which are inherent to the automotive industry; (4) Moody's expectation of sustainable, positive and robust free cash flow (FCF) generation, despite high investments; and (5) the company's sizeable liquidity position and solid credit metrics.

VW has been able to restore its metrics in a favourable market environment, with strong customer demand leading to improved price and mix effects for automakers, but also depressed production volumes due to supply chain issues. As a result, VW's EBITA margin (Moody's adjusted) increased to 7.5% in 2022 (6.0% in 2020). Considering VW's remarkable track record of sustainable performance against most peers over the last few years, we expect margins to be sustained at a level of around 7%, notwithstanding some weakening we expect for 2023. The group's global reach across a multitude of brands and model types while simultaneously using its large scale to efficiently deploy and use resources should allow its sufficient operating leverage to quickly recover profitability, even at times of more difficult macroeconomic conditions.

VW's ratings are currently weakly positioned, given the following constraining factors (1) the high cyclicality of the automotive industry; (2) the group's declining market share in China, its largest single market, where it has been a leader with 3.2 million units (36% of group) sold in 2022. However, Volkswagen's market share declined to 15.1% (2022), from 16% share in 2021 and 19.3% in 2020; (3) the significant divergence in profitability across passenger car brands, with particular weak margins at the VW's brand group "Core" (VW, Skoda, Seat/Cupra and Commercial vehicles; 3.6% return on sales in 2022), somewhat mitigated by strong margins at the premium brands Audi and Porsche; (4) need for high investments to cope with globally increasing environmental standards and the transition to electric vehicles (including EV battery business), and to develop a group-wide vehicle software architecture; and (5) high governance risks, due to the organizational complexity within the group, the global scale of VW, its multiple brands and product strategy.

Execution risk around the transition to electric vehicles continues to be significant. The global automotive industry remains at an early stage of a significant long-term transition to reduce carbon emissions by improving fuel efficiency and shifting to fully electric vehicles. Key risks for automakers, including Volkswagen, include a loss of market share, inability to earn adequate profits and returns on electric vehicles, as well as inability to manufacture vehicles due to potential constraints in the supply of critical materials.

That said, Volkswagen has accelerated the development and production of electric vehicles. In the first half of 2023, BEV sales increased by 49% to 322 thousand vehicles, and accounted for 7.4% of the group's light vehicle sales. Moody's believes that Volkswagen has a credible strategy to navigate the transition.

Volkswagen's rating remains constrained by high governance risks. These are exemplified by the highly complex group structure, with multiple stakeholders, including the family owners, the German State of Lower Saxony and workers unions, and the existence of minority shareholders in key businesses, like Porsche AG, TRATON SE and the JVs in China. The history of high management turnover within the group, including the early replacement of the CEO in September 2022, and the early replacement of the divisional CEO of Audi in June 2023, result in a weak management credibility and track record under Moody's ESG criteria, with the need to build credibility. These weaknesses are only partially mitigated by the company's conservative financial strategy and risk management.

At its capital market day on 21 June 2023, Volkswagen's management presented a comprehensive strategy update, addressing the main challenges the company is facing. Management presented a new group steering model to more effectively manage the company and an €180 billion five-year investment plan to manage transformational changes, especially in the areas of electrification, software/autonomous driving and efficiency. The company also aims to improve the group's profitability to 8%-10% return on sales, compared to 8.1% achieved in 2022. The main area of improvement will be at the VW brand (part of brand group "Core"), where profitability has been notoriously weak (3.6 return on sales in 2022). Management plans margin improvement to 6.5% by 2026, including improved product positioning and efficiency measures. Whilst the strategy of the new management team addresses the group's main challenges, Moody's notes that execution risks are high, given the highly competitive automotive sector environment and the high organizational complexity within the group. Moody's therefore rather expects stable group margins at around 7% (Moody's adjusted EBITA) over the next three years.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects our expectation of continued recovery in global light vehicle sales in 2023, but with increasing challenges in the second half, once the existing order backlog has been executed. On the back of this volume recovery, and despite a weakening consumer sentiment, we expect VW to be able to achieve Moody's-adjusted EBITA margin of around 6.5%-7.0% (6.2% in LTM March 2023), maintain debt/EBITDA (Moody's-adjusted) below 2.0x (1.4x in LTM March 2023) and generate positive FCF (Moody's-adjusted) within the next 12-18 months. The stable outlook further factors in our expectation of sustainable profitability improvements of the Volkswagen's brand group "Core" going forward.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Volkswagen's ratings could be downgraded in case of (1) Moody's-adjusted EBITA margins below 7%, (2) Moody's-adjusted debt/EBITDA above 2.0x; (3) FCF/debt (as adjusted by Moody's) below the mid-single-digits in percentage terms for a prolonged period as a result of an operational weakness or more aggressive financial policies; (4) an erosion in Volkswagen's market shares in its core markets; (5) inability to enhance the profitability of Volkswagen' brand group "Core" to above 5%; and (6) a weakening of the company's liquidity profile.

Moody's would consider upgrading the ratings in case of (1) Volkswagen's ability to, at least, protect its market share in the major markets where it operates, especially in Western Europe and China, regardless of potential changes in global macroeconomic conditions; (2) a significantly improved competitive position for the Volkswagen Passenger Cars brand and in the US market; (3) 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, (4) the implementation of more stringent corporate governance structures; (5) a sustained robust cash flow generation, despite elevated capital spending, with

Moody's-adjusted FCF/debt of around 10% as well as (6) a Moody's-adjusted EBITA margin sustainably above 7%.

LIST OF AFFECTED RATINGS

..Issuer: Porsche Holding Gesellschaft m.b.H.

Affirmations:

....BACKED Commercial Paper, Affirmed P-2

Outlook Actions:

....Outlook, No Outlook

..Issuer: Volkswagen Aktiengesellschaft

Affirmations:

.... LT Issuer Rating, Affirmed A3

....Senior Unsecured Bank Credit Facility, Affirmed A3

....Commercial Paper, Affirmed P-2

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

Outlook Actions:

....Outlook, Remains Stable

..Issuer: Volkswagen Group Canada, Inc.

Affirmations:

....BACKED Commercial Paper, Affirmed P-2

Outlook Actions:

....Outlook, No Outlook

..Issuer: Volkswagen Group of America Finance, LLC

Affirmations:

....BACKED Commercial Paper, Affirmed P-2

....BACKED Medium-Term Note Program, Affirmed (P)A3

....BACKED Senior Unsecured Regular Bond/Debenture, Affirmed A3

Outlook Actions:

....Outlook, Remains Stable

..Issuer: Volkswagen Group of America, Inc.

Affirmations:

....BACKED Commercial Paper, Affirmed P-2

Outlook Actions:

....Outlook, No Outlook

..Issuer: Volkswagen International Belgium S.A.

Affirmations:

....Commercial Paper, Affirmed P-2

Outlook Actions:

....Outlook, No Outlook

..Issuer: Volkswagen International Finance N.V.

Affirmations:

....BACKED Junior Subordinate 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 Actions:

....Outlook, Remains Stable

..Issuer: Volkswagen International Luxemburg S.A

Affirmations:

....BACKED Commercial Paper, Affirmed P-2

Outlook Actions:

....Outlook, No Outlook

..Issuer: VW Credit Canada, Inc.

Affirmations:

....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 Actions:

....Outlook, Remains Stable

..Issuer: VW Credit, Inc.

Affirmations:

....BACKED Commercial Paper, Affirmed P-2

....BACKED Other Short Term, Affirmed (P)P-2

Outlook Actions:

....Outlook, Remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Automobile Manufacturers published in May 2021 and available at https://ratings.moodys.com/rmc-documents/72240. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Volkswagen Aktiengesellschaft, headquartered in Wolfsburg, Germany, is Europe's largest car manufacturer in terms of passenger car unit sales, with a market share of 25% in 2022 in Europe (according to the European Automobile Manufacturers Association), and one of the two largest globally, marginally below Toyota Motor Corporation.

VW manufactures mass-market and premium vehicles under the Volkswagen Passenger Cars, SKODA, SEAT/Cupra, Audi, Bentley, Lamborghini and Porsche brands, as well as commercial vehicles under the Volkswagen Commercial Vehicles brands. VW also produces trucks and busses via its publicly listed subsidiary TRATON SE.

In 2022, VW delivered 8.3 million vehicles to its customers (8.9 million in 2021). Volkswagen generates the vast majority of its unit sales in Europe and other regions (43% in last twelve months to March 2023) as well as Asia-Pacific (40%, predominantly China), followed by North America (11%) and South America (6%).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Matthias Heck, CFA
VP - Senior Credit Officer
Corporate Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Christian Hendker, CFA
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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