

MOODY'S

RATINGS

Rating Action: Moody's Ratings changes Volkswagen's outlook to negative

11 Oct 2024

Frankfurt am Main, October 11, 2024 -- Moody's Ratings (Moody's) has today affirmed the ratings of Volkswagen Aktiengesellschaft (Volkswagen, VW or the company), including the company's long-term issuer rating of A3 and its short-term Prime-2 (P-2) commercial paper rating. The outlook has been changed to negative from stable.

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

RATINGS RATIONALE

The outlook change to negative was prompted by a weakening trend in VW's operating performance, accelerated in the last months by the recent deterioration of the market environment in the auto sector. The negative outlook reflects the challenges to turn around the current weak margin and negative Moody's adjusted free cash flow and to execute the strategic shifts initiated by the management in recent months. We positively recognize the company's strong financial flexibility, including its sizeable liquidity position, scale and diversification, which provides some cushion throughout the more challenging market environment.

Over the last months, VW management launched key strategic initiatives aiming at turning around its weakening positioning in China thanks to its new localized strategy announced in April 2024, improve its software development capabilities thanks to the Rivian partnership announced in June 2024 and sustainably reduce its cost structure with plants closure in Europe as revealed in Summer 2024. All these initiatives include significant execution risks, but if successful, could sustainably improve profitability, cash flow generation and time to market of new models in the mid-term. We do not expect to see the benefits of these actions before early 2026.

The negative outlook indicates that downward rating pressure could increase if the operating performance worsens significantly more than currently expected into 2025 and if there's no evidence within the next 18 months that strategic initiatives will lead to lasting performance improvements.

We expect VW's operating performance to be muted into 2025 driven by low volume growth globally including a weak domestic China and sluggish Western Europe, increasing price pressure, potential fines on EU CO2 emissions, as well as additional restructuring costs. Our forecast includes momentum improvement at Audi and Porsche representing around 50% of VW's profit, into 2025 from a relatively low base in 2024 thanks to a long awaited line-up renewal that started to hit the market in H2 2024. We forecast the equity income from the Chinese joint-venture to decrease to €1.5 billion in 2024 and €0.9 billion in 2025 down from €2.6 billion in 2023. As of today, VW's exposure to China including profits from locally produced cars in the joint-venture as well as profits from imported cars - mainly Porsche and Audi - represents around 30% of the group's profit, down from 50% at peak. We expect the performance of Brand Group Core to remain muted. On top of €900 million provision for severance payments booked in Q2 and €1.3 billion provision for restructuring costs at the Brussels plant booked in Q3, we forecast additional restructuring costs to be incurred in H2 2024 and FY 2025. We include in our forecast a total of €4.7 billion restructuring costs in FY 2024 and €3.4 billion next year driven by company's efforts to sustainably reduce its cost base. We assume that capex will start reducing to €24 billion per annum this year and next as the company prioritizes cash generation. In total for the next 12-18 months, we forecast Moody's adjusted EBITA margin to remain weak at around 4% (5.5% excluding restructuring costs), Moody's adjusted free cash flow to remain negative and Moody's adjusted debt / EBITDA to increase close to 2x.

The affirmation of the ratings at the current A3/P-2 level however is driven by the strong balance sheet as evidenced by a Moody's adjusted debt / EBITDA remaining around 2.0x in our forecast for 2024-25 despite the high restructuring costs and an adequate liquidity, an important support for the current rating.

VW's A3 long-term ratings are supported by its robust portfolio of highly recognizable brands (including Volkswagen, Audi and Porsche) and established market positions in Western Europe and China; its geographical diversification and good product offering and the company's sizeable liquidity position.

VW's ratings are currently weakly positioned, given the following constraining factors: the high cyclical nature of the automotive industry; the group's declining market share in China, its largest single market; the significant divergence in profitability across passenger car brands, with particular weak margins at VW's brand group "Core" somewhat mitigated by strong margins at the premium brands Audi and Porsche; 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 high governance risks according to our ESG criteria, due to the organizational complexity within the group.

OUTLOOK

The negative outlook reflects the current weak positioning of the rating and the execution risks linked to the turnaround of recent weakening trend in profit margin and free cash flow generation, in a worsening market environment.

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

We could consider to change the outlook to stable in case VW would demonstrate its ability to turn around the currently weakening profitability and free cash flow trajectory. A stable outlook would require a Moody's adjusted EBITA margin around 6.5-7.0%, a Moody's adjusted leverage well below 2x, free cash flow returning to positive territory and a sizeable liquidity position.

VW's ratings could be downgraded in case of an operational weakness or more aggressive financial policies resulting in: (1) Moody's-adjusted EBITA margin sustainably well below 7%, (2) Moody's-adjusted debt/EBITDA above 2.0x, or (3) FCF/debt (Moody's-adjusted) remaining below mid-single-digit percentages for a prolonged period. Also, an erosion in VW's market shares in its core markets, as well as its inability to enhance the profitability of Volkswagen's brand group "Core" to a more competitive level of above 5% on a sustained basis, delays in the transformation towards electrification as well as higher than expected R&D and capex requirements to achieve this, and a weakening of the company's liquidity profile could lead to a rating downgrade.

Given the negative outlook, there is currently no upward rating pressure. Nonetheless, we would consider upgrading VW's ratings if (1) it demonstrates its 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) there is a significantly improved competitive position for the Volkswagen Passenger Cars brand and in the US market, (3) more stringent corporate governance structures are implemented, (4) VW generates robust cash flow on a sustained basis, despite elevated capital spending, with Moody's-adjusted FCF/debt of around 10% and (5) VW's Moody's-adjusted EBITA margin is comfortably above 7% on a sustained basis.

LIST OF AFFECTED RATINGS

..Issuer: Volkswagen Aktiengesellschaft

Affirmations:

.... LT Issuer Rating, Affirmed A3

.... Senior Unsecured Bank Credit Facility (Local Currency), Affirmed A3

.... Commercial Paper (Local Currency), Affirmed P-2

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

Outlook Actions:

....Outlook, Changed To Negative From Stable

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

Affirmations:

.... Backed Commercial Paper (Local Currency), Affirmed P-2

....No Outlook assigned

..Issuer: VW Credit, Inc.

Affirmations:

.... Backed Commercial Paper (Local Currency), Affirmed P-2

.... Backed Other Short Term (Foreign Currency), Affirmed (P)P-2

Outlook Actions:

....Outlook, Changed To Negative From Stable

..Issuer: Volkswagen Group Canada, Inc.

Affirmations:

.... Backed Commercial Paper (Local Currency), Affirmed P-2

....No Outlook assigned

..Issuer: VW Credit Canada, Inc.

Affirmations:

.... Backed Commercial Paper (Local Currency), Affirmed P-2

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

.... Backed Other Short Term (Foreign Currency), Affirmed (P)P-2

.... Backed Senior Unsecured (Local Currency), Affirmed A3

Outlook Actions:

...Outlook, Changed To Negative From Stable

..Issuer: Volkswagen Group of America, Inc.

Affirmations:

... Backed Commercial Paper (Local Currency), Affirmed P-2

...No Outlook assigned

..Issuer: Volkswagen Group of America Finance, LLC

Affirmations:

... Backed Commercial Paper (Local Currency), Affirmed P-2

... Backed Commercial Paper (Foreign Currency), Affirmed P-2

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

... Backed Senior Unsecured (Local Currency), Affirmed A3

Outlook Actions:

...Outlook, Changed To Negative From Stable

..Issuer: Volkswagen International Belgium S.A.

Affirmations:

... Commercial Paper (Local Currency), Affirmed P-2

...No Outlook assigned

..Issuer: Volkswagen International Finance N.V.

Affirmations:

... Backed Junior Subordinated (Local Currency), Affirmed Baa2

... Backed Commercial Paper (Local Currency), Affirmed P-2

... Backed Other Short Term (Local Currency), Affirmed (P)P-2

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

... Backed Senior Unsecured (Foreign Currency), Affirmed A3

... Backed Senior Unsecured (Local Currency), Affirmed A3

Outlook Actions:

...Outlook, Changed To Negative From Stable

..Issuer: Volkswagen International Luxemburg S.A

Affirmations:

... Backed Commercial Paper (Local Currency), Affirmed P-2

...No Outlook assigned

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.

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