Research Update:

Automaker Volkswagen Outlook Revised To Negative On Weaker Revenue Prospects Due To COVID-19; Affirmed At 'BBB+/A-2'

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Rating Action Overview

- Following strong operating results in 2019, Volkswagen AG (VW)'s revenue and cash flow will likely decline in 2020 due to weak demand, especially in Europe, as a result of the COVID-19 pandemic and restrictions imposed by governments to reduce contagion risk.
- We envisage materially lower unit sales and see a high risk that VW's current production shutdown, in Europe in particular, could last well beyond the two weeks VW initially planned.
- However, VW's available liquidity sources currently offer comfortable headroom to cope with a potential production standstill of at least three months, even absent additional measures or government support to safeguard liquidity.
- We are revising our outlooks on VW and its subsidiaries--including VW Financial Services AG, VW Leasing GmbH, and Volkswagen Financial Services U.K.--to negative from stable and affirming our 'BBB+/A-2' ratings, including the 'K-1' Nordic regional scale rating on Volkswagen Finans Sverige AB.
- The negative outlook indicates risks linked to the duration of the COVID-19 pandemic and its impact on the global auto industry.

Rating Action Rationale

VW's performance will take a significant hit in 2020 due to lower global light-vehicle sales volumes. We revised our global light vehicles sales on March 24, 2020, and now expect a 15% decline in 2020 to less than 80 million units from 90.3 million in 2019, followed by a recovery in the 6%-7% range in 2021 (see "COVID-19 Will Batter Global Auto Sales And Credit Quality," published on RatingsDirect). Based on our revised scenario, we assume VW's auto revenues will decline by more than 10% this year and the adjusted EBITDA margin to take a 300 basis point hit, compared with a very solid 12.2% in 2019.

Free operating cash flow will likely approach breakeven, down from €11.5 billion in 2019, without taking into account government support, such as shorter working hours in Germany. The main assumption underlying our base case is that VW might find it difficult to rapidly cut back its cost base, since it remains committed to its electrification roadmap and introducing new models that help it narrow a persistent carbon dioxide emissions (CO2) gap (approximately 25 grams based on the latest official figure) in Europe by the end of 2020. However, our current base-case scenario does not factor in any specific government support that could partly offset some of VW's fixed cash costs if the production standstill is extended. We consider that this combination of factors would result in adjusted free operating cash flow falling rapidly from the strong €11.5 billion posted in 2019.

VW's Automotive division can comfortably absorb estimated cash costs for a one month shutdown. We assume the currently ample liquidity at VW's Automotive division would remain robust even after absorbing fixed cash costs during a potential production shutdown of at least three months, without refinancing, while still allowing dividend payments and funding of the group's planned acquisitions. In addition, we anticipate that VW would be able to arrange additional financing, if needed. We acknowledge that there are no debt maturities for VW's auto business in 2020. The group's current liabilities at year end 2019 of approximately €95 billion relate to debt at the Financial Services division.

Outlook

The negative outlook reflects our concerns regarding rapidly declining auto demand globally, and the risk of production shutdowns being extend well beyond the two weeks announced by VW for passenger cars. In our revised base case for VW in 2020, we observe rapidly fading headroom for credit metrics, with funds from operations (FFO) to debt declining to 45%, compared with the 45%-50% range commensurate with the rating; and adjusted debt to EBITDA increasing to 1.8x from about 0.9x at year-end 2019, close to the 2.0x threshold for a downgrade. We also expect a material decline of the adjusted EBITDA margin to 9.2% and a material hit on cash flow generation before a recovery in 2021.

Downside scenario

We could lower the ratings if we observed enduring pressure on margins after 2020, with adjusted EBITDA to revenue remaining well below 10%, for example due to VW's inability to meet its CO2 target in Europe, which would expose the group to potentially multi-billion euro fines in its main market.

Upside scenario

We could revise the outlook to stable if production patterns returned to normal in the second half of 2020, in Europe in particular, where VW commands 25% of the market; and demonstrates its capacity to deliver on its environmental obligations in Europe.

Our Base-Case Scenario

We have revised our base case for VW to align it with our forecast of a global light-vehicle volume decline of almost 15% in 2020, due to significantly weaker sales in all major regions, followed by a recovery of 6%-8% in 2021.

Assumptions

- In 2020, limited flexibility on research and development (R&D) activity (7% of auto revenues) and capital expenditure (€17 billion including capitalized R&D costs);
- Diesel-related special items of €3 billion;
- Dividends of about €3 billion from Chinese joint ventures;
- Acquisition of Navistar for $2.9 billion (plus additional debt of slightly below $4 billion) and the buyout of MAN's minority shareholders for about €300 million, being partly offset by the disposal of Renk for €530 million; and
- Dividend payments totaling €3.4 billion.

Key metrics

- For 2020, we estimate an Automotive revenue decline of almost 12% solely due to volumes dropping by almost 13%.
- An adjusted EBITDA margin slightly exceeding 9% compared with 12.2% in 2019.
- Free operating cash flow trending to zero versus positive €11.5 billion in 2019.

Based on our expectation of a market recovery in 2021, we forecast VW's adjusted EBITDA margin will strengthen to 11%-12% and Automotive free operating cash flow at around €6 billion next year.

Liquidity

In our view, liquidity at VW's Automotive division remains strong, with approximately €43 billion of readily available cash and committed undrawn credit facilities at the beginning of 2020. Considering that the division has no debt maturing in 2020, we regard liquidity as robust and estimate it can absorb three months of a production standstill on top of annual capital expenditure of €17 billion, dividend payments of about €3.4 billion, and planned acquisitions of €3.2 billion. Under this scenario, we assume no material cut in R&D spending from the amount reported in 2019, which we see as essential for the group's long-term competitiveness.

We acknowledge the group's generally high standing in the credit markets and well-established bank relationships, as well as recent measures announced by the European Central Bank (ECB) that will provide liquidity to the market.

While our liquidity analysis is limited to VW's auto segment, we note the sizeable current liabilities (as of year-end 2019) of the group's Financial Services division of €95 billion. We estimate approximately one-third of the amount to be short-term market instruments. We expect the ECB will support the refinancing of commercial paper and banks to bridge potential capital market closures, in light of VW's cash flow generation potential.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Negative/--

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Strong

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- COVID-19 Will Batter Global Auto Sales And Credit Quality, March 24, 2020

Ratings List

**************** Volkswagen AG ****************

Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Volkswagen AG		
Volkswagen International Belgium S.A.		
Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
Volkswagen Financial Services AG		
Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
Ratings Affirmed		
Volkswagen Finans Sverige AB		
Issuer Credit Rating		
Nordic Regional Scale	--/--/K-1	
Volkswagen Bank GmbH		
Issuer Credit Rating	A-/Negative/A-2	
Volkswagen AG		
Senior Unsecured	BBB+	
Commercial Paper	A-2	
Volkswagen Finans Sverige AB		
Commercial Paper	A-2	
Porsche Holding GmbH		
Commercial Paper	A-2	

Skofin s.r.o.	
Commercial Paper	A-2
VW Credit Canada Inc.	
Senior Unsecured	BBB+
Commercial Paper	A-1(LOW)
Commercial Paper	A-2
VW Credit Inc.	
Senior Unsecured	BBB+
Commercial Paper	A-2
Volkswagen Bank GmbH	
Senior Subordinated	BBB+
Commercial Paper	A-2
Volkswagen Bank RUS	
Senior Unsecured	BBB-
Volkswagen Canada Inc.	
Commercial Paper	A-1(LOW)
Commercial Paper	A-2
Volkswagen Financial Services AG	
Senior Unsecured	BBB+
Commercial Paper	A-2
Volkswagen Financial Services Australia Pty Ltd.	
Senior Unsecured	BBB+
Volkswagen Financial Services Japan Ltd.	
Senior Unsecured	BBB+
Commercial Paper	A-2
Volkswagen Financial Services N.V.	
Senior Unsecured	BBB+
Commercial Paper	A-2
Volkswagen Group of America Finance LLC	
Senior Unsecured	BBB+
Commercial Paper	A-2
Volkswagen International Belgium S.A.	
Commercial Paper	A-2
Volkswagen International Finance N.V.	
Senior Unsecured	BBB+
Junior Subordinated	BBB-
Commercial Paper	A-2
Volkswagen International Luxemburg S.A.	
Senior Unsecured	BBB+

Commercial Paper	A-2
Volkswagen Leasing GmbH	
Senior Unsecured	BBB+
Commercial Paper	A-2