17 December 2019 Corporates

Daimler AG
Germany, Automotive Manufacturers

A STABLE

Corporate profile

The Daimler group is a leading vehicle manufacturer, with a broad range of premium automobiles, trucks, vans and buses. Its product portfolio is complemented by a broad range of financial and mobility services.

Key metrics

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
EBITDA/interest cover (x)	29x	20x	15x	23x
SaD/EBITDA	-0.9x	-0.9x	-1.1x	-0.8x
Scope-adjusted FFO/SaD	-86%	-90%	-86%	-101%
FOCF/SaD	-40%	-24%	-22%	-36%

Rating rationale

Scope Ratings has updated its financial forecasts for Daimler AG. The revised forecasts do not change the ratings or the financial risk profile assessment.

This publication does not constitute a credit rating action. The official credit rating action was taken on 14 June 2018 with an affirmation of the ratings.

The corporate rating of A reflects the company's track record and our expectation that the group's key divisions, Mercedes-Benz Cars and Daimler Trucks, will continue to hold their strong market positions. Daimler's geographic diversification, with a strong presence in both mature and developing markets, and the added diversification benefit from the captive finance business (Daimler Financial Services, renamed Daimler Mobility in July 2019), further supports our business risk assessment. Limiting factors for our business risk assessment are the pronounced risk of negative cyclical volume changes, notably in the truck division; high capital requirements and investments in R&D to expand the product portfolio; and the technological changes currently influencing the automotive industry.

Daimler's results in 2019 have been affected by a number of cost items that we would not expect to be a drag on profitability in 2020. The same is true for free cash flow in the industrial business though with the caveat that cash generation from the industrial unit in 2020 might be affected by the release of provisions booked in 2019, notably for diesel-related issues. The one element in our business risk assessment that has weakened is operating profitability (EBITDA margin). However, we have analytical reason to believe that operating profitability can improve against the backdrop of the changing industry environment.

Automakers have benefitted from a positive macro environment in 2019 but we continue to caution that further volume support cannot be expected in 2020. Key volume markets, notably China, have shown some initial signs of weakness after almost a decade of growth in light vehicle sales.

Ratings & Outlook

Corporate ratings	A/Stable
Short-term rating	S-1

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Related Methodology

Ratings Methodology Corporate Ratings

Rating Methodology Automotive and Commercial Vehicle Manufacturers

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The key support for the rating remains Daimler's financial risk profile, with significant surplus liquidity covering both reported financial debt in the industrial business including our adjustment for pension obligations (operating leases formerly adjusted have moved on-balance sheet in 2019).

At the capital markets day in Nov. 2019, Daimler communicated its new operating targets (EBIT margins by division) and further details of its financial objectives. The take-away from management's plans is a mixed picture. Not unsurprisingly, Daimler's key unit, Mercedes-Benz Cars, will be negatively affected in 2020 by the transition towards a higher share of electrified vehicles, mainly to comply with the CO2 targets defined by the European Commission. The expected weakening of key commercial vehicle markets, Europe and NAFTA, is likewise expected to take its toll on operating profits in 2020. Daimler's announced cost reduction program of EUR 1.3bn to balance margin pressure is unlikely to come to measurable fruition in 2020. The weaker outlook for operating profits (EBITDA) has therefore weakened Daimler's business risk profile somewhat.

Daimler's weaker business prospects are balanced by the clear communication at the capital markets day that cash flow generation in the industrials unit is: i) the focus of attention; and ii) properly incentivised with key management personnel. Daimler communicated a cap on capex and R&D and plans to address its weak cash flow profile with various projects, notably through a reduction of working capital. The long-standing policy of a dividend payout of 40% is now supplemented with an additional caveat that dividend payments are likewise linked to the free operating cash flows (FOCF) generated in the industrials divisions. While Daimler has maintained a net liquidity position in its industrial operations for a several years, we view as positive the clear communication of plans for the industrials unit (Mercedes-Benz AG and Daimler Truck AG under the new corporate structure) to be operated with a minimum net liquidity balance of more than EUR 10bn.

Daimler has limited financial indebtedness in its industrial business and considerable unrestricted liquidity. The group's unrestricted and available liquidity (including marketable securities) exceeds financial debt in the industrial business as well as Scope's debt adjustments. The Scope-adjusted debt figure is therefore negative. The net cash position ultimately results in strong credit ratios, and the key credit ratios that we consider important for the assessment of automakers, i.e. Scope-adjusted debt/EBITDA and funds from operations/Scope-adjusted debt are both negative.

Our positive view on Daimler's financial risk profile is supplemented by the supportive liquidity position of the group.

Senior unsecured debt issued by Daimler AG, ratings assigned to financing companies, and debt issued by financing companies

We have assigned an A rating to senior unsecured debt issued by Daimler AG. This rating is likewise assigned to the financing subsidiaries of Daimler that issue under its Euro Medium Term Note Programme (EMTN). These financing subsidiaries are:

- Daimler International Finance B.V.
- Daimler Canada Finance Inc.
- Daimler Finance North America LLC
- Mercedes-Benz Finance Co., Ltd.
- Mercedes-Benz Australia/Pacific Pty. Ltd.

Senior unsecured debt issuances under the EMTN made by the above subsidiaries are unconditionally and irrevocably guaranteed by Daimler AG.

Outlook

The Outlook is Stable and incorporates our expectation that Daimler should be able to maintain a strong financial risk profile. Daimler has a financial buffer on its key credit metrics to accommodate the current weakness in operating earnings and additional one-off costs related to legal matters. Scope-adjusted debt will very likely remain negative.

We would consider a negative rating action if FOCF in the group's industrial business turned negative, triggered by an unexpected decrease in operating profits (EBITDA) owing to a substantially lower unit-sales volume in the key car and truck divisions. In line with our perception of Daimler's financial policy, we do not expect material changes to shareholder remuneration or any sizeable acquisitions. The ratings could be negatively impacted if Daimler's financial policy became more aggressive, for example, if the group engaged in a large acquisition funded by cash and debt. However, we do not view this as a likely scenario.

We would consider a positive rating action if Daimler were to continue its track record of a cautious financial policy including moderate dividend payouts, substantial liquidity, and strong credit metrics coupled with an improvement in the adjusted EBITDA margin to levels above 12%.

Positive rating drivers	Negative rating drivers
• Mercedes-Benz is a leading premium car manufacturer, with one of the strongest brands for premium cars worldwide • Track record of successful product launches, facelifts, and extension of the product range at Mercedes-Benz Cars • Broad geographic reach in its key divisions, Mercedes-Benz Cars and Daimler Trucks • Broad regional distribution of sales across both mature and emerging-market regions • Diversification benefits from captive finance operations, adding a source of operating profits outside manufacturing • Strong financial risk profile providing a buffer for unexpected negative operating performance and substantial financial flexibility	• Strong risks of negative cyclical volume changes that may result from worsening consumer sentiment or less favourable economic environment • Substantial investment required to develop hybrid and electric vehicles and to meet increasingly stringent emission standards • Technological changes in the automotive industry that may change the competitive landscape • Strong earnings risks in the commercial vehicle sector given the early-cycle nature of this industry

Positive rating-change drivers	Negative rating-change drivers
• Continuation of strong financial position leading to headroom that may accommodate seriously negative volume developments at Mercedes-Benz Cars and Daimler Trucks • Substantial technological advancements at Mercedes-Benz Cars, suggesting a technological lead for electrified vehicles	• Deterioration of operating performance such as sustained market share losses in key markets (Europe/US) in either the passenger or truck division • Change in financial policy towards higher shareholder remuneration, including share buybacks or larger-sized acquisitions – risks that we currently evaluate as being low • Weakening of the liquidity position, including limited access to public debt markets

Financial overview

			Scope estimates	
Scope credit ratios	**2017**	**2018**	**2019F**	**2020F**
SaD/EBITDA	-0.8x	-0.9x	-1.1x	-0.8x
Scope-adjusted FFO/SaD	-113%	-90%	-86%	-101%
FOCF/SaD	-40%	-24%	-22%	-36%
Scope-adjusted EBITDA in EUR m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	19,077	16,428	12,629	15,926
add: operating lease payment in respective year	563	621	0	0
less: EBITDA, Daimler Financial Services	-2,125	-1,512	-2,888	-2,193
less: capitalised development costs	-2,779	-2,535	-2,535	-2,535
Scope-adjusted EBITDA	**14,736**	**13,002**	**7,206**	**11,198**
Scope funds from operations in EUR m	**2017**	**2018**	**2019F**	**2020F**
EBITDA	19,077	16,428	12,629	15,926
less: (net) cash interest paid	-117	-491	-300	-310
less: cash tax paid	-3,879	-2,858	-1,057	-2,172
less: pension interest	-209	-130	-180	-180
add: depreciation component, operating leases	447	481	0	0
add: dividends received	895	1,380	950	980
add: EBITDA, Daimler Financial Services	-2,125	-1,512	-2,888	-2,193
less: capitalised development costs	-2,779	-2,535	-2,535	-2,535
Scope funds from operations	**10,749**	**10,763**	**6,619**	**9,517**

Scope-adjusted debt in EUR m	2017	2018	2019F	2020F
Reported gross financial debt	127,353	144,999	157,029	161,818
less: debt, financial services unit	-125,541	-140,124	-147,029	-151,818
less: cash & cash equivalents	-22,135	-25,430	-25,117	-26,842
add: cash not immediately accessible	1,300	1,300	1,300	1,300
add: pension adjustment	4,007	4,116	6,100	6,100
add: operating lease obligation	2,504	3,100	0	0
less: fair value hedges	68	28	28	28
Scope-adjusted debt	**-12,444**	**-12,011**	**-7,689**	**-9,414**

Business risk profile

Our analysis of the business risk profile of global auto manufacturers is split into two parts: i) industry risk; and ii) competitive position. This includes our assessment of market position, diversification, and operating profitability (EBITDA margin).

New corporate structure

In Nov. 2019, Daimler completed the implementation of the new group structure that was announced in Oct. 2017. The annual general meeting for 2019 approved the legal organisation of the business units in three wholly-owned legally independent entities under the umbrella of Daimler AG:

- Mercedes-Benz AG now combines Mercedes-Benz Cars and Mercedes-Benz Vans
- Daimler Truck AG now combines Daimler Trucks and Daimler Buses
- Daimler Mobility AG. Daimler Financial Services, already a separate legal entity prior to the completion of the new structure, was renamed Daimler Mobility AG in July 2019.

Daimler AG acts as the holding company with responsibility for governance, legal, compliance, and capital allocation. Daimler AG is likewise the sole and exclusive access to capital markets for equity and debt.

The new structure is neutral for the rating as it has only changed the legal structure of operations. A profit and loss transfer agreement for the three legal entities with Daimler AG is in place.

There is likewise no impact through structural subordination for the Daimler AG bondholders. Daimler has repeatedly stated that an equity listing of any of the three divisions is not envisaged and likewise communicated numerous times that a divestment of any of the legal entities was not planned.

For our analysis, we continue to exclude the financials of the captive finance business (now Daimler Mobility AG) from the consolidated numbers, and our business risk profile assessment focuses on industrial activities (except for the diversification benefit we see from the financial services business). Our analysis of Daimler's business remains guided by the product segments (cars, vans, trucks, buses, financial services & mobility services).

Industry risk

We classify cyclicality risk in the auto and truck manufacturers industry as high in accordance with our Corporate Ratings Methodology. Our classification of entry barriers is likewise classified as high and we consider the auto and truck maker industry to have an industry risk in the BB category.

Competitive position

We assess the competitive position of a company in the automotive and commercial vehicle manufacturer industry by analysing several drivers:

- Market position: we determine an auto and truck original equipment manufacturer's (OEM's) market position by looking at two factors:
  (i) market shares over time, and
  (ii) brand positioning and customer awareness.
- Diversification
- Profitability

Mercedes-Benz Cars

Mercedes-Benz Cars offers a broad range of premium vehicles under the Mercedes-Benz brand as well as sub-brands such as AMG or Maybach. The range covers compact cars such as A-Class and B-Class, the C-Class and E-Class, a diverse set of SUVs, roadsters, coupes, sedans, convertibles, and S-Class luxury cars. In addition, the division offers small cars under the *smart* brand. The next generation of *smart*-branded cars will be developed in a 50:50 joint venture by Zhejiang Geely Holding Group and Mercedes-Benz Cars following the announcement of a joint venture with Geely in March 2019. The new *smart* generation will be all-electric following the product renewal that is planned to take until 2022.

In terms of electrification, Daimler has developed the EQ platform and EQ brand. EQ stands for 'Electric Intelligence' and includes services offered in connection with electric mobility in addition to the fully electrified vehicles developed under the brand. The fully electrified EQC SUV was launched in 2019 and will most likely be followed by fully electrified compact versions (EQA/EQB).

Mercedes-Benz Cars expects to have 50 fully-electric or hybrid models by 2022 and to have the model range electrified, including 48V technology, plug-in hybrids and more than 10 fully electric vehicles with battery or fuel cell powertrain. The goal is to offer customers at least one electrified alternative in each segment – from compact cars to SUVs. From 2020, the *smart* brand plans to sell only cars with an electric drive in Europe and North America with other regions to follow.

The medium-term goal is an increase in the share of battery-electric vehicles to 15%-25% of unit sales by 2025 if customer preferences and the expansion of charging infrastructure create an accommodative environment for this goal.

The company's plans, efforts and investment towards the electrification of its product range are neutral for our assessment of its market position and diversification.

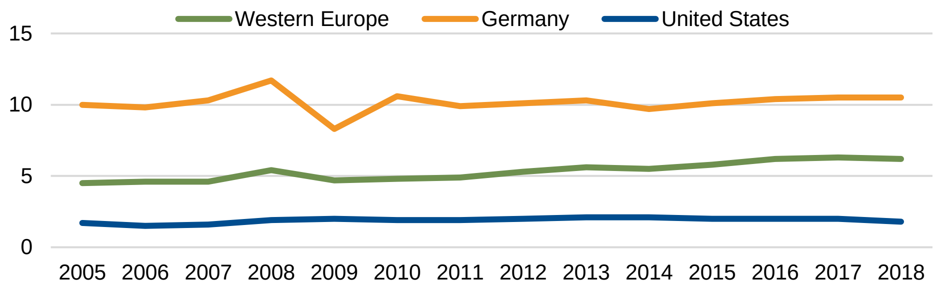
Mercedes-Benz Cars: market shares over time

An auto OEM's ability to generate operating profits and cash flows from ongoing operations is closely linked to its market position, as measured by its share of a specific product category or geographic region. Market share is affected by general demand, the product lifecycle (including new products), automotive facelifts, and the average age of the model range. In essence, the contraction or expansion of market share over time mirrors an OEM's ability to offer attractive products and is a good indication of its overall competitive position. The analysis of market share likewise implicitly includes an assessment of an OEM's ability to design appealing products.

Although it appears intuitive to measure an automaker's market share against the global volume of light-vehicle sales, we instead focus our analysis on certain product sub-categories or geographic regions. This avoids an inconsistent blending of different product types, for example, blending mass-market, entry-level vehicles with high-margin premium cars, luxury cars or SUVs.

Over the past decade, Mercedes-Benz Cars has reported a gradual improvement in the market shares in one of its key markets (Europe). The market share in North America has remained at around 2% for more than 10 years and the market share in Germany (around 10%) has likewise been stable. The history of market share developments in the Chinese car market likewise points to a gradually rising share over the past five years (2.9% in 2018 after 2.6% in 2017 and 2.1% in 2016). This further confirms that Mercedes-Benz Cars has been able to either maintain or expand its market position with the products offered, notably the expanded suite of SUVS and compact SUVs. We view the overall market position of Mercedes-Benz Cars as strong and supportive for the rating.

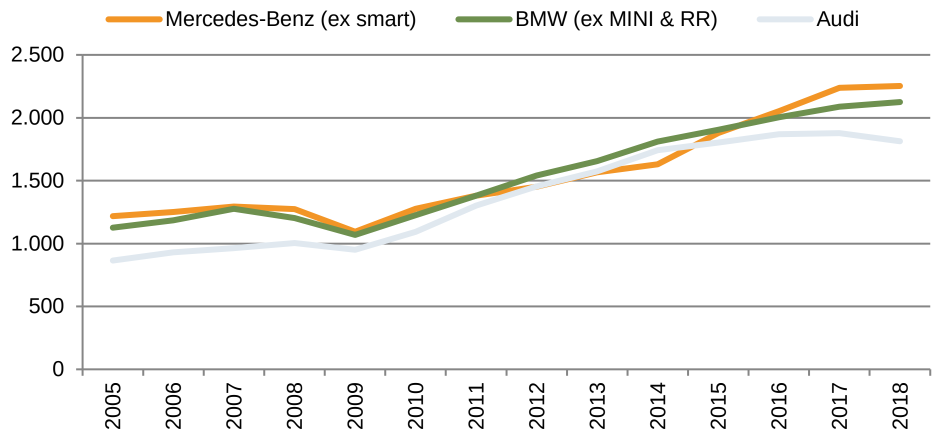
Figure 1: Mercedes-Benz Cars – market share development (%)



Source: Daimler

The stability and/or slight improvement of market shares have been achieved against a backdrop of rising volumes for premium cars over the past years. Starting with the year after the financial crisis (2010), premium car makers such as Mercedes-Benz, BMW or Audi have enjoyed a favourable economic environment, supporting a considerable increase in unit sales volumes. Mercedes-Benz Cars' growth (CAGR) in 2010-2018 was about 90 basis points higher than that of Audi. The positive gap built to BMW has narrowed as expected given the different product lifecycle at BMW (such as the 3 series and 5 series).

Figure 2: Premium car makers – unit volume development

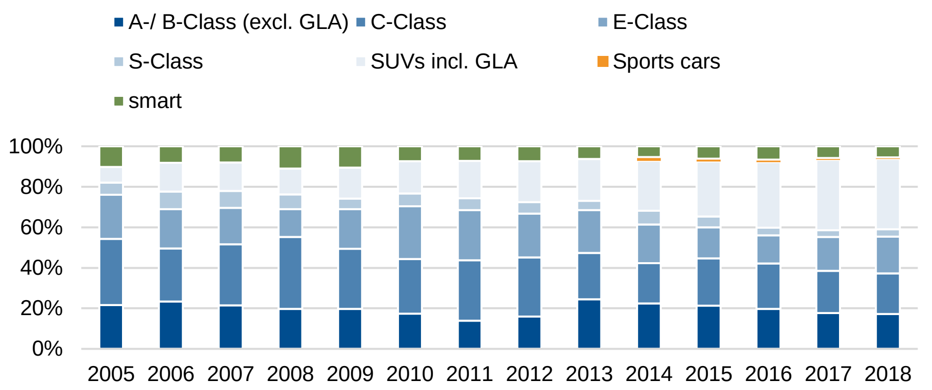


Source: Daimler, BMW, Audi (in thousands of units)

Effectively, the market position of Mercedes-Benz Cars continues to be supported by the model offensive launched back in 2012. About half of the new models launched since then have no predecessor.

The expansion of the product range, in particular a broadened product offering of compact cars (such as the CLA launched in early 2013 and the GLA launched in 2014 in addition to the A-Class and B-Class) have attracted a younger demographic. The growing popularity of compact SUVs is a further key to the success of the broadened product mix, which appeals to a wider group of potential customers. Today, large and compact SUVs account for about 35% (2018) of the unit sales volume versus 20% five years ago.

Figure 3: Mercedes-Benz Cars – product portfolio over time



Source: Daimler

Our analysis of the trends and resilience of market shares in specific product segments or geographic regions is supplemented by our analysis of the product range.

Key considerations are future product launches (including the product-renewal cycle), facelifts, the mix of vehicles, and the number of products with alternative powertrains such as battery-electric vehicles or hybrid cars.

In 2017, Mercedes-Benz Cars’ unit volume benefitted from the launch of the new E-Class in 2016, with all variants and derivatives of this model available from 2017. The facelifted versions of the GLA and S-Class have likewise supported unit sales since 2017.

Mercedes-Benz Cars’ sales volumes in 2019 are positively supported by the facelifted C-class (2018) and positive contributions from the new compact cars including the new B-class, A-class sedan (launched in spring 2018) and the new GLB. We continue to expect volume support from more profitable vehicles to come from the new GLE and GLS and the upgraded GLC. A key focus besides the launch of electrified vehicles under the EQ brand will be the successor models to the C-class and S-class (to be renewed in 2021).

The upcoming cycle of product renewals and facelifts confirms our view that Mercedes-Benz Cars is very likely to maintain or slightly improve its market position in the medium term.

Figure 4: Mercedes-Benz Cars – product lifecycle

2014	2015	2016	2017	2018	2019
GLA	GLE Coupe	E-class Sedan	E-class Coupé	A-Class	A-Class Sedan
C-Class Sedan	GLC	E-Class Estate	E-class Convertible	C-Class Sedan facelift	B-Class
C-Class Estate	C-Class Coupé	S-Class Convertible	S-Class facelift	C-Class Estate facelift	GLE
S-Class Coupé	CLA Shooting Brake	C-Class Convertible	AMG GT R	C-Class Convertible facelift	EQC (E-SUV)
smart fortwo	Mercedes AMG GT	GLC Coupé	AMG GT Roadster	C-Class Coupé facelift	GLC facelift
smart forfour		smart fortwo cabrio	smart fortwo cabrio EV	CLS	GLS
V-Class*			smartfortwo EV	S-Class Convertible facelift	GLB
			smartforfour EV	S-Class Coupé facelift	CLA Shooting Brake
			Pickup (X-Class)*	AMG 4-door Coupé	
			GLA facelift	G-Class facelift	
				GLC F-Cell	

Source: Daimler; *included in MB Cars retail sales but Vans division

Mercedes-Benz Cars: brand positioning

Mercedes-Benz Cars has one of the strongest brands for premium cars worldwide. Its strength and customer awareness results from appealing and technologically leading products. Through a broadening line of electric and plug-in hybrid vehicles, we expect the group's brand perception to strengthen, allowing it to participate in the increased demand for alternative powertrains. Mercedes-Benz, the group's core brand for passenger cars, ranks among the leading global brands.

Daimler Trucks

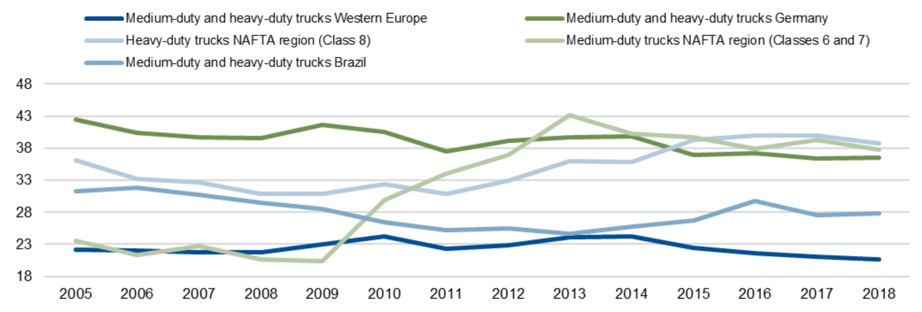
Daimler Trucks is the largest truck manufacturer worldwide for commercial vehicles with gross vehicle weight of more than six tonnes. The product range includes light-, medium, and heavy-duty trucks for local and long-distance deliveries, in addition to special vehicles. Key brands include Mercedes-Benz, Freightliner (US), Western Star (US), FUSO (Japan), and BharatBenz (India).

Daimler Trucks: market shares over time

Daimler Trucks is the leading producer of heavy- and medium-duty trucks worldwide and is the market leader in Europe and the NAFTA region. The division likewise holds strong market positions in Brazil (second), Japan (third) and India (fourth).

The market share development of Daimler Trucks has been a mixed picture in recent years. Market share changes relevant for our analysis (2016-2018) suggest that the market share declines in Western Europe continued, now at a level of about 21%. As pointed out in our earlier analysis, we see this more as a normalisation of market shares back to the trends observed prior to 2013 and 2014, when Daimler Trucks significantly improved its long-term market position (market share rose to 24% from 22% in preceding years). With the launch of the new Actros V heavy-duty truck in Oct. 2019, we see the market share in the heavy-duty market stabilising. Current market shares in Western Europe are only slightly below the 10-year average of market shares. Daimler Truck's market share for heavy-duty trucks in Germany is, however, still under pressure.

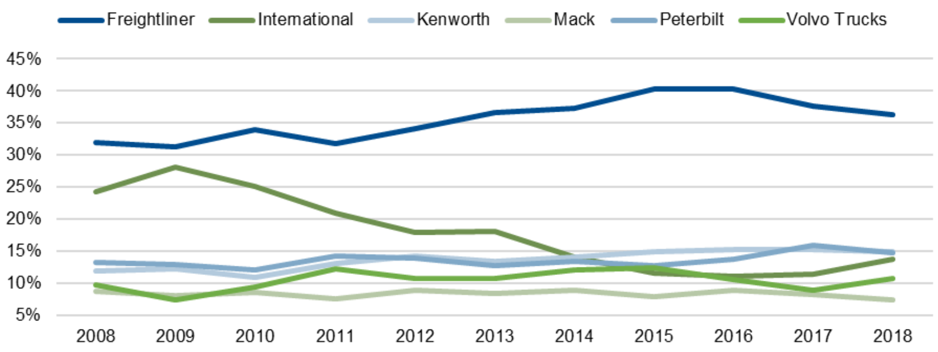
Figure 5: Daimler Trucks – market share development (%)



Source: Daimler

On the other hand, the division substantially improved its market position in the NAFTA region for heavy-duty trucks (class 8) in the observation period (2016-2018). The two-year change in market share was negative (-120 bps) but Daimler Trucks maintained a market share of about 39% for heavy-duty trucks (class 8) in the NAFTA market, a level not observed in the 2005-2015 period.

Figure 6: Daimler Trucks – market share, US Class-8 market



Source: Daimler; Freightliner = Daimler Trucks

Market share data in key developed markets of 21% (Europe), 39% (NAFTA heavy-duty trucks), and 38% (NAFTA medium-duty trucks) point to the strong overall competitive position of Daimler Trucks. In view of the sub-sector's high degree of consolidation, with only a few players in the key truck markets (Europe, NAFTA, South America, Japan), we expect a stable continuation of market share for the top manufacturers worldwide. Our view is also backed by comparatively high customer stickiness. Market shares and product positioning exhibit different patterns in emerging markets such as India or China. Western commercial-vehicle manufacturers such as Daimler Trucks, MAN/Scania, Volvo or Paccar still play a minor role in emerging markets given that demand for high-technology and high-end commercial vehicles in those regions remains limited. Consequently, truck markets in emerging regions are more fragmented and more intensely competitive.

Mercedes-Benz Vans

Mercedes-Benz Vans was legally folded into Mercedes-Benz AG in Nov. 2019. The division is primarily active in the market for mid-size and large vans. Key products are the Sprinter, the Vito, the V-class multi-purpose vehicle, and the Citan city van. Key markets are Western European countries, accounting for about two-thirds of unit sales volume. Mercedes-Benz Vans has enjoyed strong volume growth in the past years, and unit volumes sold have more than doubled since 2009, partly due to new products and distribution channels in new regions. The division's market share for mid-sized and large vans in western Europe has been fairly stable, at 16%-18% over the past decade and we see no indication that the division's market position will deteriorate.

Daimler Buses

Daimler Buses was legally folded into Daimler Truck AG in Nov. 2019. This division, with the Mercedes-Benz and Setra brands, is a market leader for buses of more than eight metric tonnes. The division's product range comprises city and intercity buses, coaches, and bus chassis. Revenues are primarily derived from western Europe and Latin America.

Daimler Mobility

Daimler Financial Services was renamed Daimler Mobility in July 2019. The division represents an integral part of the group's business. The financial services arm supports the vehicle sales of the Daimler group's brands in around 40 countries. Its product portfolio primarily consists of financing and leasing packages for customers and dealers, but also includes insurance brokerage, fleet management services, credit cards, and innovative mobility services such as 'mytaxi' and 'car2go'. In April 2018, BMW and Daimler signed an agreement to merge their respective mobility service units to create a leading provider for mobility services including car sharing, on-demand mobility, ride hailing and charging.

The financial services division provides an indirect (earnings) benefit to the industrial units. Buyers of passenger cars and trucks have higher brand and dealer loyalty if the vehicle's purchase is supplemented with a financing package arranged by the OEM (relative to cash buyers). In addition, buyers with arranged financing have shorter holding periods and tend to have more (high-margin) add-on equipment for the vehicle.

Daimler Mobility directly contributes to the group's financial performance, and our business risk assessment captures the benefits of incremental diversification from an in-house financial services unit. For the purpose of our financial risk assessment of Daimler, we separate the financial effects of Daimler Mobility from those of the industrial business (Mercedes-Benz AG, Daimler Truck AG).

Diversification

Diversified business operations across key geographic areas and a broad range of products helps to mitigate the risk of a single business segment disproportionately impacting an OEM's cash flows. A company's diversification determines its ability to offset cash flow volatility arising from economic cycles and industry dynamics alike, and consequently supports the stability and reliability of cash flows.

Daimler's diversification is supportive of its business risk profile.

We split our analysis of diversification into two elements:

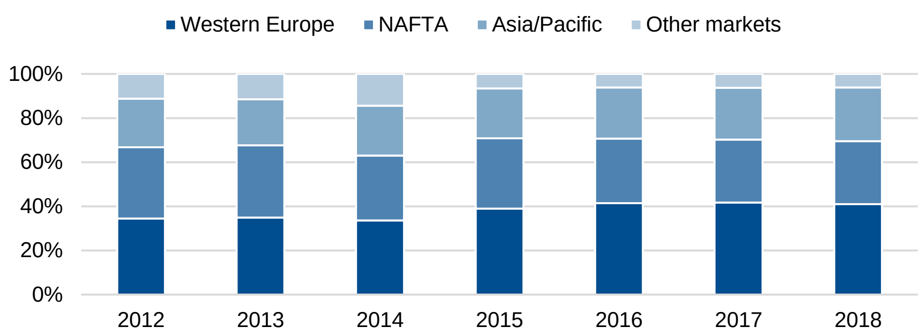
(i) geographic and

(ii) products.

Geographic diversification

Daimler is present in key automotive markets such as Europe, North America, China, Japan, and South America. Mature markets such as North America and Europe provide a floor to earnings, while above-average vehicle growth in emerging markets such as China supports long-term growth opportunities.

Figure 7: Daimler group – geographic diversification

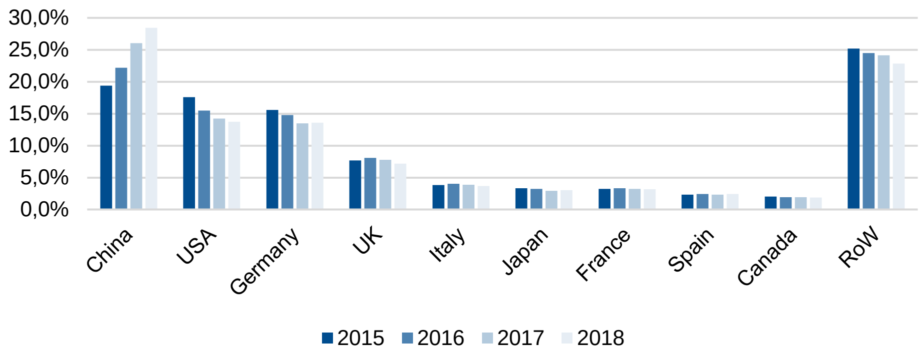


Source: Daimler

Given the difficult characteristics of the fragmented Chinese and Indian markets, including pricing pressures from domestic commercial-vehicle manufacturers, we consider Daimler Truck's presence in China and India to be neutral for its business risk assessment.

The broad diversification of activities is likewise reflected in the regional sales mix of the largest division, Mercedes-Benz Cars (see Figure 8).

Figure 8: Mercedes-Benz Cars – regional retail sales by volume



Source: Daimler

Product diversification

We consider Daimler's product diversification to be a positive rating driver. The group's line-up focuses on premium customers and shows a well-diversified product breadth across all vehicle categories, ranging from small, compact vehicles to luxury and ultra-luxury vehicles. With a broad range of new vehicles such as compact SUVs and compact cars, the number of variants and models at Mercedes-Benz Cars has increased substantially over the past few years. Consequently, we believe that the risk of Mercedes-Benz Car's volatility of unit sales volume (resulting from product lifecycle sales) has reduced over the past years. We note that Daimler announced an investment of up to EUR 10bn to develop battery-electric vehicles (BEV), as well as plans to launch more than 10 new BEVs until 2022, which further adds to the product diversification of Mercedes-Benz Cars.

Daimler's globally well-diversified business activities are also reflected in the group's captive finance activities, which mainly support their dealer network and retail sales.

Product diversification in the truck unit, however, is limited, reflecting the small number of medium- and heavy-duty product variants. We likewise caution that the benefits to diversification from Daimler Trucks could prove to be a substantial risk in less favourable economic environments. Demand for commercial vehicles reacts quickly to negative economic trends (early cycle), and unfavourable economic changes could have a materially negative effect on the group's earnings and cash flow generation.

Profitability

When determining Daimler's operating profitability, we considered the EBITDA margin of the group's four industrial units and disregarded earnings from the captive finance unit (DFS).

In our calculation, we adjusted the EBITDA of the industrial operations for capitalised development costs.

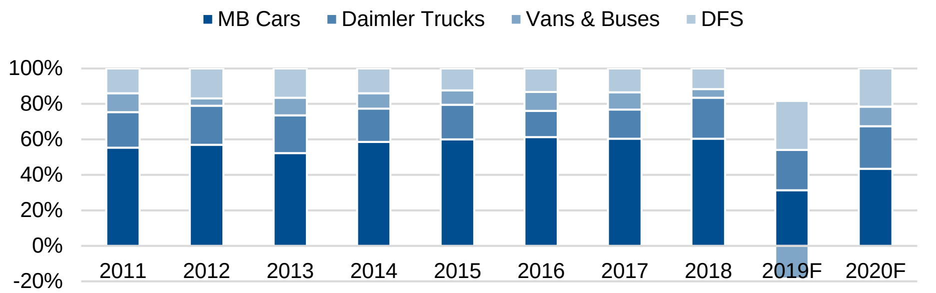
Daimler's operating profitability (EBITDA margin) is currently the weak spot in its overall business risk profile and profit margins have deteriorated for several reasons. Following the guidance provided by Daimler on its capital markets day in Nov. 2019, a significant improvement in operating profitability should likewise not be expected.

In 2019, operating profit has been affected by exceptional items such as the recall of Takata airbags (EUR 600m), court proceedings for negligent violation of supervisory duties (EUR 870m), some foreign exchange headwinds and the costs related to the legal separation of Daimler into three entities.

Going into 2019, the key profit generators, Mercedes-Benz Cars and Daimler Trucks, will suffer from either transitory changes towards electrification (cars) or a softening of underlying volume demand (trucks). The slowdown of the European and US truck market already affected the Q3 2019 results. Order intake for the period suggests that earnings in the truck division will continue to be negatively affected until the end of 2019 with a continued weakness in 2020. Mercedes-Benz Cars will be affected by the additional costs related to the electrification of the fleet (higher variable costs) and the lower profitability of new models. 2020 will be the first year in which Mercedes-Benz Cars needs to meet EU-wide thresholds for average fleet emissions and the planned share of electrified vehicles (plug-in hybrids, 48V, BEV) in the portfolio will leave its marks. This development is not completely unexpected and we had factored in a weakening of Mercedes-Benz Cars' margins in 2019/2020 due to increased expenses for electrified vehicles and lower cost absorption in our previous analysis. Daimler has initiated a cost reduction programme of EUR 1.3bn for the entire group with the majority related to Mercedes-Benz Cars (EUR 1.0bn).

We are now looking at a weaker EBITDA margin of about 8% (adjusted for capitalised development costs) in the 2020/2021 period. Our business risk assessment and profitability assessment is linked to the execution of the business plan that Daimler laid out at its capital markets day in Nov. 2019.

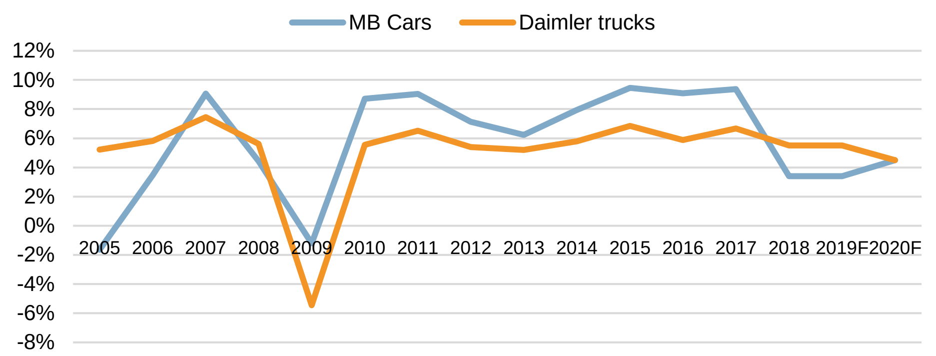
Figure 9: Operating profit (EBIT) distribution, Daimler group



Source: Scope, DFS = Daimler Financial Services

In our base case, we expect Mercedes-Benz Cars to report an operating profit margin of 5.4% in 2019 (excluding one-off items) and 4.5% in 2020. For Daimler Trucks, we see a reported EBIT margin of 5.5% in both 2019 and 2020.

Figure 10: Operating profit margin (EBIT), Mercedes-Benz Cars and Daimler Trucks



Source: Scope, Daimler.

Financial risk profile

Our analysis of the group's financial risk profile is based on the financials of Daimler's industrial activities (Mercedes-Benz AG and Daimler Truck AG). To that end, we separate material line items from the consolidated accounts that relate to Daimler Mobility (formerly Daimler Financial Services), notably its financial debt. In the financial services business, Daimler has a very high level of gross financial indebtedness, and the majority of the group's reported financial debt relates to the (matched) funding of captive-finance assets.

Figure 11: Breakdown of financial debt at Daimler

			Scope estimates	
EUR m	**2017**	**2018**	**2019F**	**2020F**
Short-term (current) debt reported for group	48,746	56,240	56,240	61,960
Long-term (non-current) debt reported for group	78,378	88,662	99,758	99,758
= Group gross financial debt reported	**127,124**	**144,902**	**155,998**	**161,718**
Market valuation and currency hedges for financial debt	229	97	1,031	100
Financing liabilities nominal	**127,353**	**144,999**	**157,029**	**161,818**
of which is industrial business	1,812	4,875	10,000	10,000
of which is financial services	**125,541**	**140,124**	**147,029**	**151,818**

Source: Daimler, Scope

Accounting adjustments

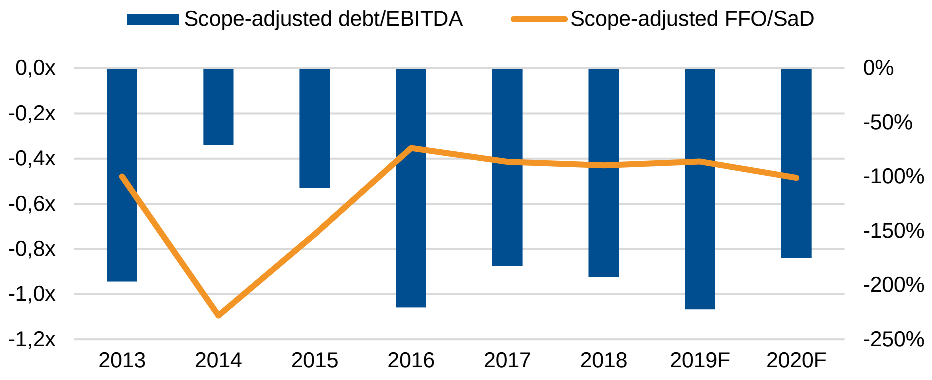
Our adjustments primarily include i) unfunded pension obligations; ii) operating leases; and iii) restricted cash.

In an initial step, we deducted from gross-adjusted debt the cash and marketable securities totalling EUR 25.3bn in 2018. This number also includes cash and marketable securities reported under the captive finance operations (DFS) as those can be accessed by the entire group to service obligations. In a subsequent step, we did not, however, credit the amounts of cash and cash equivalents that are deemed restricted and therefore not centrally available for immediate debt repayment (but included in the EUR 25.3bn). The amount of cash that is not credited is EUR 1.3bn.

In view of the limited financial liabilities in its industrial business and considerable financial flexibility (cash and cash equivalents), Scope-adjusted debt is negative to a significant degree.

The net cash positive position (i.e. the negative figure for Scope-adjusted debt) lead to strong credit ratios. We expect Scope-adjusted debt to stay negative going forward, i.e. available and unrestricted liquidity should continue to exceed financial debt reported in the industrial business.

Figure 12: Credit metrics – development of leverage



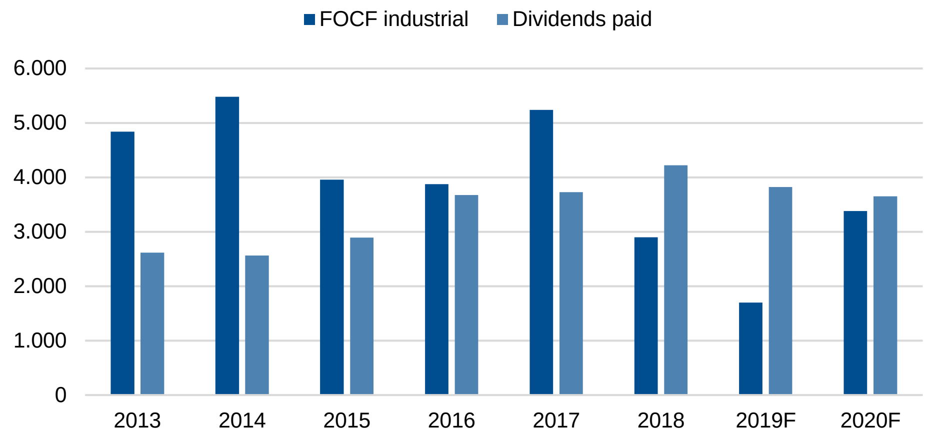
Source: Scope, Daimler, SaD = Scope-adjusted debt

The financial risk profile is a key support for the corporate credit ratings of Daimler and its related financing subsidiaries.

Currently, free cash flow generation is a weak spot in the overall assessment. The projected excess of dividends over free cash flow generation does not, however, change leverage or credit metrics materially. In 2019, FOCF was dragged down by investments in future products, working capital effects and diesel-related payments. Daimler has already guided for FOCF in 2019 significantly below the prior year's level (EUR 2.9bn).

One of the key take-aways from Daimler's capital markets day (Nov. 2019) is the clear focus on an improvement of cash generation from ongoing business. While Daimler has not provided public guidance on FOCF, the business plan for the 2020/2021 period suggests that FOCF generation should be supported by the capex 'freeze' and a clear incentivisation through cash flow-related key performance indicators. In 2019, the FOCF from the industrial unit will be lower than the dividend payment. For 2020 and beyond, Daimler has rephrased it dividend policy and linked dividend payments to the coverage by FOCF, a credible positive for debtholders. What is unclear at this stage is the release/payments related to provisions booked in the first half of 2019. Provisions related to diesel have increased to EUR 2.5bn in June 2019 and once the cash outflow from those provisions crystalizes, reported free cashflow generation could prove to be lower. Neither the timing nor the size of any such payments related to provisions booked can be reasonably assessed.

Figure 13: Free operating cash flow – industrial business vs. dividends paid



Source: Daimler, Scope estimates, in EUR mio.

Liquidity

The short-term rating is S-1. We view Daimler's liquidity and financial flexibility as 'better than adequate' in accordance with our methodology to determine the liquidity of corporates. In accordance with our methodology on automotive and commercial vehicle manufacturers, we disregard financial maturities from captive-finance operations when determining our liquidity coverage ratios, only taking into account financial maturities of the industrial segment. In addition, we include balances of cash and cash equivalents reported by the captive finance segment when calculating liquidity coverage, as these funds are accessible for the whole group.

Financial liabilities in Daimler's industrial division are substantially covered by internal sources (cash and expected cash generation) and external sources (committed syndicated credit facility). In our view, Daimler has strong banking relationships, as evidenced by the high number of banks participating in its syndicated credit facility, and a good standing in public debt markets, as evidenced by the issuance of numerous public debt instruments in various currencies.

Liquidity is supported by:

- Cash of EUR 15.8bn on 31 December 2018. This includes the cash reported by the industrial business (EUR 12.8bn) and the captive finance unit (EUR 3.0bn). Of the reported liquidity, about EUR 1.3bn is not immediately accessible due to different (short-term) restrictions such as currency-conversion limitations and/or other restrictions on repatriation. Therefore, we neither deducted the EUR 1.3bn when determining our financial credit ratios, nor did we consider this amount in our liquidity assessment.

- Cash equivalents in the form of marketable debt securities, in an amount of EUR 9.6bn reported by both the captive finance unit and the industrial units

- A EUR 9.0bn syndicated credit facility with a consortium of more than 40 banks. The facility is due in September 2020. The facility was unused.

- Our projection of FOCF

Contractual and potential uses of liquidity are:

- Financial maturities in the industrial division
- Dividend payments in a range of EUR 3.7bn in each of 2020 and 2021. (including those dividends paid to minorities)

Figure 14: Liquidity

Liquidity and financial maturities in EUR m	2017	2018	2019F	2020F
Unrestricted cash & cash equivalents	20,835	24,130	23,817	25,542
Available and undrawn committed credit lines	9,000	11,000	11,000	11,000
FCF, industrial units	5,005	2,893	1,699	3,382
Dividends paid	-3,727	-4,220	-3,820	-3,650
Available financial flexibility	**31,113**	**33,803**	**32,696**	**36,273**
Financial debt, industrial units (t-1)	-1,488	1,812	4,875	0
Internally and externally provided liquidity cover	**-20.9x**	**18.7x**	**6.7x**	**N.M.**

Source: Daimler, Scope

Mobility Services (formerly Daimler Financial Services)

In 2018, Mobility Services had 5.2m leasing and financing contracts with a contract volume of EUR 154bn. The majority of vehicles financed are passenger cars, followed by trucks and vans. The group-wide penetration rate (i.e. the number of vehicles sold by any of the industrial units being financed through the Mobility Services division) remained at 48% with slightly higher penetration rates for Mercedes-Benz Cars. Mobility Services follows an indicative goal to have roughly 'one half' of industrial units' vehicles financed provided that customer credit risks are acceptable. The targeted split of contract volume for operating leases is at 'roughly 35%', 50% financing (including finance leases) with the remainder being floor plan funding for dealers.

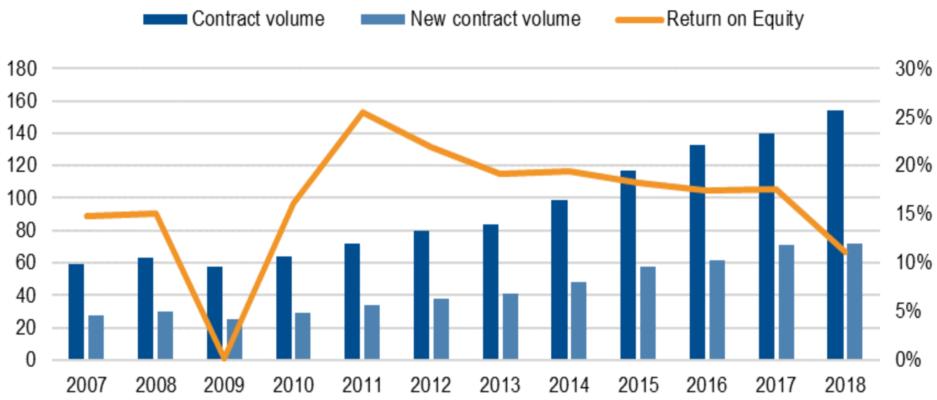
The maturity profile of the group's captive finance liabilities and underlying assets match well. Like any other captive finance operation in the automotive industry, Mobility Services follows the policy that asset-liability risks (for example, on maturities, interest rates, and currencies) are matched from the initiation of the contract.

Roughly one-third of Daimler's captive finance assets are exposed to residual value risks (products under operating lease contracts for which Mobility Services is the lessor). Residual value risks exist if a vehicle's expected market value at the end of the contractual lease term is lower than its estimated residual value at the date the contact is entered into.

Like its car OEM peers, Daimler does not disclose detailed residual value figures and residual value assumptions are subject to an ongoing review in conjunction with annual and quarterly reporting. At Daimler, the majority of residual value risks are borne by the industrial business. A topic widely discussed is the deterioration of residual values/used car prices for diesel vehicles. With regard to the deterioration of residual values of diesel cars in Germany, Daimler has taken a EUR 100m charge in the first quarter 2018 with no further charge thereafter. The special charge booked (EUR 100m) was insignificant from a credit perspective and related to the general deterioration of diesel used car prices (notably for vehicles that comply with the Euro 5 emission norm). The value of diesel cars older than the Euro 6 emission norm in the (operating) lease portfolio in early 2018 was less than EUR 1bn and this risk has diminished further with customer payments and the completion of underlying operating lease contracts in the interim.

We believe that the group's accounting policy and monitoring approach on estimating future price developments (notably used-car/truck prices) of assets under risk is appropriate.

Figure 15: Development – captive finance activities (in EUR bn)

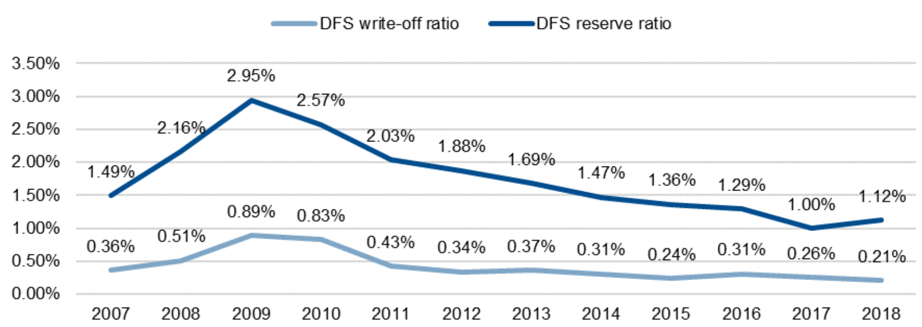


Source: Scope, Daimler

The financial services business has a proven history and track record of managing underwriting and credit risks. The percentage of credit losses in the division has been low ever since the end of the economic and financial crisis in 2010. The history of credit losses (write-offs) over the past few years should, however, be judged with the caveat that the economic environment, interest rates, and unemployment rates have been very favourable, i.e. the probability of credit risks materialising has been very low in the past few years. Mobility Services has built credit reserves at about four times the size of the current run rate of credit losses. As pointed out by Daimler at its capital markets day in Nov. 2019, it is reasonable to expect a 'normalisation' of credit losses. We likewise do not believe that the low credit losses in the captive finance portfolio are about to continue at this level. In view of the credit reserves built, however, we do not see a significant impact on either the industrial units or Mobility Services if credit losses start to pick up again.

Overall, we view the risk profile of Daimler Mobility as adequate. Nevertheless, we point out that the emergence of further credit losses would have a double effect on the division's return on equity as there would be: i) higher write-offs; and ii) higher credit-reserve charges (provisioning) whenever the write-off ratio worsens. The crisis in 2008-2009 has shown that credit risks and residual value risks materialise when unit sales volumes decline, i.e. credit risks unleash their worst impact when an industrial unit's operating profits are under pressure from declining demand.

Figure 16: Credit loss ratio and credit loss reserves at Daimler Financial Services



Source: Daimler. DFS = Daimler Financial Services

Key supplementary rating drivers

Financial policy

The group has publicly declared certain transparent financial parameters on its principal financial policy and strategy, including on shareholder remuneration. The group seeks to meet the following targets:

- Dividend payout/shareholder remuneration: Daimler targets a dividend payout ratio of about 40% and has maintained its dividend payments at about this level in the past (the payout ratio was 48% for 2018, 37% for 2017, 41% for 2016 and 40% for 2015). In view of deteriorated earnings in 2018, the dividend payable for 2018 was reduced by 11%. An important new characteristic of the dividend policy was announced at the capital markets day in Nov. 2019. Daimler still targets a 40% payout ratio but this is now linked to the requirement that any such dividend payment is covered with FOCF generated in the industrial divisions, i.e. that the dividend payment is covered with cash generated from ongoing business operations. In 2019, dividend payments will be higher than FOCF in the industrial business. Over the past few years, Daimler has repeatedly and publicly indicated that share buy-backs are not on the agenda.
- A new feature of financial policy, besides the reiteration of a strong commitment towards a rating in the A' category, was likewise communicated at the capital markets day in Nov. 2019. Daimler communicated its target of a 'net industrial liquidity' of about EUR 10bn (i.e. surplus of cash and cash equivalents over reported financial debt in the industrials units). While Daimler has effectively lived up to this financial goal in the past (significant net liquidity in the industrials business), we view the introduction of a clearly formulated liquidity goal positively. Shareholder remuneration, including share buybacks can and must be viewed in conjunction with this 'net liquidity goal'. From a credit perspective, we view as positive new Daimler management's conviction that a focus on a liquidity buffer remains the appropriate risk management for the group.
- While not being a very specific element of financial policy, we understand that the business plan for 2020/2021 will place significant emphasis on cash flow generation including incentivisation of management with cashflow-related key performance indicators. Investment caps (capex and R&D) are in place to ensure that free cash flow generation is supported.
- Liquidity: Daimler aims to maintain available financial flexibility (including cash, committed lines, unused ABS) at levels at least equivalent to upcoming short-term financial maturities, which include bond debt mostly relating to the financial services business (Daimler Mobility). This prudent approach places Daimler in a position of not having to seek external funding in critical situations (at least in the short term) and minimises the reliance on public debt markets should the volatility of global debt markets turn unfavourable.

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