Daimler AG
Germany, Automotive Manufacturers

SCOPE A STABLE

Corporate profile

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

Ratings

Corporate Rating	A
Outlook	Stable
Senior Unsecured Debt	A
Short-Term Rating	S-1

Rating rationale

Scope Ratings assigns a corporate issuer rating of A to Germany-based Daimler AG and financing subsidiaries. The short-term rating is S-1. The Outlook is Stable. The senior unsecured debt issued by either Daimler AG or financing subsidiaries is rated at A.

The corporate rating of A reflects the company's track record and Scope's expectation for a continuation of the strong market positions held by the group's key divisions, Mercedes-Benz Cars and Daimler Trucks. 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), is a further support for Scope's business risk assessment. Limiting factors for the business risk assessment are the pronounced risk for 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.

Automakers currently benefit from a favourable macro environment, which is showcased by low gasoline prices supporting volume sales of very profitable SUVs, low interest rates including availability of credit, a weakened euro, high demand for automobiles in China, positive consumer sentiment, and rebounding southern European markets. Daimler has likewise benefited from these developments over the past few years, in addition to positive effects resulting from new and successful car models. Consequently, Daimler's financial risk profile is very strong and the key support for the A rating.

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. Therefore, the Scope-adjusted debt figure is negative. The net cash position ultimately results in strong credit ratios, and the key credit ratios that Scope considers important for the assessment of automakers, i.e. Scope-adjusted debt/EBITDA and funds from operations/Scope-adjusted debt are both negative.

Scope's positive view on the financial risk profile is supplemented by the supportive liquidity position of the group. Going forward, Scope expects the free operating cash flow in the industrial business to cover forecasted dividend payments. Therefore, Scope-adjusted debt should remain negative, i.e. available unrestricted liquidity should continue to exceed financial debt and debt-like adjustments.

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Related Research // Methodology

Ratings Methodology Corporate Ratings, Jan. 2017

Rating Methodology European Automotive and Commercial Vehicle Manufacturers, Feb. 2017

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Bloomberg: SCOP

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

Scope has 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 Japan 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 Scope's expectation that Daimler should keep a strong financial risk profile. The rating case suggests that free operating cash flow generated in the industrial business is sufficient to cover projected dividend payments. Therefore, Scope-adjusted debt will very likely remain negative with no meaningful incremental financial debt in the industrial business, if any.

Scope would consider a negative rating action if free operating cash flow 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 its perception of Daimler's financial policy, Scope does 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, engaging in a large acquisition funded by cash and debt. However, Scope does not view this as a likely scenario.

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

Rating drivers

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

Rating-change drivers

Positive	Negative
Continuation of strong financial position leading to headroom that may accommodate seriously negative volume developments at Mercedes-Benz Cars and Daimler Trucks	Deterioration of operating performance such as sustained market share losses in key markets (Europe/US) in either the passenger car or truck division
Substantial technological advancements at Mercedes-Benz Cars, suggesting a technological lead for electrified vehicles	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 limitations to access public debt markets

Financial overview

		Scope estimates		
Scope credit ratios	**2015**	**2016**	**2017F**	**2018F**
EBITDA/interest cover	29x	34x	32x	33x
Scope-adjusted debt (SaD)/EBITDA	-0.5x	-0.9x	-1.1x	-1.2x
Scope-adjusted funds from operations/SaD	-176%	-103%	-84%	-74%
Free cash flow/SaD	-50%	-30%	-27%	-24%

		Scope estimates		
Scope-adjusted EBITDA in EUR m	**2015**	**2016**	**2017F**	**2018F**
EBITDA	18,123	17,591	18,490	19,172
add: operating lease payment in respective year	491	539	539	539
less: EBITDA, Daimler Financial Services	-1,687	-1,819	-1,906	-1,997
less: capitalised development costs	-1,815	-2,323	-2,323	-2,323
Scope-adjusted EBITDA	15,112	13,988	14,800	15,391

		Scope estimates		
Scope funds from operations in EUR m	**2015**	**2016**	**2017F**	**2018F**
EBITDA	18,123	17,591	18,490	19,172
less: (net) cash interest paid	-159	-18	-135	-135
less: cash tax paid	-2,573	-2,950	-3,573	-3,717
less: pension interest	-290	-222	-220	-220
add: depreciation component, operating leases	401	440	432	432
add: dividends received from equity	242	188	170	190
less: EBITDA, Daimler Financial Services	-1,687	-1,819	-1,906	-1,997
Scope-adjusted funds from operations (FFO)	14,057	13,210	13,258	13,725

		Scope estimates		
Scope-adjusted debt in EUR m	**2015**	**2016**	**2017F**	**2018F**
Reported gross debt	101,142	117,686	124,058	130,750
less: debt, financial services unit	-97,347	-116,137	-122,570	-129,262
less: cash & cash equivalents	-18,209	-21,729	-24,543	-27,334
Add back: cash not immediately accessible	1,300	1,300	1,300	1,300
add: pension adjustment	3,803	4,007	3,952	3,952
add: operating lease obligation	1,813	2,131	2,131	2,131
less: fair-value hedges	-498	-72	-72	-72
Scope-adjusted debt (SaD)	-7,996	-12,815	-15,745	-18,535

Business risk profile

Scope's 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.

The activities of the Daimler Group comprise the following segments: Mercedes-Benz Cars, Daimler Trucks, Mercedes-Benz Vans and Daimler Buses (the industrial activities), and Daimler Financial Services (DFS; financial services). For our analysis, we have excluded DFS's financials 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).

Industry risk

The auto and truck manufacturer industry displays high cyclicality in accordance with our Corporate Ratings Methodology. Demand for passenger cars and light commercial vehicles are both strongly tied to macroeconomic conditions and subject to the risk of substantial fluctuations, including sudden contractions of production during economically weak times. Government intervention, including tax incentives for vehicle purchases such as those introduced in China in the third quarter of 2015, or scrappage schemes implemented during the 2009 recession ('cash for clunkers' in the US and 'Abwrackprämie' in Germany), can partly mitigate negative volume effects triggered by changing economic conditions. The relevant metric to assess the credit characteristics of the industry is the risk of severe declines in both volume and operating profit. Median EBITDA figures in the industry collapsed by more than 45% during the last recession (2008-2009), a clear sign of the industry's high cyclical dependence on the general economic environment.

The automotive manufacturer industry is highly concentrated. Design, development, production and sales of passenger cars and light commercial vehicles are in the hands of a few companies. The top three volume players in Europe – Volkswagen, Renault Nissan Alliance and the PSA Group – have a combined market share of about 50% of European automotive vehicle production (more than 30% global production). The market is extremely competitive despite the high market concentration. Sales incentives, mostly in the mass-market/volume segment, are the norm, and the broad customer base limits the pricing power of automakers.

As a result of the Volkswagen emissions scandal in 2015, we expect European authorities to tighten the surveillance of emissions, for example, by focusing on real-world driving environments rather than on laboratory testing conditions. Meeting the EU CO_2 emissions target by 2020 (95mg/km) for the fleet average of vehicles sold will be challenging for manufacturers. Carmakers have addressed this target by changing the powertrain in vehicles (hybridisation including plug-in hybrids), reducing vehicle weights and producing a higher share of compact vehicles with lower emissions. Regulations on vehicle safety have also increased R&D needs. While innovation in this industry is mostly driven by original equipment manufacturers (OEMs) and their component and system suppliers, there is nevertheless a substantial weight on operating cash flows created by R&D.

The barriers to enter the oligopolistic market for auto and truck manufacturing are classified as high in accordance with our Corporate Ratings Methodology. Substantial investment is needed in property, plant and equipment (capex) and R&D. Capex and R&D typically represent about 8%-10% of revenues in the industry and are primarily spent on the development of new models, the improvement of emission-reducing technologies (notably CO_2), product enhancements, and the development of materials that reduce vehicle weight (such as carbon fibre). Establishing and maintaining a global distribution network creates further substantial barriers in addition to the considerable investment needed to build a strong brand to create customer awareness.

Scope assesses the threat of substitutes to the automotive and commercial vehicle manufacturer industry as medium in accordance with its Corporate Ratings Methodology. Despite the existence of other modes of transport, such as trains or air travel, the independence and flexibility provided by passenger cars is not easily replaceable. However, recent industry dynamics pointing to electric and connected car developments may dilute the current borders of the traditional automaker towards becoming a technological player.

For a combination of high cyclicality and high barriers to entry, we derive a combined assessment of BB/BBB for the automotive and commercial vehicle manufacturer industry. Added to our assessment of medium substitution risk, this results in a final industry risk score of BB.

Outlook: automotive and commercial vehicle industry

Our outlook for the automotive and commercial vehicle industry is stable. Global demand in the passenger car industry is supported by long-term secular trends such as rising middle class and disposable incomes in emerging markets and a low level of motorisation (i.e. rising car density per capita). Further demand drivers are replacement demand (as measured by the average age of the car fleet), availability of credit, level of interest rates, and lending practices. Low gasoline prices can support demand for larger vehicles such as the more profitable SUVs (sport utility vehicles), whereas higher prices can lead to the opposite. State intervention measures such as import tariffs or local content requirements can limit demand in certain countries, but measures such as government-funded scrappage schemes can support the industry in periods of weak end-market demand.

European automakers have completed structural changes to production set-ups in the past few years and adjusted capacity by closing plants. While this eventually supports higher utilisation rates, the industry nevertheless still struggles with overcapacity. Given the sector’s economic importance, and high political and social sensitivity, exit barriers are high, and government intervention, other than import tariffs or local content requirements, effectively limit possible adjustments of supply-side factors. Added to this is a very competitive environment exacerbated by sales incentives, resulting in an imbalance of demand production and ultimately constraining the operating profit margins of automotive manufacturers. The pressure on costs is amplified by the ever-shorter product renewal and innovation cycles.

Compared to the total global automotive light-vehicle market, the sub-segment of premium cars is expected to grow more strongly than the overall industry. According to IHS, global premium volumes are forecasted to be up by 16% in 2020 (compared to 2015). Most of the global growth is driven by China (31%, implying a CAGR of 5.5%), the BRIKT (Brazil, Russia, India, South Korea, Turkey) countries (29%, CAGR of 5.2%) and North America (+12%, CAGR 2.3%). Western Europe, a relatively saturated market, is still forecasted to grow by 7% (CAGR of 1.3%).

Competitive position

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

- Market position: Scope determines an auto and truck OEM's market position through 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.

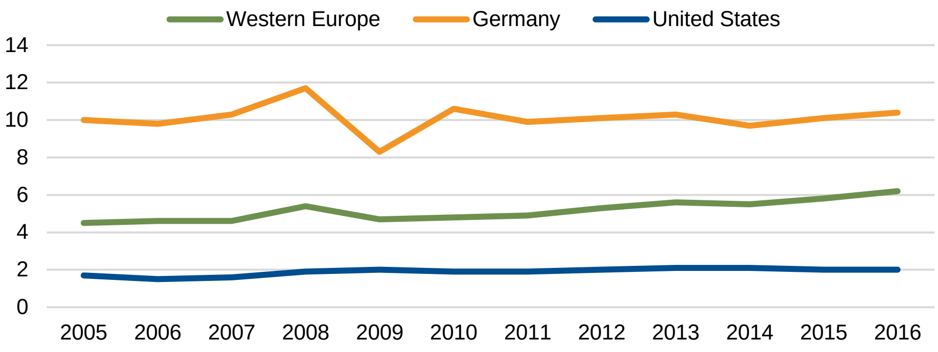
Mercedes-Benz Cars: market shares over time

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 fairly gradual improvement in the shares of its key markets, i.e. Germany and the rest of Europe, as well as North America (see figure 1). The history of market share developments in the Chinese car market likewise points to a gradually rising share over the past five years (2.1% in 2016 versus 1.4% in 2012). This further confirms for us that Mercedes-Benz Cars has been able to either maintain or expand market position with the products offered. Scope views the market position of Mercedes-Benz Cars overall as strong and supportive for the rating.

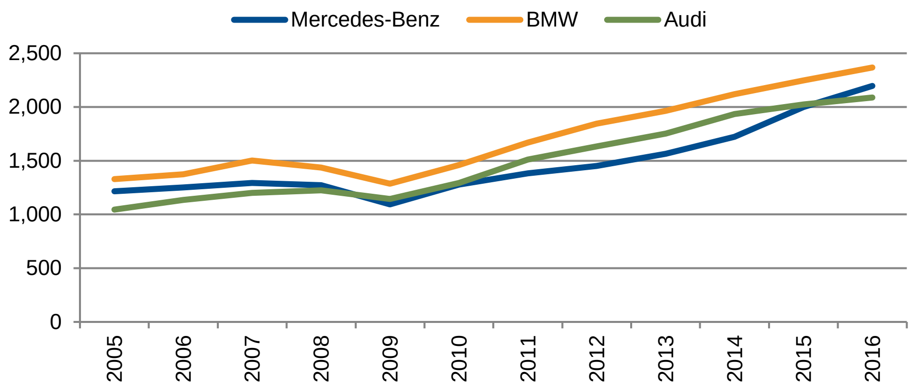
Figure 1: Mercedes-Benz Cars – market share development (%)



Source: Daimler

The stability and/or slightly improving 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) during 2010-2016 was about 100 basis points higher than those of its key competitors (BMW, Audi). To some extent, the weaker growth momentum at BMW was attributable to the different product lifecycle for key volume cars (such as the 3 Series and 5 Series) and we expect the gap in growth rates between BMW and Mercedes-Benz cars to narrow in the coming years.

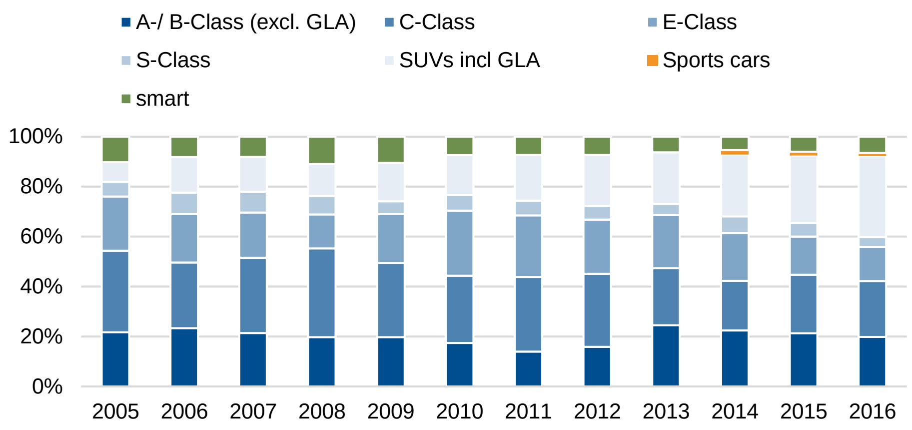
Figure 2: Premium car makers – unit volume development



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

The market position of Mercedes-Benz Cars continues to be supported by the model offensive launched back in 2012, and 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 and supported a good pricing position. A further key to success of a broadened product mix, which appeals to a wider group of potential customers, has been the growing popularity of compact SUVs. Today, large and compact SUVs account for about one-third 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 should benefit from the launch of the new E-Class in 2016, with all variants and derivatives of this model being available in all key markets by the end of this year. The facelifted versions of the GLA and S-Class should likewise support unit sales in 2017. 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	2017F
GLA	GLE Coupé	E-Class Sedan	E-Class Coupé
C-Class	GLA SUV	S-Class Cabrio	E-Class Convertible
S-Class	GLC SUV	C-Class Cabrio	S-Class (facelift)
smart fortwo	GLE SUV	E-Class T-Model	smart cabrio EV
smart forfour	C-Class Coupé	GLC Coupé	smart forfour EV
GLA	GLE Coupé		Pickup (X-Class)
			GLA facelift

Source: Daimler, Autobild

In terms of product development, Mercedes-Benz Cars presented its electric-vehicle brand, EQ, at the Paris auto show in 2016. Series production of the first all-electric vehicle based on the show car presented at the Paris auto show, a sporty SUV coupe with a 500km range, is scheduled for 2019. The battery for the new electric vehicle will be developed by Daimler's subsidiary ACCUMOTIVE, and an investment of about EUR 500m is planned to expand battery production capacity in the coming years. Overall, Daimler plans to launch more than 10 all-electric vehicles by 2022. The company's plans, efforts and investment towards the electrification of its product range are neutral for our assessment of the business risk profile for the time being.

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 and MB cars 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 (ninth according to Interbrand's 2016 ranking).

Daimler Trucks

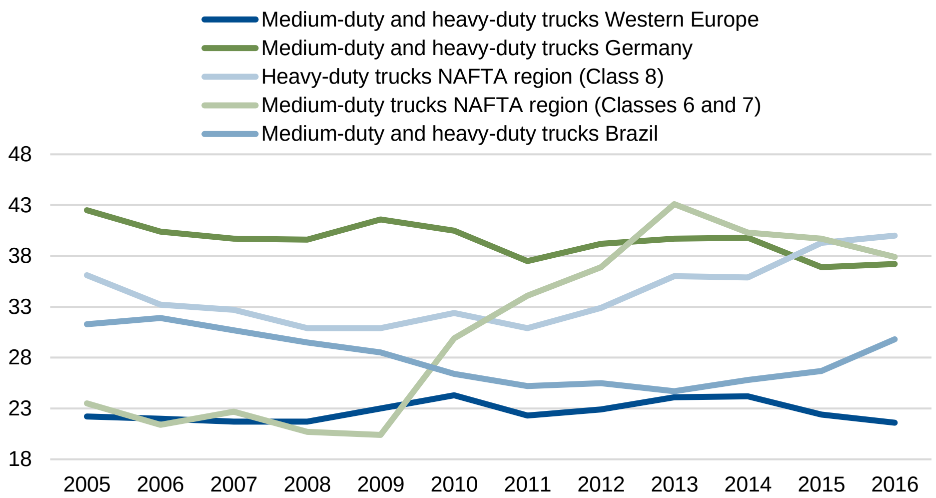
Daimler Trucks is the largest truck manufacturer worldwide for commercial vehicles with gross vehicle weight of more than six tonnes. The product range includes light-, medium, and heavy-duty trucks for local and long-distance deliveries, in addition to special vehicles. Key brands include Mercedes-Benz,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

Daimler Trucks: market shares over time

Daimler Trucks is the leading producer for 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 is a mixed picture over the past years, declining markedly in Europe during the period relevant for analysis, namely between 2014 and 2016. The same holds true for the German market. The decline in the European market seems, however, more a normalisation of market share back to the trend observed prior to the strong years of 2013 and 2014, when Daimler Trucks significantly improved its long-term market position (market share rose to 24% from the 22% in preceding years). This observation is less true for the German market, where Daimler Trucks currently has lost market share in an increasingly competitive market.

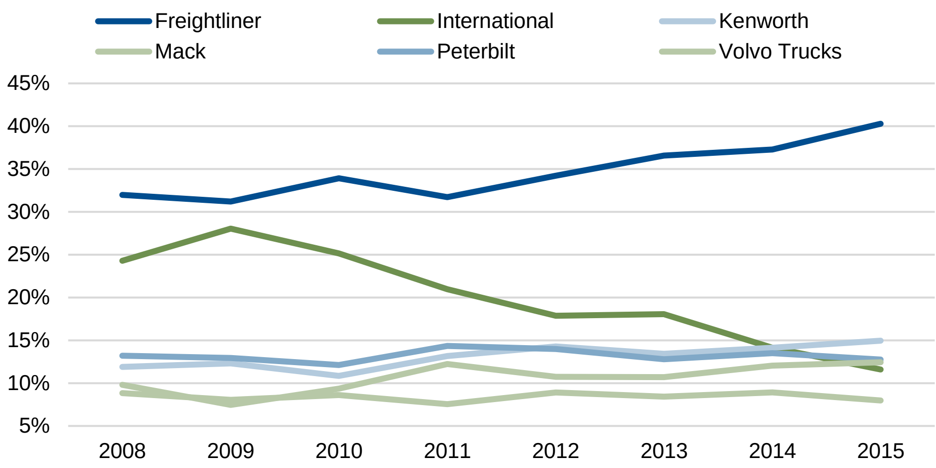
Figure 5: Daimler Trucks – market share development (%)



Source: Daimler

On the other hand, the division has substantially improved its market position in the NAFTA region for heavy-duty trucks (class 8) in the observation period (2014-2016), i.e. the two-year change in market share was significantly positive and reached levels that were not attained in the past decade (40% in 2016).

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



Source: Daimler; Freightliner = Daimler Trucks; data for 2016 not available for all brands as of the date of publication

Market share data in the key developed markets of 22% (Europe), 40% (NAFTA heavy-duty trucks), and 38% (NAFTA medium-duty trucks) overall point to the strong 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 the 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

This division is primarily active in the market for mid-size and large vans. Key products are the Sprinter, the Vito series, the V-Class multi-purpose vehicles, 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 was fairly stable, at 16-18% over the past decade, and despite our assumption for a more moderate growth from 2017 (unit volume growth of 2-3%), we see no indication that the division's market position will deteriorate.

Daimler Buses

This division, with 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 Financial Services (DFS)

Daimler Financial Services (DFS) 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'.

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.

DFS 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 DFS from those of the industrial business (Mercedes-Benz Cars, Daimler Trucks, Mercedes-Benz Vans, and Daimler Buses).

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 the business risk profile.

We split our analysis of diversification into two elements:

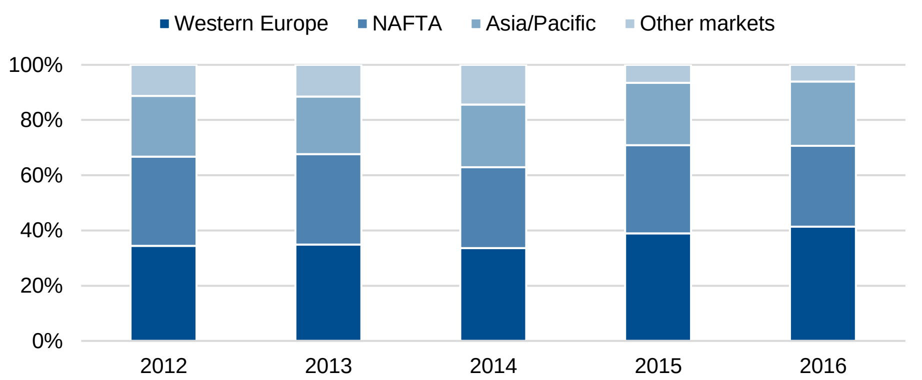
(i) geographic and

(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 a China supports long-term growth opportunities.

Figure 7: Daimler group – geographic diversification

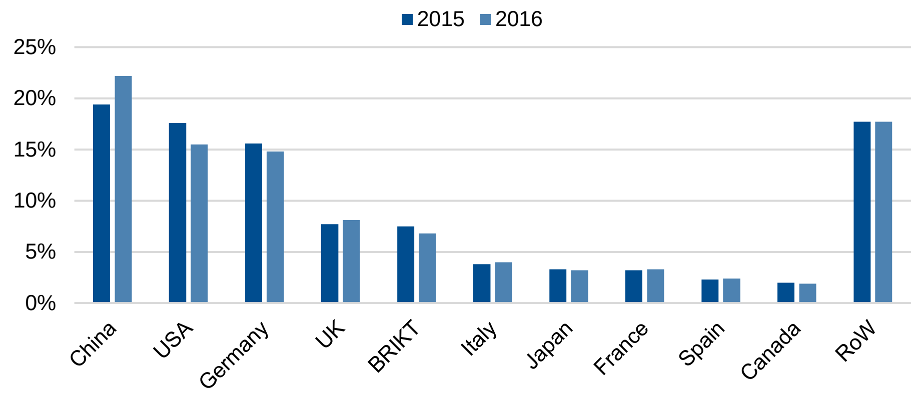


Source: Daimler

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 the 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, BRIKT = Brazil, Russia, India, South Korea, Turkey

Product diversification

Scope considers 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.

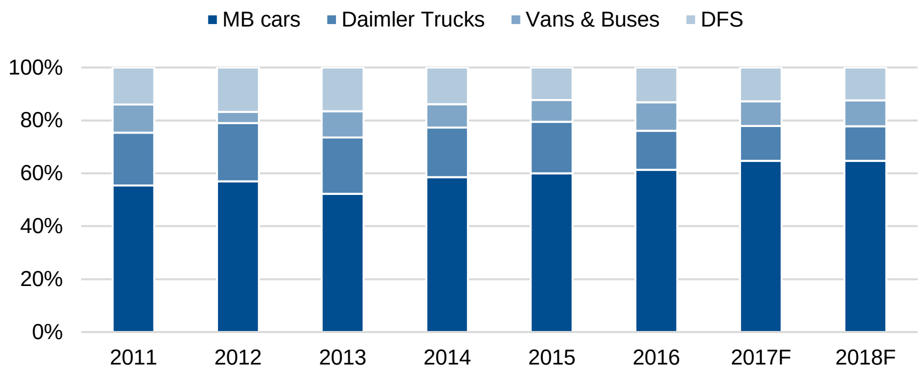
Product diversification in the truck unit, however, is limited, reflecting the small number of medium- and heavy-duty product variants. We likewise caution that the benefits to diversification from Daimler Trucks could prove to be a substantial risk in less favourable economic environments. Demand for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

Profitability

To determine Daimler's operating profitability, Scope considers the EBITDA margin of the group's four industrial units and disregards earnings from the captive finance unit (DFS). In our calculation, we adjust the EBITDA of the industrial operations for capitalised development costs. The group's leading position in the premium automotive market is reflected in its margin profile. Overall, we view the current and prospective operating profitability (EBITDA adjusted for capitalised development costs) as credit-positive for the business risk profile. We forecast the Scope-adjusted EBITDA margin to stay at about 10-11% over the forecast horizon (versus 10.5% in 2016). Daimler's operating profitability has been fairly stable over the past five years, reflecting a number of factors that include, among others, the favourable economic environment, low interest rates, low gasoline prices, successful product launches at Mercedes-Benz Cars, better sales mix at Mercedes-Benz Cars (notably in China), cost reductions from increasing standardisation and modularisation of components in the manufacturing process, and the streamlining of capacity (notably at Daimler Trucks).

The highest share of operating profits (EBITDA) is generated at Mercedes-Benz Cars and any materially negative developments at Mercedes-Benz Cars could eventually have a negative impact on our profitability assessment. We note, however, that the risk for material earning swings in the key automotive division may have been mitigated by the expansion of the product portfolio. Historically, Mercedes-Benz Cars was largely reliant on the product lifecycles of its core product lines (C-Class, E-Class, S-Class). The expansion of the product portfolio into compact cars and compact SUVs, including the broader array of different variants for all car models offered, should have reduced the dependence of operating profit generation from specific lifecycle developments.

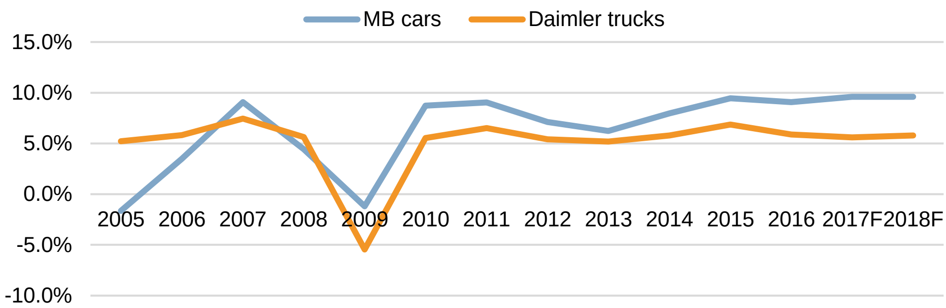
Figure 9: Operating profit (EBIT) distribution, Daimler group



Source: Scope, DFS = Daimler Financial Services

In our base case, we expect Mercedes-Benz Cars to report an operating profit margin of close to 10% from 2017F and stable EBIT margins of around 5.5% at Daimler Trucks.

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



Source: Scope, Daimler.

Financial risk profile

Scope's analysis of the financial risk profile of the group is based on the financials of Daimler's industrial activities. To that end, we separate material line items from the consolidated accounts that relate to DFS, 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	**2015**	**2016**	**2017F**	**2018F**
Short-term (current) debt reported for group	41,311	47,288	53,660	60,352
Long-term (non-current) debt reported for group	59,831	70,398	70,398	70,398
= Group gross financial debt reported	**101,142**	**117,686**	**124,058**	**130,750**
Market valuation and currency hedges for financial debt	-583	-61	-61	-61
Financing liabilities nominal	**100,559**	**117,625**	**123,997**	**130,689**
of which is industrial business	3,212	1,488	1,488	1,488
of which is financial services	**97,347**	**116,137**	**122,570**	**129,262**

Source: Daimler, Scope

Accounting adjustments

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

Our pension adjustment only captures half of the reported pension deficit (defined benefit obligation less the fair value of pension plan assets, i.e. a total adjustment of EUR 4.0bn in 2016). Pension plan assets cover annual pension payments significantly in excess of 5x, the threshold for this treatment under Scope's Corporate Rating Methodology. Minimum payments under operating lease contracts for which Daimler is the lessee were discounted with our standard rate of 5% applicable to determine the net present value of operating lease obligations.

In an initial step, we deduct from gross-adjusted debt the cash and marketable securities totalling EUR 21.8 bil. in 2016. 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 do, however, not 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 21.8 bil.). The amount of cash that is not credited is EUR 1.3 bil.. The amount of restricted cash not immediately accessible (EUR 1.3 bil.) is not disclosed in the annual accounts of Daimler and we have obtained this figure on request from Daimler.

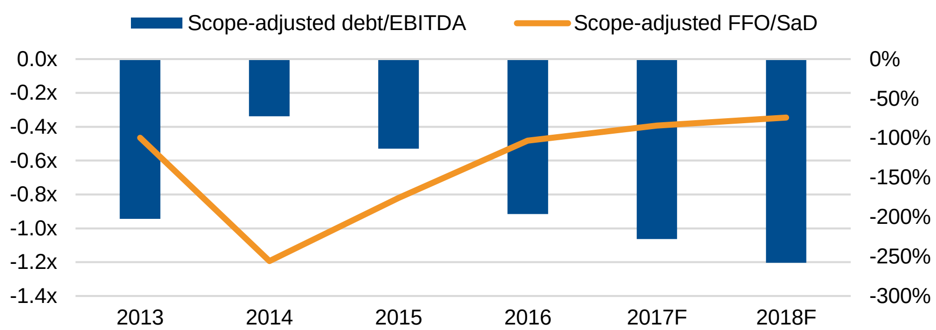
Figure 12: Scope-adjusted debt

	Scope estimates			
Scope-adjusted debt in EUR m	**2015**	**2016**	**2017F**	**2018F**
Reported gross financial debt	101,142	117,686	124,058	130,750
less: debt, financial services division (DFS)	-97,347	-116,137	-122,570	-129,262
less: cash & cash equivalents	-18,209	-21,729	-24,543	-27,334
add back: cash not immediately accessible	1,300	1,300	1,300	1,300
add: pension adjustment	3,803	4,007	3,952	3,952
add: operating lease obligation	1,813	2,131	2,131	2,131
less: fair-value hedges	-498	-72	-72	-72
Scope-adjusted debt (SaD)	-7,996	-12,815	-15,745	-18,535

Source: Daimler, Scope

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) eventually leads to strong credit ratios. We do not expect additional external financial debt in the industrial units and slightly improving EBITDA (together with positive free operating cash flows from industrial operations that is over and above projected dividend payments).Therefore, 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 13: Credit metrics – development of leverage



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

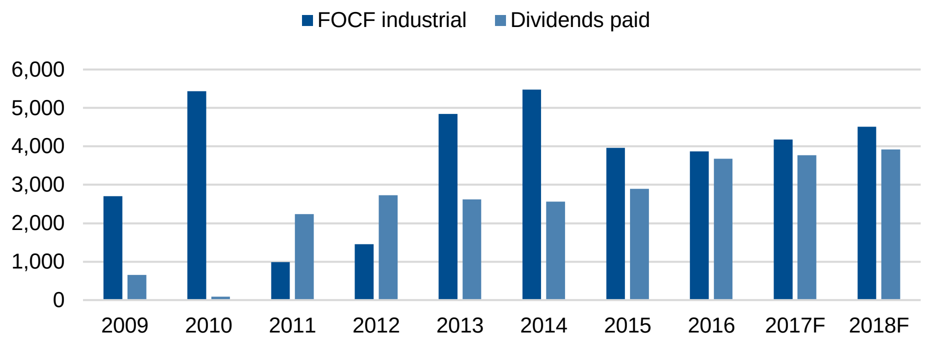
Figure 14: Scope credit ratios

	Scope estimates			
Scope credit ratios	**2015**	**2016**	**2017F**	**2018F**
EBITDA/interest cover	29x	34x	32x	33x
Scope-adjusted debt (SaD)/EBITDA	-0.5x	-0.9x	-1.1x	-1.2x
Scope-adjusted FFO/Scope-adjusted debt (SaD)	-176%	-103%	-84%	-74%
FCF/Scope-adjusted debt (SaD)	-50%	-30%	-27%	-24%

Source: Daimler, Scope

The financial risk profile is a key support for the corporate credit ratings of Daimler and its related financing subsidiaries. Our positive assessment of the financial risk profile is supported by Daimler's record of positive free cash flow generation in its industrial business. During the financial crisis (2009), positive effects for free cash flow were mostly the result of working-capital effects; and thanks to a dividend cut at that time, the group has maintained its financial flexibility. Going forward, we believe the industrial units should generate sufficient free cash flow to cover annual dividend payments including those to minorities. We have factored in an incremental uptick in dividend payments over the forecast horizon, reflecting higher absolute dividend payments and assuming a stable dividend payout ratio. Any surplus of free cash flow over dividend payments will very likely be used for smaller bolt-on acquisitions in order to support the expansion of knowledge around electrification, autonomous driving, and digitalisation.

Figure 15: Free operating cash flow – industrial business vs dividends paid



Source: Daimler, Scope estimates

Liquidity

The short-term rating is S-1. Scope views 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 European automotive and commercial vehicle manufacturers, we disregard financial maturities from the captive-finance operations to determine 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 the 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 participating banks 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 11bn on 31 December 2016. This includes the cash reported by the industrial business (EUR 8.8bn) and the captive finance unit (EUR 2.2bn). 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 deduct the EUR 1.3bn to determine our financial credit ratios, nor do we consider this amount in our liquidity assessment.
- Cash equivalents in the form of marketable debt securities, in an amount of EUR 10.7bn 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 2018 with two extension options of two years in total. In 2015, Daimler exercised the first option to extend the facility until 2020. As of 31 December 2016 the facility was unused.

- Our projection of free operating flow from the industrial business, in a range of about EUR 4.0bn-4.5bn in 2017 and in a similar range in 2018.

Contractual and potential uses of liquidity are:

- Financial maturities in the industrial division of EUR 1.5bn as of 31 December 2016; and

- Dividend payments in a range of EUR 3.8bn-3.9bn in each of 2017 and 2018. This compares to dividend payments of EUR 3.7bn in 2016 (including those paid to minorities).

Figure 16: Scope credit ratios

Liquidity and financial maturities in EUR m	2015	2016	2017F	2018F
Unrestricted cash & cash equivalents	16,909	20,429	23,243	26,034
Available and undrawn committed credit lines	9,000	9,000	9,000	9,000
FCF, industrial units	3,960	3,874	4,176	4,513
Dividends paid	-2,895	-3,678	-3,768	-3,919
Available financial flexibility	**26,974**	**29,625**	**32,652**	**35,627**
Financial debt, industrial units (t-1)	3,456	3,212	1,488	0
Internally and externally provided liquidity cover	7.8x	9.2x	21.9x	N.M.

Source: Daimler, Scope

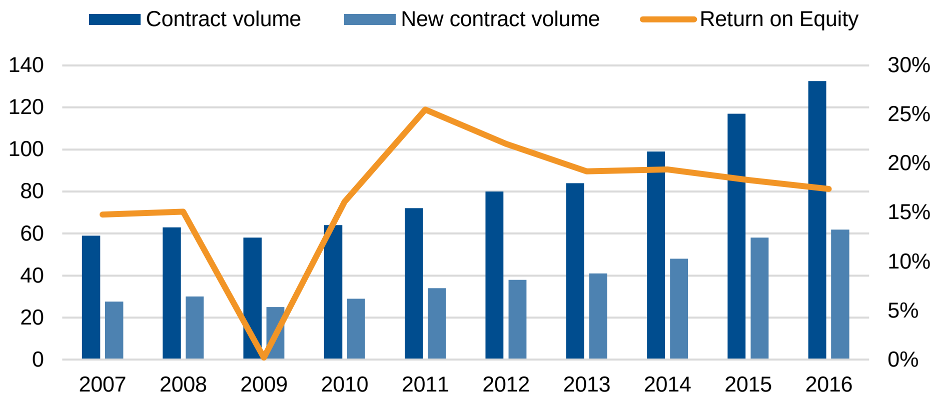
Financial services: Daimler Financial Services (captive finance)

Alongside growing unit volumes in Daimler's industrial operations (notably Mercedes-Benz Cars and Daimler Trucks), the captive finance segment (DFS) showed increasing business volume and a rising number of contracts signed.

In 2016, DFS had 4.3m of leasing and financing contracts. The contract volume increased by a net EUR 62bn to EUR 133bn in 2016. The majority of vehicles financed (76%) were passenger cars, followed by trucks (12%) and vans (11%). The group-wide penetration (i.e. the number of vehicles sold by any of the industrial units) stood at 48%, with slightly higher penetration rates for Mercedes-Benz Cars.

The maturity profile of the group's captive finance liabilities and underlying assets match well, and DFS follows the policy that asset-liability risks (for example, on maturities, interest rates, and currencies) are matched from initiation of the contract. DFS follows the indicative goal to have roughly 35% of contract volumes in operating leases, 50% in financing (including finance leases) with the remainder being floor-plan funding for dealers. In 2016, roughly one-third of Daimler's captive finance assets were exposed to residual value risks (products under operating lease contracts for which Daimler 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. 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 is borne by the industrial business. Scope believes 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 17: Development – captive finance activities (in EUR bn)

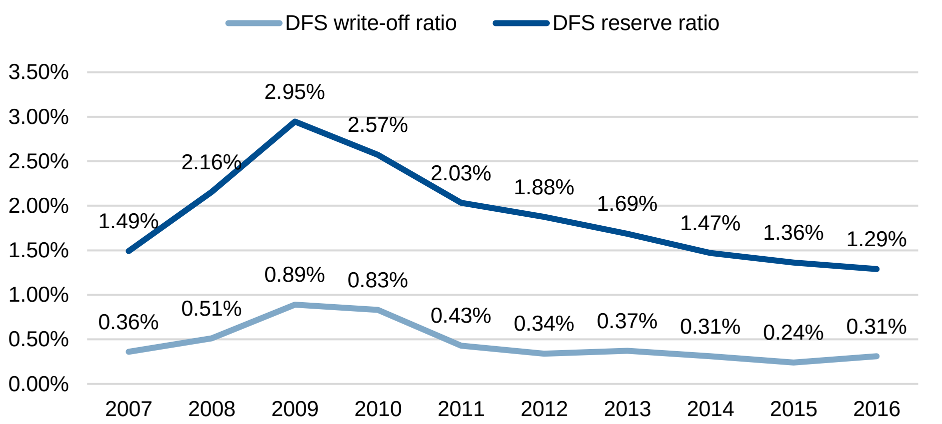


Source: Scope, Daimler

DFS has a proven history and track record of managing underwriting and credit risks. The percentage of credit losses in the division continues to be 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 was very low in the past years. DFS has built credit reserves at about four times the size of the current run rate of credit losses.

Overall, we view the risk profile of DFS as adequate. Nevertheless, we point out that the emergence of further credit losses would have 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 unfold their worst impact when an industrial unit's operating profits are under pressure from worsening demand.

Figure 18: 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 in both 2015 and 2016 was 41%). We have no reason to believe that Daimler will substantially change its dividend policy and likewise expect that forecasted free operating cash flows from the industrial business should be sufficient to cover dividend payments over the course of the forecast horizon. Over the past years, Daimler has repeatedly and publicly indicated that share buy-backs are not a preferred option to deploy the excess of cash generated over dividend payments.
- 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 arm (DFS). 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.

Regulatory disclosures

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund.

Rating prepared by	Responsible for approving the rating
Werner Stäblein, Lead Analyst	Olaf Tölke, Committee Chair

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The rating concerns entities which were evaluated for the first time by Scope Ratings AG.

The rating outlook indicates the most likely direction of the ratings if the ratings were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

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Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Methodology

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Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

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