Mercedes-Benz Group AG Germany, Automotive and Commercial Vehicles

A POSITIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	41.3x	70.8x	110.4x	220.9x
Scope-adjusted debt/EBITDA	Net cash	Net cash	Net cash	Net cash
Scope-adjusted funds from operations/debt	Net cash	Net cash	Net cash	Net cash
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	Net cash	Net cash

Rating rationale

Scope Ratings affirms the A issuer rating on Mercedes-Benz Group AG and related issuing entities. The Outlook is revised to Positive from Stable. Senior unsecured debt is rated A. The short-term rating is S-1.

Mercedes-Benz Group's issuer rating continues to be strongly supported by its financial risk profile, assessed at AA. This is mainly driven by its prudent financial policy, reflected in the longstanding net cash position in the industrial business. The business risk profile, assessed at BBB+, remains a constraint but could benefit from a potentially higher profitability assessment derived from the ongoing premiumisation strategy. Product and geographical diversification remains supportive. Profitability has sharply recovered since 2021, mainly driven by a positive price-mix and lower fixed costs. Liquidity is adequate.

Outlook and rating-change drivers

The Outlook revision from Stable to Positive reflects our expectation that the group's profitability will structurally improve and show strong resilience in 2023 amid a deteriorating market environment and inflationary pressures. Our base case assumes an adjusted EBITDA margin of above 16% in 2022, around 15% in 2023 and slightly above 16% in 2024. We anticipate that Mercedes-Benz Group's profitability will be supported by strict cost discipline, enhanced pricing power as well as a richer mix driven by the portfolio shifting toward the higher end of the premium segment. The positive Outlook also reflects our expectation that Mercedes-Benz Group will maintain a strong financial risk profile and solid credit metrics, even in a less supportive environment.

We would consider an upgrade if Mercedes-Benz Group succeeded in generating sustained EBITDA margins higher than 15%, combined with strong cash flow generation and a continuous net cash position in its industrial business. Mercedes-Benz Group's increased focus on brand premiumisation, cost optimisation and profitability enhancement would thus support a rating upgrade.

We could return to a stable outlook if Mercedes-Benz Group fails to reach an adjusted EBITDA margin above 15%. We see further downside should the group's EBITDA margin fall back to around 12%.

Rating history

Date	Rating action	Issuer rating & Outlook
27 Jan 2022	Affirmation	A/Stable
03 Feb 2021	Affirmation	A/Stable

Ratings & Outlook

Issuer	A/Positive
Short-term debt	S-1
Senior unsecured debt	A

Analyst

Georges Dieng
+33 1 86 26 18 52
g.dieng@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2022

European Automotive and Commercial Vehicle Manufacturers Rating Methodology; February 2022

European auto industry: fast-tracked EV transition raises challenges and uncertainties

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Mercedes-Benz is a leading premium car maker, with one of the strongest brands in the global premium space • Premiumisation strategy and associated technological push will strengthen brand positioning and help to structurally improve operating profitability • Broad geographic outreach in its key divisions, Mercedes-Benz Cars & Mercedes-Benz Vans • Broad regional distribution of sales across both mature and emerging market regions • Diversification benefits from captive finance operations, adding a source of operating profits to the industrial business	• Strong risks of negative cyclical volume changes that may result from worsening consumer sentiment or a less favourable economic environment • Substantial investments required to develop hybrid and electric vehicles and to meet increasingly stringent emission standards (ESG factor) • Technological changes in the automotive industry that may change the competitive landscape

Positive rating-change drivers	Negative rating-change drivers
• EBITDA margins above 15% sustainably, while keeping credit metrics at current solid levels	• EBITDA margin failing to exceed 15% on a sustained basis • Further downside should EBITDA margin fall back to around 12%

Corporate profile

Formerly known as Daimler AG (until the change of name effective since February 2022), Mercedes-Benz Group AG was founded in 1886 and is headquartered in Stuttgart, Germany. The group is positioned as one of the leading global manufacturers of premium and luxury cars and vans.

Mercedes-Benz Cars develops, manufactures and sells premium and luxury passenger cars under the Mercedes-Benz brand, including AMG, G-Class, Maybach and EQ brands as well as small entry cars under the smart brand.

Mercedes-Benz Vans develops, manufactures and sells private vans and commercial vans with a differentiated approach (follows Mercedes-Benz' strategy for private vans and pursues a premium strategy for commercial vans).

Through Mercedes-Benz Mobility and its various brands (Mercedes-Benz Financial Services, Mercedes-Benz Bank, Athlon), the group provides financing and leasing packages for end-customers and dealers, and offers car subscription, car rental, fleet management, automotive insurance brokerage, digital services for charging and payment as well as innovative mobility services.

The group has a significant presence in all relevant automotive markets in terms of demand for premium vehicles. It also benefits from an international manufacturing footprint with production facilities in Europe, North and Latin America, Asia (China in particular) and Africa.

In 2021, Mercedes-Benz Group sold 2.8m vehicles (thereof 1.9m passenger cars, 0.4m vans and 0.5m commercial vehicles) across the globe and generated revenues of EUR 168bn (thereof EUR 134bn from continuing operations) and consolidated EBIT of EUR 29.1bn (thereof EUR 16bn from continuing operations). Net liquidity in the industrial business amounted to EUR 21bn at year-end 2021. As at 31 December 2021, the group had a workforce of 172,425 employees (excluding the spun-off Daimler Trucks & Buses).

Core shareholders include the Chinese partner BAIC Group (10%), Li-Shufu, chairman of Geely Automotive via Tenacious3 Prospect Investment Limited (9.7%) and Kuwait Investment Authority (6.8%).

Financial overview

			Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	41.3x	70.8x	110.4x	220.9x	194.5x
Scope-adjusted debt/EBITDA	Net cash	Net cash	Net cash	Net cash	Net cash
Scope-adjusted funds from operations/debt	Net cash	Net cash	Net cash	Net cash	Net cash
Scope-adjusted free operating cash flow/debt	Net cash	Net cash	Net cash	Net cash	Net cash
Scope-adjusted EBITDA in EUR m					
EBITDA (industrial business)	13,377	21,339	22,102	21,009	23,633
less: capitalised development costs	-2,472	-2,333	-2,233	-2,233	-2,233
Scope-adjusted EBITDA	**10,905**	**19,006**	**19,869**	**18,776**	**21,400**
Funds from operations in EUR m					
Scope-adjusted EBITDA	10,905	19,006	19,869	18,776	21,400
less: (net) cash interest paid	21	-213	-130	-75	-100
less: cash tax paid per cash flow statement	-1,993	-3,812	-4,348	-4,819	-5,424
less: pension interest	-160	-50	-50	-10	-10
add: dividends from associates	1,783	1,625	1,250	1,250	1,300
Funds from operations (FFO)	**10,556**	**16,769**	**16,591**	**15,122**	**17,166**
Free operating cash flow in EUR m					
Operating cash flow	16,373	15,606	14,890	16,605	17,721
less: capital expenditure (net)	-6,019	-7,810	-6,810	-7,974	-8,340
less: lease amortisation	-945	-868	-652	-551	-440
Free operating cash flow (FOCF)	**9,409**	**6928**	**7,428**	**8,079**	**8,941**
Net cash interest paid in EUR m					
Net cash interest per cash flow statement	104	167	130	75	100
add: pension interest	160	50	50	10	10
Net cash interest paid	**264**	**217**	**180**	**85**	**110**
Scope-adjusted debt in EUR m					
Reported gross financial debt (industrial)	7,957	3,620	3,620	3,620	3,620
less: cash and cash equivalents	-29,445	-30,699	-37,846	-42,911	-48,881
add: non-accessible cash	1,300	1,000	1,000	1,000	1,000
add: pension adjustment	5,980	2,950	735	735	735
add: fair value hedges	1,182	566	566	566	566
Scope-adjusted debt	**-13,027**	**-22,564**	**-31,925**	**-36,990**	**-42,960**

Table of Content

Environmental, social and governance (ESG) profile[1]

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Tighter regulations shaping auto industry

Like all carmakers, Mercedes-Benz Group faces increasing pressure from tightening environmental regulations (including potential fines for non-compliance) and the race to carbon neutrality (ESG factor). These regulatory requirements will shape the future of the auto industry globally, as evidenced by the EU's recent decision to ban ICE-powered vehicle sales in the member states from 2035 onwards.

Investment in innovation and workforce required

Addressing these challenges will require substantial investment in new technologies, innovative products, battery production capacities and software capabilities. It also entails a deep transformation in manufacturing processes and workforce competence (notably via training, reskilling and upskilling the current personnel while hiring new talents with more specific profiles).

Ambition 2039: a clear roadmap for reaching carbon neutrality

Mercedes-Benz Group has committed to the Paris Climate Agreement. With its 'Ambition 2039', the group has a clear roadmap for reaching carbon neutrality along the whole value chain (in products, production and upstream activities, service life, recycling). Several key milestones have been set accordingly. An important milestone was reached in 2022 with CO_2-neutral production at all MB Cars and MB Vans plants worldwide. The decarbonisation roadmap includes an ambitious electrification plan (up to 50% plug-in hybrid vehicle/battery-powered electric vehicle (PHEV/BEV) share in 2025, and a 100% BEV share in 2030 'where market conditions allow'), a 100% reduction in vehicles' carbon footprint throughout their lifecycle and the accelerated use of renewable energies, green materials (e.g. green steel) and circular economy (recycled and secondary materials).

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB+

Our analysis of the business risk profile of automotive manufacturers comprises the assessment of the industry risk profile and of the issuer's competitive position. Our analysis of the business risk profile focuses on the industrial activities, except for the diversification benefit provided by the financial services business.

Our overall assessment of Mercedes-Benz Group's business risk profile remains unchanged at BBB+.

Industry risk profile: BB

We assess industry risk for automotive and commercial vehicle manufacturers at **BB**, based on its high cyclicality, high entry barriers and medium substitution risk.

Automotive and commercial vehicle manufacturer industry		Entry barriers: Low	Entry barriers: Medium	Entry barriers: High
Cyclicality	High	CCC/B	B/BB	**BB** BBB
Cyclicality	Medium	B/BB	BB/BBB	BBB/A
Cyclicality	Low	BB/BBB	BBB/A	AA/AAA

Source: Scope.

Competitive positioning a bit more challenged

Mercedes-Benz Group has maintained its overall competitive position, despite its reduced size and diversification following the spin-off of Daimler Trucks in December 2021. Over the past decade, despite intense competition in the premium space, Mercedes-Benz Group has reinforced its market positioning on the back of a diversified product offering and the strong brand appeal of its core Mercedes-Benz brand, supplemented by high-end brands and models such as Maybach, AMG and G-Class. However, the group's market positioning has been challenged in the past two years by the market share erosion at Mercedes-Benz Cars and, to a lesser extent, at Mercedes-Benz Vans. Beside product cycle effects, reasons for the lost momentum at MB Cars can be explained by the 'value over volume' strategy and the shift toward the upper-end of the premium segment.

Successful premiumisation should boost brand positioning

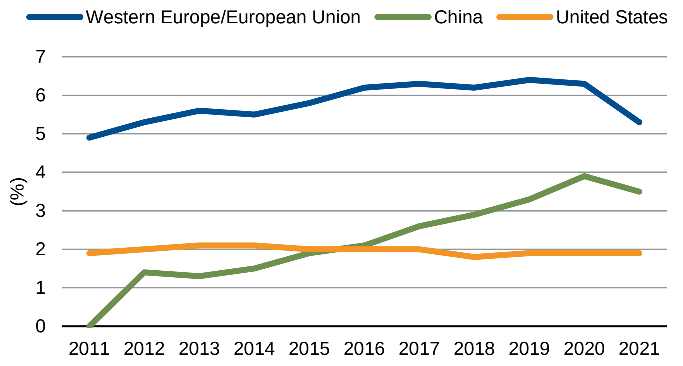
This premiumisation strategy and the associated technological push should strengthen brand perception and positioning, with further support from a proper execution of the ambitious electrification strategy. In terms of product cycle, Mercedes-Benz Cars should regain some momentum in 2023 thanks to the renewal of the E-Class family (core luxury), the market launch of the EQE SUV and numerous facelifts.

Figure 1: Mercedes-Benz Cars – product cycle and pipeline (FL: facelift)

		2021	2022	2023E	2024E	2025E
Top-end Luxury	ICE	SL Roadster AMG Coupe FL	SL Cabrio G Class FL	AMG GT (gen2)		S Class FL
	EV	EQS	EQS SUV	Maybach EQS SUV	All electric G-Class	
Core Luxury	ICE	C Class (estate/limo) CLS Coupe FL	GLC	E Class family facelifts		facelifts
	EV	EQE		EQE SUV		Electric C Class Limousine
Entry Luxury	ICE		A Class FL B Class FL	facelifts		CLA
	EV	EQA EQB		facelifts	Electric CLA	CLA derivatives

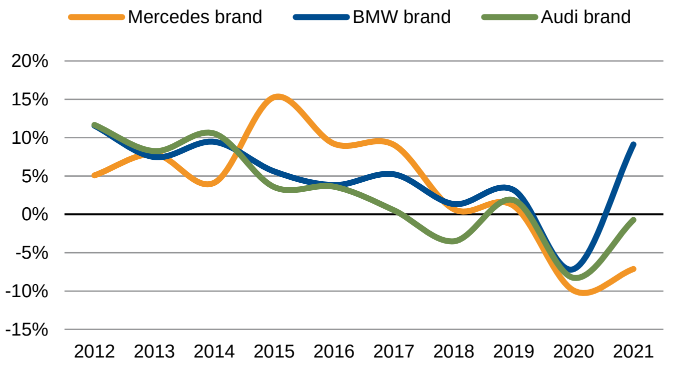
Sources: Mercedes-Benz, motoring press, Scope

Figure 2: MB Cars – regional market shares



Sources: Mercedes-Benz, Scope

Figure 3: German premium OEMs – YoY change in unit sales

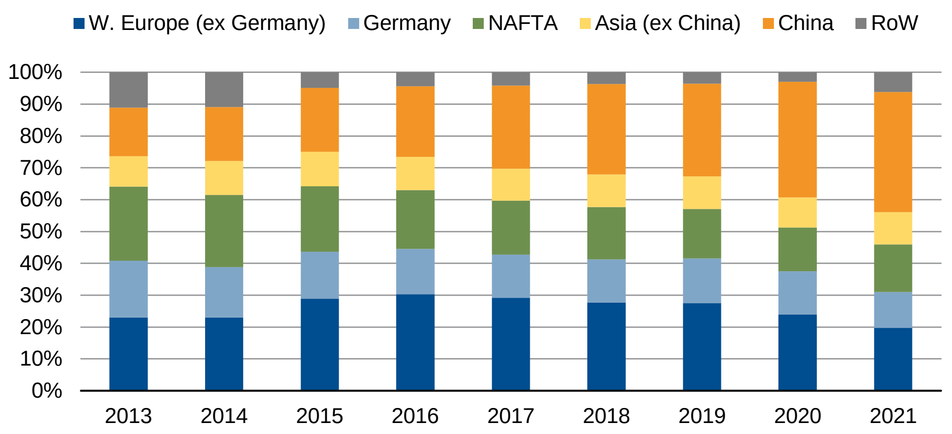


Sources: Mercedes Benz, Audi, BMW, Scope

Supportive product and geographical diversification

The group's product and geographical diversification supports the business risk profile. The group has a significant presence in all key automotive markets in terms of premium demand, and notably in the world's largest market of China. The group thus benefits from a global geographical outreach in terms of sales and manufacturing footprint.

Figure 4: Passenger car deliveries by region



Sources: Mercedes-Benz, Scope

The group's product line-up focuses on premium customers and is well-diversified across all vehicle categories, ranging from small, compact vehicles to luxury and ultra-luxury vehicles. After a sizeable expansion of the product range over the past few years, Mercedes-Benz Cars is now streamlining its portfolio in order to reduce complexity and refocus on the biggest profit pools. The new strategy, announced in May 2022, aims at reshaping and elevating its product portfolio, with an even stronger focus on luxury.

Expansion of EV portfolio improves product depth

Mercedes-Benz's electrification offensive is improving product depth. At Mercedes-Benz Cars, the share of electrified drive systems (~15% over 9M 2022 vs 7% in 2020) is expected to increase steadily and reach up to 50% in 2025, mainly driven by all-electric vehicles. By 2025, the objective is to allow customers to choose an all-electric alternative for every model produced by the company. The van division is also accelerating its portfolio electrification and targets to significantly increase its electrified share from 4% in 2021. The division's product pipeline will be dominated by electric vans. This comprehensive electric offensive hinges on the development of appropriate vehicle architectures, both flexible (multi-fuelled like the MMA platform due in 2024) and focused (BEV-dedicated like the MB.EA, AMG.EA and VAN.EA platforms due in 2025). It also entails partnerships or equity investments in key relevant areas (battery cells with ACC, Farasis, CATL and Envision AESC; electric motors with Yasa; solid state battery technology with Factorial). Together with partners, the group is currently setting up eight battery cell factories with a capacity of over 200 gigawatt hours.

Electrification supports compliance with CO_2 regulations

The portfolio electrification is a key lever for compliance with increasingly stringent environmental regulations, especially in Europe. Mercedes-Benz Cars overachieved its European CO_2 targets for both 2020 (average fleet emissions of 104.3g/km compared to a target of 106.6g/km based on the NEDC test procedure) and 2021 (average fleet emissions of 115g/km, below the target of 125g/km and significantly below the comparable WLTP value of 136g/km in 2020). This was primarily driven by the accelerated penetration of its electrified vehicles (BEV/PHEV) in Europe. The division's fleet emissions deteriorated slightly in 2022 due to a slower than expected ramp-up of electric vehicles because of supply chain constraints. Despite this, Mercedes-Benz Cars should meet its European CO_2 emission targets for 2022.

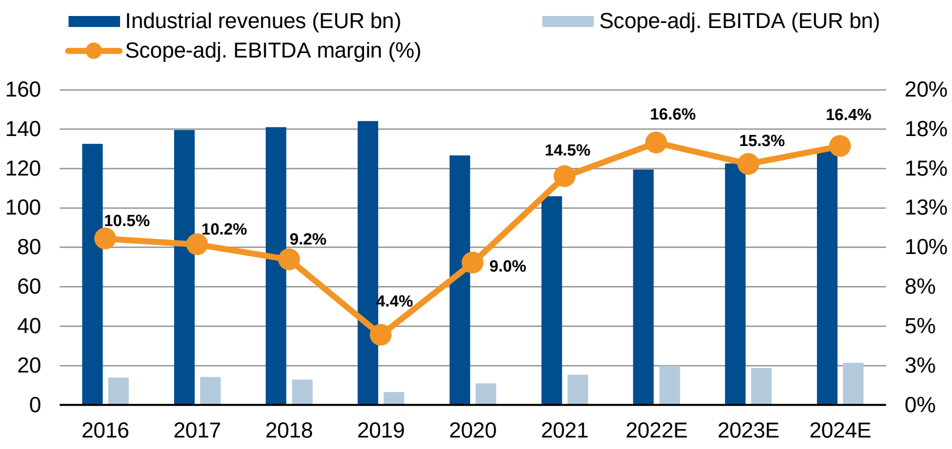
Financial services segment contributes to business line diversification

Lastly, Mercedes-Benz Group's well-diversified business is reflected in its captive finance activities (Mercedes-Benz Mobility), which encompass a wide range of products and services, in particular the fast-growing mobility services.

Strong rebound in profitability in 2021

After a resilient 2020, underpinned by positive price-mix effects and accelerated cost reduction, the sharp rebound in profitability was confirmed in 2021, primarily driven by the automotive division. Like the rest of the industry, Mercedes-Benz benefited from an unusual imbalance between supply and demand due to tight vehicle availability, which helped enhance net pricing and prioritise more expensive, higher-margin vehicles. Scope-adjusted EBITDA margin increased from 9% in 2020 to 14.5% in 2021.

Figure 5: Revenues and EBITDA margin development (%)



Sources: Mercedes-Benz, Scope estimates

Further progress in 2022

In 2022, the group overcame the impacts of the war in Ukraine and repeated pandemic-led lockdowns in China. Despite persistent semiconductor shortages and bottlenecks in logistics, the group continued to deliver strong results, thanks to a gradual recovery in volumes, healthy pricing, favourable product mix and strict cost discipline. This performance prompted management to raise its guidance twice this year, in Q2 and Q3. For the full year, we forecast divisional margins in line with company's latest guidance, with an adjusted EBIT margin of 14.5% for Mercedes-Benz Cars (guidance of 13% to 15%) and 10.4% for Mercedes-Benz Vans (guidance of 9%-11%). At group level, we forecast an adjusted EBIT of 20.1bn (13.8% margin) and a Scope-adjusted EBITDA margin of 16.6%, up 210 bp year over year.

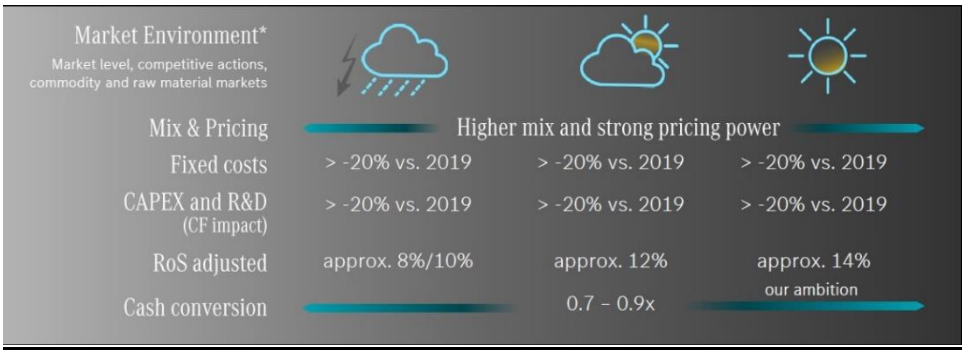
Strong resilience expected in 2023

The outlook for 2023 is becoming more challenging due to weakening demand, rising interest rates and inflationary pressures. We expect Mercedes-Benz Group to remain resilient thanks to its premium repositioning, ability to pass some cost inflation to customers and continued cost optimisation and efficiency gains. We anticipate a diverging trend between a stable EBIT margin at MB Vans (which should benefit from a sizeable reduction in fixed costs after a similar increase in 2022) and a lower margin at MB Cars (13% expected) against the backdrop of cost inflation. The Scope-adjusted EBITDA margin is expected to decline slightly to around 15% in 2023 before returning above 16% in 2024.

Medium-term financial targets raised again

The group's mid-term targets point to structurally higher profitability, underpinned by the ongoing premiumisation strategy (focus on pricing power and higher mix), supplemented by the rightsizing of the retail network (format and number of outlets) and a firmer grip on pricing thanks to an accelerated shift to direct sales and an agency model. This positive momentum has prompted management to raise its mid-term financial targets for the third time since 2020.

Figure 6: Mercedes-Benz Group – mid-term financial targets



Source: Mercedes-Benz

Financial risk profile: AA

Financial risk profile unchanged at AA

Mercedes-Benz Group's issuer rating continues to be supported by its strong financial risk profile, assessed at AA. The group's financial risk profile mainly reflects its low leverage and prudent financial policy, mirrored in a sizeable net cash position in the industrial business.

In 2021, the net cash position (using the company's definition) increased even further to EUR 21bn (compared to EUR 17.9bn at year-end 2020) despite a EUR 6bn cash transfer to Daimler Trucks as part of the spin-off implemented in December 2021. Thanks to the significant free operating cash flow anticipated in 2022 (EUR 7.4bn), and despite a negative trend in working capital, net industrial cash should exceed EUR 27bn at year-end 2022.

Scope-adjusted debt deeply negative

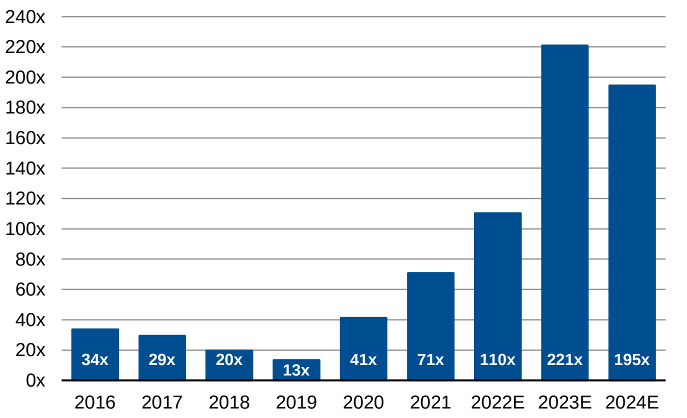
The vast majority of the group's reported gross financial debt pertains to the financial services business and stems from the matched funding of captive finance assets, which are primarily customer-finance receivables. Given the limited external financial debt in the industrial business and high cash balances and marketable securities, Scope-adjusted debt has been negative over the past decade. We calculate net cash of EUR 22.6bn at YE 2021 (against EUR 13bn at YE 2020), adjusted for pensions, and including cash from the financial services arm. Adjusted net cash is expected to reach EUR 32bn at YE 2022, driven by improved cash flow and a much lower pension deficit following a EUR 1.3bn contribution to the German pension fund, from the 5% stake in Daimler Trucks in Q1

2022. Despite more challenging business conditions, we anticipate a solid net cash position in 2023-2024.

Net cash status leading to strong credit metrics

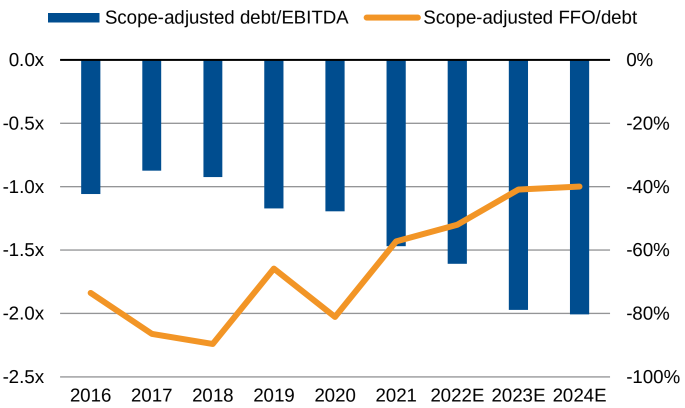
This net cash position translates into strong credit metrics, with Scope-adjusted debt/EBITDA and Scope-adjusted funds from operations/debt both negative. We forecast that Scope-adjusted credit ratios will continue to reflect this net cash status in the next two years.

Figure 7: EBITDA interest coverage



Sources: Mercedes-Benz, Scope estimates

Figure 8: Leverage metrics



Sources: Mercedes-Benz, Scope estimates

Once volatile, industrial FOCF is now supportive for the financial risk profile

Free operating cash flow (FOCF) has been relatively volatile over the past decade but has stabilised and improved since 2019 thanks to drastic cash preservation measures, greater capex discipline and tight working capital management. Management has recently put in place group-wide initiatives aimed at driving a cultural shift to a cash-flow-oriented company, including a quarterly cash call dialogue with employees, cash flow training and a 'cash map workshop'. We expect industrial FOCF to fully cover annual dividend payments in the next few years. Dividend payments (including those accruing to non-controlling interests) are forecast at EUR 5.7bn in 2023 and EUR 5.5bn in 2024. Dividends paid to Mercedes-Benz Group's shareholders are based on an unchanged dividend pay-out ratio of 40%, in line with the group's stated target.

Adequate liquidity

Our view on Mercedes-Benz Group's financial risk profile is also supported by the group's adequate liquidity. Unrestricted cash and cash equivalents comfortably cover all financial debt in the industrial business. In addition, Mercedes-Benz Group benefits from a EUR 11bn revolving credit facility (RCF) granted by an international banking consortium. This facility was recently converted into a sustainability-linked loan, which included key environment performance indicators related to issues such as climate protection and CO_2 emissions reduction. This RCF, maturing in 2025, remains undrawn at year-end 2022.

Figure 9: Liquidity analysis

Balance in EUR m	2022E	2023E	2024E
Unrestricted cash (t-1)	29,699	36,846	41,911
Open committed credit lines (t-1)	11,000	11,000	11,000
Free operating cash flow	7,428	8,079	8,941
Short-term debt (t-1)	3,620	3,620	3,620
Coverage	**>200%**	**>200%**	**>200%**

Source: Scope estimates

Supplementary rating drivers: +/- 0 notch

The conservative financial policy is reflected in the group's strong credit metrics. The dividend policy has historically been stable, aligned with the group's strategic target of distributing 40% of earnings after tax attributable to shareholders. Governance is also credit-neutral as no specific issues have been identified.

Long-term and short-term debt ratings

Senior unsecured debt rating: A

Long-term senior unsecured debt has been affirmed at A, the same level as the issuer rating. Notes issued by Mercedes-Benz Australia/Pacific Pty Ltd., Mercedes-Benz International Finance BV, Mercedes-Benz Canada Finance Inc., Mercedes-Benz Finance North America LLC and Mercedes-Benz Finance Co. Ltd benefit from an unconditional and irrevocable guarantee given by Mercedes-Benz Group AG.

Short-term debt rating: S-1

Mercedes-Benz Group's short-term rating, affirmed at S-1, is supported by better-than-adequate liquidity, strong access to capital markets and well-established banking relationships. We believe that Mercedes-Benz Group would be able to address any short-term financing and refinancing requirements.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer