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EMEA
Special Report

European Auto Manufacturers:

Slower, Lower, Weaker

Analysts

Corporates
Emmanuel Bulle
+33 1 44 29 91 84
emmanuel.bulle@fitchratings.com

Markus Leitner
+49 69 7680 76241
markus.leitner@fitchratings.com

Financial Institutions
James Longsdon
+44 20 7417 4309
james.longsdon@fitchratings.com

Related Research

- *Global Automotive Industry Outlook (February 2009)*
- *Life After Detroit Auto Bankruptcy — the Effect upon European and Asian OEMs (May 2009)*
- *European Auto Industry: Do Premium Brands Have More Powerful Engines Than Volume Manufacturers? (September 2007)*
- *Tyre Tracks - European Auto ABS Index (March 2009)*

Ratings of European Auto Manufacturers

Issuer	LT IDR	ST IDR	Outlook/ Watch
Daimler AG	BBB+	F2	Negative
Fiat S.p.A.	BB+	B	Negative
Peugeot S.A.	BB+	B	Negative
Renault SA	BB	NR	Negative
Volkswagen Group	BBB+	F2	Watch Negative

Source: Fitch

Background

As the automotive industry has entered one of its deepest crises ever, manufacturers' credit profiles have deteriorated in quite a dramatic way. In light of the unprecedented structural issues facing the industry, Fitch Ratings has taken rating actions, sometimes multiple, on all car manufacturers.

The latest rating actions were taken on 24 March 2009, when a portfolio review led to Daimler AG's (Daimler) 'BBB+'/'F2' ratings being affirmed but the Outlook revised to Negative from Stable; Fiat S.p.A.'s (Fiat) and Peugeot S.A.'s (PSA) ratings being downgraded to 'BB+'/'B' from 'BBB-'/'F3'); and Renault SA's (Renault) rating being downgraded to 'BB' from 'BBB-'. The Outlooks on Fiat, PSA and Renault are Negative. Volkswagen Group's ('BBB+'/'F2') ratings remain on Rating Watch Negative.

In particular, the rating actions reflected Fitch's revised forecasts for European car manufacturers, and expectations for industry contraction over the next two years. These, in turn, are notably impacted by the agency's assumptions for economic growth in 2009 and 2010. Fitch is increasingly concerned about the extent of manufacturers' falling profitability and the potential for accelerated cash consumption in the next two years, and the consequent potential for heightened volatility in financial metrics. While Fitch has employed conservative forecasts, the distribution of possible outcomes for revenues and operating cash flow is still biased towards the downside, and underpins the negative outlooks on all car manufacturers.

Key Conclusions

All manufacturers are facing several common challenges which continue to put substantial pressure on credit profiles. The main challenges are:

- Weak macroeconomic growth in 2009 and 2010. Lower consumer spending and confidence are likely to put pressure on new vehicle sales and on the product mix, as consumers increasingly choose cheaper vehicles — which are also less profitable for manufacturers
- Lower availability of consumer credit is expected to compound the underlying weaker demand for cars
- Uncertainties regarding the potential for a rebound in sales, and the high risk of a pay-back effect when the incentives which are currently being offered in several countries to support sales stop and/or when demand for incentivised purchases wears off. The premium market may be less at risk of a pay-back effect, though, as the underlying demand has been less distorted by incentives. Fitch also anticipates risks of price deflation and deteriorating product mix as incentives weigh on average vehicle prices
- Weak demand and lower sales will exacerbate the general overcapacity of the auto industry, and lead to sometimes painful and forced restructurings and strategic decisions
- Rationalisation and restructuring will not be immediate, and may indeed take a few years. It will be costly and weigh further on both earnings and cash flows, as charges will not be only related to accounting (probable asset and development costs write-downs) but also have a cash impact

- Risk related to the supply chain, and potential cash injection into distressed suppliers or more favourable payment terms. Financial support to dealers is also likely
- Heightened volatility of — and stress on — financial profiles; notably profitability, cash generation and financial structure
- Large and continuing financing needs of financial services operations
- Necessity to comply with tighter emissions legislation and invest in future technology to keep up with the ability to offer new models, while revenues and earnings are falling
- Uncertainty over the role of governments and European institutions — and potential support. Several governments have already shown their willingness to intervene and provide (financial) implicit or explicit support, through guarantees, loans, or scrapping incentives. However, such support should not be overestimated as it may not come for free, nor will it be equal for all groups, and will not last indefinitely.

This being said, the auto industry still benefits from strengths and opportunities, including long-term growth prospects. Despite the saturation of several markets, worldwide growth in vehicle sales should be supported by emerging markets demand, continuous demographic expansion, and the lack of substitution products. The significant and pivotal importance of the auto industry in several countries and regions from a strategic, economic, political and social point of view provides further support to the auto sector as a whole.

In addition, Fitch believes that not all companies are, nor will be, affected to the same extent, and this relative position is reflected in the recent rating actions and current ratings. A few manufacturers will emerge if not stronger than before, at least in a sounder situation than others. The main differentiating factors between the lowest- and highest-rated groups would be:

- Extent of the product and geographical diversification
- Recent and expected market share developments and product positioning
- Strength of the financial profiles entering the recession, and expectations of relative "exit" profiles from the current downturn, including expected increases in leverage and capacity to take advantage of a return to trend levels of economic growth
- Ability to implement further cost-saving efforts and restructuring measures, and to curb investments and capex, to limit the extent of the downside

Ability to manage the industry's changing landscape and evolution. New alliances and/or strategic co-operations are likely to materialise, reshaping the sector in the next two to three years. A clear strategy, solid brand equity and strong financial profile will be crucial to manage these changes and emerge as long-term winners.

OEMs' Positioning on Main Differentiating Factors

	BMW NR	Daimler BBB+	Fiat BB+	PSA BB+	Renault BB	Volkswagen BBB+
Product and geographical diversification	0/-	+	0	-	0/+	+
Market share and product development	+	0	0	-	0	+
Position in industry's transformation	0	0	+	-	0	+
"Start" financial profiles	+	+	0	0	-	+
Expected "exit" financial profiles	+	+	0	-	-	0

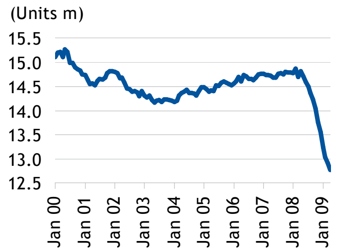
Please refer to Appendix 1 for further comments on this table, by manufacturer
+ is above peer group's average; 0 is average; - is below average
Source: Fitch

Overall Credit Concerns

Falling Industry Sales

Developed Markets – Watch for the Pay-back Effect of Incentives

Passenger Cars Sales in WE
12-month rolling average

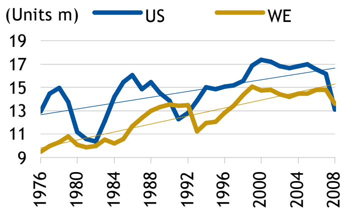


Source: ACEA

New vehicle sales in Europe started to fall in early H208, and were down by 8.4% in 2008. Sales were down 1.1% in H108 in western Europe, but fell by 17% in H208. The decline accelerated in the autumn 2008 as the global financial crisis intensified with the collapse of Lehman Brothers; and early 2009, in the wake of a worsening economic environment and declining consumer confidence. Most consumers are wary about purchasing a new car while unemployment is rising and the prospects for economic improvement are unclear.

This prompted several European governments to implement incentive schemes for scrapping vehicles to limit the collapse in new car sales. Although new vehicle sales have shown positive signs of a tentative rebound or of stabilisation in several European countries in March/May 2009, Fitch believes that the better tone is only temporary and will wear off later in 2009. In particular, the full effect of the recession forecast by the agency will be felt later in the year and should lead to lower demand for new cars. Besides, the novelty effect from these incentives will likely fade in the next few months, and Fitch is concerned that the number of interested consumers may quickly diminish — even before the schemes are withdrawn.

Passenger Cars Sales in WE and US
Long-term trend



Source: ACEA, Bloomberg

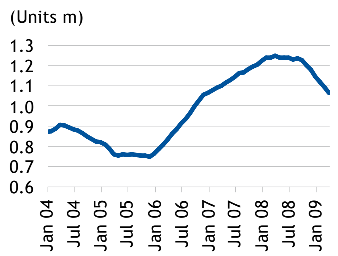
In addition, Fitch believes that demand is brought forward rather than stimulated in absolute terms. Looking at previous experiences in the US or Europe, a pay-back effect is extremely likely when incentives stop. New vehicle sales in the US had been running approximately 15%-20% above their long-term underlying trend line since 2001.

This should lead to renewed depressed sales in 2010 — and possibly as soon as late 2009. Longer term, although a recovery in new car sales will happen at some point in the future — and some blips are likely in the meantime — developed markets may not see previous peak levels before four of five years. However, Fitch believes that the premium segment may be less at risk of a pay-back effect as incentives were lower and have had a less distortive effect on the underlying demand.

Nonetheless, uncertainties remain over the potentially changing automotive customer preferences. Entry-level vehicles are gaining ground, and confirm Fitch's previous comments about a market polarising towards low-cost cars on one side and premium vehicles on the other. For further details, please refer to Fitch's special report *Do Premium Brands Have More Powerful Engines Than Volume Manufacturers?* 3 September 2007, available on www.fitchresearch.com

Emerging Markets: Weaker Support in 2009-2010

Passenger Cars Sales in CEE
12-month rolling average



Source: ACEA

Emerging market regions have significantly supported demand growth in the past couple of years, serving to mitigate the saturated demand in developed and mature markets. Although long-term growth prospects are intact (on the back of the low number of vehicles per capita), growth rates are expected to be low in several regions, or to even turn negative in some others. Among key countries, Fitch expects double-digit declines in Russia and Argentina in 2009, and limited probabilities for a recovery in 2010. Sales in Russia almost halved in the first five months of 2009, while they were down 34% in Argentina. Sales in the large Brazilian market were flat, but are difficult to forecast at this time because of uncertainties related to government intervention measures. Brazilian exports were down 46%. Fitch's weak projections for GDP growth in Russia and Brazil in 2009 (3% contraction in Russia and flat in Brazil) do not bode well for automotive demand.

Overcapacity

A widely accepted issue facing the auto industry overall is the overcapacity plaguing all manufacturers. Already an issue in 2007-2008, this problem is exacerbated by the current sales slump.

Highlighting this point, passenger car sales fell by about 800,000 units — in Europe alone — in the first four months of 2009 versus the corresponding period the previous year. This figure corresponds approximately to the annual European sales output of an average manufacturer like Daimler or BMW; or, put differently, to three to four assembly plants. The total decline expected in Europe and the rest of the world in 2009 points to even higher figures in terms of overcapacity and restructuring potential. Industry consultant *Global Insight* mentioned in H109 that as many as 10 major assembly plants would have to be closed to restore utilisation rates to pre-"Credit Crisis" levels.

According to *Global Insight*, capacity utilisation by country is projected to fall to barely above 50% in France in 2009, down from more than 70% in 2007; while it should fall from 80% to 55% in Italy — and from more than 80% to 65% in Belgium, where several plants are located. In Germany, it should decline less, from more than 90% to 80%. Capacity utilisation is forecast at only 65% in Europe overall in 2009, down from 70% in 2008 and more than the 80% limit deemed to be the profitability threshold in 2007.

Meanwhile, Fitch notes that overcapacity is less an issue in other countries, including in central and eastern Europe where several manufacturers have recently opened plants. These factories are usually more competitive than those in western European countries and besides, they assemble better-selling vehicles (notably small cars).

Restructuring

Partly because of the strategic and political importance of the auto industry in the respective countries where European manufacturers are based, restructuring and headcount reduction have been rejected and delayed for decades. This industry is labour-intensive, and job preservation has always been crucial. Most manufacturers have been discouraged by governments and prevented from decisively tackling the fixed-cost issue.

In Fitch's view, a profound restructuring of the industry is unavoidable within the next couple of years, as the current situation and environment provide opportunities to save costs and engage in corporate activity — with the ultimate goal of eventually raising long-term profitability. The auto industry is well-known for its weak or negative operating margins, and also for destroying value (low or even negative return on capital).

The current industry crisis may provide an opportunity to act, although most governments will continue to interact with companies' strategies. In France, Renault's state shareholding may be a major constraint to implementing the necessary cost-cutting. Nonetheless, constraints are likely to be nearly as high on PSA, especially after the French state provided a EUR3bn loan to each of Renault and PSA. France has a strong history of interventionism, and the current period may prove no exception — with the wider economy also weak and redundancies expected across industries.

The Opel example, where the German state was deeply involved in the choice between bidders (a consortium led by auto supplier Magna, associated with Russian auto manufacturer GAZ, was finally preferred to Fiat), underlines the strategic and economic importance of the auto industry in Germany — all the more so as 2009 is an election year in the country. However, not all manufacturers may be helped, or, on the contrary, be forced to avoid restructuring options.

Fitch also believes that cost-saving will go through more intense cuts in R&D and development costs. The model proliferation witnessed in the past decade or so, as manufacturers entered new product niches and offered increasing variants of their core models, is likely to be curbed. Although consumers will continue to request rapidly-changing models and new vehicles, the recent rate of development is unsustainable in an industry where overall selling volumes have fallen by 15%-20% yoy and margins are notoriously low.

Restructuring Costs

With or without government support, most original equipment manufacturers (OEMs) will have to incur material restructuring costs in the coming years, coming on top of expected financial support to their dealers, suppliers, and the financing of their working capital needs. A portion of these costs will be non cash, and will only have an impact on P&L accounts, but some other charges will have a cash component and will weigh further on manufacturers' financial structures.

Main cash costs are related to the closure and/or relocation of factories from domestic bases towards lower-cost countries, and imply headcount reductions to reduce labour costs.

Availability of Credit

Tighter and/or more expensive available financing from financial institutions and banks — resulting from the credit crisis — has had a two-fold direct negative impact on auto manufacturers. First, it limits consumers' access to credit and prevents many potential buyers from purchasing a new vehicle, exacerbating the underlying negative trend of new vehicle sales. Incidentally, this trend was itself partially caused by the credit crisis as banks were hit by the spiking interbank lending rates and the drop in house prices in a number of countries, which led to a fall in consumers' wealth — and hence their capacity and willingness to buy a car.

Second, it complicates or even prevents the huge refinancing of manufacturers' financial services divisions (captives). As a captive financial subsidiary usually finances 20%-30% of the group's sales through retail financing and leasing, an inability to secure refinancing through banks, financial markets or internal cash flows would put 20%-30% of the manufacturer's sales at risk in a worst-case scenario. In addition, this would have even more negative effects on operating margins, as financial services divisions have usually been more profitable than industrial operations.

All manufacturers are suffering from the lower availability of credit. Although retail customers of premium brands may need less financing than those of mainstream brands, premium manufacturers rely heavily on their captives because of the high proportion of leasing in their sales, notably relating to company cars.

Risks to the Supply Chain

As vehicle sales and manufacturers' revenue drop, so do suppliers' sales — as OEMs cut back on production. The whole supply chain is at risk as the number of financially distressed small and medium suppliers rise. Further cuts in manufacturers' inventories and production will continue to push several suppliers to the brink of bankruptcy (please refer to Fitch's comment *European Leveraged Automotives Face Increasing Stress*, 2 April 2009, for further comments on leveraged suppliers). Large and strong suppliers have also been substantially impacted, and even strong suppliers like Robert Bosch GmbH (Bosch, 'F1+') announced expected losses for financial year 2009 (FY09).

In addition, suppliers also suffer from the lower availability of credit. As banks have become reluctant to lend or have tightened their credit conditions, bridging loans to fill the gap between shipment of products — and the time when the invoice is paid by the manufacturer — become scarce and/or expensive.

Fitch expects manufacturers to provide various forms of support to the supply chain, which will weigh on their earnings and cash flow generation. Such support could include loans, guarantees, accelerated payment terms, purchase of inventories, or providing advice on how to cut costs. Incidentally, OEMs may also have to bring production back "in-house", which may lead to a reversal of the previous trend of integrating suppliers.

Emission Regulations

Although investment to comply with tighter and fiercer environmental standards will make a relatively harder hit on the premium car manufacturers with bigger and heavier vehicles and with bigger engines, all groups will have to make heavy investments in the coming years.

Relative Positioning – Business Profiles

Geographical and Product Diversification

Geographical Diversification

Geographical Breakdown of Sales (%)

	Europe	Rest of the World
BMW	49.7	50.3
Daimler	57.6	42.4
Fiat	57.5	42.5
PSA	63.8	36.2
Renault	63.3	36.7
Volkswagen	47.8	52.2

Source: Companies, Fitch

In view of the synchronised fall in vehicle sales around the world, with virtually all regions posting a high-single-digit or double-digit sales decline, the advantage of geographical diversification may be questioned at this moment. However, the medium- to long-term benefit does remain, as all markets will not rebound at the same time. Besides, the potential to increase sales will be higher by expanding into new countries than by increasing market share in already-competitive markets.

Scale and Product Diversification

Scale remains a key differentiating factor in the auto industry in view of the economies of scale related to R&D and production. The amortisation of the industry's high fixed-costs on a large number of products is vital to ensure maximised profitability. The fall in sales since H208, and the immediate damaging effect on profitability, has illustrated the issue of under-absorption of fixed costs.

Mergers, acquisitions, cross-shareholdings or partnerships (see *M&A and Alliances* below) contribute in increasing the number of cars assembled on each platform to maximise economies of scale, as about three-quarters of costs come from the architectural underpinnings. This strategy includes in particular engine development, which constitutes a major investment in manufacturers' R&D costs. Several manufacturers and industry consultants have pointed to a targeted level of more than 800,000 to 1 million vehicles produced per platform, to drive down costs.

Volkswagen is a good example of companies sharing costs across their model range; with the same platform being used for the VW Golf, Skoda Octavia, Seat Leon and Audi A3, totalling sales of more than 1.5 milion vehicles a year.

Scale often goes hand in hand with product diversification, as a large company is usually able to cater to various customers' needs, mitigating the impact of a decline in any one vehicle category or segment. Again, Volkswagen has the most comprehensive model range, from entry-level to premium and even super-luxury brands.

Platforms

In the purest sense, two vehicles are considered to have a common platform if they share the "underbody", or the foundation of a vehicle. In the most widely accepted sense, two cars share a common platform if they share the underbody, plus the suspension and powertrain that go with it. A platform can be slightly widened or narrowed, shortened or lengthened, and still be part of a common platform as long as no other major stamping changes occur to the underbody

M&A and Alliances

After the intense acquisition activity of the late 1990s/early 2000s, the auto industry went through a quieter period in terms of M&A. Manufacturers reflected on the failure or weak success of a few enterprises, and decided rather to sign selective agreements and alliances. The latter enable companies to partner on selective engine or model developments, and reach economies of scale without merging with or purchasing a competitor.

Fiat and PSA have been the most effective in signing selective agreements and partnerships. Such a strategy underlines the interest of scale, rather than size for the sake of it. As mentioned in previous comments and reports, Fitch believes that absolute size is not the key rationale for M&A, and that synergies and savings are better found in relative size, eg by segment or region.

The current industry crisis offers renewed opportunities for consolidation, and a few players are choosing a more proactive approach to ensure that they belong to the surviving players and are not left aside. Fiat has been the most active in 2009, taking a 20% stake in Chrysler — with an option to reach 35% if certain requirements are met — and seeking to purchase GM's European operations. Fiat's CEO has been very clear that he believes that the minimum volume to produce for a volume manufacturer to be profitable is between 5.5 million and 6 million vehicles per year. Although the Chrysler deal comes with high execution risks, financial risk is limited as Fiat will not use cash to acquire its stake, and Fitch views as a positive the group's strategy to expand its product and geographical diversification — and improve its breakeven point. The group's decision not to purchase Opel at any cost, and not to jeopardise Fiat's financial profile, is also viewed as distinctly positive by the agency.

Volkswagen is also playing a consolidator role, as Fitch assumes a consolidation of some sort with Porsche in the coming months. Volkswagen is also playing an active role in the truck industry, to expand its operations in the sector. However, Fitch deems it extremely unlikely that VW will purchase any brand or merge with any other auto manufacturer apart from Porsche.

Renault's cross-shareholding structure with Nissan Motor Co., Ltd. (Nissan, 'BBB-'/Negative) has provided both groups with huge synergy potential since the alliance was signed 10 years ago, but such savings do not appear to have been fully reaped. However, Renault has recently confirmed its renewed focus on extracting synergies and accelerating cooperation between the two companies. It announced plans to find a further EUR1.5bn in savings in 2009; 45% of this amount accruing to Renault, the rest to Nissan. Both groups are under pressure now in the wake of the current crisis, and must overcome the difficulties from the past 10 years since the alliance was signed.

The next steps for the alliance should come from platform consolidation and additional commonalities. Nonetheless, this may take time to deliver. Should further cooperation with Nissan be unsuccessful, other options remain limited for Renault in the global sector consolidation, in view of the French state shareholding. Fitch notes also that Renault should not benefit from the same cash inflow from Nissan's dividends as in the past few years, as Nissan's financial profile has also deteriorated materially.

BMW and PSA remain relatively small players on a global scale, and isolated in Europe — with question marks regarding how they can share costs with any of their peers, and improve their positioning. Their shareholding structures, with the Quandt and Peugeot families still holding 40% and 31% of BMW and PSA (43% and 45% of voting rights), respectively, complicate the possibility of a merger, either with another company or together — the latter option looking sensible on paper in view of their complementary product lines and geographical exposure.

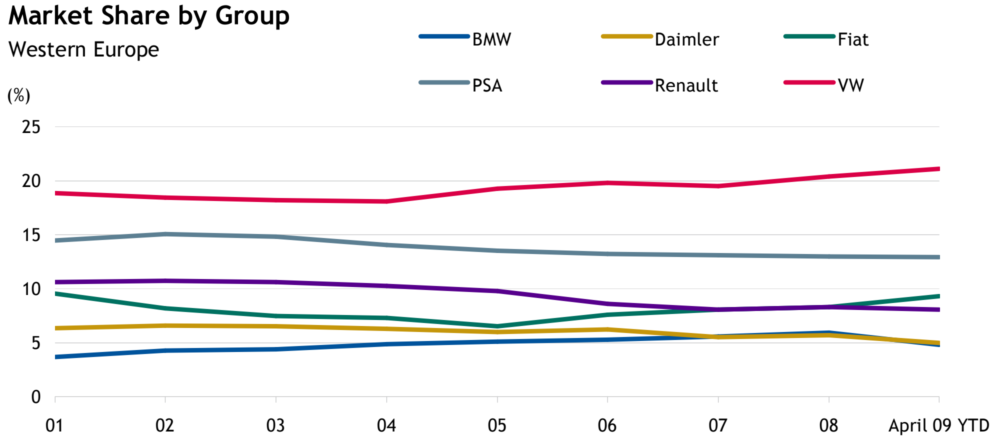
The decision by the Peugeot family to appoint a new CEO at the helm of PSA may point towards a more flexible approach towards consolidation, however. It may also be a sign of a smoother relationship with the French state, compared with the more rigid stance of the previous CEO. A recent quote from a Peugeot family member also confirmed the family's openness to accept a dilution of its share in PSA.

Fitch also notes that a national solution cannot be fully discounted in light of social and political pressure in the case of plant closures, extremely limited pan-European answers, and the precedence of the German government intervening in the Opel sale. Although probabilities are low, PSA and Renault might end up together with the backing of the French state.

Market Share Developments

Volkswagen and Fiat stand out as the key winners in terms of market share gains in Europe. Volkswagen benefits from the success of its Audi and Skoda brands in particular, in the premium and entry level segments, respectively, and the continuous strength of its core Volkswagen brand. Fiat's rebound in market share started with the successful launch of the Fiat Grande Punto, the rejuvenated image of its model range, and the current attraction to customers of small and medium cars in which Fiat has particular strengths.

Market Share by Group
Western Europe



Source: ACEA

By contrast, Renault's and PSA's market shares have continuously declined since the start of the 2000s. The recent rebound of PSA's Citroën's market share has not been able to offset the weakening of Peugeot-branded vehicles. Similarly, the weakness of the core Renault brand has been mitigated by the strong sales of Dacia models, but not enough to compensate for the harsh competition in Renault's main segments. Renault's further market share development will rely heavily on the recently-launched new Megane Scenic in June 2009.

On the one hand, the launch of expected best-sellers or the new version of a best-seller is set to support sales, and provides a boost to declining sales hit by the negative environment. On the other hand, launching a key product while the underlying demand is weakening, may lead to disappointing sales. Some manufacturers have indeed decided to postpone the launch of some of their new products and wait for more favourable opportunities. Such postponement may also lead to cost savings (eg marketing).

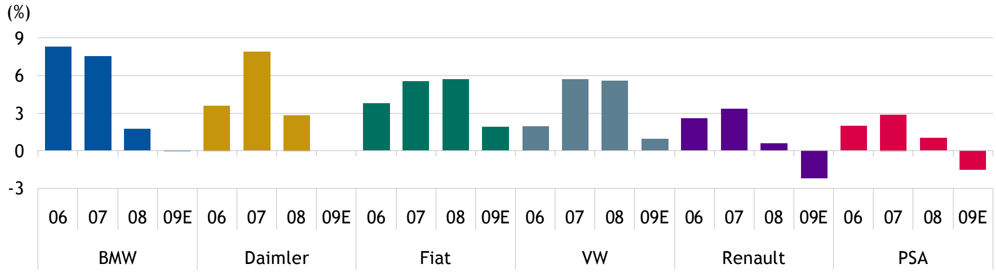
Relative Positioning – Financial Profiles

Profitability

The high fixed costs typical of the auto industry lead to substantial operating leverage and disproportionally falling earnings when revenues decline. They also require the highest possible level of production to amortise these fixed costs on as many vehicles as possible. Therefore, as a result of the falling sales and the under-absorption of fixed costs, operating margins of all manufacturers have come under substantial pressure since H208.

However, some manufacturers' operating margins have been more resilient than others in 2008, as all groups have not cut production at the same speed and to the same extent — hence have not experienced the same under-absorption of fixed costs. These groups are set to see a more pronounced revenue decline in 2009, as they will need to cut production and adjust inventories, leading to a decline in profitability. Fitch expects further diverging developments of profitability in 2009.

Group Operating Margin
Ranked by 04-09E average



Source: Companies, Fitch

Profitability is also driven by the group's positioning as a premium or volume manufacturer, the latter's operating margins usually being lower per unit and compensated for by higher volumes (for further details on the differences between premium and volume manufacturers, please refer to the special report *Do Premium Brands Have More Powerful Engines Than Volume Manufacturers?*

BMW and Daimler's Mercedes Benz (MBC) division have usually posted higher-than-average operating margins, although Daimler's group margins have been dragged down by other divisions' lower profitability and MBC issues in 2005-2006. Fitch also notes that neither group has been immune to deteriorating earnings in line with the rest of the industry. In addition, BMW, and to a lesser extent, Daimler, have suffered from the issue of their vehicles' falling residual values, which entailed massive provisioning in 2008.

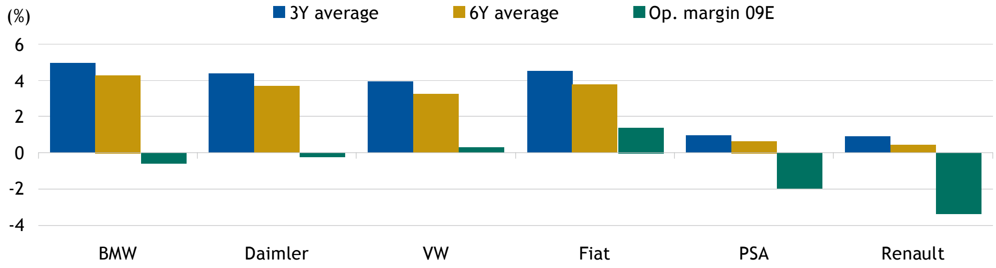
Volkswagen's unparalleled brand portfolio gives it an unmatched advantage to spread costs and investments. The operating margin of its Audi division benefits from this advantage, and outperforms MBC's and BMW's margins. In addition, the implementation of several restructuring plans since 2003 to attack falling margins has given a solid advantage to the group as it entered the industry crisis.

Likewise, Fiat has managed to substantially and consistently improve its profitability since 2001-2002. It posted the second-highest operating margins, just below Volkswagen in 2008.

On the contrary, Renault and PSA have struggled to structurally strengthen their profitability as it constantly declined between 2003-2004 and 2006, with only a slight rebound in 2007, before deteriorating again in 2008 as a result of falling sales.

Fitch anticipates negative operating margins for PSA and Renault in 2009. Only Volkswagen and Fiat are expected to post positive operating margins this year, while BMW and Daimler should be around break-even. However, Fitch notes that the effect of the various "scrapping incentives" in Europe and several other countries may mitigate the weakness in profitability, although operating margins may notably suffer again in 2010 — and not rebound as soon as previously expected because of the expected pay-back effect (see *Falling Industry Sales, Developed Markets - Watch for the Pay-back Effect of Incentives*).

Industrial Operating Margin
Ranked by 04-09E average



Source: Fitch

Financial Services

While financial subsidiaries have historically had a supporting role for OEMs' earnings, their contribution is expected by Fitch to be lower in the next couple of years, or may even be a drag on some groups' results. The profitability of a few manufacturers' financial services operations, especially among premium groups, has been substantially impacted by the falling residual value of their vehicles coming off-lease, particularly in the US. The cost of risk is also expected to rise and loan losses to increase as customer default will increase.

In addition, Fitch believes that the material growth of financial services in the past four to five years, supporting the expansion of industrial activities, has come to a halt — and will limit further growth of auto sales.

BMW and Daimler appear the most at risk, in light of their higher exposition to the US and UK market than Renault and PSA, and the higher proportion of operating leasing in their books. BMW reported a total EUR1.9bn impact from residual values and bad debts in FY08 (EUR911m booked in the auto division and EUR1,058m in the financial services division). However, it must be noted that BMW has lowered the residual values included in lease agreements concluded in 2008, which reduces the residual value risks for new contracts. Losses in residual value were not detailed by Daimler, but Fitch understands the negative impact was lower than for BMW as its financial services operations were somewhat more resilient in 2008. They should, however, deteriorate in 2009 — in line with the rising cost of funding, an expected higher loss ratio, and lower growth rates for this business.

Cash Generation

Cash Flow from Operations - Industrial Operations (EURm)

	2006	2007	2008
BMW	5,373	6,340	4,471
Daimler	6,457	5,588	-1,865
Fiat	3,995	5,756	156
PSA	3,596	4,592	-464
Renault	3,544	4,526	357
Volkswagen	11,745	13,675	8,771
Total	**34,710**	**40,477**	**11,426**

Source: Companies, Fitch

Change in Working Capital - Industrial Operations (EURm)

	2006	2007	H108	H208
BMW	-227	-433	-433	1,610
Daimler	-2,460	-3,058	-1,839	-4,047
Fiat	679	1,675	-534	-3,252
PSA	424	920	-417	-2,507
Renault	-346	-26	-823	-1,881
Volkswagen	1,014	318	-723	-1,995
Total	**-916**	**-604**	**-4,769**	**-12,072**

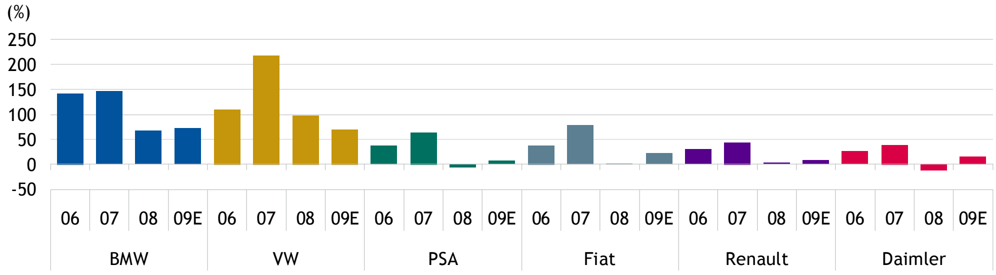
Source: Companies, Fitch

The much greater-than-expected fall in sales in H208 led to massive inventory excesses, which are taking some time to come down. This in turn caused huge negative working capital swings in H208 in spite of drastic actions taken by manufacturers to cut their inventories. As a result of these working capital moves and depressed underlying EBITDA, all manufacturers posted sharply reduced — or even negative — cash flow from operations (CFO) in 2008. In spite of expected working capital reversals in 2009, Fitch anticipates further low or negative CFO in line with falling underlying EBITDA. As with profitability, however, cash burn in 2009 may be mitigated by the positive impact of incentives, leading to de-stocking and lower working capital needs.

All companies have announced a clear focus on cash preservation in 2009, including cuts in capex, reduced or no dividends in 2009, and/or asset disposals to boost liquidity. However, such measures may not be enough to compensate for lower CFO, and net debt is likely to rise again for most companies at financial year-end 2009 (FYE09).

CFO/Adjusted Debt (Industrial Operations)

Ranked by 04-09E average

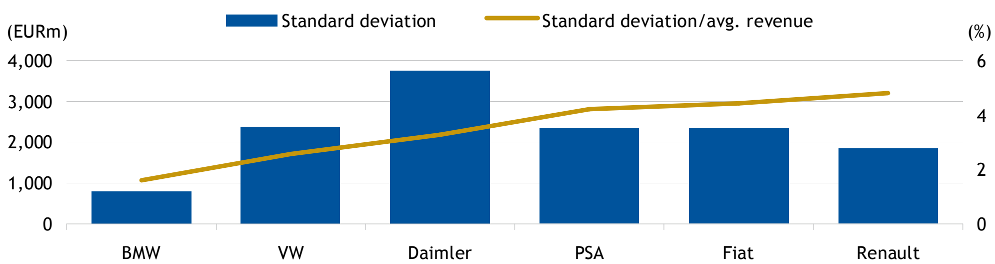


Source: Companies, Fitch

The recent fall in sales and working capital moves has also led to higher volatility in cash generation. Fitch views stable cash flows as positive for the ratings. Although the chart *Standard Deviation of CFO on Average Revenue (5Y)* is only one part of the analysis, it shows the higher cash flow volatility — expressed as the standard deviation of CFO in the past five years as a percentage of the average revenue on the period — above 4% for Fiat, Renault and PSA (all rated in the 'BB' category) than for BMW, Daimler and Volkswagen, between 1.5% and 3.5%.

However, it also shows that the gap in cash flow volatility between companies rated in the 'BB' and 'BBB' categories is not as substantial as for other cash flow or other financial metrics. In particular, debt coverage by CFO shows more material differences between BMW, Daimler and Volkswagen on the one hand and Fiat, Renault and PSA on the other. However, Fiat's high volatility has a positive bias as the group's CFO consistently improved between 2003 and 2007.

Standard Deviation of CFO/Average Revenue (5Y)



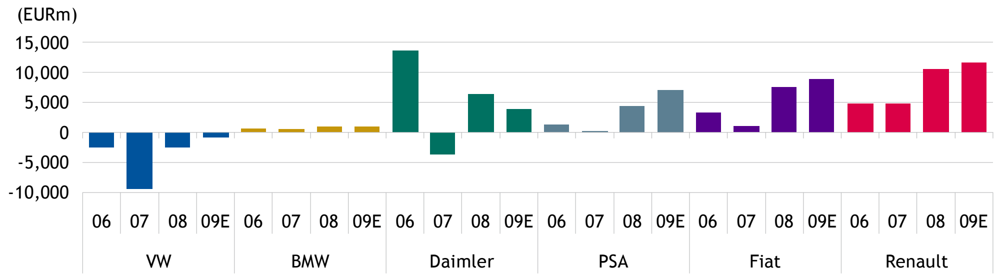
Source: Fitch

Financial Structure

Liquidity and Leverage

Strong liquidity and sufficient cash reserves are essential to support customer financing, leasing activities and dealer financing. The high liquidity on the balance sheet of several manufacturers pre-crisis has put them in a relative better situation to cope with the current downturn.

Adjusted Net Debt/(Net Cash) Position
Industrial operations



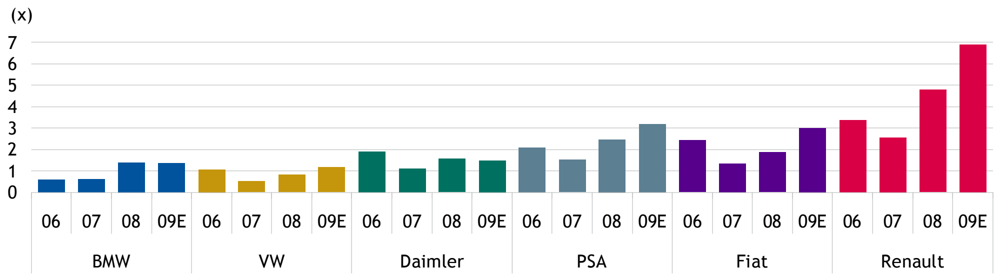
Source: Companies, Fitch

Companies having entered the crisis with a (strong) net cash position are now favourably positioned. Although they burned substantial cash in H208 and/or Q109, manufacturers like BMW, Daimler and Volkswagen still benefit from a net cash position (before adjustments for operating leases and pension liabilities), providing a cushion to absorb further negative free cash flow (FCF) in the remainder of 2009 and potentially in 2010. Fitch cautions, however, that these three groups are all likely to swing to a net debt position at some point in 2009 — be it from falling FFO and/or working capital needs, or because of corporate activity. While Fitch does not expect Volkswagen's net cash position to be materially impacted by negative FCF, Porsche's high financial and its highly leveraged financial profile may be detrimental to Volkswagen.

Conversely, Renault already had a high indebtedness at FY07, which was further impacted by the investment in Russian manufacturer AvtoVAZ for USD1bn in H108. As a result, Renault closed FY08 with by far the highest leverage and debt levels of its European peer group.

PSA's and Fiat's financial structures improved until H108, but the trend reversed and they both posted a much higher net debt at FYE08, which Fitch has forecast will worsen by FYE09.

Pension- and Lease-Adjusted Debt/EBITDAR
Ranked by 04-09E average



Source: Fitch

Financial Flexibility

Continuous access to liquidity is crucial for automotive manufacturers to finance the investment and working capital of their industrial business, but, even more importantly, as their financial services operations have substantial and ongoing refinancing needs. In spite of a recent improvement in Q209, all manufacturers have a more stretched liquidity position now than in H108, and the sector's refinancing risk is expected to remain generally high amid limited capability and the higher risk-awareness of the banking sector and capital markets.

However, Fitch has not identified a particular near-term risk of default for any of the European OEMs. All groups benefit from sufficient cash balances and credit facilities to cover anticipated negative FCF and short-term debt requirements. In addition, bond issuance has significantly rebounded for the auto sector since the start of the year, and virtually all manufacturers accessed the bond market in H109.

With financial services operations demanding continuous refinancing, the virtual closure of capital markets and bank lending in late 2008/early 2009 exposed most manufacturers to critical situations at the time and led them to look for alternative sources of financing, including public aid (state support to Renault, PSA, Volkswagen and the EBRD providing funds to all manufacturers) and capital increase (Daimler). Companies including Fiat (through its CNH subsidiary) and BMW have also raised funds through the US government's TALF programme.

Liquidity risk remains a concern for financial services operations in view of their material and continuous cash requirements. However, these divisions can reduce their loan books to improve their refinancing needs. Maturing financial services short-term assets also cover a large part of the related short-term debt. However, access of financial services subsidiaries to liquidity remains exposed to a variety of key risks, including further deterioration in bank credit availability and any variation in policy measures for asset-backed instruments by the ECB.

Fitch will issue a special report by mid-summer 2009, to comment specifically on the liquidity of European auto manufacturers.

Non-Core Assets

Contrary to past periods when several manufacturers had non-core assets — which they disposed of to boost liquidity — disposable assets are scarcer at this point, and will not be able to replace other funding sources.

Renault benefits from its stakes in Volvo and Nissan. Although Fitch does not expect Renault and Nissan to untie their cross-shareholding, a disposal of a small stake in Nissan might be possible should liquidity issues become problematic. The stake in Volvo (valued at approximately EUR2bn), however, is deemed non-core and could be divested, provided an interested buyer emerges.

As with Renault, Fitch believes that Fiat (though to a lesser extent) may dispose of assets in its portfolio. However, this would not be sufficient to cover a real liquidity crisis. PSA is in a similar situation as its main subsidiaries — auto supplier Faurecia and logistics company Gefco — are unlikely to yield attractive value at present.

BMW, Daimler and Volkswagen would have no material assets to sell, assuming that Volkswagen will not want to exit the truck sector.

Potential Recapitalisation

Daimler set a precedent in the recent period by issuing EUR1.95bn of new equity to Abu Dhabi's Aabar in January 2009. As most manufacturers swung, or are about to swing, from a net cash to a net debt position — and with the environment set to deteriorate further, driving up gross and net debt — the need for fresh equity has become more urgent, and likely.

The shareholding structure of most manufacturers (families or governments/sub-nationals) makes it difficult to assess the potential for rights issues. Some of the main shareholders may want to avoid dilution and would participate in a capital increase, but this would obviously depend on the state of their wealth at the time, assessment of their readiness to remain present in the auto industry, and interest from third parties.

Captive Recapitalisation

Fitch believes that a widespread recapitalisation of the OEMs' financial captives is unlikely at this stage, but cannot be entirely discounted. The need to find adequate funding rates and comply with all regulatory ratios may prompt some groups to recapitalise their captives at some point. Fitch notes that the size of most captives' portfolios has not declined in line with the fall in industrial revenues in 2008 and 2009, as their captives' penetration rates with car buyers have tended to increase to replace the withdrawal of third-party banks or financial institutions less eager to lend.

Appendix 1

Positioning on Main Differentiating Factors, by OEM

BMW	Relative positioning	Comments
Product and geographical diversification	0/-	Reliance on the US and German markets; reliance on the premium segment; but increasing expansion in Emerging regions
Market share and product development	+	Solid development of the BMW, Mini and Rolls Royce brands and model range; impressive market share gains; strong brand equity
Position in industry transformation	0	Possible isolated player in the consolidation process; uncertainty over the role of the main shareholder; cooperation with peers (Daimler in particular) is likely, and would enable substantial cost savings
"Start" financial profiles	+	Solid net cash position; high, although declining, operating margins; strong cash generation; conservative financial strategy
Expected "exit" financial profiles	+	Impact of residual value losses; however, sales of premium vehicles may bottom out quicker than volume, due to lower distortion from incentives; strong financial profile entering the crisis will enable better cost and cash management

+ is above peer group's average; 0 is average; - is below average
Source: Companies, Fitch

Positioning on Main Differentiating Factors, by OEM

Daimler	Relative positioning	Comments
Product and geographical diversification	+	Reliance on the US and German markets; reliance on the premium segment; but increasing expansion in Emerging regions; diversification provided by the exposure to the heavy truck and bus sectors
Market share and product development	0	Rebound in market share after several quality issues; strong brand equity
Position in industry transformation	0	Long and costly (cash and management time) failure of the Chrysler acquisition may weaken Daimler's will to embark again on further corporate activity; however, cooperation with peers (BMW in particular) is likely, and would enable significant cost savings
"Start" financial profile	+	Solid net cash position; high operating margins; strong cash generation; conservative financial strategy
Expected "exit" financial profile	+	Impact of residual value losses; however, sales of premium vehicles may bottom out quicker than volume due to lower distortion from incentives; recent capital increase mitigates the negative effect of operational cash burn

+ is above peer group's average; 0 is average; - is below average
Source: Companies, Fitch

Positioning on Main Differentiating Factors, by OEM

Fiat	Relative positioning	Comments
Product and geographical diversification	0	Diversification provided by the exposure to the heavy truck, agricultural and construction equipment, and auto supply sectors; however, heavy reliance on the Italian and Brazilian auto markets
Market share and product development	0	Strong rebound in market shares in Europe; heavy reliance on small and medium cars, with lower profitability per unit; continuous challenge to reinvigorate the Lancia and Alfa Romeo brands
Position in industry transformation	+	Proactive attitude to be one of the main consolidators in the industry, as testified by the purchase of a stake in Chrysler and the offer to buy Opel; leading group in terms of selective alliances and agreements; question mark regarding the future of the auto division part — to be retained or spun off from the group.
"Start" financial profile	0	Solid net cash position; high, although declining, operating margins; strong cash generation; conservative financial strategy
Expected "exit" financial profile	0	Low operating leverage reported in Q408 and Q109 bodes well for the coming quarters

+ is above peer group's average; 0 is average; - is below average
Source: Companies, Fitch

Positioning on Main Differentiating Factors, by OEM

PSA	Relative positioning	Comments
Product and geographical diversification	-	Heavy reliance on the French and west European markets
Market share and product development	-	Strong position in the light commercial vehicle segment; strengthening of the Citroën brand, but not fully offsetting the continuous decline in market share in Europe
Position in industry transformation	-	Possible isolated player in the consolidation process, and likely to be more a prey than a consolidator; uncertainty over the role of the main shareholder, the Peugeot family, and rgarding the new CEO's decisions (CEO appointed 1 June 2009; a leading group in terms of selective alliances and agreements
"Start" financial profile	0	Net cash position; conservative financial strategy; sound but declining operating margins
Expected "exit" financial profile	-	Heavy operating losses and cash burn to weaken the financial structure; liquidity bolstered by the French state's support;slightly improved expectations for FY09 in light of "scrapping incentives" supporting PSA's sales and cash flow (quicker destocking) which should be offset by a weaker outlook for FY10

+ is above peer group's average; 0 is average; - is below average
Source: Companies, Fitch

Positioning on Main Differentiating Factors, by OEM

Renault	Relative positioning	Comments
Product and geographical diversification	0/+	Increasing expansion in emerging regions; still heavy, although somewhat declining, reliance on a few key models; material improvement in geographical diversification
Market share and product development	0	Success of the Dacia model range mitigating the weakness of the core Renault brand; success of the recently launched new Scenic will be decisive to support market share and compensate for the slow launch of the new Megane
Position in industry transformation	0	Cross-shareholding with Nissan and the French state shareholding puts Renault in a difficult situation in any further industry consolidation; decision to invest in AvtoVAZ and benefit from the strong growth potential of the Russian market hurt by the sudden and unexpected collapse in vehicle sales in Russia; however, proactive attitude to lead consolidation
"Start" financial profile	-	Leveraged financial structure and high debt burden; early rebound in profitability stopped by the industry and economic crisis
Expected "exit" financial profile	-	Will probably be the most leveraged company at FYE10; liquidity bolstered by the French state's support; slightly improved expectations for FY09 in light of "scrapping incentives" supporting Renault's sales and cash flow (quicker destocking) which should be offset by a weaker outlook for FY10

+ is above peer group's average; 0 is average; - is below average
Source: Companies, Fitch

Positioning on Main Differentiating Factors, by OEM

Volkswagen	Relative positioning	Comments
Product and geographical diversification	+	Most comprehensive product portfolio in the industry; increasing diversification in the truck sector; broad geographical diversification
Market share and product development	+	Consistent market share gains of the Skoda and Audi brands in the entry-level and premium segments; however, weak success/failure of the Seat brand and remaining challenges in China and the US
Position in industry transformation	+	Consolidation expected of Volkswagen and Porsche leading to an even stronger product portfolio; possible further consolidator role in the truck sector, but no other corporate activity expected in the auto sector
"Start" financial profile	+	Solid net cash position; improving operating margins; strong cash generation
Expected "exit" financial profile	0	Potential negative impact of the consolidation with Porsche, leading to much higher financial debt; low potential to cut on capex as the company's investments have been below trend in the past three to four years

+ is above peer group's average; 0 is average; - is below average
Source: Companies, Fitch