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Research Update:

Germany's Daimler AG Outlook Revised To Stable From Negative On Strengthening Credit Ratios; 'BBB+/A-2' Ratings Affirmed

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Overview

- Daimler is seeing stronger improvement in demand for passenger cars and trucks than we had anticipated. As a result, its credit ratios are stronger than we anticipated.
- We are revising our outlook on Daimler to stable from negative and affirming the 'BBB+/A-2' ratings.
- The stable outlook reflects our opinion that Daimler should be able to maintain credit metrics commensurate with our indicative ratios for the current rating.

Rating Action

On Aug. 26, 2010, Standard & Poor's Ratings Services revised its outlook on German automaker Daimler AG to stable from negative. At the same time, we affirmed the 'BBB+' long-term and 'A-2' short-term corporate credit ratings.

Rationale

The outlook revision reflects our opinion that Daimler has considerably improved its financial risk profile over the past year, notably in the past two quarters, from a fairly weakened position in 2009. Our view is supported by Daimler's improved reported operating results and order intake for the first half 2010, which suggest to us that Daimler's debt protection measures are back to levels more commensurate with the current rating. We also envisage an improved outlook for Daimler's major markets, notably passenger cars.

Daimler reported a significant increase in operating profits (EBIT) in the first half of 2010, with the reported EBIT margin expanding to 7.1% after a negative figure in the comparable period of 2009. Results were particularly strong in the automotive unit. Mercedes-Benz Car (MBC) division reached an EBIT margin of 9.8% in the second quarter after 7.0% in the first quarter, both representing high margins compared with results achieved in preceding years. MBC's considerable jump in profitability was supported by strong production volumes, up 20% year on year, and strong volume demand for high-end S-class and E-class vehicles, particularly in China.

Profitability in the truck division likewise improved to 4.0% in the first half of 2010, mostly supported by year-on-year volume growth of 29%. The smaller divisions, vans and buses, also benefitted from stronger volumes, while risk costs in the financial services division are gradually declining.

Daimler raised its public EBIT guidance for 2010 twice this year. The company now expects to achieve a group EBIT of €6.0 billion in 2010. We believe that this target is achievable and we have incorporated a similar level of profitability into our forecasts. Nevertheless, we consider Daimler's twice altered public earnings guidance in 2010 as further evidence that visibility in the auto sector is poor.

Free cash flow generation in the industrial unit was €2.8 billion in the first half 2010, which has led to a further reduction of Daimler's financial debt. In contrast to our earlier expectation, we now expect Daimler to report a substantially positive free operating cash flow (FOCF) in 2010, despite the considerable capital expenditures and development expenses for new product generations. Daimler also improved its financial risk profile by suspending dividend payments, which allows it to use FOCF entirely for debt reduction. Furthermore, Daimler's capital increase of €1.95 billion in March 2009 continues to be supportive for the financial risk assessment overall.

Despite the solid bounce-back of operating profits and free cash flow generation in 2010, we consider Daimler's underlying business continues to be exposed to the material risk of strong earnings and cash flow volatility. Visibility in the auto sector is generally low and operating leverage high. We continue to view Daimler's business risk as "satisfactory" under our criteria, still constrained mainly by the cyclicality of earnings and the need for substantial research and development costs to cope with tightening emissions standards, both for trucks and passenger cars.

We believe that the improved profitability and demand prospects should help Daimler keep its credit metrics in line with ratios we view as commensurate with the rating category in 2010. These are fully adjusted funds from operations (FFO) to debt of about 45% and debt to EBITDA of about 1.8x.

Liquidity

The short-term rating on Daimler is 'A-2'. We consider the group's liquidity as "strong". Daimler's financial flexibility and liquidity are underpinned, in our view, by:

- Cash and cash equivalents of €6.5 billion in the industrial division as of June 30, 2010, of which we view €5.5 billion as necessary to maintain ongoing operations.
- Unused credit lines, notably a $4.9 billion syndicated revolving credit facility due in December 2011 and a €3 billion syndicated credit facility due in October 2011. Both facilities were unused as of June 30, 2010, and carry change-of-control clauses, but are free from financial covenants and material adverse change clauses. These credit lines serve as collateral for a commercial paper program and can likewise be used for general corporate purposes. As of June 30, 2010, commercial paper usage was very low.
- Access to term debt, as evidenced by a placement of several public

benchmark bonds with an aggregate amount of €5.7 billion in 2009.

Total industrial net liquidity was €9.4 as of June 30, 2010, supported by the FOCF generated in the course of the year. For 2010, we now expect Daimler's FOCF in the industrial division to be substantially positive and consequently not to affect the liquidity position. Daimler will make no dividend payments in 2010. Total industrial financial debt was €1.3 billion as of June 30, 2010.

In 2010, Daimler plans to gradually reduce its liquidity position and to use cash over and above the group's minimum cash requirement deemed necessary for both ongoing operations and as a risk buffer (about €7 billion in total) to reduce outstanding debt.

As is common in the industry, Daimler's Financial Services division has substantial needs to fund new business. Its asset composition is very liquid, as demonstrated by two asset-backed securities transactions with an aggregate amount of $1.8 billion in 2009. The debt of Daimler's financial services division is matched with the underlying assets. The financial services division demonstrated relative robustness in its capital market funding mix throughout the difficult funding environment in 2009, and is supported by funding from customer deposits. The annualized write-off ratio as of June 2010 was 0.92%. The write-off ratio was 0.91% in 2009 after 0.53% in 2008 and about 0.40%-0.70% in the years 2003-2007. With reference to 2009, this implies that the division has failed to recover 0.91% of its loans extended to borrowers.

Outlook

The stable outlook reflects our opinion that Daimler should be able to maintain credit ratios that we consider commensurate with the 'BBB+' rating, including fully adjusted FFO to debt of about 40%-45%, supported by the anticipated continuing trading improvements. Our stable outlook assumes an earnings outlook similar to the public guidance communicated by Daimler and, effectively, that the group will maintain about the level of operating and financial performance reported in the first half of 2010.

The ratings could come under pressure, in our view, if the favorable operating trends reverse, if the company fails to maintain a positive FOCF from the industrial business, or should it engage in significant shareholder distributions that would trigger a substantial deterioration in credit measures.

We consider rating upside currently constrained by the "satisfactory" business risk profile. We would consider raising the rating if Daimler were able to develop a stronger financial profile than we currently anticipate and if this stronger financial profile provided a substantial buffer to accommodate the risks of significant earnings swings. This, however, would also assume a stringent and reliably implemented financial policy, including limited share buybacks and moderate dividend payments.

Related Criteria And Research

- Credit FAQ: How Standard & Poor's Adjustments To Automotive Firms' Captive Finance Operations Affect Daimler AG, July 11, 2008.
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009.
- Key Credit Factors: Business and Financial Risks In The Automaker Industry, Sept. 25, 2008.

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Daimler AG		
Daimler Australia/Pacific Pty Ltd.		
Daimler North America Corp.		
Corporate Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2

Ratings Affirmed

Daimler AG	
Senior Unsecured	BBB+
Commercial Paper	A-2
Daimler Australia/Pacific Pty Ltd.	
Commercial Paper	A-2
Daimler Canada Finance Inc.	
Senior Unsecured*	BBB+
Commercial Paper*	A-2
Commercial Paper*	A-2(Cdn)
Daimler Finance North America LLC	
Senior Unsecured	BBB+
Daimler International Finance B.V.	
Senior Unsecured*	BBB+
Daimler North America Corp.	
Senior Unsecured*	BBB+
Commercial Paper	A-2
DaimlerChrysler Co. LLC	
Senior Unsecured*	BBB+
Mercedes-Benz Australia/Pacific Pty. Ltd	
Senior Unsecured*	BBB+

*Guaranteed by Daimler AG.

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