MOODY'S
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Rating Action: Moody's upgrades Volvo Car's ratings to Ba2; stable outlook

Global Credit Research - 12 Oct 2016

Frankfurt am Main, October 12, 2016 -- Moody's Investors Service, ("Moody's") has today upgraded to Ba2 from Ba3 the corporate family rating (CFR) and to Ba2-PD from Ba3-PD the probability of default rating (PDR) of Volvo Car AB (Volvo Car). Concurrently, Moody's has upgraded to Ba2 from Ba3 Volvo Car's senior unsecured notes rating. The outlook on all ratings has been changed to stable from positive.

"The upgrade of Volvo Car's ratings reflects the company's strong operating performance over the past 12 months based on the successful introduction of the new XC90 and our expectation of further improvements in the company's credit metrics driven by several new product launches, including the recently launched S90 and V90, over the next 2 years," says Falk Frey, a Moody's Senior Vice President and lead analyst for Volvo Car.

RATINGS RATIONALE

Volvo Car's operating performance in H1 2016 has improved further based on continued unit sales increases (up 10.5% to 256,563 from 232,284 in H1 2015) across all regions driven by the strong demand for the XC90. This resulted in revenue increases to SEK83.6 billion (+11.2%) in H1 2016 compared with SEK75.2 billion in H1 2016 and translated into a strongly improved reported operating income of SEK5.6 billion versus SEK1.7 billion in H1 2015.

Following the recently started sale of the new S90 premium sedan and V90 premium estate cars we anticipate the good momentum to continue. As both models are based on the same platform as the XC90 operating leverage should remain high and consequently result in further profit improvements while these models are rolled out across all major markets.

Volvo Car's Ba2 CFR continues to be supported by (1) its well-known brand identity with a long-established position in its domestic market; (2) a global footprint with a growing presence in the Chinese market helped by the company's close relationship with its main shareholder, the Geely group (unrated); (3) the expectation of rapid sales growth over the next few years on the back of several new product launches, like the S90 and V90, (4) recent sizeable investments in a new engine family and modular platforms, giving the company a more efficient platform for its new model range; (5) prudent financial policies with no dividends paid and a recent parent equity injection in the context of the acquisition in 2015 of an additional stake in the company's Chinese subsidiaries; and (6) a good liquidity profile.

At the same time, the rating is constrained by (1) Volvo Car's modest market position and small size compared to other rated global premium competitors in a fiercely competitive global passenger car market; (2) its history of low margins with a short track record of operational improvement; (3) risks related to the ongoing revival plan in the US where Volvo Car has lost ground in the years before 2015, though there have been signs of a turnaround and market share gains there since 2015; and (4) a degree of execution risks related to the expected fast-paced model renewal programme over the next few years. The renewal programme would make Volvo Car less dependent on only a few models (in 2015, more than 50% of its volumes were generated by only three models), but it will require continuous investments for the development of new models as well as for new technologies, such as alternative fuel vehicles or autonomous driving.

LIQUIDITY

Volvo's liquidity profile is very strong, underpinned by (1) cash and cash equivalents, including marketable securities (after a 20% haircut), on the balance sheet of SEK26.4bn as of 30 June 2016, (2) expected positive free cash flow in the next 12 months and (3) access to a covenanted EUR660 million (approximately SEK6.2 bn, unrated) back up facility (maturing in June 2019). The company had sufficient headroom under its financial covenants as of 30 June 2016. The company's existing resources would be sufficient to cover its corporate cash requirements over the next 12 months including sustained high levels of capital expenditures and intra year working capital needs.

The stable outlook is based on our expectation that the renewal programme and subsequent sales and earnings growth will lead to a further improvement in Volvo Car's credit metrics, which will position it

comfortably in the current rating category.

What Could Change the Rating -- Up/Down

A further upgrade of Volvo Car's ratings to Ba1 would require evidence of robust performance over a prolonged period of time despite a fluctuating market environment mainly driven by a successful new product roll out as well as the successful execution of the US revival plan. More specifically an upgrade could occur should (1) adjusted EBITA margin increase materially above 6% and remain there on a sustainable level, (2) adjusted debt/EBITDA ratio maintained sustainably well below 2.0x and (3) Volvo Cars be able to generate a consistently positive and robust free cash flow.

The ratings of Volvo Car could come under pressure in case of deterioration of operational performance and consequently credit metrics evidenced by (1) an adjusted debt/EBITDA in excess of 2.5x, (2) an EBITA margin below 4x, (3) free cash flow turning negative for a prolonged period of time or (4) weakening in the company's liquidity profile.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Automobile Manufacturer Industry published in June 2011. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Gothenburg, Sweden, Volvo Car AB is a premium manufacturer of passenger cars. The company produces and markets sedans, station wagons and SUV vehicles under the Volvo brand. In the full year 2015, Volvo sold 503,127 vehicles through 2,300 dealers mostly across Europe, the US and Asia. The company generated approximately SEK164 billion in revenue and SEK6.6 billion in reported operating profit in 2015 (including the full contribution from the company's 50%-owned Chinese subsidiaries, fully consolidated since 2015).

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