

Stance  
**Overweight**

Country  
**Germany**

Industry Class  
**Automobiles**

Company  
**Volkswagen**

Date  
**26<sup>th</sup> February 2014**

Bloomberg  
**VOW GY**

Company Update

<b>Price</b>	<b>€185</b>
<b>Price Target</b>	<b>€203</b>
<b>52-week Range</b>	<b>€131.35 – 198.10</b>
<b>Dividend Yield</b>	<b>2.16%</b>
<b>P/E</b>	<b>9.93x</b>
<b>Market Cap</b>	<b>€86.8bln</b>

Events  
**FY13 official results out on 13/03/2014**

## Investment Thesis for Full Year 2014 (following the Company's update on 2013 f/s issued on 21.02.14)

Volkswagen is a dominant player in the automotive industry. Not only does the Group boast of first class brands in all categories but also in Western Europe, almost one in four new cars (24.4%) is made by the Volkswagen Group.

Our valuation is based on:

- **Higher revenues** – in line with our view of an improvement in global growth and increased new car registrations. We are forecasting revenue growth of 2.25%, 3.00% and 3.50% in 2014, 2015 and 2016 respectively. Demand for new passenger cars in the EU increased for the fifth consecutive month in January, with a rise of 5.5% in registrations. In January:
  - Most EU markets posted growth in registrations, as did all the major ones, from +7.6% in the UK and Spain, to +7.2% in Germany, +3.2% in Italy and +0.5% in France.
  - Demand for new commercial vehicles in the EU increased for the fifth consecutive month. Total commercial vehicle registrations grew by 4.7%, totalling 132,503 units.
- **Well diversified** - The Group comprises twelve brands from seven European countries: Volkswagen Passenger Cars, Audi, SEAT, SKODA, Bentley, Bugatti, Lamborghini, Porsche, Ducati, Volkswagen Commercial Vehicles, Scania and MAN. Each brand has its own character and operates as an independent entity on the market. The product spectrum ranges from motorcycles to low-consumption small cars and luxury vehicles. In the commercial vehicle sector, the products include ranges from pick-ups, buses and heavy trucks.
- **Less affected by forex than its competitors** – Being a dominant brand present in most countries worldwide, the Group sets up plants in many countries so revenues set off expenses in the same currency making the effect of forex movements less of a burden on the income statement of the Group. The Group operates 106 production plants in 19 European countries and a further eight countries in the Americas, Asia and Africa. The Volkswagen Group sells its vehicles in 153 countries.
- **Lower expenses** going forward due to the adoption of the 'Modular Toolkit System'. In 2013, VW began to implement its sophisticated and highly flexible platform with the deceptively simple label MQB, a German acronym for "modular transverse matrix." Virtually all of the group's small and medium front-wheel-drive family models are being designed around MQB as their base. We expect the positives from this new platform to be:
  - Unit costs reductions of c20%
  - Engineered hours per vehicle c30%
  - Significant weight and emission reduction
- **Competitive finance packages for customers** - On average, the cars sold by the Group are costlier than the average in each category. However, due to the strong balance sheet of the Group, they are able to borrow at lower rates than competitors in general and pass on this advantage to customers by offering them loans at very attractive rates.

- **Attractive Margins** – We are maintaining the margins obtained by the Group in 2013. Although we are not forecasting an improvement, the 2013 operating margin was attractive compared to the historical average and we see the company maintain or improve margins going forward.

**Furthermore;**

- Volkswagen announced a public offer to the shareholders of Scania AB to tender all shares in Scania to Volkswagen at a price of SEK 200 in cash per share. The shares in Scania are listed on NASDAQ OMX Stockholm.

## Group Strategy 2018

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1. Volkswagen intends to deploy intelligent innovations and technologies to become a world leader in customer satisfaction and quality.
2. The goal is to increase unit sales to more than 10 million vehicles a year; in particular, Volkswagen intends to capture an above-average share of the development of the major growth markets.
3. Volkswagen intends to increase its return on sales before tax to at least 8% so as to ensure that the Group's solid financial position and ability to act are guaranteed even in difficult market periods.
4. Volkswagen aims to become the top employer across all brands, companies and regions; this is necessary in order to build a first-class team.

## Positioning

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1. We position Volkswagen as a long term core holding.
2. We expect Volkswagen to outperform the auto sector over a 5-year investment horizon.

## Valuation

We start with our 1yr price target of €203 based on the assumption of sales growth of 2.25% in 2013, 3.00% in 2014 and 3.50% in 2015. The price target is calculated using an Earnings Based Model with a forward PE of 10x and an Equity Risk Premium of 9.28%.

€'mln	FY 2016F	FY 2015F	FY 2014F	FY 2013F*	FY 2012A
<b>Revenue</b>	<b>214,745</b>	<b>207,483</b>	<b>201,440</b>	<b>197,007</b>	<b>192,676</b>
Cost of Revenue	174,974	169,057	164,133	160,516	157,518
<b>Gross Profit</b>	<b>39,771</b>	<b>38,426</b>	<b>37,307</b>	<b>36,491</b>	<b>35,158</b>
Other Operating Revenue	5,369	5,187	5,036	4,500	4,238
Operating Expenses	31,567	30,500	29,612	30,000	28,086
<b>Operating Income</b>	<b>13,572</b>	<b>13,113</b>	<b>12,731</b>	<b>10,991</b>	<b>11,310</b>
Interest charges	2521.9	2395.8	2719.7	2,843	1,399
Foreign Exchange Losses (Gains)	-	-	-	-	(108)
Net Non-Operating Losses (Gains)	(3,670)	(3,681)	(3,724)	(4,280)	(15,474)
<b>Pretax Income</b>	<b>14,720</b>	<b>14,398</b>	<b>13,735</b>	<b>12,428</b>	<b>25,493</b>
Income Tax Expense	3,827	3,744	3,571	3,283	3,608
<b>Income Before XO Items</b>	<b>10,893</b>	<b>10,655</b>	<b>10,164</b>	<b>9,145</b>	<b>21,885</b>
Minority Interests	100.0	99.5	96.7	-79.0	168.0
<b>Net Income available to shareholders</b>	<b>10,793</b>	<b>10,555</b>	<b>10,067</b>	<b>9,224</b>	<b>21,717</b>
<b>Basic Weighted Avg Shares</b>	<b>486.0</b>	<b>486.0</b>	<b>486.0</b>	<b>486.0</b>	<b>467.6</b>
<b>Basic EPS</b>	<b>22.21</b>	<b>21.72</b>	<b>20.71</b>	<b>18.98</b>	<b>46.45</b>

\*Based on Volkswagen's statement on the 21.02.14

Source: Company's financial statements, Calamatta Cuschieri estimates

## Historical Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
VOW GY	26.02.2014	€185	€203	Team Coverage	Overweight

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