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Fiat: sales push on track despite weak Q2 results

Muted Q2 results should not harm credit quality but investors should ask how ambitious growth targets will be funded, says Jon Brager, Senior Analyst at Hermes Credit.

In Q2 Fiat Chrysler Automotive increased year-on-year revenue by 4.5% and its operating profit of €890m declined 13.5%, undershooting market estimates by 17%. Weaker performance in Latin America has compressed group operating margins from 4.6% to 3.8% in the past 12 months, but still outpaces those of Renault and Peugeot, at 1.9% and 1.1% respectively.

The results had a negligible impact on Fiat's overall credit profile. Net automotive leverage remained unchanged at 1.2x and free operating cash flow rose during the quarter from €303m to €592m. With \$18.7bn of cash and equivalents and a further \$3bn available through undrawn credit facilities, it has plenty of liquidity.

Its full-year guidance is unchanged: group shipments of "about 4.7m units" are expected, which would beat the amount sold in 2013 by 8.5%. It targets revenues "at or above €93bn" and EBIT "between €3.6 - 4.0bn" but the market remains sceptical, estimating 2014 EBIT of €3.4bn. To us, this pessimism implies a decent chance that Fiat will beat estimates in 2H14, which would clearly be positive for its bonds.

We expect Fiat to burn a lot of cash through 2015 to sustain the capex required to meet these ambitious growth targets, and how this funding gap will be filled remains a big question for bondholders. Sergio Marchionne, Fiat CEO, has hinted that issuance of mandatory convertible bonds, which automatically become equity upon maturity, "is a possibility". The instruments are not classified as debt, but any increase in capital – whether through a rights issue, preferred shares or convertibles – would be positive for senior bondholders.

Perhaps the biggest concern for creditors is recent press speculation of M&A talks between the controlling shareholders at Fiat, VW and Peugeot. Fiat has "categorically denied" any merger plans; however reports suggest the Agnelli family aims to sell some, or all, of its stake in Fiat but do not cite motives. Depending on the buyer, such an event could have profound implications for investors.

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Notes to Editors:

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