

## RATING ACTION COMMENTARY

# Fitch Affirms Ferratum at 'B+'; Outlook Negative

Thu 04 Mar, 2021 - 12:32 ET

Fitch Ratings - Frankfurt am Main - 04 Mar 2021: Fitch Ratings has affirmed Ferratum Oyj's (Ferratum) Long-Term Issuer Default Rating (IDR) at 'B+' with a Negative Outlook and the long-term rating of the senior unsecured notes issued by Ferratum Capital Germany GmbH (Ferratum Capital Germany) at 'B+' /RR4.

Ferratum is an online-focused consumer and SME finance company operating in the high-cost credit sector with an international footprint in 20 countries, including a strong presence in its domestic market of Finland. The company, which is listed on the prime standard segment of the Frankfurt Stock Exchange, also incorporates a Malta-domiciled bank (Ferratum Bank p.l.c., not rated) under its wider franchise.

## KEY RATING DRIVERS

### IDR

The Negative Outlook reflects Fitch's view that while near-term rating pressures arising from the Covid-19 pandemic in 2020 have somewhat abated, downside risk prevails over the short to medium term, particularly with respect to franchise resilience and asset quality strength. Fitch expects a gradual reduction in government support measures over the coming months across various key markets, resulting in a potential re-prioritisation of debt

servicing at consumer level as unemployment levels rise, placing pressure on key financial metrics (most notably asset quality, profitability and leverage).

Ferratum's business model is mainly based on the extension of credit to individual consumers via its online lending offering. This relatively capex-light business model has allowed the company to build-up diverse geographic coverage in recent years, focusing mainly on Central Europe but also other developing market economies globally (mainly conducted via local market partnerships). Although geographic expansion has historically been relatively opportunistic, a refinement in its operational strategy has seen an increased focus on market commonality of late, with the company exiting a number of unprofitable markets (most recently Poland, Russia, New Zealand and Canada).

While geographic diversification mitigates the exposure to interest rate caps (and ultimately margin pressure) in select markets, our company profile assessment remains weighed down by the risk of regulatory intervention, which we see as heightened in the current environment.

Following the onset of the Covid-19 pandemic in March 2020, the company notably tightened approval criteria for existing clients in an effort to protect its balance sheet, while also adopting a more selective stance towards new business. Fitch considers the company's underwriting response to the coronavirus pandemic as adequate in the context of its business model. The resilience of the risk management framework is likely to be tested over the short to medium term, as the company eases stringent underwriting measures adopted during 2020 to scale-up lending efforts and pursues SME business on an incrementally larger scale (which we generally consider more risky than online consumer loans).

Our assessment of Ferratum's asset quality recognises a higher base line level of loan impairments compared with commercial banks (four-year historical average: 36.6% of loans), largely due to the fact that the company focuses on consumers that fall outside the scope of traditional banks, increasing credit risk. Relative to Fitch's initial expectations at the onset of the Covid-19 pandemic, Ferratum's asset quality held up reasonably well, with the loan impairment ratio rising to 41.6% as at end-3Q20. Management considers the current environment to have stabilised sufficiently to pursue loan extensions under more normalised approval parameters. However, we still see some downside risk to asset quality over the short term arising from impairment vulnerabilities.

Leverage remains elevated, with the gross debt to tangible equity ratio at 6.6x at end-3Q20. This was a deterioration relative to Ferratum's pre-pandemic leverage level (5.5x as at year-end 2019), but leverage during the crisis has trended somewhat below Fitch's initial base

case projection of 8x (peak leverage through the crisis: 1H20: 7.5x). In the absence of any extraordinary capital support, Ferratum's ability to de-leverage over the short to medium term will depend on its ability to profitably grow the balance sheet, which we consider as challenging in view of the relatively weak macroeconomic backdrop in most of its key markets.

Earnings generation for 2020 was negatively affected by both a tightening in approval criteria (leading to lower loan originations and fee revenues) as well as the exiting of unprofitable markets. Coupled with a rise in loan impairments, pre-tax profits notably reduced in 3Q20 to EUR2 million (from EUR20 million in 3Q19), although for the full year 2020 we expect Ferratum to have remained marginally profitable. Over the near term, we anticipate improved revenue generation (albeit still trailing pre-pandemic levels). However, in our view, the risk of earnings weakness (and curtailed capital accumulation capabilities) prevails given the ongoing risks to asset quality.

Ferratum benefits from a largely unsecured funding profile, comprising mainly online bank deposits and senior unsecured bonds. While we note the shoring up of the deposit book and extension of term maturities during the pandemic, our funding assessment at group level remains weighed down by the limited fungibility of funds across the group as well as the comparatively less sticky nature of these deposits compared with traditional banks.

Liquidity is adequate (EUR267 million cash buffer at end-3Q20), but the bulk of these funds are held with the Maltese Central Bank for regulatory compliance purposes, with free liquidity being more limited. The bonds issued by Ferratum Capital Germany (EUR180 million outstanding) mature in 2022 (EUR100 million) and 2023 (EUR80 million), which implies limited refinance risk over the short term.

## SENIOR UNSECURED NOTES

Ferratum Capital Germany's senior unsecured bonds are rated in line with Ferratum's Long-Term IDR because Ferratum acts as the guarantor of the bond issuance. The rating alignment reflects Fitch's expectation of average recovery prospects of the senior unsecured bonds, reflected in the assigned 'RR4' Recovery Rating. The bonds constitute a direct and unsecured senior obligation of Ferratum Capital Germany and rank pari passu with all present and future senior unsecured obligations of the issuer.

Ferratum has an ESG Relevance Score of '4' for Exposure to Social Impacts and Customer Welfare stemming from a business model focused on high-cost consumer lending and hence exposure to shifts of consumer or social preferences and to increasing regulatory scrutiny. This has a moderately negative influence on the rating in terms of impact on the pricing strategy, product mix, and targeted customer base and is relevant to the ratings in conjunction with other factors.

## **RATING SENSITIVITIES**

### **IDR**

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A significant increase in leverage measured as debt to tangible equity above 8x;
- A weaker franchise, arising from a sustained loss in revenue/operational losses, an adverse reputational event, or a significant tightening of regulatory requirements in key markets resulting in a significant loss of business or notable margin pressure could result in a downgrade;
- Increased risk appetite leading to higher credit losses as the product mix evolves toward larger and longer-term origination (such as SME loans), notably if combined with looser provisioning standards, pressuring profitability and ultimately eroding Ferratum's capital base;
- Signs of funding weakness in the form of a loss of retail deposits at Ferratum Bank or a loss of wholesale funding market access leading to higher refinancing risk;
- Any sustained adverse operational developments at the Ferratum Bank level (either of a regulatory nature or with regard to customer confidence), thereby impacting the company's ability to effectively leverage its banking subsidiary as a market-facing financial services provider;
- The growth of Ferratum Bank in comparison with the rest of the group leading to increased structural subordination risk for wholesale creditors outside the bank

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Materially lower leverage approaching 5x on a sustained basis;
- A demonstrated franchise resilience through improved scale and pricing power without a marked increase in risk appetite.
- A stabilisation in the operating environment, in turn translating to business model stability, better franchise entrenchment and asset quality improvements.

## SENIOR UNSECURED NOTES

The senior unsecured notes' rating is primarily sensitive to changes in Ferratum's Long-Term IDR. Changes to Fitch's assessment of recovery prospects for senior unsecured debt in default (e.g. the introduction of debt obligations ranking ahead of the senior unsecured debt notes) could also result in the senior unsecured notes' rating being notched below the IDR.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>]

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Ferratum Oyj: Exposure to Social Impacts: 4, Customer Welfare - Fair Messaging, Privacy & Data Security: 4

Ferratum has an ESG Relevance Score of 4 for Exposure to Social Impacts as a result of its exposure to the high-cost consumer lending sector. As the regulatory environment evolves (including a tightening of rate caps), this has a moderately negative influence on the rating in terms of our assessment of Ferratum's business model.

Ferratum has an ESG Relevance Score of 4 for Customer Welfare, which arises in particular in the context of fair lending practices, pricing transparency and the potential involvement of foreclosure procedures as part of its focus on the high-cost consumer credit segment. This has a moderately negative influence on the rating in terms of our assessment of risk appetite and asset quality.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

RATING ACTIONS

ENTITY/DEBT	RATING			RECOVERY		PRIOR
Ferratum Oyj	LT	B+	Rating Outlook Negative	Affirmed		B+ Rating Outlook Negative
	IDR					
Ferratum Capital Germany GmbH						
● senior unsecured	LT	B+		Affirmed	RR4	B+

VIEW ADDITIONAL RATING DETAILS

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## **APPLICABLE CRITERIA**

[Non-Bank Financial Institutions Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

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