FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Ferratum to B+/Negative on Coronavirus Disruption

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Fitch Ratings - Frankfurt am Main - 03 Apr 2020: Fitch Ratings has downgraded Ferratum Oyj's (Ferratum) Long-Term Issuer Default Rating (IDR) and the Long-Term Rating of senior unsecured notes issued by Ferratum Capital Germany GmbH (Ferratum Capital Germany) from 'BB-' to 'B+'/RR4 on increasing coronavirus-related risks. The Outlook on Ferratum's Long-Term IDR is Negative.

Ferratum is an online-focused consumer finance company operating in the high-cost credit sector with an international footprint in over 20 countries, including a strong presence in its domestic market of Finland.. The company is listed on the prime standard segment of the Frankfurt Stock Exchange and also incorporates a Malta-domiciled bank (Ferratum Bank p.l.c.) under its wider franchise.

KEY RATING DRIVERS

IDR

The downgrade primarily reflects coronavirus-related pressures on Ferratum's business and financial profile. In particular, Ferratum's revenue generation, notably interest income, will in Fitch's view in the short term come under pressure from suppressed consumer confidence and government-initiated customer relief measures (such as payment holidays). Given its focus on sub-prime or near-sub-prime unsecured lenders, we also expect distressed borrower credit profiles to lead to higher loan impairment charges negatively affecting operating profitability. We also see increased downside risk for Ferratum's Company Profile assessment, particularly pertaining to its ability to attract business flows and sustain franchise strength across its numerous markets in the current environment. As a result, Fitch's assessment of Ferratum's Company Profile (which was previously identified as an important factor for the rating outcome) is no longer commensurate with Ferratum's previous 'BB-' rating.

The Negative Outlook reflects Fitch's view that while short-term rating pressures are now limited at Ferratum's current rating level, downside risk in the medium-term persists, in particular if the deterioration of Ferratum's revenue base and asset quality materially exceeds Fitch's base case.

Under Fitch's base case, we have assumed a sharp reduction in new loan volumes both as a result of weakening consumer appetite and because of more challenging conditions in Ferratum's funding markets. We have also assumed a moderate increase in impairment charges (in absolute terms) and a significant reduction in both staff and other operating expenses reflecting cost reduction measures which are to some extent supported by government furlough measures. Based on these assumptions, Fitch sees increased downside risk to Ferratum's profitability and capitalisation, in particular if lockdown measures extend beyond 2Q20.

Ferratum's leverage was high even before the onset of the coronavirus pandemic (gross debt/tangible equity: 5.5x as at year-end 2019) and the coronavirus-related dislocation exacerbates leverage downside risks in Fitch's view. In its recent rating review of Ferratum earlier this year, Fitch cited a gross debt-to-tangible equity ratio of 6x as a downward rating trigger for leverage. While gross leverage at FYE19 remained within the stipulated range (at 5.5x), Fitch anticipates gross leverage to increase notably over the near term (to around 8x based on Fitch' base case assumptions described above), with earnings pressure constraining internal capital generation. Ferratum's ability to de-leverage after the crisis will depend on its ability to grow the balance sheet profitably in a post-stress environment, which Fitch considers challenging in the current environment without easing current prudent underwriting standards.

However, Ferratum has adopted a number of corrective measures to limit the business impact of the coronavirus challenges. These measures include a tightening in underwriting standards (aimed at curbing loan impairments), as well as a focused improvement of its deposit offering in its banking subsidiary (targeted at enhancing deposit stickiness and funding stability).

Ferratum's liquidity profile is in Fitch's view adequate for its rating level and benefits from a EUR155 million cash buffer (at end-2019) and no near-term upcoming wholesale funding maturities. Ferratum has a largely unsecured funding profile (which Fitch views positively), mainly comprising bank deposits (EUR242 million at end-2019) and senior unsecured bonds (EUR180 million at end March 2020). While the bonds have long-term maturities (three to four years), online deposits are mostly shorter-term. In our view, these are less reliable than traditional retail deposits (particularly in periods of market stress). However, the company has some discretion with rate setting, which supports liquidity management.

SENIOR UNSECURED NOTES

Ferratum Capital Germany's senior unsecured bond is 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 bond, reflected in the assigned 'RR4' Recovery Rating. The bond constitutes a direct and unsecured senior obligation of Ferratum Capital Germany and ranks pari passu with all present and future senior unsecured obligations of the issuer.

RATING SENSITIVITIES

KEY 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 and/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 on 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 on a sustained basis, if combined with an enhanced and more resilient franchise;

- A strengthening in the franchise through improved scale and pricing power without a marked increase in risk appetite.

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

Ratings of Financial Institutions 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 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 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 and the increasing levels of regulatory scrutiny, including tightening of interest rate caps. The evolving regulatory environment has had direct impact on Ferratum's business model including the pricing strategy, product mix, and targeted customer base.

RATING ACTIONS

ENTITY/DEBT	RATING			RECOVERY
Ferratum Oyj	LT IDR	B+	Downgrade	RR4

ENTITY/DEBT	RATING			RECOVERY
Ferratum Capital Germany GmbH				
• senior unsecured	LT	B+	Downgrade	RR4

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

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

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Ferratum Capital Germany GmbH	EU Issued
Ferratum Oyj	EU Issued

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Non-Bank Financial Institutions   Europe   Germany   Finland