FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Ferratum's Subordinated Hybrid Notes 'B-(EXP)'

Thu 10 Jun, 2021 - 03:13 ET

Fitch Ratings - Frankfurt am Main - 10 Jun 2021: Fitch Ratings has assigned Ferratum Oyj's (Ferratum) proposed new issuance of subordinated hybrid perpetual capital notes an expected rating of 'B-(EXP)'/RR6. Fitch has also affirmed Ferratum's Long-Term Issuer Default Rating (IDR) of 'B+' with a Negative Outlook and the long-term debt rating assigned to the senior unsecured notes issued by Ferratum Capital Germany GmbH (Ferratum Capital Germany) at 'B+/RR4'.

The rating of the planned subordinated issue with an indicative size of between EUR30 million to EUR50 million is notched down twice from Ferratum's 'B+' Long-Term IDR.

The assignment of a final rating is contingent on the receipt of final documents conforming to information already received.

Feedback

KEY RATING DRIVERS

Fitch has notched the subordinated perpetual hybrid callable notes twice from Ferratum's Long-Term IDR as the notes will represent subordinated obligations of the company, which rank junior to any present or future claims in respect of all unsubordinated obligations and subordinated indebtedness of the company. The notching also recognises Fitch's expectation of zero recovery prospects for the subordinated notes, which corresponds to a recovery rating of 'RR6'.

Ferratum is an online-focused consumer and SME finance company operating in the high-cost credit sector with an international footprint in 19 countries, including a strong presence in its domestic market, 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., not rated) under its wider franchise.

Ferratum's Long-Term IDR reflects its concentrated business model and evolving franchise as a predominantly pan-European online-focused, specialised consumer lender in a niche market segment, which remains exposed to an evolving regulatory landscape in most of its key target markets. The rating also takes into account Ferratum's elevated leverage profile, generally sound (albeit recently weakened) profitability and inherent asset quality risk arising from its focus on high-cost consumer lending.

The Negative Outlook on Ferratum's Long-Term IDR 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.

The proceeds of the new subordinated hybrid notes will principally be used for general corporate purposes. This includes the potential re-financing of any upcoming bond maturities at Ferratum Capital Germany (its wholly owned subsidiary), which currently has EUR180 million in unsecured notes outstanding (earliest maturity: EUR100 million in May 2022).

Fitch has assigned no equity credit to the planned issue due to a significant coupon step-up within five years (indicatively 450bp), which notably exceeds Fitch's stipulated aggregate coupon step-up threshold of 100bp. In Fitch's view, this implies a strong incentive for the issuer to exercise its right to call, which in turn limits the permanence and loss absorption capacity of the issuance on a sustained basis.

Proforma for the planned issue, Fitch expects balance sheet leverage (gross debt to tangible equity) to increase moderately on a post-transaction basis, but remaining within our stated negative rating trigger of 8x on a sustained basis. Assuming that issue proceeds are used for the refinancing of existing debt (i.e. bonds issued by Ferratum Capital Germany), the transaction would be leverage neutral.

For 1Q21, the company reported a small EUR0.6 million pre-tax profit (1Q20: EUR8.3 million pre-tax loss), supported by the tightening of its underwriting criteria during the Covid-19 pandemic as well as dedicated cost containment efforts. While the planned issue could result in increased finance charges (subject to final pricing and the use of proceeds), the net impact on profitability (and also debt servicing) should be reasonably well contained given the limited size of the planned of issue.

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

SUBORDINATED NOTES

The subordinated notes' expected rating is primarily sensitive to changes in Ferratum's Long-Term IDR.

Changes to Fitch's assessment of going concern loss absorption or recovery prospects for subordinated debt in a default scenario (e.g. the introduction of features resulting in easily activated going concern loss absorption or a permanent write-down of the principal in wind-down) could also result in a widening of the notching for the subordinated notes' rating to more than two notches below Ferratum's Long-Term IDR.

LONG-TERM IDR

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

- A significant increase in leverage measured as gross 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;

- Increased structural subordination risk for wholesale creditors outside the bank or a marked increase in group liabilities outside Ferratum Bank if it leads to materially lower debt serviceability at parent company level.

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 into business model stability, better franchise entrenchment and asset quality improvements.

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

RATING ACTIONS

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Ferratum Oyj					
• subordinated	LT	B-(EXP)	Expected Rating	RR6	
Ferratum Capital Germany GmbH					

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ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	LT	B+	Affirmed	RR4	B+

VIEW ADDITIONAL RATING DETAILS

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Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

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

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Ferratum Capital Germany GmbH	EU Issued, UK Endorsed
Ferratum Oyj	EU Issued, UK Endorsed

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Non-Bank Financial Institutions Europe Germany Finland

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