FitchRatings

RATING ACTION COMMENTARY

Fitch Publishes Volkswagen Financial Services AG's 'A-' IDR; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 26 Jan 2024: Fitch Ratings has published Volkswagen Financial Services AG's (VWFS) Long-Term Issuer Default Rating (IDR) of 'A-'. The Outlook is Stable. A full list of rating actions is below.

KEY RATING DRIVERS

Support-Driven Ratings: VWFS's ratings are driven by an extremely high probability of support from its ultimate shareholder, Volkswagen AG (VW; A-/Stable), the leading global car manufacturer. This is reflected in VWFS's Shareholder Support Rating of 'a-'. The Stable Outlook on VWFS's Long-Term IDR is aligned with that on VW's Long-Term IDR.

Fitch does not assign VWFS a standalone credit profile score because its franchise is highly correlated with that of its parent and there is a high level of financial, operational and management integration with the parent, reflected by, among other things, the current control and profit-and-loss transfer agreement between VWFS and VW.

Core Subsidiary, Highly Integrated: Fitch views VWFS as a core subsidiary of VW because of its central role in supporting VW's strategic objectives, the huge reputational impact a default of VWFS would have on VW in our view, high levels of integration and the extensive record of ordinary and extraordinary support provided by VW in the past.

VWFS is fully owned and similarly branded as VW and has a long and successful record of supporting group sales as the key platform of VW's mobility solutions offering. VWFS's penetration rate (VWFS contracts/VW car sales), excluding China where penetration rates are materially lower for all car manufacturers, was 46% at end-2022 (46% at end-1H23), which is broadly in line with peers and emphasises VWFS's importance for VW.

Support Unaffected by Planned Reorganisation: To optimise funding access for its European financial services division, VW plans to transfer ownership of VW Bank GmbH (not rated) to a new ECB-supervised intermediate holding company, which will also become the direct or indirect owner of other Europe-focused financial services entities (including the sizeable Volkswagen Leasing GmbH that is currently owned by VWFS). VWFS will reduce in size and be renamed Volkswagen Financial Services Overseas AG (VWFS Overseas) to become the main intermediate holding company of VW's financial services activities outside Europe and North America, with material credit exposures in China and Brazil among other markets.

VWFS's current control and profit-and-loss transfer agreement will remain in place. Fitch does not believe that the planned reorganisation, which management expects to be largely implemented by mid-2024, will lead to a material reduction in VWFS's importance for VW, as reflected in the Stable Outlook on VWFS's Long-Term IDR. After the reorganisation VWFS Overseas will be materially smaller and its average penetration rate will drop, but in our view it will remain central in supporting business growth in a number of VW's core growth markets.

Sound Asset Quality: At end-1H23, around 65% of VWFS's EUR138 billion assets related to customer loans and receivables, of which around a third related to operating lease exposure, exposing VWFS to direct residual value (RV) risk. Credit risk is well-managed, supported by the secured nature of company's exposures, as well as the sound risk framework and granular portfolio. VWFS's impaired receivables ratio (stage 3/total financial assets) has been consistently low (around 1.1% at end-2022) and its credit loss ratio remained below 0.5% in 2022 and 1H23.

Well-Managed RV Risk: VWFS has a good record of managing RV risks, reflected in positive net used car sales results, which have been particularly strong recently due to high used car prices. We expect used car prices to reduce in 2024, but do not expect VWFS to report RV-related losses, reflecting generally prudent RV risk-setting. VWFS is exposed to moderate interest rate risk (controlled by a value-at-risk model), but its appetite for foreign exchange (FX) risk is low, with management hedging all FX cash flows with currency forwards or cross-currency interest rate swaps.

Sound Profitability to Moderate: VWFS's profitability is sound, reflected in a pre-tax income/average assets ratio averaging around 1.8% in the last four financial years, which equates to a 'bb' implied earnings and profitability score for finance and leasing companies operating in a 'bbb' sector risk operating environment. In 2024, higher interest expenses and a reduced net car sales result will weigh on VWFS's profitability, but we expect profitability to remain sound, supported by higher financing and leasing income and the implementation of VWFS's cost-saving programme.

Parental Support Allows High Leverage: VWFS's leverage ratio, defined as gross debt/tangible equity, is higher than that of comparable independent finance companies and was 6.3x at end-1H23 (end-2020: 7.9x). However, VWFS's leverage profile is supported by its sound earnings profile and the control and profit-and-loss agreement with VW. We believe VW will and is able to provide material capital support to VWFS, if ever required, without impairing its own rating.

Solid Funding Profile: VWFS sources a significant proportion of its funding from global asset-backed securities (ABS) markets (25% of total debt), with its unsecured/total debt ratio averaging around 74% in the last four years. Funding sources also include bank loans (16% of total debt), customer deposits (25%) and notes (56%, including ABS). Around 23% of VWFS's liabilities at end-2022 were from related parties including VW and other affiliate entities. VWFS has access to a committed liquidity facility from VW, which in our view would be accessible should the company require liquidity backup.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Any negative rating action on VW would likely be mirrored in VWFS's ratings and Outlook.

A weakening of VW's propensity to support VWFS, for instance, due to VWFS becoming less central to VW's overall mobility services strategy, could lead to Fitch notching VWFS's Long-Term IDR from VW's Long-Term IDR, which would result in a downgrade. In particular, consistently below sector-average penetration rates or a transfer of business activities to other financial services entities beyond the current reorganisation plan could indicate reduced relevance of VWFS for VW.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

As VWFS's ratings are equalised with VW, any positive rating action on VW would likely be mirrored in VWFS's ratings and Outlook.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

VWFS's Long-Term IDR is driven by VW's Long-Term IDR.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		
Volkswagen Financial Services AG	LT IDR	A- Rating Outlook Stable	Publish
	ST IDR	F1	Publish
	Shareholder Support	a-	Publish

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Ilya Makunin
Associate Director
Primary Rating Analyst
+49 69 768076 169
ilya.makunin@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Markus Glabach
Director
Secondary Rating Analyst
+49 69 768076 195
markus.glabach@fitchratings.com

Aslan Tavitov
Senior Director
Committee Chairperson
+44 20 3530 1788
aslan.tavitov@fitchratings.com

MEDIA CONTACTS

Matthew Pearson
London
+44 20 3530 2682
matthew.pearson@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria (pub. 17 Jan 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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