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Research Update:

Dutch Bank LeasePlan Outlook Revised To Positive On Robust Operating Performance; 'BBB-/A-3' Ratings Affirmed

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Overview

- We expect LeasePlan Corp. will remain focused on its current strategic targets, which have already shown supportive results, including improving earnings and lower credit losses than peers'.
- We believe this will likely support stronger consolidated capitalization, help reduce double leverage at the ultimate holding company, and further improve financial flexibility.
- We are therefore revising our outlook on LeasePlan to positive from stable, while affirming our 'BBB-/A-3' ratings on LeasePlan and our 'BB+' rating on intermediate nonoperating holding company Lincoln Financing Holdings PTE Ltd.
- The positive outlook on LeasePlan indicates that we could raise the ratings during the next 24 months if, combined with a solid credit loss track record, we continue to observe a stable risk appetite, satisfactory profitability, and robust financial resources.
- The stable outlook on Lincoln reflects our view that double leverage will continue to reduce, albeit remaining relatively high over the next 12 months.

Rating Action

On Nov. 28, 2017, S&P Global Ratings revised its outlook on The Netherlands-based LeasePlan Corporation N.V. to positive from stable. The 'BBB-/A-3' long- and short-term issuer credit ratings were affirmed.

At the same time, we affirmed our 'BB+' long-term issuer credit rating on Lincoln Financing Holdings PTE Ltd. The outlook remains stable.

Rationale

We believe LeasePlan will achieve more robust operating performance, supporting its earnings prospects and profitability. After a period of uncertainty following a change in ownership, we think the group's revised strategy, which is to focus on solidifying its position in its core markets and improving its efficiency, reduces the risk of more aggressive or acquisitive growth. We also believe this strategic focus supports the group's current profitable business model and internal capital generation. In our view, this could enhance the group's financial flexibility, currently constrained by high double leverage at the ultimate holding company, and gradually strengthen its consolidated capital position.

Our analysis of LeasePlan captures the broader group to which it belongs. Based on the group structure, we determine a group credit profile (GCP) of 'bbb-'. The GCP is not a rating, but a component of a rating that represents our opinion of a group's creditworthiness as if it were a single legal entity. Our GCP includes LeasePlan and its operating subsidiaries, LeasePlan Group B.V., and the various debt-issuing intermediate holding companies between LeasePlan and its shareholder consortium (see "LeasePlan Corporation N.V.," published July 6, 2017, on RatingsDirect). LeasePlan is by far the largest member of the group, contributing close to 100% of the consolidated group assets. We therefore view it as integral to the group and equalize the issuer credit rating on LeasePlan with the GCP.

In the six months to June 30, 2017, LeasePlan reported an underlying return on equity of 18.5%, up from 16.4% for the same period in 2016. Its underlying net income of €291.7 million, which was up 18% and excludes net one-time costs of €17 million, was supported by growth in gross profit from lease income and vehicle sales (+4%) and higher net interest income (+5%), partly offset by an uptick in operating expenses (+2%). This primarily reflects the group's strategic focus on improving efficiency, including by moving to a centralized operating model, and rationalizing its operations across more than 30 countries. By our measures, the group's cost-to-income ratio, calculated as noninterest expenses to operating revenues, reduced to 51% at midyear 2017 from 61% at year-end 2016. Combined with controlled organic growth of its fleet, continued gains from vehicle remarketing, and stable credit quality, we expect the group's strategy will continue to support its earnings capacity and profitability over the next two years.

In turn, consistent profitability will benefit internal capital generation, which may gradually strengthen its relatively weak financial flexibility. We believe the group's financial flexibility is weaker than that of typical banking peers, as a result of high double leverage (calculated as holding company investment in subsidiaries divided by holding company shareholders' equity).

On a consolidated basis, the group's capitalization is weaker than that of LeasePlan, whose stand-alone risk-adjusted capital (RAC) ratio was 9.1% on Dec. 31, 2016. We expect the ratio will remain at 9.0%-9.5% over the next two years, close to the upper limit for an adequate capital assessment. Our RAC ratio is lower than in previous years, since we changed how we capture exposure to residual value risk on the operating lease portfolio, based on our updated methodology published in July this year. Previously, we captured this risk qualitatively within our risk position assessment. We believe the group will continue its sound management of residual value risk, which has limited historical losses and supported the more recent profitability from the sale of used vehicles. We also acknowledge that the absence of dividends outside the consolidated group has supported the consolidated group's capitalization through retained earnings and reduced double leverage.

We base our rating on Lincoln on our view of it as a nonoperating holding company. We currently maintain a one-notch gap between our rating on Lincoln and our rating on LeasePlan to reflect Lincoln's reliance on dividends to meet its obligations. There is no further notching for structural subordination, since we consider that potential regulatory barriers to cash flows will exist only between LeasePlan as an operating company and LeasePlan's holding company, LP Group B.V. (The Netherlands). We do not consider that there will be further potential barriers to cash flows beyond LeasePlan Group B.V. to Lincoln.

We estimate that double leverage at Lincoln will remain above 120% over the next 12 months compared with just above 150% at present. Lincoln's cash interest coverage currently supports debt-servicing capacity and there is no short-term debt. However, Lincoln's liquid assets do not cover the absolute amount of double leverage, which could strain its liquidity over the medium term, especially since its cash inflow relies on ongoing profitability at LeasePlan and the regulator's approval of dividends. We believe these risks are consistent with our rating on Lincoln, with limited rating upside.

Outlook

The positive outlook on LeasePlan reflects our view that the group's stable strategy will support its earnings capacity and capital building, and contribute gradually to the reduction of double leverage at the ultimate holding company level.

We could raise our ratings on LeasePlan in the next 24 months if, combined with a prolonged track record of lower credit losses than peers, we continue to observe a stable risk appetite, satisfactory profitability, and financial capacity to reduce the currently high double-leverage ratio to below 120%.

We could revise the outlook to stable if LeasePlan's operating performance deteriorates or its capital position weakens. This could result from acquisitive growth that entails increased leverage, or a material upstreaming of dividends to the group's ultimate shareholders.

The stable outlook on Lincoln reflects our view that double leverage will continue to reduce and debt servicing will remain supportive. However, over the next 12 months, we believe that double leverage will remain relatively high, thereby potentially constraining Lincoln's liquidity.

We could lower the ratings in the next 12 months if we observe an increase in double leverage, for example following further debt issuance at Lincoln, or if Lincoln's debt-servicing capacity reduces.

We consider an upgrade of Lincoln to be unlikely in the next 12 months. However, we could raise the ratings if Lincoln's liquidity strengthens beyond our current expectations, or if double leverage diminishes to levels that reduce the potential liquidity risk for Lincoln.

Ratings Score Snapshot

LeasePlan Corporation N.V.

	To	From
Issuer Credit Rating	BBB-/Positive/A-3	BBB-/Stable/A-3
SACP	bbb-	bbb-
Anchor	bbb+	bbb+
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Adequate (0)	Strong (+1)
Risk position	Adequate (0)	Moderate (-1)
Funding and Liquidity	Below average and Adequate (-1)	Below average and Adequate (-1)
Support	(0)	(0)
ALAC	(0)	(0)
GRE	(0)	(0)
Group	(0)	(0)
Sovereign	(0)	(0)
Additional factors	(0)	(0)

ALAC--Additional loss-absorbing capacity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- LeasePlan Corporation N.V., July 6, 2017

Ratings List

Ratings Affirmed; Outlook Action

	To	From
LeasePlan Corporation N.V.		
Counterparty Credit Rating	BBB-/Positive/A-3	BBB-/Stable/A-3
Senior Unsecured	BBB-	BBB-
Commercial Paper (1)	A-3	A-3

Ratings Affirmed

LeasePlan Australia Ltd.	
Senior Unsecured (2)	BBB-
Lincoln Financing Holdings PTE Ltd.	
Counterparty Credit Rating	BB+/Stable/--
Lincoln Finance Ltd.	
Senior Secured (3)	BB+

(1) Co-issued by LeasePlan Australia Ltd., LeasePlan Finance N.V. (Dublin Branch), and LeasePlan New Zealand Ltd. (2) Guaranteed by LeasePlan Corporation N.V. (3) Guaranteed by Lincoln Financing Holdings PTE Ltd.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.