

Research Update:

# Dutch Bank LeasePlan Affirmed At 'BBB-/A-3' On Solid Capital Base And Resilient Revenues; Outlook Stable

December 5, 2019

## Overview

- We believe Netherlands-based bank LeasePlan Corp. continues to display solid operating performance in most markets where it operates, while it executes its medium-term growth strategy.
- The issuance of an additional Tier 1 instrument and a predictable dividend policy contribute to capital strengthening, but this does not change our view on the bank's solvency.
- LeasePlan still displays high double leverage, considering debt instruments issued by the intermediate holding companies being serviced via earnings generated at the operating company level, which limits the group's financial flexibility.
- We are affirming our 'BBB-/A-3' ratings on LeasePlan and our 'BB+' rating on intermediate nonoperating holding company Lincoln Financing Holdings PTE Ltd (LFHP), while maintaining our stable outlooks.

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## Rating Action

On Dec. 5, 2019, S&P Global Ratings affirmed its 'BBB-/A-3' long- and short-term issuer credit ratings on the Netherlands-based LeasePlan Corporation N.V. The outlook is stable.

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

The 'BB+' long-term issue ratings on the senior secured notes issued by Lincoln Financing S.a.r.l. and guaranteed by LFHP were also affirmed.

## Rationale

We believe LeasePlan will continue to benefit from good prospects in markets where it operates and keep on expanding its revenue base. This is supported by the bank's continuing business diversification across the car leasing business, from car leasing origination to corporate and retail clients, car maintenance and insurance, to the sale of used vehicles (through CarNext.com).

LeasePlan will likely maintain a robust capital position, thanks to resilient revenue generation, strengthening of core capital with issuance in May 2019 of a €500 million additional tier 1 (AT1) capital instrument, and a predictable and conservative dividend policy. However, this improvement is insufficient at this stage to change our overall assessment of its solvency.

The bank's common equity tier 1 (CET 1) ratio stood at 17.8% and the Tier 1 ratio at a high 20.6% as of Sept. 30, 2019. Our risk-adjusted capital (RAC) metric, which stood at 9.2% at year-end 2018, would have been close to 10.8% pro forma the €500 million AT1 issuance. We now expect the RAC ratio to remain in the 9.75%-10.25% range in the next two years, assuming:

- Resilient revenue growth and an increase of operating expenses to cater for business growth and digital transformation, leading to net income of around €450 million in 2020-2021.
- Resilient asset quality indicators and adequate management of residual value risk.
- A dividend pay-out ratio of 60% and no exceptional dividends.

Whereas revenue generation appears resilient, LeasePlan's bottom line performance has shown some volatility due to exceptional items. In 2018, LeasePlan made a €132 million pretax impairment charge in relation to its exposure to asset risks in Germany and Turkey. Then, in early 2019, it charged off €92 million with respect to its legacy IT system and other continuing investments in its two main activities, Car-as-a-Service and CarNext.com. This compares with a reported net result of €423.6 million for the full year of 2018 and €288 million for the first nine months of 2019.

We note management's intention to better segregate CarNext.com's activities and disclosures, and explore strategic options for this perimeter, including a full or partial separation from the group. In our base case, we cannot exclude that additional investments in business development will again weigh on LeasePlan's net results.

Although we expect LeasePlan to maintain a supportive capital policy, our combined assessment of its capital, earnings, and risk position remains neutral for the rating. In particular, we believe the material amount of debt issued by various intermediate holding companies constrains LeasePlan's financial flexibility, and therefore our ratings. Assuming LeasePlan's profitability, remains broadly in line with the 2018 results, and it keeps a 60% pay-out ratio, we don't envisage additional pressure on our ratings on LeasePlan over the next two years.

Our view on the materiality of double leverage, aiming to capture the issuance of holding company debt, is informed by several measures, in line with our group rating methodology. In particular, we compare the group's investment in LeasePlan (numerator), its main asset, with the equity base of Lincoln Topco Pte. Ltd. (denominator), which is at the highest level in the group structure. At about 190% as of June 30, 2019, the corresponding ratio appears elevated versus our materiality threshold of 120%. We also consider the comparison between the nominal amount of double leverage in the group structure, and LeasePlan's net income. We estimate the nominal amount of double leverage currently stands at about €2.15 billion following the issuance earlier this year of €1.35 billion of senior secured notes rated 'BB+', and a €796 million hybrid notes (not rated) with interest capitalized at 12% per annum. These instruments were issued to refinance debt to

finance the acquisition of LeasePlan in 2016 by a consortium of international investors. We note that the nominal amount of double leverage represents more than 4x LeasePlan's annualized net income, which is very high.

We base our rating on LFHP on our view of it as an intermediate nonoperating holding company. We currently maintain a one-notch gap between our rating on LFHP and our rating on LeasePlan to reflect LFHP'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.

We consider LeasePlan's revenue generation sufficient to service debt in the short to medium term, and that there is no repayment risk in the next two years, given the maturity profile of debt instruments issued by the holding companies and the absence of short-term debt at the holding company level. Therefore, for the moment, we do not widen the rating gap between LFHP and LeasePlan. However, we note that Lincoln's liquid assets do not cover a material part of double leverage. Moreover, given the hybrid notes' capitalization of interest, double leverage will continue to increase, absent management's actions. In our base case, we expect stakeholders will take actions to address this situation in the coming quarters.

## **Outlook**

### **LeasePlan**

The stable outlook on LeasePlan reflects our view that the group's ongoing growth strategy will continue to support its earnings capacity and capital building. This could help reduce double leverage, but it will remain a rating constraint. We also expect LeasePlan's credit risk metrics will remain broadly supportive of the current rating. We also expect that the postponement of the IPO announced in October 2018 will not result in a more aggressive financial policy or risk appetite.

**Downside scenario** We could lower our rating if LeasePlan's operating performance deteriorates significantly because of asset quality issues, which could put pressure on the group's ability to reduce double leverage. We could also lower the rating if LeasePlan's 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.

**Upside scenario** An upgrade is remote in our view, as long as double leverage remains elevated. We could raise our ratings on LeasePlan in the next 24 months if, combined with a prolonged track record of low credit losses and controlled residual value risk, we continue to observe a stable risk appetite, satisfactory profitability, strengthening balance sheet, and financial capacity to service debt obligations higher up in the group structure.

### **Lincoln Financing Holdings**

The stable outlook on LFHP reflects our view that double leverage will remain elevated in the next 12 months, absent any specific management action to redeem debt issued at intermediate holding companies, but that debt servicing will continue.

**Downside scenario** We could lower the ratings in the next 12 months if we observe double leverage keeps increasing, for instance because total debt repayment risk is rising or debt-servicing capacity is reducing.

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

## Ratings Score Snapshot

<b>LeasePlan Corporation N.V.</b>	
Issuer credit rating	BBB-/Stable/A-3
SACP	bbb-
Anchor	bbb+
Business position	Moderate (-1)
Capital and earnings	Adequate (0)
Risk position	Adequate (0)
Funding and	Below average and
Liquidity	Adequate (-1)
Support	0
ALAC	0
GRE	0
Group	0
Sovereign	0
Additional factors	0

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

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: 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

## Related Research

- LeasePlan Corporation's Proposed Additional Tier 1 Notes Assigned 'B+' Rating, May 17, 2019
- Dutch Bank LeasePlan Outlook Revised To Stable From Positive; Ratings Affirmed, Nov. 27, 2018

## Ratings List

### Ratings Affirmed

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**LeasePlan Corporation N.V.**

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Issuer Credit Rating    BBB-/Stable/A-3

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**Lincoln Financing Holdings PTE Ltd.**

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Issuer Credit Rating    BB+/Stable/--

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**LeasePlan Corporation N.V.**

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Senior Unsecured        BBB-

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Junior Subordinated    B+

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**Lincoln Financing SARL**

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Senior Secured         BB+

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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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.

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