FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Volkswagen Financial Services AG at 'A-'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 01 Jul 2024: Fitch Ratings has affirmed Volkswagen Financial Services AG's (VWFSO) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook and Short-Term IDR at 'F1'. Fitch has also assigned VWFSO Long-Term and Short-Term expected senior unsecured debt ratings of 'A-(EXP)' and 'F1(EXP)', respectively. The final ratings are contingent upon the receipt of final documents conforming to the information already received.

A full list of rating actions is below.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Volkswagen Financial Services Japan Ltd.				
senior unsecured	LT	A-(EXP)	Expected Rating	
senior unsecured	ST	F1	New Rating	
senior unsecured	ST	F1(EXP)	Expected Rating	
Volkswagen Financial Services Australia PTY Ltd.				

senior unsecured	LT A- New Rating		
senior unsecured	ST F1 New Rating		
Volkswagen Finance Overseas B.V.			
senior unsecured	ST F1(EXP) Expected Rating		
Volkswagen Financial Services AG	LT IDR A- Rating Outlook Stable Affirmed		A- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

KEY RATING DRIVERS

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

Fitch does not assign VWFSO 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 VWFSO and VW.

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

Smaller Size Due to Reorganisation: VWFSO will reduce in size and be renamed Volkswagen Financial Services Overseas AG as a result of this reorganisation, becoming the main intermediate holding company of VW's financial services activities outside Europe, the US and Canada, with material credit exposure in China, Brazil, Mexico and Australia, among other markets.

VW transferred ownership of Volkswagen Bank GmbH to Volkswagen Financial Services Europe AG, which is the newly-established ECB-supervised intermediate holding company as of 1 July 2024, consolidating the European financial services entities (including the sizeable Volkswagen Leasing GmbH).

Support Unaffected by Reorganisation: VWFSO's strategic importance will not be affected by the reorganisation, despite being materially smaller. VWFSO will remain central in supporting VW sales in a number of important growth markets. The current control and profit-and-loss transfer agreement remains in place. We believe VW is able to and will provide capital support to VWFSO, if required, without impairing its own credit profile.

Well-Managed RV Risk: VWFSO's assets will mostly relate to loans and leases, supporting VW sales in mostly non-European markets, exposing the company to direct and indirect residual value risk (RV). VWFSO 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 the medium term, but do not expect VWFSO to report RV-related losses, reflecting generally prudent RV risk-setting.

Robust Asset Quality: VWFSO's impaired receivables ratio (stage 3 and purchased or originated credit-impaired /gross loans and finance leases) has been consistently low (around 0.7% in 2020-2023), with high coverage at around 2x at end-2023. Under its new structure, we expect VWFSO's asset quality to be moderately weaker than before because of its sizeable exposure to more volatile operating environments.

Acceptable Profitability: VWFSO's profitability was acceptable, while lower than that of its finance and leasing company peers, reflected in a pre-tax income/average assets ratio averaging 1.7% in 2020-2023. In 2024, still high interest expenses, inflation and additional operating expenses related to reorganisation, as well as uncertainty around RVs could weigh on profitability.

Capital Support Decreases Leverage: VWFSO's leverage ratio, defined as gross debt/tangible equity, decreased to 5.3x at end-2023 from 6.3x at end-2022, as VW increased VWFSO's capital by around EUR3.8 billion in 2H23 to support the reorganisation in 2024. VWFSO's leverage ratio is supported by the control and profit-and-loss agreement with VW.

Changing Funding Profile: We expect VWFSO to fund itself equally with ABS, bank loans and bonds and to retain its access to a committed liquidity facility from VW.

RATING SENSITIVITIES

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

Negative rating action on VW would likely be mirrored in VWFSO's ratings and Outlook.

A weakening of VW's propensity to support VWFSO, for instance, due to VWFSO becoming less central to VW's overall mobility services strategy, could lead to Fitch notching VWFSO'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 VWFSO for VW.

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

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

DEBT AND OTHER INSTRUMENT RATINGS: KEY RATING DRIVERS

Senior Unsecured Debt

VWFSO's expected senior unsecured debt ratings are aligned with its IDRs, with VWFSO's EUR5 billion debt issuance programme long-term rating of 'A-(EXP)' and short-term rating of 'F1(EXP)' and VWFSO's EUR2.5 billion commercial paper programme Short Term rating of 'F1(EXP)'.

We assigned Volkswagen Finance Overseas B.V.'s (acting as a co-issuer) EUR2.5 billion commercial paper programme an expected short-term senior unsecured debt programme rating of 'F1(EXP)' and Volkswagen Financial Services Japan Ltd.'s (acting as a co-issuer) EUR5 billion debt issuance programme an expected senior unsecured debt programme long-term rating of 'A-(EXP)' and short-term rating of 'F1(EXP)'. For both programmes the alignment of the ratings with those of VWFSO's reflect the expected unconditional and irrevocable guarantee by VWFSO.

We have assigned Volkswagen Financial Services Japan Ltd's existing JPY60 billion electronic commercial paper programme a short-term debt programme rating at 'F1', aligned with that of the parent, reflecting the guarantee by VWFSO. We also assigned Volkswagen Financial Services Australia PTY's AUD5 billion debt issuance programme a senior unsecured debt programme long-term rating of 'A-' and short-term rating of 'F1', aligned with that of the parent, reflecting the guarantee by VWFSO.

DEBT AND OTHER INSTRUMENT RATINGS: RATING SENSITIVITIES

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

A downgrade of VWFSO's IDRs would lead to a downgrade of the programme ratings.

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

An upgrade of VWFSO's IDRs would lead to an upgrade of the programme ratings.

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

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

ESG CONSIDERATIONS

As support-driven issuers have strong linkages to their support providers, the ESG Credit-Relevance Score assigned to the 'supported' subsidiaries often mirrors those of their corporate and FI parents. This reflects our opinion that many of the ESG elements at the parent level are credit relevant for the subsidiary.

Therefore, VWFSO scores are mostly aligned with those of VW. VWFSO's differ from VW with scores for 'GHG Emissions' at '3' and 'Governance Structure' at '3', reflecting its indirect focus on the automotive industry and clear governance structure, respectively.

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.

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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

ENDORSEMENT STATUS

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