

## Volkswagen Financial Services AG

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# Volkswagen Financial Services AG

## Major Rating Factors

### Issuer Credit Rating

BBB+/Stable/A-2

Strengths:	Weaknesses:
<ul style="list-style-type: none"><li>• Core subsidiary of car manufacturer Volkswagen AG.</li><li>• Broad geographic diversification.</li><li>• Sound financial profile with stable earnings.</li></ul>	<ul style="list-style-type: none"><li>• Business concentration on car financing.</li><li>• Dependence on Volkswagen's franchise and funding support.</li><li>• Wholesale funding profile.</li></ul>

### Outlook

S&P Global Ratings' stable outlook on Germany-based captive finance company Volkswagen Financial Services AG (VW FS) mirrors that on its parent, carmaker Volkswagen AG (VW; BBB+/Stable/A-2), on a 12-24 month horizon.

A revision of the outlook on VW would result in a similar action on VW FS. We could lower our ratings on VW FS if we saw a weaker commitment from VW to support its subsidiaries, which could lead us to reassess our view of VW FS as a core entity of the VW group. We consider such a scenario to be very remote, but it could happen if VW relinquished its majority ownership of VW FS or if the captive finance operations ceased to be pivotal to the VW group's worldwide strategy.

## Rationale

The rating on VW FS reflects our view of the company's established business position as a captive finance subsidiary and its core group status to its direct parent, VW.

On Sept. 1, 2017, VW FS transferred ownership of Volkswagen Bank GmbH (VW Bank) to VW AG. This is part of a strategic reorganization within VW group to consolidate, more efficiently manage, simplify, and better-insulate its European banking activities relevant to the European Central Bank (ECB) authority under VW Bank. As a result, VW FS' share in European business decreased materially, with total assets declining by 47% year on year to about €69 billion as of Dec. 31, 2017.

However, we anticipate that VW FS' total assets could increase by up to 50% by 2020. This mainly reflects our current base-case expectation that VW's banking operations in the U.K. might no longer be under the ECB's supervision following the U.K.'s exit from the EU, and could be transferred to VW FS from VW Bank, in line with their role within the VW group. In the reorganization, VW FS' current profit and loss transfer agreements, guarantees, and letters of comfort remain in place with respect to its subsidiaries, and VW FS' profit and loss transfer agreement with VW Bank was transferred to VW. We no longer determine a stand-alone credit profile (SACP) for VW FS because, following its reorganization, it is now a pure captive finance player and core subsidiary of VW. As a result, the ratings on VW FS will move solely in tandem with those on its parent.

The rating further incorporates our view of VW FS' solid franchise as the captive finance company for the VW group. With total assets of €74 billion as of midyear 2018, VW FS coordinates most of the group's global financial services and provides car financing, leasing, dealer financing, insurance, and other services to its customers. We note, however, that diversity has diminished at VW FS, owing to VW Bank's role as an EU bank.

In our view, VW FS remains more diverse than many peer captive finance subsidiaries of other European automotive groups in terms of its geographic presence and product offerings. VW FS conducts business in more than 40 countries globally. This wide geographic diversity provides VW FS with a competitive advantage over its peers, which have not been able to expand their revenue streams due to their parent companies' focus on the European market. The main weaknesses we see in VW FS' business profile, which we consider to be fairly volatile, are its narrow operations from its core role as VW's captive finance company. This role makes VW FS reliant on trends at VW, such as unit sales and brand recognition, and automotive cycles in general.

VW's emissions issue, revealed in September 2015, has so far had no meaningful impact on VW FS' business development. However, we think that VW FS' business stability and growth prospects will develop in line with the prospects for VW--one of the three largest car manufacturers globally--regarding revenues, sales, and profits. We note that VW FS finances both new and used cars, so its revenue streams tend to be more stable than those of the parent group.

Considering VW's commitment to maintaining both adequate capitalization at VW FS and high capital ratios in its remaining banking business, we continue to expect that VW FS' capital and earnings position will remain an overall strength. Moreover, we think we adequately capture VW FS' auto loans, dealer financings, and leasing in our risk-adjusted capital (RAC) ratio. We also consider auto loans to be highly collateralized. Although VW FS' annual profit under the unconsolidated accounts is upstreamed to VW, we expect the parent will continue to support VW FS' sound capital position to bolster business growth. Therefore, we factor in further capital injections within our 12-24 month forecast period, if needed.

The quality of VW FS' total adjusted capital remains high because VW FS has no hybrid issues. We believe that VW FS will preserve its current conservative capital and risk management and that its asset mix and growth are unlikely to change markedly in the short to medium term, apart from potential Brexit-related asset transfers. So far, the recent emissions events have not put undue pressure on VW dealers, and we expect nonperforming loans (NPLs) will remain generally stable at below 2% of total loans in 2018-2020. Positively, we note that VW FS' loan loss reserves covered NPLs by 1.76x at year-end 2017, making its NPL coverage more favorable than peers'.

As a primarily wholesale-funded entity, VW FS bears structural weakness, but we think that its funding and liquidity benefit from prudent management and VW's position as a potential lender of last resort. Of VW FS' wholesale funding base, about 28% was short term and 72% long term at year-end 2017, but this will change in the coming years in light of asset transfers following the reorganization. While VW FS' funding profile is highly diverse and the company makes use of intragroup funding, and secured and unsecured wholesale funding, the degree of wholesale funding makes it sensitive to investor confidence in general. As such, we consider this will remain a weakness compared with domestic commercial banks.

**Table 1**

<b>Volkswagen Financial Services AG Key Figures</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(Mil. €)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Adjusted assets	73,569	68,894	129,998	121,102	107,047
Customer loans (gross)	54,826	51,606	103,630	95,462	88,323
Adjusted common equity	7,915	6,227	15,748	14,623	11,711
Operating revenues	1,380	2,814	4,361	4,246	3,679
Noninterest expenses	901	1,670	2,012	2,051	1,882
Core earnings	247	570	1,141	1,209	897

\*Data as of June 30.

**Table 2**

<b>Volkswagen Financial Services AG Business Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Total revenues from business line (mil. €)	1,380.0	3,198.0	4,361.0	4,246.0	3,679.0
Insurance activities/total revenues from business line	5.7	3.7	1.8	1.3	1.2
Other revenues/total revenues from business line	94.3	96.3	98.2	98.7	98.8
Return on average common equity	6.3	7.4	7.2	9.0	8.6

\*Data as of June 30.

**Table 3**

<b>Volkswagen Financial Services AG Capital And Earnings</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Tier 1 capital ratio	N/A	N/A	11.7	12.0	10.3
S&P Global Ratings' RAC ratio before diversification	N/A	N/A	13.7	13.9	12.6
S&P Global Ratings' RAC ratio after diversification	N/A	N/A	14.1	15.5	14.5
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	68.0	66.1	85.9	89.0	93.0
Fee income/operating revenues	4.3	4.5	0.3	2.3	3.6
Market-sensitive income/operating revenues	4.2	(1.1)	(1.5)	1.8	(0.1)
Noninterest expenses/operating revenues	65.3	59.3	46.1	48.3	51.2
Provision operating income/average assets	1.3	1.1	1.9	1.9	1.8

**Table 3**

<b>Volkswagen Financial Services AG Capital And Earnings (cont.)</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Core earnings/average managed assets	0.7	0.6	0.9	1.1	0.9

\*Data as of June 30. N/A--Not applicable.

**Table 4**

<b>Volkswagen Financial Services AG Risk Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Growth in customer loans	12.5	(50.2)	8.6	8.1	17.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	N/A	(3.3)	(10.5)	(13.3)
Total managed assets/adjusted common equity (x)	9.3	11.1	8.3	8.3	9.2
New loan loss provisions/average customer loans	0.5	0.6	0.7	0.7	0.6
Net charge-offs/average customer loans	N.M.	0.3	0.1	0.2	0.2
Gross nonperforming assets/customer loans + other real estate owned	N/A	2.0	2.4	2.4	2.8
Loan loss reserves/gross nonperforming assets	N/A	176.7	121.6	118.5	99.2

\*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful.

**Table 5**

<b>Volkswagen Financial Services AG Funding And Liquidity</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2018*</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Core deposits/funding base	0.0	0.1	33.6	27.6	28.7
Customer loans (net)/customer deposits	N.M.	72,179.7	278.2	330.0	327.5
Long-term funding ratio	75.7	75.1	79.0	78.0	78.6
Stable funding ratio	74.5	74.1	80.4	80.4	79.6
Short-term wholesale funding/funding base	27.4	28.1	24.2	25.2	24.1
Broad liquid assets/short-term wholesale funding (x)	0.1	0.1	0.3	0.3	0.2
Net broad liquid assets/short-term customer deposits	N.M.	(260.0)	(46.1)	(52.2)	(56.1)
Short-term wholesale funding/total wholesale funding	27.4	28.2	36.5	34.8	33.9
Narrow liquid assets/3-month wholesale funding (x)	0.4	0.5	0.7	0.7	0.5

\*Data as of June 30. N.M.--Not meaningful.

## Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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: Group Rating Methodology, Nov. 19, 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

### Ratings Detail (As Of December 10, 2018)

#### **Volkswagen Financial Services AG**

Issuer Credit Rating BBB+/Stable/A-2

#### **Issuer Credit Ratings History**

06-Nov-2017	BBB+/Stable/A-2
01-Dec-2015	BBB+/Negative/A-2
12-Oct-2015	A-/Watch Neg/A-2
24-Sep-2015	A-/Watch Neg/A-1
22-Sep-2014	A/Stable/A-1

#### **Sovereign Rating**

Germany AAA/Stable/A-1+

#### **Related Entities**

##### **Banco Volkswagen S.A.**

Issuer Credit Rating  
*Brazil National Scale* brAAA/Stable/--

##### **Scania AB (publ.)**

Issuer Credit Rating  
*Nordic Regional Scale* --/--/K-1  
*South Africa National Scale* zaAAA/--/zaA-1+

##### **Volkswagen AG**

Issuer Credit Rating BBB+/Stable/A-2

##### **Volkswagen Bank GmbH**

Issuer Credit Rating A-/Negative/A-2  
Commercial Paper  
*Local Currency* A-2  
Senior Subordinated BBB+  
Senior Unsecured A-  
Short-Term Debt A-2

##### **Volkswagen Finans Sverige AB**

Issuer Credit Rating  
*Nordic Regional Scale* --/--/K-1

##### **Volkswagen International Belgium S.A.**

Issuer Credit Rating BBB+/Stable/A-2  
Commercial Paper  
*Local Currency* A-2

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.



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