

Research Update:

Norway-Based Debt Purchaser Axactor Assigned 'B' Rating; Outlook Stable

August 17, 2021

Overview

- Axactor SE is a midsized, moderately diversified, and efficient player in the debt collection industry that has underperformed peers in terms of collections and profits, despite its sizeable asset base.
- The company's leverage and interest coverage are therefore weaker than that of peers, which weighs on our view of the firm's credit profile. However, we do expect the company earnings will improve over the medium term.
- We assigned our 'B' long-term issuer credit rating to Axactor.
- The stable outlook reflects our expectations that the group will expand its franchise and increase gross collections and earnings, allowing it to reduce adjusted debt to EBITDA to below 5.0x over the next 12 months. The stable outlook also reflects our view of no further material revaluations over this period.

Rating Action

Axactor is a relatively young midsized debt purchaser and collector. Axactor has grown substantially since its founding in 2015, with about €2.2 billion estimated remaining collections (ERC) as of June 30, 2021. Our rating reflects Axactor's modest scale in the European debt purchasing and collection market, and the company's high adjusted leverage as indicated by a debt to adjusted EBITDA of 5.5x as of December 2020. Axactor concentrates primarily on nonperforming consumer finance debt and is moderately diversified across well-established and closely regulated markets, including Spain, which makes up the largest portion of revenue (43% for the 12 months to June 30, 2021), the Nordics (35%), Germany (14%) and Italy (8%). We see the scale and diversification of Axactor's business as similar to that of Arrow Global and B2Holding, although Axactor's operating track record is more limited and it has experienced some teething problems that led to a weaker earnings profile, in our view. This includes the company's investment in Spanish real estate-owned assets, which turned out to be unsuccessful and are now in run-down.

PRIMARY CREDIT ANALYST

Gabriel Zwicklhuber
Frankfurt
+ 49(0)6933999169
gabriel.zwicklhuber
@spglobal.com

SECONDARY CONTACTS

Olivia K Fleischmann
Stockholm
+ 46 84 40 5904
olivia.fleischmann
@spglobal.com

Francesca Massarotti
Frankfurt
+ 49 69 3399 9130
francesca.massarotti
@spglobal.com

The company's strategy in unsecured consumer debt is narrower than that of larger peers that are less vulnerable to one specific segment.

Axactor operates alongside larger and more diversified debt purchasers and collectors, such as Intrum and Lowell. Compared with them, Axactor is more constrained due to its focus on one subset of the wider nonperforming loan market, that is unsecured consumer loans from banks and other lenders, which account for about 98% of its receivables. This leaves Axactor more susceptible to selling behaviors of vendors or less favorable pricing than more diversified peers that can pivot to other segments more quickly, if necessary. Axactor has a meaningful presence across its geographic footprint, particularly in the Nordics and Spain, but it lacks the leading market positions of its larger peers.

Axactor's third-party collection (3PC) and its solid efficiency support the rating. The company's clear focus on unsecured consumer debt and limited legacy infrastructure allowed the company to set up an efficient platform with one of the lower collection costs among peers, and we believe this will increasingly benefit Axactor with higher collection volumes. Additionally, we expect about 20%-25% of statutory revenue will continue to come from its 3PC business, a level roughly at the average of the peer group. This supports the franchise in our view and differentiates Axactor from its smaller peers, such as AnaCap Financial Europe, and DDM Debt AB, because it provides some diversity and is often contractual, which can offer more-predictable revenue.

The economic disruptions in relation to COVID-19 tested Axactor's portfolio quality. Through 2020, Axactor has recorded a negative revaluation total of €37 million on its receivables portfolio reflecting a change in expected future collections and their timing. This represents about 3.5% of the book value, and exceeds that of other unsecured specialists we rate (Lowell, Intrum, B2, and iQera). The group also realized a further €16 million impairment on its real estate-owned portfolio (12% of book value) in 2020. We believe that Axactor's large presence in Spain explains some of the higher impact, although a more conservative approach toward revaluations and uneconomical pricing of back book acquisitions in the past could also play a role. Under our base-case scenario, we don't expect any further material revaluations, but any sudden declines in collections performance and book value could weaken our view of Axactor's earnings trajectory.

Axactor's high leverage and weak interest coverage weighs on our view of its credit risk. When assessing Axactor's financial risk, we look at the company's credit metrics with EBITDA calculated in two ways (see "Europe's Distressed Debt Purchasers Look To Steady The Ship In 2021," published Feb. 12, 2021, on RatingsDirect). Cash-adjusted debt to EBITDA and EBITDA to interest, which adds back the amortization of principal, were 5.5x and 2.7x for full-year 2020, respectively. We note that our calculation of cash-adjusted EBITDA differs from Axactor's reported cash EBITDA, which additionally adds back the reversal of book value for real estate-owned assets. Without the add-back for collection applied to principal, credit metrics are materially weaker, although this is tempered somewhat by Axactor's solid debt to tangible equity ratio of 3.1x as of December 2020.

We expect Axactor will reduce cash-adjusted leverage to about 4.0x-4.2x and statutory leverage to about 8.5x-9.5x by end-2022 supported by the economic rebound and favorable industry growth prospects. Regardless of whether we look at EBITDA including or excluding the add-back for collections, we expect Axactor's credit metrics will remain weaker than that of peers with better financial risk profiles, such as B2Holding or Intrum. The expected deleveraging hinges on Axactor's ability to better capitalize on newly acquired portfolios from primary sellers and convert its expanding asset base into earnings, which so far have lagged that of peers. We attribute this to the lack of highly profitable assets with older purchase dates, a back-loaded collection curve, and possibly also collection operations that could not fully keep pace with the rapid growth in

receivables.

We assume that Axactor's management will follow a balanced financial policy despite the company's short operating track record.

We understand increasing its return on equity is Axactor's key goal to initiate dividend payments, but we don't expect this will come at the cost of its deleveraging. We also don't expect a negative influence on the company's financial policy from its dominant shareholder Geveran Trading Co Ltd., which held a 44% stake in Axactor as of June 2021 and exercises some control over the board, in our view. We take into account Geveran's expected longer term investment horizon as a family office--Geveran is an investment company whose interests are indirectly represented by Mr. John Fredriksen--and the associated lower propensity to employ an overly aggressive financial policy to generate short-term returns. We also view Axactor's recent refinancing and reorganizational measures as credit positive because they have extended the company's debt maturity profile, increased the equity base, and lowered organizational complexity.

Outlook

The stable outlook reflects our expectation that, over the next 12 months, Axactor will increase its gross collections, allowing it to reduce leverage, with adjusted debt to EBITDA declining below 5.0x while maintaining sufficient headroom to covenants. The stable outlook also reflects our view that COVID-19-related collection shortfalls have largely been recognized in 2020, and we do not expect further material negative revaluations.

Upside scenario

We could raise our ratings if Axactor strengthens its market position across its footprint and materially and sustainably improves its leverage beyond our current expectations such that adjusted debt to EBITDA remains below 3.5x and debt to statutory EBITDA remains below 8.0x, without jeopardizing future earnings potential with portfolio acquisitions below its replacement rate. An upgrade would also be contingent on sufficient headroom under its covenants, no indications of asset quality problems, and solid liquidity buffers.

Downside scenario

We could lower our ratings if Axactor fails to increase its gross collections and earnings, which could be an indication of a weaker competitive position, or followed a more aggressive financial policy, such that we expected adjusted debt to EBITDA to stay above 5.0x on a prolonged basis. This would likely come alongside renewed pressure on covenants or materially weakening asset quality, which could also result in a downgrade.

Company Description

Axactor is a Norway-headquartered debt purchaser and servicer that was founded in 2015. Its core business is the purchasing of nonperforming debt in the Nordics, Spain, Germany, and Italy. It specializes in unsecured consumer debt from banks and other consumer lenders. Approximately 20%-25% of statutory group revenue comes from consumer debt collections on behalf of third parties and ancillary services. Axactor also owns a portfolio of real estate assets in Spain, which are in run-off. The group is publicly traded on Oslo Stock Exchange, but investment company

Geveran Trading Co Ltd., which is an indirectly owned by Mr. John Fredriksen, owns about 44% of share capital.

Our Base-Case Scenario

Assumptions

- Economic recovery continues in 2021 and 2022 with European real GDP growth of 4.4% this year and 4.5% in 2022. However, we note that COVID-19 variants and renewed lockdown measures could threaten our base case for Axactor.
- Gross collections on own portfolios to increase to €280 million-€300 million in 2021 and €340 million-€360 million in 2022, from €237 million in 2020, boosted by the recovery in underlying markets post-pandemic, as well as continued growth in and better utilization of Axactor's existing asset base. For 3PC, we forecast 20%-30% organic growth in 2021 and 12%-18% in 2022, following the dip in 2020.
- Adjusted EBITDA margins improving toward 60% by end-2022 as the group increasingly leverages its asset base and efficient collection platform and executes on its cost-savings program.
- Portfolio acquisitions beyond the replacement rate of about €200 million-€250 million in 2021 and €400 million-€450 million in 2022, compared with €213 million in 2020.
- No shareholder distributions and acquisitions in 2021 and 2022.

Key metrics

Table 1

Axactor--Key Metrics

(x)	2020	2021f	2022f
Debt to EBITDA	5.5	4.8-5.0	4.0-4.2
Debt to statutory EBITDA	28.9	11.6-12.2	8.5-9.5
EBITDA cash interest coverage	2.7	3.8-4.0	4.2-4.4
Statutory EBITDA cash interest coverage	0.5	1.4-1.8	1.7-2.1
Debt to tangible equity	3.1	2.8-3.0	2.7-2.9

f--S&P Global Ratings' forecast.

Liquidity

We view the company's liquidity as a neutral factor to the rating currently, although we could revise this viewpoint if headroom weakens on any of the firm's covenants. The company keeps relatively low cash on hand, but it has some capacity on its revolver and benefits from the cash flowing nature of the business. The company's liquidity needs primarily consist of portfolio purchases, which it could reduce to an extent if needed, particularly following the company's reduced usage of committed forward flow agreements. However, as a result, the company's

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earnings generation would also likely decrease in the future.

We expect liquidity sources will be about 2.1x uses over the next 12 months, which also benefits from little debt maturities over this period as the result of active debt maturity management over the past year. We expect the company will continue to proactively manage its liquidity. Despite a solid liquidity coverage, Axactor's liquidity assessment is constrained by its limited breadth and depth of available funding instruments, its relatively unproven track record in the capital markets, and the company's capacity to increase its assets beyond the replacement rate hinging on its ability to access debt markets.

We estimate that Axactor's principal liquidity sources during the 12 months to June 30, 2022, will comprise:

- Cash balance of about €44 million;
- Cash funds from operations of €200 million–€220 million; and
- An undrawn revolving credit facility (RCF) balance of about €81 million (we do not include the €75 million accordion option of the RCF as a source of liquidity because it is uncommitted).

We estimate that Axactor's principal liquidity uses during the same period will comprise:

- Maintenance portfolio purchases at about €140 million to replenish Axactor's asset base;
- Debt maturities of about €13 million; and
- Capital expenditure of about €4.0 million.

Covenants

Axactor has several covenants under both its RCF and bond documentation. Currently the company has adequate headroom on the majority of its covenants, although in 2020 the cushions were tighter due to lower collections and a high share of committed forward flow agreements, which limited Axactor's flexibility to scale down portfolio purchases amid the COVID-19 pandemic. However, Axactor was able to obtain a waiver on the RCF's group leverage ratio covenant for the last three quarters of 2020 to avoid a breach. Additionally, the headroom of the net loan to value (LTV) covenant under the bond documentation has been small but we expect the company will remain in compliance with the threshold. We believe LTV covenants are easier for the company to actively manage than leverage ratio covenants, although potential revaluations could pose a risk.

RCF covenants:

- Restricted group leverage ratio below 3.0x ;
- Portfolio loan to value ratio below 60;
- Portfolio collection performance above 90%; and
- Parent loan to value below 80%.

Bond covenants:

- Interest coverage ratio above 4.0x;
- Leverage ratio below 4.0x;
- Net loan to value below 75%; and
- Net secured loan to value below 65%.

Ratings Score Snapshot

Issuer Credit Rating: B/Stable/--

Business risk: Fair

- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Europe's Distressed Debt Purchasers Look To Steady The Ship In 2021, Feb. 12, 2021,

Ratings List

New Rating /Outlook Action

Axactor SE

Issuer Credit Rating	B/Stable/--
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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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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.

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