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Research Update:

DDM Debt AB Assigned Prelim 'B' Rating On Continued Opportunistic Growth Plans; Outlook Stable

March 22, 2021

Overview

- In our credit assessment of Swedish-domiciled DDM Debt AB, the main financing entity of the DDM Holding AG group, we consider the group's limited scale, high statutory leverage, and its financial policy, which we view as stable.
- The group intends to issue €225 million of senior secured notes, maturing in 2026, to refinance existing debt.
- We assigned our preliminary 'B' ratings to DDM Debt and the group's proposed senior secured debt.
- The outlook is stable, reflecting out view that the DDM group will maintain high and controlled growth over the next 12 months.

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Rating Action

On March 22, 2021, S&P Global Ratings assigned its preliminary 'B' long-term issuer credit rating to DDM Debt AB, the primary issuing entity in the DDM Holding AG group. The outlook is stable.

We also assigned our preliminary 'B' issue rating, with a '4' recovery rating (35% recovery prospects), to the group's proposed €225 million senior secured notes, maturing in 2026.

Rationale

Switzerland-based DDM group, listed on the Swedish Nasdaq First North Growth Market Exchange, is a nimble, but small debt purchaser. The company invests in debt portfolios across Central, Eastern, and Southern Europe, and 77% of its €258 million 120-month estimated remaining collections are from secured assets, as of Dec. 31, 2020. Relative to peers, DDM has a narrower business profile. The company is smaller than most rated peers, but its revenues are entirely derived from collections on its assets. Alongside its smaller scale, however, the narrower franchise and a lack of revenue diversification constrain our rating.

DDM operates with weak statutory credit metrics that weigh on its credit quality, in our view. A key driver for our rating is our conservative view of DDM's financial risk profile. This is based on the company's relatively weak leverage and interest coverage metrics using statutory EBITDA figures. In 2019 we estimate the debt-to- statutory EBITDA ratio and statutory EBITDA interest coverage were 10.2x and 0.8x, respectively, and moved toward 4.8x and 1.6x in 2020. We expect debt to statutory EBIDTA to remain above 5.0x, and that the interest coverage will stay below 2.0x over the next 24 months. These metrics are commensurate with a financial risk profile of highly leveraged, in line with that of some of DDM's sector peers. At the same time, the group's metrics adjusted for collections from principal remains at solid levels. As a result of DDM's size, business mix, and portfolio composition, there is a relatively large difference between statutory EBITDA and adjusted EBITDA. We expect these adjusted metrics to remain in a range of 3x-4x compared to debt and 3x-6x in terms of coverage. That said, given DDM's focus on secured portfolios, we see a significant risk that collections timing and volume may become volatile, undermining the sustainability of these metrics. As such, the group's statutory EBITDA metrics are critical elements of our assessment (table 1).

DDM Key Metrics

(x)	2020	2021f	2022f
Debt/EBITDA	1.4	3.7	3.4
Debt/statutory EBITDA	4.8	10.1	8.8
EBITDA cash interest coverage	5.3	4.3	4.3
Statutory EBITDA cash interest coverage	1.6	1.6	1.7

f--S&P Global Ratings' forecast.

DDM's financial policy is neutral for the rating. DDM has been listed on the Nasdaq First North Growth Market Exchange since 2014, though the free float remains relatively modest at approximately 11% of group equity. The remaining 89% is held by DDM Finance Group S.A., which is currently outside of the DDM group, and whose interests are largely represented by long-term investor Mr. Erik Fällström, who therefore indirectly holds 81% of DDM Group. Importantly, we believe that DDM's well-experienced board and management are dedicated to maintaining financial discipline over the company's upcoming expansion phase. DDM has historically remained controlled in their expansion e.g. primarily growing either organically or through private-equity co-investments and joint-ventures, rather than pursuing a leveraged approach. Furthermore, DDM's stated policy that dividends are unlikely to be paid out in the next few years as liquidity and growth is being prioritized underscores our view of the company's sound financial policy.

The group intends to use the proceeds of the proposed €225 million senior secured notes to refinance its existing capital structure. The €123 million of debt outstanding being refinanced comprises €37 million secured notes (maturity 2021), €77 million secured notes (maturity 2022), and €9 million drawn under a €27 million revolving credit facility (RCF). Residual proceeds from the issuance are to be used for general corporate use, which we expect to be primarily diverted toward portfolio investment. Our 'B' rating on the proposed debt reflects our expectation of a 35% estimated recovery on the notes. We also weighed into our analysis the group's €27 million RCF (due 2023 and held at the DDM Debt AB level) and a €18 million senior secured note (due 2022). The latter are held at the DDM Finance AB level and the net proceeds have been down-streamed to DDM Debt AB through a shareholder loan.

Outlook

The stable outlook on DDM reflects our view that the group's leverage and debt-service metrics will remain steady. Specifically, we expect statutory debt to EBITDA will stay above 5x.

Downside scenario

We could lower the rating on DDM if we observed an overall weakening in its franchise and financial discipline that led to a more aggressive financial policy. This could materialize as a sizable dividend distributions or an inorganic growth strategy that prompted us to view a pronounced deterioration in the group's already constrained financial risk profile.

We could lower our ratings on the notes to 'B-' if DDM were to see its book values markedly decline, through impairments or amortization of the book, or if the group increased its priority debt. Both scenarios would weaken recovery prospects, in our view.

Upside scenario

We currently regard an upgrade as unlikely. This is because we note that DDM's revenue streams are less diversified. Also, because of its secured portfolio focus, the group's financial metrics are less stable than that of peers that have a larger revenue scope. That said, we would view positively a meaningful improvement in the group's statutory coverage.

Issue Ratings--Recovery Analysis

Key analytical factors

- The preliminary issue rating on DDM Debt AB's €225 million senior secured bond due in 2026 is 'B' with a preliminary recovery rating of '4', indicating our expectation of average recovery (rounded estimate: 35%) in an event of default.
- We assume that the senior secured RCF, with a current volume of €27 million, will be 85% drawn in an event of default.
- In our default scenario, we contemplate a default in 2025, reflecting a significant decline in cash flow, difficult collection conditions, or greater competitive pressures, leading to the mispricing of portfolio purchases.
- In line with other debt purchasers, we use a discrete asset-valuation approach.
- We take DDM's portfolio size and investments in affiliates as of Dec. 31, 2020, assume 70% of the undrawn RCF balance is used for portfolio purchases, and apply a 25% haircut to the total expected book value as an estimate of resale value in a liquidation.
- We assume the DDM's would find a potential acquirer for its portfolio, albeit with a 25% haircut to the carrying value

Simulated default assumptions

- Year of default: 2025
- Jurisdiction: Sweden

Simplified waterfall

- Gross enterprise value at default: €119 million
- Administrative costs: 5%
- Net enterprise value after admin. costs: about €113 million
- Total first-lien debt claims: About €24 million under RCF
- Total second-lien priority debt: About €233 million
- Total third-lien debt: circa €18 million issued by DDM Finance AB
- Recovery expectations: 35%

Note: All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer Credit Rating: B(prelim)/Stable/--

Business risk: Weak

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

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

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- 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

Ratings List

New Rating	
DDM Debt AB	
Issuer Credit Rating	B(prelim)/Stable/--
Senior Secured	4(35%)(prelim)