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Sherwood Parentco Ltd.

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Sherwood Parentco Ltd.

Credit Highlights

Issuer Credit Rating
B+/Stable/--

Overview

Key strengths	Key risks
Good market position as a distressed asset purchaser and servicer across core markets of Portugal, the U.K., Italy, the Netherlands, and Ireland.	Rising exposure to real estate and secured debt, which increases collections and cash flow volatility.
Ongoing growth of the integrated fund management business, supporting prospectively higher free cash flow and lower leverage.	Persistently high leverage.
Comfortable debt maturity profile, with the closest maturity of senior secured notes in November 2026.	Smaller scale (based on balance sheet investment and revenue) compared with that of some pan-European players like Intrum and Lowell.

Sherwood Parentco Ltd., holding company of Arrow Global Group Ltd.'s operating subsidiaries, will continue its transformation to an integrated fund manager of distressed assets. This involves continuing deployment of capital attracted to Sherwood's credit funds (such as ACO 2, closed at €2.75 billion, as well as the recently launched real estate and dedicated lending fund) and lower use of Sherwood's own capital to acquire debt portfolios. This transformation will gradually reduce the capital intensity of Sherwood's business and support higher free cash flow with a growing proportion of recurring fee-based revenue in the mix.

Sherwood demonstrates relatively weak underlying performance this year versus 2022, mainly due to lower collections and realization of collateral from its secured assets. In first-half 2023, underlying collections (which excludes one-off cash income of £91.5 million divestment of 50% of its U.K. unsecured portfolio) fell 27.5% year-over-year to £139.4 million. Despite the continued growth in servicing and management revenue (up 27% year-on-year), the decrease in collections resulted in a 25% drop in adjusted EBITDA and consequently an increase in annualized adjusted debt to EBITDA to 5.7x from 4.6x at year-end 2022.

We expect Sherwood's reduced collections will largely recover in 2024, supporting EBITDA growth and leverage reduction, with adjusted debt to EBITDA falling to 4.3-4.6x. In our view, the jump in leverage is temporary and Sherwood will likely get back to deleveraging next year, supported by a recovery in collections and increasing fees from fund management. Nevertheless, we think that Sherwood's greater focus on real estate and secured assets increases volatility of its cash flow and leverage profile. Also, fees from the fund management and servicing business, while rising, will remain less than 50% of the company's cash revenue over the next two years, making Sherwood's cash generation highly dependent on its cash collections. Finally, the company's leverage ratio, which does not include the adjustment for the cash amortization of the portfolio, will remain very high, exceeding 10x over the next 12-18 months.

Sherwood continues to benefit from its comfortable debt maturity profile, with the nearest bond maturity in three years. In our view, the lack of near-time refinancing needs gives Sherwood flexibility to deleverage and demonstrate a track record in the fund management business before it would need to refinance.

Outlook

The stable outlook reflects our expectation that Sherwood will reduce its adjusted debt to EBITDA to below 4.5x over the next year. Our key underlying assumption is that collections will recover in 2024 after the material decline this year due to lower collateral realization and collections from the secured portfolios. We expect the group's continued pivot toward fund management and asset servicing in the European distressed debt market will further support this trend.

Downside scenario

We could lower the rating if collections do not recover in 2024, leading to adjusted debt to EBITDA staying persistently above 5x. Although we don't think it's likely, this could be precipitated by rapid, material drawing under the group's revolving credit facility (RCF) to fund mergers and acquisitions, which would increase leverage or worsen the group's liquidity position.

Upside scenario

We believe that an upgrade to Sherwood or its debt instruments is unlikely over the couple of years given its high leverage and private-equity ownership.

Our Base-Case Scenario

Assumptions

- Gross collections will fall 23%-25% this year with growth of close to 10%-12% next year, reflecting the recovery of a major portion of collections from secured portfolios in 2024.
- In light of increased volatility of collections and still difficult economic conditions, our collection forecast is more conservative than management's expectations, and we can't exclude that collections recovery in 2024 might be faster.
- We expect growth in servicing and management revenue will remain strong, nearing 17%-22% on average over the next two years as Sherwood continues to deploy capital from its credit funds and benefits from related management fees.
- Cash EBITDA will drop by about 25% this year mirroring the collection dynamics and will only be partially offset rising fund management (FM) revenue. Cash EBITDA will likely recover next year with growth of 24%-26% following the growth of collections next year. The sustainable growth of FM revenues from the higher net asset value of Arrow's funds will further support its EBITDA.
- Capital expenditure for portfolio purchases will continue to decline, at 5% this year and 10% anticipated for 2024, reflecting the lower need to invest proprietary capital as the company will continue deploying its ACO 2 fund (Arrow coinvests just 10% of its own capital with the rest invested by the fund's limited partners).
- The company's gross debt will likely fall by about £100 million this year (including £95 million in first-half 2023) and by £90 million-100 million in 2024 mainly through repaying its drawn RCF.
- Interest expense will peak this year, reflecting the highest base rate and will gradually decline starting from 2024 due to lower floating rate debt (RCF repayment) and potentially lower base interest rates.

Key metrics

Sherwood Parentco Ltd.--Key metrics*

	--Fiscal year ended Dec. 31--			
(Mil. £)	**2021a**	**2022a**	**2023e**	**2024f**
Adjusted EBITDA	260.8	315.4	230-245	290-300
Debt-to-EBITDA (x)	5.6	4.7	5.5-5.8	4.3-4.6
Debt-to-EBITDA (x)§	14.0	15.4	>15.0	14.0-15.0
EBITDA interest coverage (x)	3.0	3.8	2.4-2.8	3.2-3.6
FFO/debt (%)	13.4	16.2	10.0-12.0	15.0-17.0

*All figures adjusted by S&P Global Ratings. §EBITDA excluding portfolio amortization. FFO--Funds from operations. a--Actual. e--Estimate. F--Forecast.

Company Description

Sherwood is a U.K.-based intermediate non-operating holding company that consolidates Arrow's activities after Sherwood was acquired by private equity sponsor TDR Capital at the end of 2021. TDR Capital's funds control about 90% of Arrow.

Arrow's core business activities include distressed debt fund management, servicing of distressed debt portfolios, and as purchasing and collecting various distressed asset classes, including secured and unsecured consumer nonperforming debt. By third-quarter-end 2023, total funds under Arrow's management in its credit funds reached €9.3 billion, assets under servicing exceeded €70 billion, and total 120-month estimated remaining collection (ERC) was close to £1.3 billion. Arrow continues to develop its credit fund management business providing access to the European distressed debt market to institutional investors through its asset credit opportunities funds, and recently launched its first real estate fund. The group's key markets include the U.K., Portugal, Italy, the Netherlands, and Ireland.

Peer Comparison

Table 1

Sherwood Parentco Ltd.--Peer comparison

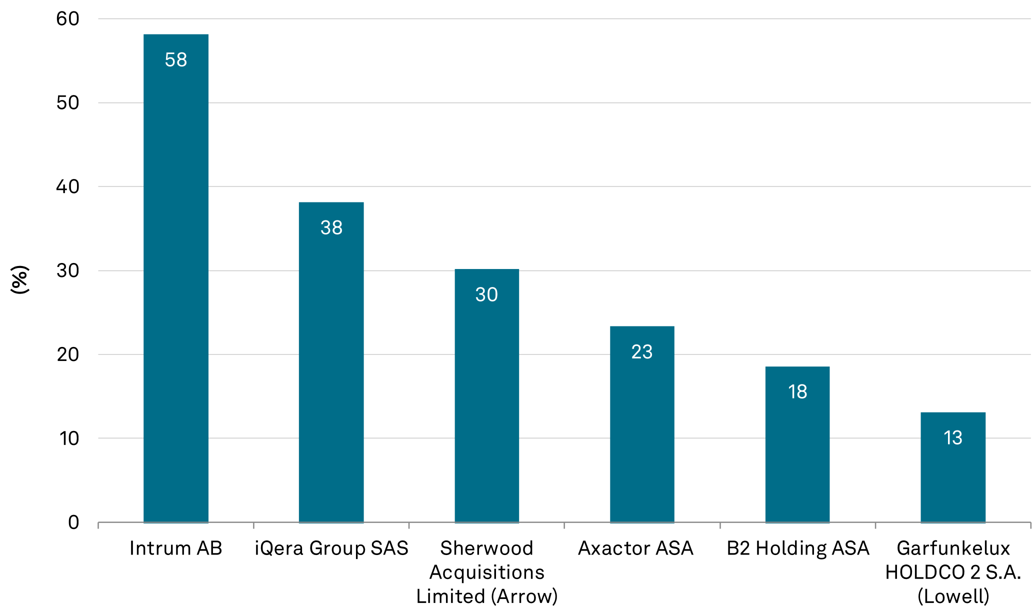
	--Fiscal year ended Dec. 31, 2022--					
(Mil. £)	**Sherwood Parentco Ltd. (Arrow Global)**	**Garfunkelux Holdco 2 S.A.**	**Intrum AB (publ)**	**B2 Impact ASA**	**iQera Group SAS**	**Axactor ASA**
Ratings as of Nov. 20, 2023	B+/Stable	B+/Stable/B	BB/Negative/B	B+/Positive/--	B/Stable/--	B/Stable/--
EBITDA	315.4	481.8	1,033.0	289.0	82.3	192.2
Funds from operations (FFO)	240.6	329.7	737.0	228.2	50.1	137.3
Adjusted ratios						
Adjusted EBITDA margin, %	58.1	59.0	53.8	70.2	49.3	64.8
Debt/EBITDA (x)	4.7	5.5	4.4	3.0	7.0	4.4
FFO/debt %	16.2	12.6	16.1	26.1	8.7	16.2
EBITDA interest coverage (x)	3.6	3.4	5.0	5.1	2.4	4.2

Although Sherwood is transitioning towards an alternative asset management model, we still consider best peers other European distressed debt purchasers and servicers. The company's main peers are Intrum AB (publ) (BB/Negative/B); Garfunkelux Holdco 2 S.A. (the holding company of Lowell group; B+/Stable/B); B2 Impact ASA (B+/Positive/--), Axactor ASA (B/Stable) and iQera Group SAS (B/Stable/--).

Sherwood's good geographical diversity and well-established position across a number of European markets supports the predictability of its business volumes compared with smaller competitors such as iQera and support its ratings. Sherwood has significantly increased its share of capital-light revenue, which was close to 30% of the group's cash income as of year-end 2022 and higher than most rated peers save Intrum.

Chart 1

Servicing and investment management revenue as a share of total cash revenue for 2022



Sources: Company filings and S&P Global Ratings.

Nevertheless, we view Sherwood's size and scale as weaker than pan-European majors such as Intrum and Lowell in terms of ERC, revenue, and earnings. Following its acquisition by TDR Capital, Sherwood remains one of the most leveraged companies among peers with three-year weighted average debt to adjusted EBITDA of close to 5.0x, mainly reflecting a sharp jump in leverage in 2023 due to weaker collections from secured portfolios this year and the sale of 50% of its portfolio of unsecured U.K. assets in the second quarter. Leverage excluding amortization is also among the highest in the sector and its tangible equity is negative due to significant goodwill. Nevertheless, we think Sherwood will benefit from its pivot toward a capital-light fund management model, which will likely support deleveraging. Similar to some large peers like Intrum and Lowell, Sherwood retains financial flexibility thanks to steady cash flow, a sizable untapped RCF, and no material refinancing needs over the next 12 months.

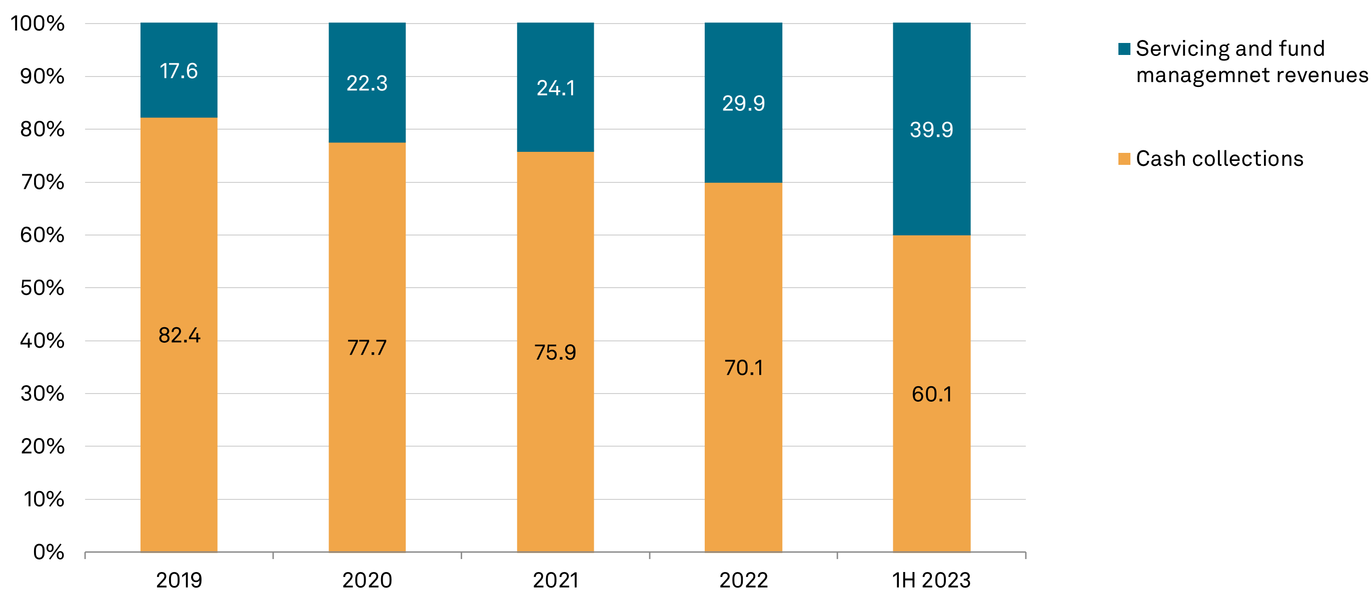
Business Risk

We think Sherwood's established position in its key markets of operations, sound relationships with European distressed debt providers, and improved business diversity support its business risk profile. Operating across five European markets via local servicing platforms, the company has a well-developed franchise in underwriting, acquiring, and servicing a range of distressed asset classes, including consumer secured and unsecured loans, small and midsize enterprise debt, and real estate. The group has a long record of sustainable returns from its acquired portfolios with an average net deal internal rate of return of 18% since 2010. Sherwood also has trusted, strong relationships with European banks and closed-end funds, allowing the company to avoid competitive auctions with over 80% of investments in first-half 2023 have been off-market. This, in turn, improves transaction pricing, simplifies the process of on-boarding and gives it a structural advantage over players in the targeted markets. Besides the traditional distressed debt purchasing business, Sherwood is prominent in the third-party servicing business. Arrow is servicing portfolios for more than 200 parties with total assets under servicing reaching £79 billion. Nevertheless, with adjusted last-12-month EBITDA of close to £211 million and 120-month ERC of £1.3 billion, the group is a relatively small player with a lower scale than peers like Intrum and Lowell. Capital deployment from distressed debt funds and co-investing with limited partners (LPs), however, will allow Sherwood to meaningfully increase its scale in key markets.

Sherwood has made a significant progress in shifting its business model towards becoming an integrated fund manager, with a focus on investment management and servicing businesses rather than balance-sheet investments. Unlike most peers, Arrow strategically positioned the business as a vertically aligned servicing and management platform. Although there is a strong emphasis to develop servicing and fund management business, all three segments are supposed to operate synergistically where its fund management business creates investment opportunities, in which its direct balance sheet business co-invests into and its servicing business can then service. In addition to the fully deployed ACO 1 closed-end fund of €1.7 billion, Sherwood closed its ACO 2 fund in first-quarter 2023 with total capital commitment of €2.75 billion, improving client diversity. Also, the company launched a strategic initiative to develop real estate and direct lending investment business and closed its first trial real estate fund (AREO) of €100 million. To strengthen its capabilities in these new asset classes, Sherwood consolidated its ownership of Maslow (a pan-European real estate and direct lending platform) and Eagle Street (a U.K.-focused RE platform) in first-half 2023.

Chart 2

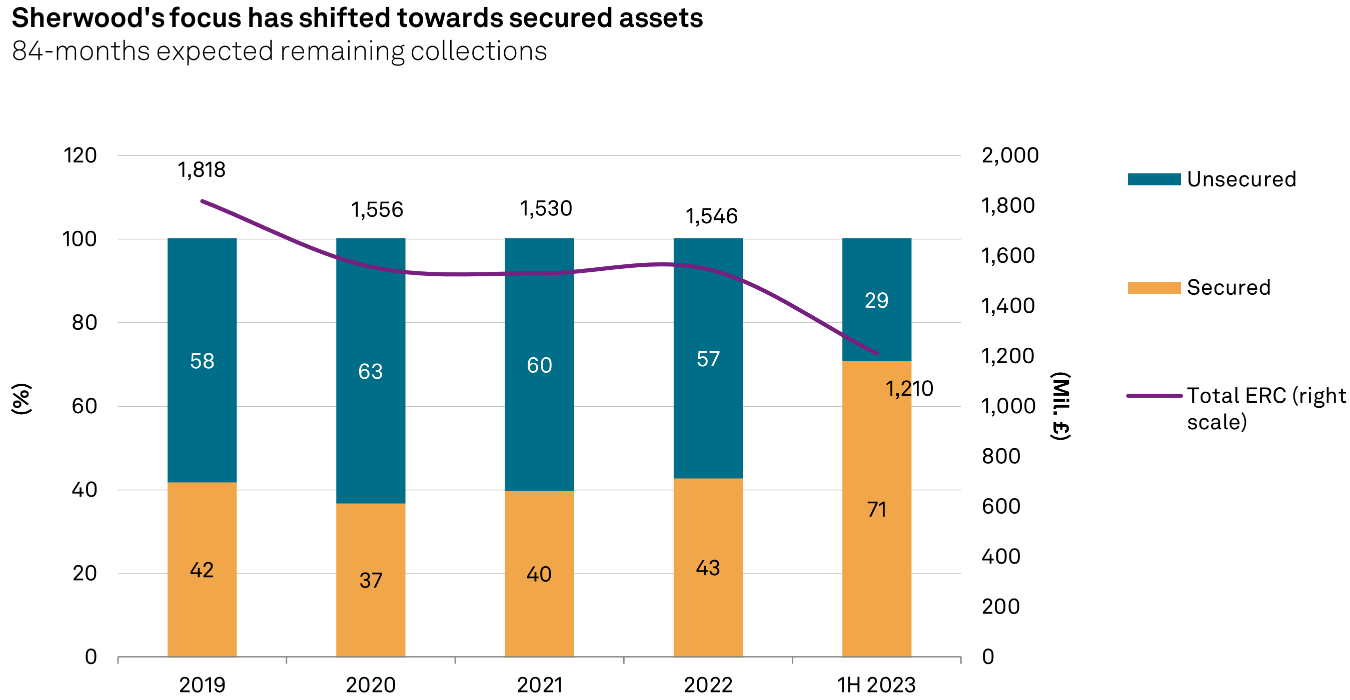
Sherwood is increasing capital-light revenue in its revenue mix



Sources: Company financials and S&P Global Ratings.

We view the transition to the integrated fund management model from purely distressed debt purchasing and servicing business as credit positive. We expect continuing growth of fund management revenue alongside the rising net asset value of funds under management. In our view, it will improve Sherwood's business diversity and predictability over the economic cycle and offset, to some extent, increased collection volatility from its exposure to secured portfolio and real estate. We also think the target business model would allow Arrow to support its scale without having to rely on attracting new debt and possibly significantly change its financial profile with enhanced returns and deleveraging. However, the strategy's ultimate success will depend on Sherwood's ability to deliver an appropriate return to LPs and attract investors. Although the company managed to deliver above the target return for its ACO 1 so far with a net deal internal rate of return of close to 18%, its total funds under management of €9.3 billion is small and the group is still transitioning towards this business' larger scale. Finally, we think that, over the next two years, portfolio collections will remain the dominant source of the company's cash revenue and EBITDA.

Chart 3



Sources: Company financials and S&P Global Ratings.

We expect Sherwood's profitability will remain relatively high, with EBITDA margin exceeding 45% in coming two years. Although the platform segment, which includes servicing and AM business, demonstrates lower EBITDA profitability than the balance-sheet business (about 20% versus 55%-60%) and expected to increase faster, Sherwood's operating efficiency remains close to major peers'. Also, the fund management activity has a significantly higher return on deployed proprietary capital than traditional balance sheet investments. The company's delivery of returns above funds' hurdle rates, allowing for performance fees, might also support profitability. However, given the timeline and uncertainty, we do not include any in our projections.

Financial Risk

We expect Sherwood's high leverage will gradually improve over the next two years thanks to the likely recovery of collections in 2024, lower capital investment needs, and debt reduction. In particular, we expect the company's adjusted debt to EBITDA will decrease to 4.3x-4.6x by year-end 2024 against 5.7x expected at year-end 2023. The expected jump in leverage in 2023 is due to a significant decline in underlying collections from its secured portfolio, which now represents 55% of Sherwood's ERC and which tend to be more volatile than unsecured assets, because the realization of collateral and court proceedings might take longer than expected. Although we expect Sherwood will likely return to its deleveraging trajectory in 2024, the illiquid nature of real estate collateral create uncertainty regarding actual collections and deleveraging speed over the next two years, especially in the current economic environment. Likewise, high interest rates might have a negative impact on real estate valuations.

Our assessment of Sherwood's financial risk profile is constrained by the company's very high unadjusted leverage metrics and ownership by a private equity financial sponsor. We forecast the group's debt to EBITDA, excluding portfolio amortization, will remain sustainably above 10x over the next two years. Our assessment of the group's financial risk profile incorporates its ownership by a private equity financial sponsor, although we acknowledge management and shareholder's publicly stated policy to lower net leverage to about 3x. We therefore do not see TDR's ownership as a risk factor for deleveraging.

Financial summary

Table 2

Sherwood Parentco Ltd.--Financial summary

	--Fiscal year ended Dec. 31--				
(Mil. £)	**2022**	**2021**	**2020**	**2019**	**2018**
Revenue	542.4	484.0	435.9	536.7	504.1
EBITDA	315.4	260.8	233.0	324.4	285.1
Funds from operations (FFO)	240.6	196.3	176.1	266.1	231.2
Interest expense	83.7	85.9	57.6	54.6	49.7
Cash interest paid	75.0	56.0	50.4	44.3	44.5
Cash flow from operations	242.3	196.9	151.4	324.2	203.7
Cash and short-term investments	143.6	198.9	182.9	88.8	92.0
Debt	1,488.8	1,464.1	1,377.2	1,241.5	1,205.0
Equity	427.4	510.4	116.7	201.9	192.3
Adjusted ratios					
Cash EBITDA margin (%)	0.6	0.5	53.0	62.0	59.0
Return on capital (%)	15.1	14.0	14.6	21.5	21.1
EBITDA interest coverage (x)	3.6	3.0	4.0	5.9	5.7
FFO cash interest coverage (x)	4.2	4.5	4.5	7.0	6.2
Debt/EBITDA (x)	4.7	5.6	5.9	3.8	4.2
FFO/debt (%)	16.2	13.4	12.8	21.4	19.2

Reconciliation

Table 3

Sherwood Parentco Ltd.--Reconciliation of reported amounts with S&P Global Ratings' adjusted amounts

	--Fiscal year ended Dec. 31, 2022--			
Sherwood Parentco Ltd. reported amounts (mil. £)				
	Debt	**EBITDA**	**Operating income**	**S&P Global Ratings' adjusted EBITDA**
Reported	1,457.7	69.1	45.9	315.4
S&P Global Ratings' adjustments				
Cash taxes paid	--	--	--	0.3
Cash interest paid	--	--	--	(75.0)
Reported lease liabilities	31.0	--	--	--

Table 3

Sherwood Parentco Ltd.--Reconciliation of reported amounts with S&P Global Ratings' adjusted amounts (cont.)				
Nonoperating income (expense)	--	--	2.2	--
Noncontrolling interest/minority interest	--	--	--	--
Revenue: Finance/interest income	--	0.5	0.5	--
EBITDA: Fair value changes of contingent consideration	--	225.7	225.7	--
EBITDA: Foreign exchange gain/(loss)	--	10.8	10.8	--
EBITDA: Other (situational)	--	9.3	9.3	--
Total adjustments	31.0	246.3	248.6	(74.8)
S&P Global Ratings' adjusted amounts				
	Debt	**EBITDA**	**EBIT**	**Funds from operations**
Adjusted	1,488.8	315.4	294.5	227.3

Liquidity

Sherwood has adequate liquidity. We expect sources of liquidity will exceed uses by more than 1.2x in the coming 12 months.

We anticipate the following liquidity sources over the 12 months from July 1, 2023:

- Cash generation net of cash interest and taxation of about £283 million.
- Headroom under the senior RCF of approximately £177 million.
- Cash and cash-equivalents of about £99 million.

We anticipate the following principal liquidity uses over the same period:

- Capital investments for portfolio acquisitions of £160 million-£165 million.
- Working capital outflow of close to £50 million.
- Debt repayment of £110 million-£120 million.
- Cash spent on acquisition of 51% of Maslow and Eagle Street of £40 million.

Debt maturities

- 2026: £108.5 million of the drawn RCF
- 2026: €400 million and £350 million of fixed-rate senior secured notes
- 2027: €640 million of floating-rate senior secured notes

Covenant Analysis

The group maintains comfortable headroom under its covenants.

There is only one covenant on the RCF: debt to adjusted EBITDA ratio not exceeding 7.0x. As of midyear 2023, Sherwood's calculated ratio was 3.4x, which gives comfortable headroom below the threshold. There is a difference with S&P Global Ratings-calculated leverage, because Sherwood added £91.5 million of proceeds received from the assets' sale to Intrum, which is consistent with the covenant's calculation rules.

Comparable Ratings Adjustment

We adjust our 'b' anchor up by one notch to arrive at our 'B+' rating, reflecting the following factors:

- Sherwood's most comfortable debt maturity profile among peers, with the earliest public debt maturity coming in the end of 2026, three years from now.
- The group's pivot towards a capital-light model of servicing and fund management, where Sherwood co-invests in purchasing new debt with other LPs, which gives the ability to expand its business without attracting new debt.
- High and rising servicing and fund management revenue, reaching 40% of cash revenues as of June 30, 2023, which improves business diversity and earnings stability over the economic cycle. We also see a clear path for further increase of this revenue's share closer to 45%-50% over the next two years.

Issue Ratings--Recovery Analysis

Key analytical factors

- We rate the senior secured notes issued by Sherwood Financing PLC 'B+'. The recovery rating of '4' indicates our expectation of average recovery prospects (30%-50%; rounded estimate: 40%) in the event of default.
- The issue ratings incorporate our view of the group's asset base and the prospective scale and contribution to group income of its servicing business and investment management business.
- Our simulated default scenario contemplates a default in 2027, reflecting a significant decline in cash flow following adverse operational issues, lost clients, difficult collection conditions, or greater competitive pressures leading to the mispricing of portfolio purchases.
- We calculate a combined enterprise value considering different business segments and assuming Sherwood's portfolio of debt receivables would find a potential acquirer.
- We deduct assets pledged to the securitization in our analysis and assume the facility would be 100% drawn at default. We apply a 25% haircut to the book value of the debt portfolios after adjusting for the pledged assets.
- In addition, we assume earnings from its servicing and management businesses will decline and apply a valuation using a 4.0x EBITDA multiple. We assess it on a going-concern basis, given its long-term contracts and established relationships with customers.

Simulated default assumptions

- Year of default: 2027
- Jurisdiction: U.K.

Simplified waterfall

- Net enterprise value on liquidation (net of 5% administrative expense): £766 million
- Priority claims: £249 million
- Collateral value available to secured creditors: £517 million
- Senior secured claims: £1.27 billion
- --Recovery expectations: 4 (30%-50%; rounded estimate: 40%)

Debt totals include six months of prepetition interest expense.

Ratings Score Snapshot

Issuer credit rating: B+/Stable/B

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)
- Liquidity: Adequate (no impact)
- Financial policy: FS-6 (no additional impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: b+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 | 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

- Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening, Sept. 25, 2023
- Europe's Distressed Debt Purchasers Face Mounting Risks Amid Tough Economic Conditions, Jan. 24, 2023
- Sherwood's Plan To Sell Part Of Its U.K. Business Highlights Shift Toward An Integrated Asset Manager Model, Nov. 25, 2022

Ratings Detail (As Of November 28, 2023)*	
Sherwood Parentco Ltd.	
Issuer Credit Rating	B+/Stable/--
Issuer Credit Ratings History	
21-Jan-2022	B+/Stable/--
Sovereign Rating	
United Kingdom	AA/Stable/A-1+

*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.