

## Sherwood Parentco Ltd. (Arrow )

*Primary analyst: Dmitry Nazarov*

We lowered the ratings on Sherwood Parentco Ltd. and its SSNs to 'B' from 'B+' and affirmed the stable outlook. The downgrade follows the implementation of the new Criteria and our new approach to calculate revenues and EBITDA and reflects Arrow's significantly higher leverage and earnings volatility compared with other financial and corporate entities with 'B+' credit rating, including alternative asset managers to which Arrow is transitioning. By the end of 2023, Arrow's adjusted debt to EBITDA had increased to 11.4x from 8.5x in 2022, because of expectedly lower collection performance and the significant investments needed to develop its investment management business. Last year Arrow divested some of its UK portfolios and used the proceeds to develop its fund management franchise, but we do not include these proceeds in our EBITDA calculation, because we consider the divestment a one-off transaction. We understand that the company expects to realize some of the collections deferred last year during 2024. This could increase Arrow's adjusted revenue by about 30% in 2024 and would deliver a reduction in leverage.

We attribute this high level of collections volatility to Arrow's increased exposure to real estate and secured assets and anticipate that collections will remain volatile for the next two years. During this period, estimated remaining collections are likely to contribute more to revenue than income from fund and asset management services. We expect Arrow's investment management and servicing revenue to grow by about 20%-25% over 2024-2025, although this will only partially offset the expected decline in collections during 2025 caused by Arrow's low proprietary investments in its back book, given its shift to a more capital-light business model. Growing EBITDA and debt repayment of about £75 million-£100 million in 2024 and 2025 is likely to reduce Arrow's leverage over the period. Nevertheless, in our base case, we assume that debt to EBITDA will still exceed 5.5x by year-end 2025. Arrow is likely to invest some of free cash flow in developing its investment management franchise--potentially by making bolt-on acquisitions. This would slow the reduction in leverage going forward.

Given the significant progress Arrow has achieved in transitioning toward an investment management business model, we also compare it with alternative asset managers. Last year, the group's total assets under management increased by about 50% to

€9.3 billion. Despite the strong growth, Arrow commenced its transition to a fund manager in 2019 and as such remains small in the content of the asset management space.

Revenue from the management and servicing business increased by 19.3% to €193.6 million (about 40% of Arrow's cash revenue). Arrow also increased its total origination to €1.2 billion from €0.8 billion and launched two new funds in real estate and direct lending. It continues to attract capital from new limited partners. These developments will allow Arrow to grow its future asset management revenue, as growth in fund management earnings will accelerate closer to end of the funds' life, maintain proprietary investments at the current lower level, and generating significant free operating cash flow (FOCF). Although Arrow's strategy allows it a path to significantly reduce its leverage, so far it has not made use of the benefits to improve its financial profile as management prioritized reinvestment in its business over debt repayment.

In our view, Arrow maintains a comfortable debt maturity profile—its earliest maturity is the senior secured notes, which are due in 2026. We expect it to refinance these well in advance, although its high leverage may complicate the task.

### *Outlook*

The stable outlook indicates that Arrow is likely to gradually reduce its leverage so that adjusted debt to EBITDA drops toward 6.0x over the next two years. Our key underlying assumption is that collections will recover in 2024 after collections from the secured portfolios saw a material decline in 2023 due to lower collateral realization. The group's continued pivot toward fund management is expected to support this trend. We anticipate that management will refinance the senior secured notes maturing in November 2026 well in advance.

#### *Downside scenario:*

We could lower the rating if we see a significant increase in refinancing risks. We could also lower the rating if financial leverage is persistently above 7x, or interest coverage falls below 2x.

#### *Upside scenario:*

We could raise the rating if Arrow's adjusted debt to EBITDA falls below 5.0x and the group maintains its financial flexibility, with FOCF to debt above 15%. An upgrade would depend on the successful implementation of management's strategy to

increase the scale of Arrow's investment management business, as well as a lack of significant refinancing needs.

**Sherwood Parentco Ltd.--Key Metrics\***

<b>Mil. GBP</b>	<b>Fiscal year end Dec.31</b>			
	<b>2022a</b>	<b>2023a</b>	<b>2024f</b>	<b>2025f</b>
S&P Global Ratings Adjusted Debt to EBITDA (x)	8.5	11.4	6.5-7.0	6.0-6.5
Company reported Debt to Cash EBITDA (x)	4.1	3.9	--	--
EBITDA Interest Coverage (x)	2.1	1.2	2.1-2.3	2.3-2.5
FOCF to Debt (%)	3.1	13.6	15.0-16.0	17.0-18.0
Debt-to-tangible equity (x)	-3.9	-2.6	(1.2)-(1.6)	1.4-1.8

\*All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast.