FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Sherwood Parentco Limited's to 'B+'; Outlook Stable

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Fitch Ratings - London - 25 Jun 2024: Fitch Ratings has downgraded Sherwood Parentco Limited's (Arrow) Long-Term Issuer Default Rating (IDR)to 'B+' from 'BB-'. The Outlook is Stable. Fitch has also downgraded Sherwood Financing Plc's senior secured debt, guaranteed by Arrow (among other Sherwood entities) to 'B+'/'RR4' from 'BB-'.

Arrow is the parent company of Sherwood Acquisitions Limited, a UK-based entity set up by TDR Capital LLC (and owned by investment funds managed by TDR Capital LLC) to acquire Arrow Global Group, a European fund manager specialising in a range of distressed and performing assets.

KEY RATING DRIVERS

The downgrade reflects Arrow's continued material leverage, which amid higher interest rates increases pressure on its financial metrics while it moves towards a fund management-based business model. It also reflects its developing investor franchise and the longer-term benefits expected from shifting to an asset-light strategy, which differentiates it from traditional debt purchasers.

Shift to Low Balance-Sheet Usage: Arrow is transitioning from traditional debt purchasing towards acting primarily as a manager of funds investing in NPL portfolios as well as other distressed and performing assets, and as the servicer of those assets. Under the revised business model, own balance-sheet usage reduces principally to co-investments in funds and decreased to around 10% in the new funds (ACO 2, AREO) from 25% of total fund size in the first fund (ACO1). As a result, Arrow's 2023 purchases for its own balance sheet reduced to GBP148.5 million, materially lower than 2022 (GBP181 million).

By end-1Q24, Arrow's total funds under management (FuM) had grown to EUR9.3 billion. In Fitch's view, the long-term FuM growth rate remains sensitive to performance in existing funds, which are still at an early stage of their lives, as well as continued investor appetite for investments in non-performing and real estate assets.

Significant EBITDA; Weak Profitability: Arrow's adjusted EBITDA margin remained sound in 2023, reflecting the growth of asset-light activities, in line with Arrow's strategy to grow its capital-light business. However, net earnings remain negative, with a pre-tax loss of GBP 125 million in 2023 (2022: GBP 84 million), after accounting for high financing costs and the GBP36 million fair-value adjustment cost resulting from the acquisition of Maslow Capital.. We expect Arrow to generate increasing earnings from its growing discretionary funds in the medium term, as the company keeps fundraising and deploying capital.

Leverage Constrains Rating: Arrow's Long-Term IDR is constrained by high cash flow leverage, with a Fitch-calculated gross debt/adjusted EBITDA ratio of 4.4x at end-2023, down from a high 5.6x at end-2021. Similar to many European distressed asset purchasers, Arrow's tangible equity is negative following material inorganic growth, and this is also reflected in Fitch's capitalisation and leverage assessment.

Management targets net cash flow leverage at 3.0x-3.5x in the medium term and Fitch expects leverage to benefit from growing revenue in the integrated fund management segment. This may lead Fitch to adopt a hybrid approach to benchmarking leverage, once the EBITDA base has achieved a more even split between investment activities and fund management.

Medium-Term Refinancing Requirements: Fitch expects Arrow's funding needs to remain significant in the medium term, despite the longer-term movement towards a balance-sheet-light business model. However, it benefits from a lack of bond maturities before November 2026 and liquidity is supported by a GBP285 million revolving credit facility.

Diversification of Income: Arrow's scale is below that of higher-rated alternative asset managers (measured by assets under management) and debt purchasers (measured by estimated remaining collections). However, the company's integrated fund management business has shown continued fund-raising growth since launch in 2019. Arrow largely targets smaller and often off-market local transactions, which are less price sensitive than more standard auction-led transactions

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Inability to keep leverage (gross debt/adjusted EBITDA) below 4.5x, or to demonstrate movement towards pre-tax profitability.

- Material collection underperformance, in particular if leading to meaningful portfolio impairments.

- Material increase in Arrow's risk appetite or weakening of its corporate governance.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Sustained improvement in Arrow's gross leverage ratio to below 3.5x, alongside sound fund performance that facilitates ongoing investor support for investment in future funds.

DEBT AND OTHER INSTRUMENT RATINGS: KEY RATING DRIVERS

As Arrow's senior secured notes are the company's main outstanding debt class, Fitch has equalised the notes' ratings with the Long-Term IDR, indicating average recoveries for the notes.

DEBT AND OTHER INSTRUMENT RATINGS: RATING SENSITIVITIES

-A downgrade of the Long-Term IDR would likely be mirrored in a downgrade of the notes. In addition, worsening recovery expectations, for instance, through a larger layer of structurally senior debt, could lead Fitch to notch down the notes' rating from the Long-Term IDR

-An upgrade of the Long-Term IDR would likely be mirrored in an upgrade of the notes. In addition, improved recovery expectations, for instance, through a larger layer of junior debt, could lead Fitch to notch up the notes' rating from Arrow's Long-Term IDR

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Sherwood Parentco Limited has an ESG Relevance Score of '4' for Financial Transparency due to {DESCRIPTION OF ISSUE/RATIONALE}, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Sherwood Parentco Limited	LT IDR	B+ Rating Outlook Stable	Downgrade	BB- Rating Outlook Stable
Sherwood Financing Plc				
senior secured	LT	B+	Downgrade	BB-

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

David Pierce
Director
Primary Rating Analyst
+44 20 3530 1014
david.pierce@fitchratings.com
Fitch Ratings Ltd
30 North Colonnade, Canary Wharf London E14 5GN

Marwa El Quitouni El Idrissi
Analyst
Secondary Rating Analyst
+44 20 3530 1736
marwa.elquitounielidrissi@fitchratings.com

Aslan Tavitov
Senior Director
Committee Chairperson
+44 20 3530 1788
aslan.tavitov@fitchratings.com

MEDIA CONTACTS

Matthew Pearson
London
+44 20 3530 2682
matthew.pearson@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria (pub. 17 Jan 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Sherwood Financing Plc	UK Issued, EU Endorsed
Sherwood Parentco Limited	UK Issued, EU Endorsed

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