

Research Update:

# Sherwood Parentco 'B' Rating Affirmed; Outlook Stable; Sherwood Financing Proposed Senior Secured Notes Rated 'B'

November 21, 2024

## Rating Action Overview

- Sherwood Financing PLC, a financing subsidiary of Arrow Global Group (Arrow) controlled by Sherwood Parentco, today announced an offer to exchange its existing senior secured notes for new ones, extending the maturity by three years.
- We view the transaction as a treasury management exercise rather than distressed exchange.
- We think that the transaction is leverage neutral, should improve Arrow's debt maturity profile, and potentially reduce its refinancing risks depending on the amount of existing debt remained outstanding after the transaction.
- We affirmed our 'B' long-term issuer credit rating on Sherwood Parentco Ltd. and assigned a 'B' issue-level rating and '4' recovery rating to the proposed notes.
- The stable outlook indicates that Arrow's continuing pivot toward integrating its fund management model should reduce its leverage in the coming two years, and that the exchange offer should diminish its refinancing risks to some extent.

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## Rating Action Rationale

**S&P Global Ratings today assigned its 'B' issue level rating to Sherwood Financing PLC's three proposed senior-secured notes due 2029 (final amounts to be determined).** The group today launched an offer to its bondholders to exchange its existing €400 million 4.5% senior secured notes due in November 2026 and to exchange its €640 million three-month EURIBOR+4.625% senior secured notes due in November 2027 for new floating rate notes due in December 2029 with a minimum amount of £450 million. Concurrently with the exchange offer, the group launched new minimum €250 million fixed-rate senior secured notes, and minimum £250 million fixed-rate senior secured notes due in December 2029 to refinance existing notes. The proposed notes will rank pari passu with the remaining existing notes and will be guaranteed by Sherwood Parentco and several of Arrow's operating subsidiaries. Sherwood Financing is a wholly owned financing

subsidiary of Sherwood Parentco. The rating on the proposed notes is in line with our rating on the existing senior secured notes and our long-term issuer credit rating on Sherwood Parentco Ltd. (B/Stable/--). The '4' recovery rating on the notes indicates our expectation for average (30%-50%; rounded estimate: 45%) recovery in a simulated default scenario.

**We understand that the exchange offer is fully voluntary, and we view the transaction as a proactive treasury management exercise, rather than a distressed exchange.** The final amount of the new notes will be subject to the acceptance rate by the exiting bondholders under the exchange offer. Arrow will not incur any additional debt with the transaction, and we view the exchange offer as leverage neutral. The exchange offer, if implemented, should be positive for the group's debt maturity profile and refinancing risks. That said, there is still an uncertainty of how much existing senior secured notes will remain outstanding after the transaction and it will depend on the bondholders' acceptance rate. In addition to the exchange offer, Sherwood plans to extend the maturity of its £285 million revolving credit facility (RCF) from April 2026 to June 2029 (as of Sept. 30, 2024, £147.6 million was drawn).

**For the first nine months of 2024, Arrow demonstrated solid results, in line with our base case.**

Arrow's cash revenue increased by 45% year on year and reached £491.4 million, driven by growth of investment management and servicing revenue by 37.6% year on year and a significant recovery of collections that were delayed in 2023. Arrow's integrated fund management EBITDA rose by 79% to £52 million, reflecting the growth in fee-paying funds under management (FUM), which we view as positive given the higher predictability compared with balance-sheet portfolio collection. Total FUM increased to €10.5 billion, with €5.1 billion under management in Arrow's fund and €5.4 billion managed by servicing platforms.

**We expect that S&P Global Ratings-adjusted debt to EBITDA will reduce to 6.5x-7.0x by the end of 2024 from 11.4x last year (6.9x as of Sept. 30, 2024), and S&P Global Ratings-adjusted EBITDA to interest expense will recover to 2.0x-2.5x.**

Although the continuing growth of Arrow's investment management business and revenue should support deleveraging, we think that the group will remain highly leveraged in the coming two years with S&P Global Ratings-adjusted debt to EBITDA remaining above 5x by the end of 2026. This is because growing investment management revenue will be offset to some extent by the gradual decline in collections, due to Arrow's smaller proprietary back book. Although coupon rates on the new debt will be higher than those on the existing senior secured notes, the exchange should not materially increase the group's interest burden and should reduce its interest coverage ratios.

## Outlook

The stable outlook on Sherwood indicates that Arrow is likely to gradually reduce its leverage so that S&P Global Ratings-adjusted debt to EBITDA declines toward 5.0x-5.5x over the next two years. Our key underlying assumption is the group's continued pivot toward fund management will support this trend, despite lower collections from its back book. We anticipate that management will exchange most of its existing senior secured notes for the new ones, reducing its refinancing risks.

## Downside scenario

We could lower the rating if we see a significant increase in refinancing risks, for example if a

substantial portion of the existing debt will remain outstanding and the group does not refinance it well in advance. We could also lower the rating if financial leverage increases again persistently above 7x, or interest coverage falls below 2x.

## **Upside scenario**

We could raise the rating if Arrow's adjusted debt to EBITDA falls closer to or below 5x and the group maintains its financial flexibility, with free operating cash flow 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.

## **Liquidity**

We view Sherwood's liquidity as adequate because we think that the group's liquidity sources will continue to exceed its liquidity uses by at least 1.2x over the next 12 months.

Principal liquidity sources over the 12 months started June 30, 2024 include:

- Headroom under the senior RCF of approximately £100 million.
- Cash generation net of cash interest and taxation about £431 million.
- Cash and its equivalents of around £91 million.

Principal liquidity uses in the same period include:

- Portfolio acquisitions from proprietary capital of £145 million-£150 million.
- Working capital outflow of close to £30 million.
- Debt redemption of about £75 million.

## **Issue Ratings--Recovery Analysis**

### **Key analytical factors**

- We updated our recovery analysis on Sherwood Parentco to reflect the group's proposed exchange offer and new debt issuance.
- The proposed senior unsecured notes issued by Sherwood Financing are rated 'B' with a '4' recovery rating, indicating our expectation for average (30%-50%; rounded estimate: 45%) recovery in a simulated default scenario.
- 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 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 4x EBITDA multiple. We assess Sherwood on a going-concern basis, given Arrow's 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): £840 million
- Priority claims: £249 million (RCF).
- Collateral value available to secured creditors: £517 million.
- Senior secured claims: £1291 million.
- Recovery rating: 4
- Recovery expectations: 30%-50% (rounded estimate: 45%)
- Debt totals include six months of prepetition interest expense.

### **Related Criteria**

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

\*\*\*\*\* Sherwood Parentco Ltd. \*\*\*\*\*

### Ratings Affirmed

#### Sherwood Parentco Ltd.

Issuer Credit Rating	B/Stable/--
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### New Rating

#### Sherwood Financing PLC

Senior Secured	<b>B</b>
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Recovery Rating	4(45%)
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### Ratings Affirmed;

	To	From
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#### Sherwood Financing PLC

Senior Secured		
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EUR400 mil 4.50% nts due 11/15/2026	B	B
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Recovery Rating	4(45%)	4(40%)
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EUR640 mil fltg rate nts due 11/15/2027	B	B
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Recovery Rating	4(45%)	4(40%)
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£350 mil 6.00% nts due 11/15/2026	B	B
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Recovery Rating	4(45%)	4(40%)
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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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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