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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**
Ongoing growth under the integrated fund management business model, supporting prospectively higher free cash flow and lower leverage.	High financial leverage.
Strong expertise in investing in and servicing of distressed assets across several European markets.	Elevated exposure to real estate and secured debt, which increases collections and cash flow volatility.
Comfortable debt maturity profile after recent refinancing of its public debt.	Smaller scale compared to both large European investment managers and some pan-European distressed debt purchasers like Intrum and Lowell.

Arrow Global Group, controlled by holding company Sherwood Parentco Ltd., will continue to grow as an integrated fund manager of distressed assets. This involves continuing deployment of capital attracted to Sherwood's funds (such as Arrow Credit Opportunity [ACO] Fund 2 and Arrow Real Estate Opportunity 1), ongoing growth of funds under management with plans to launch ACO 3 fund in 2025, 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 generation with a growing proportion of recurring fee-based revenues in its mix.

For the first nine months of 2024, Arrow demonstrated solid results, in line with our base case. For the first nine months of 2024, Arrow's cash revenue increased by 45% year-on-year and reached £491.4 million, driven by the growth of investment management and servicing revenues by 37.6% and a significant recovery of collections that had been 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 the balance-sheet portfolio collection. Total FUM increased to €10.5 billion, with €5.2 billion under management in Arrow's fund and €5.3 billion managed on a non-discretionary basis by its platforms.

Sherwood successfully reduced refinancing risks through public debt refinancing in November 2024 but increased maturity concentration, with nearly 90% of outstanding debt maturing in December 2029. 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 its debt again. Although Sherwood still needs to repay around £98 million of its old senior secured notes over 2026-2027, we expect that Sherwood will be able to cover it with cash, a revolving credit facility (RCF), and free operating cash flow.

Although low investment needs will likely allow Sherwood to reduce its leverage, we think that the company 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. We estimate that adjusted debt to

EBITDA reduced to 6.5x-7.0x by the end of 2024 from 11.4x in 2023 (6.9x as of Sept. 30, 2024), and adjusted EBITDA to interest expense will recover to 2.0x-2.5x. However, we consider positively the lower volatility of revenue from management fees compared to those from its balance-sheet secured debt collection.

Outlook

The stable outlook on Sherwood indicates that Arrow is likely to gradually reduce its leverage so that adjusted debt to EBITDA declines toward 5.0x-5.5x over the next two years. Our key underlying assumption is that the company's continued pivot toward fund management will support this trend, despite lower collections from its back book.

Downside scenario

We could 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 company 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.

Our Base-Case Scenario

Assumptions

- We estimate that gross collections recovered in 2024 by around 30%-31% to £375 million-£380 million boosted by deferred collections from 2023. In 2025, however, collections are set to decline again by around 34%-38% because of the declining proprietary investments by Sherwood over the past three years and sale of U.K. unsecured portfolios to Intrum in 2023. For the same reason, collections will continue to decline 2026 by another 13%-16%.
- Servicing and investment management (IM) revenues grew by 30%-35% in 2024, mainly supported by investment management fees from Sherwood's growing FUM.
- The growth in servicing and IM revenues will remain close to 25%-30% during 2025-2026 driven by growing fee-generating FUMs.
- Adjusted EBITDA growth in 2024 is expected to be 65%-70% driven by cash revenue growth. However, we expect it will decline by 5%-10% in 2025, which is less severe than that of cash revenues, because of progressively less impact of portfolio amortization on the company's EBITDA and growing contribution from IM fees.
- Capital expenditure for portfolio purchases will continue to decline by around 5% per year over 2025-2026 (after an estimated reduction by 4%-6% in 2024) reflecting Sherwood's lower need to invest its proprietary capital and growing deployment of resources from limited partners (LPs) under Arrow's management.

Key Metrics

Sherwood Parentco Ltd.--Key metrics*				
	--Fiscal year ended Dec. 31, 2023--			
(Mil. £)	2023a	2024e	2025f	2026f
Adjusted EBITDA	128.7	205-215	190-210	230-250
Debt to EBITDA (x)	11.4	6.5-7.0	6.5-7.0	5.0-6.0
EBITDA interest coverage (x)	1.2	2.0-2.5	1.7-2.2	1.8-2.3
FFO/Debt (%)	1.8	5.0-10.0	5.0-10.0	7.0-12.0

*All figures adjusted by S&P Global Ratings. 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 91% of Arrow.

Arrow's core business activities include investment management of several credit and real estate funds, servicing of distressed debt portfolios, and purchasing and collecting distressed assets, including secured and unsecured consumer nonperforming debt. The company has a large portfolio of distressed assets on its balance sheet with estimated remaining collections (ERC) of £1.18 billion and cash collections generated close to 60% of its revenues in 2024. The company's key markets include the U.K., Portugal, Italy, the Netherlands, and Ireland.

Peer Comparison

Table 1

Sherwood Parentco Ltd.--Peer comparison					
(Mil. £)	Adjusted ratios, 2024 estimate				
	Sherwood Parentco Ltd.	Garfunkelux Holdco 2 S.A.	Intrum AB (publ)	B2 Impact ASA	Axactor ASA
Ratings as of Jan. 14, 2025	B/Stable/--	CC/Negative/C	CC/Negative/C	BB-/Stable/--	B-/Negative/--
Adjusted ratios					
Debt/EBITDA (x)	6.5-7.0	8.5-9.0	7.0-7.5	4.0-4.5	5.0-5.5
FFO/Debt %	5.0-10.0	3.0-5.0	6.5-7.5	15.0-16.0	9.5-10.5
EBITDA interest coverage (x)	2.0-2.5	1.0-1.5	1.9-2.1	3.2-3.4	2.0-2.2

Although Sherwood is transitioning toward an alternative asset management model, we view other European distressed debt purchasers and servicers as its best peers and apply the same revenues and EBITDA adjustments. The company's main peers in the distressed debt market are Intrum AB (publ) (CC/Negative/C); Garfunkelux Holdco 2 S.A. (Lowell group; CC/Negative/C); B2 Impact ASA (BB-/Stable/--); and Axactor ASA (B-/Negative/--). We also compare Sherwood with European alternative asset managers, but these tend to have higher ratings because of more established franchises and lower financial leverage.

Sherwood's good geographical diversity and well-established position across a few European markets supports the predictability of its business volumes compared with smaller competitors and supports its ratings. Sherwood has significantly increased its share of capital-light revenue, which was close to 39% of the company's cash income as of September 2024 and higher than most rated peers save Intrum.

Nevertheless, we view Sherwood's size and scale as weaker than pan-European majors such as Intrum and Lowell in terms of revenue, earnings, and asset base. The company is still relatively small compared to many European alternative asset managers. Following its acquisition by TDR Capital, Sherwood remains one of the most leveraged companies among peers with an estimated three-year weighted-average debt to adjusted EBITDA of close to 6.1x. Unlike many peers, Sherwood retains high financial flexibility thanks to its highest free operating cash flow to debt, relatively low investment needs, a sizable untapped RCF, and no material refinancing needs over the next three years.

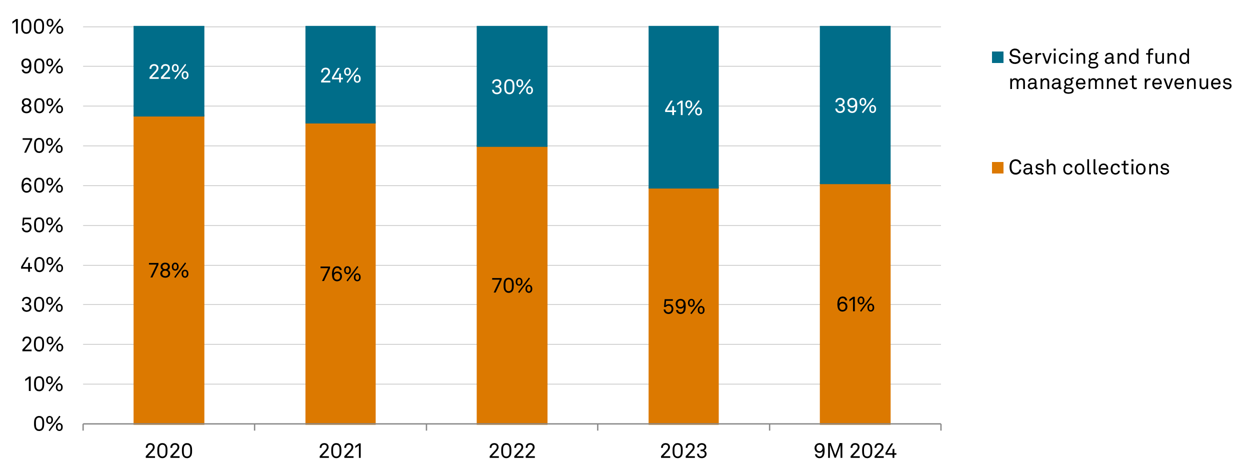
Business Risk

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 six 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 company 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 85% of investments in first-half 2024 having 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. The company is servicing portfolios for more than 200 parties with total assets under management reaching €90 billion. Nevertheless, with estimated cash revenues of around £630 million-£640 million for 2024 and 120-month ERC of £1.18 billion, the company 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 LPs, however, will allow Sherwood to meaningfully increase its scale in key markets.

Sherwood has made a significant progress in shifting its business model toward 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. In addition to the fully deployed ACO 1 closed-end fund of €1.7 billion, Sherwood has deployed approximately 75% of its €2.75 billion ACO 2 fund and secured more than €650 million of commitments to its first real estate lending fund, increasing its total FUM close to €10.5 billion, including €5.4 billion managed by servicing platforms. Expecting to launch the fundraising for its ACO 3 later this year, the company targets to increase its FUM by 50% over the next two to three years. The deployment of attracted capital should increase the company's income-generating assets, driving the growth of capital-light income from management fees (1.75% for ACO 1 and ACO 2) and performance fees if the delivered return exceeds the 'hurdle' rate (7% for ACO 1 and 8% for ACO 2). Although we do not include performance feeds in our projections given the timeline and uncertainty, we expect that the share of servicing and IM revenues in total revenue should increase to roughly 63%-67% by end of 2026.

Chart 1

Sherwood is increasing capital-light revenues in its revenue mix



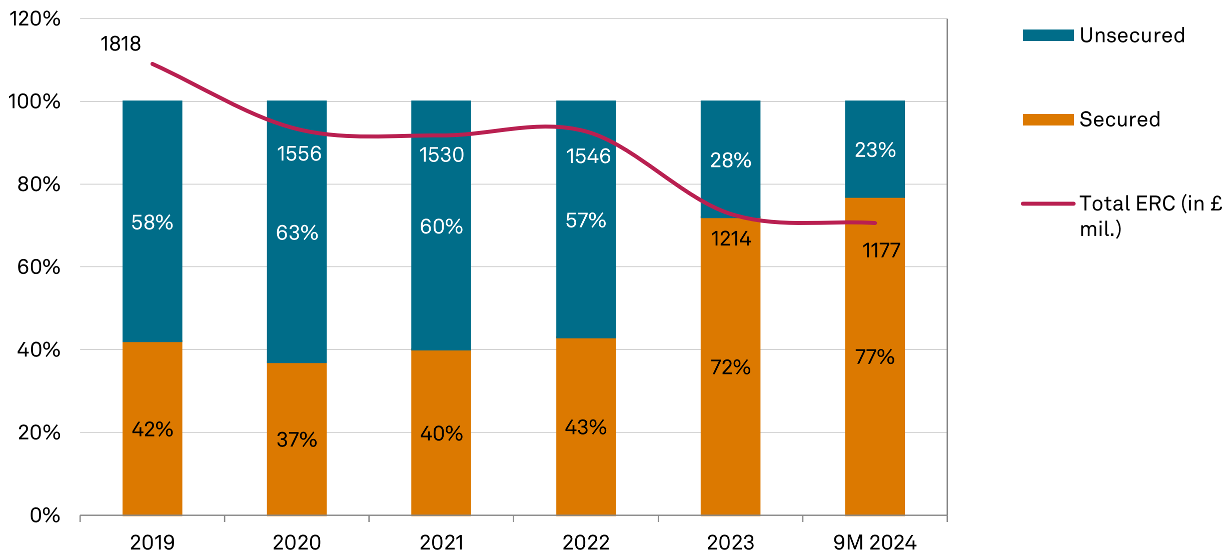
Sources: Company financials and S&P Global Ratings.

We view the transition to the integrated fund management model from purely distressed debt purchasing and servicing business as credit positive. We expect continued 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 marginally offset the increased collection volatility from its exposure to secured portfolio and real estate. The new model will also enable Sherwood to capture higher market share and increase revenue without having to attract debt as Sherwood co-invests only a small portion of deployed funds along with LPs. For example, by consolidating control over financially distressed French-based iQera (SD) in December 2024 and the U.K.-based AFE S.A. (CCC+/Stable/-) in December 2023 via its ACO funds, the company entrenched its positions on distressed and real estate markets in France, Italy, and the U.K.

Sherwood's ultimate success of its current strategy will depend on its ability to consistently deliver an appropriate return to LPs and attract new investors. Although the company managed to deliver above-target return for its ACO 1 so far with a net-deal-internal rate of return of close to 18%, its total FUM (in Arrow's funds only) of roughly €5.2 billion is small and the company is still transitioning toward upscaling this business.

Chart 2

Sherwood's focus has shifted toward secured assets
84-months expected remaining collections (%)



ERC--Estimated remaining collection. Sources: Company financials and S&P Global Ratings.

We expect Sherwood's profitability will remain solid, with adjusted EBITDA margin of 34%-39% in coming two years. Sherwood's operating efficiency remains close to major peers. The servicing and IM business demonstrates lower EBITDA profitability than the balance-sheet business (about 20% versus 55%-60%) and is expected to increase faster in the next three years. However, the fund management activity has a significantly higher return on deployed proprietary capital than traditional balance sheet investments, especially if the company generates performance fees.

Financial Risk

We anticipate Sherwood's high leverage will reduce over the next two years thanks to the low investment needs, growth in EBITDA, and modest debt repayment. We estimate that S&P Global Ratings-adjusted debt to EBITDA will reduce to 6.5x-7.0x by the end of 2024 from 11.4x at the end of 2023 thanks to the recovery of collections in 2024. We adjust revenue and EBITDA by adding back 50% of principal collected as the portfolio amortizes instead of 100% in the company's reported cash EBITDA. Although the continuing growth of Arrow's investment management business and revenue should support deleveraging, we think that the company 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, especially in 2025, due to Arrow's smaller proprietary back book.

Despite reduced refinancing risks after successful issuance of new debt in November 2024, the company's interest burden remains relatively high. In Q4 2024, Sherwood exchanged its £1.2 billion of outstanding senior secured notes due in 2026 and 2027 for new €965 million floating-rate notes, 7.625% €225 million notes, and 9.625% £225 million notes due in December 2029. The company also renegotiated its £285 million RCF with a new maturity in June 2029. The refinancing extended Sherwood's debt maturity profile, although it has become more concentrated at the later date. We expect no issues with repayment of the old outstanding issues of around £98 million over 2026-2027. Higher interest rates on new debt will keep Sherwood's interest coverage in the range of 1.9x-2.2x over 2025-2026, which is lower than for higher rated peers, but consistent with Sherwood's rating.

Reconciliation

Table 2

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

Sherwood Parentco Ltd. reported amounts (mil. £)

	--Fiscal year ended Dec. 31, 2023--			
	Debt	**Revenue**	**EBITDA**	**S&P Global Ratings' adjusted EBITDA**
	1434.4	275.5	25.7	128.7
S&P Global Ratings' adjustments				
Cash taxes paid	--	--	--	(11.3)
Cash interest paid	--	--	--	(91.5)
Reported lease liabilities	26.3	--	--	--
Nonoperating income (expense)	--	--	--	--
Noncontrolling interest/minority interest	--	--	--	--
Revenue: Finance/interest income	--	0.8	0.8	--
Revenue: Other (situational)		109.4	109.4	
EBITDA: Gain/(loss) on disposals of PP&E	--	--	0.1	--
EBITDA: Foreign exchange gain/(loss)	--	--	(19.6)	--
EBITDA: Other (situational)	--	--	12.4	--
Total adjustments	26.3	110.1	103.0	(102.8)
S&P Global Ratings' adjusted amounts				
	Debt	**Revenue**	**EBITDA**	**Funds from operations**
	1460.7	385.6	128.7	25.9

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 next 12 months from Sept. 30, 2024:

- Cash and cash-equivalents of about £90 million.
- Headroom under the senior RCF of approximately £230 million.
- Cash flow from operations of about £425 million.

We anticipate the following principal liquidity uses over the next 12 months from Sept. 30, 2024:

- Portfolio acquisitions from proprietary capital of £140 million-£150 million.
- Working capital outflow of close to £25 million.
- Debt repayment of about £70 million.

Debt maturities

- 2026: £70 million of old fixed-rate senior secured notes.
- 2027: £27.6 million of old floating rate senior secured notes.
- 2029: €285 million of RCF (55.2 million drawn as of November 2024).
- 2029: €965 million of the new floating-rate senior secured notes.
- 2029: €250 million and £250 million of fixed-rate senior secured notes.

Covenant Analysis

The company maintains comfortable headroom under its covenants.

There is only one covenant on the RCF: debt to adjusted EBITDA ratio not exceeding 7.0x to be tested if the drawn amount exceeds £114.0 million (40% of the total amount). As of Sept. 2024, Sherwood's calculated ratio was 3.6x, which gives comfortable headroom below the threshold.

Environmental, Social, And Governance

ESG factors have no material influence on our credit rating analysis of Sherwood. We consider that the company has well-placed policies to mitigate potential risks that could arise within an industry that is under constant scrutiny related to business ethics, data privacy, and security. However, we consider that these policies are broadly in line with other distressed debt purchasers and are not a sufficiently differentiating factor to underscore against other rated peers.

Issue Ratings--Recovery Analysis

Key analytical factors

- We rate the senior secured notes issued by Sherwood Financing PLC at 'B'. The recovery rating of '4' indicates our expectation of average recovery prospects (30%-50%; rounded estimate: 45%) in the event of default.
- The issue ratings incorporate our view of the company's asset base and the prospective scale and contribution to company 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 and 45% to the book value of real estate.
- 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): £870 million.

• Priority claims: £249 million (RCF).

• Collateral value available to secured creditors: £620 million.

• Senior secured claims: £1,315 million

• Recovery rating: 4

• Recovery expectations: (30%-50%; rounded estimate: 45%)

Debt totals include six months of prepetition interest expense.

Ratings Score Snapshot

Issuer credit rating: B/Stable/-

Business risk: Fair

• Country risk: Intermediate

• 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: Moderately negative (no impact)

• Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b

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 Detail (As Of January 24, 2025)*	
Sherwood Parentco Ltd.	
Issuer Credit Rating	B/Stable/--
Issuer Credit Ratings History	
26-Apr-2024	B/Stable/--
21-Jan-2022	B+/Stable/--
Sovereign Rating	
United Kingdom	AA/Stable/A-1+

Ratings Detail (As Of January 24, 2025)*(cont.)

*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.