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Together Financial Services Ltd.

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Together Financial Services Ltd.

Major Rating Factors

Issuer Credit Rating
BB-/Positive/--

Strengths:	Weaknesses:
• Predictable, recurring, high-margin earnings. • High quality capital base built from a long history of retained earnings. • Continued improvement in the group's funding diversification.	• Narrow business diversity with growing competition in non-standard mortgages. • Rapid loan book growth creates a degree of overarching risk in the business.

Outlook

The positive outlook on Together reflects our view that the group's improving track record of funding stability and diversification, and continually stable profitability, may be commensurate with a higher rating over the next 12 months.

Upside scenario

We could raise our ratings on Together and its intermediate holding company, Bracken MidCo1, by one notch in the next 12 months if the group is able to:

- Continue to successfully diversify its funding sources;
- Deliver continued stable operating performance; and
- Maintain its S&P Global Ratings stable funding ratio above 90%.

Downside scenario

We could revise the outlook back to stable if:

- Together is unable to access public residential mortgage-backed security (RMBS) markets and diversify its funding sources over the coming 12 months, reverting to its historical reliance on private warehouse facilities; or
- The group's historically stable operating performance and asset quality were to weaken materially in the context of continued rapid growth.

Rationale

The 'BB-' issuer credit rating on Together balances our favorable view of its consistent strategic approach, earnings track record, and overall capital position, against its relatively narrow focus on specialist segments of the competitive U.K. mortgage market, its history of reliance on comparatively limited, and relatively illiquid, wholesale funding sources.

Our view of Together's capital position is built from its high quality capital base, offset by a growing loan book, and falling new business margins. In assessing Together's capital we also note that its business model--characterized by non-standard lending, low weighted-average loan-to-value (LTVs), and limited historic credit losses--is an imperfect fit for our risk-adjusted capital (RAC) model, and our assessment reflects this.

Together's funding position is a rating constraint given its majority wholesale, and private profile. However, we believe that Together has demonstrated a track record of managing these facilities prudently, and has meaningfully expanded its public RMBS franchise. As such, our positive outlook reflects our opinion that over the next 12 months we could see the group's funding position as being commensurate with a higher rating.

Anchor: Three notches below the anchor for a typical U.K. bank

The anchor for Together is 'bb+', in line with our typical preliminary anchor for a finance company operating in the U.K. This is three notches below the typical U.K. bank anchor, which we derive from our banking industry country risk assessment (BICRA). We believe that the main risks for these companies are from industry risk, namely the absence of prudential regulatory oversight, lack of access to the central bank, and strong competition from banks and other credit providers.

Our U.K. BICRA trends for both economic risk and industry risk are stable.

Table 1

Together Financial Services Ltd.--Key Figures					
(Mil. £)	**Annual June, 2015**	**Annual June, 2016**	**Annual June, 2017**	**Annual June, 2018**	**Annual June, 2019**
Net interest income	112.1	143.3	157.7	199.4	226.3
Noninterest expenses	32.7	41.9	58.4	69.3	80.1
Net income	58.7	71.8	78.2	106.4	111.7
Net receivables	1,423.5	1,800.7	2,240.9	2,958.2	3,694.5
Total debt*	962.8	1,264.6	1,608.1	2,285.9	3,020.9
Total shareholders' equity	436.8	509.7	623.2	706.7	757.6

*Total debt for 2018 has been restated. Calculation is no longer net of cash in securitizations in the group. Source: S&P Global Ratings Database.

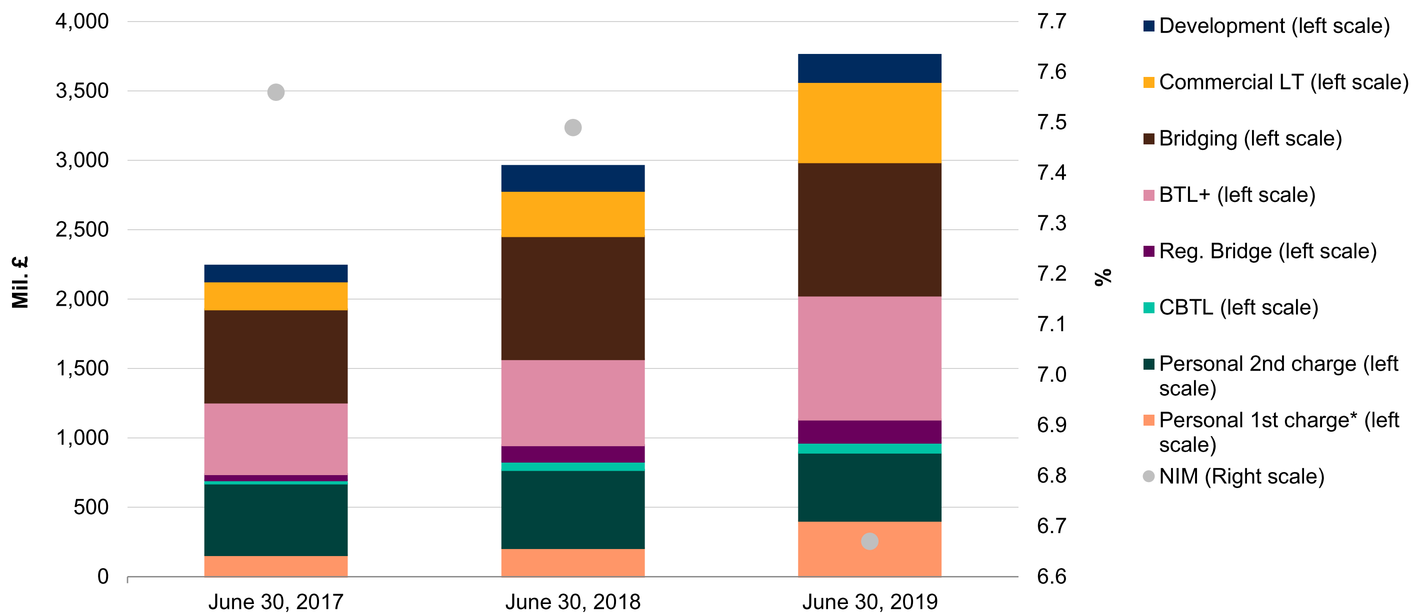
Business position: A specialist secured lender in an increasingly competitive U.K. market

Our assessment of Together's business position as moderate considers its well-established position in profitable niches of the U.K. mortgage market, against its modest share of the total mortgage market of major banks, the plethora of smaller banks and building societies, and other credit institutions. With a gross loan book of £3.9 billion as of Sept. 30, 2019, the overall moderate business risk assessment captures our view that Together is a small, if growing, presence in an increasingly price competitive and saturated U.K. mortgage market (see chart 1).

Together's focus on nonstandard, under-served lines of business including bridge and second lien lending, has given it a robust track record of profitability with a five-year weighted-average net interest margin (NIM) of above 7%. However, we note that Together has seen continued compression in its NIM as the group has had to move into price competitive and saturated markets to chase ambitious growth targets, with NIM at 6.7% for FY2019.

Chart 1

Together's Growth Has Led To Net Interest Margin Pressure

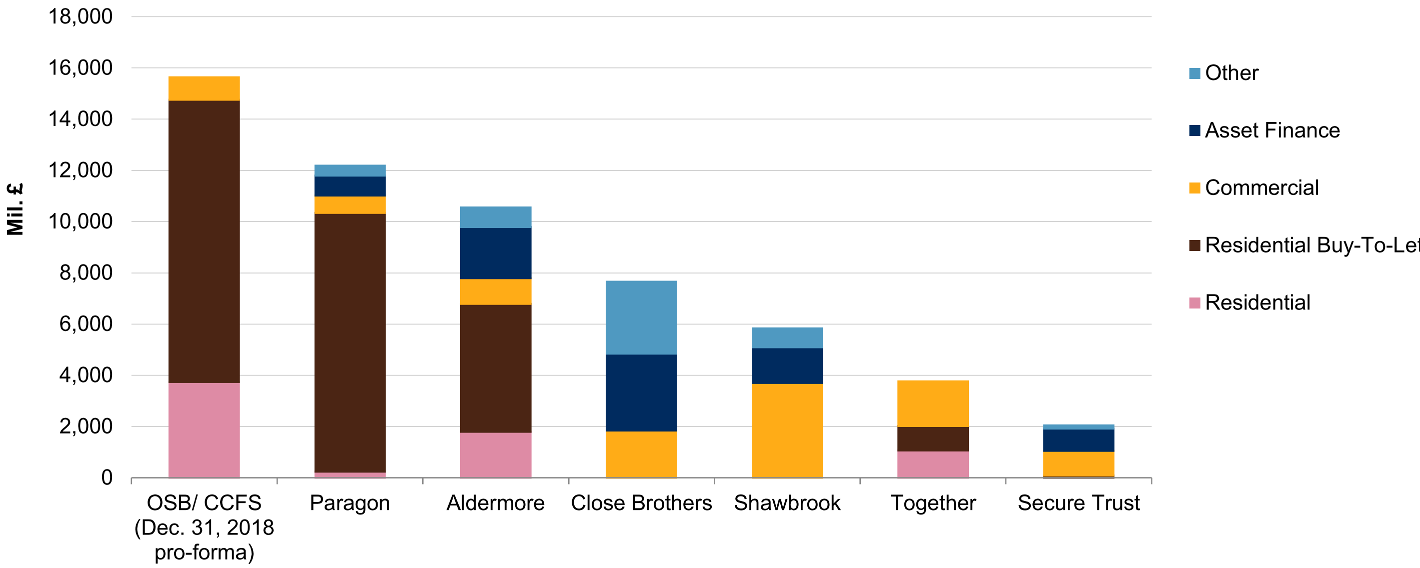


BTL--Buy-to-let. CBTL--Consumer buy-to-let. NIM--Net interest margin.

We do not expect this pressure to abate, as the group's core growth markets will continue to overlap with second tier U.K. banks and other price competitive lenders. Notably, important balance-sheet-growth drivers, namely buy-to-let (BTL) lending and nonstandard first-lien mortgage lending, are all increasingly competitive. As such, we remain vigilant to rapid deterioration in Together's NIM beyond our base case, and management guidance.

Chart 2

Together Loan Book Vs Challenger Bank Loan Books



Source: Company Reports, S&P Database. Most recent full year dates.

Overall, we expect falling margins to constrain the rating to a degree, while noting that Together's recent brisk loan growth brings a level of operational and credit risk to the group. That said, growth has not come at the expense of stable, predictable net income generation over the past 12-24 months, and the group's track-record of robust net income generation supports our rating today.

Our rating also considers Together's ongoing focus on institutionalising and expanding its management and governance framework. On Jan. 23, 2020, the group appointed Gerald Grimes as chief executive officer (CEO) designate to its founder, current CEO, and 100% owner Henry Moser. We believe this external appointment further demonstrates Together's continued efforts to support and strengthen its governance frameworks, which we see as important to future rating stability. That said, the influence and role of Mr. Grimes has yet to take shape, and we will monitor this closely as he takes up his new role.

Table 2

Together Financial Services Ltd.--Business Position

(Mil. £)	Annual June, 2015	Annual June, 2016	Annual June, 2017	Annual June, 2018	Annual June, 2019
Total assets*	1438	1818	2276	3053	3842
Gross receivables	1493	1870	2303	3020	3762
Operating Revenues	115	146	160	202	229
Net Income (After Extraordinaries)	59	72	78	106	112

Table 2

Together Financial Services Ltd.--Business Position (cont.)					
(Mil. £)	**Annual June, 2015**	**Annual June, 2016**	**Annual June, 2017**	**Annual June, 2018**	**Annual June, 2019**
Net interest margin (%)	8.7	8.5	7.6	7.5	6.7

*Total assets for 2018 have been restated. Calculation is now gross of cash in securitizations in the group.

Capital and earnings: Consolidated capital has weakened following rapid loan growth

Our assessment of Together's capital and earnings begins with its high margin earnings and good quality, stable capital base, which has never been harmed by dividends across its operating history. These strengths are set against margin pressure and rapid loan growth over our forecast period. On this basis we expect Together's RAC ratio to remain at 9.75%-10.00% over the next 12 months, commensurate with an adequate assessment.

In deriving our RAC ratio for Together we perform our analysis at the level of the ultimate parent in the group, RedHill FamCo Ltd. We do this to avoid double leverage considerations that would arise if we performed our capital analysis at the Together Financial Services level. At June 30, 2019, Redhill's RAC ratio was 10.2%, which was down by 70 bps from June 30, 2018, reflecting, amongst other things, the one-off effect of International Financial Reporting Standards (IFRS) 9 implementation and rapid loan book growth.

When performing our risk-weighted assets (RWA) calculation we do not use the standard mortgage risk weight applied to prime, first charge U.K. mortgages of 37%. Instead, we apply a greater RWA charge of 87% to its retail exposures, reflecting the nonstandard profile of many of the group's retail mortgages. Similarly, when considering its second charge mortgages, we apply a risk weight of 146%. Commercial mortgages are treated as corporate exposures and receive an 87% risk charge, and a much higher charge for the development loan book.

In forecasting our RAC ratio at the consolidated Famco, we include interest expense on senior notes that sit above the Together Financial Services level. As a consequence of this, we estimate that NIM was lower than the Together operating company at 5.50%-5.75% for full-year 2019. We expect this to tighten going forward, and foresee some modest cost inflation in 2020 as the group continues to expand its risk and operations staff, although we expect steady tapering of cost growth thereafter. Offsetting these pressures, we expect the group's low LTV underwriting policy to maintain new credit loss provisions at levels of around 0.4%-0.5% of the gross loan book into 2020 and 2021, in line with historic levels.

Table 3

Redhill Famco Ltd--Risk-Adjusted Capital Framework Data					
(Mil. £)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government & central banks	120.0	0.0	0.0	0.0	0.0
Of which regional governments and local authorities	0.0	0.0	0.0	0.0	0.0
Institutions and CCPs	0.0	0.0	0.0	0.0	18.1
Corporate	2,438.9	0.0	0.0	2,464.0	101.0
Retail	1,109.6	0.0	0.0	1,077.3	97.1

Table 3

Redhill Famco Ltd--Risk-Adjusted Capital Framework Data (cont.)					
Of which mortgage	187.1	0.0	0.0	273.4	146.1
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	168.0	0.0	0.0	219.6	130.7
Total credit risk	3,836.5	0.0	0.0	3,760.9	98.0
Credit valuation adjustment					
Total credit valuation adjustment	--	0.0	--	0.0	--
Market Risk					
Equity in the banking book	0.0	0.0	0.0	0.0	0.0
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	0.0	--	0.0	--
Operational risk					
Total operational risk	--	0.0	--	353.1	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	0.0	--	4,113.9	100.0
Total Diversification/ Concentration Adjustments	--	--	--	1,450.3	35.3
RWA after diversification	--	0.0	--	5,564.2	135.3
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		0.0	0.0	418.8	10.2
Capital ratio after adjustments‡		0.0	0.0	418.8	7.5

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'June. 30 2019', S&P Global Ratings.

The Together operating company reported adjusted profit before tax, excluding amortization of goodwill and intangibles, of £133 million in the year to June 30, 2019, up from £122 million for the same period the year before. This increase primarily reflects continued growth in the size of Together's loan book, dampened somewhat by continued growth in personnel expense. We understand that personnel expense growth was driven by Together expanding its group risk, finance, and assurance functions as well as operations management in its core commercial finance business. We see these as prudent investments in the group's evolving risk management and assurance structures, and note significant earnings capacity to absorb these expenses. Our assessment of Together's capital position is supported by a high level of internal capital generation, in addition to a history of the owner leaving capital in the business and foregoing dividends across its history.

Table 4

Together Financial Services Ltd.--Capital And Earnings

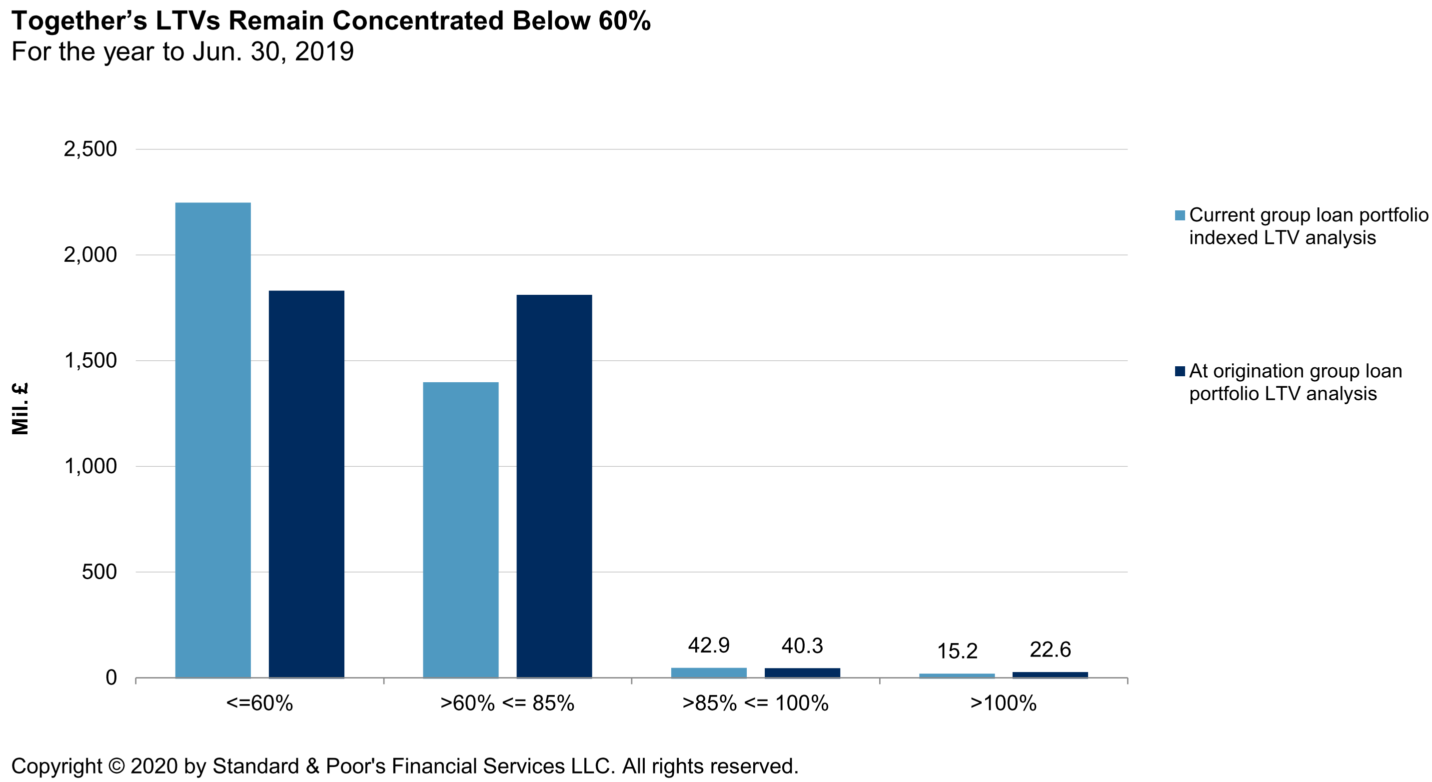
(Mil. £)	Annual June, 2015	Annual June, 2016	Annual June, 2017	Annual June, 2018	Annual June, 2019
Noninterest expenses/operating revenues (%)	28.3	28.7	36.5	34.2	35.1
Net interest income/operating revenues (%)	97.2	98.2	98.6	98.5	99.0
Return on average assets (%)	4.6	4.4	3.8	4.1	3.3
Core earnings/average adjusted assets (%)	4.7	4.4	3.8	4.4	4.7
Return on average common equity (%)	15.3	16.0	13.8	15.2	14.1

Risk position: Rapid growth in higher-risk lending mitigated by relatively conservative loan-to-value underwriting

Our RAC ratio does not fully reflect the level of risk on Together's balance sheet, as we reflect in our adequate risk position assessment. Primarily, we note that actual credit risk on Together's balance sheet is lower than suggested by our RAC model, as evidenced by the group's low historical loss experience from its weighted average LTV of 55% on its book. However, Together continues to demonstrate rapid growth, and we remain cautious on the risk that this poses to the group's rating, with its gross book growing 24% in 2019, which we do not expect to slow materially going forward. As such, whilst we believe our RAC assessment overstates risk in the group to a degree, our adequate assessment also balances Together's rapid growth in niche, higher risk market sectors.

An important constraint in our assessment of the group's position is the fact that Together's arrears are higher than those of mainstream lenders. As of June 30, 2019, its Stage 3 loans represented a high 8.4% of gross receivables. A broader analysis indicates that its Stage 2 loans represented about 11.2% of outstanding gross receivables for the same period. However, Together's expected credit loss (ECL) provisioning for these loans, representing 14.6% at Stage 3, and 2.3% at Stage 2, appears to suggest that its low LTV book provides a level of insulation from credit risk. For example, new mortgage advances in the year to June 30, 2019 had a weighted-average LTV of 58%, with the majority of loans advanced at LTVs below 60%, and we expect no change in this approach.

Chart 3



Additional support to our overall assessment of capital at Together includes our view that, in its higher risk niche, the quality of underwriting needs to be consistently strong. Together's track record of high underwriting standards and a large in-house collections team help to keep its asset quality manageable.

Funding and liquidity: Wholesale funded lender

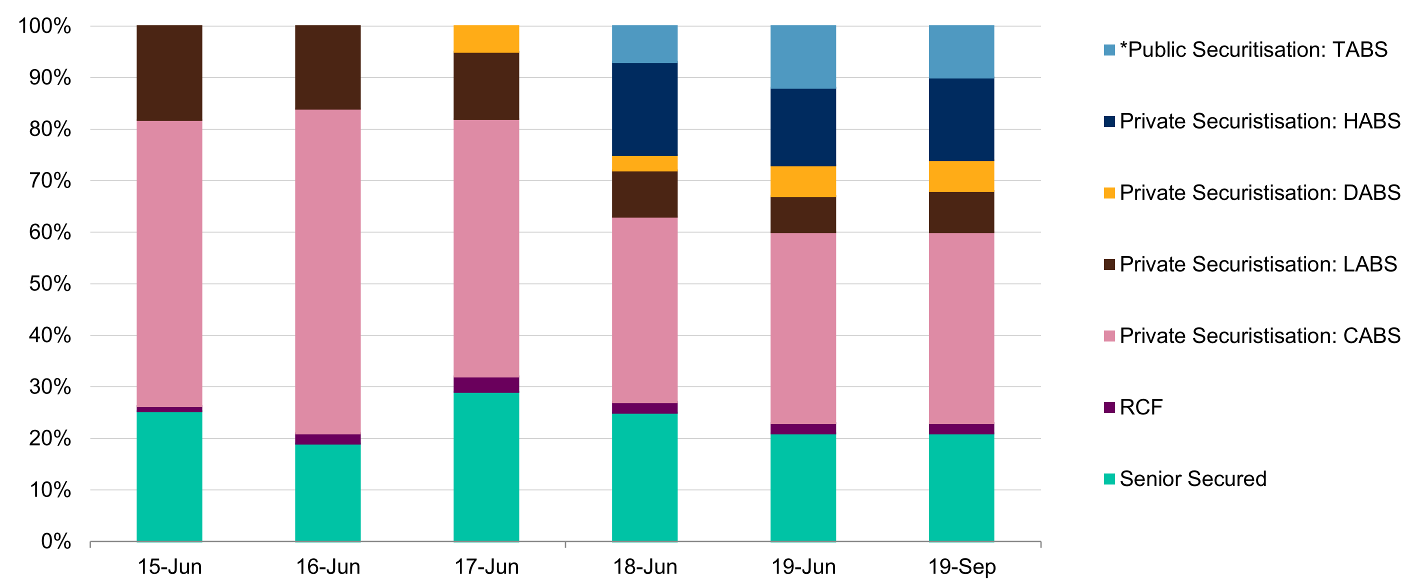
Our assessment of funding as moderate takes into account Together's reliance on wholesale funding sources, offset by an absence of short-term debt maturities and well-spread tenors on its facilities with an S&P Global Ratings' stable funding ratio of around 99%.

Historically, Together's reliance on confidence sensitive private warehouse facilities has tempered our view of its funding. However, over the past year, we think the group has demonstrated an ability to sustainably manage its private facilities, while meaningfully expanding its public franchise. We note that Together had £762 million of headroom in its private warehouse facilities (pro forma two transactions completed in October 2019) and £669 million of public RMBS issued under its "Together Asset Backed Securitisation" (TABS) program, as of Sept. 30, 2019. We think both of these figures demonstrate Together's successful diversification, particularly when considered alongside £785 million outstanding under its senior secured notes program, which reflects recent refinancing which closed on Feb. 10, 2020, and £350 million payment-in-kind (PIK) toggle notes.

Previously, when we have compared the group's funding structure to nonbank peers, such as U.K. credit card lender NewDay Group (B+/Stable), we have viewed Together's position less favorably. This is primarily due to its relatively nascent public RMBS franchise and reliance on private, illiquid funding. However, following Together's funding diversification, we now see a material prospect that its funding and liquidity will no longer be a relative ratings weakness. This is because we consider the recent improvements to be durable. That said, given Together's specialist lending profile, the group's public RMBS franchise will continue to lack the liquidity by volume and currency of a credit card asset-backed security franchise, such as NewDay's. This means Together still requires a private warehouse funding model alongside the public TABS program.

Chart 4

Together Funding Profile (June 2015-September 2019)



RCF--Revolving credit facility. Note: September 2019 values are not pro forma of October refinancing on private facilties.

Source: Company Reports

If Together continues to meaningfully diversify its funding sources over the next 12 months, whilst holding its stable funding ratio above 90%, we will likely revise our assessment to adequate. At the same time, we could also raise our rating on the group upward by one notch to 'BB', all else remaining equal.

We view Together's liquidity as adequate. The group demonstrated a favorable maturity mismatch as of June 30, 2019, stating that only about £75 million of borrowings were due for settlement within the following 12 months. We therefore do not consider liquidity to be a major risk given the absence of significant short-term debt maturities, no track record of dividend payments outside of the group, Together's relatively simple balance sheet, and its fairly predictable cash flow from interest payments. Together aims to keep a satisfactory cash buffer available at all times (over and above the cash that is encumbered with its conduit facilities), which it would be able to draw on, should it need to endure a protracted period of market stress.

Comparable ratings adjustment: None

We do not apply any comparable rating adjustments.

Support: No uplift to the stand-alone credit profile

We do not factor any external support into our rating on Together.

Holding company and issue level ratings

Within the consolidated group we rate two issuances for Together. First, the senior secured notes (SSNs) issued out of Jerrold FinCo, and second the PIK toggle notes issued out of the non-operating holding company (NOHC), Bracken MidCo 1.

The SSN ratings are equalized with the broader group credit profile of 'bb-'. This captures the guarantee between Together Financial Services and the issuing entity. As our rating on Together is below investment grade, to derive our rating on the SSNs we perform a number of asset coverage tests. Primarily, we establish whether the adjusted assets of the group--calculated as total assets minus goodwill and intangibles, minus assets pledged to the securitization facilities (given that it is nonrecourse)--are enough to cover the outstanding value of the SSNs. We expect this to be the case across our forecasts to June 30, 2020, and as such equalize the rating on the SSNs with that of Together.

The long-term issuer credit rating on the NOHC is 'B+', one notch lower than the rating on Together, reflecting structural subordination. Specifically, we believe that the senior secured notes guaranteed by Together, and issued from Jerrold FinCo (see above), have preferential rights to cash flows generated by the operating entities. We then equalize the rating on the PIK notes with that on MidCo as we see no further subordination of the notes beyond what is captured in our assessment of the issuing entity.

Additional rating factors:None

No additional factors affect this rating.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/--

Group credit profile: bb-

Anchor: bb+

- BICRA economic risk score*: 4
- BICRA industry risk score*: 3
- Business position: Moderate (-1)
- Capital and earnings: Adequate (0)
- Risk position: Adequate (0)
- Funding and liquidity: Moderate/Adequate (-1)
- Comparable ratings adjustment: None (0)

- Support: 0
- GRE support: 0
- Group support: 0
- Sovereign support: 0
- Additional factors: 0

*The typical nonbank financial institutions finance company anchor is three notches below the bank anchor, derived from our Banking Industry Country Risk Assessment. The anchor for a bank operating in the U.K. is 'bbb+'.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009

Related Research

- Together Financial Services Ltd. Outlook Revised To Positive On Continued Funding Diversification; 'BB-' Rating Affirmed, Jan. 24, 2020
- Together Financial Services Ltd., Feb. 1, 2019
- Together Financial Services Affirmed At 'BB-' On Proposed Refinancing; Outlook Stable; Senior Holdco Notes Rated 'B+', Sept. 14, 2018

Ratings Detail (As Of February 18, 2020)*	
Together Financial Services Ltd.	
Issuer Credit Rating	BB-/Positive/--

Ratings Detail (As Of February 18, 2020)*(cont.)	
Issuer Credit Ratings History	
24-Jan-2020	BB-/Positive/--
21-Nov-2017	BB-/Stable/--
26-Oct-2016	B+/Stable/--
20-Sep-2016	BB-/Watch Neg/--
08-Jul-2016	BB-/Negative/--
Sovereign Rating	
United Kingdom	AA/Stable/A-1+
Related Entities	
Bracken MidCo1 PLC	
Issuer Credit Rating	
Local Currency	B+/Positive/--
Senior Secured	B+

*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.