

Research Update:

# Together Financial Services Outlook Revised To Stable On Robust Funding Diversification And Performance; Rating Affirmed

January 27, 2021

## Overview

- U.K. specialist lender, Together Financial Services, has continued to diversify its funding base over the past 12 months, refinancing and scaling up its long-term senior secured funding, expanding its public residential mortgage-backed securities franchise, and maintaining significant headroom in its private warehouse facilities.
- Additionally, the group has displayed relatively robust earnings and manageable asset quality despite the difficult U.K. macroeconomic environment.
- We are therefore revising our outlook on Together and its nonoperating holding company Bracken MidCo1 PLC to stable from negative.
- We are also affirming our 'BB-' long-term issuer credit rating on Together and our 'B+' long-term issuer credit rating on Bracken.
- The stable outlook reflects our view that despite continued financial systemwide pressure over the next 12 months, Together's well diversified, flexible funding base, and high margin earnings will support the ratings on Together and Bracken.

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## Rating Action

On Jan. 27, 2021, S&P Global Ratings revised its outlook on Together Financial Services Ltd. and its nonoperating holding company, Bracken MidCo1 PLC, to stable from negative.

At the same time, we affirmed the 'BB-' long-term issuer credit rating on Together and the 'B+' rating on Bracken. We also affirmed our issue ratings on senior secured notes (SSNs) issued by Jerrold Finco PLC, a subsidiary of Together, and the payment-in-kind (PIK) toggle notes issued by Bracken.

## Rationale

Together has continued to diversify and stabilize its funding base, while its earnings--led by its high-margin business and low weighted-average loan-to-value profile--have remained relatively resilient. Combined, we believe these traits will support the ratings on Together and Bracken over the next 12 months, notwithstanding our negative view of U.K. financial systemwide risks. As such, we have revised our outlook on both entities to stable from negative.

Privately owned Together is a specialist mortgage lender, with a gross loan book of £4.1 billion as of Sept. 30, 2020. The group has a small, albeit expanding, presence in an increasingly price competitive and saturated U.K. mortgage market. It focuses especially on segments of the market that may require some form of manual underwriting including bridge loans, second-lien lending, and buy-to-let lending. Because of its niche, higher margin lines of business, the group has a robust track record of profitability, with a five-year weighted-average net interest margin of above 7%.

Contrary to our previous concerns that the COVID-19 pandemic could render funding markets more difficult or more costly to access, Together has issued well in excess of £1 billion of funding across its facilities from February of 2020 to date. Most recently the group closed a £500 million six-year issuance from its financing subsidiary Jerrold Finco in mid-January 2021, refinancing and upsizing £350 million of SSNs. Approximately a year ago, the group closed another round of SSN funding from Jerrold Finco, raising £435 million to refinance and upsize £375 million of bonds. Additional proceeds from these deals were primarily used to refinance securitized balances in its private facilities. In July 2020, the group closed its fourth residential mortgage-backed securities transaction, TABS 4, raising £370 million of new funding and freeing up a broadly similar amount in its private facilities. We note that these transactions are in public markets, expanding Together's funding diversification away from its historical reliance on private warehouse facilities. Though this reliance has been a ratings constraint historically, as of Sept. 30, 2020, the group had £872 million of headroom in its private facilities, which we view as a significant source of prospective liquidity.

Successful public funding diversification combined with strong headroom in its private warehouses represents a stabilizing element in our rating on Together. As such, this supports the current 'BB-' rating, and is the main driver of our outlook revision.

The group's funding actions come amid a challenging systemwide outlook for U.K. lenders. We expect the pandemic will continue to constrain near-term economic activity in the U.K. and forecast that unemployment will rise materially, later in 2021, as government fiscal support begins to wind down. This will continue to challenge asset quality and profitability in the U.K. financial system. This systemwide view will continue to weigh on our ratings across the financial services sector, and in the case of Together, will continue to constrain the rating.

Against the backdrop of the pandemic, in the financial year to June 30, 2020, Together saw further income and balance sheet growth, offset by its loan impairment rate more than tripling to 168 basis points (bps) from 44 bps as management applied conservative macroeconomic assumptions. This led to its ultimate holding company, Redhill Famco, posting broadly flat comprehensive net income for the group of £54 million--a fairly resilient result, but down versus 2019. Management has communicated its intention to limit growth over the coming year, and, indeed, after years of rapid growth we forecast a flat-to-modestly-smaller balance sheet in the year ended June 30, 2021 for the group. Together has also embarked on a round of cost control measures, reducing headcount and digitizing its back-office processes. As a result, we forecast the group will see declining net interest income, still elevated impairments against pre-pandemic

levels, and broadly flat net earnings for the year ended June 30, 2021.

Base case assumptions for Redhill Famco, the ultimate holding company for Together Financial Services:

- Flat or modestly negative loan book growth;
- Still-elevated impairments as a percentage of average loan book, at roughly 150bps for 2021;
- Modestly falling operating expenses;
- Comprehensive net income of £50 million-£55 million; and
- Risk-adjusted capital ratio above 10.5% in 2021, a solid level for the rating and up from approximately 10% at year-end 2020, before declining in future years as brisk loan growth resumes.

These earnings and balance sheet profiles should support the ratings on Together and Bracken even if the difficult and uneven U.K. macroeconomic environment in 2021 proves to be worse than we currently assume. That said, if the U.K. environment were to stabilize and Together's results exceed our base case, additional upside could resurface.

Beyond our assessment of Together's funding and liquidity position, and its capital and earnings profile, our 'BB-' rating also considers the group's niche role in the U.K. mortgage market, and its consistent underwriting standards.

We rate three issuances within the consolidated group: the two SSNs issued by Jerrold Finco, and the PIK toggle notes issued by Bracken. We equalize the rating on the SSNs with the broader group credit profile of 'bb-'. This captures the guarantee between Together and Jerrold Finco. Since our rating on Together is below investment grade, we also perform our asset coverage tests to derive the rating on the SSNs. This has no effect on the issue rating. We equalize the rating on the PIK notes with the issuer credit rating on Bracken because we see no further subordination of the notes beyond that captured in our assessment of the issuing entity. The 'B+' issuer credit rating on Bracken sits one notch below the rating on Together, considering Bracken's structural cash flow subordination.

## **Outlook**

The stable outlook reflects our expectation that Together will maintain its solid funding franchise and resilient operating profitability over our 12-month outlook horizon. We expect to see the group continue to access public and private markets to maintain its funding franchise, while holding its profitability and capital around current levels. This is despite our expectation of ongoing pressure on volumes and asset quality given the uncertain U.K. macroeconomic environment.

## **Downside scenario**

We could lower the ratings if Together's asset quality deteriorates materially beyond our base case or the group's revenue generation capacity became severely pressured.

## **Upside scenario**

We could raise the ratings if:

- The U.K. economic environment were to stabilize; and

- The group's asset quality, operating performance, and business prospects exceeded our current expectations.

## Ratings Score Snapshot

	To	From
<b>Issuer Credit Rating</b>	BB-/Stable/-	BB-/Negative/-
SACP	bb-	bb-
Anchor	bb+	bb+
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Adequate (0)	Adequate (0)
Funding and	Adequate and	Moderate and
Liquidity	Adequate (0)	Adequate (-1)
Support	(0)	(0)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(-1)	(0)
Peer Comparison Notch	(-1)	(0)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- U.K. Banks Face A Bumpy Road To Earnings Recovery In 2021, Jan. 11, 2021
- Banking Industry Country Risk Assessment: United Kingdom, Nov. 17, 2020
- U.K. Lender Together Financial Services Outlook Revised To Negative On Economic Impact Of COVID-19; Ratings Affirmed, April 24, 2020
- Together Financial Services Ltd, Feb. 18, 2020
- Together Financial Services Ltd Outlook Revised To Positive on Continued Funding Diversification; 'BB-' Rating Affirmed, Jan. 24, 2020

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Together Financial Services Ltd.</b>		
Issuer Credit Rating	BB-/Stable/--	BB-/Negative/--
<b>Bracken MidCo1 PLC</b>		
Issuer Credit Rating		
Local Currency	B+/Stable/--	B+/Negative/--
Senior Secured	B+	
<b>Jerrold FinCo PLC</b>		
Senior Secured	BB-	

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