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Ratings

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Research Update:

Specialist Lender Together Financial Services Upgraded To 'BB-' On Steady Credit Profile Improvement; Outlook Stable

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Overview

- We believe that U.K.-based specialist lender Together Financial Services Ltd. (Together), has improved its creditworthiness, supported by good profitability, increased availability and diversity of funding, and a stronger governance structure.
- We now think that Together's 'bb-' stand-alone credit profile adequately captures its creditworthiness relative to similarly rated peers.
- As a result, we are raising our long-term issuer credit rating on Together to 'BB-' from 'B+', as well as the long-term rating on intermediate holding company Bracken MidCo1 PLC (Bracken) to 'B+' from 'B'.
- The stable outlook on Together and Bracken reflects our expectation that the group will maintain its solid earnings performance, consistent strategic focus, and acceptable asset quality over our 12-month rating horizon.

Rating Action

On Nov. 21, 2017, S&P Global Ratings raised its long-term issuer credit rating on Together Financial Services Ltd. (Together) to 'BB-' from 'B+'. The outlook is stable.

At the same time, we raised the long-term issuer credit rating on Bracken MidCo1 PLC (Bracken) to 'B+' from 'B'. The outlook is stable.

We also raised the long-term issue rating on the £375 million senior secured notes and £200 million senior secured notes issued by Jerrold FinCo PLC and guaranteed by Together to 'BB-' from 'B+'. In addition, we raised the long-term issue rating on Bracken's senior payment-in-kind (PIK) toggle notes to 'B+' from 'B'.

Rationale

The upgrade reflects our view of the progress the group has made across various areas over the past 12-18 months. We believe that Together has strengthened its management and governance structure, maintained its high margin earnings, and further diversified its wholesale funding profile.

Together has recently adopted a divisional group structure, separating its Personal Finance and Commercial Finance businesses. The two divisions are also managed by separate subsidiary boards, which include experienced executive and independent nonexecutive directors. We believe that these changes are one indication--along with improvements to its risk management framework and enhanced depth of the management team--that the group's management and governance framework has matured as the group has grown. We also think that it will enhance the organization's effectiveness and help strategically position the group as it continues its phase of growth.

Although its 2016 minority buyout reduced the consolidated group's capitalization and we expect particularly high loan growth to continue into 2018, we think the group is committed to maintaining strong levels of capital. This is supported by its long track record of profitability, the absence of dividends outside of the consolidated group, and our expectation that the group will maintain consistent risk appetite and underwriting standards.

Relative to higher-rated banking peers and similarly rated nonbank financial institutions, such as Amigo Loans Ltd. and Nemean Bidco Ltd. (trading as "NewDay"), we now believe that our 'BB-' rating (and our 'bb-' stand-alone credit profile (SACP) assessment) on Together adequately captures its creditworthiness. We assess the SACPs of the two peers mentioned at 'b+'.

In the 12 months to June 30, 2017, Together reported profit before tax of £94.1 million and loan growth of 24%. Loan growth in excess of 20% has featured for the past three years, which in part reflects its small loan book but also captures the opportunities for niche lenders in the specialist mortgage market. While we don't believe that Together has relaxed its underwriting standards and it is a growth business, we note that very high loan growth rates can often be a precursor to asset quality or operational pressures, over time.

We expect Together's fast loan growth to continue, driven by the group's availability of funding and expansion of distribution channels as opposed to an extension of risk appetite. The group's reported weighted average loan to value (LTV) on the loan portfolio remained around 53% and the average weighted LTV of the new business has remained stable at 57%. We observe a positive trend in the nonperforming loan (NPL; loans overdue by 90 days or more) ratio, which had fallen to 5.7% as of June 30, 2017, from 7.2% a year earlier, supported by the stable economic environment and decreasing legacy assets, particularly in commercial real estate.

We also expect a faster pace of growth in the group's first-charge retail portfolio, which we view as positive for the risk profile. We believe that the group's commitment to strong capitalization, low LTV lending, and significant credit growth is supported by its strengthened risk governance structure and improving processes and infrastructure.

We calculate our risk-adjusted capital (RAC) ratio at the consolidated group level to be 11.4% as of June 30, 2017. Our scope of consolidation includes the various nonoperating holding companies between the group's operating subsidiaries and ultimate shareholder. Our capital and leverage analysis focuses on the consolidated group because we believe this approach is the best assessment of the resources available to service the group's various debt instruments. We expect the RAC ratio will remain in the 11.0%-11.5% range in the next 12 months, based on retained earnings offsetting fast credit growth. We expect a moderate decrease in the net interest margin as Together grows its retail portfolio at a rate higher than its commercial portfolio, although from a risk perspective, we expect this to have a positive impact on our measurement of the group's risk-weighted assets.

Based on its gross loan book of £2.3 billion on June 30, 2017, we continue to view Together's business position as constrained by its modest size relative to U.K. banks, challenger banks, and other lenders. We also believe its focus on niche areas of the U.K. residential property lending market mean that its overall risk profile is higher. In our view, second-lien residential lending, bridging finance, and specialist mortgage lending are inherently higher-risk lending activities, reflected in the group's product pricing and stock of NPLs. As an entirely wholesale funded lender, we think that the group's sources of funding are reasonably well diversified. However, Together's funding profile is constrained by our expectation that the group will be required to undertake further funding initiatives. This is because of the likely fast pace of loan growth, which we believe renders the group sensitive to changes in debt market conditions. We view its management of liquidity as adequate, based on its simple balance sheet and fairly predictable cash flows.

The 'B+' long-term issuer credit rating on Bracken MidCo1 is one notch lower than the rating on Together, reflecting structural subordination. Specifically, we believe that the senior secured notes guaranteed by Together have preferential rights to cash flows generated by the operating entities. We additionally take into account that Together is not subject to material regulatory capital requirements and the majority owner has never taken a dividend. Consistent with our criteria, a PIK feature does not cause an instrument to be rated lower than the issuer credit rating on the issuer. We therefore equalize the issue rating on the senior PIK toggle notes with the counterparty credit rating on Bracken, the issuer, which captures the notching for subordination.

Outlook

The stable outlook on Together and Bracken reflects our expectation that the group will maintain its solid earnings performance, consistent strategic focus, and acceptable asset quality over our 12-month rating horizon. We also consider that the group has strengthened its corporate governance and operational infrastructure as it has expanded, and we expect that it will continue to develop these areas. Under our base-case scenario, we do not expect any further material pressure on the group's consolidated capitalization and leverage, and we continue to view management as committed to solid capitalization.

We could raise the ratings if the consolidated group's RAC ratio returned comfortably and sustainably to above 15%. It could also occur if we observed a material reduction in NPLs, sustainable growth without an associated deterioration in underwriting standards or pricing, and improved bottom-line earnings.

We could lower the ratings if asset quality deteriorated, or the RAC ratio fell below 10%. We could also lower the ratings if we believed that fast credit growth made future business prospects less predictable.

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: Strong (+1)
- Risk position: Moderate (-1)
- Funding/liquidity: Moderate/Adequate (-1)
- Comparable ratings adjustment: Neutral (0)
- Support: 0
- GRE support: 0
- Group support: 0
- Sovereign support: 0
- Additional factors: 0

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

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Together Financial Services Ltd.		
Issuer Credit Rating	BB-/Stable/--	B+/Stable/--
Bracken MidCo1 PLC		
Issuer Credit Rating	B+/Stable/--	B/Stable/--
Senior Unsecured	B+	B
Jerrold FinCo PLC		
Senior Secured*	BB-	B+

*Guaranteed by Together Financial Services Ltd.

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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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.