STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Research Update:

U.K.-Based Jerrold Holdings Ltd. Outlook Revised To Positive On Solid Execution Of Strategy; 'B+' Rating Affirmed

Primary Credit Analyst:
Nigel Greenwood, London (44) 20-7176-7211; nigel.greenwood@standardandpoors.com

Secondary Contact:
Dhruv Roy, London (44) 20-7176-6709; dhruv.roy@standardandpoors.com

Table Of Contents

Research Update:

U.K.-Based Jerrold Holdings Ltd. Outlook Revised To Positive On Solid Execution Of Strategy; 'B+' Rating Affirmed

Overview

- In our view, specialist U.K. secured lender Jerrold Holdings Ltd. (Jerrold) is making solid progress to work out legacy loan vintages, expand its business, increase the size of its management team, and expand its operational capability.
- At the same time, its level of leverage remains a relative credit strength.
- As a result, we are revising our outlook on Jerrold to positive from stable and affirming the 'B+' long-term counterparty credit rating.
- The positive outlook indicates the possibility of an upgrade if we observe sustainable growth without an associated deterioration in loan book credit quality, improved retained earnings, and no material increase in leverage.

Rating Action

On Oct. 17, 2014, Standard & Poor's Ratings Services revised to positive from stable its outlook on specialist U.K. secured lender Jerrold Holdings Ltd. and affirmed its 'B+' long-term counterparty credit rating on the company.

Rationale

The outlook revision recognizes Jerrold's resilient balance sheet and the solid progress that management is making to work out legacy loan vintages, expand the business, increase the depth of its management team, and expand its operational capability. At the same time, we have moderately increased our tolerance for leverage in our rating analysis of Jerrold.

Because Jerold had a loan book of only £1.1 billion at June 30, 2014, we view it as having a relatively narrow profile. It is a specialist U.K. secured lender that focuses on U.K. residential property lending, including second-charge mortgages and bridging finance. We consider these to be inherently higher-risk lending activities.

Over the past year, we have observed that Jerrold has made solid progress in expanding its loan book after several years of relative stagnation while the company worked through much-needed enhancements to its management of conduct risk. Jerrold has stated that gross new lending was £354 million in the year to June 30, 2014, which was almost double the level of each of the prior two years. In our view, competition is increasing in Jerrold's chosen markets, but we anticipate that Jerrold will continue to maintain relatively high net interest margins, low operating expenses, and fairly predictable and recurring retained earnings.

The quality of Jerrold's loan book is also improving, although credit risk remains the key risk for the company, in our view. Jerrold states that 71.4% of its loan book was fully performing at June 30, 2014, compared with 62.0% a year before. In part, this improvement reflects the more favorable U.K. economy and housing market. We do not consider that Jerrold's lending standards have deteriorated. In particular, Jerrold's relatively conservative approach to loan-to-value underwriting remains unchanged. We consider this policy critical as high levels of collateralization provide the key mitigant to the relatively high arrears rates evident in Jerrold's book.

In addition, Jerrold's weaker profile commercial real estate (CRE) development loan book--which was largely originated before 2009--has reduced in size to £85 million from £97 million over the past year. Most of this book comprises completed properties and the number of large loans has reduced. We understand that any new lending will be limited in scale and underwriting standards will be relatively conservative.

Jerrold has ambitions to grow its loan book at a brisk pace. The company now has a deeper management team and management is making strides to improve the company's operational capability so that it can manage this growth. Our ratings are not predicated on management meeting these ambitions. Indeed, although we expect that lending will grow significantly, we anticipate that management will ease the pace of growth if risk-adjusted returns are weakening or there is any operational strain around new underwriting.

Our primary measure of leverage for finance companies is gross debt to tangible equity. Until now, we adjusted the equity base in this calculation to reflect the risk that the performance of the CRE development book could be heavily detrimental to Jerrold's balance sheet. In light of management's progress in reducing the book and its proven ability to exit at or above book value, we no longer make this adjustment. We now calculate Jerrold's leverage ratio to be 1.7x at June 30, 2014, which is little changed from the unadjusted ratio of a year before.

Our base-case assumption is that leverage will increase as Jerrold raises further long-term debt to fund its loan growth. However, we do not expect leverage to rise significantly above 2x--a level that we would still consider to be a relative strength compared with similarly rated peers. We also assume that Jerrold will continue to avoid meaningful liquidity risk by primarily using long-term funding sources and keeping maturities well spread.

Jerrold is majority-owned by the founder. Since 2006, private equity investors have held a 30% voting stake. Although it is not part of our base-case scenario, we see a meaningful risk that a change in ownership could lead to a substantial rise in leverage.

Outlook

The positive outlook reflects our view of Jerrold's resilient balance sheet, the solid progress that management is making to work out legacy loan vintages, expand the business, and deepen the management team and operational capability. At the same time, we consider that Jerrold's leverage remains a relative credit strength.

We could raise the ratings if we observe sustainable growth without an associated deterioration in asset quality, improved profitability, and if Jerrold maintains gross debt to tangible equity below 2.25x. We would also expect to see that the proportion of performing loans has further increased from current levels.

We could revise our outlook to stable if we see evidence that Jerrold's leverage appetite is increasing above our expectations. We will also closely monitor any changes to the ownership structure as this could lead to a reduction in Jerrold's tangible equity. Additionally, very high loan growth could lead us to consider that future business prospects will be less predictable.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Rating Finance Companies, March 18, 2004

Related Research

- Request For Comment: Nonbank Financial Institutions Rating Methodology, Aug. 13, 2014

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Jerrold Holdings Ltd.		
Counterparty Credit Rating	B+/Positive/--	B+/Stable/--
Jerrold FinCo PLC		
Senior Secured	B+	

Additional Contacts:
Joseph Godsmark, London +44 (0) 2071767062; joseph.godsmark@standardandpoors.com
Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.