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3i Group PLC

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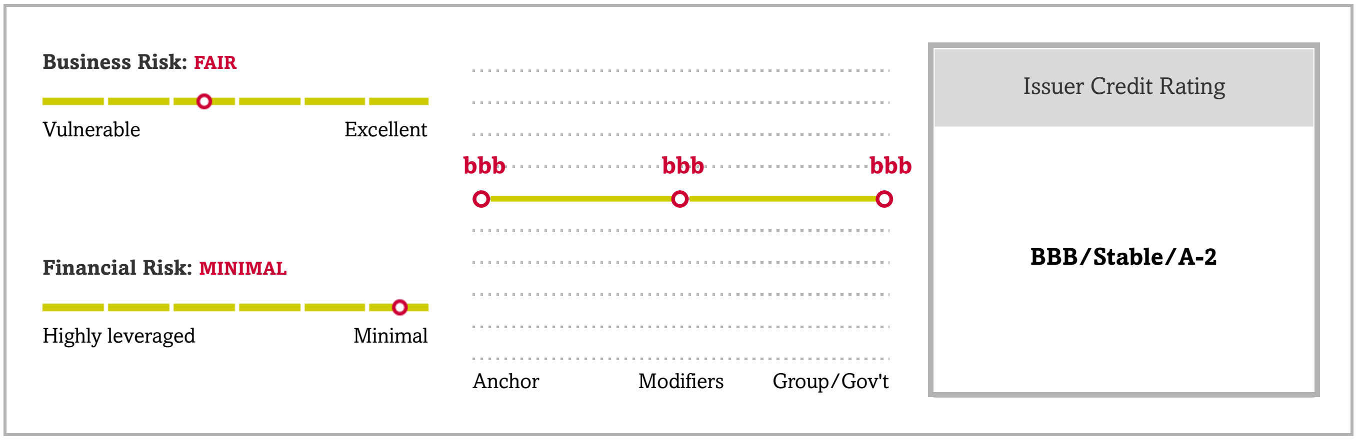


Rationale

Business Risk: Fair	Financial Risk: Minimal
• Strong track record in the European mid-market private equity market. • Exposure to investment market volatility, albeit with more stable investment performance than in the past. • Measured investment activity, with no prospects for private equity fundraising in the short to medium term.	• Conservative approach to leverage, demonstrated by a consistent improvement in leverage metrics. • Permanent capital base. • Low cash flow coverage of recurring expenses, when excluding realization proceeds.

Outlook: Stable

S&P Global Ratings' stable outlook on U.K.-based investment manager 3i Group PLC (3i) reflects its expectation that the group's strong cash returns, strong liquidity, and conservative leverage policy will continue to support its operating and financial profile over the coming two years.

Upside scenario

We could raise the rating if we observed a consistent operating and financial performance that resulted in generation of high cash returns similar to those we have seen in recent years. This would indicate that the more concentrated investment portfolio could withstand economic downturns, while leverage remains commensurate with a minimal financial risk profile.

Downside scenario

We could lower the rating over our two-year outlook horizon if we observed a deterioration in the quality and liquidity of 3i's concentrated investment portfolio. We could also consider lowering the rating if 3i demonstrates a reduced commitment to a conservative leverage and liquidity policy. However, we consider this scenario to be remote.

Our Base-Case Scenario

Assumptions

- We consider that 3i's earnings prospects over the next 12 months will remain sound, in view of its indicated pipeline of investment realizations and the successful realizations in financial 2018 and first quarter of financial 2019.
- We expect portfolio income will remain healthy as 3i continues to make measured new investments.
- Following the sale of its debt management business, we believe a challenge for 3i will be to boost fee income while reducing the volatility of its overall returns. We think it will take time to increase its fairly modest fee income relative to peers', as growth in infrastructure third-party assets under management (AUM) is broadly offset by declines in private equity fee income, in light of the limited near-term prospect of fundraising in this segment.
- We expect 3i's profitability to remain above average in financial 2019 and 2020, as measured by its adjusted EBITDA margin of above 35%.
- We expect that 3i's healthy cash buffers and lower outstanding debt will continue to support our view of its financial risk profile as minimal over the coming 18-24 months. We do not expect any further material decrease in gross debt from the current £575 million.
- Although 3i has a strong track record of portfolio realizations, we believe that its earnings may become more concentrated in the future. This would reflect the more concentrated investment portfolio and narrower business profile following the sale of the debt management business, which previously served as a third avenue for stable and recurring fee income. We note, however, that 3i's investment in Scandlines should deliver recurring dividend income. In line with our expectation that fee income will remain modest over our two-year forecast horizon, we expect a low net cash flow coverage of gross interest.

Company Description

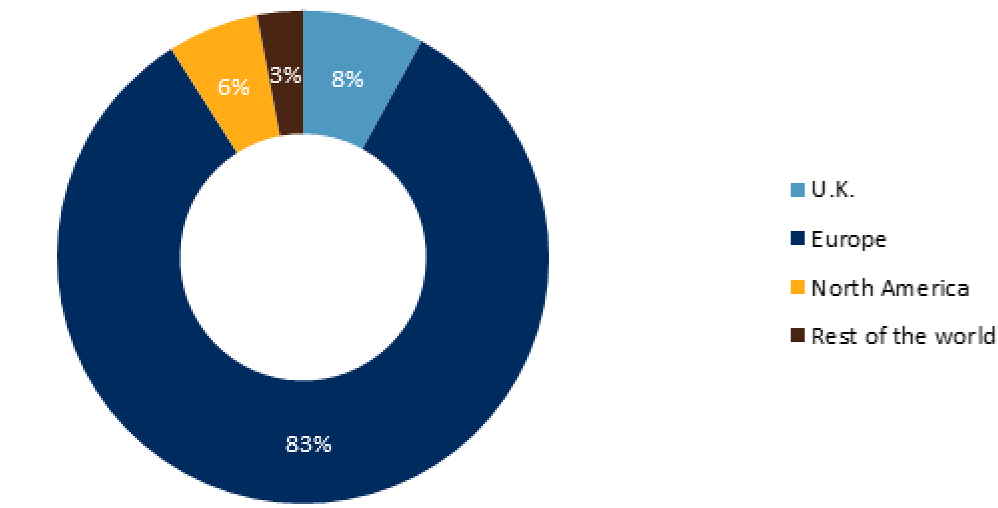
Founded in 1945, 3i is a mid-market-focused private equity firm and alternative asset manager, organized around two business lines: private equity and infrastructure. 3i is the group holding company and is listed on the London Stock Exchange, with its shares widely held. It is not regulated, but some of its subsidiaries, including 3i Investments PLC (an investment manager; not rated) are regulated by the Financial Conduct Authority. However, 3i is subject to regulatory requirements under the European Alternative Investment Fund Managers Directive. As a U.K. investment trust, 3i's capital gains are exempt from tax. 3i's total proprietary capital portfolio was valued at £6.9 billion as of June 30, 2018.

3i has a strong track record in European mid-market private equity, investing in companies with enterprise values of €100 million-€500 million. It focuses on mid-market companies operating in the consumer, industrial, and business and technology services sectors in its core regions of Northern Europe--with a bias toward Germany, France, Benelux, the U.K., and North America (see chart 1). In the first quarter of financial 2019, 3i announced £245 million in two new investments in private equity, following a volume of over £700 million in financial 2018.

3i's infrastructure business invests across mid-market economic infrastructure--primarily the utilities, communication, and transportation sectors--as well as low-risk energy projects and European public-private partnerships in developed markets. 3i is an investment adviser to 3i Infrastructure PLC (3iN). 3i manages three European infrastructure funds and one India infrastructure fund. On March 31, 2018, 3i had total AUM of £11.7 billion (including proprietary capital value), comprising £8.3 billion of private equity and £3.4 billion of infrastructure assets.

Chart 1

3i Group PLC -- Direct Investment Portfolio Value Domicile Of Investments, March 31, 2018



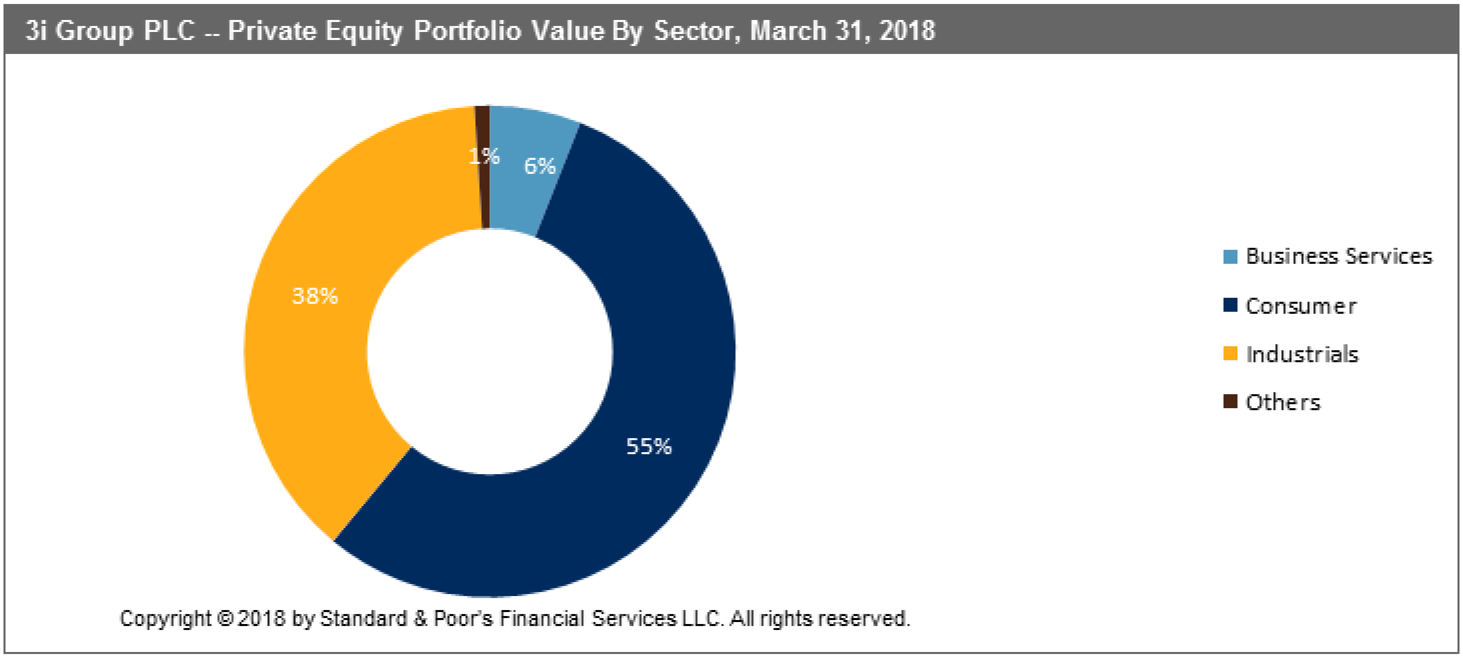
As of March 31, 2018.

Business Risk: Fair

We consider that 3i has sound franchises in its private equity and infrastructure business lines, as well as a strong track record of managing its portfolio companies with solid cash-on-cash returns. We view its investment portfolio as reasonably diverse by business classification and geography. Furthermore, we consider 3i's on-balance-sheet investment portfolio to be satisfactory in quality, with the overall portfolio defensively positioned from a sector perspective, although it has become more concentrated in recent years (see chart 2). We also view 3i's permanent capital base as a rating strength.

These strengths are offset by the majority of investments comprising companies that might typically be rated in the 'B' and 'BB' categories, and 3i generally holding either the riskier equity portion or shareholder loans in the capital structure. Moreover, 3i is smaller and less diverse than traditional asset managers and most U.S. alternative asset managers that we rate, particularly following the sale of its debt management business to Investcorp in March 2017.

Chart 2



3i embarked on a strategic restructuring in June 2012 following a period of investment underperformance during the financial crisis. The key phases, which have now been completed, included (a) streamlining the private equity business by reducing the number of investments and refocusing on its core markets; (b) improving its investment performance by strengthening controls and risk management processes; and (c) substantially reducing leverage and operating expenses. We note that 3i's recent strategic imperatives have been to:

- Invest in the private equity franchise by way of new investment and continue the strong run of realizations. Between April and June 2018, 3i completed two investments; realized two others, of which Scandlines is the second-largest investment, which generated proceeds of £835 million before a reinvestment of £535 million;
- Expand the infrastructure business, in Europe and through the launch of its U.S.-based team in 2017; and
- Maintain an operating cash profit by increasing its portfolio company earnings and keeping its strong cost discipline.

We consider that the actions highlighted above have contributed to an improved operating and financial performance, with healthy cash buffers and improved leverage metrics. In financial 2018(ended March 31, 2018), 3i reported a gross investment return of £1.6 billion (£1.75 billion in financial 2017). It also reported realization proceeds of £1,323 million (£1,275 million in financial 2017), of which £1,002 million (£982 million in financial 2017) related to private equity investments. 3i undertook £587 million of new private equity investments in financial 2018, compared with £478 million the year before. However, we note that 3i's private equity investments remain measured.

In an effort to make the private equity portfolio more manageable, 3i has continued to reduce it by number of investments. 3i reduced the portfolio to 37 investments (including one listed holding) as of June 30, 2018, meeting its steady-state target to hold between 30-40 private equity investments. This is a reduction from 52 (including five listed holdings) two years before. Moreover, on June 30, 2018, the 10 largest investments--including the group's investment in 3iN--represented 72% of the direct investment portfolio. This high concentration is due in particular to 3i's largest investment, the retailer Action, valued at £2.2 billion (32% of total portfolio), which we understand is a long-term holding with very high growth targets. That said, we note an improvement in performance as indicated by the strong period of realization activity and strong investment returns.

3i's commitment to operating efficiency in the past five years has led to substantial reductions in its cost base and subsequent improvements in operating cash profit. This allowed 3i to cover its operating expenses with stable fee and portfolio income for the third consecutive year, which we expect to continue, thanks to the growth of the infrastructure business. We assess 3i's profitability as above average, reflecting an adjusted EBITDA margin higher than 35%. We apply a 50% haircut to the five-year average of net realized performance fees and net realized investment income in the calculation of adjusted EBITDA, and exclude all unrealized gains (see table 1). We view 3i's earnings (total return) volatility as a ratings weakness because realized and unrealized returns are inextricably linked to market conditions.

Table 1

3i Calculation Of S&P Adjusted EBITDA Margin

	--Year ended March 31--		
(Mil. £)	**2016**	**2017**	**2018**
Portfolio income (fees, interest and dividends) [cash flow measure]	93	93	71
+ Third-party fee income	79	46	57
+ Other income	4	12	4
+ 5-year average carried interest, performance fees and investment income (with 50% haircut)	76	79	79
S&P sdjusted revenues (B)	252	230	211
Realized revenues	300	228	345
- Realized carried interest and performance fees paid [cash flow measure]	(15)	(131)	(48)
- Compensation expenses	(83)	(78)	(83)
- Operating expenses (excluding-D&A)	(43)	(37)	(35)
+ OLA rent	7	7	6
+ Stock compensation expense	15	18	17
+ Pension & other post-retirement expenses	(5)	(13)	1
+ Restructuring costs	5	2	2
+/- 5-year average carried interest, performance fees and investment income (with 50% haircut)	(43)	112	(109)
S&P adjusted EBITDA (A)	139	106	97
S&P adjusted EBITDA Margin (%) (A/B)	54.9	46.1	45.8

OLA--operating leasing arrangements.

We consider that 3i's sale of its debt management business in 2017 renders it less diverse--given the loss of an additional source of income growth--and adds an additional constraint to cover expenses with recurring cash revenues. That said, we note 3i's commitment to maintaining its operating cash profit, which we believe should be supported by its cost discipline, growth in portfolio company income, and expected recurring dividend stemming from their investment in Scandlines.

Peer comparison

3i's rated peers include Intermediate Capital Group PLC (ICG) and larger, more diverse U.S. alternative investment managers. Given the different business models, we consider that 3i tends to be more profitable than ICG while the latter has a better fundraising track record on the back of less volatile investment performance. 3i's leverage appetite is now much lower than that of ICG, and 3i also benefits from a solid track record of cash-on-cash returns. Moreover, U.S. peers that we rate tend to be larger and more diverse than both 3i and ICG.

We also compare 3i with some of its U.S. peers for example, Ares Management L.P., Apollo Global Management, GP Investments Ltd., Blackstone Holdings L.P., FIG LLC, Oaktree Capital Management L.P., etc. While many U.S.-based traditional asset managers have struggled to generate consistent organic growth despite a solid economic and market backdrop, the investment-grade alternative asset managers have largely thrived. These entities tend to be larger and more diverse than both 3i and ICG.

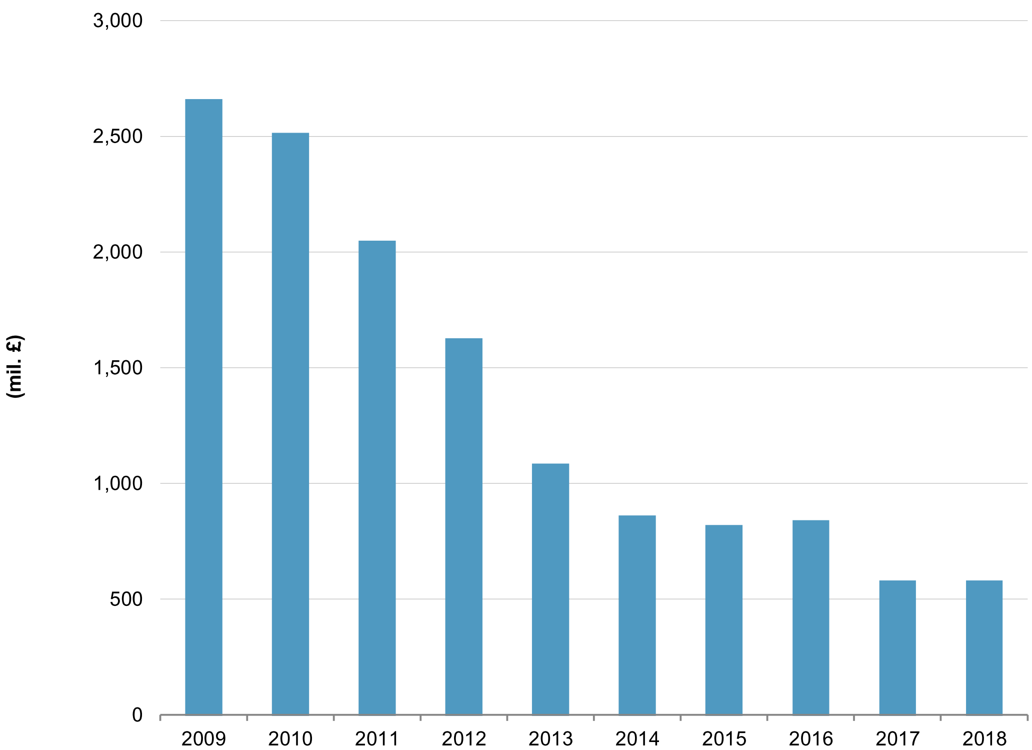
Financial Risk: Minimal

We focus on our calculation of debt to adjusted total equity (ATE), net of surplus cash, as our core leverage ratio for 3i, whereas we focus on debt to adjusted EBITDA for most other asset managers. This is because 3i has a relatively large portfolio of on-balance-sheet investments (£6.1 billion out of total balance-sheet assets of £7.9 billion, as of March 31, 2018), which increases the role of interest and investment income from on-balance-sheet investments within total revenues.

The group has significantly reduced its leverage appetite relative to historical levels, achieving its target of reducing gross debt below £1 billion by June 30, 2013. As of June 30, 2018, gross debt stood at £575 million. As a result, our calculation of debt to ATE has consistently improved (see chart 3).

Chart 3

3i Development In Gross Debt 2009-2018



3i's consistent policy of holding adequate liquidity and its well-spread debt maturity profile (extending to 2032) lead us to apply a standard haircut of 25% to 3i's cash balances to arrive at net debt. We calculate that 3i's net debt to ATE for financial 2018 was marginally negative (-0.03x), meaning that its cash buffers, even after a 25% haircut, exceeded outstanding debt (see table 2). This ratio has been rather stable since financial 2016 (0.03x) due to sizable cash generation and repayment of £262 million in debt that matured during 2017, reinforcing our view of 3i's financial risk profile as minimal.

Table 2

3i Calculation Of Net Debt To Adjusted Total Equity, March 31, 2018

	--Year ended March 31--	
(Mil. £)	**2017**	**2018**
Non-current loans and borrowings	575	575
+ OLA debt	31	25
Gross debt	606	600
-Surplus cash after 25% haircut	746	791
Net debt (A)	(140)	(191)
Reported equity	5,836	7,024

Table 2

3i Calculation Of Net Debt To Adjusted Total Equity, March 31, 2018 (cont.)		
	--Year ended March 31--	
(Mil. £)	**2017**	**2018**
-Intangibles	0	12
-Proposed dividend	178	212
-Equity in structured vehicles	49	0
Adjusted total equity (ATE) (B)	5,609	6,800
Net debt to ATE (x) (A/B)	(0.02)	(0.03)

We consider 3i's cash flow coverage of gross interest costs to be weaker than that of rated peers with minimal leverage. We note that portfolio income mainly comprises income from loans and receivables, a large proportion of which is in the form of payment-in-kind, a non-cash item that we exclude from the calculation. Considering the modest role of recurring fee and portfolio income in 3i's earnings, EBITDA covered interest expenses by only 2.5x on March 31, 2018.

Liquidity: Strong

Based on likely sources and uses of cash, we assess 3i's liquidity profile as strong and believe that it could withstand substantially adverse market circumstances over the next 24 months while maintaining sufficient liquidity to service its obligations.

We view the group's policy and track record of maintaining adequate cash balances as positive for the ratings. We consider this policy to be appropriate, given that most of 3i's investments are illiquid and investments may at times be unsuitable for immediate sale. The group also maintains cash to give it the flexibility to invest opportunistically, but carefully monitors its pipeline of investments and divestments to ensure it maintains adequate cash.

Principal Liquidity Sources	Principal Liquidity Uses
Principal sources of liquidity for 2018 remained high, at £1.4 billion (£1.32 billion in financial 2017). Cash and deposits stood at £1 billion, while the size of the £350 million undrawn committed credit facility, maturing in September 2021, remained little changed.	We expect that sources of liquidity will exceed uses by more than 2x (not considering investment and realization activity) over the coming 12 months. 3i has repaid £262 million of notes due in 2017 and now has no further maturities until 2023.

Debt maturities

The £200 million 6.875% notes and £375 million 5.750% notes mature in 2023 and 2032, respectively.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/A-2

Business risk: Fair

- **Country risk:** Low
- **Industry risk:** Intermediate
- **Competitive position:** Fair

Financial risk: Minimal

- **Cash flow/Leverage:** Minimal

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Financial Institutions - General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria - Financial Institutions - General: Key Credit Factors For Asset Managers, Dec. 9, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	**Minimal**	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	**bbb/bbb-**	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of September 25, 2018)

3i Group PLC		
Issuer Credit Rating		BBB/Stable/A-2
Senior Unsecured		BBB
Senior Unsecured		BBB/A-2
Issuer Credit Ratings History		
27-Mar-2012	*Foreign Currency*	BBB/Stable/A-2
24-Feb-2010		BBB+/Stable/A-2
23-Feb-2009		BBB+/Negative/A-2
27-Mar-2012	*Local Currency*	BBB/Stable/A-2
24-Feb-2010		BBB+/Stable/A-2
23-Feb-2009		BBB+/Negative/A-2
Sovereign Rating		
United Kingdom		AA/Negative/A-1+

*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.