3i Group plc

Update following rating affirmation

Summary credit rationale
3i’s Baa1 senior unsecured debt rating is supported by the firm’s (1) limited outstanding debt, (2) conservative financial policies, and (3) proven track record of investment and asset management. We expect the firm to maintain its disciplined investment process, which has thus far supported good value creation. The rating is constrained by the speculative grade nature of 3i’s investment portfolio.

3i is focused on private equity and infrastructure investments. The firm continues to benefit from a supportive operating environment despite still low economic growth in Europe, and heightened uncertainty as the United Kingdom (Aa2 stable) prepares to leave the European Union. This has supported the value and performance of the majority of 3i’s investments, as well as its investment realisations.

Credit strengths
» Solid mid-market private equity franchise in the UK, US and Northern Europe
» Limited leverage
» Conservative financial policy and disciplined investment process, supporting solid profitability
» Strong track record of asset management and investment realisation
Credit challenges

» High asset prices reduce the scope for profitable investment opportunities, constraining 3i’s investment activity

» Relative low operating cash generation (excluding proceeds from disposals of investments), providing a weak interest coverage

Rating outlook

The outlook on 3i’s Baa1 senior unsecured rating is stable, indicating that we do not expect material changes in the firm’s credit profile over the next 12-18 months. The stable outlook reflects Moody’s expectation that the 3i’s operating performance will remain solid and that the company will maintain a strong financial position and adequate liquidity to support its investments, if required.

Factors that could lead to an upgrade

» An increase in the credit quality in the investment portfolio

» A reduced portfolio concentration

» A sustainable increase in operating cash generation

Factors that could lead to a downgrade

» A significant increase in the firm’s leverage

» A reduction in the firm’s liquid resources

» A material deterioration in the quality of the firm’s investment portfolio

» A structural decline in recurrent cash inflows, materially reducing the firm’s operating cash generation

Key indicators

Exhibit 2

3i Group plc

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets under Management</td>
<td>13,029</td>
<td>11,700</td>
<td>9,802</td>
<td>13,999</td>
<td>13,500</td>
</tr>
<tr>
<td>Investment Portfolio</td>
<td>6,821</td>
<td>6,130</td>
<td>5,189</td>
<td>4,220</td>
<td>3,750</td>
</tr>
<tr>
<td>Total Assets</td>
<td>8,721</td>
<td>7,899</td>
<td>6,713</td>
<td>5,554</td>
<td>4,915</td>
</tr>
<tr>
<td>Net MVL</td>
<td>-5.23%</td>
<td>-6.1%</td>
<td>-7.2%</td>
<td>-3.4%</td>
<td>-0.8%</td>
</tr>
<tr>
<td>Asset Concentration [2]</td>
<td>43%</td>
<td>40.7%</td>
<td>37.2%</td>
<td>27.1%</td>
<td>21.1%</td>
</tr>
</tbody>
</table>


Source: Moody’s Investors Service; Company Annual Reports

Profile

3i Group plc (3i) is a UK-headquartered investment firm to which we have assigned a senior unsecured debt rating of Baa1 with a stable outlook, under our Investment Holding Companies and Conglomerates rating methodology. Its two main businesses are Private Equity and Infrastructure, which are focused on core investment markets in northern Europe and North America. The company’s private equity business had a total of £8.3 billion in assets under management (AUM) as of 31 March 2019, of which £6 billion is proprietary capital. 3i invests in mid-market companies, taking a majority stake. 3i’s infrastructure business holds £4.2 billion of assets. The company invests principally in mid-market economic infrastructure in Europe and North America, as well as greenfield and operational projects.1

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Detailed credit considerations

Clearly defined investment strategy and disciplined process support solid profitability levels

3i applies a consistent and well defined approach to making investment and divestment decisions, supporting the company’s profitability. 3i often monitors businesses for lengthy periods before deciding to invest in them, and adheres closely to criteria governing the size of its target companies and the sectors they operate in. The company targets mid to high teens rates of return over a typical period of four to five years. It focuses on businesses with an enterprise value of €100 million–€500 million operating in the business and technology services, consumer and industrial sectors in northern Europe and North America. It selects companies with the ability to take advantage of developing mega-trends it has identified, and utilises its extensive network of business leaders to identify and access opportunities. 3i’s network and focus on middle-market transactions in niche business sectors has allowed it to avoid more aggressive auction-driven acquisitions, which tend to be more expensive, reducing the expected return.

3i invests on its own account and on behalf of third parties. The company has increased AUM across its two business lines in recent years, reflecting both higher investment values and increased fund-raising. AUM in private equity totaled £8.3 billion at end-March 2019, flat compared to a year ago. AUM at 3i’s infrastructure division rose to £4.2 billion from £3.4 billion over the same period. 3i’s proprietary investments totaled £7.6 billion (£6.5 billion in March 2018)

In the year to 31 March 2019, 3i invested £859 million (£827 million in FY 2018). £332 million were invested in private equity investments, while £529 million were reinvested in Scandlines. The realisation of Scandlines was prompted by the closure of Eurofund V. However 3i reinvested in 35% of the company, which is now managed as a Corporate Asset, i.e. held for longer to generate cash income with the potential for further capital returns. Realisations totaled £1.24 billion in FY2019 (£1.32bn in FY 2018), including Scandlines.

3i has been a net realiser of investments in recent years, particularly through the disposal of some lower-quality assets. This has allowed management to focus on maximising the value of its larger investments. In addition, high asset prices are reducing the scope for profitable investment opportunities in the current competitive investment environment.

3i’s private equity portfolio consists largely of speculative grade investments, with about 70% of its investee companies holding debt-to-EBITDA ratios of 4x–5x. 3i’s rigorous investment and management process to some extent offset risks related to the relatively high leverage of its portfolio, and its relatively high exposure to a small number of investee companies.

3i’s largest investment creates portfolio concentration

In recent years, 3i has been reducing the number of its private equity investments, which had fallen to 32 as of March 2019 (see Exhibit 2). The company has previously guided that its desired number of investments is around 30-40, although availability of investment opportunities and changes in market conditions could cause it to diverge from this figure.

3i’s single largest private equity investment is a Northern European discount retailer (Action), which the firm values at around £2.7 billion, corresponding to around 36% of the group total portfolio. Action’s good performance is illustrated by its ability to return capital to 3i.
Action distributed £834 million to 3i since the private equity firm’s initial investment in 2011. Ferry operator Scandlines is the second largest investment (12% of portfolio). Scandlines and 3iN (3i Infrastructure) are core to the 3i portfolio as they generate strong capital returns and cash, while retaining some growth potential.

3i’s relatively high exposure to Action and Scandlines creates some concentration risk. The lower numbers of companies within the firm’s private equity portfolio could also lead to less granular income streams from investment realisations in the future.

Beyond Action and Scandlines, 3i’s portfolio across private equity and infrastructure is evenly diversified by sector, given the firm’s size and target market. The portfolio is most exposed to Northern Europe, US and the UK (see Exhibit 4), which benefit from strong macroeconomic fundamentals.

Exhibit 4
Geographic composition of 3i’s investment portfolio

Source: Company Annual Reports

Conservative and consistent financial policy offsets risks from speculative grade portfolio

3i holds large cash balances to support its business during periods of high market volatility. The company had a total of £1,070 million in cash and cash equivalents as of March 2019 (£1,033 million on IFRS reporting), largely held in Aaa-rated money market funds and bank deposits, accounting for 11.2% of its total assets. The firm also has access to a £350 million committed credit facility (undrawn as of March 2019), provided by well-rated banks. These funding arrangements were renegotiated in 2014, and have allowed 3i to benefit from lower running costs and an extended maturity to September 2021. 3i’s strong liquidity profile gives the company some flexibility regarding its investment policy, and should allow it to withstand unexpected market shocks.

The company aims to maintain or grow the dividend each year, paying an interim dividend that will be set at 50% of the prior’s year total dividend. However in setting the dividends, 3i intends to maintain a conservative financial approach. In FY 2019, the total dividend was 35 pence per share, up from 30 pence in the previous year.

Negative net debt position

3i had outstanding gross debt of £575 million as of March 2018, down substantially from £1.6 billion as of end-March 2012. The decline has strengthened 3i’s financial position and halved its funding costs. 3i’s net debt position is negative and its market value leverage (MVL) was -5.88% as of YE2019.

The company’s gross debt/EBITDA stood at 0.49x at March 2019, down from 1.71x in 2014. This strong financial position mitigates some of the risks within 3i’s private equity portfolio, which comprises of speculative grade investments with an average leverage of c.4x debt/EBITDA, as of March 2019.

3i has indicated it will likely be in a net debt position at the end of FY2020, based on lower realization levels. While cash levels are expected to come down as a result, we expect MVL to remain consistent with a Aaa score for the sub factor.
Operating cash flows expected to grow in line with infrastructure business

3i’s cash operating income is adequate to cover its operating expenses, but also reliant on Scandlines and 3iN. Scandlines is expected to generate solid cash flows while the company’s infrastructure funds will provide another ongoing revenue stream. 3i’s infrastructure expertise has also allowed the company to develop complementary fund management initiatives in Europe and North America in order to further support its operating cash position. In FY2018, 3i completed its first Infrastructure investment in North America and launched two infrastructure funds in Europe to complement the mandate for 3iN. Cash income from the infrastructure business amounted to £82 million in FY 2019.

We also note that the firm has reduced its operating expenses in recent years through headcount reductions and office closures. In the year ended 31 March 2019, cash operating expenses were £109 million. Although slightly higher than £115 million the previous year, this was down sharply from £240 million in 2012. We believe the company’s ability to significantly reduce operating costs further is limited.

Liquidity

3i’s liquidity is excellent, with cash at £ 1,070 million (£1,033 million on IFRS basis), compared to debt of £575 million. Net debt is negative. In addition, the company benefits from an undrawn credit facility of £350 million. 3i has demonstrated the consistency of its liquidity position, having been in a negative net debt position for the last 5 years. However for FY2020 the company has indicated it expects to finish the year in a net debt position, pointing to lower cash levels.
## Exhibit 6
### Investment Holding Companies Industry Grid

<table>
<thead>
<tr>
<th>3i Group Plc</th>
<th>Current LTM 03/31/2018</th>
<th>Moody's 12-18 Month Forward View As of 03/31/2018 [3]</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Factor 1: Investment Strategy (10%)</strong></td>
<td>Measure</td>
<td>Score</td>
</tr>
<tr>
<td>a) Investment Strategy</td>
<td>Ba</td>
<td>Ba</td>
</tr>
<tr>
<td><strong>Factor 2: Asset Quality (40%)</strong></td>
<td>Measure</td>
<td>Score</td>
</tr>
<tr>
<td>a) Asset Concentration</td>
<td>Baa</td>
<td>Baa</td>
</tr>
<tr>
<td>b) Geographic Diversity</td>
<td>Baa</td>
<td>Baa</td>
</tr>
<tr>
<td>c) Business Diversity</td>
<td>Baa</td>
<td>Baa</td>
</tr>
<tr>
<td>d) Investment Portfolio Transparency</td>
<td>Baa</td>
<td>Baa</td>
</tr>
<tr>
<td><strong>Factor 3: Financial Policy (10%)</strong></td>
<td>Measure</td>
<td>Score</td>
</tr>
<tr>
<td>a) Financial Policy</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td><strong>Factor 4: Estimated Market Value-based Leverage (MVL) (20%)</strong></td>
<td>Measure</td>
<td>Score</td>
</tr>
<tr>
<td>a) Estimated Market Value-Based Leverage</td>
<td>Aaa</td>
<td>Aaa</td>
</tr>
<tr>
<td><strong>Factor 5: Debt Coverage and Liquidity (20%)</strong></td>
<td>Measure</td>
<td>Score</td>
</tr>
<tr>
<td>a) (FFO + Interest Expense) / Interest Expense</td>
<td>2.1x</td>
<td>Ba</td>
</tr>
<tr>
<td>b) Liquidity</td>
<td>Aaa</td>
<td>Aaa</td>
</tr>
<tr>
<td><strong>Rating:</strong></td>
<td>Measure</td>
<td>Score</td>
</tr>
<tr>
<td>a) Indicated Rating from Grid</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>b) Actual Rating Assigned</td>
<td>Baa1</td>
<td></td>
</tr>
</tbody>
</table>

[1] All ratios are based on “adjusted” financial data and incorporate Moody’s global standard adjustments for non-financial corporations [2] As of 03/31/2019 [3] This represents Moody’s forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestures

Source: Company Annual Reports, Moody’s Investors Service

### Endnotes

1. The financial data presented in this paragraph is taken from the Investment Basis financial statements. The Investment basis is an alternative (non-GAAP) performance measure.
2. The financial data presented in this paragraph is taken from the Investment Basis financial statements. The Investment basis is an alternative (non-GAAP) performance measure.
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