

Research Update:

# 3i Group Upgraded To 'BBB+' On Robust Operating Performance; Outlook Stable

July 23, 2021

## Overview

- 3i Group PLC (3i) has demonstrated a resilient operating performance, despite the pandemic. Its conservative financial management and adequate liquidity has supported its strong investment performance.
- We have raised our long-term issuer credit rating on 3i to 'BBB+' from 'BBB' and our issue-level rating on the company's senior unsecured debt to 'BBB+' from 'BBB'.
- The stable outlook on 3i Group PLC (3i) reflects our expectation that the group will continue its conservative financial leverage policy and adequate liquidity levels, while managing concentration risks in the investment portfolio and maintaining solid operating and financial performance.

## Rating Action

On July 23, 2021, S&P Global Ratings raised its long-term issuer credit rating on 3i Group PLC to 'BBB+' from 'BBB'. The outlook is stable. We also affirmed our short-term issuer credit rating on the fund. At the same time, we raised the senior unsecured debt issue ratings to 'BBB+' from 'BBB'.

## Rationale

**The upgrade reflects 3i's robust operating performance throughout the pandemic; backed by a stable management team, the group has a long track record aided by strong governance, permanent capital, and a consistent and clear investment strategy.** Its portfolio concentration and investments in illiquid, usually unlisted, midsize, leveraged corporate entities constrains the ratings at the 'BBB+' level.

**3i is a U.K.-based investment trust company that primarily invests in private equity and infrastructure assets.** It is listed on the London Stock Exchange and is part of the FTSE 100 and reported a portfolio of approximately £10.4 billion as of March 31, 2021. The group has one of the

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longest track records in European midmarket private equity, investing in companies with enterprise values of €100 million–€500 million. It focuses on companies operating in the consumer, industrial, health care, and business and technology services sectors in Northern Europe.

3i's investment strategy has been steady since 2012, when the current CEO was appointed. In addition to private equity, the group focuses on infrastructure. It currently manages a portfolio of 33 private equity investments for growth and performance. 3i also owns 30% of 3i Infrastructure PLC (3iN), a FTSE 250 company, and acts as its investment manager. 3iN invests across midmarket economic infrastructure and greenfield projects in developed markets.

### **3i has maintained conservative financial metrics and achieved resilient earnings amid the challenging environment.**

Its track record of strong investment returns, earnings, and well managed financial and liquidity positions support our upgrade to 'BBB+'. Furthermore, 3i maintained stressed leverage at 4.5x, comfortably above our very strong threshold of 3.5x.

**3i has recently revised its leverage policy and increased its net debt tolerance to £750 million, as well as including a gearing tolerance of up to 15%.** Although this is an increase in the net debt element of the previous £500 million net cash and £500 million net debt corridor, we expect any such increase in leverage to be tactical and short term and, as such, we view the financial policy flexibility as neutral to the rating. 3i had net debt of £750 million at March 31, 2021, and gearing of 8%.

### **We assess 3i's stressed leverage as very strong and expect it to remain comfortably above 3.5x, commensurate with our longstanding view of its low leverage.**

The investment portfolio is fairly large compared with 3i's recourse liabilities, but it is composed of illiquid assets that could be difficult to fully realize in a stress scenario. When calculating our stressed leverage ratio, we apply a 50% haircut on listed stocks (Basic-Fit and 3i Infrastructure PLC listed as quoted investments) and a 60% haircut on unlisted stocks, which is commensurate with a 'BBB' stress scenario. For all the other investments we consider inherently higher risk, we apply a 75% haircut under our stress scenario.

We expect the modest deterioration in liquidity at the March 2021 year-end to be a cyclical low point. We give credit to £225 million of cash. This is much lower than the group's usual cash position, and stems from ongoing investments, low realizations, and modest liquidity requirements of a few pandemic-impacted companies in the portfolio (for example, Audley Travel and Hans Anders). We expect these dynamics will normalise as the economic recovery takes hold.

### **Structural concentration risks in 3i's portfolio partly offset the quantitatively strong stressed leverage metric, in our view.**

Its investment in European discount retailer Action (see "Peer Holding III B.V. Outlook Revised To Positive From Negative On Resilient Operating Performance; Ratings Affirmed," published April 29, 2021) represented a large 44% of the total portfolio as of March 31, 2021. This highly levered exposure has proven resilient through the pandemic, delivering 10% revenue growth despite the difficult environment for expansion. While some stores were closed during lockdowns, like-for-like sales remained steady in core markets and have accelerated as lockdowns have eased.

Overall, the valuation of the portfolio increased by £2.3 billion year-on-year, while the investment portfolio was £10.4 billion as of March 31, 2021.

**In our view, 3i's liquidity profile remains adequate despite lower cash balances as of March 31, 2021.** We note its previous extension of its revolving credit facility (£500 million maturing 2026) and the long-dated bond issuance. We expect to see cash balances rebuild as realisations normalise, although we think it could supply limited cash to already owned companies to support their liquidity. We estimate, in any case, that such liquidity uses would remain commensurate with 3i's capacity and would not jeopardize any debt repayments. Therefore, we maintain our adequate assessment of 3i's liquidity, commensurate with a 1.32x ratio.

## Outlook

The stable outlook on 3i Group PLC (3i) reflects our expectation that the group will preserve a conservative financial leverage policy and adequate liquidity levels, while managing concentration risks in the investment portfolio and maintaining solid operating and financial performances.

## Upside scenario

We see limited upside at this stage given 3i's heavily concentrated investment portfolio, the illiquid nature of its investments, and its adequate liquidity position.

## Downside scenario

We could lower the ratings if 3i weakens its commitment to its conservative leverage and liquidity policy or if the investment portfolio's quality or performance deteriorates meaningfully.

## Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2
Risk-adjusted leverage	Adequate	Adequate
Stressed leverage	Very Strong	Very Strong
Risk position	Weak	Weak
Funding and liquidity	Adequate	Adequate
Funding	Strong	Strong
Liquidity	Adequate	Adequate
Preliminary anchor	bbb+	bbb
Jurisdictional risk	0	0
Anchor	bbb+	bbb
<b>Modifiers</b>		
Track record and investment performance	Neutral	Neutral
Risk management	Neutral	Neutral
Transparency and complexity	Neutral	Neutral
Comparable rating analysis	Neutral	Neutral
Stand-alone credit profile	bbb+	bbb

## Related Criteria

- Criteria | Financial Institutions | Other: Alternative Investment Funds Methodology, Jan. 13, 2020
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Peer Holding III B.V. Outlook Revised To Positive From Negative On Resilient Operating Performance; Ratings Affirmed, April 29, 2021
- 3i Group PLC, Sept. 15, 2020
- 3i Group PLC Outlook Revised To Positive From Stable On Financial Policy; 'BBB' Ratings Affirmed On Criteria Change, Feb. 25, 2020

## Ratings List

### Upgraded

	To	From
<b>3i Group PLC</b>		
Senior Unsecured	BBB+	BBB

### Upgraded; Ratings Affirmed

<b>3i Group PLC</b>		
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2

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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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.

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