



## Fitch Rates Bracken MidCo1 Notes 'B'-(EXP); Affirms Jerrold

Fitch Ratings-London-27 October 2016: Fitch Ratings has assigned Bracken MidCo1 plc (MidCo1) a Long-Term Issuer Default Rating (IDR) of 'B+' with Stable Outlook, and its subordinated senior PIK toggle notes an expected rating of 'B'-(EXP).

At the same time the agency has affirmed the IDRs of Jerrold Holdings Limited (JHL) at 'BB-' with Stable Outlook, and the senior secured debt rating of subsidiary Jerrold FinCo plc at 'BB-'. A full list of rating actions is available at the end of this rating action commentary.

The final rating of the senior PIK toggle notes is contingent on the receipt of final documents conforming to information already received.

JHL is a UK specialist mortgage provider, offering both retail and commercial loans to niche market segments under-served by mainstream lenders. In connection with the buyout of JHL's minority shareholders by the principal owner, MidCo1 is being established as a new holding company above JHL, and issuing GBP220m of senior PIK toggle notes as part of the finance the buyout. The notes allow interest to be deferred in the event that MidCo1 lacks the necessary resources at the time to service it, but require payment if conditions pre-defined in the notes documentation are satisfied.

Additional buyout funding will come from the issuance by further new companies above MidCo1 of GBP100m junior PIK notes and a new GBP43m shareholder loan, the latter partially replacing GBP60m of shareholder subordinated debt previously issued by JHL.

### KEY RATING DRIVERS

#### JHL - IDRS AND SENIOR DEBT

JHL continues to perform soundly, reporting a record pre-tax profit of GBP90.3m for the year to 30 June 2016. Earnings are underpinned by the group's franchise and pricing power in areas such as second-charge mortgages and bridging finance, and risk is well-remunerated via wide margins.

Funding is wholesale market-focused, but diversified within that between two securitisation programmes, the group's senior secured notes and a revolving credit facility. Within the GBP1.66bn total wholesale funding only GBP29m matures before August 2018. In recent periods asset growth has been rapid, but the impact on leverage has been contained by concurrent strong internal capital generation, as JHL has not paid dividends.

Fitch is of the view that MidCo1's senior PIK toggle notes will implicitly represent an additional obligation of JHL, as MidCo1 has no separate financial resources of its own with which to service them, and failure to do so would have considerable negative implications for JHL's creditworthiness. Therefore Fitch will in future consolidate the senior PIK toggle notes when assessing JHL's gearing, increasing the ratio of debt-to-tangible equity (inclusive of subordinated shareholder loan) from 2.1x per figures reported at 30 June 2016 to 4.3x if the GBP220m of additional funding is added to debt and deducted from tangible equity.

Conversely, Fitch will exclude the junior PIK notes when calculating JHL's leverage, in the light of their deeper structural and contractual subordination, and non-cash payment features.

The Stable Outlook on JHL's Long-Term IDR reflects Fitch's view that JHL should continue to report adequate profitability without substantially increasing leverage further.

JHL's implicit obligation to service the coupon on the MidCo1 senior PIK toggle notes will require associated dividend payments by JHL in the next five years. However, Fitch expects implied interest coverage (JHL's net income divided by the senior PIK toggle notes' interest service requirement) to remain fairly comfortable (above 3x), and JHL not to make distributions beyond those needed to fund the MidCo1 senior PIK toggle notes debt service, which should limit the pressure on JHL's internal capital generation.

Other rating factors, notably JHL's risk appetite and underwriting standards, remain unaffected by the proposed transaction and continue to support the 'BB-' Long-Term IDR.

### MIDCO1 - IDR AND SENIOR PIK TOGGLE NOTES

MidCo1's Long-Term IDR is notched off once from JHL's Long-Term IDR, reflecting the former's structural subordination and double leverage, which is expected to be close to 250%. Fitch has limited the rating differential between the two companies to one notch, primarily because of the sizeable headroom within JHL's restricted payment basket under the terms of the senior secured notes (50% of post-June 2013 accumulated net income, equivalent to around GBP85m at end-June 2016).

The notching between MidCo1's IDR and the rating of the senior PIK toggle notes themselves reflects Fitch's view of the likely recoveries in the event of MidCo1 defaulting. While sensitive to a number of assumptions, this scenario would only be likely to occur in a situation where JHL is also in much weakened financial condition, as otherwise its upstreaming of dividends for MidCo1 debt service would have been maintained. The subordinated rank of the senior PIK toggle notes would then place their holders in a weaker position than JHL's senior secured creditors for available recoveries from the group's assets.

### RATING SENSITIVITIES

#### JHL - IDRS AND SENIOR DEBT

Near-term upside for JHL's ratings is limited by the additional debt now being taken on at MidCo1, which diminishes rating headroom. A significant further increase in leverage, or worsening profitability, for instance due to a deteriorating operating environment adversely affecting asset quality, could lead to a downgrade.

#### MIDCO1 - IDR AND SENIOR PIK TOGGLE NOTES

MidCo1's Long-Term IDR is primarily sensitive to changes to JHL's Long-Term IDR. Equalisation of the IDRs is unlikely in view of MidCo1's structural subordination, but a weakening of implied interest coverage within MidCo1, for instance as a result of diminishing net income at JHL or any other restrictions on JHL's dividend upstream capacity, could widen their notching and so be negative for MidCo1's Long-Term IDR.

The rating of the senior PIK toggle notes is sensitive primarily to changes to MidCo1's IDR, from which it is notched, as well as to Fitch's assumptions regarding recoveries in a default scenario. Lower asset encumbrance by senior secured creditors could lead to higher recovery assumptions and therefore narrower notching from MidCo1's IDR.

The rating actions are as follows:

Bracken MidCo1 plc  
Long-Term IDR assigned at 'B+'; Outlook Stable  
Senior PIK toggle notes rating assigned at 'B'-(EXP)/Recovery Rating 'RR6'

Jerrold Holdings Ltd  
Long-Term IDR affirmed at 'BB-'; Outlook Stable  
Short-Term IDR affirmed at 'B'

Jerrold FinCo Plc  
Senior secured debt rating affirmed at 'BB-'

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#### Applicable Criteria

Global Non-Bank Financial Institutions Rating Criteria (pub. 15 Jul 2016) (<https://www.fitchratings.com/site/re/884128>)

Treatment and Notching of Hybrids in Non-Financial Corporate and REIT Credit Analysis (pub. 29 Feb 2016) (<https://www.fitchratings.com/site/re/878264>)

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