Research Update:

3i Group Plc Upgraded To 'A-' On Higher Financial Flexibility; Outlook Stable

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Overview

- Private equity company 3i Group PLC has demonstrated strong operating performance on the back of Action's stellar growth; discount retailer Action now represents more than 65% of 3i's portfolio and is therefore the prominent source of 3i's concentration risk.
- However, the rest of the portfolio has also grown and can uphold 3i's credit metrics even without Action, somewhat mitigating this concentration risk. Moreover, Action's increasing cash generation is positive for 3i's creditworthiness as we expect the retailer to provide higher recurring dividends to support 3i's liquidity.
- We have therefore raised our long-term issuer credit rating on 3i to 'A-' from 'BBB+' and our issue-level rating on the company's senior unsecured debt to 'A-' from 'BBB+'.
- The stable outlook on 3i reflects our expectation that the group will continue its conservative financial leverage policy, and maintain low net debt and adequate liquidity levels, while maintaining solid operating performance.

Rating Action

On July 5, 2024, S&P Global Ratings raised its long-term issuer credit rating on 3i Group PLC to 'A-' from 'BBB+'. The outlook is stable.

We also affirmed our 'A-2' short-term issuer credit rating on 3i. At the same time, we raised the senior unsecured debt issue rating to 'A-' from 'BBB+'.

Rationale

The upgrade reflects 3i's good performance supported by Action's growth and its improving leverage that we expect to remain low, combined with higher financial flexibility granted by more recurring dividend income. In our view, these improving features enhance 3i's creditworthiness, when compared with peers, despite the concentration associated with Action.

Although the retailer is driving most of 3i's strong operating performance, growth amid the rest of the portfolio increases certainty around the comfortable credit metrics. Moreover, while we still consider liquidity to be adequate, the increasing cash flow generation from 3i's portfolio also supports the upgrade.

3i has achieved resilient earnings amid the lull in realizations for private equity. Its track record of strong investment returns, earnings, and well-managed financial and liquidity positions support our positive rating action. We are mindful of Action's concentration but also of its cash generating capability and relatively low leverage. Action's rising valuation, which we expect to continue in line with its EBITDA, and the resulting benefit to 3i's performance, stands out relative to peers.

3i demonstrates a consistent and conservative leverage policy, gearing, and net debt tolerance. 3i posted net debt of £806 million as of March 31, 2024, and reported gearing (net debt to total equity) of 4%, which we consider to be low. 3i has been able to maintain net debt levels within £750 million-£1 billion. In the last two instances, when 3i issued debt, it was primarily for refinancing, and the resulting leverage and net debt levels remained low. Given Action's large exposure (65% as of March 31, 2024), we have considered leverage with and without Action. While not our base case, in the event that Action is lost, leverage would worsen at the current debt levels. Therefore, we would view negatively a material gross debt increase.

We assess 3i's stressed leverage as very strong and expect it to remain comfortably above 3.5x. 3i's stressed leverage has been comfortably above our very strong threshold of 3.5x for at least four years. We estimate it to be around 7.5x-8.0x at mid-2024 based on our portfolio growth assumptions. More importantly, even if we theoretically removed Action's valuation and its high dividends, 3i's metrics would still be strong, which highlights 3i's improved capital buffer. 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.

In our view, 3i's funding and liquidity profiles remain adequate. 3i benefits from permanent capital and a diverse investor base, which leads to a strong funding assessment. Despite high cash levels and continually large cash flows from Action's dividends, we conservatively assume that much of the cash will be re-invested in new or existing companies, or returned to shareholders. Still, the higher cashflow received enhances 3i's financial flexibility. Our main assumption is that cash will be used to pay down carried interest, reinvest in Action or in other assets, or potentially be returned to shareholders. However, in a stress scenario, we believe 3i's prudent liquidity management would prioritize interest and debt repayment. Moreover, any company support would remain commensurate with 3i's capacity and would not jeopardize any debt repayments, in our view. Therefore, we maintain our adequate assessment of 3i's liquidity, with a 1.4x liquidity ratio. We acknowledge our cautious approach in this metric and thus reflect improving flexibility, both in leverage and in liquidity, in a positive comparative assessment against peers.

Company description

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.

The company's £21.6 billion portfolio is of limited size compared with the overall assets under management of the alternative investment market, but it has demonstrated strong performance over the past few years. The group has one of the longest track records in European midmarket private equity, investing in companies with enterprise values of €100 million-€500 million. 3i also maintains its most successful investments for longer; it made its largest investment, Action, in 2011, and has kept the company as a long-term compound investment.

Royal Sanders, a private label and contract manufacturing producer of personal care products (£580 million as of March 2024) is another example. 3i focuses on the consumer, industrial technology, health care, software, and business services sectors, primarily in the Netherlands, France, Germany, the U.K., and North America. In addition to private equity, the group focuses on infrastructure. 3i owns 29% of 3iN, amounting to £879 million, and acts as its investment manager. 3iN is a FTSE 250 company that invests across midmarket economic infrastructure and greenfield projects in developed markets.

Outlook

The stable outlook on 3i Group PLC 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.

Downside scenario

We could lower the ratings if 3i weakens its commitment to its conservative leverage, materially increases debt, or if the investment portfolio's quality or performance deteriorates meaningfully. A downgrade could also occur if its liquidity management becomes less prudent.

Upside scenario

We are unlikely to raise the rating at this stage given 3i's heavily concentrated investment portfolio, the illiquid nature of its investments, and its adequate liquidity position.

Issue Ratings

We rate 3i's senior unsecured notes at the same level as the issuer credit rating ('A-').

- €500 million, 4.875% notes due in 2029;
- £375 million, 5,750% notes due in 2032; and
- £400 million, 3.750% notes due in 2040.

Ratings Score Snapshot

Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
Risk-adjusted leverage	Adequate	Adequate
Stressed leverage	Very Strong	Very Strong
Risk position	Weak	Weak
Funding and liquidity	Adequate	Adequate

Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
Funding	Strong	Strong
Liquidity	Adequate	Adequate
Preliminary anchor	bbb+	bbb+
Jurisdictional risk	0	0
Anchor	bbb+	bbb+
Modifiers		
Track record and investment performance	Neutral	Neutral
Risk management	Neutral	Neutral
Transparency and complexity	Neutral	Neutral
Comparable rating analysis	Positive (+1)	Neutral
Stand-alone credit profile	a-	bbb+
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2

Related Criteria

- Criteria | Financial Institutions | Other: Alternative Investment Funds Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- 3i Group PLC, June 10, 2024
- 3i Group PLC Affirmed At 'BBB+/A-2'; Outlook Stable, New Debt Rated 'BB+', May 31, 2023
- Peer Holding III B.V. Affirmed At 'BB' On Proposed Recapitalization Transaction; Outlook Stable, June 13, 2024
- Peer Holding III B.V. (Action) Upgraded To 'BB' On Consistently Strong Operating Performance; Outlook Stable, Oct. 12, 2023

Ratings List

Upgraded

	To	From
3i Group PLC		
Senior Unsecured	A-	BBB+

Upgraded; Ratings Affirmed

	To	From
3i Group PLC		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.