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Research Update:

U.K.-Based Travelex Holdings Downgraded To 'B-' On Weakened Operating Performance; Outlook Stable

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Overview

- The operating performance of U.K.-based Travelex Holdings Ltd. in the first half of 2016 was below our expectations, due to lower banknote shipments to Nigeria, continued weakness in Brazil, and the impact of terrorist activity in Europe.
- We believe these challenges could persist over the next 12 months, and anticipate that free operating cash flow will be materially negative in 2016.
- We are revising our business risk profile on Travelex to weak from fair, to reflect pressure on profitability, and are lowering our corporate credit rating on Travelex to 'B-'.
- The stable outlook reflects our view that metrics will be commensurate with the rating level in the next 12 months, and that liquidity will remain adequate.

Rating Action

On Aug. 30, 2016, S&P Global Ratings lowered its corporate credit rating on U.K.-based foreign exchange services provider Travelex Holdings Ltd. to 'B-' from 'B'. The outlook is stable.

At the same time, we lowered the issue rating on Travelex's £350 million senior secured notes due in 2018 to 'B-' from 'B'. Our recovery rating on the notes is unchanged at '4', indicating our expectation of recovery in the higher half of the 30%-50% range in the event of a payment default.

We also lowered our issue rating on the £90 million super senior revolving credit facility (RCF) to 'B+' from 'BB-'. The recovery rating remains at '1', indicating our expectation of very high recovery (90%-100%) in a default scenario.

Rationale

The downgrades reflect our view that Travelex faces a number of business challenges that will result in material EBITDA contraction and significantly negative free operating cash flows (FOCF), in the current financial year. We anticipate a degree of recovery in 2017, but are uncertain that such recovery will sustain metrics consistent with a higher rating level.

In the six months to June 30, 2016, Travelex reported a 58% drop in core group EBITDA (before exceptional items) due to lower wholesale banknote shipments to Nigeria resulting from the imposition of capital controls, continued challenging conditions in Brazil, the impact of terrorist attacks in Europe, and increased investments in the group's digital platforms. We see these factors continuing, to varying degrees, into the second half of the year, which, in our view, limits the visibility on the recovery that Travelex predicts in 2017. Positively, we expect the company to benefit from a weaker pound sterling through higher inbound traffic to the U.K. and revenues from U.K. value-added tax refunds. A lower sterling also improves the translation of profits for Travelex.

Travelex's financial risk profile is constrained by high debt, consisting of £347 million in senior secured notes, a £90 million super senior RCF, and £681 million in payment-in-kind (PIK) notes and non-cash-pay preferred shares, all at the restricted group, as defined in the bond documentation. There is also a $490 million cash-pay loan at BRS Ventures & Holdings Ltd. (BRSV), Travelex's holding company.

As a result of EBITDA contraction, we forecast that our key measure of reported EBITDA interest coverage at the restricted group (including restructuring costs but excluding exceptional items) will fall to about 1.5x in 2016, compared with our previous forecast of about 2.0x. We exclude interest on the debt at BRSV from our calculation, because we understand that the upstreaming of dividends is currently restricted. We also anticipate a greater drop in FOCF in 2016 than we previously expected, as lower operating cash flows and increased investment in digital will be compounded by a one-time working capital outflow of about £35 million. This will result from the change in terms of a key bank notes supplier, and will only partially be offset by new alternative supply arrangements.

Our revision of Travelex's business risk profile to weak from fair reflects the pressures on Travelex's profitability, with the core group EBITDA margin before exceptional items declining to 4% in first half of 2016, from 9% in the first half of 2015. The business risk profile also reflects Travelex's exposure to the cyclical travel industry, the decreasing share of cash used by travelers, and the complex regulated environment in which Travelex operates.

These business risk weaknesses are partly offset by the company's position as the largest nonbank provider of travel money worldwide, its product and geographic diversification, and strong franchise, coupled with favorable long-term trends for air travel volumes.

In our base case, we assume:

- Mid-single-digit revenue growth, including the opening of new stores and ATMs, and an increase in outsourcing contracts.
- A four-to-five percentage point decline in the core group EBITDA margin in 2016, excluding exceptional expenses, due to lower wholesale shipments to Nigeria, declining activity in Brazil, higher investment in digital,

and lower retail volumes due to European terror attacks. We anticipate stable to modestly improving EBITDA margins from 2017 onward.
- £8 million in exceptional expenses in 2016 related to the sale of Travelex to Dr. Shetty in 2015.
- Working capital requirement in 2016 of about £50 million, of which £35 million is a one-time outflow related to the change in terms of a key bank notes supplier, partly offset by new alternative supply arrangements.
- Disposal proceeds of £32 million in 2016 from the sale of Currency Select.
- Capital expenditures (capex) of about £30 million in 2016 and £20 million in 2017.
- No dividend payments to shareholders.

Based on these assumptions, we arrive at the following credit measures:
- Adjusted debt to EBITDA of about 9x in 2016 and 8x in 2017, including non-cash-pay shareholder loans and preferred shares of about £640 million, and the holding company's debt of $490 million.
- Unadjusted EBITDA cash interest coverage at the restricted group of about 1.5x in 2016 and 2x in 2017. We use reported coverage ratios because our lease adjustments result in artificially improved metrics due to the importance of short-term lease commitments.
- Our forecast of FOCF after exceptional items at about negative £65 million in 2016 and positive £15 million in 2017.

Liquidity

We continue to assess Travelex's liquidity as adequate, despite some weakening in the last 12 months, reflecting our view that the company's sources of liquidity will cover liquidity uses by at least 1.2x over the 12 months from June 20, 2016.

We calculate the following principal liquidity sources:
- £32 million of cash considered to be readily available for liquidity purposes.
- £9 million available under the £90 million RCF. £30 million of the RCF is reserved for guarantees and therefore this portion is not freely available to cover liquidity uses.
- Funds from operations of about £30 million.
- About £32 million proceeds from the disposal of Currency Select, which is now completed.

We calculate the following principal liquidity uses over the same period:
- Capex of about £25 million, of which maintenance capex is about £10 million.
- Working capital outflow of about £30 million, including the one-time outflow related to the replacement of bank note supplier that is partly offset by new supply arrangements.
- About £30 million to fund intrayear working capital swings from peak to trough.

Outlook

The stable outlook reflects our opinion that Travelex's operating performance will progressively stabilize in the next 12 months, and that EBITDA in 2017 will moderately recover. We expect Travelex will report adjusted debt-to-EBITDA in 2016 of about 9x (including shareholder loans and holding company debt), and reported EBITDA cash interest coverage at the restricted group of about 1.5x (or about 2x on an adjusted basis, including the effect of operating leases). We also forecast that FOCF will be materially negative in 2016 and broadly neutral in 2017, and that liquidity will stay adequate.

Downside scenario

We could lower the ratings if Travelex's earnings and FOCF deteriorated beyond our current expectations, for example due to the loss of important wholesale contracts or a further deterioration of the geopolitical environment, resulting in increased leverage such that we no longer considered the capital structure to be sustainable. We could also lower the ratings if liquidity weakened, or if Travelex upstreamed cash to the holding company.

Upside scenario

An upgrade would require Travelex's operating performance to recover more strongly and quickly than we currently expect, with a broad based recovery in key markets and all business lines, resulting in EBITDA margins before exceptional items of clearly and sustainably in the double digits, and sustainably neutral-to-positive FOCF. An upgrade would also be contingent on leverage being at least stable.

Ratings Score Snapshot

Corporate Credit Rating: B-/Stable/--

Business risk: Weak
- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Weak

Financial risk:
- Cash flow/Leverage: Highly leveraged

Anchor: b-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)

- Financial policy: Neutral (no additional impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile:
- Group credit profile: b
- Entity status within group: Core

Recovery Analysis

- The £90 million RCF due 2018 has a recovery rating of '1' and an issue rating of 'B+'. The recovery rating reflects the facility's super senior status in the capital structure.
- The £350 million senior secured notes due 2018 have a recovery rating of '4' and an issue rating of 'B-'. The recovery rating is constrained by the notes subordination to the RCF and the lack of tangible security provided to bondholders given the asset-light nature of the business, but supported by the fair guarantee package.
- Our hypothetical default scenario envisages operating underperformance combined with the group's high leverage, assuming the company would be unable to renew some of its concessions upon expiry or an increase in concession fee rates. We also forecast a loss of some major customers in the wholesale business.
- We value Travelex as a going concern given its well-known and trusted brand, with a strong global presence and a resilient business model through recessions.
- Year of default: 2018
- EBITDA at emergence: £45 million
- Implied enterprise value (EV) multiple: 5.5x
- Jurisdiction: U.K.

Simplified waterfall

- Gross EV at default: £248 million
- Administration expenses: £13 million
- Net value available to creditors: £235 million
- Priority claims: £1.4 million
- Super Senior RCF claims: £62 million
- --Recovery expectation: 90%-100%
- Subordinated debt claims: £365 million*
- --Recovery expectation: 30%-50% (upper half of range)

*All debt amounts include six months' prepetition interest and 100% drawn RCF.

Related Criteria And Research

Related criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate

Entities, April 29, 2014
- Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- Corporate Methodology, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria Guidelines For Recovery Ratings On Global Industrial Issuers' Speculative-Grade Debt, Aug. 10, 2009
- Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; Outlook Action

	To	From
Travelex Holdings Ltd.		
Corporate Credit Rating	B-/Stable/--	B/Negative/--
TP Finance 3 Ltd.		
Senior Secured	B+	BB-
Recovery Rating	1	1
Travelex Financing PLC		
Senior Secured	B-	B
Recovery Rating	4H	4H

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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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at 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.