AlixPartners

MARCH 2021

ALIXPARTNERS MID-MARKET DEBT REPORT H2 2020

COVID-19 continued to have a dramatic impact on European mid-market debt in H2. Lenders reassigned focus towards a much narrower set of sectors, supported clients by deploying government-backed funding and worked through issues with existing clients.

After a year of once-in-a-generation GDP declines and with debt and working capital mounting, borrowers will need to consider all financing sources whilst ramping up profitability. One option is asset-based lending, where activity levels remain robust. Special situations teams at credit funds are also gearing up for increased activity.

Welcome to the H2 2020 edition of the AlixPartners bi-annual mid-market debt report. Our findings are based on the activity of approximately 100 bank and non-bank leveraged lenders[1] and 14 asset-based lenders[2].

COVID UNCERTAINTY DRIVES DOWN ACTIVITY

- Overall activity levels in 2020 were 38% lower than in 2019. COVID-insulated sectors including technology and healthcare continued to thrive, though lenders' appetite for COVID-impacted sectors was severely impacted.

PORTFOLIO AND GOVERNMENT FOCUS

- Banks continued to spend their time managing portfolio issues and facilitating government lending during the second half of 2020. Considering ongoing uncertainty, banks are being extremely cautious before deploying new capital.

CREDIT FUND COMPETITION

- Fewer opportunities coupled with funds' aggressive capital deployment targets is driving huge competition for the best credits. Leverage and documentation are in line with pre-COVID levels for COVID-insulated sectors and, despite the funds targeting higher returns, pricing is also heading towards pre-COVID levels.

SPECIAL SITUATIONS OPPORTUNITIES

- Even funds that have historically focused on vanilla direct lending are preparing for special situations lending. This has been achieved by hiring externally, combining direct lending and credit opportunities teams, or even by acquiring funds with experience in special situations (e.g. Bridgepoint's acquisition of EQT).

SOME RELATIONSHIPS FEELING THE STRAIN

- COVID has led to borrowers renegotiating covenants and, in many instances, needing to inject additional liquidity. In most situations, credit funds and sponsors found a consensual solution in the wake of the first lockdown. However, it is becoming more difficult for many sponsors and lenders to agree how to support businesses.

ABL GAINS GROUND AMIDST UNCERTAIN OUTLOOK

- In 2020, Asset Based Lending (ABL) activity remained robust, given the product's suitability at a time where profitability levels remain uncertain. The ABL market has continued to evolve and now offers of flexibility and pricing.

KEY ACTIONS FOR BORROWERS IN 2021:

- Develop a structured plan to improve cash flow generation through careful cost management and prioritisation of high margin activities.
- Rigorously interrogate funding requirements under alternate recovery scenarios.
- Assess a full range of debt options and retain optionality to select the one that is right for your business and industry's recovery outlook.
- Maintain close dialogue with lenders and prepare for financing events early.

1. Total debt between €20 million to €300 million
2. Total debt between £5 million and £200 million

Please refer to the disclaimer at the end of this report for further context on the data

Ongoing uncertainty and increasing infection rates put paid to the economic recovery hoped for at the end of H1 when initial lockdowns were lifted[3]. Despite this, volumes improved in H2 2020.

08 Jul 2020: The UK announces a £1,000 employee retention bonus, 5% VAT rate for food, accommodation and attractions, plus the Eat Out to Help Out scheme to run in August.

21 Jul 2020: EU leaders announce a 750 billion EUR pandemic recovery fund.

18 Sep 2020: 1 in 5 UK residents under some degree of extended local restrictions.

21 Sep 2020: 10pm closing times for UK pubs announced, and UK chief scientific advisor warns of 50,000 cases per day by mid-October without further action. The FTSE 100 falls more than 3% amid concerns over a fresh wave of the virus.

12 Oct 2020: Three-tier regional legal framework introduced in England to help curb the virus spread.

25-31 Oct 2020: Widespread new restrictions introduced across Europe.

05 Nov 2020: England enters a four-week national lockdown.

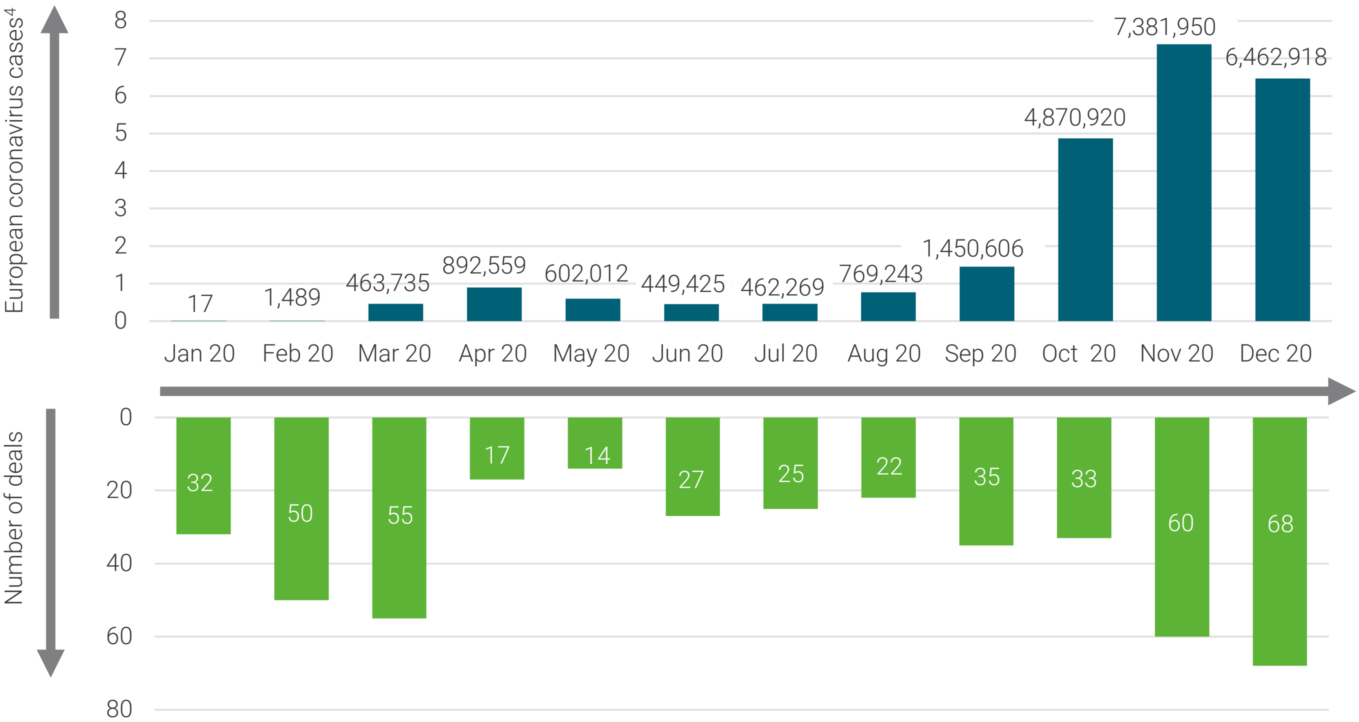
11 Nov 2020: The UK becomes the first European nation to exceed 50,000 deaths from COVID-19.

16-18 Nov 2020: Moderna announces vaccine is 94.5% effelective; Pfizer announces its vaccine is 95% effective and is approved for use in the UK in early December.

08 Dec 2020: UK resident, 90-year-old Margaret Keenan, receives the first COVID-19 vaccine globally, outside of clinical trials.

19-20 Dec 2020: A new strain of the virus is identified in South East England.

31 Dec 2020: A record 55,892 daily UK cases are reported, plus 964 deaths.



Government support

- In H2 2020, governments continued to support lending. In the UK, CLBILS reported £5 billion in support for qualifying businesses during 2020 across 675 approved facilities. The French Government launched the €300 billion PGE scheme which hundreds of thousands of businesses have taken advantage of. Italy also introduced a €200 billion state guarantee scheme operated by SACE S.p.A, Italy's Export Credit Agency.
- The injections of liquidity have been gratefully received as a method to bridge businesses to a period of more sustained recovery, although as the crisis stretches into 2021 there may be a need to review the loan structures and methods / timeframes for repayment.

M&A activity

- Overall, M&A activity has been suppressed in 2020. A significant value gap often exists between buyers seeking bargains in the COVID environment and sellers looking for post-recovery 'snap-back' valuations.
- However, there was a record 79%[5] uptick in M&A activity by value from H1 to H2. Several transactions were completed on the back of positive new flows in Q3 as investors reacted quickly to deploy dry powder.
- In November 2020 it emerged that the UK Chancellor had commissioned a review of Capital Gains Tax, which recommended slashing the annual allowance and aligning rates more closely with income tax, effectively doubling the cost of selling shares. Despite new flow deteriorating in Q4, several businesses accelerated share sales before April 2021 to maximise individual returns.
- Debt market activity in H1 was closely aligned to the number of COVID cases per month. This correlation ended in H2, as sponsors and lenders became comfortable transacting in the midst of the pandemic.

GDP trends

- In 2020, GDP declined by 6.4% in the EU and by 9.9% in the UK. This is the largest decline in the UK since 1709[6].
- Whilst certain sectors have felt the pain most acutely, very few businesses have been completely isolated. Businesses have done everything they can to build healthy liquidity buffers but paying off increased debt and deferrals is going to require cash generation to improve quickly.

3. Source: British Foreign Policy Group
4. Source: https://ourworldindata.org/
5. Source: https://transactions.freshfields.com/post/102gm2o/global-ma-in-2020-and-what-to-expect-in-2021
6. Source: https://www.ft.com/

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As the COVID crisis extended into H2 2020, new deal activity involving banks remained scarce, as banks facilitated government-backed loans and supported existing clients.

FIGURE 1: UK MID-MARKET BANK DEAL COUNT[7]

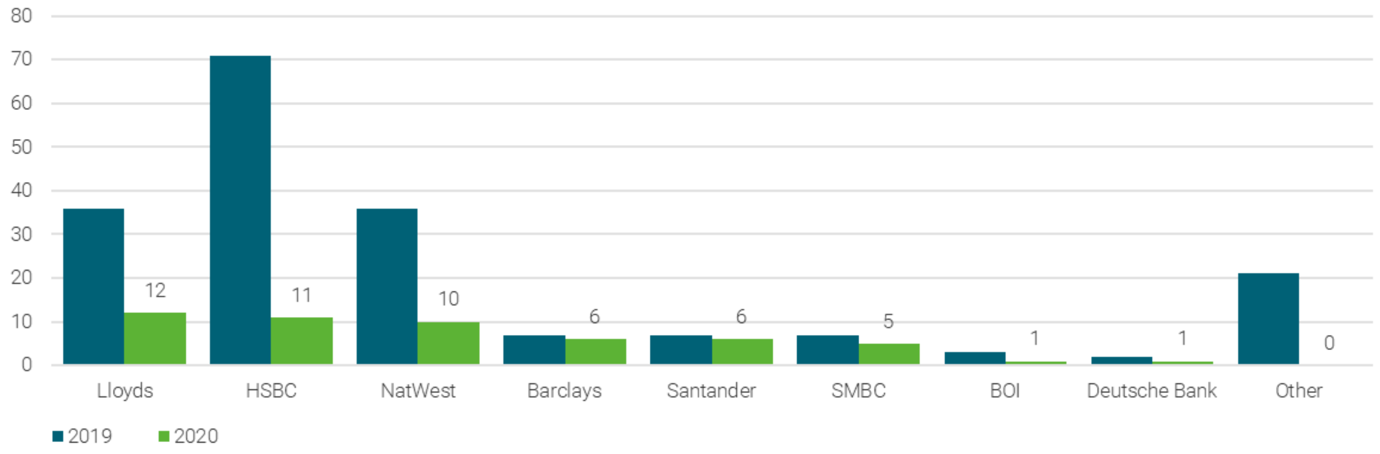
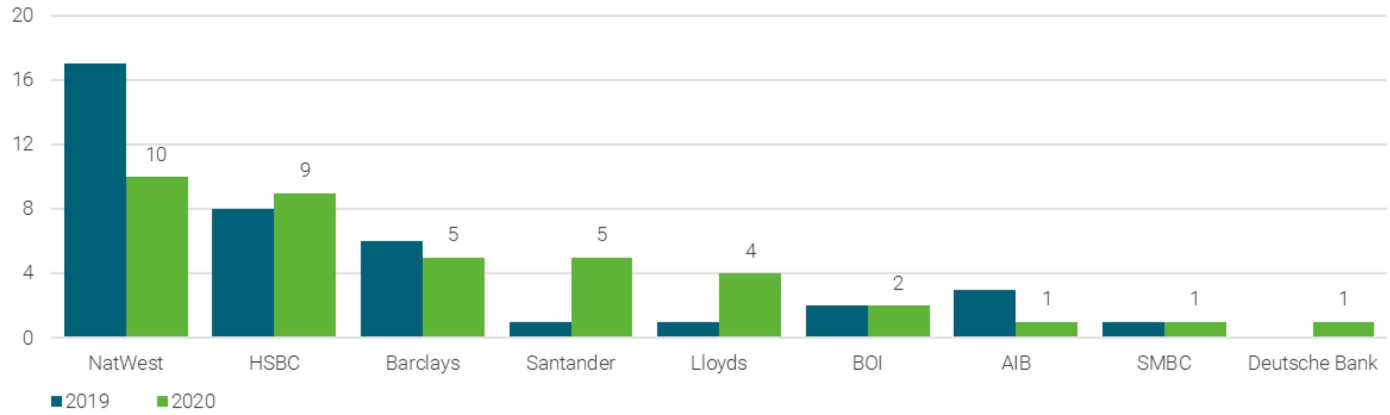


FIGURE 2: UK BANK SUPER SENIOR RCF COUNT



INSIGHTS

- The number of senior banking deals decreased from 190 in 2019 to 52 in 2020, with almost all participants in the survey reducing activity in 2020 compared to 2019.
- Lloyds completed the most senior deals in 2020 with 12 deals, a reduction in activity to a third of the number of deals completed in 2019.
- HSBC completed only 11 deals, down by more than 80% from the 71 that the bank completed in 2019. NatWest completed 10 deals, down from 36 in 2019.
- Together Lloyds, HSBC and NatWest completed deals across 15 sectors in 2020, a decrease from 46 sectors in 2019.
- With economic uncertainty expected to extend well into 2021, there is likely to be a high bar for banks to approve new transactions. This is likely to be felt most acutely in the hardest-hit industries where liquidity may be needed the most.
- 38 super senior deals were completed in 2020 in the UK, which represents only a 3% decrease compared to 2019 levels, demonstrating banks' willingness to provide working capital funding to existing customers.
- Nine banks completed super-senior deals in the UK in 2020. The most active super senior lenders were NatWest (ten deals, down from 17 in 2019), HSBC (nine deals, up from eight in 2019).

7. Excludes super senior deals.
Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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Non-bank activity also decreased in 2020, but funds grew market share by deploying in COVID-insulated sectors.

FIGURE 3: EUROPEAN MID-MARKET NON-BANK DEAL COUNT

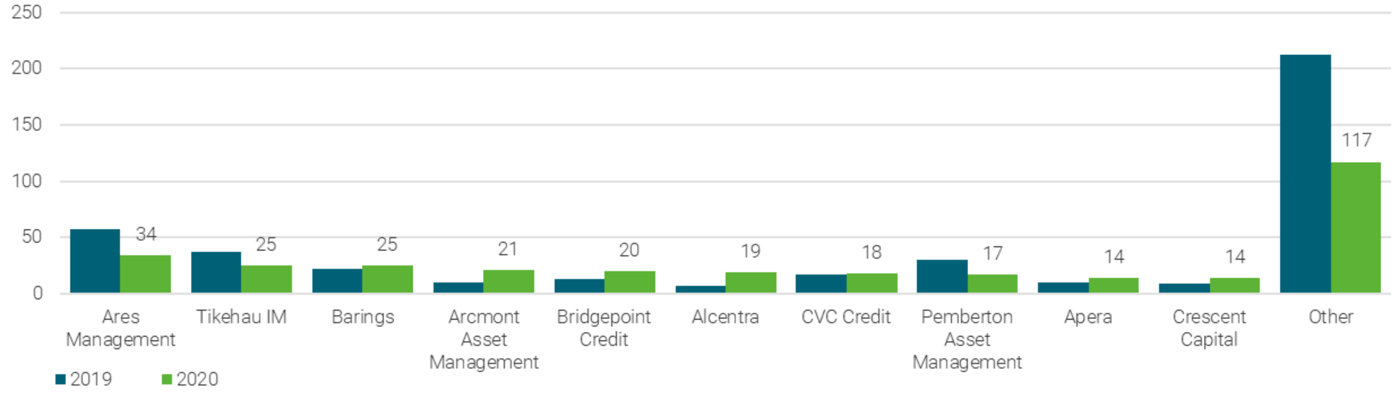
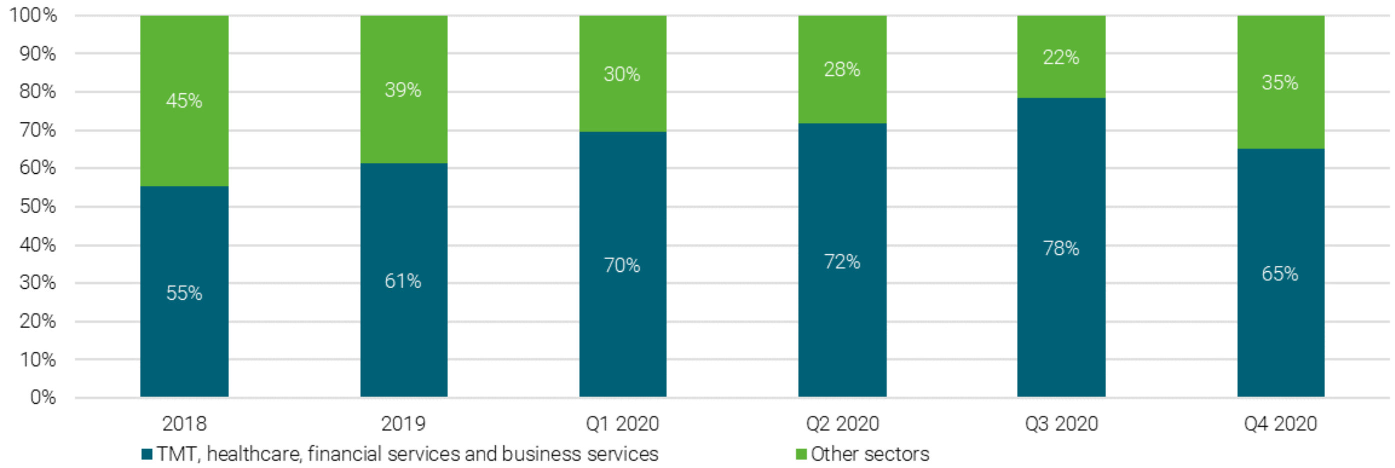


FIGURE 4: SECTOR SPLIT



INSIGHTS

- Non-bank deals decreased from 424 in 2019 to 324 in 2020. As this decline was less severe than for the banks, funds increased their share of the market to 74%.
- Ares continued to be the most active lender in Europe in 2020, completing 34 deals, down from 57 in 2019.
- Ares increased its activity in Healthcare as well as Technology, Media and Telecommunications, which together accounted for 13 deals in 2020 and 12 in 2019. Ares, like the rest of the market, focused their attention on sectors less impacted by the pandemic.
- Tikehau completed 25 deals in 2020, down from 37 in 2019. Arcmont Asset Management completed almost twice the number of deals in 2020 than in 2019, with significant growth in UK activity.
- ESG is increasingly becoming the hot topic in direct lending as LPs insist that their asset managers invest responsibly. Loan terms increasingly include ESG conditionality, where compliance (or non-compliance) can trigger margin adjustments.
- Fund raising activity by credit funds is ongoing, with investors continuing to consider direct lending as an attractive market asset class. This trend included sovereign wealth funds, with notable examples including the Qatar Investment Authority partnership with Credit Suisse and Apollo creating a $12 billion lending fund with Mubadala.

Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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ABL activity remained robust in comparison to other parts of the European debt markets.

FIGURE 5: UK IDF ONLY ABL DEAL

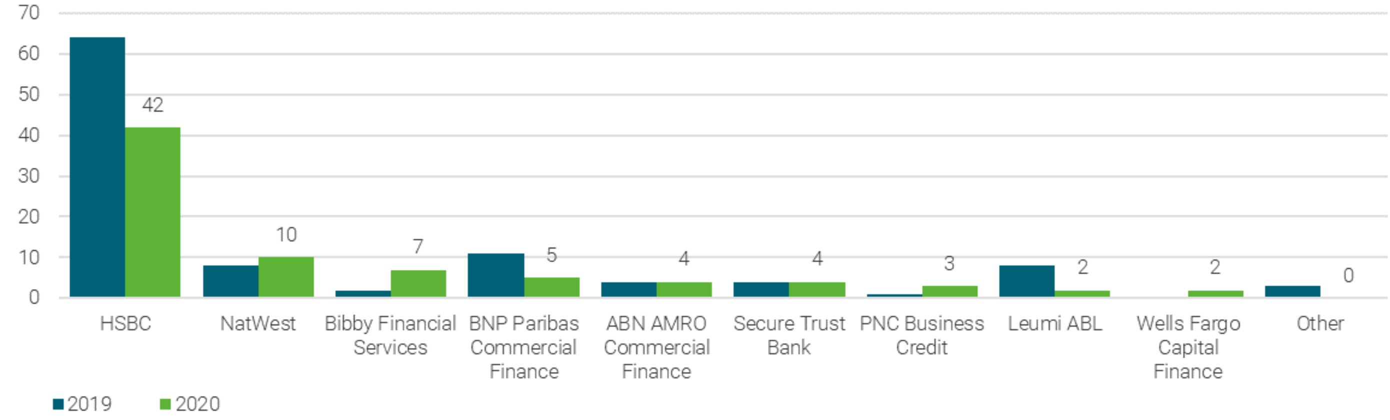
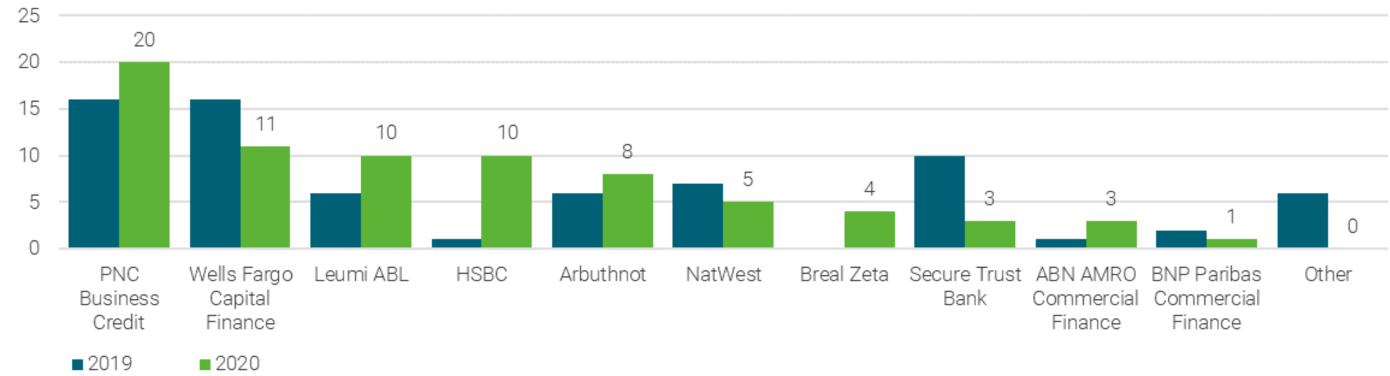


FIGURE 6: UK ABL DEALS (EXCLUDING RECEIVABLES ONLY/IDF DEALS)



INSIGHTS

- The number of IDF-only deals in the UK decreased by 25% in 2020. This contraction is much less pronounced than the depression in the leveraged banking market, as borrowers leveraged debtor balances to bolster liquidity.
- In contrast to other segments of the UK debt market, multi-asset ABL activity increased in 2020 (6%). PNC and Wells Fargo completed the most deals, with PNC's deal count of 20 representing a 25% increase from the amount completed in 2019.
- The ABL market continues to evolve with the number of lenders and range of debt products expanding. For example, Breal Zeta completed 4 deals in 2020.
- ABL providers increasingly offer a continuous spectrum of flexibility (and pricing), rather than distinct offering categories that have been associated with ABL historically.

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ABOUT US

For more than 40 years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.