AlixPartners

MARCH 2020

ALIXPARTNERS MID-MARKET DEBT REPORT H2 2019

More than a decade after moving into the European lending market, alternative lenders continue to move the needle. By employing new lending strategies and harvesting existing portfolio companies, non-bank lending now accounts for 62% of the activity recorded in our survey.

Welcome to the H2 2019 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].

CREDIT FUNDS TAKE SHARE AS OVERALL ACTIVITY INCREASES

- European mid-market lending activity increased in 2019, with lenders completing 2% more transactions than in 2018.
- There was a step-change in market share trends in 2019, with non-bank lenders' proportion of deals increasing from 52% in H2 2018 to 62% in H2 2019.

LENDING STRATEGIES OF NON-BANK LENDERS ARE EVOLVING

- Non-bank lenders are constantly seeking new, innovative ways to deploy capital.
- In H2 2019, several non-bank lenders set up senior focused funds with lower return requirements (for example AcquiVest and Muzinich), which enabled them to offer pricing which is comparable to the banks.
- As reported by Proskauer's 2019 Private Credit Insights, over 15% of European revolving credit facilities in 2019 had a margin over 4.5%, as non-bank lenders increasingly offer a 'one-stop shop' to compete in the super senior market.

CREDIT FUNDS PROSPER FROM REACHING CRITICAL MASS

- After over a decade participating in the European mid-market debt markets, non-bank lenders now have significant portfolios that require additional capital.
- Credit funds are effectively utilising their incumbent position to provide follow on funding. 25% of the non-bank deals in 2019 were used for add-on/ acquisition financing (up from 20% in 2018).

DIRECT LENDERS' BATTLE AGAINST THE SYNDICATED LOAN MARKET GAINS MOMENTUM

- Direct lenders continued to take on the syndicated loan market in 2019. Notable deals in H2 included the €1 billion financing of Primonial by lenders including Ares, and the €800 million financing of Register.
- Sponsors are attracted to the deal certainty and flexibility that funds can offer, particularly with the pricing gap to the syndicated loan market narrowing in many instances.

FUNDRAISING REINVIGORATED IN H2 2019

- After a brief hiatus in H1 2019, fundraising was back with a bang in H2 2019. Notable examples include Arcmont (€6 billion), Alcentra (€5.5 billion) and Pemberton (€3.2 billion), as well as swathes of small raises throughout the mid-market.
- With new lending strategies, portfolio critical mass and geographical expansion, non-bank lenders seem to have the tools to deploy the estimated $111 billion of dry powder in the European debt markets.

DESPITE AN UPTICK IN H2, ABL ACTIVITY IN 2019 WAS LOWER THAN IN 2018

- ABL activity declined by 2% in 2019, with reduced M&A activity being a significant driver behind this decline. A 13% decrease in UK activity was partially offset by an increase outside of the UK.
- Portfolios companies generated less follow-on opportunities for ABLs than cash flow lenders (19% versus 25% in the cash flow lending market).

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

UK banking activity was significantly down in 2019 as non-bank lenders increasingly competed for senior and super senior tranches

FIGURE 1: UK MID-MARKET BANK DEAL COUNT[3]

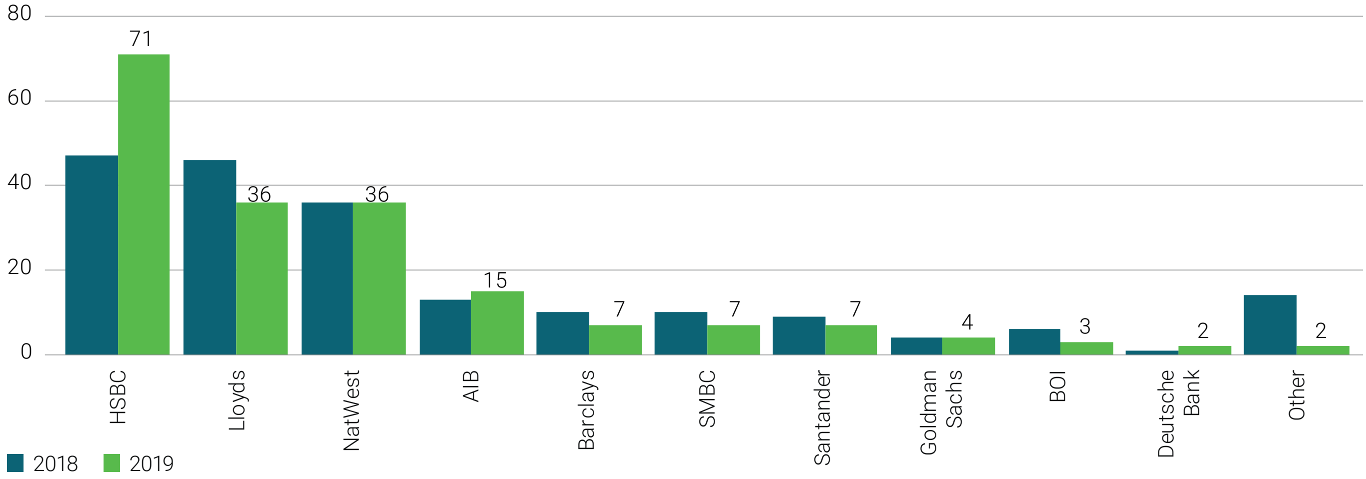
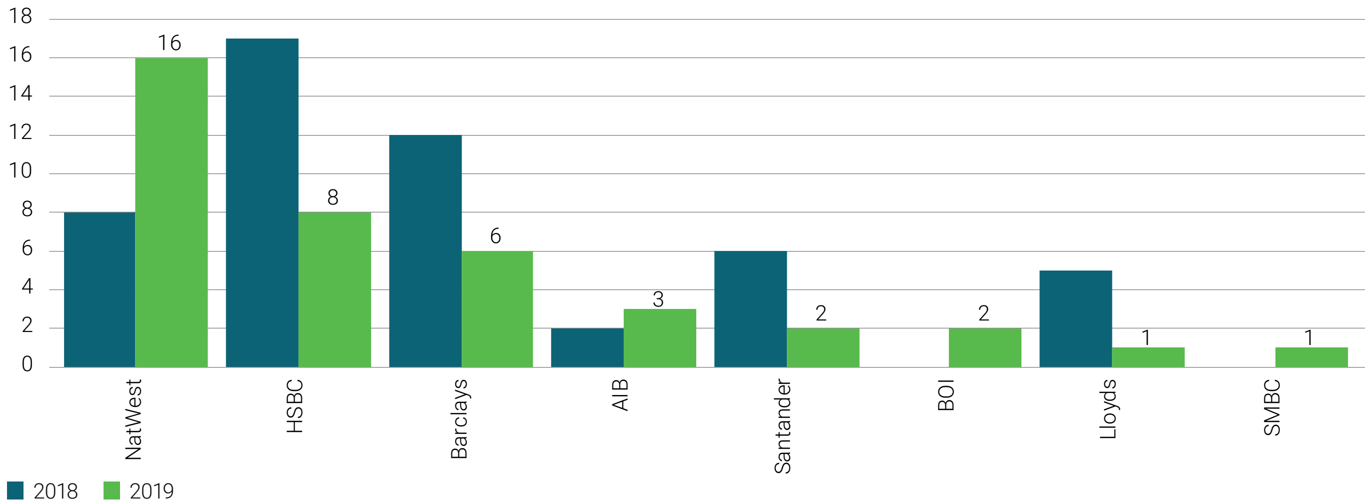


FIGURE 2: UK BANK SUPER SENIOR RCF COUNT



INSIGHTS

- The number of UK banking deals (excluding super senior) decreased from 196 in 2018 to 190 in 2019.
- The most active term bank lender in 2019 was HSBC (71 term participations, up from 47 participations in 2018). HSBC was the only lender to increase activity in 2019. HSBC's activity in 2019 included 18 TMT, 17 business services and seven healthcare participations.
- Lloyds and NatWest were the next most active lenders both with 36 participations. Lloyds was down from 46 in 2018 while NatWest remained in line with the previous year. Both lenders were active across a number of sectors.
- Despite intensifying regulation and well-publicised issues with certain bank balance sheets, the amount of banking deals per year has remained at slightly below 200 deals per year since 2017. Many borrowers still feel most comfortable with bank debt, particularly if pricing is a key focus.
- The number of super senior deals in the UK fell from 50 in 2018 to 39 in 2019. Eight banks completed super-senior deals in the UK in 2019. The most active super senior lenders were NatWest (16 deals, up from eight in 2018), HSBC (eight deals, down from 17 in 2018) and Barclays (six deals, down from 12 in 2018).
- Non-bank lenders are increasingly offering super senior facilities as part of their overall package. In addition to bolstering absolute returns, becoming a 'one-stop shop' makes the non-bank option more compelling. This trend was demonstrated in Proskauer's 2019 Private Credit Insights, which noted that over 15% of revolving credit facilities have a margin of over 4.5% (up from just over 5% in 2017).

3. Excludes super senior facilities

Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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Non-bank lenders have increased their market share significantly in 2019

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

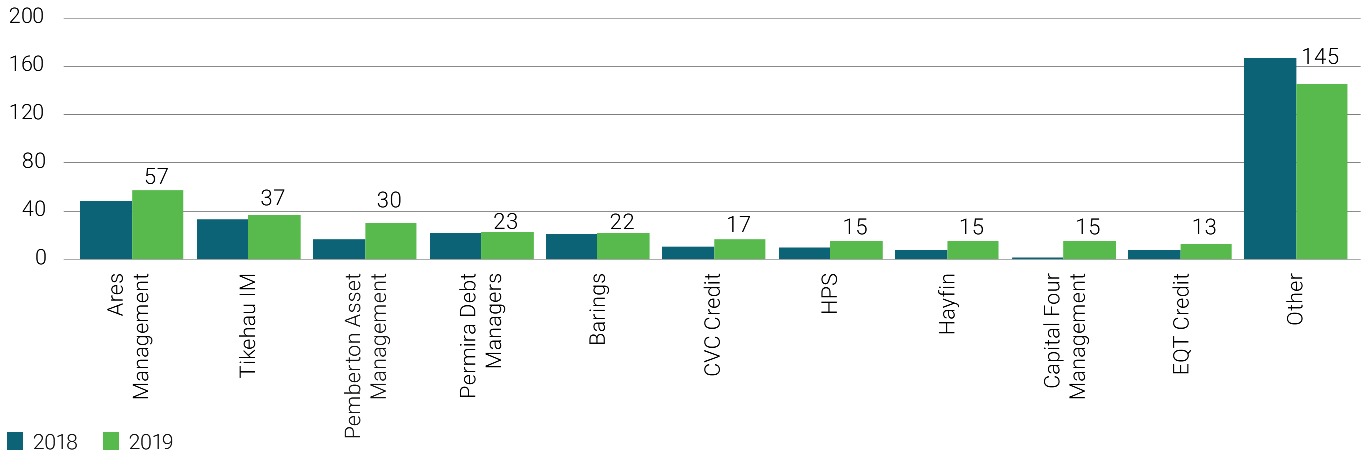
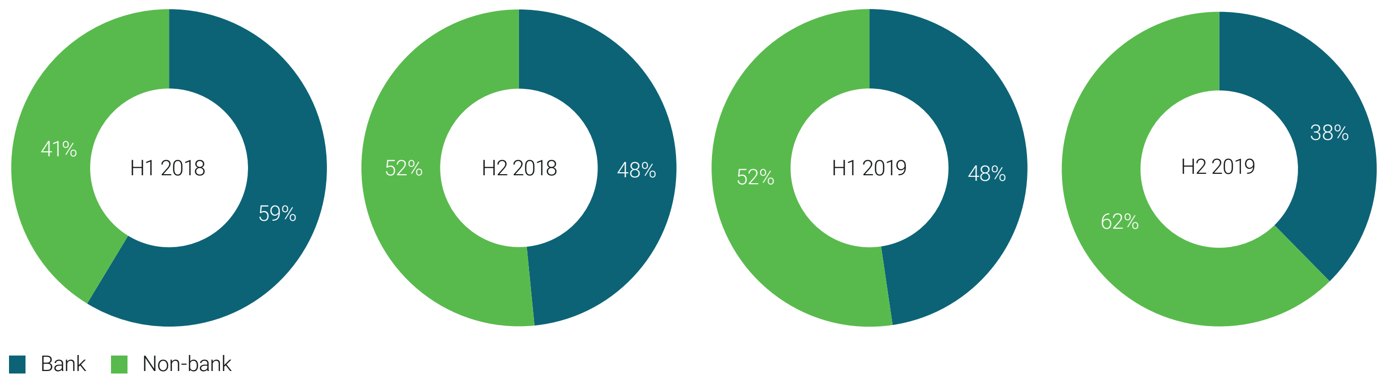


FIGURE 4: MARKET SHARE



INSIGHTS

- Total non-bank lending activity increased in 2019, with 389 deals being completed in comparison to 347 in 2018. Funds have continued growing their market share and were involved in 62% of deals in H2 2019.
- Ares was the most active lender in 2019 with activity in eight different countries during H2 2019. The fund ended the year with 57 completed deals to maintain its market leading position.
- Tikehau IM (37), Pemberton (30), Permira (23) and Barings (22) were also active during 2019.
- After several years competing in the European mid-market, non-bank lenders are beginning to harvest their substantial portfolios for follow on funding opportunities. With sponsors and management teams aspiring to deliver equity cases, there is a mid-business plan debt requirement which the funds are very happy to fill.
- Funds have successfully leveraged relationships with their borrowers. As a result, 25% of deals in 2019 were for add-on/ acquisition financing, up from 20% in 2018. Sponsors are aware of the amount of competition in mid-market, but, in order to maintain their incumbent positions, lenders have found ways to meet borrower requirements.
- Following a relatively subdued H1 2019, European direct lending funds raised $13.9 billion in Q3 2019[4].
- Notable raises include Arcmont (€6 billion), Alcentra (€5.5 billion) and Pemberton (€3.2 billion). Funds were raised for multiple strategies, including credit opportunities (AnaCap Financial Partners, €1 billion) and senior focused funds (e.g. Muzinich's senior focused fund for SMEs outside of the UK which had its first close at €104 million).
- European funds are increasingly raising lower yielding funds from investors requiring lower returns (e.g. insurance companies), enabling them to offer pricing which is competitive with the banks.
- The European direct lending market had c.$111 billion of dry powder towards the end of 2019. The availability of capital has continued to drive competition in the mid-market, with the best credits receiving higher leverage and borrower-friendly terms.

4. Preqin Quarterly Update: Private Debt Q3 2019

Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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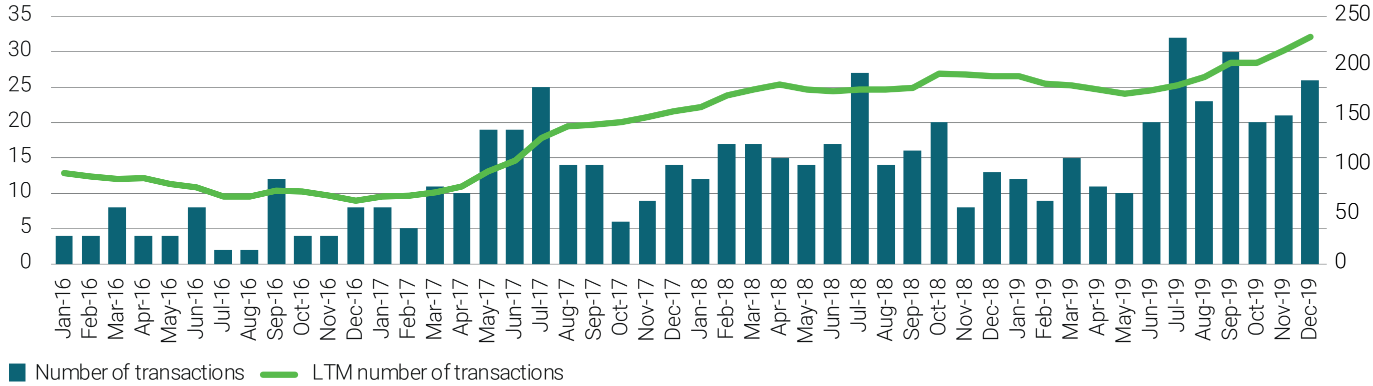
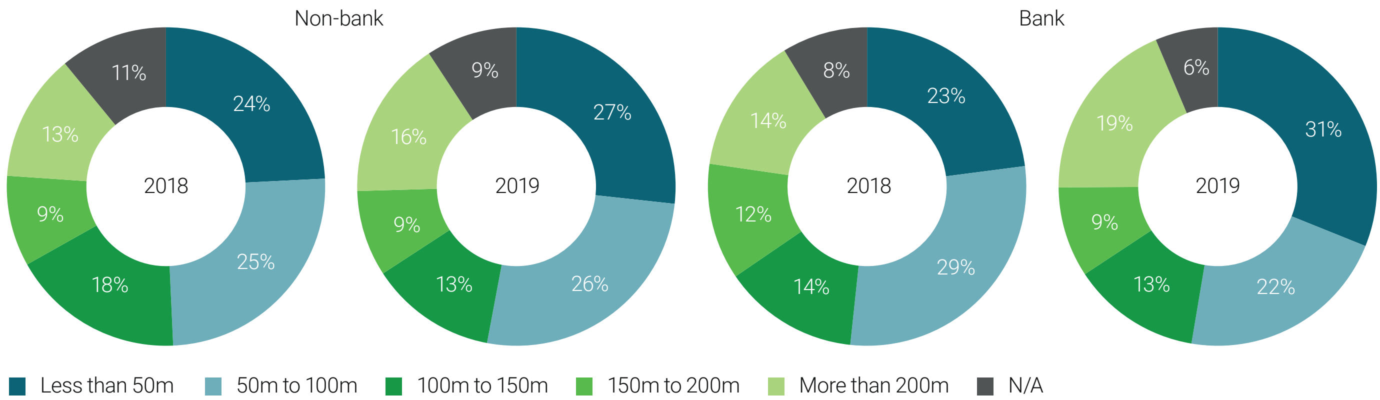
Non-bank lenders are continuously looking for new ways to employ capital

FIGURE 5: TRAILING LTM UNITRANCHE DEAL COUNT



- H2 2019 saw a significant uptick in the number of transactions, with the LTM number of transactions reaching a record high of 229 in December 2019. 220 unitranche deals were completed by non-bank lenders, which accounted for 57% of their total activity in 2019.
- The expansion of the unitranche product is largely due to non-bank lenders constantly evolving their lending strategies. In addition to competing for senior (e.g. Intracto refinancing by Alcentra) and super senior opportunities, funds are building greater presence in European markets which have traditionally been dominated by banks.
- The most notable example of this is Spain, where the number of unitranche deals increased from nine in 2018 to 15 in 2019. Lenders such as Ares, Pemberton, Arcmont and Kartesia completed deals in Spain during 2019.

FIGURE 6: MID-MARKET DEAL SIZE (BANK AND NON-BANK, €)



- 53% of non-bank lending deals in 2019 were less than €100 million, up from 49% in 2018.
- With intense competition in the middle of the mid-market, non-bank lenders are considering businesses that require lower amounts of debt. Funds continue to be set up to focus on this space and activity in the sub-£15 million non-bank lending market is accelerating. Examples of this include Shard Capital's financing of Alexander Technologies and ThinCats financing of Hickory's, the smokehouse business based in Cheshire.
- At the other end of the spectrum, several non-bank lenders are increasingly competing for deals in the traditional syndicated loan space. Examples of this include Latour Capital's acquisition of a stake in Primonial, with was funded by a €1 billion facility provided by a lending group including Ares, and BASF's chemical business acquisition by Lone Star (€700 million provided by GSO).
- The flexibility and certainty offered by funds over the syndicated loan market is very attractive to sponsors. As non-bank lenders become more competitive on pricing it is likely that more large cap sponsors will turn to the unitranche product as a viable alternative to syndicated loans and high-yield bonds.
- Banks maintained its focus on smaller deals, with 53% of bank deals being below €100 million during 2019 (in comparison to 52% in 2018). The bias towards sub-€50 million deals noticed in H1 2019 continued as banks pursued risk diversification strategies.

Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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Despite a slight resurgence in H2, UK ABL activity is significantly down on last year

FIGURE 7: UK IDF ONLY ABL DEALS

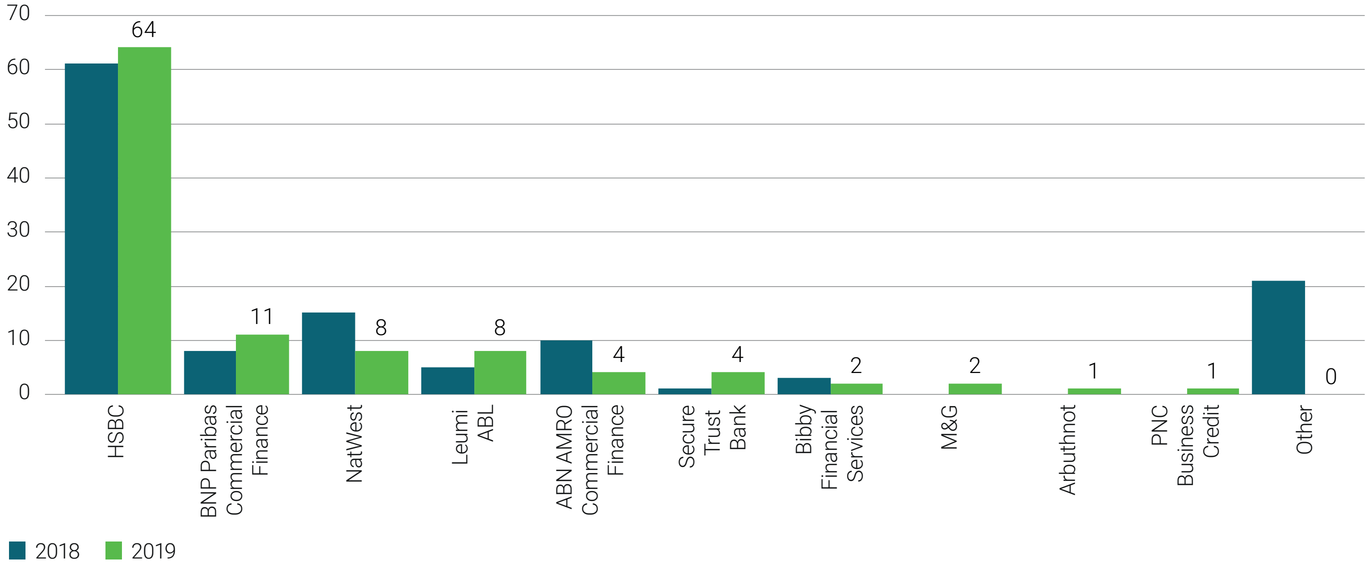
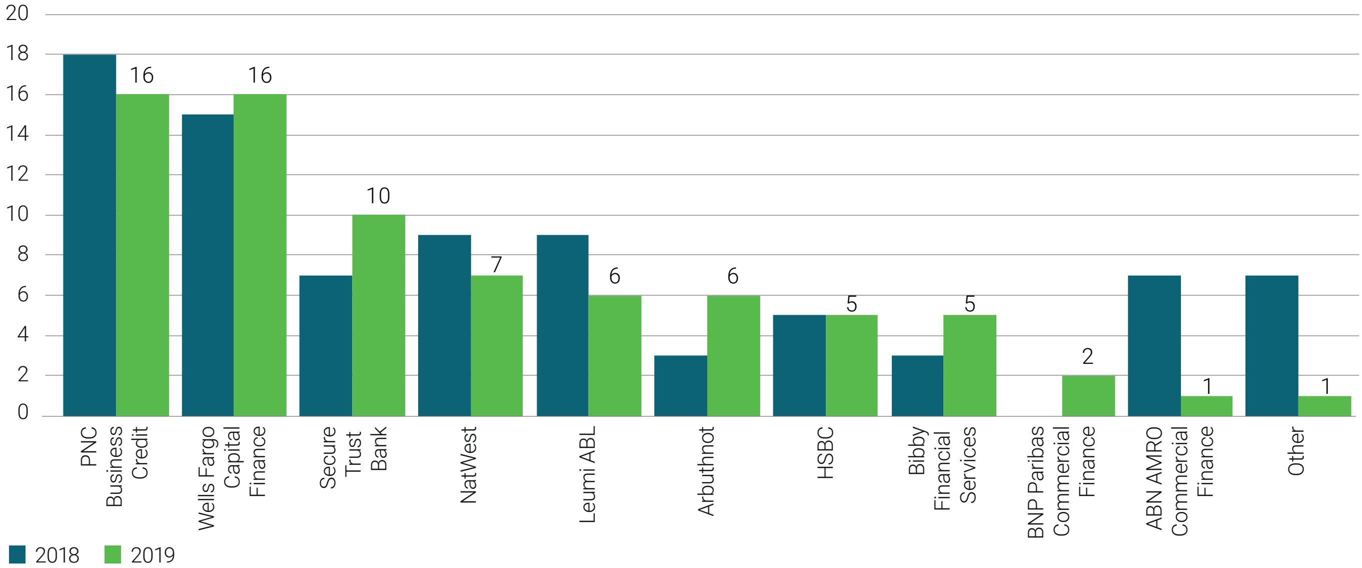


FIGURE 8: UK ABL DEALS (EXCLUDING RECEIVABLES ONLY/IDF DEALS)



INSIGHTS

- In the UK 105 IDF only deals completed in 2019, down from 124 in 2018. Given the risk/ return profile of invoice discounting, IDF only lending remains the mainstay of clearing banks, who accounted for almost 70% of activity in 2019.
- By far the most active IDF only lender in 2019 was HSBC, whose deal count increased from 61 in 2018 to 64 in 2019. The bank deployed capital across various sectors, with 14 deals in business services and manufacturing respectively. The next most active lenders were BNP Paribas (11 deals) and NatWest (eight deals).
- 75 UK multi-asset ABL deals completed in 2019. ABL activity had a clear resurgence in H2 2019 (activity up 68% on H1 2019) but, overall, ABL deal volume decreased by 10% since 2018 . The ABL space was heavily impacted by the 15%[5] drop in M&A activity (by volume) in 2019.
- ABL availability grows with the size of the asset base which, unlike cash flow lending, reduces the requirement for following-on financings. As a result, 19% of ABL activity was for add-ons/ acquisitions in 2019, versus 25% in the cash flow lending market.
- In contrast to UK ABL trends, non-UK activity has increased significantly. ABN AMRO, Wells Fargo and PNC underpinned the global increase, with a focus on multi-asset ABL deals.

5. Mergermarket EMEA Trend Summary FY19

Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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ABOUT US

For nearly forty 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.