AlixPartners

SEPTEMBER 2020

ALIXPARTNERS MID-MARKET DEBT REPORT H1 2020

The Covid-19 pandemic has had a massive impact on European debt markets, with volumes, leverage levels, terms and covenant packages completely recalibrating. After the initial shock, however, lenders are seeking ways to flourish in the 'new normal'.

Welcome to the H1 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].

GAME OF TWO HALVES

- In the first three months of 2020, the European mid-market remained active. Deals volumes were in line with the buoyant 2019, with credit funds providing borrower-friendly terms to win deals in a hugely competitive market.
- New deal activity plummeted in Q2 2020 to the lowest level recorded since our survey began in 2016. Lenders retrenched from almost all sectors to help their clients through liquidity issues.

GOVERNMENT INITIATIVES WELL-RECEIVED BUT SOME COMPLAINTS OF LIMITED ADDITIONAL LIQUIDITY

- In H1 2020, Governments across Europe announced various financing schemes to support businesses facing the impact of Covid-19. Schemes include CBILS/CLBILS and the CCFF in the UK and the French PGE scheme.
- Government support has been well-received, but many borrowers have struggled to access sufficient additional liquidity due to issues with security ranking, cross-border cash transfers and ownership structures.

COVENANT RETHINK

- Companies have faced unprecedented liquidity issues in the wake of Covid-19 and had to recalibrate to 'new normal' profitability expectations. Many covenant packages developed before the pandemic are no longer workable.
- Provided sponsors can demonstrate that the business has ample liquidity to weather the storm, lenders have accepted concessions including covenant holidays of 12 to 18 months and Covid-19 add-backs.

BANKS FOCUSING ON PORTFOLIO

- Banks have almost exclusively focused on their portfolios in Q2. New lending teams at mainstream and challenger banks have been working flat-out to process CBILS/CLBILS applications from their borrowers.
- To pay off additional debt and deferred payments, operating cash flows need to ramp-up quickly. This is going to be challenging for many borrowers, particularly as furloughing ends and deferred taxes become due.

FUNDS SEEKING NEW STRATEGIES TO DEPLOY CAPITAL

- New deal activity in Q2 2020 was almost entirely limited to Covid-resistant sectors including healthcare and tech. Even in these sectors, credit funds drew back leverage levels by up to 2x and applied a pricing premium of up to 300bps.
- With M&A activity down by 35%[3], the volume of direct lending opportunities has decreased significantly. Credit funds are focusing on their special situations and secondary strategies in order to deploy capital.

ABL WELL SET FOR THE FUTURE

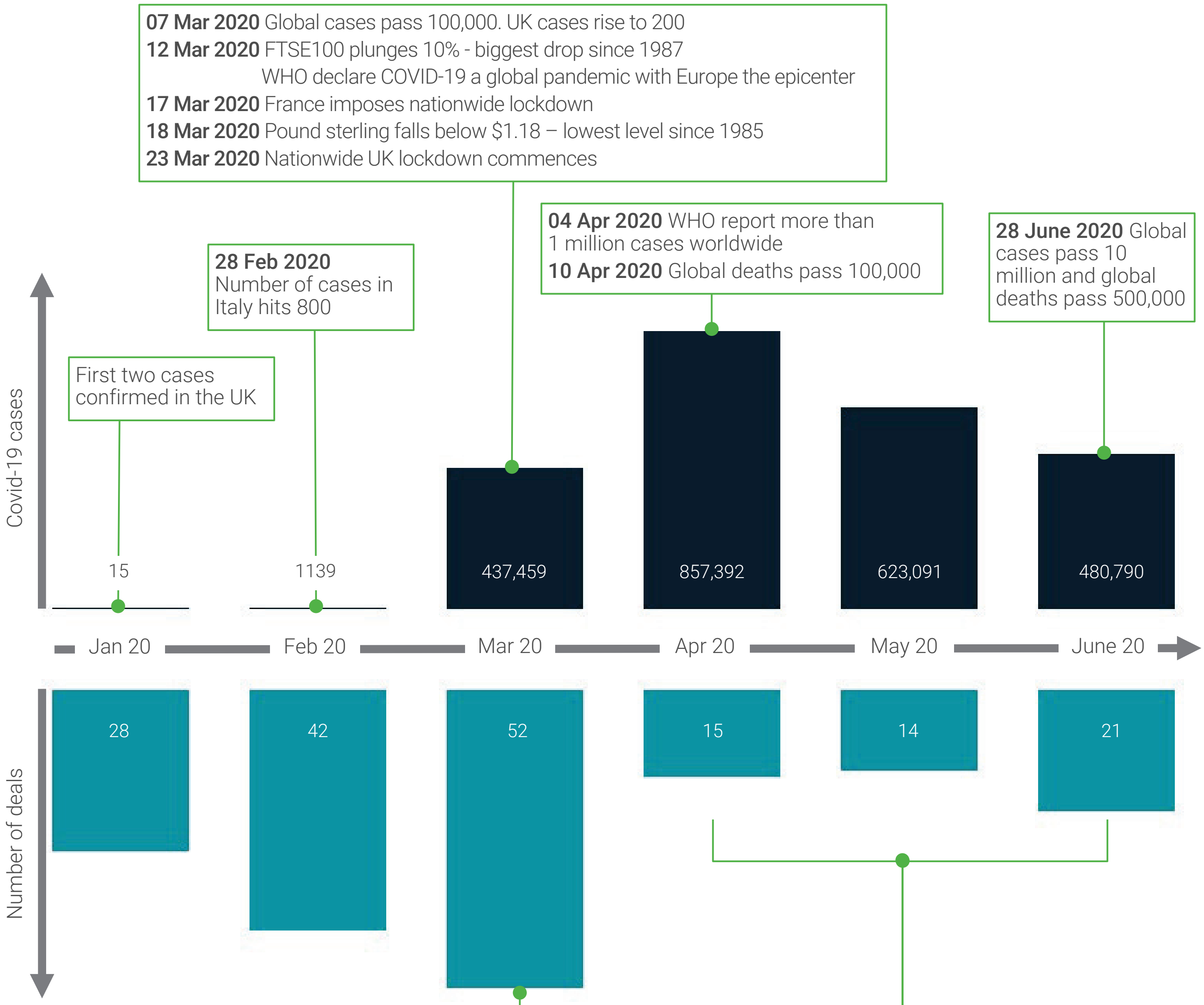
- ABL activity stayed steady throughout H1 2020, as asset backing enabled ABL participants to take a view on profitability uncertainty.
- ABL is very well-suited to situations with profitability volatility and a changing asset base, both of which are likely as the speed of post-Covid ramp-up is highly uncertain. Given this, ABL is well-placed to prosper in the medium-term.

1. Total debt between €20 million to €300 million
2. Total debt between £5 million and £200 million
3. Mergermarket HY2020 Deal Drivers EMEA

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

Covid-19 has had a far-reaching, pervasive impact on the European debt markets

The impact of the pandemic on European debt markets has been rapid and severe. In the chart below, we look back at the evolution of the crisis during H1 2020.



- In March 2020, Rishi Sunak announced CCFF scheme to support investment grade businesses with short-term liquidity schemes and CBILS scheme for SMEs, which evolved into the larger CLBILS scheme.
- There were initially 40 accredited lenders in the UK. In order to support their borrowers, other lenders including OakNorth and ThinCats became accredited to provide CBILS funding.
- The schemes have been well-received but many sponsors have complained that funding is inaccessible or does not result in meaningful additional liquidity.
- Similar schemes exist across Europe, including the French PGE scheme. Similar concerns exist for this scheme, notably regarding repayment ranking.

- The majority of borrowers passed their March covenant tests, with the trading consequences of Covid initially impacting the June covenant tests.
- In advance of this, lenders either pre-emptively reached out to borrowers or, in certain instances, discussions were forced by an imminent liquidity issue.
- There has been a general consensus between borrowers and lenders that covenant packages developed before the pandemic are not suitable. There has been a flurry of covenant waivers agreed, with lenders taking different stances on amortisation and interest payment holidays.
- New covenant packages are centered around minimum liquidity, with other tests being postponed for up to 18 months.

- Very few M&A or refinancing processes were launched in the Covid environment unless it was out of necessity. As such, the pipeline of opportunities for direct lenders diminished rapidly after Q2 2020.
- Non-bank lenders have been kept busy managing significant portfolios but still have significant capital deployment targets.
- Many non-bank lenders have switched to special situation strategies to fill the pipeline.

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

Following the onset of Covid, there were also very limited new bank deals. Banks retrenched to focus on liquidity issues within their existing portfolios

FIGURE 1: UK MID-MARKET BANK DEAL COUNT[4]

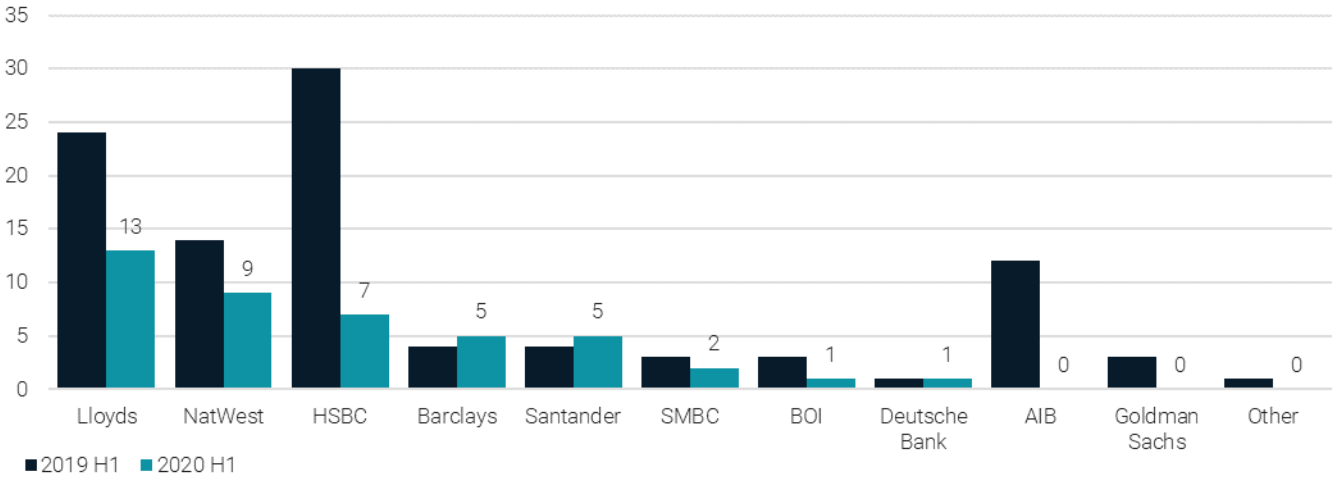
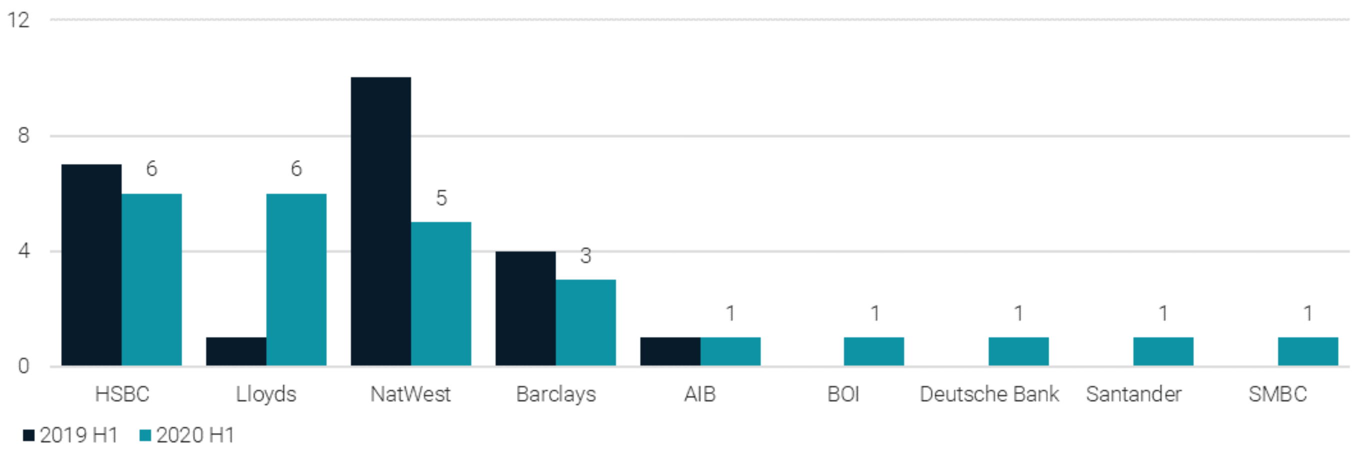


FIGURE 2: UK BANK SUPER SENIOR RCF COUNT



INSIGHTS

- The number of UK banking deals (excluding super senior)) decreased from 99 in H1 2019 to 43 in H1 2020. Over 83% of the activity in H1 2020 occurred in the first quarter, with only seven deals completed in Q2.
- In the first quarter the most active term bank lenders in H1 2020 were NatWest (nine participations), Lloyds (eight) and HSBC (seven). The banks completed deals in sectors ranging from TMT to education in Q1 2020 but, for H1 2020, combined activity for the three lenders was 57% lower than H1 2019.
- Banks have been busy supporting existing clients in Q2 2020 who have suffered during the Covid pandemic. Numerous covenant breaches have been waived and, overall, banks have engaged constructively with sponsors and borrowers to agree a road to recovery.
- Since March, 718,000 CBILS/ CLBILS applications[5] have been processed by accredited lenders. Some sponsors have complained that it is challenging to gain additional liquidity through these processes, which is demonstrated by only 50% of applications being successful.
- The number of super senior deals in the UK increased from 23 in H1 2019 to 25 in H1 2020. Six of the deals were completed after March 20, as borrowers accessed additional liquidity from lenders outside of the government-backed schemes.
- Nine banks completed super-senior deals in the UK in H1 2020. The most active super senior lenders were HSBC (six deals, down from seven in H1 2019), Lloyds (six deals, up from one in H1 2019) and NatWest (five deals, down from ten in H1 2019).

4: Excludes super senior deals
5: Source GOV.UK
Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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Non-bank lenders are working through portfolio issues while also seeking ways to deploy capital in the COVID-19 environment

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

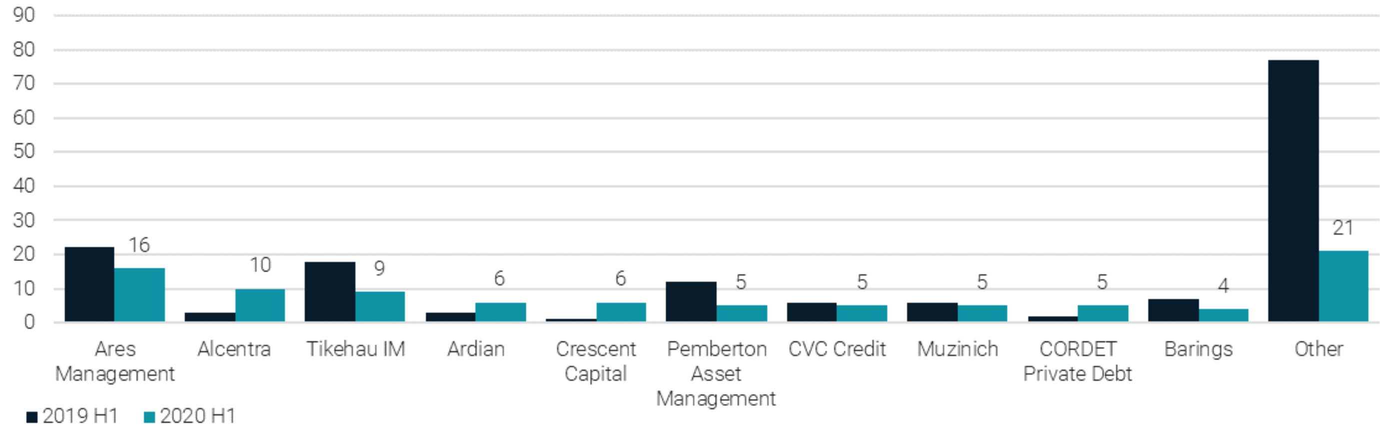
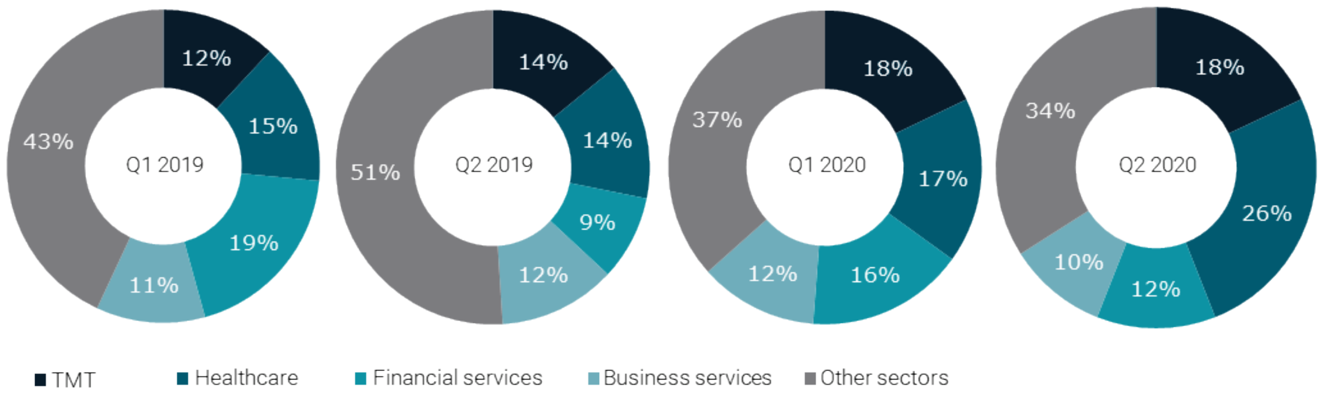


FIGURE 4: SECTOR SPLIT (NON-BANK ONLY)



INSIGHTS

- European non-bank lending continued to be buoyant in Q1 2020, with 65 deals completed in total (slightly down on 75 deals completed in Q1 2019). Non-bank lenders completed 53% of total deals, retaining the majority market share first witnessed in H2 2018. Notable fundraising examples in Q1 2020 included Ardian (€3 billion) and AlbaCore Capital Group.
- Ares Management was the most active lender in Q1 2020. The lender completed ten deals across six countries and seven sectors.
- Alcentra (eight) and Tikehau IM (six) were second and third most active in Q1 2020, completing deals across seven different sectors in six different countries between them.
- In the wake of Covid outbreaks across Europe, total non-bank deal volumes in Q2 2020 fell by 55% in comparison to Q1 2020. With companies shelving M&A or refinancing activities unless absolutely necessary, non-bank lenders' attention turned to liquidity challenges in their portfolios caused by the pandemic.
- Out of the 27 non-bank lending deals that did complete, Ares and Tikehau IM were again most active, as was CORDET Private Debt who completed four deals in the lower mid-market.
- In Q2 2020, there was a noticeable shift towards Covid-resistant sectors with 78% of deals being completed in the TMT, healthcare, financial/business services sectors (compared to 50% in 2019). This trend is even more pronounced for new deals, with 88% of LBO deals in these two sectors.
- Even in the most resilient sectors, non-bank lenders reflected additional Covid-related risk by reducing leverage levels by up to 2x EBITDA and increasing pricing by up to 300bps.
- Despite the Covid-environment, non-bank lenders still have significant capital deployment targets. Lenders have been actively promoting special situations strategies, which are likely to be applicable as the impact of Covid ripples through the economy.

Source: AlixPartners debt report, Sponsor press releases, Lender press releases
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In contrast to the leverage market, ABL activity remained robust despite the impact of Covid

FIGURE 7: UK IDF ONLY ABL DEAL

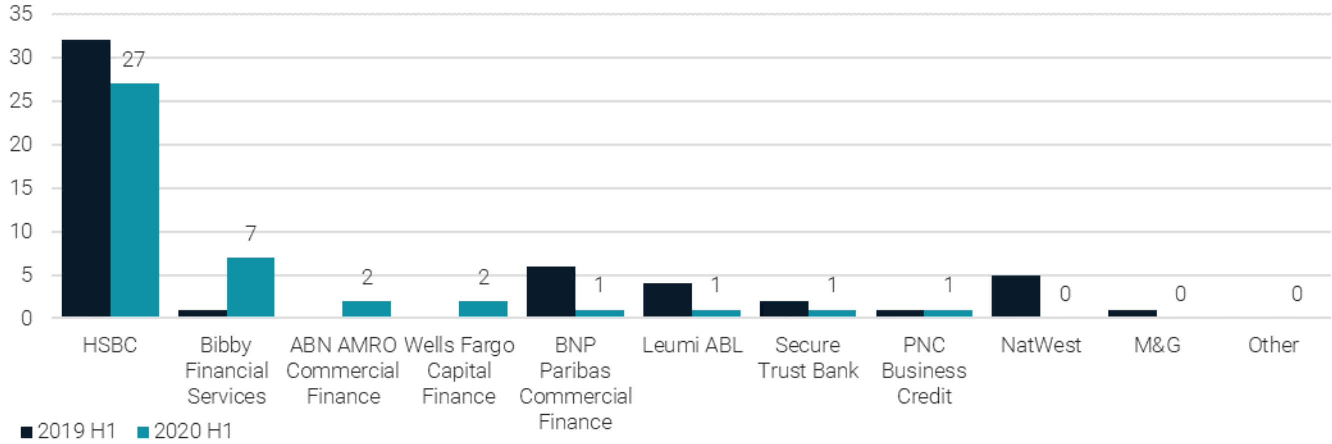
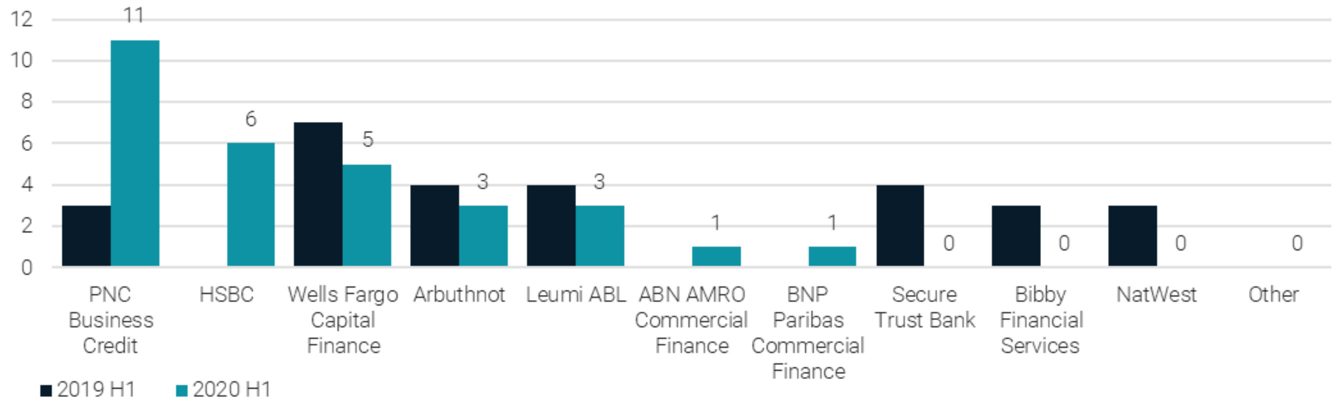


FIGURE 8: UK ABL DEALS (EXCLUDING RECEIVABLES ONLY/IDF DEALS)



INSIGHTS

- In the IDF-only market, 42 deals completed in H1 2020 in comparison to 52 deals in H1 2019. In stark contrast to the leveraged market, activity continued after the onset of the pandemic, with over 50% of the deals completed in Q2 2020. This demonstrates how applicable IDF is during periods of uncertainty.
- HSBC remained the most active IDF only lender in H1 2020 (27 deals). Whilst this was a 16% decrease in comparison to H1 2019, HSBC accounted for 64% of UK IDF only deals. Bibby Financial Services completed seven deals in H1 2020, six of which occurred after businesses felt the impact of Covid.
- In multi-asset ABL-market, 30 deals were completed in H1 2020, up from 28 in H1 2019. Multi-asset ABL activity was also consistent between Q1 and Q2 2020, as opposed to the 74% decline between Q1 and Q2 in the leveraged market.
- Following a quieter 2019, PNC Business Credit bounced back to be the most active lender in H1 2020 with 11 deals. HSBC (6 deals) and Wells Fargo Capital Finance (5 deals) were the next most active lenders.

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.