

ALIXPARTNERS MID-MARKET DEBT REPORT H1 2021

As Europe recovers past the most damaging phases of the pandemic, debt market activity is buoyant. Appetite for the COVID-insulated sectors continues to thrive, but lenders are now also focusing on businesses transitioning from survival towards growth.

Since the onset of COVID-19, leverage levels in many industries have increased dramatically. To maintain access to a wide range of financing options, businesses need to quickly demonstrate compelling plans to bolster profitability and pay off their debts.

Welcome to the H1 2021 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 lenders¹ and 14 asset-based lenders².

THE RECOVERY CONTINUES AT PACE

- In H1 2021, activity levels exploded. Investors and lenders were desperate to deploy capital, and sellers finally took the opportunity to complete deals after significant delays due to economic uncertainty.
- Global M&A activity was up 129% compared with H1 2020³, while our data also shows a 67% rise in LBO activity compared to H2 2020. M&A deals account for 74% of activity in our report – a significant increase above the level of 63% seen in 2018 and 2019.

COVID-INSULATION PROVES A MAJOR ATTRACTION

- While some other sectors have shown strong signs of recovery, COVID-insulated sectors continued to be favoured in the market.
- Huge competition from sponsors and lenders in this area has led to significant valuations, high leverage levels and loosening of terms. The jury remains out as to whether these metrics will prove to be overly aggressive.

CREDIT FUNDS TESTED 'THROUGH-THE-CYCLE'

- Credit funds emerged in the wake of the credit crisis, so had yet to be fully tested in a downturn before COVID-19 emerged last year.
- Banks and funds have typically been supportive of their borrowers, acknowledging the extreme and unforeseen circumstances that the pandemic has presented. As the world opens up, however, businesses will need a plan to return to acceptable leverage levels.

ALTERNATIVE LIQUIDITY MAY BE REQUIRED

- Unprecedented levels of liquidity from governments and sponsors have been effective in ensuring that most businesses survived the worst periods of the pandemic.
- As this support tapers away, organisations will potentially need to find alternative sources of liquidity. This is likely to create opportunities for special situations funds.

THE IMPORTANCE OF ESG INTENSIFIES

- ESG is firmly on the agenda for banks and credit funds. An increasing number of terms are now tied to ESG criteria, which provide financial benefit for borrowers meeting sustainability targets and are a hard requirement for investors in numerous credit funds.

ASSET BASED LENDING (ABL) STAYS ROBUST

- In H1 2021, ABL activity stayed robust, given the suitability of ABL for borrowers with depressed current profitability and a growth trajectory.

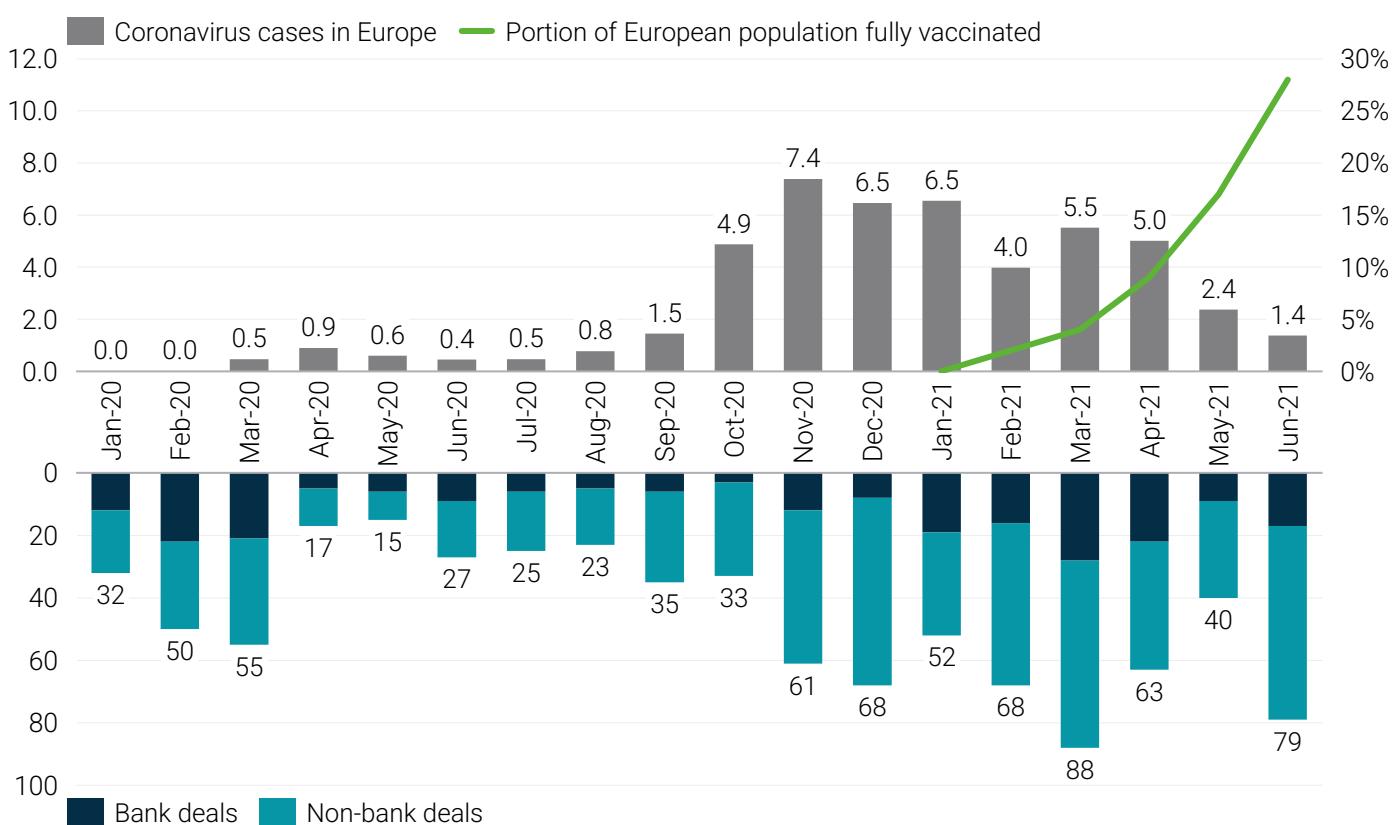
KEY ACTIONS FOR BORROWERS

- Businesses in COVID-insulated sectors should consider taking advantage of the weight of capital in the debt and equity markets.
- Overlevered businesses need a clear plan to restart their balance sheets. Borrowers should seek to optimise profit and cash as a priority, and the full range of financing options should be considered as part of deleveraging plans.

1. Total debt between €20 million to €300 million; 2. Total debt between £5 million and £200 million; 3. Financial Times/Refinitiv
Please refer to the disclaimer at the end of this report for further context on the data

Whilst lockdowns and new virus variants stalled recovery efforts, debt market activity gathered momentum in H1 2021.

- 04 Jan 2021: UK enters third national lockdown, and Germany extends lockdown to end of January, later extended to 14 February and then to 7 March.
- 07 Jan 2021: Europe passes 25 million cases.
- 13 Jan 2021: UK passes 100,000 deaths.
- 01 Feb 2021: EU tightens travel restrictions from outside of the block.
- 15 Feb 2021: Hotel quarantine from 33 high-risk countries begins in UK.
- 22 Feb 2021: PM publishes roadmap for lifting lockdown; US passes 500,000 deaths.
- 28 Feb 2021: UK hits 20 million vaccine doses delivered.
- 19 Mar 2021: COVID-19 deaths in Europe pass one million.
- 29 Mar 2021: **Roadmap step 1:** Outdoor gatherings of six people/two households allowed and outdoor sports facilities reopen. 'Stay at home' order ends.
- 12 Apr 2021: **Roadmap step 2:** Non-essential retail, hairdressers, public buildings and leisure facilities reopen. Hospitality opens outdoors only; other outdoor venues e.g. zoos reopen. Rule of six in place outdoors; no indoor mixing between different households.
- 26 Apr 2021: EU launches legal action against AstraZeneca for failure to fulfil its COVID-19 vaccine contracts.
- 10 May 2021: WHO classifies the B.1.617 variant first identified in India as a 'variant of global concern', now known as Delta.
- 17 May 2021: **Roadmap step 3:** Up to 30 people allowed to mix outdoors; rule of six or two households indoors; indoor hospitality and other indoor venues e.g. cinemas reopen; up to 10,000 allowed to attend large outdoor venues e.g. football stadiums..
- 1 Jun 2021: UK records no new deaths within 28 days of a positive COVID-19 test for the first time since July 2020.
- 13 Jun 2021: PM announces that the planned 21 June relaxation of restrictions in England will be delayed until 19 July.



GOVERNMENT/BANK SUPPORT

- The UK Government continued to deliver support to businesses – and lenders to their portfolio companies – all affected by ongoing periods of enforced restrictions. Banks have since increased other activity as vaccine rollouts gathered pace at the start of 2021, driving a slight reduction in market share for funds. However, there is a marked uptick in activity for banks and funds since the start of the year, as business recovery gathers pace.
- European governments also invested in renewed support efforts, including a further further €60 billion of supplementary budget in Germany and a 2021 plan in France equating to approximately 3% of GDP.

BREXIT IMPACTS START TO SHOW

- The implications of Brexit are rising to the surface, now that the worst of the pandemic appears to have passed. Businesses in numerous industries have reported challenges with regard to managing the exposed fragilities of supply chains and locking in labour to aid recovery efforts.
- Failure to secure agreement with the EU to mutually recognise each other's safety standards has also placed additional pressure in industries such as manufacturing and construction, where the associated red tape is causing significant delays in securing approval for the use of certain components in manufacturing processes and other products required for installation in office refurbishments or the building of new homes, for example.

ALL EYES ON BALANCE SHEETS

- The UK Government's announcement of final totals for its COVID loans support throughout the pandemic has signified an important turning point for UK businesses, as the scales of support start to tip towards repayment rather than receipt.
- With cash flow increasingly taking the strain, the emerging question is how to address increased leverage against a persistently uncertain economic backdrop.
- While equity markets have been extremely supportive, and lenders patient to this point, the onus is now on companies to strike a position where they are able to confidently articulate their plan to deleverage and recover shareholder value, in doing so maintaining stakeholder support as the second half of 2021 progresses.

Sources: <https://www.instituteforgovernment.org.uk>; <https://bfg.co.uk/2020/04/covid-19-timeline/>; <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>; <https://ourworldindata.org/covid-cases>

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Banking activity bounced-back in H1 2021, with a 173% increase in activity since H2 2020.

FIGURE 1: UK MID-MARKET BANK DEAL COUNT

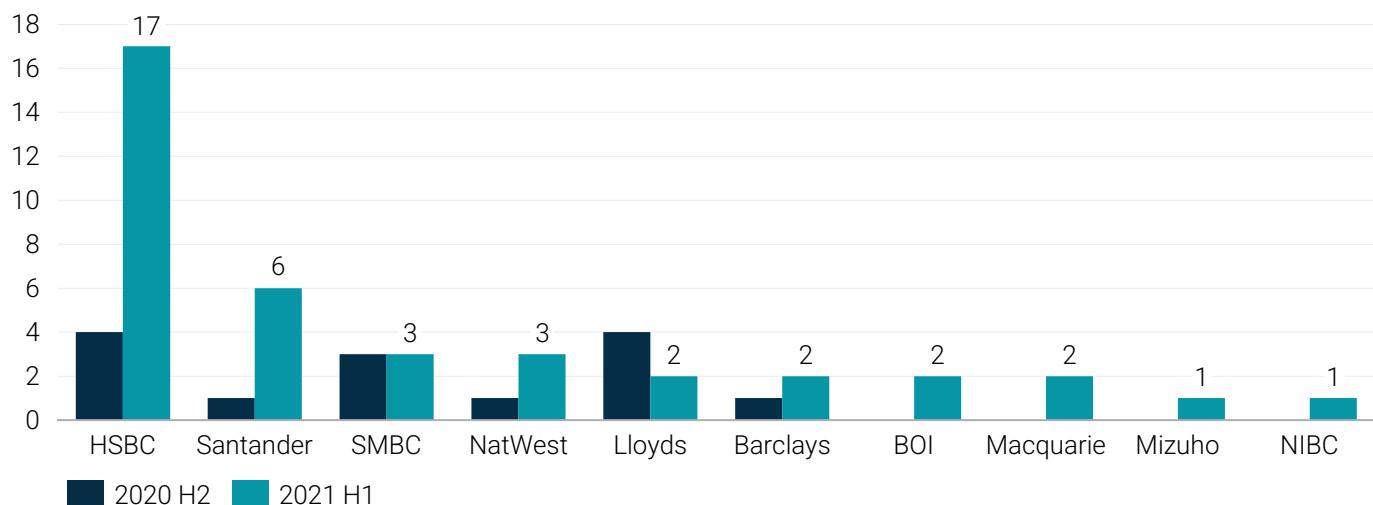
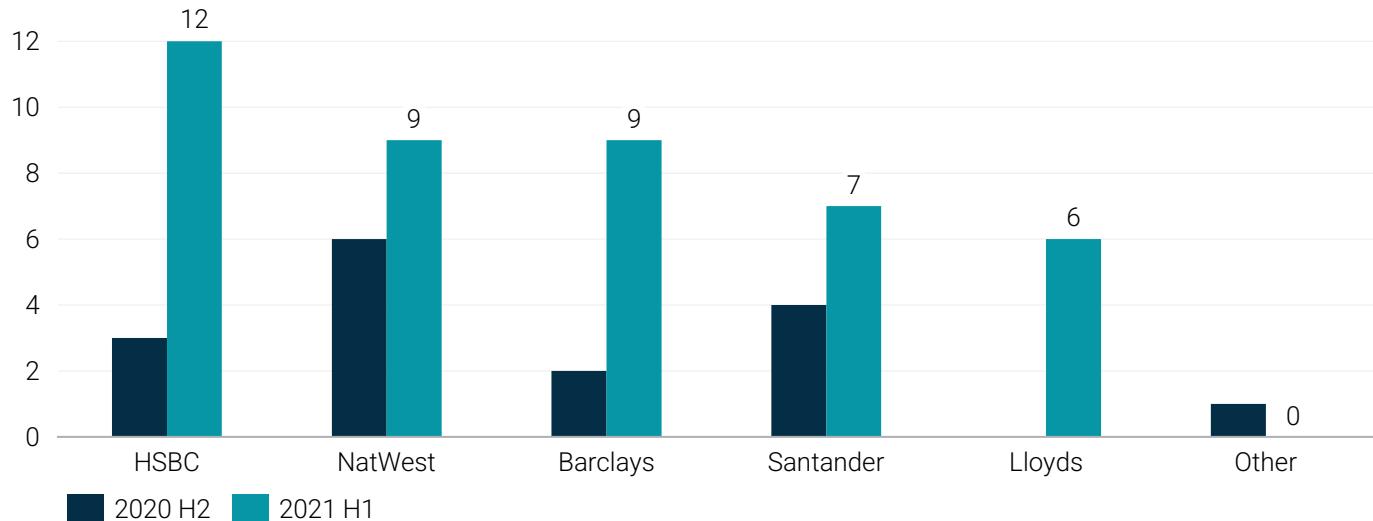


FIGURE 2: UK BANK SUPER SENIOR RCF COUNT



INSIGHTS

- The number of senior banking deals increased from 14 in H2 2020 to 39 in H1 2021, equivalent to a 179% increase.
- HSBC completed the most senior deals in H1 2021, with 17 deals, more than four times the number HSBC completed in H2 2020 and driving half of the increase in senior banking deals.
- Santander completed six deals, up from only one deal in H2 2020. SMBC and NatWest both completed three deals in H1 2021.
- Bank activity across all sectors increased. Business services, TMT and healthcare generated the most deals, accounting for 59% of total UK banking activity. 32% of activity was associated with deals in the consumer, financial services, and industrials sectors, up from 23% in H2 2020.

- In order to deploy capital, banks have taken super senior tranches alongside credit funds (RCF and first-out last-out). For example, NatWest and NIBC provided a FOLO facility alongside Alcentra to Expereo BV for more than €200 million.
- Whilst FOLO is increasing banking activity levels, it could be a double-edged sword for the banks. Partnering with a bank can reduce the blended cost of capital on credit fund-led senior deals, making terms offered by the credit funds more competitive.
- 43 super senior deals were completed in H1 2021 in the UK, equivalent to a 169% increase compared to H2 2020. In 2018 and 2019, super senior deals represented less than 20% of the UK banks' activity. Over the last twelve months this figure has risen to more than 50%.
- All banks completed more super senior deals in the UK in H1 2021. The most active super senior lenders were HSBC with 12 deals, followed by NatWest and Barclays, both with nine deals.

Significant increase in fund activity across the board. COVID-insulated sectors continue to dominate, but activity in other sectors is starting to increase.

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

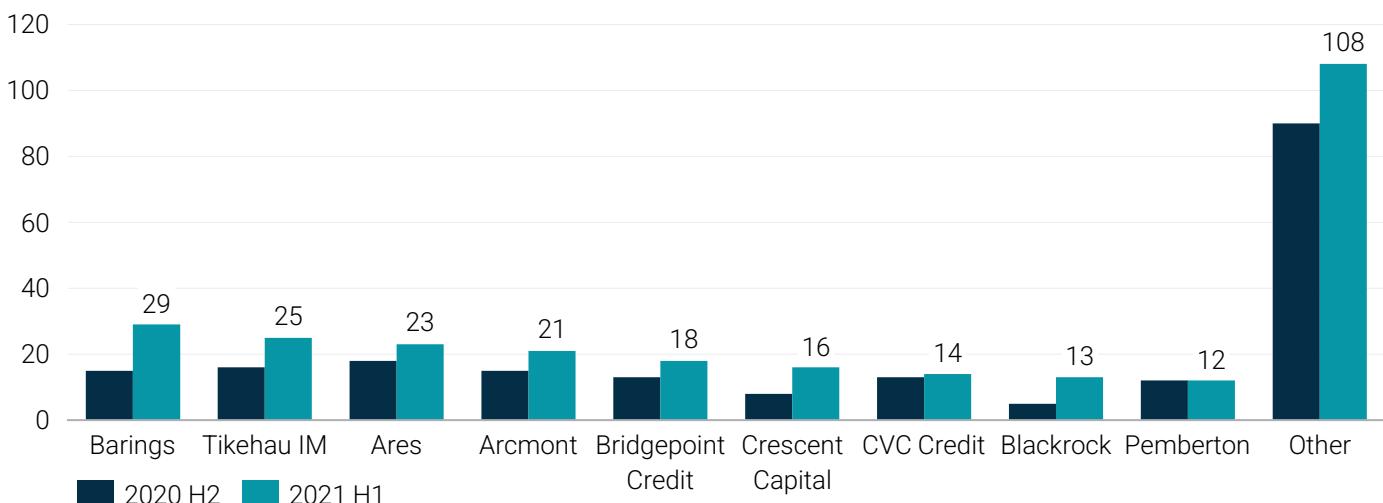
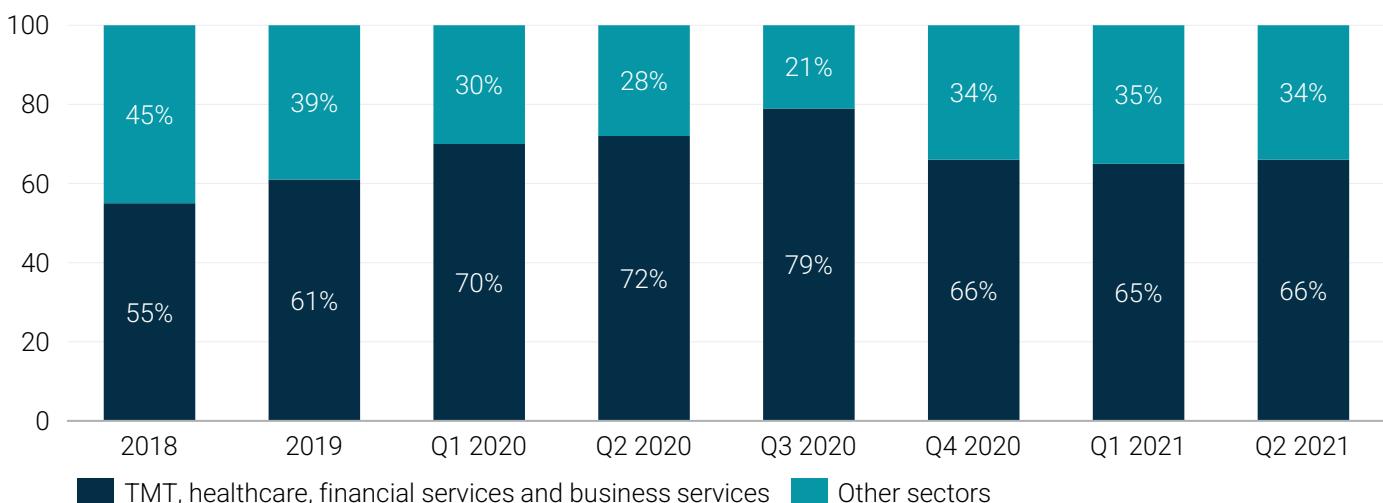


FIGURE 4: NON-BANK ACTIVITY BY SECTOR



INSIGHTS

- 279 non-bank deals were completed in H1 2021, an increase of 36% from 205 in H2 2020. This uplift was less significant than banking activity, therefore funds slightly reduced their market share to 72%, down from 84% in H2 2020.
- Barings was the most active lender in Europe in H1 2021 with 29 deals, equivalent to almost twice as many deals than in H2 2020. Tikehau completed 25, up from 16 in H2 2020 and Ares completed 23 deals, up from 18 in H2 2020.
- The perennial growth of the unitranche product continued in H1 2021. Unitranche facilities accounted for 61% of fund activity over the last year, compared to 51% in the twelve months to H1 2019.

- Since Q4 2020, 65% of non-bank activity was accounted for in the TMT, healthcare, financial and business service sectors, down from 79% in Q3 2020.
- Funds have started to increase activity in other sectors as the economic recovery builds. 16% of deals involved either the consumer, education or industrials sectors, up from 9% in Q2 and Q3 2020.
- However, certain sectors are still heavily impacted by the pandemic, such as leisure and retail. Between 2017 and 2019 leisure and retail accounted for 10% of fund deals; over the last twelve months this has dropped to 1%.
- The influence of ESG- and sustainability-linked loans continues to grow, as margin ratchets and covenants are increasingly being tied to a broad range of ESG-related KPIs. This feature was seen in 41% of H1 2021 deals in EMEA¹, reflecting the wider acknowledgement of the long-term commercial and reputational benefits from deals of this kind.

Sources: 1. <https://reorg.com/the-european-leveraged-loans-market-in-h1-2021/>; AlixPartners debt report, Sponsor press releases, Lender press releases
Please refer to the disclaimer at the end of this report for further context on the data.

ABL activity continues to be a popular choice for businesses with high-quality assets on their balance sheets.

FIGURE 5: UK IDF ONLY ABL DEAL COUNT

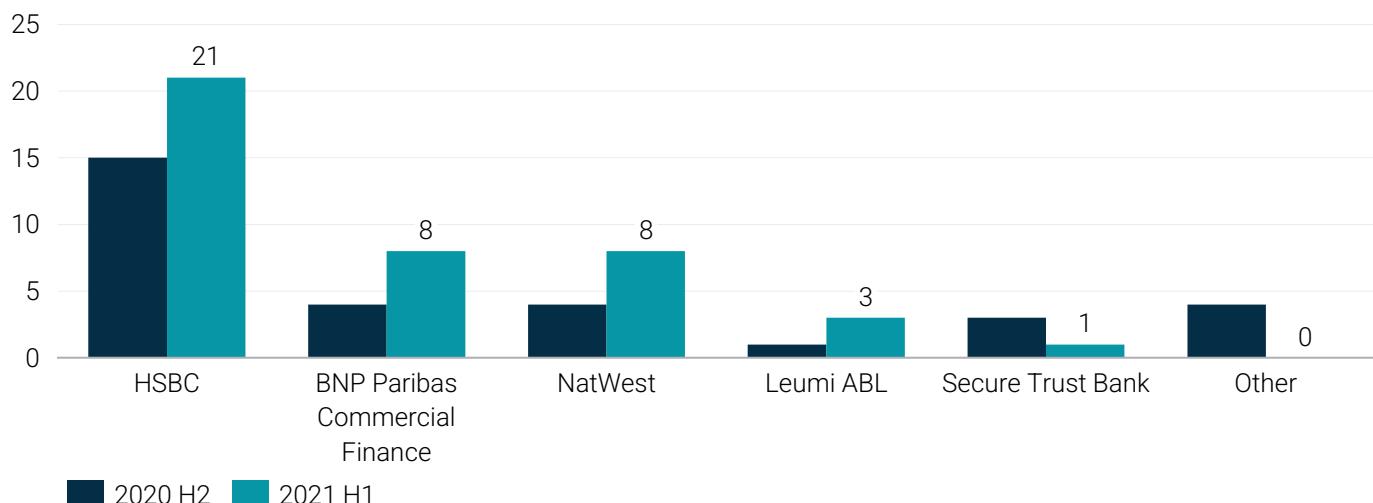
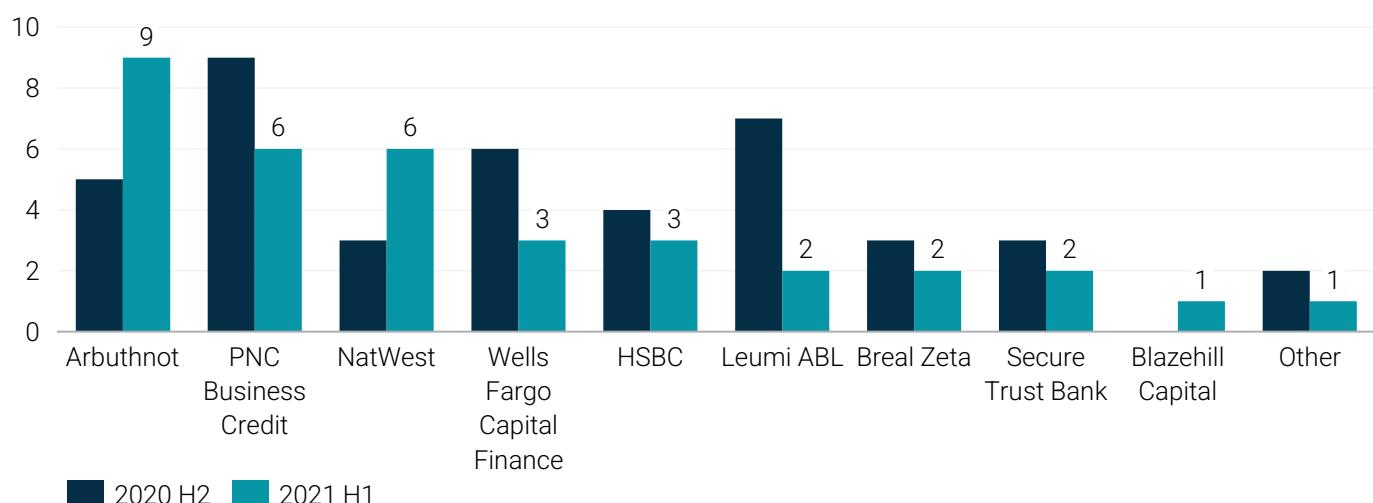


FIGURE 6: UK ABL DEAL COUNT (EXCLUDING RECEIVABLES ONLY/IDF DEALS)



INSIGHTS

- The number of IDF-only deals in the UK, included in this survey, increased from 31 deals in H2 2020 to 41 deals in H1 2021. Throughout the pandemic, IDF has provided business with a way to unlock working capital to support the financial strength of the business.
- HSBC was the most active lender in the UK, completing 21 deals, up from 15 in H2 2020. Including multi-asset ABL activity, HSBC completed more than a third of deals across Europe. BNP Paribas Commercial Finance and NatWest completed eight deals, both completing twice as many deals than the previous half.
- Business services and industrials/manufacturing were the most popular sectors, accounting for more than 50% of activity.

- UK multi-asset ABL activity decreased by 17% in H1 2021, from 42 deals in H2 2020 to 35 deals.
- Arbuthnot completed nine deals, almost doubling their H2 2020 activity. PNC Business Credit and NatWest remained two of the most active lenders, both with six deals in the UK.
- Multi-asset ABL activity was focused on capital-intensive and asset-heavy sectors, including construction and manufacturing.
- As government support is withdrawn from the market, asset-based lending may be a suitable source of liquidity for growing businesses with a strong asset base. Given the asset underpin, ABL pricing can be competitive and should be considered by borrowers.

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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.

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