

ALIXPARTNERS MID-MARKET DEBT REPORT H2 2021

Europe had its sights firmly fixed on accelerating away from the pandemic in 2021. Borrowers looked to deliver robust recovery plans to build lender confidence and debt market activity was buoyant, with activity doubling from 2020 to 2021, driven by strong M&A activity. In 2022, the conflict in Ukraine will impact European debt market activity, but the severity of this is not yet clear.

ESG continued to become a dominant theme in 2021, with environmental, social and governance metrics becoming intrinsically linked to debt terms and business valuations. Lenders and borrowers are still building out methodologies to confidently and consistently articulate the true impact of ESG. We expect this to become more refined in 2022.

Welcome to the H2 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.

BUOYANT ACTIVITY IN H2 2021

- In H2 2021, as Europe passed through what we hope to be the final throes of the pandemic, activity levels were buoyant as leveraged finance deals reported 7% higher than H1 2021.
- Lending associated with M&A activity increased by 82% between 2020 and 2021, consistent with the global increase in M&A activity of 64%³.

CREDIT FUND COMPETITION LEADS TO DIVERSIFICATION

- Since the outbreak of COVID-19, 68% of deals have focused in sectors that have proved resilient to the impacts of the pandemic, including TMT, healthcare, financial and business services. With so many investors and lenders targeting a sub-section of the market, fierce competition has driven sky-high valuations and leverage levels, borrower-friendly terms and pricing approaching the floor of return requirements.
- Credit funds are now seeking to find a less crowded part of the market through diversification: by sector, geography, quantum, in sponsorless transactions, and by participating in equity.

CREDIT FUNDS COMPETING WELL IN LARGE-CAP MARKET

- H2 2021 saw more jumbo leveraged finance deals, with the £1.5bn financing of RSK Group provided by Ares and the £1.5bn financing of FNZ, provided by HPS and HayFin.
- These financings provide additional blueprints of the credit funds going up against more traditional large-cap products and winning. Now the concept is proven, we expect more borrowers to follow suit.

ESG – WHAT DOES GOOD LOOK LIKE?

- Support for ESG initiatives is universal, and it was estimated that ESG-linked investments globally totalled \$6.1tn at the end of 2021. In the European debt markets, several ESG-linked funds were raised in H2 2021, including those by Amundi and Cheyne Strategic Value Credit.
- ESG measurement is challenging due to the bespoke nature per company. Defining environmental data points such as carbon emissions has seen success, but social and governance elements remain difficult to quantify.

REBUILDING IN A POST-PANDEMIC ENVIRONMENT

- Lenders are now challenging businesses' recovery plans, and borrowers are focusing on restoring their financial position, leaving no stone unturned to boost cash flow generation: value proposition, pricing strategy, costs, capex and working capital are all under the microscope.
- Corporates are also carving out assets, allowing borrowers to repay debt and focus on their core business. Valuations are attractive, given the number of investors seeking acquisitions and lenders supporting LBOs. While there is growing post-pandemic optimism, the ongoing conflict in Ukraine will be a scenario kept under close review.

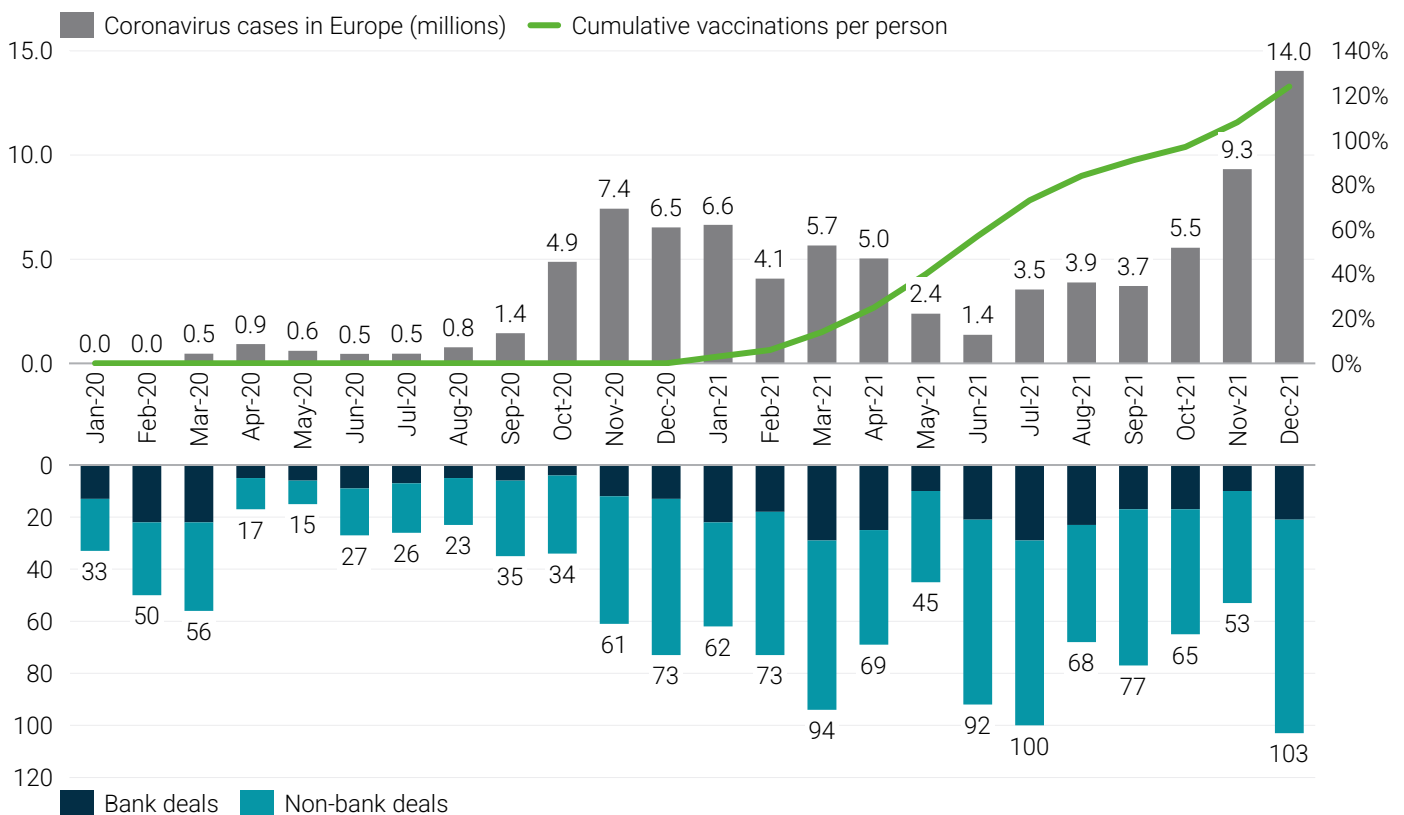
ABL REBOUNDS AND PRODUCT ATTRACTIVENESS BUILDING

- Activity in 2021 reached 2019 levels (an increase of 21% against 2020).
- During the pandemic government support reduced the requirement for alternative capital. The removal of support measures is likely to provide an opportunity for ABL lenders, particularly as asset bases increase.

1. Total debt between €20 million to €300 million; 2. Total debt between £5 million and £200 million; 3. Refinitiv Global Mergers and Acquisitions Review – 2021
Please refer to the disclaimer at the end of this report for further context on the data
Sources: <https://www.reuters.com/markets/us/how-2021-became-year-esg-investing-2021-12-23/>

Economic outlook improved in H2 2021 as booster programme rolls out and restrictions eased, but Omicron variant delivers a sting in the tail of 2021.

- 7 Jul 2021: Confirmed COVID-19 deaths worldwide pass the 4 million milestone.
- 19 July 2021: The majority of the legal limits on social contact are removed in England, and the remaining closed sectors of the economy are reopened (e.g. nightclubs).
- 21 July 2021: Boris Johnson apologises to companies affected by rising staff absences due to the NHS COVID-19 app 'pingdemic'.
- 10 Aug 2021: UK Government figures show that more than 39.6 million (75% of the population) have received both COVID vaccines.
- 12 Aug 2021: ONS data reports that the UK economy grew by 4.8% between April and June 2021.
- 6 Sept 2021: COVID infections in the UK since the start of the pandemic pass 7 million.
- 14 Sept 2021: PM unveils England's winter plan for COVID – 'Plan B' – to be used if the NHS comes under unsustainable pressure.
- 16 Sept 2021: Booster vaccination programme begins in England and Wales.
- 30 Sept 2021: The Coronavirus Job Retention Scheme reaches its final day, with estimates that around one million people have still not fully returned to work.
- 27 Oct 2021: Chancellor Rishi Sunak delivers the second budget of 2021 in which he says the economy is expected to return to pre-COVID levels by the end of the year.
- 1 Nov 2021: The global death toll from the pandemic surpassed 5 million.
- 26 Nov 2021: The Omicron variant is designated a variant of concern. The FTSE 100 index closes down 3.7% amid concerns for economic recovery following this news.
- 8 December 2021: PM announces a move to 'Plan B' measures in England.
- 26 Dec 2021: Tighter COVID restrictions come into force in Scotland, Wales, and N.Ireland. A number of European countries, including Austria and the Netherlands, also moved to reimposing full or partial nationwide lockdowns.
- 31 Dec 2021: 186,835 new cases and 168 deaths are reported in the UK.



GOVT. SUPPORT TAPERS DOWN

- The UK Government has delivered around £80bn of support during the pandemic.
- These financial crutches are tapering down, including the end of the New Payments Scheme for COVID VAT deferrals at the end of June 2021, the Coronavirus Job Retention Scheme in September 2021, and the upcoming commercial rent moratorium on 25 March 2022.
- EU countries have drawn upon a €672.5 billion Recovery and Resilience facility during H2 2021, in the shape of non-repayable grants and loans provided at favourable rates to member states.

CONTINUED UNCERTAINTY AHEAD

- Supply chain disruptions and strong inflationary headwinds are providing persistent challenges for businesses in accurately forecasting growth trajectory.
- While inflation may be considered a transitory risk, it isn't going to go away quickly. Globally, we continue to see significant supply chain disruption, with shutdowns of key ports and factories among the factors leading to higher input costs. In the UK, factory input and output costs are rising far higher than inflation as measured by the Consumer Price Index.
- Supply chains aren't expected to begin normalising until 2023 and many businesses may be underestimating the sheer scale of what is coming their way over the next 12 to 24 months.

REBUILDING BALANCE SHEETS

- As we move from crisis to recovery, lenders are applying increasing scrutiny to businesses recovery plans, challenging a host of forecast line items, particularly cost inflation assumptions and catch-up capex, which many borrowers are underestimating.
- Untested 'new normal' business plans are also coming into play and borrowers are working to optimise profit, cash flow, pricing, costs, and working capital to ensure they are fit for an immediate future of continued uncertainty, as outlined opposite.
- Corporates are also carving out assets, allowing borrowers to repay debt and focus on the core parts of their business. For now, valuations remain attractive, given the number of investors seeking acquisitions and lenders supporting LBOs.

Sources: <https://www.instituteforgovernment.org.uk>; <https://bfpq.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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As confidence in a post-pandemic recovery grew, banking activity significantly increased in 2021, up by 90% compared to the previous year

FIGURE 1: UK MID-MARKET BANK DEAL COUNT

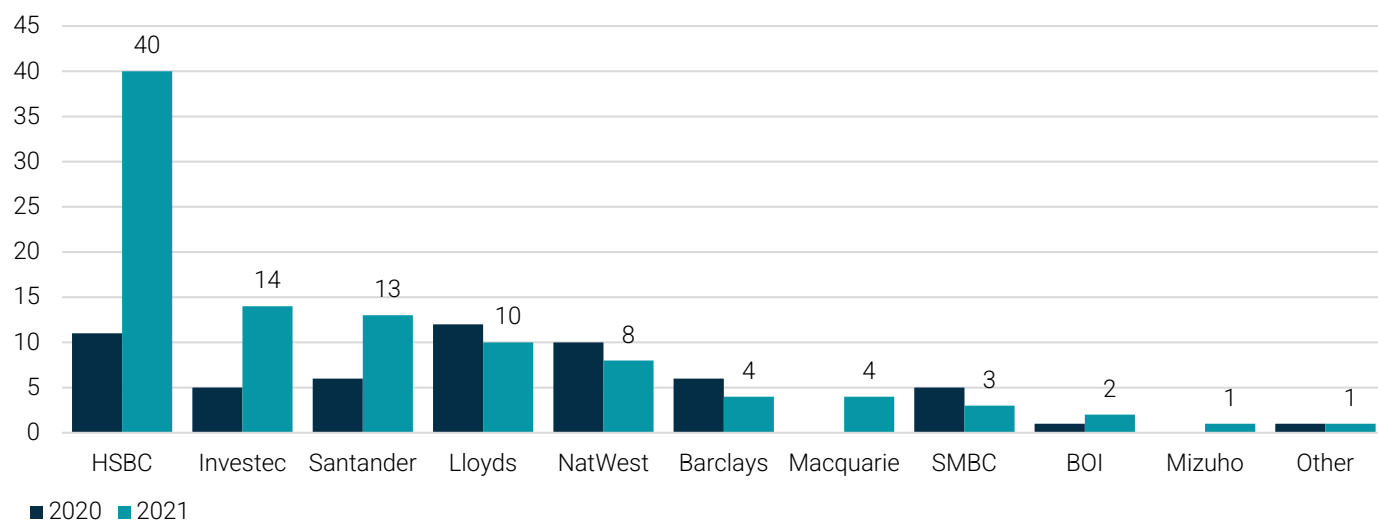
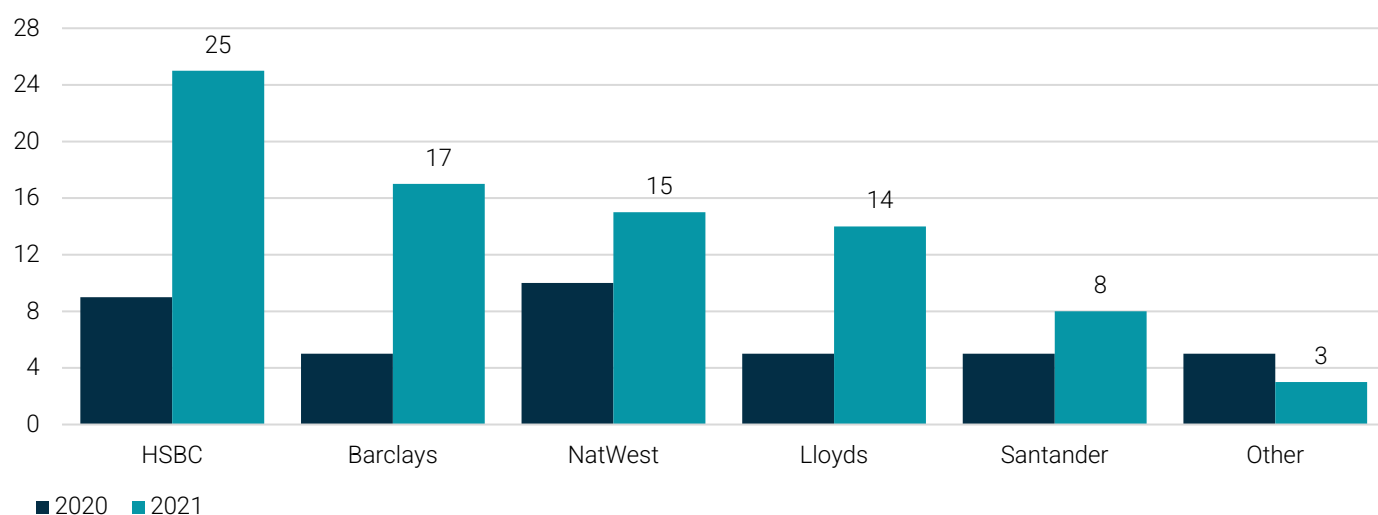


FIGURE 2: UK BANK SUPER SENIOR RCF COUNT



INSIGHTS

- The number of senior banking deals increased from 57 in 2020 to 100 in 2021, equivalent to a 75% year-on-year increase.
- HSBC completed the most senior deals in 2021, with 40 deals, more than triple the number HSBC completed in 2020, and accounting for 40% of senior deals in 2021.
- Investec completed 14 deals in 2021, compared to five in the previous year. Santander completed 13 deals in 2021, up from six deals in 2020.
- Bank activity increased in a number of sectors during H2 2021, including leisure, mining, and oil and gas. Business services, TMT and healthcare continued to generate the most deals, accounting for 59% of total UK banking activity, while activity associated with deals in the consumer, financial services, and industrials sectors was down by 38%, compared to the previous six-month period.
- It is generally accepted that the banks' appetite to provide RCFs is waning. Banks are less convinced about the economics of a super senior facility, particularly with many facilities remaining undrawn due to the government-led liquidity measures implemented during Covid.
- All banks completed more super senior deals in the UK in 2021, representing 46% of UK banks' activity, whereas in 2018 and 2019 this was less than 20%. However, activity is starting to follow the above trend as activity in H2 decreased by 14% compared to H1 2021.
- In 2021 the most active super senior lenders were HSBC with 25 deals, followed by Barclays and Lloyds, with 17 and 15 deals respectively.

Full-year non-bank activity outstrips 2020 performance, as signs emerge of growing diversification away from COVID-insulated sectors.

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

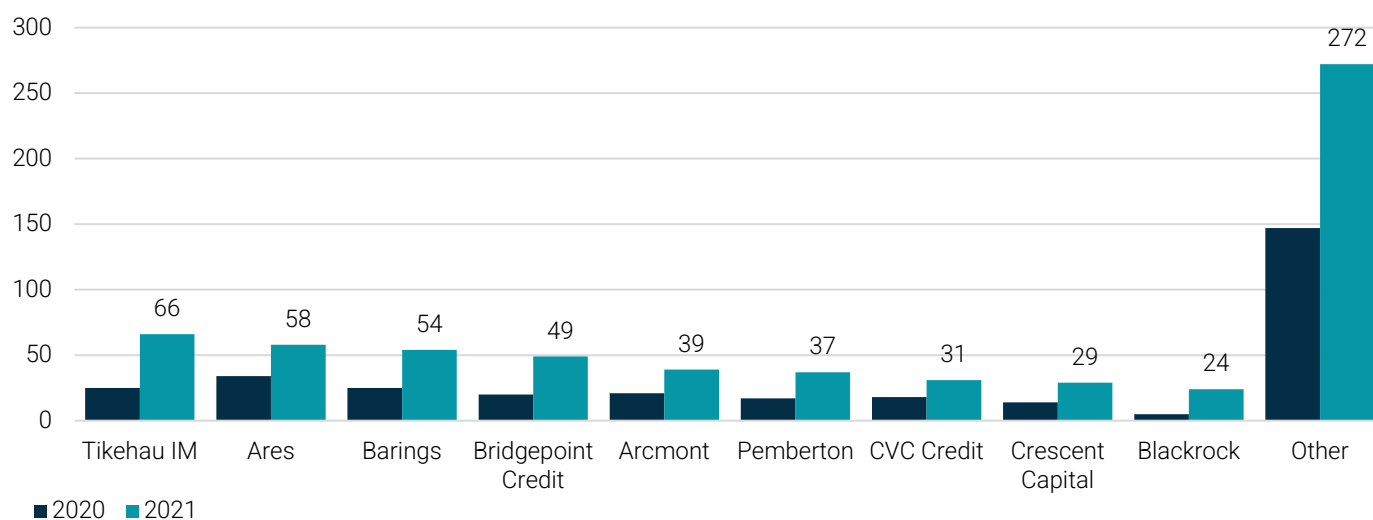
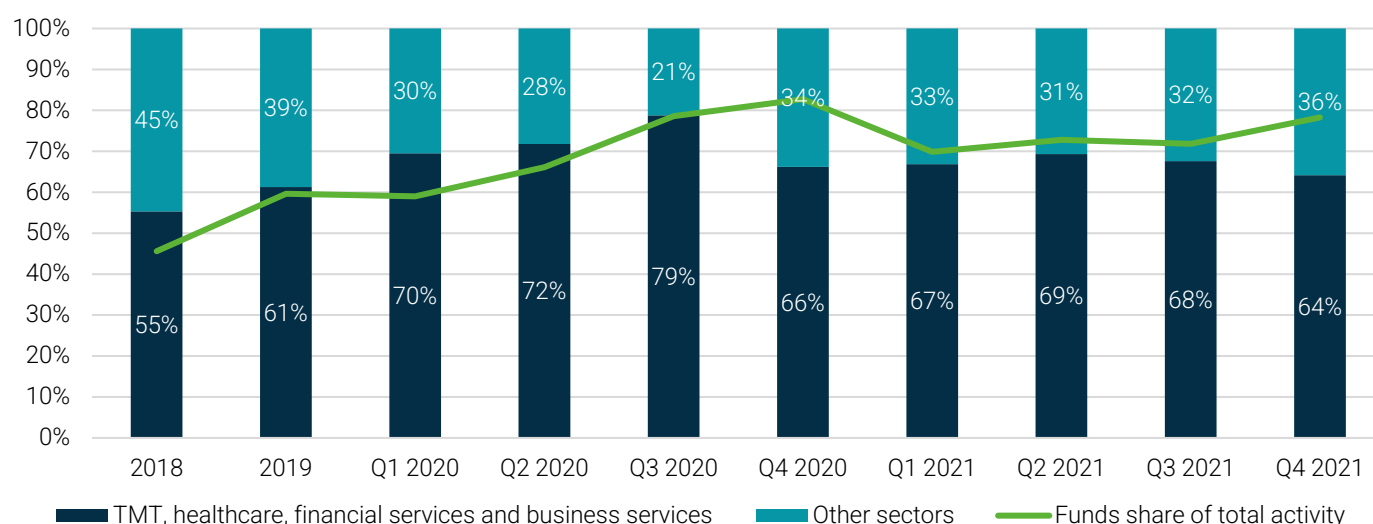


FIGURE 4: NON-BANK ACTIVITY BY SECTOR



INSIGHTS

- 349 European non-bank deals were completed in H2 2021, an increase of 13% from 310 in H1 2021.
- Tikehau was the most active lender in Europe in 2021 overall with 66 deals, well in excess of double the deals completed in 2020. Ares completed 58 for full year of 2021, up from 34 in 2020 and Barings completed 54 deals, up from 25 in 2020.
- Non-bank activity in the TMT, healthcare, financial and business service sectors has ticked down over the course of 2021, down from 79% in Q3 2020 to 64% in Q4 2021.
- Funds have continued to complete deals in other sectors as economic recovery progresses post-pandemic, with consumer, energy and utilities, environmental services, and leisure all seeing more deals completed in H2 2021 than the previous six months.
- There have been many live examples of diversification strategies emerging as a priority for funds in 2021. ESG also continues to sit high on the agenda, as the debate develops around how to standardise criteria. Amundi, for example, announced in September that specific ESG-focused language featured in new fundraisings, offering incentives for companies to attain their environmental, social and governance targets.

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.

Overall ABL activity returns to 2019 levels. Evolving market tailwinds could boost attractiveness of the product in 2022.

FIGURE 5: UK IDF-ONLY ABL DEAL COUNT

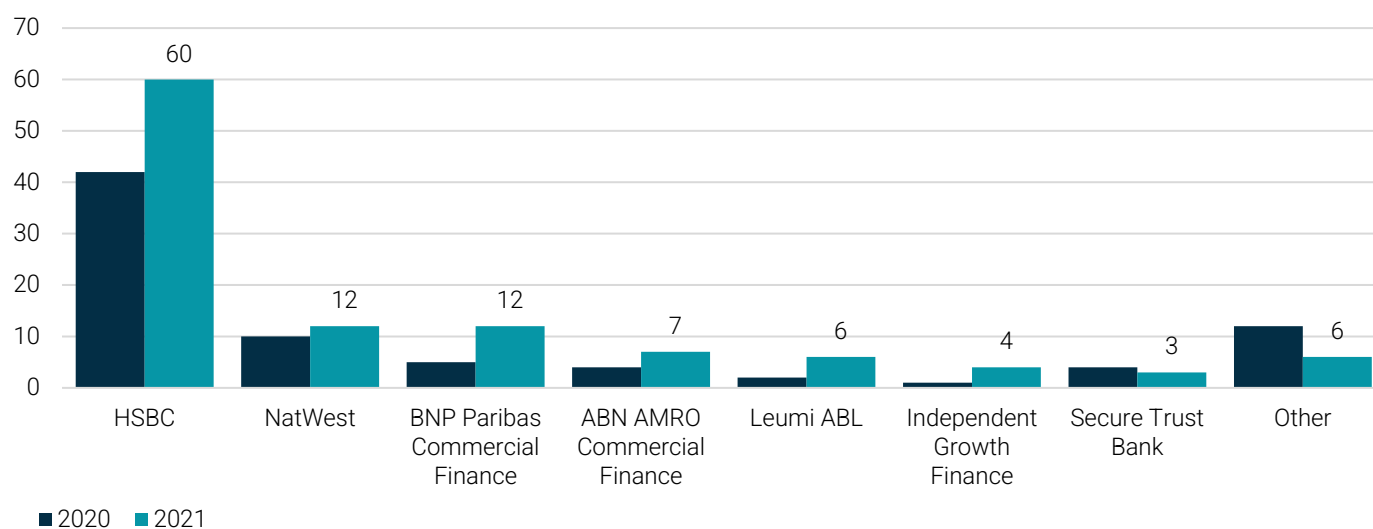
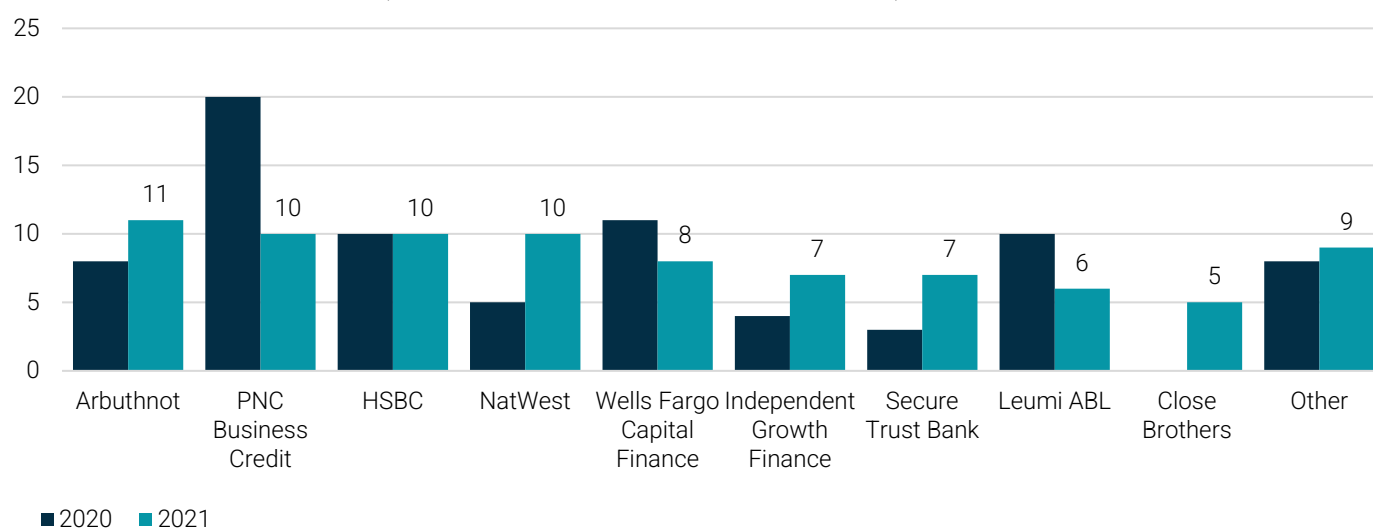


FIGURE 6: UK ABL DEAL COUNT (EXCLUDING RECEIVABLES ONLY/IDF DEALS)



INSIGHTS

- The number of IDF-only deals in the UK reported in this survey, increased by 38% from 80 deals in 2020 to 110 deals in 2021.
- HSBC was again the most active lender in the UK in 2021, completing 60 deals, up from 42 in 2020. NatWest and BNP Paribas Commercial Finance completed 12 deals in 2021, up from 10 and five in 2020 respectively.
- UK multi-asset ABL activity increased by 5% to 83 deals in 2021, from 79 deals in 2020.
- Arbuthnot completed 11 deals, up from eight in 2020, while PNC Business Credit's deal count halved from 20 to 10. HSBC also completed 10 deals in the UK in 2021.
- Government support continues to be withdrawn from the market, which may boost asset-based lending's attractiveness as a suitable source of liquidity for businesses. If banks' appetite to provide revolving credit facilities reduces, ABL lenders are likely to take advantage to provide working capital facilities.

FOR MORE INFORMATION CONTACT:

Thomas Paterson

Director
tpaterson@alixpartners.com
+44 7584 149 322

Graeme Smith

Managing Director
gsmith@alixpartners.com
+44 7932 158 222

Nick Wood

Managing Director
nwood@alixpartners.com
+44 7976 851 379

Azeem Ahmed

Director
aahmed@alixpartners.com
+44 7920 156 936

Craig Rachel

Director
crachel@alixpartners.com
+44 7919 128 328

Oliver Tudor

Senior Vice President
otudor@alixpartners.com
+44 7920 156 932

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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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