Marlborough PARTNERS

Mid-Market Quarterly Snapshot
Q2 2017

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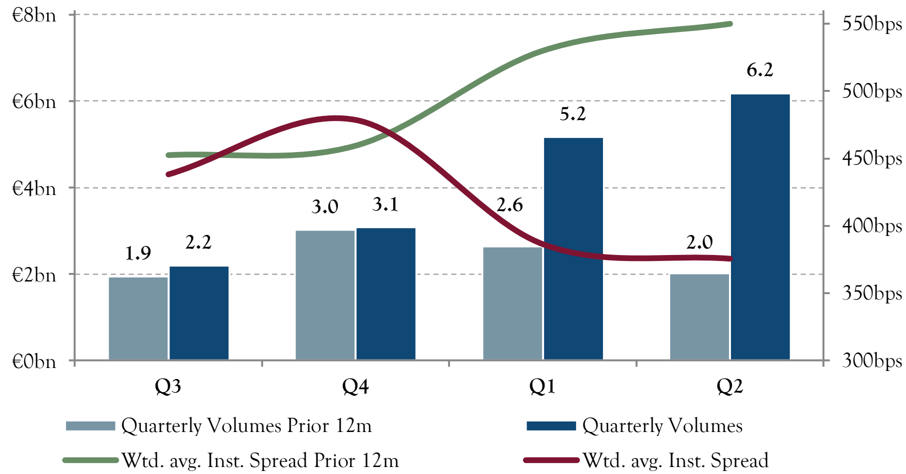
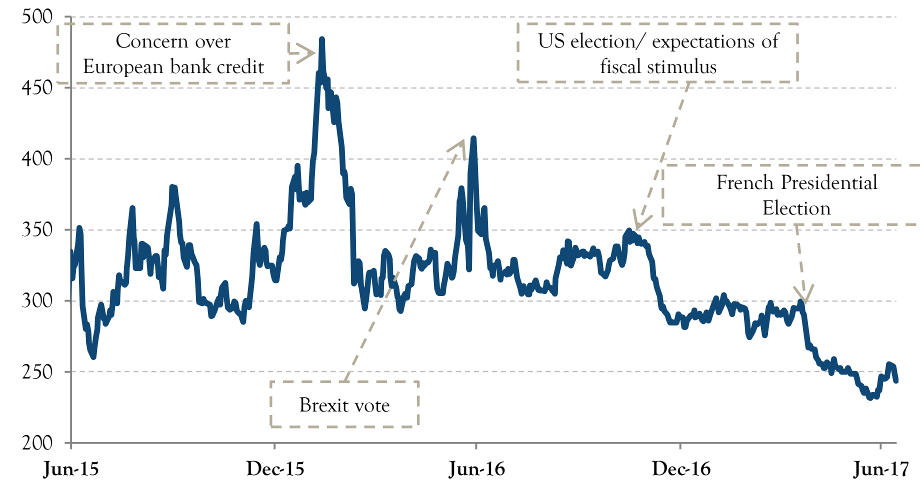
The UK leveraged loan market has remained strong in Q2'17, with LTM Q2'17 volumes almost doubling compared to LTM Q2'16

UK Senior Loan Volume and Pricing



iTraxx Europe Cross-Over



Key Themes

- UK leverage loan volumes were c. €6.2bn in Q2'17 which was >3.0x higher compared to Q2'16, reflecting the ever continuing theme of 'too much money' chasing 'too few deals'. With market yields falling in the latter half of 2016 and continuing in the first half year of '17, activity has been dominated by opportunistic refinancings and repricings, as borrowers have sought to take advance of lower pricing
- High yield issuance was slightly down for the quarter at €21.2bn following roughly €24.4bn in Q1, taking the H1'17 volume to €45.6bn which is significantly above the H1'16 total of €24bn. A number of themes continue to permeate: (i) low-yielding double-Bs dominate the market, (ii) high number of refinancings (in line with the leveraged loan market), (iii) bonds being taken out with loans, (iv) higher sterling issuance and (v) numerous FRNs, reverse-Yankees, and debut issuers
- Loans have overtaken bonds, accounting for over 50% of overall issuance in Q2'17. This is reflective of the relatively low spread and call flexibility which provides repricing options for issuers, increasing the appeal of loans to sponsors. The growing volume of high yield bonds issued since Q4'16 reflects the increasing demand from multi-asset funds as well as investment-grade fund managers and global high-yield funds allocating more to Europe
- Average TLB spreads have continued to tighten over the second quarter of 2017, declining to c. 359bps in April before increasing marginally to 368bps by the end of the period, with average TLB spreads in the UK closely following the European market average at c. 375bps at the end of Q2'17 despite uncertainty around Brexit. The ongoing trend of tighter spreads is driven by strong underlying market conditions and the imbalance in supply and demand
- The iTraxx crossover is currently trading at c.250bps and has continued to trend downwards in Q2'17 with a notable sharp drop in April 2017 following the perceived pro-market outcome of the French presidential elections

DACH Mid-Market Quarterly Snapshot
Q2 2017 Review

The healthy trend in the DACH market continues in Q2'17, with debt funds having one of their most active quarters in the region

Key Themes

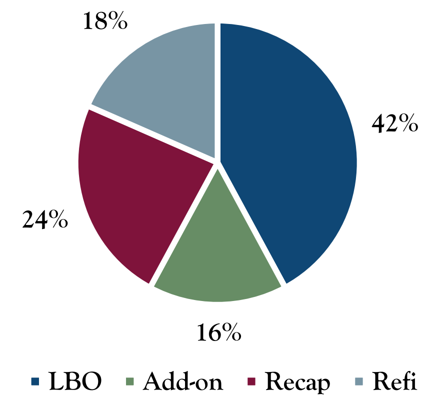
Observations from the second quarter

- For the German speaking LBO market, collected data from 18 deals in the second quarter of 2017 (compared to 15 deals in Q2 2016) confirms the good start of the year and the healthy trend observed over recent quarters
- In the first half of 2017, LBOs accounted for 42% of issuance whereas recapitalisations and refinancings accounted for 24% and 18%, respectively, with the rest being add-on acquisitions. This compares to 62% of LBOs in full-year 2016 and only 31% recaps/ refinancings
- The quarter saw a number of high-profile deals on which numerous lenders spent a lot of time including the LBOs of ProXES, Formel D and Schülerhilfe as well as the recap of ASK Chemicals. As proof of a buoyant and competitive market, ProXES, Formel D as well as ASK Chemicals attracted underwrites by banks whereas Schülerhilfe was underwritten by Alcentra (see below)
- The diversity of the banking landscape in the DACH region continues, with German commercial banks, "Landesbanken", foreign banks, as well as debt funds all trying to gain market share

Role of debt funds

- In contrast to what has been monitored in past quarters, debt fund activity peaked in the second quarter of 2017 with 8 out of the 18 deals (i.e. 44%) involving debt funds (either via unitranche or first loss/second loss structures)
- Abovementioned Oakley Capital's acquisition of Schülerhilfe is understood to be supported by the largest unitranche in the DACH region so far in 2017. Alcentra has underwritten the full amount of EUR 135m and brought in Berenberg as well as NIBC. Close second is the unitranche supporting the recapitalisation of Cordenka, a Chequers Capital portfolio company. Barings and Goldman Sachs provided the EUR 132.5m financing
- Most active debt funds in the second quarter have been Alcentra, Barings, and Pemberton with two transactions each

Type of Deals in DACH Market(i)



Most Active Debt Funds in DACH(i)

	Alcentra	BARINGS	BlueBay Asset Management	PEMBERTON Connecting Capital Across Europe	PERMIRA DEBT MANAGERS
Q1	0	0	1	0	1
Q2	2	2	1	2	1
H1	2	2	2	2	2

Notes: i) H1 2017

2017 - ECB Leveraged Lending Guidelines
Overview

ECB Leveraged Lending Guidelines: Guidelines Are In The Eye Of the Beholder

New ECB Guidelines

- In May 2017 the ECB published their final guidance on European leveraged transactions (the "ECB Leveraged Guidance") which will come into force in November 2017
- These guidelines follow in large part the path taken by the comparable Fed rules which came into play during 2013 (the "Fed Leveraged Guidance")

Who Do The Guidelines Cover?

- The guidelines cover "significant supervised entities" as determined by the ECB; as at 1st April 2017 there were 124 banking institutions that met this definition however this excludes a large number of market participants – for example direct lending funds and most UK, Swiss and Asian based banks

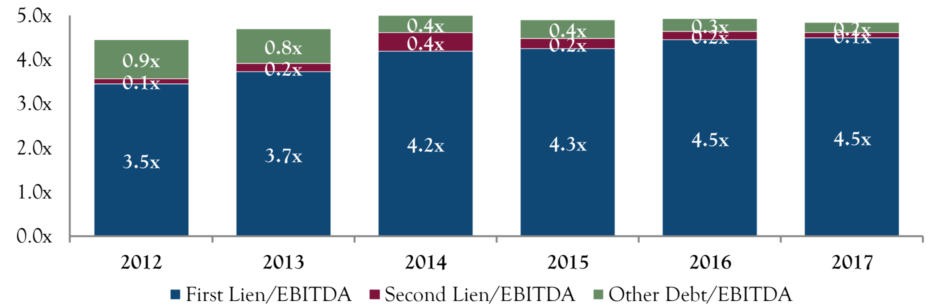
On What Deals Do The Guidelines Apply

- The guidelines will only apply to sponsor backed loans (including syndicated, underwritten, best efforts, club deals and bilaterals) with total committed gross debt facilities of greater than 4x

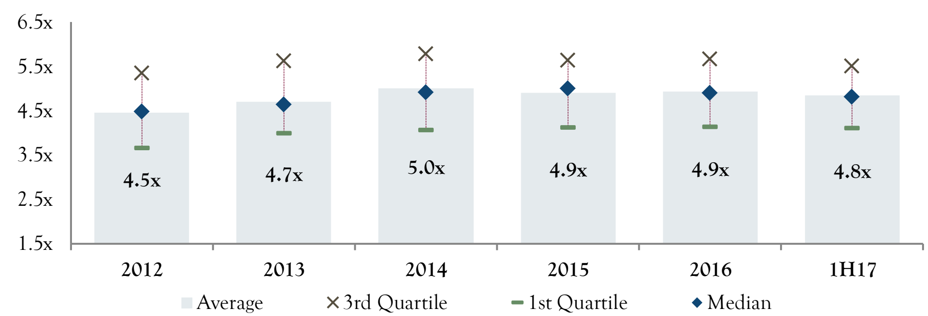
Some Key Considerations

- The guidance on what constitutes an "overleveraged" transaction is 6x total committed gross debt facilities (i.e. cash cannot be netted). Whilst this is very clearly guidance and not a fixed line it will give significant pause for thought for an ECB bank subject to the ECB Leveraged Guidance to regularly provide facilities in excess of this level other than on exceptional occasions
- The definition of total committed debt facilities outlined above includes undrawn debt, PIK and any additional debt that loan agreements may permit such as incrementals/accordions. Given that it is not unusual that revolvers account for 1x EBITDA and freebies and baskets can account for another 1x then this would translate to 4x term debt. Whilst 6x+ debt financings continue to be limited (on average 11% of all deals over the last 3 years) if this were reduced to 4x that would capture 73% of deals and would be very far reaching
- Financing case models will be required to demonstrate an adequate repayment capacity equivalent to 50% of total debt or 100% of senior debt over the life of the loan

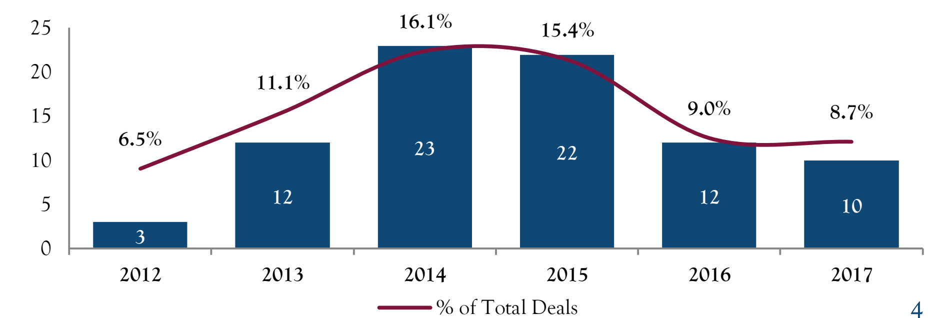
Average Leverage Multiples (Last 5 Years)



High to Low Debt to EBITDA Ratios (Last 5 Years)



No. of Deals Above 6x Leverage (Last 5 Years)



Source: LCD

The US Experience or Something Different?

What Was The US Experience?

- According to a recent Staff Report by the Fed in May 2017 banks subject to the guidance cut their leveraged lending activity significantly, bringing it down to levels lower than the pre-guidance period, however non-regulated banks did not adjust their leveraged lending and non-bank lenders increased their leveraged lending (this is reflected by the market share of regulated banks as compared to the pre guidance period declining by 11% by volume)
- As can be seen from the US Sponsor Led Leveraged Loans Bookrunner table, the Fed Leveraged Guidelines did not have a major impact overall on the relative market share of the key banking players in the US as nearly all bank market participants were covered by the Fed Leveraged Guidance

What Will Be The European Experience?

- An initial assumption must be made that in between now and the determination of the final guidance in November that clarifications will be made to exclude undrawns and PIK etc. from the definition of total debt otherwise the impact will be more widely felt on the banking community
- Given that a significant number of banks are not covered by the guidelines there may be small market share shifts to those banks not subject to the rules particularly for those deals over 6x (for example Jefferies benefited from a small increase in market share in the US where they were one of the very few banks not subject to the Fed Leveraged Guidance)
- It is likely there will be a further boost to growth in non-bank lending in Europe. Whilst the direct lending market in Europe has been rapidly growing due to inroads predominantly being made in the mid-market, there should be an expectation that PIK or more equity like instruments such as prefs will become more common-place to comply with the guidance
- Mid market ECB regulated banks may be further hindered by the requirement to meet specified repayment levels in their financial models as this will impact on the amount of financial covenant headroom they will reasonably offer and in turn provide a potential competitive advantage to non regulated banks or non-banks

US Sponsor Led Leveraged Loans Bookrunner Table

Bookrunner	2013 Rank		2016 Rank	
BaML	#1	(9.9%)	#1	(9.8%)
CS	#2	(9.2%)	#2	(8.5%)
JPM	#3	(8.8%)	#8	(5.2%)
Barclays	#4	(8.7%)	#3	(7.5%)
DB	#5	(7.4%)	#5	(6.7%)
GS	#6	(7.2%)	#4	(7.2%)
MS	#7	(6.5%)	#6	(6.3%)
Citi	#8	(5.8%)	#7	(5.5%)
Wells	#9	(5.3%)	#11	(3.5%)
RBC	#10	(5.0%)	#9	(4.3%)
Jefferies	#13	(3.0%)	#10	(4.0%)

European Sponsor Led Leveraged Loans Bookrunner Table

Bookrunner	2016 Rank		ECB Significant?
GS	#1	(8.1%)	
BNP	#2	(6.8%)	✓
HSBC	#3	(6.5%)	✓
DB	#4	(6.3%)	✓
JPM	#5	(6.2%)	
Unicredit	#6	(6.1%)	✓
BaML	#7	(5.7%)	
CS	#8	(5.4%)	
ING	#9	(4.4%)	✓
Barclays	#10	(4.0%)	✓

Source: Bloomberg
Note: ECB Significant refers to the list of significant supervised entities as referenced by the ECB

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