End of Term Report

Q4 2017

Loan Volumes Reach Post-Crisis Highs

Total 2017 leveraged loan volumes of €120bn (excl. repricing volumes) mark the highest level of issuance seen in the market since 2007 (€166bn) and represents a 70% increase compared to 2016. Issuance has been interspersed fairly evenly throughout the year demonstrating the robust nature of the market, with both Q1 and Q4 seeing c. €35bn of supply. Key themes seen in the market this year include:

Opportunistic Transactions and Repricings Remain in Vogue

- Refinancings and dividend recaps comprised the bulk of issuance in 2017 at 59% (45% in 2016); split 15% for recaps and 44% for refinancings
- Repricing activity remained high, totalling €74bn in 2017. Interestingly, 51% of loans outstanding in the S&P ELLI at the start of the year were repriced by the end of the year

Increase in New Money Resulting in More Balanced Supply & Demand Dynamics

- Acquisition financing supply was €49bn in 2017 (€38bn in 2016); €34bn of which was related to buyout activity. H2 saw the bulk of acquisition financing supply with €27bn printed (H1: €22bn)
- This new money issuance helped provide balance to supply-demand dynamics (in particular in H2)

Yields – How Low Can They Go?

- Spreads continued to grind tighter in 2017 with single-B rated spreads for Q4 at 363bps
- Interestingly, in Q3 we did see a small uptick in spreads given the increased M&A new money supply. However, spreads did subsequently fall once again in Q4
- 2017 also marked a record number of deals flexed down with 37% of deals flexed downwards

CLO Spread Tightening Supports Repricings

- On the Demand side, 2017 saw €21bn of CLOs printing (representing a 24% increase YoY)
- AAA spreads on CLOs have seen a marked decline over the year falling from 145bps at the end of 2016 to 73bps by Q4 2017 which continues to provide further support to TLB repricing activity

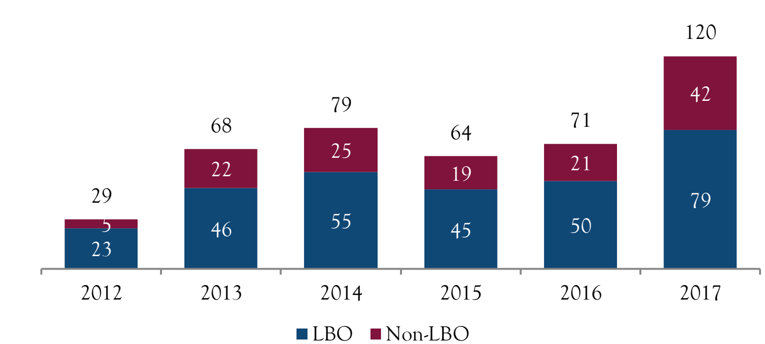
Reverse Yankees' Remain in Town

- US issuers continued to tap the European market for a record €42bn buoyed by record low yields on offer. The Yield differential between USD and EUR/GBP for Q4 2017 was c.111bps (39bps Q4 2016)

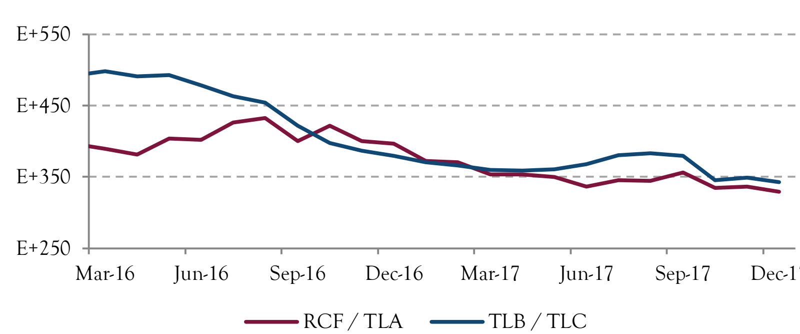
ECB Guidelines…So What?

- The ECB's guidelines on leveraged transactions came into force in November this year
- However, there remains a large element of uncertainty on how these will be implemented in practice and there have been a number of highly levered deals coming to the market post-implementation

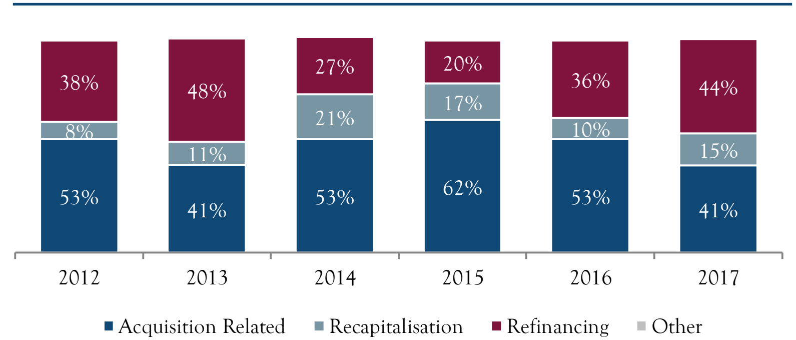
Annual Senior Loan Volume (€bn)



Weighted Average New Issue Spreads



Deal Purpose Diversification (based on volume)



Source: LCD Comps

A Bumper Year for High Yield Supply

The High Yield Bond market saw a record €94bn of supply in 2017 (77% vs 2016). Unlike 2016, the year began in buoyant fashion with Q1 seeing solid demand in particular for BB credits which accounted for 2/3 of total supply. With market fundamentals generally positive, there was a sustained risk-on sentiment and increasing risk appetite from investors as the year progressed with strong demand for B and CCC credits. Positively, despite some market softening in November, with the Crossover widening 35bps in the first half of the month, the market was able to shrug off this volatility and continued to print new deals.

Refinancings and Recaps Highlight the Strength of the Market

- Refinancing was again the key driver of supply throughout the year with c. 65% of proceeds used to refinance existing debt
- A number of high profile issues were used to pay dividends / for recapitalisation purposes, including a number of PIK deals and issuance from debut borrowers

Attractive Yields Persist Driven by Ongoing Central Bank Easing

- Supported by the ongoing corporate bond purchase programs of the ECB and BoE, yields continued to grind tighter as investors look to play further down the rating spectrum in their hunt for yield
- For B rated bonds, the average rolling 3 month yield for Q4 2017 was 5.31% (92bps lower than Q4 16) while for BB issuers this average was 2.91%, a staggering 120bps tighter than Q4 16
- Going forward, it will be important to monitor how the tapering programs of global central banks will impact the secondary bond markets

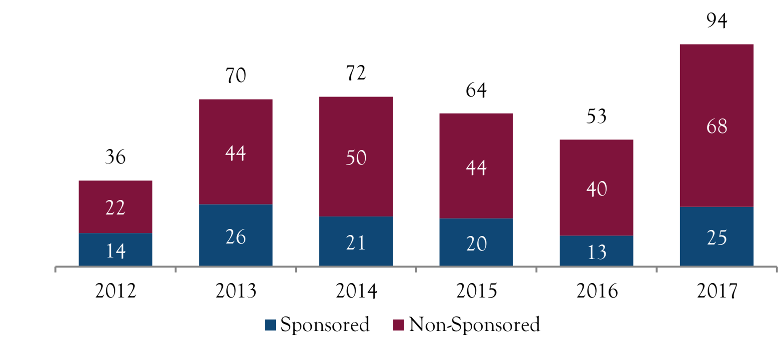
Increase in Debut Issuers

- A number of debut issuers accessed the high yield bond markets in 2017 with 25% of total supply coming from first-time issuers (14% in 2016); the second highest on record

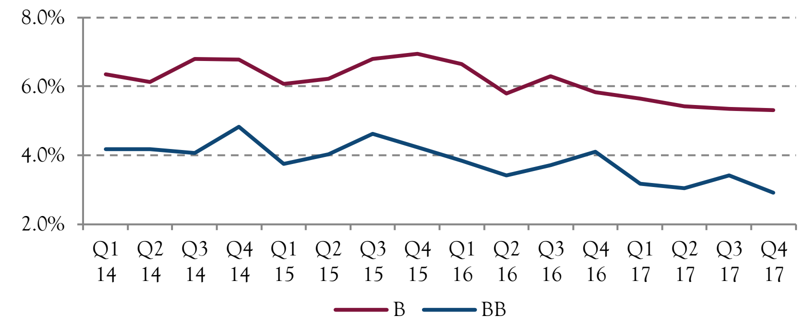
Solid Sterling Supply

- Despite ongoing noise around Brexit and political uncertainty in the UK, 2017 saw solid GBP supply with €14bn equiv. issued (€6bn in 2016)
- The market has been generally starved of Sterling paper in recent years, in particular in the run up to the Brexit vote, and this new supply marked a welcome return for funds looking to deploy their GBP cash

Annual High Yield Bond Volume (€bn)



Average Primary Yield by Rating



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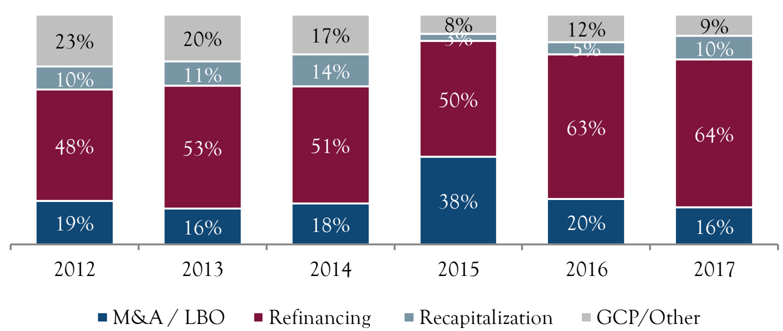


Source: LCD Comps

Private Debt Continues to Dominate with a New Vintage of Capital Emerging (1/2)

Private Debt Continues to Dominate

2017 was a fantastic year for private debt across the European landscape, with some of the largest private debt funds raised in Europe and new private lending strategies launched:

Osmosis of Private Debt Reaching an Equilibrium in Europe

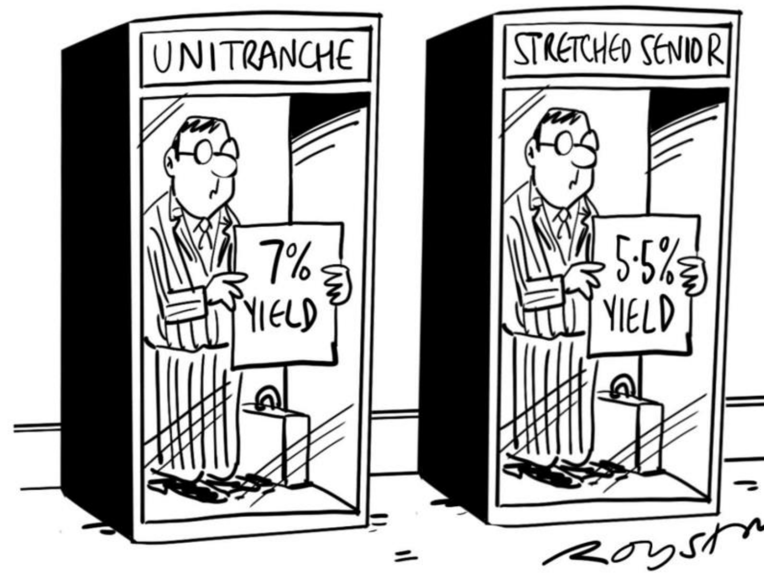
- Whilst private debt lenders have been active for some time in more mature markets (such as UK, France and Germany), intermediaries and a number of funds have paved the way in new markets (such as Benelux, Nordics and Southern Europe) in convincing Sponsors and their portfolio companies in the merits of the proposition
- 2017 has been the year where private debt has firmly cemented its position across Europe as a reliable financing alternative for numerous Sponsors who may previously have been concerned about single counterpart risk and the 'unknowns'

Proliferation of Super Senior + Unitranche Structures (a.k.a. 1st Loss / 2nd Loss)

- The optimisation of Unitranche with the combination of super senior bank debt continues to drive the adoption of the private debt product in all markets
- These structures have been prevalent for some time in more mature markets and for the top decile credits unitranche providers are providing blended pricing well inside of 6% to compete with senior plus second lien alternatives
- In less developed markets, banks are increasingly becoming comfortable with the structure and are offering super senior debt as part of their armoury to clients

Private Debt Funds the 'New Underwriters'

- A number of private debt funds are offering the option to underwrite a one stop shop solution, covering both:
  - The full senior facilities (including the RCF) along with a sub debt piece; as well as
  - The super senior term debt and super senior RCF for best execution (within a super senior + unitranche structure)
- Post signing a number of the (super) senior facilities are syndicated to bank lenders. This has been particularly popular in auction processes and transactions with tight timelines
- As such we have seen a switch in private debt lenders shaping and driving the transaction where these options are considered



Private Debt Continues to Dominate with a New Vintage of Capital Emerging (2/2)

Private Debt Continues to Dominate

New Vintage of Private Debt Capital

- A number of funds are continuing to raise senior focused funds or secure more managed accounts to provide a genuine alternative to bank capital
    - This has been particularly helped by the lowering of hurdles as new funds have been raised
- In addition, there is greater flexibility for these same funds to participate in 1st/2nd Loss structures, creating yet again another step change in the blended pricing starting 'with a 4 handle' in some cases (in-line with where TLB pricing was 18 months ago). Albeit these are for the top-quartile credits

Displacing the TLB Loan Market Alternative

- Private debt lenders have been particularly successful in displacing loan capital markets alternatives for upper mid-market transactions (both underwrites and best-effort deals)
    - This has been driven by a multitude of reasons ranging from; terms, economic crossover, debt capacity, ratings requirement and swifter execution
- Cheque sizes have continued to become bolder by a range of funds across the market
- Given the new vintage of private debt being raised and the tighter band of pricing for 1st Loss/2nd Loss structures for top-quartile credits, we would expect there to be greater displacement of loan market alternatives (particularly during periods of volatility)

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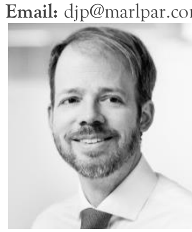

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