UK & DACH Quarterly Snapshot

Q3 2017

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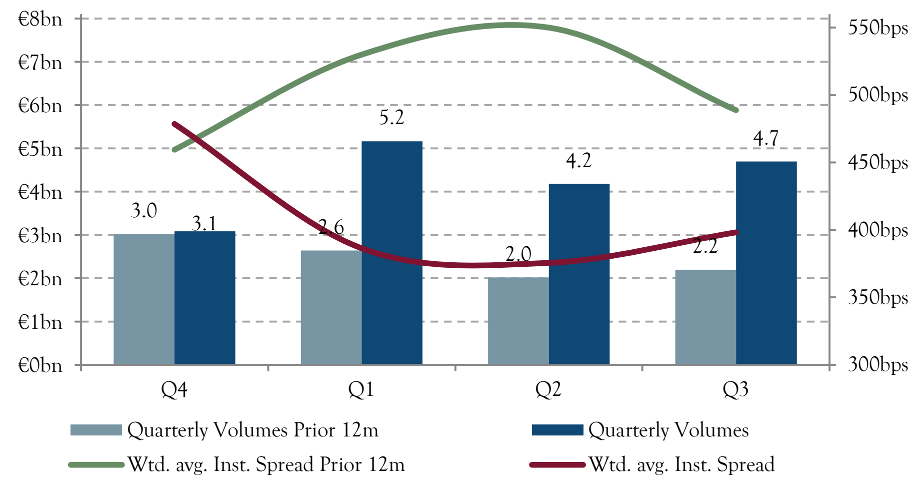
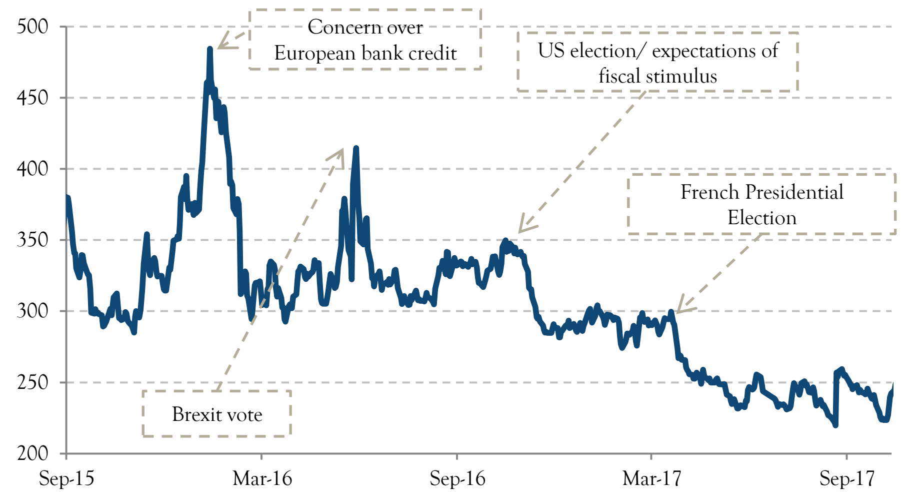
UK leveraged loan market volumes remain robust with over €17bn issued YTD vs. c. €10bn LTM Q3'16

UK Senior Loan Volume and Pricing



iTraxx Europe Cross-Over



Key Themes

- UK leveraged loan volumes were c. €4.7bn in Q3'17 which was >2x higher compared to Q3'16. Volumes remain robust with YTD volumes now 70% ahead of the same period last year. For the wider European market, issuance stands at €85bn (71% up YoY) which represents a post-crisis record
- These strong levels of volume have seen the recent trend of "too much money chasing too few deals" beginning to reverse although questions remain as to whether this is likely to continue given the typical "lumpy" nature of volumes
- Spreads remain low and favourable for issuers, currently hovering around the 400bps mark. However, in recent weeks, we have seen a slight uptick in loan spreads as the supply/demand balance begins to equalise
- Given these overall supportive market conditions, activity continues to be dominated by opportunistic refinancings, repricings and recapitalisations which have accounted for 65% of Q3 deals. Similarly, LBO supply remains healthy accounting for 35% of UK deals
- High yield issuance was again slightly down this quarter at €19bn following €21.2bn of supply in Q2. However, YTD volumes of €65.2bn remain significantly above the 2016 YTD total of €43bn
- In Q3 the iTraxx Crossover traded fairly steady at c. 240bps, currently trading at c. 230bps

Q3 saw another strong quarter of issuance in the DACH market

Key Themes

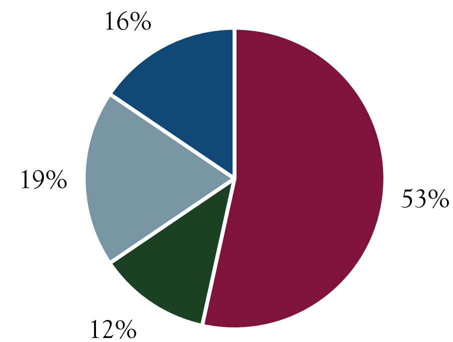
Observations from the third quarter

- In the third quarter, the number of deals in the German speaking LBO market was in line with quantums seen in previous quarters for 2017
- Interestingly for Q3, as a % of the overall market, LBO activity was higher at 53% (compared to 42% last quarter) driven by a strong M&A pipeline in Germany
- Outlook for year-end remains strong with a number of auction processes scheduled to come to an end before the Christmas period

Role of debt funds

- Debt fund activity remained supportive with 6 out of the 20 deals in the quarter involving debt funds (30% this quarter vs. 44% last quarter)
- Funds who successfully completed transactions this quarter were Alcentra, Ares, Barings, BlackRock, Bluebay, and Crescent
- Debt funds are experiencing their best year in the German speaking market so far, partly supported by first loss/second loss structures bringing interest costs down
- A number of banks in the market are actively marketing these structures towards private equity clients and pre-agreeing intercreditor principles with several debt funds

Type of Deals in DACH Market(i)



Most Active Debt Funds in DACH(i)

	Alcentra	Barings	BlueBay Asset Management	Pemberton	Permira Debt Managers
H1	2	2	2	2	2
Q3	1	1	1	0	0
YTD	**3**	**3**	**3**	**2**	**2**

Notes: i) YTD September 2017

How do Funds really behave when things go wrong?

When deciding between bank and credit fund financing options, many criteria can be easily and objectively compared (e.g. cost of financing and impact on returns, covenant headroom, basket flexibility etc.). What is harder to evaluate, and is always (and rightly) of paramount importance to sponsors is "how will the lender behave in an underperforming scenario"

The old 'banks are good, funds are bad' preconception

- Going into the last recession there was a widely held preconception amongst borrowers that banks were "good" and funds were "bad" and many therefore went to great lengths in their transferability language to prevent funds from acquiring their debt
- In the difficult years that followed many borrowers were forced to revaluate at least half of this notion, as banks moved under-performing loans away from the relationship bankers and into work-out groups
- Clearly not all banks behaved the same, but many deserted the principles of 'relationship' lending and were at best awkward and at worst aggressive, with many enforcing or selling off their positions to distressed investors
- Given most credit funds did not exist in the last cycle and those that did were in their infancy, there was little evidence of how funds behaved in stressed scenarios. In the benign years that have followed, while credit funds have rapidly grown market share there has been a lack of stressed deals such that most funds remain untested

2017 – The emergence of a clearer picture?

- Whilst the overall economy has remained robust, certain sectors, in particular oil & gas and retail, have continued to suffer from a tough 2016 such that a number of loans involving credit funds have now breached covenants
- We have advised on a good number of these situations and certain behavioural traits are starting to emerge:

1. ***Where value still demonstrably breaks in the equity***
    - Whilst a bank may be prepared to sell a loan at discount, particularly where the value received is greater than the internally provisioned value, this is very much a "last resort" scenario for a long only credit fund as it will crystallise a loss, which impacts fund returns and, in turn, a fund's track record to raise new funds
    - We have therefore seen a more constructive, partnership-like approach to stressed situations, with the key relationship individual retaining control of the process. They have been quick to process requests, commercial and transparent

2. ***Where value could or does break in the debt***
    - The flipside of this more constructive approach to situations where there is still a clear equity cushion to value, is that when value could break in the debt and force an impairment we have seen credit funds behave in an altogether more robust way, particularly when they view they can get out of a position quickly through a follow on sale
    - Until this year there were few examples of funds enforcing their security and 'taking the keys'. However we are already aware of six financings this year where credit funds have enforced which in a number of situations led to a follow on sale process

3. ***Lessons Learnt – forewarned is forearmed***
    - Whilst we have found funds to be fair, transparent and easy to deal with for basic covenant breaches, it is likely they will enforce if they believe they are at risk of an impairment and can readily realise value quickly
    - This knowledge is fundamental in evaluating restructuring options and tactics and will, sadly, become more and more pertinent as we inevitably enter the next cycle

Marlborough PARTNERS

21 Sackville Street, London,
W1S 3DN
Tel: +44 (0) 20 3053 3600

Frankfurt an der Alten Oper,
An der Welle 4, 60322 Frankfurt
Tel: +49 (0) 69 7593 8237

William Allen
Managing Partner
Tel: +44 20 3053 3603
Email: wa@marlpar.com

Jonathan Guise
Managing Partner
Tel: +44 20 3053 3602
Email: jg@marlpar.com

David Parker
Managing Partner
Tel: +44 20 3053 3601
Email: djp@marlpar.com

Gurjit Bedi
Managing Partner
Tel: +44 20 3053 3606
Email: gsb@marlpar.com

Romain Cattet
Partner
Tel: +44 20 3053 3604
Email: rc@marlpar.com

Markus Ehrler
Partner
Tel: +44 20 3053 3610
Email: me@marlpar.com

Taddeo Vender
Partner
Tel: +44 20 3053 3611
Email: tv@marlpar.com

Tim Metzgen
Managing Director
Tel: +44 20 3053 3608
Email: tm@marlpar.com

Aubrey Simpson-Orlebar
Senior Advisor
Tel: +44 20 3479 5206
Email: aso@marlpar.com

JP Davidson
Director
Tel: +44 20 3053 3607
Email: jpd@marlpar.com

Holly Bott
Associate Director
Tel: **+44 20 3053 3615**
Email: hb@marlpar.com

Jan Hoon
Associate Director
Tel: **+44 20 3053 3616**
Email: jh@marlpar.com

Alex Eptas
Associate Director
Tel: +44 20 3053 3609
Email: ae@marlpar.com

Dominic Jones
Associate
Tel: +44 20 3479 5204
Email: dj@marlpar.com

Alessandro Brembati
Associate
Tel: +44 20 3479 5203
Email: ab@marlpar.com

Jochem Bron
Associate
Tel: +44 20 3479 5205
Email: jb@marlpar.com

Steve Green
Associate
Tel: +44 20 3479 5208
Email: sg@marlpar.com

Charles Devevey
Analyst
Tel: +44 20 3053 3619
Email: cd@marlpar.com

Philippe de Courréges
Analyst
Tel: +44 20 3053 3613
Email: pc@marlpar.com

Uzair Chiragdin
Analyst
Tel: +44 20 3479 5201
Email: uc@marlpar.com

Charlie Millar
Analyst
Tel: ++44 20 3479 5200
Email: cm@marlpar.com

Randal Pringle
Analyst
Tel: +44 20 3479 5202
Email: rp@marlpar.com