Marlborough PARTNERS

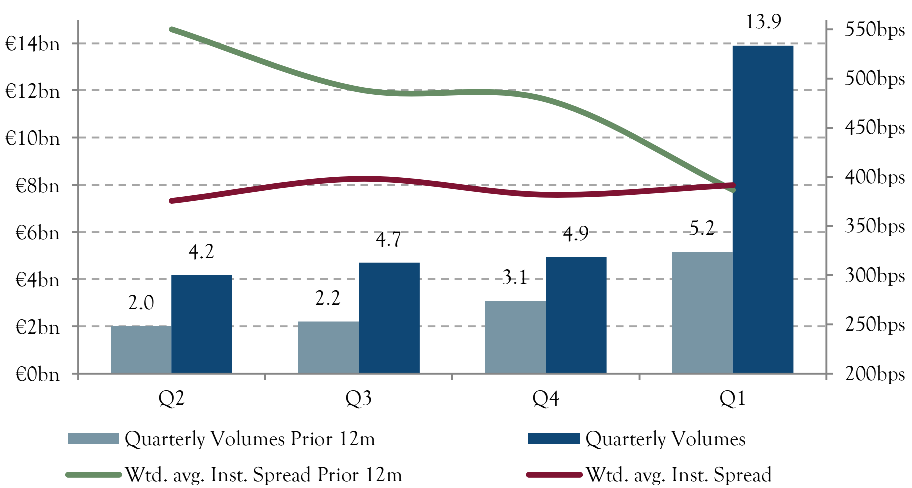
UK & DACH Quarterly Snapshot
Q1 2018

Disclaimer

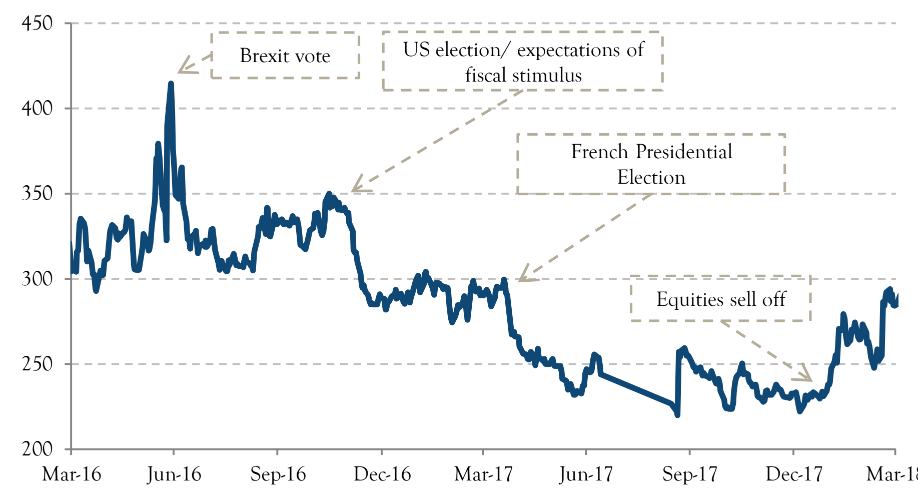
UK Mid-Market Quarterly Snapshot
Q1 2018 Review

UK leveraged loan volumes continue to grow in Q1'18 despite a more balanced market

UK Senior Loan Volume and Pricing



iTraxx Europe Cross-Over



Key Themes

- The UK significantly increased its share of the European Leveraged Loan market, accounting for 38.9% of total loan volumes in Q1'18, compared with 18.3% in the previous quarter and 15.3% in Q1'17
- Leveraged loan volumes in the UK alone were c. €13.9bn in Q1'18; greater than the previous three quarters combined. This was driven by an increase in average deal size, with several large landmark deals closing in the quarter
- Issuance in the wider European Leveraged Loan market continues to track the record pace set in 2017 with total volumes marginally up on the same period last year (€35.7bn vs. €35.3bn)
- The quarter has seen some market volatility, triggered by an equities sell off in early February, leading to the iTraxx Crossover hitting its highest level since April '17
- This market softening has driven slightly wider pricing on new transactions and the beginnings of a re-balancing between borrowers and lenders
- This has led to fewer opportunistic refinancings, with refinancings accounting for just 31% (€11.2bn) of loan volume in Q1'18, compared with 62% (€21.9bn) this time last year
- Despite yields widening, they are still close to historically low levels and the European high-yield market remains solid, hosting €19.6bn of bond volume in the quarter, which was down on the €24.9bn generated in Q1'17 but above Q3'17 levels

German-speaking LBO market starts 2018 with a high level of issuance

Key Themes

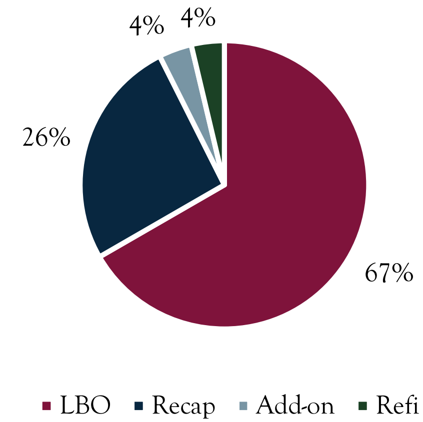
Observations from the first quarter in 2018

- With a total of 27 deals, the German-speaking LBO market started 2018 with a strong first quarter. While Q1 2018 level of issuance was below Q4 2017 issuance (35 deals), it was above the level of issuance in Q1 2017 (20 deals)
- When looking at the type of deal, the share of LBOs in Q1 2018 was slightly higher than in the previous quarter (67% vs. 57%) while the share of add-ons was lower (4% vs. 17% in Q4 2017)
- The share of recaps and refinancings in Q1 2018 was broadly in line with 30% vs. 26% in Q4 2017

Role of debt funds

- Unitranche financings remain popular in the DACH market, making up 9 out of the 27 deals in Q1 2018. This reflects a share of 33%, which is broadly in line with the previous quarter (37%)
- Of the 9 unitranche financings, 8 were provided by debt funds while one unitranche financing was provided by Credit Suisse
- The most active funds in Q1 2018 were Pemberton with 3 deals and Idinvest with 2 deals

Type of Deals in DACH Market



Most Active Debt Funds in DACH

	Pemberton	Idinvest Partners	Permira Debt Managers	BlueBay Asset Management	Alcentra
Q1 18	3	2	1	0	0
2017	3	3	4	7	4

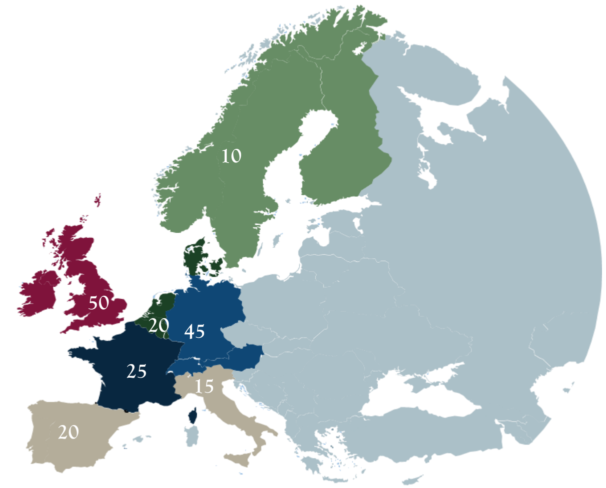
Private Debt
A Moment of Reflection

It has been over 7 years since we advised on one of the first debt transactions now commonly known as Unitranche which we had to source from a US based debt fund. At that time there were only a handful of debt funds in a lending market which was dominated by retail banks. With private debt now more prevalent in Europe than ever before, and an increasingly common financing alternative for more and more sponsors, we reflect on how much this market has moved since then.

Large number of established and active players

- Private debt has been one of the few success stories to emerge from the global financial crisis as debt fund managers filled the gap left by the shying away of traditional banks from riskier lending driven inter alia by higher capital requirements due to Basel II and subsequent iterations, and the Fed/ECB guidance on leveraged transactions
- Quantitative easing across Europe and the US has inflated the values of global stock and bond markets, leading to investors looking elsewhere for investment opportunities; estimated private debt dry powder in Europe has increased by more than 3 times since 2011 to over $67bn
- We and our sponsors now regularly work with 50 plus of these well established funds who invest on a pan-European basis, the biggest ones with access to capital of around €4bn (fund size)
- The rising magnitudes of these debt funds has driven an increase in ticket sizes and although the largest Unitranche on record in Europe remains GSO's $625m financing of Polynt and Reichhold in 2016, the number of €100m plus Unitranche deals continues to increase year on year

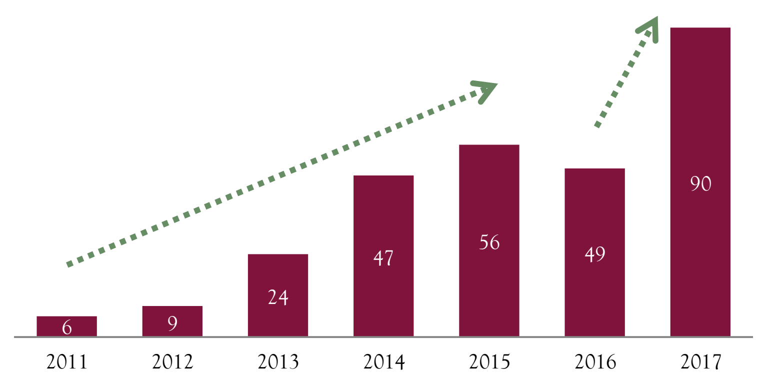
Number of Private Debt Fund Offices Across Europe



Diverse range of products offered

- As the abundance of private debt funds increases so does the range of products they offer. These funds now come in many forms and employ a wide range of strategies with different risk/return profiles; their product suite extends well beyond the plain vanilla Unitranche
- Debt funds can lend across the entire capital structure, offering Stretched Senior, Unitranche (with the option of First Loss/Second Loss), Second Lien, Mezzanine, PIK notes, and preferred equity instruments
- This allows debt funds to be versatile, increasing their activity considerably beyond straight Unitranche financings and we are seeing a growing number of single fund stretched senior financings; 90 Stretched Senior and Unitranche deals were executed in Europe in 2017, compared with 6 in 2011 and this deal rate continues to ramp up in Q1 2018

Number of European Stretched Senior and Unitranche Deals



Source: Preqin, LCD Comps

Terms which are comparable to large cap transactions

- Increased saturation of the private debt market has driven an optimisation of terms; and these funds offer an attractive alternative to both the syndicated loan and high-yield bond markets
  - Debt funds can offer large undrawn lines for acquisitions making them well suited for buy and build strategies and provide greater speed of execution
  - The now commonplace 1st Loss/2nd Loss product provides blended pricing well inside of 6% and thus competes with senior debt plus second lien financings
  - Documentary flexibility is increasing as capital market terms filter down to the private debt market (e.g. portability)
  - Some debt funds have started offering Cov-Lite or Super Cov-Loose Unitranches albeit for very strong credits (and large deals)
- Commercial banks struggle to compete on terms as a result

Looking forward

- As banks remain risk averse and mono-product with limited ticket sizes, they are likely to continue to lose market share to these now well established players
- In the UK, transactions with a club of senior lenders are becoming the minority since they can't compete on leverage, terms and flexibility offered by private debt solutions; super senior facilities are increasingly becoming the main way into the capital structure for these banks
- As UK M&A slows we are seeing this trend emerge in Europe too as private debt continues to take market share particularly in the Netherlands, France and Germany
- In line with the continuous growth of private debt dry powder, debt funds will selectively take away deal flow from both the syndicated loan and high-yield markets
- There is a very legitimate role for volume debt advisers such as Marlborough Partners to be able to navigate in a fragmented market

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