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Corporate Debt

Newsletter Q1 2022

Corporate Debt Markets in Q1 2022 – Overview

> Deal activity in 2021 has been exceptionally strong as substantial demand for refinancing and acquisition financing were driving forces.

> PWC reports 77 deals for Q4 2021 amounting to EUR 45bn (QoQ: +18%) as compared to 84 deals with a total volume of EUR 38bn one quarter prior. For FY 2021 high yield issuance have reached a total volume of EUR 200bn, marking a new record year after a previous high of EUR 179bn in 2017.

> Driven by the EUR 3.1bn issuance by Bellis Acquisition Co Plc (22% of total sector issuance), the consumer staples sector registered significant growth and reached a market share of 7% (QoQ: +6.7%).

> German Unitranche and Senior deals continue to be dominated by Software and Technology, and Healthcare sectors with both constituting for 57% of total financing.

> Lending standards on balance slightly tightened in Q4 2021 according to the latest ECB bank lending survey.

European Sub-IG Market

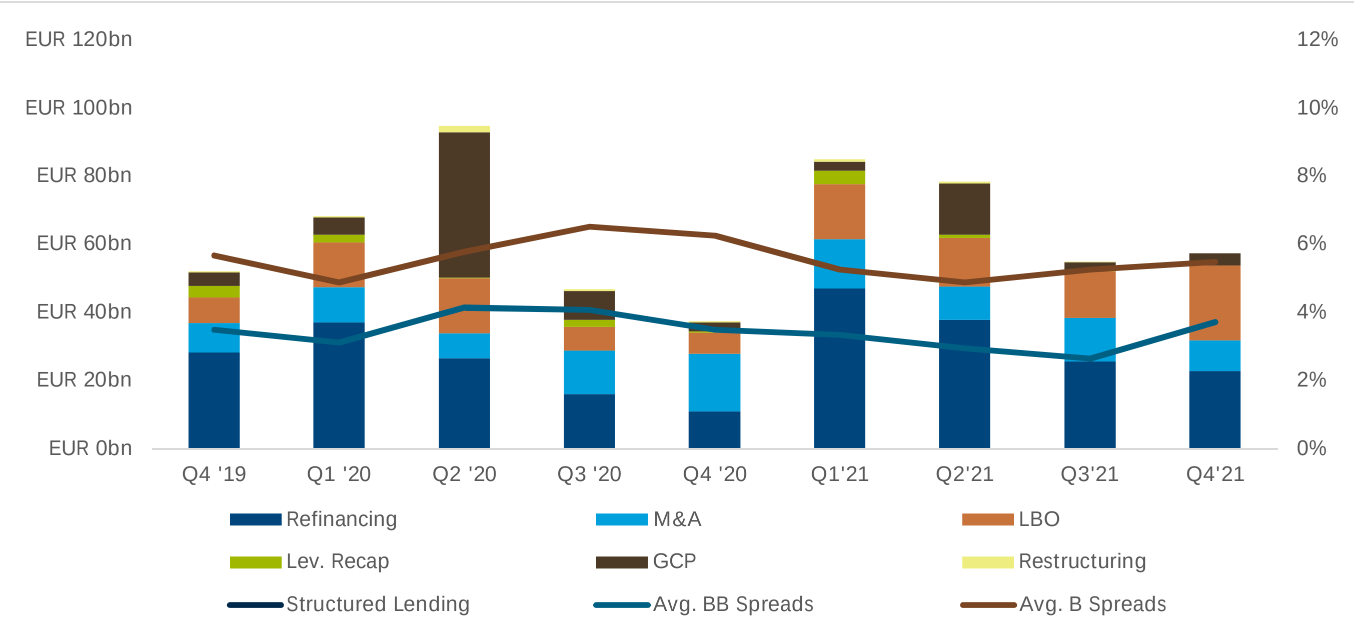

Figure 1: Volume of Sub-IG European debt markets (incl. leveraged loans and bonds) and average spreads.
Source: White & Case (Debt Explorer), PwC Debt Watch Europe Q4 2021

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Corporate Debt Market Europe

European Debt Market

According to Debtwire, 2021 has been a strong year for leveraged loans issuance with deal values amounting to EUR 289.7bn for the full year (YoY: +28%). This growth was driven by attractive pricing in the first half of the year and buoyant M&A activity in the second half. Refinancing activity has continued to slow down in Q4 with a deal value of EUR 22.6bn (QoQ: -11%). Throughout the year, however, it remained the dominant use of leveraged loans with a total value of EUR 132.6bn (YoY: +47%) as borrowers were locking in lower rates. Acquisition financing has been slightly lower in 2021 with a total value of EUR 46.5bn compared to EUR 47.6bn in 2020. Buyout financing has been very strong in 2021, amounting to a total value of EUR 66.0bn for the full year (YoY: +56%) with an exceptional Q4 that saw leveraged loan issuance for LBOs surge to EUR 21.9bn (YoY: +259%, QoQ: +60%) as PEs deployed their dry powder and lenders took advantage of heightened deal activity and demand for financing.

In its Q4 bank lending survey, the ECB finds that on balance credit standards of European banks on loans to enterprises have slightly tightened compared to previous quarters. On average, banks had a rather benign view of firms' credit risk, mainly driven by their overall positive economic outlook, despite the pandemic and the dampening impact of supply bottlenecks.

According to S&P Q4 spreads for European new issued loans continued to widen to E+423bps, while average yields increased to 4.45% as investors continued to be more selective. This compares to spreads of E+396bps and average yields of 4.15% during the previous quarter.

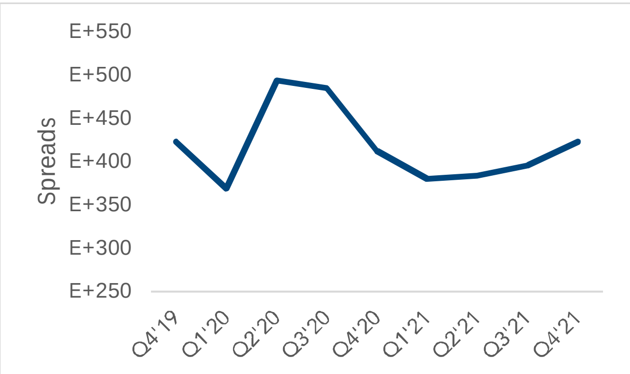

Figure 2: European new issue loan spreads
Source: S&P Global Market Intelligence

Sponsored deal activity continued to be very strong in Q4 2021 with 143 transactions closed (QoQ: +13%). For the full year, 486 sponsor-backed financings have been closed (YoY: +87%). This marks a record year in terms of deal volume as debt funds were actively pursuing add-on acquisitions while PE sponsors took advantage of favourable financing conditions for refinancings and dividend recaps.

New issuance in the European high yield market have hit a record high in 2021 with a total value of c. EUR 200bn (YoY: +25%) and 385 deals for the full year, surpassing the previous record of EUR 179bn in 2017. For Q4, PwC reports a total transaction value of EUR 45bn (QoQ: +18%) and 77 deals, compared to a transaction value of EUR 38bn and 84 deals one quarter prior. With the expected tightening of monetary policy, yields are expected to rise throughout 2022.

DACH Debt Market

In their latest guidance on the DACH region's countries, the OECD has forecasted the German economy to expand by 4.1% in 2022, while the Austrian and Swiss economic growth is forecasted to grow around 4.6% and 3.0%, respectively. However, 2022 economic growth could be alleviated by continuous supply chain issues and inflation, which is likely to be further exacerbated by the current and ongoing war in Ukraine. Nonetheless, the strong economic recovery in the DACH region throughout 2021 has resulted in a favourable environment for heightened deal activity.

In its MidCap Monitor, Houlihan Lokey reports strong numbers for German mid-market financings with 56 transactions closed in Q4 2021 and a total of 161 transactions closed in 2021 (YoY: +71%), marking a record year for sponsor-backed activity in Germany. While the trend of increased share in software and technology financing (34%) has continued in 2021, an interesting trend has materialised in the use of financing proceeds. In Q4 2021, the share of refinancings and recapitalisation has increased significantly to 29% and stood at 22% (YoY: +6%) for FY 2021. This could indicate that private equity houses consider current financing conditions as attractive and probably see the market close to its peak. Deals closed by debt funds have nearly doubled in 2021 with 102 transactions recorded (YoY: +85%).

Figure 3: German mid-market financings 2021
Source: Houlihan Lokey MidCap Monitor Q4 2021

Although Senior and Unitranche transactions saw a strong increase in absolute numbers throughout 2021, the percentage share of LBOs has declined compared to the previous year. Overall, the market has remained very competitive for high-quality assets throughout the past year. However, no significant changes with regard to structuring, pricing or documentation has been observed.

In the broader European market, Germany continues to lack behind the UK and France in terms of share of high yield issuance. While both countries together make up 30% of the total high yield market, Germany maintains its 8% market share.

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Financing Conditions

While ample refinancing activity and strong operating performance across the leveraged credit spectrum has insulated issuer balance sheets from volatility in 2021, rising benchmark rates and spreads could lead to refinancing issues later in 2022 and 2023. So far however, leveraged loan default rates continued to fall to 1.8% in January 2022, down from 2.0% in December 2021, while default rates for high-yield bonds slightly increased by 10bps to 0.8% but remain at low levels.

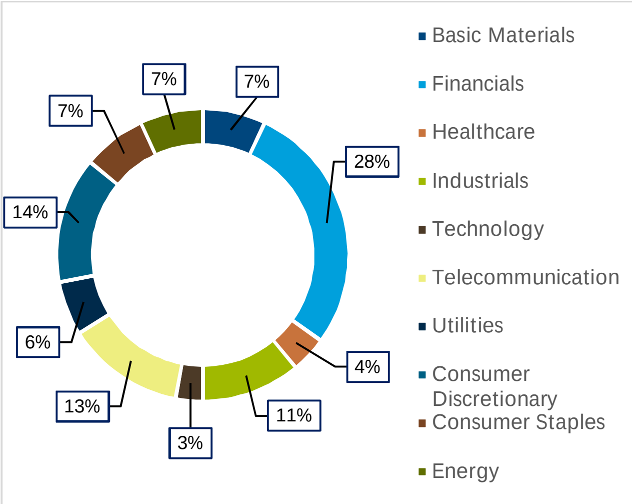

Figure 4: High Yield Volume Europe, Q4 '21 Sectoral Split
Source: PwC Debt Watch Europe, FY 2021

The fourth quarter of 2021 saw a decline in the Consumer Discretionary sector's share of new issuance, down -5.1% from 19% in Q3 to 14% in Q4, while new issuance within the Consumer Staples sector increased to 7% in Q4 from 0.3% in the previous quarter. This constitutes a reversal of the positive economic trend observed during Q3, as the last quarter of 2021 was largely impacted by supply bottlenecks. The shares of other sectors remain mainly unchanged, with Financials still dominating new high yield issuance with a share of 28% (QoQ: -7.2%).

Impact of the war in Ukraine

Russia's attack on Ukraine has changed the life for millions of people within one day with far reaching humanitarian consequences and devastating effects for people living in Ukraine and their loved ones. At this point it is unclear how long the war will last and what the outcome might be. In any case the ripple effects of the war itself as well as the consequences in form of sanctions and other restrictions will be felt throughout the world economy. It is however clear, that any forecast for economic growth has to be severly discounted.

Particularly Germany has is in a difficult economic position as it heavily relies on energy from Russia. This is however not the only consideration. According to IHK there are about 2.000 German companies with direct ties to Ukraine and about 50.000 employees in the country. Also German companies with exposure to Russia are impacted by the sanctions imposed on the country. Next to explicit sanctions companies also need to make the political decision if they want to continue conducting business with Russia.

After two years of managing the impact of the Covid19 pandemic the German Mittelstand is facing new challenges, which will impact the companies and the whole economy in the near and mid-term. While larger companies are usually more diversified in terms of customers and production, some Mittelstands companies face a very concentrated exposure to either/ or both Russia and Ukraine.

One of the immediate issues are the significant price increases for commodities, which are required for production, as well as the sanctions that lead to shortages impacting supply chains (again). Also energy costs have dramatically increased leading to higher operating costs. This impacts energy intensive production processes in particular.

According to media reports, the Federal Ministry of Finance and the Federal Ministry of Economics are working on aid packages for the German economy to cushion the impact of the Ukraine crisis. Among other things, there is talk of a "protective umbrella" along the lines of the aid packages during the Corona pandemic. However, there is still no conclusive information on the scope and volume. Many industrial companies with high energy consumption, such as the paper industry or plastics processing, are facing problems due to rising costs.

An additional difficulty is likely to be a lack of supplies from Ukraine, where a lot of corn, wheat, barley, soybeans and rapeseed are grown. In 2019, Russia and Ukraine together each accounted for about 20% of global exports of wheat, barley and corn, according to Coface. In addition, the two nations account for about 75% of global exports of sunflower seeds and safflower oil - both used as cooking oil for human and animal consumption. Sharply rising costs are also likely to strain the liquidity position of many companies in the medium term. The sanctions against Belarus may also have a negative impact on the fertilizer industry, as this country is one of the largest producers of potash and other ingredients for fertilizers.

Further challenges are added by the still looming risks of rising interest rates in the medium term, due to inflation. This will increase refinancing costs and can be difficult to manage for companies who raised a lot of debt at significantly cheaper conditions and need to refinance.

The Dutch company Daxx estimates that about 200.000 software developers used to work in Ukraine predominantly for western European companies including German Mittelstands companies. This is also true for Russia and Belarus. This severely impacts IT projects as most of them had to come to a complete halt. Some companies are trying to move their Ukrainian colleagues out of Ukraine. However given that most developers are between 20 and 30 there are restrictions for them to leave the country.

Although the war in Ukraine weighs heavily on the European economy and the German economy in particular, the IfW expects that the positive economic effects from the lifting of a broad range of Covid-19 restrictions will be able to somewhat counter the war driven economic shock.

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Our corporate debt team has accompanied and executed transaction in excess of EUR 700m. Our Private Debt Team additionally invests into Aviation Debt, Infrastructure Debt and Commercial Real Estate Debt. We expect significant further growth in these areas, which provide attractive risk-adjusted returns to our investors.

Prime Capital's Private Debt Team manages assets in excess of EUR 2bn across the aforementioned asset classes on behalf of institutional investors. Further information about Prime Capital AG can be found on our website www.primecapital-ag.com.

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Prime Capital Corporate Debt Expertise

> Advice and support for corporate debt investments, portfolio strategy and sector allocation

> Managed accounts and funds with investment expertise in various jurisdictions and markets

> Unique "multi-channel sourcing" with access to transactions via direct lending, bank and advisor sourcing on the basis of longstanding relationships to sponsors, advisors and leading banks

Further information about Prime Capital AG can be found on the web site

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