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Corporate Debt

Newsletter Q3 2021

Corporate Debt Markets in Q3 2021 – Overview

> H1 2021 saw large deal activity across Europe with further deals expected in the second half of 2021.

> LCD reports 117 Deals in Q2 2021 with a total volume of c. EUR 61 bn., compared to 95 deals with a volume of c. EUR 54 bn.

> The share of financings in the consumer discretionary space have significantly increased compared to Q1 2021 underpinning the expectation for an economic recovery.

> The share across the sectors shows, that software and healthcare have dominated the deals with more than 65%.

> Lending standards on balance remained unchanged according to the latest ECB survey.

European Sub-IG Market

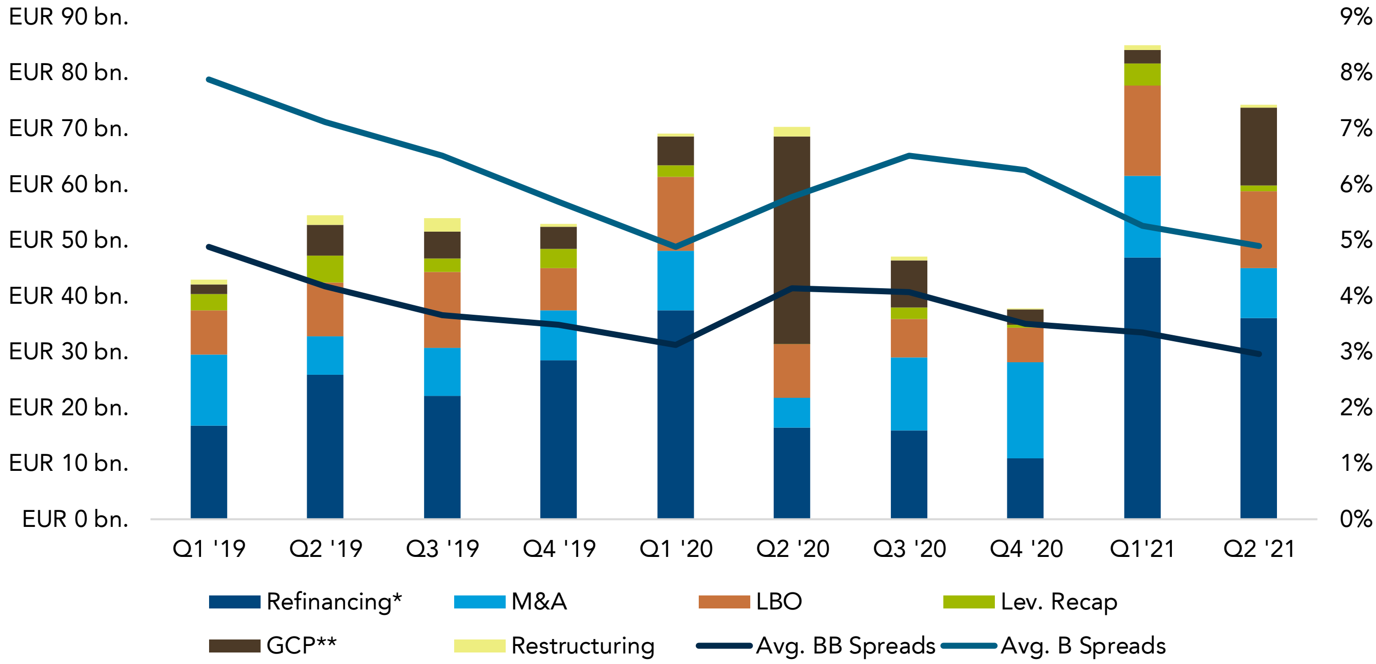

Figure 1: Volume of Sub-IG European debt markets (incl. leveraged loans and bonds) and average spreads.
Source: White & Case (Debt Explorer), PwC Debt Watch Europe Q1 2021

**Refinancing incudes repricing and amendments*
***General Corporate Purposes include Working Capital, SG&A and COGS*

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Corporate Debt Market Europe

European Debt Market

According to S&P the first half of 2021 has been a continuation of the 2020 success in the European Private Debt market. As for the previous year the majority of deals (81%) in the European mid-market have been comprised of acquisitions, while about 11% have been related to refinancing. The share of acquisition financings has further increased compared to the same period in 2020. Alternative lenders still have significant dry powder to deploy and the direct lending market has outpaced the banking market, while banks have been busy with facilitating government loans and defining their risk budgets. S&P expects that banks are not exiting the sector but will rather end up working together with alternative lenders.

In its bank lending survey the ECB reports, that on balance, credit standards in the second quarter of 2021 remained broadly unchanged (i.e. banks' internal guidelines or loan approval criteria) for loans or credit lines to enterprises- as the number of banks reporting easing of standards compared to a tightening was balanced. This follows significant net tightening of lending standards for corporate loans in the second half of 2020 and the moderate net tightening in the first quarter of 2021.

Partners Group reports in its most recent Loan Market Commentary, that in Q2 new issue loans spreads on average widened compared to a tightening in the previous two quarters. The new issue spread for B-rated issues widened to E+384 bps compared to E+380 bps in Q1 2021. However looking at the progress, spreads moved from E+375 bps at the beginning of Q2 2021 to E+398 bps at the end of Q2 2021. Partners Group expects that spreads may need to widen further to support the continued increased M&A activity

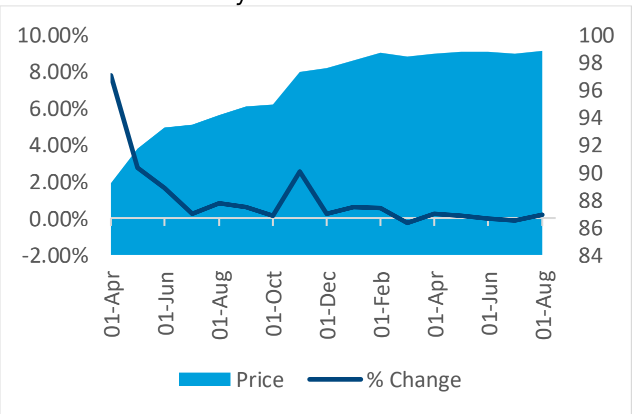

Figure 2 S&P European Leveraged Loan Index Returns
Source: S&P Global Market Intelligence

Private equity sponsored deals continued to dominate the market for European direct lending since the first quarter of 2020, 88.5% of the deals recorded in the mid-market were sponsored, according to LCD.

Issuances in the European high yield market also saw strong activity in Q2 2021, surpassing Q1 2021 levels due to increased confidence in the market. LCD reports 117 Deals in Q2 2021 with a total volume of c. EUR 61 bn., compared to 95 deals with a volume of c. EUR 54 bn. The yield-to-maturity continued to decrease on average compared to Q1 2021, as issuers took advantage of lower interest rates.

DACH Debt Market

The economy of the DACH region is forecasted to grow in 2021. The strongest growth is expected for Austria with 3.4% followed by Germany with 3.3% and Switzerland with 3.2% based on the OECD forecast. The growth expectation is mainly driven by the easing of containment measures, which promote economic confidence across the region. It can be expected that an improved economic outlook will translate into higher deal volume. Mergermarkets reports a total volume of EUR 98.4 bn. being announced in H1 2021, which is 37% higher compared to the same period in 2020. This also marks the highest volume in the past four years. The deal count increased by 160 to 700 deals, compared to H1 2020.

GCA Altium reports a strong activity for the German LBO market for Q2 2021, recording 31 transactions, which is the highest deal count for the first half of the 2021 since the launch of GCA's MidCap Monitor. The debt advisor expects 2021 to be a record year in terms of completed LBO transactions. The share across the sectors shows, that software and healthcare have dominated the deals with more than 65%. In terms of lenders, debt funds outpaced banks in the first half of 2021 with a share of 65% of the deals.

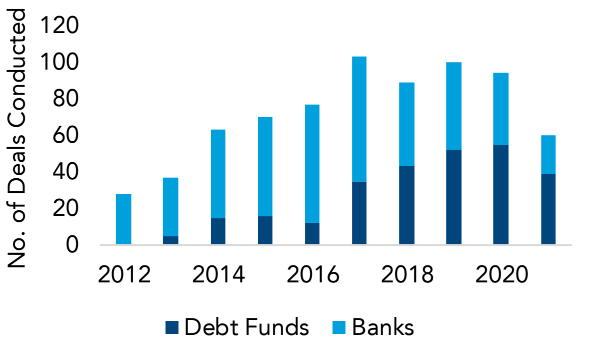

Figure 3: German mid-market financings H1 '21
Source: GCA Altium MidCap Monitor Q2 2021

The strong deal flow offers plenty of opportunities for lenders and demonstrates the economic resiliency of the region. On the other hand, lenders and sponsors have naturally focused on stable business models, which has led to increased competition around these businesses on the equity and on the debt side.

S&P reports that in terms of deal activity Germany has further fallen behind the UK and France during 2021, accounting only for 14.3% compared to 18.9% in 2020, ranking behind the UK with 32.5% (vs. 27.3% in 2020) and France with 28.6% (vs. 22.7% in 2020).

Financing Conditions

According to S&P resilient sectors like technology, healthcare and business services have attracted the most interest among sponsors, as well as lenders. This has led to a further increase in valuations along with leverage multiples. Even though PE Funds have increased equity stakes in some cases, some deals also saw an increase in debt leverage and PIK-tranches. According to S&P the average multiple in the European mid-market is around 5x.

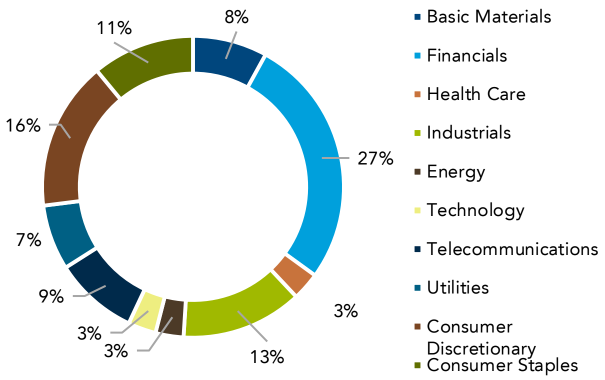

Figure 4: High Yield Volume Europe, Q1 '21 Sectoral Split
Source: PwC Debt Watch Europe, Q2 2021

The share of Energy sector has significantly decreased from 10% in Q1 2021 to 3% in Q2 2021. In contrast the share of consumer discretionary has increased by 6% to 16% in the second quarter. This can be seen as signal of further optimism for an economic recovery. The share of other sectors remains mainly unchanged, with Financials making up almost one third of all issuances.

Waiting for inflation…

The better part of the last decade was marked by very low interest rates compared to previous years in a low inflation environment, especially in Europe and the US. This has caused central banks around the globe to lower interest rates and to run large scale quantitative easing programs, in order to support the respective economies. The low interest rate environment has made it difficult for institutional investors to provide the returns promised to their clients.

Quantitative easing by central banks has led to large inflows in asset classes across the spectrum, further depressing returns and hence enforcing the search for yield.

The Covid-19 pandemic has forced governments to provide large stimulus packages for the local economies to curb the economic impact of the pandemic. Additionally the savings went up due to lockdowns and reduced consumption. With restrictions easing this cash is now flowing back into the economy.

This resulted in inflation rising across all large economies. Inflation in Europe was at 2% in May, which is the highest level seen in the last two years. This number reduced slightly to 1.9% in June, which is still significant. In the US, consumer prices saw their largest increase in 13 years in June, with the CPI increasing by 5.4% year-on-year. Also China's producer price index rose by 9% in May– which is the highest figure in more than a decade. As many goods are partially manufactured in China, this could affect prices around the world, as these higher costs might be passed on.

Central banks so far have not signalled immediate interest rate increases, however it can be expected that rising inflation will cause central banks to act and hence increase interest rates eventually.

As leveraged loans are often floating rate they provide some protection against rising interest rates. Hence, in anticipation of higher interest rates, investors might consider increasing their allocation to protect against inflation. Thus leveraged loans are positioned to benefit from rising investor inflows in anticipation of increasing interest rates.

As described above the volume of leveraged loan issuances has significantly increased in the first half of 2021, this may reflect that investors might have taken the view that loans will be the primary beneficiaries in an environment where long-term interest rates move higher.

High yield bonds saw higher inflows during the pandemic, as alternative to equity and government bond volatility. Also high yield bonds continued to provide attractive yields compared to other asset classes. However in light of higher inflation and consequently rising interest rates, investors may be more cautious allocating to high yield bonds going forward.

While rising interest rates and inflation may increase financing costs for borrowers and affect lenders risk appetite White and Case does not expect terms and pricing to significantly change until there is substantial shift in interest rates. As inflation is now on everybody's radar the impact of increased inflation will have to be taken into consideration for analysing profitability and debt service capacity of potential borrowers.

White and Case highlights that inflation is only one of many factors impacting the corporate debt market. Levels of dry powder of private debt funds still remain significant and it can be expected that debt fund activity will remain high, even if interest rates and inflation do increase. Another challenge will be Covide-19 related costs of business, which might prove to be a dominating factor in the short term, rather than inflation.

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About Prime Capital's Private Debt Team

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.

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

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

www.primecapital-ag.com