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Corporate Debt

Newsletter Q4 2021

Corporate Debt Markets in Q4 2021 – Overview

> After a strong first half of 2021, Q3 saw a drop in European deal making given lower activity during the summer months.

> PWC reports 72 deals for Q3 2021 amounting to EUR 35bn (QoQ: -43%) as compared to 122 deals with a total volume of EUR 61bn one quarter prior.

> Driven by landmark deals in France and Spain, the Telecommunication sector saw a significant increase of activity to 13.5% (QoQ: +4.5%).

> The share of high yield issues across sectors was more evenly distributed compared to Q2 with Technology and Service sectors being slightly more dominant (29% of total deal volume).

> Lending standards on balance remained unchanged in Q3 for the second consecutive according to the latest ECB survey.

European Sub-IG Market

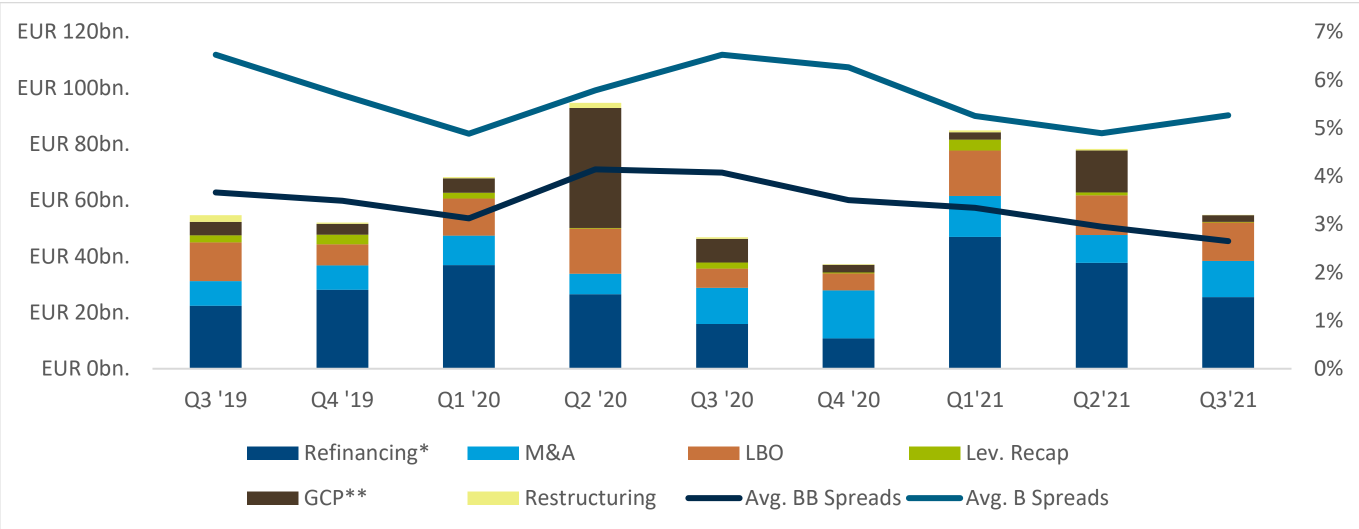

Figure 1: Volume of Sub-IG European debt markets (incl. leveraged loans and bonds) and average spreads.
Source: White & Case (Debt Explorer), PwC Debt Watch Europe Q3 2021

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Corporate Debt Market Europe

European Debt Market

According to Debtwire, the third quarter of 2021 saw a considerable drop in deal activity across Europe with total value decreasing from EUR 78.3bn in Q2 2021 to EUR 54.7bn in Q3 2021 (QoQ: -30%). In line with H1 2021 activity, refinancing has been the key driver of overall debt financing in the European market, although, refinancing volumes have been down considerable in Q3 2021 compared to Q2 2021 (Q3 volume: USD 29.5bn, QoQ: -34%) issuers were still interested in taking advantage attractive pricing to lock in lower rates and extend maturities. Acquisition financing, on the other hand, increased from EUR 10bn in Q2 2021 to EUR 12.9bn in Q3 2021 (QoQ: +30%). Similarly, buyout financing has been strong in 2021 with a total volume of EUR 44bn in the first nine months of the year, up 4% from the whole of 2020, with lenders taking advantage of strong activity in PE deal making.

The ECB reports in its Q3 bank lending survey, that on balance, credit standards of European banks for loans and credit lines to firms remained broadly unchanged for the second consecutive quarter in 2021. This indicates that despite the increasing supply bottlenecks, banks had on average a view on credit risk in line with the economic recovery of the H1 2021. However, banks expect a net tightening of credit standards for Q4 2021.

In its most recent Loan Market Commentary, Partners Group reports that in Q3 spreads for European new issue loans widened for the second consecutive quarter by 13bps to E+398bps. This is seen as the result of debt investors becoming more selective as well as several M&A transactions with unfunded tranches allowing lenders to demand higher spreads to secure buy orders.

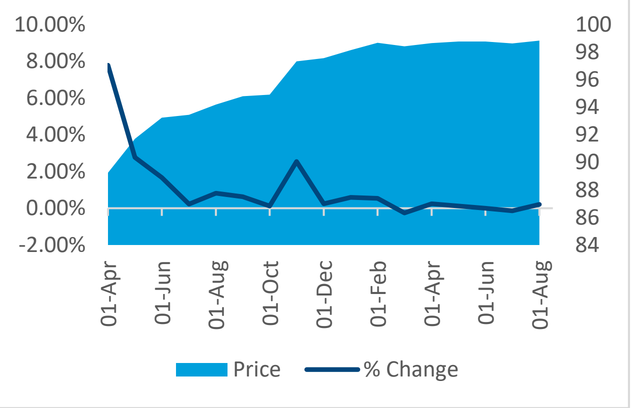

Figure 2 S&P European Leveraged Loan Index Returns
Source: S&P Global Market Intelligence

Sponsored deals remained dominant throughout Q3 with 124 deals conducted in the midmarket segment by private equity firms. This constitutes an increase of 134% compared to Q3 2020, demonstrating a strong recovery from the lows of the first year of the COVID-19 pandemic.

New issuance in the European high yield market have been supressed in the third quarter of 2021 due to low activity during the summer months. PwC reports 72 deals for Q3 2021 with a total volume of EUR 35bn (QoQ: -43%) compared to 122 deal and a volume of EUR 61bn one quarter prior. Yields-to-maturity have continued on average to trend downwards as many European countries still have stimulus packages in place in Q3.

DACH Debt Market

In their December guidance on the DACH region's countries, the OECD has revised their 2021 economic growth forecast to 2.9% for Germany (Q2: 3.3%) and Switzerland (Q2: 3.2%), respectively. The downward revision is the result of increasing concern regarding supply chain bottlenecks, increasing inflationary pressure, and continuous new waves of the Corona-Virus. However, growth in the region is expected to gain more traction in 2022, as growth rates of 4.6%, 4.1%, and 3% for Austria, Germany, and Switzerland, respectively, are forecasted. Despite a bleaker economic environment in H2 2021, overall deal activity in the DACH region has not disappointed during the first nine months of the year.

In its MidCap Monitor, GCA Altium reports a continuation of the strong LBO activity of Q2 in the German market with 38 transactions closed in Q3 2021. This brings the German deal count to 102 for the first nine months of 2021, marking a record year for sponsor backed activity in Germany. The financing deals continued to be dominated by the technology, and healthcare sectors, amounting to 60% (QoQ: -5%) of total deals during the first nine months of 2021. A strong momentum could also be observed for industrials and manufacturing as deal making in these sectors picked up. Although, market share of debt funds slightly decreased to 55% in Q3 2021, while bank lending picked up, debt funds continued to outpace banks with an overall share of 62% for the first three quarters.

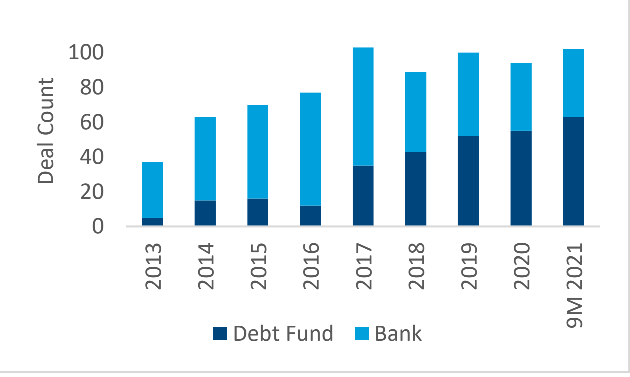

Figure 3: German mid-market financings Q1-Q3 '21
Source: GCA Altium MidCap Monitor Q3 2021

The continuous strong deal flow offers plenty of opportunities for lenders and demonstrates the economic resiliency of the region. However, with lenders and sponsors focusing on stable and matures business models, competition for deals in sectors like Energy of Industrials will further increase.

In the European market, Germany remains behind France and the UK in terms of deal activity. While the two countries make up 32% of new issues (16% UK, 16% France) Germany falls farther behind in Q3 2021 and makes up only 8% of European deals (Q2: 9%).

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Financing Conditions

With inflationary pressure increasing, a possible rise in interest rates might have a lesser impact on borrowers than expected, according to Fitch Ratings. Out of a tested portfolio of 280 leveraged borrowers only 6% would see interest coverage fall below 1.5x EBITDA. This would leave more headroom to borrowers to absorb a hike in rates. However, refinancing risks are more imminent for sharp rises in interest rates.

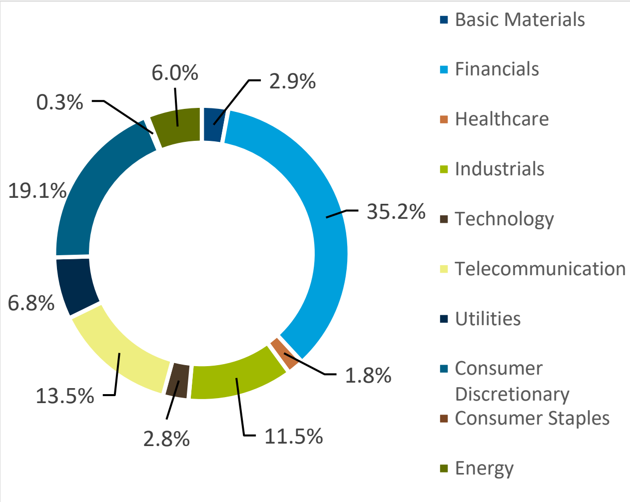

Figure 4: High Yield Volume Europe, Q3 '21 Sectoral Split
Source: PwC Debt Watch Europe, Q2 2021

While the share of the Energy sector shrank considerably in Q2, increased deal activity in the third quarter has led to a doubling in share to 6% (Q2: 3%). Consumer discretionary increased shares as well to 19.1%, up 3% QoQ. This demonstrates continuous improvement of the economic condition during the summer months as COVID-restrictions were eased throughout Europe. Similarly, the share of Consumer Staples dropped from 11% in Q2 2021 to 0.3% in Q3, showing some normalization of the traditionally less leveraged sector as the share of new issuance reaches pre-COVID levels (Q1 2020: 1%). The share of other sectors remains mainly unchanged, with Financials making up more than one third of all issuances.

Record-Year for Private Equity

Already the first half of 2021 pointed towards large deal volumes in PE and despite a slight decline in Q3 the trend continued paving the way for a record breaking deal volume in Europe as well as in the DACH region in particular. The deal volume reached a quarterly all-time high of EUR 98.3bn in Q3 2021, according to Abrdn. With the second largest deal of Q3 being the acquisition by CPPIB and BC Partners of German industrial ceramics group Ceramtec from Cinven for an estimated EUR 3.8bn. 2021 has already broken deal value records, with YTD transactions so far totalling EUR 289.3bn, which is higher than any previous full year.

After the above average buy-out volumes of Q2 2020 to Q1 2021, activity seemed to be stabilising in the second and third quarter of 2021; however at higher levels than observed historically. According to the Abrdn European Private Equity Barometer for Q3 2021, deal volume for buyout transactions in Q3 2021 was up just 2% versus Q2, with 357 deals. Deal value was also higher, rising to EUR 68.7bn (70% of total Q3 2021 deal volume), however this was still lower than the highest value EUR 76.2bn reached in the first quarter of 2021.

Pitchbook confirms a similar trend for the DACH region. Private equity's 2021 deal value reached EUR 87.4bn across Germany, Austria and Switzerland, driven by heightened middle-market activity.

According to EY's German Private Equity Deal Survey H1 2021, PE investors currently seem to have a competitive advantage in the M&A market, as strategic investors seemed to have recovered more slowly from the corona crisis. This is reflected in the deals closed. In the first half of 2021, strategists closed 250 deals worth EUR 13bn. This is a decline of almost 24 percent from EUR 18.2bn compared with the second half of 2020, making the first half of 2021 the third worst half of the past ten years, according to the EY survey.

This has impacted the exit options for PE investors. The survey shows that during the first half of 2021 year, PE investors have chosen the exit via the stock market with an above-average frequency, taking seven German companies, public during H1 2021. This compares to a maximum of two IPOs by in Germany per half-year. According to EY, all seven IPOs in the first half of 2021 raised a total of EUR 3.3bn.

While it might be expected, that inflation worries impact the deal volume going forward, the Midmarket-Private-Equity Monitor by FINANCE and DBAG, provides a more positive outlook. The survey has asked German private equity investors on how they prepare for an expected increase in inflation. According to the survey most private equity investors are not very worried about rising inflation and the impact on prices or financing costs. The majority of managers are only slightly concerned about inflation (61%). About 30% are not worried at all. Not even one in ten respondents (9%) is very worried about inflation. Nevertheless, most midmarket companies are already preparing for the possible consequences of inflation. The top priority for just under half of the respondents (46%) is an even stronger focus on non-cyclical or less cyclical sectors. Slightly more than one in four private equity managers surveyed (26%) say they want to do more "asset-light" transactions.

The trend is expected to continue and hence elevated deal volumes should provide ample opportunity for debt investors.

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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

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