MARKET REPORT

European Mid-Market Debt Update

Record Levels of Deal-Making in 2021 Despite Ongoing Pandemic

2021 Review

European Mid-Market Debt Update

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Executive Summary

Welcome to the third edition of our biannual European mid-market debt report, now being published under our new Kroll brand. Unsurprisingly, 2021 ended up being a record setting year, with M&A levels up 93% and debt transactions up 70% on 2020. Following a very strong H1, with deals up over 45% on H2 2020, many market participants enjoyed a well-deserved and much-needed summer break, to return to an exceptional H2, with deals up almost 40% on H1. Strong M&A deal making, underpinned by high levels of equity and debt fund dry powder continued to be key drivers, alongside relatively low default rates and regained investor confidence on the back of the COVID-19 vaccine rollout. Roughly 65% of mid-market leveraged loans in 2021 was M&A driven.

Leveraged lending continued to focus on businesses with low earnings volatility, with almost 65% of deals in Technology, Media and Telecoms (TMT), business services, financial services and healthcare. The UK saw the most activity, representing 37% of direct lending deals, followed at some distance by France, Germany and the Netherlands.

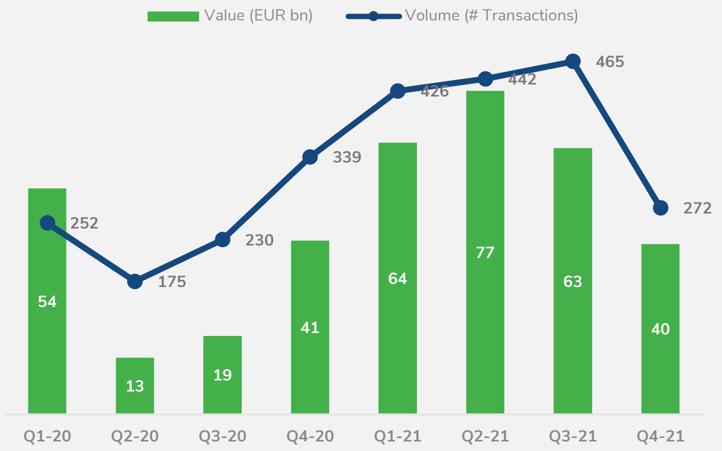
In this report we present the usual lender “league tables” for European direct lenders and UK banks and asset-based lending (ABL) providers. Debt funds maintained a 74% market share, and bank appetite for super senior revolving credit facilities (SSRCFs) remained heavily subdued in Europe.

The UK ABL market also saw an uptick in deal numbers, up more than 50% on 2020, but with most activity in the lower mid-market and with drawn portfolio levels for many lenders still below pre-pandemic levels.

Looking forward, the events in the Ukraine are front of mind and have cast uncertainty over the initial positive outlook we started 2022 with. While the mid-markets are generally less volatile than the syndicated loan and bond markets, investors and lenders will wish to assess the impact on businesses and the economy. This is compounded by preexisting concerns regarding inflation, interest rates, supply chain issues and high systemic levels of leverage on the back of COVID-19 support and loan schemes. We expect increased levels of credit scrutiny and fiercely competitive processes for high-quality credits, combined with an increase in restructurings and (dis)stressed refinancings.

Leveraged Loans – Western European M&A and Debt Deal Count

Western European M&A Value and Volume



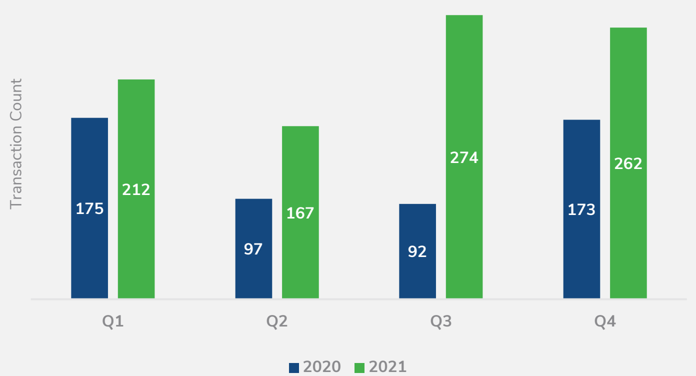
Source: Acuris Western Europe 2021 Review – Buyouts Market Overview & Financing Trends

A Record-Breaking Year for M&A/Buyouts

Western European M&A activity in 2021 was EUR 244 billion, representing an approximately 93% increase on 2020. Following a record start to 2021, the decline in Q4 2021 was due to supply chain and inflationary pressures. Key driving factors of M&A activity in 2021 included:

- Bullish market conditions as a result of pent-up demand for M&A (mainly from private equity).
- Strong supply of credit and debt fund dry powder, a consolidation of the impact of the pandemic, allowed lenders to have increased confidence identifying the right credits.
- Identification of new defensible sectors that proved resilient to the pandemic, becoming attractive targets.

Western European Mid-Market Debt Transaction Count



Source: Kroll 2021 Mid-Market Debt Surveys

With a Matching Record for Debt Capital Deployment

Fueled by a booming private debt market, we recorded 903 debt transactions in 2021, up about 70% on the 2020 entries.

As reported in our previous Market Update, H1 2021 saw a strong recovery for the debt markets, with a transaction count of 379, compared to both H1 2020 (272) and H2 2020 (265).

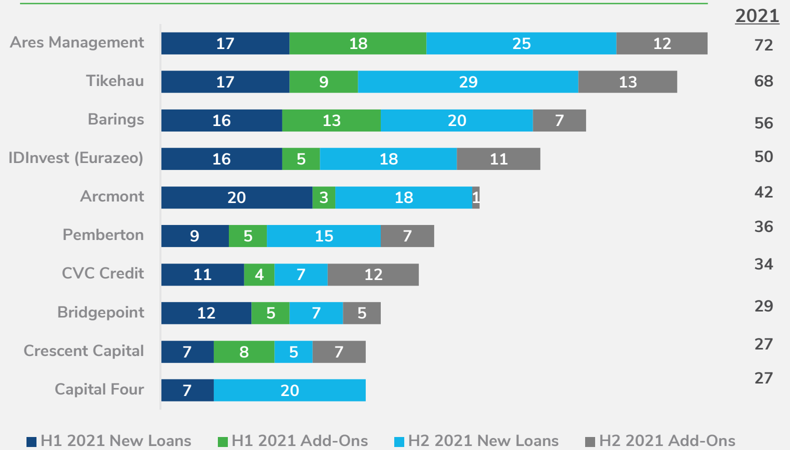
Following this recovery, H2 then strongly outpaced H1, with 536 transactions recorded.

Geographically, 37% of direct lending deals were completed in the UK, followed by 19% in France, 14% in Germany and 8% in the Netherlands (further detail in the Appendix).

During the summer, some debt funds paused on lending in the UK, having reached concentration and/or overall fund limits after heavy deployment in H1.

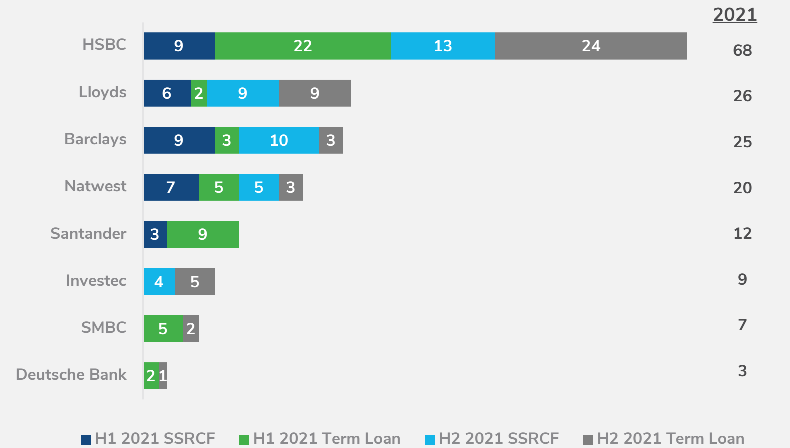
Leveraged Loans – Lender League Tables

Top 10 Funds Europe – 2021[1]



Source: Kroll 2021 Mid-Market Debt Surveys

Banks UK Market – 2021



Source: Kroll 2021 Mid-Market Debt Surveys

Familiar Lender Names Led the Way

In H1 2021, several European direct lenders almost doubled their deal count compared to H2 2020, and most followed with a strong H2, in line with the overall market trends described on the previous page. Tikehau, Pemberton and Capital Four had a particularly strong H2.

Overall, in 2021, Ares continued to be the most active lender, with 72 transactions, followed by Tikehau (68) and Barings (56). Tikehau led overall deal count in H2 with 42 transactions, with a majority of its deals being in France. Barings saw a greater European spread of deals.

A full list of survey participants and their respective deal count can be found in the Appendix.

Bank Deal Count up Strongly but SSRCFs Challenging

Most banks saw a big jump in deal count with respect to the number of senior term loans and SSRCFs compared to 2020, in line with the general market trend. HSBC widened its existing lead in the UK with two equally strong half-year periods.

While the absolute number of SSRCF's was up compared to 2021, obtaining them when the bank was not part of the term lending continued to be very challenging. This led to an increase in fund-underwritten bridge facilities and created some opportunities for ABL and specialist banks such as OakNorth to step into this gap.

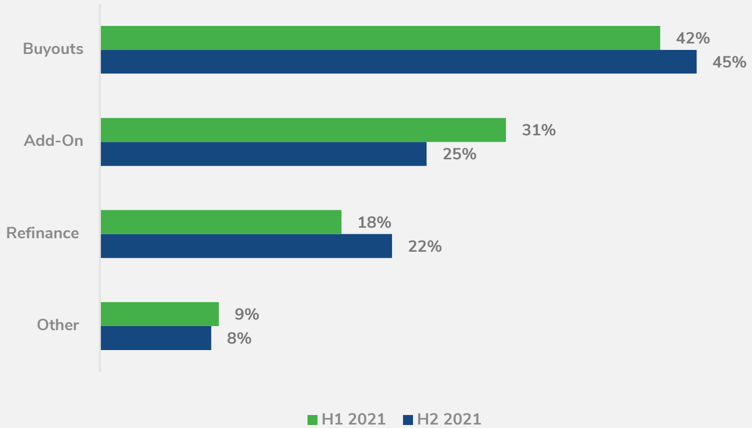
NIBC decided to discontinue its leveraged finance activities in all markets.

We saw a drop in the number of first-out last-out (FOLO) structures, noting that many lenders don't like them.

[1] Our survey focuses on completed mid-market leveraged loans with total debt between EUR 20 mn and EUR 300 mn.

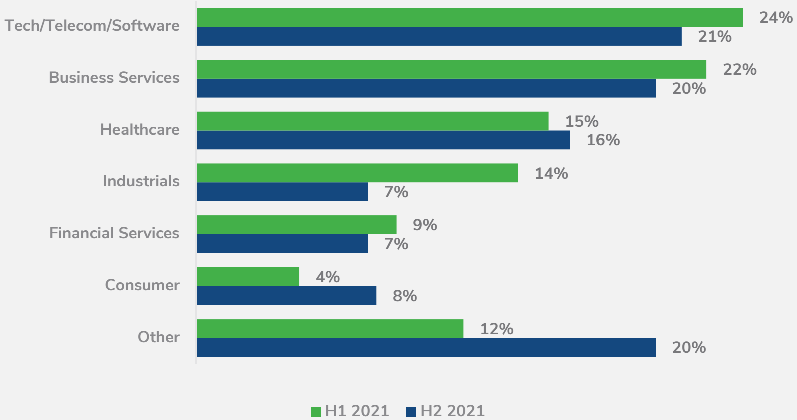
Leveraged Loans – Transaction Purpose, Size and Sector

2021 Transaction Purpose



Source: Kroll 2021 Mid-Market Debt Surveys

2021 Transactions by Sector[1]



Source: Kroll 2021 Mid-Market Debt Surveys

Strong M&A Activity Continues to Drive Debt Capital Deployment

- M&A activity (buyouts and add-ons) drove transaction purpose, representing 73% of transactions in H1 and 70% in H2.
- New buyouts accounted for 45% of transactions in H2 (up from 42% in H1), and add-ons represented a further 25% (down from 31% in H1).
- Refinancings increased slightly, from 18% to 22%.
- "Other" includes growth financings and dividend recapitalizations (noting that sometimes lenders classify these under refinancings).

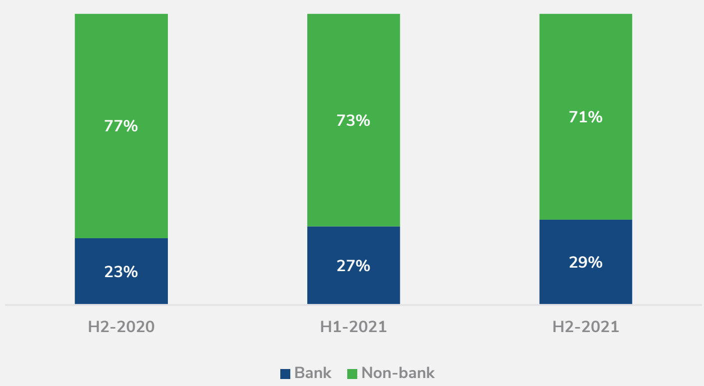
More Diverse Industry Spread but Defensive Sectors Continue to Dominate

- Business services, tech/telecom/software and healthcare continued to be the most popular sectors, as lenders continued to prefer businesses with low earnings volatility and recurring revenues.
- The data suggest that there was increased appetite for consumer retail and services in H2 2021 but reduction in activity in manufacturing and industrials, a sector more highly covered by asset-based lending.
- The sharp increase in "Other" reflects an increase in spread of deals among smaller sectors, such as leisure and hospitality, and education.

[1] Industrials also includes Manufacturing & Engineering. Consumer includes both Consumer - Retail and Consumer – Services.

Leveraged Loans – Fund vs. Bank Share and ESG Trends

Bank vs. Fund Market Share in UK



Source: Kroll 2021 Mid-Market Debt Surveys

Increase in Bank Lending Appetite in 2021, but Funds Continue to Dominate

- Strong M&A deal flow throughout the year fueled both debt funding and bank lending activity in H2 2021, with the relative share more or less flat.
- Funds continue to dominate market share in the UK mid-market, accounting for 71% in H2 2021, a small decrease from 73% in H1.
- The strong increase in the 2021 percentage of deals led by banks, compared to 2020, can largely be attributed to banks being more open for business compared to 2020, when they found themselves occupied with COVID-related portfolio issues and taking a more cautious approach on new-to-bank lending.

Growing Importance of ESG Considerations

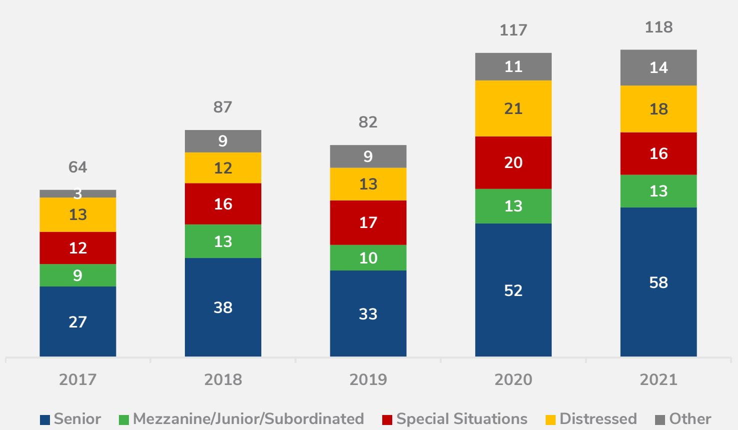
Fund Investors Drive Growth in Environmental, Social and Governance (ESG) Considerations and Ratchets

- ESG-linked interest margin ratchets[1] are becoming more prevalent, notably in the investor-driven direct lending market. Debtwire recently reported that ESG-linked unitranches now account for more than a quarter of total mid-market transactions.[2]
- Some credit funds (e.g., CVC Credit) will insist on ESG ratchets in all their deals. However, the mutual agreement of measurable KPIs in loan documentation, while working to a tight M&A deadline, often remains a prohibitive challenge.
- We do expect that industry norms will develop fast, resulting in higher implementation levels. We note that Kroll has recently formed an ESG practice that can assist both borrowers and lenders with identifying and monitoring key performance indicators (KPIs). We also note the emergence of green bonds in some countries.

[1] Typically linking a small margin step up and step down of, say 15 basis points, to ESG-related KPIs.
[2] Debtwire Par, February 3, 2022: "ESG ratchets become the new normal, but mechanism suffers teething issues - Mid Market Chatter".

Leveraged Loans – Debt Fund Dry Powder and Fundraising

Debt Fund Dry Powder (USD bn)

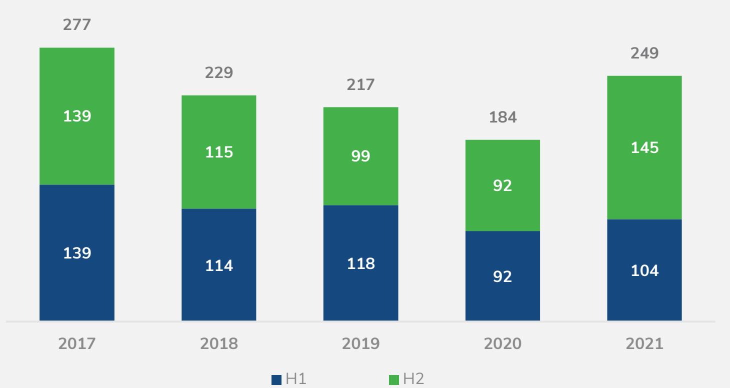


Source: Private Debt Investor, Fundraising Report H2 2021

Senior Dry Powder on the Rise

- After a sharp increase in dry powder from 2019 to 2020, the overall level was relatively flat for 2021. This is explained by the significantly higher levels of deployment in 2021, when taking into consideration the significant increase in fundraising for the same period (see below).
- Special situations and distressed dry powder decreased from a combined USD 41 bn in 2020 to USD 34 bn in 2021. This indicates a strong level of deployment in 2021 in these strategies but also potentially a reduced focus on fundraising.
- Dry powder for senior direct lending (also includes unitranche) increased by USD 6 bn when comparing 2020 and 2021, further emphasizing the increased allocation and investor appetite to less risky direct lending strategies. In 2021 Senior dry powder accounted for a record high 49% of all European dry powder.

Fundraising (USD bn)



Source: Private Debt Investor, Fundraising Report H2 2021

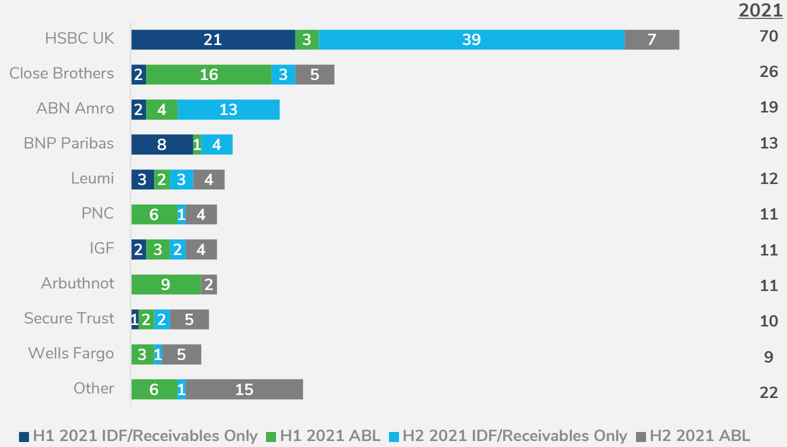
2021 Fundraising Records Second Best Annual Figure

- After fundraising hit a low of USD 184 bn in 2020 at the height of the COVID-19 pandemic, 2021 saw an impressive bounce-back, with almost USD 250 bn raised. This means 2021 was the second-best year for fundraising ever, beaten only by the USD 277 bn gathered in 2017.
- Senior debt fundraising accounted for 45% of total raised, as investors sought relatively safer asset classes due to ongoing uncertainty surrounding the global economy, geopolitical issues and inflation fears.
- Interestingly the number of funds vehicles decreased compared to FY21, meaning that for the first time the average fund size was over USD 1 bn - considerably higher than the vehicle size of USD 630 mn in 2017 (previous record setting year). This indicates that larger fund managers with established track records are gaining market share.

Note: We have changed the source data criteria and categorizations from previous editions. The selected data focuses on dry powder in private debt, where the funds' primary focus is Europe.

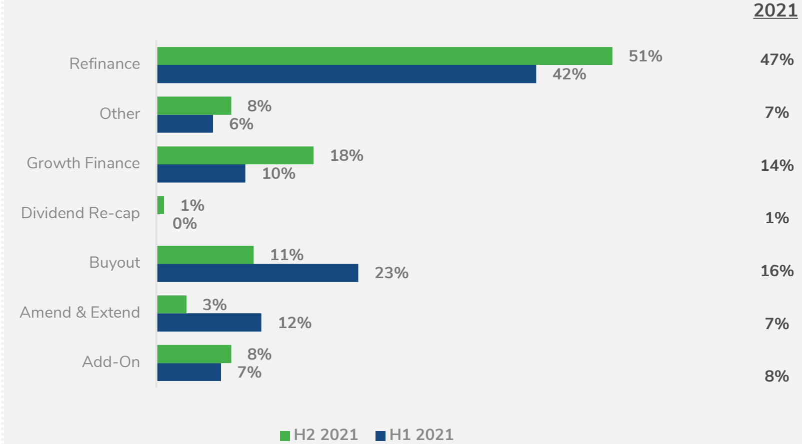
UK ABL Market: Deal Count by Lender and Loan Purpose

2021 ABL Deal Count[1] by Lender



Source: Kroll 2021 Mid-Market Debt Surveys

2021 ABL Deals by Loan Purpose



Source: Kroll 2021 Mid-Market Debt Surveys

Continued Rise in ABL Deal Activity

Sixteen participants reported a total of 120 asset-based transactions in H2 2021, up 8% on the 111 transactions recorded in H1 2021, taking the total for 2021 to 231 transactions, up 54% on the 150 recorded for 2020.

For H2 2021, in the Invoice Discount Financing (IDF)/receivables-only segment, HSBC UK (39 vs. 21 in H1) was again the most active, followed by ABN AMRO (13 vs. 2) and BNP (4 vs. 8), with a similar pattern for the full year.

In the multi-asset class segment, HSBC UK reported a strong increase in deals in H2 2021 (up from 3 to 7), with deals done by Close Brothers down from 16 to 5. However, for the full year, Close Brothers retained the lead in the ABL segment (21), followed by Arbuthnot (11), PNC and HSBC UK (10) and Wells Fargo (8).

Shift from Refinancing to Buyouts in H1 Reversed in H2

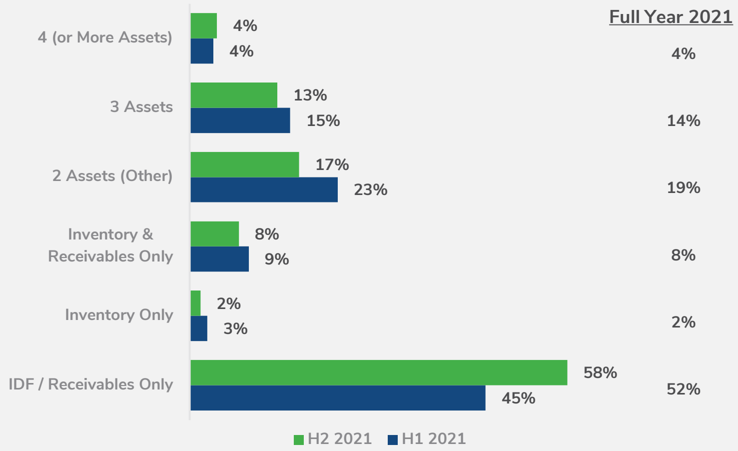
After a disappointing year for new client deals in 2020, H1 2021 saw a healthy improvement, with 23% of deals for buyouts (up from 9% in H2 2020) and only 42% for refinancing and extensions (down from 71%). This trend reversed in H2, when buyout financings dropped from 23% to 11%.

Many ABL lenders saw their drawn loan book shrink in 2020, by as much as 30–40% for some, on the back of lower levels of new deals and heavily reduced utilization levels. The uptick in deal activity in 2021 has only partially made up for this, and some participants still reported seeing their book 15–20% down on pre-pandemic levels.

[1] Our survey focuses on IDF/receivables-only facilities and multi-asset class ABL financings with total debt of between GBP 5 mn completed and GBP 250 mn.
Note: Other" represents the following lenders: BrealZeta CF, Cynergy Bank, Investec, Aurelius and FGI.

UK ABL Market: Asset Classes and Transaction Size

Asset Class Breakdown by Count



Source: Kroll 2021 Mid-Market Debt Surveys

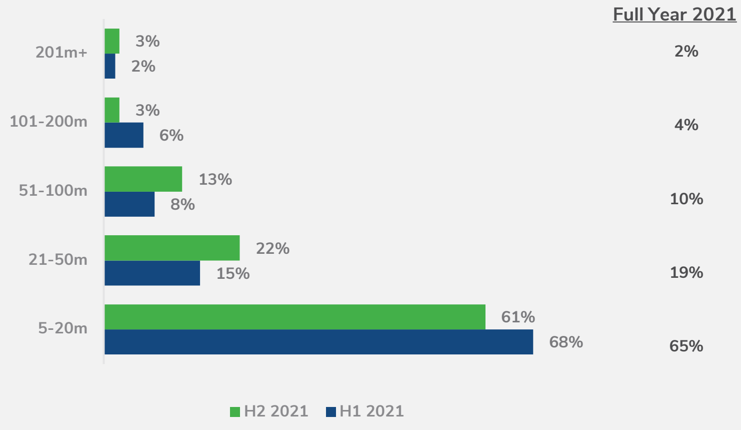
Increase in Share of IDF/Receivables-Only Lending

IDF/receivables-only deals dominated deal flow over multi-asset class transactions, up from 45% in H1 2021 to 58% in H2 2021 (for reference: 38% in H2 2020).

In the ABL segment, few transactions in H2 2021 were backed by three or more asset classes (19%), similar to H1 2021 (17%) and down from the 26% for H2 2020 reported in our previous update.

Reduced use of inventory lending on the back of the introduction of Crown Preference in late 2020 and a strong step back in the levels of Coronavirus Large Business Interruption Loan Scheme/Coronavirus Business Interruption Loan Scheme (CLBILS/CBILS) lending seen in 2020 may have been contributing factors.

Transaction Size (GBP)



Source: Kroll 2021 Mid-Market Debt Surveys

Emphasis on Sub-GBP 20 mn Deals

While deal activity focused on smaller transactions in 2021, as was the case in previous years, deals recorded below GBP 20 mn were down from 68% in H1 2021 to 61% in H2 2021 (65% for the full year). Deals recorded in the GBP 21–50 mn and GBP 51–110 mn segments were up in H2 compared to H1 (35% combined for H2, up from 23% in H1).

A notable H1 2021 deal was the Wolseley transaction financed by a unitranche (Atlantic Park) and a sizable ABL facility (underwritten by BNP). Investec completed three ABL plus term loan deals in H2, and Wells Fargo completed a sizable (GBP 100 mn+) financing for City Electrical Factors.

As reported previously, we hope to see more of these much-talked-about ABL plus unitranche deals going forward, also given reduced clearing bank appetite for SSRCFs. But we note that these will only be relevant in sectors with a large working capital requirement, and not all debt funds favor these structures.

Market Outlook

Deal Appetite Continues but Increased Uncertainty & Credit Scrutiny	• Events in the Ukraine have cast uncertainty over the initial positive outlook we started 2022 with. The mid-markets are generally less volatile than the syndicated loan and bond markets, and deal appetite continues, but investors and lenders will wish to assess the impact of rising energy costs, sanctions etc. on the economy and businesses, with some fearing a recession. • We expect increased levels of credit scrutiny and fiercely competitive processes for defensive credits due to a flight to quality.
Increased Lender Action/ (Dis)Stress Levels	• The era of free money (low interest rates, quantitative easing, various forms of COVID-19 government support and loan schemes) now seems to be behind us, and inflationary and supply chain pressures, combined with high levels of leverage in the system are likely to lead to increases in restructurings and (dis)stressed refinancing activity. The conflict in the Ukraine is likely compound these pre-existing drivers.
ESG Growing in Importance	• ESG margin ratchets are much talked about, but for the majority of deals these are not written into loan documents yet. Greenwashing remains a concern; however, given the strong focus on ESG by investors, we expect that this will change soon for PE and private debt funds. • Sectors not considered ESG-friendly are going to be under increasing pressure to improve this or they will find obtaining capital more difficult or more expensive.
Other Trends	• Debt funds are increasingly looking at new ways to deploy capital, and recurring revenue financing is one avenue several are exploring. • Compulsory interest rate hedging clauses have become the exception, a discussion interest rate hedging strategy may get back on the table. • We expect debt fund consolidation to continue in 2022.

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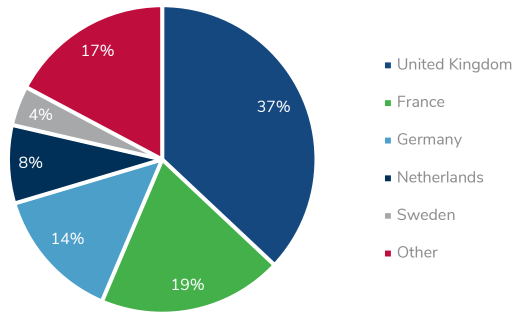
Appendix

Appendix – Further Survey Results and Data

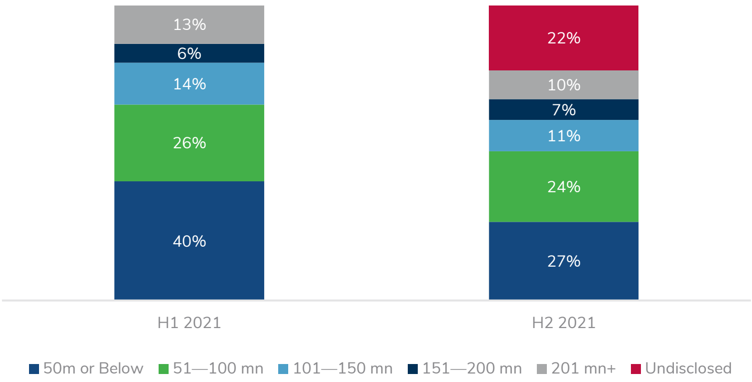
European Direct Lender Deal Count 2021[1]

Lender	H1 2021	H2 2021	2021 TOTAL
Ares Management	35	37	**72**
Tikehau	26	42	**68**
Barings	29	27	**56**
IDInvest (Eurazeo)	21	29	**50**
Arcmont	23	19	**42**
Pemberton	14	22	**36**
CVC Credit	15	19	**34**
Bridgepoint	17	12	**29**
Capital Four	7	20	**27**
Crescent Capital	15	12	**27**
Blackrock	13	11	**24**
Kartesia	8	15	**23**
Permira Credit	11	12	**23**
Bain Capital	7	11	**18**
Cordet Private Debt	9	8	**17**
Muzinich	10	6	**16**
Hayfin	2	13	**15**
Apera	4	9	**13**
Ardian	6	6	**12**
Alcentra	12	0	**12**
HIG Whitehorse	5	6	**11**
Proventus (PCP)	4	6	**10**
Ture Invest	10	0	**10**
LGT Private Debt	4	5	**9**
Pricoa Capital	4	5	**9**
Northleaf	5	4	**9**
Macquarie	4	4	**8**
Guggenheim	1	5	**6**
Five Arrows	3	3	**6**
M&G	1	3	**4**
TOTAL	**325**	**371**	**696**

2021 Leveraged Term Loans by Geography



Transaction Sizes[2]



[1]The following direct lenders also provided RCF facilities in 2021, in addition to the above deal count: Capital Four (3), Pricoa (3), Cordet (2), Dunport (1) and PNC (1).
[2]Transaction Sizes includes deals completed by banks as well as direct lenders.

Appendix – Further Survey Results and Data

Banks UK Market Deal Count 2021[1]

Lender	H1 2021 Term	H1 2021 SSRCF	H2 2021 Term	H2 2021 SSRCF	**2021 TOTAL**
HSBC	22	9	24	13	**68**
Lloyds	2	6	9	9	**26**
Barclays	3	9	3	10	**25**
Natwest	5	7	3	5	**20**
Santander	9	3	0	0	**12**
Investec	0	0	5	4	**9**
SMBC	5	0	2	0	**7**
Deutsche Bank	2	0	1	0	**3**
CIC	3	0	0	0	**3**
NIBC	1	1	0	0	**2**
TOTAL	**52**	**35**	**47**	**41**	**175**

[1] Some banks can provide unitranche loans and the following banks completed additional deals in Europe in 2021: SMBC (18), Investec (12), NIBC (9), Deutshce Bank (8, Natwest (6), HSBC (1) and CIC (1).

Appendix – Further Survey Results and Data

UK ABL Deal Count 2021[1]

Lender	H1 Deal Count	H2 Deal Count	TOTAL
HSBC UK	24	46	**70**
Close Brothers	18	8	**26**
ABN Amro	6	13	**19**
Natwest	14	0	**14**
BNP Paribas	9	4	**13**
Leumi	5	7	**12**
Arbuthnot	9	2	**11**
PNC	6	5	**11**
IGF	5	6	**11**
Secure Trust	3	7	**10**
Wells Fargo	3	6	**9**
Aurelius	3	3	**6**
BrealZeta CF	2	2	**4**
Investec	1	3	**4**
FGI	0	4	**4**
Cynergy Bank	0	3	**3**
Praetura	3	0	**3**
Blazehill	0	1	**1**
TOTAL	**111**	**120**	**231**

[1] UK deal count only. Several lenders also lent across Europe during 2021, and these have not been included in this table..

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