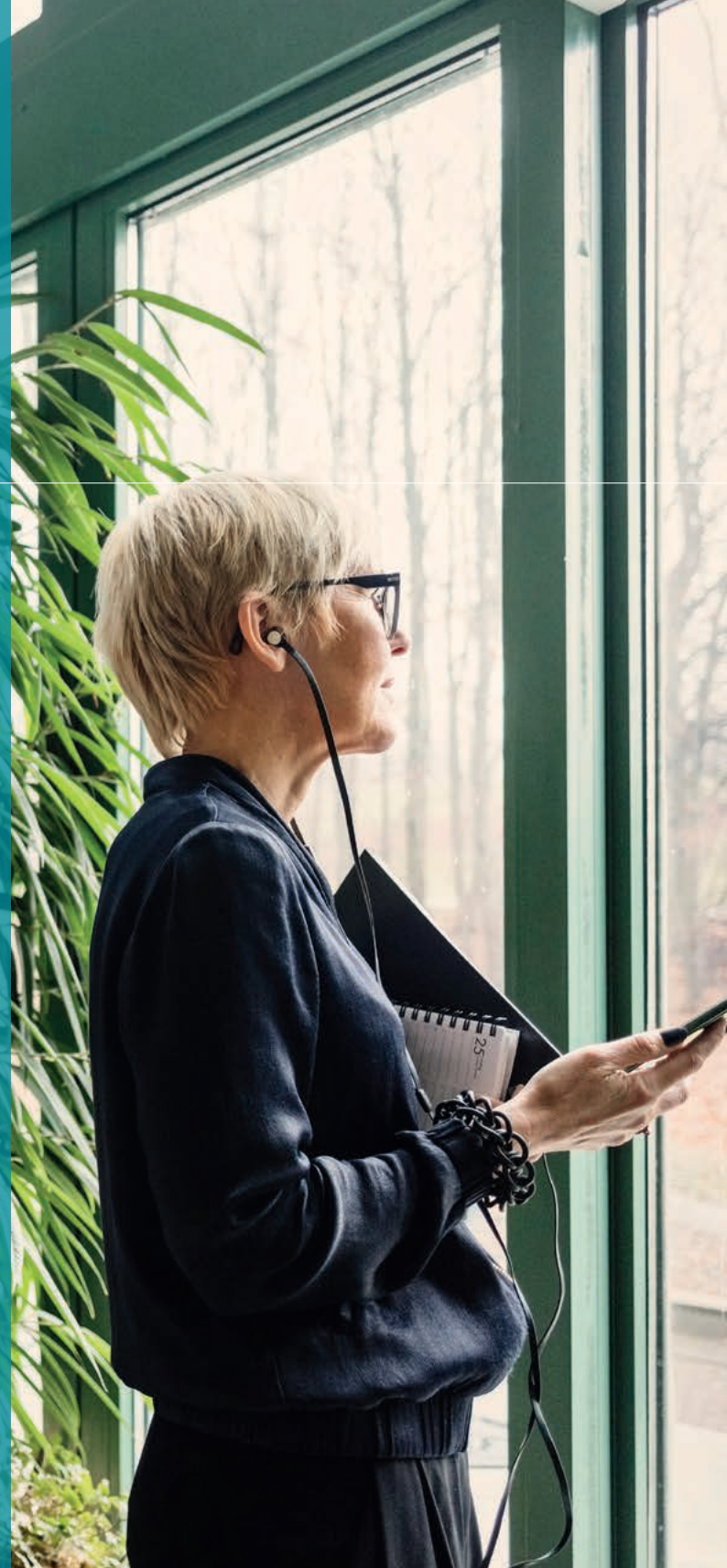


Debt Advisory 2023 Lender Survey

*Leveraged Finance
Debt Markets in the UK*





Executive summary

The UK debt markets were not immune to the global challenges experienced in 2022, with many factors having direct and indirect impacts on lenders of all types.

In particular, the movement in interest rates and inflation meant that there were changes to certain terms, and behaviour that had previously been well established.

As one of the largest independent advisers, Clearwater International's Debt Advisory team surveyed over 55 lenders operating in the UK leveraged finance market, to determine what these recent changes mean for borrowers in 2023.

The lenders surveyed were spread across banks and debt funds, covering a range of transaction sizes and multiple regions, therefore providing a comprehensive view of the UK leveraged market.

Key highlights included:

- 60% of respondents reported a reduction in leverage appetite of at least 0.5x EBITDA over the last six months
- Over the last six months, margins have increased by at least 25bps for c.80% of lenders, but arrangement fees have largely remained unchanged for 57% of lenders
- Hedging still does not remain compulsory for 74% of lenders in today's higher interest rate environment
- 40% of debt funds have increased their focus on the secondary market from six months ago
- The number of covenants per deal has remained unchanged at two or more for 80% of banks. Over 80% of debt funds are unchanged at one or two covenants



“Clearwater International’s Debt Advisory team surveyed over 55 lenders to determine changes in the UK leveraged finance market.

The lenders surveyed were spread across banks and debt funds, a range of transaction sizes and multiple regions, therefore providing a comprehensive view of the UK leveraged market.”



60%

of respondents reported a reduction in internal leverage appetite of at least 0.5x EBITDA over the last six months

40%

of debt funds have increased their focus on the secondary market from six months ago



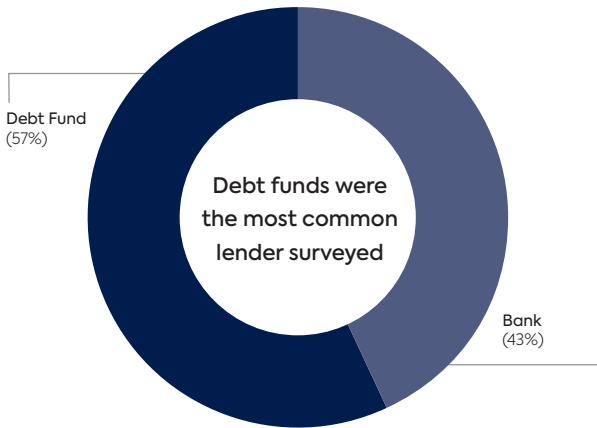
80%

of lenders reported an increase in margin of at least 25bps over the last six months

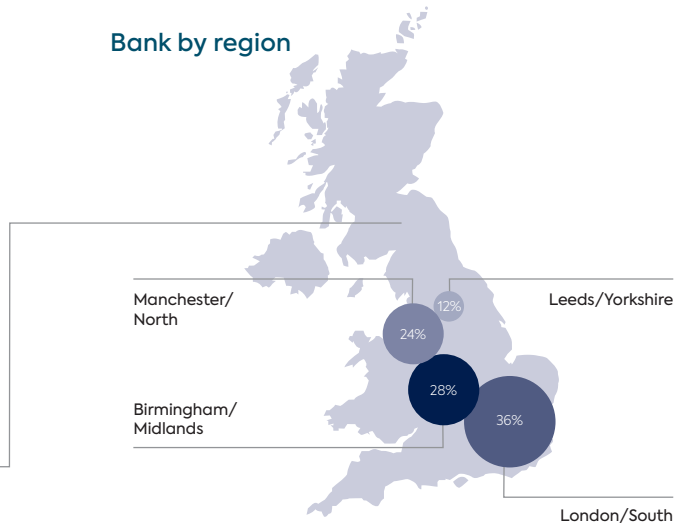


Lenders

Bank or debt fund



Bank by region



Credit processes

The majority of lenders have seen no change in the length of their credit processes, with c.33% noting these were now taking longer in the last six months.

This was reflected equally across banks and debt funds, with approximately a third commenting credit processes were taking longer.

Although these aren't always taking longer, borrowers are allowing more time for credit processes, to ensure the desired outcome is achieved. With more focus by committees on downside case scenarios, business model resilience, longer term forecasts and any exposure to cyclical risk that can't be mitigated through higher pricing.

Survey highlights

“

Parties are prepared to provide credit committees longer to consider requests, rather than the credit committee process itself is taking longer.”

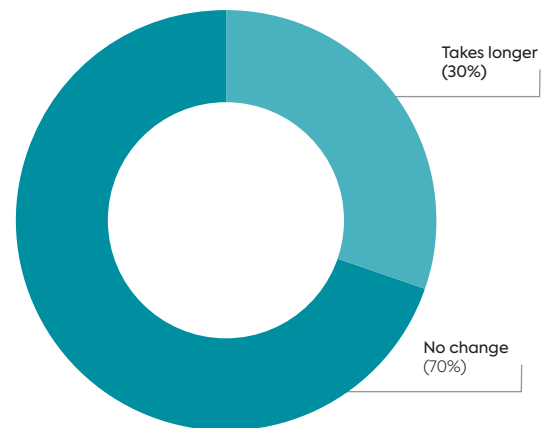
“

Any additional scrutiny by credit committees due to volume or credit environment matters, has been mitigated by efficiency improvements.”

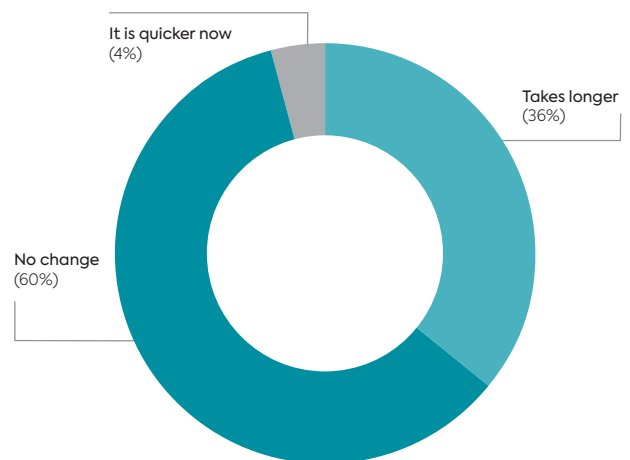
“

No change to timing, but more caution on ensuring credit analysis is complete and sensitivity work appropriately detailed.”

Debt fund credit process



Bank credit process





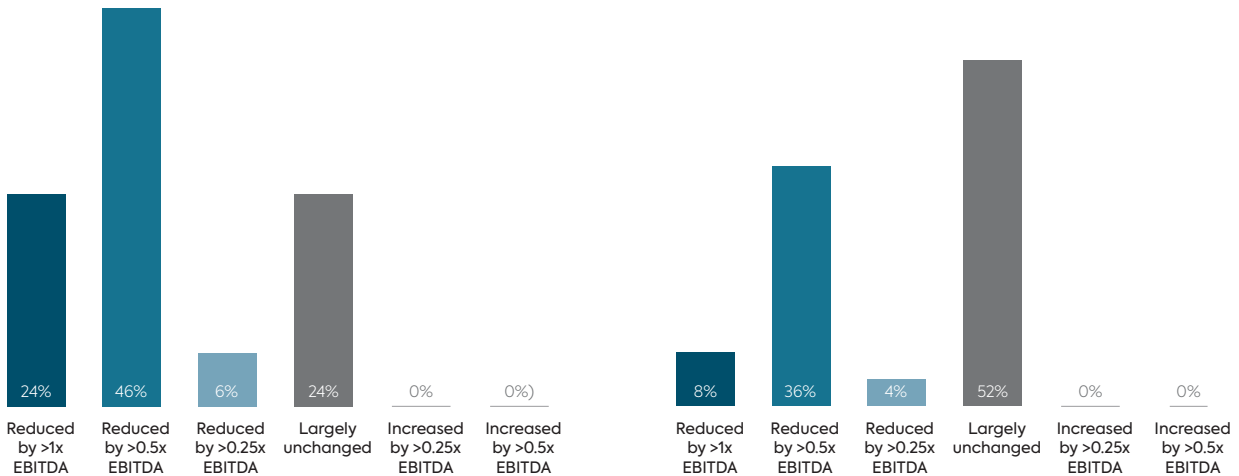
Leverage appetite

Leverage appetite has decreased over the last six months for more than 60% of lenders. This was more prominent among debt funds, with over 75% noting a reduction in leverage appetite.

For both banks and debt funds, any decrease in leverage appetite has been on average by more than 0.5x EBITDA. For the banks, this is spread evenly across the regions.

Debt fund leverage appetite

Banks leverage appetite



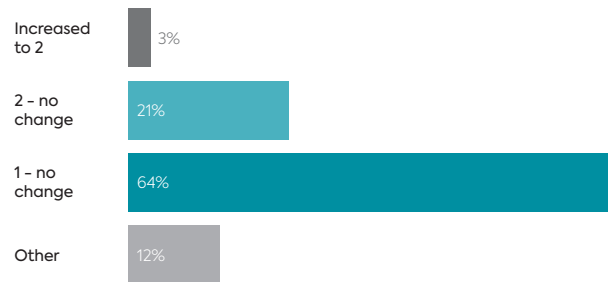
Financial covenant requirements

One of the areas of the UK leveraged market that has seen change over recent years, is the number of financial covenants and the headroom available to borrowers. In a low interest rate and competitive market environment, interest cover covenants became less valuable and the number of requested covenants reduced across the board, with more headroom being regularly granted.

With the UK leveraged market remaining highly competitive, 80% of banks have seen no change in the number of covenants required, with this remaining at least two covenants.

Similarly, 85% of debt funds have also seen no change, with this remaining at one or two covenants.

Debt fund financial covenant requirements



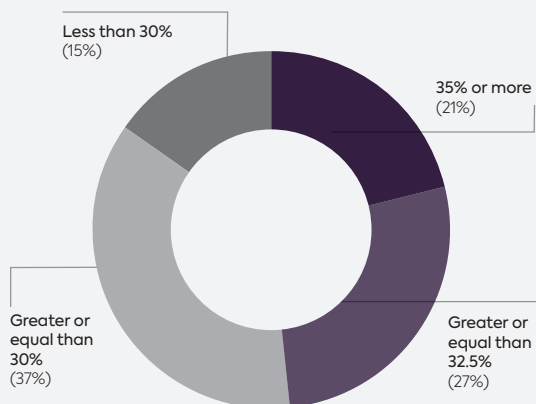
Bank financial covenant requirements



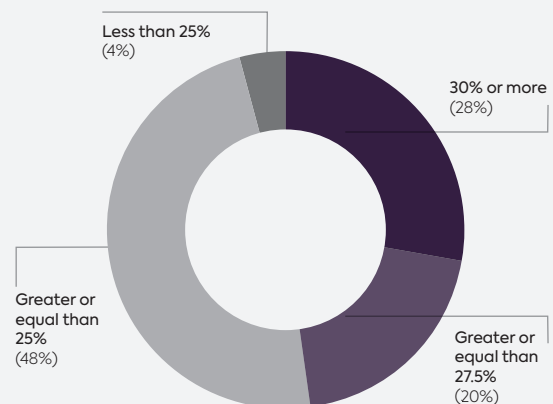
Financial covenant headroom

Nearly all banks noted typical covenant headroom of > 25%, with the average > 27.5%. Whilst 85% of debt funds had typical covenant headroom of at least 30%, with an average between 30% and 32.5%.

Debt fund EBITDA headroom



Bank EBITDA headroom



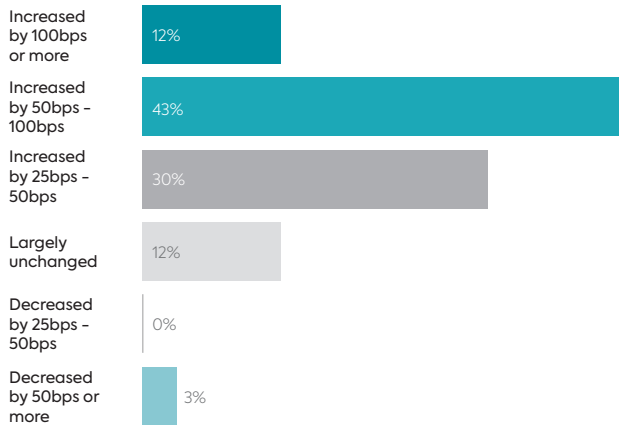
Margins

85% of debt funds have increased pricing, with over a third of respondents increasing margins by up to 50bps. A further third have increased margins by as much as 100bps.

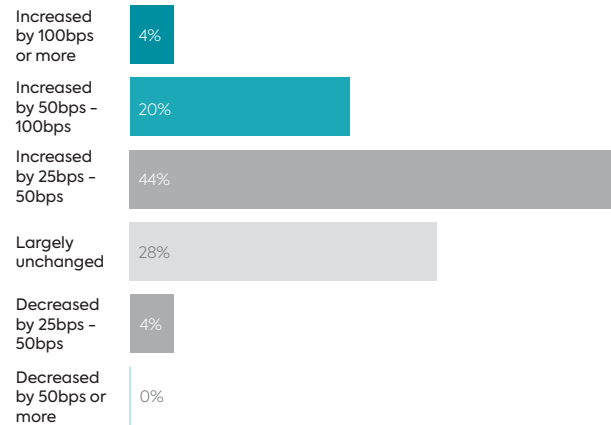
68% of banks have increased margins in the last six months, with an average of between 25bps and 50bps.

Despite these increases, nearly 75% of debt funds were not introducing more PIK into their deal structures at this time, though will still give this consideration depending on transaction situation.

Debt fund margin increase



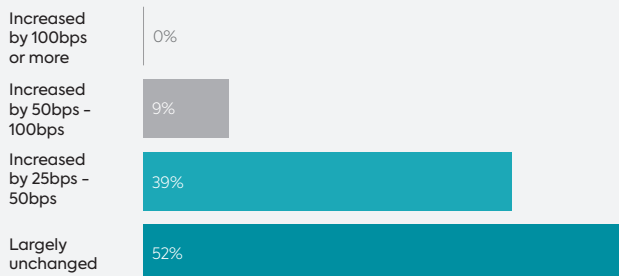
Bank margin increase



Arrangement fees

Lenders have largely kept arrangement fees unchanged.

Debt fund arrangement fee increase



Bank arrangement fee increase



Cost of funds

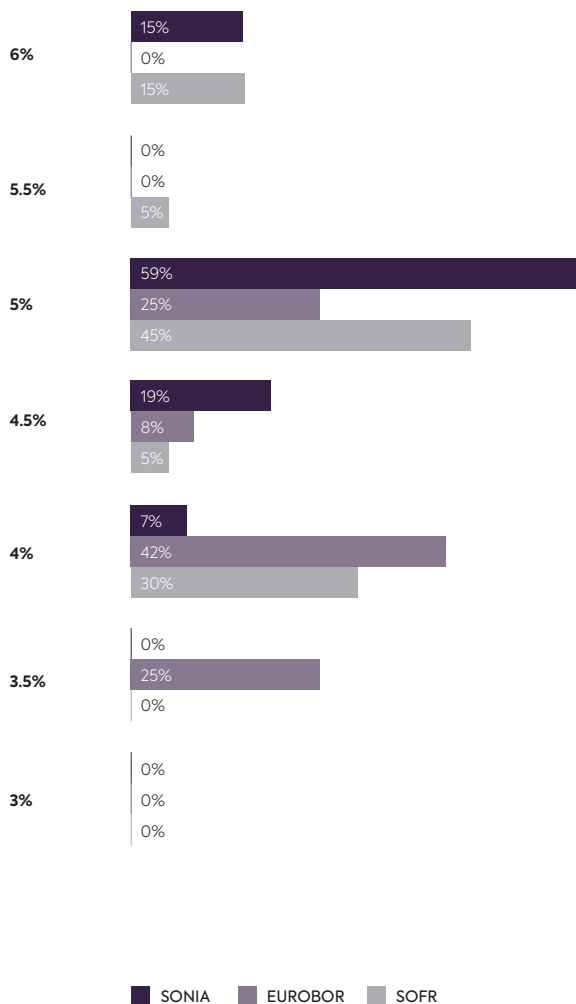
Stress testing the resilience of business forecasts and downside scenarios has become more of a key focus for credit committees, particularly on whether the business can withstand further interest rate increases.

To test this resilience, and ensuring the borrower can continue to service its debt obligations, most lenders have been assuming the following interest rate sensitivities:

SONIA - 5% EURIBOR - 4% SOFR - 5%

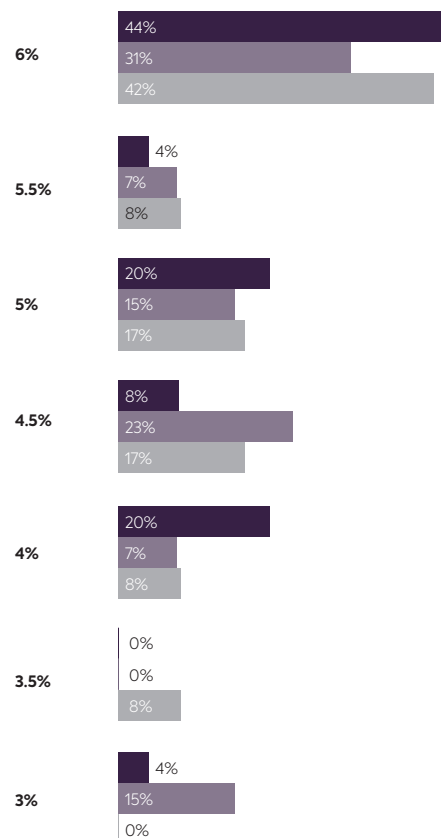
Debt fund costs of fund sensitivities

What cost of funds rate sensitivities are being used internally to stress test borrowers?



Bank costs of fund sensitivities

What cost of funds rate sensitivities are being used internally to stress test borrowers?



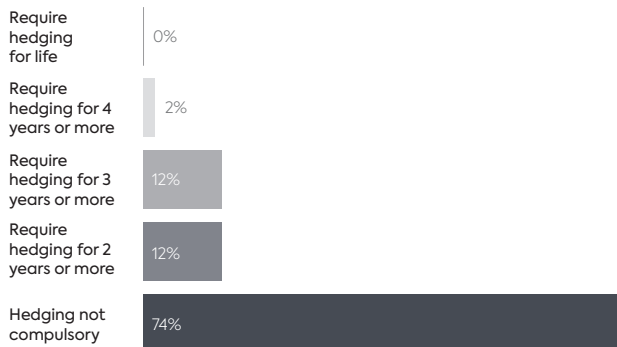


Hedging

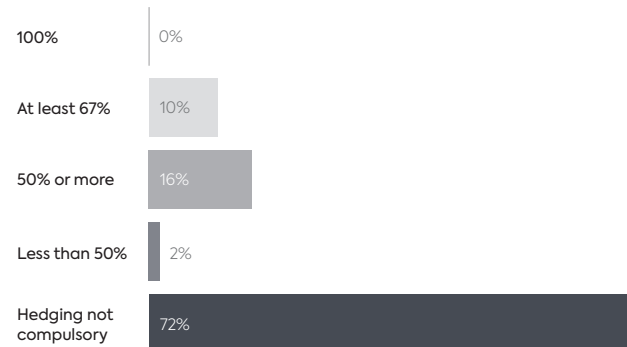
Despite the current macro and interest rate uncertainty, 74% of lenders reported they do not have any compulsory hedging requirements.

For any hedging that would be required, this would predominantly be for at least two years and 50% of the facility.

Facility term hedging requirement



Facility quantum hedging requirement



Due diligence requirements

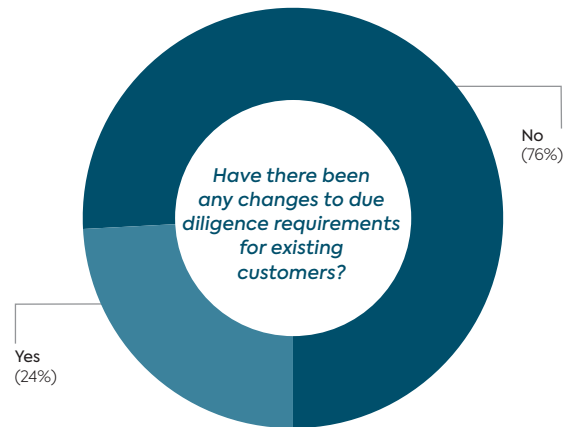
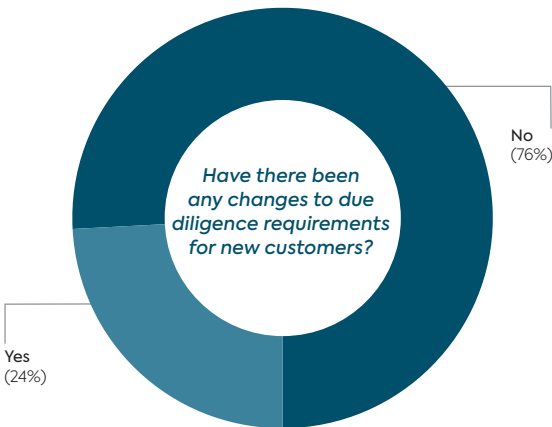
Due diligence forms a key element of a lender’s credit process and plays a significant role in the length of a debt raise process. It is fundamental for borrowers to be aware of a lender’s due diligence requirements, particularly in challenging economic environments.

Interestingly, more than 75% of lenders have not increased their due diligence requirements for new borrowers. This increases to more than 80% of lenders for additional debt provided to existing lenders.

Any increase in diligence requirements is predominantly focused on cash generation, available capital to support any performance downturn, and increased sensitivity analysis on inflation and interest rate impacts.

Anecdotally, lenders do not feel the need to require more due diligence, as more comprehensive work is being commissioned by acquirers.

Debt fund due diligence requirements



Bank due diligence requirements



Other key observations



Structuring EBITDA and EBITDA sustainability facing greater scrutiny, alongside structuring EBITDA conversion to cash

c. 75%

of lenders have not seen any change to their hold levels in the current market

“Any reduction on hold appetite is more driven by fund capacity than the current market.”



Nearly
40%

of debt funds have increased their focus on the secondary market in the last six months



Lenders seeking greater real time insight into liquidity positions, in addition to monthly MI



Cyclical sectors, such as consumer and energy, where pass through of inflationary impacts is difficult, are currently viewed as challenging by some lenders



Deal processes taking longer to complete in the current market, with greater focus on budgeting and forecasting accuracy

Conclusion

The UK debt markets continue to remain open and active, with significant amounts of capital to deploy. Lenders have adapted quickly to the current environment and are seeking to support existing borrowers, build new relationships, and back growing businesses.

There are clearly many factors to balance in today's uncertain market, ensuring the optimal level of funding is obtained to support strategic ambitions, whilst also not overburdening businesses in a higher interest rate environment.

It is also key that the right lenders are approached to support the funding requirements, and these are presented and communicated effectively with lenders.

As one of the most active and largest independent advisers in the debt market, with a team of over 40 professionals across Europe, Clearwater International Debt Advisory can provide borrowers with clear support to navigate these challenges.

Feedback

“Whilst debt appetite has not fundamentally changed, there has been an increase in the quality threshold to address likely challenges in a recessionary environment. There is increased focus on non-financial factors, such as existing customer and sponsor relationships, size and sector of businesses.”

“We have capital to deploy and look to continue to remain competitive on deals we view as attractive.”



Our team

Clearwater International's European Debt Advisory team can deliver seamless, integrated global advice to mid-market/owner-managed, corporate and private equity clients. They are supported by a number of high-profile senior advisers who are all former top tier executives, with relevant knowledge and a far-reaching network of contacts.

The team are one of the largest dedicated Pan-European team across the mid-market, with a growing headcount to over 40 dedicated debt advisory professionals across all of its international territories across 16 locations.

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Our recent transactions

Clearwater International's European Debt Advisory team have completed 20 transactions since the start of October 2022, which includes 10 in the UK alone despite market conditions, reflecting an active and current view of the market.

#SKS Business Services

raising debt and equity facilities from

KARTESIA

Refinancing

SYKES
HOLIDAY COTTAGES

raised debt facilities from

ARES

to support the acquisition of

Forest Holidays

Buy-side

VIESSMANN

refinancing of its existing syndicated loan agreement

Refinancing

VM Finance
Limited

raising debt facilities from

NatWest

Debt advisory

LIVINGBRIDGE

raised debt facilities from

BARINGS

to support the acquisition of

imagesound

Acquisition finance

Leading German multi-utility company

self-arranged bridge loan facility for the acquisition of a wind park portfolio with an output capacity of 365 MW

Acquisition finance

infraser
höchst

issued promissory notes

Financing

RAISE

raised financing to support the acquisition of

Blissim

Acquisition finance

DEA CAPITAL
ALTERNATIVE FUNDS SGR

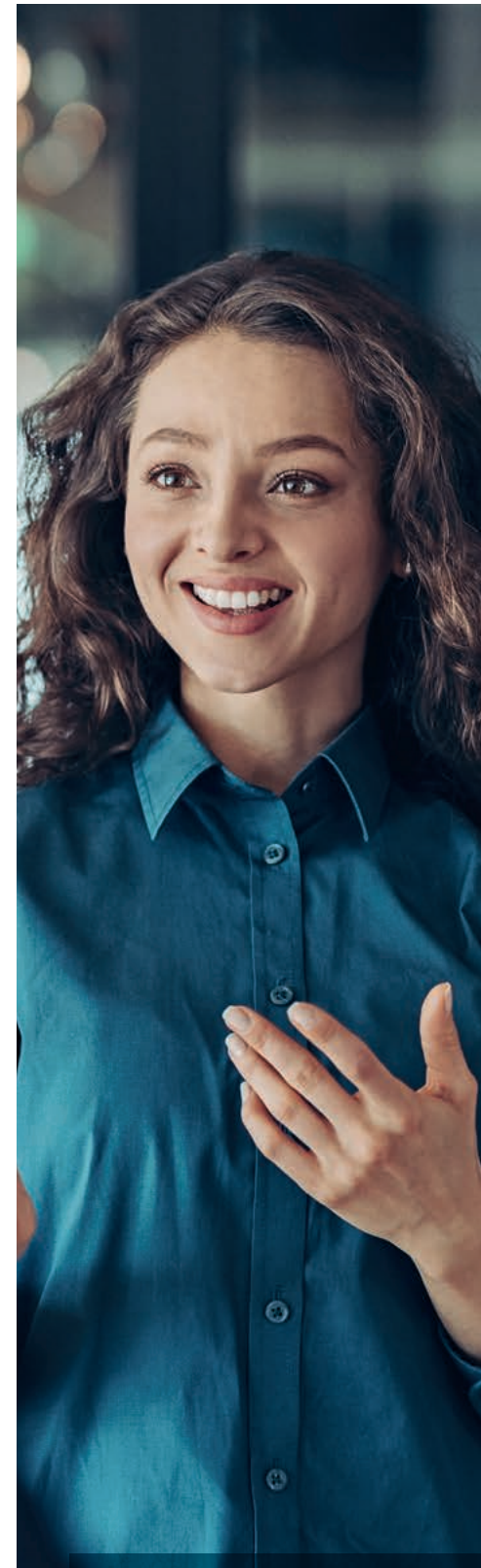
raised finance from

INTESA **SANPAOLO**
MPS **SPARKASSE**
CASSA DI RISPARMIO

to support the acquisition of

twinkl

Debt Advisory



Methodology

Research was conducted by survey platform Qualtrics by Clearwater International among over 55 senior decision markers across Banks and Debt Funds in the UK during 9th - 24th January 2023.

