



Look back, look forward

Debt Advisory Group

January 2018

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As you settle down back to work after a (hopefully) relaxing Christmas break, we wanted to usher in the New Year with some news and views for you from the debt world about the year just gone and the year ahead.

I hope that you find them interesting and that 2018 brings you opportunity and success.

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Nick Dodd

UK Head of Debt Advisory, Manchester

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Look back

2017 snapshot



David Reitman
Partner, London

and largely 'business as usual'.

We may question whether this will continue, but whatever awaits in the year ahead, 2017 produced another strong year for the KPMG Debt Advisory team, advising our clients through complex transactions and helping them to navigate the changing financing landscape.

Over the next few pages we highlight a selection of our standout transactions from 2017.

2017 was another year marked by uncertainty both domestically and internationally.

Historically, such tremors may have been expected to significantly impact lender appetite and the terms achievable by borrowers, but the reaction during the year was predominantly benign

>£12 billion

Value of debt raised



75

Number of clients advised



32

Professional advisors across the UK



Headline deals of 2017

We advised on a number of market-leading debt transactions last year

Ian Macleod Distillers – Asset-based refinancing

Deal led by **Bruce Walker, Edinburgh**

We advised Ian Macleod, the independent family-owned distiller, on the refinancing of its existing asset-based lending facilities, as well as raising the additional funding to support its growth plans.

- We led a competitive process and the company secured a new £80 million committed inventory-only asset-based facility on competitive terms with improvements in margin, financial covenants and overall flexibility compared to the company's previous facility.
- The five year deal also includes a £10 million accordion option, providing additional growth firepower.



IGas – Restructuring

Deal led by **Tim Nicholson, London**

- IGas, one of the largest onshore oil and gas E&P businesses, was facing liquidity and covenant pressures under its \$160 million secured and unsecured bonds. Complexity was increased by inherent oil price volatility, having multiple creditor groups (with competing objectives) and a hedge-fund backed investor (who held a blocking stake in the bonds) pursuing an alternate strategy for the Group.
- We helped the company deliver an innovative restructuring approach and stakeholder management programme that attracted new equity capital to the group, restructured and significantly reduced debt on improved terms, and successfully gained the support of all stakeholders (including the hedge-fund backed investor) to help deliver the group's strategy. The restructuring created a strong and flexible platform to help deliver considerable value from its portfolio.



Nisa – Asset-based lending

Deal led by **Chris Lloyd, Leeds**

- We acted as lead adviser to Nisa Retail Limited in securing a £120 million Asset Based Lending debt package.
- By converting the existing facilities to a full ABL structure, the refinancing has allowed the business to increase its debt facilities with the potential for further support if required. In addition, the new structure provides cheaper and more flexible finance than under Nisa's previous facilities.



Avant Homes – Incremental bank financing

Deal led by **John Miesner, London**

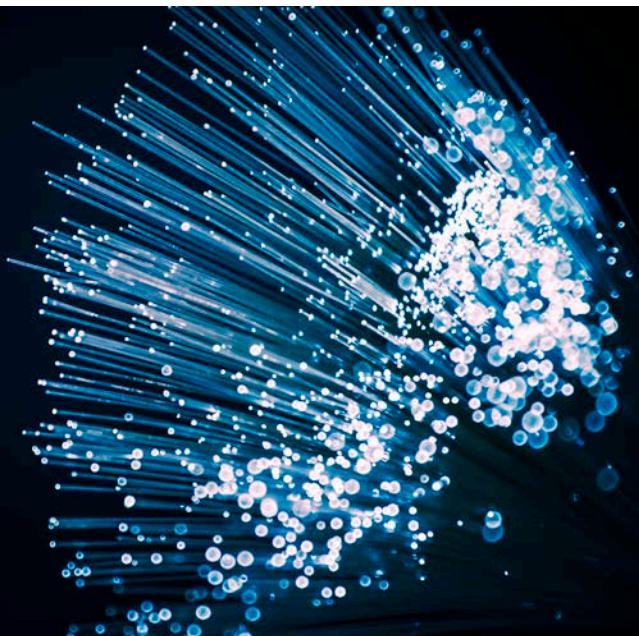
- Avant Homes is a developer of contemporary design led mid-market family homes in the North of the UK and was looking to expand its bank facility to accommodate its cornerstone ambitions to build 2,000 houses per annum in the short term; with further growth over the next 5 years.
- We advised Avant on the process to source additional lenders and add flexibility to its existing bank agreement. The £200 million facility was provided by a club of four banks and offers significant capacity to support the business through the next stage of its growth plans.



Giacom – Acquisition financing

Deal led by **Chris Lloyd, Leeds**

- We advised private equity firm Livingbridge on the debt financing to support its investment in Giacom, a specialist cloud services marketplace which provides cloud software, infrastructure and support services to IT consultants serving the SME market.
- This followed a lender education process undertaken for Giacom and LDC, the private equity sponsor which exited its majority shareholder position.
- This marks the second Giacom financing transaction on which we have advised in twelve months.





Look
forward



Introduction to 2018

“

Credit markets were largely benign in 2017 and while we believe 2018 will see increased scrutiny and a more cautious approach to risk, a good credit proposition will still attract competitive financing.

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Nick Dodd
UK Head of Debt Advisory, Manchester

So what lies in store for the UK credit markets in 2018?

With the external environment showing signs of strain, whether via UK consumer spending and debt, a disappointing Christmas for retailers or who knows what next in the political arena, can we expect the credit markets to buck the recent trend of delivering an unexpectedly benign reaction to uncertainty and change?

Here is our view. A more cautious approach to risk and closer scrutiny of existing exposures will continue the move towards higher pricing and tighter terms for corporates as lenders and debt investors look to ally the continuing desire to put funds to work with potentially increasing concerns about risk.

We wouldn't be surprised to see a clearer division between the sheep and the goats as some borrowers find the markets unwilling to support them on anything other than what will feel like punitive terms.

But let's not get too carried away.

The reality is also that banks have stronger balance sheets, there remains a lot of liquidity available in the fund and debt capital markets and interest rates are still at historically low levels. The overall supply-

demand dynamics continue to favour borrowers, with a broad (and ever increasing) range of options and markets available. Notwithstanding the above, competitive funding should remain available for good credits that can adapt to the changing circumstances of their market and the wider world, while presenting a clear and thoughtful credit proposition.

So don't dwell too much on the 'known (or indeed unknown) unknowns' and remember that the economy needs access to credit to thrive and that we enter 2018 with an ever-increasing range of lending sources with the capital to do just that.

Market and sector focus

Large Corporates



“ We are seeing signs of greater conservatism creeping into lending decisions, driving increasing focus on returns and highlighting the continuing importance of a strong credit story... ”

James Hatton

Director, London

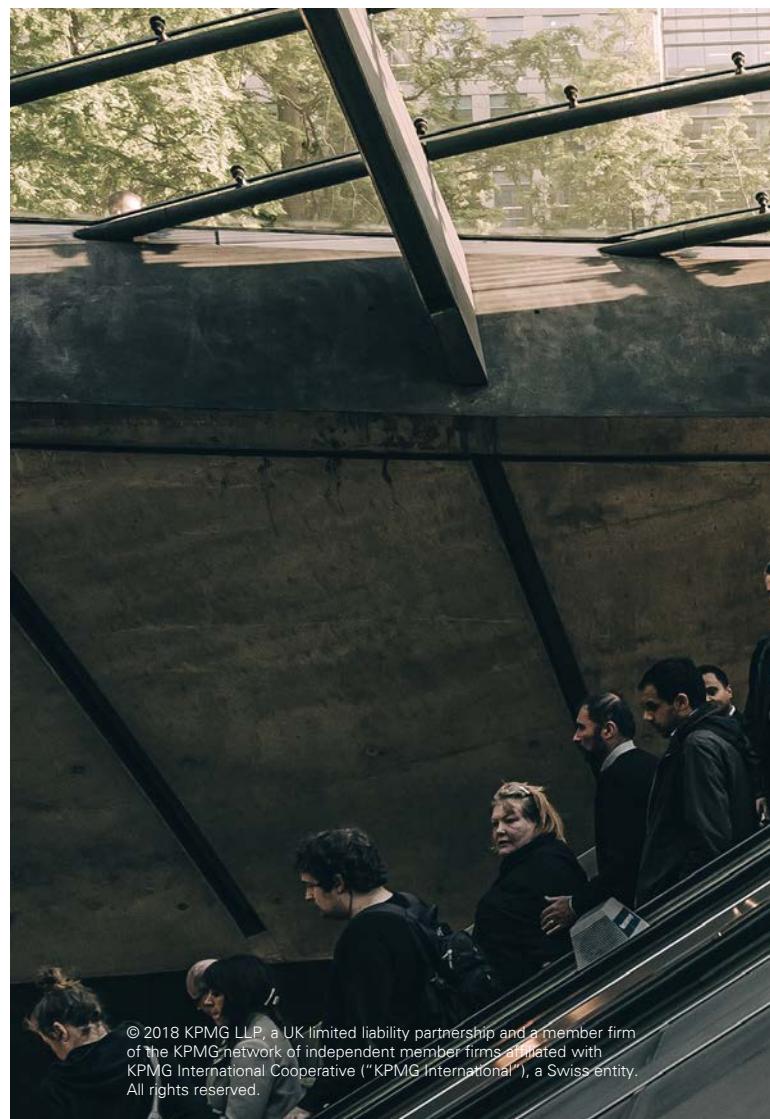
Against the backdrop of continued Quantitative Easing, including the ECB's announcement that its own programme will run until at least September 2018, strong demand has been maintained in the public bond markets, providing liquidity and supporting low yields.

However, in the UK bank market, we are seeing signs of greater conservatism creeping into lending decisions.

Regulatory changes, for example through the upcoming implementation of IFRS 9 and the increasing of the Countercyclical Capital Buffer set by the Bank of England, will see increased provisioning and capital requirements for UK banks.

Alongside these, UK bank ring-fencing and a significantly increased focus on returns have driven more selective UK bank participation, with certain lenders actively exiting long term lending relationships (even mid-term), and upward pressure on pricing and ancillary fee requirements.

International banks are taking the opportunity to increase their own participation in the UK syndicated loan market, unimpeded by ring-fencing regulations and with a real advantage over the UK competition. This is a trend that we expect to see continuing going forward.



Mid-Market



Zoe Clarke

Director, London

“ ...But with such strong lending conditions, greater access to liquidity and the sustained development of alternative funding sources continue to drive highly competitive terms in the mid-market for good quality borrowers. ”



With such strong market conditions, mid-market borrowers were able to capitalise on strong lending conditions in 2017. Liquidity has driven increasingly competitive behaviours between lenders and the strongest companies have continued to be able to take advantage of local bank markets where complacency has been seen to cost incumbent banks.

However borrowers should be aware of headwinds causing some uncertainty and changes in lender appetite and behaviours in the mid market:

Lenders are becoming increasingly sector focused when assessing credit quality and outlook, becoming more selective in the sectors they will support.

- A combination of low pricing and increasingly rigorous focus on returns is leading some lenders to re-evaluate their support.
- Whilst banks remain the primary debt market, an abundance of alternative funding sources – credit funds, private placements and asset based lending to name a few – are providing mid market borrowers with greater optionality and an ability to tailor their funding sources to meet their needs.

So there remain opportunities for mid market borrowers to lock-in what are likely to be ‘top of the market’ terms as well as to diversify their funding sources but given the headwinds, there is no certainty as to how long this benign window will last.

Higher Education



“In the HE sector, lending appetite is strongest for top-tier institutions. But for others, financing can be more challenging and universities should start planning their financing strategies early.

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Marc Finer

Director, London

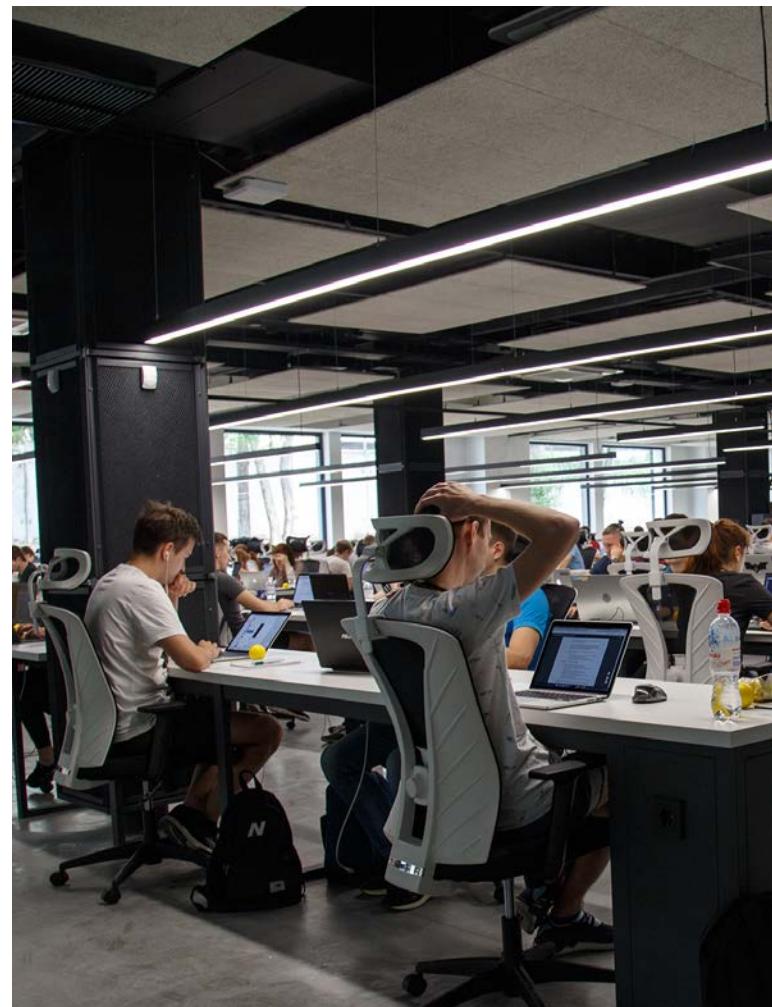
Against a backdrop of structural change in the Higher Education (HE) sector, many universities are investing heavily in their academic and residential estates to enhance their competitive position and the student experience. University borrowing levels are increasing given the scale and strategic priority of this investment, with forecasts projecting a rise in sector debt to £12 billion by 2019/20 from £9 billion at the end of 2015/16^(a).

While Russell Group and other top-tier universities have accessed capital with relative ease, credit profiles vary significantly across the sector and financing processes are not always straightforward.

Key challenges include increasing lender scrutiny over business plans, and restrictive existing debt facilities which can give incumbent lenders significant leverage and potentially limit financing options for new debt. University governance requirements can also create additional stakeholder complexity in the process.

We expect strong borrowing activity by universities to continue in the year ahead. However given sector conditions, including a new regulator, ongoing policy uncertainty and the potential impact of the wider macro-economic and political environment, we would encourage universities with a potential financing requirement to start planning their financing strategies early to ensure they stay on the front foot.

Source: (a) HEFCE: Financial health of the higher education sector: 2016-17 to 2018 forecasts, published October 2017.



Retail



“ Over the last 18 months, few industries have experienced such a seismic shift in the trading environment as the retail sector. ”

Tim Nicholson

Director, London



A ‘perfect storm’ of weakening consumer sentiment, post-Referendum FX and inflation movements, cost increases (e.g., rates/living wages) and the impact of online disruption, has meant that many retailers have needed to sprint (let alone run) just to stand still.

It is not all doom and gloom. Those willing and able to adapt (particularly to the online opportunity) have been able to deliver compelling customer offerings and world leading efficiency. These players retain the support of lenders who remain keen to back growing businesses, notwithstanding broader sector challenges.

For others looking ahead through 2018, maintaining access to funding and liquidity is likely to remain crucial to delivering the stable platform required to accommodate the new market paradigm and deliver business improvement strategies.

We would expect robust cash management and effective financial covenant monitoring to be high up many board agendas to ensure actions are being taken to mitigate volatility and the associated funding risks this creates.

Retailers often have a complex web of credit stakeholders from lenders and suppliers through to credit insurers and rating agencies. In the face of sector headwinds, the level of scrutiny from such parties has undoubtedly increased and effective stakeholder management and communication will be crucial to maintaining support.

For those needing to refinance, telling a compelling credit story will be critical to maximising lender support and differentiating your business as a ‘have’ rather than a ‘have not’.

Technology



Guy Weaver
Director, Manchester

The technology sector in the UK continues to grow with an increasing number of deals making the headlines. Over the last 12 months we have completed a number of debt finance transactions for technology businesses such as GCI.

We have seen a number of lenders become comfortable with the dynamics of this sector such as the potential for high growth. This is particularly the case with Software as a Service businesses where lenders' appetite and debt capacity has been high.

Technology businesses cannot rely on the sector being 'in vogue'; they still need to prepare adequately for a debt raising process similar to other businesses to ensure they are successful. Lenders will want a detailed understanding of the customers, contracted revenue and customer loyalty as part of their credit process. A technology borrower looking to secure a highly leveraged facility can also expect detailed questions and diligence in relation to their underlying technology platform.

As the technology sector has grown, the number of lenders and available debt products has also developed. This is particularly the case at the smaller end, with a number of lenders now funding pre profit businesses through mezzanine style instruments. For a high growth technology business with a strong credit story, there has never been a better time to approach the debt market.

“ The technology sector continues to develop and mature, with greater numbers of borrowers meeting strong lending appetite, ultimately driving increasing dealflow and more innovative financing solutions. ”



Real Estate



Simon Mower

Director, London

“Real Estate remains an attractive asset class for the debt markets, notwithstanding the macroeconomic and geopolitical situation. The number of debt providers and options has continued to proliferate and the range of alternative sectors for them to lend to continues to grow. **”**



2017 has been an interesting year in the Real Estate debt markets. UK banks continue to lend, international banks have sought to increase their exposure and alternative lenders (insurance companies, debt funds and lending platforms) have continued to grow and take market share.

However, supply of new deals has been limited with a large underpinning equity base (often from overseas) meaning that lending into traditional core assets (those that are prime and cash generative) has become hotly contested.

The gaps in the market remain in development and alternative 'new generation' asset classes (PRS, Serviced offices, Serviced apartments, Retirement living etc.). The tastes of consumers and tenants are changing, driven by demographic trends, and we are expecting this to continue into next year and beyond – lenders will need to get their head around these markets to keep up and to continue serving their customers.

Private Equity



“ The appeal of greater returns in the leveraged spectrum continues to drive a competitive lending environment, particularly as banks have begun to push back into the market. ”

Peter Bate

Director, London

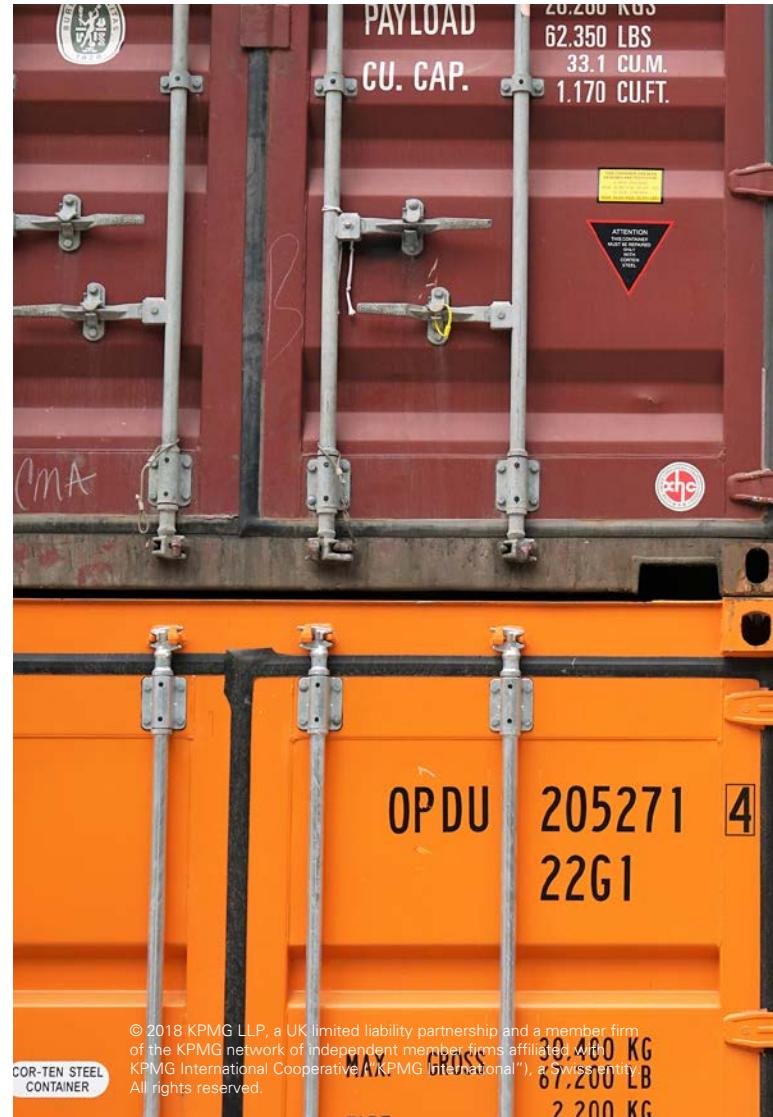
Whilst the last few years within the leveraged market have been seen as the years of the funds, where private debt lenders have taken market share to north of 50%, we might view 2017 as the period that senior debt and banks pushed back. The leveraged teams in banks still have large fee targets and balance sheets to put to work and just playing in super senior is not necessarily a sustainable business for many.

With valuation multiples remaining high across continental Europe and banks' appetite for increased leverage on deals undented, leverage is creeping steadily up in the mid-market. We have now started to see sub €200 million deals attracting higher or similar leverage to that achieved at the larger end market. Indeed according to LCD^(a), senior debt to EBITDA leverage on deals of €200 million or less was higher on average than the equivalent figure for deals under €350 million, at 4.8x versus 4.7x, respectively.

We believe this is nearly a full turn in average senior leverage for those deals of under €200 million this year. However whilst we see the increase in leverage on senior, there is not the same level of increase in total debt, so by definition, funds appear to be sticking to similar leverage but banks increasingly being aggressive.

So where does this take us to in 2018? With regulation from the ECB, ring-fencing and other restrictions, coupled with pressure in the economy, it is suspected that this must be the high water mark for banks and funds in terms of leverage. We may well see more loosening in documentation and headroom but we suspect that when we look back at 2017/18 this may well be the top of the market.

Source: (a) LCD 2018 mid-market outlook: Firm foundation for deals



Macro-economic



John Miesner

Director, London

“ It is a good time to lock in long term rates, but the benefits of flexible capital should not be underestimated. **”**

Despite November's 25 basis points increase in base rates, the market does not anticipate a material increase in interest rates in the short or medium term. Five year Gilts remain significantly below 1% and Mark Carney has signalled that the Bank of England is only targeting two more rate rises in the next three years.

In our opinion, the sense that borrowers need to rush to lock in low rates is somewhat overplayed – our advice is generally more nuanced, in that it is a good time to lock in long term rates, but the benefits of flexible capital should not be underestimated.

The overall supply demand dynamics continue to favour borrowers, with a broad range of different options and markets available. Lenders are increasingly willing to consider higher leverage and plumbing the depths of the credit spectrum in pursuit of activity and returns. This trend is exacerbated by the relative paucity of M&A and an air of caution in the market – there is little room for C-suite heroism with Brexit looming.

This is a difficult market in which to get a bad debt deal, but the difference between an average deal and a good one should not be underestimated. Increasing leverage, flexibility and lower pricing are available to those with a good debt advisor on board...

A global view

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During 2017 we observed a huge level of commentary about uncertainty and geopolitical change across the world's major economies. In reality, I suspect we are witnessing a paradigm shift to an ever more globalised, financial system with never before seen levels of interconnectivity and change.

”



Richard Dawson
Global Head of Debt Advisory

The consensus suggests that western economic growth will be relatively strong in the next 12 months, and Asia will again deliver stellar numbers. Question marks remain over the 'quality' of growth, and doubts grow on China's ability to maintain deleveraging and sustain its GDP trajectory.

Uncertainty, volatility and political change represent the new normal – an ever more globalised financial environment with never before levels of interconnectivity and change.

On the surface, changes to the traditional corporate lending environment appear relatively benign, however, how long before we see the issuance of a crypto currency Eurobond and block chain technologies revolutionise trade finance?

Lenders are employing greater rigor in assessing clients and more sophisticated, predictive risk management tools, leading to 'risk off' decisions, and we see choppy waters ahead in selected industry sectors and due to potential systemic risk events. So what are the key themes for the next 12 months?

- The outcome of the first round of the Brexit negotiations established many unknowns that will to create challenges for borrowers and lenders in the UK and across Europe. Brexit appears core to the UK's inflation woes, which may lead the BoE to re-assess their current interest rate guidance.
- Disintermediation from credit and working capital funds has not yet provided a wholesale challenge to traditional lenders, but capital in non-bank alternatives is growing exponentially and pricing more becoming competitive. Corporate borrowers are firmly in their sights.
- International politics is reeling from the collapse of coalitions, managing the impact of social media etc. Geopolitical instability leads to complexity for investors and in loan decisions – one lender recently requested a reduction in loan maturity to accommodate the UK's next scheduled election date!
- The sheer weight of regulatory change in financial services will continue to reduce loan liquidity – over time it will simply be more expensive for large banks to lend money.

- Chill winds continue to gather in the consumer credit market and our insatiable appetite for credit cards and unsecured loans are a financial headache that could easily turn into a serious migraine. Debt markets detest systemic shocks.

The development and renewal of global infrastructure has been neglected for a number of years; transport, energy, healthcare & waste systems are critical to sustainable economic growth. Financing infrastructure is a challenge and policy initiatives in the EU and US, China's 'Belt and Road' and the growth of private equity and debt funding alternatives are positive trends. Capital costs are eye watering and trickle down benefits significant.

The pool of debt capital continues to be plentiful, banks are well capitalised and borrowers in the right sectors can command competitive terms. However, systemic risk, sector disruption and regulatory pressure have the ability to interrupt and constrain loan liquidity.

Borrowers need to be constantly monitoring the financial markets, keeping existing lenders well informed and considering sources of diversification. Assess the opportunity cost of locking in duration and interest rates by refinancing early, and fix the roof whilst the loan markets shine...

Key contacts



Nick Dodd

UK Head of Debt Advisory
Manchester

T: +44 (0)161 246 4300
E: nicholas.dodd@kpmg.co.uk



David Reitman

Partner
London

T: +44 (0)20 7694 3113
E: david.reitman@kpmg.co.uk

kpmg.com/uk



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