Q3 2015: “Big trouble in little China” - a storm in the tea cup for the European lending market?

Welcome to the 2nd issue of the Debt Advisory Deal Reader, a newsletter offering insights on trends to investment professionals, management and business owners. We are pleased to provide commentary regarding relevant topics and keep you informed about developments at our firm and in the market.

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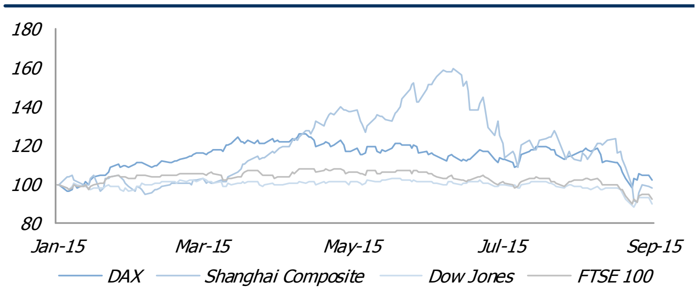
The past few weeks have not been for faint-hearted investors or lenders. As concerns were growing over the state of the Chinese economy, stock and commodity markets corrected sharply since their peak in June with the Shanghai Composite falling by almost 39%. Other stock markets echoed that trend with the German DAX dropping by 10% and the Dow Jones by 13% over the same period.

Neither the devaluation of the Yuan, the stock buying programme initiated by the Chinese government nor the reduction of the Chinese main interest rate form 4.85% to 4.6% would seem to have had any meaningful effect. A similar pattern could be observed at the commodities markets with the lowest prices observed since 2009, most notably the New York crude oil falling below USD 40 a barrel. This scenario raises the obvious question: What does this all mean for the lending markets?

Overview Stock Indices

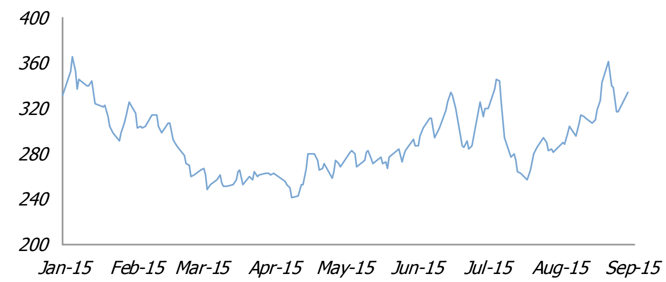


Indexed at 100 at 1st January 2015

Lending market not adversely effected

Key indices of the debt market show signs of an encouraging resilience: For instance, the 5y iTraxx Europe Crossover closed at 320 bps by the end of August, still far below the 1,120 bps observed during the Lehman aftermath in 2009.

Itraxx 5y European Crossover



Source: Bloomberg

The German 10y bund currently yields at 0.77% almost unchanged to its June 2015 level. A similar pattern can be observed at the HY-Bond market, where the annual yield of European single-B currently reads 6.73% at the end of August, only 50bps up from the end of 2Q15 and even 30bps lower than the 2014’s closing level. The current yield on double-B rated notes is at 3.91% - only 58bps higher than by the end of 2014. Clearly this is not what you would expect of a lending market in disarray.

Lenders still keen but cautious

To underpin the above, Lincoln International conducted a brief survey amongst a number of selected banks and debt funds active in the European mid-market. In particular we were curious to find out how the recent market developments have or might impact their credit decisions. Main findings are:

- **Lenders** claim to **remain open for business** with no major changes to their lending policy.
- Potential **borrowers with an exposure to BRIC countries and/ or cyclical sectors** like automotive and chemicals will **come under greater scrutiny**. In particular efforts to expand into China or Brazil and the resulting business plans will be questioned.
- On larger deals, **syndication desks** are currently **more cautious** resulting in a lower appetite for larger underwrites and wider market flex language.
- **Increased push back for dividend re-caps** is expected by some lenders.
- **Debt funds view** the **recent developments as** a **chance to promote their offerings**, as reduced underwriting levels and potentially increasing margins by banks enhance the attractiveness of their product.

Conclusion

The lending market has shown a strong resilience to the recent volatility and remains open. This is particular true for the European mid-market with debt financings in the range of ca. EUR 25 to EUR 150 mio.. For larger deals underwritings by banks are likely to become more challenging to arrange with syndication desks asking for greater flexibility regarding leverage and pricing. We expect Private Debt funds to take advantage of this.

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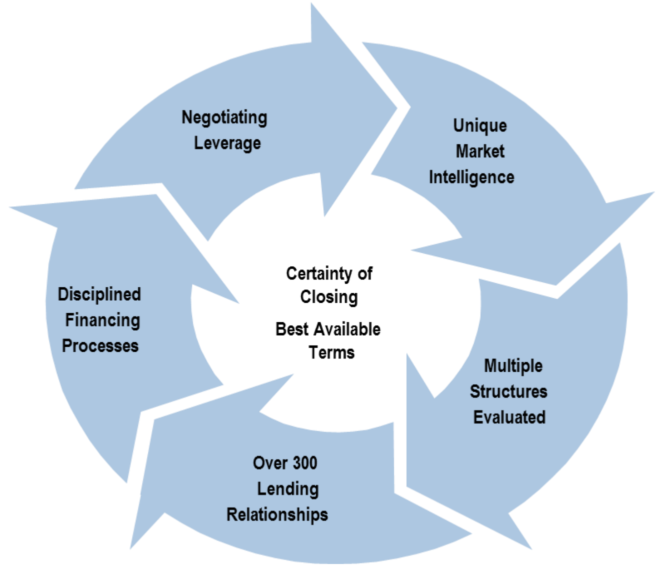
Bringing Efficiency to Middle Market Finance



Recent Debt Advisory transactions completed by Lincoln International

ADA Cosmetics International, a subsidiary of ARDIAN has acquired Pacific Direct (Creative Luxury Solutions) – Acquisition Financing	Teka – Advisor to the shareholders – Acquisition Financing	Oakley Capital Private Equity has acquired PARSHIP – Acquisition Financing	Quadriga Capital has recapitalized punker	Oakley Capital Private Equity has refinanced intergenia Aktiengesellschaft

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