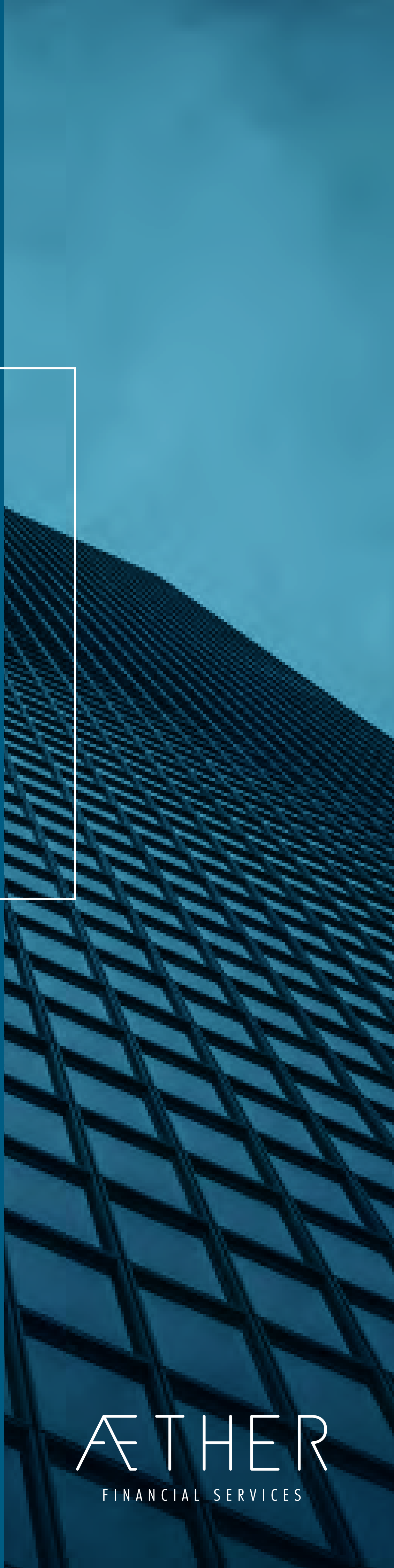
INDICE AETHER FS

UNITRANCHE FRANCE

EDITION
2023 FOURTH QUARTER

THE FIRST REFERENCE INDEX ON THE PRIVATE DEBT IN FRANCE

APRIL 2024



EDITO

2023 was a mixed year with a quiet first half for the world of Direct Lending and a hopeful second half (supported by a very active Q4).

Against the backdrop of rising benchmark rates and tense macroeconomic environment, advisers and borrowers took more time to select and optimise the debt structure of identified targets (with the return of mezzanine financings in particular). Debt funds, which are inherently more agile, seem to have lost their characteristic speed of execution, leaving the banks some time to study the deals.

In addition, as debt servicing has considerably increased for borrowers, leverage has had to be adjusted downwards. As a result, banks have managed to returned to the forefront with an attractive value proposition for leveraged finance.

Funds still managed to bounce back in the second half of the year though, with a promising month of July and a final quarter in their favour, helped by the stabilisation of interest rates and the inflation being tamed.

The levers have also adapted to the valuations applied. According to the Argos Mid-market index, valuations this year have fallen to 9.0x EBITDA compared to 9.9x in 2022, a drop of almost 10%. The fall in average leverage observed at closing correlates with the contraction of valuations in 2023, and more specifically in the second half of the year (3.99x in Q3 and 4.14x in Q4 2023 compared to 4.50x in Q3 and 4.34x in Q4 2022).

As it grows older, the Aether FS Unitranche France Index is in constant evolution to produce relevant indicators. Consequently, over the course of the year and in addition to the current index, cousins of the index will be appearing - several projects that will give you a different view of the market.

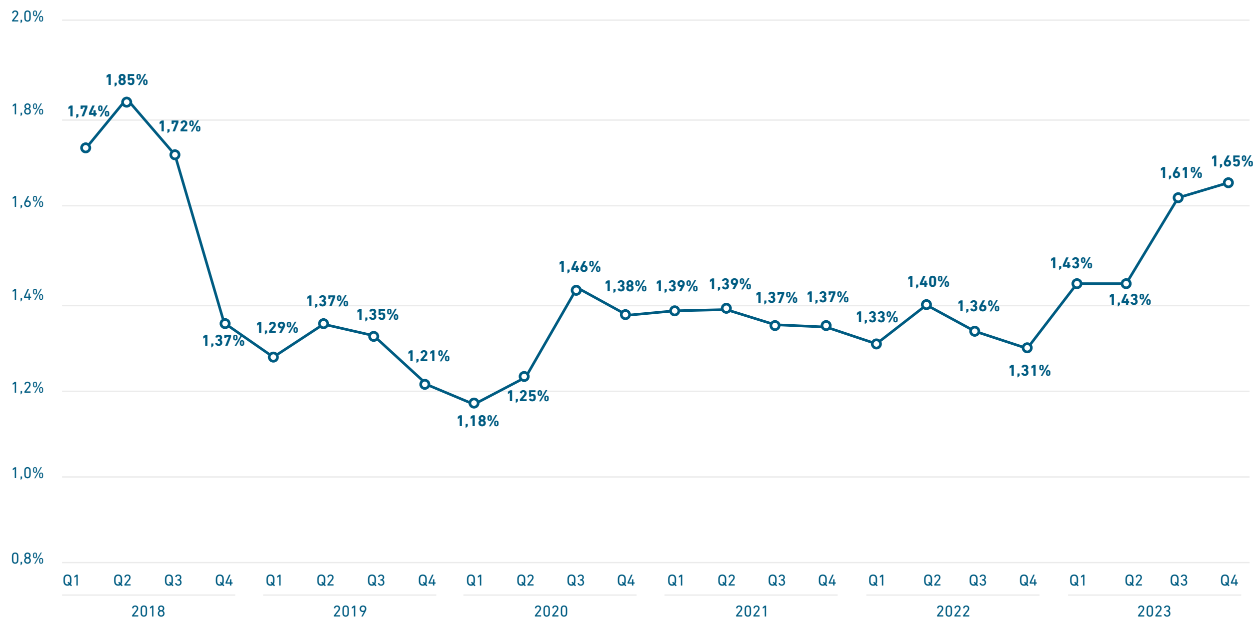
The first of these is an analysis no longer based on leverage and margins at closing over a rolling 6-month period, but a study of the 'live' portfolio, giving an insight as to certain sector's resilience and the corresponding level of leverage in real-time.

So watch this space...

Edouard Narboux
Co-fonder & CEO

INDEX AT Q4 2023

Margin/Leverage ratio average on a rolling 6 month period



In the final quarter of 2023, the Aether FS Unitranche France Index continued its upward trend, reaching 1.65% per leveraged round at closing, an increase of almost 26% compared to its level in Q4 2022. In a market that was more favourable to banks (as seen in the first two quarters), funds nevertheless managed to hold their own in the second half of the year.

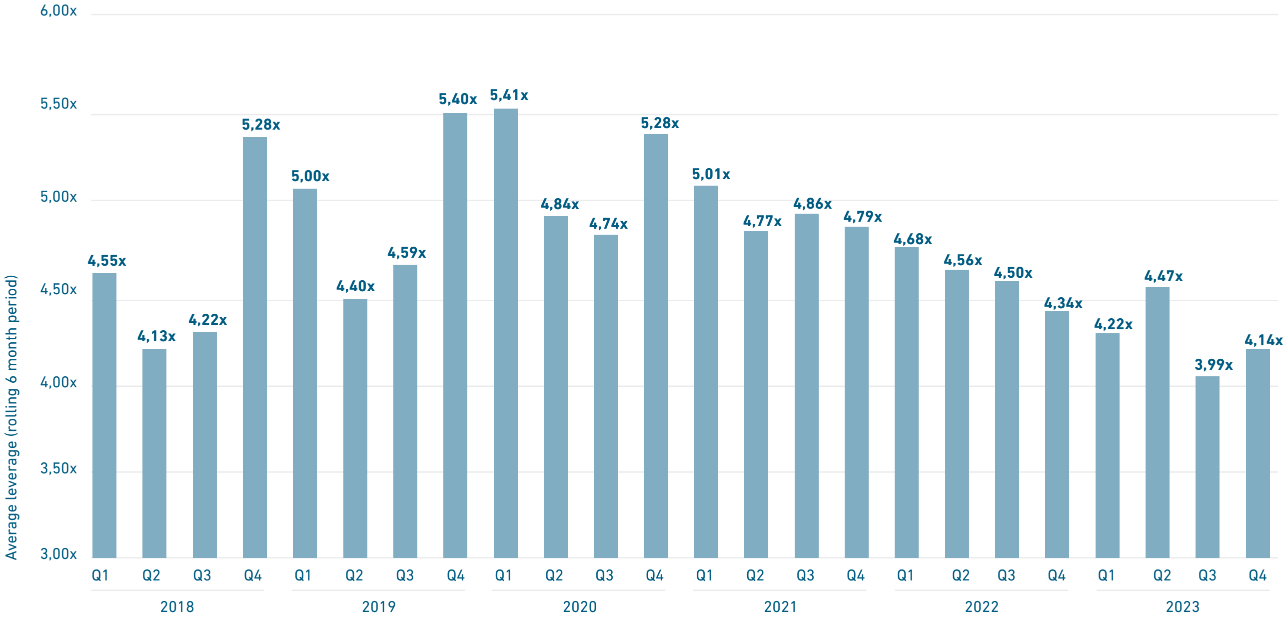
The index rise in 2023 vs 2022 results from the combined effect of lower leverage at closing and higher average margins.

As 2023 saw a 25% decline of M&A transactions in the mid-market (the worst post-COVID year according to LSEG), funds have been sitting on large amounts of dry powder that will need to be deployed over the coming months.

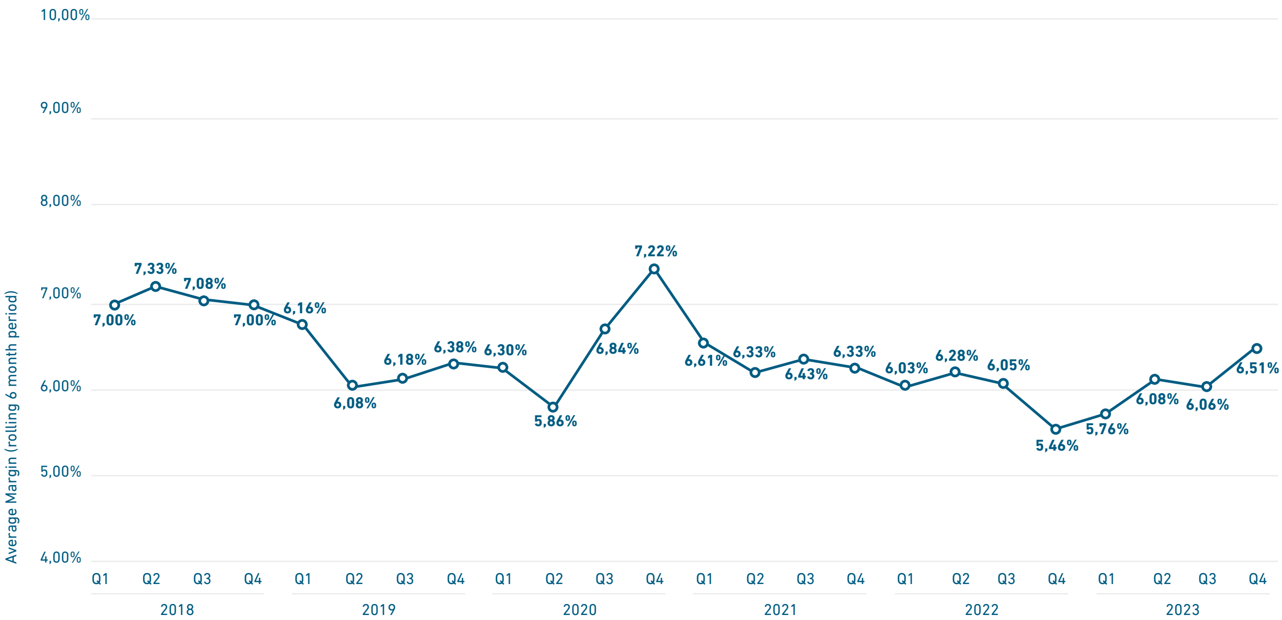
The last quarter of 2023 marked the start of a positive trend, which could be confirmed in 2024 with an upturn in transaction volumes. If we look at the first two months of the year, the signs are certainly positive, and we can expect a catch-up effect in 2024.

INDEX COMPONENTS

Evolution of levers at closing



Evolution of spreads at closing



After falling briefly and symbolically below the 4.00x mark, average leverage at closing finished the year with an average of 4.14x, in line with the stabilisation of interest rates and greater optimism about the future. Thus, the level of leverage remains prudent to enable the resulting debt servicing to be kept under control.

The average closing margin has increased to 6.51% on average (vs 6.08% in Q3 2023). It should be noted that there does not seem to be correlation between the amount of debt and the rate applied.

ANALYSIS OF UNITRANCHE PORTFOLIO

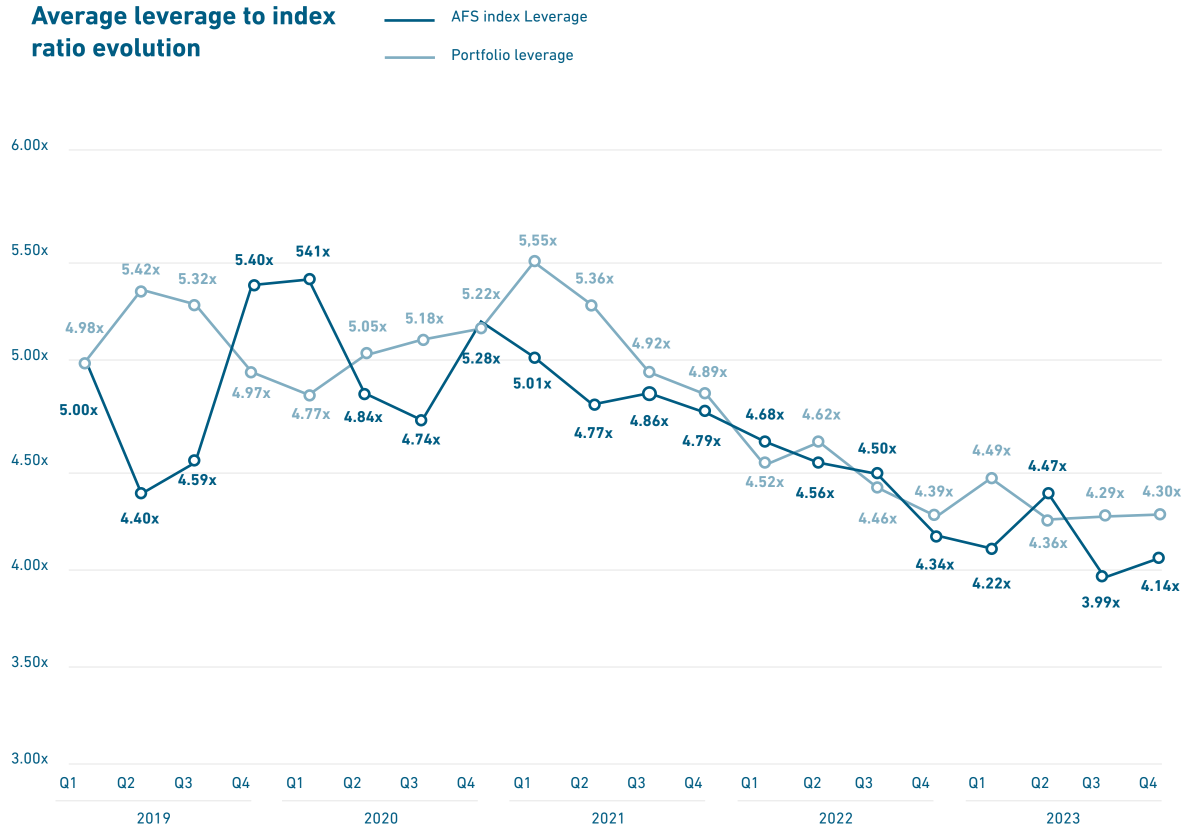
To deepen our analysis, the Aether FS Unitranche portfolio was analysed to identify the margins and leverage applicable to each quarter for each of these transactions. The work was based on certificates of compliance received and the margins applied, taking into account mechanisms for increasing or decreasing such margin according to changes in leverage ratio or ESG criteria included in the documentation.

The average of these margins and leverage levels were used as comparison with the average leverage levels and margins observed at closing, which appear in our Unitranche Index.

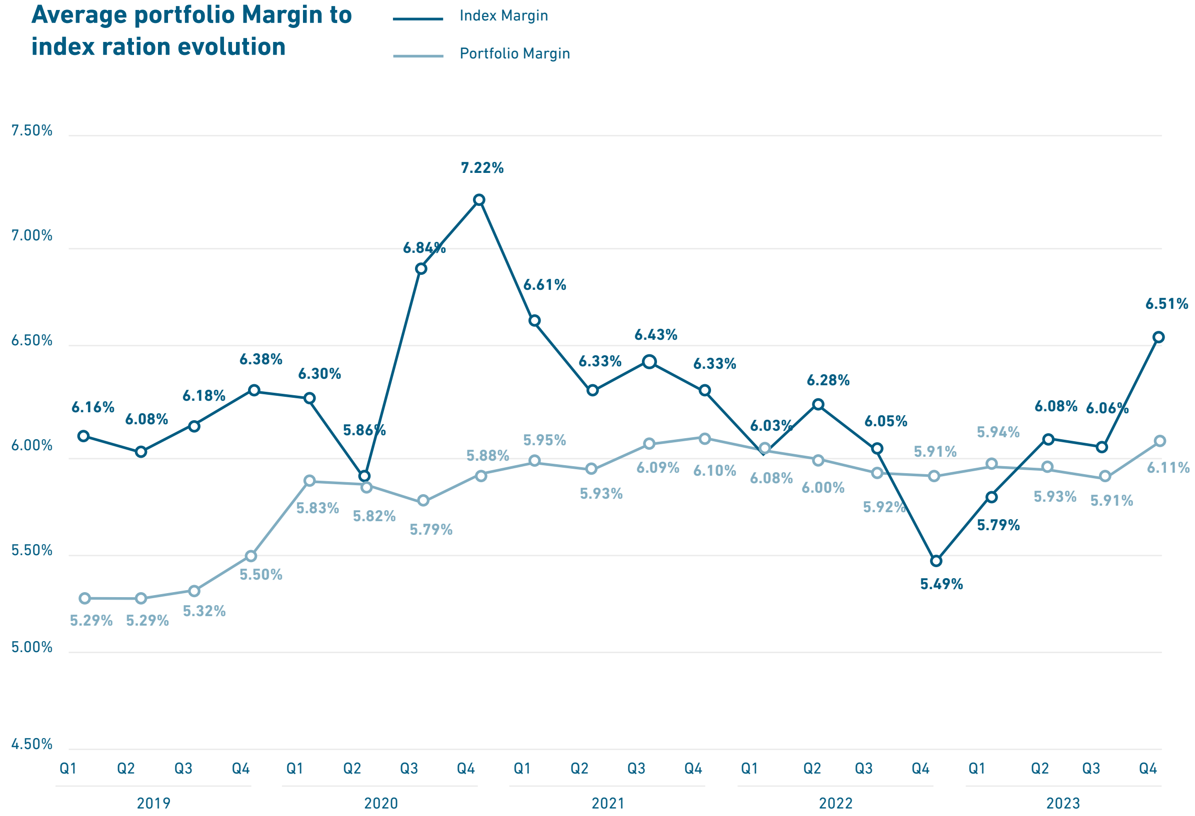
This monitoring highlights the resilience of private debt in recent years. Although the COVID crisis caused leverage to rise, the portfolio shows controlled management of the crisis, with constant deleveraging.

The two graphs below show changes in portfolio leverage (compared with average leverage at index closing) and current margins (compared with average margins at index closing).

Average leverage to index ratio evolution



Average portfolio Margin to index ration evolution

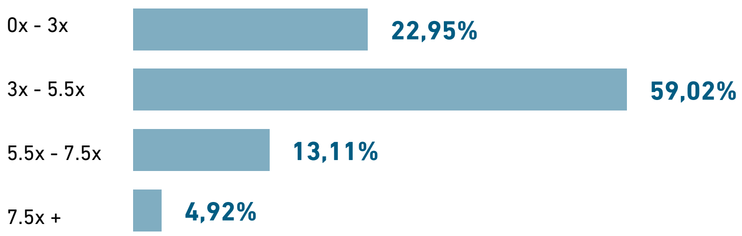


Changes to portfolio margins result from the constant accumulation of new files [What is meant here? New deals? Transactions?] and the margin ratchets used in the documentation, correlated with changes in leverage, whether or not ESG criteria have been met.

The effect of the COVID-19 crisis on leverage has been delayed, due to the «Last Twelve Months» component, with a peak reached in Q1 2021 at 5.55x.

The Q4 2023 snapshot below shows that only 18% of the portfolio is leveraged more than 5.50x, a sign of a resilient and healthy asset class.

Split between portfolio leverage in Q4 2023



FLOW MANAGEMENT

Since 2020, with ever-increasing fund-raising, the number of parties involved in a financing operation has increased sharply, resulting in a growing number of subscribers (vehicles managed by management companies). Managing the flow of funds through closings and drawdowns has therefore become a significant issue.

A closing is a series of steps in a well-lubricated engine. Managing money transfers is a source of stress for all parties. "Will the transfer go through on time, will it be blocked by an intermediary bank, will charges be levied, will the transfer be able to go through before the cut-off" - this is just a non-exhaustive list of questions that systematically arise when executing a transfer.

There are as many questions as there are issues that can jeopardise a closing. Whilst this is a source of stress for all parties, the manager of these flow is the centrepiece, as he is responsible for ensuring that the fundsflow is executed correctly, without being able to control the entire inter-banks chain.

However, there are ways to mitigate these risks. Using a single service provider to manage all the flows with all the accounts opened within the same bank is a way of guaranteeing greater efficiency when the cash from various acquisition holdings flows into the pivot account. Since all these flows are internal to the bank, they are guaranteed to be instantaneous. All that remain are the external flows (refinancing of existing debt, payment of vendors and commissions).

Repayment of the existing debt raises the issue of releasing the pledges. Should the pledges be discharged on delivery of the swaps or on confirmation that the funds have safely been delivered to each of the subscribers? Once again, the provision of a pivot account held by a third party makes it possible to monitor the arrival of only one flow and to release the pledges on behalf of the lenders being refinanced.

Finally, when an additional currency is involved, the flow execution chain becomes more complex, with the involvement of intermediary and correspondent banks, which can lengthen the time required for counterparties to receive funds. In addition, cut-off times can vary from one currency to another. Only euros management remains relatively simple. This complex system is currently undergoing a facelift. The TARGET2 system is currently undergoing ISO 20022 migration to harmonise swift messages and simplify flow management. Only time will tell whether the theory is borne out of practice.

HOW TO REGAIN LEVERAGE BY USING THE TOGGLE?

With base rates rising steadily over the past year and a half, issuers need to manage their available cashflow very carefully on a daily basis.

Without being able to establish a correlation between issuers who did not hedge interest rate at the time of closing and those who did, we can see an increased tendency to insert – and then exercise - a toggle clause, which involves much drafting in legal documentations.

The toggle clause allows an issuer to avoid paying all or part of its cash interest at the end of the relevant period. This unpaid interest is then capitalised or PIKed, i.e. added to the principal.

These clauses first appeared in 2015 and became popular in unitranche documentation during the COVID crisis.

These mechanisms, rarely used until 2022, have been widely used since June 2022.

In the first half of 2023 alone, 9% of our unitranche portfolio, for which we act as agent, exercised their clause not to pay cash interest.

The most common terms are as follows:
- No ability to capitalise 100% of cash interest;
- PIK premium between 25 bps and 50 bps;
- Start of PIK period backdated to the start of the current cash interest period;
- Limited number of opportunities to exercise the toggle clause - either (i) within one year or (ii) during the life of the transaction.

However, certain more specific clauses provide for capitalisation through the creation of new bonds or the possibility of using this option several times in a row.

Given the current interest rate environment, issuers have recently submitted requests for authorisation to:
- Capitalising 100% of the cash margin;
- Capitalisation of the reference rate, i.e. 100% of the maturity interest amount.

This option given to issuers is very useful in a context of uncertainty regarding short-term cash positions. However, issuers need to bear in mind that this has a double effect for them - an associated premium coupled with an increasing principal on the basis of which future cash (or PIKed) interest will be calculated.

The toggle is therefore like a fine wine: essential, but to be consumed in moderation.

UNITRANCHE PRIVATE DEBT MARKET AND CORPORATE BONDS: WHAT PRICING?

Over the last decade, a range of alternatives to bank debt has emerged for the medium-term financing of French companies. These include private debt (particularly unitranche financing), Euro Private Placement (Euro PP) bonds and high-yield bonds issues. Outstanding financings from non-financial companies has risen from €1,609 billion[1] to €2,024 billion[2] between 2018 and 2022, with non-bank financings accounting for almost 35% (with a significant fall of 3% in five years). However, this alternative financing does not remunerate investors at the same level... Explanations.

Three segments of alternative financings
One form of private debt, unitranche debt, has become essential in LBO deals, mainly as a result of the shortage of bank financings following the 2008 financial crisis. The advantage of unitranche debt is that it combines the features of a senior and mezzanine tranches into a single tranche, so there is a single investor, a single (blended) rate and rapid implementation (a good plan for the envisaged financing can be provided within 15 days). However, it is more expensive than bank financing.

Another segment of disintermediated financings is Euro PP. Aimed at medium-sized companies, this form of private placement is designed to be flexible, confidential and quick to execute. Launched in 2012 at the initiative of the CCIP Paris Ile de France, the Euro PP enables companies to issue bonds directly to a restricted group of institutional investors (insurers, asset managers, etc.).

Finally, the third segment: high-yield bonds, mainly used by medium-sized and/or non-investment grade companies listed on European markets (e.g. Euronext Paris, Frankfurt Stock Exchange, etc.). This market segment offers issuers great flexibility in terms of structure, maturity, currency and specific terms of issue, as well as access to a generally large market.

Main descriptive statistics / Private debt, Euro PP and High-Yield segments

France, year 2022	Private debt (incl. Unitranche)[3]	Euro PP debt[4]	High-yield
Amounts invested (€ million)	19 300	632	8-10 milliards[5]
Number of issues	449	19	-
Average amount per issue (€ million)	43	35	-
Average maturity (in years)	3-5	5	-
Medium lever	4-7x	7,3x	-
Average coupon	5-7%	5,30%	Around 7% of sales
Exchange volume (secondary)	NC, relatively low	NC, relatively low	[•]

1. Banque de France statistics, Financing of non-financial companies - France - December 2018, published on 13/02/2018
2. Banque de France statistics, Financing of non-financial companies - France - December 2022, published on 08/02/2023
3. France Invest/Deloitte (Private debt fund activity in France) and Deloitte Private Debt Deal Tracker Spring 2023
4. AFS data, Euro PP Observatory - CMS Francis Lefebvre Avocats
5. AFS, Fitch estimate

The private debt market has experienced sustained growth (+122% between 2018 and 2022[6]). The Euro PP market has contracted, with annual financing volumes of just over €600 million in 2022, compared to almost €3 billion in the middle of the decade. The High-Yield market has seen a high degree of variability in volumes issued, falling from €127.5 billion in 2021 (an all-time high) to €44.5 billion in 2022[7].

Lastly, the private debt and Euro PP segments attract investors with a traditional buy & hold approach, which is less the case for High-Yield investors.

A unified measure of the cost of financing: the margin/leverage ratio
How do you compare the returns offered to investors under these financing alternatives, in relation to the risk taken?

The Leverage ratio, i.e. the ratio of net debt to EBITDA, is probably the most commonly accepted measure of credit risk, although it does not reflect all risk factors (e.g. linked to the size of the company, its sector of activity, etc.). The margin (coupon minus base interest rate) is the assessment of the remuneration of this risk. The ratio between this margin and the financial leverage (at issue) therefore makes it possible to compare financings in terms of risk remuneration by «leverage ratio».

For example, this ratio for Unitranche financing in France stood at 1.31% in Q4 2022[8].

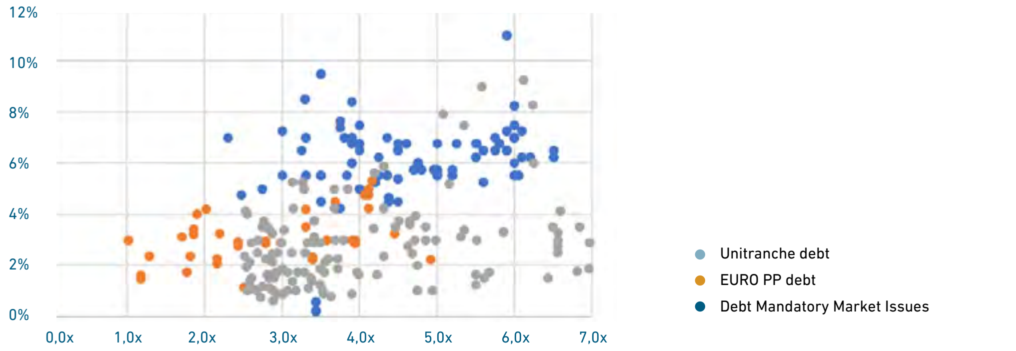
Comparison of market segments
In order to compare the levels of risk remuneration, this ratio has been calculated on the basis of three samples over the period 2018 to 2022: the first is made out of the Unitranche financing portfolio for which AFS acts as Agent supplemented with data provided by its partners; the second is formed by listing the Euro PP issues made each year for which the leverage ratio at issue is less than 7x; the third is constructed by selecting listed senior bond issues by European companies with a leverage of between 2.5x and 7x at issue, debt of between €20 million and €500 million, and a margin/leverage ratio of between 0.2 and 1.7x . This is to ensure comparability of risk profiles with the other samples.

Main sample statistics

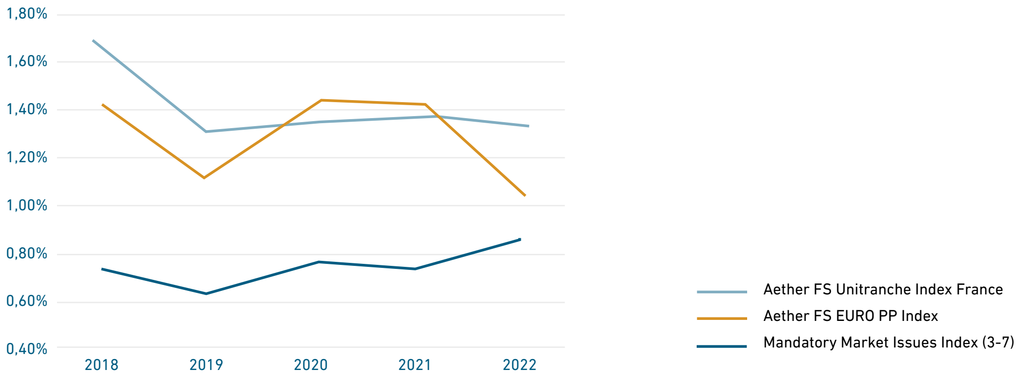
	AFS unitranche debt	EuroPP debt	Debt Market bond issues
Average margin	6,4%	3,1%	2,9%
Medium lever.	4,8x	2,9x	4,0x
Index Avg.	1,4%	1,2%	0,7%
Total amount (€ million)	10 756	2 252	48 023
Number of deals	149	37	136
Average maturity	7,00	7,34	6,98

6. Source: France Invest/Deloitte (Private debt fund activity in France), March 2023
7. Source: Fitch / Issuance European high-yield (HY) issuers
8. Source: AFS index, Q4 2022 report

Comparison Margin vs leverage according to samples



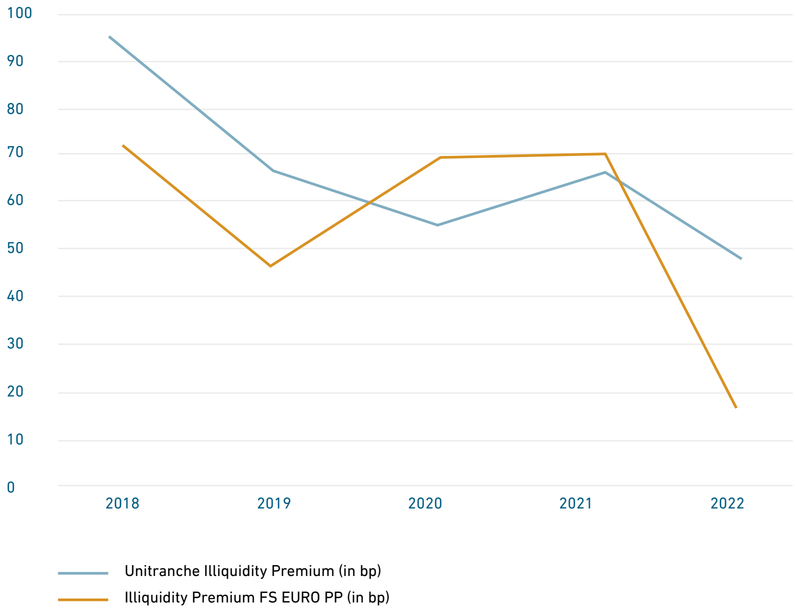
Annual evolution or Margin to Leverage ratio



Margin levels were found to be positively correlated with leverage, suggesting a degree of consistency in the margin/leverage ratio by segment.
An analysis of the margin/leverage ratio for each year between 2018 and 2022 shows (a) a significantly higher level for the Unitranche and Euro PP segments (b) an increase trendfor High-Yield vs. a decrease for the other segments (c) a «surge» for Euro PP and to a lesser extent for Unitranche in 2020 and 2021 following the pandemic period.

Difference in liquidity?
The spread between the margin/leverage ratio for financings in the form of Unitranche and Euro PP private debt and the High-Yield market is therefore around 50-60bp per 'all leverage' but varies over time and tends to decrease.

Difference between the margin/lease ratio for financing in the form of Unitranche and Euro PP private debt and the High-Yield market



This significant difference (150-180 bp for issuers with 3x leverage, for example) can be explained in several ways: different market segments, larger issuers in the high-yield segment, but above all a structural difference in liquidity.

The financing landscape in France has changed dramatically in recent years, with the emergence of alternative financing for small-mid caps (private debt, Euro PP, etc.) to complement the high-yield market. However, investors expect higher returns on such debt for an equivalent level of risk (leverage). This raises the question of the accessibility of the High-Yield market to a whole category of issuers, for whom the level of requirements and transparency may be difficult to achieve. Conversely, it is understandable that investors in private debt, which by definition is less liquid, demand a higher return. Ultimately, the execution advantages of private debt (and to a lesser extent Euro PP), associated with its illiquidity, come at a price.

PRESENTATION OF AETHER FINANCIAL SERVICES

France's leading independent provider of financial transaction execution services, Aether Financial Services was founded in 2015 by Edouard Narboux and Henri-Pierre Jeancard. Based in Paris and London, Aether Financial Services is made up of a multicultural team of more than 20 people, experts in 3 business lines.

AGENCY

Active in Private Debt and Capital Markets, Aether Financial Services covers all financing agent roles (Loan agent, Bond agent, Administrative agent, Calculation agent, Security agent, etc).

VALUATION AND CALCULATION

Aether Financial Services values all types of financial instruments or securities, from the most «vanilla» to the most structured, for recurring, specific or one-off requirements.

CORPORATE AND ISSUER SERVICES

Aether Financial Services offers a range of digital solutions dedicated to the administrative management of functions relating to securities transactions (capital increases, general meetings, record keeping, etc.).

AETHER FINANCIAL SERVICES' COMMITMENT TO SOLIDARITY

For several years, Aether Financial Services has been involved with associations through Social Impact Contracts (la Cravate Solidaire, the Auteuil Foundation and the Article 1 association). In 2021, Aether Financial Services committed to protecting the environment through reforestation and forest preservation alongside Reforest'Action. This partnership demonstrates Aether Financial Services' commitment to the environment and its desire to help combat global warming.

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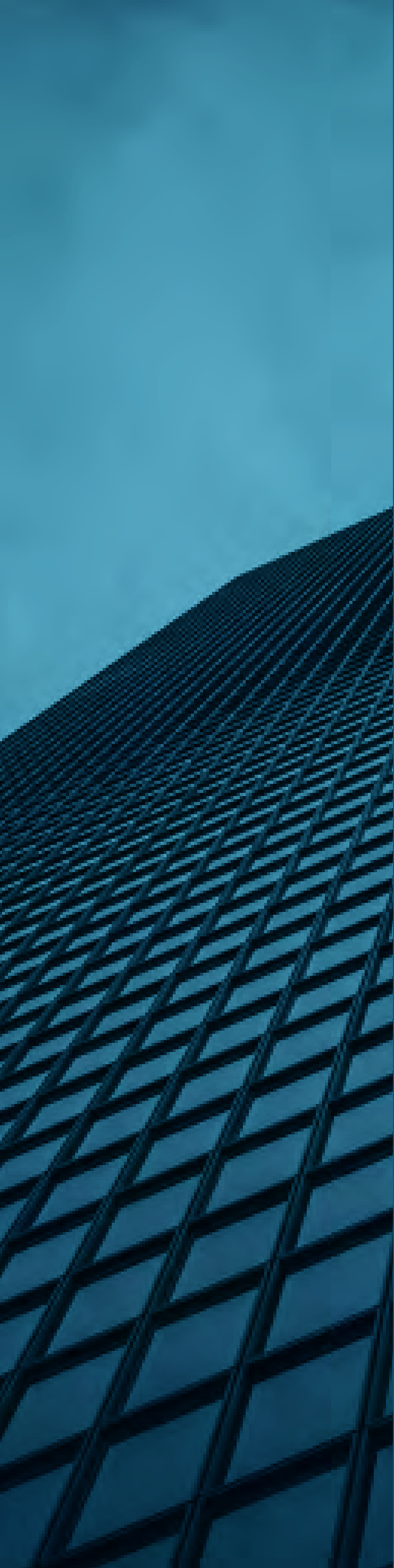

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