Debt Capital Markets

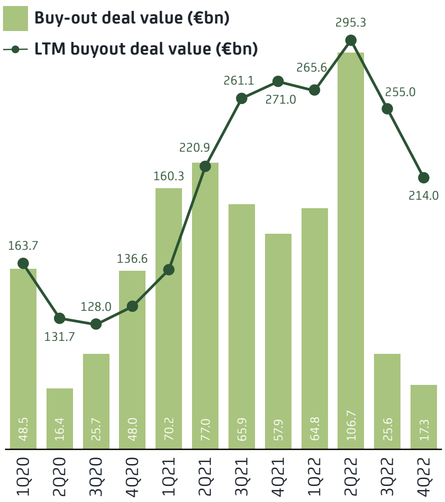
SPRING 2023

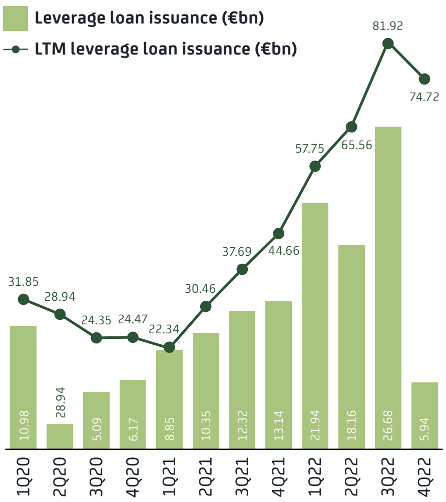
Despite market jitters, direct lenders continue to invest and attract further fundraising

Throughout 2022, the market's interpretation of the economic backdrop contributed to a sell-off across both fixed income and equities as inflation continued to rise, with the UK CPI reaching 10.5% in December 2022. In response, the Bank of England has increased interest rates to 4.25%, with continued uncertainty if this is close to the top of the yield curve versus expectations of more than 5.5% at the end of Q3 2022. The shrinking of total assets under management and the resulting increased proportion of alternative assets has created the 'denominator effect' leading to investors' portfolios becoming unbalanced.

Private equity sponsors have felt the impact of the reallocation of investors' portfolios as European fundraising in 2022 fell to €157bn, a decrease of approximately one quarter from the far stronger prior year.* The time required for fundraising has become more challenging, with the average time to close of 18 months, six months longer than the historic norm.

Following the high volume of European leveraged buyouts in 2021, continued rising inflation and monetary tightening led to a decrease in volumes in H2 2022 (see charts). Leveraged loan issuance followed a similar trend with issuance slowing during the fourth quarter as the primary market grappled with the prospect of a prolonged period of elevated interest rates and recession fears.





Source: Dealogic

"Direct lending continued to attract investment during 2022 despite market uncertainty, however, this trend remains to be proven as several lenders have noted a more challenging fundraising environment."

ANDREW SHELLARD,
PARTNER, UK

ANDREW LYNN,
PARTNER, UK

Despite this investor sentiment, senior secured private debt remained an attractive investment for LP allocations during 2022 due to the risk-adjusted return and the inherent hedge to rising interest rates given the floating nature. European direct lending fundraising for 2022 was ahead of the year prior and although investors remained positive on the asset class, the preference remained for larger platforms with the top three fundraisings accounting for approximately half of aggregate capital raised.** In recent months however, the fundraising market has proven to be more challenging as market volatility and added caution has driven greater scrutiny from LPs and their advisors.

Declining M&A volumes together with continued direct lending fundraising raises the question of where direct lenders' capital is being allocated. One explanation is that the larger direct lenders had been seizing the opportunity to supplant investors in more liquid loans and bonds as those markets closed in reaction to the volatile backdrop. The private market delivered execution certainty to borrowers, for a premium, and time will tell how much of this market they will retain.

Within the private market, direct lenders are focused on more resilient sectors, with heightened analysis on credit risk yet remaining eager to deploy. Required credit quality has increased with lenders now avoiding some sub-sectors that they were investing in 12-18 months prior. This appetite reduction has led to lower opening leverage commitments of c. 0.5x to 1.0x EBITDA and higher pricing by between 50bps to 100bps compared to the start of 2022. In addition, lenders are offsetting risk through tighter terms during documentation.

The more challenging financing environment has made quality lender relationships and depth of product knowledge crucial. At Alantra, we can help borrowers maximise those relationships and navigate the ever evolving direct lending landscape. Should you wish to explore any aspects of this article or any other debt matters, we would be keen to discuss how we can support you.

*Unquote **Creditflux

Selected recent UK debt capital markets experience

2023	LDC, FSP	SELL-SIDE ADVISORY	cbpe
2023	MML	BUY-SIDE ADVISORY	MIG Company
2022	Cow Hills, Newport Capital	SELL-SIDE ADVISORY	DL Software
2022	Bowmark Capital	BUY-SIDE ADVISORY	littlefish
2022	LDC	BUY-SIDE ADVISORY	cellhire
2022	Sovereign Capital Partners	BUY-SIDE ADVISORY	Actica consulting
2022	Mr.Fothergill's	BUY-SIDE ADVISORY	Harwood Capital Management
2022	ReadyPower Group	SELL-SIDE ADVISORY	angel Trains
2022	Pollen Street	BUY-SIDE ADVISORY	Markerstudy Insurance Services Limited
2021	charterhouse	REFINANCING	SLR
2021	Foster + Partners	INVESTMENT	Hennick & Co
2021	Pollen Street	REFINANCING	aryza

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Possibility is in the ascent