Market Intersection:

A Quarterly Look at the U.S. Credit Markets

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2Q21 US syndicated lending reaches three-year US$764bn high, second busiest quarter on record

Ioana Barza

At US$764bn, US syndicated loan volume in the second quarter was more than double 2Q20's levels and up 9% from the first quarter of this year as borrowers accessed new money to support event-driven financings and refinanced existing debt. Investment grade loan issuance reached a US$329bn record in the second quarter, while leveraged loan issuance of US$298bn was the second busiest in the past three years. "We are significantly ahead of volumes last year. High yield is breaking record after record in terms of volume of issuance in that market," said one leveraged underwriter.

M&A-related lending reached US$175bn in the second quarter, up 40% from the prior quarter, and split fairly evenly: non-leveraged M&A-related loan issuance jumped 72% in the second quarter to US$88.5bn, while leveraged M&A was up 17% to US$86bn. "It all feels very good at the moment," said a second leveraged underwriter. "Everything is positive; defaults are under control, client demand is relatively balanced; CLO formation is strong; even the Fed's comment about interest rates potentially nudging up should be good in theory. It's hard to really find an issue but we are always wondering what could screw things up."

The leveraged loan market has shown more confidence around larger capacity deals with a significant shift in dialogue toward bigger M&A financings and has been absorbing a growing level of supply on both an aggregate and weekly basis. In the past year, lenders have gone from wondering where the deals are to worrying that there could be too many deals.

The floodgates also seemed to open in the leveraged loan market as completed LBO loan issuance approached US$40bn in the second quarter, making it the busiest quarter since 4Q18. Alongside existing institutional accounts upping their commitments to the asset class, new investors have also been coming into the market. Sources said risk appetite in terms of hold levels and a willingness to commit capital has gone up considerably while new accounts have also surfaced across geographies. There have been more US$1bn or bigger LBO financings in the first half of this year than in each of the last two full years. Even so, sources said it is hard to perceive a big air pocket.

The sentiment may be similar in the investment grade market where bank appetite remains strong and the race for funded assets continues. "Everyone was super cautious and then everyone flipped the switch," said one investment grade lender. Quarterly investment grade issuance not only reached a record but was also up 82% compared to this time last year as issuers came to market who had held off during the pandemic or who wanted to lower their pandemic-era pricing. While investment grade M&A lending was roughly on par with the first quarter at US$42bn, US investment grade refinancings reached a record US$258bn in the second quarter. However, term loan issuance was down to US$20bn from the US$61bn record reached in the first quarter as lenders note that they have a competitor in the bond structure that is more cost effective today and gives the borrower prepayability after year one, replacing what would be natural term loan supply with bonds.

In terms of measuring success, top of mind on lenders' priority lists in addition to navigating deadlines and expectations around the Libor transition, are the conversations around ESG. While the European loan market led the way, sustainability linked loans have picked up among US investment grade issuers this year with 60% of lenders surveyed saying that yes, ESG conversations are core to all investment grade lending discussions they are having. While volume has increased, lenders and their particular institutions are of varying mindsets in terms of supporting ESG initiatives. Especially as pricing grinds tighter, different banks are at varying points in maturity and adoption of ESG principles. Meanwhile, the US leveraged space has been seeing "a big push from the investors of our investors to be able to demonstrate pushing a socially, environmentally conscious agenda," said one asset manager on the growing impact on market receptivity of deals. "Time will tell but there is a desire to check that box if you are a big fund manager, to be able to demonstrate you are on your front foot, not your back foot."

"We are seeing more and more M&A volume. A couple of multi-billion dollar financings have been done in the leveraged finance market but nothing in the US$10bn range like we saw a few years ago. The market today could definitely take a financing that size," said a fourth leveraged underwriter. "There is huge elasticity of demand so if you have a big deal, as long as you put a good rate on it, there is plenty of liquidity in the market to get it done."

Fig. 1 Institutional loan issuance

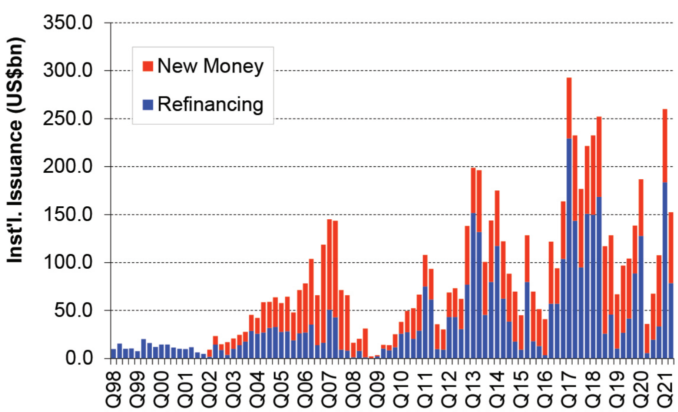
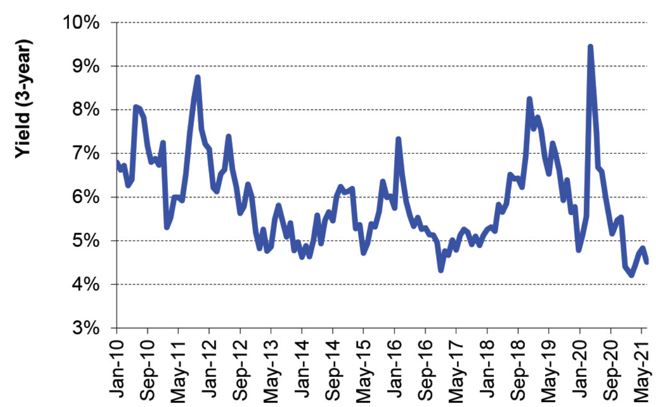


Fig. 2 Primary market yields continue to decline based on strong investor demand



Source: Refinitiv LPC

2Q21 middle market syndicated loan volume of US$46bn was at its highest since 2Q18

Diana Diquez

The syndicated middle market was at full speed in 2Q21 with volume soaring to its highest level in 3 years at US$46bn. New money lending of US$23bn was up 30% from 1Q20 and was at levels not seen since 2017. Refinancing volume of US$23bn in 2Q21, almost doubled the total logged in 1Q21; lagging one quarter behind the large corporate market, which saw a jump in refis in 1Q21. While volume was up, most respondents to Refinitiv LPC's Middle Market Investor Survey said they were not able to lend as much as they wanted to in 2Q21. In turn, competition has been intense, and terms have deteriorated significantly across the board.

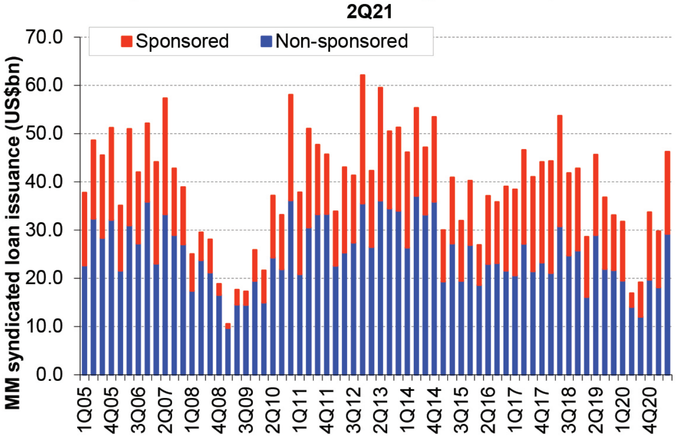
In the non-sponsored market syndicated volume was US$29bn, with new money increasing for the fourth quarter in a row to levels not seen in 7 years. However, M&A activity was almost flat in 2Q21 at US$2.5bn, representing only 22% of non-sponsored new money total. While M&A remains at low levels, lenders that focus on the space said that they are seeing some family-owned businesses expanding organically and tapping the market for funds.

Even with the increase in activity, demand continues to outpace supply and bankers said that this end of the market is as competitive as ever. One of the primary competition tools in this market is pricing, which dropped in 2Q21. The average all-in drawn spread for non-sponsored non-M&A related revolvers tightened to 192bp from 216bp in the traditional middle market and to 164bp from 185bp in the large middle market. For the large middle market, this is the lowest average since before the Great Financial Crisis. "The sad part of the non-sponsored market is that no matter how many things you do right, companies will drop you for 25bps," said one banker.

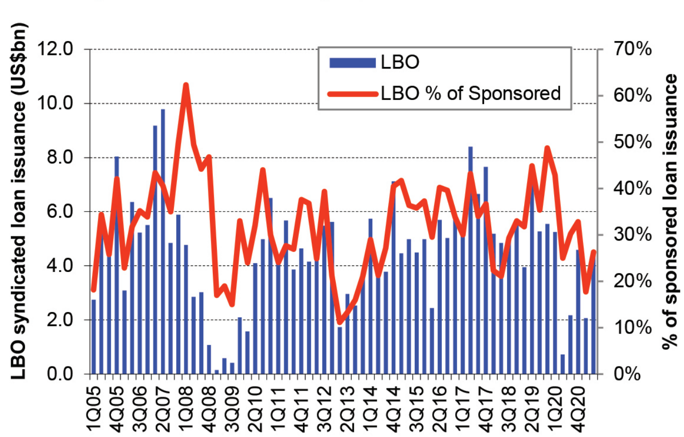
Activity also picked up in the syndicated sponsored market. At US$17bn, syndicated sponsored loan volume was up 45% from US$12bn in 1Q21, with a nice chunk coming from LBO activity. LBO syndicated loan volume jumped to US$4.5bn in 2Q21, doubling 1Q21 levels. Add-on acquisitions were also very robust at US$4.7bn. "The market is all systems go for everything: M&A, financing, and fundraising," said one lender. Despite increased activity, competition remains fierce. Bankers that focus on the space continue to be displaced by direct lenders. "We are like an outsider looking in, we have not been leading a lot of deals and the past two years have been a struggle," said one banker.

While direct lenders have taken a bigger share of the market, they are also seeing a lot of competition as more money continues to pour into the asset class. "It feels like the market is more aggressive than prior to the great recession," said one direct lender. One of the biggest changes that many lenders said took place in the middle market in 2Q21, was the proliferation of covenant lite structures. In the syndicated middle market, covenant lite volume was up to US$1.7bn, more than double 1Q21 levels. While this is still much lower than prior highs, lenders said that they are seeing this structure filter down into smaller issuers. Lenders expect to continue to have a busy year but are concerned about how they will be able to put money to work at good risk adjusted returns as not only have structures loosened but pricing has also been under pressure.

Syndicated middle market lending reached US$46bn in 2Q21



Syndicated LBO issuance jumped to US$4.5bn in 2Q21



Source: Refinitiv LPC

The Legal Corner by Paul Hastings

Amidst the disruption of 2020, many direct lenders have identified opportunities to capitalize with new and expanded product offerings throughout the capital structure as they continue to compete for market share with bank arrangers. Investor appetite remains particularly strong in industries such as technology, healthcare, renewable energy, consumer goods, infrastructure and transportation.

The implications of recent disputes between lenders and borrowers have resulted in some notable changes to loan documentation. So-called “Serta” protections, which require affected lender consent for payment and lien subordination to other debt, have become an area of focus for many lenders, particularly private credit funds. However, we have seen an uptick in meaningful carve-outs to these protections, including permitting super-senior revolvers or by only providing a right for each lender to participate ratably in a priming facility rather than an outright prohibition. In addition, the litigation involving Revlon’s credit agreement led the LSTA to propose form “erroneous payments” language to allow administrative agents to demand repayment of amounts paid to lenders in error.

We have seen an increase in “portability” features, whereby certain changes in the ownership structure of the borrower do not constitute a “Change of Control”, an event that would otherwise require a loan to be repaid. In syndicated credit facilities, it is becoming more common for non-lenders to have the benefit of credit facility collateral for their cash management and hedging obligations, a right that traditionally belonged only to members of the lending syndicate and that has the effect of diluting the lenders’ collateral position.

While the deep and prolonged restructuring cycle that some commentators had predicted at the beginning of the pandemic has not materialized, inflation, and its impact on yield, has become a topic of concern for some fixed income investors. Although market participants are monitoring this issue, the debt markets remain robust.

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A leading global law firm, Paul Hastings provides innovative legal solutions to many of the world's top financial institutions and Fortune 500 companies in markets across the United States, Europe, Asia, and Latin America. Our leading Finance practice supports clients with a deep global bench of legal experts to address various financing challenges with strategic thinking and flawless execution. We work with clients in every key financial center on an exceptional array of both domestic and international finance matters. Our lawyers represent financial institutions and servicers as lenders, and public and private companies as borrowers, in working capital and acquisition financings across a broad range of business sectors and industries. We also have particular experience in guiding clients through complex restructurings and turnarounds and are recognized market authorities on intercreditor arrangements across all lending structures.

www.paulhastings.com

Key Contacts

William Brady
Head of Alternative Lender
and Private Credit Practice
T: +1.212.318.6066
williambrady@paulhastings.com

John Cobb
Chair of Leveraged
Finance Practice
T: +1.212.318.6959
johncobb@paulhastings.com

Jennifer Hildebrandt
Partner, Finance and
Restructuring Practice
T: +1.213.683.6208
jenniferhildebrandt@paulhastings.com

Frank Lopez
Co-Chair of Securities and
Capital Markets Practice
T: +1.212.318.6499
franklopez@paulhastings.com

Phil Ratner
Partner, Financing and
Restructuring Practice
T: +1.212.318.6014
philratner@paulhastings.com

Christopher G Ross
Partner, Finance and
Restructuring Practice
T: +1.212.318.6788
christopherross@paulhastings.com

Marisa Sotomayor
Partner,
Leveraged Finance Practice
T: +1.212.318.6213
marisasotomayor@paulhastings.com

Jennifer Yount
Chair of Finance and
Restructuring Practice
T: +1.212.318.6008
jenniferyount@paulhastings.com

About Refinitiv LPC

Refinitiv LPC is the premier global provider of information on the syndicated loan and high yield bond markets. Our first-to-the-market news, comprehensive real-time and historic data helps industry players stay informed about market trends and facilitate trading and investment decisions.

From offices in New York, London, Hong Kong, Sydney and Tokyo we are the one source for comprehensive coverage of the syndicated loan markets worldwide.

Our publications, online news, analysis, valuation services and interactive databases are used every day by banks, asset managers, law firms, regulators, corporations and others to drive valuation, syndication, trading, and research and portfolio management activities.

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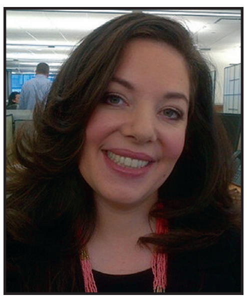

Ioana Barza
Head of Market Analysis
T: +1.646.223.6822
ioana.barza@refinitiv.com

Diana Diquez
Contributor Relations Manager
T: +1.917.364.0764
diana.diquez@refinitiv.com

David Puchowski
Director of Market Analysis
T: +1.646.223.6843
david.puchowski@refinitiv.com