Market Intersection:

A Quarterly Look at the U.S. Credit Markets

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US syndicated lending returns to pre-Covid levels

Ioana Barza

US syndicated lending activity got a boost to pre-Covid levels in the first quarter. At US$590bn, it was up 59% from the fourth quarter and up 7% year over year. Issuers sought refinancings to cut costs and lower rates from Covid-peaks while others, who held off last year or waited on the sidelines to pull the trigger on M&A, re-emerged. "A lot of the universe has been repriced over the last six months, especially as 101 soft calls roll off, those opportunities have been attacked," said one leveraged underwriter. "We have seen pushback, where deals come in at the wide end when you look at initial and official price talk and on any given day, some deals don't perform well in the aftermarket. These are tell-tale signs of market fatigue. But this is in the day to day. The trend overall is still supportive for issuers."

Strong demand has helped keep it that way with over US$13bn in retail fund inflows and US$37.8bn in new-issue CLOs.

"Buyers that were absent in 2020 have entered the market and have budgets for the year which helped to tighten spreads (on Triple-A CLO liabilities) very quickly, which also created a major back log of refis and resets in the CLO market, including all the deals done in 2020," said one CLO manager. "It's an air pocket for sure and it does feel a lot like 2018 except the market is bigger now, most managers have many more deals today." Demand isn't showing any signs of letting up and amidst a low rate environment, the search for yield and assets continues.

"In 2008, the Fed took a year, in 2020, they took weeks: the government moved quicker, rates and the economy responded," said a second leveraged underwriter. "There is a concern that they could again move quicker than expected, which makes floating rate assets attractive because it increases the coupon for loans unless there's floor. We have been seeing a transition out of fixed income into loans."

Strong demand amidst limited new money supply in the first quarter drove leveraged refinancings to US$226bn and total leveraged lending to US$327bn. Both figures are just shy of three-year highs. M&A-related lending in the leveraged space climbed to an 18-month high of US$63bn.

Financing markets snapped back last year but M&A-related financings, which also ground to a halt, have much longer timelines and tend to lag.

"There are no huge deals out there right now, but there may be processes getting underway or deals on people's dream lists," said a third leveraged underwriter.

"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

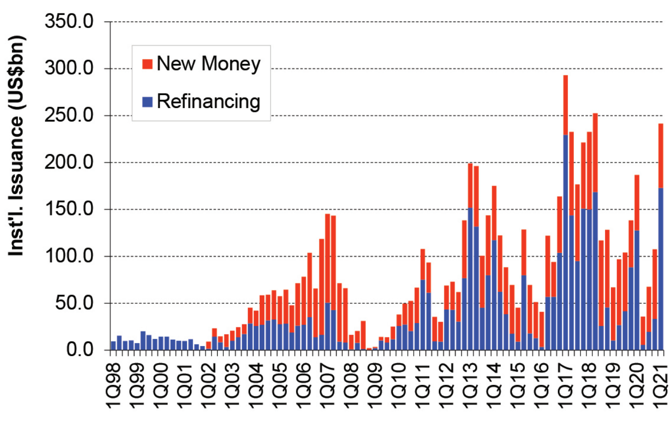
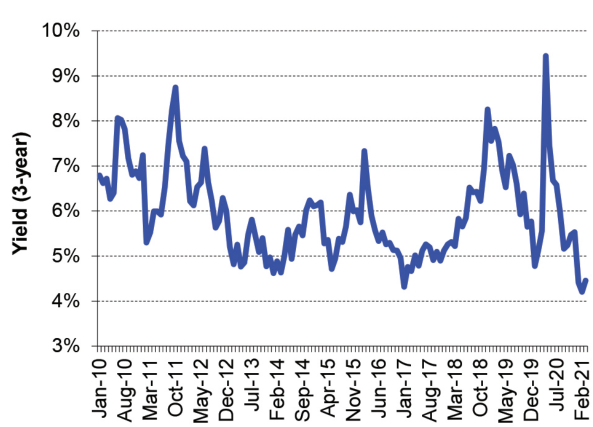


Fig. 2 Primary market yields continue to decline based on strong investor demand



Source: Refinitiv LPC

Middle market lending extremely competitive this year

Diana Diquez

After closing last year with a bang, middle market lending was lower in 1Q21. The first month of every year is usually slow, but after what lenders describe as one of the busiest Decembers, activity slowed dramatically in January.

In the syndicated middle market, lending of US$4.7bn in January was at its lowest level for this month since 2009. Activity picked up closing March at US$13bn, its highest level in three years. The pickup was not enough to compensate for a slow start and volume declined for the quarter.

In the syndicated middle market, lending of US$26.9bn was down 20% from 4Q20 levels and 15% year-over year. Demand once again outstripped supply. More than half of respondents to Refinitiv LPC's 2Q21 investor survey said they were not able to lend as much as they wanted to in 1Q21, citing aggressive competition as one of the main contributors.

Bankers that focus on the non-sponsored space said this market is as competitive as ever.

"It feels like we went from December 2019, straight to now, like the pandemic never happened. Everyone is looking for assets, and pricing and terms have collapsed," said a regional banker.

Syndicated non-sponsored lending was down roughly 16% quarter-over-quarter and year-over-year to US$16.6bn in 1Q21. Companies are sitting on a lot of cash and there is limited demand for loans. New money issuance, which increased at the end of last year, was flat at US$8bn and was much higher than the US$4.9bn logged in 1Q20. However, this was still a relative low level. Refinancing volume of US$8.7bn was down 26% from 4Q20 and 41% year-over-year.

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In the sponsored market, lending also declined after a robust end to 2020, but was almost on par year-over-year. 1Q21 sponsored loan volume (syndicated + direct) of US$32.7bn was down 21% from 4Q20 but was just US$2bn shy of 1Q20 and the number of deals was actually higher year-over-year (306 in 1Q21 vs. 278 in 1Q20).

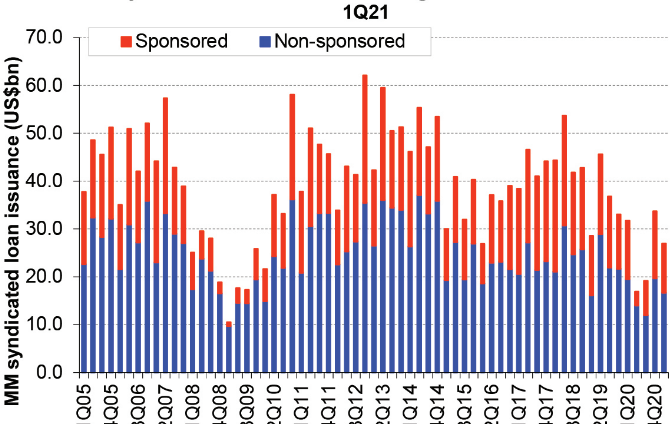
The decline in middle market sponsored volume was mostly due to a drop in syndicated lending (down 26% from 4Q20 and 16% from 1Q20). Direct lending of US$22.4bn was down a lower 18% from 4Q20 and was only US$110m shy of 1Q20's volume. Direct executions continued to outpace syndicated deals by over 2:1 in 1Q21.

Following a frenzied pace at the end of 2020, lenders said the market took a breather at the beginning of 1Q21, but then picked up pace and the quarter ended up being a busy one, with M&A activity leading two thirds of total sponsored lending.

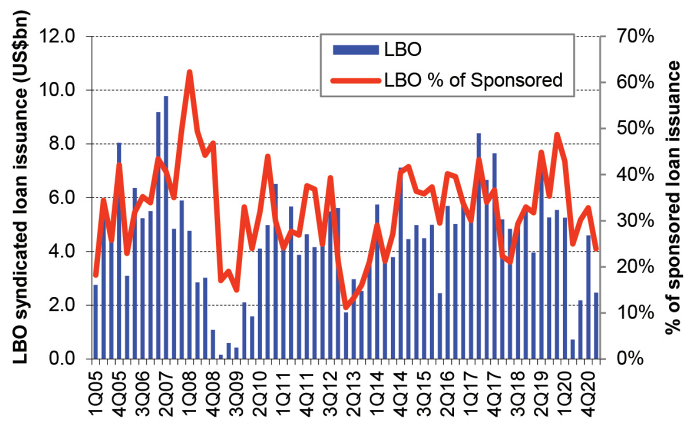
4Q20's LBO momentum spilled over to 1Q21 in the direct lending market. Direct lending LBO loan issuance of US$10.2bn in 1Q21 tied for the second-highest volume on record. In contrast, the syndicated market recorded just US$2.5bn of LBO volume, much lower than 4Q20's US$4.6bn and 1Q20's US$5.3bn. Direct lenders continue to gain market share outpacing syndicated financings by a whopping 4.3:1 in 1Q21.

Money continues to pour into the asset class. Following a peak for full year 2020, U.S. private credit fundraising had another strong quarter topping US$30bn in 1Q21. Lenders have a lot of money to put to work and larger players are moving downmarket to deploy capital and are bringing with them more aggressive terms. With the intense level of competition, lenders said that many terms are back to pre-Covid levels, at least for those companies that came out of Covid unscathed.

Syndicated middle market lending reached US$27bn in 1Q21



Syndicated LBO issuance declined to US$2.5bn in 1Q21



Source: Refinitiv LPC

The Legal Corner by Paul Hastings

The credit markets exhibited impressively robust activity in the first quarter of 2021, carrying over and improving upon the strong activity of the fourth quarter of 2020 as the country continues to rebound from the COVID pandemic. Unlike the second and third quarters of 2020, where borrowers and lenders were somewhat hesitant to engage in new acquisition financing because their primary focus was on the stabilization of investments in their existing portfolios, the fourth quarter of 2020 and first quarter of 2021 have seen a drastic increase in front-end M&A financing activity and vigorous competition among private equity groups and lenders with significant capital to deploy. Notwithstanding certain shortcomings in the overall macroenomic outlook, this increase in activity and competition has resulted in a move towards lenders putting more trust in borrowers to self-govern. The financial covenants, negative covenants and events of default contained in financing transactions give borrowers more flexibility, and a number of the flexibility items historically reserved for the large cap market are making their way to the middle market.

COVID-related documentation terms have largely eroded from loan documentation, with the exception of certain EBITDA addbacks for lost profits that are seen in larger in more competitive transactions, and documenting for PPP loan forgiveness which is largely being paid off or escrowed in new front-end financings. Lenders continue to be focused on Serta, Boardriders and TriMark protections in all new front-end financings, as they are more acutely aware of the perils of debt-layering, covenant stripping, and the transfer of assets into unrestricted subsidiary structures. Revlon provisions have also gained favor across nearly all new front-end financings (and are also being worked into amendments for existing transactions), as the attention around that case has called for the need to document for protections around inadvertent or mistaken payments.

Although several industries remain under stress, restructuring activity remains relatively quiet overall as professionals and lenders continue to closely monitor the liquidity of their borrowers. However, the upcoming quarters in 2021 should bring further clarity on the need for restructurings or workouts in certain credits and industries.

About Paul Hastings

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.

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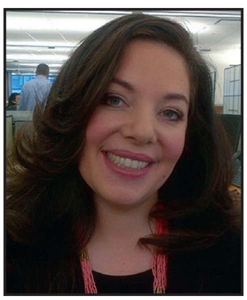

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