

The year that roared to life



Guest comment by **Ayman Mahmoud**

Trepidation greeted the arrival of 2021, but investors found themselves busier than ever as the private debt market took off

At the opening of play, 2021 looked an unpredictable path to tread. It looked potentially like driving through a minefield. With a return to travel restrictions after the holiday season of 2020, uncertainty over government stimulus and support and the expectation of market correction and restructurings, participants could be forgiven for expecting a year of fluctuations.

Clearing banks and corporate treasurers had been in close contact over liquidity lines for a year and those banks seemed to want to exercise caution.

However, beneath that dynamic of trepidation was fatigue at a year of reduced activity, a desire to transact and a very human desire to break free from the restraints of 2020. Coupled with incredibly liquid equity and credit markets (particularly in the private credit space), the market could just as easily move to loosen those bounds.

From as early as January 2021, indicators started to suggest the latter dynamic would prevail and for those participating in the market, the rest of the year may be a blur of activity. How then did expectation meet reality?

Despite the potential for doom and gloom, the private credit markets

looked set, from the start of 2021, to continue their growth trajectory.

Getting complex

The ability to do larger and more complex deals without borrowers having to take any market or syndication risk is a growing factor in choosing private credit over traditional lenders in the large-cap space, and we will invariably see more billion-plus loans from the leading private credit institutions. While this remains a popular topic, it is only one of the many metrics that have propelled private credit forward.

Historically, there has always been an understanding that private credit could be used to good effect: however,

the more conservative private equity and corporate borrowers were sceptical about borrowing in a space that was unknown compared to traditional lenders.

The patience shown by the private credit market during the difficulties of 2020, coupled with the slower responsiveness and caution shown by the clearing banks, helped to solidify the thesis of patient and flexible private capital, unhindered by capital adequacy and other regulatory requirements. This is an important point to note as, to date, there has not been any meaningful sign that regulators will look to impede private creditors and that can only be a good sign for the credit markets in supporting growth. We expect those private credit markets to continue to go from strength to strength in 2022 and beyond.

Looking deeper into the economic system underpinning private markets, there is a large investor base seeking yield. With the availability of buy-side dry powder and the support of flourishing credit markets, the capacity to transact readily exists. Through private equity and private credit, institutions have experienced strong gains and capital deployment, and this has helped mitigate the relative quietness in the immediate period following the onset

“For those restructurings which do take place, many may fall into true insolvency processes”

of the pandemic. This has undoubtedly contributed towards the sheer volume of transactions in the record-breaking markets of 2021 to date.

One slight wrinkle to the above has been the relative absence of clear opportunities in the distressed markets. This had led to some special situations and distressed creditors needing to be more creative in the search for opportunity to deploy capital.

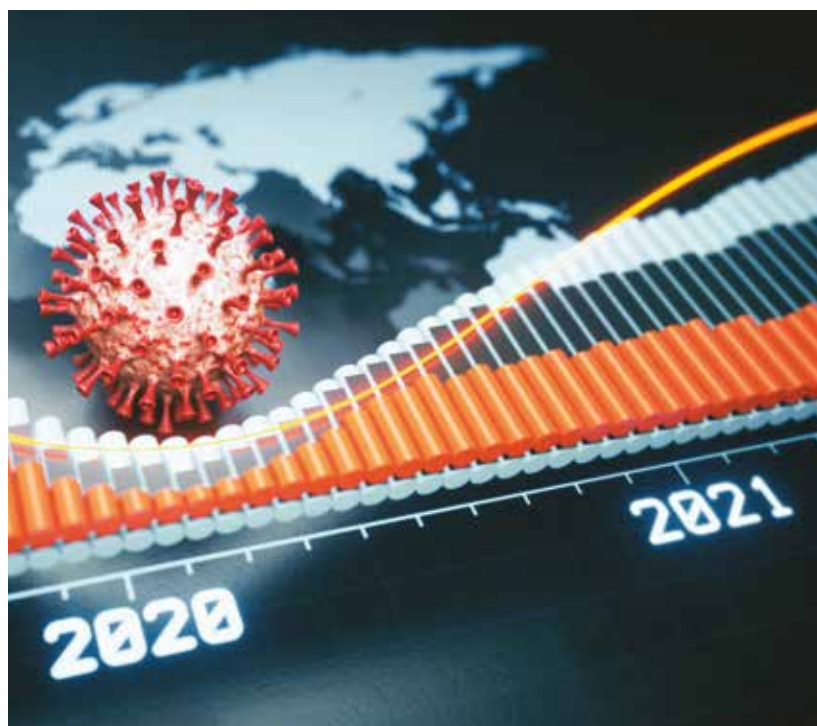
Most examples seen towards the latter stages of Q2 and Q3 have been special situations or 'stressed' investment in real estate portfolios, and indeed minority equity co-investment of creditors' more flexible pot of capital alongside borrowers. In the latter instance, this has the advantage of aligning interests between borrowers and lenders, but also allows credit funds to look beyond deployment in a low-interest environment where increased yield is hard to come by. This may also lead to an increase in holdco financings where liquidity financing in an already highly levered structure may be impractical.

Back to normal

A key driver of expectation and an important measure for the ongoing buoyancy of the markets is that of the return to normal business. For many industries, there was an expectation that it would take longer to return to normal, which led to a remarkable level of fiscal discipline, particularly within smaller businesses.

Many looked to crowdfunding for support, a wide and efficient infrastructure not meaningfully available during previous periods of economic downturn. Whether in retail, travel or hospitality, the expectation of a slow return has proved to be overly conservative – business has returned so quickly that finding employees has become difficult for many businesses as their levels of activity soared.

This is of course not just a symptom of the pandemic or a return to relative normality, but one where political machinations such as Brexit may have



acted as a catalyst for many Europeans to return to their home nations. Why then have we seen such an increased level of activity in the hospitality, retail and travel sectors?

One explanation is the very human desire to go back to going out and enjoying restaurants or sporting events after an extended period of restriction. Those restrictions may well have led to an increase in personal liquidity in some instances after a period of vastly reduced discretionary spending.

Looking back, 2021 may well feel like a whirlwind, but what can we expect at the turn of the year as we look towards 2022? First, it is clear that liquidity will continue to drive activity, but there may well be a relative slowdown to the end of the year as advisers, investors and companies consolidate and take stock of the year so far (and also start to carefully plan, set budgets and objectives for next year). From here, we can likely expect to see a growth in mid-market restructuring, albeit possibly on a smaller scale than some market participants have been expecting in the past 12 months.

For those restructurings which do take place, many may fall into true insolvency processes rather than the more consensual restructurings where the failure of the underlying business and the value-destructive impact of time makes recovery extremely challenging. Thematic sectors will likely continue to punctuate activity, with tech, healthcare and education in particular representing key areas of interest for investors while the energy sector may well come to focus in light of world events.

The European market's growing comfort with pre-EBITDA financings will provide a very strong foundation for increased investment in the tech space where potential exists for huge growth and even an increase in IPO-related activity. Overall, we can expect M&A levels to remain high and with a potential surge in activity in the first quarter of 2022, if there is a period of rest and reflection towards the end of 2021. ■

Aymen Mahmoud is a partner in the London office at law firm McDermott Will & Emery