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What to expect from cross-border financings in 2022

Debt financings appear to face some serious challenges in 2022 but Aymen Mahmoud and Samantha Koplik of McDermott, Will & Emery are confident the market will overcome them and maintain strong dealflow.

By **Guest Writer** - 46 mins ago

Following a remarkable 2021 when all deal activity metrics were broken, many in the market have asked what to expect of 2022. Could insolvency move to the fore as the pandemic stimulus unwinds? Could deal fatigue be impactful? Could inflation impact markets? Could geopolitical tensions play their part? Or will dry powder across equity and debt markets (and everywhere in between) continue to drive activity and growth across global markets?

Early indications in January and February 2022 suggest that markets remain very strong with a positive outlook for dealflow and, whether or not at the level of 2021, certain themes can be expected to drive growth in 2022.

One theme we can expect to continue into 2022 is sectoral growth. While we may expect the energy sector to face difficulties, particularly in light of geopolitical and macroeconomic events, some of that may be isolated to certain geographies or indeed lead to M&A-based consolidation and carve-out opportunities.

Conversely, the technology and healthcare platforms remain at the forefront of investor confidence and there is continued commentary around the market regarding outward investment in those sectors, particularly from sovereign money amid overly narrow exposure for certain oil-rich nations.

Adjacent businesses, such as education tech, health tech, digital health and telehealth, will continue to receive strong support from the equity and debt markets, particularly given the continued focus on balancing working arrangements with personal priorities and the scientific advances that drive retail and wholesale results.

In addition, other verticals surrounding those areas will drive synergistic growth at the same time, creating more competition between private equity and trade buyers. Finally, pre-EBITDA/revenue financings will undoubtedly continue to attract significant attention and competition among investors in light of their pure growth potential, which is very likely to be heightened by cross-border buy-and-build opportunities and synergies with established platforms.

A further emerging theme over the last three years, across both sides of the Atlantic, is size. Increased availability of liquidity in the equity and credit markets has meant increasing capacity to finance transactions outside of the syndicated lending market, in turn playing neatly into the hands of direct lenders and other private creditors. Even if US rates move as some expect them to during 2022, the net effect on private credit markets, which already impose a floor, will be very minor (if indeed there is an effect).

The competitive tension around financing deals across verticals and industries is white-hot; indeed, for a number of deals, price is not proving to be the key driver, as evidenced by the resurgence of covenant-lite unitranche deals, particularly in Europe.

Borrowers are happy to pay for covenant flexibility and credit funds which are able to (as per their investment arrangements) are happy to provide flexibility for a premium. We have seen both larger funds being raised and more variety of fund types and structures, allowing a more flexible approach to, and wider availability of, financing at higher amounts and higher multiples.

For those capital structures where there might be a need to bolster funding gaps, particularly at the onset of stress or difficulty, we have seen 'special situations' capital deployed efficiently toward new growth investments and

private equity LPs seeking opportunities to provide direct co-investment equity.

In addition, there has been an uptick in the large-cap space of holdco instruments, whether structured as PIK (very prevalent in the European market) or preferred equity (more prevalent in the US market) and specialist and traditional credit funds are happy to play in this space.

While size can be key for any individual deal, it is also needed to institutionalise lending relationships in the buy-and-build space – another theme that is strong and will continue to grow in prevalence. We have seen greater sophistication in strategies to identify targets (particularly on a cross-border basis or within verticals), which can add meaningful synergies (and even multipliers), cost-savings and growth potential.

Diligence processes increasingly utilise artificial intelligence and automation to maximise market efficiency, and if one considers the growing number of players with a proven track record focusing on integration support for management teams and utilising dedicated operating partners, we expect private equity investments to grow in sophistication.

Long-term financing needs will need to be addressed at deal inception, even for relationship players, and particularly for cross-border structures where choosing one credit market over another may have meaningful cost and operational implications.

As such, we do not see any meaningful early indicators of a distinct shift in the cross-border financing markets, despite ongoing geopolitical matters – creditors have not historically played in the markets most impacted by those issues, and the more global impact may take some time to be truly felt.

There are marked efficiencies in today's cross-border market that did not exist 10 years ago, particularly within the direct lending space, and we have withstood an unforeseen global pandemic, global geopolitical issues such as

Brexit and changes in political landscapes that many thought would herald highly negative impacts on the cross-border financing markets.

Whilst those impediments have not yet reached their natural conclusion, their darkest days appear to be behind us for the most part. There will undoubtedly be more challenges to overcome, but cross-border financing markets seem well placed to weather those storms and continue to build solid foundations based on strong credit analysis and patient capital.

Based on the themes described above, we can therefore expect confidence to continue, even if there are periods when deal volume does not quite reach the highs of 2021 – levels that far exceeded the most bullish of expectations. While any market will naturally seek growth and progression, it may be that robust markets assume that growth trajectory over longer periods and do not simply make record-breaking years the norm – the right comparator may more appropriately be seen as being the pre-pandemic period.

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