Debt Advisory 2024 Lender Survey

Leveraged finance
European debt markets

clearwaterinternational.com

CLEARWATER INTERNATIONAL

Executive summary

As one of the largest European independent advisers, Clearwater International's Debt Advisory team remains highly active, having completed 40 deals across Europe in 2023 and entering 2024 with a strong pipeline of new mandates.

The team has surveyed 58 lenders across Europe to determine what recent market changes mean for borrowers in 2024.

The lenders surveyed were spread across banks and debt funds, covering a range of transaction sizes and multiple regions, therefore providing a comprehensive view of the European leveraged finance market.

With inflation hitting highs not seen for over 30 years and central banks responding with rapid base rate increases, 2023 has proved one of the most challenging years for European debt markets since the 2008 financial crisis.

The high interest rate environment has been compounded by further threats to the global economy following two years of war in Ukraine, supply chain disruption, geopolitical tensions and the failure of three significant banks in the US.

Despite these challenges, green shoots of optimism are now coming through with inflation across Europe having reduced significantly in the final quarter of 2023. Whilst inflation is still running at broadly double central banks' target rates, interest rate swap markets are signalling strong confidence that rate cuts will be delivered across 2024.

Key highlights include:

55%
of respondents reported a reduction in leverage appetite of at least 0.5x EBITDA over the last twelve months

43%
of lenders indicated that margins have increased by up to 50bps, although arrangement fees have remained broadly unchanged for 76% of lenders

52%
of debt funds are now introducing more PIK into their deal structures, with the majority allowing between 100bps and 300bps of margin to be PIK'd

78%
of debt funds reported that they had raised new funds, with almost a quarter raising more than €2bn

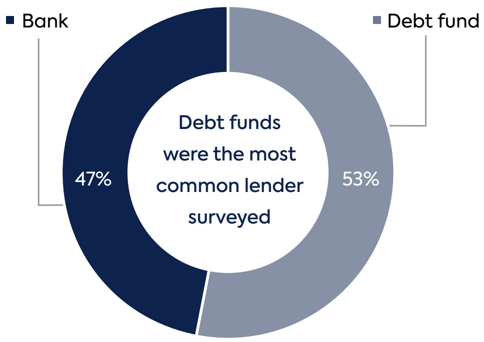
69%
of lenders stated that hedging remains optional, even in today's higher interest rate environment

68%
of debt funds have changed strategy, with key themes being greater focus on specific sectors, size, sponsors targeted, and geographies

Clearwater International's Debt Advisory team surveyed 58 lenders to determine changes in the European leveraged finance market.

The lenders surveyed were spread across banks and debt funds, a range of transaction sizes and multiple regions, therefore providing a comprehensive view of the European leveraged finance market.

Bank or debt fund



Our selected recent transactions:

WestBridge
APEM
raised debt finance
Financing
€67m

ICG
on its investment in
Direct Ferries
a portfolio company of
LIVINGBRIDGE
Buy-side
Undisclosed

WATERLAND PRIVATE EQUITY INVESTMENTS
portfolio company
COOPER PARRY
raised debt finance to support the acquisition of
Haines Watts
Acquisition finance
Undisclosed

GraphiteCapital
hansonwade
on its refinancing
Refinancing
Undisclosed

Margins

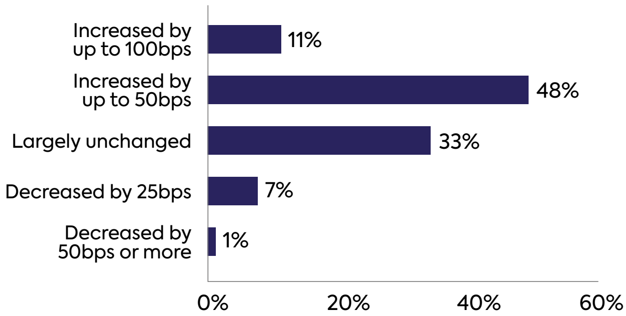
Over half of lenders surveyed reported an increase in pricing, with 43% increasing margins by up to 50bps and 10% increasing margins by up to 100bps.

This continues the trend seen in our 2023 survey, where 85% of debt funds and 68% of banks increased their margin requirements. Albeit the proportion of lenders increasing prices has decreased with only 49% of debt funds and 59% of banks now reporting pricing increases.

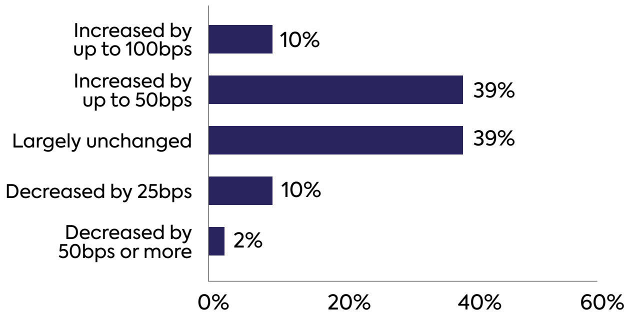
This result is somewhat surprising to us, as we have seen pricing come down on our transactions in the latter part of 2023, particularly as competition on high quality deals has increased.

How have margins changed in the last 12 months?

Bank margin change:



Fund margin change:



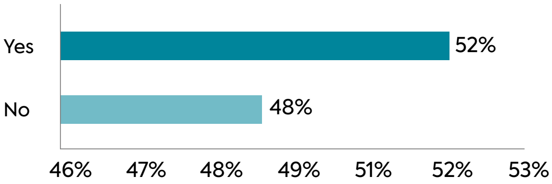
PIK

Given the significant rise in interest costs, we have observed an increasing prevalence of PIK being introduced into deal structures to improve cashflow affordability to borrowers.

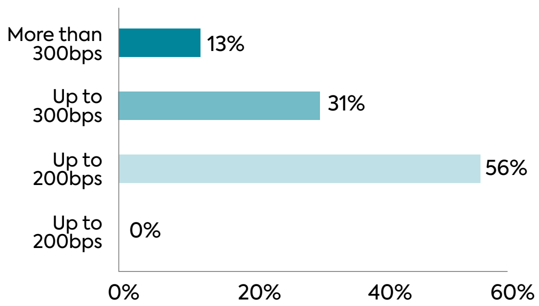
Over half of debt funds are now introducing more PIK into their deal structures, with the majority allowing between 100bps and 300bps of margin to be PIK'd.

There is an incremental cost to the borrower for this, with the PIK premium being an additional 100bps of margin on average.

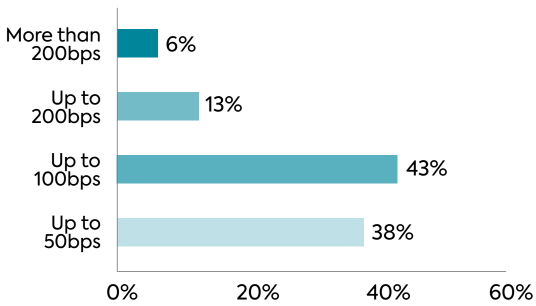
Are you now introducing more PIK into deal structures?



How much of the margin can be PIK'd?



What is the PIK premium?



Financial covenant requirements

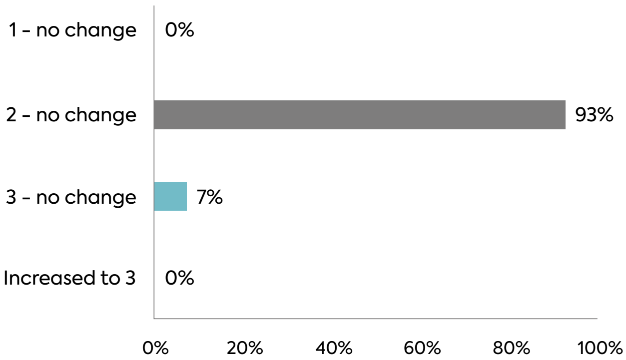
Despite the more challenging economic backdrop, the number of covenants required by both banks and debt funds has remained broadly unchanged.

93% of banks reported that they continue to require two covenants on average (typically leverage and cashflow cover).

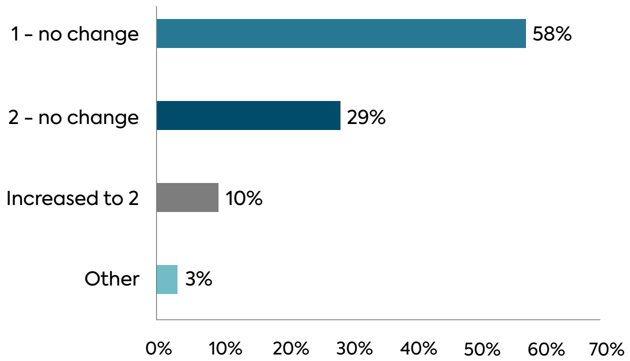
Similarly, 87% of debt funds have also seen no change, with this remaining at one or two covenants.

In relation to covenants, how many covenants do you now require?

Bank:



Fund:



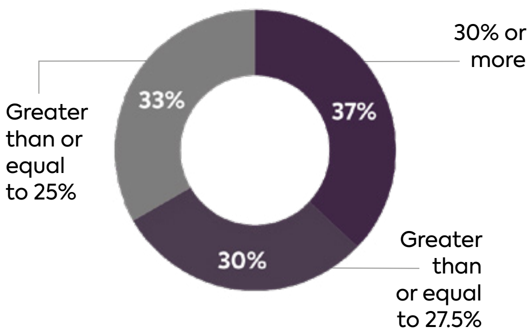
Financial covenant headroom

The levels of financial covenant headroom on offer remains broadly in line with our 2023 survey. 100% of banks now report EBITDA headroom availability of >25% (up from 96% in 2023) with the average being 27.5%.

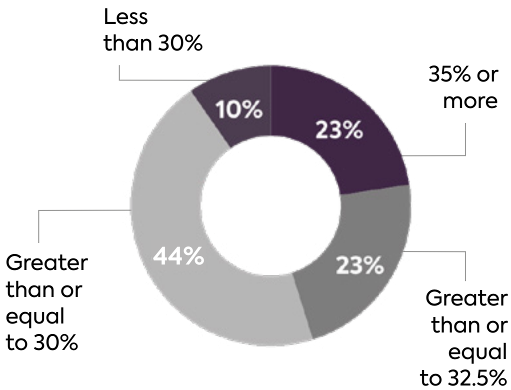
90% of debt funds report typical covenant headroom of at least 30% (up from 85% in 2023), with almost a quarter agreeing to headroom of more than 32.5%.

What is the EBITDA headroom you typically agree?

Bank headroom:



Fund headroom:



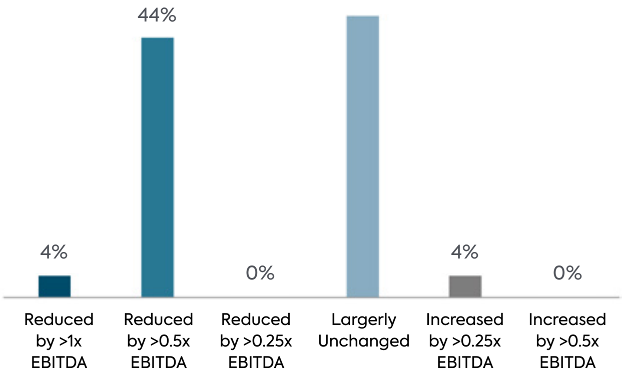
Leverage appetite

Over 60% of lenders reported a reduction in leverage appetite over the last twelve months. This was more prominent amongst debt funds, with 75% noting a reduction in leverage appetite.

This is surprising, as while we have not seen leverage return to the levels seen prior to the September 2022 Mini Budget, we have not observed further declines in leverage availability on our transactions delivered in the latter half of 2023.

How have you seen leverage appetite change over the last 12 months?

Bank:



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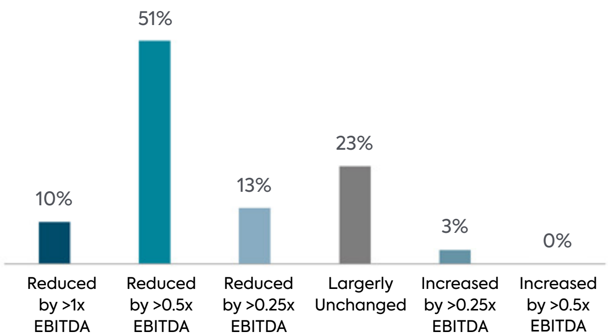


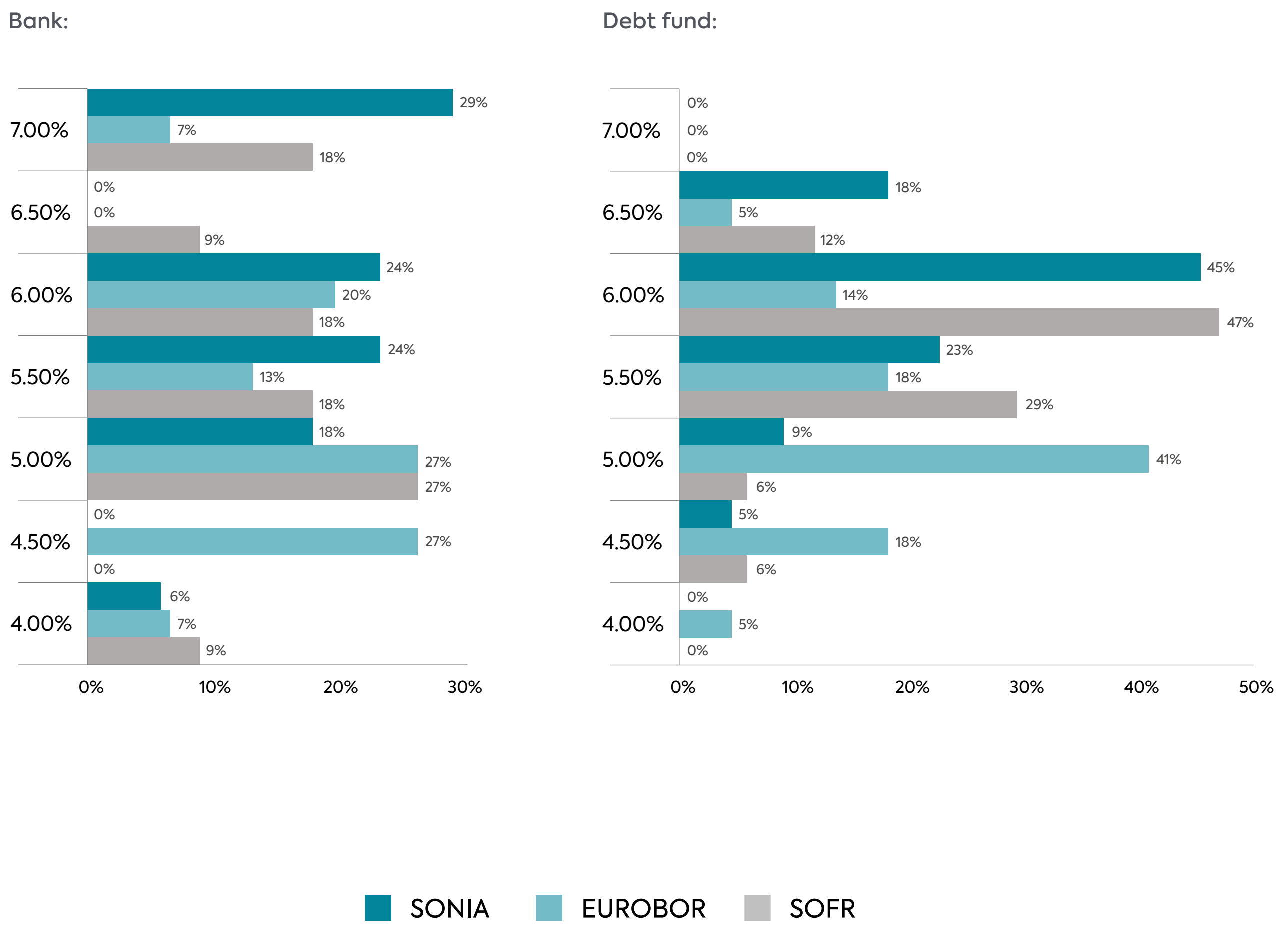
Cost of funds

Stress testing the resilience of business forecasts and downside scenarios is a key focus for credit committees, particularly on whether the business can withstand further interest rate increases.

To test this resilience, and ensuring the borrower can continue to service its debt obligations, most lenders have been assuming the following interest rate sensitivities:

SONIA – 6% EURIBOR – 5% SOFR – 6%

What cost of fund rate sensitivites are being used internally to stress test borrowers?

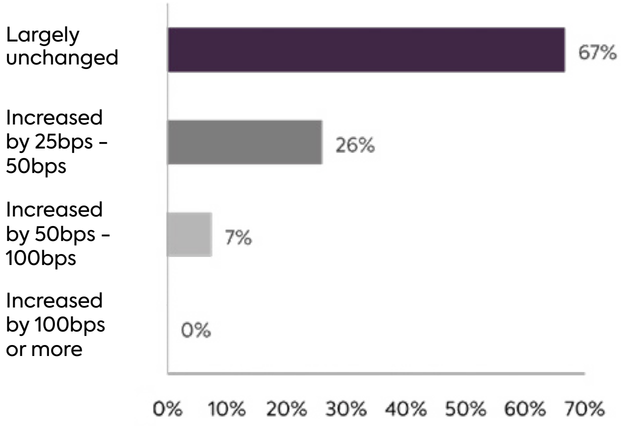


Arrangement fees

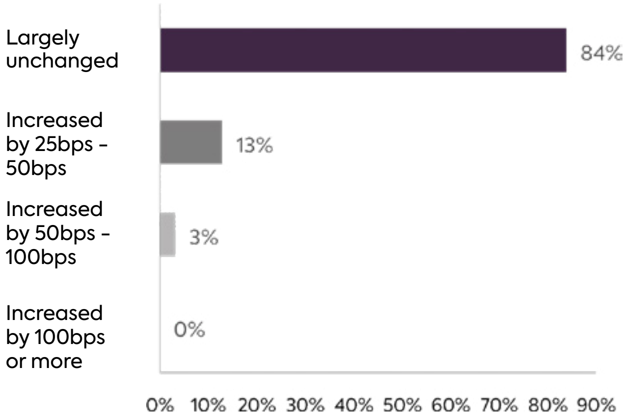
Lenders have largely kept arrangement fees unchanged (typically 3% of committed funds raised).

Have there been any changes to arrangement fees?

Bank:



Fund:

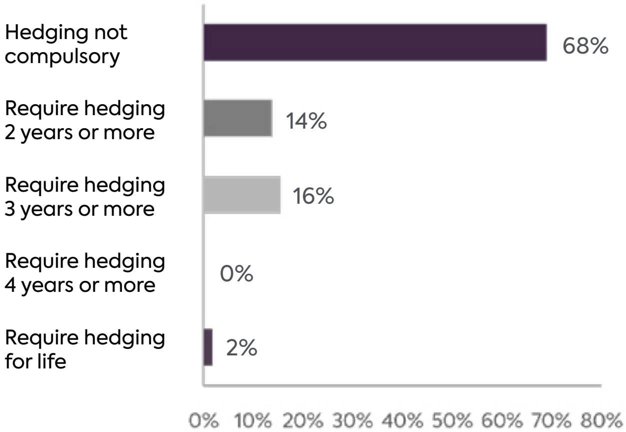


Hedging

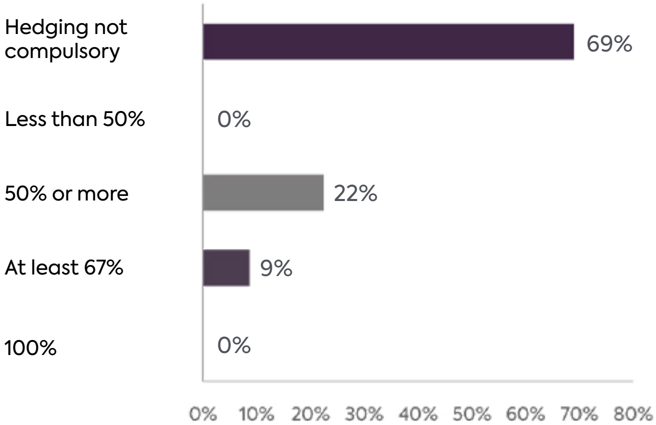
Despite current interest rate uncertainty, 69% of lenders reported they do not have any compulsory hedging requirements. This is slightly down since our 2023 report when 74% of lenders reported no compulsory hedging requirements.

For any hedging that would be required, this would predominantly be for at least two years and 50% of the facility.

In respect of hedging, what is required and how much of the term is required to be hedged?



Quantum to be hedged:



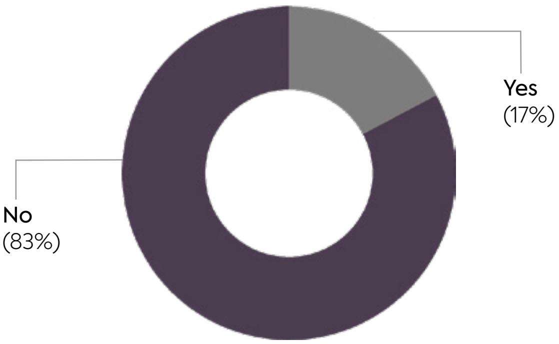
Survey highlights:

"Hedging requirements were really relevant in 2022, but are now less so, given already high base rate levels being included in the transaction from day one and expected falling rates."

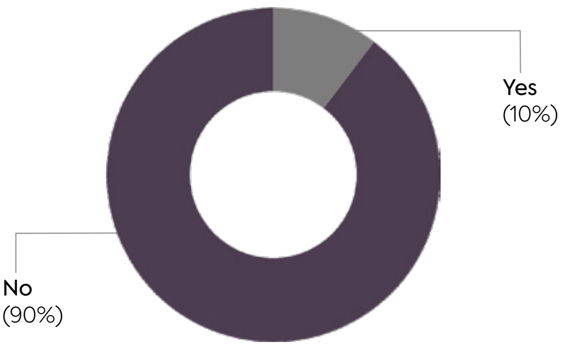
Due diligence requirements

Due diligence requirements are largely unchanged, with 83% of lenders reporting no increases to their due diligence requirements for new borrowers. This increases to 90% for borrowers who are existing customers of the lender.

Have due diligence requirements changed for new customers?



Have due diligence requirements changed for existing customers?



Survey highlights:

“Number of DD reports required hasn’t really changed, although the number of follow up questions has gone up and there is greater attention paid to the scopes of the reports.”

Credit processes

Two thirds of lenders have seen no change in the length of their credit processes in the last twelve months, with less than a third noting these are now taking longer and a small minority indicating they are now running faster.

A slightly greater proportion of debt funds (32%) indicated that credit processes are taking longer than banks (26%).

This is broadly in line with what lenders indicated in our 2023 survey, suggesting that while overall transaction processes may be taking longer given broader market challenges, lender credit processes are not the driving factor behind this.

Survey highlights:

"

Processes in general have become more drawn out, but the speed at which we can get approval from our investment committee has not changed."

"

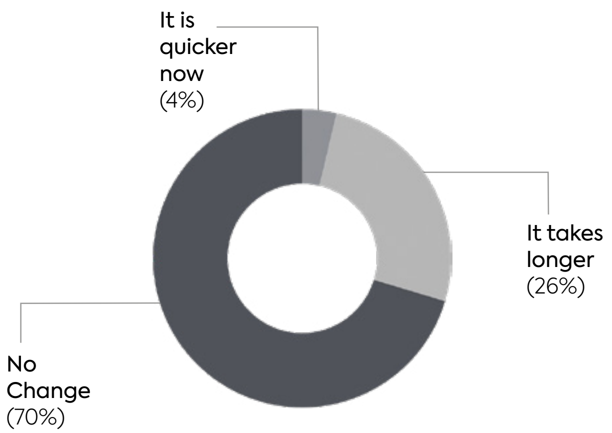
Good organisations have remained consistent with their processes, although appetite for different credits has swung towards quality, given wider macro-economic challenges."

"

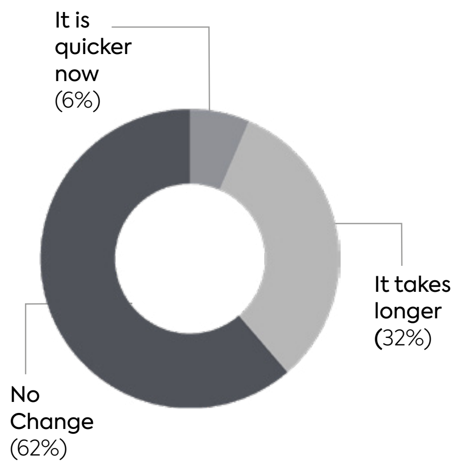
Generally speaking, financial results of companies have been more volatile which has resulted in more changes to deal structures and longer DD processes."

How do you feel the investment/credit committee process has changed in the last 12 months?

Bank:



Fund:

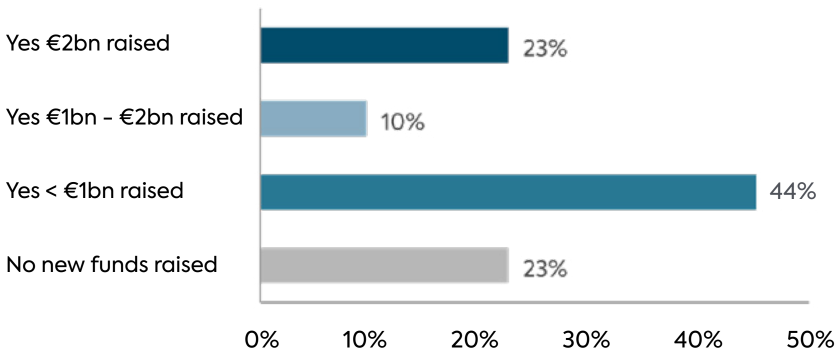


Fund raising

78% of debt funds reported that they had raised new funds, with almost a quarter raising more than €2bn.

Have you raised any new funds in the last 12 months?

Fund raising:



Other key observations

45% of lenders reported a reduction in transaction volumes over the last twelve months, with 36% experiencing no significant change and 19% seeing an increase

56% of banks reported increased levels of participation in banking club structures over the last twelve months

68% of debt funds reported material changes in strategy, with key themes being greater focus on specific sectors, sponsor backed businesses, larger deals and specific geographies

33% of lenders are currently avoiding certain sectors, with consumer being most commonly cited, followed by real estate and construction

Other lending options

Other than typical cash flow lending, lenders reported that they now also offer the following lending solutions:

Annual recurring revenue (ARR) financing	21%
Net Asset Value (NAV) financing	19%
Sustainability linked (ESG) financing	59%

Conclusion

Despite a challenging year and corresponding reduction in deal volumes, lenders have continued to support the private equity market through 2023, albeit at reduced levels of leverage and higher pricing than was available only a few years ago.

In the face of these trends, we have seen particularly robust credits continue to receive strong appetite, competitive pricing and leverage levels holding up. We have also seen an increased prevalence of banking club structures being sought by borrowers to lower their overall cost of capital.

Covenants and hedging requirements have remained broadly in line with previous market norms and debt funds have sought to reduce the impact of higher interest rates on affordability by introducing increased levels of PIK into deal structures.

Going into 2024, lenders are reporting increased confidence and fuller WIP, which is positively demonstrated by the success debt funds have had in raising significant levels of new funding to support future deals.

Lenders are looking ahead with cautious optimism, with many encouraged by falling inflation rates although still concerned that economic uncertainty and geopolitical risk may continue to impact corporate earnings.

As one of the most active and largest independent advisers in the debt market, with a growing headcount of over 40 dedicated debt advisory professionals across Europe, Clearwater International can provide borrowers with clear support to navigate these challenges.

Feedback

"We have seen a recent upturn in deal activity as management teams come to terms with the macro environment and the higher but stabilised cost of capital."

"Economic conditions and a borrower's resilience through the cycle is key in the current environment."

Our Debt Advisory team

Clearwater International's European Debt Advisory team can deliver seamless, integrated global advice to mid-market/owner-managed, corporate and private equity clients.

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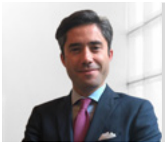

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Our recent transactions

Clearwater International's European Debt Advisory team completed over 40 transactions in 2023 despite market conditions, reflecting an active and current view of the market.

WestBridge
APEM
raised debt finance
Financing
€67m

ICG
on its investment in
Direct Ferries
a portfolio company of
LIVINGBRIDGE
Buy-side
Undisclosed

HAKIM GROUP
raised debt facilities
Refinancing
Undisclosed

WATERLAND PRIVATE EQUITY INVESTMENTS
portfolio company
COOPER PARRY
raised debt finance to support the acquisition of
Haines Watts
Acquisition finance
Undisclosed

Hyle capital partners
raised new finance to support the acquisition of
ciemme
Acquisition finance
Undisclosed

PERWYN
on its investment in
iam property
Buy-side
Undisclosed

GraphiteCapital
hansonwade
on its refinancing
Refinancing
Undisclosed

transparity
transformation • partnership • clarity
raised debt facilities to support the acquisition of
DataShapa
Acquisition finance
Undisclosed

cardo
a portfolio company of
EMK Capital
Enterprise Management Knowledge
Refinancing
Undisclosed

EURIZON ASSET MANAGEMENT
ERSEL
raised new finance to support the acquisition of
TecnoFer
Acquisition finance
Undisclosed

Majority shareholder

raised new finance to support the acquisition of

ligabue

Acquisition finance
Undisclosed

efor
RAISE

debt and equity

Sell-side
Undisclosed

CDS GROUPE
idi

raised debt finance to support the acquisition of

CRC CORPORATE RATES CLUB

Acquisition finance
Undisclosed

idi

raised debt finance to support the acquisition of

Prevost

Acquisition finance
Undisclosed

The shareholders of

CRP
in
iseris

sold an equity stake to

parquest

Sell-side
Undisclosed

MONVISO

raised new finance

Refinancing
Undisclosed

CHEQUERS CAPITAL

raised new finance to support the acquisition of

AVIA AIRCRAFT SERVICES

Acquistion finance
Undisclosed

WATERLAND PRIVATE EQUITY INVESTMENTS
Carton Group

on its acquisition of

ARK EPG Gruppo Europoligrafico

Acquisition finance
Undisclosed

H.I.G. CAPITAL

raised finance to support the acquisition of

office people

Acquisition finance
Undisclosed

Bencis

raised finance to support the acquisition of

HEYtex

Acquisition finance
Undisclosed

Methodology

Research was conducted by survey platform Qualtrics by Clearwater International among 58 senior decision makers across Banks and Debt Funds, from across the UK and Europe during the 14th December 2023 – 12th January 2024.

China - Denmark - France - Germany - Ireland - Italy - Netherlands - Portugal - Spain - Sweden - UK - US