William Blair

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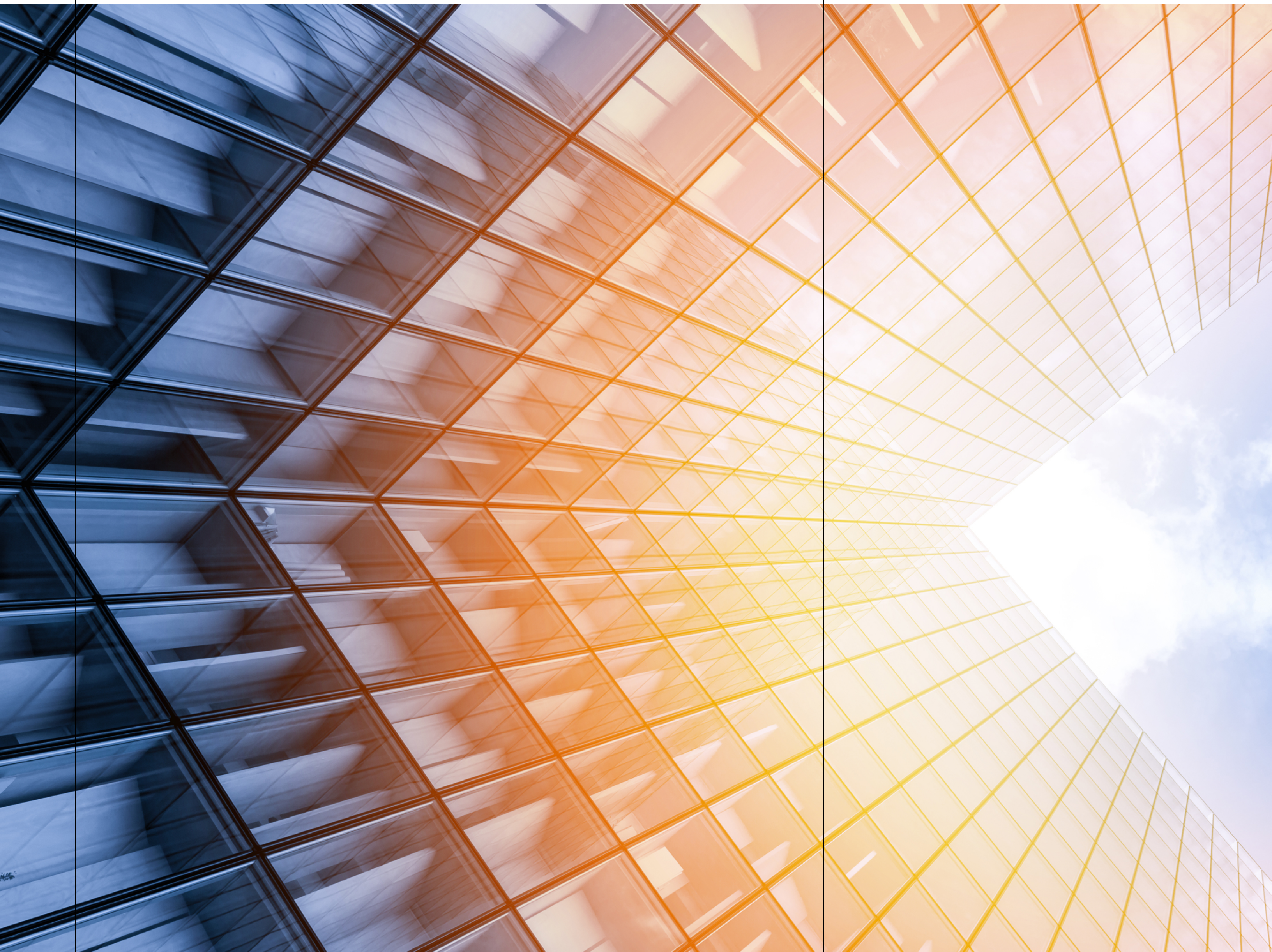
Investment Banking

In This Report

William Blair's Leveraged Finance Group reviews the key themes that drove leveraged finance markets in 2021 and looks ahead at the trends that will shape the coming year

Leveraged Finance: 2021 Year in Review

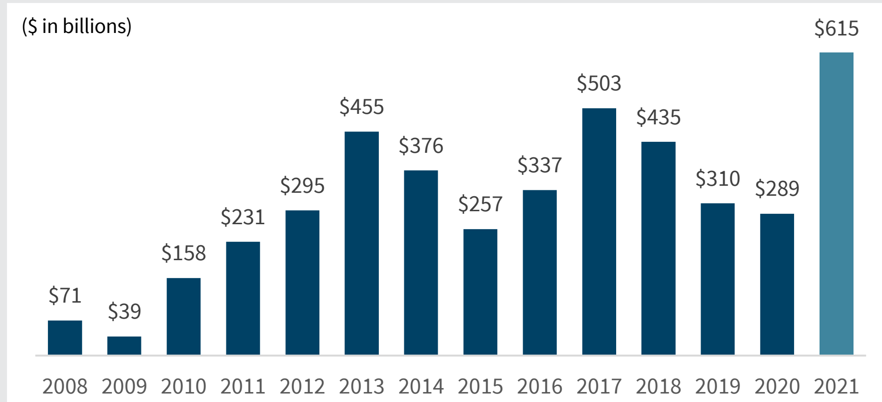


Leveraged Finance: 2021 Year in Review

Debt financing markets continued to experience powerful momentum in 2021. Deal volume hit an all-time high, new financing options emerged, and private credit continued to increase its share among middle-market borrowers. These tailwinds have set the stage for a strong 2022.

Record Loan Volumes

Volume in the new-issue leveraged loan market hit an all-time high in 2021.
US New Issue Institutional Loan Volume



Source: LCD, an offering of SPGMI

Market Hits New Highs—and Becomes More Complex

New-issue volume in leveraged loans hit an all-time high in 2021, topping $615 billion. This surpassed the previous full-year record of $503 billion set in 2017. More than half of new issuance consisted of debt raised to support M&A activity, with M&A-related loans totaling $331 billion in 2021, 20% higher than the previous record set in 2018.

The market also became more complex as new entrants and new products emerged, creating a rapidly changing leveraged loan landscape amid the influx of deal activity. More lenders entered the market, and more financing options became available to a wider range of companies. William Blair helped its clients navigate this complex landscape by providing a 360-degree view of the leveraged finance market and available financing options, running competitive auction processes to achieve market-clearing terms, and delivering unparalleled speed, execution, and certainty to close.

Heightened Competition Creates a Borrowers' Market

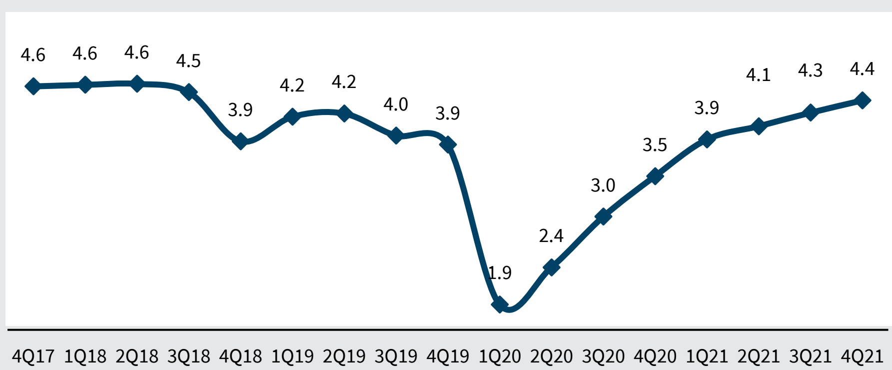
Elevated competition among lenders has led to increasingly advantageous terms for issuers. In William Blair's 4Q21 leveraged finance survey, 73% of respondents said they had to make borrower-friendly concessions that they previously would not have made to win a deal. Top concessions included reduced interest rates and fees, increased leverage, and loosened terms on covenants or other documentation items.

In 4Q21, William Blair's Leveraged Lending Index also recorded the most borrower-friendly market environment since 3Q18. The index hit 4.4 on a scale of 1–5, with 5 representing the most borrower-friendly environment and 1 representing the most lender-friendly environment. This was a dramatic turnaround from the extremely challenging conditions in 1Q20 that led to an index level of 1.9.

On the other side of the table, lenders agreed that they were being more aggressive in their approach to new debt opportunities. In William Blair's 4Q21 survey, lenders rated their aggressiveness at 7.0 on a 0–10 scale, an all-time survey high and the sixth consecutive quarter with an increase.

Borrowers Call the Shots

By the end of 2021, the leveraged loan market was the most borrower-friendly it has been since 2018, according to William Blair's Leveraged Lending Index.



1 = Most Lender-Friendly; 5 = Most Borrower-Friendly
(1) Weighted average lender response to the question, "On a scale of 1 to 5, how would your firm rate today's lending environment?"

Recurring Revenue Loans Give Late-Stage Companies New Options

Although they have been around for several years, recurring-revenue loans stepped out of the shadows in 2021, providing additional financing options for late-stage companies. These products are structured based on multiples of annualized recurring revenue (ARR) rather than on EBITDA multiples. Initial covenants and pricing are based on ARR leverage and typically “converted” midway through the life of the loan to an EBITDA-based leverage structure with a corresponding reduction in rate. These loans allow late-stage borrowers with significant recurring revenue to access debt financing and minimize dilution while continuing to invest in the growth of the business.

In 2021, the expansion of the ARR-based financing market was fueled by massive demand for investments in software businesses, an area that showed resilience during the pandemic and often features contractual revenue streams from a large base of customers. As these loans became more mainstream, numerous lenders began offering the product, which further expanded the market and narrowed the pricing spread between recurring revenue and EBITDA-based loans.

William Blair completed multiple ARR-based loan financings in 2021, all with intense levels of lender interest. One transaction saw approximately 60% of contacted lenders submit financing proposals despite having just 11 days between outreach and initial bid date. Our expertise in late-stage debt financing and expansive network within the late-stage lender universe helped issuers and sponsors navigate the uncertainties of a relatively new frontier and secure the best possible financing outcome.

Sponsors and Owners Take Chips Off the Table

The leveraged finance market saw high levels of dividend recapitalization volume in 2021 as sponsors and owners sought to reduce risk. While this activity was partly fueled by concerns over potential tax changes and inflationary fears, many owners were simply being opportunistic and taking advantage of increased valuations and borrower-friendly terms. Recaps allow sponsors and issuers to protect against tax uncertainty and generate liquidity without giving up their equity or their positioning for optimal outcomes in any future sale process.

Dividend recap volume rose to 13.4% of total institutional loan volume in 2021, the highest percentage share of any year since 2013. The total dividend recap volume of $82 billion also broke the previous full-year record of $61 billion set in 2013.

Private Credit Continues to Win Share From Syndicated Market

Direct lending/private credit became a more significant source of capital for middle-market borrowers in 2021, while the share of syndicated loans continued to fall—a trend that has been developing over the last several years. Several transactions larger than $1 billion also went the direct route in 2021. Previously, these transactions in all likelihood would have been syndicated deals.

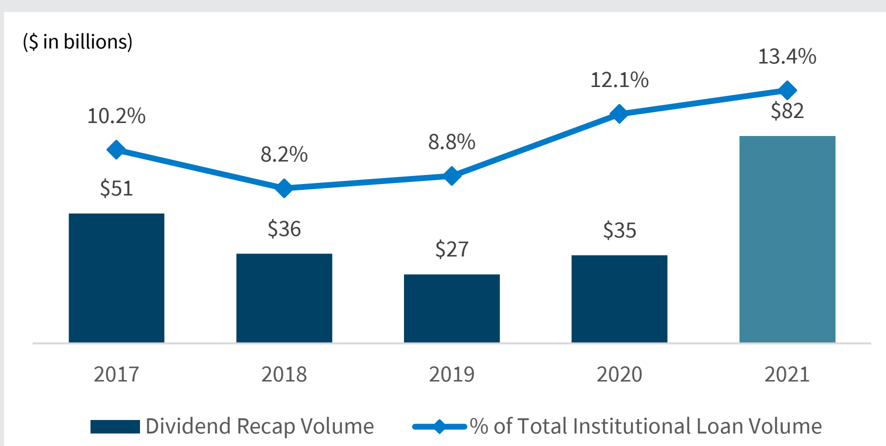
The direct market has some distinct advantages for borrowers. Private deals often reduce execution risk and offer lower transaction costs. Borrowers are also able to work with one or a few trusted partners, enjoy more privacy, and get a clearer view of who is holding their debt. These benefits led borrowers who had previously considered only the syndicated market to explore direct lending/private credit options in 2021. When advising on these types of deals, William Blair leverages its relationships with hundreds of direct lenders to tailor transactions to each borrower’s unique circumstance and deliver optimal outcomes.

Lender Capacity Constraints Become a Concern

While the competitive environment helped drive improved terms, borrowers unfortunately also found it increasingly difficult to get lenders’ attention on financing opportunities in 2021 as a result of internal capacity constraints. With so many deals in the market, many businesses struggled to attract lender interest, particularly in the second half of the year. Lenders and intermediaries that borrowers rely on—like law firms, accounting firms, and quality-of-earnings providers—were frequently unable to engage or move quickly enough to meet transaction deadlines.

De-Risking Deals

Dividend recapitalizations hit an all-time high of $82 billion in 2021, accounting for more than 13% of total institutional loan volume.



Source: LCD, an offering of SPGMI

More than half of the lender respondents to William Blair's 4Q21 survey said they had to turn down new opportunities because of capacity constraints, with more than 30% believing new business volumes will be challenged by internal capacity constraints going forward. As it becomes more difficult to get lenders' attention, issuers and sponsors may find it difficult to raise capital on their own. William Blair helps borrowers solve this problem by taking ownership of financing workstreams, designing processes specifically tailored to the client and the situation, and leveraging our broad lender network to deliver the maximum certainty of close.

Looking Ahead: What to Expect In 2022

Rising inflation/rising rates: According to William Blair's in-house economists, inflation in the United States is likely to persist before moderating to about 3.0% by the end of 2022—still higher than general market expectations today. Our economists also believe that inflation will remain slightly higher (i.e., 2.0%–2.5%) over the longer term rather than returning to the 1.75% average of the decade pre-pandemic. Our economists expect the Fed to increase interest rates twice in 2022, though they would not rule out a third increase, which the market now believes is a strong possibility. This should draw even more capital into the direct lending market, as leveraged loans are typically floating-rate instruments that can provide investors with a yield that is resistant to both inflation and interest rate risk.

Emergence of ESG issuance: We are still in the early stages, but a new type of debt issuance is emerging where issuers are tested on not only financial metrics, but also ESG metrics like carbon emissions or diversity figures. In these ESG-linked loan facilities, the proceeds are still used for traditional needs (M&A, growth, working capital, etc.). However, borrowers can improve financial terms by hitting specified ESG targets. While this structure has been found predominantly in larger syndicated facilities, ESG has become a significant focus in the middle market as well. In William Blair's 3Q21 survey, 74% of issuer respondents said their firms already had ESG policies in place, and another 15% were actively evaluating them.

Borrowers' market: The borrower-friendly market environment, characterized by lender aggressiveness in pursuing deals as well as lender concessions, is expected to persist in 2022 for those looking to tap the leveraged loan markets.

Capacity constraints: Though they are likely to moderate somewhat, capacity constraints are likely to continue in 2022, potentially making it difficult for some lenders to engage on new opportunities. This is mainly due to headcount constraints, not capital shortages.

Navigating an Increasingly Complex Marketplace

To learn more about these and other trends that are shaping the leveraged loan marketplace, please do not hesitate to contact us. Whether you are a borrower or a sponsor, William Blair's Leveraged Finance Group can help you navigate uncertainty and emerging trends in debt financing markets. Our team would welcome the opportunity to speak with you about how we can help you achieve your strategic initiatives in 2022.

Recent William Blair Leveraged Finance Transactions

Not Disclosed Country Pure Foods Senior Secured Credit Facility 2021	Not Disclosed OneCare Media First Lien Credit Facility 2021	$180,000,000 HungerRush Unitranche Credit Facility 2021
Not Disclosed KALERIS Unitranche Credit Facility 2021	Not Disclosed ConnectAmerica a portfolio company of Rockbridge Growth Equity Senior & Subordinated Debt Preferred Equity 2021	Not Disclosed uniFund Senior Secured Credit Facility 2021
Not Disclosed Andelyn Biosciences Senior Secured Term Loan Preferred Equity 2021	$350,000,000 VERRA MOBILITY Senior Notes 2021	Not Disclosed Colson Group Unitranche Credit Facility 2021

Drawing on our deep product expertise and the strength of our relationships, William Blair has built a leading leveraged finance franchise. Sponsors and business owners turn to us for outstanding execution support of their capital raising objectives.

Leveraged Finance Team

Michael Ward
+ 1 312 364 8529
mward@williamblair.com

Darren Bank
+1 312 801 7833
dbank@williamblair.com

Andrew Romer
+1 312 801 7815
aromer@williamblair.com

Ethan Burgard
+ 1 312 364 8410
eburgard@williamblair.com

Ryan Stackhouse
+1 312 364 8521
rstackhouse@williamblair.com

Shrey Patel
+1 312 364 8341
shreypatel@williamblair.com

Mark Birkett
+1 312 364 8783
mbirkett@williamblair.com

Will Ruiz
+1 312 364 5453
wruiz@williamblair.com

Chandler Dane
+1 312 364 8920
cdane@williamblair.com

Jackson Tworek
+1 312 364 8587
jtworek@williamblair.com

Ryan Fernandes
+1 312 364 5088
rfernandes@williamblair.com

William Blair Leveraged Finance by the Numbers

125+
completed leveraged finance transactions since 2015

$19B+
arranged financing since 2015

500+
lender and alternative credit provider relationships

About William Blair Investment Banking

William Blair's investment banking group enables corporations, financial sponsors, and owner/entrepreneurs around the world to achieve their growth, liquidity, and financing objectives.

Drawing on the collective intellectual capital and deep sector expertise of a global team that reaches over 20 cities on four continents, the investment banking group brings a rigorous and innovative approach to corporate board advisory projects, mergers and acquisitions, and equity and debt financing. From 2017 to 2021, the team advised on more than $680 billion in completed transaction volume.