

## Leveraged Finance

Q2 2019

**Lenders Shake Off Macro  
Concerns to Aggressively  
Pursue Quality Opportunities**

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Highlights from William Blair’s  
Quarterly Leveraged Lender Survey



# Lenders Shake Off Macro Concerns to Aggressively Pursue Quality Opportunities

**The leveraged finance market remained borrower-friendly in the second quarter as a lack of deal flow pressured lenders to compete for scarce opportunities.**

Although macroeconomic and geopolitical concerns continued to weigh on the leveraged finance market, any increase in lenders' negotiating leverage was offset by a lack of supply in the second quarter. Leveraged loan volume fell to \$108 billion for the quarter, down 18% from the first quarter and 49% year-over-year. Institutional loan volume totaled only \$71 billion, the lowest quarterly amount since 2016. A slowdown in M&A activity was largely responsible, as M&A-related institutional loan volume fell to \$38 billion, down 24% from the first quarter. While refinancings and dividend recapitalizations increased slightly to \$27 billion in the second quarter, that volume still represents a 50% year-over-year decrease.

The lack of quality opportunities coming to market, combined with an abundance of available capital, offset developments that otherwise could have moved the needle in lenders' favor, including slower economic growth, escalating trade wars, and constant political tension. The net result was an environment that was

largely unchanged during the second quarter in terms of conditions for market participants. According to William Blair's proprietary Mid-Market LBO Financing Database, the average spread on unitranche pricing in LBOs was unchanged, ending the second quarter at L+575. Additionally, average senior pricing fell by 15 basis points to L+455, and average second-lien spreads held constant at L+865.

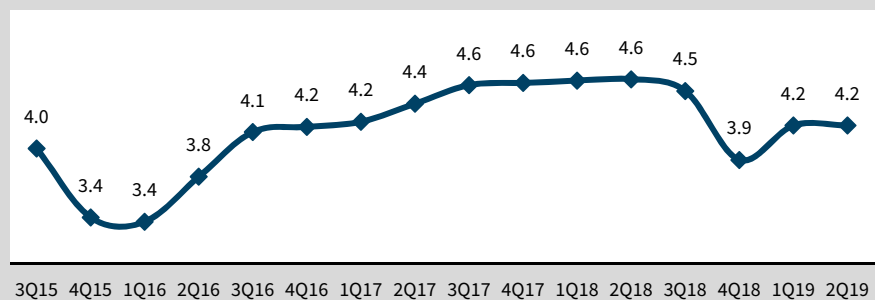
Leverage levels largely followed suit. Average senior leverage in LBOs ticked up slightly from 5.2x to 5.4x during the second quarter, while average total leverage declined slightly from 6.0x to 5.8x. The convergence of average senior and total leverage levels reflects the market's shift away from using second-liens as a significant portion of the

capital structure, a trend we outlined in last quarter's newsletter.

Lenders' responses to William Blair's Leveraged Finance Survey in June confirmed these market dynamics. Despite voicing concerns about macro market dynamics, 25% of respondents indicated that pricing for their primary debt offering had decreased during the quarter, while another 64% noted that it had stayed the same. Similarly, when asked about transaction terms and leverage, 33% of respondents indicated that these criteria had loosened during the quarter, with another 61% stating that they stayed the same. William Blair's Leveraged Lending Index further echoed this sentiment. The index, which measures conditions in leveraged lending markets on a scale

## William Blair Leveraged Lending Index Holds Steady

Each quarter we ask middle-market lenders to rate overall conditions in the leveraged finance market on a scale of 1 to 5, with 5 being the most borrower-friendly conceivable. Although it has yet to return to the levels seen in 2017 and 2018, the index has held steady at 4.2 for consecutive quarters after dipping below 4.0 in the fourth quarter of 2018.



of 1 (the most lender-friendly) to 5 (the most borrower-friendly) held steady quarter-over-quarter at 4.2 after dipping below 4.0 at the end of 2018.

### **Rapidly Changing Trade Policies Have Lenders “Tariff-fied”**

How do lenders underwrite to trade policy that is written 280 characters at a time? While political risks have never been easy to navigate, the current climate has made things considerably more challenging for underwriters and their credit committees. When asked about the topic in William Blair’s Leveraged Finance Survey, more than 70% of lenders indicated that they believe tariffs have affected the way their firms have evaluated and underwritten recent opportunities. Feedback regarding the changes, however, ranged from “increased focus on sourcing” to “deals with exposure being put on hold.”

Most lenders indicated that their increased diligence includes modeling the impact of tariffs, but the depth of the analyses varied greatly as well. Some have decided to require market studies or third-party analyses to determine tariff exposure whenever inputs include products sourced from China or Mexico. But even with perfect visibility into the entire supply chain, individual relationships and unique competitive dynamics make it nearly impossible to determine what costs

can be passed through to the customer and what must be absorbed at each level.

The lack of consensus on the nature of tariff-related underwriting risks highlights the difficulty lenders face in trying to manage these issues. This challenge is magnified by the speed and unpredictability at which the trade policy landscape is evolving.

### **Credit Inequality and a Disappearing Middle Class**

As lenders attempt to navigate the current market and strike a balance between maintaining underwriting discipline and putting capital to work, leveraged loan markets have become increasingly bifurcated. Lenders are aggressively pursuing higher-quality borrowers, offering attractive terms and structures for companies that check the right boxes.

But given how late we are in the economic cycle—and with a laundry list of concerns hanging over the market—companies that raise too many red flags are either quickly dismissed by lenders or forced to make significant concessions to get deals across the finish line. Issues such as cyclical, customer or supplier concentration, trade concerns, and reputation / headline risk can all be non-starters depending on the audience. The borrower’s industry / sector, intended use of the proceeds, and ownership structure also play a large role in determining where the

company lands on this increasingly bifurcated spectrum.

Although the lack of a “middle class” is a consistent theme throughout leveraged finance, it is particularly evident in the middle market where lenders are often evaluating businesses using less sophisticated data and typically without the help of ratings agencies. In this market, lenders are also frequently asked to operate on condensed timelines as part of competitive processes, and lenders may be evaluating several opportunities concurrently. By quickly identifying and pursuing high-quality credits, borrowers are able to minimize unwanted risks and limit time spent on opportunities where they will ultimately be less competitive. Given the market dynamics and trade-policy uncertainty, this may be a situation that persists until the current cycle ends and the market has a chance to reset.

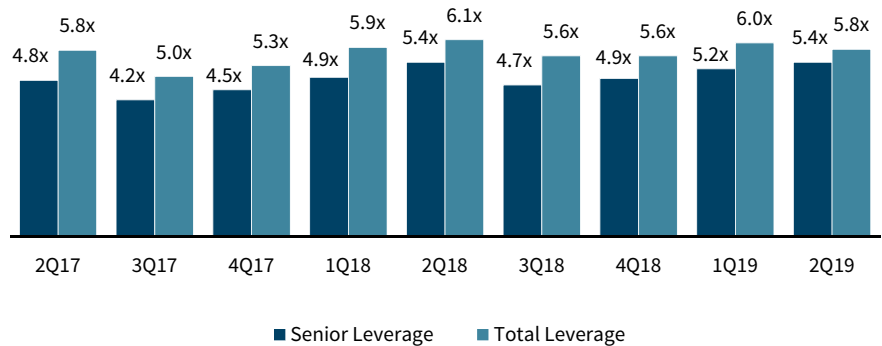
To learn more about these and other trends shaping the leveraged finance market, please don’t hesitate to contact us

## Market Analysis

Each quarter we look behind the numbers to examine the market dynamics that are driving trends in pricing and volume in leveraged finance transactions.

### Middle-Market LBO Leverage Multiples

Leverage multiples for middle-market LBOs remained relatively flat in the second quarter. Average senior leverage increased slightly to 5.4x, while average total leverage decreased from 6.0x to 5.8x.

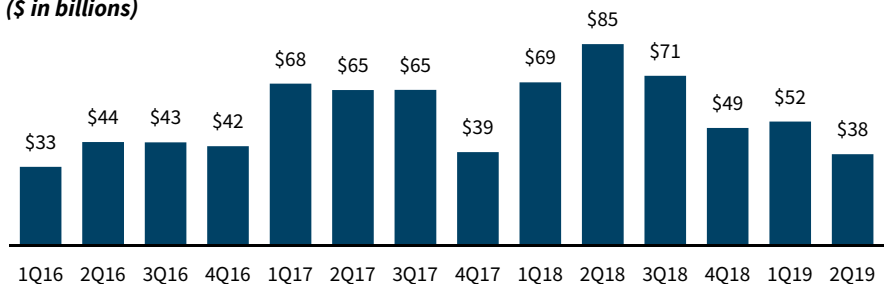


Source: William Blair Proprietary Mid-Market LBO Financing Database

### Institutional M&A Volume

While M&A activity accounted for 54% of all institutional loan volume in the second quarter, it was down 24% quarter-over-quarter and down 55% from the second quarter of 2018.

(\$ in billions)



Sources: S&P LCD

### High-Yield Bond Volume

New-issuance high-yield bond volume increased 19% to \$72 billion, the second consecutive quarter of growth after a difficult end to 2018. The second quarter's volume was the most it has been since the first quarter of 2017.

(\$ in billions)



Sources: S&P LCD

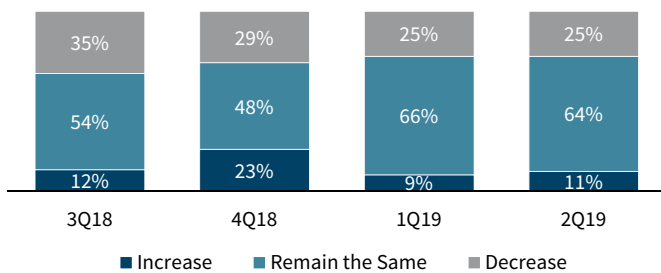
## Highlights From William Blair's 2Q 2019 Leveraged Finance Survey

Each quarter William Blair surveys middle-market leveraged finance professionals representing leading credit funds, BDCs, commercial finance companies, commercial banks, and other credit providers to measure sentiment in the leveraged finance market. The data reflect responses from the 75 leveraged finance professionals who participated in the survey this quarter.

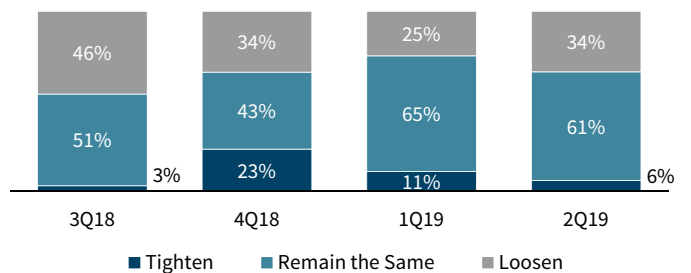
### Leveraged Lending Market Conditions Remain Relatively Flat Through First Half of 2019

Despite ample macroeconomic and political concerns that arose, the leveraged lending market maintained the aggressive position it reclaimed in the first three months of the year. While market sentiment is still less borrower-friendly than 12 months ago, the vast majority of lenders reported that pricing and terms were either unchanged or changed in favor of issuers during the second quarter.

#### Pricing



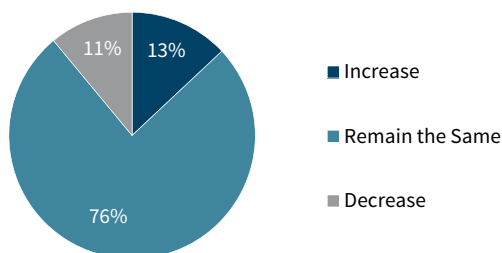
#### Leverage and Terms



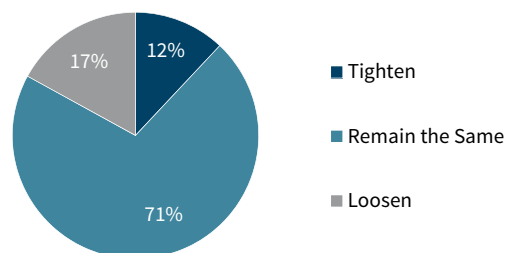
### Lending Expectations for the Remainder of 2019

Respondents overwhelmingly expect pricing, leverage, and terms to remain the same over the remainder of 2019.

#### Pricing Expectations

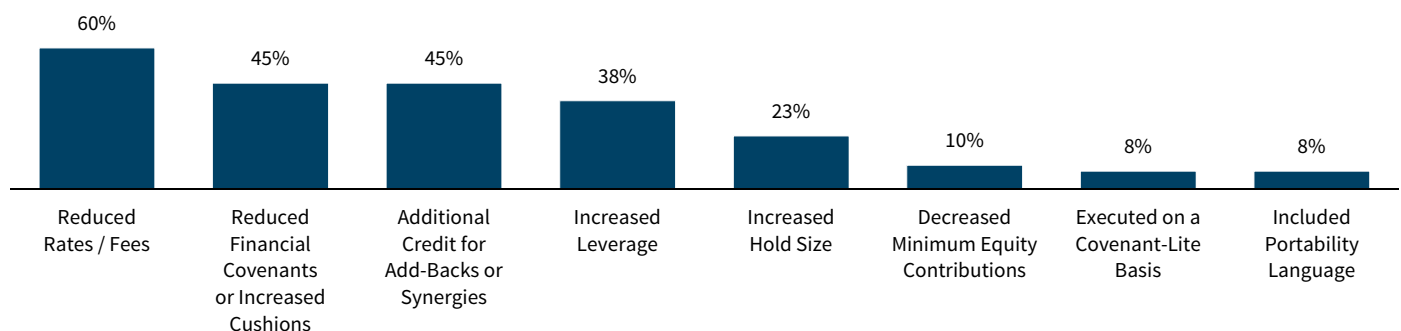


#### Leverage and Terms Expectations



### Playing to Win

We surveyed lenders to see if they made any concessions this quarter that they historically wouldn't have made to win a deal. 53% responded affirmatively, up from 47% to start the year, with reduced rates once again being the most common concession. However, lenders appear less willing to give on covenants and add-backs than they have been in the past.



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 in support of their capital-raising objectives.

**Recent transactions include:**

\$160,000,000



Unitranche Credit Facility

May 2019

\$410,000,000



First Lien and Second Lien Credit Facilities

May 2019

Not Disclosed



Senior Secured Credit Facilities

April 2019

Not Disclosed



Senior Secured Credit Facilities

February 2019

\$80,000,000



Unitranche Credit Facility

November 2018

Not Disclosed



formerly doing business as Pearl Technologies, Inc.

Unitranche Credit Facility

September 2018

**William Blair  
by the Numbers**

**175+**

*completed leveraged finance transactions since 2012*

**\$30bn**

*arranged financing since 2012*

**400+**

*lender and alternative credit provider relationships*

William Blair's Leveraged Finance team structures and arranges debt capital in support of acquisitions, recapitalizations, and growth through its well established relationships with debt capital providers globally.

- \$30 billion of completed financing arranged since 2012
- Specialists who are experts in complex engagements, including those requiring insightful credit positioning and the arrangement of multiple layers of capital
- Robust distribution capabilities providing a 360° view of the market; relationships with over 400 lenders and significant transaction experience with alternative credit providers
- Real-time, proprietary view of the leveraged finance market from William Blair's global M&A and debt advisory practices
- Senior banker attention and unbiased, objective advice; senior bankers average more than 20 years of experience
- Thoughtful, customized financing processes that produce outstanding outcomes

With more than 160 senior bankers around the world, William Blair has completed more than 1,050 advisory and financing transactions totaling more than \$330 billion in value for our clients.\*

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\* In the past five years as of June 30, 2019

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Drawing on the collective intellectual capital and deep sector expertise of a global team that reaches 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 2014 to 2018, the team advised on more than \$300 billion in completed transaction volume.