The State of Private Credit in Europe (Second of a Series)

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Our fondness for colorful metaphors led us, in our 2016 series, to compare European direct lending to Burger King's new hot dog venture. The burger giant's thesis was to apply "sixty years of flaming-grilling expertise," but also recognized they'd have to "chop the onions a little differently."

Apparently, hamburger prowess didn't translate to frankfurters. The experiment lasted six months.

Similarly, there are fundamental differences between US and European private credit markets. Banks are more "efficient" in Europe and represent a greater share of leveraged loans. And despite the toe-hold direct lenders have established there over the past decade, barriers remain.

In a recent column in *Private Debt Investor*, a banker referred to a survey showing 22% of private equity sponsors favored one-stop solutions, preferring bank loans instead. The rationale seems to be both a reluctance to overleverage borrowers, and comfort with their banking relationships.

But the private debt Covid experience was the same here and overseas in many respects. This was particularly true of its initial impact on portfolios. One fund of fund manager estimated of the more than 200 borrowers in its funds, 23% were "highly-impacted" compared to 17% in its private equity portfolios. These companies were found mostly in the retail, hospitality, and travel sectors.

As time passed, though, conditions improved. One top lender, also quoted in PDI, said "valuations of companies have not declined and, on the contrary, we can highlight some inflation in asset prices. So, overall loan to value is still quite strong, which means from an investor perspective the asset class has been shown to be extremely resilient."

Companies under private equity ownership are quick to react, she went on to say. The same nimble reactions and effective communication displayed by US firms happened in Europe.

Deloitte's Altemative Lender Deal Tracker, produced by Robert Connold and his stellar team, provided excellent data to support these observations. Their most recent report highlighted a "record-breaking run of deals seen in Q4 2020 [that] continued into Q1 2021, with 160 alternative lending deals closed in Europe, the highest ever recorded number of deals in a single quarter."

The report went to note that "the last two quarters also mark the most activity-dense stretch in the history of the deal tracker, with 319 deals closed in total, almost two and a half times as many deals seen in the preceding six months."

Contrary to the survey mentioned above, "70% of the quarter's 160 deals were Unitranche facilities compared to only 59% in Q4 2020, with the majority of the increase coming at the expense of senior facilities which fell from 26% of deals in Q4 2020 to only 17% this quarter."

Next week: We examine more closely the current characteristics of European direct lending.