A Review of European Direct Lending (First of a Series)

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Over the years the US has been by far the dominant supplier of leveraged loans globally. (See our *Chart of the Week*) But given similar regulatory pressure being exerted on overseas banks as here, Europe is gaining media attention as a source of debt opportunities for both managers and investors. How should these opportunities be viewed relative to senior credit in the US? Is there something fundamentally different about the direct lending space in Europe, or is it the same asset dressed in a different currency?

According to S&P LCD, Europe was a €15 billion market in 1998. Before that deals got done among an informal club of banks. Things remained clubby through the early 2000's when a growing number of institutional buyers pushed the market over €100 billion.

Then following the bull loan market of 2006-07, it peaked at €165 billion. As cash flowed into funds and CLOs, the sell-side friendly features of the US broadly syndicated market crossed the Atlantic. But that all came to a halt with the credit crisis. Loan volume collapsed after 2008 and was on its way back until 2012, when the imposition of new regulatory frameworks knocked activity down again.

Today the European loan market is where the US was in terms of development a decade ago. Unlike the US, disintermediation of regulated lenders in Europe by non-banks has only been going on since 2009. Banks there have always played a central role in corporate lending, and while their share has eroded, it's still well over the 10% of banks here.

In some ways, Europe has been ripe for middle market lenders for a while. As one top attorney familiar with its history told us, "The fabric of the European landscape is mostly small and medium-sized companies. There just aren't a lot of large companies there compared with the US."

While European banks are more active in leveraged loans than their American counterparts, middle market borrowers – with facility sizes less than €250 million – tend to fall below the radar of most corporate lending teams. For those regional, or "country" banks, that do support smaller companies, their focus tends to be on working capital financing with ABL facilities or lines of credit.

And though some European banks can be competitive in select private equity-driven transactions, in general they are less nimble with comprehensive credit solutions than non-banks. But private credit funds have distinct hurdles as well. For one thing, the patchwork nature of multiple jurisdictions makes origination in Europe a real challenge.

Over the next several weeks we'll be exploring the dynamics of the European market, including the different economic backdrops, the comparative volume and deal metrics, the identity of market participants, and the relative opportunities for buy-side and sell-side players between that market and the US.

Next week we look at the interplay between banks and non-banks in Europe vs. the US.