Baker McKenzie.

In The Know

Leveraged Finance Annual Report | 2021

TRANSACTIONAL POWERHOUSE

Leading and closing complex deals every day

CONTENTS

2020: The Year in Review

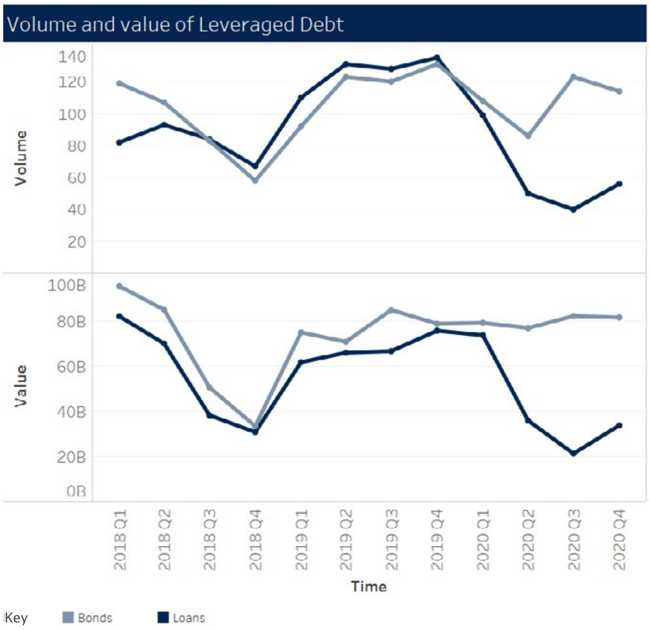
The EMEA leveraged finance market in 2020 showed a shift in trend from previous years in terms of product mix, with a renewed interest in high yield bond issuances over Term Loan B borrowings. High yield bond issuances (volume and value) over the course of 2020 remained fairly stable while Term Loan B borrowings contracted in Q2 and Q3 2020, with a strong recovery in Q4 2020. The main drivers for the 2020 leveraged finance market were the COVID-19 pandemic and geopolitical movements (US election and Brexit), which in turn slowed down M&A activity in H1 2020. Despite this market uncertainty, market participants have adjusted to the new norm and M&A activity in Q4 2020 bounced back and is poised for a strong 2021. Direct lending products continued to be a viable alternative for raising capital and allowed for more bespoke funding solutions, such as equity-linked loans, throughout the year.

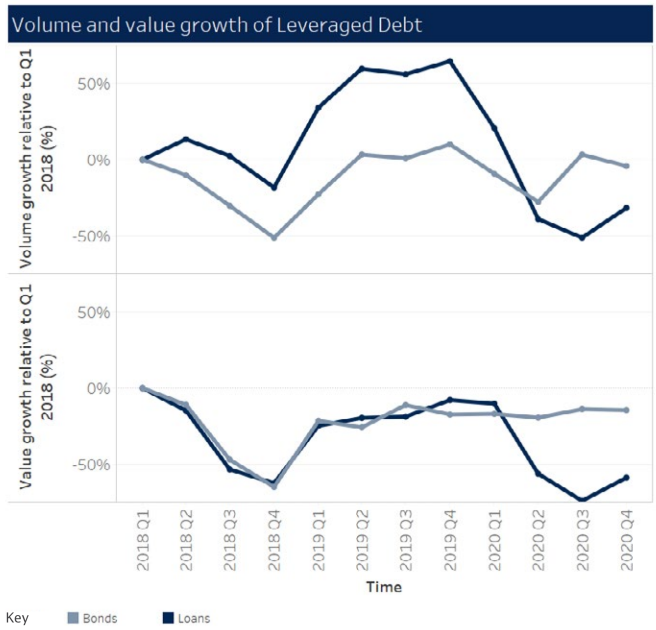
Market participants were focused on weathering the storm that was COVID-19 while keeping a close eye on geopolitical developments, with those too heavily impacted looking to restructuring their capital structure. Despite the pandemic weighing heavily on certain industries (such as travel and leisure), others were well placed to evolve and expand (technology, gaming, cannabis). Emerging markets also had a relatively strong year, continuing to develop and diversify their sources of capital toward green bonds and more complex covenanted borrowings. ESG factors have also been a focus for investors and other stakeholders throughout the year, with continued developments in the green bond market as well as more innovative social and sustainability-linked solutions.

2020 by Product

In 2020, the EMEA bond market remained stable while the loan market saw a sharp contraction in the first three quarters followed by a strong correction in Q4 2020. While refinancings and operational liquidity needs kept the markets open, weak M&A in H1 2020 and disruptions due to COVID-19 led to the market decrease. The end of the year saw a strong rebound in the loan market which we expect to see continue through 2021 as vaccines are deployed and markets stabilise.

The charts below show deal volume and value of high yield debt and loans by quarter since 2018:





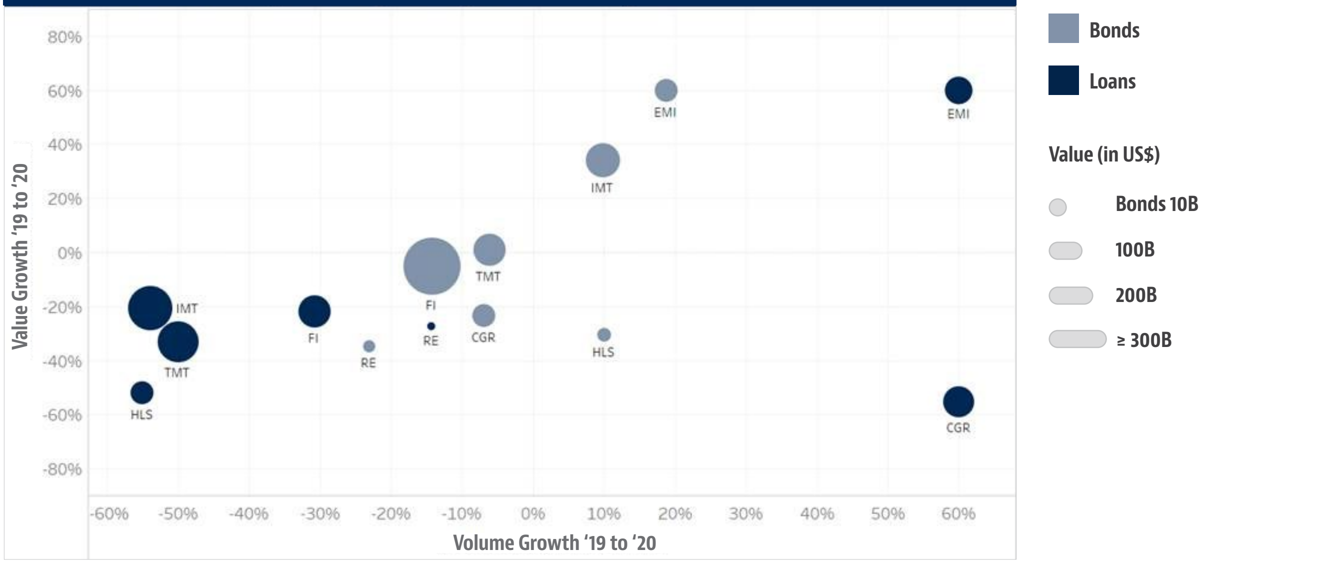
Source: Refinitiv

2020 by Industry

Transactions by industry saw strong volatility in 2020 due to the COVID-19 pandemic, which created significant opportunities to develop and expand in certain industries but caused serious disruptions in others. Bonds remained the preferred financing option in the financial industry and remained fairly stable. On the loan side, which was more affected by the pandemic, the energy, minerals and industrials sector showed the most resilience in terms of value and volume while all other sectors saw value and volume decrease (other than consumer goods & retail which saw an increase in volume but a decrease in value). Loan-funding remains the preferred source of funding for LBO activity but was negatively affected by slower M&A in the first half of the year.

The chart below shows deal volume and value growth from 2019 to 2020 of high yield debt and loans across EMEA broken down by industry:

Volume and value of Leveraged Debt by industry



Source: Refinitiv

2020 by Geography

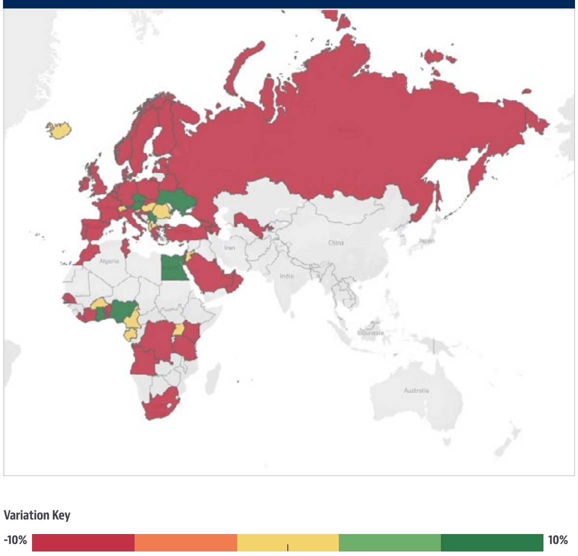
Changes in product mix in 2020 versus 2019 continue to show interesting developments that may not reflect trends so much as confirm the fact that products are available interchangeably across EMEA. In terms of both volume and value, the loan market was most heavily impacted by the pandemic, while the bond market remained relatively stable. Overall, the leveraged finance market in 2020 saw the largest upticks in Eastern Europe and certain CIS countries, while the remainder of EMEA contracted over the period.

Germany, Spain and Italy saw the largest drop in loan volume and value over the past year, while bond volume and value in these countries remained fairly stable and even slightly increased. Although France observed the largest drop in loan volume over the year, a few big ticket transactions maintained the stability of the overall value of transactions year over year. Despite Brexit still looming over the United Kingdom for the year, the aggregate volume and value of bond transactions increased while loan volume and value decreased. Nordic countries, Russia and most of Africa saw significant decreases in volume and value of leveraged finance transactions over the year due to the COVID-19 pandemic and slowed M&A activity. Emerging markets continued to grow over the year, with significant increase in bond issuances (in terms of volume and value) observed in Turkey and Greece.

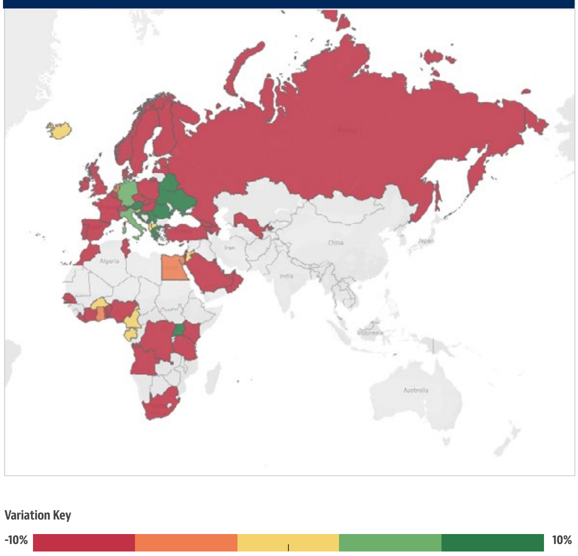
It will be interesting to watch 2021 as markets and industries adjust to the new post-pandemic normal, emerging markets continue to increase access to international capital markets and M&A activity continues to bounce back.

The charts below show movements in combined bond and loan volumes by jurisdictions comparing 2020 to 2019:

Volume growth



Value growth



Source: Refinitiv

2021: Ten Predictions for the EMEA Leveraged Finance Market

1. COVID-19 – Weathering the storm: Challenges and opportunities of a "new normal"

It's an understatement to say that the COVID-19 crisis disrupted the financial markets in 2020 in a variety of significant ways. Companies shored up on cash in the early days, corporates in certain markets (travel, leisure, etc.) were driven into restructuring territory while others (telecom, online products, life sciences) prospered. On the whole though, the financial markets remained robust during 2020, with the M&A slowdown balanced in part by some opportunistic moves by corporates and sponsors. While hopefully our 2022 predictions will not have COVID-19 on the list, 2021 won't be so lucky.

Prediction:

The COVID-19 crisis will evolve in two phases in 2021. In the first part of the year, as vaccines are rolled out and the pandemic finally starts to subside, market participants will dust off pre-COVID operating procedures; affected industries will see some relief as business starts to recover and offices, travel and face-to-face meetings will make their way back into the business norm.

Even so, the post COVID-19 world will be marked by what commentators call the "new normal." We expect that many short and medium-term business models that have been developed over the course of the pandemic will morph into long-term solutions that create long-lasting value-add to their businesses and opportunities in the future. As companies continue to adapt to the new environment, we expect such evolutions to help businesses in their recovery and to become more resilient.

Nevertheless, we expect to see significant distress and restructuring activity marking much of (at least) H1 as the inevitable for many companies cannot be delayed indefinitely.

2. Brexit implementation marks the next era for EMEA finance

With a sigh of relief over the Brexit deal finally adopted between the UK and EU, market participants can finally turn their attention to the new post-Brexit landscape, which will continue to provide implementation challenges but also opportunities for new initiatives and market growth outside of London.

Prediction:

Brexit terms will be an area of focus in 2021, but the Brexit blueprint will return more certainty to the financial markets. Market participants will likely need to adapt to a new post-Brexit landscape, but now they will have visibility. Expect a combined boost in M&A and private equity, supported by financial solutions.

3. US geo-political led volatility

The past four years in the US have seen the stock markets rise to record highs (almost a 100% increase over the period) as policies under President Trump have eased regulation, but the Trump years have been similarly marked by inconsistent global actions and policies. With Joe Biden's inauguration as 46th president of the US on 20 January 2021, many policy shifts are to be expected from the US that will have a knock-on effect on US markets and globally.

Prediction:

The shift in US policies will likely impact the markets. As the year progresses and new policies unfold (on both sides of the Atlantic) uncertainty and volatility will diminish as the "new normal" sets in.

4. Financial product mix to continue to evolve and further emergence of alternative sources of capital

2020 has been a turbulent time for the global economy. This environment has posed problems for many investors and businesses seeking to deploy or access capital due to lack of visibility. In these conditions, certain market participants have turned to more complex and bespoke financial instruments to meet investor and corporate requirements. Equity-linked instruments for instance, with their hybrid nature, have been a helpful tool for investors by generating a fixed return on capital deployed as debt now with the flexibility to capitalize that debt and achieve an equity upside at a later date (presumably once the investor has a clearer picture of the value of the underlying business).

Prediction:

Corporate financing options and alternatives will continue to evolve and shift in 2021. Places to watch: the TLB vs. high yield bond market share trade-off, the continued emergence of direct lending alternatives, the evolving and expanding ESG universe and the development of more complex financial instruments to meet specific corporate or investor requirements. Hybrid instruments will remain an attractive alternative for market participants throughout 2021 as uncertainty lingers.

5. Growing supply and demand of ESG products

Corporates are receiving increasing pressure from their stakeholders to focus on ESG factors and promote such factors in their ways of doing business, as well as raising capital. 2020 has seen an increase in the prevalence of ESG investor mandates requiring pension funds and numerous other investors in the market to invest in ESG-linked products. During 2020, the market has also expanded horizontally, expanding from green bond constructs into more innovative social and sustainability solutions.

Prediction:

As global awareness of the importance of ESG factors increases, we expect to see continued focus on ESG factors in the market through 2021, leading to an increased supply in ESG-linked financial products used by companies looking to raise capital as well as investors looking to place capital in ESG products. Global awareness (and in some cases, recognition) of the crisis will put pressure on market participants to seek ESG solutions. This will lead to continued growth in supply and demand of ESG products in the market in 2021 and beyond.

6. Travel and leisure: rebound or bust?

Industries hardest hit by COVID-19 include travel and leisure, with many having sought to modify their business models to survive during the pandemic. How quickly people get back to pre-COVID business and non-business personal travel (also taking into account the “new normal”) is a big question mark that will start to be answered in 2021.

Prediction:

The pent-up demand for travel and leisure (e.g., hotels, cruises, airlines etc.) will show a strong rebound in late 2021 as vaccine distribution advances. Restructuring efforts will help many of these companies to withstand the COVID storm, including successful restructurings, but there will be many casualties along the way.

7. New market focus in evolving regulatory environments: cannabis, gaming, new technologies

Regulation in a number of industries adds complexity to structuring and executing a leveraged finance transaction. Enhanced international regulation regarding money laundering, bribery and foreign corrupt practices can also weigh on investment banks or investors, causing them to bypass certain industries. Still, market watchers are always on the lookout for evolving legislation that could open up new opportunities.

Prediction:

Changing regulations and market perception will lead to increased focus on industries as regulatory restrictions adapt and loosen, particularly in areas including US-linked cannabis companies, online gaming and new technologies that move from start-up phases into companies that can support a full leveraged financial structure.

8. Emerging markets strong growth to continue

2020 has been a relatively strong year for emerging markets, sovereigns, financial institutions and larger-scale corporates in particular. The past year has seen emerging markets diversifying their sources of capital by accessing capital markets, with moves towards green bonds (Georgia Capital and Akbank) and English-law governed covenanted Eurobonds (Ulker), which we believe is only the beginning.

Prediction:

Emerging markets continue to provide new investment opportunities, particularly for investors look for yield. As emerging markets access international capital markets, ESG factors will become more of an area of focus (as a requirement for international investors) and borrowers will have more options for sources of financing (rather than being limited to local banks/sources of capital). Expect to see more complex capital structures as these markets continue to follow the US and EMEA models for capital structures to diversify their investor bases and seek multiple sources of financing.

9. M&A: 2020 Q4 bounce-back to continue

COVID-19 and other market factors slowed down M&A activity in H1 2020. With Brexit and the US election behind us, and the distribution of the vaccine for COVID-19 on the horizon, big-ticket M&A markets are optimistically poised to continue the increase in activity from the end of 2020 into 2021.

Prediction:

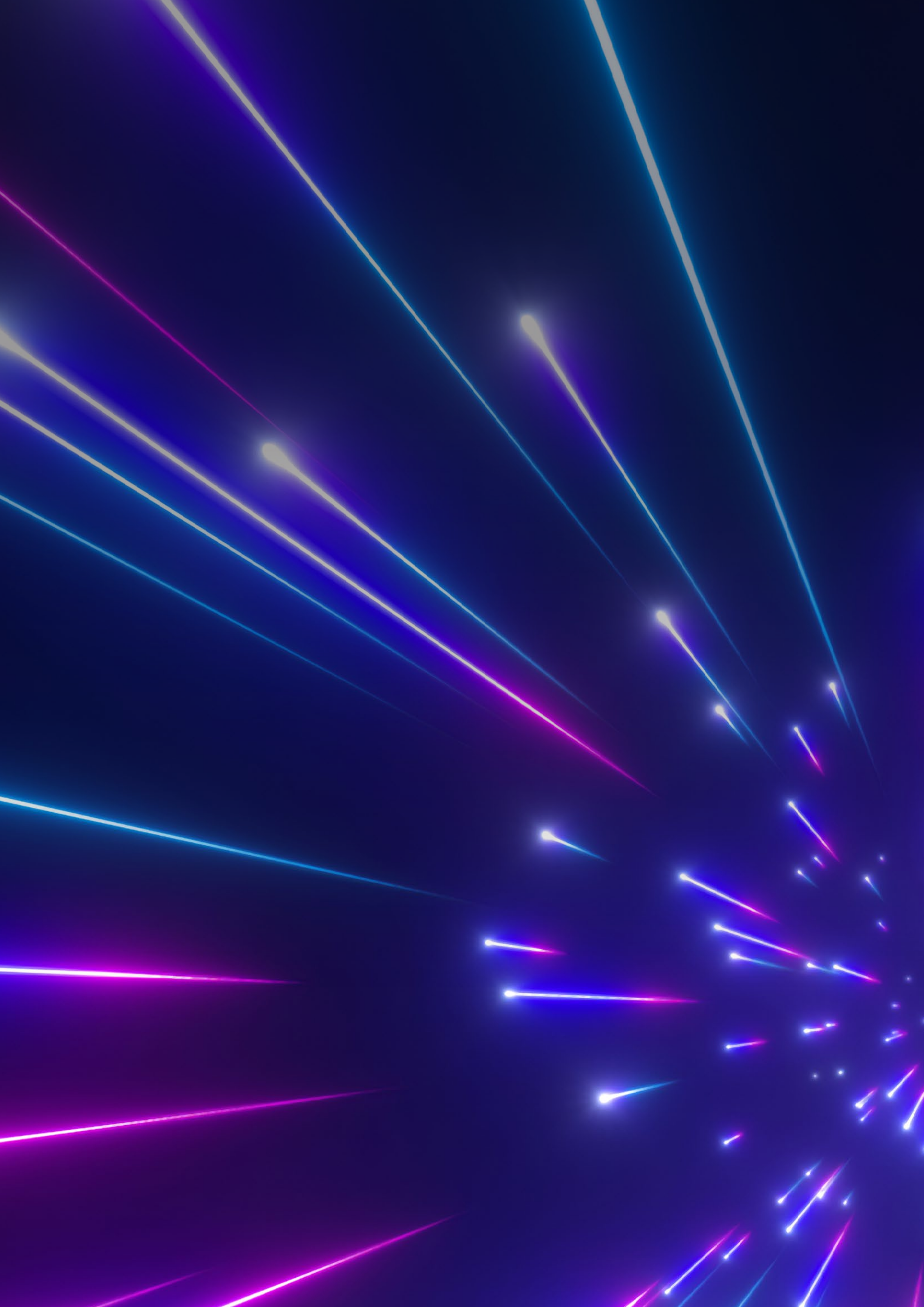
Pent-up M&A supply and demand due to a slow H1 2020 will fuel a stronger 2021. Stronger credits will pick up distressed assets and, as market volatility decreases, pricing discrepancies and risk uncertainties for buyers and sellers will mitigate, fueling market action. Sectors such as tech that have prospered in the pandemic will continue to account for a high proportion of M&A and private equity deals into 2021, as will carve-out transactions as multinational corporates review their operations to rationalize costs and concentrate on core revenue streams and geographies.

10. Opportunistic refinancing on the rise

Based on the factors discussed above, 2021 is poised for a strong start. The financial markets came out of 2020 relatively stable (in most industries) so a baseline is set for some real action in 2021.

Prediction:

Continued low interest rates, ongoing government support and the world economies recovering from the COVID social and economic crisis will provide a real opportunity for a strong refinancing performance in 2021, which may be accompanied by dividend recaps and acquisition financing as market participants consider their options.



Annex: In the Know Newsletters 2020

To read our In the Know newsletters that were published during 2020, please click on the relevant links below

Not Just a Matter of Interpretation: Beware What Is Lurking in the Boiler-Plate
Publication month: January

Novel Coronavirus Outbreak: Don't Overlook These Implications for Your Leveraged Finance Documentation
Publication month: February

Cash is King: How Can Issuers Maximize (or Preserve) Liquidity in the Shadow of COVID-19
Publication month: March

Falling Angels: The Effects of the COVID-19 Crisis on Corporate Ratings
Publication month: May

Nordic Corporate Bonds - What Happens Next
Publication month: June

Finding certainty in uncertain times (Part 1)
Publication month: July

Finding certainty in uncertain times (Part 2)
Publication month: August

Top Ten Tips for ESG Debt Financings
Publication month: September

From one into many - Replacement rates for LIBOR
Publication month: October

Filling the funding gap - Convertible loans as an alternative financing solution during times of market volatility
Publication month: November

144A vs Reg S only - considerations in high yield offerings
Publication month: December

Contributing Authors

We have an integrated corporate finance and leveraged finance practice made up of leading practitioners representing clients across the whole spectrum of equity capital markets, debt capital markets, public M&A and leverage finance/high yield. Our extensive team is made up of almost 500 fee earners in 34 offices and 25 countries across EMEA.

Lana Ahern
Associate | London
lana.ahern@bakermckenzie.com

Matt Cox
Partner | London
matthew.cox@bakermckenzie.com

Nasri Ashkar
Associate | Chicago
nasri.ashkar@bakermckenzie.com

Nick Cusack
Senior Associate | London
nick.cusack@bakermckenzie.com

Mark Bell
Partner | Singapore
mark.bell@bakermckenzie.com

Matthew Dening
Partner | London
matthew.dening@bakermckenzie.com

Ben Bierwirth
Senior Associate | London
ben.bierwirth@bakermckenzie.com

Adam Eastell
Partner | London
adam.eastell@bakermckenzie.com

Andrew J. Brown
Associate | London
andrew.j.brown@bakermckenzie.com

Adam Farlow
Partner | London
adam.farlow@bakermckenzie.com

Natalie Butchart
Partner | London
natalie.butchart@bakermckenzie.com

Charles Farnsworth
Of Counsel | London
charles.farnsworth@bakermckenzie.com

Contributing Authors

Samantha Greer
Associate | London
samantha.greer@bakermckenzie.com

Matt Mazenier
Associate | London
matthew.mazenier@bakermckenzie.com

Haden Henderson
Partner | London
haden.henderson@bakermckenzie.com

Markus Meuller
Partner | Stockholm
markus.meuller@bakermckenzie.com

Maxim Khrapov
Senior Associate | London
maxim.khrapov@bakermckenzie.com

Geoff O'Dea
Partner | London
geoff.odea@bakermckenzie.com

John Lawlor
Senior PSL | Chicago
john.lawlor@bakermckenzie.com

Nick O'Grady
Partner | London
nick.ogrady@bakermckenzie.com

Caitlin McErlane
Partner | London
caitlin.mcerlane@bakermckenzie.com

Amit Parekh
Associate | New York
amit.parekh@bakermckenzie.com

Rob Mathews
Partner | London
robert.mathews@bakermckenzie.com

Mats Rooth
Principal | Stockholm
mats.rooth@bakermckenzie.com

Contributing Authors

Emily Rothfield
Associate | London
emily.rothfield@bakermckenzie.com

Kiki Tienstra
Senior Associate | London
kiki.tienstra@bakermckenzie.com

Andrew Sagor
Principal | London
andrew.sagor@bakermckenzie.com

Priyanka Usmani
Partner | London
priyanka.usmani@bakermckenzie.com

Megan Schellinger
Partner | London
megan.schellinger@bakermckenzie.com

Gabby White
Knowledge Lawyer | London
gabby.white@bakermckenzie.com

Chen Tang
Associate | New York
chen.tang@bakermckenzie.com

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 70 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instil confidence in our clients.

bakermckenzie.com

Baker & McKenzie Global Services LLC / 300 E. Randolph Street / Chicago, IL 60601, USA / +1 312 861 8800.