9fin 12:11 22nd December 2022

9fin-Feature LevFin Wrap

US LevFin Wrap — So long 2022, it's been emotional (9fin)

12:11 22nd December 2022

•

5 min read

William Hoffman | william@9fin.com, Will Caiger-Smith | will@9fin.com and Emily Fasold | emily@9fin.com

This year's market selloff has been a bit like Kanye West's latest fall from grace: it was a long time coming, we all watched it happen, and there wasn't much we could do but sigh and shake our heads.

You all know what happened in leveraged finance this year. You lived it, you worked it. And you've probably read a bunch of 2022 wraps and 2023 outlooks already, so we won't be offended if you scroll past our obligatory contribution.

If you want the fun content, go straight to the awards section.

The 2023 outlook

Alright, let's get this over with.

The consensus view in US credit markets is pretty simple — it's going to get worse before it gets better. There are signs that the Fed could pull off a soft landing, but most agree that a recession is on the way.

This is not a surprise. The past few months have been volatile; there's been a lot of pain, and asset prices have dropped significantly. But it's also been somewhat orderly, so the market has had time to prepare.

"It's probably the most predicted recession in the history of modern economics," said Jeremy Burton, a portfolio manager at PineBridge Investments.

Some predict a deep selloff in equities over the coming months. This would inevitably have an impact on credit, especially in the lower rungs of the ratings spectrum. Others see a mild recession ahead, and there are still some who think we could avoid a recession altogether.

The underlying factor for many of these forecasts is inflation, and how the Fed reacts to it. Recently the market has rallied on data that inflation is coming down, but a change in that data could easily upend this trend. So people are voicing their optimism very carefully.

"If we continue on this trend of positive data and economic results, that we'll start to get to more normal operating conditions as we move into next year," said Michele Cousins, head of leveraged capital markets for the Americas at UBS.

Not exactly going out on a limb there! But hey, at least this uncertainty will make things interesting. In 2021, the deluge of primary and the relentless tightening of spreads was stressing people out, partly because it was so monotonous. At least things were more varied in 2022.

"Even though there's been very little primary issuance this year, it has been a much more interesting market than it was this time last year," said Burton at PineBridge. "There's dispersion, convexity. It's not like everything is trading around par."

This is good news for credit pickers! There are bargains to be found. It's just, you never know if there might be an even bigger bargain tomorrow, or next week, or next quarter. And as they say, you've got to be in it to win it.

"If you're not sure exactly when the bottom is going to be, why not put a little bit of money to work now?" said Andrew Relph, a managing director at Concise Capital.

"If there is the big sell-off that everybody's expecting and spreads do widen, then you can be more aggressive and deploy capital at that point in time. But I think it's going to be difficult for everybody to try to catch the bottom."

A word on private credit

(This is the last serious section, we promise)

Earlier this year, we asked whether primary could even function without private credit anymore. Then markets got even worse, and even the private credit funds started pulling back; hold sizes came down, and it got harder to club up mega unitranche deals.

In the run up to the holidays, those giant financings have come back a bit. Just this week, Sixth Street Partners led a $2.3bn loan for Advent's $6.4bn buyout of **Maxar Technologies**, a few days after leading a $2.6bn facility for Thoma Bravo's $8bn buyout of **Coupa Software**.

Still, the word on the street is that the recent vibe-shift in private credit isn't going to suddenly reverse. Economic uncertainty is still making direct lenders a lot more cautious about the way they do deals.

Terms are tightening, and lenders are less inclined to hold large chunks of single loans. Some private credit deals that used to have three or four lenders now have 10-20, according to one portfolio manager. This might make the market slightly less agile than it used to be.

There is a chance that this dynamic, coupled with the fact that direct lenders are demanding much higher yields, could drive some borrowers (especially higher-rated ones) back to the broadly syndicated market next year.

"I do think this will start shifting momentum away from private credit in 2023," said a CLO manager. "If a company is 5x levered and has to pay over 12% yields for a direct lending deal, they might have better luck in the broadly syndicated market."

Some will inevitably call that wishful thinking. Others may point out that the new-issue loan market has been more robust in recent weeks. But while CLO managers may want more supply, it's unlikely that the turf war between BSL and private credit will quieten down.

Still, there's something interesting in the shift towards larger lender groups. Traditionally, part of private credit's appeal is having a smaller group of lenders to answer to; more lenders means more people to please, and keeping creditors sweet will probably get harder in 2023.

Just one example: private credit borrowers are looking for ways around investor protections like MFN language, as they seek to minimize the impact of higher rates. As Tim Lyne of Antares recently told us, we may see a lot more of that in the comings months.

And now…

The 2022 awards

LBO of the year: Twitter

Hung LBO financing of the year: also Twitter

Covenant of the year: Citrix's EBITDA builder basket

Asset class of the year: obviously crypto

Haircut of the year: Nielsen exchange holdouts

Quote of the year: basically anything Sam Bankman-Fried or Caroline Ellison have ever said

Song of the year: Taylor Swift, Anti-Hero

Drink of the year: the Negroni Sbagliato*

Meme of the year:

(via Twitter)

Stuff to look out for in 2023

New insurance regulation, which could [affect CLOs]

Secondary LBO debt selldowns (à la [Citrix], [Nielsen])

Continued growth in the [ABL market]

Loan borrowers being cheap on SOFR amendments

Bond buybacks from Coinbase (…maybe)

Scrutiny of private credit funding arrangements

Scrutiny of private equity funding arrangements

More fallout from the CLO reinvestment crunch

More spectrum issuance from DISH Networks

More tech layoffs…

…and a raging culture war over ESG

Happy holidays!

**it wins this award every year*

***no wrap next week, see you in January*