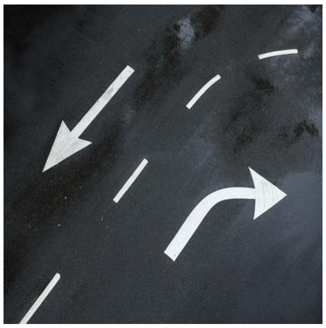
William Blair



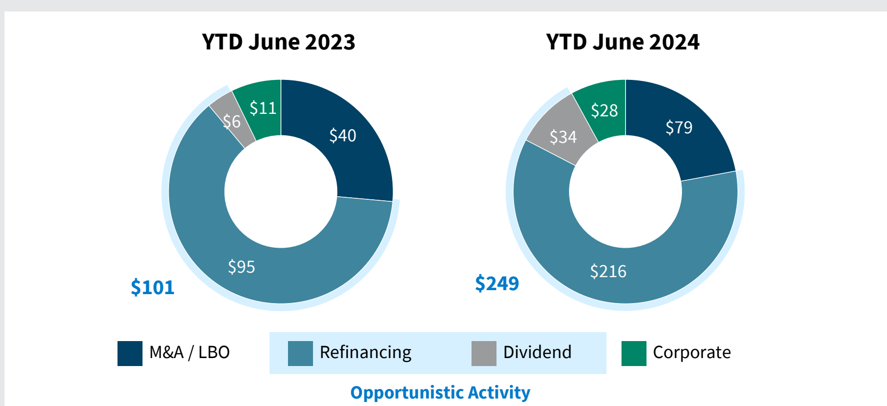
Lenders Eyeing Opportunistic Transactions; Borrowers Should Take Note

With interest rates stabilized and lenders' risk appetite increasing, U.S. leveraged loan volume has rebounded in 2024—and done so with force. Indeed, after a second quarter that was one of the busiest on record, lenders are competing to put their money to work as demand for loans outstrips supply.

As a result, credit spreads in both the broadly syndicated loan ("BSL") and private credit markets have dropped to multi-year lows. BSL activity, including repricings, more than doubled over the first six months of this year compared with 2023, reaching $518 billion, according to PitchBook LCD[1]. Private credit markets have been equally robust. As M&A activity continues to lag, lenders have pivoted to opportunistic transactions—namely refinancings and dividend recaps. Indeed, opportunistic activity in the BSL market has more than doubled this year. (see chart below).

These broader trendlines appear poised to continue as lender sentiment in William Blair's quarterly lender survey recently reached levels not seen since 2021.

Broad Syndicated Loan Volume—Use of Proceeds (in Billions)[2]



Leveraged Finance Group Leadership

Michael Ward
+1 312 364 8529
mward@williamblair.com

Darren Bank
+1 312 801 7833
dbank@williamblair.com

1. Source: PitchBook LCD.
2. Source: Ibid.

Our survey also finds that investors anticipate even more borrower-friendly conditions for the rest of this year—all of which means now is a great time for borrowers to consider refinancing existing debt or returning capital to shareholders.

BSL, Private Credit Compete for Repricings, Refinancings

Repricings and refinancings continue to dominate the BSL market as loans not dedicated to one of those two areas clocked in at just 15% of volume at mid-year. So far in 2024, U.S. companies reduced borrowing costs on $403 billion worth of debt, saving 54 basis points on average. That translates to $2.2 billion of annual interest savings, according to PitchBook LCD.[4] Private credit markets have countered by also lowering spreads, albeit at rates that on average remain slightly higher than the BSL market.

Still, private credit's counter-offensive seems to be working, as the volume of direct loans refinanced by BSLs slowed and even reversed in the second quarter compared with the previous three months, as more BSLs were refinanced by direct loans than vice versa. Spread reductions were not the only way direct lenders have been fighting back, as they have increasingly deployed features such as Delayed Draw Term Loans ("DDTLs") and Payment-in-Kind ("PIK") components, both of which are hard to come by in the BSL market.

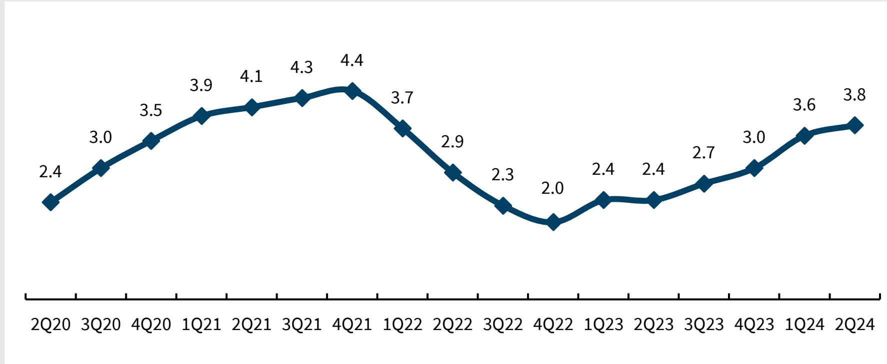
The increased competition was clear in William Blair's second quarter survey of lenders, with 81% of respondents indicating that they lowered pricing during the quarter and 61% reporting increasing leverage or loosening terms.

Dividend Recaps Pick Up Steam

Dividend recaps also have picked up steam as the year rolled on, even if they have been somewhat overshadowed by repricings and refinancings. With sponsors eager to return capital to their limited partners, they have increasingly turned to dividends for liquidity in the face of a still somewhat challenging M&A environment.

Leveraged Lending Index[3]

Each quarter, we ask middle-market lenders to rate overall conditions in the leverage finance market on a scale of 1 to 5, with 5 being the most borrower-friendly conceivable.



This turn is reflected in the numbers. According to PitchBook LCD, BSL issuance funding for dividends was $33.5 billion through June 30 of this year, surpassing the $23.0 billion in 2022 and 2023 combined. Shareholders had certainly been waiting for a while, as the median time between the initial buyout and dividend had reached 4.2 years—the longest such wait time in at least five years.[5]

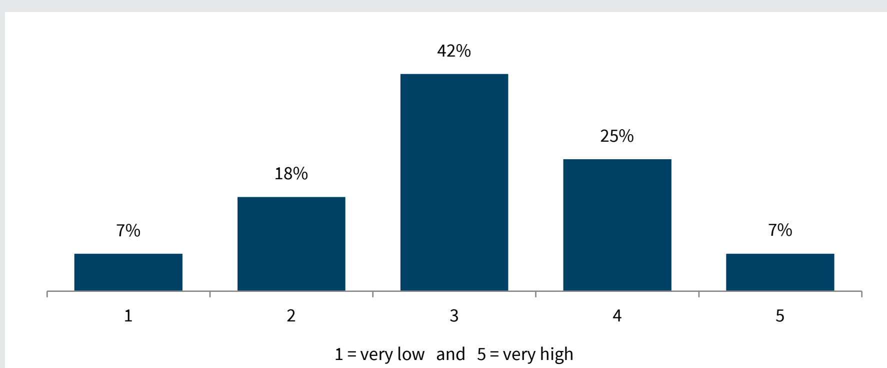
The dearth of loan supply has also prompted direct lenders to revisit dividend deals, and lenders generally appear more receptive to dividends. Nearly 75% of respondents to our survey rated their appetite for dividend recaps as a 3 or better on a scale of 1 to 5.[6]

An Untapped Area; Pre-Caps

Amid the increased receptivity to dividends, sponsors may be underutilizing an interesting strategy for tapping leveraged financing—something we refer to as a precapitalization.

In a pre-cap, a portfolio company is refinanced ahead of a near-to-intermediate term sale, with the immediate use of proceeds often including a meaningful dividend. The process enables companies to proactively address potential financing issues and refine its story to investors. At the same time, a pre-cap can address any diligence blind spots, establish a leverage floor for the sale process, and position a company to strategically respond to pre-emptive offers.

Borrowers' Appetite for Supporting a Dividend Recapitalization in H2 2024[7]



3. Source: William Blair Q2 Quarterly Leveraged Finance Survey.
4. Source: PitchBook LCD.
5. Source: Ibid.
6. Source: William Blair Q2 Quarterly Leveraged Finance Survey.
7. Source: Ibid

Perhaps most importantly, by closing a deal with the right lender ahead of an eventual sale process, a pre-cap establishes an incumbent lender who is supportive of the business—and, in some cases, is willing to make the debt portable. Indeed, the more uncertainty around lender receptivity, the greater the value of a pre-cap transaction before a sale.

Positive Outlook for the Rest of 2024

Lenders are bullish about the rest of 2024, especially with the likelihood that the Federal Reserve will cut interest rates in the coming weeks. We may even be looking at the most borrower-friendly period in years—especially given the supply and demand imbalance noted above.

William Blair's is uniquely qualified to help companies and owners with refinancings, dividend recaps, and other debt financing needs. Our team leverages vast lender relationships as well as our firm's deep sector-specific expertise to optimize solutions for our clients.

Please don't hesitate to reach out to our Leveraged Finance team to discuss you company's particular needs. We look forward to hearing from you.

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

Company	Transaction	Year
MedVet	Senior Secured Credit Facilities Preferred Equity	2024
Starrett	Senior Secured Credit Facility	2024
Diverzify	Senior Secured Credit Facilities	2024
Sensor Tower	Senior Secured Credit Facility	2024
Bishop Lifting	Debt Placement	2023
Primutec Solutions Group	Senior Secured Credit Facility	2023
Certified Power Inc.	Unitranche Credit Facility	2023
amino	Senior Secured Credit Facility Preferred Equity	2023
Cellipont Bioservices	Senior Secured Term Loan	2023