Navigating Change
LMA 10th Syndicated Loans Conference
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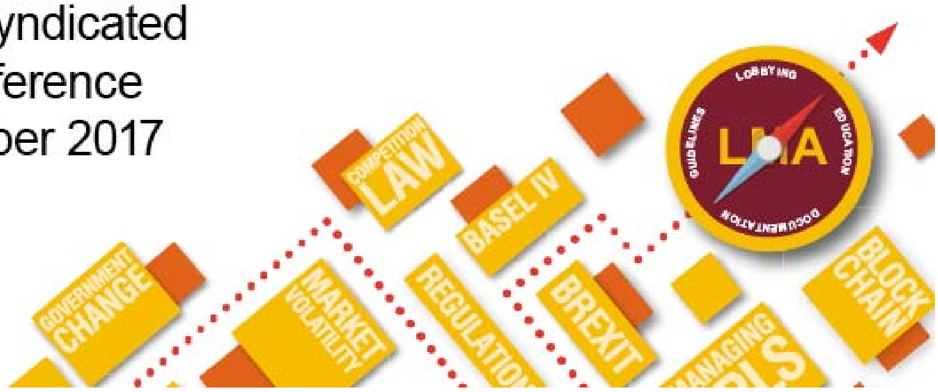

Heads of Syndication: steering through the market

The Heads of Syndication panel debate provided insight into the syndicated loan market, and offered a look forward at what the next 12 months might hold.

The panel was chaired by **Keith Taylor**, Head of Loan Syndication, EMEAPAC for **Barclays**. He was joined by **Paul Gibbs**, Co-Head of Loans & Acquisition Financing, EMEA at **Citi**; **Nick Jansa**, Global Co-Head of Leveraged Debt Capital Markets at **Deutsche Bank**; **Itziar Letamendi**, Head of Loan Markets for Continental Europe at **Banco Santander**; **Mathias Noack**, EMEA Co-Head of Debt Capital Markets for Loans & Bonds, EMEA at **MUFG**; and **Terence Shanahan**, Global Head of Syndicate at **SG CIB**.

The current shape of the syndicated loan market

As the market currently stands, volumes have stayed broadly the same over the last year. However, the actual number of deals has fallen 25% since 2016. There have been a number of significantly larger deals that have boosted overall volumes, a good indication that the market is resilient in the face of a turbulent, demand-led environment.

There are a number of challenges facing the market; these are, however, almost identical to those the market faced in 2016, perhaps with the addition of the heightened tensions on the Korean Peninsula. The tapering of quantitative easing presents an uncertain threat; central banks are steadfast in their continuing abstinence from altering interest rates; levels of economic growth are unsteady, with ongoing regulatory hurdles adding to complications; and, of course, there is Brexit. However, all of these potential challenges are set against the backdrop of a highly competitive environment, and a market ready and able to cope with upwards M&A demand.

Private markets have continued to burgeon; M&A and refinancing transactions have remained steady – providing confidence to the market as a whole. The syndicated loan market is healthy, and has matured in the last decade; proactivity has displaced reactivity – with the LMA reflecting this change through initiatives relating to LIBOR, Brexit, and regulatory regime changes. The market is focusing on technical growth through use of existing products, though this may change over the next 12 months, with the growing prevalence of facilities such as green bonds and green loans.

An economic turning point

In the UK, inflation is at a four-year high, with unemployment at a 42-year low; Europe is starting to experience the same economic changes, with Germany's CPI figures at 1.8%, up from 2016. The Bank of England has made efforts to support the Sterling; in an attempt to displace imported inflation. There is not much more the Bank of England can do to remain impactful within the marketplace without changing interest rates, which is tipped to happen in early 2018.

The Euro has remained strong; the European Central Bank wants to bolster export-led economic growth and it is therefore reluctant to increase interest rates, which would further strengthen the Euro. However, due to creeping inflation, the future on this front remains uncertain. Quantitative easing within the Eurozone is set to taper off in December 2017. The consequent reduction in liquidity may create an environment in which Treasurers pre-empt the drop in liquidity by increasing their refinancing.

As interest rates begin to rise, institutional investors may show more interest in buying credit in floating-rate form. This has been the trend in the US over the course of 2017, and is expected to continue into 2018. Greater competition between banks and financial institutions is therefore expected to follow with respect to these types of facilities.

Looking past the macroeconomic headwinds

There are a number of ongoing geopolitical risks that threaten to cause heightened market volatility. In Europe, the Brexit negotiations are beginning to take shape; as they progress, and positions on either side become clearer, the market may be disrupted by the headlines that follow. On the other hand, the election of Emmanuel Macron, and the re-election of Angela Merkel, signal a growing pro-European stance on the continent; this increased political stability may catalyse further market consolidation. However, with the events unfolding in the Korean Peninsula, the effects of which may be magnified by the unsteady performance indicators coming out of China, the global syndicated loan market is in need of some real certainty. In the face of this commotion, the market itself has been stable and has functioned well; a market shock would have to be significant to have any real impact on liquidity.

Modest growth within the primary market

Currently, the primary market has been characterised by subdued volumes and numbers; the only constant seems to be an abundance of liquidity. It is still a borrower's market, and whilst the market is poised for an expansion in M&A activity, it is difficult to predict future outcomes with any certainty. Given the current economic and political climate, growth prospects are modest to say the least. An increase in refinancing going forward is likely: given the expected tapering of quantitative easing, corporate entities are, at the least, discussing refinancing alternatives. This is indicative of a more proactive market, as participants seek to extend the maturity profile of their existing facilities.

Another possible trend is an increase in restructuring and reorganisation of syndicates by banking clients; some will be looking to increase the number of banks, others will be looking to downscale, and in any event lenders must remain flexible and proactive. Increased willingness to provide structures and pricings that clients require will have a noticeable impact on the direction of the loan market – relationship banking will remain essential over the next few years.

Optimism for M&A activity

There has been increased activity in Western Europe but, from a wider geographical perspective, other markets are subdued. M&A activity in North America is down 24%, the Asia-Pacific region is down 7%, and CEEMEA is down 28%. Intra-EMEA transactions, with a volume increase in the region of 80%, shows commitment to further consolidation. Outwards Chinese investment has slowed in recent months, owing to the capital controls they have imposed.

On the other hand, the relative strength of the US Dollar has seen greater EMEA investment from the US; however, it is expected that the Euro will gain relative strength going forward; meaning US outward investment may soften. The energy market has seen increased consolidation; healthcare, consumer and real estate sectors are all expected to continue upwards in terms of M&A activity. Notwithstanding this increase, growth within Europe will likely remain slow and steady. Shareholders will be looking for accelerating growth when choosing to invest, placing greater pressure on corporates to successfully execute further M&A.

Underwriting appetite for M&A is fundamentally strong; desire to provide acquisition-related finance has been, if anything, increasing. This is partly due to abundant liquidity, but another driving force will continue to be a lack of other available opportunities in the investment grade cross-over space. The large number of participants and relationship banks looking to provide capital for event-driven finance is likely to mean that risk appetite will only increase; in the absence of a significant economic or political shock, this behaviour is unlikely to change. Alongside the trend of increased competition, many lenders are having to increase their risk appetite.

The leveraged market; turning a new page

Whilst buoyant, a large chunk of the volume within the leveraged loan market has been fundamentally supported by refinancing, but this has begun to change as of mid-2017. Acquisition activity is set to accelerate, but this is driven mostly by private equity funds as opposed to corporate entities – this, really, is the trend from investment grade all the way down to sub-investment grade. Total volumes have increased by approximately 70%, and increasingly larger transactions demonstrate that EMEA firms are starting to compete within the US markets in terms of transaction sizes.

Another trend over the last few years has been a diversification of the investor-base within the leveraged market. This is mostly due to the efforts of asset management firms in making the case for investment in high-yield bonds and sub-investment grade credit. The types of investor participating within the leveraged market, both in loans and bonds, is much more diverse than it was pre-financial crisis. Multi-strategy, broad-based asset managers are set to continue with their success and will remain key players within the leveraged market.

Secondary loan market opportunities

Despite last year's concerns over EMEA growth, the first six months of 2017 saw volumes increase by around 5% (with 74% of total market volume coming from leveraged finance). The trend is towards an increase in par loans; largely as a result of increased CLO issuance. Increased market transparency is increasing overall efficiency; settlement times have been consistently decreasing, with an overall reduction compared to 2016 of around 25%. Efficiency within the secondary market will also be driven by a higher degree of automation within settlement systems; platforms are being developed to allow new players to establish themselves.

Key trends in Structured & Project Finance

EMEA market activity in this market has decreased by 9.6% on 2016, largely due to decreased volumes within the Middle East and Africa. However, within Europe, volumes have increased by around 3% – most of this coming from the UK and Northern Europe. European bank liquidity remains high, but more participants are joining from Asia; equity funds and insurance companies are also increasing their holdings, generating a widening risk appetite.

Banks within the capital markets are investing in renewables and green/brown-field developments, and are moving towards shorter transaction periods. Infrastructure finance has enjoyed a revival recently; a sector that traditionally involved construction of bridges and tunnels now offers much wider investment opportunities.

The length of investments has shortened drastically, and the investor-base has become more competitive and flexible – meaning that there is an appetite for more variable financing. In jurisdictions such as Turkey, Poland, Hungary, governments are continuing to incentivise infrastructure growth. However, due to increasing client sophistication, ancillary services, such as underwriting, are in danger of being crowded out.

Developing markets, a disappointing performance?

Transaction volumes in the Middle East have been down, however, parts of Eastern Europe were, until August 2017, promising. The renewed US sanctions on Russia have made it harder to act on opportunities arising out of the jurisdiction, but finance providers will persist within these parameters. Within Asia, there has been promising growth in terms of infrastructure opportunities. In Africa, as the commodity cycle begins to stabilise, more opportunities are set to arise. The appetite of lenders to complete transactions is certainly present, but 2017 has been largely disappointing in terms of volumes.

2018 and beyond, threats and opportunities

A good description of loan market participants' current outlook is "optimistic limbo", whereby the true direction of the market will become clearer with time. There is potential for the tapering of quantitative easing to cause some market disruption, the threat of widening political divides and regulatory disparity between the US and the EU may also lead to fragmentation of the market. Overall, however, demand is expected to grow, and there is promise that pro-European sentiment, coupled with increasing market maturity and vigilance, will mean that the outlook for M&A in 2018 is promising.