Financing Trends in 2023 and Outlook 2024

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After the unexpectedly buoyant mood in 2021 and early 2022, the M&A and financing markets suffered a significant setback following the Russian invasion of Ukraine in February 2022. In 2023, the total volume of syndicated loans granted in Europe fell significantly compared to previous years, which particularly affected acquisition financings. Continuing the trend from 2022, refinancing transactions dominated the European credit market. Among other things, this was due to the political and economic turmoil, soaring energy prices and inflation. Although liquidity remains abundant in the hands of private equity and private debt providers, lenders are increasingly reluctant to support highly leveraged buyout transactions, fearing that target companies are increasingly vulnerable to economic risks and political instability. At the same time, the constant increases in base rates by central banks and the associated rise in reference interest rates have led to a considerable increase in the cost of debt capital. This ongoing financial burden must not only be taken into account when entering into new financing transactions, it also puts pressure on some companies with existing financing arrangements. These developments have made lenders more aware of default risks in acquisition financings which is now causing them to act more cautiously. Against this

backdrop, it is notable that potential target companies are being scrutinised more critically by potential lenders.

Private equity investors were once again the most active parties on the buyer side in European M&A transactions, albeit at a lower level than in previous years. Financing part of the purchase price with debt capital is a key element of M&A transactions with a private equity investor as the buyer. In recent years, debt funds have increasingly established themselves as an alternative to traditional acquisition financings made available by banks. While debt funds generally demand higher margins than banks, in many cases they are able to provide a significantly larger financing volume than a single bank, which makes it easier for borrowers to negotiate terms with only one or a very small number of debt funds. In addition, debt funds commonly offer acquisition financings that provide for a bullet repayment at the end of the term, which is advantageous for private equity sponsors pursuing a buy-and-build strategy. Banks, on the other hand, generally require that a portion of the facilities they provide be repaid in instalments. This ongoing outflow of funds from the financed group reduces the possibility of using its own generated liquidity for further acquisitions.

On the other hand, for structural reasons, debt funds are rarely or only to a limited extent in a position to provide revolving credit facilities to finance the ongoing business activities of a company or group, because unlike banks, debt funds have to call the required funds from their investors. The granting of loans for short periods of time does not suit this financing model. In addition, debt funds are often unable to grant letters of credit or bank guarantees. If there is a need for a revolving credit facility, it may be an option to form a consortium consisting of debt funds and banks. For example, a debt fund can provide the term loan facilities to finance acquisitions, while a bank makes the revolving credit facility available. As the isolated provision of the revolving credit facility may not be economically attractive for a bank in the context of an acquisition financing transaction, it may be a solution to additionally offer the bank a portion of the acquisition facilities. However, agreeing on the details of such a structure is often the subject of intense negotiations, as the debt fund will generally be keen to secure extensive decision-making powers in the ongoing contractual relationship with the borrower.

It is difficult to predict developments in 2024. Sponsors are under pressure to make investments, and the cooled M&A market of recent months will eventually push some older portfolio companies onto the market, so that at least some gains can be realized by the investors. This is likely to lead to increased activity in the M&A market in 2024. With regard to acquisition financings, much will depend on whether the increases in base rates will come to an end and whether the new interest rate environment is taken more into account in sellers' price expectations. It will also be important that the attention of lenders is not taken up too much by insolvencies and financial difficulties by existing borrowers.

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