EXPERT Q&A

After a slowdown following the eruption of the pandemic in early 2020, direct lenders can look forward to a busy year ahead, say Rich Christensen and Grant Haggard, senior partners at Twin Brook Capital Partners

The deal pipeline is building

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Q M&A came to a halt in the wake of covid-19 early last year. What did this mean for direct lenders?

Grant Haggard: At the beginning of last March, M&A activity was off to a traditionally active start. Then the pandemic hit and the brakes went on, with attention turning from executing new deals to managing existing portfolios and assessing each situation to determine the impact of early shutdowns and expected needs from a liquidity perspective.

Many lenders and sponsors alike spent much of the second quarter internally-focused, but things began to stabilise in Q3, as it became clear the impact of the pandemic wasn't uniform across industries.

Rich Christensen: Despite the slowdown, we found opportunities to deploy capital, both in new platforms and through add-ons. Our private equity clients remained focused on executing on their value creation strategies where possible, so we saw a number of sale processes that were already in motion continue. Elsewhere, for some companies that were performing, the downturn presented acquisition opportunities. Our senior management team has been through multiple cycles and understands the importance of maintaining a long-term view, looking beyond the macroeconomic environment and working with companies and their sponsors to both navigate challenges and execute on opportunities for growth.

GH: I think the ability of lenders to continue closing deals depended in large part on the capital they had available, as well as where they sat in their fund lifecycle and the issues they had in their portfolios. In the early days of the pandemic, I think the biggest challenge from a deployment perspective was establishing conviction around potential new investments when there was so much uncertainty.

Q How did mid-market activity and dealflow evolve through the second half of 2020?

GH: New deal activity really returned in mid-Q3, but it was inconsistent across sectors, with healthcare – for example – picking up quite quickly. By year end, things were increasingly active across most industries, so fourth quarter dealflow was pretty robust.

RC: Moving into Q4, the market began to approach pre-pandemic levels, with lenders willing to take on more underwriting risk. Leverage was down, but pricing was heading back up; by Q1 2021, any benefits on pricing had generally evaporated.

Q In terms of the rebound in activity and deal quality, have you seen any variation across sectors?

GH: Aside from the industries that are still disrupted, the lasting effects appear to – for the most part – be relatively narrow. I think most portfolios have recovered quicker than initially anticipated.

RC: We believe the recovery will continue to take longer in sectors heavily reliant on human congregation, such as restaurants, gyms, events and transportation. Beyond that, I think lenders feel they know where they stand at this point and are optimistic about the durability of companies that performed through the pandemic or have substantially recovered.

Q How would you describe the current market environment?

RC: It's an active sale environment, and our pipeline remains robust. We are seeing opportunities across both existing portfolio companies and new platforms, so the outlook appears relatively good.

GH: From a dealflow perspective, it feels like things are returning to normal – we think this year will be on par with 2018 and 2019 on that front. We saw a lot of companies that were likely positioned for a sale pre-pandemic and held off, so they are now coming to market and creating churn in lender portfolios. We also expect that concerns about the potential for policy changes could motivate some businesses to pull forward sales to take advantage of current tax rates.

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>
> **GRANT HAGGARD**

Q There's been speculation about pent-up change of control situations and how lenders dodging run-off last year could translate into more activity this year. What are your thoughts?

GH: Talking to sponsors and investment bankers, that pent-up demand is coming through and the deal pipeline is building. Lenders and sponsors have assessed the risks, with many now taking the view that we have been through the worst and that companies doing well today are only going to get better.

RC: We are seeing deals come to market now that were delayed processes from 2020, and I would expect sponsors to continue to take advantage of the robust market to monetise performing credits. This delayed 2020 deal activity should be additive to 2021 deal volume as pipelines continue to build.

Q What has all of this meant with respect to lenders' pipelines moving into 2021 and beyond?

GH: In our experience, first quarter transaction volume was extremely healthy – both in comparison to the past few quarters and by historical standards – and we believe pipelines will continue to grow stronger through Q2 as more deals come to market. It is going to be competitive, but we expect the opportunity set to remain robust in the coming quarter.

RC: There's a lot of capital out there, both on the private equity side – driving transaction volumes – and on the lender side, supporting those deals. What we're seeing in our portfolio and hearing from bankers and sponsors all bodes well.

Q How has the pandemic affected the relationship between lenders and sponsors? And what carryover do you expect will persist post-pandemic?

RC: We came into last year with strong sponsor relationships; we had been through previous cycles with many of our clients, so we had already developed the trust and open lines of communication that come from working together through challenging situations. I think the pandemic has reinforced the value of those long-term relationships on both sides.

GH: In our experience, sponsors in the lower mid-market have generally maintained a more relationship-focused approach, so not much has changed there. I think this experience likely had a more meaningful impact on some sponsors in the larger market who, in the long bull cycle post-2009, may have forgotten the value of being able to turn to trusted, reliable lenders through a downturn and began taking a more commoditised, transactional approach.

Regardless of what part of the market you focus on, this environment – in which people can't travel or have in-person meetings – has made it more difficult to establish relationships with new sponsors. I think this has been particularly true for newer players in the space, who may not have the ability to point to track records and experience through cycles or established, scaled platforms. ■