

2024 European Private Credit Outlook: Strong, mature market faces emerging risks

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Across European new-issuance markets, 2023 has been a strong and defining year for private debt, despite challenges to the asset class from subdued M&A deal-making and high interest rates.

The pick-up in activity from sponsors, lenders and advisers alike now means the asset class is predicted to exceed \$2 trillion of AUM globally by 2025, market players broadly agree. Meanwhile, banks are also trying to get into the private credit space — including well-established players such as Goldman Sachs, whose asset management arm is increasing its position in private credit, as well as firms such as Nomura, JP Morgan and HSBC, which are seeking to break into the asset class for the first time, market sources note.

Growing up

Adding to that, deals are getting bigger, such as the recent financing from **Adevinta** with its [record-breaking €4.5 billion private credit facility](#) — the first transaction of this size in Europe, which showcases how private credit is maturing as an asset class.

Indeed, jumbo deals are a direct consequence of the scarcity of bank financings, as what used to be an obvious borrower candidate for a syndicated term loan or bond is now looking to a private credit club for financing. For example, **Civica** refinanced a term loan in August with a portable financing before a sale process for the company. But direct lending was born to serve the European mid-market to the extent that, until recently, the two terms were used interchangeably. Typically, sole lenders on modest tickets would provide private credit loans, but in response to market need the product has now evolved to see lenders clubbing together to provide massive financings.

Another sign of the market's maturity is the nature of fundraising. Due to slower deal volumes, LPs are finding it difficult to get their money back from private equity, and have invested less as a result. Conversely, direct lenders' success at winning market share means investors have increased their deployment in private debt. There is still a challenge for first-time managers and new strategies, but large established managers in Europe have been able to raise capital, sources said.

The economic backdrop remains dire in terms of M&A deal-making, but for private equity sponsors this situation has been favourable — not in terms of deal volume of course, but in the sense that it has helped strengthen the asset class.

First and foremost, private credit is benefitting from a retrenchment in banking activity. But it also has a set of tools that makes the product attractive both for lenders and issuers alike. For lenders, a higher interest-rate environment is improving risk-return ratios — there is now potentially a yield of up to 10-13% that comes with lower leverage multiples, lower LTVs, and higher equity contributions from sponsors. Meanwhile, documentation is much tighter with fewer adjustments, market players agree. “There is also the potential for additional sources of return, such as PIK, early repayment premiums and repricing adjustments for add-ons,” a debt manager explained.

“The use of HoldCo PIK has been far more prevalent in 2023 than in previous years, and we can expect junior capital to play a large part in 2024. It continues to be seen as a good way to help bridge the gap between senior secured leverage tolerance and the capital structures desired by private equity,” said Aymen Mahmoud, partner at McDermott Will & Emery.

Bubble trouble

Given the high rate environment, however, there are concerns among participants about the market overheating. The nature of private credit is mostly to arrange loans on a floating-rate basis, and rising rates could therefore become problematic for issuers' capacity to repay their loans.

“Many fear a bubble — or at least a test for the asset class that could expose some weaknesses, but I have not seen that,” said one manager at a private lender. “They said Covid would have an impact, then war in Ukraine, but all I can see is the asset class getting stronger.”

Furthermore, private credit firms' risk aversion could play against them as they all chase the same credit stories and sectors — generally in the software, healthcare, and business services segments. Conversely, sectors that are highly cyclical or rely too much on consumers are more likely to be shunned by private credit. This may offer a route for bank lenders to return in the sectors that are less liked by private credit.

This sector focus does not apply to regions though, and private credit is now well established across Europe. Regions that were lagging behind the core markets of the UK, France and Germany — such as Benelux and the Nordics, for example — are now very much part of the market picture. “This year we've seen the private credit market's ability to regularly deliver multi-billion financings across various regions in Europe. These

bigger transactions can be highly sought after by the larger funds, who are willing to take sizeable exposure to high quality credits,” said Dan Matthews, head of EMEA leveraged finance at SMBC.

Road ahead

Meanwhile, a few macro trends are creating uncertainty, which will eventually have an impact across the asset class, and on the kind of businesses coming into the market. Geopolitical tensions, for example, continue around the globe, and are by their very nature unpredictable. Furthermore, artificial intelligence is going to have a profound impact on the labour market (and beyond) in the long run, while some private lenders also warn the asset class will have to contend with a low-growth world that is trending towards deglobalization.

That all said, sources suggest there is scope for macroeconomic optimism. Firstly, there is a downward trend in the inflation forecast for Europe, according to the ECB, and second, there is the prospect of an uptick in M&A. Indeed, a few recent deals — such as those for [Dorc](#), Civica, [Iris](#), and Adevinta — have attracted a good amount of interest from both sponsors and lenders, and this activity is bringing back a certain amount of confidence in the market (though Dorc has now been [acquired by trade buyer](#) Carl Zeiss Meditec). “Although pretty low by historic standards, there has been an uptick in M&A with sizeable deals that bode well for the year to come,” explains SMBC’s Matthews. “There have also been some very interesting deals in the pipeline, and it feels optimistic.”

As the market comes out of a relatively low default-rate environment for European corporates, liquidity is going to be in the spotlight in 2024, and some companies still need to adapt to a higher-rate environment. Those firms that agreed their loans three to five years ago and did not hedge their interest-rate liabilities, for example, could find their debt costs go up by as much as 50%, one manager said. However, private debt funds — thanks to their selective sourcing, strong diligence, sound structure, direct access to borrowers and their financials, and ability to influence workout agreements — could be well-placed defensively to fend off many problems arising from this scenario.

As for the M&A pipeline in general, the prospects here appear to fall into three broad categories. Firstly, there will be the 'superb' top deals that are ultra-competitive and will attract everyone, achieving historic EV multiples and whatever leverage is being sought (such as the top end of the software sector). Secondly, there will be those deals where a company is forced to sell instead of doing a costly refinancing, which will generally have lower EV and low leverage (these deals will stem from firms that either did not hedge or could not factor in the interest-rate hikes properly). In the third category are other companies that will try to wait as long as possible, so as not to sell at a loss. Throughout 2023, auctions have started and stalled, mostly because of a mismatch in price expectations between buyers and sellers. For example, the [AD Education](#) auction has been stopped, according to market sources.

As a final thought — and providing yet another example of private credit’s maturity — the asset class could expand into the CLO market next year, on the back of increased optimism regarding a private credit [CLO](#) pricing in Europe. However, there remain several formidable hurdles to overcome first, spanning diversity, currency, and how such vehicles would be rated.