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UK & European restructuring market outlook 2015
A split forecast
Introduction

Welcome to the UK & European restructuring market outlook for 2015. In our 4th year of conducting this survey we interviewed 80 senior restructuring professionals from banks and alternative lending institutions across the UK and Europe. Our report provides an insight into their views of the restructuring market in 2014 and the prospects for 2015.

In 2014, we saw a more stable macroeconomic environment, coupled with increased access to financing in the capital markets, resulting in a quieter year for restructuring professionals. However, the effects of low consumer demand, geo-political risks, Government spending limits across Europe and reduced demand from developing economies continued to precipitate restructuring activity, especially in the business services, waste management, real estate, retail and commodities sectors.

2014 also saw increased regulation and testing of European banks by the European Central Bank. In response, banks continued to deleverage – and alternative lenders capitalised on this opportunity, picking up circa €89bn of these portfolios through the year. We also saw alternative lenders increase their influence via increased direct lending and by entering new markets and new geographies. They will undoubtedly play a key role in the future restructuring market.

We would like to thank all those who have contributed time and insight into this report. We hope you find this reading interesting and look forward to further debates about the future of our restructuring market.
UK Banks

- **89%** expect to see a fall in restructuring activity in 2015.
- **83%** saw a decrease in restructuring activity in 2014.
- **71%** saw an increase in leverage multiples for new lends.

- **67%** saw an increase in debt repayments via refinancing.
- **59%** see the strategic direction for their banks to be more retail focused.
- **44%** believe an interest rate rise is the biggest threat to economic stability.
The shape of the UK lending landscape has changed significantly in the past year. Alternative lenders have had substantial amounts of money to invest, and have gained market share from mainstream lenders in both the mid-market and big ticket lending space.

In 2014 the UK economy enjoyed strong growth with an increase in consumer spending, low inflation and a fall in unemployment. With low interest rates and greater liquidity in the capital and equity markets, companies took the opportunity to strengthen their balance sheets by refinancing. Investment in growth by companies rose 8% in the fourth quarter of 2014. A fall in the rate of non-performing loans also translated into lower levels of restructurings.

With this in mind, we spoke to senior members of workout teams in banks who focus on UK lending only. Many of them operate within a particular region rather than across the whole of the UK; and for about two-thirds of them, the size of debt in which their institution participates is typically less than £50 million.

What happened in 2014?
Most respondents saw a drop in the volume of restructurings compared to 2013, and this is in line with their predictions in last year’s survey. The decrease in restructuring activity was partly a result of UK banks continuing to exit from non-core assets, many of which were picked up by alternative lenders.

Restructuring activity was spread quite widely across business sectors, although professional services, retail, health care and real estate were prominent, see Figure 1.
What happened in 2014? (Continued)

In 2014, the three key challenges facing companies in workout were the same as in 2013: poor capital structure, sector-specific factors and operational issues.

There seems to have been a conscious shift by banks towards non-insolvency solutions. Most respondents confirmed that their approach to restructuring was influenced by reputational considerations, against a backdrop of challenges such as the Tomlinson report (released in November 2013). For one half of respondents there was a decrease in the number of insolvency-based solutions compared with the previous year; whereas two-thirds saw an increase in exits via refinancing and over one half in exits via a business sale as the M&A markets recovered. Although still commonly used, about one half of respondents saw a reduction in the number of A&Es. See Figure 2.

Lending strategy

As banks have emerged from the financial crisis, there has been a gradual shift in lending practices during 2014. About 40 per cent of respondents saw changes in their lending strategy, although their experiences were not all the same. See Figure 3.

Most had exited from non-core asset classes and about half had increased their focus on lending to SMEs. With strong competition in the market, many saw lower fees and margins, fewer covenants and increased leverage multiples for borrowers. One respondent commented: “The number of good-looking deals was limited and lenders have participated in sub-optimal deals as capital had to be deployed.”

“The number of good-looking deals was limited and lenders have participated in sub-optimal deals as capital had to be deployed.”
**UK Banks**

**Alternative lenders: rivals or allies?**
Most of our respondents had experienced greater competition in 2014 from alternative lenders, who increased their involvement in the mid-market segment as yields in the mid-market space proved more attractive than in the big ticket space.

Increased competition has resulted in lower margins for new loans, as reported by nearly 70 per cent of respondents. On the other hand, the presence of alternative lenders in the market has offered more opportunities for refinancing and a valuable exit route for banks from some restructurings. The impact of the increased competition from alternative lenders on our respondents’ banks is summarised in Figure 4.

In some cases alternative lenders held back from buying debt in the secondary market, because of higher loan prices caused by increased liquidity in the market. Some loans with poor credit quality traded close to par rather than at a discount. One respondent commented on how “loan prices are going off the scale and it’s amazing how quickly we seem to have forgotten the crisis.”

The relationship between banks and alternative lenders started out as ‘them vs. us’ at the negotiating table; but as they have worked together more often, the relationship has developed and can now perhaps be best described as a ‘healthy tension’. Some alternative lenders are seen by banks as making a positive contribution to restructurings, since they drive deeper and faster solutions in order to deliver positive returns on their investments.

“Loan prices are going off the scale and it’s amazing how quickly we seem to have forgotten the crisis.”

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![Figure 4. Impact of increased competition from alternative lenders in the UK](image)

![Figure 5. Expected impact of increased regulation of alternative lenders on UK banks](image)
Respondents had mixed views about whether alternative lenders will be more closely regulated in the future. Those expressing the view that regulation will happen did not expect it for two to five years. The most common opinion was that such regulation would not have a significant impact on their institutions, see Figure 5. Some banks acknowledged concerns, however, that regulation of alternative lenders might reduce refinancing/exit opportunities, further strengthening the importance of the capital markets and increased covenant protection in lending.

The outlook for 2015 and beyond
Respondents expect the current high level of liquidity in the market to continue and do not expect any major macroeconomic shocks in 2015. 80 per cent of respondents indicated that they did not see another recession coming for three to five years, anticipating a quieter time for UK restructuring teams.

50 per cent of our respondents anticipate that the two biggest uncertainties for growth in the UK are the timing of any interest rate increase and UK general elections. Until then, businesses will have a chance to focus on operational improvements and to continue investing in growth.

Most expect restructuring levels to stay at the same level for at least 12 – 18 months. Two sectors in which our respondents expect to see continuing stress in 2015 are retail and education.
Identified real estate as non-core

Saw a decrease in restructuring activity

Expect increased regulation of alternative lenders

Expect to see an increase in restructuring levels in 2015

Saw an increase in debt repayments via refinancing

Saw an increase in lending to corporates with poor credit

Identified real estate as non-core

69%

51%

33%

31%

68%
European Banks

European lenders
In 2014 the economic performance across Europe was uneven. With the threat of a Eurozone break-up diminishing, geopolitical risks and deflation were seen as the key threats. Sentiment remains cautious around the economic outlook despite improving macroeconomic trends.

Against this background we interviewed senior members of workout teams in large European banks and, not surprisingly, respondents to our survey gave mixed answers to questions. Nonetheless some common trends and features were evident throughout many of the European markets.

What happened in 2014?
Restructuring activity in many jurisdictions was lower than the previous 12 months. Just over half of respondents reported a decrease in restructuring activity; those reporting an increase were based in Spain and Austria.

There have been some signs of change in the use of different methods of restructuring. Over a third of respondents had seen an increase in exit via refinancing due to high liquidity in the capital markets, and over a quarter saw an increase in exit via sale of business as the M&A market gained momentum. Insolvencies also increased in some jurisdictions (noted by 13 per cent of respondents). These appeared to be mainly zombie companies where previous attempts to restructure had failed, leaving insolvency as the only option (see Figure 1).

Although 27 per cent of respondents saw a reduction in the number of A&Es completed, these along with covenant resets were the most common form of restructuring, even though the credit quality of some of the borrowers was considered poor.

Restructuring activity in many jurisdictions was lower than in the previous 12 months.
There seem to be several reasons for the continuing large number of A&Es. In a few jurisdictions, particularly those with less developed insolvency markets or a cultural preference for consensual solutions, some restructurings were seen as too painful to handle. Other factors are the composition of the syndicate (for example, bank heavy vs funds light) and sufficient liquidity in the business to avoid the need to address capital structure. Maturities were extended in the hope that borrowers would be able to repay their debt when the economy improved. Although a number of respondents accepted that A&Es were often only a temporary solution and they expected to see certain cases come back.

Changes in insolvency legislation in France, Germany and Spain have made these markets more predictable and easier to implement restructurings. However, only about a quarter of respondents felt that the changes would have a positive impact on their lending strategy in these countries.

Three-quarters of respondents’ institutions had gone through a process of identifying and developing strategies for dealing with non-core assets during the year, as it increasingly became an integral part of capital planning. The most commonly-used approach was to identify non-performing loans rather than to focus on specific business sectors. However, a number of sectors have been affected more than others: notably real estate, shipping and infrastructure. In a few cases, banks had made a conscious decision to withdraw from particular geographical areas, with Commonwealth of Independent States (CIS) and some Central and Eastern European (CEE) regions the most commonly identified.

A number of respondents accepted that A&Es were often only a temporary solution and they expected to see certain cases come back.
What happened in 2014? (Continued)
Although sector performance varied in each of the jurisdictions, there were common themes. Historically across Europe, retail and real estate have been the sectors that have kept work-out teams busy, and this continued to be the case in 2014. However 2014 also saw signs of distress in energy and resources, particularly in:

- Mining, on the back of low commodity prices, with coal and iron ore particularly hard hit
- Oil refineries and service companies in the oil sector
- Steel, given a global slowdown in construction (particularly in China)
- Renewable energy (wind and solar power) following legislative changes which reduced tax breaks

Many of the issues facing the restructuring market vary between countries. Below is a short overview of the key messages coming out of the countries we visited.

Austria
Austria has seen an increase in restructuring activity due to its exposure to countries in CEE, in particular Croatia, Romania, Slovenia and Ukraine. The problems of restructuring in these jurisdictions have been compounded by political dynamics, and a shortage of liquidity in the capital and equity markets, as well as their creditor-unfriendly jurisdictions which reduce restructuring options.

Lenders however were generally more positive on the degree of stress and outlook in the Austrian domestic market.

France
In France, although there were not many new cases during 2014, banks continue to deal with legacy cases that some describe as ‘dead horses’. There has been an increase in insolvencies, as zombie companies that had been through workout unsuccessfully two or three times were left with no option. Another key development noted by respondents was that Mandataires have become more receptive to lender-led solutions, which they now believe could help facilitate future restructurings.

Investment by alternative lenders has risen over the last few years, although their inability to provide undrawn facilities means it is very difficult for banks to completely exit a situation. Since alternative lenders typically acquire debt below par, they are more willing to agree debt forbearance than the French banks.

Germany
Germany saw a steady volume of restructuring activity over the past year, with an expectation of marginally increased activity in 2015. The strength of capital market liquidity provided an opportunity to exit investments via sale/M&A or refinancing in the first half of 2014, but this window narrowed during the second half of the year.

Alternative lenders were not seen as major competitors for new deals in the domestic mid-cap (‘Mittelstand’) space due to the funds’ higher return requirements, but German banks continued to exit problem loans selectively via the secondary markets. Whilst there was no global expectation of large-scale portfolio solutions following the Asset Quality Review (AQR), certain institutions indicated that they were actively contemplating joint ventures or securitisation solutions for loans in certain sectors.
European Banks

Italy
Although the Italian banks did not participate in the survey, many respondents expressed concerns over the economy, which shrank by 0.17% per cent in 2014. Many Italian companies are cash-strapped, and achieving a consensual restructuring is challenging. Respondents were frustrated by the insolvency regime which they described as complex, slow and inefficient.

Following the AQR, we expect this to be the most active country for restructuring, with both bank deleveraging and company restructurings.

Netherlands
Banks were generally positive about the local economy, with the greatest concerns being around exposures to the CEE and CIS regions. Dutch banks continue to favour A&Es, especially where there is no burning need for liquidity in the business.

Alternative lenders, whilst actively holding discussions with banks, have so far completed only a small number of transactions. Regulators have expressed some concern over the lack of transparency as to who the ultimate investors actually are, and it is not yet clear whether they intend to take steps to address this.

Spain
Many lenders indicated that they would have seen a drop in restructuring cases had it not have been for issues in the renewables sector triggered by legislative changes. The new insolvency regime is generally viewed as positive by the market and a step in the right direction in terms of dealing with the problems there. Respondents believe that it has had a positive impact on reducing the number of A&Es, as small participants are no longer able to block deals.

Alternative lenders have been active, mostly by picking up loan portfolios and respondents believe they will drive more aggressive approaches to restructuring as A&Es come back for the second or third time.

Overall respondents were reasonably positive about the outlook for the Spanish market; however they cautioned that it may take longer to bounce back than some economists are indicating.

Sweden
Compared to any other jurisdiction, A&Es remain the most popular method of restructuring. Swedish banks are highly focused on relationship banking and are therefore very supportive of borrowers. As the concept of ‘mark to market’ does not exist, there is no trigger to drive other forms of restructuring.

However, banks believe that the Swedish economy is in for a difficult time in 2015 in view of limited growth in retail and manufacturing, exposures into key trade partners Russia and Germany (where there is a perception of economic slowdown), political dynamics, and a bubble in the domestic residential real estate market. Key challenges for 2015 are expected to be an increasing complexity of cases and lack of restructuring skills within banks to deal with anything other than A&Es.

Alternative lenders are showing greater interest, and this has started to affect pricing as companies have greater access to credit, however alternative lenders have not as yet successfully penetrated the market.
Impact of the Asset Quality Review (AQR)

Many of our respondents completed the survey before the results of the AQR were announced, and their responses were in line with the outcome of the tests. 79 per cent of respondents’ institutions were subject to the AQR and about a third of these felt that one outcome would be (or already had been) an increase in their level of provisioning against non-performing loans (NPLs). Some also expected a requirement for continued disposal of loan portfolios; AQR resulted in a €136 billion increase in NPL exposures across European banks.

Overall most respondents believed that their institutions were well prepared for AQR, as they had started to right-size by deleveraging, had undertaken capital raisings and were confident about their provisioning levels. Consequently they did not expect to be adversely affected by the review.

The biggest impact post-AQR is expected to be on A&Es, as forbearance rules are introduced in 2015. Forbearance rules are complex, but in short they will require banks to report any A&E where the borrower is in financial difficulty and to make provisions much earlier. Tighter reporting and controls enforced by the ECB are expected to make A&Es more difficult to execute, forcing a fuller restructuring solution.

On the whole, however, the impact of the AQR was less than originally expected. As one respondent mentions: “it brought discipline, rigour and fear.” A number of respondents predicted that there were likely to be one or two ‘sacrificial lambs’ to justify the exercise and that these would most likely come from second or third-tier banks in Italy or Spain.
European Banks

Alternative lenders: a growing presence in some markets
In 2014 alternative lenders increased their influence in several Western European markets, notably Spain, Germany and France, by buying loan portfolios from deleveraging banks and buying debt in the secondary market. We understand from several (bank) respondents that they have been contacted with increasing frequency by alternative lenders seeking an opportunity to invest, although they are yet to penetrate certain markets.

Banks have a somewhat ambivalent attitude towards alternative lenders and can argue the merits and disadvantages of having them buy into stressed situations.

In Spain, many banks are reluctant to sell debt to alternative lenders, and some loan documents include a provision preventing a sale (or in the event of a sale, providing that the buyer should have no voting rights). Banks in the Nordics, Austria and Netherlands expressed similar reservations given the focus placed on relationship banking.

On the other hand, banks in all jurisdictions recognise the positive influence that alternative lenders have brought to the restructuring market. Their willingness to provide new money, force the pace (as opposed to sitting on the fence) and drive operational restructuring, were frequently cited. Alternative lenders seeking a longer-term value play are more likely to be successful with European banks than those focused on short-term profits.

The overall views of respondents regarding the effects of competition from alternative lenders on their organisation are shown in Figure 5.

Alternative lenders seeking a longer-term value play are more likely to be successful with European banks than those focused on short-term profits.
Alternative lenders: a growing presence in some markets (continued)

Among our respondents, 72 per cent thought that alternative lenders would be regulated, most probably in the next two to five years; the sentiment was that this ought to happen in order to ‘level the playing field’, as opposed to believing that it actually would occur. As alternative lenders do not hold public deposits, the rationale for regulation is not clear and so perhaps difficult to justify. Many believed their jurisdictions were unlikely to introduce regulation and that any decision to do so would need to be taken centrally by the ECB. A number believed this might only be triggered by either a catastrophic failure or the emergence of a significant fraud.

Figure 6 shows our respondents’ views on the expected impact on their institution of increased regulation of alternative lenders.

The next 12 months: what is likely to happen?

Looking forward, respondents had mixed views about whether economic conditions would improve. About a third expected the European economy to worsen over 2015.

Some had changed their views since the summer, from being buoyant to more cautious as bond markets appeared to have closed, there were concerns over a slowdown in the German economy, the proximity of elections and uncertainty of outcomes. Deflation is seen as the biggest threat to the European economy (and a rise in interest rates as the biggest threat to the UK). Many respondents also felt that the political landscape may have a destabilising effect in some countries, and were concerned about the lack of consistency in government measures to manage the economy. There was also concern that in some countries, despite positive macroeconomic conditions, governments have not taken the austerity measures that may be necessary for sustained economic recovery. Overall lenders remained cautious about the economic outlook.
European Banks

Many respondents did not foresee any change in the level of restructuring activity in the next 12 months, but about a third expected a decrease, principally where measures had already been taken to address non-core loans. The trend in 2015 therefore appears to remain relatively flat overall, although a number of respondents believe that activity is likely to rise again from 2016. During 2014 about a half of respondents saw a reduction in the size of their work-out teams. If restructuring activity continues to decrease, there will presumably be further cuts in staff numbers as people are redeployed within banks or leave. A key concern for many respondents is how to retain the key skills and knowledge gained during the financial crisis. The rise of high yield bonds has also created concerns that future restructurings will be more complex, with new instruments sitting alongside traditional bank debt.

Conclusions

The European market has traditionally been dominated by banks, and whilst this will continue to be the case in a number of jurisdictions in the short to medium term, we expect to see a number of changes going forward.

Whilst a decrease in restructuring activity in 2015 was expected by most respondents, we expect restructuring activity to increase across Europe, although this may not occur until the post-summer period. We believe this because:

- Forbearance rules should force banks to deal with their ‘amends & pretends’
- Alternative lenders will either enter or expand their presence in more European countries

We believe this will lead to a step-change in the level of comprehensive restructurings. Equally, the prevalence of different stakeholder groups and of high yield bonds alongside traditional bank debt has increased the complexity of debt structures.

A combination of all of these factors will lead to the need for greater coordination and collaboration between banks and alternative lenders, as some of these deals become unstuck.

Authored by

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See Profile
71% reported they were able to reach their hurdle rates.

Expect to see increased restructuring activity in 2015.

86% identified poor capital structure as the key trigger of restructurings.

43% expect to exit their investments through refinancing in 2015.

40% believe an interest rate rise is the biggest threat to companies in 2015.

72% identified poor capital structure as the key trigger of restructurings.
Alternative Lenders

The influence of alternative lenders in the restructuring market is growing. With the backing of billions of dollars of investment, funds are extending their involvement at a time when banks are reducing theirs. With this in mind, we spoke to several key alternative lenders who are active in both the big ticket and mid-market restructuring space.

Profile of alternative lenders
Most of our respondents invest in both the UK and across Europe. The UK has a more developed market, with funds active in both mid-market and big ticket situations. In comparison, deals in Europe tend to be weighted towards the big ticket space. However, several alternative lenders are opening offices throughout Europe to pursue mid-market opportunities for both single loan names and loan portfolios. One respondent commented: “Expansion into Western Europe is difficult; if you don’t have a local contact, you end up getting the dregs.” Alternative lenders continue to be cautious investing in less creditor-friendly jurisdictions. One respondent commented: “Good to do business with the beer drinking countries rather than the wine drinking ones.”

With interest rates remaining low in 2014, the hunt for yield by investors has led to an increase in demand for alternative credit strategies, with nearly three-quarters of our respondents raising additional funds during the year. Reflecting their overall levels of confidence, 86 per cent of respondents reported that they were able to reach their hurdle rates with few finding it necessary to return money to investors.

What happened in 2014?
Higher levels of liquidity resulted in an increase in loan prices in the secondary market and keen pricing in the primary market. However there is evidence of prices moderating, with one respondent commenting: “Prices have levelled out, but leverage is going up to pre-2008 levels.”

Our respondents expressed the view that the low interest rate environment, combined with the general willingness of lenders in Europe to forbear and Amend and Extend (A&E), has allowed struggling companies to defer restructuring. At the same time strong capital markets have refinanced highly-leveraged loan structures with bonds. The overall result has been low levels of restructuring activity throughout 2014.

Banks sought to take advantage of high liquidity levels with increased loan portfolio sales. About one half of our respondents bought loan portfolios of non-core assets from banks in 2014.

The most popular investment strategies for alternative lenders were yield (i.e. hold the debt to maturity), trading/arbitrage, and pursuing a loan-to-own strategy.

“Good to do business with the beer drinking countries rather than the wine drinking ones.”
Alternative Lenders

What happened in 2014? (Continued)
The sectors that had the most investment varied widely, including retail, business services, telecoms, media and technology. See Figure 1.

Our respondents noted that companies struggled primarily with over-leveraged capital structure, followed by operational problems. See Figure 2.

Alternative lenders faced a number of challenges in restructurings during the year. Many commented on the problems of poor company management and turning around the operations of struggling businesses. Others referred to the complexity of the laws in differing jurisdictions and divergence in the expectations of the lender groups in restructurings.

Deals were complicated by the different structural and contractual security arrangements for instruments. Additionally, many situations involved multiple stakeholder groups, with various combinations of local and international banks, ABLs, alternative lenders and bondholders. Not surprisingly our respondents indicated a preference for deals in which there were fewer players, allowing for a faster restructuring when needed.

Deals were complicated by the different structural and contractual security arrangements for instruments.
The next 12 months: what is likely to happen?
Most alternative lenders, unlike the banks, expect an increase in restructuring activity in 2015. There are a number of reasons for this:

• Banks are becoming healthier and better provisioned. Many older vintage Collateralised Loan Obligations are through their reinvestment periods, making it less likely they will seek to ‘kick the can down the road’. At the same time, issuance of non European CLOs is gathering pace.

• ECB regulation is forcing a far more consistent approach to provisioning across the Eurozone, and harsher regulatory capital penalties on forbearance and A&E activity will be introduced.

• Capital markets have cooled since summer 2014 and are showing signs of being more selective, pushing up the costs of refinancing highly-leveraged structures.

• Interest rate increases are on the horizon, although the likelihood of this occurring during 2015 appears to be receding, particularly in the Eurozone. See Figure 3.

The post-Asset Quality Review landscape is expected to include a higher level of loan portfolio sales by banks in Europe. One respondent commented that: “German banks have been nervous and they don’t want to be selling cheap, so they are waiting. What’s missing is intent to sell.” Tightening ECB regulation may well provide the catalyst for selling.

Most of our respondents expect an increase in trading in high-yield bonds, unsurprising given the large number of bond issuances. Many also believe that there will be increased trading in leveraged loans, both single names and loan portfolios. See Figure 4.
The next 12 months: what is likely to happen? (Continued)
When asked what would cause their organisation to amend its investment strategy, respondents mentioned a number of factors. Most said that they intend to expand into new lending structures, reflecting a broadening of their credit strategies. See Figure 5.

A majority of respondents expect alternative lenders to be more closely regulated in the future, however most noted they did not expect this to happen for two to five years.

Opportunities for restructuring activity in the future would be improved by the adoption of more lender-friendly insolvency regimes in various European countries. UK law is by far the most commonly used, for large European insolvency proceedings. However, complex restructurings involving a combination of bonds and loans may have three or more governing laws. It is not yet clear whether US Chapter 11 will become the preferred basis for restructuring high-yield bonds issued under US law by European issuers.

Figure 5. Factors that would cause respondents to amend their investment strategy

German banks have been nervous and they don’t want to be selling cheap, so they are waiting. What’s missing is intent to sell.
Conclusions
We believe that complexity is here to stay with the shift towards a US style funding model, encompassing capital markets and alternative/institutional lenders, gathering pace. Secondary pricing should moderate with increased supply, due to healthier bank balance sheets and tougher regulatory penalties for forbearance and A&E activity.

Capital markets, and M&A to a lesser degree, have provided attractive options for heavily-indebted borrowers. However, the bond market has lost some of its froth since the summer, and is likely to remain difficult for the most needy borrowers.

An increased bank appetite to restructure rather than A&E, combined with more moderate levels of capital market activity, suggest that 2015 and beyond should see an overall increase in restructuring. We also expect greater volatility in secondary markets compared to previous cycles, as broker-dealers are less able to utilise their balance sheets to warehouse assets.

Unless there is a substantial shock to the Eurozone or UK economies, we expect funds to continue to diversify, increase assets under management and create various pools of capital with differing risk/reward profiles. This will allow them to participate in a range of deals from origination through special situations.

However, the bond market has lost some of its froth since the summer, and is likely to remain difficult for the most needy borrowers.
Asset Based Lenders

44% saw an increase in restructuring activity in 2014

38% believe competition from banks both domestic and international is their biggest threat

67% saw most restructuring activity in the manufacturing sector

42% expect to see an increase in restructuring activity in 2015
The Asset Based Lending market has continued to see strong year-on-year growth in the UK. In 2014, the market grew seven per cent compared to 2013 with total revenues of £215bn. In addition, 2014 saw increased competition in the marketplace as a result of new entrants, including international banks, alternative lenders and hedge funds, many of whom are from overseas, especially the US.

The increased competition in the market and improvement in the economy have resulted in greater liquidity, leading to a greater level of funding options and products for the mid-market.

Against this background, we sought the views of Asset Based Lenders (ABLs) on the restructuring market and its future.

**What happened in 2014?**
Helped by strong economic growth and an end to the squeeze on consumer disposable income, there has been a reduction in the percentage of loan books with borrowers under stress. However, 2014 was a mixed year for our respondents, where most saw either no change in their levels of restructuring or an increase, with only 11 per cent noting a decrease (see Figure 1). The increase was attributed mainly to continued trading under-performance and mismanagement of ABL facilities.

With increased competition in the ABL market, some respondents saw their net loan books shrink as attrition exceeded new deals.

The financing raised by companies through ABLs was used for management buyouts (MBOs), management buy-ins (MBIs), restructuring, refinancing and providing finance for growth, see Figure 2.

Although our sample size was fairly small, it appears that the most common business sectors for restructuring were manufacturing and business services.
Asset Based Lenders

Expectations for 2015
All our respondents expect either an increase or no change in the level of restructuring activity in 2015, with most activity expected to be in manufacturing, business services, recruitment and telecoms, media and technology sectors, see Figure 3. Several ABLs expect restructuring levels to increase due to overtrading by companies and the expected rise in interest rates toward the end of 2015.

However, ABLs are not expecting an increase in drawdown levels by clients, which suggests that the funding challenges for companies emerging from the recession may have already taken place in 2014.

Our respondents also expect to see an increase in new lending opportunities, especially through private equity led transactions, although this relationship between ABLs and private equity is still in its infancy. They also expect an increase in large syndications with credit lines of £50 million or more.

The under-developed UK ABL market has produced significant opportunities, attracting new competitors to the market. Competition has come from retail banks (both national and international) and hedge funds. This has placed downward pressure on pricing and some loss of market share for existing players.

All respondents expect competition to remain high throughout 2015, but believe that their strong relationship with customers will help them retain their market share. Their ability to structure new products, and the quality of their customer service, sector expertise and commerciality will also help them differentiate their offering from their competitors, see Figure 4. One respondent stressed the importance of getting to know clients very well through monthly reviews and restricting the number of deals client managers handle.

Figure 3. Sectors where restructuring in 2015 is expected by ABLs

<table>
<thead>
<tr>
<th>Sector</th>
<th>ABLs Expecting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>78%</td>
</tr>
<tr>
<td>Business Services</td>
<td>56%</td>
</tr>
<tr>
<td>Telecoms/Media/Tech</td>
<td>33%</td>
</tr>
<tr>
<td>Recruitment</td>
<td>33%</td>
</tr>
<tr>
<td>Retail</td>
<td>22%</td>
</tr>
<tr>
<td>Energy &amp; Resources</td>
<td>22%</td>
</tr>
<tr>
<td>Construction</td>
<td>11%</td>
</tr>
<tr>
<td>Agribusiness</td>
<td>11%</td>
</tr>
</tbody>
</table>

Figure 4. How ABLs believe they will differentiate their offering in the face of increased competition

<table>
<thead>
<tr>
<th>Differentiation Aspect</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitively priced</td>
<td>43%</td>
<td>57%</td>
<td></td>
</tr>
<tr>
<td>Relationship</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer service</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ability to respond to opportunities quickly/deliverability</td>
<td>86%</td>
<td>14%</td>
<td></td>
</tr>
<tr>
<td>Wider product offering</td>
<td>43%</td>
<td>57%</td>
<td></td>
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<tr>
<td>Commerciality</td>
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<td>Sector expertise</td>
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Conclusions
As the economy and the M&A market pick up, ABLs have a positive outlook for 2015. We have already seen increasing activity in the M&A and private equity markets in 2014, with further growth in 2015 anticipated to provide more lending opportunities for ABLs. The continuing development of the relationship between private equity and ABLs will unlock much greater funding opportunities. It will be interesting to see how this relationship develops and if, as in the HY bond market, this will replicate the US model.

The ABL players also continue to expect fierce competition in 2015. Product differentiation will therefore be high on their agenda, along with quality of service to protect their market share.

So far ABLs have been able to react relatively quickly to funding needs in the market due to the lack of regulation. There are however some concerns about increased regulation in response to the growing influence of ABLs (and alternative lenders) in this segment of the lending market. However, our respondents believe that regulation will not happen in the near future.

We expect ABLs to continue to grow market share in 2015 and provide alternative and cheaper sources of funding to corporates to address working capital challenges as the economy improves further.
Some final thoughts...

As banks shrink their balance sheets, the restructuring and lending landscape is developing more like the US market, with alternative lenders in Europe and ABLs playing a bigger role. We expect their influence to strengthen further in 2015, though some of the newer funds are yet to be tested on the success of their investment strategies.

A number of our respondents expressed the view that restructuring activity will continue to decline in 2015, but we concur with the alternative lenders that this will not be the case.

In Europe, the AQR was a backward-looking exercise and only the start of a process heralding stricter regulatory control and supervision of banking. The ECB’s forbearance rules are likely to result in greater recognition by European banks of non-performing loans, which should trigger an increase in portfolio disposals and restructurings. This is likely to provide broad opportunities in countries such as the Netherlands, Austria, Germany and especially Italy, as banks and alternative investors find their feet in the new regulatory environment.

Restructuring levels will also be impacted by macro-economic and sector-specific issues. The sectors we consider most likely to be affected are energy, commodities, retail and insurance. Lower productivity in Europe could also put a strain on the manufacturing sector, especially in Germany. The only practical relief that we see would be demand-driven growth, especially from China and other developing economies.

Despite all the efforts of governments and European institutions to sustain economic growth through fiscal and monetary measures, conditions in the market may be affected significantly by political developments. Fallout from the situation in the Ukraine and Russia, or the Middle East, has the potential to derail the growth of the European economy.

Much will depend too on the availability of cheap capital for companies to invest, which we expect to continue through 2015. Interest rates are expected to stay low as the ECB tries to fend off deflation. There are encouraging signs too, with CFOs showing increased confidence in the future and companies starting to invest in larger projects and M&A.

No matter how the mix of external factors pans out, the restructuring community can take comfort from the knowledge that there will always be restructurings driven by operational issues, poor management and inappropriate capital structures.
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