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The distressed opportunity mounts up

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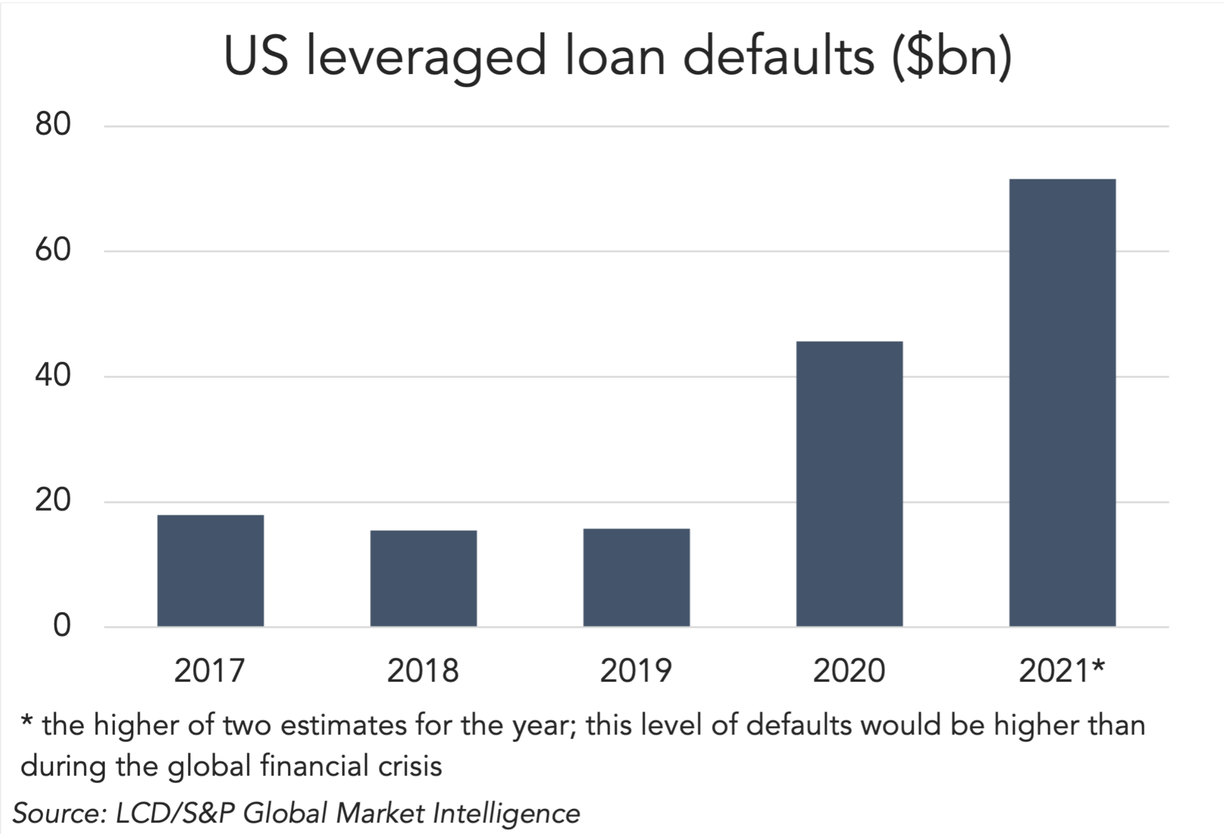

Leveraged loan defaults have been accelerating, with companies having come under strain during the pandemic.

Considering there has been a lot of talk about the delaying of the distressed opportunity as a result of companies being propped up by government support schemes, the figures in the chart above – showing US leveraged loan defaults shooting through the roof – may come as something of a surprise.

In a recent article for *Private Debt Investor*, David Conrod of FocusPoint Private Capital Group pointed out that liquidity needs, downgrades and defaults are already at double the heights they reached in the global financial crisis. At the end of last year, according to LCD data, there were $6.4 trillion of distressed opportunities across the US and Europe – almost 3.5 times the level in 2007.

Because most of the distressed loans are held by organisations described by Conrod as “passive market participants”, there is a strong incentive for these loans to be sold in a bankruptcy or restructuring process. Experienced distressed debt investors, many with large piles of capital accumulated during the fundraising boom years of 2017 and 2019, are waiting in the wings.

Conrod says many businesses “misallocated capital” during the crisis of last year, using cash to cover losses instead of investing in long-term digital capabilities and improving ESG standards, both areas that provided a boost to businesses through the pandemic. It is this shelving of long-term investment which means that the distressed opportunity could stretch well into the future.

In the months and years ahead, the distressed opportunity will likely be focused on the pockets of industries and segments of the economy that have been over-levered and under-invested. The challenge for investors looking to take control of these businesses will be to prioritise today’s areas of growth – such as technology and ESG – and thus avoid falling into the trap of the prior owners.

(Past performance is no guarantee of future results.)