Key Takeaways from Looking Ahead in Special Situations

On February 2, 2022, our Private Credit and Special Situations Group hosted a webinar moderated by restructuring partners Matt Warren and Roger Schwartz, featuring Lauren Krueger (Managing Director, KKR Credit), Heidi Rinehart (Managing Director, Antares Capital) and Nicole Drapkin (Managing Director, Blue Owl Capital). We emerged from the panel with valuable insights and perspectives concerning the current special situations and restructuring market, expectations for 2022 and future investment strategies.

1. Lasting Impact of 2021

The key drivers that led a record-breaking 2021 for the private credit market, including strong private equity investments, are likely to continue into the new year. Private credit presented itself as a compelling alternative for borrowers to traditional lending sources, and those opportunities do not look to be slowing down – particularly in the middle market. However, government stimulus may have only forestalled the inevitable for certain sectors and industries facing liquidity and supply chain issues.

"2020/2021 saw a "historic amount of dry powder... and the past two years have shown how resilient private credit as an asset class really is."
— NICOLE DRAPKIN, BLUE OWL CAPITAL

"Organizations have to be prepared for all market changes, both the good and the bad, to navigate risk. We've learned change can happen quickly, and accelerate, and we need to stay nimble and not be complacent."
— HEIDI RINEHART, ANTARES CAPITAL

2. Macro Trends for 2022

Factors such as inflation, wage pressure, COVID-19 and ongoing geopolitical pressures look to continue in the near to mid-term, particularly impacting commodity heavy businesses and sectors that rely on a build up of inventory. Businesses that can influence and navigate the supply chain will have a leg up, but competition for inventory will impact working capital and liquidity levels that borrowers and lenders will need to monitor closely. Expect to see more distress as a result, although certain industries (e.g., business services, travel and entertainment) are likely to continue to recover.

"Increased retirement rates, lower immigration, people (for a variety reasons) permanently leaving the workforce... we anticipate that this impact will not reverse in the near term."
— LAUREN KRUEGER , KKR CREDIT

"What we are seeing is that the most susceptible businesses are not necessarily being hit by demand destruction, but rather, the supply chain and inflation impact, which varies by industry...and the winners are those seeking more technological innovations."
— HEIDI RINEHART, ANTARES CAPITAL

3. Preparing for Downside Scenarios

Documentation today provides greater flexibility than during the great recession, so recognizing and understanding lender protections and covenants are a central focus. As companies review their options, it is becoming more common place to examine and execute on liability management type solutions to address maturity issues, modify covenants, and capture discount and equitization in the capital structure. Liability management transactions, including creative and novel structures, will continue to play an outsized role, with applications beyond the distressed space.

"Underwriting process is critically important when thinking about your downside protections. Documents in a competitive market do not contain the same features as seen several years ago,.. [and] a covenant in your document is only as good as your definition of EBITDA."
— LAUREN KRUEGER , KKR CREDIT

Lenders are "evaluating an increasing amount of opportunities that look non-traditional, and are more akin to asset securitization, including around intellectual property rights. "
— NICOLE DRAPKIN, BLUE OWL CAPITAL