



# Unlocking special opportunities in the mid-market

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**“These significant challenges for corporates create opportunities for special situations teams, which can be found across a wide range of sectors and geographies.”**

**Special situations and distressed debt expert, Adam Phillips, discusses the special situations landscape and looks at the sectors where these opportunities occur.**

Today, the US and European high-yield and leveraged loan markets total around \$3.5 trillion. This is a highly dispersed market, with a notable proportion of CCC-rated companies across a wide range of sectors facing a perfect storm of challenges. Many are starting from a position of being highly leveraged. They are also having to manage the effects of Covid, address rising interest rates, high inflation and surging energy costs, as well as the consequences of war on the edge of Europe. These significant challenges for corporates create opportunities for special situations teams, which can be found across a wide range of sectors and geographies. As a special situations team, we go where the stress is.

### Mid-market opportunities

The mid-market, is a highly stressed sector and a focus for opportunities for special situations investors. Further to general macro factors, companies of this size have the additional challenge of having limited access to credit markets compared to their larger counterparts. Mid-market companies are, therefore, more reliant on banks just at the time when banks themselves are tightening their lending criteria and becoming more risk averse. These companies are also naturally less diversified by geography and sector, adding to their stressed position.

### European real estate is stressed

The European real estate market is another sector that represents an interesting opportunity, especially when we consider the impending maturity wall anticipated in 2024 and 2025. As a sector, it is undoubtedly stressed and, in specific incidences, distressed, leading to investment opportunities arising from reduced asset prices. The market is locked currently, so there are uncertainties around what valuations will look like in the next year or two when it unlocks. There is also the question of whether real estate companies can divest assets and refinance their balance sheets in this challenging environment when access to credit may be more limited.

## Multiple sectors

Surging energy prices have also created challenges. Any sector that uses a lot of energy will be stressed and contain potential opportunities. We see these in industries such as chemicals, paper and packaging and auto parts. However, one of the most interesting things about this cycle is the broad opportunity set.

## “As well as the sectors themselves, we also need to consider the impact of other market participants.”

There are opportunities in industries as varied as oil and gas, manufacturing, shipping, telecoms, cinemas, retail, and food and beverages. This is a crucial differentiator from previous cycles, which have been more sector-specific, such as telecoms and cable in 2000-2001 and the dot.com bubble.

## Hedge funds too big for mid-market

As well as the sectors themselves, we also need to consider the impact of other market participants. Many hedge funds and asset managers investing in special situations and distressed debt have grown significantly over the past ten years. As they grow, their appetite for deals less than \$100 million wanes, enhancing the opportunities available in the mid-market.

### Looking ahead

Defaults are increasing, and we expect this trend to continue. The opportunity for special situations is wide-ranging across sectors and geographies. At RBC BlueBay, our special situations team is positioned at the forefront, ready to take these opportunities as they arise.

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