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Private lenders muscle in on LBO underwrites - RLPC News

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LONDON, Jun 23 (LPC) – Private lenders are expected to increasingly underwrite European buyout loans alongside banks, as volatility continues to ravage the leveraged finance market.

Direct lenders are increasingly stepping up in large buyout financings, mirroring the US market, which has a long history of credit funds and banks working together on underwritings. Across the pond, the market is much deeper

- the US leveraged loan market was about US$1.3tn in 2021, almost five times the size of the European market.

This month, enterprise software business Kofax completed a US$1.7bn buyout financing that was backed by several non-banks including Blackstone Credit, PSP Investments, Antares Capital, Stone Point Capital and Brinley Partners. The debt funds took down a large portion of financing before general syndication kicked off.

However, joint underwritings between banks and private lenders in jumbo deals are still rare in Europe. KKR Capital Markets, a unit of the private equity firm, is the most active non-bank lender, including the recent €3.4bn-equivalent financing backing buyout of Dutch-based bottling company Refresco in May 2022. KKR Capital Markets was a joint physical bookrunner on the deal alongside JP Morgan and Goldman Sachs.

Debt advisers believe market volatility will provide more opportunities in the European market for private lenders.

“It only happens in difficult times as banks want to reduce their underwriting risks. With direct lenders taking a bigger part of financing, it provides certainty that is most needed in this market,” said Floris Hovingh, managing director of debt advisory at Perella Weinberg.

Bankers in Europe are welcoming the idea of working with direct lenders in sizeable deals.

"We're seeing direct lenders take 'take and hold' positions’, and part of that is getting a co-underwriting role. We're happy to explore avenues of liquidity right now for bigger trades,” a loans banker said.

Banks have been struggling to sell down leveraged paper to investors in the US and in particular Europe, and some are scaling back their underwriting capacity on the back of higher inflation, rising interest rate and a war in Ukraine.

However, some bankers believe that syndicating deals is not a priority for most direct lenders.

"I don't think that there are a lot of direct lenders who want to get into the business of underwriting syndications," said a second loan banker. "The lenders who will do it have specifically quite flexible mandates, so it's far from everyone."

Distribution capability

While most US non-bank lenders normally take a passive role by holding the loans, some private lenders are trying to build up a distribution capability to compete with banks. Antares Capital, a US private debt manager with more than US$50bn of capital under management, is one of a handful of players that has had that capability in the US dollar market for years.

“Our primary focus is originating loans to hold for ourselves and our investors, however we also have a distribution capability to syndicate to tradable investors," said Vivek Mathew, head of asset management and funding at Antares Capital.

"On around 90% of our deals, we are either the lead left or lead right. That means most of the time we have a lead role and we always have a strategic angle.”

Antares took a lead-left arranger role in a number of syndicated loans in recent months, including a US$1.33bn loan for food and beverage company Dessert Holdings, a US$1.68bn unitranche for storage products manufacturer Tank Holdings, and a US$900m loan for STG Logistics.

With more US credit managers expanding into Europe, joint underwriting with banks may well become a permanent feature in the leveraged loan market.

“We have absolutely thought about Europe, though that may not be immediately in 2022,” said Mathew. “We’d want to play a significant role in the market supporting investors and private equity sponsors, so we would plan to do something we could scale to make it worth the effort.”

However, the European direct lending market is not yet as mature as the US equivalent. Some direct lenders believe the larger end of the European market is trending towards more club deals among direct lenders themselves.

“Direct lenders in Europe know each other well and often go for similar deals. We wouldn’t do a €2bn financing on our own, but we could club a deal without any bank involvement,” said Mattis Poetter, partner and co-CIO at Arcmont Asset Management, which manages around €21bn of assets in Europe.

((Prudence Ho: +44 07920 833252, prudence.ho@lseg.com, Twitter: @prudencehoho, @LPCLoans))

Additional reporting by Eleanor Duncan

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Oaktree warns of bubble in direct lending - RLPC News

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LONDON, Jun 24 (LPC) – Direct lenders need to tighten loan documentation terms as market volatility rises, or risk creating a bubble in the red-hot asset class, a credit head at distressed debt firm Oaktree Capital has warned.

Private credit funds, flush with inflows, are chasing a dwindling number of leveraged buyouts as acquisition processes falter on the back of recession woes. The mismatch of capital and opportunity has meant that margins on loans provided by direct lenders have only widened gradually in recent months, while most documentation terms including covenants and equity cushions haven’t changed at all.

“We're cautious about that market and concerned about the risks bubbling up,” said Armen Panossian, head of performing credit at Oaktree Capital, which manages US$98bn in its credit business.

“There has been so much capital raised and deal flow in the leveraged buyout has declined, but terms have not improved. You're seeing the same terms as last year. Some portion of direct lending assets will not be compensated properly despite the elevated risk in the economy.”

Some sizeable private credit funds have been switching their focus to issue covenant-lite unitranche deals for larger borrowers, taking market share from banks.

The move has put more power in the hands of borrowers because those loans lack traditional covenants such as leverage, interest, cashflow and capex ratios. The leverage multiples for those deals are often see as high as 8 times or above.

But whereas underwriting banks distribute risk to a diverse group of investors, direct lenders tend to keep the loans that they underwrite on their balance sheet, concentrating the risk among a small pool of lenders.

According to research company Preqin, direct lending fundraising in both Europe and the US markets hit a record high last year. As of June 23, the US market had record dry powder of US$110.8bn, while the European market had US$85.2bn.

Panossian said smaller players that focus on backing private equity sponsors might be most affected by the supply and demand imbalance.

Unprecedented opportunity

Large direct lenders see a different picture.

They argue that terms have largely been left untouched because the market dislocation has offered them an unprecedented opportunity to lend to higher quality companies, given that sponsors have increasingly shifted to source funds from private debt.

“We are seeing lot of opportunities with bigger companies with Ebitda of €200m, or more. These are high quality borrowers that we haven’t seen often before,” said Mattis Poetter, partner and co-CIO at Arcmont Asset Management, which manages around €21bn assets in Europe.

The latest example of the shift is Envirotainer, a Swedish company that rents cold containers for pharmaceutical products. A group of five private debt managers including Blackstone Credit and Goldman Sachs Asset Management edged out banks to provide a €1bn unitranche backing the firm’s acquisition by EQT and Mubadala.

New buyouts aside, direct lenders also see a growing demand for backing add-on acquisitions from existing borrowers.

“That [business] is materially up for us. It used to be just 60%-65% of deal volume, but it now accounts for approximately 85%,” said Vivek Mathew, head of asset management and funding at Antares Capital, which manages more than US$50bn of capital in the US.

“If there are tough times ahead, we like the idea of providing financing to companies we know really well.”

Quality is king

To weather the storm, some private lenders are now focusing more on loan-to-value ratios and deal valuations -- particularly on new buyout financings -- to ramp up protections.

“We are now doing deals at 40% LTV on average, which is lower than in recent years”,” said Mathew. “Direct lenders are looking for increasing alignment with the sponsor and welcome larger equity cheques. Skin in the game from sponsors is something we look for. We always stress that, but it’s even more important right now.”

Private lenders are also avoiding deals in which they believe sponsors have paid excessive prices in order to minimise risk exposure in the event of valuation decline, Mathew said.

Asset quality is essential, with most direct lenders focusing on borrowers in resilient sectors, such as financial services, software and healthcare.

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