THE LEAD
https://theleadpc.com/the-great-stay-in-fourth-of-a-series/

The Great Stay-In (Fourth of a Series)

THE LEAD | April 2, 2020

"We did not underwrite for this."

So said the managing partner of a top-tier middle market private equity firm. In a conversation last week, he spoke of the challenges and uncertainties surrounding the impact to businesses of COVID-19.

"We always model downside scenarios for any investment we consider," he said. "But the zero revenue case wasn't one of them. This is such a dramatic shift from anything anyone has ever encountered. We're working 24/7 to figure it out."

How are direct lenders helping their private equity clients navigate these uncharted waters? In recent updates with our peers, some common themes emerge.

The focus on new deals has pivoted sharply to existing credits. Lenders have quickened the pace of portfolio reviews. Same with sponsor dialogue about their strategies to battle the myriad COVID headwinds.

Liquidity is the number one shared concern among credit providers. Overall it appears anywhere from half to three-quarters of middle market issuers have drawn down on their revolving credits. That mirrors the RC drawdowns for the broadly syndicated market. Per S&P LCD, half of those issuers are investment grade.

Included in these concerns are delayed draw term loans. Used typically for add-on acquisitions and significant capex programs, lenders worry that sponsors will be tempted to use DDTLs to buttress their companies general liquidity.

Are lenders seeing a rush of amendments? What about payment defaults?

"It's early days," one credit veteran told us. "Most companies have enough cash for 1Q interest payments, but June 30 is a long way off. It's going to be ugly given the virus impact across multiple industries. Anything touching the consumer is affected."

"We are working very closely with our sponsors," another top lender reported. "The majority are being cooperative about being part of a solution. But visibility on their businesses is near zero. They don't know how much capital they'll need because they don't know how bad it's going to get. The outlook changes every day."

The head of one leading direct lender said the game of big purchase price and leverage multiples is over. "Everyone's trying to figure out structures that will work, given all the uncertainty. For strong credits, there's still long-term faith in the business model. It's the next month or two that everyone's worried about."

A credit op manager agreed. "By the fourth quarter, some normality will return to the financing markets. But until then, it's 'Battle stations!'"

? Next week: The economic outlook for 2020.