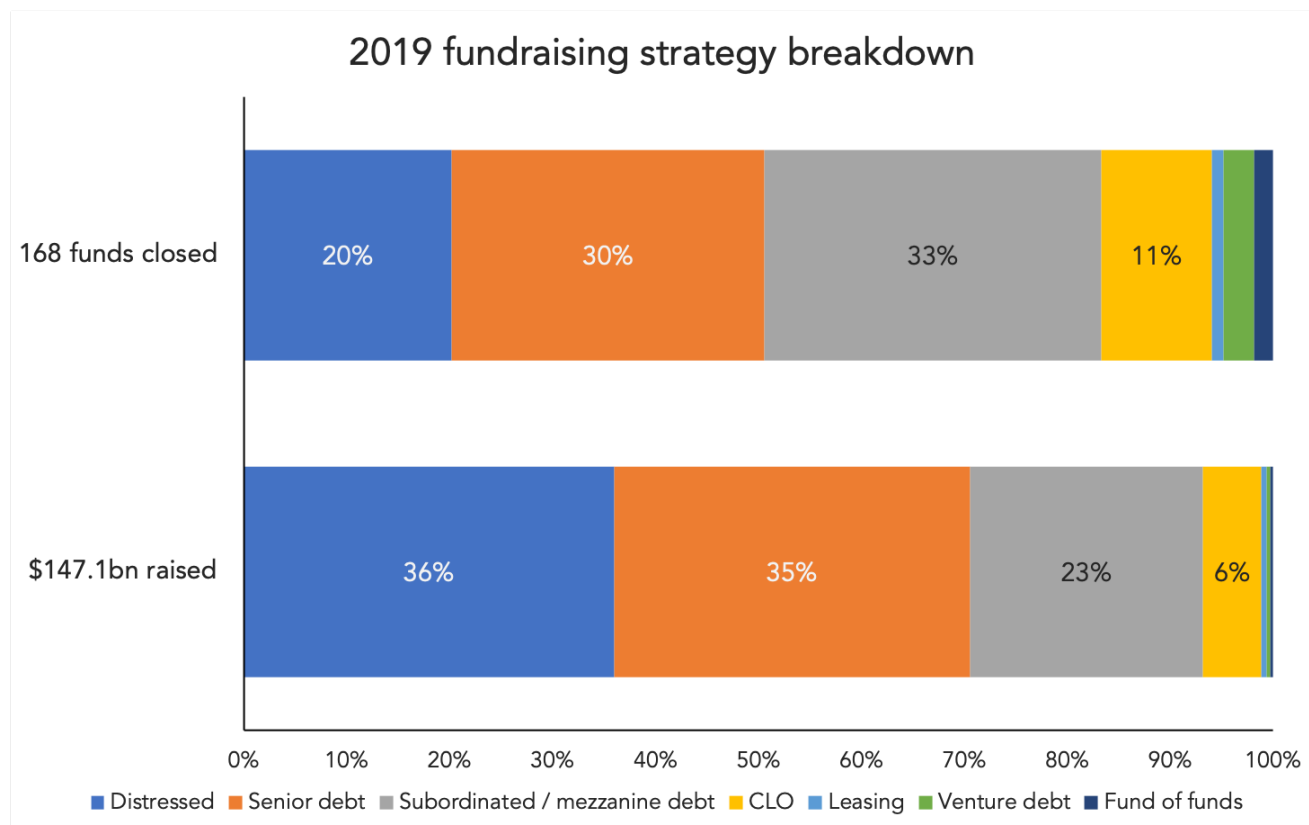


The passing opportunity for direct lenders

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Companies that may have gone to the syndicated finance market are looking closely at more private alternatives.

In Europe, a leveraged finance market which had effectively been on hold since the covid-19 outbreak emerged in March has been slowly waking up. But, as it does so, banks are beginning to see more competition from direct lenders.

Given the state of the global economy, it's no surprise that the re-emergence of the financing market is tentative. But there are deals to be done in favoured sectors such as TMT, healthcare and stable infrastructure. The appetite for mega-deals will be slow to come back. For the time being the focus is mainly at the smaller end of the market, and this is where the larger private debt funds can compete with the banks.

Although direct lending finance will typically be more expensive and quite possibly demand a covenant or two (covenants having become a rarity in leveraged finance in recent years), we understand this is a price companies are increasingly willing to pay in exchange for a private transaction, where sensitivities around financial information can be more easily protected than when companies are underwritten and syndicated by a banking group.

For direct lenders, which have been highly successful at raising capital (see “senior debt” in chart above) and have large war chests to deploy, this is potentially a great opportunity to access attractive yield generated by high-quality assets. Since the crisis struck, the focus has shifted to distressed debt/special situations and hybrid strategies and how they might take advantage of this peculiar investing environment.

But it's clear there are opportunities for direct lenders to be opportunistic too. How long the opportunity lasts may depend on when a covid-19 vaccine comes along given that, when it does, a revival of leveraged finance may be strong and sudden. The bear case is that if a vaccine takes a long time – or doesn't come along at all – investments made now may have to be held through a long and deep recession. The focus will then be on whether the assets were as high quality as hoped for.