Why it’s time to revisit documentation

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Lenders have had a tough time at the negotiating table in a borrower-friendly market, but things may be changing.

With economic clouds gathering, there is a sense that now is as good a time as any for investors/lenders to start flexing their muscles again in deal negotiations. Indeed, some say they see signs of this already and one area they point to is the EBITDA addback – the tool used by many borrowers to increase their available leverage on the basis of assumed revenues that may not actually materialise.

“The big thing is EBITDA definition addbacks, that’s really where we’re seeing documentation and covenants moving in favour of lenders across the board,” says Mikael Huldt, Stockholm-based head of alternative investments at AFA Insurance. “I think everyone is really keen to understand what the impact of inflation and higher input costs will be on EBITDA; you want to be on top of it so in terms of addbacks, whether it’s synergies or cost savings, there is less wriggle room being given to borrowers.”

Huldt says lenders are focused on risk and an unwillingness to saddle businesses with too much leverage. “Leverage levels have always been fairly stable, whether you’re looking at unitranche, senior secured or whether it’s first lien or second lien, but what’s been moving around is the multiple of ‘what’: it’s the definition of

EBITDA that has been changing and I think there's been more discipline around that from the lenders' side."

Other market sources agree that in the face of inflation, rising interest rates and an unstable geopolitical situation, the focus of managers is on the highest-quality companies that they feel can withstand the various pressures and successfully pass increased costs onto their customers.

Huldt adds that one specific issue he has noticed becoming a hot topic is factoring in cost savings initiatives or M&A-related synergies before they've happened. He says when a borrower is looking to make an add-on acquisition these days, it is becoming increasingly likely that lenders will agree to only add synergies that can be delivered over a short-term timeframe – generally six months up to a maximum of a year, unlike at the peak of borrower power, when several years was possible.

(Past performance is no guarantee of future results.)