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The syndicated fightback

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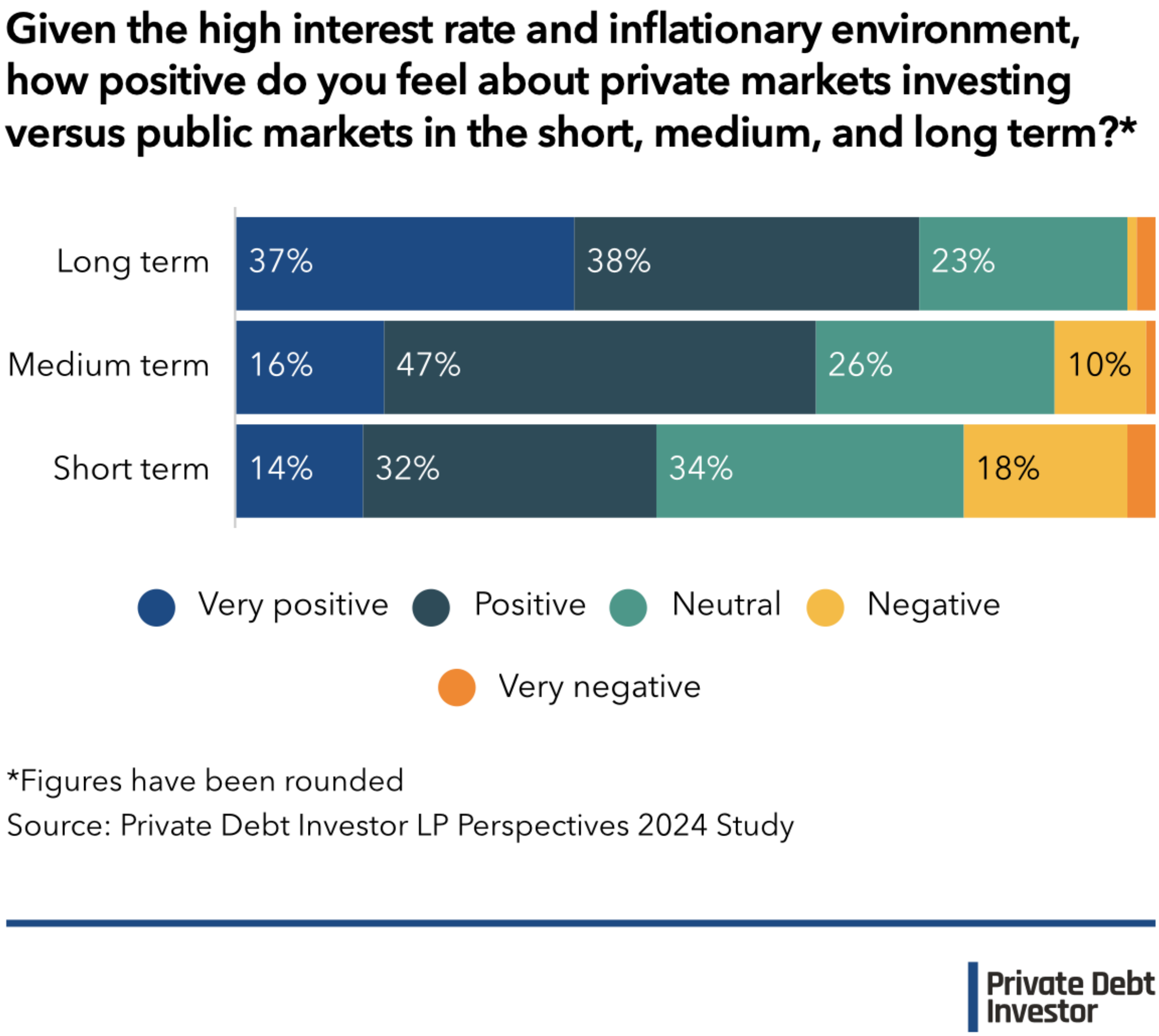

As expected, the BSL market is retaking some of the ground lost to direct lending for larger deals.

A recent research note from Alcentra contained some interesting reflections arising from the broadly syndicated loan fightback against direct lending in the larger loan arena.

As global M&A activity tumbled in 2022 and 2023, with banks pulling back from underwriting new leveraged buyouts, direct lenders stepped up in deal size and took a large chunk of the market for any new financings. For borrowers, direct lenders represented a more expensive option but were often the only game in town.

With the BSL market opening up again in 2024, Alcentra notes that it is now being used to refinance upper mid-market direct lending transactions as borrowers seek to revert to a lower cost of capital. These loans range in size from €300 million to €4 billion.

This represents a return to the status quo prior to 2022, which the report describes as “a co-existence of both markets where larger deals were syndicated in the BSL market and smaller deals were issued in private credit. We expect this trend to persist”.

Alcentra said it expected private debt to maintain good market share in the smaller end of the upper mid-market (loans between €200 million and €350 million) where there is insufficient liquidity for the BSL market.

The report also notes:

Margin compression. There has been a squeeze on upper mid-market direct lending pricing as a result of the increasing competition. LCD reports the margin differential being as much as 250 basis points between the upper and lower mid-markets.

Relaxation in terms. To stay competitive with BSLs upper mid-market direct lenders have been moving from having a financial covenant to covenant-lite and offering significant reductions in the loan margin paid to try and stop refinancings in the BSL market. Meanwhile, leverage on upper mid-market deals has increased from 4-5x to around 6x.

Worsening outcomes for LPs. Alcentra identifies multiple potential issues for limited partners with exposure to the direct lending upper mid-market: lower cash multiples in portfolios as loans fail to reach target duration and yields compress; dwindling fund deployment and diversification as the bigger GPs can’t compete for deals and are left with significant dry powder (or accept worse terms); and an overlap in investment positions across portfolios.