# Perspectives
# Debt capital markets update

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## Competition driving a return to pre-Covid terms

As we battled through the heavy weather of lockdown in March, April and May, most accepted that we had a strange few months ahead but tried to look through the summer and imagined a back-to-school type start to September.

As it stands however, while a number of us are back in our offices (including at Alantra) and there are even hints of a "V" shaped economic bounce, the full climb out of the crisis looks like it will take much longer. That doesn't mean the debt market hasn't started to find its feet again. Both through our own deal activity and continued dialogue with lenders, we can see how the market has switched to virtual due diligence and management meetings, and written some new business. Furthermore, while initially deals were those delayed from pre-crisis, more recent transactions such as Crescent's support for Accel-KKR's acquisition of NAVTOR and the £1.875bn of facilities for Ardonagh led by Ares (the largest European unitranche facility on record) come from new borrowers that can present a plan little, or even positively, affected by Covid-19.

Given the scale of the task in front of them, the banks have had a tougher crisis than the debt funds. Their clients range from the largest listed corporates to the smallest SMEs and all have been impacted in some form, added to which has been the political pressure to support the UK economy. Little wonder then that the bar for writing new business (especially new to bank) has moved higher and higher.

It is quite a different dynamic among the debt funds which, while having varying degrees of stress in their portfolios, have had to deal with far less volume, no political pressure and a continued incentive to deploy the capital that many have continued to raise.

Nevertheless, while new deals have started to flow again, volumes are of course significantly down, which is creating a competitive environment such that it's often difficult to distinguish from that pre-crisis.

While the early stages of the crisis saw a drop in secondary prices creating potential for funds to make a higher return (or at least the benchmark against which to push primary pricing higher), this window closed quickly and with it followed the pricing in terms sheets.

It's easy to argue that, globally, risk has increased but faced with lower deal flow, funds with capital aplenty are pricing to deploy. This clearly assumes a credit can hold its own in an intra/post-crisis world, but for those quality credits, we see this competition evident in leverage multiples and other structural terms too.

The search for credit quality, however, means deals have been concentrated into a smaller number of sectors. With few exceptions, deals are neatly falling into one of healthcare, technology or financials given the ability of these sectors both to weather the storm and present credible plans. In contrast, it is of course in the more challenged consumer-facing sectors where lenders' portfolio problems lie.

Since the global financial crisis, sponsors have asked the question how this evolving world of private credit will behave in a downturn and now have the chance to find out. The real answer always lies at the firm/individual level, although some themes have emerged and the influence of external leverage in a fund has a part to play.

Ultimately, debt funds' focus is on the protection of capital but, like banks, they are long-term institutions which invest in building relationships to ensure they see future deals, so potential damage to those relationships is an important factor.

> The past few months have provided the chance to test lender behaviour in a crisis and now see how competition for the reduced deal flow is pushing terms back to pre-crisis levels.

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However, what if a request to, say, switch-off cash interest would be the straw that breaks the back of the fund's own credit facility, triggering a default and potentially limiting access to further liquidity? Unlike banks, while direct lending funds were always expected to be the last to sell-out of positions, there has been talk of some funds soft-marketing stressed assets to cleanse a portfolio of problems that might otherwise trigger fund level covenants. Ultimately, leverage in funds means borrowers can benefit from a lower cost of debt, but is the premium of borrowing from an unlevered fund now showing its value? While the generally modest leverage in most direct lenders' vehicles will limit these issues, understanding fund structures could well be of greater focus when mandating a direct lender in the future.

We wrote in May how it was still too early to assess the full impact of the crisis on many leveraged credits and that remains the case today. Despite the more positive backdrop, with potential second waves and the ultimate failure rate of SMEs (being the customers of many leveraged credits) still unknown, the temptation to "kick-the-can" remains high for borrowers and lenders alike. What was being talked of as Q3/Q4 clarity now looks increasingly like Q4/Q1 or indeed beyond. There's little doubt that otherwise strong, viable businesses will emerge from this crisis with over-leveraged structures through no fault of their own and it will be for shareholders or new forms of (or just differently priced) credit to fill the gaps.

Markets by their very nature evolve and rebalance in the face of change. While a lot is happening beneath the surface, you could be forgiven for thinking that little has changed in mid-market debt. Appearances can, however, be deceiving and the value of quality advice has never been greater. At Alantra, our integrated debt and M&A activities across Europe, acting for Covid-hit borrowers and fundraising for new transactions gives us excellent insight both into what incumbent lenders will accept and what this evolving market can deliver.

## Alantra Global Debt Advisory team

Our team of c. 30 professionals advise privately owned companies, private equity-backed businesses, large privately owned corporate groups and public companies on raising and refinancing debt capital.

**80+**
Debt transactions in the last two years

**€1.5Bn+**
Refinanced in the last two years

**c. €8Bn+**
New debt raised in the last two years

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