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Do the documents offer lenders hope?

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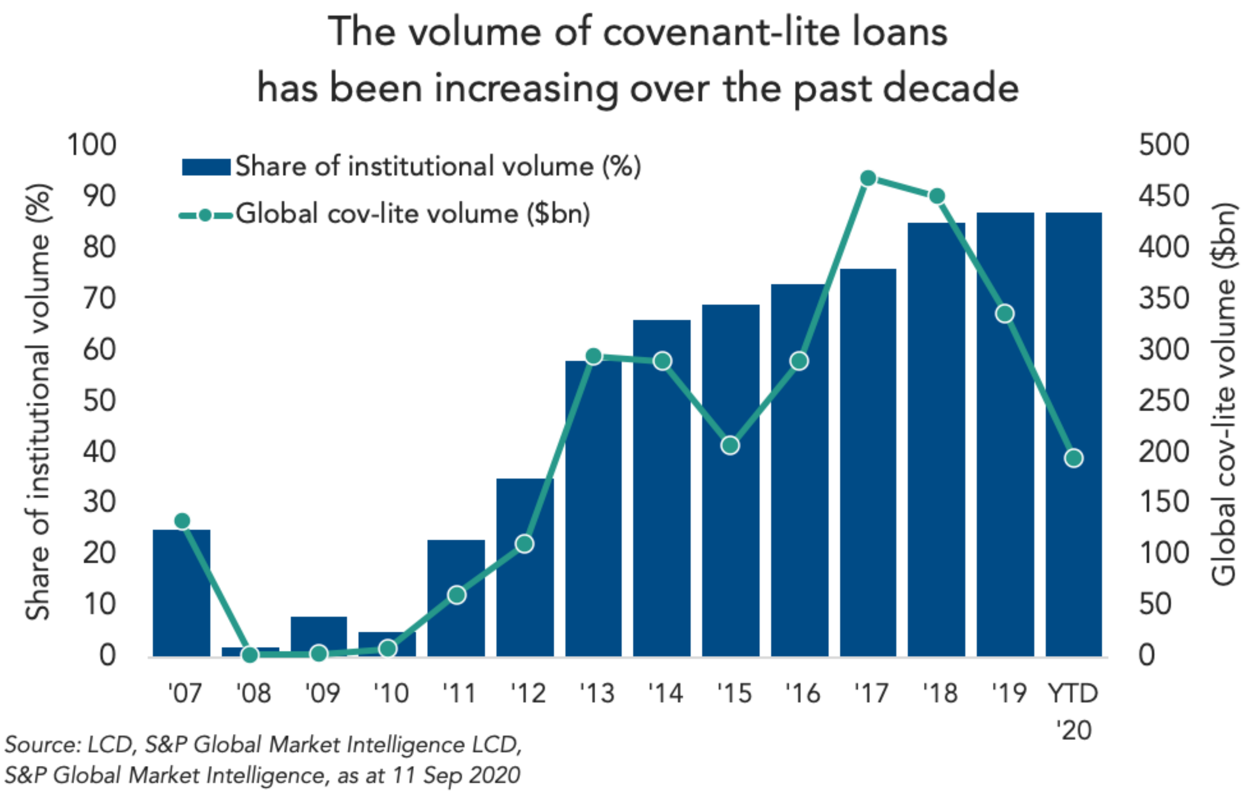

Borrowers have held the balance of power for some time when it comes to deal negotiations. There are signs that their grip is being loosened, if only a little.

In the wake of the covid-19 crisis, it's hard to view the positives but you should always try. For direct lenders and others in the private debt market, the light at the end of the tunnel was supposed to be better terms and documentation as the borrower-friendly market that had seen a profusion of covenant-lite loans (see chart above) was brought to an end.

Has that shift happened? Anecdotally, it does appear that some much more constructive conversations are taking place. Sponsors, we hear, are being more willing to drop EBITDA addbacks – or at least certain types of EBITDA addback – in such a volatile economic climate. In addition, sponsors do not appear to be pushing the envelope on leakage and dividends, recognising that cash should stay within businesses for the next year or two of uncertainty. As one market source put it to us: "Some of the signs of a very frothy market have disappeared."

It's also worth bearing in mind that, when it came to degrees of borrower-friendliness, the 'mainstream' private debt market has always been less willing to sell off the family jewels than the broadly syndicated market. The point has justifiably been made by direct lenders in recent years that they are often still able to incorporate at least one meaningful covenant in deals, while rejecting the most egregious suggestions put forward by lawyers on the other side of the table.

However, it’s most certainly not the case that we have now entered a golden era for private debt lenders when it comes to the documentation. While there may be improvement overall, it’s worth bearing in mind that deals in certain sectors – think strong recurring cash flows in a sector such as software – are witnessing competition at least as strong as before the covid-19 outbreak. Indeed, it may even be stronger as a larger number of lenders gravitate towards a relatively small universe of covid-resilient companies. For these businesses, competition may very well extend beyond pricing to the devil in the fine print.