Twenty is the new 50; Cov-lite invasion continues into direct lending

KBRA DLD | March 25, 2021

It's no exaggeration that covenant-lite is invading direct lending. Market participants across the board say today's cutoff is $20 million EBITDA, compared to $35-40 million pre-Covid, and $50 million prior to the Great Credit Crisis of '08.

Last week *DLD* covered a covenant-lite buyout financing for a borrower generating $22 million of EBITDA in the engineering and field services industry. Total leverage was 6.5x.

Lenders have been battling tough competition for years: Too many players chasing too few deals. And now that direct lending has performed as advertised during Covid, more investors are coming to this space seeking yield to exacerbate the supply/demand imbalance.

In 2020, DLD tracked about 50 core direct lenders that were administrative agent on senior financing. Many of them have the flexibility to underwrite 1L, 2L, unitranche and cov-lite, and can hold at least $100-150 million.

Moreover, managers have branched into other funds that soak up assets—SMAs, CLOs and BDCs.

Beyond intramural competition, direct lenders are losing mid-sized mandates to the syndicated market. Current blended rates can easily beat the L+500-600 range that direct lenders demand for tweener-sized borrowers.

Single B spreads have dropped to the mid-300s and second-liens are being absorbed at an average of L+700. **AIT Worldwide Logistics** and **Denali Water Solutions** hit the syndicated market this month and were not widely distributed previously.