

The State of Private Credit in Europe (Fifth of a Series)

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This week we continue our conversation with members of Lincoln International's Capital Advisory Group, managing directors, Aude Doyen, Xenia Sarri, and Dominik Spanier.

"US and Europe are competing markets," Ms. Sarri told us. "The US was increasingly aggressive when I first came here, but six years later terms are more favorable in Europe. For instance, there are no baskets around restricted payments. Also, we've seen covenant holidays lasting nine months or longer. No excess cash flow sweeps, no amortization and tighter flex language.

"Covenant head room is now 35%, having widened, with probably 30% with the banks. For direct lending cov-lite, it's less about size than having a reason to do so, such as volatile Ebitda. You can certainly find someone to do it for smaller borrowers, but it's expensive. For \$30 million Ebitda and below, you usually need at least one covenant.

"These are things where the US has largely held the line because the European market is more fragmented with different jurisdictions. We're working on a deal where a US lender is financing a target in the UK for a US sponsor. With UK docs and denominated in pounds sterling, it's a good example of geographic arbitrage."

Are there pricing differences? "Arrangement fees are twice as high in Europe than in the US," Dominik Spanier said. "We think this is because the US is a more mature market. But margins are very similar. [See our [Chart of the Week](#)]. Also, the European secondary market is less well-established. So when Covid happened, German loans didn't trade."

"The activity level overall is very high right now," Ms. Doyen reported. "The first half was so busy it created bandwidth issues. Tough to get people to work on deals. Structures are very tight. In acquisition financing the timelines are so short sometimes the buyer will close with all equity, then refinance it later with lenders."

Ms. Sarri agreed. "Competitively direct lenders can be more nimble. You can commit and close deals with them by the time you've negotiated the NDA with the bank! And some of the larger funds, such as Ares and GSO, are starting to compete with the syndicated loan market. We saw a number of examples last year, especially when borrowers turned to direct lenders to avoid taking market risk given the volatility. As M&A processes are getting more competitive and timelines more compressed, private capital solutions tend to be more valuable."

What about consolidation among direct lenders? Not so far, says Ms. Doyen. "They are raising fund sizes, but first-time funds are tougher. There are about 100 UK direct lenders today. That includes funds targeting issuers less than \$20 million Ebitda. Some are even doing non-sponsored and minority-owned transactions – a change from five or six years ago, though cautiously given Covid."

"The direct lender's Holy Grail," Mr. Spanier added, "is finding a good performing company. But those have an easier time finding cheap bank debt, putting DLs at a disadvantage. They risk ending up with borrowers the

banks won't finance."

Next week we take a look at fundraising for European private credit