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Direct lenders land big deals as small syndicated credits fade

As direct lending funds have raised hundreds of billions of dollars over the past few years, and direct lenders continue to poach in the traditional leveraged loan space, the share of smaller syndicated credits (deals of $350 million or less) has been dwindling.

In 2010, these smaller deals made up 18% of overall U.S. syndicated loan volume, according to LCD. So far in 2019 these credits account for just 4% of the market, down from 5–6% since 2016.

Clearly, smaller deals are forgoing syndicated executions, and instead are looking to the private markets.

And in the past year, of course, larger deals ($900 million-plus) have also been getting done via direct lenders.

- At the beginning of August, Apollo committed to providing a $1.792 billion senior secured term loan to support the acquisition of **Gannett** by **New Media Investment Group**. Gannett is a public company (NYSE: GCI). Closing is expected by the end of 2019.
- In July, Golub Capital was sole lead arranger and administrative agent on a $950 million credit backing the acquisition of Amber Road by **E2open**. The loan is a GOLD (Golub One-Loan Debt) facility composed of a $920 million unitranche term loan and a $30 million revolver.
- And back in June, HPS and Goldman Sachs Private Credit provided a $1.25 billion unitranche loan to support **ION Investment Group**'s acquisition of a controlling stake in **Acuris**. UBS had been mandated to underwrite the debt financing to support the acquisition.

This trend of jumbo deals being done privately is indicative of the strength of the direct lending market.

"It's not uncommon to see a private deal grow to a billion, which was unheard of five years ago," says Andy Steuerman, head of middle market lending at Golub Capital. "We've done that a handful of times. Nowadays, you don't have to have a syndicated deal to get a billion-dollar facility."

Indeed, global dry powder for private debt funds remains close to all-time highs, according to Preqin. As of June 2019, total private debt dry powder was $269 billion, a slight decrease from $287 billion as of December 2018. Furthermore, direct lending funds hold $103 billion of the $269 billion.

The move to private deals is more than a function of direct lender capacity. There are tangible deterrents to executing loans in the syndicated market. For ION, the decision to turn to the direct lenders follows ION's troubles in the broadly syndicated market. The company withdrew a $1.96 billion cross-border term loan refinancing from syndication in May, bringing to an end a deal that launched in April as a $2.21 billion-equivalent TLB, to refinance debt at four entities, to create ION Corporates and pay a $250 million dividend. The loan went through several iterations in syndication before being shelved, including the removal of the dividend element, the carve-out of a four-year tranche, at least two sets of doc amendments, timetable extensions, and pricing revisions.

Another potential deterrent in today's syndicated market: ratings.

“The ratings agencies have had a higher level of scrutiny on EBITDA adjustments in the past few months, and there are more deals that have had a risk of being downgraded to CCC,” Steuerman says. “The ratings agencies have gotten tougher, so some borrowers are opting to come back to the private market, where ratings are certainly less critical to the execution of the deal.”

The hypercompetitive dynamic in private equity also is driving borrowers to direct lenders, as purchase price multiples continue to rise in the middle market.

“As the M&A market remains very competitive, buyers are looking to differentiate themselves,” Steuerman says. “One way of doing this is by securing speed and certainty through a private loan, versus a syndicated loan. And buyers are willing to pay a premium in a private deal for that speed and certainty. Part of what’s driving the prevalence of these large private unitranche deals is the ease of execution. Especially if you’re trying to win a public company, you have to show certainty and speed. You don’t have to sit there and talk about syndication strategy and timing.”

High purchase price multiples have another consequence on private equity strategy. Sponsors typically will try to buy down the purchase price through multiple add-on acquisitions. “If you’re trying to buy lots of businesses because your purchase price requires access to capital, the direct lending market is a lot more amenable to supporting that thesis,” Steuerman explains. — Shivan Bhavnani