

Direct lenders left exposed by permeation of permissive documentation – Mid-Market Chatter

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Direct lenders in Europe's middle market are increasingly adopting large-cap-style documentation that leaves private credit funds more exposed to risks while affording them less control over collateral and a weaker hand in negotiations with sponsors.

Permissive legal documentation that typically underpins large-cap covenant-lite deals with higher margins is gradually trickling into smaller deals, according to several market participants.

These documents include – or sometimes exclude – clauses that allow issuers to transfer key assets and cash out to unrestricted subsidiaries and shareholders. There are clauses that can also permit a fundamental recut of the capital structure, even in instances in which a significant minority of lenders don't consent.

As a result of these clauses, lenders are effectively not given a seat at the table until their borrower has an immediate liquidity crunch, according to Ben Davis, a leveraged finance partner at Eversheds.

"The other risk for lenders with looser documentation is seeing deals restructured without their consent, resulting in the possible loss of their secured or senior position in the structure," said Davis, referring to the prospect of direct lenders being "primed".

Warning signs

An infamous example of permissive documentation wreaking havoc for debt providers is the ongoing high-profile restructuring of Altice France.

The telco company attracted widespread scrutiny in March when [management announced](#) that it would not contribute proceeds from asset sales back into the restricted group.

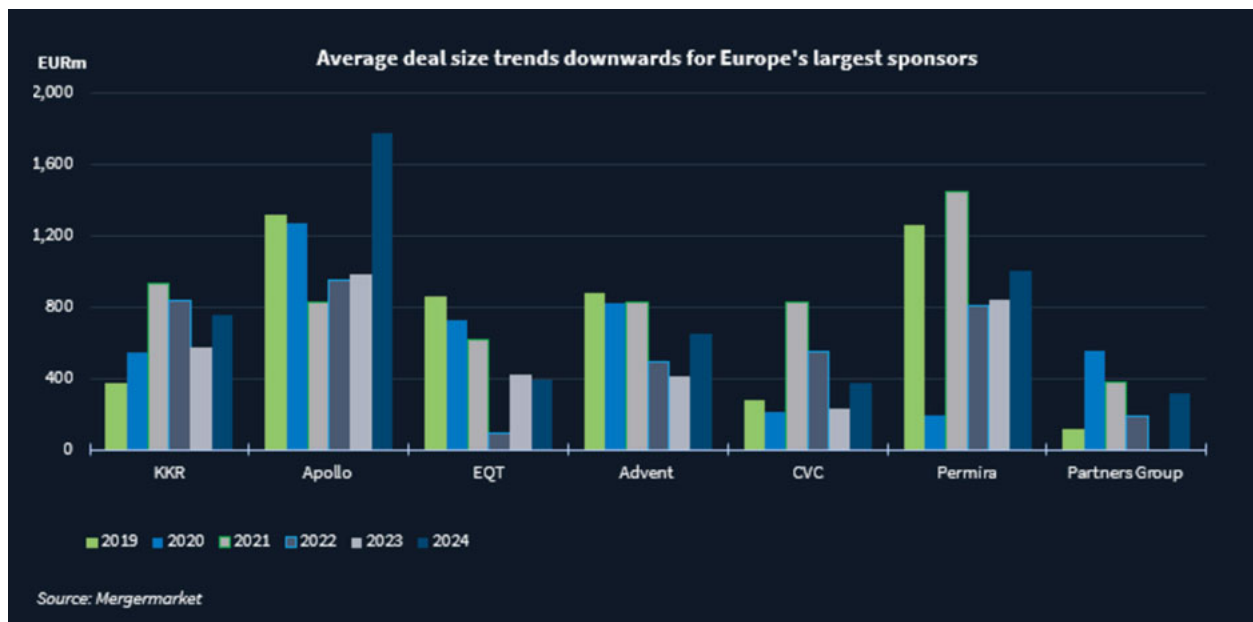
While Altice is not a private credit deal, the situation nevertheless should serve as a warning to direct lenders, according to Davis.

"Altice is a good example of how private credit funds can be exposed in Europe, with the risk of key assets being removed from the security net without lenders being de-levered," he said.

Direct lenders financing mid-cap leveraged buyouts are becoming increasingly exposed to such risks, as large-cap sponsors are increasingly finding fertile ground in the mid-market.

As these big buyout groups dive deeper into the mid-market, their pursuit of smaller deals is increasingly accompanied by demands for looser documentation, Davis explained.

Some of the biggest names in Europe's private equity market including KKR, Advent, CVC, EQT, and Permira have all decreased the average size of their deals over the past five years, according to a recently published [report](#) by this news service.



Even certain small-cap transactions in recent months have been marketed with large-cap-style terms, according to one market source, who spoke on the condition of anonymity.

“There was a lower-mid-market financing for a GBP 10m EBITDA business earlier this year that had very loose US-style, large-cap terms,” this source explained.

Good documentation won't save a bad credit

However, the potential threats posed by loosening documentation in Europe's direct lending mid-market are downplayed by other market participants.

Kirstie Hutchinson, a partner at law firm Macfarlanes, said that while private credit funds are becoming more comfortable with looser documentation, this should not be viewed as an overwhelming trend.

“Private credit has long since left its traditional hunting ground in the mid-market to take deals from the big beasts in the upper reaches of the broadly syndicated loan and high-yield space. The result of this is credit funds active in the upper market becoming more comfortable with typical broadly syndicated loan features, such as covenant-loose or covenant-lite, in smaller deals for the same private equity sponsors,” Hutchinson said.

She added: “We wouldn't term it a flood by any means. Private credit tends to be less driven by precedent, taking a more thoughtful, longer-term approach to documentation terms, diligencing and considering a deal on its merits.”

“That can mean looking at terms holistically rather than focusing on ticking a particular covenant box. Ultimately, as the saying goes, ‘good documentation won't save a bad credit,’” she said.

Echoing this sentiment, Aymen Mahmoud, managing partner at McDermott Will & Emery's London office, remarked that while looser documentation terms are frequently discussed, documentation aggression has held steady.

“Suggestions routinely surface about how documents have become ‘looser’ as time has gone on, and that borrowers are able to command significant operational flexibility through the documentation. In reality, documents have remained at or around the same levels of aggression for a long time now, including post-pandemic.”

“Individual examples of more pronounced flexibility may simply be reflective of a combination of a greater number of larger deals in recent times, and only the very best credits being financed in more difficult markets,” he said.

Mitigating risk

While large-cap sponsors may increasingly be driving a hard bargain on terms when it comes to negotiations with mid-market direct lenders, the risks posed by permissive documentation can be mitigated by the ability to lead – take the largest ticket on – a transaction.

Mark Bickerstaffe, co-head of direct lending at Hayfin Capital Management, which plays in the mid- and large-cap market, said that “larger lenders who can lead transactions are able to take control of deal documentation and structure”.

by Amelia Weitzman

Market PIKs

With year-end fast approaching, private credit deal makers across Europe are wrapping up transactions, with many completions announced in the last few weeks alone.

In the UK, ECI Partners recently lined up a private debt package to support its acquisition of **Independent Governance Group (IGG)**, as exclusively reported by *Debtwire*. HSBC is one of the lenders providing the debt facility for ECI. Crescent Capital will also participate in the debt financing, one of the sources added. The lenders are providing a financing package worth almost GBP 80m, comprising GBP 75m of drawn day-one debt, a GBP 3m revolving credit facility (RCF), and a delayed-draw term loan (DDTL).

Also in the UK, Apera Asset Management is refinancing LDC-backed **James and James Global Fulfilment (J&J)**. Based off structuring EBITDA in the region of GBP 8m, the deal carries leverage of 2x–3x. The refinancing draws a line under a process that Arrowpoint oversaw on behalf of LDC, as revealed by this news service.

In the Benelux, **Schenk Tanktransport** secured an up to EUR 180m debt package from a consortium of banks to finance the acquisition of **Sutton Tankers**, an English road tanker logistics provider, *Debtwire* revealed. Schenk Tanktransport, a Dutch business backed by PE house ArgosWityu, secured a financing package from ING, Rabobank, and ABN AMRO to finance the investment. The acquisition was announced on 30 October. The debt package is levered at around 3x the company's EBITDA between EUR 55m–EUR 60m.

Sticking with the Netherlands, direct lenders vying to finance a leveraged buyout of **Synthon** have pitched private-debt packages worth over EUR 1.1bn to support private equity-led bids for the Netherlands-based generics manufacturer. Based off structuring EBITDA in the region of EUR 130m, private credit providers are eyeing 6x–6.5x leverage on unitranche, implying a quantum in the region of EUR 780m–EUR 845m.

In case you missed it, in France, direct lenders are expected to table private-debt packages worth up to EUR 130m amid Ardian's sale of a minority stake in France-based business management consultancy **Argon & Co**. Based off structuring EBITDA in the region of EUR 30m, a senior debt quantum of EUR 120m–EUR 130m is anticipated. Edmond de Rothschild is advising Ardian on the auction process.

And lastly, in the DACH region, **Isoplus**' owner **Egeria** is beginning to reach out to lenders as the sale process for the German provider of pre-insulated piping systems gets underway. Information memoranda (IMs) were sent out in October, and a teaser was also sent out to prospective bidders last month.

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