(NY) Private equity sponsors expected to help borrowers ride out deadly Delta variant

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Private equity firms' willingness to provide capital to medium-sized companies helped borrowers thrive through the Covid-19 pandemic and may now help them stay afloat through volatility created by the contagious Delta variant.

Between March and September of last year, alternative lenders, including business development companies (BDC), worked with sponsors to shore up their investments. Private credit firms made loan amendments, and private equity investors put additional capital into middle market businesses.

"Sponsors injected a tremendous amount of capital into the companies, more than we anticipated," Chelsea Richardson, a Fitch Ratings BDC analyst, said. "Some BDCs were willing to do amendments for the right companies if the sponsor wasn't putting in money. But largely, amendments were done with sponsor injections."

The Delta variant has shaken the stock market and prompted new mask mandates that could impact consumer behavior. It delayed corporate plans to return to the office and could put the economic recovery at risk if Americans pull back on consumption in a meaningful way.

Middle market businesses of different sizes received private equity capital through investors such as Golub Capital and Deerpath Capital Management, which funnel money to both the upper and lower parts of the middle market, respectively.

Portfolio companies of Golub Capital BDC received more than US$700m of additional support from private equity firms, Gregory Robbins, a senior managing director at Golub, said on a December earnings call, according to a transcript.

Deerpath saw the private equity owner of a pediatric dental care provider put in two separate equity investments, according to an investor presentation.

In June 2020, the sponsor invested US$10m of equity, which equated to 39% of the company's senior debt. Later, the sponsor returned with an additional US$4.5m in equity to fund growth.

Lower leverage levels can provide a strong rationale for private equity firms to infuse additional equity into a business, according to Antonella Napolitano, Deerpath's head of business development.

"When the senior leverage is low, the junior capital (typically the equity from the sponsor) is quite significant, providing a plentiful financial incentive for the sponsor to continue to support their already significant equity investment when a problem arises," she said in an email. "What adds to this incentive is when the lender sets in place lots of rights and protections that can be used early on when a problem arises."

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The new Delta variant of Covid-19, more contagious than the original virus, could present middle market companies with some additional challenges.

“With the Delta variant, that does increase the potential that we could see some more amendment activity if it further extends the amount of time that these businesses need to get up to pre-pandemic levels,” Richardson said.

Suppose further problems arise because of the new strain. In that case there will still likely be capital available to see the business through the volatility, at least for some time, Rachel Ehrlich Albanese, a partner and vice-chair of DLA Piper’s restructuring group said.

This year "has been eerily quiet on the restructuring side. It is because there’s just so much money in the market that companies with significant problems, both operational and financial, can still get capital. I don’t see the Delta variant at this point reining in the market exuberance,” she said.

Secular trends make the glut of liquidity unlikely to end soon. Investors will continue to search for yield, a phenomenon that catalyzed the growth of private debt and private equity.

“I’m not seeing a driver for the pullback in interest in the private debt market,” Jamie Knox, chair of DLA Piper's New York finance practice group, said. “If interest rates are hiked up, and you can park your money in Treasury bonds for a significant return, that’s a different story. But I don’t see that happening."

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