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Lead Left Interview – Stephen Boyko (Part 2)

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This week we continue our conversation with Stephen Boyko of Proskauer. Steve is a partner in the firm's corporate department and co-head of the private credit and finance groups. He represents one of the largest client rosters in the industry, including an array of specialty finance companies, private debt funds, and BDCs. ***Second of two parts –*** ***View part one***

The Lead Left: What do you see as the leading edge of structures and documentation?

Stephen Boyko: Many are looking for flexibility for growth for acquisitions and further debt incurrence. For the top tier sponsors, they want to relever back to the original leverage. It's not like the old days when leverage came down over time. For top-tier sponsors, those days are gone.

Secondly, sponsors are very focused on financial covenants. They are writing them to include lots of flexibility. For example, we see a number of additional add-backs allowing the company to do things over the next one or two years. Also, some top-tier sponsors are trying to eliminate or reduce the number of step-downs in leverage. In those deals, leverage goes down two steps, maybe three or four, then that's it. That's different than what lenders have been accustomed to in the past. Sponsors each have their wish list, so everyone's different.

TLL: Are you seeing sponsors bringing large cap terms down-market?

SB: If they play in the upper middle market, they will ask for upper middle market terms. For example, we saw a deal recently where the sponsor requested $100 million EBITDA terms for a $10 million EBITDA company. The deal was an attractive credit and generated a lot of lender interest. The message was "If you want to do business with us, these are the terms that we expect." That's one of the reasons our clients like our *Private Credit Insights* publication. It gives them a view into an otherwise opaque market. In that report, we break-down deal terms by EBITDA bands.

TLL: Anything else of interest?

SB: We are seeing more documents provide for "limited condition" transactions. If the sponsor is committing to purchase a company with no outs, they want their financing sources to have no outs. This has largely been accepted in the market. What remains an issue is how to treat acquired EBITDA before the acquisition closes. Should it count for purposes for future debt incurrence or dividends? Top-tier sponsors are looking for this flexibility.

TLL: That's assuming the acquisition is accretive. What if the acquisition doesn't happen?

SB: It's tough because you can't unscramble the egg. You'd hope your sponsor would be prudent enough to plan for that possibility. And if the acquisition is not accretive, they certainty won't be looking to add negative EBITDA.

TLL: You guys are very good with unitranche trends. Anything going on there?

SB: Unitranche is a broadly defined term. It includes senior loan funds and joint ventures, senior stretch, and bifurcated structures, with the latter typically comprising a “first out” revolver and term loan and a “last-out” term loan. These products can be used to synthetically replicate more traditional structures like first lien/second lien, senior/mezz as well as more exotic structures like an upside-down silent-first out. We’ve seen fewer bifurcated structures over the past couple years. There has been a definite shift to senior stretch, whether it’s provided by a dedicated senior loan fund or one of our other client types like BDCs, private debt funds, insurance companies, etc. Sponsors are figuring out different ways to raise capital. For example, with a 6.0x structure, sponsors may look at a senior stretch solution for the full 6.0x, a senior/mezz or first lien/second lien through 6.0x, or a bifurcated structure with a first out/last-out in which the FO is 1.0x to 4.0x and the LO rounds out the balance.

As to other trends, there are not as many synthetic structures as there used to be. There seems to be a trend towards simplicity. We’ve also seen significant growth in standalone funds. For example, BDCs using their “bad bucket” capacity to go as deep in the capital structure as they want to go. We’ve seen a number of our clients team up to do this as well.

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