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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: You represent mostly lenders, correct? So I'm sure you're being asked for some pretty stretchy stuff by sponsors.

Stephen Boyko: Yes. Sponsors are asking for more and more room on incremental debt, such as free and clear baskets. If the deal has closing leverage of 5.5 times, they are looking for a free and clear basket of an additional half turn to full turn of leverage (i.e. 6.5 times). Depending on the deal dynamics, this will typically settle around a half to three-quarters of a turn of additional leverage.

TLL: Where do you see total leverage ratios going?

SB: We did presentation with Lincoln International recently to discuss our data and their data for the first half of the year. It was a great event. We had about 200 lenders and sponsors in the room. Our data on leverage showed a decrease, on average, by 0.3 turns to 4.8x for the first half. Lincoln's leverage number for the approximately 1,000 companies in their database was about the same- 4.7x. We scratched our heads and triple-checked our numbers (we always double-check). But they were correct. We think it's because a large proportion of our clients are finding more off-the-run credits to complement the higher leverage deals they are doing for top-tier sponsors. While we close lots of deals with leverage at 5, 6 and 7 times, we also close a good number of deals with 2, 3 and 4 times leverage, which drags the average down. With that said, competition for deals remains intense and we anticipate that leverage will likely trend higher as we go further into the year.

TLL: What about pricing? What kind of trend are you seeing?

SB: Pricing is down across all product types and EBITDA bands. We believe that two factors are contributing to this – competition (for sure) and the increase in lower cost capital available to our clients. Most of our clients have raised senior funds, which allow them to compete directly with banks. The big change in the market is that direct lenders now are offering two financing solutions to borrowers – a senior-only solution and a complete capital structure solution

TLL: What percent of deals were unitranche?

SB: 44% were either 1^{st} lien or unitranche.

TLL: How do you define unitranche?

SB: We classify by leverage. Once you're over 4.25x or 4.5x, that's really unitranche.

TLL: I noticed in your data that the prevalence of non-bifurcated unitranche structures is continuing.

SB: Yes, 76% are straight unitranches (no bifurcation). There's such an appetite for product, clients will hold the whole thing. Also direct lenders have raised lower cost capital so they can keep the entire tranche rather than having to sell off the first out tranche to meet their hurdles.

TLL: So Steve, what kind of market are you predicting for the 2nd half? More of the same?

SB: It does feel like more of the same. The market is very competitive. You always see a number of folks competing for the same deal. This drives down pricing and results in looser terms. While markets are strong, there's still not an abundance of deals. And there's a ton of cash looking to be deployed.

With that said, we do see clients picking their spots on terms. For the right credits, clients will take a beating on the pricing as long as they get the terms they are looking for. It's possible some tightening will happen, but I wouldn't bet on it in the near term

TLL: How about my favorite topic: ebitda adjustments?

SB: We are seeing adjustments everywhere, not just for top-tier issuers. Our lender clients are paying attention to add-backs, but the trend is not good. There's also not a uniform approach. We are tracking add- backs by type and deal size. It's one of the 200 data points we collect on each deal. We are starting to see trends by EBITDA size with fewer and looser EBITDA caps as EBITDA increases.

In the traditional middle market, non-recurring items such as a plant catching fire or a staff downsizing, we're seeing a little loosening on terms. For run-rate synergies – giving credit for expected expense reductions – lenders are a bit more conservative.

TLL: So Steve, last April we talked about the Trump effect. Any updates?

SB: The status quo is fine for the capital markets. We know that lots of items are being discussed, such as rolling back Dodd-Frank and increasing BDC leverage. Who knows what will actually get passed.

But we do know is that the chance of taxes and regulations increasing appear to be very small. This is good for the market.

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