Winter Games (Part One)

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We knew Disney World would involve some long lines. Even with Fast Passes, it's tough to zip through everything. And with three young girls in tow (two daughters and a friend), flexibility is key. The surprise was the four-hour wait at one Disney destination that's not on the usual tour: the Buena Vista Urgent Care clinic.

Turns out that's the place to go when your daughter's friend gets influenza B on the second day of your trip. Seemed like half of Orlando was there as well. So now, besides Elsa, Gaston, and Rapunzel, our new favorite Disney character is Tamiflu.

Preventative medicine was thus much on our mind this week. Specifically how lenders try to inoculate themselves against bad structures in the leveraged loan market.

One helpful resource was the recent Private Credit Insights conference hosted by Proskauer. This annual event, led by our friend, Stephen Boyko, reviewed the changes his practice witnessed in covenants, pricing, leverage and other credit documentation.

Proskauer's data base consists of more than 200 deals closed with 84 private equity sponsors during 2017. For reasons we'll discuss, these are more appropriately categorized as "club" rather than "syndicated" transactions. That makes this information more representative of middle market lenders such as Churchill and others who either lead, co-lead, or are clubbed up by the private equity sponsor.

Interestingly, loan structures are rationalizing. The majority are either first-lien/second-lien or unitranche. The rest ("the funky stuff," as Professor Boyko characterized split collateral deals, mezzanine, and holdco PIK) seem a diminishing breed.

Leverage at 5x total debt to ebitda hasn't changed much year over year. Underlying that fact, however, are adjustments which are taking bigger bites out of cash flows.

What highlights the private credit nature of Proskauer's universe is that of deals they disclosed last year, only 13% were cov-lite. That's far lower than the broadly syndicated market, of which (per Thomson Reuters LPC) 80% lacked a maintenance test. Or even the institutional middle market which is now up to 60% cov-lite.

2017 was when the firm began tracking "covenant-loose." At 14% of the total sample, these were defined as having at least a 40% cushion to management projections.

So while many in the lending world feel infected by weakened credit structures, there's cause for private credit players to feel relatively healthy.

Next week we'll review Proskauer trends on debt baskets.