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Winter Games (Second of Two Parts)

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We tend to be a late adopter of cultural phenomena, so our appreciation of curling was understandably delayed. A sport that plays like shuffleboard, tosses around terms like hack and hog line, and employs practitioners who carry brooms, is a tough sell.

But thanks to relentless Olympic coverage, the US men winning a first-time ever gold medal ("Miracurl on Ice"), and a certain fascination with the South Korean women's team, your correspondent is now all-in on the "roaring game." Go Garlic Girls!

Speaking of double take-outs, we return our attention to Proskauer's Private Credit Insights. As we discussed last week, the firm reviewed covenant, pricing, and documentation trends from its 2017 data base of 203 (mostly) sponsored deals.

Besides the standard covenant-lite and covenant-loose occurences, Proskauer's Stephen Boyko also noted how higher leverage was infiltrating credit structures. In documentation this was reflected in a number of ways.

Take ebitda definitions. In 62% of the cases, lenders imposed caps on non-recurring expenses (rising to 70% for companies with ebitda less than $50 million). When applied, this cap amounted to an average of 20-24.9% of those expenses.

Another popular cash flow allowance is run-rate synergies. Here the issuer can add back ebitda generated from run-rate vs. actual revenues. Proskauer found 70% of their financings contained these allowances.

An issuer's ability to take on additional debt, beyond that of the credit facility, is governed by a variety of baskets. There's the general debt basket. Then there's the incremental debt basket. As our *Chart of the Week* highlights, this allowance tends to increase in size as the company's ebitda grows.

The majority of incrementals are leverage-based, though small borrowers (less than $15 million ebitda) tend to have hard caps. So-called "free-and-clear" baskets allow additional debt based on an ebitda percentage (73% average for Proskauer's sample).

Interestingly, the private equity community cares less about the use of incremental baskets than one might think. The real audience is other lenders who may benefit from a built-in debt allotment that's outside the existing facility.

Available amount baskets grant the borrower the ability to build restricted payments, junior capital, and investment baskets. 83% of the time these have a "starter" basket that operates (in Mr. Boyko's term) as a "gimme" for those purposes.

Finally, "grower" baskets expand over the life of the loan, usually with performance. They are typically more allowable for other debt and investments than dividends.

As we've argued in previous columns, the addition of these baskets, not to mention the dilution of reported ebtida, has led to an insidious upwards creep of leverage. When a downturn does come, this could leave some lenders on very thin ice.