Lead Left Interview – Jessica Reiss and Kerry Kantin (Part 2)

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This week we continue our conversation with Jessica Reiss, the head of leveraged loan research at Covenant Review. Also joining the conversation is Kerry Kantin, a managing director covering leveraged loans at sister company LevFin Insights. Begun in 2006, Covenant Review is the world's first boutique research firm focused on bond and loan covenants. LevFin Insights provides news and analysis covering the debt capital markets including leveraged loans, high yield, secondary trading, CLOs, middle market and BDCs. ***Second of two parts – View part one.***

The Lead Ledt: *Sort of like the mythic fruitcake that keeps getting passed around during the holidays.*

Kerry Kantin: But now the calendar is building. Investors have increased leverage to negotiate deal terms. One such example is delayed draw term loans. With more issuers seeking DDTLs with 24-month availability, investors have pushed back for better ticking fees. It was a hot market for issuers in January. It's more investor friendly now.

KK: Another area is free-and-clear baskets. They've been launched at one times ebitda, but are getting reigned in. Sponsors know they won't necessarily get it. But investors are pushing back. MFN [most favored nation] sunset provisions are good examples. The sunset periods are extending from six to twelve months. And the spread differentials are tightening from 75 bps to 50 bps.

TLL: *I suppose with exceptions to everything.*

Jessica Reiss: Yes, there are carve-outs and exceptions to everything. Usually there's a list of reasons and carve-outs. There are random exceptions out there. We've seen an aggressive deal where there's no MFN protection at all. Look, if the sponsor goes out with fifty crazy things and ten get dropped, lenders are happy!

TLL: *How do you read lenders' sensitivities right now? What's the latest?*

JR: It depends on the credit. If multiple tranches of bonds are maturing inside of your loan, that's a cause for concern. Sometimes ebitda addbacks – as you've written about – are too aggressive. In those cases, caps are critical. For credits that are well-regarded, leverage can be higher.

TLL: *We know you've written extensively about asset sales like Chewy/Petsmart. Lenders are worried about proceeds not getting back into their hands.*

JR: People are very focused on it, but I don't get a ton of questions on the new issue front. Perhaps on secondary issues. We're trying to be increasingly transparent, but not a lot of calls on it. Certainly the concepts of moving IP [intellectual property] or if the borrower sells a certain percentage so that it's no longer a guarantor. They go back to their portfolio companies, as was the case with Chewy, it probably was intentionally drafted in a way that was ambiguous.

TLL: *On the middle market front, we've heard about situations if the ebitda reaches a certain level, say $50 million, then the leverage test goes away. It's called covenant-fade.*

JR: Covenant-fade! I like that. Never seen it in large cap land, since 84% of deals syndicated this year and tracked by LFI have no maintenance covenants. It's probably more for the club market.

TLL: *We've also seen reports of the covenant-lite trend for high-yield bonds. They're already covenant-lite, but this seems to be covenant-liter.*

KK: You're probably talking about an investment grade covenant package for high-yield issuers. Our colleagues on the high-yield side of the business would have better color.

TLL: *Ok, so last question. What's the biggest surprise for each of you about what's been going on this year?*

KK: I would say the thing I've been the most surprised by is how aggressive terms have proliferated. Ticking fees are now all over the map, and we've seen U.S. issuers push not only for 75 bps of MFN protection, but also for 100 bps of MFN protection, with sunsets and all sorts of carve-outs. And while sponsored deals tend to be more aggressive, these terms have crept into both corporate and middle-market transactions.

JR: Yes – along those same lines, I've been surprised not only at some of the MFN terms, but also the ratio calculations that have cleared the market. Even though we've seen some provisions get tightened over the last few weeks, there have been many deals this year with very flexible terms that go beyond what we've seen in the past.

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