Feeding the Chickens

THE LEAD | January 24, 2019

"I believe in being fully transparent," we told our spouse, negotiating NFL playoff viewing rights this past weekend. "It's working," she said. "I can see right through you."

In that same spirit of confession, your correspondent reminds readers of last week's forecast regarding fund flows. We predicted outflows from retail loan accounts, which had been in the $1 billion-plus range (settling down to $327 million last week), would moderate to close to zero. Perhaps even a small in-flow.

So it was a surprise when out-flows continued in a robust fashion – $943 million for the week. In our defense, this outcome was a surprise to at least one other credible analyst. "It certainly didn't feel like $1 billion left the market," he wrote.

There was also the suggestion that broadly syndicated loan PMs are more comfortable managing with less cash, given the lower volatility we've been seeing since the start of the year. Nevertheless it's hard to believe more outflows in this range would not at some point begin to affect overall liquidity in the market.

Other analysts pointed to the ease with which some large-ish transactions are moving through the market. MKS Instruments, Cast & Crew, and Aimbridge Hospitality (as LCD highlighted) all wrapped up on tighter terms. This week another jumbo financing, this one for Caliber Collision's acquisition of Abra Auto Body Repair, launched.

At $1.85 billion, this cov-lite Hellman & Friedman-backed financing was initially price-talked at L+400 bps. Contrast that with Caliber's existing loan spread of L+300. There had been hope from some quarters that pricing for liquid deals in the pipeline would end up in the L+400-450 range. "Juicy," one observer hoped.

But as our Norwegian grandmother was fond of saying, hope don't feed the chickens. Institutional cash, in fact, feeds the chickens. And there's still enough cash in coffers to move spreads. LCD reported yesterday Caliber flexed down by 50 bps to L+350, pushing all-in yield (with a step-down to L+325 when first-lien leverage goes below 4 times) to 6.65% (vs. around 7.2% originally).

Not every deal in the pipe is a Caliber or MKS. If BSLs come in at the higher range, where will middle market spreads be for primary issuance? Midcap volume so far this month has been on the light side. The $50 million-plus ebitda segment behaves much like BSLs, with cov-lite and tighter spreads. LCD data shows these larger loans are being priced with an all-in yield of 7.43%. Clubbier deals (per LPC) are around 8%.

And as our *Chart of the Week* depicts, much of the middle market volume is in the form of senior, senior-stretch, or unitranche. It's also a fact that activity will be driven less by syndications (and institutional appetite) and more by direct lender capacity.

At the risk of being held accountable for this prediction, we expect that private credit capacity is sufficient to drive improving deal flow well beyond the first quarter.