THE LEAD
https://theleadpc.com/whitecaps-in-large-caps/

# Whitecaps in Large Caps

THE LEAD | November 5, 2019

Issuers in leveraged lending today are divided into three categories: the haves, the have-nots, and the wish-they-hads.

As the 2019 loan calendar heads into its final six weeks of activity, the differences between the first two categories are becoming more pronounced.

In the broadly syndicated market, as we covered last week, the combination of triple-C anxiety among CLO managers and cash out-flow worries with retail funds have impelled a flight-to-quality. Better rated issuers in defensive sectors are the haves; challenging "story" credits are only getting done with investor-friendly tweaks.

Using the syndicated middle market, this trend is illustrated by our *Chart of the Week*. For the first time since 2015, flex-ups in midcap pricing reached $2.2 billion. By definition, a flex-up means the loan arranger expected the financing to clear the market at a lower spread (and other terms), and guessed wrong.

This misjudgement highlights how market conditions can change without notice. Or change in less visible ways without lead underwriters understanding buy-side nuances. The lesson is never to assume because a deal sold easily yesterday, it will sell easily tomorrow.

What is the relationship between large cap headwinds, and needing to improve yields in the middle market? While the former is driven by technical issues, as we've outlined, the latter is more deal specific.

Sponsors are often attracted to the syndicate process because they believe better pricing and terms can be squeezed out there. But this strategy can backfire. If a specific credit or a sector is a "story," for whatever reason, the institutional investor will push back. This is even more likely as managers have made budgets for the year.

In these instances, sponsors are better advised (and are increasingly doing) to work with direct lender relationships disposed to lean into idiosyncratic credits. This approach may not necessarily be less flexible or more expensive than going wide. Indeed, club executions are typically more favorable than a flexed-up market result.

Will these bifurcated conditions persist into 2020? Certainly it will in the broadly syndicated market as long as recession angst continues, and as the low-rate environment lasts that's favoring fixed income amongst liquid credit managers.

For the non-syndicated middle market, where long-term capital provides locked-in demand, terms are more competitive. This is particularly true for unitranche financings. Increasingly direct lenders are offering these one-stops at spreads that two years ago would have been more appropriate for first-lien term loans.

And what should we make of the "wish-they-had" category? Despite some choppy waters in leveraged loans, investors who may truly feel disadvantaged, are those who have no private debt strategy at all.