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Smooth Sailing

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In what was described as a series of events in which "several things went wrong," a 230-foot long replica of Noah's Ark plowed into a Norwegian patrol boat last week. The collision cut a gaping hole in the side of the bible boat, leaving the owner distraught. "It's an awful dream, to have an accident with the ark of Noah."

No mention whether the vessel carried two of the same insurance policies on board.

Closer to home, investors have seen mostly calm waters in the leveraged loan markets over the past couple weeks. Steady, but still modest, deal flow mixed with available cash makes for positive conditions – a dramatic turnaround from a tepid first quarter.

The demand side is not tough to figure out. S&P LCD reports a modest turnaround of retail fund flows from outflows of about $700 million in April, to $376 million of inflows last month. That in combination with steady new CLO formation this year – over $5 billion in May – has put cash in the pockets of institutional funds.

On the supply side, the broadly syndicated pipeline stands around $40 billion; not too shabby, but off from the average forward calendar. That's caused a bit of a feeding frenzy for better credits. One example was *Ennis-Flint* , Olympus Partners' buyout that flexed its $442 million TLB down by 25 bps (to L+400) and tightened OID (to 99.75).

Another sure sign of a sell-side-itis is the number of repricings hitting the market. Issuers like *Prime Security Services*, *Microsemi*, and *Petco Animal Supplies* all asked existing lenders for lower spreads as arrangers sensed a pocket of opportunity.

More evidence? Dividend recaps have reappeared after a long absence. May's volume of almost $8 billion (per LCD) tripled April's $2.5 billion figure. *Ferrara Candy* upsized its financing to $535 million, also providing its sponsor, Catterton Partners, with a bigger dividend ($214 million). That was joined by *St. George's University*, a $600 million TLB that financed "strategic initiatives," as well as a dividend.

Less visible, but no less a tell-tale of frothy markets, is the addition of so-called sunset provisions to "most-favored nation" clauses in large cap credit agreements.

MFNs protect existing lenders from borrowers getting incremental debt on better terms (for the lender) without benefitting from the same terms. Typically if the coupon of the new financing is 50 bps higher, existing lenders get the benefit of the higher coupon.

Sunset provisions remove MFN protection after a period, typically 12-18 months. In aggressive markets, however, that period can be shortened to as little as six months.

Next week, we'll take a further look at how certain covenants and terms are being weakened in the current broadly syndicated market – and how that compares to conditions in the middle market.