Lead Left Interview – Jessica Reiss and Justin Forlenza

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This week we chat with Jessica Reiss and Justin Forlenza, attorneys with Covenant Review. Begun in 2006, Covenant Review is the world's first boutique research firm focused on bond and loan covenants.

The Lead Left: It's been a while since we first featured Covenant Review. Give us an update.

Justin Forlenza: We're an independent research firm, comprised of fifteen lawyers. Our focus is on credit agreements and bond documents as well as intercreditor agreements and term sheets. We provide analysis through our website in the form of research reports.

Jessica Reiss: We have a diverse customer base, primarily broadly syndicated loan investors, but also sell-side focused managers. We review terms from a covenant and legal perspective, and advise our customers on the risks. It's really about providing documentation ins and outs from a market perspective. It's also about weighing where terms are on the spectrum from aggressive to conservative. Our historical focus has been on large cap, but some are less than $100 million ebitda. We don't see as much in the traditional middle market, but we do see some in the $50-100 million range.

TLL: Do you have any plans to expand your research to the middle market?

JF: Our mandate is mostly syndicated deals, but there's been some discussion about expanding to club type deals. That's in the initial stage of development.

JR: We have a bond group and a loan group. Justin and I focus on loans, along with about eight other lawyers. About the same number cover bonds. For bonds we cover every new high yield issue, except small or privately placed deals.

TLL: What's your typical issuance size?

JF: Over $250 million. That's the overwhelming majority. We write up new issue and secondary deals that become interesting; for example, if something goes from investment grade to junk. We try to answer specific investor questions on credits. Also, we do event-driven reports, mostly on the bond side; say, if there's an acquisition that causes a change of control. Intelsat is one name with plenty of noise around it, with lots of loans and bonds and intercreditor issues. Valeant is another we've written a bunch of reports about.

TLL: What trends have you seen in covenants this year?

JR: Market terms swung quickly from tightening at the end of 2015 and early part of this year, to the borrower-friendly terms we've seen recently. Deal volume is up, as is repricing volume. There were hung deals in October through December that ended up being funded by the arranger, and are now back out being marketed.

JF: Back then lenders could push back on incurrence tests, free and clear tranches were brought down, and ebitda-based grower baskets extended to 12-18 months. But the market has exploded since. We've seen fifteen to twenty term sheets in the last week or so, with pretty aggressive terms. That agents think they can go out with these is indicative of the market.

One good example is asset sales sweep language. In a mandatory prepayment from an asset sale, typically 100% goes to repay debt. Now we are seeing step downs to 50% subject to a leverage test, and even to zero assuming leverage falls below a certain level. The company used to have to reinvest in the business, but now can do anything with the cash.

TLL: Give us another hot covenant topic.

JR: A real hot button is the sunset provision for MFN [most favored nation] treatment. That's the one that protects existing lenders from other debt getting favorable pricing. We're seeing that protection disappear in six months, which is pretty short; more typical is 12-18 months.

Most debt accordions [allowing lenders to increase the existing tranche] have either a free and clear basket based on a fixed dollar amount, or governed by leverage. Endurance International was a hung deal back in February. The accordion's MFN should have been triggered because the deal was funded at a discount, but that fee wasn't considered OID [original issue discount] – it was just a bad underwriting decision.

Contact:
Justin D. Forlenza
jforlenza@covenantreview.com

Jessica Reiss
jreiss@covenantreview.com