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Lead Left Interview – Steven Miller (Part 2)

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This week we continue our conversation with Steven Miller, CEO, Fulcrum Financial Data. Fulcrum publishes Covenant Review, CapitalStructure and PacerMonitor and has recently backed LevFin Insights, which was started by market veterans to report on the loan and high yield market. ***Second of two parts – View part one***

The Lead Left: Your colleague Kelly Thompson recently wrote about "cov-wide." Tell us more about that.

Steven Miller: Kelly, who writes the middle market beat for LFI and is a great reporter in that space, talked about the growing use of what used to be called covenant-lame in the middle market.

Her reporting found that more and more loans in this segment are structured with ceilings set so wide of actual numbers that the borrower is more likely to default on payment before ever tripping the test. In a cov-wide deal, the test might run as wide as 30-40% of closing leverage, market sources say. Picture a 5x deal set against an 8x or 9x covenant. For all practical purposes, then, these are cov-lite deals.

TLL: What's the next big thing in terms of covenant erosion?

SM: Of course it's hard to say. But what we've heard from players is that terms used to be sacrosanct, with yields and OID moving up and down based on market technical conditions. As we all know, that's no longer the case. Given today's muscular conditions, the consensus view is that terms will remain under pressure across the spectrum.

TLL: Are you seeing any differentiation between bank and non-bank arrangers in terms of covenants?

SM: We don't have any data on that, but it's certainly something to watch as the non-bank market develops.

TLL: You recent published on growing use of ebitda adjustments in new deals. Can you give us a taste of this analysis?

SM: Here are some highlights. The average adjustment for new M&A-related deals pushed to 28% of trailing EBITDA in the third quarter from 23% in the second quarter. Drilling down to just private equity-backed issuers, the adjustment percent pushes to 31% in the third quarter, compared to 28% in the second. These adjustments shaved the pro forma debt multiple for third quarter M&A-related loan transactions by nearly a turn, on average, to 5.38x from 6.29x based on non-adjusted EBITDA.

Similarly, through the free-and-clear incremental tranche adjustments reduced pro forma leverage to 6.10x from 7.12x. Drilling down to just private equity-backed issuers, the adjustment percent pushes to 31% in the third quarter, compared to 28% in the second.

TLL: What's been your biggest surprise so far this year?

SM: I don’t know anyone who predicted the stunning revival the market has enjoyed in 2016. Certainly, I did not. In January, as we all remember, the market was flat on its back. There seemed to be little hope of a revival with secondary prices down, demand weak and arrangers forced to take heroic measures to print certain deals that were pushing the edge of the credit envelop.

As you well know, the market has turned 180 degrees since, with issuers now back in the driver’s seat. It shows how dynamic the loan market has become.

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