Lead Left Interview – Stephen Boyko

THE LEAD | September 20, 2017

This week we chat with Stephen Boyko of Proskauer. Steve is a partner in the firm's corporate department and co-head of the private credit and finance groups. He represents one of the largest client rosters in the industry, including an array of specialty finance companies, private debt funds, and BDCs.

The Lead Left: Steve, thanks for joining us again. We spoke in April to review 1Q trends. You recently came out with your first half survey [link]. What's activity been like?

Stephen Boyko: Activity remains strong as we move into vacation season. For example, last Friday afternoon I got four new transactions. And we had eight new deals overall by the end of the day. So there does seem to be a fair amount of M&A activity going on.

It's very competitive. We are witnessing a constant loosening of pricing and terms. In auction deals, we are seeing 3-5 sponsors competing for the deal, and each are bringing 3-5 lenders to the table. The vast majority of deals that we are doing are sponsor-backed. Only 20% is non- sponsored, direct-to-borrower deals. And roughly 70% of our transactions relate to acquisitions.

TLL: Have you seen much of a change from the first quarter? Any surprises?

SB: There have been a few surprises. We weren't surprised that spreads are going lower. We were surprised that there has been so much activity in the healthcare space, given all the uncertainty surrounding healthcare reform. We thought lenders would be picking their spots. But 25% of our deals have been healthcare-related, which is somewhat surprising.

TLL: Within healthcare what subsectors are you seeing?

SB: In the past we've seen lab deals and some physician roll-ups in anesthesiology, urgent care, and emergency room space. While we are still seeing some physician roll-ups, we've also seeing a fair bit of healthcare technology deals.

TLL: Any other first half surprises?

SB: We hear in the market that there is a lot of cov-lite. In the direct space, the vast majority of mid-market issuers ($40 million of ebitda or less) are not cov-lite. This is especially the case when they are financed by direct lenders. Interestingly, even the direct lenders who are offering the most aggressive terms want covenants when they hold a good chunk of the deal.

TLL: How do your stats break that down?

SB: We did 73 deals in the first half, and only 16% of them were cov-lite. This was the case even though 39% of our deals had greater than $50 million in ebitda, with the balance spread being across the mid-market. We are also continuing to see step-downs on covenants. 78% of our transactions had at least 5 step downs!

TLL: What percent of your deals were "principal investing" vs "syndicated"?

SB: The vast majority is principal, in which the lender is holding a significant piece of the capital structure. It's mostly senior debt; only 20% of our deal flow is either 2nd lien or mezzanine.

TLL: Have you seen continued deterioration in structures?

SB: It really has continued, things like wider baskets and flexibility in incremental debt baskets. Also free and clear baskets. However, we have seen tightening in a few deal terms. For example, cash flow sweeps. Some lenders are keeping step-downs at lower levels of leverage. In 2016, the first step-down point occurred at 3.9 times leverage. For the first half of this year, that number is 3.5 times- half a turn lower.

For transactions between $25-50 million ebitda, the excess cash flow sweep step-down occurred at 3.1 times. For deals over $50 million ebitda the sweep stepped down at 4 times. That really bucked the trend.

We've also seen a little tightening in restricted payments. That ratio for dividends for issuers between $25-50 million ebitda was 3.3x, with leverage coming down from initial levels of 5 or 6 times.

For the greater than $50 million ebitda companies the ratio was 4.8 times – a big jump. The middle market space is requiring significant deleveraging before allowing dividends.

Another trend deals with starter baskets. The rule of thumb is allowing a basket equal to one quarter turn of leverage. That ratio pretty much held last year. For the first half of this year, it crept down to 20%.

To be continued the week of Sept 25

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