The New Price is Right

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Amid all the wondrous frolicking enjoyed by many this past holiday weekend, we were reminded again of one corollary to good parenting: Otherwise well-mannered children get into trouble when not occupied with constructive activities.

That observation came to mind on reading an interesting note yesterday from content partners S&P Capital IQ. They report that May showed the highest level of leveraged loan re-pricings since early 2014. Apparently the dearth of buyouts and acquisitions has compelled idle loan arrangers to squeeze lenders for a few more basis points.

This outcome should have been expected. The supply/demand imbalance continues in the market with too much cash chasing too few deals. New money deal flow has been slow to pick up this year for a variety of factors, and lenders are approaching the mid-point of the year with plenty of capital to put to work. In those circumstances, cash often gets put to work in less-productive (relative to buyouts and acquisitions) ways.

Adding fuel to the fire, large cap spreads, after having risen through the second half of 2014, have been contracting since February. As one data point, S&P shows single-B all-in-yields slipping from 5.2% in March to 4.8% at last week’s measurement.

So far the middle market has not shown as much propensity to re-price itself. This may be the result of continued pressure on regional banks to eschew “risky loans.” Collective anxiety among debt providers has helped keep aggressive re-pricings in check. Unlike their large cap counterparts, middle market loan spreads actually rose from the end of last year through March 31 of this year. Since then spreads have settled from 6.5% to 6.25%, per Thomson Reuters LPC.

The main difference between liquidity in the broadly syndicated and club markets is the appetite of institutional investors. Supply of cash has been constructive for larger credits from several sources. First there’s the volume of CLOs coming to market this year – $44 billion so far, per LPC, with $90 billion anticipated for the full year.

Then there’s the swing to the positive (at least for the past couple weeks) of cash flowing into loan funds. While not big numbers, this represents a change in tone from earlier in the year when retail investors seemed allergic to floating rate debt.

For whatever reason, the middle market deal flow for LBO’s and dividends has actually picked up significantly in the last few weeks. That seems to have kept re-pricings in the background for the time being.

Smaller deals also tend to be stickier in terms of pricing changes. It’s more challenging to open clubby syndicates to the broader market, making drive-by pricing reductions trickier to execute. Our experience is that middle market lenders are harder to steer towards opportunistic mark-to-market re-pricings, absent other deal modifications.

But the upside for mid-cap issuers and sponsors is smaller lending groups tend to be more patient with ups and downs of the credit. So, as always, you get what you pay for.