# State of the U.S. Loan Market – 4Q18

Confidential

January 17, 2019

Leveraged loan market activity rebounded slightly in the fourth quarter of 2018 from the sharp drop in issuance in the third quarter, but the year ended with a whimper as issuance tailed off in December to its lowest monthly issuance since July 2016. Although low volume of issuance has strengthened borrowers' hands in previous quarters (including, strikingly, the 3Q) by exacerbating the mismatch between supply and demand, in this case demand also ratcheted down. A jittery market unsettled investors and led to second thoughts about snapping up every loan on offer, whatever the state of its covenant protections. And again, as in the 3Q, issuance was driven primarily by new money, with refinancing activity accounting for its lowest percentage (40%) of total quarterly issuance all year.

As a result, some loans were pushed into the new year or saw their pricing widen. Others experienced successful investor pushback on loose provisions. In some individual cases, the pushback was quite significant: previously unlimited investments in non-guarantor restricted subsidiaries were capped; and the amount of delevering required to access the unlimited Restricted Payment basket was increased. Overall, however, the gains were modest. As you view the charts in the following pages, please bear in mind that changes in data point percentages from one quarter to the next may reflect a change in direction of only a handful of loans, their effect magnified by the reduced size of the loan pool.

As a reminder, in the 3Q report, we introduced a new set of data points: those that measure (as a percentage of closing date EBITDA) the ability of the borrower and its restricted subsidiaries ON THE CLOSING DATE to (A) incur additional first-lien debt; (B) make investments in non-guarantor restricted subsidiaries and unrestricted subsidiaries; (C) make Restricted Payments; and (D) to incur structurally senior debt. These data points are identified as the borrower's Day One Capacity; each one reflects the aggregate amount of baskets available to the borrower on the closing date to take the specified action.

In addition, we have added three new data points for the report this quarter:

- loans which permit an amount of incremental debt to mature earlier than the initial term loans;
- loans which allow the mandatory prepayment percentage to step down if the borrower meets a specified leverage ratio; and
- for those loans that permit the prepayment percentage stepdown, the amount of delevering required to trigger it.

Because we started capturing these new data points only recently, the first point is presented only for the fourth quarter, while the second and third data points are presented for the third and fourth quarters.


 

We typically segment the data into three groups: (1) sponsor deals with a TLB facility balance of at least $350mm ("Sponsor"), (2) non-sponsor deals with a TLB facility balance of at least $350mm ("Non-Sponsor"), and (3) sponsor deals with a TLB facility balance of less than $350mm ("Middle Market"). However, because the drop in issuance in the Non-Sponsor and Middle Market groups was especially sharp in the third quarter, we did not present data for those groups in the 3Q report, because we felt statistical presentation of the data for those groups would be misleading due to the small sampling size. Issuance was not much better in the fourth quarter, and therefore, in order to avoid presenting misleading data, we have aggregated the data for the third and fourth quarters for each of those groups (under the heading "3&4Q"). The number of agreements included in each segment were as follows:

| | 1Q2018 | 2Q2018 | 3Q2018 | 4Q2018 | LTM |
|---|---|---|---|---|---|
| Sponsors ($350mm+) | 53 | 71 | 45 | 45 | 214 |
| Non-Sponsors ($350mm+) | 24 | 39 | 12 | 17 | 92 |
| Middle Market (< $350mm) | 22 | 29 | 15 | 14 | 80 |
| | 99 | 139 | 72 | 76 | 386 |

The significant findings for the 4Q were as follows.

In the Sponsor market -

- Day One Capacity: The amount of both additional first-lien debt and structurally senior debt that could be incurred on the closing date tightened as did the amount of investments that could be made in unrestricted subsidiaries;
- The number of loans which allowed the mandatory prepayment percentage for asset sale proceeds to step down reduced by half, and of those loans that permitted the stepdown, the amount of delevering required to trigger the stepdown inched up;
- the set of loans with a cap on EBITDA addbacks for cost savings saw the emergence for the first time of a cap of 35%;
- at the same time, the look-forward period for implementing cost savings steps decreased, with a significant number of loans moving from allowing a 24-month period to allowing only an 18-month period;
- in addition to the general tightening of EBITDA, the percentage of loans with a 'free-and-clear' incremental basket calculated by reference to EBITDA dropped slightly; the number of loans for which the percentage of EBITDA in that basket calculation was 100% (rather than something less than 100%) saw a more significant drop, falling almost 20 percentage points;

- MFN protection saw mixed results, as the frequency of a 75bp permitted yield differential increased, while the length of the sunset pushed out at the edges, with both 6- and 24-month sunset periods seeing growth at the expense of 12- and 18-month ones;
- the number of loans that required at least 1x of delevering before the borrower could make unlimited Restricted Payments shrank by almost 10 percentage points, with an almost identical increase in the number of loans that required only between 0.5x and 0.9x; and
- paradoxically, while the numbers of loans which made the unlimited RP basket available at closing (i.e., required no delevering at all) remained steady, the number of loans which made the unlimited investment basket available at closing shrank. This is perhaps due to intensive investor focus on the Investment covenant following their travails with J. Crew, PetSmart and Neiman Marcus.

In the Middle Market –

- as in the Sponsor subset, of those middle-market loans with a cap on EBITDA addbacks for cost savings, the 3&4Q saw the emergence for the first time of a cap of 35%;
- at the same time, the look-forward period for those cost savings addbacks decreased, with a significant number of loans moving from allowing a 24-month period to allowing only an 18-month period; and
- MFN protection saw mixed results, as the frequency of a 75bp permitted yield differential increased, while the length of the sunset pushed out at the edges, with both 6- and 24-month sunset periods seeing growth at the expense of the 12-month one.

In the Non-Sponsor market –

- with respect to those loans with a cap on EBITDA addbacks for cost savings, there was a perceptible shift to the lower percentage cap buckets, with almost half of the loans having a cap of 20%, and the 25% cap losing ground to all lower percentage cap buckets;

- the number of loans for which the percentage of EBITDA used in calculating the 'free-and-clear' incremental basket was 100% (rather than something less than 100%) trended up in the 3&4Q; and
- MFN protection saw mixed results, as the 75bp permitted yield differential made its first appearance in the 3&4Q, while the 12-month sunset period grew by 20 percentage points, at the expense of both the 6- and 18-month ones.

**NOTE:** The data reflected in this report were drawn from New York-governed credit agreements of dollar-denominated first-lien (and split collateral) Term B loans that were originated during the LTM period from 1Q18 through 4Q18, either in draft or, to the extent available, final form. We have obtained the information provided in this report (other than the loan issuance statistics) from our Deal Data platform. More detailed tables for each data point are available on request. If you are interested in subscribing to Deal Data, please contact us at inquiry@xtractresearch.com. The loan issuance statistics were drawn from Debtwire's U.S. Leveraged Insights – Year-end 2018. If you are interested in receiving a copy of Debtwire's report, please contact natasha.brooks@acuris.com.

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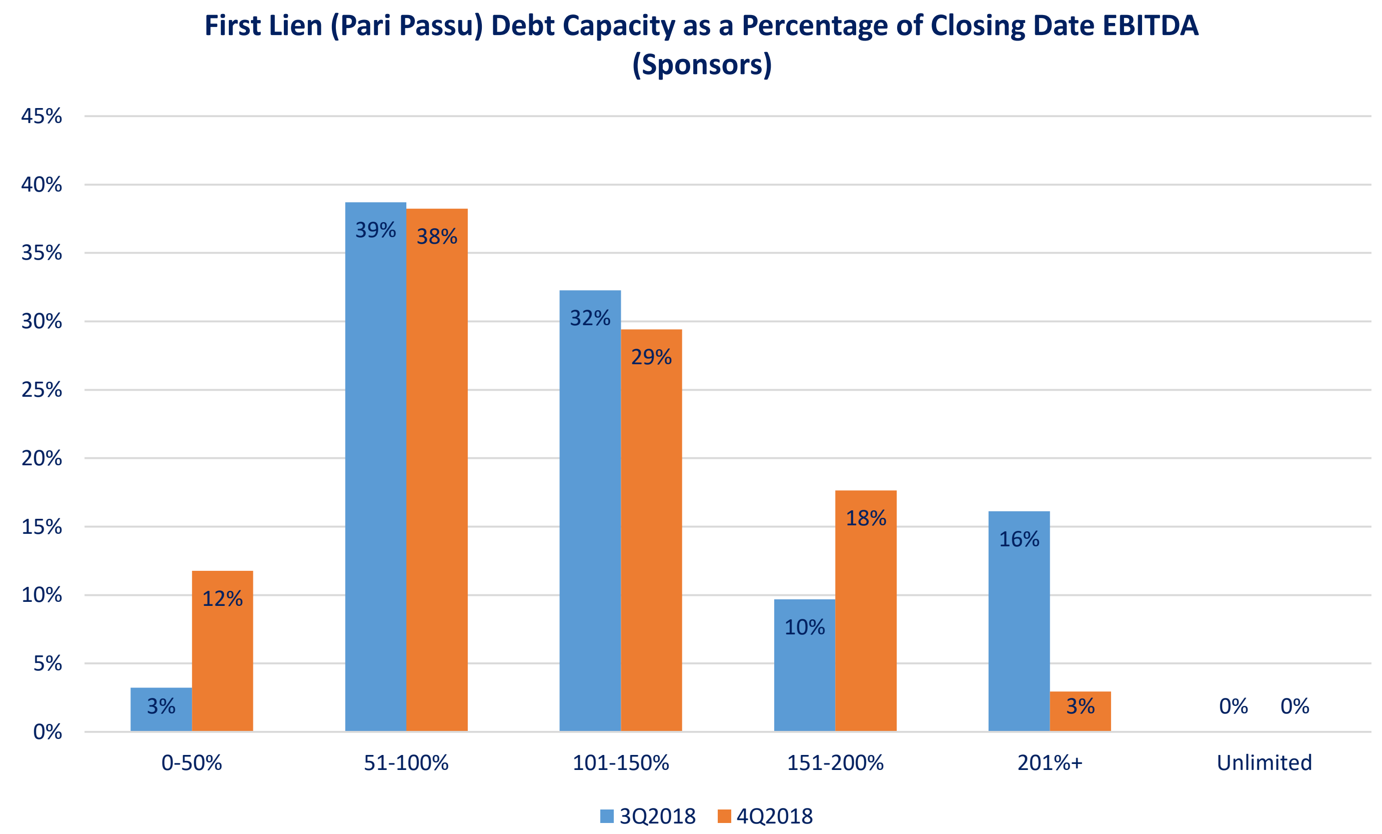



 

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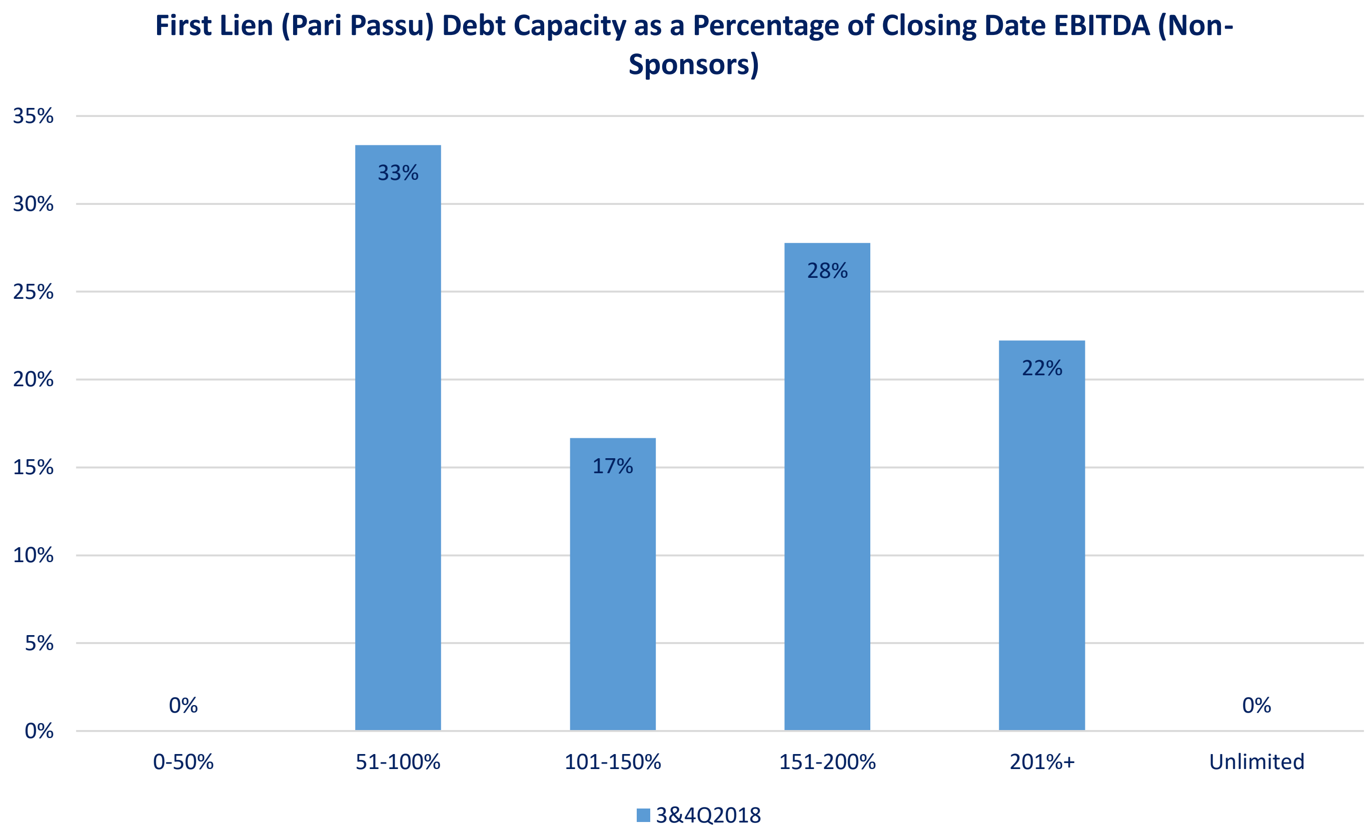

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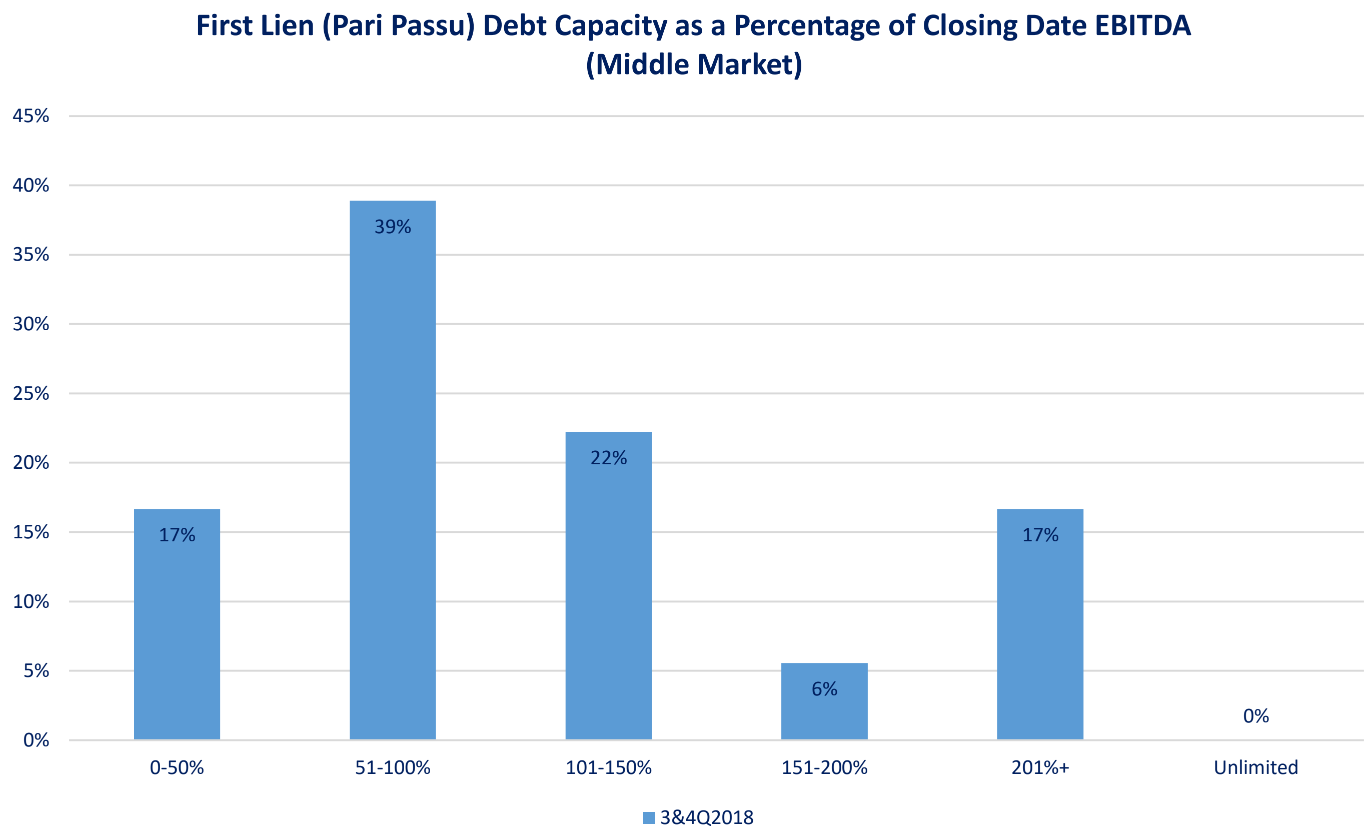

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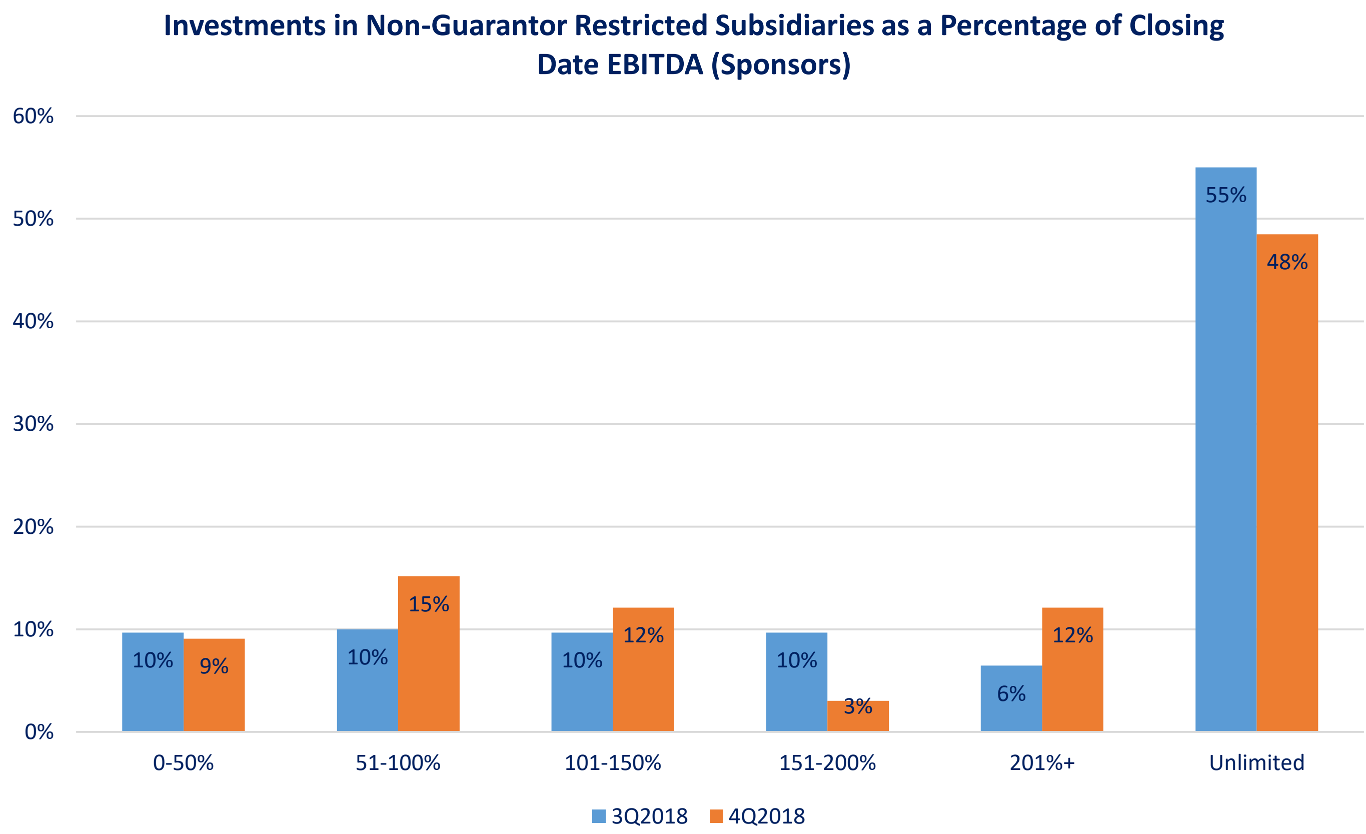
# Investments in Non-Guarantor Restricted Subsidiaries



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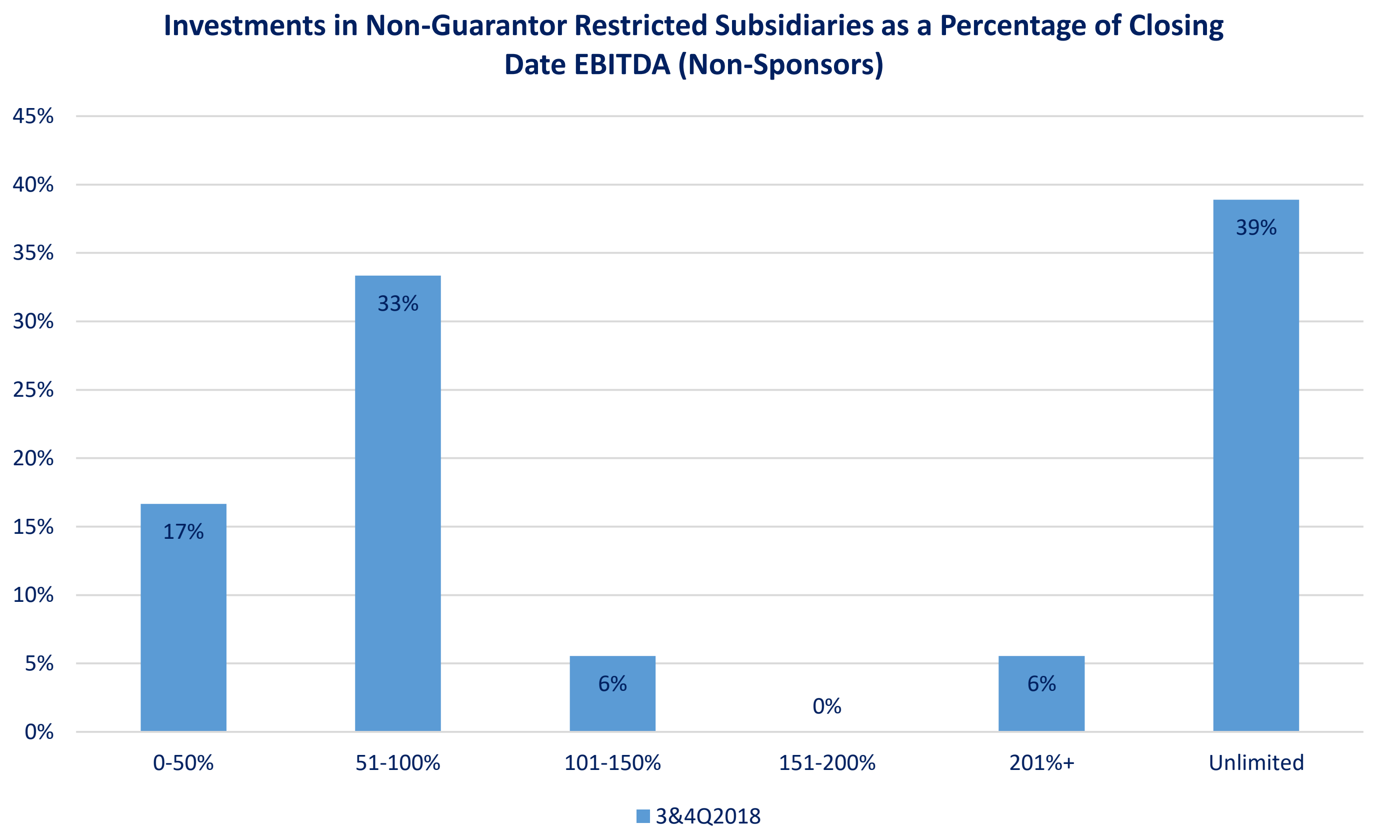

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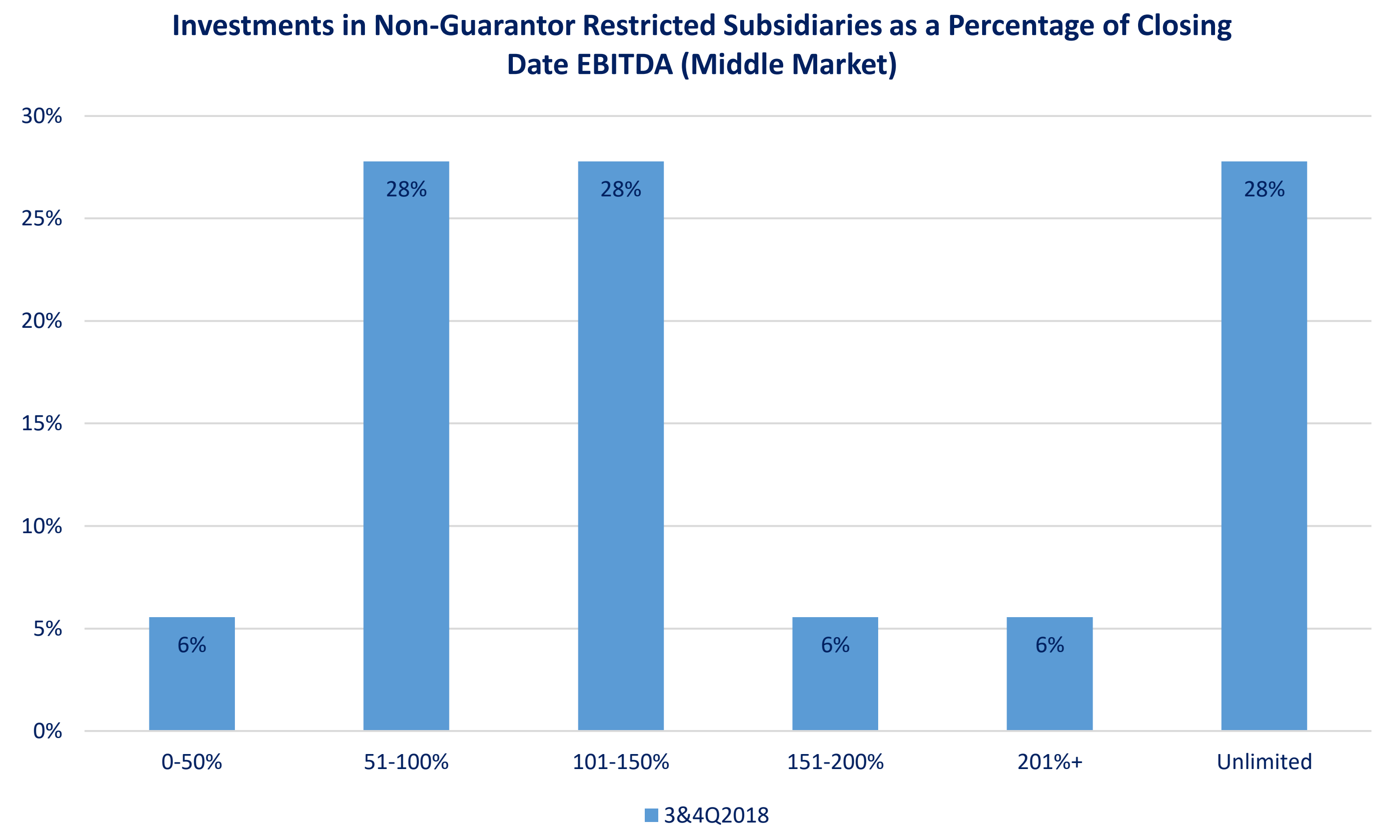

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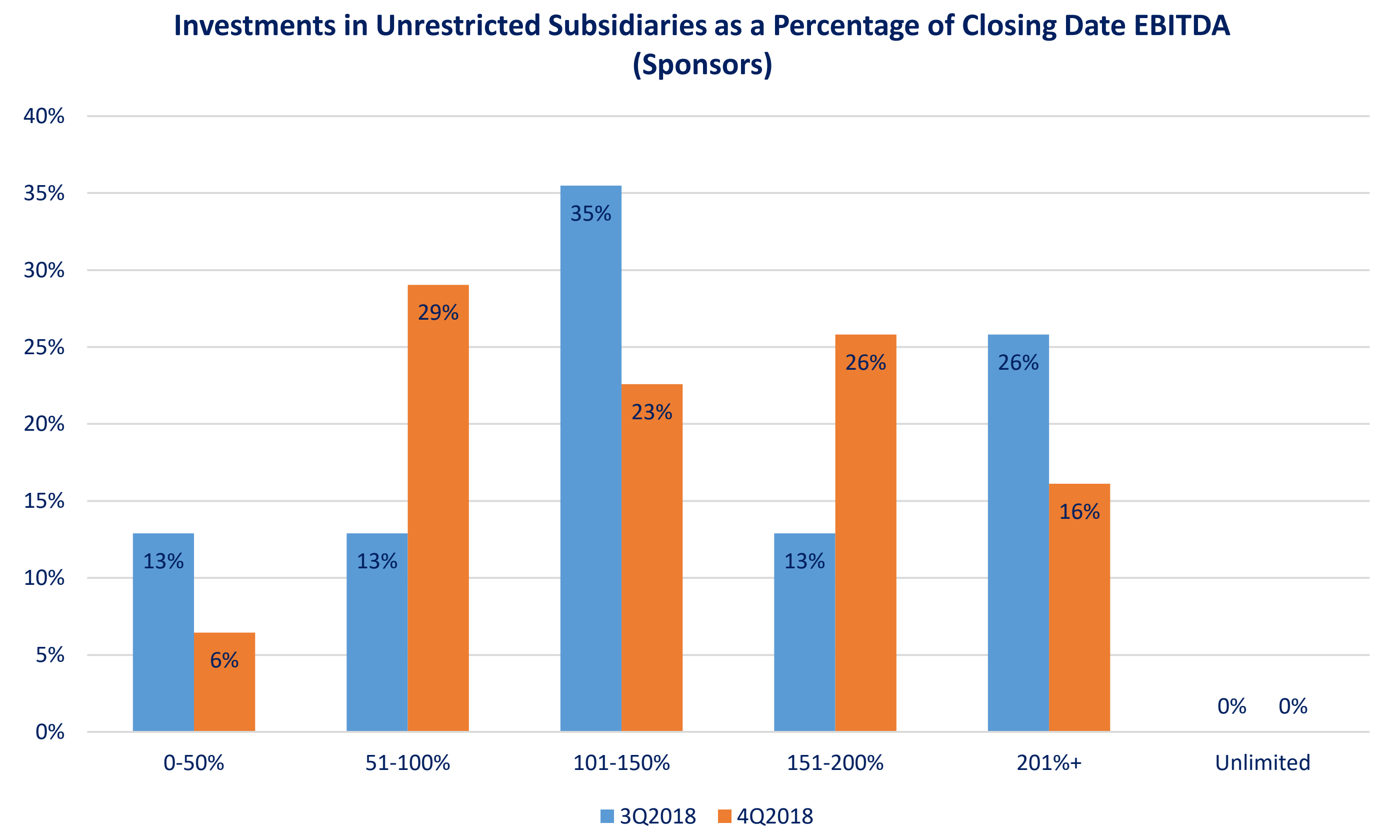

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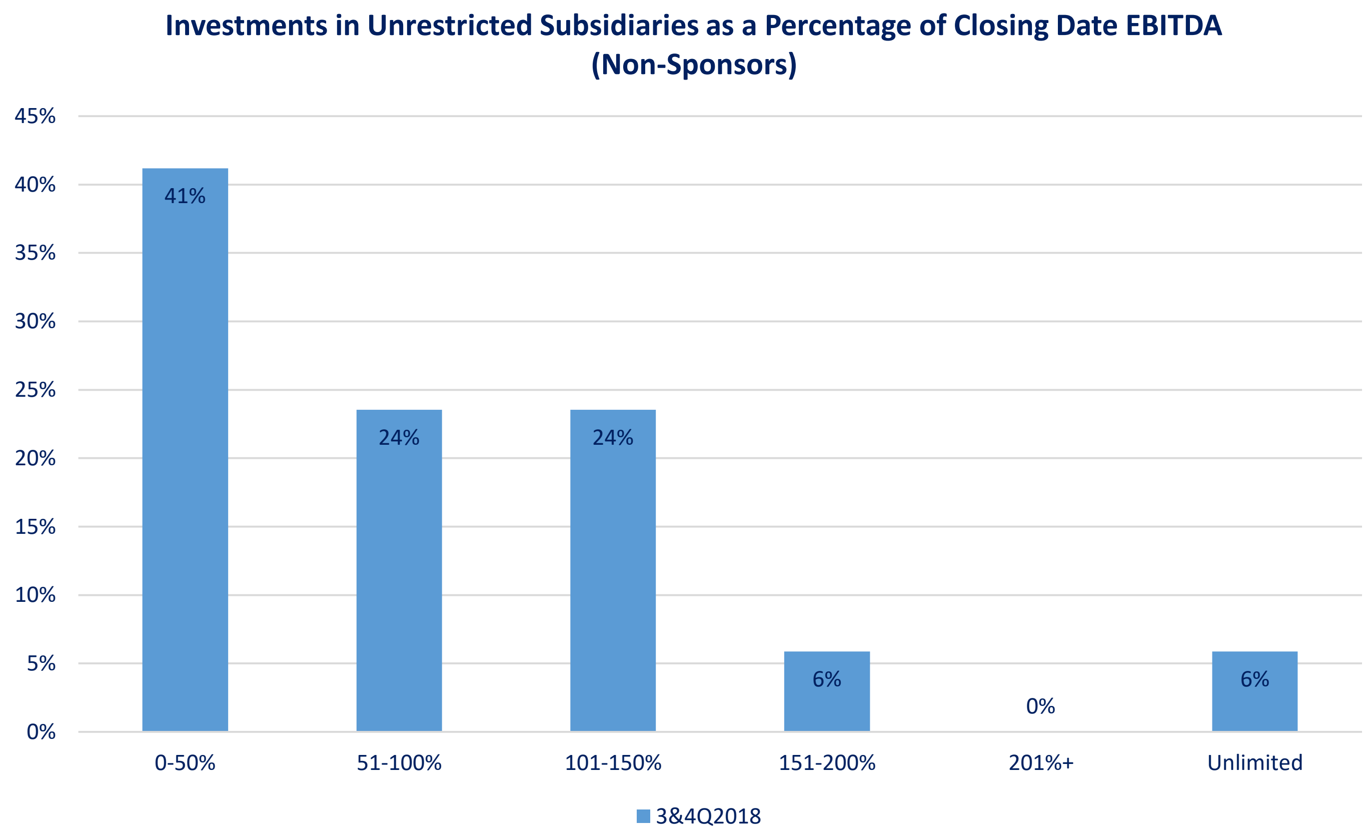



 

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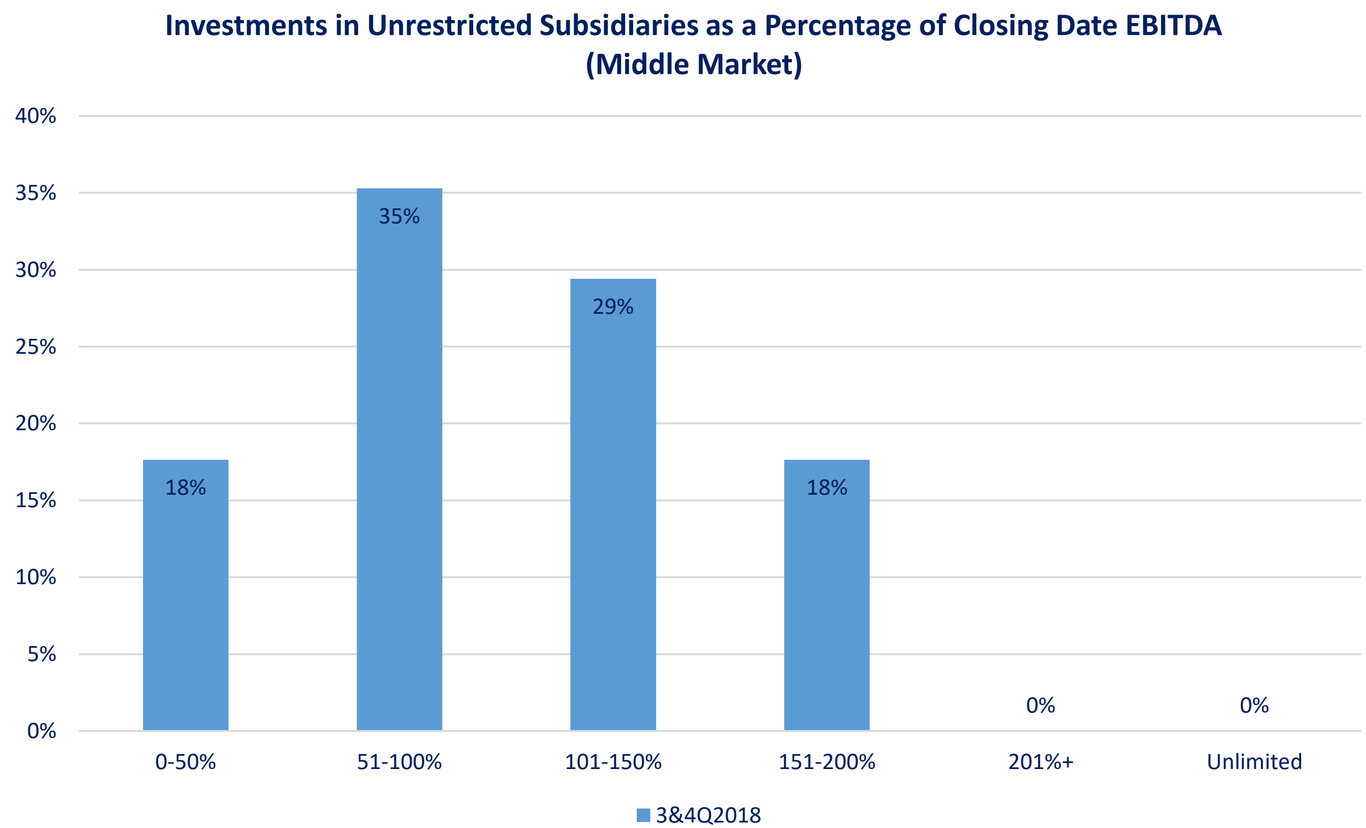

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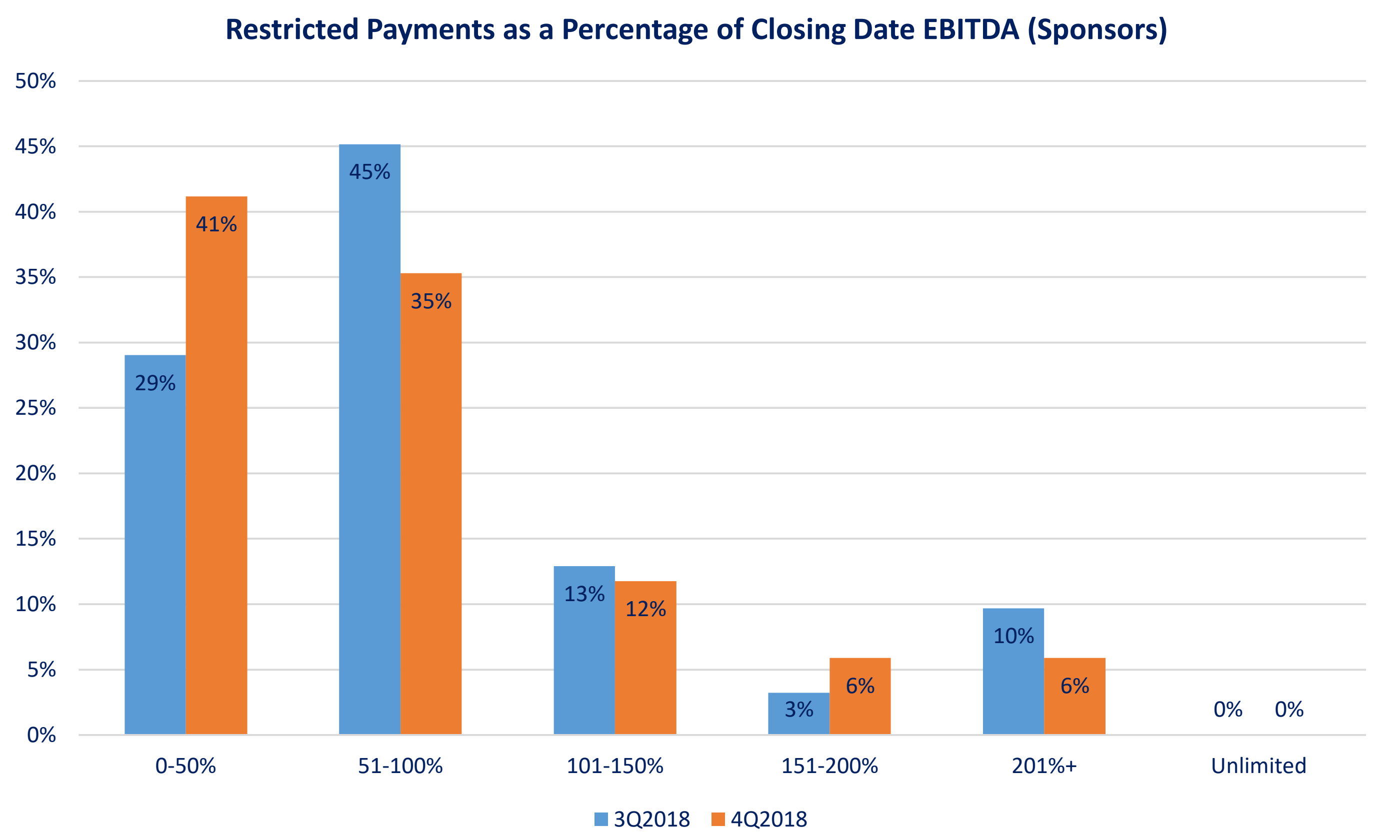
# Restricted Payments





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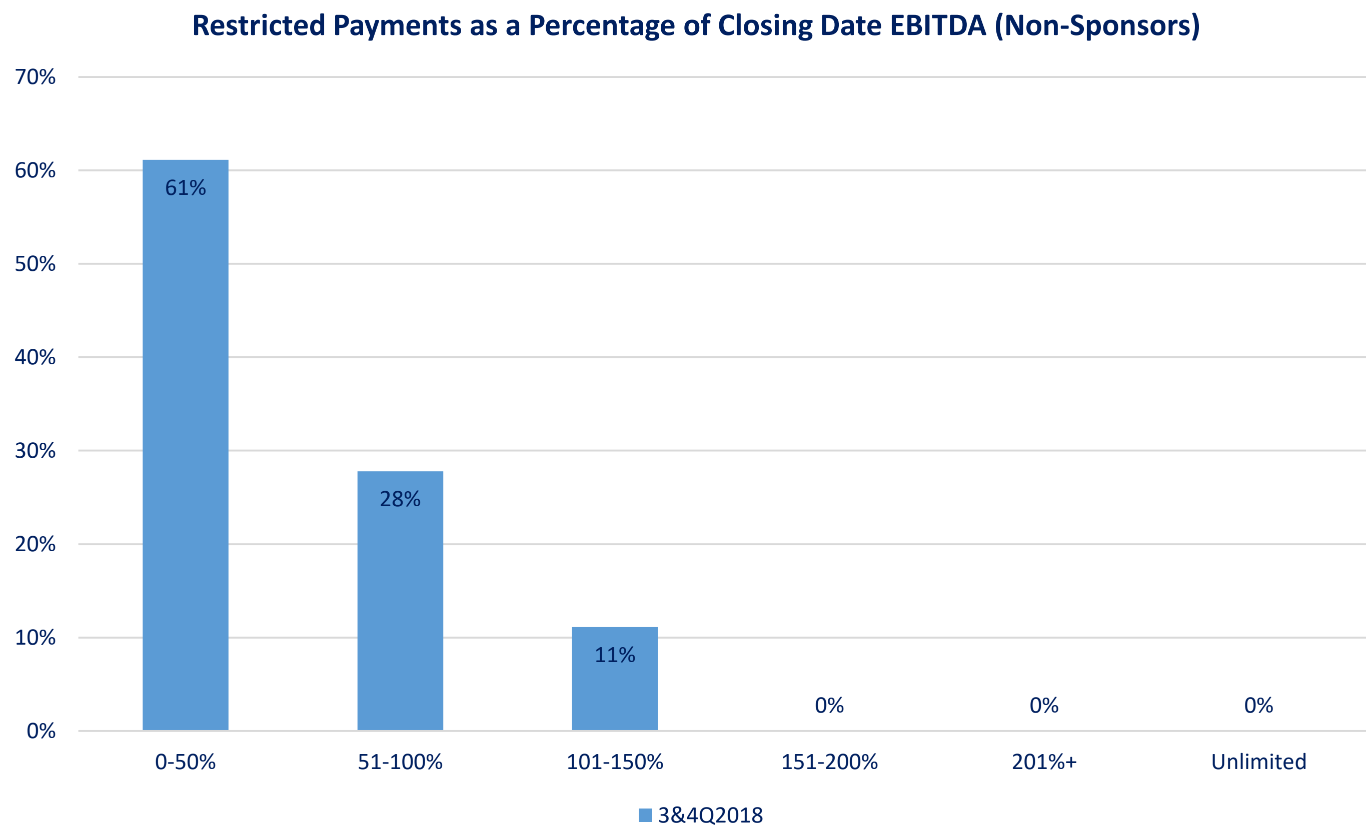

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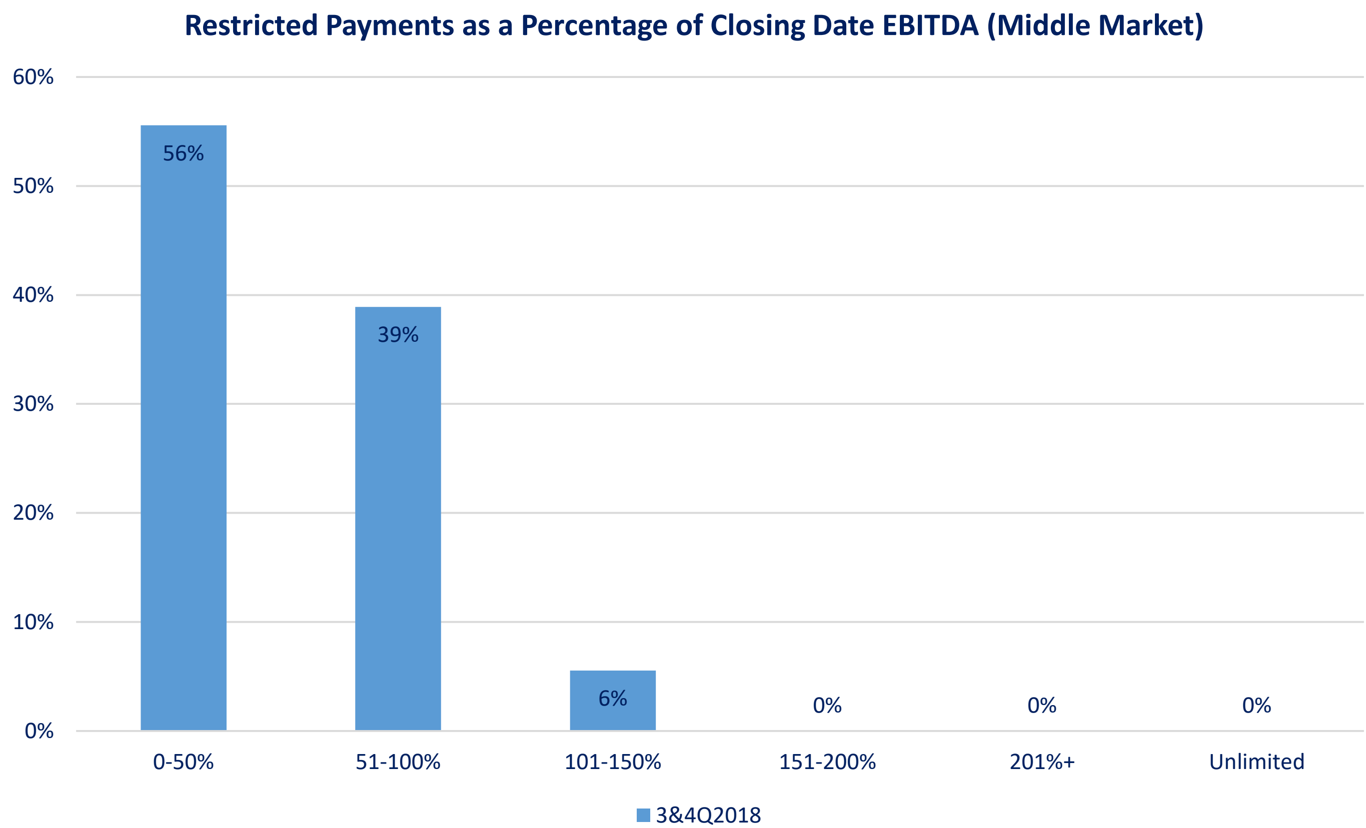
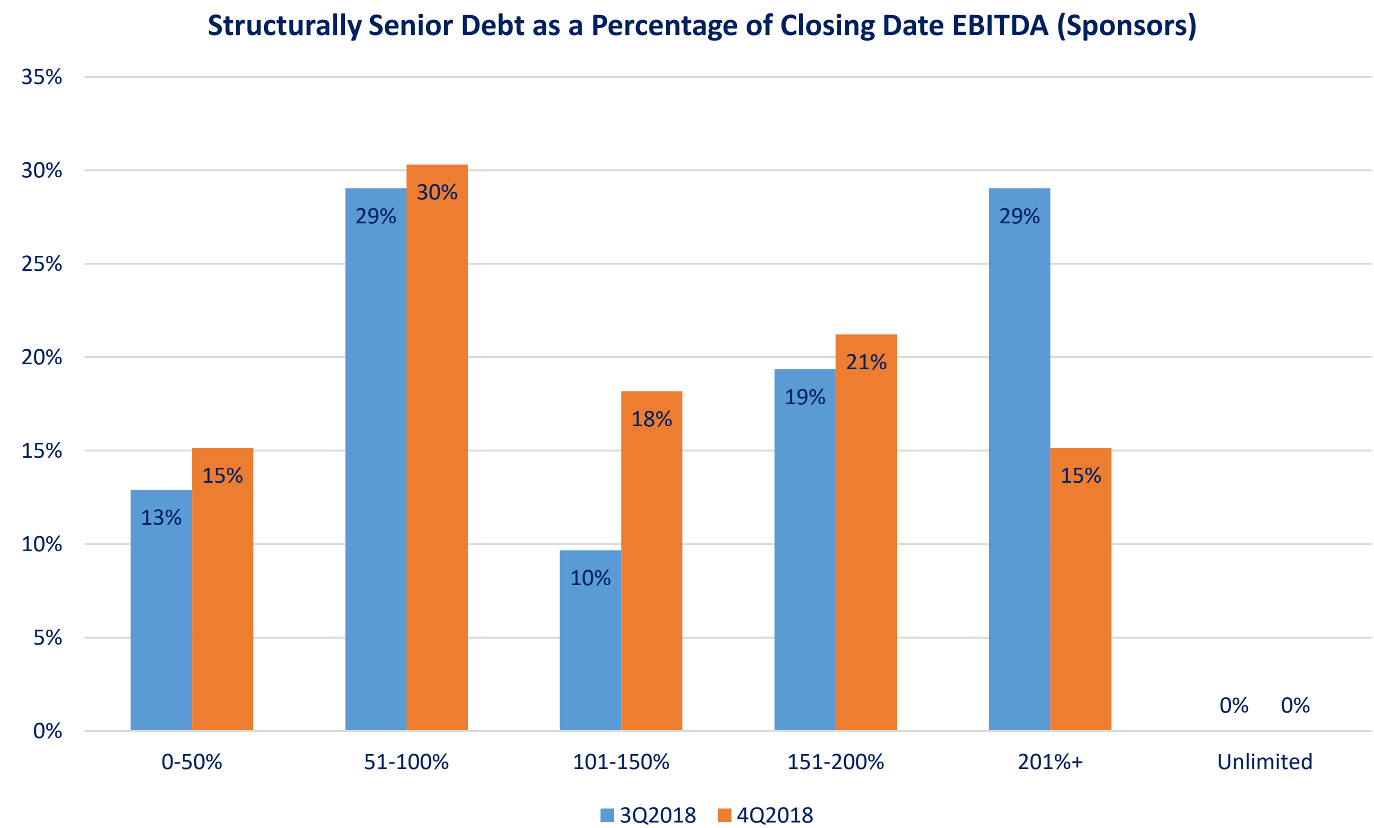


# Structurally Senior Debt



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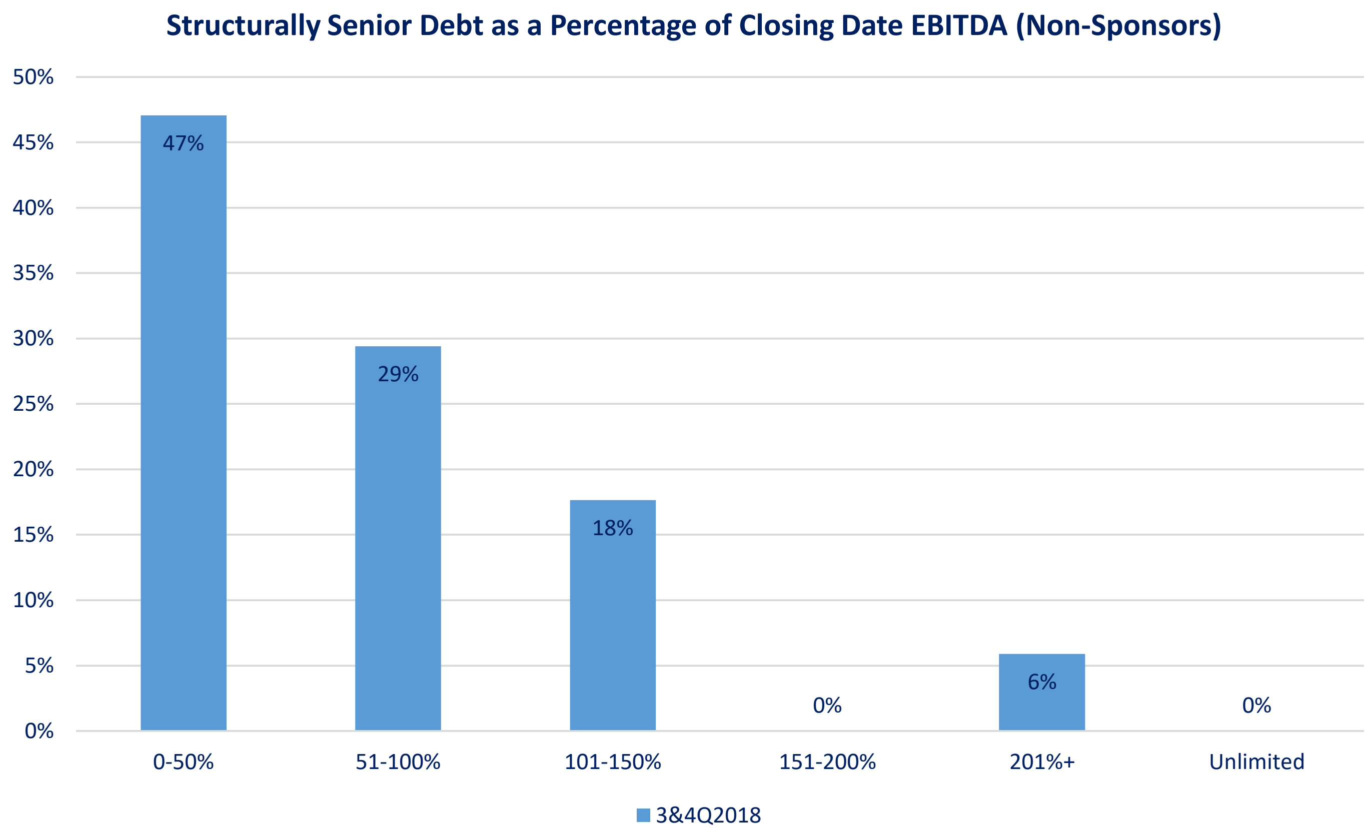

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