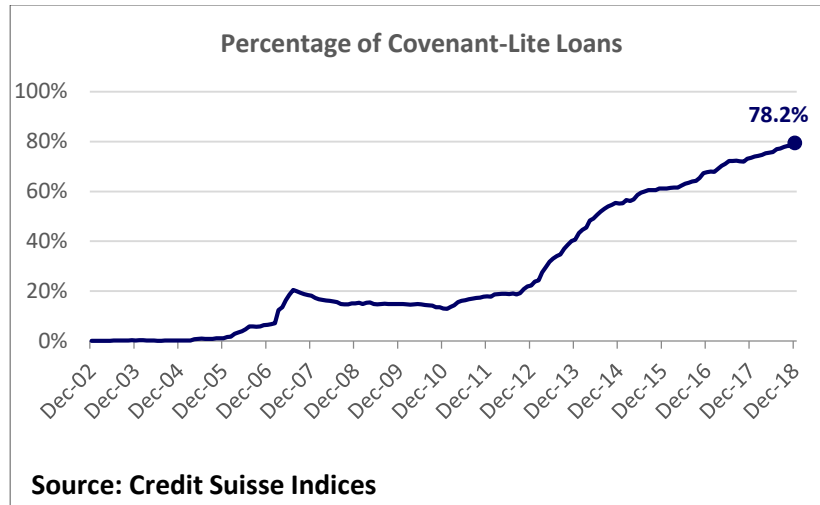


Introducing Covenant Review Documentation Scores for U.S. Institutional Loans

Over the past 15 years, the deterioration in covenant protections is the most profound—and arguably least understood—loan market theme. Unlike spreads and credit statistics, which have been subject to fundamental and technical conditions for as long as anyone can remember, tightly drawn covenants were an unwavering pillar of leveraged loans until the mid-2000s, when improved secondary liquidity and booming demand from CLO vehicles opened the door to more flexible terms. The first link in this chain, of course, was covenant-lite structures that replaced the traditional maintenance financial tests for looser bond-like incurrence tests. In recent years, covenant-lite has gone from the exception to the rule.



With covenant-lite structures now pervasive—and maintenance tests unlikely to return outside of club deals, rescue finance or, perhaps, the few regular-way deals that clear when markets are in extremis—tracking covenant trends requires new metrics that reflect a deeper look into the loan agreement to see how much, say, collateral leakage the agreement allows, or how much debt an issuer can pile onto its balance sheet without permission from lenders.

It's in this context that Covenant Review has developed Documentation Scores. The Scores run from 1 (highest) to 5 for each first-lien syndicated U.S. loan we analyze. The initial data set includes the 150 largest loans in the Credit Suisse Leveraged Loan Index as well as all new issues launched since September 2018 (Note: we plan to expand Scores to Europe loans later in the year). The Documentation Scores and Sub-Scores are derived from a combination of empirical data, qualitative factors and judgment grades from Covenant Review's legal analysts.

We will publish Documentation Score and Sub-Score in two parts for each loan:

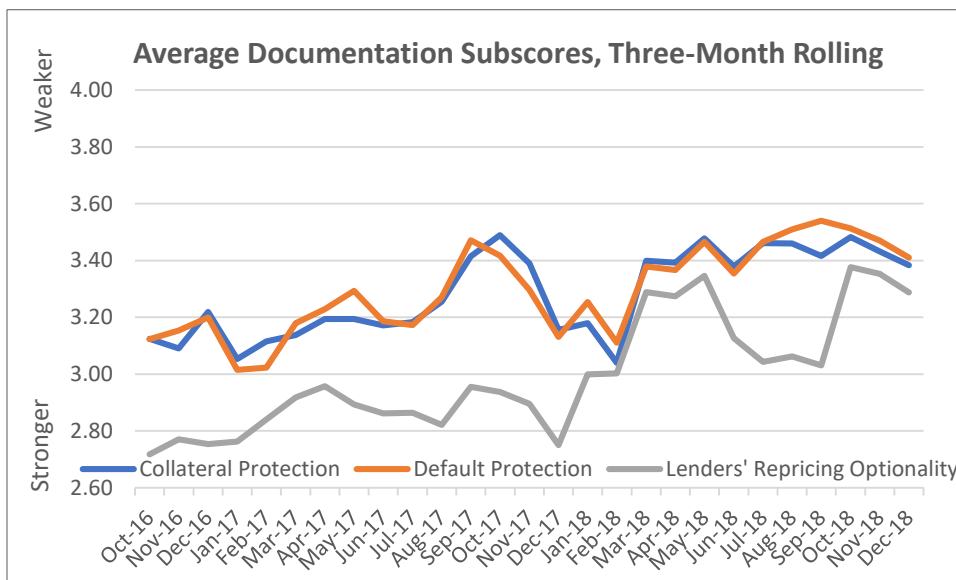
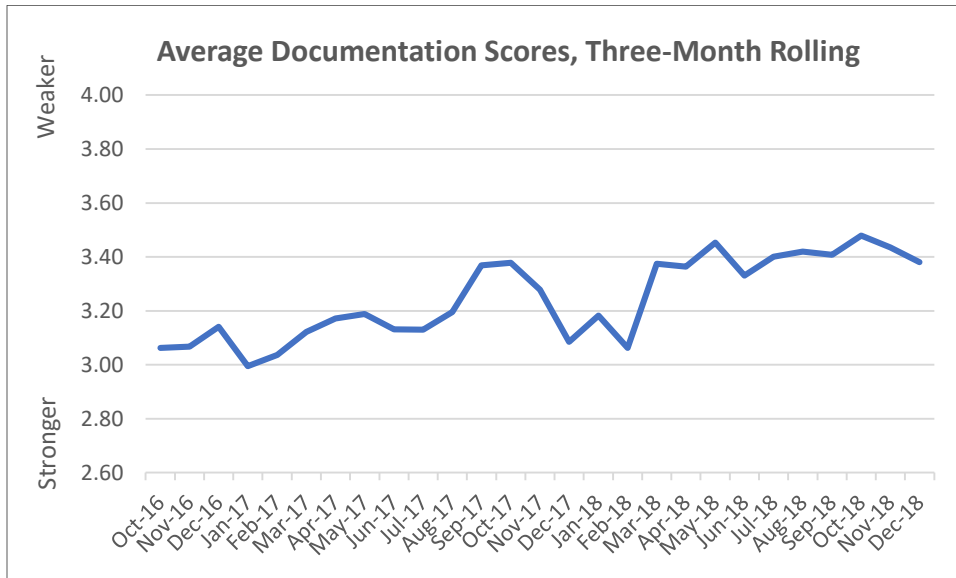
- Preliminary Scores on the draft credit agreement circulated to potential lenders during syndication.
- Final Score information based on the executed credit agreement.

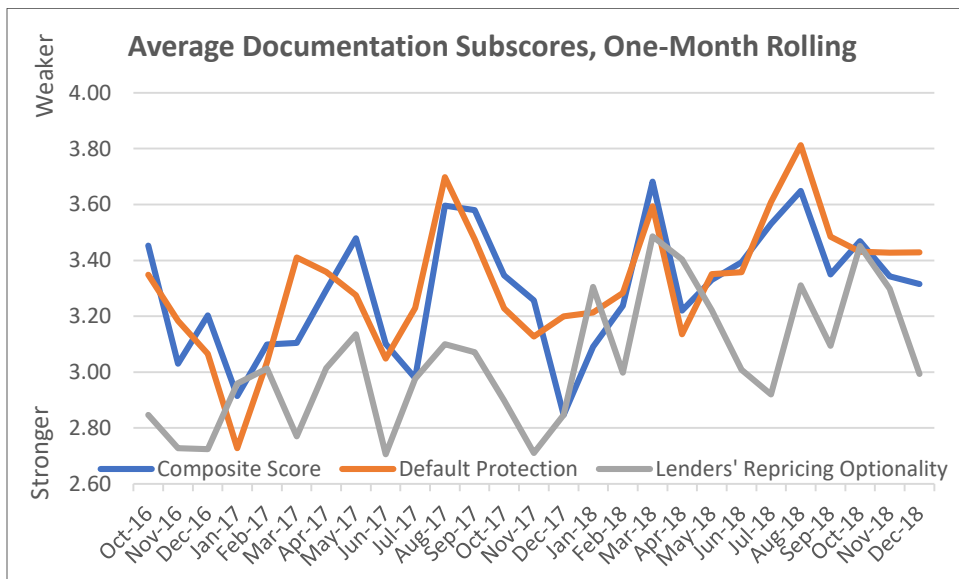
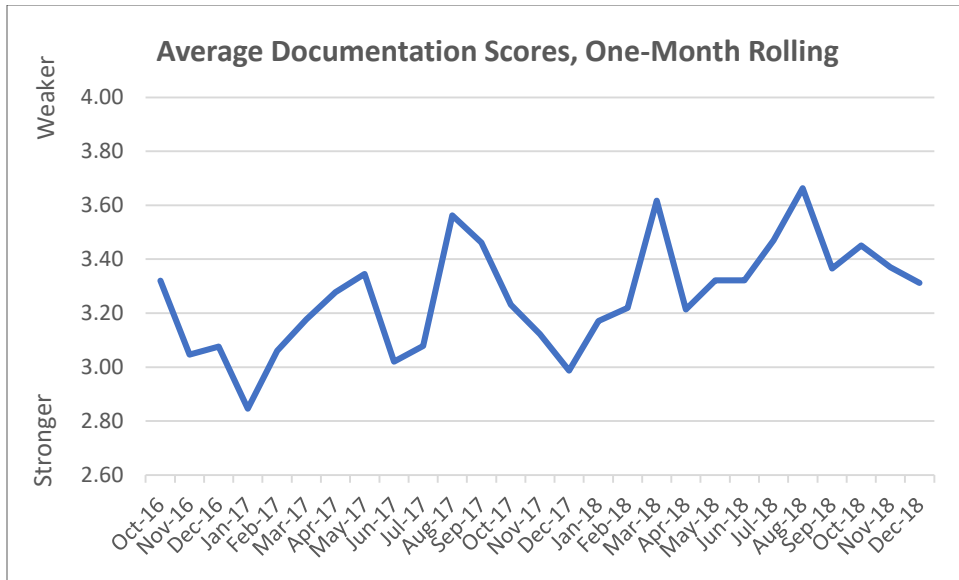
In addition to a composite Documentation Score, we provide Sub-Scores that reflect the document's efficacy in (1) limiting collateral leakage, (2) limiting the issuer's ability to put further stress on the balance sheet and (3) allowing lenders to extract additional value in the form of wider spreads or fees if the issuer's financial condition deteriorates, or it tries amend the document.

All the methodology and particulars are described in materials that can be found [here](#). In summary, Documentation Scores and Sub-Scores are a way to rank loans relative to each other. Because today's documents are structured far differently from those of the pre-2010 period, there is no way to line up the impact of particular covenant concessions on ultimate recovery rates—for that we'll need to wait until the next default cycle. As a result, we based the scoring method on expert judgment from Covenant Review's unrivaled team of experience attorneys and guidance from a myriad of market participants.

Recent Trends

These charts illustrate how lender documentation protections have trended looser in recent years until the fourth quarter's technically driven snap back.





For the full set of materials, please check the link [here](#).

Covenant Review’s loan subscribers can also access individual scores at this link.

What’s driven the recent improvement in Documentation Scores? Clearly, choppy market conditions allowed lenders to push back on some of the more heavily negotiate covenant terms such as MFN sunsets, free-and-clear incremental tranche caps and growers, asset sales sweep step downs and basket

sizes. As well, recent loans have cross the goal line with much tighter EBITDA adjustment definitions. This table summarizes the top 10 factors that drove the improvement in the scores. For a full list, please contact us.

Average Over Last 3 Months Ending			
	10/31/2018	12/31/2018	Change
Builder Basket Terms	2.5	2.0	-0.5
MFN Sunset Terms	3.2	2.7	-0.4
Mandatory Prepayment Percentage	4.8	4.4	-0.4
Starter Basket Amount	3.4	3.1	-0.3
Restricted Payments Definitions	3.7	3.5	-0.3
Restricted Payments Cap	3.3	3.0	-0.2
F&C Grower Percentage	3.8	3.6	-0.2
Basket for Unrestricted Subsidiaries	3.2	3.0	-0.2
Mandatory Prepayment Definitions	3.7	3.5	-0.2
EBITDA Adjustment Definition	4.1	4.0	-0.1

Here are a few examples of fourth-quarter loans that cleared with meaningful document improvements that moved the needle on Documentation Scores.

Borrower	Concrete Pumping Holdings		Dealer Tire		LifePoint Health	
Sector	Services		Wholesale Distributors		Healthcare	
Credit Agreement Date	11/5/2018	12/6/2018	11/16/2018	12/14/2018	11/13/2018	11/16/2018
Status	Preliminary	Final	Preliminary	Final	Preliminary	Final
Composite Score	4	3	5+	3-	4	3-
Collateral Protection	4+	3	5+	3-	4+	3-
Default Protection	4-	3	5+	4+	4-	3-
Lenders' Repricing Optionality	4+	2-	4-	3+	3-	3-
Adjusted EBITDA	4-	3-	5+	4	5+	4-
Builder Basket	4-	3-	5	4+	4	3+
Amendments	3-	3+	5	3-	4-	4-
Mandatory Prepayments	3-	3	5+	3	4	3

- Steve Miller, smiller@covenantreview.com