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You wait 12 years for loan dislocation and $1 trillion comes along all at once

by Michelle de'Souza

The waiting is over – distressed debt managers have the best entry point in about a dozen years as the S&P/LSTA Leveraged Loan Index plunged to 80 in just two weeks.

"It's the fastest and most breathtaking drop in the loan index," says Steve Ketchum, founder and chief investment officer at Sound Point Capital Management, of the 18% drop in the index. "Even in the 2008 crisis, the drop in loan price was spread over a significantly longer time period."

Ketchum: 'It's the fastest and most breathtaking drop in the loan index'

Around $140 billion out of the $1.2 trillion leveraged loan market was trading below 90 at the end of 2019, sources say. That made up around 11-12% of the leveraged loan market. "There wasn't a huge opportunity set, but still plenty of work to do. Several of those names were in the energy sector – and we weren't really keen to make energy bets," Ketchum explains. In early March that figure doubled to around $287 billion and as Creditflux goes to press it has escalated to around $1 trillion of loans trading below 90 cents.

"Now is a great time to make equity-like returns of around 20-40% IRR, for the first time in 11 years," says Ketchum. "The sheer size of opportunities will be greater because of the explosion in the volume of broadly syndicated loans."

The timing couldn't have been better for Sound Point, with Creditflux reporting last month that the New York-based firm launched a distressed debt fund focused on sub-90 cent loans.

Several other market participants are looking to cash in on the volatility. "Quite a few debt managers have come to us to pursue extremely short fundraises with short investment periods, rapid realisations, sometimes with traditional economics and sometimes with lower management fees and higher carried interest, in order to take advantage of this dislocation," says Jessica O'Mary, partner at Ropes & Gray. "Some LPs are also looking to gain distressed or opportunistic exposure in something they can invest in the market rapidly because they see short and long-term opportunity."

Distressed managers are not only targeting companies negatively affected by covid-19, such as airlines, hotels and cinema chains. They are also eyeing up credits that have benefited from the aftermath.

"We are looking at a US-based cable television company that has benefited from this volatility," says one New York-based fund manager. "People are at home in quarantine watching CNBC or Netflix – and the loans are now trading in the low 80s."

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