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A Year in Review (First of a Series)

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The notion that the middle market has reached a level of maturity was supported by a plethora of evidence this past year. For one thing, arrangers showed astonishing underwriting capacity by taking on a number of large-cap sponsored buyouts. Probably the most precedent-setting was *Qlik Technologies*. At just over $1 billion, this Ares-led unitranche represented a genuine "shot-across-the-bow" to traditional investment banks whose province is typically the mega-LBOs.

But Qlik was hardly alone. Other large unitranche executions included Golub's *Marketo* ($400 million), *SRP Companies* ($303 million) and *Ansira* ($300 million) – both by Antares, and *QualaWash* ($250 million), co-led by Carlyle, Antares and Madison Capital.

The other remarkable attribute of these deals was that they were not distributed widely in the manner of most broadly syndicated loans. Instead, arrangers and sponsors selected a discrete group of lenders, mainly non-banks, to form the underwriting club. Each of these lenders have amassed significant side pockets of capital that permit them to comfortably hold well over the $40 million or so the bank crowd typically retains.

This "cargo pants" strategy (as we've dubbed it) has turned loan syndications on its head. Instead of slicing up smaller pieces for pure buy-side shops, middle market arrangers are feeding them to their self-controlled funds. Golub, for example, has honed this technique to a fine art, allocating loans amongst a large number of vehicles including its own BDC, CLOs, and separate managed accounts.

That has allowed the mid-cap lenders to speak for well north of $250 million per deal. The effect of this for issuers and private equity sponsors is a dramatic enhancement of the traditional distribution practice. Instead of being subject to such market-driven elements as pricing flex, intercreditor agreements, and syndication timetables, clients minimize execution risk. These "distribution-less" syndications allow PE buyers to compete effectively in auctions against cash-rich strategics whose bids carry few outs.

The other trend that accelerated during 2016 was the alignment of direct lenders with other asset managers in the form of joint ventures and/or partnerships. For those managers who otherwise lack the origination capability or credit underwriting experience it provides access to the middle market asset class. For lenders, it gives them a larger virtual balance sheet and enhanced fee income. Examples include Solar Capital/PIMCO, TCW/Security Benefit, and Medley/Great American Life.

This arrangement has also afforded more lenders to offer unitranche solutions. Whether in a first out/last out "agreement among lenders" version (e.g. PNC/Cerberus) or a strip through the entire tranche (Antares/LoneStar), this one-stop option is a permanent fixture in a growing number of the largest financings in the middle market.

Next week we look closer at the issue of middle market supply and demand.