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A Year in Review (Second of a Series)

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Along with the sense that mid-cap lenders can now more than hold their own against the largest investment banks in terms of deal size has come a predictable question: With all the lending capacity that's now available in the middle market, isn't there too much cash chasing too few deals?

A long-time middle market practitioner took on the "overheating" worry with us recently. "Honestly," he remarked. "When do lenders *not* complain about too much cash chasing deals? You hear that every year. Yet everyone always seems to find enough good deals to work on and comfortably make their budgets."

He went on. "Banks are increasingly disintermediated from leveraged lending. That's a lot of capacity leaving the market. And it's not over yet. Plus a lot of the funds being raised today are for higher yielding vehicles, such as private BDCs. They need 8% yields at the asset level. That's not the first-lien cash flow middle market loans that comprise most of sponsored volume.

Another private credit chief agreed. "People confuse 'stock' of dollars raised with 'flow,' he said in a recent *Lead Left* interview to be published later this month. "We've raised $5 billion of capital for our direct lending business. That's what the Preqins of the world report when the data is published. But $4 billion of that is capital already deployed. Our flow is the $1 billion private BDC that's true dry powder. So I believe a fraction of the numbers being advertised are actually soaking up deal supply."

Understanding the nature of the loan data is also critical to accurately sizing the market. For example, loan participants had been told by various reporting agencies that middle market loan volume was off quarter over quarter as 2016 progressed, and also lower than 2015's level of activity. Yet our experience reflected a steady flow of transactions all year long. What accounted for the discrepancy?

It's likely the difference comes from the way deals are now distributed, and thus reported, as we discussed last week [link]. Rather than middle market banks syndicating loans advertised in the "public" data, more financings are bought-and-held by private lenders. These numbers don't always show up in the usual flow.

Efforts are underway to remedy this. Thomson Reuters LPC has been collecting private sponsored deal data from the club lenders for several years now, and the results are instructive.

According to LPC, roughly 52% of middle market sponsored volume in 2015 was reported as syndicated, while private deals comprised the 48% balance. The private deal share of sponsored issuance grew to 53% in the first three quarters of 2016 while only about 47% was syndicated.

We'll report on the full 2016 private deal data when they are published. Suffice it to say there's more going on in the world of cargo pants lending than meets the eye.

Next week we examine the quality of middle market deal flow last year