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Lead Left Interview – Mitch Drucker

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This week we chat with Mitchell Drucker, Managing Director of Garrison Investment Group. Mitch is the head of Garrison's corporate lending team and is responsible for transaction origination, analysis and execution. He has more than 30 years of experience in the lending business and formerly served in various positions at CIT, presiding over a team of more than 200 professionals. Founded in 2007 Garrison is a middle market credit and asset based investor headquartered in NYC.

The Lead Left: Mitch, it's been a while since we sat down for a Q&A. Catch us up on Garrison.

Mitch Drucker: This is the 10 year anniversary of our funds and we now have about $3.5 billion assets under management across our three business verticals: corporate finance, real estate, and financial assets. We participate as the agent or in club deals between $10 million and $100 million in size. Half of our team has an ABL background which we view as a big advantage. Our leads often come simultaneously from sponsors and bank ABL groups and we are able to offer bifurcated, split lien structures.

We also have the flexibility to engage in larger club deals in the $100 million to $300 million size range due to the strength of our capital markets relationships. In fact, as we await a pickup in lower middle market sponsor volume, we've seen better relative value in the larger market. When we see nuanced credits in the upper middle market, we are flexible and we view that as a key differentiator for us. For example, we can target a 7%-8% yield in transactions not being financed by the CLO market. What makes this deal compelling is a sound structure with low loan-to-value levels.

TLL: You mentioned ABL/Term Loan splits. Could you give us more color on those structures?

MD: We participate in bifurcated structures where a bank provides a revolver against current assets while Garrison executes the term loan with a first lien on the balance of the assets. We have significant partnerships with some of the key asset-based lenders, including Wells Fargo, PNC, B of A, JP Morgan, and Capital One, and these structures represent a significant portion of our deal flow. A bifurcated deal structure is attractive to both lenders and effectively brings down the cost of capital to the borrower, by blending the higher yield of the term loan and the lower yield of the ABL facility. We rely on the overall enterprise value of the borrower to ensure interests are aligned in these types of structures.

TLL: What kind of industries do you like or dislike?

MD: We're obviously concerned about industries in secular decline, such as hard copy media and printing. We're also skeptical about new age technology and internet advertising companies that rely on internet positioning or are paid by the click. Highly regulated industries, such as for-profit education companies or cash flow deals in the retail and restaurant sectors, are also areas in which we tend to not participate.

We like business services, light manufacturing, software, healthcare, and consumer branded companies. Our underwriting across all industries takes into consideration how these companies will perform if a recession hits in the next 12 to 24 months.

In addition, we have an opportunistic side of our business, coupled with our ABL backgrounds, that allows us to participate in select opportunities to provide rescue or DIP financing against inventory and other valuable assets within retail.

TLL: What about healthcare?

MD: We currently have borrowers in certain areas within healthcare, including medical and surgical supplies arena, diagnostic lab testing, hospital and outsourced care sectors and a distributor of oxygen tank services to nursing homes. However there are an abundance of divisions within the industry and we cautiously underwrite any potential deals. We tend to avoid businesses reliant on third party government reimbursement that may result in a binary outcome for the lender.

TLL: What's your overall assessment of market conditions?

MD: For the last six months, it's been about too much dry powder and not enough deal flow. Over 100 different funds have raised money in the direct lending space over the last 24 months. At the same time sponsor volume declined due to uncertainties related to the commodity markets, Brexit and the election. On the whole, structures have become too aggressive and spreads have tightened to unreasonable levels. We've seen this story before in 2006 and 2007 and believe there will be a shake-out of funds during the next downturn.

New sponsor volume is starting to pick up here in the second quarter, but my sense is that it will continue to remain incredibly competitive to win new mandates. Currently, we are seeing more activity in our restructuring and rescue financing business. This is not surprising as the economic cycle has been elongated and the volume of leveraged loans outstanding has more than doubled from $400 billion in 2007 to near $1 trillion today.

Direct lending is not one monolithic market; it's very fragmented. While we occasionally participate in deals up market, we still believe that the lower middle market provides the best opportunity from a risk-return perspective because there is less competition and more inefficiencies than in the larger markets.

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