THE LEAD
https://theleadpc.com/ways-of-the-lender/

Two Way Street

THE LEAD | May 17, 2017

"We can do this the easy way or the hard way."

"What's the hard way?"

"It's harder. It's harder than the easy way. That's what I know."

This classic exchange between Benicio Del Toro and Alicia Silverstone in the otherwise forgettable 1997 comedy *Excess Baggage* came to mind as we followed recent developments in the leverage loan market. It's often a puzzlement how middle market arrangers assess the best way to get transactions safely through the distribution process.

One shift this year has been increased receptivity of larger midcap credits by institutional buyers. Last year arrangers used their burgeoning capacities to commit and hold more dollars to underwrite financings. Today investment banks are fighting back by offering sponsors the so-called benefits of a syndicated process.

This trend is in part thanks to fewer buyouts in the broadly syndicated space. It's also exacerbated by large cap liquidity that has caused those spreads to contract, making middle market all-in yields even more attractive.

What's far from clear is whether the easy way of "going wide" to meet institutional demand is the best way to manage middle market loan distribution. For one thing, those investors don't typically play in smaller deals. The nature of middle market credits – private, illiquid, and unrated – demands a different set of disciplines to be successfully managed than retail funds expect.

While most sponsors appreciate the pitfalls of syndication, some do not. The allure of "big boy" terms that afford smaller credits greater flexibility may fade in a downturn. As we saw in 2009 when investors rush to the exits, loan values plummet. Accounts accustomed to selling when they need to, can't. That means private equity must replace lenders when obtaining new capital is the toughest.

There's also a cost to having funds in your lender group who trade on rating (when it's available) and price. Familiarity with middle market credit agreements is less, creating complications when the issuer hits a speed bump.

Middle market managers are congenitally disposed to own a loan through maturity. That enforces behavior aligned with the sponsor. Having a deep understanding of the company's strategy and what could go wrong is critical to a constructive lender/borrower relationship that enhances enterprise value.

Leading midcap arrangers recognize that, to compete effectively with investment banks, they need the tools to toggle between syndicating and clubbing larger loans. Unlike the banks, however, they are also asset managers with a fiduciary responsibility to create long-term value for their investors. Any other way to incorporate asset distribution strategies will end up being the wrong way.

Attention investors! As a proud managing partner of the Creditflux Private Credit Conference on June 21 in New York City, we would like to offer on behalf of Creditflux complimentary tickets to all investors. Please click here to apply.