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That’s Why It’s Called a ‘Market’

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F. Scott Fitzgerald wrote, “The test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function.” For observers of the capital markets, this quote is especially apt.

Today’s cross-currents are bewildering. Unemployment is up, yet the number of people finding jobs is also up. The economy is strong, yet recession worries persist. The Fed has thrown in the towel on rate hikes for the foreseeable future, yet some predict at least one more this year.

Through mid-January, junk bonds endured 40-plus days of zero issuance – the longest dry spell in over a decade. The media had fixed income dead and buried.

Yet three weeks ago, the primary flow spigot opened wide, particularly for secured instruments. As loan pants have lost their crease, thanks to continued fund outflows, recognized names such as Dun & Bradstreet and Commscope shifted more of their debt structures to bonds. TransDigm elected to go exclusively with junk.

As one astute big-bank analyst pointed out, this is neither unexpected, nor a knock against leveraged loans. That’s just the way efficient markets work. If one alternative sports better terms, it doesn’t mean others are dysfunctional or doomed. Capital can walk and chew gum at the same time.

On the other hand, some ideas are not contradictory. In the middle market we’ve noted the growing capacity of direct lenders with large holds. Private equity sponsors are increasingly relying on them as a way to circumvent the uncertainties of the syndication process.

One top-tier PE shop we know has closed over forty financings in the past couple years. Only two or three were via a bank syndicate execution. That is not unusual. According to our friend Fran Beyers at Refinitiv, more than thirty-four lenders can now commit and hold $100 million or more per transaction.

But the real headline is that at least eight of these firms can hold *$200 million*. Assuming four-times ebitda senior leverage, that points to a $50 million issuer – the higher end of the middle market range. Sponsors are unlikely to rely on only one lender. They can assemble a tight club, each lender with multiple cargo-pants pockets of capital. No flex, no market outs. Easy to see why the non-syndicate route is so popular.

Are there any advantages with institutional buyers? In seller-friendly times, you can get aggressive terms, such as cov-lite and higher leverage. Pricing can also be tightened for the better rated credits. Some sectors like aerospace, gaming and mining are more the province of banks than direct lenders.

But the days when mid-cap sponsors choose to syndicate as the default option are over. As the direct lender arms race for hold levels continues, the definition of a “club” deal is moving higher. Perhaps first-rate market intellects will soon entertain the notion of a broadly clubbed loan.