Lead Left Interview – Tom Lesch (Part 2)

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This week we continue our conversation with Tom Lesch, Director, Livingstone. Livingstone is a global M&A and debt advisory firm with six international offices including Chicago. Its core industry sectors include Business Services, Consumer, Healthcare, Industrial and Media & Technology. ***Second of two parts – View part one***

The Lead Left: Last year we saw how the OCC's Leverage Lending Guidelines affected the market, do you see something else out there that could impact lenders?

Tom Lesch: The OCC's guidelines impacted commercial banks and their ability to finance sponsor cash flow deals. Although ABL deals are not counted in the HLT buckets, what if the OCC required that ABL transactions would also qualify for HLT's?

TLL: What could that mean for borrowers?

TL: ABL deals typically price in the L+150-L+ 250 range. Generally only Commercial Banks can afford to play in this game due to their lower cost of capital. What happens if deals that were financed cheaply with ABL debt are forced to find alternative lenders? Unitranche pricing is generally 3x more expensive than commercial bank ABL pricing. The increase cost to service the loan would likely be too difficult for the borrower, which would cause a significant problem.

TLL: Lets hope that doesn't happen.

TL: Agreed, the impact of that would be far greater than what we saw where alternative cash flow lenders stepped in when commercial banks pulled back from cash flow loans last year. Again that is just a hypothetical, and the OCC thus far is fine with properly structured and monitored ABL credits.

TLL: What's your view of the high purchase price multiple environment PE buyers are complaining about?

TL: We have seen lenders remain very accommodating of large purchase price multiples. Keep in mind, the commercial banks who traditionally haven't been as accommodating to these multiples are no longer as prevalent in this space. As long as debt remains less than 65% of capital structure, there are options out there.

TLL: What has surprised you most?

TL: Even in this hyper aggressive market, we have seen macro factors disrupt the markets. Take the second half of 2014, this was the first time in three years that we saw lenders retreat. The combination of commercial banks interpretation of the OCC's leveraged lending guidelines, coupled with several BDC's pulling back due to Net Book Value issues caused the 4th quarter of 2014 to move back towards the lenders favor. However, the lack of volume in Q1 2015 caused the market to snap right back.

TLL: As an advisor how do you navigate this?

TL: This is where our value really comes in. We are in market with several deals across various capital structures and this real time intel equips us the knowledge of where the markets are moving. In addition to the knowing the markets, we also advise our clients select a lending partner that is built for the long haul.

TLL: Certainly, because as we saw in the downturn, a problem with a lenders capital base usually causes a problem for the borrower.

TL: Exactly, given the lender/ borrower relationship is a partnership we advise our clients to select a partner who understands their business, but also we look for lenders that have stable management and a capital base to support our borrowers.

TLL: What's the outlook middle market borrowers?

TL: With the supply of debt capital available, I see this environment continuing for the foreseeable future. There are excellent opportunities for small to midsized private companies seeking financing options as lenders compete for their business.

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