ACG® Philadelphia

# Annual M&A Lenders' Panel

By Robert Jaffe, Director of Business Development, Baker Tilly Virchow Krause, LLP

Setting the table for the next 50 minutes, **Stefan Shaffer**, Founding & Managing Partner of SPP Capital Partners and moderator of the Annual M&A Lenders' panel highlighted that the current recovery has lasted 118 months from the end of the Great Recession in June 2009: "I'm not saying we are on the precipice of a recession, but I think a lot of lenders are looking at a potential downside…."

### Featured Speakers

- **Bob Kane,** Market President, Key Bank
- **Hardeep Saini,** Managing Director, AB Private Credit Investors
- **Anne Vazquez,** Partner, NewSpring Capital

### Where Are We in the Credit Cycle?

**"**I do think we are towards the end of [the cycle], I just don't know when" stated **Anne Vazquez**. "Twelve to 18 months ago sponsors seemed to be less selective in the deals they were going after. Now however, economic cycle considerations are in the forefront of the conversations however, I have not seen these considerations necessarily reflected in a more conservative capital structure

**Bob Kane** agreed that "we are late in the credit cycle" Rather than holding assets on the balance sheet for growth, the leveraged lending group underwrites larger credit transactions then syndicates the loans into the broad market, with a high percentage being sold to non-banks. Why the change in strategy? At the higher end, for a $50 million EBITDA borrower, a "blip" could cause a big problem for a bank, and the non-bank market has a big appetite for these assets.

### Rise of Independent Sponsors

The types of the Independent Sponsors in the market are extremely wide and varied.

**Stefan Shaffer** characterized the rise in Independent Sponsors as tremendous. There are more "Institutionalized" Independent Sponsors in the market - firms that have been around for 15 to 20 years, have offices, and have go-to partners on the equity capital side. On the other end there are sponsors that still have a full time job and are trying to launch a fund on the side.

At AllianceBernstein's direct lending platform, the first thing **Hardeep Saini** evaluates is the credit; and then it becomes a time and resource allocation decision. **Bob Kane's** biggest concern is where the capital or equity will come from in the event of a capital need. Leverage has to be lower because there may often be a "bump in the road." NewSpring focuses on the company and partners; and overall alignment relative to risk and dollars invested.

**Non-Bank Lending Community**

The non-bank lending community represents a big chunk of the market. **Hardeep Saini** believes that institutional investors and a broad investor base understand that this asset class has a very good risk-adjusted return, and thus has attracted a lot of capital. Investors are willing to give up some liquidity for premium, and when looking at historical defaults and losses, the asset class has performed pretty well. Has this asset class lived through a true down-cycle? **Hardeep Saini** believes it has performed well.

**Next Big Problem**

The banking market has changed. Banks are no longer holding highly leveraged loans like they were in 2008. Today, increased leverage guidance from the OCC, and adherence to the “3 x 4 leverage box” keeps traditional banks disciplined. **Bob Kane** noted that non-performing loans have gone down since Q3 of 2018. When banks do not see upside on those Criticized Assets, they will sell them since the market is very liquid.

Will those covenant-lite, no amortization leveraged loans be the next area of the big toxic asset? **Hardeep Saini** does not disagree that there are more of those lenders out there and some in the community have higher risk tolerance from a covenant perspective. Lenders must be able to get management to the table if problems arise, and that requires establishing appropriate control when drafting the documents.

**General Market Conditions**

Several indicators cause consternation for market participants. The Russell 2000 companies as a group have ballooning debt level trends that outweigh EBITDA generation, and the definition of EBITDA seems to include more addbacks. Is the market at a point of inflection? Market participants observed that in Q1 of 2019 buyers have started pushing back against loose terms. Deals are getting wider priced, and some sanity is prevailing. At least in Q1, the lower end of the market seems not to do covenant-lite transactions.

Still, the market is hyper competitive and PE firms have a lot of capital to deploy. At the lower end of the market, in some cases, the panel is seeing that PE is putting more capital into the deal if they want to win it, and that works to the advantage of traditional banks.

**Deal Flow**

US institutional leverage loans are down 40% YTD according to LCD. **Hardeep Saini** found that 2018 was a record year from deal origination and capital deployed for his platform. In general, certain industries, such as technology, software, healthcare, business services represent a significant percentage of deal flow, whereas industrials and manufacturers have been very slow, and sponsors are being cautious in those sectors too. Change in multiples? Not for good deals. Sponsors are still “paying up” because there is a lot of capital.