THE LEAD
https://theleadleft.com/lead-left-interview-m-grier-eliasek/

Lead Left Interview – M. Grier Eliasek

THE LEAD | December 3, 2014

This week we speak with M. Grier Eliasek, President and Chief Operating Officer of Prospect Capital Management. Prospect is a $7+ billion AUM leading provider of flexible private debt and equity capital to sponsor and non-sponsor owned middle market companies.

The Lead Left: *Grier, is it my imagination or is a lot of capital coming into the middle market space?*

Grier Eliasek: Randy, there's definitely an influx of new capital coming into the private illiquid loan space. There are at least three reasons for that. First, there's been a real increase in the listed BDC market place. When we went public ten years ago, there were only a handful of BDCs. Now there are over thirty. Second, there are a number of non-traded BDCs coming to market.

TLL: *Is that unusual?*

GE: They are outraising the traded funds by almost 2:1 year to date. That's an unusual trend in a non-recessionary environment. Third, you're also seeing a lot of private funds bringing senior lending capabilities to market, many of them leveraged. That all adds up.

TLL: *What else are you seeing?*

GE: One dynamic is a movement away from bifurcated loans. It's all-senior with very few junior capital components. And of course there's spread compression, probably as much as 200 bps over the last two years.

TLL: *Is that the case more at the upper end of the middle market?*

GE: The upper end is changing. We are seeing competition in the up to $50 million deal sizes, but when you get over $50 million deal sizes, it's less competitive because few lenders can hold that much capital in one place. Our deal sizes often range from $50 to $300 million, and we win business based on the ability to hold larger sizes.

TLL: *Particularly unitranche.*

GE: We don't call them unitranche. "Uni" implies one structure, but they get sliced and diced so many ways. We prefer the term "one-stop."

TLL: *How are risk retention rules impacting the market?*

GE: The regulators are scrutinizing the underwriting of traditional syndicated loan arrangers. There's an opportunity for BDCs like us to take advantage of that and to take share at the upper end of the market. CLOs are holding around 60% of all syndicated loans, so CLO buying power will likely be curtailed through risk retention. Think about earning a 50 bps management fee on a $500 million CLO.

TLL: *$2.5 million.*

GE: But if you have to write a $25 million check, think about the economics – that's ten times the annual management fee. Some well-capitalized managers can do that, but smaller ones can't. It will take two years for the risk retention rules to kick in, but over time loan spreads should rise as new CLO formation constricts.

TLL: *What about the supply side of the equation?*

GE: We've never had a problem originating. Deals are out there. We look at 3,000 to 4,000 deals per year. Our close rate is 1% to 2%. But that requires us investing in a significant sized team. Smaller lending groups will be more subject to commoditization. We just eclipsed 100 people at Prospect.

TLL: *Are you seeing a slowdown in your pipeline, given that M&A and refinancings are off?*

GE: The macro issues haven't impacted the micro for us, and we're seeing plenty of deals. From a pricing perspective when one weighs supply and demand in our market, it's misleading to say someone can earn outsized market spreads over time. You're probably taking way more risk, and risk control is critical in our business to have staying power.

TLL: *Is most of your business sponsor-driven?*

GE: We're different from other BDCs that are mono-line businesses solely focused on sponsor finance. Sponsor finance is about 50% of our overall business. We also get involved in one-stop buyouts (managing for yield), CLO equity investments (where we're the largest buyer in the US market), real estate yield investments, online lending, and aircraft leasing.

To be continued the week of December 8

Contact: Grier Eliasek
grier@prospectstreet.com