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Markets at the Midpoint (Last of a Series)

THE LEAD | July 27, 2016

The setting was Arlington Park, a storied horse racing venue about a forty-five minute Uber ride northwest of Chicago. We had just lost $50 on a "sure thing" in the 5th race, though we should have been suspicious with a horse named *Diminishing Return*.

The summer gathering there was hosted by one of the leaders in middle market finance, and has always been a superb way to hear what's going on in the minds of industry players. It turns out bankers' views of market activity mirrored the action on the track – periods of inactivity punctuated by brief cheering and ticket shredding.

"Things are definitely picking up," one participant commented, "especially over the past few weeks. But it remains competitive. We see properties with sponsors in the early stages of auctions where leverage is being pushed. Some businesses can handle six times [total ebitda] or more, but others can't. That's where our focus is."

How about senior leverage? "Around four times, give or take, for good credits," another top capital markets veteran said. "But on what ebitda? Is it pro-forma, adjusted, run-rate on quarterly numbers? That's more important than the leverage multiple."

That sentiment was echoed by others as well. We chatted with a top arranger as they cashed in their trifecta winnings. Are we in for a more sell-side friendly market?

"For some credits, yes," he answered. "Particularly with proven track records and good sponsors. Deal flow is better than it was, but that's relative to a weak first quarter."

Is the pipeline building, we asked? He nodded. "We're working on a ton of sponsor bids, but the hit rate isn't great. Plus there are so many financing options for them to choose from. Unitranche, stretch senior, even second lien is available at a price. And if someone wants to throw a bit more leverage at a deal, they can and will."

How's pricing holding up? "At the moment, pricing is still in a range around L+500," he reported. "To some extent, that's thanks to the banks stepping away from leverage loans. It's also due to sponsors being willing to accept more coupon for certainty of execution and locking in their relationship lenders. There's a cost to doing that, but sponsors accept that, up to a point."

We asked a number of lenders how the post-Labor day calendar was shaping up. One market leader said they had a number of transactions on the runway for early September. But there's still caution about being too aggressive on underwritings. "You don't want to be long with limited visibility," they said. "We've seen how markets turn on a dime. If we hit an air pocket like we did last August, you could be wearing paper."

But a big difference between bank and non-bank arrangers is the latter doesn't need to distribute paper. If the market backs up, they don't mind holding a good asset at a reasonable yield. That's creating a horse race in which non-banks have a growing, and perhaps unbeatable, advantage.