

MEZZ LENDERS SQUARE OFF

by Ken MacFadyen



Lawrence Golub

The mezzanine market has been besieged in recent years with hedge funds, new BDCs and the traditional mezzanine firms all fighting for the same spot in the LBO capital structure. It should not be at all surprising that as these groups jockey for position some lenders might step on the toes of others.

Golub Capital is one incumbent mezzanine player that has been unabashed in taking aim at the competition, publishing advertisements that portray many of its rivals in the mezz marketplace as deal poachers or even weasels. In one memorable ad, Golub eschewed the

traditional tombstone placement for a basketball motif that listed the firm's "stats" as 10 assists and zero steals—the implication being that Golub won't encroach on the terrain of the equity sponsors.

Lawrence Golub, the president and founder of Golub Capital, describes the ads as "lighthearted," saying they are designed to "poke fun at every lender that competes with its clients."

While he won't explicitly cite the business development companies or hedge funds as among the targets of the ads, the insinuation is clear that the two groups would fall within Golub's definition of deal poacher if one were to connect the dots. Public BDCs such as **American Capital Strategies**, **Gladstone Capital** and **Allied Capital** have consciously transitioned themselves to pursue buyout transactions, and few know for sure whether or not the hedge fund lenders will make a similar transition should the financing market turn.

It's this alleged hat-switching that Golub wants to call attention to.

"You won't find Coca Cola Corp. serving Pepsi in the company cafeteria," Golub says, further asking, "Why should a sponsor give business to someone that might take advantage of that later on?"

Golub may be the most outspoken critic, but he is by no means a lone mudslinger. One mid-market GP gripes, "[The BDCs] compete very directly with us. We've seen them over and over again competing for deals."

But even as there may be a rising tide of critics, the BDCs and others are not exactly clearing their throats to apologize. **Mark Opel**, a principal at **American Capital Strategies** and senior vice president of business development at the firm, believes the catcalls are a natural outgrowth for competition.

"The mezzanine space has gotten more competitive," he says. "There's a lot of liquidity above mezzanine in the senior debt markets with the new entrants, and a lot of money flowing into the CDO (collateralized debt obligation and second lien markets, so that's created pressure on the mezzanine space."

Robert Long, a managing director at Allied Capital, backs Opel's sentiments, saying, "There are more sources of capital competing for transactions every day, so everyone is feeling the pressure."

Opel also dismisses as "nonsense" any inference to American Capital as a deal poacher, and claims that his firm invests "more mezzanine with sponsors than any other group in the US."

Part of the criticism heaped on the business development companies and the hedge funds is that in the absence of a typical fund life inherent to traditional mezzanine vehicles, there is a constant pressure to put money to work and continually invest. Golub, again not mentioning any hedge funds or BDCs by name, takes issue with what he calls the “commoditized” lenders, citing that these “groups are not focused on relationships.”

Long, however, notes that Allied will try to avoid any auctions being marketed to financial sponsors as a way to maintain the firm’s standing in the eyes of its clients. “We try to walk away whenever we hear there’s a financial sponsor that’s been contacted about a company—we are a relationship-driven firm and the financial sponsors are our most important relationships.”

Opel, meanwhile, readily admits that buyouts are an important part of American Capital’s strategy, but does add that in no way is the firm abandoning its role as lender. Indeed, subordinated and senior debt account for more than two thirds of its portfolio.

“The interest on our mezzanine investments helps pay our shareholder dividend, while the gains on our equity investments provide growth capital. We can re-deploy our [equity] gains instead of raising more capital in the public markets,” he says.

Opel also adds that there is never any confusion as to American Capital’s intentions as they related to a particular deal. “We’ve teamed with over 80 private equity firms. We work hard to serve them, we value our relationships and we are always straight with people,” he says.

Golden Gate Capital is one GP that has repeatedly tapped American Capital for financing, most recently partnering with the firm for its refinancing of catalogue retailer Appleseed’s in April. Calls to Golden Gate were not returned by press time.

What Opel and Long left unsaid was that many BDCs and hedge funds have an advantage over traditional mezzanine providers when it comes to price. Business development companies can raise capital on the public equity markets, while both BDCs and hedge funds will frequently lever their funding, a ploy that is not typically permissible for conventional mezzanine funds. This gives each asset class a lower cost of capital, which allows business development companies and hedge funds to come in under the competition in terms of price.

Golub, meanwhile, holds tight to his contention that the best lenders are relationship oriented, and believes that chasing buyouts should ultimately occlude lenders from such a characterization.

“We don’t think a lender that is sometimes bidding against its clients, even if it’s for a different target, can provide the best answer for those clients,” he says. “It’s the sophisticated mezzanine lenders that operate exclusively in the space that can really evaluate what is best for the deal, and operate with loyalty and diligence to help their clients achieve greater success. The rest are just commodity lenders.”

To be sure, the war of words in the mezzanine space is not unlike similar dustups that often grow out of the private equity landscape. When hedge funds first began eyeing private equity, most traditional

buyout shops dismissed the asset class as unsophisticated and only interested in a quick buck. Perhaps more apt for the battle currently being waged in the mezzanine market were the cries of impropriety lobbed at the investment bank-affiliated LBO arms when those groups began to impede the large-market buyout firms.

Like many debates, though, the mezzanine square-off won’t likely end as long as the market flourishes and participants continue to compete over the same plot of land. But few if any GPs would ever dare complain about healthy competition among lenders.