A Bright Spot in the Market

M&A Conditions Remain Strong: Lenders Play Important Role

Madison Capital Funding offers long-term capital, deep sector expertise, and reliable deal execution to meet the financing needs of an ever-changing market. Madison Capital benefits from the financial strength and stability of New York Life Insurance Company. This enables us to be a long-term partner you can count on in both good times and challenging ones.

Bill Kindorf, Managing Director, Head of Specialty Industries, Madison Capital Funding (L)
Sunil Mehta, Managing Director, Head of General Industries, Madison Capital Funding (R)

How would you characterize the deal making environment today?
Kindorf: It is highly competitive. Purchase price multiples are higher than either of us have ever seen in our careers. Auctions are driving a lot of interest and our private equity clients are stretching into new spaces. For example, we see larger funds looking at smaller deals. Private equity funds are branching out into new industry verticals, which has provided us a unique opportunity to leverage our specialty industry silos.

Additionally, time frames to get deals completed are being condensed and lenders are expected to fully commit faster than they have been expected to in the past. It’s an area where we’ve had to adapt and our ownership and capital base has given us the ability to do so effectively. It’s all driven by the record amount of capital that private equity firms have today and the amount of leverage available.

What has changed in the lending industry over the last five years?
Mehta: We have experienced tremendous growth over the last five years while also adapting to a number of changes in the industry. The most noticeable change is that individual lender hold sizes have grown dramatically. Prior to the last recession, a $100 million credit facility used to be held by four to five lenders and currently one or two lenders will hold that amount. In addition, as we get longer in the economic recovery, documentation terms have become borrower friendly. Prior to the last cycle, financial covenant cushions were 15%-20% and currently are 30%-35%. Furthermore, EBITDA definitions are heavily negotiated so lenders need to recognize that EBITDA is potentially not a true cash flow measure of the borrower.

What trends are you seeing in the private equity market today?
Kindorf: Companies in highly fragmented sectors are getting a lot of attention today. For example, we see a lot of activity in healthcare practice management as well as in insurance brokerage. The strategy involves making numerous add-on acquisitions to grow the portfolio companies. It usually requires a credit facility and a delayed draw facility or other incremental debt facilities to finance those deals.

Mehta: Purchase price multiples are at an all-time high. Private equity firms are purchasing their platform companies often times at double digit multiples and using our credit facilities to make smaller add-on acquisitions at discounted multiples.
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What do specialty finance companies bring to the table?

Kindorf: Specialty finance companies can be more aggressive in terms of a leverage profile and they have more flexibility around credit terms. We are also seeing specialty finance companies taking down larger holds as well. One thing to note, 15 years ago specialty finance companies were the new players on the block versus the commercial banks. That’s not the case anymore. At Madison Capital, we have a 17-year track record and are well-established in the market. We have over 250 unique borrowers and have invested more than $30 billion since our founding in 2001. Our backing by New York Life continues to provide us with the ability to adapt to various market conditions as well as allowing us the benefit of patient capital to seek the best outcomes for our borrowers, our private equity sponsors and ourselves.

What role are traditional banks playing in the financing structure today?

Mehta: Since 2013, when the leverage lending guidelines were put into place, the banks were often on the sidelines. It helped put finance companies like us in a position to dominate the market. However, the current administration has taken a more lenient approach and we are seeing traditional banks compete on larger transactions where they can utilize an underwrite and broadly syndicated financing strategy.

How has the fact that some private equity firms have launched lending facilities impacted lending?

Kindorf: We have seen this trend, but in terms of head-to-head competition there hasn’t been a huge impact. Private equity firms typically participate in deals versus competing for a lead or co-lead role on a deal. For many borrowers there can be a perceived conflict of interest. The borrower can wind up having a competitor in their bank group. We don’t believe this will go much beyond where it is today for this reason.

What changes in lending or private equity do you expect to see over the next five years?

Mehta: A period of slower growth is likely coming over the next five years. Current economic conditions appear to be strong, but the yield curve is flat and monetary policy is tightening. Historically, those factors have been a precursor to a recession. Given the aggressive debt structures put in place today with the potential for slower growth, we expect to see more default activity from private equity borrowers.

Do you worry that we will have another financial crisis?

Mehta: Our capital base is extremely flexible and patient, so we have a unique ability to work in partnership with our private equity sponsors should an underlying portfolio company have an issue. In addition, we take an investment-like approach in our underwriting and portfolio management functions. We have conviction that our capital deployment since the financial crisis was both smart and efficient.

How do you differentiate yourself as a lender?

Kindorf: It’s all about relationships. We have been a relationship-oriented business since the beginning. It’s key to being a successful lender in the market. It’s important to acknowledge again that a key differentiator is our capital base from New York Life. New York Life provides us with a stable, patient capital base that we can rely on in all economic cycles. It gives us a unique advantage which is understood and appreciated by private equity sponsors.

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