Substantial changes afoot

Private equity dry powder, a benign economic environment and pro-growth policies could all add up to a transformed market. **Trevor Clark** and **Chris Williams** of Twin Brook Capital Partners explain why

This year could bring major changes to the private debt market including an increase in mergers and acquisitions and an easing of banking regulation under President Donald Trump. Trevor Clark and Chris Williams, the founders of Twin Brook Capital Partners - the mid-market lending arm of Angelo, Gordon & Company established in 2014 - believe they are positioned to handle whatever the future brings. Andrew Hedlund sat down with the two men to discuss key trends.

Chris Williams and Trevor Clark

Q What do you expect to see in the sponsored financing markets in 2017?

Trevor Clark: As we look at the landscape for mid-market lending in 2017, we are very optimistic. Consensus expectations point to a 10 percent to 20 percent increase in year-over-year M&A volume which should help drive additional financing opportunities. While new groups and/or funds will continue to explore financing opportunities within the mid-market, we believe that experienced players will have a sourcing advantage. We experienced quarter-over-quarter increases in deal flow and transaction closings for every quarter in 2016, and ended 2016 with a record backlog in terms of deals scheduled to close in 2017. Absent a major macroeconomic event, we would expect to see this trajectory of growth continue in 2017.

Q What are the factors that point to a higher level of M&A activity in 2017?

Chris Williams: The recent administration change in Washington has clearly impacted investor expectations in regard to regulation, tax policy, etc. The result has been a more positive outlook for near term-economic growth and pro-growth policies. This change in investor expectations in combination with a fairly benign domestic economic environment has been the catalyst required to move some investors off the side lines. While M&A volumes have recovered from the depressed levels witnessed after the last credit cycle, the amount of "dry powder" sitting in current private equity funds would suggest that there is ample capital to support a higher level of M&A activity.

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Chris Williams

Q What trends are you seeing in pricing, covenants and other terms for sponsored deals in the mid-market?

TC: Mid-market debt fundraising reached a record $50 billion in 2016. This inflow of capital has created a 'temporary' supply/demand imbalance for mid-market loans which has led to pricing and structuring concessions from lenders. The magnitude of the lender concessions have been driven by the quality of the individual credits, but have included items such as: reduction in interest rates and fees, increase in funded debt, easing of covenant restrictions and allowing greater income addbacks.

Q Are you seeing more and more private equity firms turn toward alternative lenders when they take on debt to fund a transaction?

CW: Absolutely, this has been an ever-increasing trend over the last several years. Many of the commercial banks have either completely exited the leveraged mid-market or have greatly reduced their appetite for the asset class. While the bank exodus has created more transaction opportunities and a subsequent increase in the number of new alternative lending firms, our experience has been that many of the lower mid-market private equity firms prefer to work with lenders who they know well and have closed multiple transactions with previously. Many of these new alternative lenders have found success accessing financing opportunities in the upper middle and broadly syndicated markets.

Q How do you think the mid-market will react to a Trump administration?

TC: From the conversations we have had with our borrowers and private equity clients, it appears that there is generally a "wait and see" approach being taken. Specifically, the owners and managers of these mid-market companies want to see what tangible change is being driven by the new administration versus the sound bites that are delivered as part of a campaign. While many believe that the Trump administration may actually provide an improved environment for mid-market companies, they want to be cautious in regard to overestimating the impact of this change. If Trump is able to enact many of the policies he has suggested surrounding regulatory constraints, lower taxes, reduced healthcare costs, etc., that should create a more business-friendly environment for mid-market companies.

Q What are your thoughts surrounding the Dodd-Frank Act and the possibility of commercial banks becoming more active in the market?

CW: A roll-back of Dodd-Frank (see accompanying panel) will definitely make it easier for banks to return. We actually think this is a good thing for the market and will create additional capital to support M&A. With regards to our business, we have competed against banks our entire careers. Our private equity clients are coming to us for consistent execution and reliability which we have provided throughout our careers over multiple cycles. I think where you will see the most disruption in the direct lending market by the return of the commercial banks is with many of the new entrants who have come into the space over the last five to six years since the last downturn. Many of these groups don't have long-term established relationships to differentiate themselves. ■

The Dodd-Frank Act: Key facts

Full name: The Dodd-Frank Wall Street Reform and Consumer Protection Act

Initially proposed: June 2009

Signed into federal law: July 21, 2010

Named after: Senate banking committee former chairman Chris Dodd and then financial services committee chairman Barney Frank

Reason for introduction: The global financial crisis

Overall aim of the Act: In the words of president Obama to bring about "a sweeping overhaul of the United States financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression"

Other main aims: Consolidation of regulatory agencies, comprehensive regulation of financial markets, consumer protection reforms, tools for financial crises, increasing international standards and cooperation

Incoming president Donald Trump's view of Dodd-Frank (source: Reuters): "Dodd-Frank has made it impossible for bankers to function. It makes it very hard for bankers to loan money for people to create jobs, for people with businesses to create jobs. And that has to stop."