Adams Street

The Advantages of Being a Lead Lender: Bill Sacher Q&A

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KEY TAKEAWAYS

- The designation of lead lender often confers significant advantages for a private credit manager, including privileged access to data and influence over capital structure, covenants and loan terms
- Private equity deal sponsors in a middle market company auction bring in lead lenders at the outset of the underwriting process, typically two to three months before a transaction closes, while club participants have only a few weeks to conduct their deal diligence
- Lead lenders typically have greater access to the raw data that the company provides as part of the sale process; enjoy more management interactions; and have early access to third-party consultant work that pressure tests key metrics including quality of earnings, market analysis, and other potential risks
- Underwriting advantages derived from lead lender status can drive superior risk-adjusted returns and mitigate potential losses, while the extra work undertaken by lead lenders can result in incremental fees

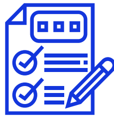
Bill Sacher, Partner & Head of Private Credit, shines some light on some of the key differences between lead and participant lenders in the private credit space.

What is a lead lender and what benefits does being a lead lender provide?

Being a true lead lender is more than a title – lead lenders are given better access to information throughout the underwriting process, have influence over capital structure design, directly negotiate loan documentation, and can receive incremental economics. All of this allows lead lenders to undertake private equity style due diligence to help drive superior risk-adjusted returns, seek to mitigate losses and make better informed underwriting judgments. Non-lead lenders typically lack this informational advantage.

What does a due diligence process look like for a lead lender in a typical middle market company auction process?

The diligence process for a private equity sponsor looking to acquire a company typically takes two to three months or more. Lead lenders are usually brought in at the earliest stages of that process, often before the private equity sponsor has attended the initial introductory management meeting. As a result, lead lenders typically work collaboratively alongside the private equity sponsor throughout the process, drawing on their collective resources and sharing findings.



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As the process unfolds, lenders can see how the private equity firm approaches various bid dates, how they diligence their key areas of focus and develop their own views, and how they direct third-party consultants and due diligence advisors. The process and access allow the lender time to undertake its own comprehensive due diligence, digest information, interact with the company's management team, conduct third-party industry calls, and directly work through questions with the sponsor. Lead lenders often directly influence the scope of a sponsor's third-party consultant work on issues such as quality of earnings and environmental assessments, to ensure key concerns are addressed as the process moves along.

How does this differ from the due diligence process and timeline that a participant/club member is provided with?

Often, participant lenders are brought into the transaction after the lion's share of the diligence is completed and, in many cases, after the sponsor has completed their due diligence. In addition, this is typically after the sponsor has negotiated most, or all, of the credit terms with the lead lender and signed up the asset. Participant lenders are then given pre-packaged due diligence information that is more limited, a high level sponsor model, and credit agreement terms negotiated by the lead lender. At this stage, participant lenders are typically given two to three weeks to commit to the transaction.

Can you expand on the access to information point? In addition to sponsor access, what information will a lead lender receive that participant lenders may not receive?

Lead lenders are typically afforded several information advantages that may not be made available to a participant lender. Some examples include:

- Company dataroom – The raw data that the company provides as part of the sale process that is the same data the private equity sponsor receives; this allows a lender to independently verify management's assertions through their own analysis
- Management interactions – In-person or virtual meetings allowing lenders to meet and interact with company management
- Sellside and buyside third-party consultant work – Typically, private equity sponsors commission third-party consultants to pressure test "sellside" consultant work that the bankers make available as part of the process. These key workstreams typically include a quality of earnings report, market study, tax, environmental, legal, insurance/benefits, IT, ESG, and background checks. Participant lenders may not receive the sellside work, may not receive some of the key third-party workstreams, and generally have no influence on the scope of the work.

What key documentation advantages are afforded to lead lenders?

Lead lenders typically have influence over important considerations such as capital structure design, financial covenants, and all other loan documentation provisions, such as financial statement delivery provisions, collateral and payment protections, and negative covenants. Typically, given their position, lead lenders also have some form of a block against changes to covenants or other key documentation provisions. Lead lenders also directly negotiate the entire credit agreement documentation process and comment on other important ancillary documents – such as a security agreement, intercreditor – that other lenders generally have to accept on a take-it-or-leave-it basis.

Are there economic advantages for a lead lender?

In certain situations, lead lenders earn extra fees for committing their balance sheet before other lenders are brought into the deal. This can serve as a distinct economic advantage. In addition, lead lenders are generally given the opportunity to negotiate economics and documentation provisions holistically to better control risk.

Other than the specified documentation provisions, are there other practical benefits of being a lead lender after closing of a transaction?

Absolutely. Whether or not contractually required, the lead lender is typically the company's first call whenever that company seeks additional capital or provides performance or important business updates. Being that first point of communication throughout the life of the loan can also help the lender to be in a position to continue to lend to the company under future ownership, when the sponsor chooses to exit its investment.

Additionally, as it relates to amendments and any liquidity concerns, a company will typically negotiate a solution with its lead lender first before bringing it to the rest of the lender group, which provides that lender with significant leverage/influence if that situation were to ever arise.

How does a private credit firm become a lead lender?

It is very difficult to become a lead lender overnight; it takes years of experience and relationship building to be a credible lead lender in the marketplace. To entrust a lending partner to be a lead lender, a sponsor will look to a number of factors, including relationship, scale, and flexibility to be a solution provider, and the trust in that lender to provide certainty of financing.

To execute as a lead, lenders themselves must have experience and knowledge of financing processes, loan documentation, and the wherewithal and sophistication to communicate with a multi-lender group. Sometimes, lead lenders are asked to be Administrative Agent, and having the ability to provide that functionality and robust infrastructure to handle administrative funding requests among many lenders are table stakes.

How do lead lenders help the sponsor win an asset? What benefit does the sponsor have in bringing in a lead lender early in the process, especially if they are able to provide an equity backstop for their auction bid?

Lead lenders provide sponsors with certainty of financing, which can help better position the sponsor to win an asset in a competitive auction process. By bringing in lead lenders early in the process, the sponsor can try to build confidence that they will have financing, and can understand and address any capital structure considerations up front. This can help them better assess the likelihood of execution of different capital structure alternatives, cost of funds, and key stakeholder dynamics as they refine their own underwriting cases and build conviction.

Would Adams Street ever not be a lead lender in a transaction?

We like the benefits that being a lead lender affords us and strive to be a lead lender in the vast majority of our transactions. However, we consider all deals where we believe the underlying circumstances are compelling. In any event, if the due diligence process and documentation terms are not up to the standards we would otherwise have as a lead lender, we will generally not engage in those transactions.

How do you think being a lead lender has benefitted your private credit business?

We are able to more thoroughly diligence our underlying investments and be higher touch on a regular basis to our portfolio companies, which lets us be proactive in addressing any underlying concerning trends. An added benefit is that it allows us to showcase our abilities to our private equity sponsors as a lead lender, win repeat deals, position us with incumbency for future financings, and cement the institutional relationships that we have. ■

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