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Len Tannenbaum: “There’s Been Major Capitulation”

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Since BDCs rely on their stock for liquidity, it’s safe to say they’re in a world of hurt right now. We saw [American Capital](#) and Allied Capital [post losses](#) and either reduce or possibly eliminate their dividends last week, for example.

Today Fifth Street Finance, a lower middle market BDC that went public in June (one of the whopping two financial services IPOs this year), released its monthly shareholder update. I spoke with CEO Len Tannenbaum about fake term sheets, who’s really in business (he names names), nosebleed lending rates and what his

firm will do when it runs out of money:

What do you mean by “fake term sheets”? Are lenders really trying that hard to keep up the appearance of being open for business?

Some of them have submitted term sheets that have no way or desire to be completed. They have no money to do it, so they’re trying to do it with such onerous terms, and not negotiating, so that the equity sponsor won’t go with them. And if they go with them, the terms don’t get passed through the committee. It’s not a real term sheet.

That seems like delusional behavior, is this happening across the board, or is it anecdotal?

Well, now that American Capital sort of blew up with their dividend and a number of other firms are getting called on capital lines, it’s slowed down. It was very visible for awhile there, but that was more of what was happening last month, as a last ditch effort to stay alive. Now we’re seeking a lot of layoffs and contraction, and very little competition.

What do you mean by calls on capital lines?

Basically, for firms with leverage, the banks are hitting their net worth covenants so that they’re not able to access them or draw on them. They have to deliver. For example [TICC Capital Corp](#) delivered entirely.

Got it. So you said Fifth Street isn’t seeing much competition right now. Does that mean you’re still open for business, and how is that possible?

Since we only went public this year, we still have no leverage. We're still deploying the cash from the IPO. The idea is that we could go into some modest leverage but we can't get it. Either way, we're not in wind-down mode, we're still in ramp-up mode. The question, though, is now what? Everyone runs out of money eventually. Some of them had a good idea to raise committed funds. Ares raised a \$250 million committed fund. [Triangle Capital Corp](#) and [Hercules Technology Growth Capital](#) have SBIC leverage, which allows you to take up to \$135 million. We'll probably go that way eventually. Our hope is for Obama's plan to expand the SBIC program, so it would benefit us more.

Remind me the size of companies do you lend to?

We only lend to companies with around \$60 million to \$100 million in revenues.

The SBIC expansion bodes well for you, then, but it could be awhile for any changes in the SBIC program to take effect.

Yes. We have a \$50 million undrawn line of credit now, and we still have cash from the IPO. Also, M&A has really slowed, so we're not that busy. We used to do \$60 million in origination every quarter, and now we're down to half of that. We're getting amortization every month. We couldn't ramp back up to that level again, but at least the rates are much higher.

How high?

Rates are at nosebleed levels. It's good, but there's only so much you can charge. Twenty percent is what we're charging for safe loans.

So to reiterate, are you saying that lenders who were pretending to be in business a month ago have now dropped the facade?

Six weeks ago, they were trying to stay in the game, but people have just given up now. There's been major capitulation.

Can you say who?

Well, Patriot Capital is out of money. Allied Capital and American Capital have now fallen. Ares and Apollo have money but are not really in the market, they're still out there picking away cautiously. GE Capital has pulled back altogether. Madison Capital has finally pulled back.

Madison? Really? I wrote that they were definitely still doing deals a few weeks ago.

They were pouring money in the market, but I haven't seen them in the past month. They have pulled back from an extremely aggressive stance. But you should talk to them about that.

Naturally, I took Len's advice and emailed Chris Williams, senior managing director of Madison Capital. He responded with the following:

- (1) We are still in the market and continue to issue term sheets for financing new platform acquisitions by our sponsor clients
- (2) We have closed four new platform financings in the last four weeks and expect to close a fifth next week
- (3) Deal flow has dropped off significantly as sponsors are reluctant to bring portfolio companies to market in this environment
- (4) Yes, we are being very conservative in terms of what we are agreeing to finance.