MERGERS & ACQUISITIONS
THE DEALMAKER'S JOURNAL
April 2010

Lender of the Year

Brick by Brick

Fifth Street is quickly building a franchise, incrementally adding funding, people and clients

By Ken MacFadyen

Fifth Street Capital's Leonard Tannenbaum isn't necessarily concerned about his status in BDC circles. His relationship with David Einhorn pretty much makes him an outcast among some of his peers, as Einhorn's hedge fund famously battled the likes of Allied Capital and other business development companies throughout the past decade. Einhorn is best known as the short seller that predicted Lehman Brothers' collapse, but he seemed to make a hobby of picking apart the inconsistencies on the balance sheets of BDCs.

Tannenbaum, who launched Fifth Street Capital's third fund as a business development company in 2008, is actually on the board of one of Einhorn's offshore funds, while Einhorn was an adviser of Fifth Street's second fund and currently holds a long position in the Fifth Street BDC. Tannenbaum is unapologetic about the connection, a fact that speaks to the difference between Fifth Street and many of the progenitors that preceded his firm in the BDC marketplace.

Success in the debt market in 2009 hinged as much on how a firm accumulated capital as it did in how it dispensed the money. Fifth Street was as scrappy as any lender last year, a twelve month stretch that saw the company build its resources, grow its team, and help fund over 30 deals in the small and mid market.

The $140 million IPO that launched Fifth Street's third fund as a BDC in 2008, created momentum that carried over to last year. The firm executed two follow-on offerings that together generated proceeds of $145.7 million; lined up a $100 million, three-year credit facility from Wells Fargo; and made significant headway toward receiving clearance for its SBIC license.

Tannenbaum, describing the year, says bluntly, "It was really hard."

Of course, he didn't take any shortcuts either. To get an SBIC license, Fifth Street had to raise equity. "I had to reach out to every investor to inform them that we'd be selling our stock below book value," Tannenbaum says, noting that he wanted to make sure the investor base understood the benefits that would come with the SBIC license. The SBA, meanwhile, spent a year and half poring over Fifth Street, an 'expedited' due diligence process that included 200 reference calls and FBI checks. Tannenbaum says it was well worth it for the license.

This effort in a way reflects Tannenbaum's connections with Einhorn. He cites that one of the ways Fifth Street stays in line with the shorts is to "follow David's three rules," the first being transparency. "You don't hide anything," he describes.

The second and third rules, Tannenbaum adds are discipline and staying true to marks either for or against the book value.

Fifth Street, in 2009, was the No. 2 BDC in terms of capital raised. Beyond a strong portfolio, the firm curried favor by doing the little things investors appreciate. Following its equity raise, for instance, the firm waived the fees on the cash on its balance sheet.

The firm tries to take the same approach when it comes to putting the money work and forging partnerships with its clients. Tannenbaum says, for instance, "We won't write a term sheet unless we're willing to complete it on the specified terms every single time." The firm, in 2008, signed 21 term sheets and closed on all 21 deals, and last year, added another 31 to its tally of closed transactions.

In a few cases, Fifth Street even patched up deals that faltered on the equity side. In one transaction, involving two sponsors, one of the equity providers bailed two weeks ahead of the scheduled close. Fifth Street reached out to its existing relationships and managed to find a new sponsor, closing the deal within two weeks.

The firm attributes its nimbleness to its core unitranche offering. From the sponsors' side, Tannenbaum cites that clients prefer a one-stop solution. From his perspective, unitranche facilities allow Fifth Street to avoid inter-creditor agreements, which caters to quicker decision making. The firm can syndicate out a portion, but Tannenbaum adds that he prefers not to. "I don't want anyone else to have a say in how to structure the debt or manage the credit," he describes.

Fifth Street's momentum in 2009 was in part reflected by additions to the firm's ranks. The biggest hire was Casey Zmijeski, who joined from Churchill Financial as a managing director overseeing origination. Other additions included vice presidents Lawrence Beller, formerly an executive director at JPMorgan in its CDO structuring group, and David Harrison, who joined from law firm Dewey & LeBoeuf.

Going into 2010, Tannenbaum expects to hire another 15 employees in the next year. Fifth Street has already managed to raise another $78.4 million through a follow-on offering and its SBIC license finally cleared. In February, ING Capital committed to a syndicated three-year revolving credit facility providing another $150 million to the lender.

Meanwhile, Fifth Street's stock was up by more than 90%, year over year, as of the second week of March. David Einhorn might just yet learn to love the BDC. M&A