
E X P E R T Q & A

A turbulent market is creating opportunities to support non-sponsored entrepreneurs with creative solutions in the lower mid-market, says Kevin Griffin, CEO and CIO at MGG Investment Group



Demand growing for flexible capital

Q How important is the availability of flexible capital for growing businesses in the lower mid-market?

Fundamentally, private credit managers need to be able to be nimble to provide solutions to a borrower's needs. If you are geared towards just ticking one box, then you are not providing the solutions that businesses are asking for.

In an evolving world, one type of capital or one type of solution is not always going to be sufficient. Maybe a re-financing will be required, but the underlying company may also need some features that are not typical, so while it is all very well doing traditional lending, we feel it is important to look at

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your ability to solve current and future situations for borrowers. We call these our structured solutions opportunities.

We invest in mainly non-sponsored deals, and non-sponsored owners tend to have a range of requirements. In the lower middle market, borrowers can't tap the broadly syndicated liquid market that large firms may be able to, and they have fewer sources of capital. They therefore offer lenders better returns, better structures and better covenant protections.

We have an excellent and proprietary

sourcing network to bring in those deals with limited competitive dynamics, and we see a big niche in the non-sponsor segment that has been ignored by banks and other lenders since the financial crisis. Also, a lot of managers that started out in the lower middle market have since graduated to larger cheque sizes, and so we are able to find and source good deals in that space more easily than our competitors.

Q What demand are you seeing for your structured solutions strategy?

Today, there is a level of debt capital cost that a business can naturally afford, and it's clear when you reach that line.



Q How should investors think about structured solutions? Is it a dislocation play, or a more permanent need?

Structured solutions is definitely a permanent play, but it is one that dislocation makes even more compelling. I have been doing this for over 25 years, through multiple cycles, and it is always there as the backbone of the lower middle market in the US. There is a clear universe of borrowers that are looking for this type of capital and we have a tried-and-tested way of sourcing the deals, structuring them and underwriting them.

This is a solution that is needed through all economic cycles. When you have dislocation in the market, your rates are going to go up from a borrower perspective, leverage is going to be down because lenders become more conservative, and so from a lender point of view it is a great time to put capital to work. Despite these macro facts, businesses are still looking to evolve and if we can offer multiple solutions, we will fill our portfolio with enhanced returns. Right now, we are really stepping on the pedal; we see the economy going into the next cycle and we are determined to take advantage. There are a lot of lenders operating in the middle market lending space, but 90 percent of what they are doing are private equity sponsor-backed deals. We have a real point of differentiation. Those sponsor-backed deals get shown to 50 or 100 potential lenders by the investment banks, whereas, on the non-sponsored side, I can probably count on the fingers of one hand how many people are being shown the opportunity. So it is a much less competitive space.

There is a misconception that turbulence is a bad thing for our strategy, when in fact we were conservative pre-pandemic and we did incredibly well because of that conservatism. We have been conservative in the run-up to this cycle too, and we now view it as the opportunity of a lifetime. Structured solutions will always be appealing to the right kind of borrowers and we continue to see it as an exciting space to be in.

If you have \$10 of cost, you need to generate \$11 of profit to be able to pay those costs, so there's a natural level to which you can lever a company.

The structured solutions that we provide can be a mix of preferred equity, minority common equity or PIK junior debt capital, typically, in conjunction with a first-lien loan – these structures allow the owner to continue doing what they want to do. We will likely combine secured debt, but then we are able to provide some additional or structured capital to support different growth trajectories that they may not be able to achieve with debt capital alone.

The structured solutions strategy means we may get into an investment on a smaller scale where they want preferred equity for a period of time and then they may want to transition to more traditional debt on a larger scale further down the line. The key thing is that the strategy allows us the ability to be a solutions provider for borrowers and deliver the flexible capital they need.

Q Since you focus on non-sponsored businesses, how do you source those opportunities?

Our sourcing is based on a network that was built over multiple decades of experience. When I compare the roughly 1,500 new deals we will see this year, the typical middle market manager would source around 90 to 100 percent of those opportunities from sponsors. That is not our model.

For us, only around 20 percent of our dealflow comes from private equity sponsors and bulge bracket banks, and we continue to maintain good relationships across those channels. A further 30 percent of our deals, however, come from repeat borrowers or CEOs that we have done business with previously. I have personally done multiple deals with the same parties working at different businesses during my career,

and people who need this type of capital typically like the experience they get from working with us on an ongoing basis.

Critically, the remaining 50 percent of our dealflow comes from what I call our secret sauce, which is middle market investment banks and what we like to call ‘banks without balance sheets’. That ranges from smaller brokers that have just one or two offices right up to the much larger players like a Houlihan Lokey. But, in my experience, the more ‘single shingle’, mom-or-pop brokers that you have in your rolodex, the better. That is a really big part of our sourcing and accounts for around half of our dealflow. Geographically, the vast majority of our sourcing is US-based, but we do between 5 and 10 percent elsewhere. We have done deals in the UK and Australia, for example, so we are certainly open to looking outside of the US for the right opportunities.

Q How large do you consider the opportunity set for structured solutions to be, and how is it changing?

We have grown our assets under management to \$4 billion today, across senior secured debt and structured solutions. We have deployed our first Structured Solution Fund and are now raising our second vintage. (We have also largely deployed our third Flagship Fund and will be raising the fourth vintage in 2023).

The way for us to do what we do best is to aim to always have between \$1 billion and \$2 billion of dry powder available to invest across the spectrum. Our third flagship fund was \$1.25 billion and our next fund will be a little larger, and our first Structured Solutions Fund was \$360 million and we have a target of \$500 million for our second vintage, but for us the right answer at any one time is to have over a billion of dry powder available to us.

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fifth largest economy in the world by GDP. Not all of those businesses are looking for capital every day, but there is a huge universe of companies out there with capital requirements. We tend to find a lot of great businesses and we see the opportunity set just getting bigger and bigger. In good times and bad, that is a nice place for us because those borrowers do not have a lot of alternatives and we have capital and an ability to think creatively.

Dealflow never stops in tougher economic conditions, but access to capital becomes challenging. The cost of capital in the last few months has gone up considerably, while leverage has come down, which means we can achieve a better structure and better risk-adjusted returns. Right now, the supply of capital is constrained, and we are going after non-sponsored, entrepreneur-led businesses that tend to be a little harder to understand and require proprietary diligence. Any time there are challenges in the market we tend to do better, and we have never been busier than we are today.

Q What types of industries do you focus on and see the most demand from?

We are industry agnostic and generalist. We tend to avoid tobacco and fossil fuel energy, which was the first part of our ESG plan that we implemented a few years ago, and we are extremely conservative, so we don’t really do anything in bricks and mortar, unless there is a specific reason to do so. We also don’t like to invest in retail or restaurants because those situations tend to be too levered and we are not keen on the risk-reward there.

We have invested in well over 100 businesses and in our portfolio today we have everything from insurance and software to a professional sports franchise. It is very industry diverse, with 20-plus industries represented in our portfolio and interesting opportunities cropping up all the time. ■