SPONSORLESS DEALS

some type of bond with the owner of the business, and source capital from private equity funds or junior capital funds or other sources, but may not have an operating background.

The second is the 'operating executive', who may have been affiliated with private equity funds previously and has the business experience.

The final, and one of the new, growing entrants to the field, is the private equity professional who has left a traditional private equity firm to focus on this segment of the market.

3. FAMILY BUSINESSES HAVE ADVANTAGES OVER PE SPONSORS

For the independent sponsors and family businesses, what matters most is who the lender partners with, where that lender is in the capital structure, their experience in a particular industry, and their longevity in the market.

"Picking a partner with the lowest cost of capital is not always the ultimate decision influencer," says Echausse. "Because independent sponsors don't have committed capital, they want to know how you are going to behave during the ebb and flow of a company's performance."

Most family businesses don't want to over-leverage the business, he says. The lower leverage reduces the risk in those businesses, as it was often formed by the vision of the founder, through 'sweat' equity and tremendous sacrifice.

"So these people eat and sleep the business as it has grown up and matured," he adds. "The managers or owners of family businesses typically want to manage the business with a sustainable risk appetite in terms of growing of the business, given that there are multiple family interests to be mindful of."

As far as comparative risk, Echausse finds that family-owned business deals are usually leveraged at a lower rate than

> "SOME OF THE INSTITUTIONAL INVESTORS ARE LOOKING TO ACCESS THAT CHANNEL FROM THE EQUITY PERSPECTIVE, WHILE FAMILY OFFICES ARE KEENLY INTERESTED IN SOURCING DEALS FROM INDEPENDENT SPONSORS AS WELL"
> **Paul Echausse**

a private equity-sponsored deals. If the market for leverage in a private equity deal is 4.5x EBITDA, leverage in a family-owned business will typically be one-half to one-full turn of leverage lower, or 3.5x to 4.0x EBITDA.

4. MORE PROCESS CAN MEAN MORE YIELD

Echausse says that unlike with a private equity firm that has committed capital, an investment committee meets all the time, and can "drive the due diligence process", independent sponsors are typically dealing with a variety of equity capital sources. With more hurdles to cross, this process can lead to an extra 30-60 days to get a deal done.

That resonates with what other private debt executives told *PDI* in its supplement on sponsorless deals this June. Tom Aronson, co-founder and head of loan origination at Chicago-based Monroe Capital, agreed that completing sponsorless deals can be time-consuming.

"The private equity sponsor will give you largely completed due diligence information," said Aronson.

By contrast, "a family will often say, 'I want to borrow from you, but I don't know what you need."

He estimated that it took Monroe, on average, an extra 45-60 days more to complete a sponsorless deal than it does for a sponsored deal. Monroe has assets under management of about $3.5 billion in loans to mid-market companies, split fairly evenly between sponsored and sponsorless finance.

But Aronson also argued that the extra legwork on sponsorless deals paid off because of the higher yield. In the US market, he said that yields for sponsorless deals are about 150bps higher than for sponsored deals made to similar companies.

This premium appears to be similar across the Atlantic too, as Fenton Burgin, head of UK debt advisory at Deloitte, said in the same June supplement that yields for sponsorless deals in Europe are about 100-150bps higher, on average, than sponsored deals.

5. KNOWLEDGE IS POWER

There are things that companies looking for yield, and willing to put in the extra diligence, in the sponsorless deals space should consider.

Brett Hickey, CEO of Star Mountain Capital, told *Lead Left*, in the publication's series on sponsored deals that ran this September and October, that investors should ask themselves several questions when thinking about a sponsorless deal.

First and foremost, firms should have to measure whether they have the knowledge to assess the borrower's operational capability.

Second, the lender should consider if it has the operational resources to help develop or replace the borrower's current management.

Third, the lender or borrower must both ask themselves if they have the additional capital to support the borrowing company if it faces challenges. And finally, the lender needs to know if the borrower has the sophistication to execute its business plan and exit strategy. ■