

# How Big is the Middle Market?

The Lead Left - A Special Report

**Beginning in July 2017 The Lead Left published a series of articles on the size of middle market. This report consolidates those articles.**

## Introduction

As great mysteries of life go, it's not quite in the same category as what's the universe made of, how does gravity work, or what ever happened to tan M&Ms. But for those who make it our career home, one of the most often-asked and vexing questions over the years has been, how big is the middle market?

It feels like something that should be answerable. As **Exhibit I** depicts, the outstanding total of all US leverage loans is well-established at around \$925 billion. One would think it a simple matter to separate out smaller loans from that data set.

Unfortunately there are several hurdles. First, there's no consensus on what constitutes the middle market. As a loan conference veteran, we've witnessed midcap panelists each proffering different definitions.

The top loan research agencies themselves aren't in agreement. S&P LCD defines middle market issuance as borrowers with ebitda of \$50 million or less. But because private equity sponsors are reluctant to publish borrowers' financial information, only a minority of companies can be accurately ranked.

Thomson Reuters LPC categorizes midcaps as borrowers with \$500 million or less in revenues and facility size equal or less than \$500 million. This makes tracking quarterly and annual issuance an easier matter. However, knowing how many loans come to market doesn't tell you how many of them are actually out there.

Another challenge is that, unlike the broadly syndicated loan market, middle market loans are mostly to private companies. They generally have unrated debt and small "clubby" lender groups that buy-and-hold rather than trade their loans. Visibility on new issuance and repayments is less certain than for the large cap market.

Finally, the burgeoning of new direct lenders in the private credit space has made accounting for all middle market loans tricky. Deep-pocketed arrangers can now take down an entire \$250 million financing themselves. Non-syndicated deals may never make it into LCD

## About The Lead Left

*The Lead Left* reviews deals and trends in the capital markets with a unique focus on the mid-market space and is read by thousands of influential industry participants.



### More about us

- Original commentary backed by thirty years of capital markets experience
- Weekly interviews with top decision makers in banking, private equity, and credit investing
- Data and commentary from four of the leading global capital market research firms
- Detailed information on deals in the market
- Plus our popular Charts and Quotes of the Week

News, LevFin Insights, or LPC Weekly.

To glean better insights into middle market outstandings we reached out to Fran Beyers, Thomson Reuters' middle market specialist.

"No one knows how big the middle market is," she told us in a recent interview. "We have data on BDC outstandings and MM CLO outstandings. That's it."

What about the universe of all loans? Can we extrapolate from that? "I don't think a lot of the middle market is in that \$925 billion," she said. "That's just the LSTA Index. It includes mostly the larger institutional loans and second liens that get sold off to the larger buy-side firms."

Over the following sections, we'll assemble some relevant facts towards a more accurate picture of just how many middle market loans are out there.

## Churchill Asset Management

Churchill Asset Management is a leading provider of senior and unitranche debt financing to middle market companies, primarily those owned by private equity investment firms. The firm currently manage approximately \$3.4 billion in committed capital and are part of Nuveen (formerly TIAA Global Asset Management), one of the largest global asset managers across multiple asset classes with over \$900 billion in assets.

### Benefits to Borrowers and Sponsors



Reliable partner for both private equity sponsors and other middle market lenders



One-stop capability across the capital structure



Senior management involved in all aspects of deal process



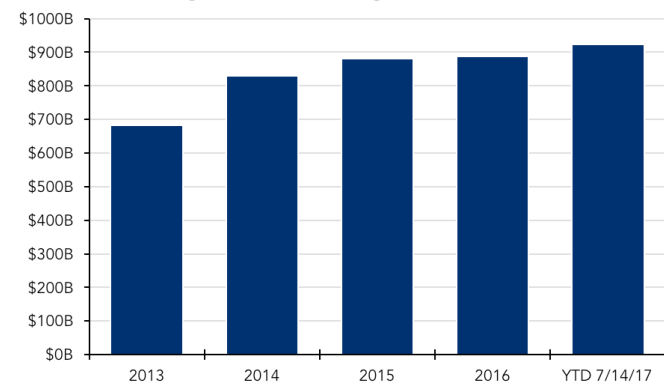
Agile and responsive team with consistent investment approach

### [More about us](#)

## Exhibit I: Expanding Universe

The outstanding volume of all US leveraged loans, now at \$924 billion, has steadily risen.

Leveraged Loan Outstandings (Total US Market)



## By Definition

To get a better handle on the total universe of middle market loans, let's define what we mean by the middle market.

Should we include, for example, both non-sponsored as well as sponsored loan volume? Thomson Reuters LPC estimates there's been an average of \$100 billion in annual non-sponsored activity since 2000. But these financings tend to be working capital driven with

more than 70% comprised of revolving credit capacity. That results in the relatively modest \$30 billion of yearly funded debt.

Also, many non-sponsored loans fall under the heading of C&I loans by commercial banks. To accurately assess the extent of these holdings would involve reviewing things like Shared National Credit reports – an effort beyond the scope of this exercise. For simplicity's sake, let's confine our study to PE-backed leveraged loans.

As **Exhibit II** shows, annual sponsored volume according to LPC generally hovers around the \$100 billion mark, though now at a \$140 billion pace for 2017. This includes both syndicated ("league table credit") and clubbed/sole lender transactions from arrangers who report to LPC's Private Deal Analysis survey.

One way to guesstimate total middle market outstandings is to multiply the average sponsored issuance by the average life of these middle market loans. LPC's Fran Beyers walked us through some numbers.

"You can look at the average four years of sponsored activity, annualizing for the first half of this year," Fran told us. "That gives you \$113 billion. It's reasonable to think we aren't capturing every deal being done out there, so let's also assume we're missing 25% of volume. That brings you up to \$141 billion."

What kind of average life do you assume for middle market loans? "Cliffwater Research recently put out an excellent study [link] that reports a 2.91 year life for their direct loan index," Fran said. "That's close to the experience of most lenders."

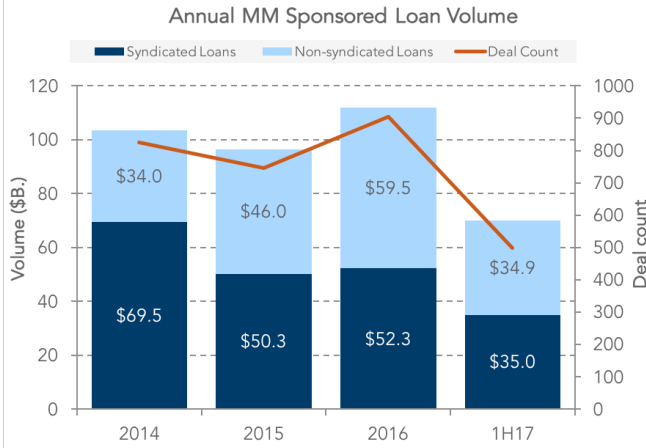
"So if you multiply \$141 billion by 2.91, that totals \$410 billion," she concluded. "If your average life pushes out to four years, that number is higher. You also need to account for run-off and refinancings, which vary depending on spreads and market conditions."

How should we think about the levels of refinancings versus new money in deals today? "You can use 75% as a gauge for middle market sponsored new money," Fran said. "For syndicated deals that percent is 70%, and for the private/club market it's closer to 80%. So if you average the two and go with 75% that is probably pretty accurate."

Using 75% of issuance for new money, then, we end up back at \$113 billion for annual sponsored volume, excluding refinancings, with outstandings around \$340 billion.

## Exhibit II: Taking Credit

Annual issuance of middle market sponsored loans has averaged just over \$100 billion, though 2017 is running at a \$140 billion pace.



Source: Thomson Reuters LPC

## By the Numbers

Now we turn our attention to the sponsored middle market refinancing cliff. As our **Exhibit III** highlights, about \$238 billion in loans mature over the next six years, peaking at a quarterly rate of \$14 billion during 2Q 2021.

According to Fran Beyers, this represents syndicated loan maturities. “We don’t track maturities of the private club transactions,” she told us. “Since there’s about the same level of issuance between clubs and syndicates, I would assume the maturities are similar. So double the \$238 billion and you’re at \$476 billion of total middle market maturities.

“It’s important to note the refinancing cliff is somewhat overstated,” Fran continued. “That’s because we can’t track amortization or excess cash flow recaptures. Also if a direct lender refinances a deal it won’t show up unless they submit it for league tables.”

To get a sense of how much the upcoming maturities exceeds total outstandings, we looked at the equivalent numbers for the broadly syndicated institutional market. According to LPC, the sum of maturities for large caps is \$1.523 trillion. Compare that to LPC’s estimate of total institutional outstandings of \$925 billion – a 1.65: 1 ratio.

If you use the same ratio for middle market sponsored maturities of \$476 billion, you get about \$290 billion in outstandings. That compares reasonably well with the \$340 billion figure (net of refinancings and runoff) we arrived at previous section.

What about the non-sponsored middle market? As we’ve shown, this is mainly revolving credit capacity. But as the big institutional market includes some corporate financings, let’s throw in the \$377 billion of non-sponsored midcap maturities as well. With the 1.65:1 ratio that’s \$228 billion. Add the sponsored \$290 billion gets you to \$518 billion.

Another interesting source of data is Fitch. They report that the institutional middle market represents 14% of total institutional outstandings of \$1 trillion, or \$140 billion.

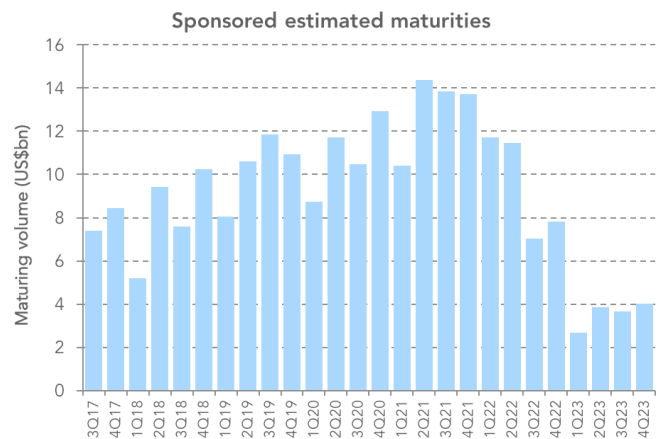
We know from LPC data that the syndicated sponsored market is about 50% institutional (TLBs and second liens) and 50% pro rata (RCs and TLAs). So if you take Fitch’s \$140 billion and double it, that’s their equivalent for syndicated middle market loan outstandings, or \$280 billion. Take out the 20% or so that’s undrawn RCs and that gets you down to funded debt of \$224 billion.

Finally, let’s assume there’s an equal volume of non-syndicated, clubby deals. Double the \$224 billion and you’re at \$450 billion.

So using these methods we’ve ranged the middle market universe at between \$450-\$518 billion.

## Exhibit III: Coming Due

Between now and 2023 some \$238 billion of middle market sponsored syndicated loans mature, peaking at over \$14 billion by the second quarter of 2021.



Source: Thomson Reuters LPC

## Conclusion

In summary we've used three methodologies to size the universe of middle market loans.

Using annual issuance data and average life calculations, we arrived at outstandings of \$410 billion, before run-off and refinancings. Then we took the middle market refinancing cliff, which is overstated relative to outstandings, to come up with a midcap universe of \$518 billion, including non-sponsored loans.

Finally, Fitch estimates middle market institutional outstandings of \$140 billion. Accounting for non-institutional and non-syndicated loan boosts that to \$450 billion.

Now let's examine how these middle market loans are held. There's some transparency to this information. For example, in the world of collateralized loan obligations (CLOs), we know that for middle market assets, the outstandings are around \$33 billion (see **Exhibit IV**). Some of this issuance has been significant of late, with MidCap Financial and Antares Capital both coming out with large vehicles.

Assets held by business development companies (BDCs) also are relatively easy to track, at least for public ones. Wells Fargo, a leader in BDC analysis, puts outstandings at \$67.5 billion as of 3/31/17. Backing out equity and structured products to only include first lien, second lien, and mezzanine that number eases down to \$55.4 billion.

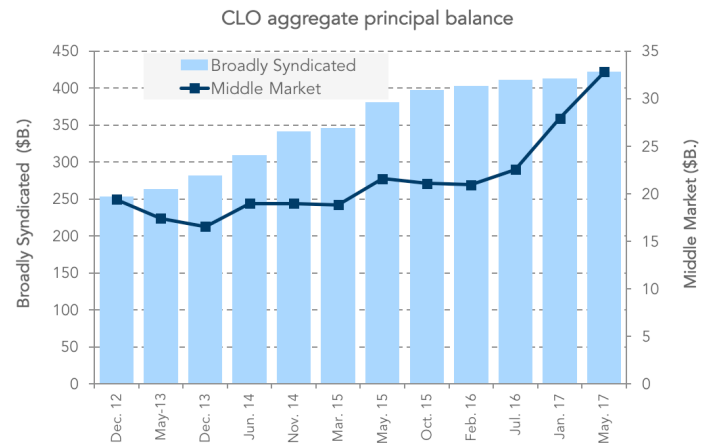
But Wells doesn't cover every BDC so this omits many private ones. One way to value the rest is examine BDC collateral. For this we again turn to Fran Beyers from LPC.

"Using BDC collateral," Fran told us, "we can capture all the private and public BDCs. That collateral shows total BDC outstanding investments of \$78.4 billion. Our BDC database is in early development, so we can't yet back out equity and structured products from the collateral figure. But to calculate the first lien, second lien, and sub debt numbers we can use the same formula Wells Fargo does."

Fran continued. "Wells reports 82% of the collateral represents first lien, second lien and sub-debt (mezzanine debt is included in the private data set). 82% of \$78 billion comes out to about \$64 billion in first lien, second lien, and sub-debt outstandings.

## Exhibit IV: Asset Rich

Loans held by middle market CLOs are \$33 billion, less than 8% of those held by broadly syndicated vehicles.



Source: Thomson Reuters LPC

"So I think you can safely say," Fran concluded, "that \$64 billion of BDC and \$33 billion of middle market CLO loan outstandings total close to \$100 billion."

What about all the loans held by banks? Or loans held by direct lenders with their various pockets of separate managed accounts and side-car private credit funds?

"Direct lenders and private debt funds are most of the middle market pie," Fran said. "Fundraising data shows direct lending funds were 50-60% of capital raised over the last two years. BDC public equity and midcap CLOs were only 15-25% of inflows.

"But SMA numbers are elusive, so it's hard to assess all the cash out there. Knowing BDC and CLO outstandings helps, but there's less transparency on direct lenders. We continue to work on ways to capture this. Your readers should stay tuned."

## Contact

### Randy Schwimmer

Senior Managing Director, Head of Origination & Capital Markets

**Churchill Asset Management LLC**

T 212-478-9203

[randy.schwimmer@churchillam.com](mailto:randy.schwimmer@churchillam.com)

### Liz Perreten

Principal, Head of Investor Relations & Business Development

**Churchill Asset Management LLC**

T 212-478-9211

[liz.perreten@churchillam.com](mailto:liz.perreten@churchillam.com)