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Wachovia's Sale To Tighten Mid-Market Lending

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By Shasha Dai of LBO Wire

Wachovia's sale to Citigroup marks the disappearance of a major independent player in the middle-market lending space, further shrinking the amount of debt available to finance buyouts.

Charlotte-based Wachovia, who last month hired Carlyle David Zwiener as finance head, said yesterday it would sell its banking operations to Citigroup for $2.16bn (€1.5bn). The buyer will assume $53bn in Wachovia's debt, with the US government responsible for a portion of future losses from Wachovia's troubled mortgage securities portfolio.

Wachovia ranked No. 4 in terms of leveraged loan syndication volume so far this year in the US, with more than $24bn, after Banc of America Securities, JPMorgan Chase, and Citigroup, according to data provider Dealogic. Globally, Wachovia ranked as the sixth largest lead loan lender, with $24.9bn.

In high-yield bonds, Wachovia ranked as the 10th largest book-runner in the US, with $1.6bn in volume so far this year. It was No. 14 globally.

Wachovia has loaned money or served as an underwriter for some of the bigger buyout deals done in recent years, like the purchases of Clear Channel Communications and now-bankrupt Linens 'n Things. But it is also an active lender to deals done by such middle-market firms as Cadent Energy Partners, Fenway Partners, Oncap, Parthenon Capital and Sun Capital Partners.

Citi said the deal enhanced its standing as a middle-market lender. "This is admittedly an area that we have historically not focused on," said Danielle Romero-Apsilos, a spokewoman for Citi. "But with today's announcement, we will become a leader serving this important client segment." Elise Wilkinson, a spokeswoman for Wachovia, wasn't available for comment by press time.

Despite Citi's enthusiasm for the mid-market, the combination of the two banks is likely to shrink the amount of capital available for deals. "Liquidity is going to be much less," said the head of a major middle-market lender.

Citi and Wachovia combined are expected to lend less than they would separately, according to this person. How much exactly will depend on "what Citi's risk profile will be, how Citi views the overall situation, and how much it wants to make a concerted effort" to serve the middle market, he said.

While mid-market lenders thus far haven't cut back as much as their peers that serve the mega-deal arena, they haven't been immune to the credit squeeze and the carnage on Wall Street. The problems at larger banks affect smaller ones at least indirectly, since larger banks extend credit lines, known as warehouse lending facilities, to mid-market lenders, which in turn provide credit to borrowers.

"Problems at the top of the house take a while to trickle down to the middle," said Gregg Smith, senior managing director and group head of investment banking services for CIT Group.

Consolidation has been going on in the middle-market arena for some time, and is expected to accelerate. Merrill Lynch sold its middle-market lending arm Merrill Lynch Capital to GE Capital late last year, well before setting plans to sell itself to Bank of America. GE Capital is now being pared back as its parent company General Electric Co. tries to reduce its exposure to risky businesses such as lending.

"When you look at left and right, there aren't that many players any more," Smith said.

The consolidation will leave those players who manage to remain independent in "enviable" position, allowing them to exact better terms on loans and making them magnets for people who may become disillusioned with life inside bigger institutions, according to the middle-market lender. He said his group has already reached out to Wachovia bankers.

And his group isn't alone. "While it pains us all to see a great institution like Wachovia disappear, there might be an opportunity for us to add to our talent pool, especially with our investment bank already headquartered in Charlotte," CIT's Smith said.

"There are a lot of people in North Carolina that we'll be talking to after today's news," said Mary Lou Malanoski, co-head of investment banking at Morgan Joseph & Co.

- With reporting by Laura Kreutzer.