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NASHVILLE NOTES

$20B of storage assets for Goldman Sachs

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A couple of months ago I had a post about Goldman Sachs Group Inc. in the context of Wall Street's moving (i.e., trading) vs. storage (lending) businesses. The gist was that Goldman's trading-heavy business model is not well suited for today's Wall Street and that more recurring revenues from the lending business are needed. I suggested an acquisition of Signature Bank. A few who read the post reached out to me to say that is not going to happen for various reasons.

Acquisition or not, Goldman executives have committed to building the lending business with a goal of adding $5.0 billion of revenue over the next three years with $2.0 billion attributable to "lending and financing efforts." Only $2.0 billion of $24.2 billion of year-to-date revenue consists of net interest income.

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It is simplistic math, but assuming a 2.0% spread (with fees) then $100 billion of additional loans will be needed. As of Sept. 30, Goldman reported on its regulatory Y-9C $104 billion of loans that were not classified as held for sale, while its press release classified $61 billion of assets as loans. The delta may be margin loans and other Street-related lending, but nonetheless the magnitude of increase in the loan portfolio will be sizable if achieved.

While Goldman's online push into consumer lending and deposit gathering via its consumer bank Marcus may get more press, it seems to me that corporate lending will be key to achieve the loan piece of the objective. What is the saying about effort? Go big, or go home.

Goldman is going big. CVS Health Corp.'s pending acquisition of Aetna Inc. will require $49 billion of cash financing, $20 billion of which will be provided via a Goldman loan. A unit of Barclays Plc is providing $20 billion, too, while Bank of America Merrill Lynch is providing $9 billion.

Not surprisingly, Goldman and Barclays served as financial advisers to CVS, while Centerview Partners advised the board (or maybe a subcommittee of the board). Lazard, Allen & Co. LLC and Evercore Partners Inc. advised Aetna. Missing from the adviser and financing mix are JPMorgan Chase & Co., Citigroup Inc. and Morgan Stanley among the major banks. Maybe none had a close relationship with Aetna, which seems doubtful to me given the size of the banks and Aetna, or there was a conflict. Nonetheless, it is interesting to me that Aetna used boutique advisers rather than a major bank when it did not have to have financing unlike CVS.

Goldman, Barclays and Bank of America are getting a large piece of business, but the loans may not stay on their balance sheets that long, or not all of it anyway. The three banks have or soon will commence a roadshow to round-up other banks and institutional investors to take part of the loans. Later, a portion of the loans will be replaced with a bond issue assuming the market cooperates that presumably will be led by the same three banks.

I suspect the decision to ramp-up lending at Goldman has been controversial inside the organization. The company's roots are in advisory, securities underwriting, trading and asset management. Some executives might argue lending represents a lot of risk for not a lot reward beyond interest and being repaid. Plus, loans have to be funded and require allocated capital. Originating a loan at par affords no margin of safety beyond looking to collateral as opposed to price if the loan or bond is purchased at a discount in the secondary market. To go big in the lending market for Goldman has to entail other considerations.

What might those factors be in the CVS-Aetna transaction? According to Bloomberg, Freeman Consulting Services

estimates the banks and boutiques will split $250 million of estimated M&A advisory fees, while the banks that will provide financing will split an additional $350 million to arrange the bridge loans and subsequent bond issue. To state the obvious: The leverage lending business is a big fee business unlike lending to investment grade companies.

The other notable aspect of the transaction from the CVS side is the role Centerview Partners played in providing advice to the board. Goldman and Barclays can provide advice, but it is hard not to notice the sizable financing fees that will be earned. Life is full of conflicts. The key is disclosure.

RBC Capital Markets was hit for a $76 million judgement for a 2011 sales process for Rural/Metro Corp. in which RBC did not disclose to the board its efforts to obtain a role in financing the buyer and that of a competitor to Rural/Metro that was on the block. Potential financing fees of $55 million were over 10x the advisory fee. There are too many details in the case to rehash in this post, but one takeaway I had other than financing pays better than advisory is that RBC's efforts were more heroic than piggish. RBC sold Rural/Metro for a 37% premium to its public market price prior to announcement. The premium absent any other context than the absolute amount appears to be attractive to me, but it is really attractive given that Rural/Metro filed for bankruptcy in 2013 protection, a year before the first court ruling against RBC occurred.

Goldman has a number of good reasons to venture deeper into lending now that it is a bank holding company. The first one that comes to my mind is fees, whether classified as interest income or not.

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