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Trevor Clark joined Twin Brook in 2014 to establish the firm's middle-market direct lending loan business. Prior to joining Twin Brook, Trevor was a co-founder and C.E.O. of Madison Capital Funding LLC, a wholly owned subsidiary of New York Life Investments where he oversaw all operational and strategic activities of the middle-market lending operation. At Madison Capital, Trevor led the Executive Committee that was responsible for all credit granting decisions and managed the relationship with New York Life Investments and other third party investors. Prior to forming Madison Capital, Trevor held various positions in loan underwriting and origination at Antares Capital, GE Capital, and Bank of America. He holds a B.A. degree from the University of Iowa, Iowa City and an M.B.A. degree from Indiana University, Bloomington.

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Christopher Williams joined Twin Brook in 2014 to establish the firm's middle-market direct lending loan business. Prior to joining Twin Brook, Chris was a co-founder of Madison Capital Funding LLC, a wholly owned subsidiary of New York Life Investments, where he was part of the Executive Committee and Group Head for the organization's specialty lending businesses (Healthcare, Insurance & Financial Services and Microcap). Additionally, at Madison Capital, Chris was a member of the Investment Committee for all investment decisions and directed the firm's HR functions and promotional activities. Prior to forming Madison Capital, Chris held various positions in loan underwriting and origination at Cochran, Caronia & Co., GE Capital, and Bank of America. He holds a B.S. degree from the University of Illinois, Champaign-Urbana and an M.B.A. degree from the University of Illinois, Chicago.

Differentiators for middle-market lenders in the current environment

A Q&A with Twin Brook Capital Partners

Can you provide a little background regarding your experience and insight to the segment of the market you target the most?

Chris Williams: Trevor and I each individually carry more than 23 years of middle-market lending experience and have worked together for 19. We've been in the traditional middle market, specifically the lower middle market, for the last 17 years. Our focus is on the lower part of the middle market—which we define as companies with $3 million to $50 million of EBITDA typically, with an emphasis on companies of with $25 million of EBITDA and below. In terms of our background, we've had a variety of experiences when it comes to lending; we've both worked at large commercial banks, like Bank of America, and in the merchant banking group at GE Capital. We also wrote the business plan for Madison Capital in 1999 and subsequently initiated it with four other individuals in 2001. We've been working with Angelo, Gordon & Co. to build out the Twin Brook platform since October 2014.

What are your primary lending structure preferences (revolver, first lien, second lien, etc.)?

Trevor Clark: We've built relationships with approximately 350 different PE firms over the last 15 to 20 years, and have closed deals with more than 225 different middle-market PE firms over the course of our careers. We primarily provide first-lien, senior secured products. In fact, 95%+ of the assets in our portfolio are first-lien senior secured. We also provide same-day funding revolving credit facilities, so we are distinctive in the fact we provide revolvers in every single deal we do. Many of our competitors will sell off revolvers to commercial banks, while we ensure we can provide a revolver in deals we complete. Additionally, we have the flexibility to invest up and down the balance sheet (second lien, mezzanine, equity co-invest, etc.), however, we are primarily first-lien senior secured lenders.

> **An aspect that unfortunately gets overlooked by most is that a revolver is a great way to see what's happening with the business on a daily basis.**

Why do you like providing revolvers—a counterintuitive strategy to the majority of the market?

Chris Williams: PE clients appreciate working with one solution provider. When competitors sell off a piece like a revolver to a commercial bank, a sponsor then must manage two relationships. We don't want to be holding the clear majority of a loan and sitting behind a commercial bank that is controlling the liquidity for a business. Over the span of our careers, we've found it much more simplistic to provide a revolver, which helps us focus on the execution and overall experience for the sponsor. When we work with borrowers owned by PE firms, we get very entrenched in these relationships, so from that perspective, we find it to be a critical element in driving our win rate. To date, we have been Administrative Agent on more than 80% of the deals we close, partially because we bring this capability to the table. An aspect that unfortunately gets overlooked by most is that a revolver is a great way to see what's happening with the business on a daily basis. When you are effectively managing a credit, there's no better way than to understand the daily liquidity needs of a borrower. Especially when a liquidity crunch in the credit cycle begins to unfurl, having the granular insight a revolver can bring along with controlling access to those funds can be critical.

What types of businesses are you typically looking to finance? What kind of sector expertise do you have?

Trevor Clark: We're going to see anywhere from 1,000 to 1,200 opportunities a year, as we are a generalist firm, however, we have very strong sector expertise in healthcare, insurance and financial services, aerospace & defense, specialty chemicals and software services. The professionals on our team that cover these sectors are highly experienced and have been doing these types of deals for many years. At the end of the day, PE firms value this experience and want to work with a lender that understands the fundamentals of the business they are acquiring. The coupling of the generalist side of the business along with the sector expertise allows us to create a highly diversified portfolio of borrowers, which is important in terms of managing downside through credit cycles.

Why do you feel that origination through PE sponsors is the superior model?

Chris Williams: Most of the senior leadership team here at Twin Brook has worked together for over 10 years; Trevor and I have worked together for over 19. As you can see, we have a lot of cohesion across our team. Our senior origination team has sourced deals various ways throughout their careers. We feel that sourcing through PE sponsors is a far superior model versus other forms of deal sourcing, especially when you factor in loss-adjusted returns after a major credit cycle. There's an extensive amount of companies within the US middle market; a large percentage of the higher-quality, better-run companies are being pursued and acquired by PE funds. When you think of the selectivity that PE firms bring to the table and couple it with the fact that we're reviewing 1,000 to 1,200 of these companies each year, we're seeing a large part—if not most of—existing deal opportunities. By limiting the number of opportunities we select, we increase our capability in targeting the right types of companies, whether by industry or size, and certainly by credit quality. By the end of the process, we close on less than 5% of the deals we see.

> **At the end of the day, PE firms value sector-specific experience and want to work with a lender that understands the fundamentals of the business they are acquiring.**

To that point, on a loss-adjusted basis, it's our opinion that the sourcing model using PE sponsors is far superior. From a relationship perspective, we like the model of sourcing via PE sponsors because when you've focused on a certain part of the market for as long as our team, it creates a barrier to entry for newer, capital-raising firms in terms of experience. Most of these firms have entered the market in the past six to seven years, while we've managed businesses through the 2008-2010 credit cycle. Building deep relationships through the economic downturn established a level of experience and credibility which firms newer to the market lack.

How thorough is the diligence process?

Trevor Clark: A typical deal process for us is 60 to 90 days. Through a combination of third-party diligence being performed by the PE firm (accounting review, market studies, customer calls, legal, background checks, environmental, etc.) along with our own thorough diligence process, we find ways to peel back the layers of the business to fully understand what makes a company tick. What's also incredibly important is operational support. Their outreach to operating partners and additional management means that when it comes time for us to sit across the table with mostly committed funds, they're more likely to remediate with capital to resolve any problematic situations.

> The fact our team has closed over 1,200 transactions with 225 different PE firms over the last 17+ years of our careers speaks volumes to our ability to execute.

What are PE sponsors looking for in a lender?

Chris Williams: In our part of the market, PE firms are more relationship-focused and looking to work with lenders they know and have closed transactions with previously. The fact that our team has closed over 1,200 transactions with 225 different PE firms over the last 17+ years of our careers speaks volumes to our ability to execute. They also want to work with a lender they know is going to be efficient and reliable in terms of being in the market. The borrowers in this part of the market are typically very active as the sponsor is usually looking to expand their facilities and products, purchase add-ons, or do things to grow the enterprise value of the company. They want a lender that is consistently in the business, knows what they're doing, how to execute efficiently, and can do all that with an experienced team. We've been there and done that for a long time, and that's the reason we've been the agent on 80% of our deals.

> You'll start to see a bit of a shakeout where the more established, long-term lenders continue to gain share and newer entrants will struggle to maintain relevance.

What are your thoughts regarding Dodd-Frank and other possible regulatory changes that may make it easier for banks to reenter your market?

Chris Williams: Someone must provide capital to these businesses, so new lending entities have emerged over the last six-plus years to fit that need as many banks exited due to the shifts in the regulatory environment. Regulatory changes were the impetus for this. There are still commercial banks that are active in the market, especially larger banks focused on the upper end of the market. Given the ease of raising money over the last several years, many new players have entered the market. Some of these entities have experienced teams and long track records of lending through credit cycles. However, many new lending entrants to the middle market within the last four to six years are green to the game and have not managed large portfolios through a cycle like that of 2008 to 2010. At some point, we feel as though the regulatory environment will ease and the ability for commercial banks to reenter the market will naturally occur. I think you'll start to see a bit of a shakeout where the more established, long-term lenders continue to gain share and newer entrants will struggle to maintain relevance. Also, when the next credit cycle comes—which it will at some point—it'll be interesting to see how some of the inexperienced players in the market work through that process.

What's your outlook on the market moving forward?

Trevor Clark: Without sounding repetitious, it really comes down to what part of the market you're focusing on. When looking back at how people previously defined the middle market, you'll notice it's changed dramatically, and there's a reason for that. It used to be companies with $50 million EBITDA and below—now it's being defined as companies with upward of $125 million to $150 million of EBITDA. There are large asset managers that decide to implement a direct lending operation and enter the market because it's a great environment to raise capital and grow assets under management. Historically, it has always been a very good business as long as you have the right team in place that understands how to underwrite the businesses appropriately on the front end, and also how to manage through tough situations. Looking at the current management running newer groups and their origins, they come from the broadly syndicated lending market or other asset classes that are fundamentally different. Many of the new management teams weren't even a part of the management team at their prior organizations or certainly weren't making credit or workout decisions. If you're really trying to break into the middle market and move in to historically defined segments—where Twin Brook has been for three years—how are you going to get deals done? They begin to redefine the companies with $125 million to $150 million EBITDA, as different types of sponsors are less relationship-focused at that stratospheric level. Who's going to provide the highest leverage and loosest terms? There's a different process at that level, and that's where a lot of people have been pushed. That's where they get their deal flow. It's an interesting development and even more interesting to see who raised that capital and what they need from the market.

> If you are really trying to break into the middle market and move into historically defined segments—where we have been for a long time—how are you going to get deals done?

What will happen when the next credit cycle occurs, and how will the lending landscape change?

Trevor Clark: I think you're going to see a large shakeout similar to what happened in 2008 through 2010. Look back at how many lenders went away during that timeframe. Many of the less-experienced firms that started in 2005 to 2008 went through experiences that mirror what you see happening today. Many new firms have popped up over the last five to six years. Our view is that you'll certainly see some pain in the portfolios of those taking on riskier assets and the groups that don't have experience managing through a credit cycle.

Are you giving away pricing or terms, or doing covenant-light deals to separate yourselves from the rest of the market? How has business been so far in 2017?

Chris Williams: No, we don't do covenant-light deals. Also, our spread pricing and leverage levels have remained very consistent over the last 12 to 18 months. We feel very strongly about the opportunities we're seeing and our ability to win mandates on the companies we choose to pursue. It simply comes down to our ability to tap deep relationships. There's no easy answer or better way than that. Our highly experienced origination team grew up on the underwriting side of the business and knows credit extremely well. We've built many of these sponsor relationships over a 15+ year period and have closed a double-digit number of transactions with many firms. Trevor and I feel that our team is one of the best in the market. One of the primary reasons why Trevor and I decided to partner with Angelo, Gordon & Co. was its long-term focus and desire to build a best-in-class business. Bringing over a high-quality team to join Trevor and myself was a big part of that business plan. From our perspective, we feel good about our capital base. We're on pace to see over 1,200 transaction opportunities in FY 2017, and so far, we've closed over $1 billion worth of deal commitments in 2017. Assuming that market conditions hold steady, my expectations are that we end up closing somewhere between $2.0 billion to $2.25 billion for FY 2017 happening today.

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