A Look into the US Private Debt Market

- John Brignola, Managing Partner, LBC Credit Partners

What changes have you seen in the US private debt market over the past 12 months?

2014 was an interesting year, and one that has kept us on our toes. Pricing came under pressure in the first half of 2014, followed by a relatively steady increase throughout the rest of the year. We saw a lot of our competitors reach for yield, which was something we needed to be mindful of. We took a step back as we saw this unfold and kept true to our discipline. In terms of dollars, 66% of the deals we closed in 2014 were funded in the second half of the year.

Where do the opportunities lie within the space for 2015?

We have seen an increase in M&A activity which has led to more deal flow from our sponsor partners. We are still seeing opportunities from our private owner network, but we have noticed a bigger spike on the sponsor side.

With such high (purchase price) multiples witnessed in the mid-market and lower-market private equity space, have you seen this translate into less deal flow in the private credit space?

Not at all, in fact our deal flow has actually increased over 20% in the TTM period. We have a strong, senior team of investment professionals that are out in the market every day building our brand with sponsors, bankers and a multitude of other deal sources. We are very lucky to have our existing group of partners. They know us well and have worked with us for many years. I think being an established and trusted lender in the space for over 10 years has really kept our pipeline consistent.

Despite increased multiples, private equity sponsors are still putting money to work. Overall, there is a decent amount of dry powder out there, and sponsors are continuing to raise capital. What we look for in our sponsor partners is commitment to the businesses in which they are investing, which means financially and operationally supporting them throughout their ownership term. That gives us an alignment of interest between the equity owners and LBC.

As investors across the capital structure, did 2014 present more opportunity in the senior part of the capital structure or among more subordinated debt? Do you see this holding true in 2015?

Absolutely, from a risk-adjusted perspective we have seen better opportunities on the senior side. This actually has been a favorable environment for us. We tend to overweight senior in the debt stack; our goal for our investors is to provide current income while preserving principal. It is a balance that we have maintained throughout our 10 years of business and we are proud of that discipline, and our investors have come to expect that from us.

2015 is likely to play out like last year. The better risk adjusted returns are likely to be in the senior part of the capital stack. It is difficult getting an appropriate return for junior risk today. If the market perceives a changing default environment, we may see some more opportunity on the junior side, but for now the market does not seem to be pricing in an elevated default rate.

When will we see a rise in interest rates and how could this affect the private debt markets? Near-term effects and long-term effects?

We think this is going depend on several factors, not least of which is the outlook for jobs and wages, both of which have shown solid growth in the final months of 2014. Based on the short-term interest rate curves, we think a rate increase will happen sometime in mid-2015. As long as LIBOR rises gradually, companies should be able to adjust to higher interest rates. If the increases are accelerated, we may see some companies struggle with the higher debt service. In the long-term, companies will learn to adjust to higher borrowing costs. From an M&A perspective, elevated rates may put a damper on purchase prices.

Has the explosive growth in private debt within Europe affected the markets here in the US? Has this created a more international allocator base here in the US?

I think the growth in the European markets is positive for investors looking to diversify their private debt portfolios. I do not think it will impact our ability to attract investors because it is not what we do; we are focused on North America-based borrowers. Investors that want European exposure are not going to be looking to us, and I do not see increased activity in European private debt cannibalizing our investor base.

LBC Credit Partners

Founded in 2005, LBC is a leading provider of middle market financing solutions including senior term, unitranche, second lien, junior secured, and mezzanine debt; and equity co-investments to companies with EBITDA generally greater than \$5mn. LBC follows a long-term approach to investing adhering to a “lend and hold” strategy and typically invests \$10mn to \$50mn per transaction supporting acquisitions, growth strategies, refinancing, recapitalizations, and restructurings.

John Brignola is a founder of LBC Credit Partners and chairs the firm’s Investment Committee. He is responsible for LBC’s origination, research and credit underwriting functions. Mr. Brignola has 26 years of senior debt, junior debt and special situations investing experience. Prior work experience includes various positions at Citadel Investment Group, PPM America and AT&T Capital. He is a board member of Supply One Holdings, LLC, an LBC portfolio company, former board member of the Turnaround Management Association and a member of the Association for Corporate Growth, Turnaround Management Association and Commercial Finance Association.

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