What Is Next for US Private Debt?
- John Brignola, Managing Partner, LBC Credit Partners

The Fed recently raised rates 25 basis points. What effect, if any, will this have on the private credit space in 2016? Would any further increases have a different impact?

A large amount of loans in our market have LIBOR floors that are above current LIBOR levels, so this increase will likely have a limited impact on existing borrowers' cost of borrowing and a small impact on loans that are in the process of being finalized. During the last rate cycle, private debt was a much smaller market, so there is not a lot of past precedent to go on. That being said, it has been the expectation of most Fed watchers that the Fed will continue to increase rates modestly over the course of 2016. LBC and other market participants have factored increasing rates into our analyses when determining proper debt loads for potential borrowers. Of course, a material deviation in Fed policy from current expectations could alter those analyses over time.

There has been quite a bit of press focused on the high-yield credit market, more specifically issues of liquidity. Does this have any effect on the private debt market?

When the high-yield market experiences a broad change in risk appetite, whether manifested through a change in overall credit spreads or a change in demand for riskier deals, the private debt market usually experiences some impact several months later, because private deals take more time to complete and there is some investor base overlap. In this particular instance, much of the selling in the high-yield space appears to be driven by the rising rate environment and the desire to exit distressed energy investments. Private loans are typically floating rate instruments and therefore not subject to rate risk. Additionally, because there is limited trading of loans in our market, lenders to the energy space must take a long-term view when working with distressed borrowers. At this time, LBC has minimal energy exposure.

Does the theme of banks retreating from lending still continue to be the main driver in increasing deal flow? Are you continuing to see more borrowers that may have traditionally sourced capital from a bank?

It is a source of our deal flow, but there are other factors contributing to the increase of deals in our pipeline. Our team has been together for over 10 years, executing the same strategy, same borrower profile, same suite of financing solutions; the only change has been the refinement of our process. The market knows LBC, what we do, how we do it, so borrowers view us as less risky from an execution standpoint. They know we spend time understanding their business, current and future capital needs and the growth plan; they appreciate having a lender as a partner.

Certainly as sources of capital recede, others, such as LBC, step in to fill the gap. We understand that we must stay the course in terms of our diligence process, our pricing discipline and the other factors that contribute to our decision to lend. Now is not the time to waiver on these principles.

As more and more managers are entering this space, are you seeing increased competition for deals? Has this affected yields in any way?

On any given day there are competitors in every market, it is what makes a free-market economy great. For us, a few years back we saw an increase in BDCs, prior to that, CLOs. These days it is the junior lender looking to make senior deals, equity sponsors starting a debt fund or large cap lenders moving down market. When more money is being put to work in the space, yields can compress and vice versa. Again, being a veteran lender with the same product, same company size and a deep diligence process has really had a big impact on our ability to win the right deals.

What is the biggest threat to the private debt space?

We feel pretty confident that the bank regulatory environment, the amount of money raised by private equity sponsors, and the vintage of existing private equity investments will act as tailwinds for private debt investors such as LBC and mitigate any minor economic disruptions. The biggest threat to the private debt space in an environment such as this is a geopolitical or economic event that affects the broader economy as a whole.

What do you see happening in the space over the next 12 to 24 months?

It is always difficult to predict what will happen over the next few years, but we have found that the firms that survive and thrive throughout the cycle share similar characteristics. Those qualities are the ability to maintain consistent credit standards and the application of a flexible mandate, which allows them to invest throughout the capital structure in order to generate the best risk-adjusted returns for each situation.

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 29 years of senior debt, junior debt and special situations investing experience, with the past 18 years dedicated to private debt investing and special situations markets. Prior work experience includes various positions at Citadel Investment Group, PPM America and AT&T Capital.

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