KEYNOTE INTERVIEW

Reflecting on the past, preparing for the future

Twin Brook Capital Partners' founder and managing partner Trevor Clark looks back at trends in 2019, discusses the current state of the market and shares his views on the keys to continued growth in 2020

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Q Looking at the industry's evolution over the past year, how has the dialogue around manager and lender selection changed?

With a significant amount of capital raised across the direct lending landscape in 2019 and the increasingly common view that we are nearing the end of the credit expansion, we're seeing investors and the private equity community place greater emphasis on experience, reliability and consistency.

If you look at the universe of direct lenders today, there are not only many new entrants, but also a number of firms whose strategies or the sectors they serve have shifted over time. In our view, firms led by professionals with decades of experience are not commonplace, and it's even rarer to find highly experienced lenders that have remained focused on the same strategy or part of the market.

Our focus has long been the lower middle market, and we don't veer in and out of other sectors. Many of our senior professionals have been lending in this space through multiple credit cycles – managing portfolios and working hand-in-hand with borrowers and their sponsors through both periods of expansion and stress. These experiences have allowed us to build strong sponsor relationships, and I think that consistency and reliability – particularly in periods of uncertainty or in the face of potential market disruption – have led to us being viewed with a greater level of confidence.

Q BDCs continue to be a popular point of conversation. Are there any specific trends or topics that you're seeing attract more attention? And what do these mean for BDCs going forward?

When it comes to BDCs, we saw the often talked-about, but not yet realised, wave of consolidation among public players finally start to accelerate in 2019. This was particularly true of public BDCs that had been subscale for an elongated period of time or that had experienced some performance issues, a number of which – whether by choice or due to activist investor pressure – decided to scale by merging with others.

Another recent trend has been the proliferation of private BDCs, and I think the opportunity set in that marketplace is real and won't be going away in the near term. While we may see further consolidation among existing subscale public BDCs, I believe some of the new private players will likely start coming to market and taking up some of that space.

Now that the older crop of public BDCs has started to shake out and we're seeing more private BDCs be created, I think the questions on many people's minds are: how many of those private BDCs will ultimately come to market; and how will that impact the competitive dynamic among the direct lending groups involved?

Q As we've moved into the new year, there has been much speculation about a potential turn in the credit cycle. In your view, what will be the key factors that drive manager differentiation in the face of the next downturn?

Much of this will depend on what's driving the next downturn, but assuming it's a broad macroeconomic contraction, this circles back to why there's been an increased focus on experience. If a manager doesn't have the ability to look at history as a guide, I think they might struggle to understand what the early warning signs of a turn in the cycle mean in terms of the actions they should be taking.

For example, in some parts of the middle market we've seen a shift away from covenants, but many of these lenders weren't in the market during the global financial crisis, so they have never been in a situation where they needed them. Having experience navigating a downturn can help inform what covenants a lender puts in place today because they know, in the face of a larger number of defaults, that they are going to need to take certain actions with some borrowers. Those that have been less stringent when it comes to covenants and lender protections may not be as well prepared to manage those stressed credits through a downturn.

We've found that lenders that have navigated a downturn are likely to also have experience with and understand bank group dynamics, so they know that they'll need to work collectively alongside borrowers' private equity owners in an effort to achieve the best possible outcome for all parties.

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Q Stepping into that a bit, do you think portfolio management has started to garner greater attention? Do you think managers are beginning to do anything or will need to do anything differently in order to navigate a downturn?

I think portfolio management has certainly become more of a focus – both among managers and across the investor community – as conversation about a potential downturn has increased. With that said, we believe having the right team, processes and tools in place is key regardless of where you are in the cycle.

If you wait for a broader economic contraction to begin hiring people who have worked through multiple credit cycles and getting the appropriate resources locked down, you're behind the curve and playing catch-up. We believe it's key to ensure that for each borrower in a lender's portfolio, there is a committed team with deep knowledge of the company, and that your people have the bandwidth to manage those cred-

its. This is the reasoning behind the maintenance of our borrower-to-account manager ratio. We believe this enables us to ensure we have the capacity built into our system to give credits the appropriate time and attention, and if an issue arises during the life of a loan, additional people and resources can promptly be brought in.

With that said, it's not just about having the right borrower-to-underwriter ratio. It's also about the system and processes you put behind those people to make sure they can operate as efficiently as possible and are ultimately successful. We can speak to just how important this is and have built a system that utilises a number of tools, including a proprietary software package. This system not only allows us to monitor our credits and a broad range of analytics in real time, but equips us to better serve our borrowers and their sponsors, as it helps us spot potential issues and understand the factors driving them early on.

Q Assuming the economic status quo continues, with no near-term downturn, where do you see the mid-market going over the coming years? And how could that impact deployment across the space?

One of the things we love about the lower middle market – where there are constantly new companies being created and established, entrepreneur owners selling their businesses – is that because we frequently first work with borrowers when they're very small, we often lend to them repeatedly through a couple of different private equity sponsors.

Additionally, when we look at what has transpired over the last 12 to 24 months, we've seen an amplification of lower middle-market private equity firms' ability to bring down their multiples via add-on acquisitions, draw out synergies and highlight the value of their operating expertise. We've seen these sponsors demonstrate a great deal of sophistication when it comes to growing small businesses and improving operations, and their efforts to meaningfully transform their portfolio companies often call for continued lender interaction and additional financing.

As a result, we strongly believe that the market opportunity is very attractive, even in a status quo environment, and that this is mainly due to the nature of the sector in which we operate. ■

People power

Q With your emphasis on experience and having the right people in place – regardless of where we are in the cycle – in mind, what are the biggest challenges when it comes to establishing and growing a strong team?

The headline challenge is: how do you attract, train, motivate and retain high calibre talent? Members of our senior management team have been working in the lower middle market for over 20 years, and we built Twin Brook with the knowledge that this is a human capital business – especially in our part of the market – top of mind.

Years ago, commercial banks ran large training programmes that firms could recruit from. But those programmes do not exist anymore, which forced many to change their approach to hiring and team growth. Our view has always been that in order to establish and steadily expand a great team, you need to find skilled, dedicated people who are not only capable of carrying out their respective roles, but who also buy into and are accretive to your broader business strategy and the organisational culture that guides how it's executed.

We have long been committed to fostering a culture that attracts smart, collaborative individuals at all experience levels and ensuring we have the infrastructure and resources to support both initial training and ongoing professional development. When it comes to the interview process, we want people to understand that it's about more than just the analytics and "can you do the job?" It's understanding our process, how we approach the business and how we interact as a team – all of that is equally important to us.

We have found that our people are ultimately our greatest asset when it comes to stable growth. They are central to the recruitment, sourcing and screening of talent, and at this point, almost enable us to self-populate by surfacing excellent candidates through a variety of personal and professional networks.