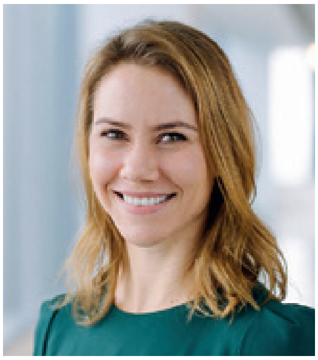
E X P E R T Q & A

In the direct lending space, portfolio management has come under increased focus, explain Twin Brook's Drew Guyette, Therese Icuss and Kim Trick



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Q How has portfolio management changed in recent years?

Drew Guyette: From a fundamentals perspective, Twin Brook's approach hasn't changed and that consistency is key. Portfolio management has been and continues to be focused on risk management as well as client experience and execution. As a firm dedicated to serving the lower mid-market, the frequency of our borrowers' financial reporting and the regular interactions we have with them remain core to our approach of spotting trends so that we can address the needs of these companies as a lending partner, support their private equity sponsors as they execute on their value creation strategies, and mitigate risk across our portfolio. The depth of analysis and work that goes into monitoring each borrower's performance and these trends is very much rooted in the experience our senior management team has gained during their 20+ years in this space. With that said, the technology and systems for monitoring and managing private debt portfolios have improved significantly over the last decade. We've invested in more advanced, flexible technology and built a proprietary system that not only allows for the monitoring of our credits and a wide range of analytics in real-time, but equips us to better serve our borrowers and their sponsors and manage our broader portfolio, as it helps us identify trends and potential issues and understand the factors driving them early on.

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Q Is the topic increasingly a point of focus for mid-market sponsors and LPs?

DG: It's certainly started to garner increased attention in the private debt space. Historically, the natural default was often to focus on originations and the new deal underwriting process. In recent years, we've seen the conversation, among both investors and private equity clients, shift to portfolio management experience. I believe that's a function of a number of things, including increased speculation about where we are in the credit cycle and greater awareness of how important portfolio management experience can be when it comes to effecting positive outcomes through both periods of growth and distress.

Therese Icuss: The value sponsors place on lenders' portfolio management approaches and capabilities is also influenced by what part of the market they operate in. Private equity firms that focus on the lower mid-market often have a more active ownership style, as they seek ways to create meaningful value at their portfolio companies. Their strategies frequently include initiatives that require additional financing and continued lender interaction, so they're looking for a long-term lending partner that's not only committed to working alongside them as they grow these businesses, but that also has a demonstrated ability to manage through multiple credit cycles in their sector.

Q How does portfolio management differ in the lower mid-market versus the broadly syndicated (BSL) market?

DG: In our experience, portfolio management in the lower mid-market is rooted in high-frequency, high-quality touch points with companies, their management teams and their private equity sponsors; whereas in the upper middle or BSL market, lenders may take a more passive approach to managing a large number of borrowers. On a regular basis – whether it be daily, weekly or monthly – we're interacting with our borrowers about everything from liquidity management, to financial performance, to organic events taking place at the company. In contrast, we see much of the portfolio management-related activity in the BSL market taking place on a quarterly basis, with longer gaps between touch points with companies, lags in financial reporting, and a dialogue that may not go beyond the financial statements.

Q When it comes to managing a portfolio effectively, are there advantages to being an agent versus a participant?

DG: As the administrative agent, you have greater access to a company's management team and sponsor as well as higher-quality, more timely information that goes beyond what's in the financial statements. You're typically interacting with a company's CEO, CFO and controller and their private equity sponsor on a consistent basis, providing for greater insight into the business's key performance indicators, forecasts and discussions around customers, sales and more. Additionally, the in-depth diligence the agent is able to lead pre-close allows them to develop a better understanding of the nuances that will continue to impact the business going forward, making that lender better-positioned to manage the credit within their portfolio and support the company and its sponsor.

Kim Trick: Being the administrative agent also allows you to be the revolving lender, which we believe can offer tremendous value, as it provides for an early indicator of stress on a company's cashflow, well before you'd receive monthly financials. Cashflow stress can be driven by positive or negative factors, but providing the revolver and having early visibility into that stress makes you better able to directly impact outcomes regardless of the cause.

Q Given the current market environment, are you changing your approach?

TI: We of course pay close attention to the economic environment and have always had regular, real-time dialogues with our borrowers about a range of topics, including how their businesses could be impacted by macro moments. These frequent conversations are a staple of lower mid-market lending and continue to take place, especially in these unprecedented times. However, it's important to note that we apply the same rigorous approach to new deals and portfolio management regardless of where we are in the cycle. As a firm, we've long tried to avoid businesses that are heavily cyclical or exhibit performance volatility, and we're not looking to time the market.

KT: Therese and I worked through the last recession and our senior management team has been through multiple cycles, so we've seen what can go wrong when strong standards aren't maintained and understand the importance of proactively monitoring for and addressing potential issues. That experience has definitely driven Twin Brook's commitment to consistency and informed our underwriting and portfolio management strategy. Our high-touch approach when it comes to relationships and dedication to active tracking were born out of the knowledge that having the right infrastructure, resources and data are critical to being able to manage accounts and serve as a reliable partner to borrowers and private equity clients.

Q How would you describe Twin Brook's approach to underwriting and portfolio management?

TI: I'd describe both as consistent, methodical and comprehensive, regardless of market conditions. Our underwriting process and post-close monitoring are aimed at both mitigating risk and supporting our sponsors' growth strategies for their portfolio companies. Our teams are designed with this in mind, as the deal team that underwrites a new opportunity remains with that account through the entire lifecycle of the credit. This is important because we find that what's learned during the underwriting process often helps guide the areas we focus on tracking during portfolio management.

KT: We believe this team continuity also provides a seamless experience and greater surety of execution for our borrowers and sponsors. The frequent and ongoing nature of our interaction with these management teams and private equity firms not only allows for consistency and clarity in expectations when it comes to working together, but supports our efforts to build on and expand those relationships. I think the fact that we've worked with many private equity firms on multiple transactions with a variety of their portfolio companies demonstrates how much those sponsors value our approach and appreciate the expertise and reliability we bring to bear. ■