Q&A: A partner through cycles

The first two quarters of 2021 have proved to be busy ones for PE sponsors and direct lenders alike, and many expect that pace to continue as we head into the latter half of the year. This comes in sharp and welcome contrast to early 2020, when the outbreak of the COVID-19 pandemic resulted in an abrupt slowdown in M&A. Twin Brook Capital Partners' Pete Coffin, Nick Fessler, and Aaron Pontsler discuss their experiences working through the pandemic, the state of the market today, and their expectations for the future.

Pete Coffin (left) | *Vice President*

Pete Coffin is a Vice President at Twin Brook, focusing on the origination, evaluation, structuring, and negotiation of new healthcare lending opportunities with PE sponsors.

Aaron Pontsler (middle) | *Vice President*

Aaron Pontsler is a Vice President at Twin Brook, focusing on the origination, evaluation, and structuring of new loan opportunities with PE sponsors across a broad range of industries.

Nick Fessler (right) | *Vice President*

Nick Fessler is a Vice President at Twin Brook, focusing on the origination, evaluation, and structuring of new loan opportunities with PE sponsors across a broad range of industries.

The past 12+ months have been eventful to say the least. What are your key takeaways from working through the height of the pandemic and beyond?

Nick: I think this experience really shined a light on the importance of the detailed diligence we do during initial underwriting and our high-touch approach to ongoing portfolio management. Our deal teams put in a lot of work getting to know these companies at the outset and maintain ongoing dialogues with their management teams and sponsors. This was key through the pandemic, as I think the strong relationships, open lines of communication, and deep knowledge of each of our borrowers that we already had in place proved vital. Having that foundation positioned us to respond quickly, supported our ability to proactively work with borrowers and sponsors to navigate any potential issues, and allowed for greater flexibility when it came to generating solutions and helping them execute on opportunities as their focus returned to growth.

Aaron: I think the resilience of our portfolio companies through the pandemic also speaks to Nick's point about the importance of underwriting and our focus on credit selection. Much like our PE clients, we look to support businesses that are cycle-agnostic and have compelling value propositions. As a result, these companies were able to survive mandated shutdowns and other pandemic-related challenges and come out the other side—in some cases, even stronger than before. In my view, this situation also demonstrated why experience and relationships matter. Our senior leadership team has worked through multiple cycles in this space, cultivating extremely deep sponsor relationships, and that experience has certainly informed how we operate. From our immediate response as the pandemic erupted in the US last March, reaching out to assure borrowers and sponsors that Twin Brook was there for them, to working hand-in-hand to make sure those businesses had what they needed to navigate the initial shock and beyond, our commitment to being a reliable, long-term lending partner was clear.

Pete: Expanding on Aaron's point about the value of longstanding relationships, I think this proved to be true for lenders and sponsors alike. Having trust that your counterpart will make the right decisions in a challenging environment and the alignment of expectations that comes from developing those relationships is invaluable. And I think it is very difficult to establish that dynamic if you take a commoditized, transactional approach to selecting who you work with. I think the events of last year also highlighted the importance of being thoughtful when it comes to structuring deals, with a focus on ensuring companies have the ability to maintain adequate liquidity through both periods of growth and distress. Looking to the broader market, the companies that we have seen run into trouble have often been those that were aggressively structured in terms of leverage or pro forma EBITDA adjustments. Although looser terms and more aggressive structures have become increasingly common in recent years, Twin Brook has long remained consistent and disciplined in its approach, and I think we saw the benefits of that during the pandemic.

How would you describe the market environment today?

Aaron: I would say it has been, and we expect it will continue to be, a very active and competitive environment. Beginning around September of last year, transaction activity started to pick up, and the pace has continued to accelerate since then. We had an extremely busy fourth quarter and a record first quarter in terms of deployment, and we are hearing similar commentary across the market and from investment banks. In terms of the types of transactions we are seeing, it has been a healthy mix of existing portfolio or add-on activity as well as new deals.

Pete: Activity in the healthcare space, in particular, has been consistently high over the past few quarters. There are some businesses that performed well through the pandemic and are now looking to opportunistically consolidate their respective subsectors and capitalize on rebounding market conditions, as well as some smaller companies that are looking for the resources and expertise that can come with rolling into an established, PE-backed platform. Additionally, we're operating in a constantly evolving regulatory and reimbursement environment, which I think has and will continue to drive robust deal activity in the healthcare space.

Nick: Looking to the economy broadly, you hear a lot of commentary about pent-up demand, and I think that concept also rings true for PE firms and direct lenders. There was an abundance of dry powder in both spaces in 2019 and early 2020; then the pandemic hit, and markets ground to a halt as sponsors and lenders alike turned inward to focus on their existing portfolios. Now that some of the uncertainty plaguing markets last year has subsided and there is more visibility around company performance, I think many are looking for ways to put their money to work.

What do you expect deal flow to look like through the balance of this year?

Nick: Our pipeline has been robust through the first half of 2021, and we expect that intensity to continue in the months ahead. We covered many of the reasons for this before, in our discussion about the current market environment, but there are a few additional points I think are worth highlighting. There were a lot of transactions that were put on hold last year, as companies and their sponsors waited for the environment and financial performance to stabilize. Many of those businesses fared better than initially anticipated and, with the country reopening and vaccination rates increasing, they are now coming to market. Additionally, we expect concerns about the impact of potential changes in tax policies may motivate some businesses to pull forward sales.

In this environment, what do you think PE sponsors and their middle-market companies are looking for in lenders?

Aaron: Given how competitive the market has been and is expected to remain, deal processes have been moving extremely quickly and, in many cases, PE firms don't necessarily have time to run a full debt process and entertain multiple lenders. I think they are looking for a reliable lending partner that understands their value creation strategies for their portfolio companies and will do what they say they will, when they say they will. Being able to offer the best pricing and terms is essentially meaningless if you can't get the deal to close. In this environment, I think being able to hold the entire facility, work under an accelerated timeline without cutting corners, and provide surety to close is really important to sponsors.

Pete: Having a proven track record as a lending partner and wealth of experience have, in my view, also become meaningful differentiators in the eyes of PE firms. Being able to demonstrate that you have successfully managed your portfolio and supported borrowers through cycles, that you consistently deliver on your commitments, and that you have the appropriate expertise, infrastructure, and resources to support their growth strategies and work with them through whatever may happen post-close is critical.

To learn more about Twin Brook and its cash-flow based financing solutions for the middle-market PE community, visit www.twincp.com.