Lead Left Interview – Robert Grunewald _ Part Two

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This week we continue our conversation with Robert Grunewald, chief investment officer at BDCA Advisor, LLC. BDCA (Business Development Corporation of America) is a BDC focused on senior debt investments in middle market companies. ***Second of two parts –*** ***View part one***

TLL: *Waive fees to preserve the dividend for investors? That is unusual.*

BG: With almost $2 billion in AUM, we have some room to do that. Our philosophy is we are in this war forever with a very large organization that can support us for the long run.

TLL: *Who is that?*

BG: Our parent is ARC, American Realty Capital, a large, diversified asset management company which owns nine other real-estate oriented products in the non-traded space. It also controls a public entity called Realty Capital Securities. They've raised over $10 billion in capital across three vehicles; two REIT's have gone public.

TLL: *Switching to the markets, how long do you think this period of frothiness lasts?*

BG: I don't have a good answer for that. No one knows. Our view is we are in a period like 2007, in which rates and structures are compressed, but the difference now is that we don't have leverage in the system. So odds of a horrific crash are low. Plus the central banks will come to the rescue at the hint of any illiquidity.

TLL: *And volatility is non-existent.*

BG: Well, you've seen some in retail fund outflows in the broadly syndicated market. That's been helpful, because while middle market spreads aren't directly impacted by larger market technical, they are informed by them. Which means we don't have to chase the market at the moment.

TLL: *But there's so much capital coming into the middle market. Doesn't that concern you?*

BG: We are not a hedge fund, so we aren't going all to cash. We need to generate and protect yield and protect book value through the cycle. We will have a recession and we will have weakness in the portfolio, but we are well-diversified with over 100 companies in the portfolio.

TLL: *So it doesn't concern you that now everyone is a middle market platform?*

BG: Well, you know better than anyone that the term "middle market" is used without clearly defining what it means. You need to help us get clarity on that. But there are two natural barriers to accessing smaller companies. First, not everyone wants to make a $10 million loan. We're fine doing that. Second, not having a sponsor owning the equity isn't everyone's cup of tea.

TLL: *How about industry sectors? Likes and dislikes?*

BG: We are industry agnostic. Don't love restaurants, but willing to do them. But definitely won't do second liens for restaurants! Learned our lesson there. Healthcare and IT are two sectors that are covered by two great analysts of ours, so that's extremely helpful.

TLL: *Ok, so our standard final question: what's been your biggest surprise so far this year?*

BG: Well, on a personal note, when we founded BDCA we were very small. To grow AUM, we reached out to our friends in the market to team up on deals. It really helped to work with other firms who had great reputations to help us do business. So that was a nice surprise.

TLL: *Any negative ones?*

BG: Nothing really. Yes, there's lots of cash coming into the space. Or you might say, lots of uninvited guests in the house! But where's the better alternatives? Especially if you don't want to be in cash. Stocks? We're at all-time highs. Bonds? High yield is my least favorite place to be right now. Retail funds? Lots of technical risk.

TLL: *Which leaves middle market loans!*

BG: Middle market isn't a screaming buy, but it can generate good returns. New participants will either have to do it cautiously, or if they don't, they'll be out of business. And face it, with leverage we have $2.5 billion of capital, which is a lot, but not in the scheme of a $700 billion market.

TLL: *Can you stay differentiated?*

BG: We own an aircraft leasing business and a triple net lease business. And we're looking at factoring companies. So if we invest $100 million in each of those strategies, I would say that's differentiated. And we'll be earning good returns to our investors.

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