Lead Left Interview – Chris Flynn and Sam Tillinghast

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This week we speak with Chris Flynn and Sam Tillinghast, co-CEOs and co-CIOs of THL Credit. Headquartered in Boston, with investment teams in Chicago, New York, Los Angeles and Houston, THL Credit manages a BDC that invests primarily in middle market mezzanine debt for companies seeking capital for growth and acquisitions.

The Lead Left: Chris and Sam, congratulations on the Perspecta senior loan joint venture. But first tell us about what the market looks like for you today.

Chris Flynn: Our origination pipeline continues to be robust. To some extent, there are issues that help drive that flow like banking regulation that creates opportunities for alternative lenders. In terms of how competitive the credit markets are, we take the longer view and remain very selective. Our BDC's conservative growth is evidenced by the fact that we've only had two follow-on stock issuances since April 2010. We see lots of similarities to what happened in 2007 in the market today as it relates to aggressive pricing and structures.

Sam Tillinghast: In this environment, some managers choose to grow quickly by reducing their required yields. Others grow by maintaining yields but loosening their credit standards. We're sticking to our underwriting criteria and managing our yields and some quarters that may mean that our BDC doesn't grow.

CF: We think the joint venture with Perspecta is an appropriate way to create double-digit type returns for our BDC shareholders with a focus on first lien structures. It's an attractive risk-adjusted return in our view.

TLL: Great. Could you tell us about Perspecta?

ST: It's a trust business based in New Hampshire that provides investment and business services to high net worth individuals. Perspecta has been an important relationship of Thomas H. Lee Partners in private equity and THL Credit has a strong relationship with Perspecta investing in middle market loans.

TLL: How do you see this fitting with all the institutional appetite for loans out there?

CF: This is more of a family office type of investor that sees the benefits of directly originated loans.

ST: The joint venture focuses on first lien loans with less risk, less leverage and more security, allowing us to put up to two times leverage on assets. Our BDC is committing a $120 million equity contribution to the JV, with Perspecta committing $30 million. The equity is called as needed.

TLL: What kind of assets are in the BDC?

ST: We look at companies with Ebitda of $5 million and higher. We can do anything size-wise between $10-50 million, though we're best holding $30 million and less per investment. We can do first lien, second lien, unitranche and mezzanine. We have the ability to go up and down the balance sheet to find value.

CF: Our deal teams are in five separate offices; they are also responsible for origination. Each of the teams covers their own regional relationships.

TLL: What's the break-out between private equity and non-private equity financings?

CF: The BDC portfolio is about 82% PE focused, with the expectation that it will go slightly higher.

TLL: *How do you tackle industry coverage?*

CF: We try to keep an open mind. We thought at one time we would avoid restaurants and retail, but we've done some investments in both those sectors that have turned out well. Our strategy has been to develop expertise within different offices.

TLL: How much do you have in assets under management?

CF: We're approaching $5 billion across our platform, with about $1 billion in direct lending that includes our BDC and two private funds – our Greenway funds. The balance is in our Tradable Credit group which manages broadly syndicated loans in CLOs, closed end funds and separately managed accounts .

TLL: Do you have other joint ventures like Perspecta in the offing?

CF: We're open to other ideas. THL Credit is about developing a business; it's not like managing a bond fund. It's all about accessing proprietary deal flow from our five offices. It's Sam's and my job to effectively utilize the five-office footprint.

ST: The driving force behind the Perspecta JV is that it is difficult to hold a lower-yielding asset in the BDC and meet our targeted returns. However, the JV loans are attractively priced relative to the risk and the BDC will benefit from the additional portfolio leverage. In the third quarter, for example, our weighted average yield on new investments in the BDC was around 11%.

CF: Keep in mind that people misprice risk all the time. Lenders sometimes look at where they've raised money, not what the issuer should pay. The cost of funds for the lender shouldn't drive the price. Just because you have more leverage, doesn't mean you should lend your money at a lower rate.

To be continued the week of March 16

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