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Lead Left Interview – Patrick Dalton (Part 2)

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This week we continue our conversation with Patrick Dalton, CEO, Gordon Brothers Finance Company (GBFC). GBCF is a commercial finance company focused on middle market lending. They originate and underwrite secured loans for both asset-rich and cash flow generating businesses across a wide spectrum of industries.

Second of two parts – View part one

The Lead Left: Do you leverage your balance sheet?

Patrick Dalton: Deutsche Bank and Credit Suisse provide leverage facilities. For the client, it's a blended cost of capital. How much capital is available? Before BlackRock Kelso we had small holds. Now we're adding multiple pockets. We can use BRK's balance sheet – that gets us up to $100 million.

TLL: So I assume not much overlap with them.

PD: There are relationship benefits with BRK. They turn down 90% of what they look at. Most of the referrals they get didn't fit their lender appetite.

TLL: Are there any plans for BlackRock to increase their ownership stake in BRK?

PD: BlackRock owns one-third of BRK. It's their intention to acquire 100%, so it will become a BlackRock-controlled entity. Ultimately BRK will be BlackRock's direct lending middle market business.

TLL: Is there anything left of GB Credit?

PD: Most of the loans have been sold. We will liquidate that fund down. We want to grow. We will need resources.

TLL: What happens to your business when the cycle turns?

PD: Our business changes in a couple ways. First, our companies aren't always driven by cycles, more by specific micro issues. They may be affected by retail trends or the regulatory environment. But in a cycle, we will benefit. Banks, which have stretched in this frothy market, will pull back.

TLL: What if interest rates go up. Does that hurt you or help you?

PD: We have a huge competitive advantage. We know what the second lien values are if rates go up. That's great for us. We're 85% floating rate, but we're not expecting rates to go up much. In sectors such as energy, consumer, and aerospace – overcapacity will create opportunities, especially in Europe.

TLL: What are your typical advance rates?

PD: Generally we look at 90% of accounts receivable, but we can go up to 110% of inventory.

TLL: How do you get comfortable with that kind of advance rate?

PD: It depends. Our advance rates are asset dependent. In Europe banks aren't lending against inventory. There are different nuances in the US. Will Samsung want its TVs back? Probably. But will a manufacturer want their fasteners back when it's work-in-process? Probably not. We're more cautious on machinery and equipment, real estate, and intellectual property such as brands.

TLL: You said earlier you provide the next layer after the ABL revolver. Is that just first lien?

PD: We divide the balance sheet into five different asset classes. As our advance rates are asset dependent, so are tranches. We'll provide a first-lien on some assets, a second-lien on others, even a third-lien in some cases. We've never lost a penny in ten years on a collateral ABL loan.

TLL: Do you look at both sponsored transactions as well as non-sponsored?

PD: Ours is not typically a sponsor business. We're not competing against high yield or second lien at 6%.

TLL: How about pricing?

PD: Our target is double-digit net returns, not including PIK or warrants. We're mostly in cash-driven investments. The average return is 11-12% on a gross basis.

TLL: What's been your biggest surprise?

PD: That 40% of our deals are from the bigger guys – KKR et al. We want to be an equal share with them. We're looking to expand our reach. BlackRock and BRK will help us do that. No other valuation business has a credit platform.

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