Lead Left Interview – Robert Gefaell (Part 2)

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This week we continue our conversation with Robert Gefaell, co-founder and partner, Plexus Capital. Plexus focuses on subordinated debt investments in middle market companies, with a total of $550 million under management across three funds. ***Second of two parts – View part one.***

The Lead Left: That's pretty typical of smaller companies.

Robert Gefaell: You bet – most owners are looking for help in strengthening their balance sheet and their management depth in a growth scenario, while others are seeking to begin the succession planning process with the end goal of liquidity. We can help them in all these scenarios.

TLL: What kind of industries do you favor? Or not.

RG: We're agnostic. We like businesses we can understand – business services, light manufacturing, healthcare, distribution, etc. We are precluded from investing in real estate, re-lenders of capital, and project based financings per the SBA regulations – although it is rare we encounter businesses operating in these industries.

TLL: Any concerns about where we are in the cycle?

RG: Candidly, the large purchase multiples and increased leverage multiples in the market today give me pause. Pretty much reminds me of where the market was in the years leading up to the meltdown in 2008 – unfortunately there are groups out there who haven't listened to their rearview mirror – "Warning – objects may be closer than they appear!".

TLL: How much competition are you seeing in the mezz arena?

RG: We're certainly seeing it – lots of money chasing deals. Mezz funds, BDC's, unitranche funds, and senior debt funds are feeling pressure to deploy capital to keep their investors content. In a crowded market like we are in, this typically results in aggressive leverage profiles with squeezed pricing. It is imperative to Plexus' success we remain disciplined, first and foremost, on credit underwriting, and secondarily on risk appropriate pricing. We believe we are doing this well.

TLL: So your pricing is above market?

RG: That is one way to look at it, although I prefer to look at it as appropriate pricing for the market we serve. We aren't the cheapest capital in the market, but we aren't the most expensive either.

TLL: Fund I started before the Great Recession, so you experienced the full downturn. How has your track record held up?

RG: You're right, we invested right through the recession. We're quite proud of our track record for Fund I having generated to date (with two assets remaining in Fund I) a 10.3% net IRR, and a 1.7x cash-on-cash return. Fund II is 100% invested, but as Fund I was artificially low due to the recession, one might argue Fund II returns will be artificially high given the attractive investment window we had on the heels of the recession – we estimate an 18-20% IRR and 2.0x COC for Fund II given the returns realized to date and the status of our remaining investments. Fund III should be on target with our stated goal of a net IRR of 12-17% to our investors.

TLL: How do you view the economic backdrop?

RG: It appears relatively healthy, and I hope it stays that way, but I just can't help feel there is something around the corner – what, where, and how soon I don't know – but my gut is telling me something and to me that screams remain disciplined and remain alert.

TLL: What economic factors could be most vulnerable?

RG: I think the rate environment is potentially at risk. While I don't see the Fed doing anything drastic anytime soon, when rates go up it's definitely going to have an impact on those companies sporting larger-than-prudent leverage levels. Cash will get tighter, covenants will start to trigger, and lenders, specifically senior lenders with jittery credit officers, will most certainly get their antennas up with one finger on the panic button.

TLL: You've mentioned some SBA regulations impacting you. What are some others?

RG: The SBA is a great partner and gives us a lot of room to maneuver. The only other regulation worth mentioning is we are precluded from investing in foreign entities. It is rare we encounter this, but we have certainly seen a handful.

TLL: Anything else to mention about your track record?

RG: I'm proud to say Plexus was named the 2013 SBIC of the year by the SBA out of over 300 SBIC's across the country. I think that speaks to the wonderful team of 18 people we have assembled. I know it sounds clichés-ish, but we truly are a family with a lot of respect and trust in each other.

TLL: Congrats! So what's been your biggest surprise?

RG: I would say I'm still shocked by the precipitous fall of the economy and what transpired in 2008 and 2009. It really showed us that backing the right management teams and having conservative capital structures in place at close of a transaction paid off. We had a few issues, but the portfolio held up and we were able to ride through it.

TLL: Give us an example of the "few issues"?

RG: Well, we had an investment in a high-end door and millwork manufacturer in Florida focused on the residential building market…not sure I need to say anything else!

TLL: You said it well…no you don't. Thank you for your time.

RG: Thank you Randy.

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