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Lead Left Interview – Robert Radway

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This week we chat with Robert Radway, chairman and chief executive officer of NXT Capital. Started in 2010, NXT is a finance company that is focused on middle market corporate finance and commercial real estate along with having a very significant asset management platform. Prior to NXT Robert Radway was founder and president Merrill Lynch Capital.

The Lead Left: *Robert, thanks for making time for us today. How has the blueprint for NXT changed since you started the firm in 2010?*

Robert Radway: Thanks Randy. We've evolved in corporate finance and commercial real estate as we and our capital partners thought we would when we launched in 2010. NXT has recaptured a significant portion of the competitive position Merrill Lynch Capital enjoyed both in middle market leverage finance and in commercial real estate bridge lending. The flow, scale, and sponsor relationships – we have achieved much of what set out to do.

What is surprising is the extent to which institutional capital has come into the market. It's really changed the business and the firms competing in it. For NXT, it has meant that the amount of off-balance sheet capital we manage is substantially greater than what's on-balance sheet, which we didn't anticipate when we launched the company. Back then we thought we might have one or two off-balance sheet programs. Today we have nine and we recently closed NXT Capital Senior Loan Fund V with over $1.0 billion of capacity. Access to off-balance sheet capital is now a strategic and competitive imperative.

TLL: *How large is NXT today? How does your model differ from that of Merrill Lynch Capital?*

RR: Today we have just under $11 billion in committed capital, with about $4 billion on the balance sheet. Our team is around 125 people in size. It has not been difficult to manage NXT relative to what we did at Merrill Lynch Capital. That business was three times our current size. While we are smaller than MLC, the business priorities have stayed the same. It's about remaining disciplined over time in the face of changing competitive dynamics. That's what has made us successful, focusing on risk management, and not getting caught in a strategic or product drift. We've stayed focused on our senior debt orientation and working within our underwriting framework as consistently as we can.

TLL: *What's your typical borrower profile?*

RR: Our bookends are $5 million of EBITDA up to $75 million but the vast majority of our deals fall below $35 million in EBITDA. Our average senior debt commitment is $75-85 million and average senior/total leverage is around 4.1x/5.2x.

TLL: *How many portfolio companies are below $10 million in EBITDA?*

RR: It's around 15%. We do smaller platform transactions for the sponsors we work with. Our job is to help them grow these smaller companies above $15 million of EBITDA or more by providing delayed draw term loans for smaller tuck-ins and maintaining significant capacity to support larger add-on acquisitions. We have done deals that started at $30 million of financing which over time grew to over $100 million. All of it provided by NXT. We really like doing these smaller platform deals as they drive significant portfolio growth. But smaller companies still need to exhibit attributes which we know will produce consistent financial results over the long term. For example, they need to have a diverse customer base, consistent gross and EBITDA margins and an absence of binary risk from product concentration, regulatory changes, or other hard to predict factors. There needs to be a real reason for the company to exist – will customers care if it goes out business? The sponsor's growth thesis also must be viable as evidenced by significant white space in the company's market segment for organic growth and/or consolidation.

TLL: *Robert, what's your firm's origination strategy?*

RR: We have a direct origination model and have 13 senior people with sponsor coverage responsibilities in our Corporate Finance segment. We also have a dedicated Capital Markets team that sources co-lending/club opportunities with other lenders. We cover over 300 sponsors and to date have transacted with over 160 of them. We believe it's critical to have a constant dialogue with the sponsors we cover. As a senior debt provider in a crowded market, we need to remain relevant — to be on the top of the client's list of preferred lenders. We act as a sounding board, providing guidance to help sponsors develop a framework for how a deal can be financed.

Our goal is to get as many at-bats as we can get. Saying yes or no quickly, and when we have conviction, to move forward aggressively. We've been and continue to be quite prolific. Having a significant footprint is important, as is having a dispersed base of private equity relationships. It's all about feet on the street and relationships.

TLL: *It's pretty competitive today, of course. How has that affected your hit ratio?*

RR: We see 1200-1300 discrete transactions annually, and on average we close 5-6% of those depending on where we are in the cycle. But that "look-to-book" ratio recently has been in the low-to-mid 3% range." That forces us to work harder; to get to the same number of closed deals we need to increase the volume of transactions we're looking at. That's the competitive impact. We're working twice as hard as we were five years ago.

TLL: *How many deals are lead arranged transactions?*

RR: About 85% are either lead or co-lead positions. The majority of our larger deals are club executions. Quite frankly, I'm a bit disillusioned with the upper end of the middle market. There's been a more dramatic erosion of credit terms there. EBITDA addbacks and adjustments have become very aggressive. I think people are kidding themselves regarding the leverage they're financing into. When you parse through the numbers and take a more sober look at adjusted EBITDA, some of these larger deals have total debt multiples north of seven or eight times in a transaction that's being marketed as a 4x/6x deal. At these multiples, the debt quantum is approaching the enterprise value when looked at over a cycle.

TLL: *Where's the flow coming from?*

RR: New buyouts are still a major driver but our portfolio has been very active as sponsors have aggressively pursued add-on acquisitions and, to a lesser extent, refinances or dividend recaps to drive returns.

To be continued the week of Jan 15

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