Lead Left Interview – Richard Petrocelli and Frederick Buffone (Part 2)

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This week we continue our conversation with Richard Petrocelli, CFO of FSC and FSFR, and Frederick Buffone, Head of Capital Markets, FSAM. Fifth Street Asset Management (FSAM) is a credit-focused asset manager with $6 billion of AUM across two public BDCs, Fifth Street Finance Corp. (FSC) and Fifth Street Senior Floating Rate Corp. (FSFR), as well as multiple private investment vehicles. ***Second of two parts – View part one***

The Lead Left: *What are you expecting for 2015 in terms of pricing and structure?*

Fred Buffone: We see a leveling of spreads and leverage. The middle market is trying to be prudent. Volatility has stopped some of the worst offenders. Right now the calendar is very manageable.

TLL: *Is it new deals or refinancings?*

FB: We're seeing more M&A transactions. The share of new money deals has grown from 50% to 75%. Of course there have been a lot of false starts. August was a very busy month for us, which then slowed into September and October. Recently though, it has picked up again.

TLL: *How's your portfolio holding up?*

FB: It's in very good shape. Our portfolio companies are experiencing good organic growth. It's top-line improvement, not just cost-cutting. The strong US economy is benefiting the middle market because, unlike the Fortune 500, smaller companies mostly serve the domestic market.

TLL: *That's a great point. What are you focused on from a credit perspective right now?*

FB: We look for borrowers with high barriers to entry; ideally companies that don't have high capex and are less cyclical.

TLL: *Getting back to Fifth Street's strategy, where will you look to take the overall business? Any acquisitions?*

Richard Petrocelli: In 2013, FSC acquired Healthcare Finance Group, a healthcare asset based lender, and now we're thinking about leasing companies. We're talking to lots of folks. We recently hired Todd Owens who ran the FIG group at Goldman Sachs. He will be leading our strategic initiatives. And Renee Noto who heads up business development for us.

TLL: *Do you consider having advantages as a buyer?*

RP: Most other BDCs have used up their 30% "bad asset" baskets to invest in businesses that don't fall within the allowed classifications. FSC has $2.6 billion in AUM, which gives us bad asset capacity of $800 million. That's a lot. Some of our competitors, for example, have used a significant portion of their bad asset buckets.

***TLL**: Your investment in FSFR's JV would count as a bad asset, correct?*

RP: Yes, that's correct.

***TLL:** How about revolving credits? No one seems to want to hold them.*

FB: It's easier for the BDC to hold a small percent of revolving credits. In a bigger transaction we can syndicate that. There's actually interest there, particularly pro rata with term debt.

***TLL:** Are you buying liquid loans given where spreads are?*

FB: We will buy for our three senior funds, FSFR and two warehouses that act as CLOs. The CLO market is clearly robust now and we will be active in that arena.

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