Lead Left Interview – Timothy J. Conway

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This week we chat with Timothy J. Conway, chairman and chief executive officer of NewStar Financial. Founded by Mr. Conway in 2004, NewStar is focused exclusively on providing sophisticated financing options to mid-sized companies through four national lending groups: leverage finance, business credit, equipment finance, and real estate.

The Lead Left: Your first question, congrats on FOC Partners…

Timothy Conway: Thanks. We are excited about the opportunity to accelerate the growth rate of that part of our business and FOC is a great platform. NewStar operates as a combination of a direct balance sheet lender and an asset manager. Our strategy is to prudently grow the balance sheet and to expand our asset management capabilities in areas that are consistent with our core strengths. The launch of our relationship with Blackstone and GSO has been a catalyst for growth in both the balance sheet and asset management. Feingold O'Keeffe fits perfectly into our thinking on the asset management side. FOC's capabilities, which are centered on liquid loan strategies, complement our existing asset management platform which has been focused on co-investment strategies in middle market loans, which we offer through a series of side-car style funds.

TLL:How did the deal come about?

TC: I was introduced to Andrea and Ian by a mutual friend and we had the opportunity to have several conversations about a combination of the firms. That helped us get to know each other and figure out the strategic and cultural fit. They have built a great business that was independently successful, but there were constraints on their ability to grow related to the whole issue of risk retention. They also recognized that scale is becoming increasingly important. As part of NewStar they will continue to operate their business focused on CLOs, hedge funds and retail funds. The transaction will add about $2.3 billion to our AUM, increasing our total AUM to $6.4 billion. The larger platform and proprietary deal flow from direct origination will clearly enhance the products they can offer investors in the future. So, it's a very attractive investment for us and an opportunity for them to grow faster with our help.

TLL: You said they invest primarily in BSL?

TC: Yes, a significant part of their AUM is managed across six CLOs employing liquid loan strategies. They have an excellent track record and performance in the top quartile for most of the CLOs. I believe that some of their success results from finding opportunities in over-looked, less liquid assets in the smaller end of the syndicated market, which crosses over into the higher end of the middle market where we play.

TLL: Isn't it amazing that more of the smaller players haven't taken a similar approach and partnered up with platforms like yours?

TC: I guess we've all been anticipating more of it for at least 10-years. That said, there is probably more to come and we will look to scale our business.

TLL: Talk about the Blackstone GSO investment. That really is a game changer for you.

TC: You are right, it has been a game changer in many ways. Since closing in the 4th quarter of 2014, we have broadened our product offering to our customers which has enabled us to double origination volume, lead more deals and earn more fees. I have known the GSO team for many years. They were exploring ways to expand their coverage into the lower end of the middle market and decided to accomplish that through an investment in us rather than building it themselves. After a series of conversations, they agreed to invest $300 million as part of a broader strategic partnership. We complement each other very well. With our existing customers, we can now write a larger check to lead senior financings and we can bring GSO to the table to provide additional junior capital and larger uni-tranche facilities. For transactions they originate with larger customers, we often provide the first-out facility, which has given us new access to the larger end of the middle market. Their ability to deliver large, flexible financing solutions is pretty unique and I think we help them do that in certain situations.

TLL: How does the split between you and GSO work?

TC: It depends on the type of deal, but let me provide an example. Let's say $250-300 million of debt is required for an acquisition. We would typically provide $50-60 million of a uni-tranche in a first out position and they hold the remainder. On a risk adjusted basis, I really like the pricing on the first out. We have done about $400 million in volume using this approach since closing the deal in November.

TLL: What size can you speak for?

TC: NewStar will now underwrite $150 million in senior debt in a deal and will hold more than $50 million. The largest deal we have done in conjunction with GSO is $400.

TLL: Impressive. How is the rest of your business outside of Leveraged Finance?

TC: The Asset Based Lending and Equipment Finance are synergistic with the rest of the business, and they work well in the GSO relationship. For example, we can efficiently provide an asset based revolving credit facility in a uni-tranche solution. Equipment Finance is a natural cross-sell into our private equity relationships. Given where we are in the cycle and with continued competition from banks, ABL is in a slower growth phase. Demand is usually counter-cyclical, so we will see more opportunities in a down market. Equipment Finance is growing nicely and the yields are very attractive for secured debt.

TLL: Tim, let's talk about the economy and the markets. What are you seeing out there?

TC: Our portfolio is my best barometer for where we are in the U.S. economy. Based on that, I would say the economy is performing pretty well. There is reasonable GDP growth with some obvious sector-specific volatility, but not related to fundamental, underlying growth issues. We are underweighted in energy and materials, so we are not seeing the impact of commodity prices too much, in addition to the fact that we finance domestic companies that are less impacted by the value of the dollar.

In terms of the middle market, we have seen yields widen about 50 bps to 6.00%-6.25%. Funding costs have widened a bit, high yield has traded off and then we have seen choppiness in the second lien markets. The banks are pulling back from leveraged finance and most BDCs are not raising capital, so it will be interesting to see how much impact all of that has on the loan markets; although the middle market is much more relationship-oriented and less volatile than the more liquid markets.

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