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FOUR LOOMING CRISES ARE SET TO RATTLE THE GLOBAL ECONOMY AND INVESTORS' PORTFOLIOS.

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Back Together Again

Former Deutsche Bank Securities CEO Tommy Gahan is building his credit business far from Wall Street.

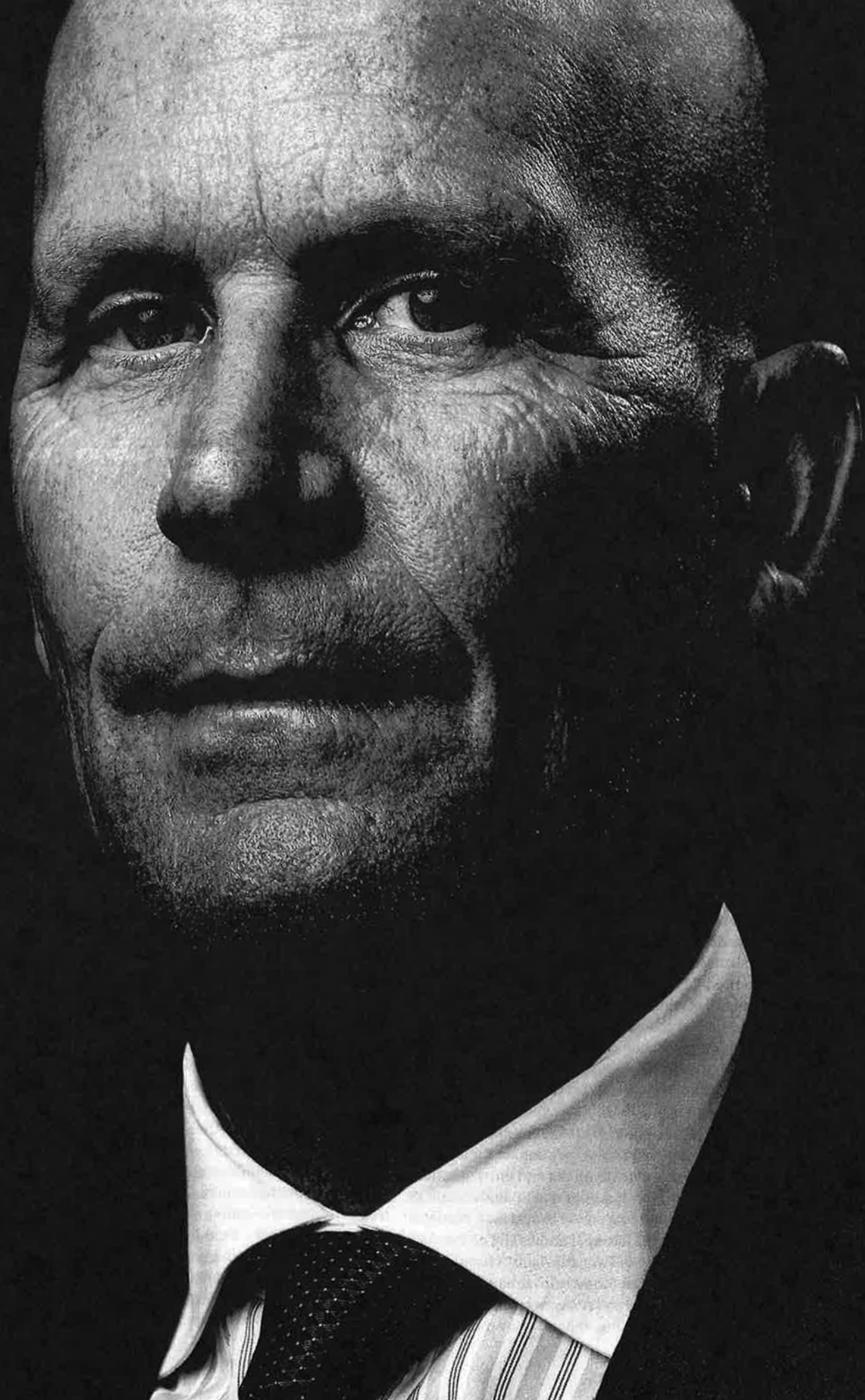
By Julie Segal
PHOTOGRAPHS BY
PATRICK JAMES MILLER

Benefit Street Partners CEO Gahan hopes to capitalize on recent volatility in credit markets

WALL STREET'S JUST NOT FUN ANYMORE. THIS spring, when Thomas (Tommy) Gahan was trying to recruit Ray Costa to New York-based Benefit Street Partners, they talked about the billions of dollars they could put to work in credit markets once the froth started to dissipate and things took a turn for the worse. Gahan (pronounced "gan"), who had quit his job as CEO of Deutsche Bank Securities in March 2008, on the eve of the financial crisis, didn't need to say much. Costa, a star trader who once ran U.S. distressed-debt products for Gahan at Deutsche and had since risen to become the firm's co-head of North America credit fixed-income, knew he wasn't going to be able to take advantage of a market panic while at the bank. Regulators had taken care of that.

Gahan was offering the fast-talking Costa the chance to get back in on the excitement. It took a few more conversations for Gahan—described charitably by some as a man of few words, while others say he is awkward and gruff—and Richard Byrne, Benefit Street's more gregarious second-in-command, to persuade Costa to leave a post that once would have been considered one of the top jobs on Wall Street. But this summer Gahan hired Costa, putting in place another pillar of his investment firm, which has brought together the key people who turned Germany's Deutsche Bank into a U.S. power in leveraged finance. Costa joins Byrne, who had succeeded Gahan as CEO of Deutsche Bank Securities; Michael Paasche, who had been global head of leveraged finance at the bank; and David Manlowe, former chief operating officer and head of global capital markets at Deutsche.

"We were at the table inventing many of the structures that are currently in the market," says Gahan, 52, who founded Benefit Street in September 2008 as the credit investment arm of Providence Equity Partners, a \$40 billion private equity firm specializing in the communications, education, information and media industries. "That understanding is fundamental for an investor trying to reengineer and disentangle these securities."



Gahan is betting that the bankers who started in the early days of junk bonds — and helped guide the massive transformation that saw banks go from simply advising companies to financing multibillion-dollar corporate deals — have a winning formula to pick credit investments. Last month's gyrations in fixed-income markets, which saw the biggest intraday move in Treasury yields since Lehman Brothers Holdings collapsed in September 2008, gave investors a preview of the type of environment in which Benefit Street expects to thrive. While global regulators have successfully shut down risk-taking at banks, deal makers like Gahan and his former Deutsche colleagues are plying their trade at asset management shops and shepherding private capital to replace a financing system that broke down in 2008.

"We've built an entire business and all of our fund structures to withstand and thrive on volatility," says Byrne, 53. "We want to be a liquidity provider when everyone else is selling."

So far, Benefit Street has gathered \$9 billion in assets; it recently closed its third middle-market private debt fund. The firm launched a long-short hedge fund in 2011 and a long-only liquid credit business, now consisting of four collateralized loan obligations, in 2012. Last year Benefit Street hired Scott Waynebern to head up its new commercial real estate group. Waynebern ran real estate capital markets and trading for Deutsche and was later president of Limekiln Real Estate Advisors. Costa, the firm's most recent hire, is standing by to launch a distressed debt strategy.

Benefit Street's performance track record is attracting attention from investors. Its earliest credit funds have all returned more than 13 percent annually, net of fees. Its hedge fund has returned more than 7 percent net since inception, a notable feat given that half the fund is in single-name short positions designed to make money in a down market that hasn't quite happened yet.

"Tommy can take a deep breath and calmly realize that what he thought the day before is no longer a reality."

— Seth Waugh, former CEO, Deutsche Bank Americas

Seth Waugh, retired CEO of Deutsche Bank Americas and an adviser to the bank, says Gahan has the unique ability to "slow the game down" during market chaos, not unlike the best quarterbacks during the last few minutes of a football game. "Tommy can take a deep breath and calmly realize that what he thought the day before is no longer a reality," Waugh explains. "It's what the price is going to be tomorrow that matters."

It was logical that Gahan and Providence founder Jonathan Nelson would team up. Gahan was Nelson's banker for almost a decade, helping to finance big-name media and entertainment deals, including the \$13.7 billion acquisition of Spanish language broadcaster Univision Communications by Providence, Madison Dearborn Partners, Texas Pacific Group, Thomas H. Lee Partners and Saban Capital Group in 2006. Two years later Nelson, whose firm is headquartered in Providence (home to his alma mater Brown University), saw the huge opportunity for an investor who could sift through securities that every Wall Street bank was now throwing

overboard. What he didn't know was that tighter rules on bank capital requirements and regulations like the Volcker rule prohibiting proprietary trading would a few years later essentially destroy a big part of the bank lending and risk-taking business. That massive change would hand private equity firms like Providence and others a long-term chance at becoming financiers of companies, not just owners.

"Government regulators are the silent partners in this business," says Nelson, 58, during an interview at his firm's New York offices, overlooking Central Park.

Benefit Street is hardly the only firm to plant a new flag in alternative credit management; in fact, it's somewhat late to the game. "We stayed on Wall Street longer than many, gaining invaluable experience from a dynamic but turbulent time," says Byrne. "We financed and structured many of the biggest deals in the world and saw firsthand all the investments out there."

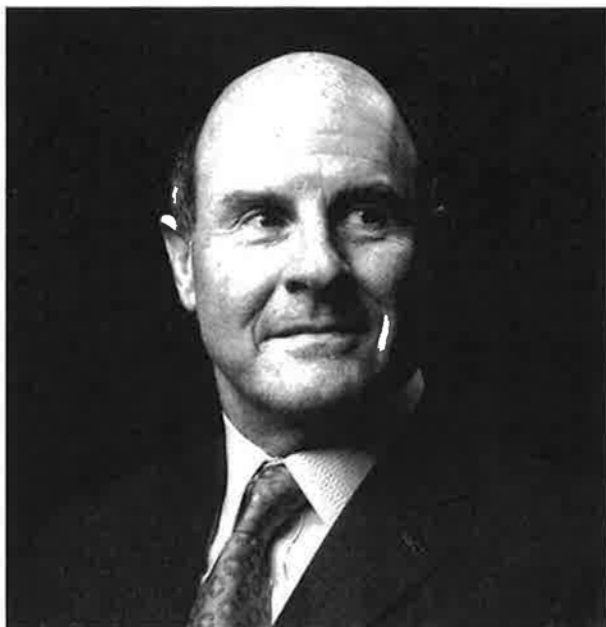
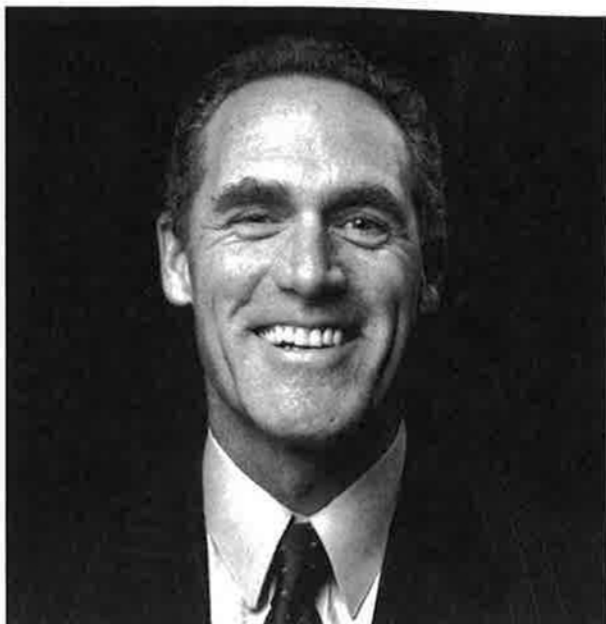
The Deutsche boys grew up professionally with many of the people they now compete against, including Leon Black, Marc Rowan and Joshua Harris of Apollo Global Management; Antony Ressler of Ares Management; David Tepper of Appaloosa Management; and Bennett Goodman, Douglas Ostrover and Tripp Smith of GSO Capital, which was bought by Blackstone Group for \$1 billion in 2008. These men are part of a small group of Wall Street executives

who leveraged Michael Milken's invention of the junk bond to help remake finance. The junk bond allowed less-than-stellar companies to get cheap financing and helped spur the economic boom of the 1980s and '90s. The junk bond also changed the face of banks as they moved into more-complex structured finance and helped turn what were once known as corporate raiders into the modern private equity industry. Of course, the banking part of the story ended in 2008. The leveraged-finance men, however, are once again at the leading edge and are part of an unprecedented experiment in finance and regulation.

GAHAN GREW UP BREATHING THE AIR OF old Wall Street. His father, James, worked for more than 20 years at brokerage firm E.F. Hutton Group,

where he rose to head of fixed-income and equity trading and was a key lieutenant of longtime president George Ball. The younger Gahan joined Hutton as a trainee following his graduation from Brown in 1984 with a BS in economics. (His dad, who had gone directly from high school to Wall Street and had a reputation as a tough trader, had left the firm earlier that year to become president of Rothschild Securities Trading.) Gahan landed on the high-yield trading desk at Hutton. After the firm ran into trouble in October 1987, he moved to Merrill Lynch, which was building its high-yield-bond business. Within months he was running high-yield-debt trading. Gahan would go on to become one of Wall Street's top junk bond traders, ultimately running all corporate debt trading for Merrill.

In 1995, Merrill's fixed-income chief, Edson Mitchell, left to join Deutsche Bank to build its fledgling U.S. investment banking business. Gahan resisted Mitchell's efforts to recruit him, saying Deutsche was too small. But in November 1998, after the bank had agreed to buy Bankers Trust Co., Mitchell called Gahan to ask, "Is



Benefit Street's Michael Paasche (top left), Richard Byrne (bottom left) and David Manlowe (bottom right) are longtime colleagues of Gahan, who has known Providence's Paul Salem (top right) since the early 2000s, when Deutsche helped finance a deal for him

this big enough for you now?" Gahan said yes and joined Deutsche in February 1999 as global head of credit products with the mandate to integrate the two banks' credit businesses. Byrne, a onetime gaming analyst who had helped found Merrill's high-yield research department, followed in May.

Deutsche's ambitions were thrown off course when Mitchell died in a plane crash in December 2000, but Gahan's leveraged-finance business largely avoided the power struggles that followed. Over the next two years, Gahan was involved in deals for EchoStar Corp., Jefferson Smurfit Corp. and Wynn Resorts and rose to head up investment banking for the Americas. He later became global head of capital markets, including real estate, and gained a seat on the executive committee for global banking and global markets. "I've been lucky," he says. "I've had a chemistry set to play with at the office, learning new businesses and becoming more intelligent about how all the pieces work together."

In 2005, a year after Gahan became CEO of Deutsche Bank Securities, the firm was No. 8 on the U.S. fixed-income trading and underwriting league tables and No. 4 in high yield. During that period Deutsche financed some of the largest leveraged buyouts in history, including KKR & Co.'s \$29 billion LBO of credit card processor First Data Corp. in 2007. But the credit markets started to show cracks that year and Gahan lost enthusiasm for his job. In March 2008 he received his annual bonus and told his bosses he wanted to go off on his own. "Things were ripe for a market blowup," he says. "It was time to become an investor and an entrepreneur."

The difficult part would be raising capital. But in the spring of 2008, Providence founder Nelson and Paul Salem, who had started the firm's London office, already had \$1.2 billion of Providence Equity Fund VI earmarked for opportunistic credit that they were looking to invest. (Gahan had originally met Salem when Deutsche helped

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finance the risky takeover of Irish telecommunications company Eircom in the early 2000s by a consortium, led by Irishman Sir Anthony O'Reilly, that included Providence and hedge fund manager George Soros.) Later that year Salem raised an additional \$1.1 billion on a Wednesday afternoon after showing investors a spreadsheet of senior debt securities of companies that he either owned or used to own; most were trading at 60 cents on the dollar. "Either the world is ending or this is the best buying opportunity that I've ever seen," he told investors.

Gahan, who spent his six months off improving his golf handicap and catching up with his wife and five daughters, joined Providence in September 2008 — a week before Lehman filed for bankruptcy. With just a phone and a computer, he started investing, focusing on bulletproof companies with recurring revenue and buying more loans than bonds, which get paid back first in a bankruptcy. Paasche joined him in October.

In 2009, as economic conditions started to improve, Gahan took more risk and looked at different types of companies and securities deeper in the capital structure that didn't offer investors as many assurances. Gahan, who is criticized by some for being more of a trader than an investor, says that during the worst months of the crisis he could have taken a lot more risk and generated even higher returns, as many of his rivals did. Salem says he didn't expect Gahan to be as conservative an investor as he turned out to be. "I thought of the swashbuckling investment banker from Deutsche Bank," he adds. Byrne and others who know him well, though, say they aren't surprised at all. Gahan ran one of the first long-short portfolios for a Wall Street bank's so-called

customer book — inventory kept to facilitate trades for clients — back before the days of proprietary trading. "He left some money on the table when markets were rising, but Tommy proved that you could make money just with your inventory," says Byrne.

Manlowe, 50, a former *II*-ranked analyst, joined as COO in 2010 to build out Benefit Street's infrastructure and research. That year the firm raised a middle-market lending fund that would focus on financing companies with \$25 million to \$100 million in earnings. Although by then the credit markets had stabilized, many smaller or troubled companies had been abandoned by banks. Benefit Street focused on developing relationships with generally healthy companies that wanted to expand, originating loans and then becoming partners with management on their strategies. "If we can provide capital, advice, treat them like a partner and help them increase the total value of their business, they won't fight us on a couple of basis points on the financing," Gahan says.

Benefit Street is moving fast.

"They're originating transactions and not buying things baked by somebody else. That's the alpha." Griffin president David Rupert says of the Benefit Street team. "You can't look at the same deals that everybody else is looking at and expect to have dramatic outperformance," adds the 50-year-old Paasche.

Middle-market lending involves labor-intensive credit analysis to make sure the risk is appropriately priced, says Gahan.

During one interview he compares it to climbing Mount Kilimanjaro, which he did for a friend's 50th birthday. "It was a grind. We had awful weather — it rained, snowed, sleeted the entire time," he explains. "But that's our story here; we grind away." When asked about his reputation for fierceness, Gahan laughs and says people view him as tough because of his shaved head, but he says it's also because he doesn't mince words.

It's not surprising that Byrne, who runs interference for Gahan with the press and investors, gave the first presentation about Benefit Street at Providence's annual investor meeting in October. He was eager to talk about his group's view on where the markets are in the credit cycle (near the top), pointing out that this year the market is on track to issue \$289 billion worth of covenant-lite loans — which offer investors little protection if things go sour — three times as much as in 2007, the last peak.

With banks having retreated from making markets in corporate credit, Manlowe expects to find plenty of securities selling at distressed prices. "We think there is the possibility that we'll get distressed-priced bonds and loans without necessarily having a classic default-led distressed cycle," he says.

Still, Gahan and his team are being patient. Although it appears that a credit market pullback could be coming soon, pundits have been saying that for years. And when it does arrive, it may look very different from what even the most experienced investors have been expecting. After all, central banks around the world have experimented with monetary policy in unprecedented ways, and the new rules and regulations designed to protect the financial system from the kind of bloodbath seen in 2008 have not been stress-tested by a real crisis.

Former Deutsche Bank Americas CEO Waugh says Gahan is the perfect guy to keep calm in a crisis and even make you laugh. He tells a story about when the two of them were working day and night during the Russian debt crisis in the late 1990s, trying to figure out a hedge, when the Brazilian central bank doubled its overnight lending rate, an unprecedented move that sent markets into turmoil. When one of the senior managers came in to ask what they should do next, Gahan turned to Waugh, sphinxlike, and said, "What'd we do the last time this happened?" ●●