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BENEFIT STREET

THE NEXT LEVEL

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CAPITAL TALK

BENEFIT STREET PARTNERS

The Benefit Street Partners team *(from left to right):* Michael Paasche, Blair Faulstich and Richard Byrne

THE NEXT LEVEL

With a solid foundation in place, Benefit Street Partners is expanding into new strategies. **Anastasia Donde** caught up with the team on why non-sponsored deals are better and hiring in private debt is so hard.

CAPITAL TALK

Moving from a bank to a private debt fund is not as simple as it looks. Learning to run a business and raise money from institutional investors when all those other functions have been performed for you for most of your career, must be a bit of a culture shock.

For Tom Gahan and Michael Paasche, formerly senior executives at Deutsche Bank, the journey was simplified in 2008 when they were taken under the wing of Providence Equity Partners, a large well-established private equity firm with its own infrastructure and business development team. Not only that, but Providence had already raised about $1.2 billion for a credit fund, at a time when it was getting increasingly difficult to raise money. So when the duo joined in autumn 2008, they hit the ground running.

More recently, Benefit Street Partners, as Providence Equity's credit group is now called, partnered with Los Angeles-based Griffin Capital to launch a non-traded business development company (BDC). Richard Byrne, Benefit Street's president who came on board in 2013 also from Deutsche Bank, says that Griffin, who has experience managing real estate investment trusts, is better connected in the retail world.

Benefit Street has already grown impressively: it has $9.2 billion under management and almost 100 employees. BSP is investing its third private debt fund and has other strategies in the works. It recently moved into swanky office space overlooking Central Park.

Ray Costa, who previously worked with Gahan and Byrne at Deutsche Bank, came on board in November to get a distressed debt strategy up and running. And whereas some of the firm's older funds were listed under the Providence name, these days they more often brand as Benefit Street.

Byrne, who took over Gahan's job as chief executive of Deutsche Bank Securities when Gahan left in 2008, followed on five years later to help raise Benefit Street's profile. He is affable and accommodating, frequently cracks jokes and makes sure everyone has what they need. He seems very aware of being appointed to craft the firm's image, adjusting his tie often as our photographer works and weighing his words carefully, frequently correcting himself.

Byrne and Gahan have worked together for 28 years, first at Merrill Lynch and later at Deutsche. As his right hand man, Byrne reckons he was hired to do "everything else" at the firm allowing Gahan to focus on investments. This includes talking to the press. "He dedicates his time to analysing deals and investing. He's a brilliant investor. He loves sitting with analysts and PMs and going through names, talking about credits. And part of our secret sauce is having him in that role," Byrne says.

Gahan himself declined the interview with *PDI* and does so with most journalists that come calling. Though Byrne regularly does interviews with Bloomberg TV and other print publications.

THE DEUTSCHE BANK LEGACY

Most of the senior employees at Benefit Street came from Deutsche Bank and previously worked with Gahan. Byrne took over Gahan's role, but says the plan ultimately was to join Benefit Street. "From those early days, people suspected that I may join Tom, but given the job that I had at the bank, I felt that I needed to stay because there was a lot of work to do post-crisis," Byrne notes, pointing out that the bank had come through the worst of the crisis by the time he left and that it was one of the few that didn't take an equity infusion from government during the financial crisis.

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Asked why they left the world of investment banking, Byrne and his colleagues hum the familiar tune of bankers turned alternative investors. "The banking industry had changed a fair amount post-regulation and everything we do here is an offshoot of what we used to do at the bank," says Byrne.

Mid-market lending especially, Benefit Street's focus, has largely been abandoned by banks, as the rewards don't outweigh the risk. "We didn't call it middle-market lending, we just called it 'loans to smaller companies' in our portfolio and they were some of the best performing and were always a great part of the business," Byrne explains. "Post-regulation banks retrenched from the middle-market space, not because it wasn't a good business, but because they were now forced to operate under a stricter risk-weighted capital regime. It also took as many people to underwrite a $100 million loan as it took to underwrite a $1 billion loan. Banks were always focused on cost cutting and people are the easiest way to get at that," Byrne notes.

HIRING CHALLENGES

Byrne says Costa was a good fit for Benefit Street, as the distressed debt strategy he'll be managing is very similar to what he was doing at Deutsche Bank. Otherwise, Byrne often finds it challenging to hire out of banks because, he says, culturally, private debt firms and banks are very different. "There are a lot of good investment bankers, but how much of what they were doing at the bank was really mid-market lending?" Byrne questions.

When it comes to interviewing people from the large alternative credit shops, another challenge is finding individuals who cover specific companies and industries rather than private equity sponsors. The firm's strategy in its private debt funds is to dedicate at least half of the capital to unsponsored deals, where they can find more edge. "Every time we interview somebody from one of those bigger places, the interview almost doesn't work before it starts because they are exclusively focused on sponsor coverage. We say, 'Who do you cover?' And they'll say 'Midwest sponsors'. We prefer people with a broader client base," explains Byrne.

[redacted]

DIRECT LENDING, ACTUALLY

There has been a lot of debate in the private debt arena about what exactly is direct lending. At Benefit Street, the execs say true direct lending is working with companies on unsponsored deals. While they admit those clients are more difficult to research, it's also what gives them a competitive advantage over other lenders, who, by working with sponsors, are chasing the same and more competitive deals. Byrne says the firm uses its old connections from Deutsche Bank, as well as intermediaries and other channels to source transactions.

Benefit Street is an industry generalist and Blair Faulstich, who heads up origination, doesn't like to say that there are any industries it wouldn't cover. Though it has avoided deals where he doesn't think they have enough coverage to diligence them well. [redacted]

More recently, Benefit Street passed on a German chemicals deal, because it doesn't have a team in Europe or individuals focused on chemicals. "We're diligence geeks," Faulstich contends, so in areas where it doesn't have enough coverage, it will let the deals go.

Faulstich also worked with Gahan at Deutsche Bank several years ago. His background is in investment banking in the technology, media and telecom (TMT) space. He started his career at Alex. Brown, which was bought by Deutsche, then went to Merrill Lynch, and later spent two years at hedge fund firm Citadel before joining Gahan in 2011.

ORIGINATION AND TMT

Faulstich is the kind of guy who talks at a mile a minute and is always on-the-go chasing deals. He lost a deal just 10 minutes before walking into his *PDI* interview, and was reviewing several others at the same time. Although Benefit Street has broad industry coverage, it gets more of a look into the media and communications pipeline, a specialty of both Providence Equity and Faulstich.

"A lot of people cover sponsors, we're trying to hire people who can diligence businesses. The backgrounds of our people are investment bankers and private equity professionals who can manage a very extensive diligence process," Faulstich says echoing Byrne's preference for people who can think outside the sponsor box.

"There are lot of different channels for sourcing deal flow. We have a lot of touch points, my joke is that we kiss a lot of frogs to find deals that provide the right risk-adjusted returns for our portfolio," Faulstich says. The firm gets its deal flow partly from Providence Equity, as well as boutique investment banks, intermediaries, lawyers, consultants and directly from corporate executives.

Although Faulstich's own background is in TMT, he says the firm has evolved into other areas since its founding.

Faulstich thinks the firm is well positioned to branch out into the energy space. "We think the timing is great, but we also feel vindicated that we turned all those deals down last year, because obviously things have changed a lot in that sector," he says.

Whatever sector it is, the firm is big on being able to diligence deals properly. "We're not getting through our process without a tremendous amount of analysis and a tremendous amount of due diligence. If you don't have the team to be able to do it, we're not going to do it," Faulstich says. "For unsponsored deals, there is usually no data site, so we have to tell [the companies] what we need from them to get through our process."

The firm's typical loan size is between $30 and $75 million, though it has sometimes gone up to $150 million or down to $20 million. Typical tenors are four to six years, sometimes seven. The firm's pipeline in early March included a software deal, a clean tech company, a healthcare investment, other media and telecom deals and several energy situations. "In two weeks, it might be totally different," Faulstich notes.

While a lot of other lenders and investors are concerned about the downward spiral of media and communications and tend to avoid it, Faulstich thinks there are still good deals to be had. "People are concerned about the impact of technology on traditional media. It's not the easiest space to be in but, within the broadcast sector, there is a lot of collateral and, in traditional media, the demise will be slower than people expect," he says, adding that Benefit Street has lent to businesses in secular decline before and got out ahead of total revenue collapse.

STRATEGY EXPANSION

At present, Benefit Street is investing its third private debt fund. It started managing long/short credit in 2011 and now has about $1.5 billion in that strategy. It also manages six CLOs totalling around $500 million each and has a small commercial real estate business.

The Griffin-Benefit Street Partners BDC Corp was recently approved for registration by the SEC. The non-traded vehicle, is a partnership with Griffin Capital, which has experience in managing real estate investment trusts. The firm opted to form the BDC as it was keen to diversify its investor base as well as access more long-term capital than institutional investor fund commitments. "Permanent capital is very important to an asset manager," Byrne says, noting the cyclicality of closed-end funds.

The partnership makes sense for both sides, Byrne continues, adding that Griffin have the infrastructure in place.

The new BDC will work through the thousands of brokers and financial advisors. The set-up is similar to the one GSO Capital Partners has with Franklin Square Capital Management. Their FS Investment Corp started out as a private BDC and one of the three vehicles publicly listed last year.

As Benefit Street grew its private debt fund business, the strategy also changed.

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The first fund was more of an opportunistic credit strategy that did a little bit of direct lending towards the end. The second and third fund were dedicated exclusively to private lending. The latest fund, Providence Debt Fund III closed at $1.75 billion in April last year, exceeding its $1 billion target. The fund's investment window expires in April 2016.

"Some of those earlier funds balanced across the entire debt capital structure, you take what the market gives you," says Paasche, head of illiquid investments at Benefit Street, who was previously global head of leveraged finance at Deutsche Bank. "I think now we're seeing more opportunity at the top of the capital structure as markets get a little too frothy. When rates stay this low for this long, people tend to search in very unnatural places for yield. Fund III has seen a greater proportion of senior debt and first lien loans than previously," explains Paasche.

LPS AND FUND MANAGEMENT

The firm has some large US public pension funds as clients, including the Florida State Board of Administration, the Hawaii Employees Retirement System, [redacted] the Austin Police Retirement System and the Los Angeles City Employees' Retirement System (LACERS).

The firm's two TMT funds achieved high returns. The first Providence TMT Special Situations Fund LP delivered 15 percent net IRR and the second Providence TMT Special Situations Fund II earned 13.6 percent net IRR, according to LACERS' documents. The third fund, which LACERS invested in, charges a 1 percent management fee and has a 15 percent carry over a 6 percent hurdle rate. The investment term is two years with a single two-year recycle period. The fund term is seven years, with two one-year extension options. (BSP declined to comment on performance, fees and terms).

LACERS also said in September 2013, that BSP's investment highlights included the firm's experienced team, attractive prior performance, expanding industry focus beyond TMT and increasing AUM. Gahan, Paasche, and Paul Salem, senior managing director at Providence Equity, are named as key men, according to LACERS.

BENEFIT STREET BY THE NUMBERS

2008
Year the firm was founded

Nearly 100
Number of employees

$9.2bn
Assets under management

$1.75bn
Capital raised for the latest BSP Debt Fund III

15%
Net IRR from Providence TMT Special Situations Fund

13.6%
Net IRR generated by Providence Special Situations Fund II

$1.5bn
Common stock to be offered in the planned IPO of Griffin-Benefit Street Partners BDC Corporation

STAR TRADER

When you talk to the firm's clients, competitors or former colleagues, most people launch straight into talking about what a talented trader Gahan is. He has approached other former colleagues from Deutsche Bank and Merrill Lynch about jobs at Benefit Street, sources tell *PDI*. People familiar with Gahan say he prefers to work with people he already knows. "His line of thinking is that, even if this person has issues, I already know their issues and know how to work with them, rather than having to learn a whole new set of issues," says one credit firm executive familiar with Gahan. One former colleague says of his reticence with the press: "They like to keep him behind a velvet rope."

As Benefit Street works on establishing a listed vehicle required to disclose a lot of information on their assets, the velvet rope may have to come down in the next few years.

With more and more BDCs listing – Goldman's vehicle listed in March and Credit Suisse have applied to register one too – as well as all the biggest managers in the business trying to capitalise on dislocation in the oil market, Benefit Street is pivoting a little away from the rich non-sponsored mid-market lending seam that has supported its development so far. From here on out, scale could play a bigger role than specialisation. ■