Evolving with the times

Now in its teenage years, NewStar Financial has grown up with the private debt market, becoming a consistent fixture as the asset class has gone mainstream. **Tim Conway**, the firm’s CEO and founder, discusses a range of topics from the firm’s history to its investment philosophy.

Q  We can start with a little bit of the firm’s history - how did it come to be and how has it has evolved over the years?

I founded the company with a team of banking executives, most of whom I had known and worked with over the years. We founded it in 2004 and went public in 2006 with a strategy to build a leading mid-market lender. We started out with about $200 million in equity capital from a group of private equity firms, including Corsair Capital, Capital Z and Och-Ziff.

We’ve been in business now for 12 years and our core investment strategy hasn't really changed. The biggest change for us has been the transition from operating as a pure balance sheet lender to more of a hybrid asset manager – lending and investing our shareholders’ capital through our balance sheet, while also managing money for institutional investors through credit funds, CLOs and separate accounts.

Q  What are your mid-market strategies and solutions, and how do you differentiate yourself from other firms?

Our mid-market investment strategy is focused on providing flexible, first lien senior debt financing options to a core group of private equity firms that we have long-standing relationships with. We will provide up to $50 million or more of capital in transactions with companies operating across a wide range of industries, and although we focus on senior debt in the capital structure we also have the capability to provide unitranche and stretch financings to our customers.

When we make a new investment, it then gets allocated across our balance sheet and managed accounts that employ co-investment strategies, which enables us to maintain a high degree of diversification in all of our portfolios and, importantly, ensures a tight alignment of interests between us and our fund investors. This systematic approach to co-investing in the same loans held by our managed funds is an important point of differentiation for us compared to other managers.

We have invested more than $12 billion across nearly 600 transactions with 250 private equity firms since the firm’s inception. We’ve worked on two or more deals with over 130 different firms and worked constructively with our clients through a complete business cycle. So, we have a long-established and time tested investment strategy that has cumulative unlevered returns in excess of 6 percent net of losses over that period, which as you know included a hundred-year flood type of recession.

We also have a unique strategic relationship with GSO Capital that provides us with access to additional proprietary deal flow and more firepower in terms of broader product capabilities. They invested $300 million of long-term capital in the company and anchored one of our managed funds.

Lastly, in addition to our middle-market direct lending business, we manage liquid credit strategies focused on non-investment grade, corporate credit.

We have about $2.3 billion in assets under management that employ liquid loan strategies across seven CLOs. As you may
know NewStar, over its history has been a leader in the development of the middle-market segment of the CLO market with about $8 billion across 20 issuances.

Q Can you talk a little bit about the condition of the mid-market right now and how it is impacted by macro factors, like geopolitics and the economy?

It’s a very large and fragmented market. The most significant trend has been the retreat of banks from leveraged lending due to regulatory constraints, which created an attractive opportunity for non-bank lenders like ourselves. I would say that our target market is now more of an oligopoly comprising a handful of lenders like NewStar who compete aggressively but also work together to finance ‘club-style’ transactions.

Although the market is slower than last year, I think there’s still a lot of deal activity. We invested about $3 billion in new loans last year, and, although slower, our current investment pace remains good. We think economic conditions are constructive, with a reasonable pace of growth based on macro-economic indicators and what we can see directly in our portfolio companies. That said, there are various sources of volatility in the global economy. So, we think investment strategies focused on senior debt in the middle market are the best option for investors seeking yield with downside protection.

Q Can you talk a little bit more about the relationship with GSO?

The operational focus of our relationship with GSO is co-lending with them across a range of transactions where we have complementary market positions and investment strategies. They work with us on transactions with our customers in the lower end of the middle market to provide additional unitranche and second lien capabilities, as well as lending capacity. And we also work with them on deals with their customers in the higher end of the middle market where we might collaborate on a large unitranche and commit to the first-out tranche.

So, the combination enables us to make larger credit commitments to our customers and broadens our product offering, especially into unitranche deals in the middle market. We also have access to their credit resources and leverage that when we are doing due diligence and credit research.

Q Can you talk a little bit about what it takes to be a successful mid-market investor?

I’d say longevity and consistently delivering for customers would be number one. As a firm, we have consistently committed capital – $12 billion just in the middle market. We’ve built really good, long-standing relationships and on the credit side, we are very, very thorough. We look at a lot of deals. We’re highly selective, have industry expertise, and we don’t take any shortcuts.

If you talked to some of our private equity clients, they’d say our coverage guys are solid bankers with excellent transaction capabilities. So, they understand the unique dynamics of acquisition financing and their insights can add real value in fast-paced mergers and acquisitions. You can imagine over 12 years we’ve developed an incredible archive of deal information and market studies that our bankers use to help inform their views on deals and provide quick feedback when clients look at a company in a competitive auction. As a result, our team is able to draw on their experience and the firm’s resources to identify comparable companies they’ve looked at, or maybe even the same company, or a supplier or a customer.

To sum it up, we call on our customers with senior bankers who provide great feedback on transactions. They know the exact kind of deal we are looking for. We respond quickly and then we always deliver on what we promised. As a result, we’ve developed a long record of investment performance that distinguishes us from just about anyone in the market.