November 2022 Live Event-AICA Fall CEF/BDC/Interval Fund Bootcamp and Roundtable Panel #7; "Listed & Non—Listed BDC Options for Variable Secured Loan Access"

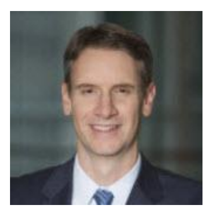
Wednesday, November 16, 2022

Kenneth Burdon, Counsel with Skadden, Arps, Slate, Meagher & Flom LLP, moderates the seventh panel of the AICA November 16th, 2022 live event; "Listed & Non-Listed BDC Options for Variable Secured Loan Access". Read the transcript below to hear the discussion among Mr. Burdon and panelists Laura Stolfi, Managing Director, Private Credit Product Specialist with Nuveen, Milwwod Hobbs, Jr., Managing Director with Oaktree Capital Management, and Jason A. Mehring, Managing Director with BlackRock.


Kenneth Burdon


Laura Stolfi


Milwood Hobbs, Jr.


Jason A. Mehring

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Kenneth Burdon: All right, hello everyone, my name's Ken Burdon, I'm an attorney at Skadden Arps. I'd like to welcome you to today's seventh panel discussion which is called "Listed & Non-Listed BDC Options for Floating Secure Loan Access". I think we've got a great panel here to offer today, with deep experience and a nice diversity of use. So to kick it off I would like to invite each panelist to provide a brief introduction to the audience. Milwood?

Milwood Hobbs, Jr.: Good afternoon, I'm Milwood Hobbs Jr., I'm a managing director and head of sourcing origination at Oaktree and sit on the investment committee for our direct lending business. Oaktree, we manage about $160 billion across a lot of strategies, it was founded in 1995 by Howard Marks and Bruce Karsh, and my specialty is on private credit.

As you know, private credit has been a prolific growth area for Wall Street since post-Dodd-Frank when liquidity shifted from the banks to frankly the funds. And I think the hallmark of what we try to do, between our trading franchise, the different strategies in my group, is really provide capital structure solutions for our clients ultimately, and we try to avoid losses. So we don't swing for the fences, we don't want to strike out. So look forward to getting to know everyone today.

Laura Stolfi: Okay, fantastic. Good afternoon, everyone, Laura Stolfi, and I'm with Nuveen. In my role I am a private credit product specialist, so therein lies my specialty is really in middle market senior lending or directly originated middle market lending. And so Nuveen today is about a one trillion dollar asset manager, and within that large asset management umbrella, we have a dedicated middle market private capital provider, and that's Churchill Asset Management.

Today Churchill has over $40 billion in committed capital. We're a leading provider of private capital to private equity owned middle market businesses. And I think that's something important that we'll unpack a little bit today is how we think about the middle market, how we operate within the middle market, and our investment philosophy and strategy within that marketplace.

And so when thinking about solutions that we provide to inventors across the globe, really when I mentioned we're a leading capital provider, what does private capital mean to us? It means we're able to provide capital at the senior or first-lien unitranche level, we're able to provide second-lien subordinated or mezzanine capital, and then also we can do private equity co-invests. So really it's a really flexible solution to providing this capital to our private equity sponsors in that we can go up and down the capital structure. And so with that we then formulate a number of wrappers, funds, vehicles, SMAs, CLOs, a variety of structures and vehicles that we can then offer to our clients across the globe. Pass it over to Jason.

Jason A. Mehring: Good afternoon, Jason Mehring, I'm a managing director at BlackRock in our US private capital group, which is basically our form of direct lending here in the US. Been with the firm, joined as a managing director 17 years ago, and have spent the entirety of my career which dates back to the mid-90s, investing in private markets. Over that stretch of time, fair amount of evolution. When I started there was no term called direct lending, just was sort of a cottage industry of people largely doing mezzanine type loans and then a lot of commercial banks, but things have changed quite a bit.

Within our group at BlackRock, we've invested nearly $35 billion in middle market private credit over the course of the last 20 plus years. We do this in addition to obviously the full litany of more liquid market, larger cap things that the firm does. Our focus right now is primarily in the more senior secured portion of the capital structure. We do mezzanine, we do unsecured as well, but senior portion structure is really where we are emphasizing our time and our efforts at the moment.

Kenneth Burdon: All right. Great, thank you all. So for the audience, we're happy to take questions either during the panel or there'll be a little bit of time at the end as well. Just raise your hand and I'm happy to call on you.

Audience: Hi Jason. How is what you're talking about different than Tennenbaum and BlackRock?

Jason A. Mehring: Sure. We're one combined platform, and you're referencing a couple names in the past, but basically BlackRock's private credit activities started with a platform by the name of BlackRock Kelso, which some people might be familiar with. And then in 2018 we acquired the Tennenbaum Capital Group which is based out in Santa Monica, and we operate and have operated since 2018 as one combined group.

We have one investment team. We look at all private credit transactions for performing new issue credit within that team. We have a handful of different shape sizes and colors of funds, some private, some public, a variety of different structures, so it's one team. So if you're thinking about that business and you have those two names floating around in your head, it's really one combined group and one combined effort at this point in time, and has been for four, coming up on five years.

Kenneth Burdon: Great, thank you. And so the panel today is going to talk about BDCs as an access option for private and floating secured loans. So let's start with the first thing people might be thinking about which is rates. So I'd just like to see what the panelists think about what they're preparing for over the course of the next year. Obviously we've been in a rising rate environment, and how that's impacted your investing in your portfolios, and what you're looking forward to over the course of the next year.

Laura Stolfi: Sure, I'll kick it off. So as mentioned, the Churchill Asset Management platform was originated in 2006, so we have a 16-year track record of navigating multiple credit cycles. And yes, the underlying investments in our portfolios, the textbook definition if you will, are privately negotiated floating-rate debt, so floating-rate debt. So as interest rates started to go up, that was probably the number one question that we started to get in call it the early part of this year is, well, fantastic for us as the investor, as this yield passes through to us. But it begs the question, how will our borrowers be able to service their current debt obligations?

And so we've seen this movie before, hence the track record, and how we think about this is in a couple ways. First is when we saw our first interest rate increase in March of '22, we didn't just wake up that next morning and say, "Oh no, holy smokes, what are we going to do?" And we certainly weren't waking up in the subsequent days in call it May, June, July, and November when rates continued to go up 75 basis point at a clip and say, "Well, how will our borrowers be able to fare a higher interest rate environment?"

So what we do when we underwrite transactions is that we take a view of the forward SOFR curve, so for any one underwriting that we are undergoing, we're taking a look at what that company will be able to handle from a debt service perspective 24 months out, but also using that forward SOFR curve. So again, we didn't wake up in March and say, "Oh no, how will all our borrowers be able to handle the additional interest expense that they now are facing?" All of that was contemplated at the onset of our underwriting and assuming a forward rate curve.

In addition to that, we're not just thinking about just the curve looking out over the tenor, but we're also adding an additional cushion to that. So it's a very conservative approach to how our borrowers will be able to fare in a higher interest rate environment today and going forward.

And the last point I'll make is that on our platform today we have over 200 plus individual companies that we've provided capital to, and it isn't a one-and-done exercise where we model out, okay, well, what will rates look? What will their interest coverage ratios look like under a variety and set of scenarios. We're constantly stress testing these borrowers across our platform, so we have an early warning if something was to occur.

And then last point I'll make is that over our 16-year history, our cumulative loss rate is 60 basis points cumulatively. So I think that it really portfolio construction is key, it's being highly selective. And so for borrowers that have stable free cash flows and can withstand higher rates, that's where you start.

Jason A. Mehring: I'm happy to jump in real quick. So I would say our book similarly is floating rate, and all of our modeling and our underwriting work over time always considers the forward curve. I'd be exaggerating if I said that we thought that the trajectory of the curve was going to match what's actually playing out, but nonetheless we always had the forward curve in mind. And our expectation by the way, I think part of the question was what do we see coming up? I think our expectation is that rates certainly aren't going down anytime soon. I think that there's going to active and continued effort to try and control inflation. That's going to come through increased activity on the rate side of things, so we think the higher rates are here to stay.

Something else that we've generally done on a proactive basis is that we've gravitated towards businesses that typically have a more flexible or variable cost structure, not necessarily a lot of businesses that are really capital intensive such that they can vary their costs if and when demand profiles change. That's something that again we've done consistently, that's not just something that's been a pivot anytime recently, and our portfolio is really comprised of businesses that lean in that direction pretty substantially.

Obviously the topic of and the concept of passing along price increases has also been something that's been increasing on everyone's mind. It started in and around Covid when you had various supply chain disruptions as a result of that, and obviously it's mushroomed into cost pressure in about every different category you can imagine now. And again, the businesses that we've tried to target historically, not just now, are ones that have some demonstrated ability to pass those costs through. Perhaps there's a little bit of a lag, perhaps it's harder now, but nonetheless it's been a demonstrated pattern of behavior.

Again, the businesses we invest in, we typically don't do much in businesses south of 15 of EBITDA, so 15-75 EBITDA [inaudible] mark as we define it. And those are businesses that have a little bit of heft to them, a little bit of scale, they typically have been around through and executed through economic cycles before. So while no two cycles are the same, we can look back at their history and see how they performed and have a real-life example of what they've been able to do in times of pressure. So that's really our approach, but we do fundamentally think that the higher rates are here to stay.

Milwood Hobbs, Jr.: So I've been doing leverage finance since 1995, and in my history, no financial model from any borrower was right after six months. And so when you think about rates, I'm 100% sure no one thought rates would move as fast as they did. I'm also 100% sure no one actually created a capital structure based on the movement in rates. So if you think about the last four years, deals that were done in private credit theoretically are over-levered because there was a base assumption in interest rates. I mean, LIBOR was below 1%, we were putting LIBOR floors at 1%. And the spreads were 400, 500, and 600. So theoretically you could convince yourself to put more leverage on a business because there was sufficient cash flows to support that debt.

What you have in a higher rate environment is you have less cash flow, and so the ability to support that debt is being hemorrhaged. And so I think the interesting next 12 to 18 months will be how do companies perform with increased stress on generating cash flow? And we've seen it time and time again where leverage brings operational inefficiencies of a business to the surface because they're managing for cash.

And just by movement of rates, you've got borrowers who a year ago were paying 5-6% are paying 10% on the same capital structure. That creates a lot of stress in a system. And on top of that you've had 200 plus private credit firms show up in the last three years, which means there's at least 200 bad deals. Because every new private credit firm's deal is the deal no one else wanted to do. So I think if you mix all that into a pot, you're going to have a pretty interesting time over the next 12-18 months.

And I think what we have tried to do, and I say this a lot is, we try to price risk. We don't really think about capital flow, we've got a lot of money so we've got to put it to work, and then we raise more money we've got to put it to work. We will send money back if there's no opportunities. We'd rather avoid a loss, because no one remembers the 10 you got right, they remember the one you got wrong. And so we're really trying to avoid losses versus can we put out more money, more money? I don't know if that answered your great question.

Kenneth Burdon: Yeah, I've got kind of a related follow-up to that though. So what continue to make the private credit attractive as the liquid rates continue to go up as well?

Milwood Hobbs, Jr.: Look, I think what's interesting about private credit is the public markets, the marks don't necessarily reflect credit risk. If you think about the inherent risk in a fixed income or floating-rate security is duration risk, is credit risk, and it's just interest rate risk. Those are the three risks Fabozzi talks about. And so when you think about the public markets, that generally is a liquidity risk that's being measured on a mark. And because you've got two thirds of the market being cov light, something that goes from par to 96 to 94, generally means out of one tranche where it’s 15 investors, two or three may be trying to get out, and there’s no level to which someone is willing to pay for that risk on the other side.

Private credit, the marks should reflect the true underlying business that’s going on, so there’s two components to the mark. One is just the change in rates, that’s obvious, and the other is just the business performance and where it’s at in its cycle. And so theoretically you have less volatility on the mark because there’s only one or two lenders in there and they’re in a storage business not in the moving business.

And then the second component of it is that that mark is tested quarterly, and so the lower volatility in the marks, the ability to control your destiny a little bit more. Whereas in a public security you’re not really controlling much. And so I think those components, topped with the fact that today you can get 12% risk, first-lien risk, because of where SOFR is and new deals are priced in at 700, I think all that makes for a very interesting private credit mark.

And oh by the way, most of our competitors are dealing with legacy portfolio issues. So if they invested in the last three years, they’ve got to preserve capital for the inevitable situation that may be occurring with the portfolio company. And so there’s less competition actually in private credit, not in the 15 to 75 EBITDA business because a lot of people can write $50 million checks. But if you think about 100 plus EBITDA businesses, there aren’t a lot of competitors out there relative to us that can write 200, 300, $400 million checks today. So we actually not only price risk in this market but we get a premium to that because no one else is doing it. And that’s what makes private credit interesting.

Laura Stolfi: Yeah, I’d echo everything that Milwood said there. Broadly syndicated loans, which are the close cousin to directly originated middle market loans, traded down to 92 as early as March, February even of ‘22. And so I totally agree with the points that, for those borrowers, was that really a reflection of their true fundamental value or is that really just a reflection of those positions trading off in sympathy with macro headlines, geopolitical, and really what we were facing as a very unstable time?

There’s a couple other mitigating features of private credit and why it is so attractive, and these are things that both folks here have touched on, but smaller lending group, oftentimes called club lending. Really, and I like Millwood’s phrasing, is you can kind of control your own destiny. But you’re seated at a table with three, four, five other lenders, you guys are all coming in at the same entry point, par if you will. And so right you’re negotiating terms, structure, pricing with a very small group of like-minded individuals that likely probably want to do a deal with you in the future. So you’re going to all negotiate something that is fair if you will and attractive for everyone.

So that's at the onset. But even if that company were to get into trouble or were to come to a point where their burn rates, they weren’t generating enough free cash flows, you can come back to that same table with that small group of lenders and work something out. As opposed to being seated in a room with 50-100 different creditors that all maybe came in at different entry points and have different motivation intentions in mind.

The other thing in our market which made it become very attractive is that deal docs can be tighter. As I mentioned, it's a small group of lenders, negotiating, working on terms, working with the private equity sponsor to come up with something that's tighter. So covenants are not the silver bullet that prevent a company from defaulting which is often a misconception, they're there, they are used, we liked them in our market, and they're more prevalent in the private market than they are in the public space. So those are some of the other mitigating features that I think are really attractive. You were going to add?

Jason A. Mehring: Yeah, I was just going to say if you compare and contrast the lifecycle of a private credit deal versus a syndicated or a more liquid market deal, the gestation period for deals that any of the three of us or our firms work on, it can be a number of months between when an opportunity rolls in the door and when you actually make a decision to invest or not. And during that stretch of time, you're typically doing very granular due diligence, you're meeting with management teams, you're meeting with owners of businesses. You're negotiating your structuring specific documentation provisions, which again you hope you never need to use but you have them none the less. And you compare and contrast that with a stylized more liquid market type transaction, where typically a deal with arrive more or less baked, you have a couple weeks to review it and decide whether you want to place an order.

And while that certainly is a very, very good business, is none the less very different. And again, in days and times such as this, the level of time and attention that you can give and goes into creating and crafting a private credit deal is just different and I think those are the sorts of dividends that pay off. Covenants have been mentioned, obviously that's something that's not really resident or hasn't really been resident in the larger cap market for quite some time. Whereas those are things that we have and we hold onto in very near and dear fashion.

And I should say covenant breach is not a four letter word in our firm, or in any of the firms up here. That's an opportunity to get to the table and make sure that things are tracking in a way that's acceptable, opportunity to perhaps negotiate a change in terms or help set a different path for business along with the owners if that's what's required.

Information flow is something else that's really different in the middle market and in the private credit deals and the larger cap deals. Not only is there that longer due diligence period on the front end, which obviously helps you walk in the door as a fundamentally more educated investor, but you have greater information flow along the way. So if something does in fact go bump in the night, you're probably going to be more up to speed on exactly what's going on, industry and company specific-wise than you would otherwise be. All of which goes into giving you the ability to engineer better outcomes, all else equal, in the middle market or the private credit landscape than you can in some other markets.

Kenneth Burdon: Thank you, thank you. And so with the BDCs being a retail option to get access to these types of investments, to these private floating-rate types of investments that they really wouldn't be able to get access to otherwise. What do you say about the risks and benefits of being exposed to the middle market and being exposed to those types of private investments? Maybe I'll kick it over to Laura to start if she'd like.

Laura Stolfi: Sure, absolutely. I love that you read Fabozzi.

Milwood Hobbs, Jr.: The sixth edition. Sixth edition.

Laura Stolfi: But yeah, so of the risks in our marketplace, I'd say credit risk is the number one risk. That is lost in the event of default. And so when you're doing the forensic due diligence, Jason was talking about when you're underwriting these transactions, when you have a very large swath of opportunities to pick from. I think the three of us are probably all operating somewhere in the core traditional middle market, if not in slightly the upper middle market at times, you have a large opportunity set of credits to choose from. So selection is key at the onset in avoiding credit risk and being able to work through troubling times.

So we had a point in Covid where there were businesses that, of no fault of their own, were completely shuttered. They were either inaccessible in shopping malls and movie theaters, what have you, and they were basically burning cash. And so being able to partner with a private equity sponsor that showed us a company that has such high future potential value, and because of a one sort of blip if you will in their ability to generate free cash flows, us being able to work through that and not have the company default.

So credit risk I would say in our market is the largest, and avoiding credit risk comes from a very large opportunity set to select from, meaning sourcing, and then also selectivity. Being able to parse through, our team saw 1,800 transactions in 2021, our selectivity rate is 8%. So being able to parse through all of the noise that's out there and really construct a portfolio of credits that meet our discipline is how we avoid losses.

Milwood Hobbs, Jr.: So sourcing, near and dear to my heart since I run sourcing, and in that, so we do non-sponsored deals as well as sponsored. To tell a funny story, I would fly to Dallas, Texas four times a year, everyone would meet with me. "Oh, Milwood, great to see you." I take 'em out to dinner. By the time the deal's made it to me in New York, everyone in Texas had already passed. So I said, "I've gotta hire somebody in Texas." And the person I hired in Texas would not do good in New York, but in Texas he's amazing.

And what that allows for me is we're managing relationships, capital is the commodity. And generally borrowers of ours is they want three things, they want max leverage, maximum flexibility, and lowest cost, they're all the same. My job, and our job at Oaktree is how do we manage that to where we can preserve some of that? And so if I'm going to be lowest cost, highest leverage, and maximum flexibility, sure, I can win every deal. That's not what we want to do. What we're trying to do is build relationships. So we've got folks throughout the US that their job is to build a relationship, so that when there's an opportunity, the first person they think of is someone on my team because we spent time on them when there's nothing to do. And so we really spent a lot of time sourcing origination.

On the BDC side, I'm a retail investor, I own our BDC, I know what's in it. What BDCs have done is taken it's a very institutional product and made it available to the masses. Now it's inherently illiquid, so if you're a buyer of BDCs you buy when everybody else is selling, if you're selling, you sell when everyone is buying. It's kind of what you do in all things. I like the fact that an individual can get access to our deal flow and our knowledgebase through a BDC. I think it's a great way, and I think that product has been awesome for the retail investor.

So I'm encouraged by what the retail investor can have access to. Having said that, it's still a sophisticated asset class, and so you've got to educate yourself on what it is you're buying, read the 10-Ks. In fact, 10-Ks are the most underutilized, underread documents in the world. They're factual, the footnotes say a lot, and if you've read a 10-K you would be smarter than 99% of the people in the room on a deal. So read the 10-Ks, that's why the SEC is good at what they do, they produce documents that actually tell a story about our BDC. We file public financials so that you can actually understand what you're investing in.

Jason A. Mehring: Not to repeat too much, but I think the primary virtue is providing an access mechanism to a part of the market that might not otherwise be readily available. As I mentioned at the outset, been investing in middle market private deals since the mid-90s. First part of my career was in junior capital, so I've seen a lot of different cycles and a lot of different situations. And I can tell you from my own experience that even junior capital investments, much less senior ones like we're focused on right now, you can make it through cycles and do very, very well so long as you're selecting the right assets in the first place. And having a vehicle or a type of vehicle that gives retail investors access to the return premiums that you get in the middle market, I think is a terrific thing.

In terms of how we go about executing our business and how we think about running our BDCs and the entirety of our private credit business, we're not buying the market basket, we're trying to be very, very selective. There's been some stats mentioned up here, and I think a lot of firms have similar ones where you pick the businesses that you think are truly the best and have the characteristics that meet your credit eye and you structure them appropriately. And the reality is that everyone's loss rates, like others, show the ability to get through a variety of situations with very, very low losses.

And again, that's a part of the market that's not otherwise readily available unless you want to go into private drawdown type funds that have all sorts of other bells and whistles associated with them. They are very, very good for institutional investors, but at the retail level, BDCs just offer an access point to an asset class that I certainly believe in.

Kenneth Burdon: So picking up on something that you were talking about, Milwood, in terms of the competitiveness of the different segments of the middle market and how BDCs can play in a higher segment of that. In that higher segment, what kind of competition do you see? BDCs being a non-bank lender, do you see benefits to that? Do you see drawbacks to that? What competition are you facing at the level that you can play at?

Milwood Hobbs, Jr.: So if the deal is middle of the fairway, I'm probably your last option because it's priced to perfection, everyone wants it. I play golf, so I'm going to talk golf. We like to be on the fringe of the fairway, it's good enough lie, less competition. So if it's a corporate [inaudible] that doesn't have audits, a lot of folks who deal with sponsors, they want this nice pretty package, they want the Q of E, they want all the third-party diligence, and they want it wrapped in a bow and they want to say, "Here."

We would prefer to be able to shape the transaction. And by the way, if it's not packaged very well, we have told someone, we say, "Hey, you should go hire Lincoln, Piper, somebody. Let them package it and come back to us." That's our polite way of saying, "This isn't ready for our capital." Competition, what's interesting about the smaller side of middle market, we avoid that because if you're a $20 million EBITDA business you're generally one customer away from being $10 million. And if you levered it four times, you're at an eight times. So we really prefer not to play in that space.

So the folks who say, "Yeah, we can get SOFR plus 900, we're the only lender, we got a covenant," blah, blah, blah. We avoid that. Covenants are good and covenants are bad. If you structure covenants too tight, you're LPs will say, "Well, maybe you're not the smartest guy in the room because you did a deal and you tripped a covenant." So you've got to be thoughtful around creating covenants that keep you from having the wheels fall off the bus, but also don't put the company in a death spiral.

And the other thing is we're tied to a very large platform, our BDC is not originating deals just for the BDC. It's part of the Oaktree family, and so those deals in the BDC aren't just in the BDC, so you're getting access to the broader Oaktree platform. I think about the BDC as like instead of driving an Explorer I have a Suburban. I have more seats, I can fit more people in the vehicle. We think about it no differently than the rest of the firm. It's not like, oh, that'll be great for the BDC. Does it work for the firm? And then we think about how we should allocate it based on a methodology around allocation.

Laura Stolfi: Can I jump in? Oh, we had a question.

Audience: [inaudible]

Kenneth Burdon: Just to restate it so that the recording picks it up. The question is, "How does a particular deal end up in a BDC as opposed to some other product? And is the BDC somehow a driver of that versus not?" Yeah, or the allocation.

Audience: [inaudible]

Milwood Hobbs, Jr.: So one, there are actually rules around 40 Act funds, and when a deal comes in there's rules around that. But for us, we look at a deal and because we're capital solution we say, "Is this deal interesting?" as a group. So the BDC is not managed by someone sitting in Iowa, they're all part of the same group that manages private credit holistically. So the

BDC is merely, when I think about is we have SMAs, we have evergreen, we have BDC, we have sleeves. And the deal gets allocated into those sleeves based on a methodology of what percent capital is the BDC relative to everybody else?

And so if the BDC represents 10% of our private credit capital, it gets 10% of the deal. And so we're not shortchanging one sleeve from the other sleeve, we're basically saying, "We want to do this deal," and we allocate it based on the allocation methodology. Which generally coincides with what percentage of our vehicles are represented by what sleeves, so it's not any different.

Jason A. Mehring: Yeah, there's a very methodical process which you go through, where if there's a deal fit for a collection of different funds, it gets allocated to those funds on a pro rata basis, there's no decision to weight things differently to one fund versus another. If an investment opportunity fits a number of funds, it will get allocated to those funds on a pro rata or on a fair basis. As a fiduciary that's something that we're sensitive to and all of our processes are geared towards that.

There will be certain deals that we do across our private credit platform that aren't a fit for some funds, maybe the return profile just isn't appropriate or it doesn't fit for other reasons. In which case obviously it won't get allocated to those funds where it's not a fit. But where there's a fit across multiple investment vehicles, whether they're public, private, or otherwise, there's a methodology to make sure that each fund gets its fair share based on a pro rata methodology.

Milwood Hobbs, Jr.: There's buckets too within a BDC that you have to manage to as well. So if it's a bad asset for a BDC, then we clearly couldn't put it in a BDC.

Laura Stolfi: Yeah, and I'd say on behalf of the Nuveen Churchill platform as well, we also take the approach where we are fund agnostic. So whether it's a LP-GP fund, meaning a private placement closed-end fund or it's a separately managed account, or whether it's one of our BDCs, we are agnostic as to saying, "Okay, this particular credit fits this fund," or everything is allocated on a pro rata basis. So that's a theme you've heard all three of us say, is we are allocating on a pro rata basis.

So very simply, if you receive a $500 million facility, call it a first-lien term loan, we take that $500 million facility and that is allocated pro rata across, for us we have 30 different unique fund, strategy, vehicles that all could, if they are eligible, could take that loan, we'll take their pro rata allocation of that, call it a $500 million facility. So very much fund-agnostic. And so I think that that's the approach that investors would want to hear, that you're not pulling or setting aside loans for one particular strategy or vehicle versus another, that would be something like cherry picking.

So I think that that gives a lot of comfort in the process that if you've heard our three teams here all say that we have a very, very rigorous process or framework, governance, and oversight around ensuring that that pro rata allocation policy is enforced. And so a last example of a deal, meaning a fund that would not get an allocation would be, let's say it was an LP-GP structure and they're past their investment period, we're starting the process of returning capital to investors. So that would be an example of where a fund would not get their pro rata allocation, just very simply.

Audience: Different question. You guys have been in the industry for a long time, it's my understanding that there wasn't always leverage applied to middle market lending. I guess each one of you would say, "I love my portfolio and I want the most leverage I can get." But if you had to buy the market basket over a whole cycle, you're saying, "I'm getting prime credit beta." What do you think is a prudent amount of leverage where you would say, "I might not love it, but one times leverage I'm not going to freak out."

Because BDCs are all levered, so to the layman you look at BDCs you're like, I don't know these guys, even though you're a portfolio. Is one times going to get me in trouble? Because credit risk is the biggest risk, and you all seem to know what you're doing but [inaudible].

Milwood Hobbs, Jr.: This guy, this guy is good. First of all, he said BlackRock Kelso, not a lot of people know Mike Lazar from BlackRock Kelso.

Laura Stolfi: It's like a sleeper cell over here.

Milwood Hobbs, Jr.: Look, so the leverage is real fascinating, and we don't have enough time on this panel to talk about it. But you're right, BDCs, all of us have leverage on our facilities, right? If you look at our BDC, there are times when our leverage has been 0.5, 0.6, 0.7, I think one, one feels full. If you're above one, 1.08, okay. But once you start getting above that, the problem you have is that in a bad market, here's what happens. You can't sell your bad assets in a bad market, you can only sell your good assets at a loss.

So if Wells Fargo or J.P. Morgan says, "Hey, I need you to reduce your leverage," what do you do in this kind of market? You have to sell the good assets at a loss, and then the only way to fill the gap is with equity. And so in 2020, no one remembers this, all of the private equity firms drew the revolvers of all these BDCs. And a couple of them had no liquidity just because they weren't set up, revolvers for BDCs, no one thought that they would all be funded.

And so I would be very careful, not only with the leverage, but just thinking through who's their leverage provider? Because some of them, I'm getting calls where the bank is saying, "Hey, we don't want to put them out of business, but we're nervous on their portfolio. Is there anything you can do?" So those calls are happening real time.

Audience: From the warehouse lenders?

Milwood Hobbs, Jr.: From the warehouse lender, yeah. So that's the elephant in the room, is the leverage providers who have all this hung LBO risk are starting to say, "Where can I reduce my risk-weighted assets?" And they're going to look at these BDCs and say, "Well, if I'm losing money on a $17 billion LBO, probably not doing so well on $150 million TEV private credit loan." So I'd be very careful with the leverage on the BDCs.

Jason A. Mehring: I guess I would just chime in, I'm going to give you a really bad answer, which is it depends. And specifically but in all seriousness, what I mean by that is within the BDC universe you may find grounds that focus in different areas within the capital structure. And I think that anyone that's been around the markets, you might be willing to live with a higher level of leverage for a BDC or a fund of any structure that's more oriented towards senior debt for example, top of the capital structure secured. Whereas the flipside might be if you have a fund that's more focused on junior debt or bottom of the capital stack and therefore is going to have higher risk of loss. So I think it's important to peel back the onion a little bit just to understand what the portfolio composition is.

Another element is level of diversification. Again, different funds might have different approaches to that. If you've got a fund that runs 90-125 names in its book, that implies one level of diversification, which again you still have market risk but you don't have quite as much idiosyncratic risk as a group that might have – pulling an extreme number out of the air – 25-35 names in its portfolio. So leverage, when used prudently and applied to the proper assets, I think can still be very even conservative. But I think you just have to understand what the underlying strategy is and how the managers like to run their book in terms of diversification when you're assessing, hey, is this too much leverage or is it just right?

Kenneth Burdon: All right, are there any other questions? We've got one minute till time, so we'll take another question, yep.

Audience: [inaudible]

Jason A. Mehring: I would go for C, which is both, and I am being serious. You might think that, again just speaking from our own perspective, we have the benefit of a big platform, we have a diversified book. I think that because of the resources we have and the nature of the manner of work that we do both on the front end and on the monitoring front, we do have pretty close ties to and tabs on each of our borrowers even though we have a high level of diversification.

So I don't necessarily think that they need to be mutually exclusive, maybe in some cases they are, but I would rather have both. I'd rather have a good amount of diversification with a manager that in addition to having the requisite experience so they know what they're doing, has the resources to manage a book that's filled with a lot of different names.

Audience: [inaudible]

Milwood Hobbs, Jr.: So what we have done, through one of our strategies we funded [inaudible 0:44:53]. Oaktree funded that business, it grew, and then it was sold recently. So if we think there is an exceptional management team, and there's a product gap that we don't have the expertise but we can put capital to it and generate return, we'll do that.

I think it's hard if you are smaller BDC, you're getting a call from the client that can't get me on the phone. Generally speaking, a CFO or a CEO doesn't get fired for hiring Goldman Sachs for M&A advice. So in the world we live in, that's no different. Is the CFO going to get fired if he said Oaktree or Nuveen or BlackRock or XYC small BDC? So I would think about it and I'd say, "Hmm, that small BDC, what makes them unique?" Was it just because no one else would do the deal? Or do they have an expertise around a particular industry that makes them small and unique?

If they've got a life sciences BDC, and they've got four doctors and three people who are ex-FDA specialists, then maybe that makes some sense because they're only going to get life science deals and they've got a concentrated focus. But if you're just a broad BDC that's just small and subscale, I think it's hard to get to the same deals we have access to.

Jason A. Mehring: Yeah, I guess I would just extend that concept to look not only at the BDC proper, the market cap or if it's a private BDC, you know how much capitals been raised, and look across the ecosystem within which that's managed, which is a way of saying the overall firm. I mean, there may be some boutiquey players out there that are small, that also have small BDCs and they have less breadth across the platform.

Again, maybe that's because they're specialized in a specific industry or industries like we just talked about. But I think all else equal, even if it's a comparatively small from a dollar size fund, but it's within a bigger platform that has a lot of resources devoted to the space, I think that's something that probably just gives you more alternatives, more tools in your toolbox, more resources to draw from in any market condition.

Kenneth Burdon: All right, thank you, panelists. Great informative discussion, thank you very much and we'll be onto the next panel.

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