

Ted Koenig: Time for Growth at Monroe

By Michele Ocejo

Theodore L. Koenig, president, CEO and founder of Monroe Capital LLC, has over 30 years of experience in structuring and investing in debt and equity transactions. Monroe Capital LLC is a leading provider of senior and junior debt and equity co-investments to middle-market companies in the U.S. and Canada. Investment types include unitranche financings, cash flow and enterprise value based loans, acquisition facilities, mezzanine debt, second lien or last-out loans and equity co-investments. Monroe has been recognized by Global M&A Network as the 2013 and 2014 Small Mid Market Lender of the Year; by Private Debt Investor as the 2013 Unitranche Lender of the Year and 2014 Senior Lender of the Year; and, by the U.S. Small Business Administration as the 2015 Small Business Investment Company (SBIC) of the Year.

Koenig also serves as the Chairman, President and CEO of Monroe Capital Corporation (NASDAQ: MRCC), a publicly traded business development company (BDC).

Prior to founding Monroe Capital in 2004, Koenig was president and CEO of Hilco Capital LP, a junior secured/mezzanine debt fund established in 2000. Prior to that, he spent 13 years at the Chicago-based law firm of Holleb & Coff as partner and co-chair of the firm's Corporate Law, Mergers & Acquisitions and Business Finance groups, where he supervised and was responsible for structuring, negotiating and documenting acquisitions and sales of middle-market companies as well as representing the firm's bank, financial institution and commercial finance clients in financing transactions for buyout, growth, recapitalization and restructuring transactions. Before joining Holleb & Coff in 1986, Koenig spent three years in the Mergers/Acquisitions and Corporate Finance practice group of Winston & Strawn where he was involved mostly in structuring and documenting buyouts, sales and financings for middle market companies.

Koenig is a graduate of the Kelley School of Business at Indiana University (B.S.) in accounting with high honors and Chicago-Kent College of Law (J.D.) with honors. He is also a certified

public accountant. Koenig is a director of the Commercial Finance Association, and a member of the Turnaround Management Association and the Association for Corporate Growth.

In this interview, he discusses Monroe's beginnings, its recent growth, and his 2016 predictions.

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Please tell our readers how you got your start in asset based lending.

I learned asset-based lending (ABL) the old-fashioned way—as a lawyer billing a ton of hours in the late 1980s and 1990s representing some of the best asset-based lenders and thought leaders in the industry.

I did loan documentation work for clients such as Congress Financial, The CIT Group, Foothill, Finova, GE Capital, LaSalle Bank, American National Bank, Continental Bank, Greyhound Financial, Nationsbank, Heller Financial, BancBoston and Fleet Bank, among others...what is really amazing is that none of these institutions are still around today in the business of ABL with the exception of CIT. I also had the benefit of watching and learning the business directly from the likes of Bill Davis, Larry Marsiello, Vic Russo, Pete Schwab, Jim Ungary, Walter Macur, Mike Sharkey, Dennis Harrison and Ward Mooney, all ABL legends. Finally, I was fortunate enough to learn my legal craft from the best of the best ABL attorneys who were all much older and wiser than me like Bruce Bernstein, Jon Helfat, Richard Kohn, Bob Zadek and Ken Latimer. All of these individuals took time and effort from their busy days to help a young and hungry lawyer (me), who asked lots of questions about granting proper security interests, perfection and priority of liens, possible bankruptcy outcomes, and many other more mundane

topics. These firms and individuals created and built the modern-day ABL industry and gave me my MBA and Doctorate degrees in ABL. For that, I am tremendously grateful.

What about Monroe? How did the firm begin and grow to be what it is today?

Monroe Capital was established with the idea to be a customer-friendly middle-market finance company that did what the banks could not do well or on a timely basis. I never thought that 16 years later it would mean displacing most of the traditional banking industry in the middle market for transactional leverage finance (buyout lending) and, to some degree, asset-based lending in certain circumstances.

Our business grew from a standing start in 2000, doing second-lien ABL loan transactions, mostly in and around the retail industry with Hilco under the banner of Hilco Capital from a small suburb of Chicago with about \$38 million in AUMs, to an asset management firm today with almost \$4 billion in AUMs, over 200 portfolio company borrowers, eight offices located throughout the U.S. and one in Toronto, 75 employees and 10 investment fund vehicles later. We made 64 investment loans last year in 2015 involving close to \$2 billion. It's been remarkable for me to watch the evolution of Monroe and even more so considering the senior management team of Tom Aronson, Mike Egan, Alex Franky and I have been together since we first opened the doors of Monroe in 2004 and, prior to that, at Hilco Capital. Since then, we have added more high-quality management talent including Zia Uddin, Jeremy VanDerMeid, Aaron Peck, Jim Cassady, Carey Davidson and others, to help manage our private investment fund vehicles, our CLO vehicles and our publicly traded BDC, Monroe Capital Corporation (NASDAQ: MRCC). Last year, we raised about \$1 billion in fresh dry powder in committed LP investment fund vehicles from institutional investors such as city, state and county public and private pension funds, insurance companies, sovereign wealth funds, universities both large and small, foundations, hospitals, church organizations, and ultra-high net worth families throughout the U.S, Europe and the Middle East. We will likely raise a similar amount of new investable capital this year as well. Today, Monroe is the same customer-friendly finance company we set out to create in 2000, but now it is also a global asset management firm that has been delivering

double-digit, annual current returns to its LP investors and public stockholders for over 15 years, each and every year.

Monroe certainly has been busy. Can you comment on where and how you generate your business? We recently read about two of your new vertical businesses: ABL for retail and consumer goods and also, specialty finance. Can you comment on those verticals and why you chose to establish them now?

We have pretty good geographic market coverage for our finance products, which include senior secured loans, unitranche loans, junior capital loans and, to a lesser extent, mezzanine loans and equity co-investments. We have full and dedicated origination offices staffed by seasoned professionals at the managing director level in New York, Boston, Chicago, Los Angeles, San Francisco, Atlanta, Charlotte, Dallas and Toronto. In addition, we also have industry vertical coverage. That means we have experts on our team that focus their entire time in specific industries so that they can move quickly and respond to market trends and needs in those areas as they arise. The specific industry verticals that we have are healthcare, technology, media, ESOPs, ABL for retail and consumer goods and specialty finance. All have proven to be important areas of growth for us. The industry vertical businesses that we established recently like ABL for retail and consumer goods and specialty finance will allow us to take advantage of opportunities in those market segments as the banks continue to withdraw from them and become less aggressive due to regulatory constraints and also due to performance headwinds in those industries. We are just starting to see early stages of those performance headwinds now with quarterly earnings announcements from industry leading companies in both of those areas.

Our philosophy at Monroe has always been to bring on board the best athletes we can find, be it new business generation, underwriting or credit (and we are constantly looking to add more top athletes to our team), and then let them find the best companies with the best management teams in the various industries for us to finance. Many firms can say and have said this, and many of those firms are no longer around. In my opinion, the key to Monroe's long-term success is that we have built a "zero loss/credit first" mentality in underwriting, credit and portfolio management over the last 15 years. It takes time, patience and saying a polite "no thanks" quite

often to deals. For some in our industry, that is very difficult to do. For example, in 2015, we looked at 1,700 investment opportunities and we ended up closing on only 64. While 64 is a lot of deals to do for most any shop, it represented less than 4% of the transactional finance opportunities we reviewed.

What's next for Monroe?

You can expect to see more of the same. It's good to sometimes be boring and in our business that is a very good thing. Our customers and referral sources can continue to expect that we will do what we say we will do. In our business, execution is key. We will continue to do deals!

Our firm is completely 100% owned by management (no banks, pension funds, insurance companies, hedge funds, PE funds, nobody) so our foremost interest is in our various funds' performance so that our people can earn their carried interests in our various funds. For example, in our latest 2016 investment fund of around \$800 million in LP commitments pre-leverage, we have about 56 of our employees with carried interests in that particular fund. That is unheard of in our industry and I think creates the proper alignment of interests with our LPs. Just as important, however, it also creates the ability for our people to not only work in a fast-paced, challenging and creative daily environment, but also where they can be well compensated outside the bounds of what traditional regulated financial institutions are able to do.

We are now almost 50% thru 2016, what does the rest of the year have in store for us? What is your outlook for this year and what will be hot and what is not hot?

I think the rest of 2016 will be much like 2015. Money will be readily available and there will be enough deals to go around, but quality will remain the question. As in 2015, investment banks are playing and will continue to play a greater role in the sale process of middle-market companies. The sale processes today are more robust than ever with many strategic buyers showing up, but also, many international buyers as well. Organic growth is difficult so many companies will be looking to inorganic growth or acquisitions to move the needle.

I think that the private equity business will continue to be a very difficult business. There is currently at least \$500 billion of dry PE powder in the U.S., i.e., funds raised and not yet invested. Purchase price multiples will continue to remain elevated. The days of buying a company for a low multiple, doing some financial engineering, growing EBITDA and then selling the company for a higher multiple are in the past. Today, PE firms need to add some real and ongoing value in terms of management, customers, markets, margin, etc. if they are going to succeed in generating acceptable investment returns for their limited partners.

Banks will continue to be less relevant in the transactional buyout finance market due to imposed limits on leverage lending. That is particularly true in the middle market. In the larger syndicated loan markets, banks will still dominate issuance of high yield debt and other investment grade products and services through their massive distribution channels. That is what the regulators wanted, and that is what they have, in fact, achieved.

In terms of specific outlooks and trends for the remainder of 2016, my personal views are: dividend recap volume will be lower; M&A volume will be down or, at best, flat to 2015; we will see a pronounced decline in CLO issuance for the remainder of 2016, as we have already seen in 1H 2016; default rates will increase from 1-2% to 3-4% overall with energy trending much higher; BDC firms will continue to see cracks in their portfolios, especially those with exposure to oil and gas, metals and mining, and commodities, same for those with heavy exposure to mezzanine debt and second lien loans; overall leverage rates will trend lower as the year continues; interest rates will go higher, but not at the steep incline predicted by the Federal Reserve Chair; and, the stock market will be range bound for quite some time.

Finally, industries where we anticipate growth in 2016 will include: healthcare, technology, business services, specialty finance (consumer lending and fintech), food and beverage, and new media – digital. Industries that will have their challenges include: energy, metals, mining, commodities, retail, housing, consumer lending (if the economy legs down or unemployment legs up), and general cyclicals.