HDC
HUNTING DOG CAPITAL

A Q&A with Hunting Dog's Leadership Team

1. Investors still see the strong value in direct lending amongst this challenging investment environment. What do you attribute that to?

We believe there are several forces at work here. First, with interest rates at historic lows, direct lending can generate consistent, largely uncorrelated returns. Furthermore, as the trends of bank consolidation and asset concentration among the largest banks continue, smaller companies are left underserved by more traditional lenders. Since 2006, as a senior-secured lender, we have always been focused on tangible assets as collateral to protect principal. HDC fills the void left by commercial banks and other lenders by providing growth capital to lower, middle-market, US-based companies.

2. There's an argument that says there have been too many amateurs in the credit space and, this current crisis may create a shake out. The weaker may default. How has Hunting Dog stayed relatively impervious when others are struggling?

First, no one is impervious. But unlike a lot of lenders that focus strictly on cash flow or are willing to take a junior security position, Hunting Dog Capital only lends on a senior-secured, first lien basis that is backed by tangible assets as collateral. Historically, this has meant, on average, collateral in excess of 2x the loan amount at closing. If a problem arises, we are first in line to get repaid. We have also always been covenant-heavy lenders, which enables us to act earlier and more proactively, if needed. And by doing the same thing for over fourteen years, we have the battle scars and hard-learned lessons of how not only to identify potential problems early, but also successfully work out troubled loans. Finally, we are highly selective in our deal-selection process, especially because we participate in every loan. With the origination network we started building even before Hunting Dog was formed, we see, on average, between 150-200 opportunities each year. Since we only expect to close 6-8 loans each year, we are able to be highly selective to ensure only the best opportunities are pursued.

3. What are the core investment principles that Hunting Dog established at its start that you continue to adhere to?

Going back to when we founded Hunting Dog Capital fourteen years ago, we have always focused on tangible assets as collateral to protect principal and minimize risk. We take a blanket lien (first position) on nearly all the assets and have never used leverage at the fund level. We look for a mix of assets, such as equipment, inventory, accounts receivable and real estate. Additionally, we are focused on cash. We get paid monthly and have always been covenant-heavy, which are tested monthly. Finally, we require an alignment of interest for everyone involved, which is a key factor for achieving optimal results. To that end, we require borrowers with meaningful at-risk equity and my partner Chris and I have personally invested in every loan made.

4. What opportunities do you see in this market given your investment objectives?

We expect to see significantly better and more numerous opportunities as banks and more traditional lenders pull back even further from the lower, middle market, which is the area we target. Because of our focus on tangible assets as collateral, we expect to see better asset coverage as well as the ability to negotiate more favorable terms and covenants. Additionally, just like during the last recession, we also expect to see incumbent lenders willing to take meaningful discounts to exit existing relationships. Our origination network that we have been building for more than fifteen years and has over 7,500 names primed to prudently put investment capital to work.

5. What are the various risks in direct lending that investors should be aware of?

Direct lenders lack the ability to make changes to operations within portfolio companies, though because of their position in the capital stack, they can often influence management teams. Additionally, these loans are largely illiquid with an inefficient secondary market. However, unlike a private equity investor, loans are generally much shorter in duration. Finally, these loans are often to smaller companies, which can be riskier, but with a higher potential return, than lending to larger companies.

6. Do you have recommendations for investors making a first-time allocation into direct lending?

First-time allocators into the direct lending space should look for a few things. First, experience counts. We have worked together since 2002 and have the battle scars to prove it, not only the '08-09 recession, but also workouts and turnarounds. Also, given the current economic environment, we believe a senior (first-lien) lender with a focus on tangible assets to provide downside protection will be well-positioned to generate favorable risk-adjusted returns with very low correlation. Finally, avoid lenders with legacy issues in existing portfolios. Investors want their PMs to spend their time making new loans, not managing legacy investments. Hunting Dog Capital has the experience and a clean slate with no legacy issues to slow down our investment process.

7. What would you describe as Hunting Dog's edge? What can you do that others cannot?

We have the acumen, judgment and historical track record to successfully target small, US-based growth companies with tangible assets that seek loan amounts that are generally too small for more traditional commercial banks or larger competitors. Our experience and eighteen years of working side by side provides further "check and balances" in conviction-weighted, decision making. As a result, we see far less competition and are able to negotiate better terms and pricing. Moreover, by offering senior secured, collateralized debt, we are safeguarding investor capital should incremental or significant losses require recovery and remuneration for capital loss. Finally, we have the hard-learned workout and turnaround experience to protect principal and achieve our investment objectives.

8. Do you have a prescient view of this time in history and its advantage to your investors?

We thought the financial crisis of '08-09 was a once in a lifetime opportunity for our direct-lending strategy. With bank failures, increased regulation and a flight to significantly larger borrowers, not only were we inundated with potential lending opportunities, but also, we were amazed by the quality of the opportunities presented. Arduous negotiations over pricing and covenants were replaced with CEOs seeking comfort and reassurance in our ability to close. During this period, coupons above 14% for senior-secured loans were not uncommon for companies with tangible assets greater than 2.0x the loan amount.

Today, against the growing backdrop of fear and uncertainty caused by COVID-19, a twice in a lifetime opportunity is now upon us. During the great recession, available credit to lower, middle-market companies quickly disappeared as banks failed and credit markets seized. We believe the table has been set to re-create the most favorable lending environment last seen a decade ago. We believe this for several reasons:

- Since 2002, the number of banks has declined approximately 40.9% from 7,870 in 2002 to 4,708 in 2018 New bank charters averaged 138 per year from 2002 to 2008; since than an average of less than five per year and some years with no new charters
- Big banks keep getting bigger. Since the financial crisis, the nation's biggest banks have grown substantially. All in all, the top fifteen largest banks now hold a combined estimated total of approximately $13.7 trillion in assets or approximately 75.3% of all US bank assets
  - The average asset size is approximately $3.5 billion, largely driven up by the biggest four, which account for approximately 40.0% of all bank assets. For comparison, the average credit union has an average of approximately $286 million in assets
  - The median asset size, by contrast, is approximately $230 million
- Increased regulations, such as Dodd-Frank, escalate not only regulatory scrutiny, but also expenses, which are more difficult for smaller banks to absorb. Inevitably, this leads to even less lending to lower, middle-market companies
- With the Federal Reserve slashing interest rates to unprecedented lows, bank profits will be negatively impacted, particularly smaller banks, which will cause them to reduce lending even more, particularly to lower, middle-market companies

Like our name, we are diligent, disciplined and tenacious when it comes to achieving our investment objectives. We are committed as acting fiduciaries of our clients' capital to aligning interests by investing alongside our institutional and private clients.

In today's low-yield and challenging economic environment, we have the hard-learned restructuring and workout experience to generate favorable returns and current income, which are largely uncorrelated. Even with recent events, our existing portfolio companies continue to perform, thus highlighting the importance of deal selection, underwriting and post-close monitoring. And, we have never wavered from our covenant-heavy approach. HDC targets a net return of 10%+ and provides current income – true alpha – on a quarterly basis.

We are ready to hunt.

Our Leadership Team

Chris Allick
Managing Partner & Co-Founder

Chris Co-Founded HDC in 2006 with Todd Blankfort. Chris is a member of the Investment Committee and is responsible for overseeing the day-to-day management of the Firm and its investment and business development activities.

Prior to HDC, Chris founded boutique investment bank Instream Partners LLC in 2000, thereafter founding Instream Capital LLC in 2004 to make senior-secured term loans similar to those made by HDC. Before founding Instream Partners LLC, Chris spent over 20 years in the investment banking industry where he pioneered several structured finance products used primarily by financial institutions to assist in managing high-yield debt portfolios. In 1990, Chris helped found the corporate finance department at Jefferies & Company, Inc. (subsequently acquired by Leucadia National Corporation), of which he acted as co-head until 2000. From 1986 until 1990, Chris was a Managing Director and Co-Head of financial institutions coverage in the investment banking department of Drexel Burnham Lambert in Beverly Hills. Chris began his career in the investment banking division of Dean Witter Reynolds in New York. Chris earned an MA in economics from York University and a BA in economics and English literature from the University of Colorado Boulder.

Todd Blankfort
Managing Partner & Co-Founder

Todd Co-Founded HDC with Chris Allick in 2006. Todd is a member of the Investment Committee and is responsible for managing the Firm's investment process, portfolio management and operations.

Prior to HDC, Todd was previously a Managing Member of Instream Capital LLC, with responsibility for originating, evaluating, and structuring investment opportunities, having joined Chris at Instream Partners LLC as a Vice President in 2002. Before joining Instream Partners LLC, Todd was an Associate Director with UBS Warburg LLC in its investment banking division, working primarily with software companies. Previously, he worked for Veronis Suhler Stevenson, executing primarily mergers and acquisitions advisory assignments in the consumer publishing field. Todd also spent two years in the real estate corporate finance group at Citigroup. Todd earned an MBA, with distinction, from the University of Michigan (Ross School of Business), and a BA, cum laude, in economics from the University of Pennsylvania.

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