Owl Rock's Packer: BDCs Have Been Strong Through Pandemic And Getting Stronger

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Craig Packer, co-founder, Owl Rock Capital Partners, and chief executive officer at Owl Rock Capital Corp. Read the Q & A below as Craig says that business-development companies held up well through the pandemic – noting that his own company has been making loans at rates that are twice the cost of the financing – with better-than-expected performance which should only get better as the economy re-opens. He also discusses the impact of interest rates and inflation and more on lending activity, and whether booming activities in SPACs – special purpose acquisition companies – is having any impact or fallout on BDCs.

Craig Packer

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CHUCK JAFFE: We're talking business-development companies and the BDC loan market with Craig Packer, co-founder of Owl Rock Capital Partners, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And by the way, if you're looking for more direction on business-development companies and closed-end funds, check out the Alliance website, which is AICAlliance.org. Today on The NAVigator I'm joined by Craig Packer, president and chief executive officer at Owl Rock Capital Corp., that's ticker symbol ORCC, and you can learn more online at OwlRock.com. Craig, thanks for joining me on The NAVigator.

CRAIG PACKER: Thanks Chuck, great to be here. Appreciate it.

CHUCK JAFFE: The BDC space, really interesting what's been going on in the loan market, especially as we've seen just the economic conditions and what's been going on with rates throughout the pandemic and then as we start to get out of it. So let's start with a general update of where you're at at Owl Rock and what you see happening with the BDC loan market.

CRAIG PACKER: Sure, so I'll use as a starting point where we were a year ago and how far things have come. Our fund at Owl Rock Capital Corp., publicly traded company, second largest publicly traded BDC, we focus our attention on making loans, private loans to upper middle market companies, average cashflow of $100 million typically backed by private equity firms in recession resistant spaces. So some of our biggest sectors: software, insurance, healthcare, food and beverage, etcetera. We are primarily a first lien lender to privately held companies. Obviously a year ago we had a portfolio that was performing extremely well, but Covid hit and I think there was a big question around these private loans and how they would hold up given the economic impact from Covid. Roll the clock forward a year later and the BDC space has held up extremely well, better than folks expected. And a year later more companies continue to do very well, their results are improving, these spreads that we have on our loans in our portfolio are north of 8% and the portfolio has had very, very few credit issues. And given a general expectation that the economy's going to continue to improve as vaccinations get spread around, we're feeling really good about how we're positioned and the outlook.

CHUCK JAFFE: In fact, you guys were making some headlines back in December because you had, what I believe, was the biggest bond issuance ever in the BDC space. Explain what was going on. It's got to take a little bit of confidence to do that deal in these market conditions.

CRAIG PACKER: Sure. Well, thank you for that. Yes, in December we did a billion dollar unsecured bond deal, which was the largest bond deal ever done in the BDC space. And it really speaks to the evolution of BDCs. We're a relatively new entrant, we began our business in 2016 but we're much larger than many other BDCs. One of the things that size allows us to do is finance ourselves much more efficiently. ORCC has four investment-grade ratings from all the major rating agencies, and that gives us access to the unsecured investment-grade bond market, which is a very cost effective place for us to finance our loans. I mentioned a minute ago, our loans that we extend were earning north of 8%, but our bond financing and that bond financing in particular was done at 3.4%. And so obviously that's very valuable for our shareholders if we can lend at a rate that's twice the amount of a cost of our financing. We put very moderate leverage on the BDC, a turn of leverage or less, and that's why we're able to get the investment-grade ratings. So I don't want to spook anyone that we're using an excessive amount of leverage, it's a moderate amount of leverage. But being able to finance in the bond market, that's the five plus year maturity bonds, in that case we have a fixed rate. And so if you think rates are going to go up, we've got our liabilities at a fixed rate and our assets are almost all floating rate, and so that could be very attractive if you think we're going to enter into a rising interest rate environment.

CHUCK JAFFE: When you started you wanted to make a comparison from a year ago to now. I want to keep you there but I want to take it a little bit further. We have seen changes in interest rate pressures, in inflation, and of course in the underlying economy. We had things that went to a full stop, we have other businesses that are coming back, we're expecting major economic growth in the awakening sectors and what have you. Has it changed the way you're writing loans or the businesses that you're pursuing, etcetera? Is there any significant difference in Owl Rock and what you're doing now than there was a year ago as we were entering the pandemic and not expecting it to last this long?

CRAIG PACKER: It really hasn't changed our process, and candidly, it really hasn't changed the types of companies we lend to. And it's not to say that we're not thoughtful about trying to learn lessons about what we've just been through or the economy or where it's going, but we're a private lender. Our loans when we make a loan, it's typically five to seven years in maturity. And so unlike other investors that you might speak to or other funds you might invest in, we're making illiquid loans that we're going to hold to maturity. So generally the loans we make are going to have to endure throughout the business cycle. We don't have the luxury of trying to pick a short economic pocket and bet one way or the other, and so we try to lend to all-weather companies that can survive the ups and downs of the economy. As a result of that, if anything the stresses of Covid and their impact on our portfolio only validated just how important it is, that focus on quality versus return. One of the temptations if you're a private lender, there's always this temptation to be willing to take a little bit of extra credit risk to get paid. At Owl Rock we firmly believe that we're trying to get the premium you can get for doing illiquid lending, but beyond that try to mitigate credit risk as much as possible. So no change to the types of companies, the size of the companies, the way we structure our loans. There's always going to be that temptation to try to make a bit of a bet, but we think the recession resistant sectors are still the way to go. With respect to Covid specifically, there's certainly businesses that were temporarily impacted by Covid that now have recovered significantly, and in those cases we'll be open minded. For example, in the healthcare space there are businesses in the dental or dermatology sector. For a couple months nobody could go to their dentist or dermatologist, but that's now rebounded quite significantly. So that might be the kind of sector that was impacted by Covid but we would now be very openminded about financing. On the other hand, there's other sectors, particularly those related to travel, casual dining, consumers having to get on an airplane or in a stadium, where we haven't yet seen the recovery. We're lenders, at the end of the day we don't get the upside if things work, we get the downside if we don't. And so we'd be pretty cautious about businesses that are still feeling significant impacts from Covid.

CHUCK JAFFE: We've got this changing interest rate environment. It's ultimately going to change the landscape on lenders a little bit. But we also have a changing environment for raising money as public companies. We have the whole emergence of SPACs right now; SPAC, special purpose acquisition company. Because a company might use a SPAC, a specialty financing company, as a way to raise capital, as a way to go public and raise capital. Very different from getting a loan but still an option for somebody who's got a business and is trying to grow it. Are they in any way competition? Or do they change the landscape at all for BDCs like yourself?

CRAIG PACKER: I don't see them as competition. Simply put, at least for Owl Rock we focus on lending to companies that are owned by private equity firms. SPAC, its simplest form is just an alternative way for a company to go public versus a traditional IPO. And so this explosive growth in the SPAC area is really just opening up new avenues for private companies to go public. It's really just another way for the private equity firms that we are lending to to get an exit on their investment. By instead going public through a traditional IPO, they can just choose to go public through a SPAC. I certainly don't view it as competition, but I view it as another potential value enhancer for the companies in our portfolios. Given the number of SPACs out there, we are certainly getting asked by SPAC sponsors whether there are companies in our portfolio they should be speaking to, and we generally send those inquiries over to the private equity firms. But I generally view it as more equity capital to help make sure that eventually our loan gets repaid.

CHUCK JAFFE: That makes it sound like this is a way to actually maybe goose your returns or get a little bit more certainty that things are going to work out.

CRAIG PACKER: It's another way for us to exit. We make a loan for five to seven years, we want to make sure that ultimately that loan gets repaid. It could get repaid in a number of ways; refinanced, it could get sold, or it could go public. And the rise of SPACs just enhances the chances our company will go public and we get repaid, which is terrific for us and our investors.

CHUCK JAFFE: Craig, really interesting. Thanks so much for taking the time to join me.

CRAIG PACKER: Great Chuck, I really appreciate it. Thanks for having me.

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