DebtRush

Newsletter

RSC Market Update - May 2017

Traveler Photo by ©4corners

Rush Street Capital is a boutique financial advisory firm that specializes in all aspects of debt: **debt private placements**, **debt advisory**, **debt market surveys**, **mergers and acquisitions advisory**, **debt restructuring**, **special situations**, and **capital markets**.

Proud Members Of:

How High Can Interest Rates Really Go?

When does a 1.04% interest seem high? The answer is when it was 0.55% a year earlier. That is our reality today in the U.S. economy. 1-year U.S. Treasury rates stood at 0.55% on May 1, 2016, so today's lofty levels of just a hair over 1.00% seem quite high by comparison.

The question of the day seems to be, how high are rates going to go in 2017 and 2018? Maybe a better question is – in reality, how high can interest rates really go? After all, with anyone and everyone holding more and more mountains of debt on their personal, corporate and federal balance sheets, how much further can rates really move up?

One certainly cannot question our nation's proclivity toward debt. What Starbucks is to coffee, the United States is to debt. We simply love the stuff. From U.S. consumers, to U.S. corporations to our nation itself, we have been vociferously gorging ourselves on debt for many, many years. And this trend does not seem to be slowing itself down any time soon. As an intermediary who spends most of our days matching borrowers with lenders, perhaps you wonder if our perspective may be skewed. However, with the U.S. national debt about to touch $20 trillion, new issuances of U.S. corporate debt continuing to hit new record levels (total U.S. corporate debt is $8.5 trillion) and U.S. consumers more indebteded than ever (nearly $13 trillion at last count), the proof is everywhere – we are a nation of debtors. The total well over $40 trillion of debt and rising every day.

But after a period of sustained low interest rates which were set in motion to help our economy grow its way back to health, perhaps a now rising interest rate environment will cause us to want to deleverage a little bit, take our foot off the old debt accelerator for a while, so to speak. Maybe tap the brakes a little on this debt expansion.

Ahem, count us in the camp that does not think that is very likely.

On the contrary, we think it more likely that instead of rising interest rates causing us to want to deleverage as a nation, the inverse is true: Our addiction to debt has placed an unnatural low ceiling to the potential height of interest rates. We simply question just how high interest rates can actually rise in the United States. As one market participant joked recently, "what's the coupon payment increase for a 25 basis point rise in the interest rate on $40 trillion of debt?" (Spoiler alert – the answer is roughly around $100 billion.)

We believe that this unnatural low ceiling should act as sort of a dumbwaiter on the market levels of interest rates as we continue through 2017, despite the best efforts of our U.S. Federal Reserve to gradually raise interest rates by increasing the Fed Funds rate. With so many critical industries reliant on low interest rates (mortgage, housing, consumer finance, etc.) and so many market participants absolutely petrified of a sustained period of rising interest rates, there is a powerful pull to stop this insanity of higher interest rates. Basically, there is an inherent market "cap" on just how high rates could actually go.

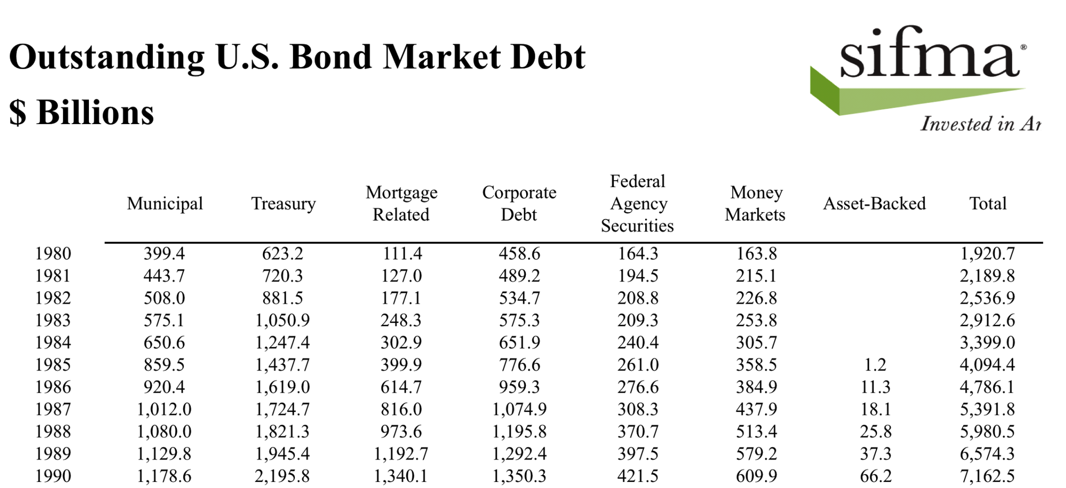
With each 25 basis point increase in interest rates, Americans holding credit card debt pay an additional $1.6 billion in annual finance charges. This is money that comes right out of a U.S. economy that is 2/3 driven by consumer spending. And that is just the beginning of the negative economic impact of higher interest rates.

At some point, the economic data that are leading the Federal Reserve to conclude that it is time to raise interest rates will start declining and flashing warning signs (if that data hasn't already). The cycle becomes self-fulfilling and an inherent stop button is placed on the march toward higher rates.

And maybe the most salient point to our thesis of an artificial ceiling on interest rates is this - how much higher is the Federal Reserve really prepared to raise interest rates given that the U.S. government itself owes $20 trillion of debt? With each 25 basis point increase in the Fed Funds rate, an estimated $400 billion is added to the 10-year Federal budget deficit or an additional $1.6 trillion in the budget deficit for an increase of 100 basis points or 1 full percent of higher interest cost.

The yield curve is definitely upward-sloping and may stay that way for the foreseeable future. Interest rates appear that they will steadily rise throughout 2017. However, count us in the camp that believes that this period of interest rate hikes will not be very steep because if it is steep, it will rather quickly bump into an inherent ceiling to the level at which rates can rise. Interest rates may well continue to rise for a number of years, but if they do, they will do so at a slow, gradual and measured pace. Any sudden or sharp increase in rates would have a devastating effect on our economy.

Our best guess is that the Federal Reserve will probably raise rates 2 or 3 more times in 2017, barring any unnerving economic data and barring any extraordinary events (e.g. war, terrorism). After that, the Fed governors are already hinting that they will use 2018 to begin to reduce the Central Bank's bloated balance sheet and keep interest rates steady. This plan makes sense for many reasons and the progression is logical. However, a skeptic may wonder if it is also a convenient alibi for government agents to avoid further increasing the interest payments on themselves. No one knows better than those at the Federal Reserve Bank about just how much debt we have issued over the past several decades. And no one knows more about price setting and interest rate manipulation that those very same Fed governors.



Outstanding U.S. Bond Market Debt

$ Billions

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	Municipal	Treasury	Mortgage Related	Corporate Debt	Federal Agency Securities	Money Markets	Asset-Backed	Total
1980	399.4	623.2	111.4	458.6	164.3	163.8		1,920.7
1981	443.7	720.3	127.0	489.2	194.5	215.1		2,189.8
1982	508.0	881.5	177.1	534.7	208.8	226.8		2,536.9
1983	575.1	1,050.9	248.3	575.3	209.3	253.8		2,912.6
1984	650.6	1,247.4	302.9	651.9	240.4	305.7		3,399.0
1985	859.5	1,437.7	399.9	776.6	261.0	358.5	1.2	4,094.4
1986	920.4	1,619.0	614.7	959.3	276.6	384.9	11.3	4,786.1
1987	1,012.0	1,724.7	816.0	1,074.9	308.3	437.9	18.1	5,391.8
1988	1,080.0	1,821.3	973.6	1,195.8	370.7	513.4	25.8	5,980.5
1989	1,129.8	1,945.4	1,192.7	1,292.4	397.5	579.2	37.3	6,574.3
1990	1,178.6	2,195.8	1,340.1	1,350.3	421.5	609.9	66.2	7,162.5
1991	1,272.1	2,471.6	1,577.1	1,454.6	421.5	565.9	91.7	7,854.5
1992	1,295.4	2,754.1	1,774.3	1,557.1	462.4	579.0	116.4	8,538.8
1993	1,361.7	2,989.5	2,209.0	1,782.8	550.8	580.0	132.6	9,606.5
1994	1,325.8	3,126.0	2,352.9	1,931.1	727.7	623.5	162.1	10,249.0
1995	1,268.2	3,307.2	2,432.1	2,087.5	924.0	700.4	215.7	10,935.1
1996	1,261.6	3,459.7	2,606.4	2,248.5	925.8	803.0	297.8	11,602.9
1997	1,318.5	3,456.8	2,871.8	2,459.3	1,021.8	979.4	397.6	12,505.2
1998	1,402.7	3,355.5	3,243.4	2,781.8	1,302.1	1,172.6	482.7	13,740.8
1999	1,457.1	3,266.0	3,832.2	3,122.7	1,620.0	1,402.4	588.9	15,289.3
2000	1,480.7	2,951.9	4,119.3	3,403.4	1,853.7	1,614.0	705.5	16,128.5
2001	1,603.4	2,967.5	4,711.0	3,827.1	2,157.4	1,474.0	816.7	17,557.0
2002	1,762.8	3,204.9	5,289.4	4,038.4	2,377.7	1,374.9	905.5	18,953.6
2003	1,900.4	3,574.9	5,714.5	4,313.5	2,626.2	1,292.9	996.4	20,418.8
2004	2,875.2	3,943.6	6,301.7	4,541.7	2,700.6	1,399.1	1,100.9	22,862.8
2005	3,098.2	4,165.9	7,218.1	4,607.8	2,616.0	1,644.2	1,281.9	24,632.1
2006	3,285.1	4,322.9	8,389.9	4,845.1	2,634.0	1,958.4	1,654.5	27,089.8
2007	3,544.9	4,516.7	9,386.0	5,257.0	2,906.2	1,788.9	1,956.6	29,356.3
2008	3,658.7	5,783.6	9,467.4	5,419.6	3,210.6	1,599.8	1,823.0	30,962.7
2009	3,833.0	7,260.6	9,352.5	5,932.6	2,727.5	1,138.0	1,707.1	31,951.2
2010	3,940.0	8,853.0	9,258.4	6,539.6	2,538.8	1,057.6	1,498.7	33,686.0
2011	3,893.5	9,928.4	9,075.5	6,614.3	2,326.9	969.3	1,351.5	34,159.4
2012	3,887.2	11,046.1	8,838.1	7,046.6	2,095.8	952.4	1,272.3	35,138.4
2013	3,818.3	11,854.4	8,741.6	7,454.9	2,056.9	951.6	1,268.2	36,146.0
2014	3,776.3	12,504.8	8,764.2	7,827.5	2,028.7	930.4	1,333.1	37,165.1
2015	3,791.2	13,191.6	8,759.1	8,159.5	1,995.4	941.5	1,359.2	38,197.5
2016	3,833.7	13,908.2	8,916.4	8,516.9	1,971.7	884.9	1,329.8	39,361.5
2015								
Q1	3,802.9	12,630.2	8,733.9	7,931.9	1,975.6	952.7	1,354.7	37,382.0
Q2	3,812.9	12,698.8	8,767.7	8,082.6	1,963.0	978.8	1,384.1	37,687.9
Q3	3,801.1	12,841.4	8,786.6	8,205.7	1,958.6	991.3	1,375.0	37,959.6
Q4	3,791.2	13,191.6	8,759.1	8,159.5	1,995.4	941.5	1,359.2	38,197.5
2016								
Q1	3,812.1	13,431.1	8,806.9	8,352.5	1,946.7	1,021.1	1,352.1	38,722.7
Q2	3,840.7	13,417.8	8,829.9	8,426.0	2,005.1	1,015.9	1,360.1	38,895.5
Q3	3,833.4	13,647.6	8,864.3	8,555.1	1,994.2	911.3	1,354.2	39,160.1
Q4	3,833.7	13,908.2	8,916.4	8,516.9	1,971.7	884.9	1,329.8	39,361.5

Interview with Accord Financial

We sat down with Terry Keating and Matthew Panosian of Accord Financial. Terry Keating is Executive Vice President at Accord Financial and Matthew Panosian is Chief Credit Officer at Accord Financial.

What size is Accord Financial in terms of assets?
Approximately $125m USD.

Where is Accord Financial headquartered?
Our corporate headquarters is Toronto, Ontario Canada. Our US business is headquartered in Greenville, SC.

What is the history of Accord Financial?
The company was founded in 1978 Ken Hitzig (current non-executive Chairman). The Company went public in 1992 and is still traded on the Toronto Stock Exchange (TSX) under the symbol ACD. Proceeds of the offering were used to buy a factoring company in Montreal Canada and a factoring company in Greenville, SC. Both these today are named Accord Financial, Inc.

How long has the group been doing asset-based lending?
In the US we have been doing asset based lending for about 8 years.

How many employees are there at Accord Financial?
Accord has 27 full time, and the company over has 103 employees.

What is your sweet spot in terms of loan size for borrowers?
In the United States we will do a/r only financing as small as $20k and with ABL structures as large as $20m. Our average transaction however is approximately $5m.

How long is your typical underwriting from beginning to end?
The timing can vary significantly depending on the complexity of a transaction. For straight forward accounts receivable only 1-2 weeks if quite feasible. For larger more complex transactions it can take 60 days or longer. The longer transaction time is generally associated with acquisition financing and due to the timeline of the acquisition process not the financing process.

What are the competitive advantages of Accord Financial?
The biggest competitive advantage is our very flat organization for credit approval. We source deals without the usual BDO sales force, by connecting our highly experienced credit executives directly with referral sources and prospects. This means we know exactly what questions we want to ask, what information to request, how to assess it quickly and provide very clear specific and decisive feedback on what we can do.

How long do borrowers usually stay with Accord Financial?
Accord almost always represents "transition" money; but having said that we have several clients who have been with us for more than 10 years.

What are the keys for borrowers to foster a good relationship with Accord Financial?
Simple, candid and timely communication, detailed financial and operational reporting.

What are some huge no-no's for borrowers, either during underwriting or after funding?
Hold back information or miss-represent facts. The other thing is I insist that all of our staff be treated with the same respect that we treat others with.

How is deal flow so far in 2017?
After a slow start it has picked up significantly, we currently have almost 50 prospective transactions in process and 5 proposals outstanding.

What is your take on the current state of the debt markets?
They are always competitive and never more than now. All the money the Fed poured into the financial system to alleviate the financial recession has resulted in a persistent supply/demand imbalance with no real sign of that abating. This means that lenders have to, accept slower growth than they may otherwise prefer, find niches of business they can exploit or give in and lower pricing and/or credit standards. The latter is something that at Accord we will not do.

What trends do you see in the marketplace?
I am not sure there is really any trend, some days things are better, some days they are worse. One trend that definitely is here to stay is the evolution of the retail business. Some say that brick and mortar retail is dead; to those I'd say pay attention to the biggest retail disruptor of all, Amazon is building stores. So yes retailing is changing but it is far from dead.

Has Accord seen a bump in deal flow due to increased regulation on banks over the past few years?
The wet blanket of regulation and reporting has definitely made it difficult for banks to be responsive and competitive for companies that are in anyway challenged or in business lines that are under scrutiny. Retail is a great example, we've recently closed a new transaction with a niche retailer and have several others in our pipeline. Not that we'll do just any retail, but if there is a good story and some distinctive aspect to the product and or customer experience, then Accord is interested.

We are very thankful and appreciative to Terry and Matthew for sitting down with us for a few minutes to discuss their business and the debt markets.

LevFin Insights

RBC Capital Markets this afternoon outlined an offer price of 99 on the $50 million add-on term loan for Accuride, according to sources. The add-on will be fungible with the borrower's $225 million term due November 2023, which is priced at L+700, with a 1% floor, and is covered by a 101 soft call premium that rolls off in November.

Proceeds, along with fresh equity, will back an acquisition. Commitments are due by Wednesday, April 26.

The loan is governed by leverage and interest-coverage tests. Existing corporate and facility ratings are B3/B, with a 3 recovery rating from S&P.

Proceeds from the original $225 million loan backed Crestview Partners' take-private LBO of Accuride, a supplier of components to the North American and European commercial vehicle industries. The LBO levered the issuer at 3.3x, sources said at the time.

– Kerry Kantin/Chris Donnelly

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LevFin Insights

Quad-C Management recently tapped Madison Capital for senior debt in support of a recapitalization of Krayden Inc., a greater Chicago area distributor of adhesives, sealants and various types of specialty chemicals and solvents.

Madison Capital served as joint-lead arranger and co-bookrunner.

Quad-C Management is a middle-market private equity firm that targets companies with enterprise values of $75 million to $400 million. The Charlottesville, Va.-based firm takes majority positions and will contribute equity of $35 million to $125 million in any one transaction.

- Kelly Thompson

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Channeling one's inner Yogi Berra, someone at this year's ACG InterGrowth conference was overheard saying, "one of my colleagues decided not to come to InterGrowth this year, because there's just way too many people.

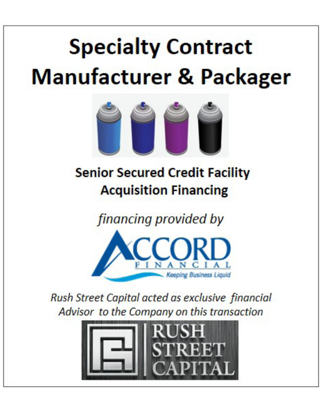
QUOTE OF THE MONTH

"If you put the federal government in charge of the Sahara Desert, in 5 years there'd be a shortage of sand."

--Milton Friedman

Rush Street Capital and DebtMaven at InterGrowth Phil Jordan

RECENT TRANSACTIONS



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