

NewStar Financial, Inc.  
Form 10-K  
March 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-33211

NewStar Financial, Inc.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

54-2157878  
(I.R.S. Employer  
Identification No.)

500 Boylston Street, Suite 1250, Boston, MA  
(Address of principal executive offices)

02116  
(Zip Code)

Registrant's telephone number, including area code: (617) 848-2500

Securities registered pursuant to Section 12(b) of the Act:

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Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2015, the last business day of our most recently completed second fiscal quarter, the aggregate market value of the voting stock held by non-affiliates was \$257,119,775, based on the number of shares held by non-affiliates of the registrant as of June 30, 2015, and based on the reported last sale price of common stock on June 30, 2015. This calculation does not reflect a determination that persons are affiliates for any other purposes.

As of February 29, 2016, 47,369,046 shares of common stock, par value of \$0.01 per share, were outstanding.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission ("SEC") pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"),

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relating to the Registrant's Annual Meeting of Stockholders scheduled to be held May 11, 2016 are incorporated by reference into Part III of this Form 10-K. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

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Signatures



## Forward-Looking Statements

Statements in this Annual Report about our anticipated financial condition, results of operations, and growth, as well as about the future development of our products and markets and the future performance of the financial markets in general, are forward-looking statements. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. They may include words such as “anticipate,” “estimate,” “expect,” “project,” “plan,” “intend,” “believe,” “may,” “should,” “can have,” “likely” and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events and circumstances. These forward-looking statements are based on assumptions that we have made in light of our industry experience and on our perceptions of historical trends, current conditions, expected future developments and other factors. As you read this Annual Report, you should understand that these statements are not guarantees of performance or results. They involve risks and uncertainties that are beyond our control. Important information about the bases for our assumptions and factors that may cause our actual results and other circumstances to differ materially from those described in the forward-looking statements are discussed in Item 1A. “Risk Factors” and generally throughout this Annual Report.

## Item 1. Business Overview

NewStar Financial, Inc. (which is referred to throughout this Annual Report as “NewStar”, “the Company”, “we” and “us”) is an internally-managed, commercial finance company with specialized lending platforms focused on meeting the complex financing needs of companies and private investors in the middle market. The Company and its wholly owned investment management subsidiary, NewStar Capital LLC, are registered investment advisers and provide asset management services to institutional investors. The Company manages several private credit funds that co-invest in loan origination through its leveraged finance lending platform. Through NewStar Capital, the Company also manages a series of funds structured as CLOs that invest primarily in broadly syndicated loans, as well as other sponsored funds and managed accounts that invest across various asset classes, including broadly syndicated loans, high yield bonds and distressed credits. Through its specialized lending platforms, the Company provides a range of senior secured debt financing options to mid-sized companies to fund working capital, growth strategies, acquisitions and recapitalizations, as well as, purchases of equipment and other capital assets.

We believe these lending activities require specialized skills and transaction experience, as well as, a significant investment in personnel and operating infrastructure. To meet these demands, our loans and leases are originated directly by teams of credit-trained bankers and experienced marketing officers organized around key industry and market segments. These teams represent specialized lending groups that are supported by centralized credit management and operating platforms. This structure enables us to leverage common standards, systems, and industry and professional expertise across multiple businesses.

We target our marketing and origination efforts at private equity firms, mid-sized companies, corporate executives, banks, real estate investors and a variety of other referral sources and financial intermediaries to develop new customer relationships and source lending opportunities. Our origination network is national in scope and we target companies with business operations across a broad range of industry sectors. We employ highly experienced bankers, marketing officers and credit professionals to identify and structure new lending opportunities and manage customer relationships. We believe that the quality of our professionals, the breadth of their relationships and referral networks, and their ability to develop creative solutions for customers position us to be a valued partner and preferred lender for mid-sized companies and private equity funds with middle market investment strategies.

Our emphasis on direct origination is an important aspect of our marketing and credit strategy. Our national network is designed around specialized origination channels intended to generate a large set of potential lending opportunities. That allows us to be highly selective in our credit process and to allocate capital to market segments that we believe represent the most attractive opportunities. Our direct origination network also generates proprietary lending opportunities with yield characteristics that we believe would not otherwise be available through intermediaries. In addition, direct origination provides us with direct access to management teams and enhances our ability to conduct detailed due diligence and credit analysis of prospective borrowers. It also allows us to negotiate transaction terms directly with borrowers and, as a result, advise our customers on financial strategies and capital structures, which we believe benefits our credit performance.

The Company typically provides financing commitments to companies in amounts that range in size from \$10 million to \$50 million. The size of financing commitments depends on various factors, including the type of loan, the credit characteristics of the borrower, the economic characteristics of the loan, and our role in the transaction. We also selectively arrange larger transactions that we may retain on our balance sheet or syndicate to other lenders, which may include funds that we manage for third party institutional investors. By syndicating loans to other lenders and our managed funds, we are able to provide larger financing commitments to our customers and generate fee income, while limiting our risk exposure to single borrowers. From time to time, however, our balance sheet exposure to a single borrower exceeds \$35 million.

NewStar offers a set of credit products and services that have many common attributes, but which are highly specialized by lending group and market segment. Although both the Leveraged Finance and Business Credit lending groups structure loans as revolving credit facilities and term loans, the style of lending and approach to credit management is highly specialized. The Equipment Finance group broadens our product offering to include a range of lease financing options. The operational intensity of each product also varies by lending group.

Although NewStar operates as a single segment, the Company derives revenues from its asset management activities and four specialized lending groups that target market segments in which we believe that we have competitive advantages:

- Leveraged Finance, provides senior, secured cash flow loans and, to a lesser extent, first out, second lien and unitranche loans, which are primarily used to finance acquisitions of mid-sized companies with annual cash flow (EBITDA) typically between \$10 million and \$50 million by private equity investment funds managed by established professional alternative asset managers;
  - Business Credit, provides senior, secured asset-based loans primarily to fund working capital needs of mid-sized companies with sales revenue typically totaling between \$25 million and \$500 million;
  - Real Estate, provides first mortgage debt primarily to finance acquisitions of commercial real estate properties typically valued between \$10 million and \$50 million by professional commercial real estate investors;
  - Equipment Finance, provides leases, loans and lease lines to finance purchases of equipment and other capital expenditures typically for companies with annual sales of at least \$25 million; and
  - Asset Management, provides opportunities for qualified institutions to invest in a range of credit funds managed by the Company that employ credit-oriented strategies focused on middle market loans and liquid, tradeable credit.
- Information regarding revenues, profits and losses and total assets of this single segment can be found in the financial statements in Item 8.

NewStar is a Delaware corporation that was incorporated in 2004. Our principal executive office is located at 500 Boylston Street, Suite 1250, Boston, Massachusetts 02116, and our telephone number is (617) 848-2500. We maintain a website at [www.newstarfin.com](http://www.newstarfin.com).

#### NewStar Capital

On October 7, 2015, NewStar acquired Boston based Feingold O’Keeffe Capital, LLC (“FOC Partners”), a boutique credit manager with \$2.3 billion of assets under management, to expand its existing asset management capabilities. The Company operates FOC Partners as NewStar Capital, which is a wholly owned subsidiary of the Company. The assets and liabilities of FOC Partners were recorded at their estimated fair values as of the date of the acquisition and resulted in goodwill of \$17.9 million. The acquisition was accounted for as a business combination and is consolidated in the Company’s financial statements effective October 7, 2015.

#### Strategic Relationship

In December of 2014, NewStar formed a strategic relationship with GSO Capital (“GSO”), the credit division of Blackstone, and Franklin Square Capital Partners (“Franklin Square”), one of the largest managers of business development companies, to expand the Company’s lending and asset management platforms. The relationship combined a series of initiatives to accelerate our loan growth and expand the Company’s asset management platform, with a long-term strategic investment to partially fund the related growth strategy. Under the terms of the investment, funds managed by Franklin Square and sub-advised by GSO committed to purchase \$300 million of 8.25% subordinated notes due 2024 with warrants exercisable for 12 million shares of our common stock at an exercise price of \$12.62 (the “warrants”). The Company issued \$200 million in principal amount of the notes in December 2014. The warrants were issued in two tranches in December 2014 and January 2015. We issued \$75 million of the remaining \$100 million of notes during 2015, and the remaining \$25 million notes were issued in January 2016. The Company used the proceeds from these issuances to enhance its ability to originate and lead transactions across all of its



specialized lending groups. As a result, we significantly increased our origination volume and facilitated the growth of our asset base. In addition, our relationship with GSO has resulted in cross-referral and co-lending opportunities, provided us with access to new channels of origination, and enabled us to provide larger capital commitments and a more complete set of financing options to our clients.

#### Lending Groups

Our lending activities are organized into four specialized lending groups: Leveraged Finance, Business Credit, Real Estate, and Equipment Finance.

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## Leveraged Finance

Through our Leveraged Finance group, the Company provides senior, secured cash flow loans and, to a lesser extent, first out, second lien and unitranche loans, to middle market companies. These companies are typically backed by established private equity groups that manage large investment funds and have proven investment track records. The proceeds of these loans are used primarily for acquisitions, recapitalizations and refinancing or other general corporate purposes. The Leveraged Finance group also provides senior secured loans to larger middle market companies with greater financing needs by participating in larger credit facilities with other lenders as a member of a syndicate.

We believe that private equity backed companies represent an attractive segment of the overall market for financing middle market companies. Commonly known as sponsored lending, this financing segment is large, often representing 30-40% of total middle market lending measured by new loan volume. Transaction activity in this financing segment is driven by an estimated 600 private equity firms in the US that specialize in investing in middle market companies. By focusing our origination activity on this universe of firms, the Company seeks to leverage its direct origination effort into significant transaction flow, as each firm typically completes several transactions per year.

We believe that NewStar is among the most active lenders focused on financing private equity backed companies in the middle market. We have established a recognized brand in the market with a reputation as a smart, reliable lender that is responsive, consistent and constructive. Since inception, the Company has funded loans totaling more than \$8.8 billion to approximately 618 companies backed by nearly 239 different financial sponsors. The Company's national lending strategy is supported by a network of offices located across the country. We develop new customer relationships and source our loans primarily through the direct marketing and origination efforts of our bankers. The Company's bankers call directly on prospective clients and referrals sources from this network of offices. They have established relationships with a wide range of prospective customers and referral sources, including approximately 239 private equity groups with investment strategies focused on the middle market, mid-sized companies, corporate executives, banks, other non-bank "club" lenders, and investment banks. To a lesser extent, we may also source loans and other debt products by participating in larger credit facilities syndicated by other lenders.

We generally compete for lending opportunities on the basis of our reputation and transaction experience. Through our strategic relationship, we also originate financing opportunities from referrals of transactions in which we co-lend with Franklin Square or other affiliates of GSO. We believe that our strategic relationship will continue to help us compete more effectively for lending opportunities by enabling us to provide larger credit commitments and "one-stop" financing solutions to customers comprised of unitranche loans or a combination of senior and junior debt capital in partnership with GSO or Franklin Square.

NewStar offers a range of senior debt financing options, including revolving credit facilities, term loans and other debt products secured by a variety of business assets. Loans are typically structured to mature in five to six years and require monthly or quarterly interest payments at variable rates based on a spread to LIBOR or the prime rate, many with interest rate floors. Through our strategic relationship, we also seek to offer a more complete range of debt financing options, including second lien term loans, unitranche term loans, subordinated notes and, to a lesser extent, private equity co-investments.

We target mid-sized companies operating in a broad range of industries and market segments where we believe that we have competitive advantages and significant lending and underwriting experience, including:

- healthcare;
- manufacturing and industrial;
- financial services;
- energy/chemical services;
- printing/publishing;
- consumer, retail and restaurants; and

·business and technology services.

Our loans and other debt products, which may be part of larger credit facilities, typically range in size from \$10 million to \$50 million, although we generally limit the size of the loans that we retain to \$25 million. In certain cases, however, our loans and debt products exceed \$35 million. We also have the capability to arrange significantly larger transactions which we syndicate to other lenders, including funds that we manage. As a result of syndication and asset management activities, our exposure to certain loans and other debt products exceeds \$35 million from time to time through “Loans held-for-sale,” which represent amounts in excess of our target hold for investment position.

The Company has well established lending guidelines and transaction parameters. We focus on transactions with established companies that have strong market positions in targeted industry sectors. Our borrowers are typically unrated, but have credit profiles that we believe are comparable to B1/B2/B3 rated companies due to their limited size and use of leverage. The Company's preference is generally to finance acquisitions and other productive uses of capital subject to structural parameters, such as maximum leverage, that can vary significantly depending on the facts and circumstances of each situation. Substantially all the Company's loans have significant lender protections, including financial covenants that are set at levels with cushions to projected financial performance. They also typically include restrictive covenants and mandatory prepayment provisions that limit borrowers' ability to incur additional indebtedness and make acquisitions. Many transactions also include an excess cash flow recapture provision, which is designed to accelerate debt repayment and de-leveraging.

NewStar is also selective in targeting transaction sponsors, focusing on more established firms with between \$500 million and several billion dollars of committed capital managed across multiple funds. The Company invests significant resources in developing relationships with target sponsors and understanding their respective investment strategies, performance track records, access to capital, and industry focus, as well as the backgrounds of their investment professionals. Our management believes that a significant factor in the Company's success has been the quality of its private equity franchise and the breadth of relationships it has developed with private equity firms. In many cases, the relationships that members of our management have with investment professionals at these firms extend from early in their professional careers. We believe the value created by our private equity relationships is reflected in the transaction flow that the Company generates and in the repeat business we have experienced with targeted sponsors.

NewStar's origination and credit strategies are strongly influenced by industry dynamics. The Company has invested in the development of an experienced staff of portfolio managers with deep industry expertise responsible for covering nine broad industry sectors. These portfolio managers maintain extensive networks of industry contacts in their respective industries and employ a research-driven framework to develop insights into these sectors intended to guide origination strategy and credit selection.

As of December 31, 2015, our Leveraged Finance loan portfolio totaled \$3.5 billion in funding commitments and \$3.2 billion in balances outstanding, representing 83.9% of our loan portfolio. This represented 227 transactions with an average balance outstanding of approximately \$14.2 million. During 2015, we originated \$2.7 billion of new Leveraged Finance loans, of which we retained \$1.7 billion and originated \$1.1 billion for credit funds. As of December 31, 2015, our exposure to energy (oil & gas) was approximately \$82.6 million or 2.1% of balance sheet assets (inclusive of loans within our total return swap). Two of these credits with a total balance of \$20 million have been designated as high attention credits.

#### Business Credit

Through its Business Credit lending group, NewStar provides working capital financing to asset-intensive companies that typically borrow against the value of their inventory and accounts receivable. These asset-based loans may also be used to support other business purposes, including acquisitions and recapitalizations, as well as growth strategies. Typical borrowers generate sales revenue between \$25 million and \$500 million and operate across a range of industry sectors. The Company generally provides revolving credit facilities in amounts linked to borrowers' expected working capital needs and may also provide term loans backed by longer term assets and other excess collateral.

This type of fully-followed, asset-based lending is highly credit and operationally intensive. As part of the underwriting process and ongoing management of credit relationships, Business Credit tracks collateral values and performs regular field audits to confirm financial and borrowing base reporting. Audit results and appraisals are used to determine collateral eligibility and advance rates. Collateral values are tracked by specialized collateral analysts and daily borrowing activity is managed by collateral analysts and experienced account executives.

Nearly all of our asset-based lending relationships require dominion over borrowers' cash. Cash dominion gives us significant control of a borrowers' cash flow, including collections of all accounts receivable through lock-boxes controlled by the Company. This also facilitates subsequent disbursements of cash to repay advances under the credit line or for other corporate purposes including paying vendors, employees and others. We also verify receivables in certain circumstances, which involves verification specialists contacting account debtors of borrowers to confirm the existence and amount of receivables pledged as collateral.

Business Credit develops lending opportunities and sources transactions through an extensive network of long-standing relationships with corporate executives, private equity firms, intermediaries, turnaround consultants, banks and other referral sources. With our main Business Credit office in Dallas and marketing offices in Boston, Chicago, Portland and San Francisco, we have a national asset-based lending origination platform capable of originating significant loan volume. The group's centralized marketing effort combined with regional sales coverage is designed to generate a significant flow of prospects and capitalize on the most attractive lending opportunities in the market.

The Business Credit group also benefits from the strategic relationship with Franklin Square and GSO by offering asset-based revolving credit facilities as a co-lender with them. We also expect to continue to provide financing for companies referred to us by GSO or Blackstone that are experiencing some financial stress or completing turnarounds.

Asset-based loans originated by this group typically range in size from \$5 million to \$50 million. We also have the ability to arrange significantly larger transactions that we may syndicate to others.

Business Credit targets mid-sized companies in a variety of asset-intensive industries for our asset-based loans including:

- business services;
- auto/transportation;
- marketing;
- retail;
- general manufacturing;
- wholesale distribution; and
- technology.

Our asset-based credit products include the following:

- revolving lines of credit; and
- senior secured term loans.

In determining our borrowers' ability and willingness to repay loans, our Busin