Titans in Finance – The Rise of Private Debt[1]

By Kinne Manente and Phong Tran

This panel focused on the current state of the private debt market and covered a broad range of topics. Here are some key takeaways:

- The private debt market has exploded over recent years due to the following:
    - A pivotal point for successful private creditors was an early recognition that they needed to invest heavily in their teams and technology. Building out well rounded teams and investing in the infrastructure to manage all aspects of these relationships requires heavy input on the front end.
    - Diversifying investment structures to more readily access different markets. The panelists discussed how the original GP/LP structure does not fit the entire market, and exploring structural modifications has paved the way for BDCs, CLOs, SMAs and other fund structures to bridge this gap.
    - The perpetual structure of debt funds and diverse product offerings have opened up entire market segments and expanded existing segments, taking market share from the syndicated loan market. In 2022, this has significantly expanded in light of the syndicated loan market drying up due to balance sheet constraints and the high interest environment.
    - Investors are diversifying their portfolios and specifically allocating capital for private credit opportunities and doing so at significant scale.
- The largest private credit managers have increased their scale and diversity of offerings, making them more akin in the marketplace to the largest banks of 20 years ago. While the largest players used to enter transactions at approximately $100MM, the price of entry is trending up and now may require participation in the $300M to $500MM range.
- From a broader market perspective, the panelists noted that the significant rise in interest costs have created a challenging dynamic for companies. They expect collateral damage to many companies and foresee a choppy economic climate over the next 12 to 24 months. On a more positive note, however, the panel sees a difference from the great financial crisis, in that there is a significant amount of dry powder in the private equity market to deliver capital to companies in need.
- As lenders, private credit managers are underwriting with the expectation of a recession. Although they anticipate bad eggs must lie within existing portfolios, they noted that major market participants have yet to acknowledge underperforming assets. On the contrary, their portfolio of companies has seen significant growth year over year, with revenues up over 36% and EBITDA up over 20% on average. They expect this growth to continue as only non-troubled assets have a reasonable expectation of obtaining credit.

[1] Moderated by Jocelyn Hirsch, Partner at Kirkland & Ellis LLP, and Nick Mitra, Managing Director at Société Générale, the panel was made up of the following titans: Jonathan Bock, Senior Managing Director at Blackstone Credit, Ken Kencel, President and CEO at Churchill Asset Management, and Art Penn, Founder and Managing Partner of PennantPark Investment Advisers.

Accordingly, from the panelists' perspective, this is a great time to enter into transactions and be more selective on how they want to deploy their capital. With less competition from the syndicated loan market, yields from private credit instruments have doubled in recent years and it is easier to obtain better terms and covenants. For those portfolio companies that are struggling, it appears that sponsors are willing to sit tight and pay additional costs to presumably refinance once rates come down.

- Private credit managers are focusing lending efforts on companies with lower leverage as they anticipate the Federal Reserve will continue taking a hawkish position until inflation is under control. The panel optimistically anticipates the rise of interest rates to moderate over the coming months, though it will require the Federal Reserve striking a delicate balance. Notably, the SOFR curve suggests interest rates will come down in late 2023/early 2024.

- Looking to the future, the panelists see this as an expanding market with new horizons to explore. An area of keen interest is the democratization of private credit from institutional investors to high-net-worth wealth investors, as they see this as a significant driver in the private credit market going forward. In the short term, the biggest challenge for investors will be obtaining enough capital to invest now, as the panelists anticipate this will be an excellent vintage.

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