EXPERT Q&A

Private credit has served the mid-market for years, but now the sector is expanding into larger transactions with great success, explains Lee Kruter, partner and head of performing credit of GoldenTree Asset Management

Moving beyond the mid-market

Uncertain economic times don't tend to discourage private credit providers. That's one of the strengths of private debt as an asset class: the ability to look beyond the headlines, focus on the long-term value of an asset and be willing to act when others in the market are timid. For the best providers, that's not pure bravado, but an act supported by their own rigorous diligence – or they won't be around for very long.

GoldenTree Asset Management, the winner of *Private Debt Investor's* Americas Distressed and Special Situations Investor of the Year award, has been providing private credit for over a decade. GoldenTree currently manages more than $48 billion across its platform for institutional investors globally, and recently closed an oversubscribed distressed fund of $3 billion that is already generating a 50 percent-plus IRR. Lee Kruter, GoldenTree's head of performing credit, sat down with *PDI* to discuss his view of the market as a whole, where he sees opportunities and risks, and how the world of private credit has evolved.

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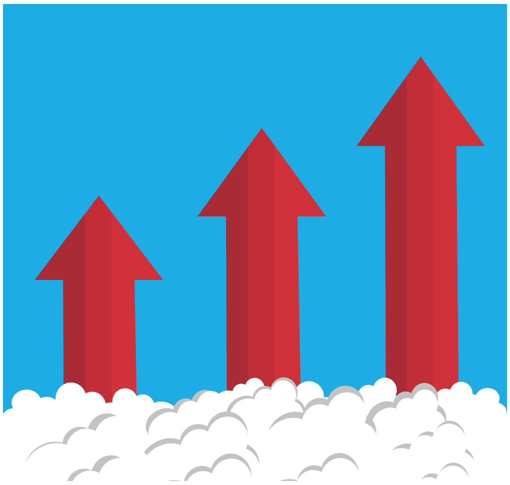
Q What trends are you seeing in private debt today?

Private credit is where we are seeing the most innovation across markets. Growth in issuance has significantly outpaced public markets, with that growth concentrated in larger issuers. In this more uncertain environment, private credit can create solutions for issuers and sponsors in situations where public market alternatives have limitations.

Q Can you describe the GoldenTree model: how do you work with borrowers and investors to generate returns?

For our investors, we have historically captured 400-600 basis points of premium yields to public markets, a higher margin of safety that has delivered a very consistent unlevered return profile. For our borrowers, GoldenTree creates unique value by providing solutions across the capital structure, for a wide set of proceeds, and across any industry as we see opportunity. We also partner with borrowers to help to analyse and structure in situations that may be less straightforward or have more complexity.



Q Are there certain structural changes you see that are leading to a sustained opportunity?
First, the depth and sophistication from the lender community has increased materially over the past several years. As a result, the quality and size of the issuers has also changed; larger companies that may have not utilised private credit previously now see it as a permanent tool regardless of the market environment. Borrowers value aspects such as speed, confidentiality, avoiding a rating process and ability to finance more complex opportunities. These priorities are among the reasons why a public syndicated option may be inferior in certain circumstances. Second, PE dry powder remains at historically high levels, now exceeding $2 trillion, and valuations are lower, which will encourage activity. Private credit is critical to financing these transactions and will play an increasingly important role.

Q How does GoldenTree source new investments?
We source across multiple channels. GoldenTree has strong sponsor relationships and we have been increasingly active in helping these sponsors in a variety of ways, such as financing accretive M&A or monetising successful investments while public markets are volatile. We invest in more than 1,000 corporate issuers across our performing credit strategies. These large issuers, many of which are public, are increasingly seeking private transactions from their largest lenders to finance a tuck-in acquisition or refinance a facility. As an incumbent issuer, we are typically very familiar with the business and its management team.

We also have been working with banks for over 20 years, and while less active today, they remain an important source of new opportunities. These banks look for a close-knit group of partners to help finance transactions as their hold size remains limited. GoldenTree is well positioned to work closely with them on this.

Q What type of opportunities are you seeing today?
The most attractive risk-return today has been the top of the capital structure. GoldenTree is sourcing first lien, senior secured investments to large, healthy companies with LTVs of 30-35 percent, double-digit unlevered yields and multi-year call protection that create an attractive total return profile. We are also securing strong covenant packages and terms. This profile represents cycle-high returns and margin of safety.

Q Is there a specific sector you see as compelling value?
GoldenTree has been quite active in LBO financings of large, best-in-class software companies that are now being taken private at materially discounted valuations and with substantial equity contributions for the sponsors. We avoided technology transactions over the last several years because the valuations didn't meet our margin of safety threshold.

Private credit lenders that were highly active in the technology sector over the past several years, in many cases, have larger legacy positions and, as a result, more limited appetite to invest further in the sector. Furthermore, given the larger size and more complex structure of these transactions, sponsors are agreeing to stronger terms to secure financing. Historically, about half of our private credit investments have been to non-sponsor-backed companies, which contrasts with the typical private credit manager for whom the vast majority of transactions are to sponsored companies. We are seeing an increasing number of public companies utilising private credit.

"We are seeing better terms and economics for larger transactions than for smaller issuers"

Q You mentioned that GoldenTree is focused on larger companies. Why do you see value in this segment specifically?
I think many investors associate private credit with mid-market lending. Historically that may have been more accurate. However, now we see growth for

companies generating more than $100 million in EBITDA, which is where we focus. Historically, GoldenTree's average issuer generates more than $250 million in EBITDA, and in 2022, the average was closer to $400 million.

With public markets effectively shut for much of 2022, these issuers needed to utilise private credit to solve capital needs. Even as markets normalise, these issuers now recognise the value proposition private credit offers. Just like our collective experience with Zoom during the pandemic, even though we have returned to meeting in person, we now realise the value in Zoom and it will always be a tool for doing business.

Additionally, for our investors, margin of safety is a critical component and larger issuers are better positioned to ensure that. Larger issuers generally have longer track records, stronger governance, and better management teams. Also given the growth and size of certain of these transactions, we are seeing better terms and economics for larger transactions than for smaller issuers where there has historically been a larger base of lenders to provide capital.

Q GoldenTree is also well known for its distressed investing. How does that interact with your private credit investing?

We see this as a big competitive advantage in several ways. GoldenTree has made over $30 billion in distressed investments, leading successful turnaround across a range of economic environments. These investments can provide attractive sources of special situation opportunities, proprietary financings of growth acquisitions, or exits in post-turnaround situations. We have a 19-person restructuring team, which differentiates us from private credit peers that typically have limited resources in this capacity, given it is not part of their investment strategy. This allows us to look at situations through a lens of what can go wrong and to ensure through our documentation and underwriting that we are best positioned.

"The most attractive risk-return today has been the top of the capital structure"

Furthermore, private credit has grown over an economic period with low defaults and solid growth. Given the environment of higher inflation and weaker growth that we are in today, defaults are likely to be higher on a go-forward basis. We can add resources and expertise in situations where a borrower may be underperforming to help preserve value. While not anticipated, in a situation where performance deteriorates and necessitates a restructuring, we can lead that process and create a better long-term outcome.

Q What risks do you see in the private credit markets today?

Given the investor appetite for the asset class, you see some lenders that are in the manufacturing business and focused on origination. The pace of growth for these lenders has been substantial over the past several years, with many of these deals done in a much tighter market environment. This leads to a higher degree of performance dispersion across managers. It may also limit the ability for additional capital as lenders need to focus time on their legacy investments. At GoldenTree, we are very selective and focused on our capital providing the best risk-return; we will make 10-20 transactions per year that allow us to maximise value for our investors.

Q Beyond that, what other factors would you credit for GoldenTree's success and longevity as a private credit investor?

We have a diverse product offering and have achieved top-quartile performance across our products over multiple decades. GoldenTree's strategies invest across all credit asset classes, public and private credit, distressed, structured products and emerging markets.

Our deep experience across credit markets positions us well to expertly underwrite and execute on opportunities that might have more complexity than traditional private credit lenders. To that extent, rather than being focused on origination like many private credit lenders, we are quite selective and will make a more limited number of investments each year. We can therefore focus on being a solution provider and utilise our tenured investment team to create value for issuers and outperformance for our investors.

Additionally, Steven Tananbaum established GoldenTree more than 20-years ago as a partnership structure where he could use the equity of the firm to attract and retain one of the more experienced teams. Today, we are one of the largest independently owned credit managers – 100 percent of the firm is owned by its employees. This structure also provides a strong alignment of interests with our clients and allows us to be deliberate in our capital raising with the view of sizing our funds to consistently deliver top quartile performance across market cycles. ■