PERMANENT & PRIVATE CAPITAL SUMMIT 2022

2022
Permanent & Private Capital Summit

KEY TAKEAWAYS

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SUMMIT OVERVIEW

On May 24 and 25, 2022, the 8th Annual Permanent & Private Capital Summit, sponsored by Dechert, ING and KBW/Stifel, brought together fund sponsors and asset managers for an interactive and engaging in-person event. During the two-day conference, hosted at New York City's iconic Times Center, panels comprising more than 30 chief executives, chief investment officers and other senior leaders from the world's top financial institutions discussed the current unstable climate and the broader trends and developments impacting the private credit and private capital space.

Dechert partner Jim Lebovitz opened the Summit with a review of the past year. "It's been a volatile time for private credit," he said. The industry has witnessed record amounts of capital being raised, and larger and larger transactions being financed against the backdrop of turbulent financial markets, the lingering effects of the coronavirus and geopolitical uncertainty. "At times, it feels like we're toggling between screaming highs and mournful lows." he said. While disruption is expected to continue, one trend from the prior year that seems likely to persist is the overall growth and expansion of the private credit industry.

Over the six panels that followed, the conference speakers gave a wide range of candid and sometimes counterintuitive perspectives on issues impacting the private credit industry. Key takeaways from each of the sessions are highlighted on the following pages.

Private Credit Roundtable

As the private credit market continues to raise unprecedented amounts of capital and expand into new areas, equity and debt valuations – among business development companies (BDCs), as well as in the market overall – are trending downward. The question: can these two trends continue to coexist indefinitely, and if not, will investors start to leave private credit for greener pastures?

- Despite widening debt yields on BDC bonds and reduced price/NAV ratios, panelists expressed confidence in the underlying portfolios. Companies are still performing well. Particularly in the tech space, where enterprise values have clearly declined in public markets, portfolio performance is still quite robust. Given relatively conservative underwriting standards in that sector, loan-to-value ratios still have substantial buffers, even after the selloff.
- The panelists emphasized the historic growth in the private credit space over the last few years. A key driver of this growth has been the advent of the perpetually non-traded BDC, and its distribution through private wealth channels.
- The significant appetite from investors has resulted in substantial capital availability to managers, who now have the ability to underwrite correspondingly larger transactions. While deals valued at US$1 billion were rare as recently as 2019, in 2021 panelists have considered dozens of deals of that size, and many bigger, with transactions as large as US$5 billion becoming increasingly common. Panelists also expressed the view that they believed such larger companies represented inherently better risk, an opinion that had contrarian views in later discussions.
- Still, today's down market includes many concerning trends, from labor market pressures and inflation to supply chain issues and the specter of recession. And while this recent spate of negative news does feel particularly challenging in light of so many years of growth, our panelists stressed that planning for downturns, and even recessions, is a core part of what good managers do.
- The pandemic shock was difficult to manage, while the current economic environment can be more readily analyzed and underwritten. The important questions during uncertain times like these, are along the lines of understanding the sources of capital and the expectations of investors, the levers of liquidity, and the terms and covenants of portfolio investments.
- For investment managers and funds that have liquidity at their disposal, periods of volatility can present valuable opportunities that can distinguish managers from their peers. One common refrain was "it's easy to make money in an up market," but being able to effectively weather uncertainty is what separates the more disciplined and thorough portfolio managers from others. Given the strong flows of capital towards the private credit sector, the current environment represents an attractive opportunity, while more liquid markets are somewhat convulsed.
- The market is concerned about defaults, and in a down market more defaults are certainly possible. One point our panelists made more than once, however, is that not all defaults are created equal.
- With so many more businesses turning to private credit for their funding, and more investor capital to work with, portfolio managers should be more thoughtful about where they invest, including the fact that investments outside the syndicated markets tend to be more structured, which should yield better recoveries for private credit investors.

MODERATORS:

Jay Alicandri
Partner, Dechert LLP

Patrick Frisch
Head of Americas Fund Finance, ING Capital LLC

SPEAKERS:

Steve Kuppenheimer
Senior Managing Director of Blackstone Credit and Portfolio Manager, Blackstone Private Credit Fund

Craig Packer
Co-Founder and Senior Managing Director, Blue Owl

Grishma Parekh
Managing Director and Co-Head of North American Core Senior Lending, HPS Investment Partners

Dan Pietrzak
Partner and Co-Head of Private Credit, KKR

Rates, Recession & Returns: Perspectives on Where the Private Credit Industry Is and Where It Is Headed

Our second panel featured industry luminaries from across an array of private credit firms. Together, they provided a fresh perspective on the current climate – answering the question "how is the current volatility in the equity and fixed income markets affecting their business?"

- Our panelists stressed that value creation doesn't happen overnight; instead, it's about building relationships and establishing reliable returns that stand the test of time. Credit is cyclical, they stressed, and managers that take the most risk during growth markets may not turn out to be as smart as they seemed at the time.
- Managing downturns and downside risk, in fact, can be as valuable a tool for generating alpha as any other. Established underwriters who are confident in due diligence and in their workout abilities can significantly outperform their peers in the current climate and emerge from a shakeup with their reputations enhanced.
- A critical caveat here, though, is that while uncertainty overall can be good, the sources of that volatility may not be, and often must be considered separately, with zeitgeist trends like the fear of a recession requiring a different response than geopolitical developments like the war in Ukraine.
- And while turbulent times help differentiate the better managers from their peers, these times are also valuable for the private credit industry as a whole. When everything was "moving up and to the right," more and more market entrants were looking for ways to put their growing pools of capital to work. As things have gotten tighter, though, that competition has backed off, leaving private credit firms looking like a more stable and more certain option than ever before.
- Planning, due diligence, and risk management are key to creating and protecting value. And while portfolio managers may be able to prepare for contingencies, they should resist the temptation to predict what will happen next.

MODERATORS:

Al Laufenberg
Managing Director, KBW/Stifel

John Timperio
Partner, Dechert LLP

SPEAKERS:

Scott Bluestein
Chief Executive Officer and Chief Investment Officer, Hercules Capital

David Golub
President, Golub Capital

Eric Lloyd
President, Barings

Stephen Nesbitt
Chief Executive Officer, Cliffwater

Trends in Capital Raising and Private Credit Investments

As private credit and other alternative asset classes become a more significant part of investor portfolios, the investors funding private credit are changing as well. What will the private credit investor of tomorrow look like?

MODERATOR:

Tom Friedmann
Partner, Dechert LLP

SPEAKERS:

Alex Chi
Co-Chief Executive Officer and Co-President, Goldman Sachs BDC

Omoz Osayimwese
Partner, Dechert LLP

Phil Tseng
Managing Director and Co-Head of U.S. Private Capital, BlackRock

- As mentioned in other panels, the relative strength and stability of private credit lending make it an attractive asset class even during periods of market volatility. This has attracted the attention of large institutional investors who have traditionally been "underweight" in private credit, most notably insurance companies.
- Non-U.S. institutions have been investing both directly in fund shares as well as through offshore feeder funds.

- These institutions join a massive influx of high-net-worth and retail investors now investing in the sector as well.
- Previously, individuals without the resources to perform their own due diligence or source their own investments could not access private credit. Thanks to 'permanent' vehicles of various types, however, including continuously offered BDCs, retail investors have gained access to private credit investments, bringing both positive and negative developments for asset managers.
- On the positive side, there has never been more capital available for investment, and the potential for more to enter the market is staggering. High net worth and retail investors, particularly in the United States and in Asia, are sitting on trillions of dollars in liquid assets.
- With this increased capital and permanent fund structures, though, come expectations for consistent returns within a short timeframe and pressure on investment strategies typically focused on middle-market investing. These factors may limit the freedom of portfolio managers to pick when and how they lend, making it difficult to defer investments when market conditions are not favorable. Still, our panelists expect asset managers to find this capital influx too appealing to pass up, and to accept some conditions or modifications to their investment strategies in exchange for increased liquidity.
- As a general matter, the panelists expect fund managers to remain focused on middle-market investing and not shift to investing in broadly syndicated loans or specializing in subsegments of the market.

The Role of Structured Finance in Private Credit

The world of structured finance and securitization has expanded significantly over the last ten years, giving asset managers more tools than ever to work with. How does the structure of this financing impact private credit firms?

- Defining what structured credit is, and determining what it is best used for, can vary extensively.
- For some panelists, structured credit is a tool for accessing capital that may not be otherwise open to a private credit portfolio. One example is insurance companies, whose fiduciary duty to manage risk can make new types of investment tricky. By converting accounts to a rated notes structure, portfolio managers are able to provide insurers with a structured investment that is more consistent with and comparable to their investments in other asset classes.
- For others, structured credit – and its many varieties – is an important tool in efforts to build a responsive and flexible capital stack that balances costs with liquidity. For example, CLOs are a relatively straightforward and inexpensive form of securitization, but are unable to be modified once closed, while other forms of financing are more flexible but can incur higher costs.
- And while structure, terms and conditions are all critical, there is still a human component to managing capital. While some more sophisticated investors in the United States expect more leveraged deals, for example, investors in some other parts of the world look at any use of leverage as a red flag. Finding the right structures that fit with both your strategy and your investor pool is critical.
- In the same way that maintaining a portfolio is all about managing downside risk, influencing the capital stack is all about navigating liabilities. The bottom line: be sure to direct the terms and structures around your capital carefully, so you are never put into a position where your investment decisions are driven by your liabilities.

MODERATORS:

Chris Duerden
Partner, Dechert LLP

Grace Fu
Managing Director, Fund Finance, ING Capital LLC

SPEAKERS:

Michael Ewald
Managing Director, Global Head of the Private Credit Group, Bain Capital Credit

Lesley Goldwasser
Managing Partner, GreensLedge

Kristine Jurczyk
Managing Director, Credit, Vista Equity Partners

Art Penn
Founder and Managing Partner, PennantPark Investment Corporation

Structuring for Investor Demand

As the world of private credit investment grows, portfolio managers have more options than ever for securing sources of funding. How do they approach raising capital in this environment?

MODERATORS:

Bill Bielefeld
Partner, Dechert LLP

Lindsay Trapp
Partner, Dechert LLP

SPEAKERS:

Bilal Rashid
Chairman and Chief Executive Officer, OFS Capital

Sengal Selassie
Chief Executive Officer and Founder, Brightwood Capital

Oliver Thym
Partner, Thoma Bravo

- As alternative assets have become a more significant piece of their portfolios, some institutional investors are approaching private credit with more sophisticated and complex structures in mind. At the same time, retail investors have become more interested in private credit, with new investment channels and vehicles opening up to accommodate them. Together, these changes are driving new approaches to capital raising.
- On the institutional front, investors are approaching private credit investment with the goal of addressing gaps in their portfolios. This could include a need for more floating-rate assets, or a need to diversify across geographies or industries, or to achieve certain cash flow or liquidity goals. As they seek more uniquely tailored structures, the increasing complexity in their financing can demand more of portfolio managers' time.
- For retail investors, their interest in private credit stems from some of the industry's hallmarks, such as floating rates and senior secured terms. As mentioned in previous panels, however, the structure of the permanent capital funds used to access retail capital can come with restrictions of their own.
- With more options for raising capital, portfolio managers face a real risk of spreading themselves too thin, and spending more time raising funds than they do managing them. The trick, our panelists say, is to know your strategy and your value proposition, and target investors more thoughtfully.

Convergence Picks Up Steam - Traditional Asset Managers Join the Game

In the past year, traditional asset managers have made significant acquisitions in the private credit space, becoming major players in the industry virtually overnight. At the same time, these transactions raise questions about how to achieve inorganic growth in private credit, and what it will take for different organizations with different cultures to effectively integrate their operations.

- The value proposition for these kinds of deals can be compelling, with asset managers gaining new products to offer their clients while private credit managers rapidly scale up their access to sales and distribution channels.
- While price is probably the most important consideration, strategic, brand and cultural fit are key as well.
- As difficult as it can be to nail down a transactional structure, our panelists recommend taking a broader view from day one – focusing not just on the transaction, but on clarifying an operating structure after the deal has closed, and a commercialization strategy for going to market as one.
- Putting all these factors on the table early on can be messy, but it raises important discussions and helps unify the leaders of both organizations around a single vision of the future state.
- Investment management is a talent business, and focusing on the human elements of the integration, and scoring some early wins that help cement a feeling of unity, are critical.

- When things go wrong, the issue is generally a human one, not one of economics. Open and transparent communication, and doing what you say you will do, are keys to avoiding some of the most common pitfalls.
- And while efficiencies and economies of scale are all worthwhile pursuits, the acquiring organization must take a very light hand in implementing changes, resisting the temptation to make their new subsidiary do things their way. Our panelists agreed that a patient and flexible approach is key to successfully integrating a private credit operation without squashing the entrepreneurial spirit that made them an attractive target in the first place.

MODERATORS:

Richard Horowitz
Partner, Dechert LLP

Ken Young
Partner, Dechert LLP

SPEAKERS:

Matthew Bass
Head of Private Alternatives, AllianceBernstein

Richard Byrne
President, Benefit Street Partners

Jennifer Dardis
Chief Financial Officer and Treasurer, T. Rowe Price Group

Leslie Wims Morris
Head of Corporate Development for Consumer & Community Banking, JP Morgan Chase & Co.

Highlights Reel From the 2022 Permanent & Private Capital Summit

Sponsors:

Dechert LLP

Dechert is a leading global law firm with 22 offices around the world. Our multidisciplinary permanent and private capital team is actively engaged in advising asset managers in all aspects of their capital strategies. Our lawyers possess a detailed understanding of the most current trends and developments, the latest regulatory hurdles, up-to-the-minute market terms and an insider's perspective when it comes to regulatory compliance. We are committed to turning our experience and expertise into value for our clients.

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Thank You

About the Permanent & Private Capital Summit

The Permanent & Private Capital Summit is one of the premier conferences covering the latest in private credit and alternative asset diversification. Since its debut in 2015, the Summit brought and continues to bring together leaders in the industry to address the rapidly developing financial and regulatory issues surrounding permanent capital.

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