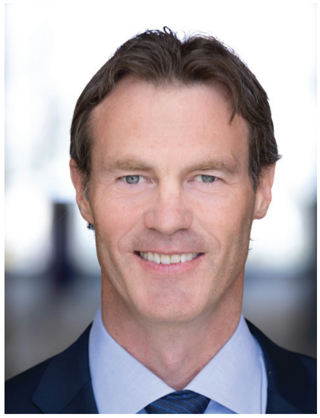
EXPERT Q&A

Scale and creativity will be essential to success over the next decade, but so will relationships and investment discipline, say Crescent Capital's John Fekete and Chris Wright



How innovation will drive private debt forward

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Q Why do you believe that below investment-grade corporate credit will continue to be a compelling strategy for the long term?

John Fekete: Below investment-grade corporate credit has provided attractive returns since the inception of Crescent Capital in 1991. Even in today's uncertain market, it is an asset class that provides both a high level of income and strong preservation of capital.

In fact, we expect both public and private credit to provide higher returns than equity over the next couple of years, with lower standard deviation. And while yields are high across fixed income, below investment-grade corporate credit is the only area providing real yield when you adjust for inflation.

Q What challenges is the industry facing today, and how can these be overcome?

Chris Wright: As more and more asset managers have gone public, they have experienced pressure to grow AUM. The challenge has been balancing that inherent shareholder requirement with the need to innovate on one hand, and the need to maintain investment discipline on the other.

Crescent was born out of innovation. We were early in the high-yield bond market, early in structured credit, early in mezzanine, and I know that this innovation culture will continue. We also know that our pursuit of innovation needs to be balanced with growth and consistent investment returns.

Q How has Crescent sought to manage that balance over the years?

CW: We have stayed true to our investment philosophy. Our focus is exclusively on credit, and we have always prioritised principal preservation. We have evolved to meet our investors' and sponsors/management teams' varied and more sophisticated needs.

When John and I first joined Crescent more than 20 years ago, we were very much a product-led firm, like all market participants were in those days. We had a bond product, we had a loan product, and we made the products we had fit the situation.

Over the past decade, we have increasingly become a solutions provider. Today, we offer everything from the most senior part of the structure down to junior debt by offering bespoke financings that are flexible and accretive, meeting the needs of the individual borrower.

A key element is to provide flexibility – meaning we ensure we can support the sponsor/management team's business plan going forward. Today, we have to have substantial capital available to help the sponsor and company execute their growth strategy. Lenders are now much more active participants in that growth story, and increasingly we are allocating capital to those companies.

We have also evolved our products for our investors. In the past, like much of the industry, we offered a single commingled, closed-end fund by strategy. Today, we are constantly raising capital and evolving our products to meet the specific needs of a broad range of investor types.

At the same time, John and I work together with investors putting public credit together with private credit, which means we can be very nimble in offering more or less liquidity, or with a more global or domestic focus, depending on the investor's needs.

If an investor is looking to ramp up quickly, we are able to deploy capital in public credit and then transition to private credit – generating cash returns while we selectively assess private debt opportunities. It is all about offering true flexibility and having that deeper relationship with investors by understanding their challenges so the resulting solution matches their needs.

Q Europe is one market that has grown rapidly in the wake of the global financial crisis, in particular. How are you exploiting that opportunity?

CW: We have been investing in Europe for more than 25 years. Historically, the below investment-grade corporate market has operated very differently in Europe when compared with the US.

Historically across the region, bulge bracket and regional banks were largely responsible for providing credit. That has now changed dramatically. European companies and sponsors now embrace the idea of relationship lending with private credit providers as opposed to banks. The sponsor universe in Europe has also grown dramatically. We first entered the market by following core relationships in the US as they opened offices in Europe. There are also more Europe-based sponsors with a lot of capital on the private equity side. Therefore, we think the private credit side will continue to grow for us, and in general, as well.

JF: Nearly 80 percent of assets that we manage today in benchmark-related strategies are in products created since Crescent became independent in 2011. It is important to recognise how much we have evolved to meet changing client needs, and that has meant creating new and innovative products.

Q How has the role that below investment-grade corporate credit plays in investor portfolios changed over the years?

JF: When both of us started out in this business 30 years ago, this was a nascent asset class and most institutional investors approached it tactically. Few, if any, managers had strategic or permanent allocations. That has now changed, and these kinds of fixed-income products are now standard parts of most institutional investors' portfolios.

CW: Back when we were raising our mezzanine funds in the late 1990s and early 2000s, we were competing against private equity allocations. That is no longer the case. Private debt has become an asset class in its own right, and a highly attractive one over the past decade.

Q What role do you expect that asset class to play as alternative asset classes open up to individual investors?

CW: The democratisation of alternatives is providing massive tailwinds. A number of players are seeking to capitalise on that trend, which I believe will only increase as more products emerge that are conducive to retail or high-net-worth investors.

We are still in the early stages of that product development. Interval funds and perpetual capital vehicles have attempted to solve some of the liquidity issues that have arisen, but I think there is more product innovation to come. Certainly, this is something we are looking at closely, and our partnership with Sun Life offers additional opportunities as this investor demand continues to grow.

Q What lessons have you learned from previous downturns that are relevant to the volatility we are experiencing today?

JF: Our singular focus on below investment-grade credit has proven extremely helpful. As we have all seen in previous downturns, a number of firms allowed their focus to drift, which got them into trouble. For example, some firms were incorporating mortgage securities into their portfolio around the time of the great financial crisis. They were legally allowed to do so, but it wasn't really in the spirit of what they had been hired to do. We believe it is extremely important to be consistent in your strategy in both good times and in bad.

CW: I would add that we have learned the importance of relationships and of being good long-term partners.

Q How have competitive dynamics evolved in the space over the past decade?

CW: We are definitely seeing many new entrants with greater competition, though the total addressable market has also grown significantly. However, success will ultimately centre on relationships. Sponsors typically have a capital markets expert dedicated to ensuring that capital is available for buyouts and add-on acquisitions, and they want to work with trusted partners to ensure certainty of execution in any market environment. Having those relationships and being able to demonstrate longevity and experience provides a clear competitive edge.

"We have evolved to meet our investors' and sponsors/ management teams' varied and more sophisticated needs"

CHRIS WRIGHT

"We believe it is extremely important to be consistent in your strategy in both good times and in bad"

JOHN FEKETE

Q Crescent participates in both public and private below investment-grade markets. How do you look at relative value across the platform?

JF: Having a platform that spans both public and private credit enables us to pivot as opportunities shift across sectors or asset classes. Last year, there was significantly more volatility on the liquid side, which highlighted our ability to assess relative value and identify actionable opportunities. Increasingly, large institutional investors are looking for that broad platform approach, accessing public and private credit in managed accounts, rather than subscribing to a series of discrete funds.

Q Do you see specialisation by size and where do you play on that spectrum?

CW: We have positioned ourselves to grow alongside the companies we back. To that end, we have a lower mid-market business focused on smaller companies and then, because relationships are so important in this business, we stay with those companies as they grow and change hands. This allows us to capture the value of incumbency.

Q What do you think it will take to remain successful over the next 10 years?

JF: Size and scale will certainly be critical, but I would also reinforce the importance of listening to what customers are asking for, whether that is different products or investments across different geographies or across the risk spectrum. These markets are expanding rapidly today, and didn't really exist 20 or 30 years ago.

Q If you had a crystal ball, what do you think this industry would look like in 10 years?

JF: I think we will continue to see consolidation as the industry moves increasingly towards solutions providers. Managers will require flexibility, creativity and capital to deploy. The rush to scale will also continue. ■

John Fekete is managing director and head of capital markets at Crescent Capital; Chris Wright is managing director and head of private markets

About Crescent Capital

Crescent Capital Group is headquartered in Los Angeles with offices in Boston, Chicago, London, and New York. With more than 100 investment professionals and over 200 employees, the firm invests at all levels of the capital structure, with a significant focus on below investment grade credit through strategies that invest in senior bank loans, unitranche loans, high yield debt, mezzanine debt, and other private debt securities. As of December 31, 2022, Crescent Capital Group managed over $40 billion of privately-originated debt investments as well as marketable securities. For more information about Crescent Capital Group, please visit www.crescentcap.com.

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