

E X P E R T Q & A

Investing in larger companies has many advantages, especially in these more challenging times, say Blackstone's Brad Marshall and Jonathan Bock



Why bigger deals can drive better returns

Q Let's start by discussing how this asset class has grown into what it is today. How would you describe the growth of private credit?

Brad Marshall: We started our private credit business back in 2005 when the deals that were done privately were for companies that couldn't get financed publicly. They were smaller businesses and more complicated credits. There were only a few private capital providers, representing about 5 percent of US leveraged finance.

Since then, we have seen a secular shift from public to private markets. In 2021, there was an acceleration of multi-billion-dollar private financings and

SPONSOR
BLACKSTONE

companies now routinely choose to go with a private solution. Going into 2024, we now believe we could be the largest and lead lender in a \$12 billion private financing if an issuer was looking for that.

Jonathan Bock: One of the largest private credit managers in 2005 was a company that sold refrigerators, GE. The institutionalisation and quality of managers has evolved materially, with most major alternative asset managers having large private credit arms today.

The deals have changed too. In the early days, it was very much a junior debt market because managers believed they had to find double-digit returns to compensate investors for taking that risk. Then there was a recognition that you could do a senior loan with lower risk; those opportunities were plentiful and popular with insurers, pension funds and now individual investors.

Q What is driving the evolution of the opportunity set in private credit?

BM: At a high level, we continue to see growth driven by the shift towards private credit, away from the public

markets, driven by investor demand and companies that are seeking more flexible capital solutions. We are also seeing the size of the deals and types of solutions grow.

When the market thinks about private credit, they often think about corporate finance for sponsor-backed transactions, which has been the bulk of the industry's growth.

What is driving the evolution today is not only the size of deals, but also the range of private credit products that managers like ourselves can offer.

Banks have historically been in the "package and distribute", or syndication business. Today, issuers are seeing the benefits of working directly with private lenders who have long-term capital from their investors and are able to hold the loans. And then the private managers partner with the banks in a variety of different ways. So, you are seeing this evolution around a more efficient way to own and distribute risk. Private solutions have moved past just corporate loans to royalties, asset-based financings, private investment grade, structured credit in more complicated sectors like technology, life science and energy transition. And then from a geographic standpoint, you are seeing the same maturation globally, in Europe and Asia.

Similarly, there is the evolution of the investor base, with more individuals looking for longer duration and yield premium in private structures. That evolution on both the product

and the investor side is creating an interesting intersection of opportunities for managers like us.

JB: As managers like Blackstone expand, our ability to offer loans now touches audiences that have never had the option before, so we continue to evolve our offerings and capabilities in the market.

Q **The growth of private credit also has its sceptics, often when it comes to large deals - why would an investor want exposure to larger transactions?**

BM: We work with companies of all sizes. No matter the size, you need to be investing in the right sectors, in the right capital structure and on the right terms. But in addition, we increasingly see that investing in larger companies has a lot of intuitive advantages. Bigger companies tend to grow because their products or services are high quality, they may attract a strong management team, a compelling PE sponsor and they are likely a bit more diverse in terms of their business mix, which de-risks the investment.

All those elements are supportive to a credit manager, especially in a period that is a little bit more complicated. You want the depth of capital of a big private equity sponsor and managers that can be supportive, plus you want a well-managed company that can navigate headwinds if necessary. We have been doing this for 18-plus years and in US direct lending, and we have not experienced a default on a large company with EBITDA of \$100 million-plus. For context, the average EBITDA of companies we lend to is \$200 million-plus. Our data shows that bigger deals have tended to drive better risk-adjusted returns.

Q **A big driver of growth in the private credit industry, and specifically at Blackstone, has been the BDC structure.**

"I expect AI and data science to transform not just private equity but private credit as well"

JONATHAN BOCK

How are BDCs positioned in this environment?

JB: When the BDC structure is operated with the right alignment and a sophisticated investment manager, great things can happen. For too long, the space had too high an underlying fee structure, which resulted sometimes in riskier, bad deals or poor returns.

Blackstone began to offer institutional-calibre funds to individual investors, allowing the space and the structure to evolve. Others followed suit and that has been a positive for the structure and for its investors.

We have started to see BDCs emerge as a way for individuals to access private credit, so the structure continues to grow – this is a great thing. It will be a big focus for both individuals and institutions because it allows investors to put capital to work immediately without navigating the traditional fund drawdown process and offers low leverage as well as a level of liquidity in an otherwise illiquid asset class.

Q **Everyone mentions they have favourite sectors they like to lend to. What are yours? Why?**

BM: Unsurprisingly, we take a fairly diversified position given the amount of capital we oversee. We do have some sectors we like more than others, which fall into three categories: technology and software; healthcare and life

"Investing in larger companies has a lot of intuitive advantages"

BRAD MARSHALL



Q What’s the next shoe to drop? And how does Blackstone prepare for it?

BM: As credit investors, that is all we think about – we aim to deliver for our clients. The market has shifted so much in the last 18 months because of interest rates, which have effectively doubled the interest burden of companies. So, there is some concern around companies’ ability to service that debt and, therefore, rising default rates.

This is where the ‘three S’ come into play. Sector selection, scale of company, seniority of capital. All three elements are defensive, and a manager’s weightings in these areas will drive fund performance. We have been talking to our investors about this for quite some time as we saw the inflationary data flowing through our private equity portfolio years ago, which prompted our move to be defensive.

sciences; and renewable energy and energy transition. All three are large, have good growth outlooks, historically lower defaults and generally much better cashflow characteristics. Each of these is highly specialised, so you need an additional layer of resources to source, structure and underwrite those deals.

Q Many managers speak to their size, experience and diligence as points of differentiation. What would you say are the greatest points of differentiation for a partner working with Blackstone?

JB: There are plenty of people with the intellectual capital and the financial capital to make a loan, but I believe we are one of the only firms that can offer supplemental support to a company after a loan is made. Our Value Creation programme provides both operational support and resources for portfolio

companies. Blackstone’s proposition of taking its scale across businesses to drive revenue and cost advantages for borrowers is what differentiates us. Being a value-add partner is a rarity on the lending side.

BM: We think of ourselves as a capital partner, not just a capital provider. Ninety percent of the credit companies that our Value Creation team is introduced to use this post-investment offering that Jon mentioned. What also makes our platform exceptional is that we can go and create solutions, not just react to a company or sponsor calling us. We can provide those solutions globally and we can do so with scale. Committing to \$4 billion in a single deal is within our capabilities and that opens up more opportunities for our investors. We aim to win by being creative and flexible, with deep pools of capital and by adding value where we

can – that’s what being a good partner is all about. If we create value for our equity partners, we can create wealth for our investors.

Q Finally, what’s next? Any future innovations we can expect?

BM: There is product innovation, where we will continue to see more ways to bring various private assets to different types of investors, just like the innovation we have already seen in the BDC space. You are also going to see innovation in other markets, with more evolution in Europe to open up the asset class to different classes of investors – like individuals and insurers – and a shift in the Asian markets away from a historical reliance on banks for financing. Away from investors and product structures, you’ll see the evolution of more specialised lending over time to serve a broader need across the corporate and asset-based market.

Furthermore, data is going to drive the market in a lot of different ways. Blackstone, like others, sits on a treasure trove of data from our companies and the buildings we own or to whom we lend. Artificial intelligence is something we have been working on for a while – as leveraging our proprietary data can help drive better decision-making, whether at the macro level or in specific deal analyses. We think AI is also going to be disruptive in certain sectors, so understanding that, especially from a credit standpoint, is important.

JB: I agree. I expect AI and data science to transform not just private equity but private credit as well. If the investment industry is all about connecting dots better than your competitors, Blackstone’s scale and expertise gives us more dots than anyone else, with \$1 trillion AUM across all our major markets. ■

Brad Marshall, global head of private credit strategies, and Jonathan Bock, senior managing director, are co-CEOs of Blackstone Private Credit Fund and Blackstone Secured Lending Fund