

E X P E R T Q & A

In a rapidly changing landscape, you can't overstate the importance of sticking to what you do well, says Park Square's Robin Doumar



How private debt grew into a trillion-dollar market

The private debt industry has changed beyond all recognition in recent years. From humble beginnings, the asset class has grown into a vital part of the global financial system – and its expansion shows few signs of slowing down.

Robin Doumar, founder and managing partner at Park Square Capital, looks back on the past decade and shares his key predictions for the future. Despite the enormous changes, he believes many of the key ingredients for success in private debt will remain constant. Most important of all, he says, is maintaining discipline and ensuring alignment of interest between lenders and investors.

Q What did the private debt industry look like when you started Park Square in 2004?

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Leveraged finance in Europe only really began in the mid- to late-1990s. The world was extremely different then, as banks dominated lending and often took massive hold positions. There were around 20 banks in Europe that each could do deals of more than \$100 million.

The big difference between Europe and the US banks was their take and hold appetite. Junior debt in Europe developed as an extension of the banking market – unlike in the US, where junior debt and much of senior debt developed as an extension to the bond market.

When I arrived in Europe around

25 years ago, it felt as though banks could do whatever they wanted in terms of price. It was crazy to compete with them because they had the ability to make the price super-low to win the deal, and then held it all on their balance sheets – which, in retrospect, was very risky.

Q What gave you the confidence to think that a different market for private debt could evolve?

I was convinced that an independent firm focused on making good investments would have a big competitive advantage. When organisations reach a certain size, they tend to lose focus on their performance and can have conflicts of interest and misalignment between investors and fund managers.

Analysis

I believed that creating a conflict-free organisation that was investor-orientated and fully aligned on a strategy would not only be successful, but also could take on the banks. At this time, banks were very aggressive in senior lending, but shy of junior lending because you could get very badly burned if you got it wrong. So, there was always more of an opportunity in junior lending to solve problems for clients.

The European market also presented a big opportunity, although I thought the opportunity was likely to trend in the direction of the US market. Private debt was always an interesting space, but I couldn't have predicted that the asset class as a whole would gather such momentum.

Q What have been the key steps in the evolution of the industry over the past decade?

Two critical things have happened. First, after we went through the global financial crisis, it became clear that we needed to be very careful about banks making risky bets with depositors' money. The regulation and the retreat of banks from the lending space created a big market opportunity for private credit.

Secondly, very low interest rates pushed institutional investors, in their search for yield, to look for alternatives to traditional credit and fixed income.

What really changed things was the movement of pension funds and institutional investors into alternative credit as a standalone asset class. Private equity allocations historically were quite small; credit managers were raising money from that small alternative allocation.

But big, sophisticated institutional investors – pension funds, insurance companies and others – created separate buckets in the form of fixed-income alternatives, including for private credit. That has had an enormous

impact because when you start taking sizeable percentages of entire pension fund allocations, it translates into a massive amount of capital available for the market.

Q What are the most important lessons from the past decade that private debt managers should keep in mind over the next decade?

You can't overstate the importance of staying disciplined – sticking to what

you do well, being very, very systematic about the way you build portfolios, and being investment-focused. Rule number one in private credit is don't lose money; rule number two is don't forget rule number one.

There's no substitute for good fundamental investment decisions, and high-touch, hands-on management. Proper credit selection and asset-picking skills are key; there are a lot of different ways to be successful, but with performance, it is vital to remain

Q How optimistic do you feel overall about the future of the asset class?

I'm very optimistic. Along with the growth we'll see with institutional investors increasing their allocations and replacing fixed income, one of the other trends is the allocations of retail investors and high-net-worth individuals into the asset class. That's a massive growth opportunity.

It's a great asset class to be investing in, particularly in this market environment. To be floating rate, inflation-protected, earning a high current cash yield with base rates rising – it's extremely attractive. It deserves an outsized allocation from investors, relative to something like public equities, where there's a lot of risk at this moment. If you can be earning almost a double-digit return just from fundamental underlying bank loans, that's spectacular.



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disciplined, focused and detail-oriented to maximise your return.

Especially in an environment like this, people who buy the market are going to be badly disappointed. There’s been a movement to passive management over the last decade, which works well in the equity markets where one good stock can make 10x. But from a portfolio standpoint, buying the market in private credit is not smart, because avoiding mistakes is more important than striving for overly ambitious returns.

Q Do you think the industry is well positioned to weather economic volatility?

As an industry more broadly, we’re very well positioned, as most fund managers have long-dated, locked-up capital, and capital structures that are appropriate for the risks they’re taking.

If we step back, everyone should realise that it’s a great thing that private credit exists – because it’s a good shock absorber in turbulent times. Most of our fund structures have seven or 10-year lives, where investors’ capital is locked up. The big picture is that this is a well-capitalised industry, and we can absorb a lot of volatility.

That said, during the covid years, there were a number of managers who focused on getting their capital deployed and raising their next fund, which resulted in a bit of an arms race for gathering assets, and that’s not healthy for managers. There’s going to be a big differentiation in manager performance because if you’ve been overly focused on capital deployment, performance is really going to suffer.

Q Why might some managers get distracted from performance?

There’s a direct correlation in our industry between discipline and performance. The concern I have is that at a certain size, people become undisciplined in the way they operate.

Frankly, some credit funds have

grown too large; you need a sizeable fund, but it doesn’t need to be intergalactic. It’s important that funds are appropriately sized for the market opportunity. If you get too big, there is a risk that credit standards are lowered, and you are forced to buy the market. Conversely, if you’re appropriately sized and thoughtful, you can be disciplined in the way you invest, which is really important to achieving strong, consistent returns.

Alignment is critical and often overlooked. The financial community, and even investors, don’t focus enough on alignment. As an investor, you should look to invest with managers who have skin in the game, where the people who are investing your money personally have their own money tied up in those vehicles.

Q What key trends can we expect to see in the coming years?

One trend we’ll see is the asset class growing substantially, driven by institutional investors increasing their allocations to private credit – which are still quite small globally, in relative terms.

The markets have changed enormously during my career. The end buyers of the product have moved upstream. The ultimate holders – insurance companies, pension funds, sovereign wealth funds, foundations, institutions, high-net-worth investors – are more forwardly integrated into the process. This whole group is becoming much more closely linked to the origination of the deal through their relationships with intermediaries, and in some cases doing deals directly.

I think the ultimate holders are going to become increasingly sophisticated. That’s an important trend, which I think disadvantages the small purchasers in syndications. And it means there are a group of people globally who are both originating and holding loans, and who have replaced the banks. That does require a certain scale and proper alignment. ■