-- [00:00:00] Ross Butler: You're listening to Fund Shack. I'm Ross Butler, and this week I'm talking with Marcus Meyer Krug, partner and cohead of Portfolio Management at Arcmont, a private credit manager founded in 2011, which was acquired in 2023 by Nouveen, an investment manager with over a trillion dollars in assets under management. Marcus has a huge amount of experience in private credit and we're going to look at the state of the market today, the drivers and opportunities, how things could evolve as we head towards 2024 and beyond.

Marcus, welcome. Fund Shack thanks for having me.

[00:00:32] Speaker B: It's a pleasure to be here.

[00:00:33] Speaker A: It's a strange market at the moment in terms of private equity and deal making. What do things look like on the private credit side?

[00:00:40] Speaker B: I think private credit has been very eventful over the last ten to twelve months.

There's been an unprecedented amount of volatility in the market and that's had an impact on portfolios of private credit managers, and it's also had an impact on origination and the origination opportunities that we have. So while there's been a heavy impact on M and A volumes for new deals which have been under pressure for the last ten months, there have been new buckets of opportunities which have opened up for private credit managers in that time period through, for example, liquid market substitution deals which really were not available in the past.

So it's been a time period where private credit managers have had to adapt and some have adapted better than others, but I think overall it's just been extremely dynamic.

[00:01:33] Speaker A: Okay, so let's get into all of that. But first of all, I've got to confess, I'm not a huge private credit expert and so I was wondering if you could just walk us through the basic types of products that Arkmont have in terms of private credit and what they mean.

[00:01:46] Speaker B: The fundamental thing to understand is the main difference between private credit and what you would potentially get on the liquid market is you're tending to get a bespoke piece of financing which is negotiated with a limited amount of counterparties. So typically one private credit fund, maybe a small club of two to three private credit funds who will then hold all of that financing themselves rather than the traditional leveraged finance model where you have an underwriting bank who come to a set of terms and then try and syndicate that out to as many potential syndicates as they can find, retaining only a very small sliver of that.

And the debt then becomes publicly traded. And that's one of the big differences between private credit and what you can get on the liquid markets in terms of the actual product. There's very little difference in a sense because most private credit managers, and certainly Arkmont, have the ability to play up and down the capital structure. So really we can provide anything that a private equity sponsor might be looking for. Whether it's a senior secured deal, whether it's a unitranch deal, whether it's subordinated debt, equity, co investments. There's really a range of things that we can provide. And one of the main attractions of private credit is that we have that flexibility. And so the sponsor can really think about what structure works for them and what do they need and how can we potentially find something that fits within that parameter.

[00:03:16] Speaker A: Does that have an upper limit? So if I'm going to do a monster buyout 5 billion or something, it.

[00:03:20] Speaker B: Does by virtue of fund sizes of private credit players. So generally we would say we would underwrite something of, let's say 500 million to a billion is where we would probably cap out on a single deal. Many of the larger private credit managers out there would have similar types of limits. So you can probably club a deal of a billion and a half, maybe

-- probably then would have gone straight to the liquid market, and frankly, in the past, you would have gone straight to the liquid market at anything above €500 million deal size. Because the liquid market was then accessible to you, you had a minimum level of investment size for it to be traded and liquid, which is a fundamental requirements for those investors.

And at that point you were getting better economics, pretty much a guaranteed financing because the bank would underwrite it for you. And so that was a very attractive option to take in the past. That has changed given the volatility in the markets and now really private credit players will be a very serious contender at those deal sizes. And so I think that is a fundamental difference and has changed. And once you get to very large deal sizes where potentially they can't be clubbed by private credit alone we have seen situations where private credit provides incremental financing on top of an existing senior deal. And that could be at the time that the deal is done, for example, in a subordinated position, it could be done as an incremental or add on financing after the deal is done. And that's been one of those new buckets that's opened up for private credit has been deals that have been liquid market deals who are looking to make attractive add ons but can't raise the additional capital in the liquid markets given the volatility or can't get certainty of that. And they really need that certainty in order to acquire the target. And so private credit suddenly becomes very attractive because partially enabled by the very loose documentation that you have in those liquid deals, it allows the borrowers the flexibility to go out and seek financing from other parties while providing a similar level of security. So we can actually come into deals like that, provide very significant financing firepower for acquisitions, benefit from the same security package and sit alongside the existing senior bank in a separate document, but benefiting from the same security with better economics.

[00:06:14] Speaker A: Everything you just said, does that pertain globally or to Europe, or is it different in the US?

[00:06:19] Speaker B: That is, broadly speaking, global? I think the major difference to the US market is the US market has developed a model where deals are generally clubbed by more parties than they are in Europe, that market is a bit more developed. And so you have tended to see, ironically, the private credit market becoming somewhat like the traditional liquid market in the sense that you will tend to have one or two private credit funds which will originate a transaction and that's a very important part of the puzzle. And once they originate it, they may actually underwrite that deal and then parcel it out amongst a few other funds. And so funds might come in and take quite small pieces, whereas in Europe, vast majority of the transactions are still done by very small clubs or even sole deals. So most of the deals that we do are either sole deals or we are potentially one out of two parties.

[00:07:17] Speaker A: Is that a function of maturity? Will we follow the US or is there some structural difference that it's possible.

[00:07:23] Speaker B: And I think we've seen that happen already at the larger end of the market where it's just, for diversification reasons, not possible to do such large deals entirely by yourself. And so you do need additional players to club those deals up. Whether or not we follow that model down into the smaller size deals I think is uncertain. But generally we have tended to follow the US in many other things, so it wouldn't be entirely yeah, yeah, great.

[00:07:50] Speaker A: OK, so let's get back to the state of the market today, which you've already given a summary of what's deal flow looking like.

[00:07:58] Speaker B: So deal flow is good overall for us, but I would say it has been a quite interesting year. The reason I say that is because the headline numbers are deal volumes are declining and that is a fact.

And so the overall universe of deals, if you want, at the top of the funnel has been decreasing.

Now, generally speaking, that would be negative for private debt, but there have been some mitigating factors that have offset this. And one of those factors has been the opening up of new

-- s. So deals which previously would have gone entirely to the liquid market, which now come to us given the state and volatility in those liquid markets, just because.

[00:08:53] Speaker A: The banks can't get the deals done.

[00:08:54] Speaker B: Correct and they're nervous to underwrite. And so those are deals where if you want transaction certainty, and that is one of the main benefits of private debt is it provides the private equity house transaction certainty and financing certainty at a price, but it does provide certainty. And previously those deals were effectively guaranteed in the liquid market model with very strong underwrite from banks that went away and that opened the door for private credit funds to come in and look at those transactions.

And not all of them go private credit's way, but some of them do. And that's a whole universe of deals which previously didn't exist.

[00:09:33] Speaker A: The second, can I just ask, is that a transitory opportunity or do you think it'll stick?

[00:09:38] Speaker B: So it's a very good question and I get asked this all the time by investors.

[00:09:42] Speaker A: Good, I'm glad I'm asking the right question.

[00:09:46] Speaker B: I think it is both in the sense that the opportunity such as it existed over the last twelve to 24 months, even if you go as far back as COVID Lockdowns, when really private credit was your only option, that sort of level of penetration of private debt will not hold. The liquid markets will reopen. We have seen certain segments of that market start to reopen and when it does, there will definitely be issuers who will prefer that route. But I think I liken this in a way to the development of private debt in Germany over the last ten years. And I have a lot of experience there just because that was primarily my focus area.

And what you saw there was a transition away from banks, even in the lower mid market mid market, which was historically always very strongly bank dominated in.

[00:10:46] Speaker A: Germany, the land banks and things like.

[00:10:48] Speaker B: That correct to private debt over a period of time where the share of private debt has now risen to over 50%.

And the reason for that is that once people have the experience of using private debt, they notice that there are certain benefits to having private debt and there will be issuers in the future who will continue to value those benefits and they will continue to want to use a private debt solution, even if it's more expensive.

So we think that there is a part of that market which will be permanently retained, but it's clearly not going to be as large as what we've seen over the last twelve to 24 months. That has been a very unusual situation, but nonetheless it provides a permanently new market for us, which previously was virtually nonexistent.

[00:11:35] Speaker A: Right, okay, I'll let you get back to your mitigating factors now because I derailed you on the specific liquid market opportunity. So my question, let me remind you, was what's deal flow? Like you said, it's looking down. But there are several factors, right?

[00:11:50] Speaker B: The first one was the fact that we have these new pockets of deals and that's been very helpful in offsetting the overall decline of the deal universe.

And in addition to that comes the fact that both fundraising for private credit players as well as portfolio management for private credit players has become more difficult over the last twelve to 18 months. And that's something that we see across the board.

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[00:13:13] Speaker A: Right?

[00:13:14] Speaker B: And I think the final point is the quality of deals that we're seeing in the market. So previously you had a very large funnel at the top, but the reality is you declined the vast majority of those opportunities because they simply weren't high quality enough for us. The reality now is as the markets have become more volatile and difficult, those more challenging deals oftentimes don't even make it to the market. And so the selection of credits that you're seeing is generally higher quality. So you have a higher conversion rate. Purely off the fact of that as well.

[00:13:45] Speaker A: I guess the fourth factor is the one you mentioned earlier, which is that while there's very few primary buyouts going on, there is a lot of buy and build activity.

[00:13:52] Speaker B: Correct.

Again, it's an advantage that people who have been in the market for a long time and have very large portfolios like ourselves, can take more advantage of than newer or smaller players. And for us that means that there is a substantial portion of our deployment every year which comes out of our existing portfolio because those companies will be busy looking for acquisitions for add on targets, they may require add on financing for other purposes, being building new facilities, investing, whatever it might be. And so those are attractive opportunities for us to increase our deployment with businesses that we already know and like in effectively an exclusive situation because they're never going to go to an outside source for that. They're always going to consider us in the first instance. And so that's another very attractive cornerstone for us that helps to offset maybe some lower New Deal activity.

[00:14:47] Speaker A: What does the deal look like at the moment? In terms of the process?

[00:14:51] Speaker B: The terms I'm hesitant to get into specific terms, but in terms of the process, what has been noticeable is that the amount of time that processes tend to take has expanded. And that's a virtue of the fact that debt advisors who are oftentimes involved here in these transactions are more hesitant to force people out of the process early at the risk of being left at the end with no one. So there was a period of real worry about obtaining a financing at all and so those processes have been much longer than they were before. There's been earlier and more pronounced involvement from financial sponsors as well, also from the management teams. There's much more handholding through the process, more involvement and contact with the management teams to really sell the business, as it were, to the potential financing parties. Much of that fell away and it was very similar in the last financial crisis. I still remember to this day we were working on a transaction and we were actually penalized for asking too many questions and they said if you keep asking questions then we're just going to drop you out of the process because you're being too difficult. And lo and behold, after the crash people were suddenly very willing to answer our questions and they should be because we're a major part of the financing.

[00:16:17] Speaker A: What's your due diligence like?

[00:16:19] Speaker B: It's a combination of vendor provided information. So there's usually a very extensive vendor information package which will include an analysis of the market, an analysis of the company, its position, potential growth prospects, competition, et cetera. Financial analysis, legal tax analysis. These reports in total, all created by the vendor, will run anywhere from two to 600 700 pages. So it's a substantial amount of information.

In addition to that, it's always customary that you will have a similar set of information from a potential buyer. They will engage their own firms, their own consultancies to do all the same type of work that the vendor is doing. So basically kicking the tires from their perspective. And so depending on how many buyers you're working with on an individual transaction you may get

-- nk that's very necessary. And then the third part of the due diligence is our own experience and frankly we have a huge investment team who've been investing for a very long time, they know many of the issuers and even if they don't know the specific issuers, there's a real value to understanding markets which can be in certain instances, extremely complex. So a classic example is the German healthcare market. When I was working at my previous employer at European Capital, it was impossible for us to do a German healthcare deal because our investment committee sat in the US. And they just fundamentally didn't understand that you could have a state funded healthcare system. And the dynamics of what that means and why that makes those potential assets so attractive were completely lost on them.

[00:18:31] Speaker A: It's quite common outside of the US.

[00:18:34] Speaker B: That's the bizarre thing.

And so once you've built up that experience, you understand how the system works and again, it will be different, the regulation will be different for every little subvertical within that market. That's valuable, that allows you to immediately be up to speed, immediately understand a business, be credible in front of the management team. And that's important to win deals because the management team are a very key decider in this process on which fund they ultimately want to go with.

[00:19:02] Speaker A: As you alluded to earlier, it's a difficult market, difficult trading environment, how's that affecting the types of transaction opportunities you're seeing, but also the work that you are doing with your existing portfolios.

[00:19:16] Speaker B: So on new opportunities, it's been beneficial for us in the sense that terms have generally improved from where they were and that has really been almost across the board. So whether it was restrictions in the documentation, whether it is around pricing, whether it is around leverage, all of those terms have, generally speaking, improved. And that's partially a function of the dynamic I mentioned before, where getting that certainty of financing is more difficult than it was in the past. And so some of those borrowers are now more willing to be a bit more constructive on some of those terms.

And part of it is mechanical in the sense that interest costs have risen, base rates have risen, so the overall interest burden for those companies, given the same leverage, has increased. And so more conservative financial structures are frankly just required because the cash flow just can't support them otherwise. So it's been, generally speaking, quite good because everything has moved closer in our direction. The flip side of that has been on the portfolio and clearly these same dynamics, whether it be the volatility in the markets, whether it be the various economic pressures that we've seen over really since, really since the COVID lockdowns, it's been unrelenting in terms of different pressures that we've seen on the portfolio. All of those are a real challenge. And I think one of the strengths of private credit is that we tend to be in a sole financing provider position or potentially one of two or very small group of financing parties. So it gives you an outsized control in the documentation, which is something that you're lacking on a liquid market deal.

And so what that's meant is it's meant very heavy involvement by private credit managers to deal with a lot of these stresses, whether that be addressing potential Covenant breaches or other issues in the document.

Those are all these kinds of issues, restructurings that might have had to take place depending on how difficult a situation is. They're all very time consuming.

And as I said, I think it's again going to benefit those larger players because they have the bench to really dedicate the resources to work on those situations without losing the capacity to originate new deals.

[00:21:55] Speaker A: At Arkmont, do you have dedicated resources or do they tend to be the

-- that's unpopular and that's unpopular. And the reason it was unpopular and it really showed itself. It's a classic example. One of those things I mentioned earlier of the experience that people made with the banks, for example, in Germany after the financial crisis was very negative because they did a deal with someone and then after the crisis, or in the crisis, they had to maybe renegotiate some of those terms or restructure that deal. And suddenly the counterparty that they're speaking to is a completely different person they've never met before with a completely different agenda.

[00:22:56] Speaker A: It creates a misalignment of interest, complete misalignment. A lot of problem in GFC with some Scottish banks around that and it.

[00:23:02] Speaker B: Was very, very similar in Germany and it was quite a negative takeaway from many financial sponsors. And so that's why I think that model is not ideal. You want to have the same partner. But on top of that, I think the reason it's useful and the reason why we like to do it with the existing deal team rather than a separate team is also the familiarity that you have and the knowledge that you build up on the market and on the business when you're doing your due diligence. There's a real benefit to reading through thousands of pages of due diligence, doing these due diligence calls with third parties, meeting the management team. You build up a knowledge base of what this company does, who their competitors are, what the dynamics in the market are. So when something happens, you can better assess what that means and that allows you to take better decisions. And the third aspect to that is if you keep it with the same deal team, they've probably built up a relationship with the management team since the due diligence process and into the portfolio monitoring process, which is something we major on. So it allows you to have a very close dialogue with the management team and rather than waiting passively for a problem to appear, you have the proactive ability. And again, this is very different from the liquid market where you're 2% of a giant syndicate. You have zero connection to management. You get a management presentation once a year on the budget and that's it. And in our model, because we're so important and because we've built up this relationship with the management, we can phone up the CEO anytime we want and we can say, hey, we've been seeing that material prices have been drastically increasing. How is that going to affect you going forward? What does that mean for your business? And they can explain that to us. They have no obligation to do that, there's no legal obligation to that. But we've built a relationship with them which allows us to then react far more proactively than just sitting there passively and waiting for something to happen.

The final point is if you unfortunately do have to go into a situation where it becomes a very heavy restructuring, there are certain jurisdictions and it is very jurisdictional based. Enforcement law is very jurisdictional based, where management plays an outsized role. So in certain jurisdictions, like France or particularly Germany, you have fiduciary duties by management teams to place a business in insolvency if they believe the business is at risk. And the worst thing that can happen to you is to be in the middle of a discussion, of a restructuring discussion and we all think we can get to a positive outcome, but management gets nervous and they decide to file for insolvency.

And so that advantage of being able to speak to them, to know them personally and reassure them that we're going to come to a positive solution and support the business that helps preserve value for everyone.

[00:25:56] Speaker A: So I've been thinking about what's the alpha in private credit because it's quite obvious to some degree in private equity that private equity firms are different in what they do. It wasn't obvious to me before we started talking what was different in private credit, but now it is more obvious. And it seems to me it's subtler, it's more nuanced, and it's about kind of taking the time, because it sounds like you could do a lot of what you do through basically just signing off and box ticking. And there's a world of difference between that and actually being, I guess, diligent, properly diligent. Is that where your alpha comes from? And in addition, let's talk a little bit about Arkmont and your culture because th --

-- at's going to be embedded.

[00:26:37] Speaker B: So I think that it is one of the major drivers and one of the major drivers for our success certainly has been the investment mindset of the team. That's very important. If you look at the senior profiles within our team, they're always from an investment background. They're not bankers. So they think of investments differently. They think about a position where you're negotiating a deal and you own that risk for an extended period of time, three years, maybe even seven years. These tend to be seven year deals. So it's a very different mindset of looking at things and it also changes the way that you think about solutions to problems.

And that's quite important because that will change the way that you structure these deals and also the way I think more importantly to your point of how do you really provide better performance or generate better performance than other private credit managers? Partially it's being able to originate transactions and win those off the back of your relationships with the private equity sponsors and that's something you build up over a very long period of time.

And the other part of it is not losing capital for us, it's really a game of managing the downside. And that's why I say it's important to have those large teams because if you have the large team and you can dedicate the resources to dealing with difficult situations, you can make sure or at least you have a better chance of avoiding capital losses and that can really swing the pendulum one way or the other.

[00:28:08] Speaker A: So you're not a bunch of investment bankers that decided to jump ship like ten years ago and set up your own operation?

[00:28:15] Speaker B: No, that sounds a bit derogatory to investment bankers. It has been a very different mindset and it's reflected in the way that we discuss investments as well. So I was at my previous employer in a model where the investment committee was the three most senior people in the firm of our parent company and as I already alluded to, they were miles away from understanding the dynamics on the ground in Europe and frankly, Europe was a footnote to them.

Our investment committee process, while we formally take investment decisions across the entire partner level, which is already a fairly large group of people. So we're not talking about three people, we're talking about 8910 people.

In addition to that, all our investment committee meetings include our entire investment team of over 40 professionals up and down the ranks. So really as far down as the analysts, all the way up to the partners.

[00:29:07] Speaker A: And they all have a vote.

[00:29:08] Speaker B: They don't have a vote, but they're part of the discussion and they're encouraged to be part of the discussion and anyone is free to challenge anything in that discussion and opine on anything in that discussion. And that's really important because there are a lot of things that maybe I myself as a middle aged white man don't necessarily have the best opinion on or I'm not very connected to, but someone else maybe does. And those views need to be reflected for us to take better decisions.

[00:29:33] Speaker A: The thing that we haven't dealt with, we dealt with the. Specifics of the market at the moment. But if you zoom out, what are the fundamental attractions from an investor perspective of private credit at the moment? What's the sell?

[00:29:45] Speaker B: I mean, private credit has become increasingly attractive for a variety of investors, and part of it is that it naturally provides more diversification to what they had before, because it's effectively just a new bucket for them, where they don't necessarily have assets allocated. So it's access to a different pool of issuers, which therefore naturally provides some diversification to them. But more importantly, the attractions are that you have an inflation

-- tions of those products, which is something that investors absolutely hate. So investors don't want to have to deal with something that is constantly jumping up and down in valuation. It creates all kinds of headaches for them in terms of allocations.

And so it's very attractive in that sense. Personally, I also believe part of what is attractive in private debt for investors is that you fundamentally have a different position, and in my opinion, a better position than some of these liquid market deals. So the documentation is better. We have covenants on virtually all our deals, which is unheard of in the liquid market. It's virtually all covenant light. So you have a document that has better controls. You're getting paid more than you would for an equivalent liquid loan market deal.

You have a better ability to potentially control the outcomes because you have more voting power by virtue of being one of two or three, rather than hundreds of syndicated people. And you have a senior secured product, so you're first ranking in any sort of recovery. So it's very powerful, I think, and has a lot of advantages. And the one major disadvantage that of course you have to accept with that is it's just not liquid and you can't trade it.

[00:32:04] Speaker A: So what's your view on private credit? Because you've been doing this a long time. Given that it's a relatively recent addition to private markets, I think you've been doing it since something like 2006, correct?

[00:32:15] Speaker B: Yeah. So I originally started to help set up the European arm of at the time, american Capital Strategies BDC, and they were one of the many US players that came into the European market. And at that time, the market was very much a subordinated debt market. That's what private credit was. It was mezzanine primarily, and then later second lien and pick. And that market effectively got taken apart by the financial crisis. It was very difficult time. I spent a lot of time restructuring a lot of those deals. You're in a terrible position because you're subordinated. So it's very difficult to avoid capital losses in those scenarios in a scenario where there's that much stress.

Really. Out of that came the private credit model that we know today, which is the senior secured lending product and it comes under various different names including unitranch. But fundamentally the shift was from subordinated to senior secured and that has dominated the market right now. And I think that is a product which will probably continue to make up the lion's share of the market as we go forward. But there will always be a need for people to provide other bits of the capital structure whether that is subordinated debt or anything else or even equity.

[00:33:40] Speaker A: They would be specialist providers presumably then.

[00:33:42] Speaker B: Well, we have that same flexibility. All right. And I think that's the beauty of the model is for us. For example, we in the last 18 months started up our Capital Solutions strategy. So this was a new arm for us where our real focus was on performing high quality credits, where we provide senior secured loans. And what we saw was we were originating out of our existing network, a lot of businesses which didn't actually fit into that mold because maybe it was a sector which we traditionally don't like something cyclical like automotive or consumer discretionary. Maybe it was a company turnaround or it had some other unique feature that made it unattractive or not suitable for our traditional standard direct lending funds. And previously we had to decline those deals and we would decline those deals. And what we found is setting up the Capital Solutions strategy allowed us to then take those deals and say well, this isn't suitable for our main fund, it's not suitable for the risk profile of those investors. But private credit can provide a solution here because ultimately the advantage of private credit is the flexibility that we have. So we were able to take those deals and say well we can provide a solution, we expect higher returns but we can lend to this business and we can find a structure that works for us. It's not a flat no and that is very accretive. And I think as you go forward, many of the private debt managers are going to try and leverage that origination capability as much as they can because that's where the real value is. It's in the origination is getting those loans in.

-- the firepower, the breadth of the team and the flexibility to find an appropriate solution for them, it can be something that's very attractive and leads to deployment.

[00:35:35] Speaker A: Yeah, that's very convincing because it's very easy to turn down something based on a textbook problem or more like a policy actually like no automotive. But the value is often in the context and that's where great private equity value comes from. But presumably it's also where great private credit value will come from. But it requires judgment. It really is not a box ticking exercise, I'm guessing.

[00:35:57] Speaker B: No.

[00:35:58] Speaker A: Arkmont was recently acquired by Nuvine, which is a very large investment manager. How does that affect things on a day to day basis or how does it affect your sell really from a.

[00:36:09] Speaker B: Day to day perspective? It hasn't affected us at all, which is good know we would consider ourselves and Naveen clearly agreed when they agreed to buy us a very high quality manager. So we're clearly doing something right and we shouldn't be changing what we're doing. And Naveen takes the same view. And on our day to day operations it really hasn't changed all that much. So we still originate amongst the partner team in Europe. We still have the same investment committee discussions that we had previously, we still deal with portfolio management and workout situations the same way we did before. But now we have this partner in our journey, in Naveen which has incredible resources and along with our sister firm Churchill, which is the US private credit arm that sits underneath Naveen, there are a number of strategies which are really interesting to look at, either from Churchill in the US. And bringing those strategies into Europe or even just being able to club up on deals, which, as we mentioned, are becoming increasingly large, more cross border, as we kind of look into the more liquid, market substitutional, larger deals. And so having that additional firepower from Churchill, having the ability to more easily work around US borrowers and US dollar financings which are oftentimes key components of global businesses, which are the larger businesses that we're now looking at, that is very advantageous.

So that's why we're really excited about the partnership with Naveen. At the same time, I know I'm personally very happy that we haven't had drastic changes in the way we operate because that can always lead to the situation I mentioned earlier, which we had at American capital, European capital, where decision making was taken out of our hands in a way and sent to the US. Which never leads to an optimal outcome. You always want to have decision making on a local level.

[00:38:23] Speaker A: Yeah, I'm sorry, I want to jump back, I'm going a little bit back and forth, but things keep popping into my head. So I understand the benefits of private credit as you've explained them, but we're not necessarily dealing with a static market. Presumably the investment banks are going to look at the sponsor deal flow that they always had, realize it's being taken from them and adapt accordingly.

[00:38:49] Speaker B: They've tried, but their systems and their structures are fundamentally just set up differently.

And we saw that with the market in Germany. Again, I go back to the market in Germany because it's the one I know you know, banks were not happy to lose share to private debt funds and their initial reaction was extremely adversarial. But the reality was frankly, they were unable to provide underwriting for some of the structures that we were able to provide. Be that because the leverage was higher, be that because we were looking at an instrument which maybe they couldn't provide. So they will tend to not hold subordinated debt. The capital requirements on their end are far too intense for that. So they've had to deal with adverse regulation on their end, which has made it much more difficult for them to underwrite deals. And at the same time they lacked the flexibility that we have in terms of structures and they're slower and that's just purely down to their internal decision making processes.

-- do. It's a fundamentally fairly unattractive piece of paper for us because it's primarily undrawn and it can be drawn and repaid continuously. So there's a lot of operational heavy lifting that comes along with that piece. And what the banks tried to do is they tried to say, well, if you don't take term loan financing from us, we're not going to provide the RCF.

That did not go over well with their primary clients, which of course is the financial sponsor community.

That did not work. And ultimately there were various different constructs that were then developed either trying to give the banks part of the term loan in exchange for providing the RCF, sometimes on a super senior basis. So this is the sort of first out, second out structure you may have heard of, but ultimately it has ended in a market where I think fundamentally the solutions are very different and bank solutions are still relevant, particularly in Germany where the banks are still very much open to underwrites as well as in the Nordics. And that is one type of deal. And then there is a private credit deal which will be attractive for other reasons and people will just have to decide what makes sense to them. And if a sponsor is looking for a very responsive, fast moving party, a financial counterparty which has access to significant follow on financing capability, which a bank will not have because they will tap out at a certain hold. And if you then want to raise more capital, you have to bring additional banks into the syndicate, which means more work, more credit committee decisions, et cetera, et cetera, then really if you have any of those two parameters then private credit is a more attractive solution and you're willing to pay marginally more for that.

[00:42:11] Speaker A: Well, let's conclude with this. You've been in the market a long time and it's grown a lot in the last few recent years. Where's it headed? Is there much more growth left in it?

[00:42:21] Speaker B: I think there is, and.

[00:42:24] Speaker A: I think.

[00:42:25] Speaker B: The exciting part of where that growth is, is in new opportunities that previously were not necessarily accessible to us. And the liquid market substitution part of the market is something I never really thought would be relevant to us and it was created by volatility in the market and combined with, I think the flexibility of people like us to adapt very quickly and provide solutions for a problem like that. So there will be other issues that crop up in the future which will provide opportunities for us. And again, I think the beauty of private credit is flexibility. So if you have the flexibility, you will be able to take advantage of those opportunities. And frankly, in Europe the penetration of private debt is still much lower than it is in the US. So purely even in our core markets, I think there continues to be growth. But on top of that, I think there are always these interesting events that come along which create additional opportunities for those people who are creative, fast and flexible and that ultimately is the advantage of private credit.

[00:43:30] Speaker A: What about kind of fund sizes? Is your expectation that the market will grow because more funds will come along or is there room for kind of large and mega private credit funds in Europe?

[00:43:42] Speaker B: So the market is already extremely bifurcated and so what we've seen is you have a very large number of smaller funds and you have a small number of large funds.

We count among the larger funds and we're in a very small handful of funds. And I think the dynamic which has developed over the last twelve months, given the volatility in the markets, is that those large players are becoming bigger and those smaller players are struggling. And I think it's my opinion that that will be a trend that will continue over the next few years. I think it will benefit those large players. I think there will be consolidation in that space because fundamentally the model works best when you're big, when you have a big team and a lot of actual financial firepower, and that benefits you at origination, that benefits you at deployment

-- the market's at. It'd be great to have an absolutely, I'd love to come by. Thanks very much. Marcus thank you. You've been listening to the Fun Shack podcast and I've got a special offer for all of our listeners. If you go onto your podcast platform of choice and leave a review including your name. And if you like your firm, I will make sure I mention you at the end of the next episode. Thanks for listening. --