EXPERT Q&A

There will be increased demand for opportunistic credit as M&A markets remain depressed, says Matt Teichner, managing director and head of credit opportunities at Golub Capital



Opportunistic credit's flexibility premium

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Q Opportunistic credit seems to mean different things to different people. What is your definition of the strategy?

When people hear the term opportunistic credit, many immediately think of distressed or stressed situations, but that is a narrow definition. We take a different approach: we built our credit opportunities strategy around the entire Golub Capital ecosystem to leverage our collective expertise and strengths. We have built our opportunistic strategy around our high-quality borrower relationships and a credit-first approach, investing across different parts of the capital structure or in market conditions that allow us the potential to generate a higher return.

There are four distinct sub-strategies within our opportunistic credit business. There is direct lending opportunistic credit, which is focused on corporate lending; there is what we call dislocations, which primarily involves buying liquid loans in the syndicated market; then there is collateralised loan obligation (CLO) liabilities, which is focused on acquiring double-B junior CLO debt tranches from third parties; and finally, there is our capital solutions vertical, which involves synthetic risk transfers and credit secondaries.

With the exception of CLO liabilities, where spreads are tight right now, the overall lack of liquidity in the credit ecosystem is resulting in a compelling set of opportunities in each of these sub-strategies.

Q Which market dynamics are creating the most compelling opportunities for opportunistic credit investors today?

There are two main factors driving opportunities today: lower M&A

"There are two main factors driving opportunities today: lower M&A volume and credit market dislocation"



Q How should LPs and investors think about opportunistic credit fitting into their overall allocation going forward?

A lot of allocation models have broken down over the past few years as investors have ended up with far more private markets exposure than they planned for, owing to a lack of distributions, particularly on the private equity side. However, investors are now hearing about all the positive tailwinds behind opportunistic credit and therefore feel the timing is right for the strategy.

We are currently finishing the deployment of the sixth vintage of our credit opportunities fund while actively fundraising for the seventh. The story of how we approach opportunistic credit is really resonating with the LP community, which I believe is a testament to the strength of the advantages we bring to market: deep sponsor relationships, strong underwriting capabilities and better access to information.

volume and credit market dislocation. We are now in year three or four of a prolonged M&A drought which has severely limited private equity distributions. That is creating a lot of corporate credit opportunities. Structured equity, junior capital or minority recapitalisations can make perfect sense for strong businesses that would otherwise have been sold to another sponsor, a strategic buyer or else gone public.

Sponsors are finding themselves owning portfolio companies for much longer than they originally anticipated, increasing the need for capital in order to provide distributions to shareholders. We see this as being a significant driver behind direct lending opportunistic dealflow.

Meanwhile, despite the noisy headlines about the private credit industry, we haven't yet seen many opportunities for our dislocation strategy where we look to buy good loans at attractive prices. It is important to remember that dislocation, for us, doesn't mean distress. Rather, it means buying an asset or loan at a price that is lower than its intrinsic value. That could be due to ratings concerns or market volatility, for example.

We are now starting to see this opportunity set pick up, however. We have probably seen more opportunities in dislocation over the past three months than we did in the prior six, so I do think the market is starting to open a little bit there.

As I mentioned, the CLO liabilities market has been relatively tight, so we have not done much in this space so far this year. Back in 2023 and 2024, however, that was our most active area. Finally, in capital solutions, we are seeing a lot of credit secondaries flow, while synthetic risk transfer activity remains consistent. Banks continue to look to reduce risk in order to meet capital adequacy requirements, so we are seeing strong deployment opportunities there, too.

Q How are sponsors responding to the depressed M&A environment, and what role can opportunistic credit play in addressing the challenges they are facing?

There are four routes that a private equity firm can take when trying to sell a business. The first route involves selling to another private equity firm, a strategic buyer or the public markets,

"I think opportunistic credit is going to play an important role in providing flexible capital solutions for many private equity firms and their portfolio companies [over the next 12 to 36 months]"

and there is very little of that happening today. The second option is for them to put the asset into a continuation vehicle (CV), which is proving increasingly popular. Their third option is just to do nothing, and that's what we are seeing the most of right now. But it is the fourth option that we are most excited about, which is to put in place some kind of structured capital solution.

When a private equity firm ends up owning a business for significantly longer than they expected, they will inevitably have unanticipated needs. We look to partner with those private equity firms by taking a junior capital position that is equity-like in nature, but that is debt-like in terms of the drivers of our return. These are win-win deals where, through a bespoke structure, the sponsor and the company get the liquidity they need and we gain access to what we view as an attractive investment opportunity.

Two or three years ago, there was still a fair bit of resistance to these structured solutions in the sponsor community. The feeling was that the M&A market would improve sooner rather than later. However, we are now seeing far greater appetite for this kind of flexible capital as the M&A slowdown continues.

For example, we just made a sizeable investment in a structured solution involving a franchise restaurant business in which Golub Capital had previously invested. The company outperformed for us and we were no longer active investors, but we remained close to the sponsor and management team. When that sponsor decided to place the asset in a CV, they called us to see if we wanted to be equity investors in it. However, after three weeks or so of negotiations, the opportunity pivoted into the creation of an opportunistic credit structure.

This involved creating a debt-like structured equity deal whereby we put cash on the balance sheet, allowing for substantial store growth, as well as a small distribution to some older shareholders who wanted liquidity. We now own a minority stake in this strongly performing business through a conversion feature.

This is exactly the kind of situation we look for – the opportunity to partner with sponsors and companies that we already know well, drawing on our expertise across the entire Golub Capital platform to take advantage of attractive opportunities that don't fit neatly within our core investment strategies.

Q How important is it for an opportunistic credit business to sit within a broader platform?

It is critical. Our opportunistic strategy focuses exclusively on areas where we already have expertise. Whether we are doing direct lending opportunistic credit or junior capital, dislocations, CLOs, secondaries or synthetic risk transfers, our team is fully connected with other parts of Golub Capital.

When we do a CLO, for example, we not only analyse the structure, but we will also have data on the underlying company via our direct lending business. If we are investing in a dislocation opportunity, we will often have been a lender to that borrower in a prior life. Everything that we do as opportunistic credit players is fully integrated into the broader platform.

Q Where do you believe the most attractive opportunistic credit opportunities are going to come from over the next few years?

I think opportunistic credit is going to play an important role in providing flexible capital solutions for many private equity firms and their portfolio companies. I don't anticipate any significant recovery in the M&A environment any time soon, so the need for flexible capital is going to increase over the next 12 to 36 months.

I also think that the dislocation opportunity is set to grow. Fundamentally good companies are currently facing complex market dynamics, which will result in dislocation and the chance to buy good businesses at below-market rates.

Meanwhile, the CLO opportunity may also make a comeback, and credit secondaries are still in the early innings, so there is a lot more growth to come there.

Overall, I would say that it feels as though the last six to nine months have been a prelude of what is to come over the next two to three years. We are therefore really excited about what lies ahead in each of the four strategies that make up our opportunistic credit business. ■