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January 10, 2022

PREMIUM

FINANCE

Golub Capital's president on why banks should be afraid of direct lenders, which 'proved in 2021 that they can provide multi-billion dollar solutions.'

Aaron Weinman

- **Direct lender Golub Capital nearly tripled its lending last year to more than \$36 billion.**
- **Private equity firms are increasingly turning to direct lenders for loans once handled by banks.**
- **David Golub sees business continuing to boom in 2022, even if rates tick higher.**

Direct lender Golub Capital just capped off a record year fueled by the private-equity industry's growing appetite for loans, and its president sees the frenzy continuing this year — even if interest rates tick slightly higher.

Golub Capital nearly tripled its loan business last year, closing more than \$36 billion of deals in 2021 from approximately \$13 billion in loans in 2020, giving the lender its “best year ever,” President David Golub told Insider.

The firm also notched up a record fourth quarter, closing more than \$15 billion in loans, up from roughly \$7 billion for the same quarter in 2020. Golub's record year was spread across 371 deals in 2021, and Golub's president expects a similarly busy 2022 as private equity increasingly turns to alternative lenders for help with acquisitions.

“Deal activity will likely remain high in 2022, but it will be hard to reach the levels seen last year, which was a blockbuster year for private-equity M&A,” Golub, the brother of the firm's founder and CEO Lawrence, told Insider. “But, private equity will likely double in size over the next four years.”

Golub operates in the so-called private-credit market, a pocket of banking that provides direct loans to private-equity firms, which use that financing to support their acquisitions. The asset class, also known as direct lending, has grown to more than \$1 trillion in size from roughly \$400 billion 10 years ago, according to Private Debt Investor. This could swell to roughly \$1.5 trillion in the next five years, according to Moody's, as investors allocate more cash to alternative investments like



GOLUB CAPITAL

David Golub, President of direct lender Golub Capital.

private credit, which promise greater returns in today's low interest-rate environment than traditional fixed income.

The specter of rising interest rates, meanwhile, are likely to impact fixed-income bonds more than the loans that Golub and its competitors make because they're structured to float alongside interest rates. Floating-rate loans don't decline in value as rates go up, Golub said.

The risk, however, is if the Federal Reserve raises rates too quickly

that it causes an economic slowdown, which could also slow down dealmaking.

“The Fed has got to thread a needle. Raise rates fast enough to contain inflationary expectations, and slow enough not to cause an economic slowdown. The risk is that they overshoot and we have a slowdown,” Golub said.

Private-equity firms amassed more than \$2 trillion in unused capital as of the end of last year, according to Preqin data. It’s a trend that will benefit direct lenders, Golub said, as buyout shops borrow money to support their investments. Private-equity shops usually raise a portion of debt from lenders, alongside their own capital, to purchase a portfolio company.

Typically, investment banks will raise billion-dollar financings for buyout firms by selling the debt to several investors through the bond or loan markets. The growth of private credit, however, has enabled borrowers to seek jumbo financing from just one, or a handful, of lenders.

Golub, for example, has lent over \$2 billion to Insightsoftware over the last three years, a portfolio company of TA Associates and Genstar, to support its acquisitions. In new business, Berkshire Partners-owned equipment manufacturer Parts Town received a \$1.5 billion loan from Golub that supported an equity investment into the company from Leonard Green Partners last November.

It’s not just Golub that’s benefiting. Fellow direct lender Owl Rock provided \$2.3 billion to Thoma Bravo for its purchase of fintech Calypso

Technology, Insider reported last April. And investment manager Ares led a \$2.6 billion loan to support Thoma Bravo’s \$6.6 billion acquisition of Stamps.com in July.

Supporters of the direct-lending market tout the speed of private credit as these deals are often negotiated quickly with fewer lenders, while an investment bank can sometimes take weeks to sell a loan or bond into the institutional investor market. In exchange, direct lenders usually charge a higher interest rate than Wall Street banks due to the deeper pools of capital the latter have available to them in the bond and institutional loan markets.

With the growth of private credit, direct lenders are increasingly capable of arranging bigger loans that in the past were exclusively handled by investment banks.

Golub said just after the financial crisis of 2008, a big loan from a direct lender would be around \$80 million, but today, direct lenders regularly provide loans in excess of \$500 million, deals that Golub calls “mega one-stop” transactions. In fact, Golub arranged 38 so-called mega one-stop deals in 2021, a record for the firm, and more than half of the direct-lending market’s loans in excess of \$500 million last year, the firm said.

“The syndicated market is going to continue to lose share to direct lenders,” Golub said. The syndicated market is where investment banks sell loans they’ve underwritten to institutional investors. “Direct lenders proved in 2021 that they can provide multi-billion dollar solutions.”