

Golub Capital – The gold standard, 30 years in the making

DAVID GOLUB, PRESIDENT OF GOLUB CAPITAL, INTERVIEWED BY ALEXANDER RAYDEN, SENIOR MANAGING DIRECTOR AT EVERCORE

Alexander Rayden: Congratulations - you are approaching the 30th anniversary of Golub Capital. What do you think have been the key elements that have contributed to Golub Capital standing the test of time and market cycles?

David Golub: There are two principles that have really guided us and underlie what we have chosen to focus on as a firm. The first of those principles, which may sound obvious, is that investing is hard. Sure, there are a few geniuses out there, like Warren Buffet. But ultimately, investing is just like any other business. In order to consistently produce premium returns over time, you need a set of competitive advantages, you need to have an edge. This has driven us to specialise and focus on one market where we can build and nurture a set of competitive advantages over time. In a world of multi-strategy alternative asset managers, we are specialists. We focus on the business of sponsor finance, providing loans to companies that are controlled by private equity firms. And, we strive to be best at it.

The second principle is that relationships matter. Maybe we are just old-fashioned, but we don't believe in this concept of counterparties that is so prevalent on Wall Street these days. We think good businesses work with the same parties over and over again, so there is a level of trust that is built. There is a level of inter-dependence; we are looking out for each other and working in the context of a win-win partnership.

We work with the same parties time and time again. We've got about 200 private equity firms that we've done multiple deals with. If you look at our origination over the last decade, 80-90% of our business comes from the same group of client partners each year. If you look at our investors, they're overwhelmingly folks who've been with us for a very long time. It's very unusual for an investor to end their relationship with us. It's much more common for them to invest in a second or third fund or invest additional capital.

These two principles, as simple as they are, explain a lot about how our business has developed, why we have made the choices that we have made and why I think we've been successful.

ARay: As you look back over the years, what aspect of Golub Capital are you most proud of?

DG: It's very consistent with the principles we just discussed. A long time ago, we set out to define our culture around a phrase that we commonly use, which is "gold standard". Gold standard means a lot of things. Primarily, it means being the best at something, being looked up to. So, we are proud that we are often referred to in private credit circles as being the gold standard firm. In June 2023, we were awarded Lender and Senior Lender of the Decade, Americas by Private Debt Investor, which I think is a reflection of Golub Capital living up to this gold standard.

Gold standard also means something else internally: treating our partners the way we would want to be treated if we were on the other side of the table. I think this cultural value has led to the development of an extraordinary team at Golub Capital. We've got great talent, and people stay. They are long-tenured. We've got an enormous number of individuals who have grown up at the firm, from relatively junior positions to the leaders of today.

We currently have over 850 people at the firm. We are acutely aware that every talented person has choices about where they want to work, so we don't take anything for granted. We understand that we need to present a compelling value proposition to our team, and we assess how good a job we are doing in a number of ways, including an annual employee engagement survey. We are proud to be in a position where our engagement survey shows an unusually high level of employee engagement and enablement.

ARay: You have also been very successful at fostering home-grown talent who have gone on to take senior positions within the firm. How have you gone about doing that?

DG: You're 100% right. If you look at why people stay at organisations, the most influential factor is whether they feel that their career aspirations are being heard and they are supported in developing the skills needed to achieve their goals. We are very intentionally dedicated to doing both of those things. We listen to our people when they tell us about what they want to be doing, and we put in place training and development programmes to help them develop the skills they need to be successful in the next role.

And look, it's challenging to manage growth. If you don't focus on training and development, you are going to have a problem because the managerial job of running a 400-person firm is very different to that of running an 800-person firm.

So, this focus on training and development has not only enabled us to offer career growth opportunities to our people, but, to your point, Alex, it's enabled us to not have to rely on a lot of external hires. Now, of course, an external hire can be very good to some degree. You can bring in fresh blood and some new ideas. But, it can also be very challenging, because it's hard to consistently bring in new senior people who are a cultural fit.

ARay: What has been the biggest challenge that you have faced in the last 30 years?

DG: It is very clear to me that the biggest challenge, and probably the most important period to our success, were one and the same. That was the Global Financial Crisis in 2008. Over the past 30 years, that was by far the period of most financial stress.

We're credit folks; we worry about everything, right? But, we are particularly worried about the ability of our borrowers to pay us interest and principal when it is due. So, significant economic downturns represent the periods when we are most tested. In our business, we don't get paid a lot more if our companies grow slightly faster. The way we differentiate our returns is by having lower losses, and having lower losses is tested during periods of economic stress.

So, that was a challenging period. In the aftermath of the failures of Bear Sterns and Lehman Brothers, there was an enormous amount of uncertainty about the financial conditions we'd all be facing.

Having said that, this was also, in my judgement, the most important period for us in a positive way. We didn't expect this. We didn't predict the financial crisis. We didn't see the subprime mortgage crisis coming. However, we were very prudent in the period prior to the financial crisis. We curated our loan portfolio so that we were invested in resilient businesses, and we curated the right-hand side of our funds' balance sheet. We were very careful about the kinds of leverage that we used. We were not mismatched in having leverage that was shorter than the duration of the loans that we made.

What happened during the financial crisis was that a very large proportion of our competition developed issues. Sometimes it was credit issues because of the portfolios they had put together. Sometimes it was financing issues because they were overly reliant on short-term sources of credit. So, in the aftermath of the financial crisis, we found ourselves amongst a very small number of firms in our industry to come through the other side. We came through it well too, with very few losses and capacity to grow during the period thereafter when lending activity was very attractive. So, the period around the financial crisis was the most important in establishing the Golub Capital brand.

ARay: What do you think have been the key milestones in the private credit asset class?

DG: One key milestone preceded the financial crisis and I would describe it as our "Clayton Christensen moment". For those unfamiliar, Clayton Christensen was a long-standing professor at Harvard Business School, and he talked about innovations that cause inflection points. If we go back to the early 2000s, a typical private equity firm would finance a deal by going to a bank to get a senior debt loan. The bank would be restricted by a variety of different regulatory and internal bureaucracy issues. The loan would therefore need to be crafted very carefully with a certain amortisation rate, limitations on leverage and particular documentation terms in order to fit within the square peg of what the bank was permitted to do. The private equity firm typically also would need to borrow from a second source, a junior debt provider, usually an insurance company or a mezzanine fund. The insurance company or the mezzanine fund had their own particular needs and concerns. So, by the time you were done, you've had a very awkward set of discussions with each of the two lenders, because they were asking for things that didn't make a lot of sense, and in

turn, they've had a very awkward discussion amongst themselves in negotiating an inter-creditor agreement because they both look at the world very differently.

And, then you close the transaction. The next day, you wake up as the private equity sponsor and realise that you have two lenders with violently different interests and incentives. You just want to grow the company and increase its value over time, but your mezzanine investor really wants to get paid back and keep their warrants. Meanwhile, your senior lender does not want to have to go back to their investment committee. Thus, growing your company is going to be really hard because every time you need new capital, you have to navigate this very complicated labyrinth at two different sets of organisations.

So, what did Golub Capital do? We came in with our Clayton Christensen alternative in the form of the one-stop loan. We provided a single-lender solution that blended the characteristics of the senior and junior loans and allowed the private equity firm to avoid this very complicated, multi-layered capital structure. This also pivoted the tenor of the relationship to a long-term partnership in which we will be incentivised after the transaction to lend more money. We want this relationship to be a long-term, win-win partnership. At first, sponsors were a little sceptical, perhaps even a little nervous at the thought of putting their fate in the hands of a single party. But more and more sponsors tried this new structure, liked it, and came back to us, wanting to do further financings. As we grew, we were able to offer larger solutions.

Often in the investing business, if you give a manager more money, their risk/reward degrades. Our business improved as we got more capital. We were able to be more important and strategically relevant to our private equity sponsor clients, and as a result, we were able to get more high-quality business. So, our Clayton Christensen inflection point came in the early 2000s when we developed this one-stop product. And, if you look at the market today, post-financial crisis, the biggest boom area in private credit has been from folks copying our one-stop product.

ARay: It seems everyone is saying we are in a "golden age" of private credit investing. Is this the best market you have seen?

DG: I'm going to sound like a credit guy... but the short answer is no. I think people who talk about a golden age are best characterised as salespeople. There are both pros and cons about the environment that we are in today. Amongst the pros, the higher base rates have been good for us. We get paid in terms of a floating rate benchmark called SOFR, which

has gone from approximately 1% to over 5%.¹ This means what we are earning has gone up, which is great. Next, you have the continued retreat of banks and the broadly syndicated market in the last year and a half. If you look at the market with a longer-term lens, the growth of the private equity ecosystem has also been a tailwind. You know, 30 years ago there were ten big private equity firms. Today, there are thousands. It is a trillion-plus market which is still growing.

That said, we also need to be honest with our investors about the headwinds. Higher interest rates mean that interest expense has gone up for borrowers and their margin for error is narrower. The amount of free cash flow that is left has gone down and that in turn means we are very likely going to see increased levels of credit issues. Many companies will be fine; companies that are growing will be able to raise their margin for error in the best way, by increasing EBITDA.

Inevitably, there is going to be some dispersion, and some companies will struggle. So no, I do not think this is the golden age. I think it is the age in which the ability to pick companies that are truly resilient will become the differentiator between successful and unsuccessful firms.

ARay: What are you doing at Golub Capital today to prepare you for tomorrow's market?

DG: Let me tell you a story before I answer your question. As part of our internal training and development programme, we bring in external speakers, experts in a variety of fields, to talk to the group about what the keys to success are. Recently, we had Peyton Manning come in. And the takeaway from his session was "prepare like Peyton". Good leaders, and good organisations, do the work to be better prepared than their competitors. Now, we've done this for a long time at Golub Capital. I am not suggesting that this is a new insight from Peyton Manning, but it was great to hear him talk about it in a football context, because it reinforced some of the cultural aspects we have been talking about for decades.

So, how do you prepare like Peyton for an environment where you anticipate that credit stress is going to worsen? Well, as soon as you start thinking about it in that way, the answer is obvious. You redirect resources to an internal project to reassess how your borrowers are doing and try to identify which are the most vulnerable. That's what we have done. Starting in Q2 2022, we launched an internal project – we call it the resiliency project – given that interest rates and the expectations about a potential recession had changed meaningfully. Through this process, we assessed which of our borrowers needed more of our attention, so that we could then talk to their management teams and their

sponsors about ways in which they could bolster their defences before a problem arises. In essence, we wanted to help them to prepare like Peyton. We have been renewing the analysis every quarter since. Where we identified some vulnerability, which is a small subset of the portfolio, we have been working hard with those companies. The goal of this exercise is to avoid problems early and increase margin for error.

ARay: We've talked about the beginning of the private credit asset class 30 years ago. We've talked about what you are doing today to prepare for tomorrow. Where do you see Golub ten years from now?

DG: Ten years is a long time. If you had asked me that question in 2013, I would have given you a very different answer about where we would be as a firm today. To echo Yogi Berra: it's tough to make predictions, especially about the future. What I can tell you very clearly is what we are not going to do. We are not going to change our stripes. We are not going to move away from the core principles that I talked about at the start of our discussion. We are going to continue to stick to areas where we think we have strong competitive advantages – where we have an edge – and are enabled to achieve consistent premium returns. We are going to keep being a great partner to all the key stakeholders we work with.

ARay: It is probably every parent's dream (certainly my mother's!) to have their sons grow up together and then build a widely successful business together. How do you go about doing that, and can you really separate work when you're around the family dinner table?

DG: The great thing about working with my brother, and it may be a little different to what you are expecting, has been the freedom to have passionate disagreements and know that, no matter what, we are still going to be brothers and best friends. That freedom has been one of our keys to success. We are very different, and we come to decisions from different perspectives. One of our strengths is our ability to use these differences to get to good answers. We almost always get to the same answer – but we get there a different way.

ARay: If you could go back in time, what advice would you give to your younger self with the privilege of retrospect?

DG: I've got too many different answers to choose from. If forced to choose, my advice would be work hard to make sure you are surrounded by people you really enjoy spending time with. With a group of like-minded people who get along well, it is

amazing what you can accomplish.

ARay: Last question, I promise. Who is or has been your role model?

DG: In my office, I have quotes on my walls from different key mentors and thinkers. All day I stare at Andy Grove's "Success breeds complacency. Complacency breeds failure. Only the paranoid survive." Andy and I worked closely together later in his life on the Michael J. Fox Foundation Board, after he developed Parkinson's. I use one of his books in a leadership training course that I teach at the firm. He has been an enormous influence on me around the importance and value of process.

The second quote accompanies a picture of Muhammad Ali boxing with Michael J. Fox. It's Muhammad Ali's comment about the word impossible: "Impossible is just a big word thrown around by small people who want to pretend that they can't change their worlds." That quote is reflective of the advice I would give to my younger self. What I interpret that to mean is don't be fooled by small thinking – it is remarkable what you can accomplish. But, you must have a great team around you to make it happen.

ARay: I am a big Muhammad Ali fan. That is a phenomenal note to leave us on, David. Thank you.

1. The Secured Overnight Financing Rate is a benchmark interest rate for dollar-denominated derivatives and loans that replaced the London Interbank Offered Rate (LIBOR). According to data from Refinitiv, between June 2022 and October 2023, the SOFR increased from 0.7% to 5.3%



David Golub is President of Golub Capital, a market-leading, award-winning direct lender and experienced credit asset manager. As of 1 October 2023, Golub Capital had over \$60 billion of capital under management, a gross measure of invested capital including leverage. Golub Capital partners with institutional investors and family offices offering tailored solutions for investors' credit asset strategies.

Prior to joining Golub Capital in 2003, David was a Managing Director of Centre Partners, a leading middle market private equity firm, and of Corporate Partners, a Lazard-sponsored \$1.5 billion private equity fund formed to acquire significant minority stakes in established companies.

David is a member of the Founder's Council of the Michael J. Fox Foundation for Parkinson's Research, where he was the first board Chairman and a long-time Director. He is a member of the Stanford Graduate School of Business Advisory Council. He is also a member of the Director's Circle of the Association of Marshall Scholars. He previously served on the boards of the Loan Syndications and Trading Association, Hudson Guild and the World Policy Institute. David is on the board of directors of Burton Snowboards and has served on the boards of numerous public and private companies.

David earned his A.B. degree magna cum laude in Government from Harvard College. He received an M.Phil. in International Relations from Oxford University, where he was a Marshall Scholar, and an M.B.A. from Stanford Graduate School of Business, where he was named an Arjay Miller Scholar.



Alexander Rayden is a Senior Managing Director of Evercore and a founding member of its Private Funds Group ("PFG"). Alex leads the PFG team coverage of institutional investors across Europe and the Middle East as well as being involved in all aspects of originating, developing and managing capital raising mandates for financial sponsors.