Lead Left Interview – Lawrence E. Golub (Part 2)

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This week we continue our conversation with Lawrence E. Golub, CEO of Golub Capital. Golub is a nationally recognized credit asset manager with over $10 billion of capital under management and four complementary business lines: Middle Market Lending, Late Stage Lending, Broadly Syndicated Loans and Opportunistic Credit.

Second of two parts – ***View part one***

The Lead Left*: Lawrence, talk about your "cargo pants" strategy. That's what I call managers enhancing lending capacity by adding multiple side-pockets of capital from outside investors.*

Lawrence Golub: Cargo pants – I like that! We have three strategic imperatives. First, be utterly reliable lenders to sponsors. Second, deliver good returns for investors. And finally, be a satisfying and lucrative place for deal professionals to work. You can't do just one! We started doing all three at once.

TLL*: Tough in such a cyclical business.*

LG: You can't be at the mercy of investors' changing attitudes regarding the attractiveness of the asset class. You can't be dependent on insurance company or bank regulations changing. It's all about being diversified in your sources of capital. But it's hard to achieve scale with multiple sources of capital.

TLL: *That's an excellent point. You build up horizontal, but not vertical, capacity. But you act as a direct lender as well as an asset manager.*

LG: When we say "Yes", we'll be there. But we don't say Yes to every deal. At the large end of the middle market – firms like Credit Suisse and Jefferies – the question they ask themselves is, "Can we sell the paper?" Instead, we worry about what we're doing with the sponsor.

TLL: *Are we back to 2007's market conditions?*

LG: We were heading in that direction before the correction in mid-October. But the core health of the economy is pretty good, relative to 2007. Nobody knows what the impact of qualitative easing will ultimately be. It's all conjecture. There are potential bubbles, certainly. Credit risk, other than real estate, is different. No question 4x leverage is better than 5x. We're big fans of our GOLD (Golub One-Loan Debt) loans, for that reason. But our borrowers are strong, profitable businesses with real enterprise value that should hold up even when the next recession comes.

TLL: *That's your middle market direct lending funds, correct?*

LG: Yes. Of course, it's a trade-off with those loans. For the one stops, the market gets thin in terms of the number of participants.

TLL: *Will the big guys continue to come down market? Can we finally say the middle market is a mature market?*

LG: Flows of funds are cyclical. You go from so much smart money chasing deals, to not-so-smart managers. There will certainly be tears at the next downturn. There will be some good periods, and some dumb periods – like the first half of 2007. By the way, you should look at the latest report Stifel Nicolaus published. It's fascinating!

TLL: *Yes, will have to re-read that one.*

LG: People can do stupid things before the safety belts get attached. Einstein said that only two things are infinite: the universe and human stupidity, and he said he was not so sure about the universe. Some BDC's are not creating value for their shareholders. One has to wonder about taking two-and-twenty dollars and putting the money into CLO equity that pays its own level of fees.

TLL: *That's a two percent management fee on assets managed and 20% incentive to the manager over a specific hurdle rate.*

LG: It's a double fee structure, with the underlying assets being BSL loans. Leveraging those up as a way to try to deliver yield to shareholders. So you're getting the same assets as are in prime rate funds but at a multiple of their fees. We have less interest in taking this money. We really are concerned about broadly syndicated loan spreads hurting BDCs.

TLL: *Lawrence, any final thoughts?*

LG: The middle market is cyclical. Which is why it's all about smart managers getting outstanding returns in good markets and okay returns in bad markets. And versus getting blown up in bad markets. It's all about natural selection – survival of the fittest managers.

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