Opportunistic Credit & Distressed Debt

EXPERT Q&A

Opportunistic credit involves bespoke financing across a broad set of market environments, says Bryan High, head of global private finance and capital solutions at Barings

An all-weather approach to opportunistic credit

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Q What is a capital solutions strategy? How does it differ from traditional direct lending?

At Barings, we think of capital solutions as an opportunistic, all-weather strategy that aims to deliver attractive risk-adjusted returns across various market environments. These strategies typically target a premium over traditional direct lending by sourcing and structuring bespoke financing opportunities. We typically focus on situations beyond the remit of a traditional direct lender. Often, these are less trafficked deals in which the supply and demand of capital tends to be more favourable, positioning us to potentially achieve an enhanced return.

One key differentiator of this strategy is that the capital is flexible and thus able to migrate with the different phases of the market cycle, aiming to uncover the most attractive opportunities at any given time. There is a common misconception that capital solutions centres on stressed or distressed opportunities that are more episodic, or tied to particular parts of the cycle. And while those opportunities certainly exist, other opportunities within the strategy are appropriate through the entire business cycle and tend to be more idiosyncratic.

When it comes to navigating the investment landscape, a manager's origination capabilities and expertise are paramount – not only to capitalising on market dislocation, but also to investing in the broader, through-the-cycle opportunity set, which can include areas such as aviation finance, litigation finance and healthcare royalties.

Opportunistic lending is at the core of our portfolio. We look for credit opportunities where companies are either facing some level of stress, or looking to grow but not yet ready for traditional capital markets. This approach requires a thoughtful process to structure the financing – every single one of our assets has nuances, so there is no cookie-cutter approach.

The other key element of the portfolio is structured asset finance. This consists of non-corporate investments that might be in pools of loans or assets we can securitise. It can also include areas like aviation finance and healthcare royalties that I mentioned earlier.

Q What are the benefits of flexible capital?

When it comes to bespoke transactions, where your aim is to create a capital solution for a particular opportunity, it's important to be able to offer something as customised to a borrower's needs as possible. That means providing capital in different forms, whether debt, preferred equity or some sort of structured transaction with a pool of assets financed more efficiently.

Our ability to move up and down the capital structure allows us to provide more customised solutions for those capital needs and to offer creativity from a structuring perspective to ensure we can partner with the borrower to deliver something that works for both of us. There is usually complexity to the transaction that we need to take into account, solving a problem for the counterparty.

Q What's your approach to this type of portfolio?

From a portfolio perspective, capital solutions tends to be more concentrated than the average direct lending portfolio, with a smaller number of high-conviction deals. At Barings, our approach is to anchor the portfolio in senior debt that spans a highly diversified mix of industries. In addition to helping protect us from a downside scenario, this allows us to take advantage of our skills and expertise from a restructuring standpoint, if that becomes necessary. We also aim to build portfolios with a contractual return that yields slightly higher than a traditional direct lending portfolio while providing upside potential through warrants or PIK enhancements, for example.

In many ways, a capital solutions portfolio looks and feels like a private credit portfolio, but it may be more appropriately considered an extension or enhanced variation of traditional private credit. We tend to focus more on the mid-market. Origination in this segment tends to be a little more proprietary, given that many of the large players in this space focus primarily on the larger end of the market.

From an LP perspective, if you think about traditional special situations vehicles, there is a lot of overlap in the underlying issuers in those vehicles. In capital solutions, particularly in the mid-market, our portfolio should look very different from an LP's other managers in the space – in that sense, we are also offering diversification. We view ourselves as complementary to some of the larger managers but also complementary to a core-satellite strategy in a private credit portfolio, diversifying the exposure and enhancing the overall yield of a broader allocation to private credit.

Q How do you view the market opportunity today, specifically in public versus private credit?

From our perspective, the opportunistic lending part of the pipeline is relatively robust right now and looks fairly attractive. We have seen more traditional lenders, such as banks and the broader public markets, retreating in the face of market volatility over the past year or two. Some borrowers in the market are facing issues around increased leverage, higher interest costs and looming maturities. The cost of capital has doubled over the last few years and that is putting a squeeze on cashflows, allowing investors such as Barings to come in and provide solutions up and down the capital structure.

The supply-demand imbalance we are seeing in the market is creating a more lender-friendly environment. We have the ability to generate attractive risk-adjusted returns by tailoring financing solutions to meet the bespoke needs of borrowers that have unique issues or idiosyncratic drivers that bring them to a pool of capital like ours.

As far as the distinction between public and private is concerned, we have our ear to the ground on the public side but for now we are more focused on the private markets, based on relative value. The risks associated with public markets – like liability management transactions getting done, the loose documentation that allows for lender-on-lender violence, and the sheer cost of going through restructuring processes in the broadly syndicated loan market – have created a cap on the upside in our view. We do not see that risk being fully priced in the marketplace.

We would much rather create a more customised solution on the private side that allows us to control our own destiny, and we see the potential for better risk-adjusted returns if we stick to the top of the capital structure and avoid becoming active participants in complicated turnaround situations. We certainly like to take advantage of the public markets when there is true dislocation, but we don't currently see that playing out.

Q How do your capital solutions operations benefit from the broader Barings investment platform?

We are a cross-platform investment team at the intersection of public and private markets, positioned to leverage the firm's resources – whether that is industry analysts, sector expertise or relationships on the private side from an origination perspective.

Our capital solutions platform can create a very large funnel and be a home for deals that don't fit into a box but present attractive risk-adjusted returns for those willing to create more bespoke financing solutions. We are using that wide remit to capitalise on opportunities with diverse drivers that leverage the expertise of our entire bench of investment professionals. ■