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Opportunity in distress

There's nothing new under the sun of lending and borrowing, Daniel Zwirn, CEO and CIO of Arena Investors, LP, reminded the *Grant's* audience. What's unprecedented, he contended, is the size of the post-2010 asset bubble. The serial implosions of successive inflated asset classes—private credit included—will fill the pockets of value-seeking opportunists for years to come.

Investors, even the professional ones, seek comfort in volatility-masking, Zwirn went on. They are likewise willing parties to leverage-masking and nomenclatural obscurity. "In the real estate business, you can have a 'core asset' in a multifamily apartment building," our speaker said. "It makes you feel good because it's core and it's stable and it's calm, except that you're in deeply levered equity at a 5% cap [rate], and at an 8% cap you have a zero, right? And in a couple of years, you're going to find that out."

Speculative-grade private credit, Zwirn went on, couldn't exist without three allied lines of business: collateralized loan obligations, middle-market private equity and leveraged finance more broadly defined (including junk bonds and syndicated bank debt). "Without one of them," he said, "you can't have all of them." They are, in effect, "just one business."

It was the growth in, and refinement of, the techniques of leveraged finance—collateralized loan obligations were a prime example—that egged on the private equity promoters, said Zwirn. It "created an incredible desire by private equity firms to pay ever greater prices, right? And so, seven- or eight-times businesses [i.e., enterprise value to Ebitda] became 11-times businesses, and they were financed, instead of at four times [debt to Ebitda], at six or seven times. And at the extremes of what are intrinsically wonderful businesses (like recurring revenue software), you saw 20-plus-times multiples of purchase with 12-plus-times multiples of leverage. And so, ironically, some of the best businesses got some of the worst capital structures."

There were the most corporate bankruptcies in 2023 since 2010, the first full year after the global financial crisis, Zwirn proceeded, but we nowadays call those embarrassments "liability management exercises." It "sounds a lot better," he said. "Cleaner, 'nothing to see here,' no problems, right? But the reality is, we overbought, we overlent, we have a big bowl of spaghetti here that needs to get unmucked."

"I can assure you," Zwirn wound up, "that there is a tsunami of terrible, terrible businesses and assets that need to be rationalized.…And the total addressable market, if you think of it this way, is bigger than it's ever been— and growing."

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