FUNDfire

TCW Builds Out Private Credit Biz

The manager, best known as a bond shop, has added asset-backed finance and a "rescue" strategy to its menu and has partnered with PNC to further expand its reach in middle market direct-lending.

By Bridget Hickey | September 19, 2024

TCW may have a bearish stance on the U.S. economy – its leadership has been public about their recession predictions – but the manager is betting on private credit by expanding its team and partnering with a bank to develop strategies.

The Los Angeles-based manager, best known as a bond shop, is building out its asset-backed finance business, which launched earlier this year under the leadership of Dylan Ross. The former Brigade Capital Management executive will be joined by a "five to six" person team, said the firm's global head of distribution, Jennifer Grancio. She declined to share a timeline but said the new recruits would be in place by the end of the year.

TCW has also expanded its roughly $8 billion private credit arm over the last four years to include a "rescue" financing strategy. A partnership with PNC to lend to middle market companies is expected to further scale up the platform.

"Private credit is going to continue to expand its reach in the debt side of the market footprint," said Richard Miller, the firm's group managing director and chief investment officer for the asset class.

TCW's bet on private credit comes at a time when traditional managers are grappling with the long-term sustainability of their product mixes, amid fee pressure and a shift toward private markets. The $197 billion manager oversees about $174 billion in fixed income and $15 billion in public equities. Its firmwide assets have slipped from a high of roughly $266 billion in 2021, a firm spokesperson confirmed. They declined to share a breakdown of assets by client type.

Miller joined TCW in 2013 with the acquisition of Regiment Capital Advisors' special situations funds group, which became TCW's flagship direct-lending strategy. He has led the strategy since its inception in 2001.

The rescue financing platform was formed in 2020 to provide fresh capital to stressed middle-market borrowers. The timing, said Miller, couldn't have been better. "Our initial thesis didn't include higher rates or even a recession or fears of a recession."

Today's market environment has created opportunities for managers that can provide liquidity and take advantage of excess risk-taking, he said, as low interest rates over the past decade-plus led some lenders to develop a "myopic focus on deploying capital" and to disregard "a lot of historical risk metrics in lending."

These firms created "capital structures that assumed rates would stay low forever," Miller said. "[N]ow you have, in many cases, untenable capital structures simply because rates went up."

TCW's rescue strategy – which Miller said has a return profile in the high teens and low 20s – replaces existing senior secured lenders with the aim of providing liquidity and more time to borrowers so they can get "back on track."

"If the company is successful, they'll be able to refinance or sell the business – get rid of us as a lender, our expensive capital, within a two- or three-year period," Miller said. If not, TCW is prepared to own and operate the business, he added.

TCW's deal with PNC, announced in May, is focused on directly originated, senior secured cash-flow and asset-based loans to both sponsored and non-sponsored middle market companies.

The platform is targeting $2.5 billion in investor equity capital in its first year, supported by anchor investments from PNC and Nippon Life, a TCW shareholder. Investments are scheduled to begin this fall. The deal will "really help us scale the private credit business quite dramatically," the firm spokesperson said.

Earlier this year, TCW hired a new head of institutional sales and distribution, Jeff Alt. Alt was head of yield strategy sales at Apollo earlier in his career, and most recently led the U.S. institutional sales team at Brandywine Global. TCW is also adding "a handful" of additional people to its distribution team, Grancio said, but declined to share details.

Traditional managers are bullish about adding private credit to their lineups, often through acquisition. Janus Henderson struck a deal last month to acquire a $6 billion asset-backed lending firm. Fixed income giant PGIM – which manages about $100 billion in private credit assets – is also interested in buying asset-backed finance capabilities.

Private credit is a "natural expansion" for fixed income managers because "a higher-return private credit offering fits well into their existing range of capabilities," said Myles Manning, a senior consultant at strategy advisor Indefi, in an email. "In some ways, it is a necessary complement to expand the credit investment universe for clients."

Asset-backed finance is "probably the most attractive capability on demand today," he added. "The core rationale is due to the strategy's beneficial regulatory treatment for insurers. Asset-backed lending offers perhaps the most efficient return to required capital ratio of any private asset strategy."

Asset owners are turning to new strategies within private credit as their direct-lending allocations have matured and their exposure to corporate credit risk has grown, said Chris Shelby, a managing director for private markets investment consultant Verus.

"You may have allocations of private credit of 10% or more in an institutional portfolio – you wouldn't put that just in bank loans, generally speaking, and you wouldn't want to put it in just corporate private credit or direct funding, either," he said.

However, as the appeal of the asset class broadens, managers can still face an "education gap" when it comes to selling these strategies to investors, he said. "There are many strategies that may focus on extremely nuanced or niche parts of the private credit markets."

Manager selection can also pose a challenge, he added, as many private credit teams are new to larger asset manager platforms. "They may not have a fund investment track record, or their track record may be from a bank's balance sheet or another proprietary source of capital."

Some industry observers, such as UBS Chairman Colm Kelleher, in comments made late last year, have warned that a bubble could be forming in private credit.

TCW's Miller is a firm believer in the longevity of the asset class. "It's not new, it's not a fad. It's not going away," he said. What is different, he suggested, is the impact of the market environment on the asset class's explosive growth.

Private credit is "at a point in its maturity or evolution where manager selection is going to really matter and discipline around lending is going to matter," he said. "You're going to see a differentiation amongst managers that you really haven't seen in prior years."