THE LEAD
https://theleadpc.com/private-credit-better-than-ever-fourth-of-a-series/

Private Credit – Better than Ever (Fourth of a Series)

THE LEAD | September 23, 2020

We mentioned last week our turn at the SuperReturn North America Virtual conference. There we heard participants weigh in on various aspects of the pandemic on private credit, including impact on terms, structures and portfolio performance.

But what about new business? A lot depends on managers' strategies. Over the past five years, institutional investors have expected a downturn. They pointed to various signs, including overleveraged borrowers and weakened covenants, suggesting excess in the loan market.

As time passed, significant capital was raised to take advantage of fall-out from a recession when it came. Whatever the trigger, market observers predicted a decline in valuations and issuer operating performance on par with the Great Recession. When mainline lenders retreated from financings, opportunistic funds would step in.

Today the distressed, ding-and-dent debt crowd is hopeful, but wary. Would the worst economic decline in a decade produce credit assets with double-digit yield potential? Or, like Lucy snatching the football away from Charlie Brown, will current holders of those deals somehow find a way kick the ball down the road to easier refinancings.

As our *Chart of the Week* highlights, fundraising for middle market assets continued zestfully during the year, despite virus headwinds. Most of these dollars are dedicated to opportunistic strategies. Despite this plentiful dry powder, there is evidence that pickings will be slimmer than expected. For one thing, there are more direct lenders in the market than a decade ago. Also, those providers are better capitalized, with more diverse financing sources.

What will happen when special sits doesn't materialize in the volumes hoped-for?

Despite early fears, portfolio problems are unfolding slowly enough for managers to raise rescue capital or restructure troubled borrowers. Managers on successive SuperReturns panels explained how flexibility on covenants and payment terms was keeping hope alive for cash-constrained borrowers.

For better performing businesses, the challenge is a bit different. Can lenders pretend the current crisis is happening to someone else, and party like it's 2019? Pricing and terms emerging from the latest buyouts suggest as long as counter-COVID performance lasts, lenders will be willing to lean in.

The pandemic path will determine both the levels and quality of future deal activity. It's likely new business will center around tech, B2B, software, select healthcare, and other defensive sectors. And with leverage multiples down from 2019, banks could be more competitive relative to direct lenders than they've been in a long time.

? Next week: Will the worst fears of private credit investors come true in this recession?