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Business of Private Credit: Claude Says

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Q: "Hey Claude – will AI put my middle market borrower out of business?"

A: "It depends. What does it do?"

Even chatbots know AI won't have a one-size-fits-all impact on the middle market. Yet for the last year or so, the market has treated AI disruption as a storm cloud hanging over every private credit portfolio.

As we've discussed in this series, the core middle market has weathered plenty of cycles. AI is simply the newest test, but it feels of a different kind. Prior cycles tested balance sheets and demand. Now AI may test the business models themselves.

The industry has been quick to respond. Disciplined managers are busy rolling out scorecards quantifying AI exposure across their books. But that's only half the story. The real shift is happening within the credit teams. Every deal memo and IC conversation now includes the AI question(s). "*Can this disrupt the business?*" And "*Where could AI help the business?*"

Managers are drawing the distinction between what is indispensable and what is not. Mission-critical software is embedded in workflows and regulated processes. Changing them out could be prohibitively expensive and take years. The risk lies with seat-based and discretionary software where AI can replicate their core functions at a fraction of the price.

But owners and management teams are also exploring where AI can drive revenues and profitability for portfolio companies. A recent survey suggested 65% of AI initiatives have exceed their original business case (see our *Chart of the Week*). Companies are leaning into AI while also pressure-testing their assumptions. As one lender put it, "Don't buy into the hysteria, but don't put your head in the sand."

Part of that pragmatism is recognizing the AI bill is coming due. After two years of "AI will solve everything," the actual cost is steeper than forecast. When AI is expensive and the ROI unclear, the threat is less. AI may become less like a business-model wrecking ball and more a supplement to operations – boosting margins and reshaping workflows but not erasing corporate value propositions.

Which brings us to the low-risk businesses core MM managers gravitate toward. Ground-level industries such as pest control or security systems are less likely to have business plans rewritten by a large language model. But experienced sponsors and lenders aren't taking anything for granted. They're re-evaluating the process, sharpening the questions in IC, and taking hard looks at the sectors and companies they're underwriting in this new AI reality.

Which gets us back to our friend Claude. We are finding that the best managers are already writing prompts to find where AI creates value. Claude agrees.