ALTERNATIVES | OUTLOOK

2024: Private Credit Outlook

By: David Miller | December 21, 2023

KEY POINTS
1. Within Direct Lending, we focus on lending to sponsors in non-cyclical industries such as software, insurance, and residential services, which can typically maintain cash flow levels through market cycles.
2. Companies are increasingly seeking junior capital solutions to manage interest expenses and boost cash flow.
3. We anticipate ongoing support for private credit through increased private equity activity.

What We Are Seeing

Private credit in 2023 was a goldilocks period for investors, thanks to senior loans with attractive floating-rate asset yields of 11%-12%, deal structures with large equity contributions, high quality businesses seeking credit, and low default rates. Borrowers continue to value the speed, certainty, and flexibility of private credit solutions. Increasing financing costs put pressure on some borrowers in older deals, but so far there have been few defaults and orderly bilateral discussions between lenders and sponsors.

We are also seeing an increase in demand from companies looking for junior capital solutions to manage interest expenses and bolster cash flow. We expect this trend to continue as companies look to refinance.

What We Are Doing

As always, we focus on maintaining a portfolio that is diversified across sectors and we avoid deeply cyclical capital-intensive businesses. Instead, we lend to sponsors in non-cyclical industries such as software, insurance, and residential services, because they can typically maintain cash flow levels through market cycles. Higher interest rates have put pressure on certain borrowers, especially for deals from older vintages.

This spike is creating increased demand for capital solutions which can help to strengthen balance sheets. We continue to monitor the market for the opportunities where capital can provide this solution at an attractive rate.

What We Are Watching

We are also watching default rates and workouts, but we don't believe there is a bubble for the asset class. Rising rates have increased some companies' debt servicing as much as 50%, but there have been relatively low default rates so far. As rates stabilize and begin to come down, earlier vintages will feel less pressure. We believe the health of the overall economy is more meaningful to stability of cash flow generation and margins.

Private credit activity during the Covid-19 pandemic was robust. Compared to those prior years, 2023 was normalized and the asset class continues to grow. We believe the market environment in 2024 will continue to support private credit, through increased private equity activity, decreasing interest rates and capital structure optimization.

David Miller
Head of Global Private
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