Antares Capital

Five *in* Five

In a recent roundtable held with members of the media, Antares Chief Executive Officer Timothy Lyne, Antares Capital Advisers President Vivek Mathew and CPP Investments Managing Director of Capital Solutions David Colla touched on a range of topics from the state of the private credit asset class to whether they believe the Fed can achieve a soft landing. Here are some excerpts.

1 Are we still in a golden age for private credit?

Timothy Lyne: While I understand the reference, I'm not a real fan of the term "golden age" being used to describe the current period for private credit. We've been in the market for 28 years and view private credit as an "all weather" asset class that should be a permanent floating rate portfolio allocation – not a tactical allocation based on speculation over the interest rate cycle or vintage timing. Yes, yields will likely fall from double digits given recent spread compression and forthcoming Fed interest rate cuts. However, if private credit as an asset class has the potential to generate 8-9% unlevered, and near 12% levered returns in the years ahead as the SOFR base rate curve suggests, that's an attractive risk adjusted return proposition for most investors.

2 Is there too much money chasing too few deals? How has the resurgence of the syndicated market impacted private credit?

Timothy Lyne: Direct markets have certainly been very competitive of late given lackluster M&A activity. That said, the middle market direct lending yield premium over broadly syndicated yields has held up very well and loan-to-value ratios remain historically low. There certainly are still attractive opportunities to selectively deploy capital in the current market environment.

As far as the resurgence of the syndicated market, we actually view it as a sign of health for the economy and a favorable omen for a pickup in M&A. Banks have been eager to win back share via syndicated issuance as spreads have compressed in the face of surging CLO loan appetite. But this cyclical tug of war between private credit and syndicated markets is really nothing new. We have been competing with the banks for decades and have always believed it is important for a best-in-class lender to offer best-in-class execution, be it unitranche, club or syndicated execution. We are seeing more sponsors ask us for both a syndicated and direct option to choose from given current market conditions. The direct lending value proposition remains very much alive and well. There are still examples of syndicated deals going to direct, so it's not all one way, even as spreads have compressed. Most of the surge in syndicated activity has been related to refinancing activity. "New money," including M&A only accounts for 13% of syndicated institutional loan issuance in 1H24 (*Source: LSEG LPC*).

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> *Chief Executive Officer, Antares Capital*

3 How is the relationship between banks and non-bank lenders evolving?

Timothy Lyne: Banks are competitors, but they also play a symbiotic role with non-bank lenders. Banks compete via their underwrite-to-distribute model in the syndicated markets, but they also provide leverage lines to private credit funds – which has been an important source of growth for banks. More recently, banks have been increasingly partnering directly with private credit funds on the commercial side in order to maintain their customer relationships and to be able to offer their customers and prospects a private credit solution. These partnerships hold appeal to the non-bank lenders because they can benefit from leveraging the banks' front end to boost origination opportunities. These partnerships can span a broad range of models ranging from a simple referral model to a full-blown joint venture partnership with equal financial and credit decisioning ownership. We expect mixed success for these partnerships given challenges around credit decisioning speed and potential for partnership friction over risk assessment/appetite, culture, branding and relationship management (who owns the customer).

4 Can the Fed achieve a soft landing, or is a recession inevitable? What are the implications for private credit performance?

Vivek Mathew: The history of monetary tightening related downcycles suggests that engineering a soft landing is challenging, but we believe a soft landing remains the most likely scenario. Feedback in our June 2024 Credit Market Outlook survey from borrowers across a broad spectrum of industries shows the majority (78%) expect slower growth over the next 12 months, but only 10% expect recession, with 12% expecting growth to accelerate.

Still, even if a recession is avoided, slower growth and a "higher-for-longer" rate environment could prove challenging to some credits struggling with low interest and fixed charge coverage ratios. So we think you will likely see dispersion in GP performance widen among lenders. In fact, there is some evidence of this in BDC non-accruals. We believe that alignment with investor interest (i.e. having a shared principal risk mindset and not aggressively gathering assets to generate fees), solid underwriting/selectivity and dedicated workout capabilities will prove to be key factors in driving favorable outcomes/ avoiding losses.

David Colla: I would agree, I think the Fed can achieve a soft landing but we are likely to see a lot of dispersion and not just among GPs, but also amongst industries and consumers. I think that's part of the challenge the world economy faces today and a lot of that comes from technology. We're going through a huge technological evolution with winners and losers. So we may have a soft landing, but navigating it well as a creditor over the next few years could still prove challenging.

5 When will M&A activity rebound? Are any industries looking particularly attractive?

Timothy Lyne: Sponsors have been delaying exiting their investments in hopes that more favorable conditions will arise, but the pressure to return capital to their LPs continues to build. Our Antares June 2024 Credit Market Outlook survey suggests M&A activity could pick up in H2 2024, with most PE sponsor respondents having strong conviction they will buy a business in 2H 2024 (e.g. almost 80% noting a 50%+ likelihood of buying a business in 2H24 with ~50% projecting greater than 75% odds.)

As far as industries, interestingly, we have been seeing a pickup in M&A activity across industrials segments in 1H24. This may reflect the attraction of typically lower purchase price multiples among industrials businesses, but it may also reflect tailwinds from infrastructure spending and perhaps rising confidence in the staying power of the economy.

Vivek Mathew: I would add that sponsors are very savvy and once M&A starts to pick up, things could start to snowball. For example, I doubt that private equity executives want to be the 27th sponsor coming to market to sell a similar business. Looking forward, we believe spreads will stabilize and could actually start to widen if base rates decline and M&A starts to accelerate.

ABOUT *Antares Capital*

Founded in 1996, Antares is an experienced and cycle-tested alternative asset manager and a leading provider of financing for private equity-backed borrowers. With one of the most seasoned teams in the industry, Antares is focused on delivering attractive risk-adjusted returns for investors and creating long-term value for stakeholders. The firm manages $71B of capital under management and administration as of June 30, 2024, and maintains offices in Atlanta, Chicago, Los Angeles, New York, Toronto and London. Visit Antares at www.antares.com or follow the company on LinkedIn at http://www.linkedin.com/company/antares-capital-lp. Antares Capital is a subsidiary of Antares Holdings LP, (collectively, "Antares"). Antares Capital London Limited is an appointed representative of Langham Hall Fund Management LLP, an entity which is authorized and regulated by the Financial Conduct Authority of the UK.

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