



The New Credit Landscape: Private Credit, Asset-Based Finance, and the Refinancing Cycle

Sharon Chen 00:08

Hi, good morning, everyone, and welcome to our panel discussion on “The New Credit Landscape: Private Credit, Asset-Based Finance, and the Refinancing Cycle.” I’m delighted to share the stage with Steve Kuppenheimer, partner and head of private investments at Lord Abbett, Brigitte Posch, partner and co-head of APAC Credit and hybrid at Apollo, and Andrew Konopelski, managing partner credit at Bridgepoint. Credit markets are at an interesting crossroads. The US 10-year Treasury yield is above 5 percent as the market heads into a refinancing cycle, while private credit continues to expand beyond traditional direct lending. Borrowers are seeking more flexible sources of capital against a backdrop of higher borrowing costs, persistent inflation risk, and a multi-trillion-dollar AI investment cycle. Now, with that backdrop, let’s turn to our panel of experts to discuss the outlook for the global credit market and the biggest opportunities and risks that they’re seeing. So, I wanted to kick off the discussion by looking at how private credit is evolving across regions. Given that this is the Asia Summit, Brigitte, let’s start with you. Asia is a very diverse landscape. How are you seeing the market evolving here?

Brigitte Posch 01:25

Thank you. So, I think let’s first understand what we mean with private credit. I think most of us think about private credit as more of a direct lending, \$2 trillion. From our perspective, we see the landscape much bigger. So, we see private credit really kind of migrating not only from direct lending, but all the way to the IG front. So, we’re looking at a market that is \$40 trillion. And going to your point, what does that mean for us? That when we look at the demand, the scale of the demand, the size of the CapEx going forward between AI, digital transformation, defense, renewables, powers, we’re talking about trillions of dollars that need to be financed. And it has been financed through the traditional market, like capital markets, through the bank market. But going forward, more and more companies are looking for tailored solutions. And more and more companies want to make sure that we understand what their business strategy is and how our capital can actually be used the best way to really sponsor that business objective of those companies. So, when we look at opportunities, we are seeing opportunities, as I mentioned, on the AI digital transformation side, in which we have billions of dollars of investments over the next few years, predominantly in countries such as Japan, Korea, Australia, and to a certain extent, some countries in the Southeast Asia part. With that, we’re going to see power and energy part of that growth as well. In that, we’re talking about trillions of dollars that need to be financed over the next 10 years. When we think about what we have done over the last 12 months, we have funded around opportunities around \$8 billion, and that’s kind of 10 times bigger than the last few years in APAC. Predominantly focused, again, in Australia, Japan, Korea, and certain countries in Southeast Asia.

Sharon Chen 03:34

Okay. Thank you. So clearly, very diverse opportunity set, I think, across the different countries. Now, if we pivot over to, I guess, the opposite end of the spectrum. Steve, I think you focus mainly on the US—

Steve Kuppenheimer 03:47

Yep

Sharon Chen 03:47

—which is obviously the most developed market. Do you think the growth rate that we've seen in recent years can be sustained, and what's driving this?

Steve Kuppenheimer 03:56

I do think it can be sustained, and I think there's a couple things driving it. First, as Brigitte mentioned, which I agree with, what private credit is, what we mean by it, is that is evolving. So, if five or six years ago it meant generally sub-investment-grade corporate lending, direct lending, and that's a \$2 trillion concept. Now it's being applied in the investment-grade markets, which I think of where a lot of AIDC focus is, and that's many times larger. And it's also now applied to parts of asset-backed financing as well. All this adds to the AUM, but that's more of a definitional reference. I think that if we look at why borrowers are attracted to private credit, and some more organic growth outside of just the definition of it, I think that all of those drivers are alive and well. And what you see is the ability for customized solutions, can be confidential solutions, if it's like a take-private transaction, and there's always a higher degree of certainty. So, if you're looking to issue even a \$400 million loan or maybe it's a large AIDC transaction that is over \$10 billion, if you're just going to do that in the liquid markets, it's not going to be firmly underwritten. You're not exactly sure what that process is going to look like or for how long. And if you can arrange a small group of private lenders to speak for it, terms are negotiated, and you take that certainty out of the equation, that's going to remain attractive. And that's on trend for not just lending markets. You see it in the equity markets. You see in all capital markets, there's a trend towards more private exposure for all, and for similar reasons. And so, I think, as the markets grow, the amount of capital going into some of the frontier strategies like AI and DC, I think private credit will continue to be a large player there. And there's continued tailwinds for growth.

Sharon Chen 05:52

So, in the past few years, we've heard a lot about bank disintermediation in the US. Is that still a trend that you're seeing?

Steve Kuppenheimer 05:59

I think that concept still exists, but I don't know that it's a growing concept. I think that it's a mature concept, but you haven't seen the banks come back in really to compete. And this is a very good regional question, Sharon, because I think it's different by region. In the US, before the GFC, the banks were the primary provider of private lending, and they would provide stretch capital, not just kind of true first lien. Since the GFC, even though it's evolved some, largely the banks have remained mostly risk off in terms of how we look at it. So, banks would still do corporate lending, but they're generally doing de-levered, multiple covenants, amortization-type loans that are priced very differently, but are also kind of one-size-fits-all and not as responsive to borrowers' needs. And I think that the private alternative lending market in the US has really stepped in, and I see that as a more stable concept. I think, and I'm sure Andrew will comment on this, but I think in Europe, I don't know that the banks have left nearly as much. I think the banks have always kind of been in the market still, and that brings its own unique dynamic there. And in Asia, I think it's just a very developing concept. I think there's a lot to evolve in Asia.

Brigitte Posch 07:21

Yeah. Perhaps I can add on to—

Sharon Chen 07:23

Sure

Brigitte Posch 07:23

—APAC, and you're completely right. I think when we think about APAC, still 80 percent is being funded by banks.

Steve Kuppenheimer 07:30

Yeah.

Brigitte Posch 07:31

So, there's still more kind of evolving that we will see in this region. But some of the points you mentioned earlier about the US, I think we'll start seeing here with the RWA, with capital constraints, more focus on the ROE.

Steve Kuppenheimer 07:47

Yeah.

Brigitte Posch 07:47

So, we are actually seeing more co-lending, more SRTs, more forward flow transactions for loan trades coming from banks.

Steve Kuppenheimer 08:00

Yeah.

Brigitte Posch 08:00

So, I think this will be the normal evolution of the market.

Steve Kuppenheimer 08:05

Yeah.

Sharon Chen 08:06

Andrew, what's going on in Europe?

Andrew Konopelski 08:08

Well, I think Steve said it right. I mean, Europe has traditionally been a bank-led market. We are in a stage of evolution that probably sits somewhere between the US and Asia. But I guess what's facing Europe right now is we have some pretty significant capital needs, not just in infrastructure, digital and physical, but also in defense, energy transition. So, when you look at where some of that bank capital is going, it is leaving, I think, quite a large playing field for private credit. And we started with the traditional private equity mid-sized to large-cap buyout, but the breadth has started to increase into non-sponsored transactions. The sizes started to increase. So, as the market has matured, we see larger transactions being affected in the private credit market. And then on top of that, you

actually have, it's not quite definitional, but we start to see more private credit in infrastructure, asset-backed, but places where bank capital really isn't as prevalent now, partly because the regulators have made it their business to make it very difficult for some of those banks to get that capital to work. And it's just opening up some very interesting pockets of risk reward for, I think, for everybody.

Sharon Chen 09:23

Okay. So, one common theme, I think, across all regions is that borrowers are seeking more creative financing solutions, right? But if you look across all these opportunities, where do you find the best risk-adjusted returns? Steve, maybe we can start with you.

Steve Kuppenheimer 09:40

For us, I'd say it's the original concept of private credit, meaning middle market lending. So, originally, maybe five or six years ago, pre-COVID, when you said private credit, that's really what you were talking about is middle market corporate lending. And people always ask, "What is middle market?" And you can get numbers like it's sub-\$100 million of EBITDA, but it's more of a practical concept from my point of view, which is, are you competing with the liquid markets to provide that capital? And if you are competing, so if an issuer is big enough to access those liquid markets, it's a different game. Doesn't mean it's a bad game, but the dynamics are different. So now, your private loans are always going to be more expensive because the cost of capital is more, the expected returns are higher. You're giving up liquidity. If you're the borrower, why would you issue the more expensive loan? So, staying away from that pressure, where we see some of the largest pools of capital growing and needing to be in the larger market. If you can focus on middle market lending and avoid competing with the liquid capital markets, we do see a lot of value there. We think that you're seeing more covenants, better credit performance, generally modestly higher spread. I don't see a lot of higher spread, but the defense I think is better. But it's worth elaborating a bit because that's really the traditional concept of direct lending. And again, where Brigitte started us, which was the right place, which is now private credit, is a much bigger concept. So, if we look at other parts of it, like the investment-grade market, that's going to be a large market transaction. That's not really a middle market concept. And there, it's really about scale, capital solutions, creativity, and you can get, for what it is, you can maybe get 100 extra basis points on an investment-grade issuance that otherwise would price in the 100-spread range. So, the relative risk return is quite attractive, and that's a large market. And then in the ABS or ABF side, I think that's a very interesting space. Brigitte mentioned SRTs, which I think are synthetic risk transfer transactions. These are basically hedging banks' balance sheets, and they can deliver quite attractive first-loss-like returns, and continue to see a lot of tailwinds behind those. As you have some bank regulation coming online this January, I think that's going to put more pressure or continued momentum behind SRT transactions. So, it's not an easy answer because what private credit is, is a broad concept now. But if I break it up into those points, that's generally what I'd say.

Sharon Chen 12:23

Okay.

Steve Kuppenheimer 12:24

Yeah.

Sharon Chen 12:24

Andrew, do you want to go next?

Andrew Konopelski 12:26

Well, I'll jump on the middle market bandwagon. Europe is a middle market—

Steve Kuppenheimer 12:31

Yeah

Andrew Konopelski 12:32

—it's a middle market geography, so that's primarily where our focus has been. If I think about them, there are probably three trends, and they all coalesce around one thing, which is you can get paid for solving somebody else's problem. So, the three key trends that we see is private equity right now needs more capital. We need capital for growth. These are businesses being held longer. So how do you grow those businesses into something the multiples pay for them? We're also seeing a bit of maturity pressure. I'd never call it a wall, but some maturity pressure. How do you resolve some of those businesses that were bought in a zero-interest rate environment that are now kind of coming up to their maturities? So, PE needs more capital. Non-PE, I mean, 70 percent of European mid-market businesses are still owned by entrepreneurs or the founders of the businesses. They are a grossly underbanked and underappreciated part of the ecosystem. And as we start thinking about generational change, the growth of those businesses, we're finding a really interesting place where you can make an excess spread for very similar risk. And then the third is really where banks are leaving some of the real economy, which is some of the specialty finance areas, where it's really attractive. I'm thinking a bit more asset-backed type, cash-yielding, highly diversified portfolios, liquidating-type loans, where there's just not as much bank capital going in, and you can get paid very handsomely if you can structure those types of transactions and get access to the end market. So, there's still quite a lot to do. But again, if you can solve people's problems, you can get paid very handsomely for the risk that you're taking because you effectively split the return with them.

Sharon Chen 14:14

Okay. Brigitte.

Brigitte Posch 14:16

I can take. I think from our side, when we think about what are the opportunities, I think first we need to understand what are the pools of capital behind, right? Because different pools of capital will have different type of opportunities, different type of threshold returns and risks that they can take. So, when we think on our side, a big part of our pool of capital comes, we can consider as permanent capital, but it's coming from the insurance. So going to your point, on the private IG side, the opportunities are exactly thinking about tailored solutions. How can we help companies with this huge CapEx going forward, or even optimizing their balance sheet in a way that we can use our pools of capital the best way that can provide for us the best risk-adjusted return. But also provide the flexibility needed or a different tool to help those companies to find that business objective, which the traditional market cannot do. And I think that's important because the traditional market will take, either being the capital markets or the bank market, will take structures that perhaps fit within the box because they need to be syndicated, and they need to be done in a way that will actually hopefully reach to several different type of investors that can take a very similar structure. While to your point, and you made that point, with a solution that is more tailor-made, we can underwrite the full transaction. We can give certainty, speed of execution, and the flexibility needed for those companies. And for that, one is getting paid more, anywhere between 100 to 200 basis points, but also getting a better collateral package behind than a pure senior unsecured transaction in the capital market. So, for that, yes, there might be less liquidity. That's something I'm sure we're going to be speaking more about going forward as well. But for other pools of capital, similar to the points you made in terms of direct lending, the middle market, I think we want to make sure that also from a private lens perspective, we're getting the right protections in place and providing solutions.

Sharon Chen 16:36

So, let's put some numbers behind it. I think there was mention about 100 to 200 basis points pick up. I presume, to the liquid market. We have rates rising, or at least higher for longer rates in quite a few markets. In terms of US corporate spreads, we've seen it rising, widening this year, but it's still below long-run averages. So, Brigitte, how are you thinking about the outlook for returns?

Brigitte Posch 17:04

Yeah. It's very interesting. I mean, overall yields continue, of course, they're interesting. That's predominantly driven by rates. To your point, spreads continue to be tight. The index on the IG side is trading around 120 basis points. We have seen in some sectors, in the tech sector, predominantly some spread widening. We have seen just September, we had \$200 billion of new issuance, and some of those transactions came and they're low to mid-200s. So, there has been some widening. But in very specific areas, we haven't seen really repricing. So, what does that mean for return? I think one can say from a spread compression, where we are today will be hard to see more coming in, and that basically means it's a carry trade. But a carry trade in which a component of your yield, it's very little on spread. So, any volatility you see going forward in rates or spread, there's not much buffer to really to absorb that volatility.

Sharon Chen 18:10

Steve, Andrew?

Steve Kuppenheimer 18:11

Yeah, I definitely would like to add. I think a lot of what Brigitte discussed, which I agree with, is focus on investment grade. One perspective I'd give there, it is a newer concept, so I think as deals keep coming, are you going to continue to get almost double the spread for similar risk? Maybe, maybe not. I could argue both ways. I'd just say for me, I'm uncertain for that particular product. In the more traditional markets, the premium you're getting over the liquid markets is consistent with where it's been. And there's also a technical that you've seen over long periods of time that's not that scientific, but you still see it from a practical standpoint, and that is a decent amount of capital in the space is looking for a specific return number. They don't think about it as floating rate. So, they're looking to get nine or ten or something like that. And if base rates are doing more of the work and it's in a competitive environment, then there'll be some downward pressure on spread just because of the competitive nature of the market. Likewise, as rates get cut, there's kind of a natural gravity around spreads to stay higher because people are thinking about it in terms of a total return concept. And you've seen that play out over a longer time. There's usually a lag of one- or two-quarter lag between that dynamic, and it never fully makes up for what's happening with base rates, but it's kind of a partial offset. So, if we look at the strategy today, let's say we're looking now at direct lending. For most of our careers, we're probably used to generating a seven to eight percent return on that strategy. And now today, where it is all in, you're low double digits. And when you consider you're senior in the capital structure, it's current pay, there's not a J-curve, then you think about how that compares to other financial instruments, maybe the historic return on the stock market is 10 percent for first loss of risk and a lot of volatility. So, I still think it's a very attractive. In my mind, it's actually a very good era for the product because you have rates have gone up towards the end of '23, they went up quite a bit, about 400 or 500 basis points, and now there's more concern in the market, so you're generating a higher yield, and it's a more defensive stance. So, you're seeing more discipline around covenants, documents in general. And so, I think overall, the total return is attractive, and the defense is actually better than it's been in a few years.

Sharon Chen 20:50

Sure. Andrew, so I wanted to bring in the risk aspect because, as in the credit market, we're always looking at what is the downside risk, right? So, it's great that rates are high, yields are high in terms of a returns perspective, but for the borrowers, what they're facing is essentially higher borrowing costs. So, are you concerned at all? Have you seen any signs that borrowers might be facing more stress? How are they coping with this?

Andrew Konopelski 21:18

I'm a credit guy, so I'm always concerned. We don't get paid for the upside; we only get chastised for the downside. So, it is nice to bank the extra base rate, of course. Returns are higher, but that does come with an element of additional corporate stress. It's less cash flow that is coming in now. It's all a little bit relative. When we see a

quarter-point hike in Europe, when you're putting that on top of what's already a 700 to 750 basis-point payment, it's only incremental. So, if we take it from where we were four years ago with zero base rates or even negative in Europe. So, we keep a close eye on risk. I guess there are probably three elements to it. One is, how are the companies themselves actually performing? We have a few metrics we look at. 80 percent of our companies have shown revenue growth over the last 12 months. Now, that doesn't mean a portion of them are not showing revenue growth or are largely flat. That's pretty consistent for our portfolios over the years. You've probably seen a little bit more bifurcation. Good companies tend to get better, and tough ones tend to get a little bit worse. Now, anchor that a little bit around what Steve was saying. We're pretty deep into the capital structure here. You tend to lend at about 35 percent loan-to-value, so an awfully lot has to go wrong on the top line. We also look, people talk about bad PIK, as a good metric is to look at what percentage are using an elective PIK toggle to reduce the burden on their cash-pay interest. That's about 4 percent of our portfolio. So that is roughly, it's probably down 1 percent over where it was 12 months ago, so it's fairly flat overall, which I think is a positive sign. And the last is we look at our watchlist assets. What do we have in a higher-risk bucket? Which tends to run 8 percent to 12 percent of our portfolio over time, over 70 to 80 assets. It's been pretty consistent over the past decade. We're still at about 10 percent. So, I think we're watching all the various indicators because we get one of the benefits of private credit, at least in Europe, you get monthly results. So, you're quite close to your businesses. You have direct access to your CEOs and CFOs, so you can keep track of what's going on in the company quite closely. We don't see a massive deterioration. That doesn't mean we're not concerned. We are, and have been for years, focused very much on investing in our portfolio management teams because, look, it's very easy to put money out. It's not always easy to get it back.

Sharon Chen 23:56

Mm.

Andrew Konopelski 23:56

So, you have to be able to play defense as well. So, I think you have to be able to invest in those teams to make sure that you have the skill set that you can deal with underperforming borrowers, because it will happen in a portfolio of 70 names. You will have a few. But hopefully, you're being compensated with it by higher base rates. So, it kind of comes out in the wash.

Steve Kuppenheimer 24:15

And would you, I don't know if Andrew or Brigitte, you guys would agree that I think we're entering a period of much more differentiation and dispersion.

Sharon Chen 24:22

Yeah.

Brigitte Posch 24:23

Yeah.

Steve Kuppenheimer 24:23

So, coming off of maybe a decade of limited dispersion, not like true credit cycle type risk. COVID was a kind of a liquidity and volatility challenge, but now I think different sectors are feeling stress much differently than others. Different portfolios are performing very differently than others, and I think it's healthy for the market overall. You don't want to have—if you have no differentiation or dispersion, then I think that can lead to less discipline, because people start to think that it's not really a risky asset class. But right now, we're talking about the leveraged finance part of private credit. So, I think the dispersion is good, but I do think there's more dispersion now than it's been in a long time.

Andrew Konopelski 25:05

It's interesting, when you look at the market indices, you see very little change—

Brigitte Posch 25:09

Yes

Andrew Konopelski 25:10

—month to month or week to week, but underneath it—

Steve Kuppenheimer 25:12

There's a lot of different—

Andrew Konopelski 25:13

—there are a lot of folks that are—

Steve Kuppenheimer 25:14

Yes

Andrew Konopelski 25:14

—I'm thinking public markets now instead of private market, which is—

Brigitte Posch 25:18

But that's true on the IG front as well, right? Like, the Index 120 hasn't really moved a lot, but underlying some sectors, they're trading much wider.

Andrew Konopelski 25:29

—It's good. You need a couple of defaults occasionally to remind people the risk exists.

Steve Kuppenheimer 25:32

You do. You do. There's discipline.

Brigitte Posch 25:34

But I think what's interesting is, I guess, in my mind, more on the small-cap companies with less than \$25 million EBITDA, with refinancing coming up from the time of COVID to now with base rates much higher. Just thinking how much of that burden will be from their EBITDA, right? And how they will cope. And to your point, some sectors and the multiples have changed, and that LTV that used to be 35, perhaps it's not 35 anymore. And so, I think there will be some development going forward in some of the sectors and some of ... Yeah.

Steve Kuppenheimer 26:10

Some of that's vintage-driven as well, right? It's still probably the case that 25 to 30 percent of vintage portfolios were originated in '21 or '22, and SOFR was 25 basis points. And software was a healthy proportion of the new issuance of private lending. That vintage of loans will probably—and they're coming now to their final maturity, to

mention kind of the maturity wall. I know they don't call it a wall, but maturity pressure. So, I do think that you'll see some vintage differentiation as well, like loans originated when rates were almost zero, and they're now maturing, and they might be in more troubled sectors, will probably underperform more recent vintages in more diverse sectors.

Sharon Chen 26:55

I think you've already gone into my next question, which is about default rates. It's still relatively low right now. Can this continue? Where are we headed from here?

Steve Kuppenheimer 27:06

So, I think default rates for private credit, and again, I think it's always good to remind ourselves of what we're talking about. We're talking about such a broad array of products. So, investment-grade private credit I don't think has had material stress. Young product and it's investment grade. I don't think you're seeing a lot of observable stress there. The ABS, ABF market has held up very nicely. That's more, in my mind, a lot of discussion about consumer risk is driving a lot of that, and consumer's been surprisingly robust. But again, if we go back to the traditional concept of leveraged finance private credit, I think we're actually in a bit of an elevated default rate right now. It is actually frustrating, having been in this industry for a while, the reports on default rates, they use very different methodologies. There's not as much consistency in how it's reported, and I think it can be misleading, not misleading, but maybe confusing to people looking at the research. I think one of the benefits of it is that a good amount of the AUM is managed, at least in the US, in public vehicles in the form of BDCs. And there's public filings every quarter, and you can see there's required reporting of non-accrual loans and defaults, and that gives some real transparency. But for research, you'll see it give a disparate description. Some of them are counting just what I would call hard defaults, like failure to pay or missed interest or a distressed exchange. But others will count covenant breaches, which, that's a tough one because there's many loans, especially in a large market, that have no covenants, so they can't default under that standard. But yet that's a big credit negative. So, I tend to like to look at the hard defaults. But there I would say, interested in the rest of the panel as well, I do think that we're in a little bit of an elevated default cycle right now. I put it at between three to four percent, against a historic average of 2 percent. I don't know if you guys agree with me.

Andrew Konopelski 29:12

There's some stress.

Steve Kuppenheimer 29:13

Yeah.

Andrew Konopelski 29:14

I'm not sure if we're seeing elevated hard defaults yet.

Steve Kuppenheimer 29:18

Yeah.

Andrew Konopelski 29:18

We're seeing some people trip covenants.

Steve Kuppenheimer 29:19

Yeah.

Andrew Konopelski 29:20

So, there are really phases to it. It is difficult, I agree with you, in private credit, especially, and I'm thinking specifically direct lending, to get—

Steve Kuppenheimer 29:30

Yeah.

Andrew Konopelski 29:30

—good data on it.

Steve Kuppenheimer 29:31

Yeah.

Andrew Konopelski 29:32

You almost have to look at where people have taken the keys.

Steve Kuppenheimer 29:34

Yeah.

Andrew Konopelski 29:34

Even that is difficult to get. Because you have the advantage in the US of having public BDCs which have to report.

Steve Kuppenheimer 29:40

Yeah. Which, that is helpful. That's some real transparency.

Andrew Konopelski 29:43

But we're certainly elevated where we were, say, seven, eight years ago.

Steve Kuppenheimer 29:47

Yeah.

Andrew Konopelski 29:47

There were barely defaults in 2016 to '19.

Steve Kuppenheimer 29:52

Yeah.

Andrew Konopelski 29:52

So, by definition, and I think it'll be interesting as we come up to, there are maturities coming up. You were saying that the vintage that was acquired 2019 to '22 is coming up to their seven, eight-year maturities, their window. The

interesting thing is, against defaults, we think a lot about an agency issue, right? You very often have a loan that is in the money that you could get fully repaid if you could sell the company, but you don't own the company.

Steve Kuppenheimer 30:20

Yeah.

Andrew Konopelski 30:20

Somebody else owns the company, and you need them to exit the asset. So, I think there are probably quite a few out there that I wouldn't call them distressed or defaults, but the question is, how do you get your money back?

Steve Kuppenheimer 30:32

Right.

Andrew Konopelski 30:32

And that's the big question. Can you force a refinancing?

Steve Kuppenheimer 30:34

Yeah.

Andrew Konopelski 30:34

Can you force a sale?

Steve Kuppenheimer 30:36

You can.

Andrew Konopelski 30:36

Because we know that we're carrying trillions of unsold private equity assets that need to find new buyers, that—

Steve Kuppenheimer 30:42

Right

Andrew Konopelski 30:42

—I think we're all ready to finance.

Steve Kuppenheimer 30:43

Right.

Brigitte Posch 30:45

I do think it's probably fair to say there will be some sectors that probably will have, to your point, more pressure on refinancing. With rates where they are, with multiples in some sectors that they're not anymore where they were a few years ago. So, I think it doesn't mean it's a default yet, but I think there will be more pressure to be seen on how that will evolve or not too.

Andrew Konopelski 31:07

Agreed. Definitely.

Sharon Chen 31:08

So, I like how there was a debate about what is the actual default—

Steve Kuppenheimer 31:12

Right

Sharon Chen 31:12

—rate right now in the private credit market because one thing I wanted to touch on quickly is from a regulation and transparency point of view for the private credit market, as it is going to be a very big asset class that's hard to ignore. We have seen more scrutiny and questions around transparency in terms of the underlying risk, but also the valuation for the assets. So, Brigitte, maybe you can comment on how you think regulation and transparency will evolve. And, I think it's very timely because Apollo just announced that it's rolling out daily pricing for its credit funds. So maybe you can give us some color on that.

Brigitte Posch 31:56

Yeah. Perhaps I'll start with a little bit of history. I think when we look at different asset classes, USPP, it's a market that is \$750 billion, \$100 billion a year. And we have seen that evolution. High yield, which in the '70s was below, what, \$10 billion, and now we're talking about the trillions. Direct lending, which was in the, what, 2000s, what, \$40 billion, and is also in the trillions. So, we have seen that evolution. So, the private IG, so I will comment on private IG, I think it's kind of a similar path. We will see, I think first we need to understand the pools of capital that will start participating in this type of new product. What does that mean, pools of capital? Means that investors will have an asset allocation to it. Asset allocation, more liquidity, that will create more transparency into the market, more banks involved on the trading. So, I think that's the natural evolution of the product. We're not there yet, but to your point, we already started in Apollo. We're already moving from the quarterly liquidity to daily liquidity, over a majority of our assets. We started trading private credit over the last several months, traded over \$35 billion over different asset classes that not only go from IG private corporates to asset-backed and so forth. So, there could be different types of products within the IG space that are more bilateral transactions. So, I think it would take a few years, but I think we're on the right path, similar to what we have seen in history with other products.

Sharon Chen 33:45

Andrew, what do you think, and how do you think the industry is going to evolve?

Andrew Konopelski 33:49

Yeah, with growth comes responsibility, I guess, and increased transparency. Now, unlike Apollo, we're a little smaller. We only have \$20 billion of credit assets, and we're also blessed that none of them are retail. So, none of them actually have daily, weekly, quarterly liquidity. So, we think from that standpoint, there have been some questions about whether private credit has created an existential crisis. I'd argue no. I think we're doing a very good job of liability, asset-matching in terms of its long-term capital for long-term investments. There's nothing that's going to trigger withdrawals or a collapse of our funds. But what we do think about is transparency, I think is an important value, both within a team and decision-making, but also with our LPs. There's a lot of trust in this industry. You're given money for eight to 10 years to invest. So, with our investors, there's an increased level of transparency, what's going well, what's not, into the portfolios. We've taken on, I think like a lot of people, third-party valuers that value the portfolio on a quarterly basis, so that it's not us with a bunch of spreadsheets. So, I

think there are certain ways that you can provide transparency to your investors. Now, I guess then there's the question of the regulators. As we grow further, there will be increased regulation. But I don't think we pose an existential crisis, so hopefully it's measured.

Sharon Chen 35:13

So, I want to make sure we have enough time to discuss AI, because that is the big thing of 2026, right? And it is driving enormous investment requirements. Based on what I've read in research is that the CapEx spend for US hyperscalers is expected to reach \$1 trillion this year and continue to grow in the following years. Steve, given that a lot of the spending is in the US, what's your view on this? Is it opportunity? Should we be concerned?

Steve Kuppenheimer 35:45

I think it is both. I think it is clearly an opportunity. You have a rapidly growing industry that there's seemingly very deep support for from the capital markets, and that presents an opportunity. There's a lot of growth behind it that has merit. At the same time, when you look at just how big it is and how it's impacting the capital markets, it's almost unavoidable. So, you're now in credit committee, I'm sure my colleagues are similar, there's almost not an industry or company that you're going to talk about that you're not talking about what is the AI angle, or you're not talking about what's the data center angle, or going back to what could trip up what's been a very resilient economy. There's a lot of reliance on the projected growth of AIDC, and if people start to believe that even if it's still going to grow, but the rate of growth is perceived to decline. Even we're at that point now where even that would have an impact.

Sharon Chen 36:50

Yeah.

Steve Kuppenheimer 36:50

And so, I do think it's both. It adds some uncertainty, even though it adds opportunity. I think interesting over this year, you've seen some states in the US slow down the development of data centers, notably, and not just blue states, but red states as well. It seems to be one of these topics that there's actually less division around. And that by itself could cause a slowdown. And so, we look at it both ways. We look at it as some of these very large IG transactions, which support some of that growth, are very interesting transactions as we've talked about today, and they're easy to believe in. At the same time, looking at the impact on AI or the spend for digital infrastructure, it's just so dominant. It's dominating so many of the discussions of the capital flows that you do have a bit of caution around. Like Andrew, we're credit people, so our upside is we get our money back, right?

Sharon Chen 37:53

Yes.

Steve Kuppenheimer 37:53

And so, we're always thinking of every possible way we could not get our money back, rather than if you're an equity investor and you can just play a diverse set and you have some losers, but you have some that are massive winners. It's a different mentality. So, I think we view it as both an opportunity and a concern. It takes up a lot of time right now in our discussions.

Sharon Chen 38:14

How do you manage the concentration risk? Is that becoming a concern?

Steve Kuppenheimer 38:20

Very much so, I would say, and must be how we think about it. So again, because of that difference in point of view of equity versus debt, we look at not having too much direct, concentrated, single data center or AI plays in a sub-investment-grade portfolio. Not sure you're getting paid for the uncertainty or the lack of diversity. And you're getting enough exposure to it, like I said before, really across most industries you're having to talk about it. Even if it's not an obvious AI-impacted industry, it could be logistics, it could be health care, where there's risk there. There's upside as well. I think overall, AI is a tailwind. It's going to increase margins, it's going to increase productivity, but it's going to have a disparate impact that's not that easy to underwrite today. And so, as a result, the way we think about it is to play it more as maybe you can look at service providers that are going to service many different commercial facilities, including data centers. But it's a diverse group of business that benefits from the overall capital formation, but is not concentrated to a single data center, if that makes sense.

Sharon Chen 39:33

Yeah.

Steve Kuppenheimer 39:33

That's what we think about.

Sharon Chen 39:35

Brigitte, are you also seeing increased AI investment and, I guess, financing opportunities here in Asia?

Brigitte Posch 39:40

Yeah, a lot. I think because we always come with a global lens, not only from a relative value, but also from a credit perspective, we know exactly what's happening in the US and then we share what's happening in APAC. And I think at least one of the concerns I see here, there's also an increase of issuances. But there are certain risks that I feel the market here is more willing to take than perhaps we see it in the US. So, extension risk, servicer risk, recontracting risk, residual value risk, but not really getting paid for those risks. So, I think that's something that I think one needs to kind of monitor going forward. And to your point, yes, there are opportunities. As long as we can make sure we're mitigating those risks and getting paid for those investments. We have been looking more on the, again, on the private side, IG side with the Broadcom transaction that we have done, \$35 billion, so in which we can actually tailor the transaction, make sure that those risks that I mentioned are being mitigated.

Sharon Chen 40:51

Okay, sure. Andrew, I know that we haven't seen such large AI investments in Europe, but I think one thing that is common across globally is that AI could disrupt business models for existing companies in your portfolio, right? So how are you thinking of that, and do you think the market appreciates this risk?

Andrew Konopelski 41:14

Yeah. I think the market appreciates some of it. So, it's the biggest corporate transformation and certainly the biggest CapEx cycle that we've ever seen. So, what is coming is going to affect all businesses, and I think we probably started with, I think, probably the same approach that the firms did, was a bit of a framework to evaluate. I mean, what's with ChatGPT is about four years old, give or take. So, this isn't a new development, but it's certainly evolving, and it's evolving very quickly, and I think the capabilities are. So, we had SaaSocalypse earlier this year, so I think where most people focused their attention was in the software sector. Maybe not where we should be looking. I mean, I think there are a lot of professional services businesses that are probably being impacted just as much. If you think about time-and-materials-based businesses that are having to change their business models to more fixed pricing so that they share some of the efficiency with their clients. Transformation's happening everywhere. And we're just trying to stay on top of that by evaluating it. Now, fortunately, we are allied with a

private equity business that has also been looking at similar risks. So, we have kind of pooled and shared knowledge to make sure that we're on top of it. But ultimately, we are not, and I'm certainly not smart enough, to know exactly where the biggest impact is going to be over the next three to five, 10 years. So, we are thinking very strongly about diversify, diversify, diversify. A portfolio should have 50 names minimum in them, and you know the risk is going to hit you somewhere. So, you need to be on top of the monitoring. You need to be aware of key trends across your portfolios, sharing that information across your teams, across your firm. And then you just need a bit of defense in—I mean, Steve said it best. I mean, your kind of 35 percent loan-to-value. You're senior secured, and you're in a diversified portfolio. So, the risk is, at this point in time, quite compelling, even though we know that there are risks out there that we probably can't quite quantify yet in terms of how AI is going to impact specific markets.

Sharon Chen 43:23

So, I think we've talked about a lot in this panel discussion. Just to round it off for the audience, in just one sentence, can you share what's your outlook for the global credit market heading into 2027? Steve, do you want to start?

Steve Kuppenheimer 43:39

I think there's a lot of opportunity. I think you're going to see—So, believe it or not, as things get a little choppy, I think it's actually a very attractive time to invest because there's a more defensive mindset in the market. So, if you've been doing this a long time and you have confidence in your ability to underwrite and go deep on specific transactions, this is actually a very attractive time. And I think the mature US market, mature European market are evolving, presenting opportunities. In Asia, I think there's just a lot of positive change coming to get more mature.

Brigitte Posch 44:12

Yeah, no, I fully agree. And I think also for APAC is the scalability. I think there was always the issue can we scale here? And I think there's a good momentum of being able to participate in larger transactions. And thinking about AI and digital transformation, a lot of those companies are global companies, too. So, there will be a lot of investments, not necessarily in the region of those companies, but in the US and Europe. So, there will be a lot of APAC investments, I would say, outside APAC as well. So, I think there is some interesting opportunity, but to your point, being selective and making sure we're getting paid for the risk.

Sharon Chen 44:50

Andrew?

Andrew Konopelski 44:51

Yeah, we tend to be quite negative as credit people, don't we? We should probably be more positive. I agree. I think you are actually being paid in this market. I think you're being paid for the risk that you're taking, and I think the returns you can generate in a private credit portfolio, especially with the cash yield that comes off it, which allows you to kind of amortize down that investment quite quickly. I think over the next few years, with base rates where they are, you're being paid pretty well versus other asset classes at the moment. So, I'm quite positive on that.

Sharon Chen 45:19

All right. Thank you. Thank you for joining us, and please join me in giving a big round of applause to Steve, Brigitte, and Andrew.

[Applause]

Disclaimer: This transcript was reviewed by individuals for accuracy and serves as a reference. However, it may still contain errors or omissions. Please verify any critical information independently.