GLOBAL THOUGHT LEADER SPOTLIGHT

> *"While the overall private credit direct lending (lower middle market) asset class has continued to show durable, stable returns across various macro environments, the specific asset mix, sector focus, and approach to credit risk are all factors that drive performance outcomes."*

DOUG LYONS
Managing Director, Head of Origination – Private Credit
PineBridge Investments

As the Head of Origination – Private Credit at PineBridge Investments, I oversee the firm's middle market private credit business and lead our origination efforts. With over 30 years of experience in financial advisory and services, including middle market direct lending, investment banking, and public accounting, I specialise in the origination and execution of both private equity-supported and non-sponsored financing transactions.

With current yields of roughly 12% combined with a 2024 environment that we expect to remain generally lender-friendly, on a relative basis, we believe the lower middle market direct lending asset class is well positioned for the coming year, maintaining its attractive risk-adjusted return potential.

Here we explore our key convictions for the year ahead:

1. **Divergence is the keyword for 2024 among private credit portfolios.**

Sustained elevated interest rates over the past year and a half have hampered cash flow for over-leveraged companies and those with weak business models or cyclical earnings. We believe 2024 will be a year that exposes underperformers, with the impact evidenced by a higher incidence of defaults, losses, and payments in kind. We believe lower-middle-market companies (with EBITDA of US$7.5 million to US$30 million) that boast long operating histories, leadership positions in their market segments, and seasoned management teams remain compelling investments.

2. **Mergers and acquisitions (M&A) are likely to warm up in 2024, with ample lending opportunities.**

In 2023, a weaker macroeconomic backdrop and the resulting hit to earnings kept a lid on M&A. With many private equity sponsors having held on to assets for longer than anticipated, the time is nearing when they'll need to monetize those assets – which will help close the gap between buyer and seller expectations. Likewise, first-time buyouts that were put off in 2023 will more likely be the object of dealmaking in 2024, given the usual dynamics of family-run businesses needing to create generational wealth transfer while also obtaining growth capital. With these drivers in place for M&A, we expect the outlook for lending to lower-middle-market companies to rebound from 2023 levels.

3. Performance should remain top of mind for investors in 2024 in light of ongoing macro challenges.

It's incumbent on private credit investors to dig deeper into three key aspects of a direct lending portfolio: its fixed-charge and interest coverage, variable versus fixed costs, and leverage ratios (portfolio and asset level).

Outlook and implications for 2024 and beyond

We believe a period of marked divergence lies ahead across private credit direct lending in 2024, fuelled by a sustained high interest rate environment and the impact of varying portfolio approaches. Specifically, while the overall private credit direct lending (lower middle market) asset class has continued to show durable, stable returns across various macro environments, the specific asset mix, sector focus, and approach to credit risk are all factors that drive performance outcomes – and create the many "varieties" of private credit.

We continue to believe the opportunity set for investors in the private credit direct lending segment remains robust and deep enough to enable a selective approach, including both new and add-on lending opportunities. While M&A activity was somewhat chilled in 2023, it's likely to warm up in the coming year toward a more normal pace, fuelled in part by some pent-up dealmaking.

Doug will be presenting at Global Investment Institute's upcoming ***Private Credit Investment Forum***, taking place on *Thursday, 2 May 2024 at the Grand Hyatt Melbourne, Victoria*.

Register your interest in attending here or for more information email zlatan@globalii.com.au.

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Doug is a Managing Director, Head of Origination – Private Credit at PineBridge, having joined in 2017 to support the launch of the firm's middle market private credit business and lead the team's origination effort. He has over 30 years of financial advisory and service experience, inclusive of middle market direct lending, investment banking and public accounting.

Prior to joining PineBridge, Doug was a senior origination team member and Head of Origination at Business Development Corp of America (DBCA), having joined in 2016. Doug and his team were responsible for originating and managing over US$2.6 billion of AUM, building BDCA into the 6th largest BDC in the US.

From 2006 to 2013, Doug worked for UBS Investment Bank in their Leverage Finance Group as a Managing Director eventually overseeing its leverage finance efforts in the gaming, lodging, consumer, retail and leisure industry verticals. Prior to UBS, Doug held various financial services and advisory roles at the following institutions: CIBC World Markets (2003-2006), Deutsche Bank Securities (2000-2003), Duff & Phelps (1998-2000) and Coopers & Lybrand, LLP, (1992 – 1998), where he previously held a CPA.

Doug received a Bachelor of Science in Accounting from the University of Southern California and a Masters of Business Administration from the University of California Los Angeles.

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