HAYNES BOONE

PRIVATE CREDIT CONNECTIONS

From The Insider's View

As we head into 2024, Melissa Logan, Managing Director and Deputy General Counsel at Barings, shares some of her key takeaways from the prior year and expectations for 2024.

Melissa Logan

Company & Title: *Barings LLC, Managing Director and Deputy General Counsel*
Education: *Davidson College and The Ohio State University Moritz College of Law.*
Current City: *Charlotte, NC*
Fun Fact: *Despite living in Charlotte, I'm a co-owner of Pittsburgh Steelers season tickets.*
Favorite sports team: *Currently it's the U6 Boys Basketball Cornwell Kings in an even tie with the U8 Boys Basketball Cornwell Squirrels.*

2023 was filled with a number of different macroeconomic and geopolitical events that impacted the economy as a whole and, in turn, private credit deal flow. In your view, which of these events was the most impactful in 2023 and which will have the longest lasting implications for the private credit market?

I think the most impactful macroeconomic event of 2023 with respect to private credit was the rising interest rate environment. The increased rate pressure stressed borrowers' ability to support debt amounts that justified their enterprise value expectations, and that stress had a direct impact on the flow of deals in the market. However, I don't see this as a detrimental long-term issue, as I think the market is adjusting to the change in rate expectations and parties are relatively quickly creating new normals for enterprise value and leverage profiles.

While not specific to private credit, I think the upcoming implementation of the new Private Fund Advisers rule is going to have a long-term effect on the private credit market. Both private equity sponsors and private credit funds are going to have significant additional reporting, disclosure, and overall operational costs to doing business as a result of this rule, which will require some adjustment of platforms' models and therefore expected returns.

As we look toward 2024, how do you view the outlook for private credit compared to other asset classes?

Private credit is starting to receive specifically designated allocations from large portfolio managers (rather than being just a sub-set of a broader loan allocation). We are also seeing regulatory burdens on banks continue to impact the traditional syndicated loan market. Borrowers that would have previously approached regulated banks for middle market and broadly syndicated loans to source their debt are now able to achieve very similar debt amounts and structures in the private credit market. The combination of those factors suggests that the private credit market will continue to grow in 2024.

The adage "good company, bad balance sheet" gets thrown around a lot. In your view, how can lenders identify good investments in 2024?

In this rate environment, the simple rules may be the best. One rule of thumb that we follow is the trend in a company's net-debt, which is total debt less cash on hand. Companies that are unable to self-fund their

operations and working capital over long periods of time will ultimately need to restructure. In the current environment, if a company's net debt has been increasing for the past 12, 18, 24+ months, then it's important to figure out why that trend is happening and how the company plans to address it as a part of our underwriting process.

What do you see as the most promising opportunities for growth for private credit in 2024?

We think we will see an uptick in deal flow and AUM growth as companies get more comfortable that the rate environment is stabilizing. We also expect to see a lot of activity driven by pending maturity dates and end of life of funds, which will require many companies to refinance credit facilities that were put in place in a lower interest rate environment.

From your role as internal counsel covering a dynamic private credit business, are there any structural issues or covenant trends that you will be on the lookout for in the next few months?

There are a few dynamics that come to mind for this question. One is not necessarily a new issue, but we are always on the look-out for eroding "Adjusted EBITDA" definitions. Without a real measure of a borrower's EBITDA, the financial covenants (which often consist of leverage and/or fixed charge coverage ratios based on the borrower's EBITDA) become meaningless. More recently, we are seeing sponsors that want bigger clubs of lenders that will inevitably compete with each other to land on the lowest common denominator on business and legal terms. Overall, it's not one specific covenant trend that we worry about but rather the aggregate of the flexibility within the deals that can create the bigger issues.

> *"Without a real measure of a borrower's EBITDA, the financial covenants become meaningless"*

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*As of December 31, 2023

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Our team is comprised of lawyers based in key financial centers throughout the U.S. and abroad, including Charlotte, Dallas, Houston, London and New York.

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