Proskauer

Talking Trends with Pemberton Asset Management

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In our latest Q&A series, we delve into the world of private credit through the lens of eminent women in the field — from professionals at the forefront of industry leadership to our own lawyers. Together, we navigate the trends and topics influencing private credit against the backdrop of today's ever-evolving geopolitical landscape.

In our inaugural offering, marking International Women's Day 2024, Proskauer private credit partner Harriet West and associate Charlotte Boylin engage with Pemberton managing director, Cassandra Fahy, to explore market sentiments, competition within private credit, future prospects for this vibrant sector, and advancements in female inclusion.

There has been uncertainty in the market over the past 18 months, which is likely to be further impacted in 2024 by upcoming UK and US elections and ongoing volatility in the Middle East. How do you see this impacting the direct lending market?

Cassandra Fahy: Whilst there has been significant volatility in the market over the past 18 months, I think the biggest impact has been on investor appetite which has slowed down fundraising across private credit and private equity alike. However, we saw this turn a corner in Q4 2023, together with better sentiment in the M&A market so whilst there are some macro events dominating the international agenda this year, I would expect the direct lending market to remain a stable source of capital to support sponsor-led M&A.

Harriet West: It’s uncontroversial to say that private credit has had to contend with a range of multipronged challenges over the past four years. What this has demonstrated in its performance — through covid, inflationary environments, dramatic interest rate rises, national political volatility and geopolitical tensions — is what a durable and versatile asset class it is. Whilst there was slower M&A deal flow in H2’22 and H1’23 hampering direct lending deployment, the pipeline in 2024 is very optimistic (with predictions that deal flow will snowball, especially from Q2 onwards), and it is likely that forthcoming wider macroeconomic challenges will not dampen confidence in the markets to the levels we saw in the past 18 months.

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>
> **Cassandra Fahy**, Managing Director, Pemberton

Whilst interest rates appear to have stabilised, how do you expect the private credit market to acclimatise to higher rates as the 'new normal' going forward?

Cassandra: I think higher base rates are here to stay but fortunately, not in the same way we saw them during 2022/23. In fact, the long-term view around EURIBOR and SONIA is around 2.5% and 3.5% respectively over a 5-year horizon. Therefore, higher base rates are the new normal and will continue to be factored into leverage metrics when structuring a new investment. It will also continue to bear on private equity returns as financial engineering becomes less relevant. We will also need to be mindful of existing portfolio companies where the debt stack was put in place in the low/no rate environment we saw in 2021 and prior to that.

Charlotte Boylin: We're certainly seeing the impact of this 'new normal' in the new money deals which are being priced much lower than the historic >7% margins, with some being set at around 125-150bps below this range. On existing deals, we've seen private credit lenders be cognisant to the fact that the cost for a borrower on an existing loan is now very different from how they understood it at the outset of the original financing — changes to allow for interest to be PIK'd and amendments to financial covenants have not been uncommon over the past 12-18 months.

With competition from traditional bank lending, other private credit funds and new private credit arms established by banks, how is Pemberton dealing with the challenge of increased competition in the private credit markets?

Cassandra: Whilst there have been many new entrants into the private credit market, we continue to enjoy, in our opinion, a first mover advantage here at Pemberton and our established place in the market. Overall, a lot of the new entrants (e.g. private credit arms within banks) are more focused on the nascent jumbo private credit club market where 2-5 (sometimes 20!) funds are clubbing together for €1bn+ type financings. We expect this part of the market to become commoditized rapidly and therefore this is something that we are not prioritizing. We remain focused on mid-market lending in bilateral structures.

Harriet: The popularity of private credit is definitely creating more competition. Whether that be through new fund entrants to the market, investment banks developing their private credit platforms and strategies (either using balance sheet cash or raising funds through external investment) or banks' involvement in FO/LO structures. Whilst this may result in more competition (especially in the large-cap space and even more so as the liquid markets have started to bounce-back), as M&A activity and deal flow picks up we are likely to see more collaboration across the markets and hybrid finance solutions becoming more common, with a powerful blend of products available to sponsors and borrowers.

How do you see the direct lending class adapting in the large cap space as we start to see the syndicated markets becoming more active again?

Cassandra: We believe direct lending brings the advantage of stability and not being driven by market events in the same way the syndicated loan market is, therefore, there will always be a need for both to co-exist.

Charlotte: Recently we've seen large sponsors look to the private credit space for financing options (where they would once only tap into the broadly syndicated loan or the public markets). As you mention Cassandra, we've seen the development of larger private credit club financings within the market, and also, echoing Harriet's point about the anticipated growth of hybrid finance solutions, it's certainly possible that we may start to see more sponsors look to raise debt through both types of products in competitive processes (we have seen a recent example of this where the private credit deal was preferred over a bank lend — this involved a total of 25 credit funds and institutions (plus additional revolving credit facility lenders)).

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Cassandra Fahy, Managing Director, Pemberton

What do you see are the biggest drivers of growth for direct lending in 2024?

Cassandra: In our opinion, 2024 is poised to be an active year for direct lending in Europe, driven by a few factors. Firstly, we have finally reached a stable macro backdrop in terms of interest rates and inflation, both of which are either steady or in a slow decline depending on geography. This will ease pressures across businesses in Europe. Also, much of the M&A and refinancing pipeline that should've come to market in 2023 and in late 2022 has been on hold, and I expect to see a lot of that access the market as the year progresses. There has been a lot of talk around jumbo direct lending financings (€1bn+), and I think we will continue to see some of these in the market, but similarly, unless there are any unforeseen macro events that shake the market, I would expect us to enjoy a supportive syndicated loan market this year, which should be able to absorb large cap M&A volume.

Charlotte: I agree and it already seems like there is a lot of positivity within the market. Private credit lenders are armed with plenty of 'lending firepower' which they need to deploy — against the backdrop of heightened market competition, the larger 'jumbo' financings do provide opportunities for lenders who partake in those types of deals. That said, there is still the need for bilateral private credit deals in the 'mid-market' sphere where the financing requirements don't warrant the need for a club of lenders and borrowers can reap the benefits which come from a direct relationship with a single lender.

The private credit asset class has evolved significantly over the past decade, how do you see it continue to innovate over the next 5 years?

Cassandra: My predictions for the next 5 years would be (i) continued growth in direct lending volumes; (ii) consolidation in the market with smaller funds either being acquired or closing down (given scale is a requirement to survive in this space) and (iii) a greater dominance of private credit vs bank lending and vs the syndicated loan market.

Harriet: Despite the near-term macroeconomic uncertainty that we have discussed, investors remain positive about investing increased amounts in private debt in the long-term, which ultimately means funds with more money to deploy. With focus on this asset class at an all-time high, competition is here to stay across all areas of the market from the lower-mid right up to large-cap, where we are only likely to see the top quantum of the “mega” private credit deals go north. New players across the market will really need to find a sweet spot (whether that’s in less established jurisdictions, the sponsorless market, specific strategies such as sports financing, more bespoke capital solution lending, private credit secondaries, etc.), to avoid losing out to the dominant established players.

The theme of this year’s International Women’s Day is ‘Inspiring Inclusion.’ What progress do you think has been made in the private credit market to actively encourage inclusion and more women to take part in the sector? What tips or advice would you give to women starting a career in the direct lending industry today?

Cassandra: Diversity, including gender diversity, remains a challenge and a goal within the private credit space, as is the case across the entire financial services sector. The acceptance of flexible working and working from home on certain days of the week has been an enabler for employees with families who are better able to juggle drops offs and pick ups when there isn’t a need for a commute (and I speak from experience!), and so in that regard, there is progress happening every day. I also think there are changing attitudes amongst more junior cohorts where traditional gender roles no longer exist as we perhaps knew them 10+ years ago. At Pemberton specifically, we have PembertonID which is our firm-wide inclusion and diversity forum delivering fantastic outcomes across various areas. A great example in 2023 was the enhancement of parental leave policies which benefitted both men and women.

My advice to women starting a career in direct lending would actually be the same I give my male colleagues which is to work hard, establish your own identity and brand and seek help along the way to achieve your ambitions. As a recent mum (and soon to be mum of two) a lot of people ask about how it is possible to juggle a career and parenthood. I find this frustrating because I never hear this question being asked to male colleagues who also have young children. The reality is we live in a generation where gender roles are no longer what they used to be and partners will split household and childcare responsibilities in a variety of ways — you just have to find what works for you!

Harriet: I agree that there is still more to be done (especially on reconfiguration of society's stereotypes and addressing subconscious gender bias more widely!), but it has been encouraging to see such an increase in the number of women working within the private credit industry and firms really placing a committed focus on diversity initiatives. When I established the Proskauer Women in Private Credit network a few years ago, we had around 25 female clients in London; this has now grown to circa 150 female clients and connections active in the private credit industry in London. It is fantastic that women starting a career in the direct lending industry today not only have a larger range of roles open to them as the sector has grown, but they also have a range of female role models to look up to which, in itself, can be inspiring for young women to see.

Cassandra Fahy is a Managing Director in Pemberton's investment team covering the UK and Ireland. She is responsible for originating new investment opportunities while evaluating credit, conducting diligence and negotiating transaction terms and documentation.

Harriet West is a Partner in Proskauer's Private Credit Group in London. She advises clients on a range of financing products, with a particular focus on acting for alternative lenders and private credit providers. Her extensive experience covers a wide range of domestic and cross-border transactions, from the lower-middle market right through to the large-cap market.

Charlotte Boylin is an associate in Proskauer's Private Credit Group in London. She has guided clients in an array of transactions and financing structures in the middle and upper markets, such as national and international corporate acquisitions and refinancings, restructurings, management buyouts and buy-ins, unitranche, first out/last out and senior/super senior structures.

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For more than 20 years, the Private Credit Group at Proskauer has been intrinsically involved in the evolution of the industry, working on pioneering structures and products. Our technical strength, combined with our expansive experience, makes us the Firm of choice for first-in-kind transactions. Acting as strategic partners to our clients across industries and jurisdictions, our team of lawyers has expertise in U.S. and Europe-centric transactions, as well as North American and European cross-border transactions.

Proskauer Women in Private Credit offers a knowledge sharing and peer network platform for females active in the private credit market. **Click here to register your interest in receiving future updates**.

Related Professionals

- **Harriet West**
  Partner
- **Charlotte Boylin**
  Associate