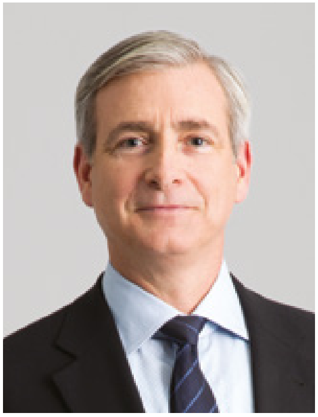
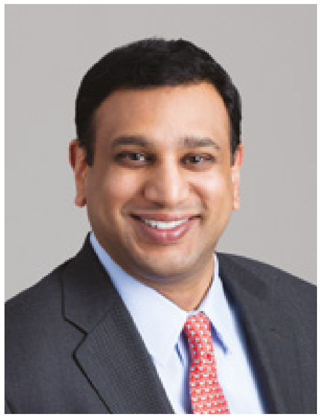
TALKING POINTS

Well-established lenders can prosper as private debt's performance impresses investors, say Antares Capital's David Brackett and Vivek Mathew





Turning from crisis to opportunity in 2021

Despite the extraordinary turbulence of the past 12 months, investors appear largely sanguine about the performance of private debt as an asset class. This is aptly illustrated by one of the headline findings of Private Debt Investor's LP Perspectives 2021 Study, with 76 percent of respondents planning to increase or maintain their allocation to direct lending this year.

Now might seem like a good time to be a private debt investor – but managers are having to work harder than ever to ensure success. Many of the traditional methods of carrying out due diligence are off-limits, while building relationships with investors is more difficult in the absence of face-to-face contact. David Brackett, CEO of Antares, and Vivek Mathew, head of asset management and funding for the firm, explain how it plans to take advantage of its position in the market and navigate the choppy waters of 2021.

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Q We're living through a period of exceptional uncertainty. How concerned are you about economic conditions affecting your portfolio?

David Brackett: Naturally, we're concerned about covid and concerned about the slowness of the vaccination process. To me, that signals that we'll have to wait until the late part of this year for real economic recovery. But just reflecting on what we experienced in an incredibly turbulent 2020 – despite an unprecedented decline in the economy, our portfolio held up very well. Our borrowers have been incredibly resourceful, flexible and aggressive in how they've managed this situation. Their resilience gives us comfort and confidence, despite uncertainty in the near term.

We finance companies that are backed by private equity sponsors. The support that our sponsors have provided in distributing best practices across their portfolio companies during the pandemic has been impressive. One focus for us is to make sure our borrowers have sufficient liquidity to manage through the ebbs and flows that we're inevitably going to experience in the

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> **DAVID BRACKETT**

months ahead, and the flexibility from a financing standpoint to execute in an uncertain environment.

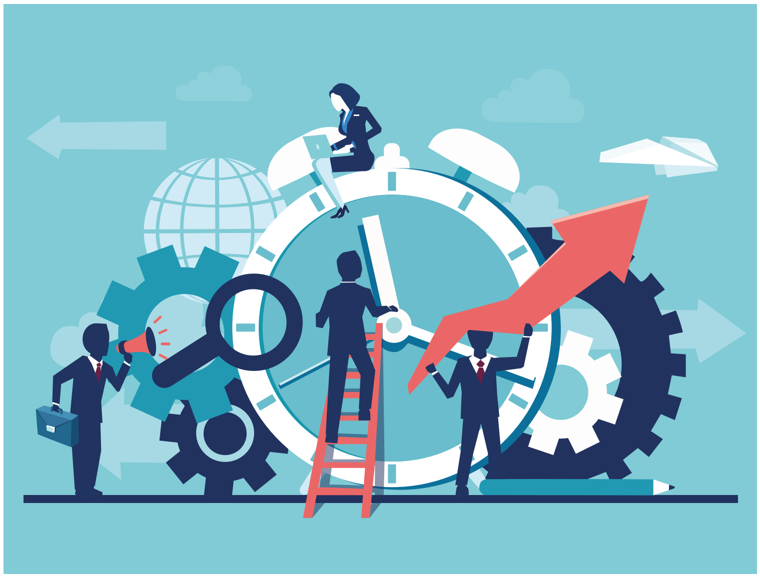
Q On the other hand, LPs seem to be feeling positive about private debt as an asset class. Why are investors bullish in such an uncertain environment?

Vivek Mathew: Even prior to the pandemic, we were seeing capital flow towards private debt in a very meaningful way. Investors had already been looking under the hood in this asset class quite a bit, doing their diligence, monitoring the market. Quite a lot of LPs still hadn't actually made a meaningful allocation to the asset class prior to the pandemic – but the ones that had were looking to do more, and the ones that hadn't were watching the market.

And then, when the pandemic hit, private debt performed incredibly well. The story's not done yet, but it feels as though it's trending the right way in terms of ultimate performance. And so, amid all this global uncertainty, investors are saying that private debt feels like a good place to put capital. There's still a global search for yield, but you obviously want to find out how you can get it without meaningfully increasing the risk that you're taking. If investors can increase their yield, but feel like it's more of a liquidity premium rather than a risk premium – which I think is how they're feeling around private debt – then global capital is going to continue to flow towards this asset class.

Q In particular, we're seeing a lot of LPs planning to invest more in distressed debt. But how long can this apparent boom continue?

VM: It makes all the sense in the world that, around a dislocation, people are interested in distressed debt. That's pretty logical. It will be interesting to



Q How has due diligence changed during the pandemic?

DB: Due diligence is the backbone, the heart and soul, of what we do. We take enormous pride around that. Right now, we're finding it's a different environment around diligence. Credit decisions, in some ways, are easier at this point in time, because the pandemic and the ensuing economic challenges have tended to expose flaws within business models. We don't have to hypothesise about how a company will perform during the next downturn – it's been laid bare for us.

What's difficult is access. In the past we had the ability to visit companies in person and look management in the eye. Now, we're increasingly dependent upon the private equity sponsor to sort through the management engagement piece – and we're a little removed. But from our standpoint, what gives us comfort is that sponsors are below us in the capital structure, they're taking on more risk, so they are intimately involved in decisions. We've got a long history of working with over 400 private equity sponsors, and for over 25 years we've been able to sift and sort through who we want to do business with.

see how big that opportunity ends up being. We saw a severe dislocation during the depths of covid, but the snapback has been surprising as well. The dislocation probably wasn't as long as people thought it would be. In our space, private equity sponsors have provided credit support, which has really helped from a credit perspective in terms of companies being able to weather the storm.

DB: As an investor, you want to make sure you're positioned to take advantage of any opportunity that may present itself in the marketplace. We certainly saw a great deal of activity, in terms of dollars allocated. Our expectations were for higher default rates, for greater dislocation. We received a meaningful number of inbound inquiries from private equity sponsors asking if there were companies we were financing where the private equity sponsor was not prepared to support it, noting that they are happy to step in and support those. But we've not had to go there. At least in our market, working with private equity sponsored companies, the distressed opportunities have not been meaningful – but time will tell.

Q What can GPs do to reassure their LPs that deals are well-structured in the current environment?

VM: Reassurance comes with alignment of interests. LPs can take comfort in knowing that we typically hold meaningful positions in the loans we make on our own balance sheet. Typically, loan terms become more attractive following a period of dislocation, so it has been a good time to lean in on deals.

DB: We have found that this moment has provided us with a massive opportunity to deploy capital on favourable terms with established borrowers – we have just enjoyed the most active fourth quarter in our history. Almost three-quarters of the deals we do come from our existing portfolio, so we benefit from incumbency and knowing these companies. It's not like we're trying to get our heads around the business model or asking if this management team has ever operated in a leveraged environment before. We already know the answers.

As you can imagine, the focus for our sponsors is to support their existing investments in portfolio companies. Once they've found stability with sufficient liquidity, they've been turning from defence to offence, to acquisitions. From our standpoint, we have companies that have demonstrated performance. We've worked with them for a period of time, we're comfortable with the management team, and now we've seen them perform well during this crisis. That's an opportunity for us to deploy more capital.

And the new platforms that have come to market are of course the most attractive platforms because there's no covid story around them. So a lot of what we're doing right now is technology, or healthcare, or business services, which have been insulated from covid. Credits almost self-select in an environment like this.

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Q With face-to-face contact largely impossible, what can managers do to maintain good investor relations?

VM: We try to put ourselves in the shoes of our investors. Proactive communication is key.

So at the beginning of the crisis, we were very proactive in going out to all our stakeholders in explaining how we were rating our portfolio in terms of covid risk.

Thought leadership is also important. It's obviously helpful to provide market information, but what investors really crave is: "You're an expert in this space, I know things are uncertain – but tell me what you think." Investors understand that not everyone can get everything exactly right every time, but telling them what we really think provides a lot of comfort. It provides direction, it provides confidence.

Q Interest in ESG has increased massively in recent years. How do you expect investor expectations around it to change in 2021?

VM: We've seen a lot more questions on ESG from LPs as debt investors recently. Historically, LPs have recognised the ability of private equity firms to control factors relating to ESG, but the traditional thought had been that with debt investors, there's only so much influence that you have. The new and interesting part is that debt investors still recognise that difference, but they also want to understand our thought process on ESG. They want to see a mindfulness around ESG factors and how they get incorporated into investment decisions.

That's a relatively new perspective. I believe LPs are going to be looking to lenders like us to capture data and standardise how we report around ESG. As a purpose-driven organisation, we welcome that – we're interested in making money, but we're also focused on how we make money. ■