EXPERT Q&A

There have been some challenging headlines this year, but Michael Ewald, a partner and global head of the private credit group at Bain Capital, is optimistic about the asset class's prospects



Navigating choppy times in private credit

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Q We have seen a lot of headlines this year about the impact of software and artificial intelligence disruption in private credit. What risks and opportunities have you identified within advanced technology?

There has certainly been a lot of noise around artificial intelligence following the new Claude release from Anthropic at the start of the year.

We benefit from the broader platform of Bain Capital. Our venture business is currently investing from its 11th fund and has expertise in AI-related companies, while our tech opportunities business is an active software investor. In collaboration with them, we have developed a framework that we have been utilising for about two years to try to quantify the qualitative question of what the AI disruption risk is in any particular company.

That list of questions gives us a relative view on AI disruption and is a big driver of how we evaluate companies in the tech space. The result is that there are a few verticals we like. If you are the single system of record for an industry, that's a great business, for example. If you are the ERP system for insurance companies, that is hard to displace with AI. Another vertical we like is an IP that is specific to you, which often ends up being a combination of hardware and software.

Bain Capital, as we understand, has comparatively lower exposure to tech and software than many of its peers in private credit. That is partly down to that framework, but also because we have a broad platform and a wide geographical and industry remit, so we are looking at a lot of other things.

In addition, AI presents a huge opportunity for software companies themselves because they already have the customers. If those customers are demanding more functionality and a

cheaper cost of delivery, existing software companies can win by themselves incorporating AI into their products.

Finally, AI disruption risk does not just impact software and tech companies. It can impact all businesses, with one obvious example being professional services. But again, the most natural beneficiary is the incumbent professional services firm that itself is able to integrate AI into its offering.

Q Given the cautious and selective risk environment today, what does new deal activity look like in terms of both volume and credit quality?

There are certainly not a lot of technology deals out there right now, though they are starting to come back. We remain open to those, though we will continue to apply the robust framework to assess AI disruption risk that we have utilised over the past few years.

More broadly, from a broader market perspective, new deal volume has been down. However, our segment of core mid-market has proved resilient. One reason for that is dealflow is not as reliant on new transactions but also on refinancings, add-ons and tuck-in acquisitions, often driven by existing portfolio companies. All of that generates new volume, and we have been flat to slightly up on a quarterly basis in our own dealflow.

As for credit quality, that has been generally fairly stable. One thing I like about the market right now is there is more discernment between an A-plus deal and a B-minus deal. Either of those could be appropriate from a debt perspective, but they need to be structured and priced differently, and the appreciation of that was lacking a bit last year.

Q Where do you expect to find the most interesting opportunities going forward?

I have heard the acronym HALO being thrown around: heavy assets, low obsolescence. There is a movement away from software and some of the more ethereal industries towards basics such as manufacturing and industrial production.

Aerospace and defence is an area where we are particularly active and see a lot of deals. That includes space, which is not just supporting the Artemis mission to the moon, but the many commercial launches that happen on a regular basis, as well as all the satellites being launched. That is certainly an area of focus for us.

Healthcare is another sector where we have been underweight for a while, partly because we considered the physician practice management roll-ups that the market has moved towards were a bit of a challenging model. That has largely proven to be the case. Now, we see an active healthcare pipeline and can lean into that.

Business services is always interesting, with opportunities to make it cheaper, faster and easier for companies to operate often being in favour, but we also need to be mindful of AI disruption risk there.

On the other hand, we are not particularly constructive on consumer:



Q How have geopolitical issues impacted both dealflow and your credit portfolio this year? How do you see that evolving?

The irony is that when I used to get asked what kept me awake at night, it wasn't the performance of our portfolio or the ability to conduct proper due diligence on a new deal, but rather the fear of unknown geopolitical risk, and now that has come to fruition.

The war in the Middle East has certainly impacted inflation, but we have just come out of an inflationary period post-covid, where companies had got used to passing on inflation. So, the good news is that most companies have managed to keep margins fairly stable. The bad news is that obviously perpetuates inflation, which is now across the board in the US. But it has not caused the kind of shock I would have expected.

Across our portfolio, we are not seeing any industry being differentially impacted or faltering. Where there is any kind of distress, the two main reasons are deals done in the 2021/22 vintage when base rates were zero, which is vintage-specific, and deals with some form of covid hangover. Even in software, we have not seen many of those businesses fall off a cliff with regard to, for example, subscription renewal rates.

Looking forward, we remain cautiously optimistic that some of the noise will settle down. There probably is some upward pressure on rates in Europe, which could have a dampening effect on growth. In the US, it is never too early to start thinking about the next election and that may have implications. But we are not seeing any big new issues on the horizon.

we are picking and choosing our spots there. The consumer is obviously hugely important to the economy, but the typical consumer is a bit strained, with inflation continuing at an elevated pace in the US and picking up in Europe. Still, we like certain trends such as better-for-you and premiumisation, which we will continue to invest behind.

Q Liquidity and BDC redemptions are another big theme. What aspects of these should investors be focusing on?

Redemption requests continued through the second quarter after the first uptick in the fourth quarter of last year. But there are also subscriptions coming in on a monthly basis, which is often missed in the press. So, the industry as a whole has still been fairly positive from a net flows perspective, especially in our core mid-market segment.

Within non-traded BDCs, five big complexes represent the majority of the industry. Then there is a tail of around 30 others, of which we are one. So it is a tale of two halves, with the big five getting hit with the most redemption requests and starting to struggle a bit for new subscriptions, and the rest of us with far less redemption requests and continued subscriptions leading to continued net growth.

"There is a movement away from software and some of the more ethereal industries towards basics such as manufacturing and industrial production"

None of this means private credit is dead. Different managers rely to varying degrees on retail and if there is a pullback there then it does have an impact from a flow perspective. But private credit is not going away. A number of us have very big institutional clients that are thinking about a much longer time horizon, and the asset class continues to be very attractive to insurance companies.

Finally, there is also a performance aspect to this. Over the past 18 months, we have outperformed those big five players by about 200 basis points on a net returns basis. Perhaps it's no surprise that people sell when they do not get the returns they anticipated. Those players are not necessarily making bad investments, but they tend to run lower leverage than the industry norm and rely somewhat inordinately on broadly syndicated loans rather than true private credit with its inherent return premium. So, they are going to have lower returns and investors are coming to realise that.

Q What is the outlook for the rest of 2026? Can we expect more divergence in GP performance in private credit?

We remain pretty optimistic about dealflow. I think the core mid-market will continue to be steady and I do not see a huge wave of defaults based on any particular industry configuration.

We may see rates potentially increasing in Europe and the US, which means a continued opportunity for junior capital that has flexibility around cash versus payment-in-kind income to help plug some capital structure holes. So, we will likely see some interesting opportunities there.

As for divergence, this is not equity, so GP performance generally sits within a fairly tight band. We probably will see a bit more dispersion related to performance and portfolio composition, with people playing in different parts of the market, however, with returns in the upper mid-market likely diverging a bit more from the core.

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Q Finally, what are you most excited about in today's credit markets?

I am excited about the consistent burn of private credit, which we have proved over time is an asset class that can adjust. Being in the most senior part of the capital structure protects you and if you have the right documentation, focus on downside management and can handle the illiquidity, you can get a nice premium to the public markets.

Retail has found this an interesting asset class and institutional investors have started to carve out part of their fixed income allocation specifically for private credit. They are willing to give up some liquidity to get a premium return, which makes a lot of sense.

Private credit is a maturing asset class that is getting a lot of attention, and rightly so. They say the tallest blade of grass is the first to be cut, and in the lawn of alternative assets, private credit is the tallest blade of grass right now, so it is getting snipped at. It is arguably a victim of its own success, but the noise will die down, and we can look forward to plenty more positive opportunities going forward. ■