VIDEO TRANSCRIPT
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Lord Abbett Explains: Private Credit—Understanding the Asset Class

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In this video, Lord Abbett Portfolio Specialist Michael Cibelli provides an overview of private credit, highlighting its fundamentals and the key considerations investors should understand about the asset class.

MICHAEL CIBELLI: Private Credit. We've all heard the term. But what does it actually mean? This is Lord Abbett Explains: Private Credit.

Hi, I'm Michael Cibelli, and today we're making sense of the term "private credit."

What Is Private Credit?

Simply put, it's an alternative form of borrowing and lending money that takes place outside of the traditional banking system or the publicly traded capital markets.

Because the loans are privately originated and not publicly traded like bonds, we get the name: private credit. Instead, the loans are made with the expectation that they'll be held until maturity.

It's an important consideration—not just for the lender, who's holding the loan—but also for the borrower, who will be partnering with that same lender on an ongoing basis for the life of the loan.

This private, non-traded nature of the loans contributes to their low price volatility relative to public debt.

What Financing Options Are Outside the Banking System and Capital Markets?

Let's unpack that through the lens of small and large businesses. When it comes to financing—smaller or less established businesses historically have turned to commercial banks. Alternatively, some have gone the private credit route, working with non-bank lenders that specialize in middle-market business loans.

For larger companies, the financing landscape looks a bit different. These businesses borrow in large enough size that they can partner with a major investment bank, which raises capital on their behalf by tapping investors such as asset managers, institutions, and individuals by issuing publicly traded bonds or loans.

But some of these larger borrowers may choose to skip the middleman entirely and source capital from the private credit markets, opting to secure a loan directly from a private lender, like a private credit fund, a Business Development Company (or BDC for short), or an interval fund.

What's the Appeal of Borrowing in Private Markets?

While issuing publicly traded loans may be a lower-cost option for these larger borrowers, primarily because they don't need to offer investors a yield premium for illiquidity, it still may be appealing for companies to borrow privately for a few reasons.

1. Partner with fewer lenders

First, they can partner with one or just a few lenders that have a long-term perspective versus a very broadly syndicated public loan with potentially hundreds of lenders that lack any real commitment to the borrower.

2. Negotiate bespoke terms

Second, they can negotiate bespoke terms with the lender based on their specific needs.

3. Certainty

Third, There is more certainty with respect to the amount of capital that will be available to borrow and the terms of the deal, whereas in the public loan market, the capital raise is on a best-efforts basis, and a longer timeframe until a deal closes may cause the terms initially discussed to differ from what the terms look like at the time of execution, especially if rates or the cost of risk changes in the market.

Periods of high volatility, such as COVID, amplify this uncertainty of execution associated with the public loan markets.

4. Preserve deal confidentiality

Fourth, private deals preserve confidentiality.

5. Reduce reporting burden

And fifth, borrowers can avoid the burdens associated with extensive reporting and ratings requirements.

Does Private Credit Always Involve Corporate Loans?

Not exactly. The definition of private credit has evolved. While it's often used interchangeably with private corporate lending, it casts a much wider net nowadays.

Historically, it meant lending money to U.S. companies in the form of private, non-traded loans, now estimated to be a $1.7 trillion market.

But today, private credit can be used as a broader term that includes loans for real estate projects, infrastructure financing, and even asset-based loans backed by inventory, equipment, receivables, and/or pools of loans.

Add all that up, and some estimate private credit to be a $40 trillion market.

Let's Recap

So what are the three most important points here?

1. Includes private bespoke loans

First, private credit encompasses various forms of private, bespoke loans made by non-bank lenders.

2. Capture broader opportunity set

Second, beyond private corporate loans, private credit can also be used to capture a broader opportunity set.

3. Loans held to maturity

And third, the loans don't trade in the public capital markets; they're held to maturity and therefore demonstrate lower volatility relative to public debt.

So, there you have it, private credit 101. Thanks for watching. Be sure to tune in to our next private credit explainer video on direct lending.

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Glossary

Asset-based loans are a financing arrangement where the lender provides credit that is secured by collateral. The collateral typically includes inventory, accounts receivable, equipment, or other property owned by the borrower.

Business development company (BDC) is a type of investment company in the U.S. that provides capital to small and mid-sized businesses, as well as distressed companies. BDCs are designed to help these firms grow during their early stages or regain financial stability.

Direct lending is a type of private credit strategy that makes direct, illiquid loans to middle market companies outside of the traditional banking system. A direct loan refers to a privately negotiated loan provided by non-bank lenders directly to a borrower, typically a middle-market company.

An **interval fund** is a type of closed-end investment company registered under the Investment Company Act of 1940 that do not trade on public exchanges. They offer periodic repurchase opportunities at specific intervals, usually quarterly, when investors can redeem a portion of their shares at the fund's net asset value (NAV).

Liquidity in daily liquidity vehicles, like mutual funds, allows investors to buy or redeem shares at the end of each day's net asset value (NAV). A quarterly liquidity vehicle refers to an investment structure that offers investors the opportunity to redeem their shares on a quarterly basis. Highly illiquid investments, such as Limited Partnerships (LPs) or private funds, may require investors to wait for a specific event or a longer period to exit their investment.

Liquidity premiums are the additional return investors demand for holding assets that are less liquid—meaning they cannot be easily or quickly sold at fair market value. It compensates investors for the risk associated with investments that are difficult to sell or trade.

Origination refers to the process by which private credit managers source, structure, and execute new loans or credit investments. It is the starting point of the lending cycle.

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