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VOICES Consolidation, Disruption in Private Credit: Q&A

Jens Ernberg, co-head of private credit at alternative money manager Capital Dynamics, sees more consolidation in the private credit market.

Ernberg, who helps oversee $12.4 billion in private equity assets that include private credit, spoke with Kelsey Butler on June 13.

Comments have been edited and condensed.

Where do you see opportunities now?

Well, given our historical focus on the lower middle market, we continue to think that that area is an interesting area of the marketplace. It continues to be a less efficient market, which translates to, in our view, better risk adjusted returns. With efficiency comes spread compression and potentially more aggressive terms as participants compete to win business. The lower middle market continues to be less competitive in our view. We've seen a lot of capital raised for middle-market direct lending, but much of that has been concentrated on what we call the upper middle market and the broadly syndicated market.

Will there be more consolidation among lenders?

We've seen a fair amount of consolidation in the space, a lot of it has been around both public and private BDCs. On the public side, BDCs on the lower end of the scale have been challenged to raise additional capital. It's very challenging if you're trading below net asset value, for instance, to raise incremental capital in the public markets. And so they tread water and have difficulty expanding and therefore struggle to retain talent, and become targets for consolidation. It also is an opportunity for larger asset managers that have aggregated a lot of capital to put significant capital to work in a single trade that allows them to immediately generate a fairly diversified investment portfolio.

I think there continues to be a lot of subscale managers out in the marketplace that struggle. And those will be opportunities for larger managers to continue to consolidate the space. So I would anticipate continued consolidation, which for us in the lower-middle market is a positive trend frankly as it creates more of a void in the supply side.

What will change the landscape of the industry?

If you start to see an economic downturn and portfolio companies start to underperform and default rates rise, that's when you'll start to see some differentiation among managers in terms of ability to manage their portfolios and to take advantage of those dislocations opportunistically.