

E X P E R T Q & A

The US private credit market remains ripe with opportunities, with software-as-a-service a particular standout, says David Flannery, president of Vista Credit Partners



Why the golden era of private credit is not over yet

As an asset class, private credit has enjoyed strong fortunes in recent years with many declaring this period as a ‘golden era’. As with any period of prolonged growth, some have raised concerns that this may be ending, but many in the sector still see numerous opportunities to continue building their loan portfolios. *Private Debt Investor* sat down with David Flannery, president of Vista Credit Partners, the credit investing strategy of Vista Equity Partners, to find out where the private credit market might go next.

Q The last few years have been named the ‘golden era’ of private credit - however,

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recent sentiment has indicated this may be changing. What factors are influencing market dynamics?

Over the last several years, the private credit market in the US has experienced one of the most attractive environments, generating higher risk-adjusted returns. Private credit has become such an important part of finance, providing a much-needed source of growth capital to companies – at a time when the banking system continues to tighten its lending

standards in response to regulation.

Additionally, more and more companies don’t want to deal with the volatility of the public markets and are staying private for longer – further driving the need for scaled financing solutions. Given these factors, I believe that with continued structure and underwriting discipline, the private credit market will continue to perform well for investors.

Q Most opportunities for private credit have been in the sponsor market. However, Vista has been able to pursue opportunities with non-sponsor, founder-led software

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companies. What opportunities do you see in this area?

The sponsor side of direct lending has certainly been more of the historical focus for the private credit market. However, we see opportunities to generate unique risk-adjusted returns by providing financing solutions directly to the founders of software companies. Our ability to capitalise on this opportunity is driven by our position within the broader Vista platform, which has nearly 25 years of experience investing in the enterprise software ecosystem.

Our credit solutions provide highly developed software companies with less dilutive capital than historical alternatives – prior funding for these businesses was largely sourced from the growth equity and IPO markets. Given current volatility in both these segments of global capital markets, we have seen significant increases in our dealflow. With the right underwriting discipline, unique sourcing capabilities and established brand, we believe these dynamics will drive more compelling opportunities in the road ahead.

Q How are the founders of these businesses leveraging the private credit channel to grow their businesses?

We often remind founders and management teams that when we make a loan to a company, the cash stays on the balance sheet for the company to invest. Most of the time, this capital is used in the go-to-market function of the business – sales, marketing and customer success. This investment is predicated upon high ROI generation that can be replicated over time.

We’ve also seen a trend emerge with more companies looking for loans to help them finance M&A. In these situations, we are lending money to software companies who are looking to consolidate market share.

Here again, Vista has a wealth of experience. Our credit strategy has

executed on more than 620 transactions since inception and we have numerous experts throughout our firm who can help us evaluate the risk.

Q How can private credit investors mitigate risks when investing in non-sponsor companies?

A core part of how we mitigate risk is the due diligence before we underwrite a loan. We deploy Vista’s operational expertise alongside our core credit underwriting to assess the breadth of potential risks that could lie in any given transaction. For example, our technology diligence process is conducted by Vista’s Value Creation Team, which often identifies underlying issues with a company’s product architecture – some are small and easily fixable, and others are serious enough that we pass on the investment entirely.

This is where the benefit of a \$100-billion-plus platform focused on software comes to bear. Generalists and lenders with fewer available resources typically don’t have that level of visibility and aren’t able to move away from problematic opportunities in the way that we can.

We often hear private credit firms talk about better structures and stronger covenants, which I’d argue rings even more true in the context of non-sponsored lending where the financings are bilateral in nature. This results in some of the tightest maintenance covenants in the market, including a covenant that often requires considerable revenue growth.

At times, we are also active investors through board seats or board observer rights. This can give us real-time information about what is happening at a company, and we have the opportunity to influence outcomes at a management level. That is uncommon in private credit. Due to the experience we bring to the table as software specialists, our viewpoints are often welcomed by CEOs. They want to hear what we have to say and how we can

Q What is your outlook for the credit market? Is the team generally bullish, bearish or somewhere in between?

It's a great environment right now for what we do in software. Companies are growing, margins are expanding and yet the public equity markets are not reflecting that optimism. This presents opportunities for lenders like us – for context, our credit portfolio is growing well above most generalist direct lending books. We're excited about this growth and the continued opportunity for our credit portfolio.



help them grow, given our experience in the market.

Q How are new structures such as business development companies, or BDCs, changing private credit?

The arrival of new structures is good for private credit overall, providing a broader base of investors, including the private wealth channel, with more liquid options and a different way to invest in the growing credit opportunity.

Accessibility is a positive, but it has made the generalist sponsor lending financing market very competitive. We believe that many BDC portfolios today are burdened with legacy positions in over-levered companies as well as a limited ability to go on the offense and capitalise on attractive investment opportunities.

Additionally, there is significant overlap among the largest private credit investors and their BDCs – we estimate more than 50 percent at the borrower level for the larger vehicles – which means a potential issue in one portfolio can have an outsized impact.

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Vista Credit Partners raised its inaugural BDC last year, and because we began deploying capital in late 2023 – after the market high – we believe we are less constrained by these factors. We believe our BDC is well positioned to deploy fresh capital into companies that have withstood the rate hike at better pricing, tighter documents and lower LTVs.

Q How has the arrival of generative AI impacted the private credit market? What opportunities are you seeing as a result of this trend?

There has been a huge amount written and spoken about AI, but in our view, there are three key opportunities.

First, AI will help private credit investors to develop tools that will allow them to access data extremely quickly and gain better insights. If we can apply generative AI to our own data and extract interesting trends and learnings we can act on, there are exciting opportunities to be had. This will also give us more time to do what we do best – invest in software businesses.

Second, we have seen a pullback from late-stage growth equity providers that have funded software businesses in the past because they are very focused on the opportunity in generative AI. There is a real gap in the market for late-stage software companies – our target market, in other words – that still presents real value. We'll continue to focus on enterprise-grade software, which we feel is a more predictable investment than consumer-focused software.

And third, data is going to uniquely drive value in AI. Software companies control the data sets for their businesses and have the domain expertise to leverage this data at scale, which is going to be very important on a go-forward basis. We believe our software companies across private equity and private credit are at the cutting edge of implementing new generative AI tools to drive new revenue opportunities. ■