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9fin-Private Credit 9fin-Unicrunch

The Unicrunch — Whether good business or FOMO, private credit wants in on AI (9fin)

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The Unicrunch is our US private credit newsletter, in which we break down everything from unitranches to ABL.

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Stranger than fiction

The trajectory of any new technology in the modern day is to begin as a miracle and later turn into something taken for granted. AI was once the figment of the imaginations of Phillip K. Dick and Isaac Asimov, but now it is the latest building block in Elon Musk's ever-growing empire.

And perhaps the same can be said of private credit: once the curious idea of US regulators post-crisis to push risky corporate lending out of the banking sector, it has now become the must-have for every sponsor out there.

So with the rapid growth of AI and private credit in recent years, it's perhaps not surprising to see the two cross paths: a $12bn path to be exact! For this week, *9fin* reported that **Apollo** is in talks to lead a roughly $12bn financing for Musk's xAI. The potential package is slated to be roughly $10bn of private loans and a $2bn revolver.

Should the deal happen, it will be the largest private credit financing the market has seen (outside of the IG private credit space), dwarfing **Magnetar**-backed **CoreWeave**'s $7.5bn facility, which was led by **Blackstone** last year. But in both CoreWeave and xAI, the deals are centered around AI infrastructure, such as building or updating data centers to help the technology grow.

The sizes of the deals are headline grabbing, and it clearly signals a belief that both the creditors and the companies have in the future of AI. But there are certainly risks involved in putting up a significant amount of money in what remains today a technology that is difficult to generate revenue from.

Yet, while the technology is a risky proposition for some businesses, the reality is that not engaging with AI is a *riskier* proposition for many. For those embracing it, they claim it can revolutionize workflow and improve efficiencies but just over half of large companies have even established a team dedicated to generative AI adoption, according to a survey from McKinsey earlier this year.

But the disruption fears are here — and software companies in the recent week have seen valuations crushed as the AI looms over the financial ecosystem. Private credit has invested billions into software in recent years, underwriting loans at a time when AI as a risk was a mere dot on the horizon. Now it is the turn of those sponsor to invest in AI and take their businesses to the next level and adapt to new demands. Yet they will need to get it right, for the last time an abundance of capital flowed into a new technology it didn't exactly go well.

The market has seen shocks this week that have directly impacted CoreWeave's stock price (which has fallen over 20% in the last five days), among many other AI companies. Such shocks, however, might be miniscule compared with Musk's famously erratic public profile and that may be the bumpy ride Apollo and other private credit firms have to look out for in any future partnership with xAI.

Still, most managers will most probably feel the FOMO and will find a way to get comfortable with xAI's underlying numbers, Musk's unique personality and invest alongside Apollo. The AI miracle is in its stage of revolutionizing markets, the hope is that Musk and other private credit lenders are still here when it is taken for granted by the already wary masses.

The Good, the bad, and the PIK

Recent research from **Lincoln International**'s Q2 private markets index found that PIK coupons are present in 11% of deals they cover. Over half of these PIK instruments are what is considered "bad PIK". In other words, it is a PIK instrument that was added after the initial financing.

"This translates to a 'shadow default rate' of 6%, which may be more indicative of the health of private credit," the report said.

The reason Lincoln describes it as a 'shadow default rate' is because it found that the 'default rate', that which covers size-weighted covenant default, came out at 3.4% in Q2. This is an increase from the 2.9% in Q1, but isn't close to the 6% PIK rate. (In February, we asked if looking at the PIK rate was a far more fruitful exercise in assessing the health of the private credit market than the default rate.)

Fitch reported a similar upward trajectory in defaults. According to its recent U.S. Private Credit and Middle Market Performance Monitor, the default rate for private credit in Q2 went up a percentage point to 5.5% from 4.5% from Q1.

A closer look at its data shows that the large middle market — which Fitch describes as issuers with revenue below $500m and loan sizes between $100m and $500m — has a higher default rate of slightly over 6% over the trailing 12 month period from the end of Q2. This is the highest it has been since 2007, with only 2023 being close at slightly under 6%.

The idea of finding distress in among the opaque data sets private credit likes to put out has been a conversation for a while. But we started tracking an uptick in it earlier this year and this data only serves to prove that things are getting worse out there for private credit firms.

Covenant breaches or adding PIK, it's starting to get ugly out there.

This week in *9fin*

Al Diaz departs Carlyle for Blue Owl

Goldman Sachs BDC — Q2 25 BDC earnings review

Direct lenders arrange $660m loan for Blackstone's AGS Health LBO

San Bernardino pension mulls $575m allocations to European credit

TPG Twin Brook and Coller close $3bn continuation vehicle

Audax leads $200m O6 Environmental LBO financing

Arena wins lawsuit alleging violation of sacred rights when Aquco failed to pay interest or principal upon maturity

MidCap Financial — Q2 25 BDC earnings review

Blackstone and Goldman co-lead debt for $2.5bn Sapiens take-private

Till debt do us part — lenders back hospice M&A

Sponsor case study — Blackstone

US private credit pipeline

123Dentist in talks with direct lenders over C$400m add-on

What's in market

For a more comprehensive list of live deals, there is 9fin's US private credit pipeline readers can explore.

xAI — Elon Musk's artificial intelligence company is in talks with Apollo for a $12bn debt package. The deal is still pending and there's room for banks to get involved.

Production Resource Group — This live events production solutions provider is preparing to undergo a second restructuring after being placed on non-accrual, according to FS KKR's latest earnings call.

Enverus — This energy data analytics platform is being acquired by Blackstone. Direct lenders, including Ares and Golub are looking to provide a roughly $3bn-$3.5bn debt package.

Kroll — This financial and risk advisory company is looking to direct lenders to refinance about $2.5bn of its broadly syndicated senior debt.

St. Croix Hospice — This hospice care provider is set to be acquired by Linden Capital as part of a potential roll-up with Agape Care Group. St. Croix is being marketed on $100m EBITDA.

Bridger Aerospace — This publicly-traded aerial firefighting company is considering tapping private credit lenders to refinance its existing debt. Stifel has been mandated to facilitate the process.

From around the web

Private credit primed to profit from new federal student loans limits (WSJ)

Private credit is a booming business. Where one pro sees risks and opportunities now (Barron's)

Private credit's PIK usage nears four-year high, Lincoln says (BBG)

US corporate defaults on private debt rose in Q2, Fitch says (Reuters)