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Asset Based Lending

Quarterly Market Commentary: Q3 2025

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Market Commentary

Whether it was references to a canary in the coal mine or cockroaches, the third quarter of 2025 brought heightened attention to the U.S. private credit market following a series of high-profile bankruptcies. While headlines focused on the collapses of Tricolor Holdings and First Brands Group and industry leaders traded jabs in the media about underwriting standards, we view these events as idiosyncratic rather than indicative of systemic risk.

Tricolor Holdings, a Dallas-based subprime auto lender and dealership, filed for Chapter 7 liquidation in September. The company specialized in buy-here/pay-here vehicle sales and in-house financing to underbanked borrowers, securitizing its auto loans and funding operations through large warehouse credit facilities.[1] In early September, Tricolor initiated mass layoffs, and its lenders pulled credit lines amid rising charge-offs and suspected fraud.[2] The company is reportedly being probed by the Department of Justice over allegations of fraud, which included the "double pledging" loans as collateral across multiple lenders and duplicated vehicle identification numbers to generate multiple loans per vehicle.[3]

First Brands Group, a Michigan-based auto parts manufacturer, filed for Chapter 11 bankruptcy later in September. The company had pursued an aggressive, debt-fueled acquisition strategy in the aftermarket auto parts sector, borrowing heavily to fund acquisitions that projected an image of growth while masking underlying problems.[4] First Brands ultimately filed for bankruptcy after creditors questioned its extensive borrowing and heavily adjusted earnings during a refinancing attempt – a cash crunch further strained by auto-industry tariffs, which raised costs for its import-dependent manufacturing.[4] Its bankruptcy petition listed liabilities between $10 billion and $50 billion, including $6.1 billion in on-balance-sheet debt, $2.3 billion in off-balance-sheet financing, $800 million in supply chain finance liabilities, and $2.3 billion in factoring obligations.[5] Just before filing, the company disclosed that SPVs expected to hold cash had none, casting heightened doubt on its liquidity and transparency.[4] The bankruptcy revelations further alarmed its financial partners, as court records showed that First Brands had accumulated billions of dollars in debt not reflected on its balance sheet, intensifying concerns about the company's true financial condition.[4]

We believe these bankruptcies underscore critical lapses in documentation and oversight that allowed fraudulent practices to persist. In both cases, many of the risks could potentially have been mitigated through expanded diligence and stronger post-funding controls. For example, a leading outsourced field-examination firm conducted due diligence on First Brands in 2022 and flagged its first concern: the company refused to grant access to one of its storage sites where the firm sought to inspect the underlying collateral supporting the prospective loan.[6]

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[1] Source: McDonald Hopkins: Tricolor Bankruptcy Causes Lenders to Reassess Risks (October 7, 2025)

[2] Source: Bloomberg: Tricolor's Frantic Final Days Began With a Call From JPMorgan (November 11, 2025)

[3] Source: Neuberger Berman: Lessons from First Brands and Tricolor (October 14, 2025)

[4] Source: Bloomberg: Why First Brands Has Sparked So Many Concerns on Wall Street (November 10, 2025)

[5] Source: Global Trade Review: First Brands Accuses Founder of Receivables and Inventory Finance Fraud (November 4, 2025)

[6] Source: Financial Times: How Apollo, Soros and Others Spotted Red Flags at First Brands (November 13, 2025)

In the aftermath of these events, clients have asked variations of, "What lessons can be learned?" and "What could lenders have done differently?" A few key items stand out, most of which tie back to the four C's of credit: Character (trustworthiness), Capacity (ability to repay), Capital (cash assets), and Collateral (loan security):

1. No Shortcuts: Run Lien Searches & Conduct Field Exams: This is fundamental to asset-based lending ("ABL") and appears to have been overlooked by lenders eager to win business at the expense of sound underwriting. It is critical to verify and confirm that the loan being made has clear title (i.e. not pledged to another lender) to the assets securing it.

2. Be Wary of Roll-Up Strategies: Accounting hijinks often take place with businesses that are serial acquirors of other businesses. While M&A can be an effective growth strategy, it warrants closer attention to the audited financials, particularly when leverage is high.

3. Tigers Don't Change Their Stripes: If someone has been accused of fraud previously, it should be a huge red flag. Lending to quality, high integrity management teams is paramount, and background checks should be conducted as part of the diligence process.

Both cases underscore the importance of forensic credit analysis and structural discipline. In addition, basic ABL documentation requirements such as the aforementioned lien searches, field exams, and more frequent financial reporting (i.e. at least monthly) may have flagged the issues that plagued First Brands and Tricolor sooner. We believe these failures likely stemmed from potential fraud or, at a minimum, questionable business practices rather than operational weaknesses, and affected a range of investment vehicles, including public ABS, BSL, and large bank warehouse lines.[7]

Going forward, we expect underwriting standards to tighten, with greater emphasis on consolidated financial reporting across complex structures, more frequent, rigorous field exams and cash-flow tracing, and stronger covenant frameworks to mitigate idiosyncratic risks.

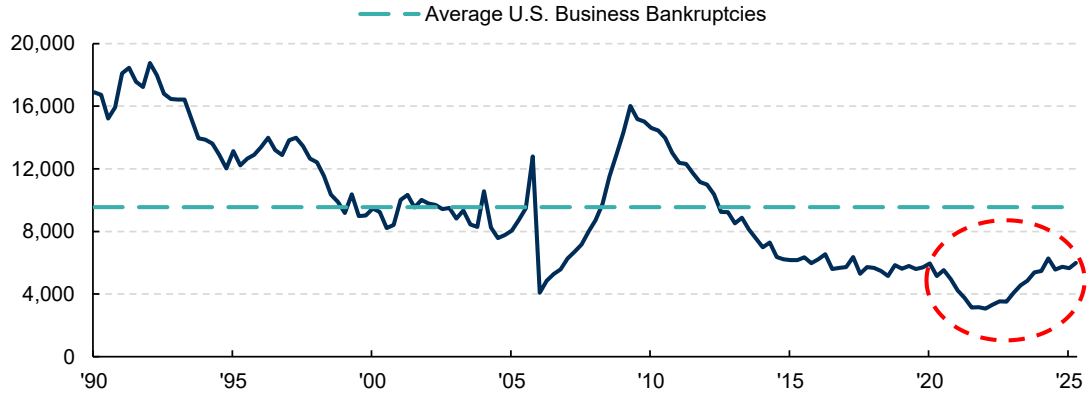
The Federal Reserve's November *Financial Stability Report* echoed these concerns, noting that while recent bankruptcies appear isolated, they highlight vulnerabilities tied to opaque financing arrangements.[8] Overall, the Fed assessed U.S. financial system risks as moderate, citing stable business and household debt levels at 20-year lows relative to GDP, strong consumer credit profiles, and subdued mortgage delinquencies.[8] Slightly elevated auto and credit card delinquencies were noted, but no material uptick in broader bankruptcies (as outlined in the chart on the next page).[8]

[7] Source: Cambridge Associates: Do the Recent Bankruptcies of First Brands and Tricolor Suggest Trouble Ahead in Private Credit? (Nov. 11, 2025)

[8] Source: Federal Reserve: Financial Stability Report; November 2025 (November 7, 2025)

U.S. Business Bankruptcies Remain Around Their Pre-Pandemic Normal Levels

Quarterly Bankruptcy Filings Q1 1990 - Q2 2025



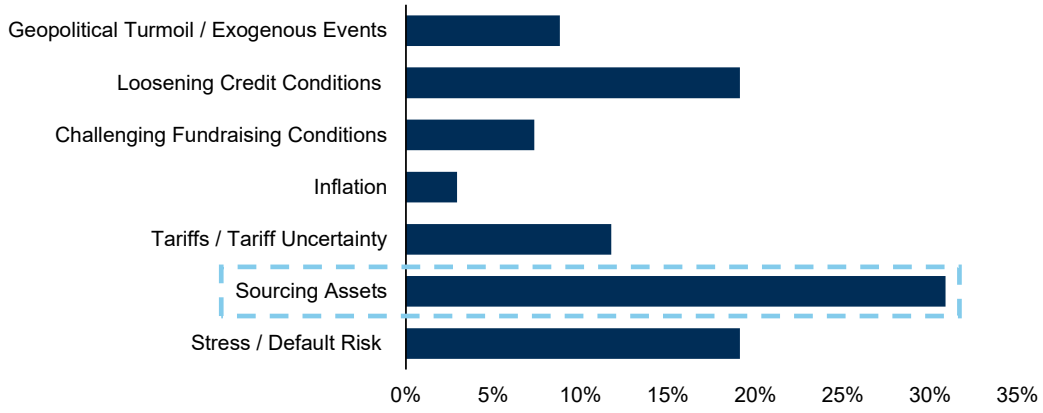
Source: US Courts, American Bankruptcy Institute, Callodine Credit Research Team

Also, middle-market fundamentals remain solid. KBRA reports that middle-market interest coverage ratios improved to 2.3x in Q3, up from 2.0x a year ago, a positive sign for fundamentals. Importantly, we are not seeing indicators of a broader default cycle.

That said, near-term risks flagged by the Fed include policy uncertainty (61%), geopolitical tensions (50%), elevated long-term rates (48%), persistent inflation (43%), and potential asset price corrections linked to AI sentiment (30%).[8] This dichotomy between business level (micro) and broader economic (macro) trends bears watching, as does the resultant monetary policy direction.

While the macroenvironment is reasonably supportive and demand for private credit remains robust, deployment continues to be challenged by supply constraints. We believe this reflects continued muted sponsor buyout activity. PitchBook's Q3 Global Private Credit Survey shows sourcing assets as the leading concern among respondents (see results below).

Which of the Following Will Be the Biggest Headwinds Facing Private Credit Market Participants in the Next Six Months?



Source: Pitchbook LCD Q3 Global Private Credit Survey (Data through Sept. 16, 2025)

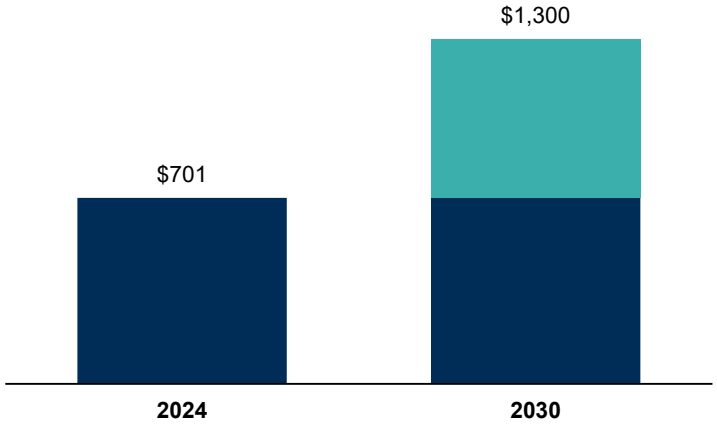
[8] Source: Federal Reserve: Financial Stability Report; November 2025 (November 7, 2025)

Higher interest rates continue to pressure debt-service costs across all markets, but in private ABL, collateralized structures and shorter loan durations may help mitigate risk.[9] Inflation can serve as a partial tailwind for ABL if asset values, such as inventory or receivables rise, whereas it tends to pressure corporate borrowers' margins and weigh on real estate valuations.[9] At the same time, tighter banking regulations are reducing banks' willingness to provide secured credit, giving private lenders a larger role than they had a decade ago.[9] As a result, elevated macroeconomic risk has ultimately created a tailwind for the ABL market, supporting increased adoption and growth across the industry.

Once a niche tool for distressed borrowers, ABL has evolved into a $700+ billion cornerstone of modern finance, which we believe to be driven by institutional capital, automation, and demand from healthy middle-market companies seeking flexible funding. As shown in the chart below, the ABL market reached $701 billion in 2024 and is projected to grow at 10.3% annually through 2030, which we believe to be supported by structural tailwinds and regulatory tightening on banks that limits their secured lending capacity. Macfarlanes reports that 58% of investors plan to prioritize ABL strategies in 2025, underscoring its transition from niche to core allocation.[10]

Asset-Based Lending Market ($ Billions)

Projected Growth at a CAGR of 10.3%



Source: Research and Markets (Data as of 12/31/2024)

Over the past 12–24 months, new entrants have emerged in the broader asset-based finance market, seeking to capitalize on growing investor demand. While this expansion reflects the asset class's increasing popularity, it has also introduced risks of deterioration in creditor protections. In the race to win business, key safeguards have eroded.[11] When the focus shifts from credit integrity to deal velocity, the entire ecosystem becomes more vulnerable.[11]

[9] Source: UBS Asset Management: Charting New Currents (September 23, 2025)

[10] Source: Macfarlanes: The Growth of Asset-Based Finance in Private Credit Markets (January 29, 2025)

[11] Source: ABL Journal: The Cost of Complacency: Lessons from First Brands and the Evolution of Asset-Based Lending (October 30, 2025)

While we are encouraged by the mainstream adoption of ABL among borrowers and investors alike, we believe success in this space requires specialized expertise and a commitment to sound structuring principles. As noted in a recent ABF Journal article, *The Cost of Complacency: Lessons from First Brands and the Evolution of Asset-Based Lending*, the fundamentals of ABL remain unchanged: understand the balance sheet and liquidity drivers, assess and know the true economics of the business, and recognize that collateral value does not always translate into realizable value.[11]

Looking ahead, we believe sound ABL lending outcomes are predicated on the sustained application of disciplined underwriting standards and asset-focused structures. Inflationary pressures may even act as a partial tailwind for ABL, as rising asset values bolster collateral coverage. In our view, ABL is well positioned for sustained growth as businesses continue to seek reliable alternatives to traditional bank financing.

[11] Source: ABL Journal: The Cost of Complacency: Lessons from First Brands and the Evolution of Asset-Based Lending (October 30, 2025)

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