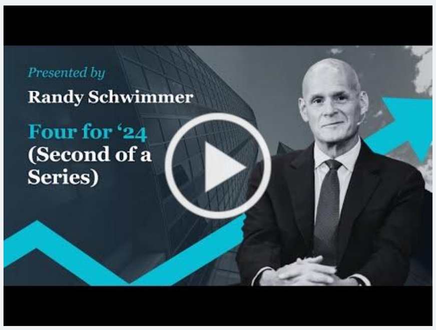
THE Lead Left

Your Tour Guide to Private Capital@

PDF | Research | Week of January 15, 2023

Quote of the Week

"Once the Fed pivoted, that really put investors into a positive frame of mind"
– Tim Murray, capital markets strategist, T. Rowe Price.



Lead Left Vodcast

Four for '24 (Second of a Series)

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Four for '24 (Third of a Series)

2. Winners and Losers: Continued dispersion from multiple dimensions of the market.

The current brew of macro pressures and broader uncertainty have combined to fuel an intriguing effect across multiple dimensions. In 2024, we expect to see continued dispersion across three key market participants: private capital asset managers, private equity firms and portfolio companies. As we navigate slowing economic growth, volatility, and geopolitical shocks, it is even more critical to identify the attributes of winners and losers.

The winners have distinct attributes. Asset managers with scale, diverse investment capabilities, multiple sources of dry powder, and sustainable deal-sourcing advantages, will thrive. These firms will continue to secure the highest quality deal flow, build the most resilient portfolios and attract the broadest capital base, fostering resilience in any market cycle.

Ample cash for deployment is also key for the best private equity firms. Having as well a proven track record of valuation discipline will allow them to prevail as the "buyer of choice" for the best platform opportunities. They will adapt more quickly to the new normal for rates, developing multi-dimensional value creation plans that don't rely on leverage for growth.

For portfolio companies, those with prudent balance sheets or bifurcated financings that offer payment-in-kind ("PIK") flexibility will be best suited to pursue organic and add-on growth. They can diversify platforms to protect and enhance profitability and cash flow generation.

No clearer example from 2023 is the private equity allocator active in both primary LP commitments and equity co-investments. The stark correlation between smaller distributions from one's primary portfolio and diminished co-investment dry powder became evident last year. Those managers with multiples sources of capital experienced significantly less competition for equity opportunities as single-sourced institutions were sidelined.

Conversely, asset managers lacking scale, comprehensive capabilities, and uncertain deal origination will face significant hurdles in an already challenged deal environment. PE sponsors lacking sufficient dry powder, ability to raise new or larger funds, or valuation discipline will fall short in auctions where value-added partnerships count most. Portfolio companies with aggressive capital structures and higher interest burdens will be disadvantaged, shifting available cash to debt service, compromising growth initiatives with little cushion to weather economic turbulence.

The dispersion effect across these key market participants will be a pivotal investment aspect in 2024. Gone are the days of hiding in the middle. Mediocre performers over time are at risk of falling into the loser camp. The strategies adopted by winners – embracing scale, cultivating diverse capabilities, leading with true sourcing advantages, exercising valuation discipline, and maintaining conservative and flexible balance sheet structures – will prove to be a brighter path for success in the year ahead.

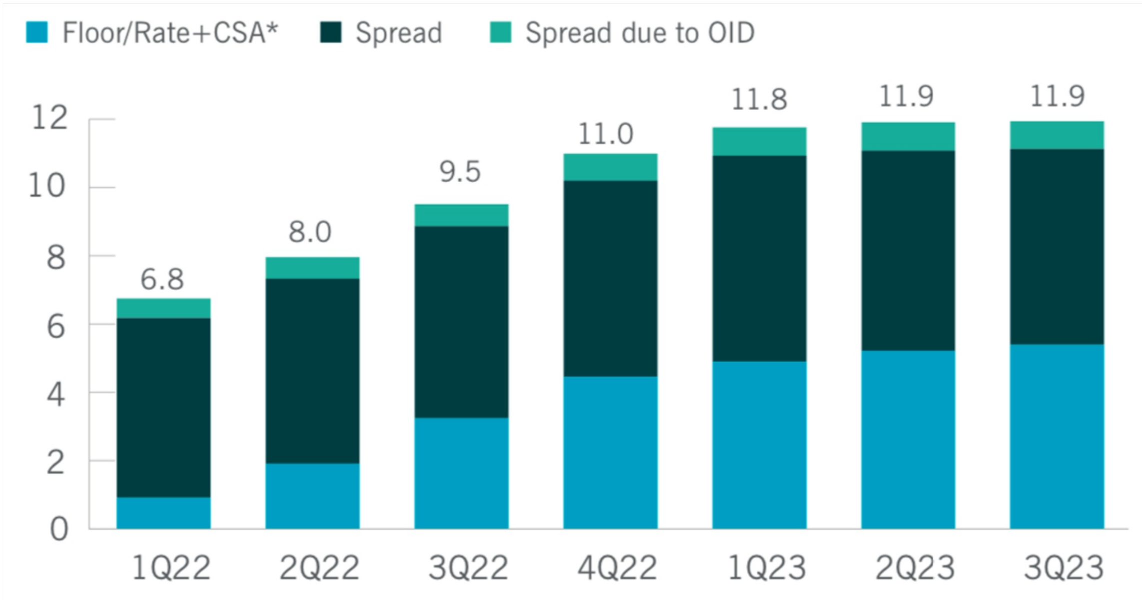
Visit our Website

Chart of the Week

Stairway to Heaven

Investors benefit from – and issuers work through – higher-for-longer rates.

Average first-lien middle market term-loan yield



Source: LSEG LPC
(Past performance is no guarantee of future results.)

Lead with Your Left

Stat of the Week

	Dec 2023	Mar 2023	Apr 2020	Mar 2009
U.S. Real Retail and Food Services Sales ($bn)	**229.8**	**225.8**	**159.4**	**115.2**

Source: Federal Reserve Bank of St. Louis

Loan Stats at a Glance

PitchBook | LCD

	This Week	Last Week	6MO Ago	YR Ago
New-Issue Clearing Yields				
$200M or less	NA	NA	NA	NA
$201M - $350M	NA	NA	NA	NA
$351M - $500M	10.19%	10.34%	10.53%	10.54%
$501M+	9.57%	9.79%	10.23%	10.10%
Middle market (≤ $50M)	NA	NA	NA	NA
Large corporate (> $50M)	9.61%	9.83%	10.26%	10.16%
Large corporate single-B (> $50M)	10.29%	10.52%	10.73%	10.85%
Middle Market Credit Stats				
Sr/EBITDA	N/A	N/A	NA	NA
Debt/EBITDA	N/A	N/A	NA	NA
Middle Market Index Data				
Monthly Returns	0.10%	1.34%	0.41%	0.12%
Average Bid	93.67	93.56	91.03	92.81

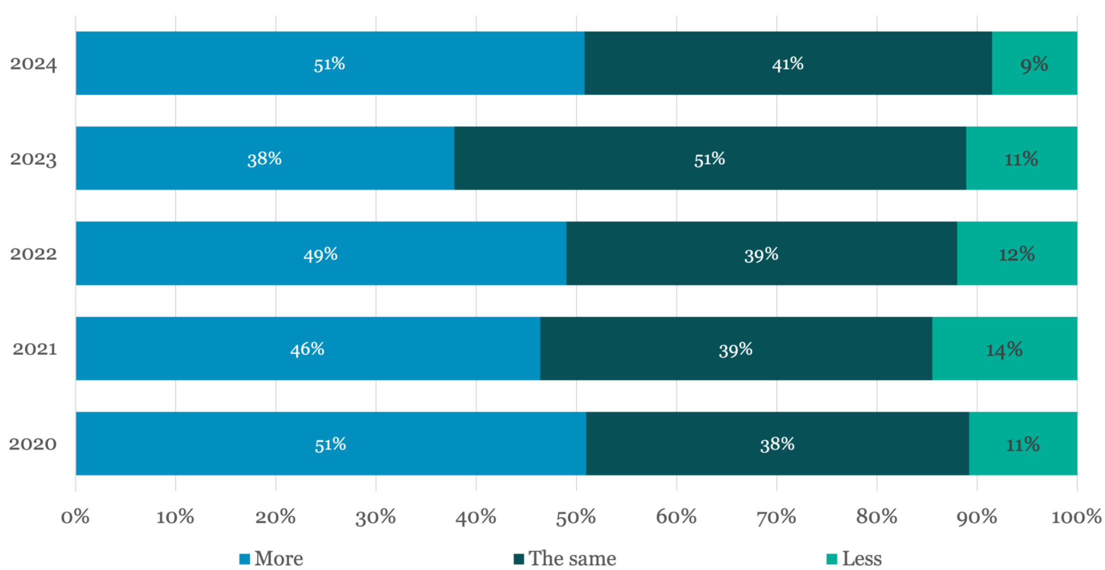
Contact: [Ryan Brown](#)/ [PitchBook LCD](#)

PDI Picks

Private Debt Investor

LPs want more private debt

How much capital do you plan to invest in private debt in the next 12 months compared to the previous 12 months?



That's the positive conclusion arising from our latest survey of investor attitudes toward the asset class.

Every year, *Private Debt Investor* conducts its *LP Perspectives* survey, in which we canvass limited partners around the world for their views on the asset class. What this year's version tells us is that investors have private debt at the top of their priority lists for 2024.

market conditions.

Although over-allocation became a big talking point in private markets following the decline in public markets, 58 percent of respondents to *LP Perspectives* said their investment policy in the event of being

Asked how much they were planning to invest in private debt over the coming 12 months compared with the previous 12, more than half (51 percent) said they were planning to commit more, with 41 percent planning to keep their commitment level the same and only 9 percent aiming for a decrease. This is the highest percentage looking to increase their allocations to private debt since 2020.

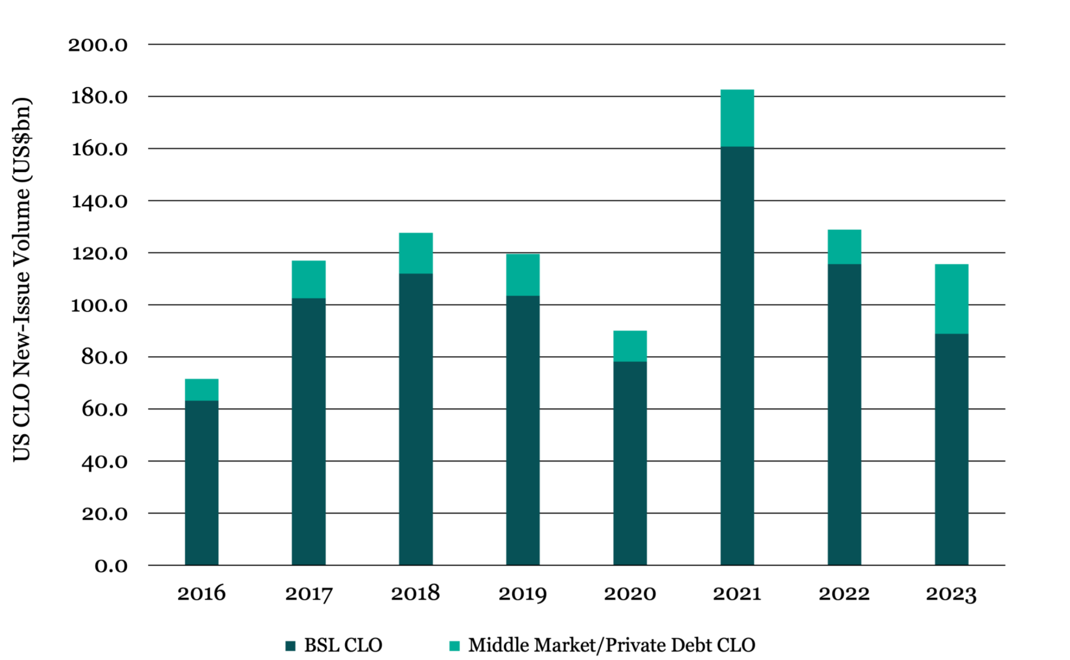
In the equivalent survey last year, only 38 percent of investors were looking to up their commitments – reflecting both the denominator effect and a lack of distributions. The latter of these two factors is cited as the equal-most important factor by those considering reducing commitments in 2024, with the other being over-allocated was simply to remain over-allocated. Thirty-eight percent said they would wait for a market correction to address the issue, while 35 percent would adjust their allocation targets and 22 percent reduce their exposure through the secondaries market.

A big clue to the current popularity of private debt resides in performance, with 39 percent of investors last year saying the asset class had exceeded benchmarks. This figure has fallen a little this time round to 33 percent but, when you add the 56 percent saying performance met benchmarks, that leaves only 11 percent disappointed by the returns achieved. Moreover, an impressive 53 percent tipped private debt to beat its benchmarks in the next 12 months.

Contact: **Andy Thomson** / Private Debt Investor

Leveraged Loan Insight & Analysis

Daily Analytic: US BSL CLO issuance falls 23% in 2023, MM/PD CLO volume more than doubles



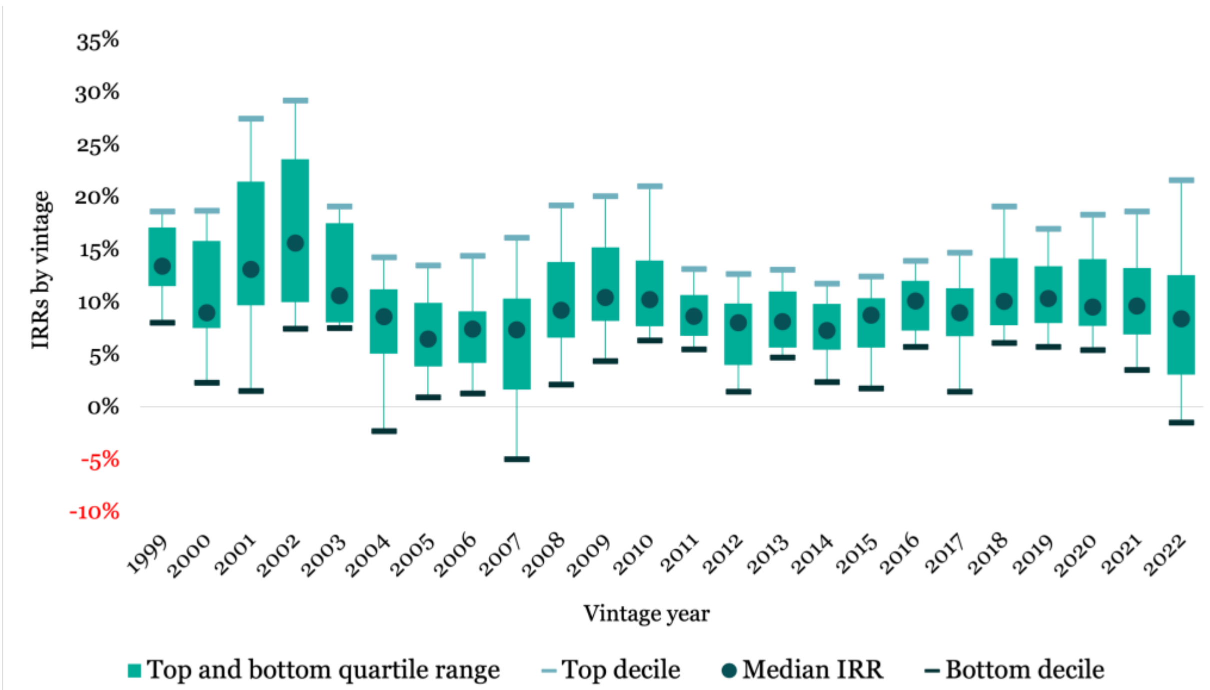
US CLO issuance declined by 10% in 2023 market/private credit CLOs was a bright to US$115.6bn, down from US$128.9bn in 2022. Notably, however, there was a marked difference in the direction of broadly syndicated loan (BSL) CLO activity compared to that of middle market/private debt CLOs. BSL CLO volume fell by 23% in 2023 to US$88.9bn, its lowest level since 2020. In contrast, middle spot in 2023 at US$26.7bn, more than double the US$26.7bn posted in 2022 and 22% above the 2021 level, as private debt managers tapped the market for funding. In the European market, CLO activity held up relatively well in 2023, with issuance totaling €26.2bn, flat versus the prior year.

Contact: [CJ Doherty] / [LSEG LPC]

The Pulse of Private Equity

PitchBook

Global private debt



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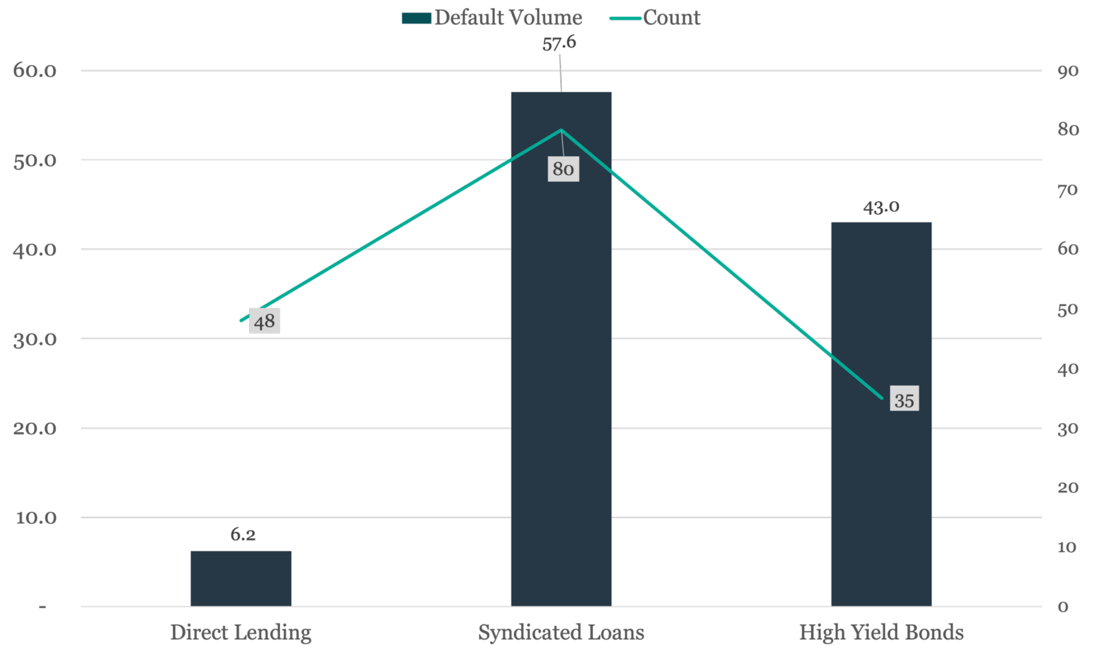
Contact: [Garrett Black] / [PitchBook]

KBRA Direct Lending Deals: News & Analysis

Direct Lending Deals
A KBRA ANALYTICS PRODUCT FOR PRIVATE CREDIT

TTM Default Volume, Count



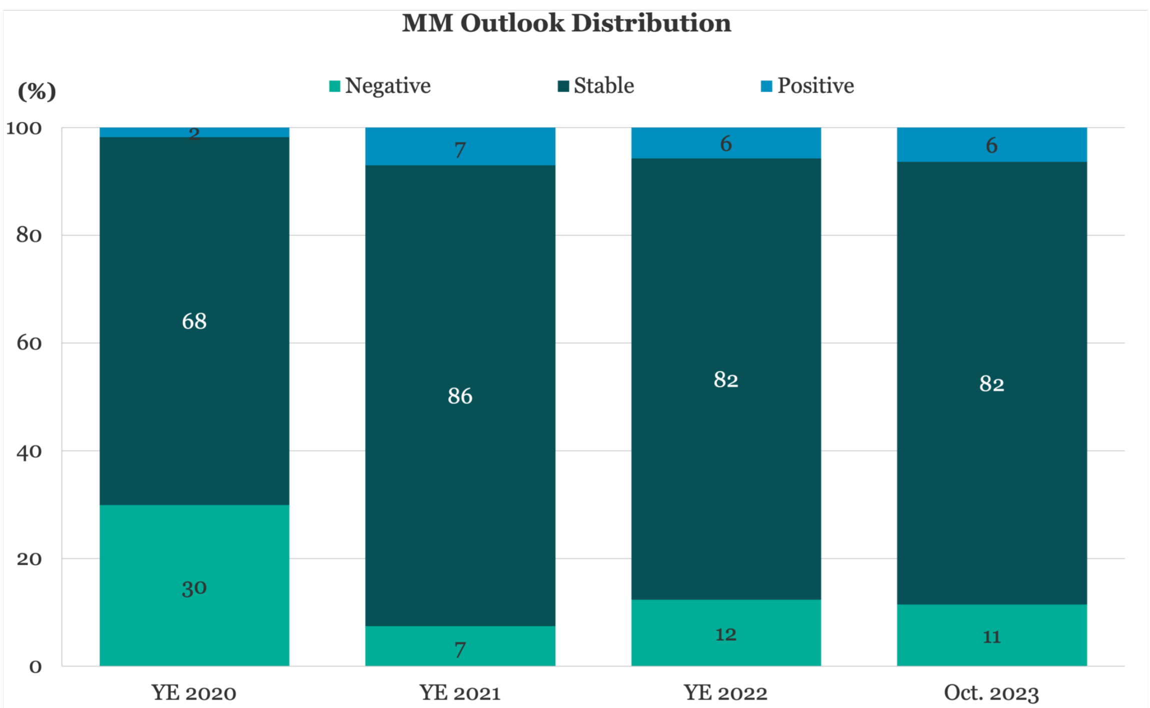
Note: Trailing 12-month defaults as of January 17.
Source: KBRA DLD

Contact: [**Eric Rosenthal**] / [KBRA DLD]

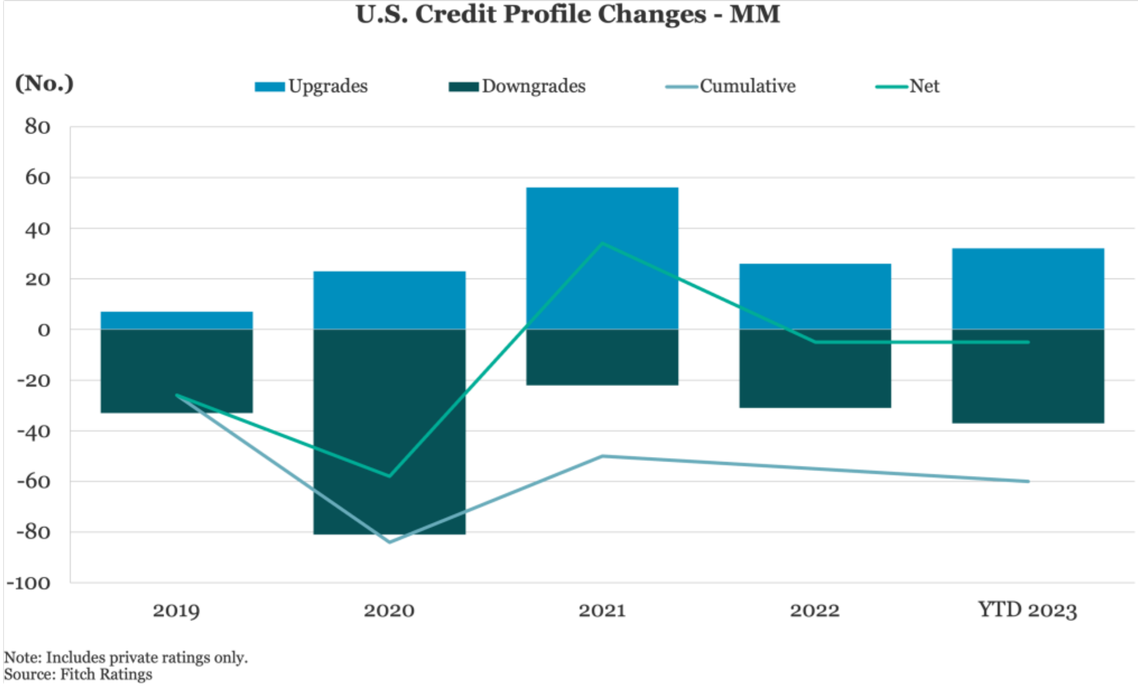
Middle Market & Private Credit

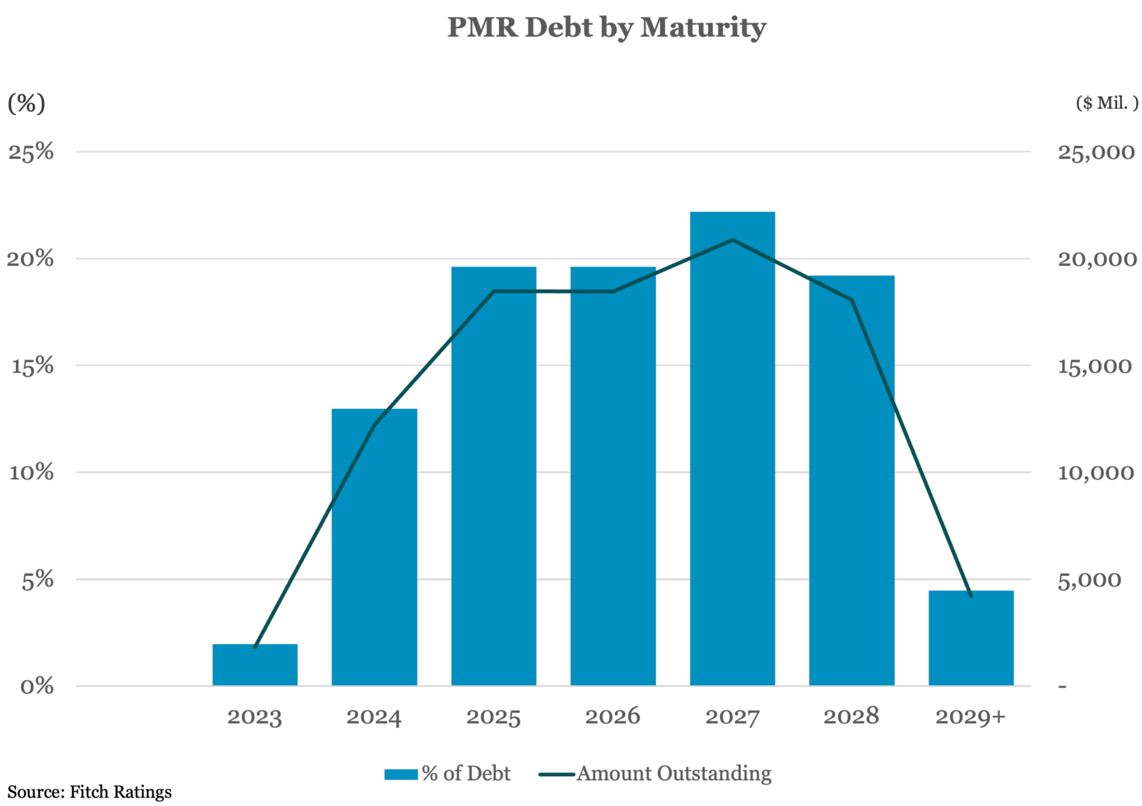
FitchRatings

Fitch's U.S. Middle Market Outlook



MM – Middle Market. Note: Positive and Negative denotes Outlooks and Watches. Includes private ratings only. Source: Fitch Ratings.





The distribution of middle market (MM) issuers' Outlooks within Fitch's portfolio stayed relatively flat in 2023 compared with 2022. Approximately 11% of MM issuers have a Negative Outlook or Watch, relatively unchanged from 2022, and a large decline from 30% in 2020. Net upgrades have hovered around zero so far this year.

The large middle market default rate within Fitch's loan index could remain elevated in 2024, in the mid-single digits, in line with expectations for 2023 but up from 1.4% in 2022, given the greater exposure to including elevated base rates and a slowing U.S. economy.

MM companies are more sensitive to negative economic conditions given their smaller scale, highly variable rate debt structures with limited use of hedges, and higher leverage relative to BSL issuers. Fitch expects challenges to continue into 2024 as weaker companies succumb to prolonged pressure on liquidity from higher rates, and seek relief from lenders and assistance from a sponsor.

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economic headwinds within the segment

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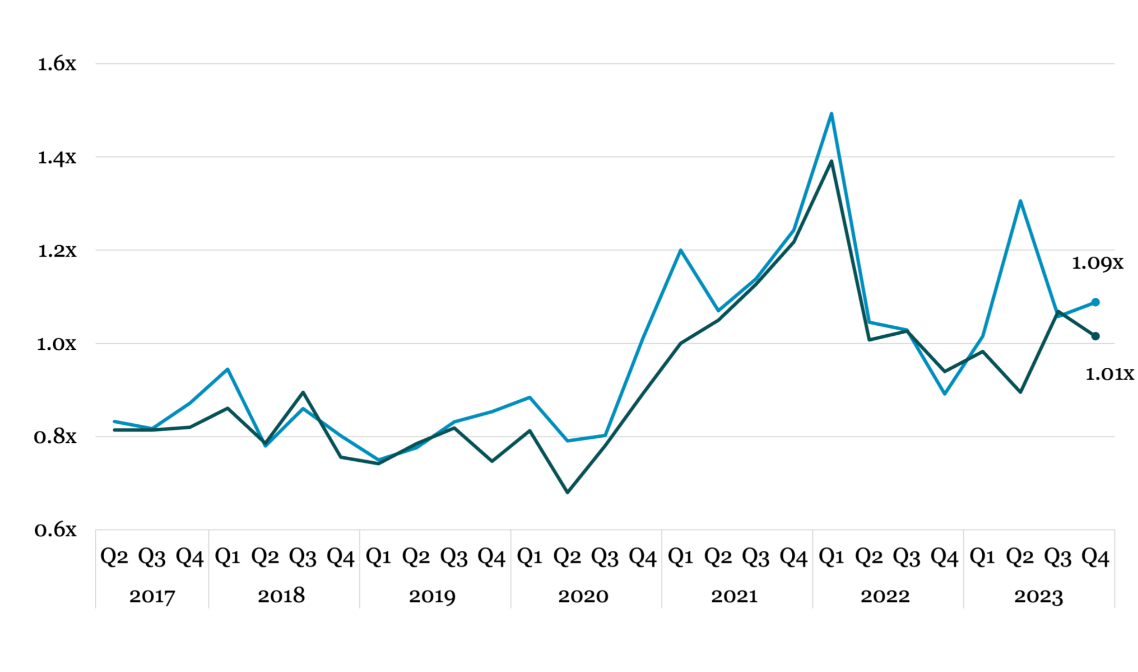
Contact: **Brad Hamner** / FitchRatings

Covenant Trends

Covenant Review

Average Free-and-Clear as a Multiple of Pro Forma Adjusted EBITDA (M&A-Related vs. All Deals)



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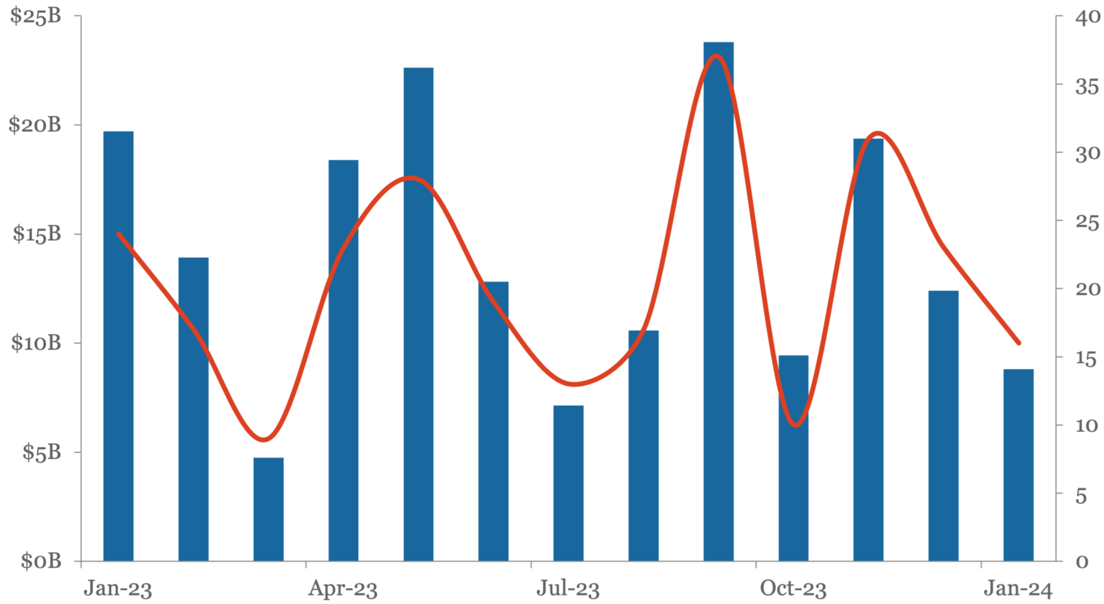
Contact: **Steven Miller** / Covenant Review

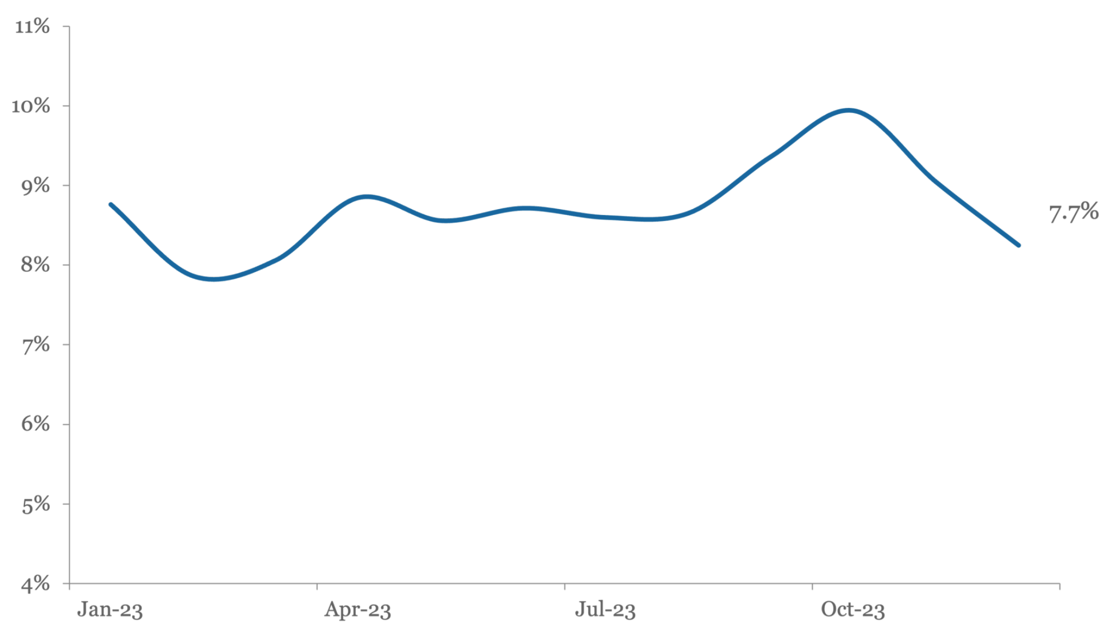
High-Yield Bond Statistics

LevFin Insights

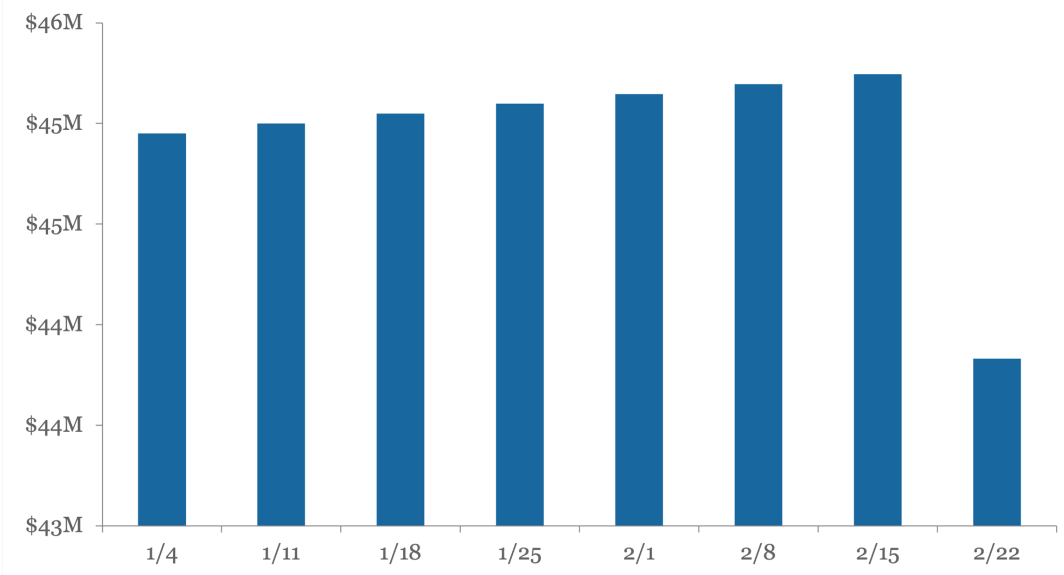
Launched Volume



New-issue Yields



Weekly Fund Flows



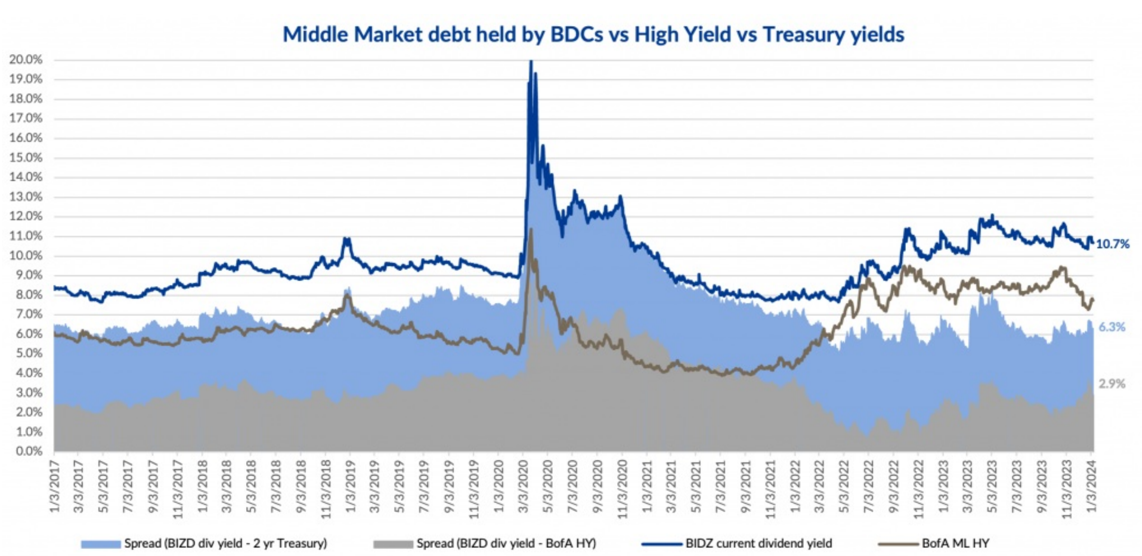
Weekly fund flows source: [Lipper]

Downlo ad Data

Contact: **Robert Polenberg** / LevFin Insights

Debtwire Middle-Market

Debtwire



The blue line in the chart is the current dividend yield of the *VanEck BDC Income ETF (currently at 10.7% as of 8 January, down from the highest level in last 12 months of 12.1% in May 2023) that tracks the overall performance of publicly traded business development companies (BDCs, lenders to privately held middle-market businesses that tend to be below investment grade or not rated, with most lending comprising of senior secured loans). The brown line displays the BofA Merrill Lynch US High Yield (US HY index - currently at 7.7% as of 8 January, decline from the highest level in last 12 months of 9.5% in October 2023), which tracks the performance of USD denominated below investment grade corporate debt publicly issued in the US.

The recent softening of yields is mainly due to inflation fading to 3.1% in November 2023, from 3.2% in October 2023, 3.7% in September 2023 and 6.4% in January 2023. On 13 December 2023, rates remained unchanged (5.25% - 5.5%, paused since July 2023 by the FED), with anticipation of rate cuts in 2024.

The spread of BIZD dividend yield minus the US High Yield (shaded area in gray) shows the premium/discount of middle-market loans over traditional high yield. As of 8 January, BIZD dividend yield was at a premium of 294bps to the US High Yield Index, above the 1-year average of 254bps. The premium for middle market, to some extent, depicts illiquidity for private loans and the credit risk associated with middle market companies. The spread of BIZD dividend yield minus the 2-year treasury (shaded area in light blue) stood at 632bps as of 8 January, marginally below the 1-year average of 636bps.

**As of 30 November 2023, BIZD's weighted average market cap stands at USD 4.7bn, with PE ratio of 8.86 and PB of 0.97, with the entire portfolio holdings in publicly traded BDCs.Click here for top holdings.*

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Contact: **Suneet Chandvani** / Debtwire

Middle Market Deal Terms at a Glance

Deal Component	January 2024	January 2023
Cash Flow Senior Debt (x EBITDA)	Micro Cap 1.50x-2.50x Small Cap 2.00x-3.50x Midcap3.00x-4.00x	Micro Cap 1.50x-2.50x Small Cap 2.50x-3.00x Midcap 3.00x-4.00x
Total Debt Limit (x EBITDA)	Micro Cap 2.50x-3.50x Small Cap 3.50x-4.50x Midcap 4.00x-5.50x	Micro Cap 3.00x-4.00x Small Cap 3.50x-5.00x Midcap 4.00x-5.50x
Senior Cash Flow Pricing	Bank: S+3.75%-5.00% Non-Bank: <$10.0MM EBITDA S+6.00%-8.00% Non-Bank: >$40.0MM EBITDA S+5.00%-6.00%	Bank: S+3.75%-5.00% Non-Bank: <$7.5MM EBITDA S+6.50%-8.00% Non-Bank: >$15.0MM EBITDA S+6.00%-7.50%
Unitranche and Second Lien Pricing	Micro Cap S+7.50%-9.50% Small Cap S+6.00%-7.50% Midcap S+5.75%-7.00%	Micro Cap S+8.50%-11.00% Small Cap S+6.50%-8.50% Midcap S+6.00%-8.00%
Subordinated Debt Pricing	Micro Cap 13.50%-16.00% Small Cap 12.50%-14.50% Midcap 11.50%-13.00%	Micro Cap 13.00%-15.00% Small Cap 12.00%-14.00% Midcap 11.00%-13.00%

*Micro Cap= <$7.5mm EBITDA / *Small Cap= >$10mm EBITDA / *Midcap= >$20mm EBITDA / *Changes from last month are in red

Contact: Stefan Shaffer / SPP Capital Partners

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