THE Lead Left
Your Tour Guide to Private Capital®

PDF | Research | Week of March 4, 2024

Quote of the Week

"The good news is the labor market and economy are prospering, furnishing the FOMC the luxury of making policy without the pressure of urgency."
– Raphael Bostic, president, Federal Reserve Bank of Atlanta.

Lead Left Vodcast

How to Stop Worrying About the Maturity Wall (Second of a Series)

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The New Order: Leverage Finance in an Asset Management World (Second of a Series)

To understand the dynamics of buyout finance today, you need to appreciate the difference in what drives the public credit markets versus private credit. The biggest change since the GFC has been the shift away from the investment banking model.

For both corporates and private equity-backed deals, borrowers often relied on investment banks to advise on, and propose financing terms for, transactions – the so-called "one-stop shop." Banks extended underwritten commitments based on expectations of buyer appetite, with buyers being CLOs, retail funds, and insurance companies. Terms held only to the extent the market didn't move substantially, otherwise underwriters could "flex" them.

It feels as if some media outlets, rating agencies, and bank research teams are stuck in the early 2000's. They report as if banks are "lending" and that non-banks operate on the same playing field. That leads to mistaken pattern recognition where dynamics such as default and valuation data in publics arise from a very different context than what actually occurs in privates.

Increasingly, leading private credit managers with capacity to speak comfortably for $1 billion or more are committing to financings with the ability to hold the entire loan among controlled funds. As a result, terms don't change regardless of market conditions. There's also no syndication process and more efficient negotiation among lenders (and with the borrower), shrinking the timing to close.

This combined with the drain of liquidity from public credit over the past two years has made financing decisions easier; the ratio of private-to-public deals has been tilted to privates for a while. With expectations for higher rates softening, CLOs are finding the equity arbitrage to be (in the words of one leading manager) "attractive both on an absolute and relative basis." Such a development leads naturally to new vehicle formation (see our *Chart of the Week*).

Armed with fresh cash, CLOs have appetite for single-B paper. It's this appetite that drives BSL lending, not (as some would have it) banks deciding to "fight back" to take share. Banks don't "lend" in the same sense as direct lenders. They underwrite to distribute, and if buyers aren't there, they don't underwrite. And since the Fed's hike regime, buyers haven't been there.

Systemic illiquidity has led to a fascinating role reversal. As one of our market friends noted, before the GFC broadly syndicated loans and high-yield bonds represented the organized, institutionalized, efficient and disciplined markets. The middle market was considered spotty, niche-y, and less well-organized. That's changed. With the influx of institutional investors over the past decade, the private credit universe is larger than either loans or bonds. Its leading managers can speak with confidence for the largest financings, regardless of cycle, rates, or complexity.

The battle for buyouts is over: privates have won. Yes, the pendulum swings back from extremes. Having buyers with dry powder, banks are pitching cheaper refinancings to private credit borrowers. All's fair in love, war, and capital markets. But the tide won't come back as far as it has in the past. Private credit fundraising has changed that narrative for good.

Visit our Website

New: Private Capital Call Podcast

Episode 4: Edward Goldstein, Partner and CIO of Coller Credit Secondaries

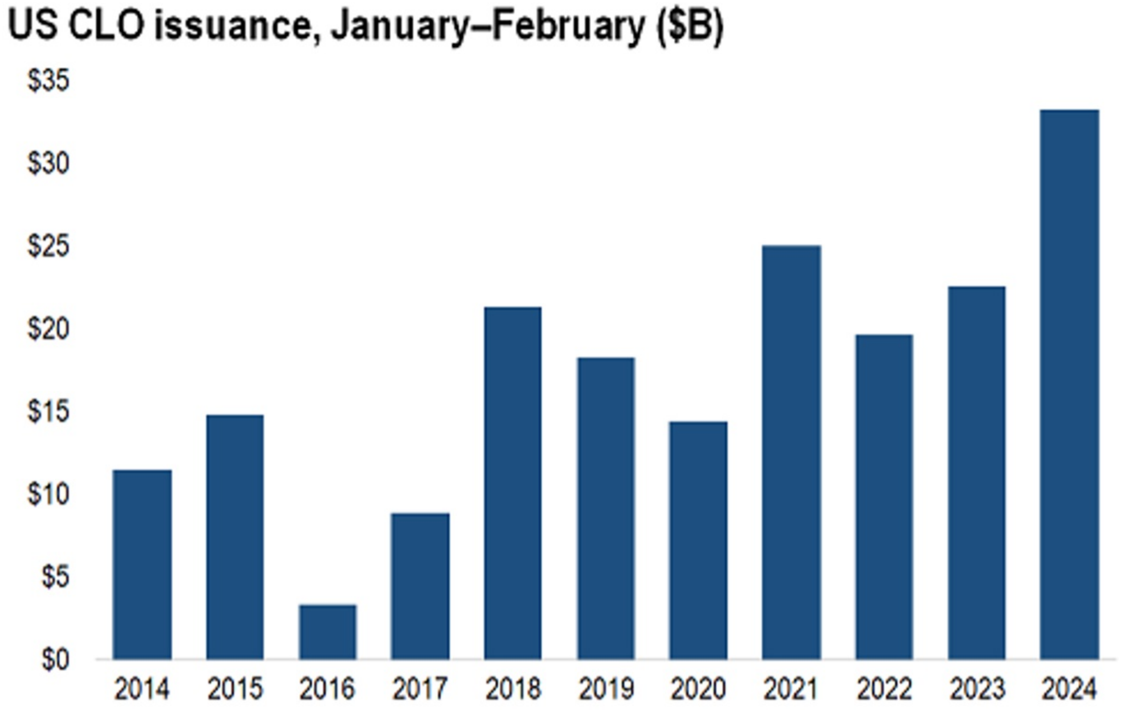
"Secondary market is at a stage where it's starting to show a level of consistency in transaction volume." - Edward Goldstein

Listen Now

Chart of the Week

Vehicle Sales

New CLO formation so far in 2024 has been the second fastest start ever.



Source: PitchBook LCD
(Past performance is no guarantee of future results.)

Lead with Your Left

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	9.56%	9.52%	9.89%	9.70%
$501M+	9.38%	9.37%	10.12%	9.89%
Middle market (≤ $50M)	NA	NA	NA	NA
Large corporate (> $50M)	9.39%	9.38%	10.08%	9.89%
Large corporate single-B (> $50M)	9.86%	9.87%	10.68%	10.46%
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	0.00%	1.60%	0.00%	0.05%
Average Bid	93.61	93.53	91.48	94.14

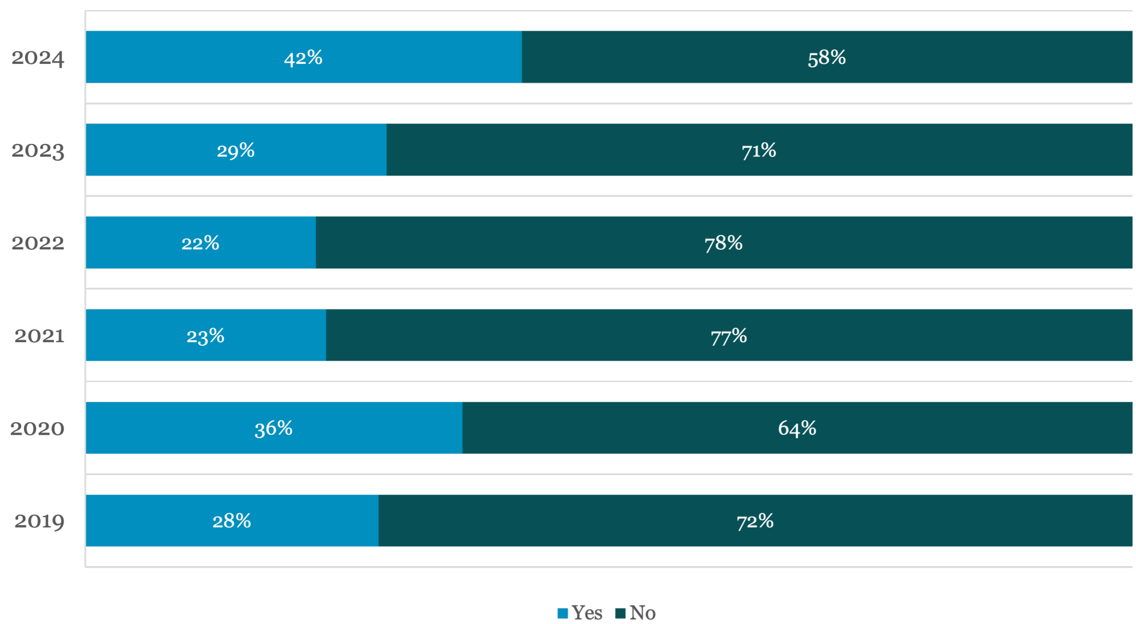
Contact: Ryan Brown / PitchBook LCD

PDI Picks

Private Debt Investor

Co-investment comes to the fore

Do you plan to participate in co-investment opportunities in private debt over the next 12 months?



More than 40 percent of investors are now looking at co-investments in private credit – representing a big increase in appetite.

After many years of discussion, LPs are finally starting to benefit from co-investment opportunities in private credit. According to *Private Debt Investor's LP* like the chance to invest alongside managers, not least because the economics are typically much more attractive.

Perspectives 2024 study, more than four out of 10 investors plan to take advantage of co-investment opportunities in the next 12 months, the highest figure we have ever recorded, and the result of a gradual increase over time.

There are a number of reasons why co-investment has tended to be less widespread in debt than private equity. Peter Olds, partner at law firm Proskauer, says co-investment is probably less available in private credit than elsewhere because of the multi-strategy nature of the asset class. "If you're a private equity GP and you have a restriction on how much you can put into any given deal, when you come across a deal that is twice as big, you have to raise the rest through co-investment," he says.

"If you're a credit manager, you likely have three other funds that can invest in the same deal, so you don't need to look to co-investment so much." Nevertheless, LPs

Co-investment activity over the years has matured greatly in terms of the number of GPs doing it and the way managers offer it to LPs, says Nick Warmingham, managing director, co-investments, at Cambridge Associates. Historically, co-investment was a post-close syndication exercise for GPs, but now they involve LPs in co-underwriting transactions and partway through the life of an investment, he told affiliate title *Private Equity International*.

"Now, for example, GPs will come to LPs partway through the life of an investment if there's a transformational or significant add-on opportunity for a portfolio company."

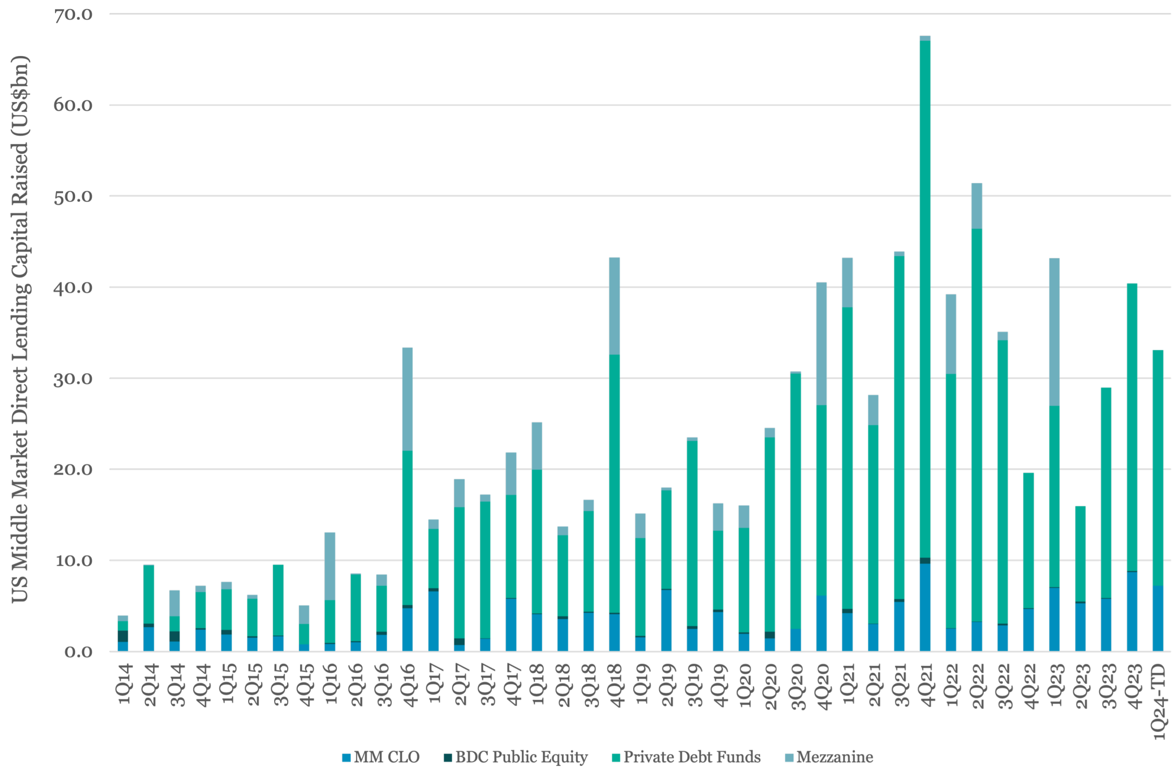
In the *Perspectives* survey, LPs say the primary issues that hinder their participation in co-investing opportunities are the speed required to conclude transactions, a shortage of staff and the risks involved. Only 28 percent say they are held back by a lack of available opportunities.

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

Leveraged Loan Insight & Analysis

LSEG

US private debt fundraising reaches US$33bn so far this quarter



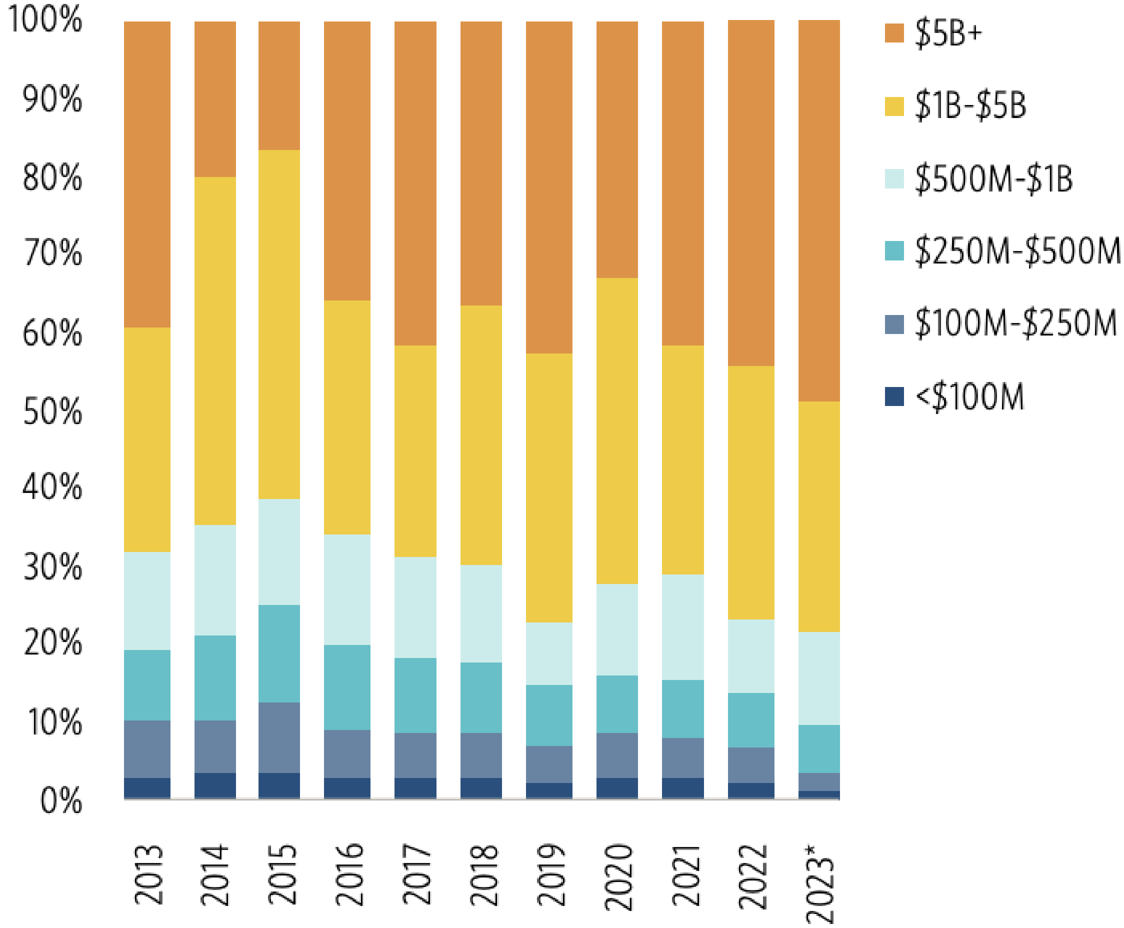
Private debt fundraising has continued at a consistent pace so far in 2024. LSEG LPC has tracked over US$33bn in US direct lending middle market capital raised this quarter. That number includes US$7.2bn of middle market CLO new issuance in January and February. Last year, there was US$128bn of direct lending capital raised, 13% lower year-over-year. Up to this point in the economic cycle, direct lender portfolios have held up well despite the higher interest rate environment. The non-accrual rate for BDCs that have filed their year-end reports is only 2.21%. According to lenders, investors have not been deterred by direct lending portfolio performance, but rather have had a harder time allocating to the asset class due to the denominator effect.

Contact: David Puchowski / LSEG

The Pulse of Private Equity

PitchBook

Share of PE capital raised by size bucket



Source: PitchBook • Geography: Global • *As of December 31, 2023

By count, middle-market funds (between $100 million and $5 billion) accounted for 62.7% of PE fundraising, the highest percentage since 2008. In particular, we saw growth within the $500 million to $1 billion fund bucket, which grew from 82 new funds in 2022 to 95 funds in 2023. As deals have become smaller due to higher borrowing costs and valuation corrections, we have seen middle-market funds multiply. Although, aggregate capital raised for this segment remains lower than in the previous two years.

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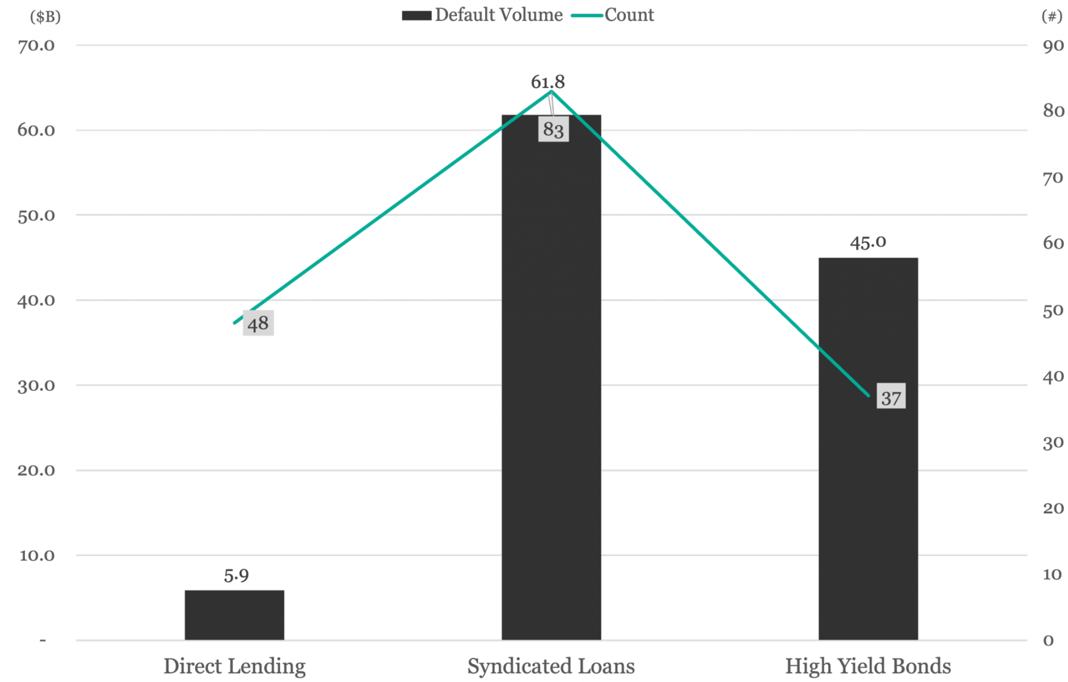
Contact: **Garrett Black** / PitchBook

KBRA Direct Lending Deals: News & Analysis

Direct Lending Deals
A KBRA ANALYTICS PRODUCT FOR PRIVATE CREDIT

TTM Default Volume, Count



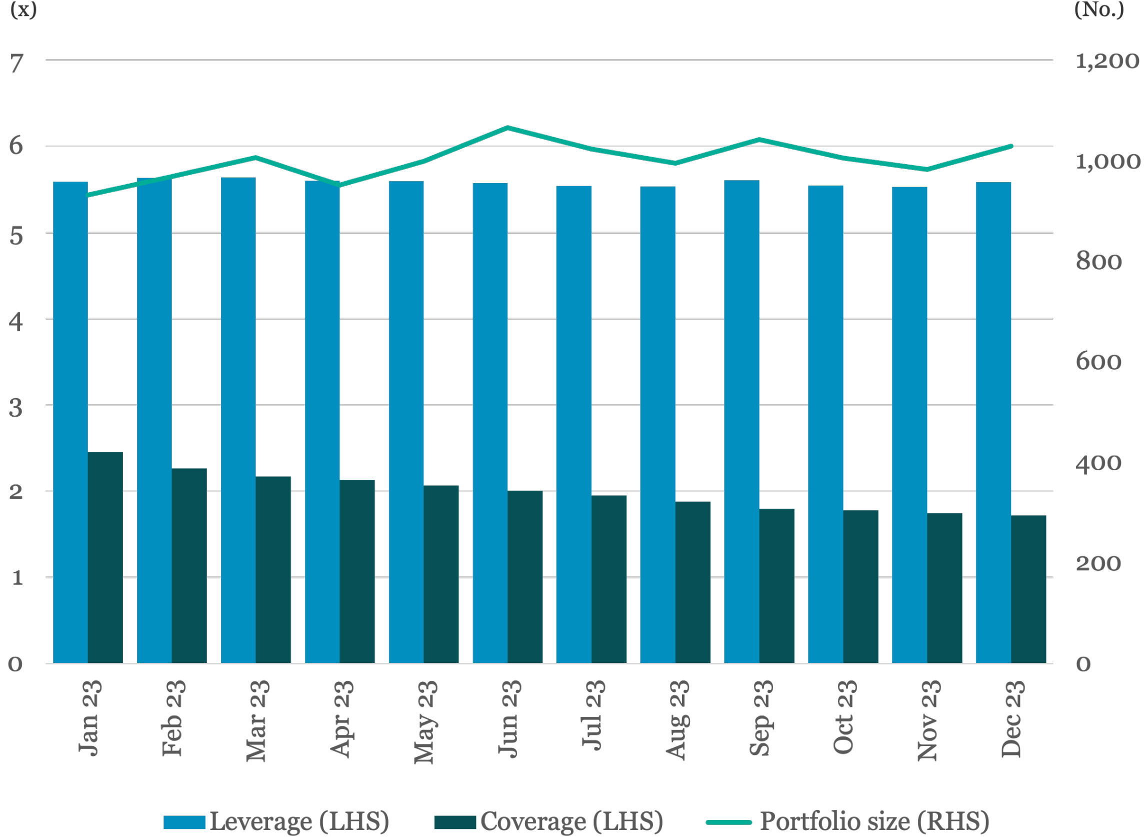
Note: Trailing 12-month defaults as of March 5th.
Source: KBRA DLD

Contact: **Eric Rosenthal** / KBRA DLD

Middle Market & Private Credit

FitchRatings

Median Leverage and Coverage



Source: Fitch Ratings

Fitch's privately covered MM portfolio is comprised of generally smaller issuers (with average EBITDA of $55 million, average revenue of $296 million and average debt of $322 million). The portfolio is comprised of issuers in the b+* to c* range (asterisk denotes Credit Opinion). Fitch's MM portfolio remains heavily allocated in Healthcare Providers, Business Services General and Technology Software accounting for 15%, 10% and 9% of the portfolio, respectively. Based on a dataset of 1,029 issuers that Fitch has analyzed through a credit opinion, 45% of issuers are assigned an IDCO (Issuer Default Credit Opinion) of b–*. The concentration is a result of a lower scale of companies in the dataset. Issuers with less than $20 million of Fitch-adjusted EBITDA are constrained to a b–* IDCO and issuers with less than $5 million of Fitch-adjusted EBITDA will not be assigned a credit opinion.

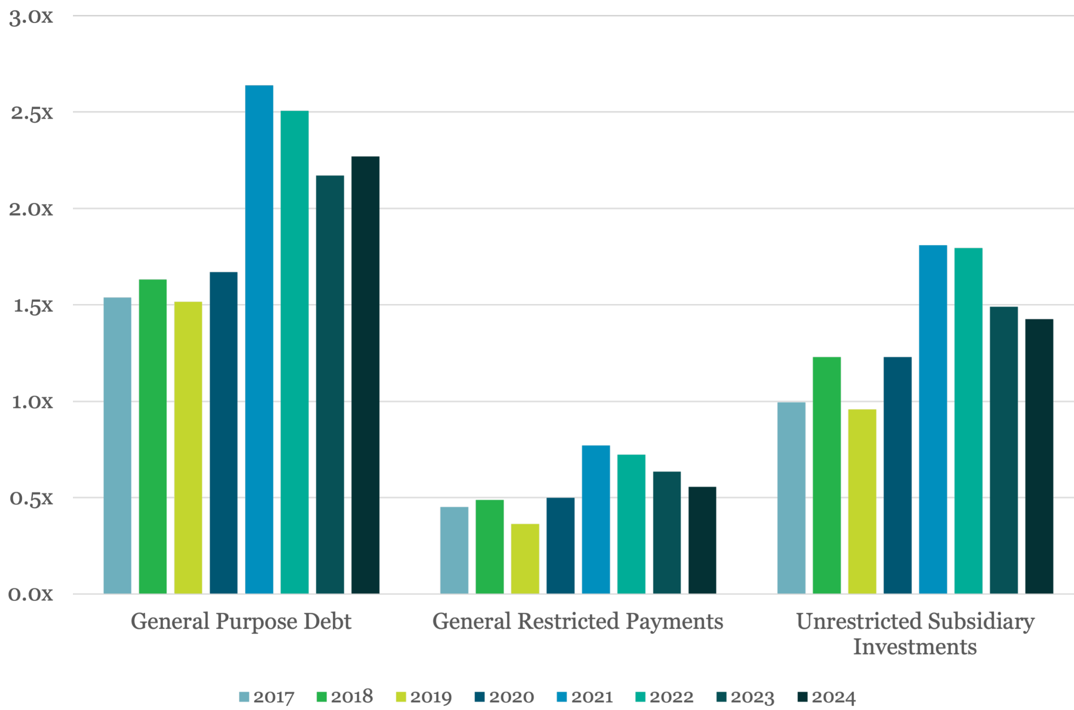
Download Report

Contact: **Brad Hamner** / FitchRatings

Covenant Trends

Covenant *Review*

Average Minimum Day-One Capped Basket Capacity, YoY



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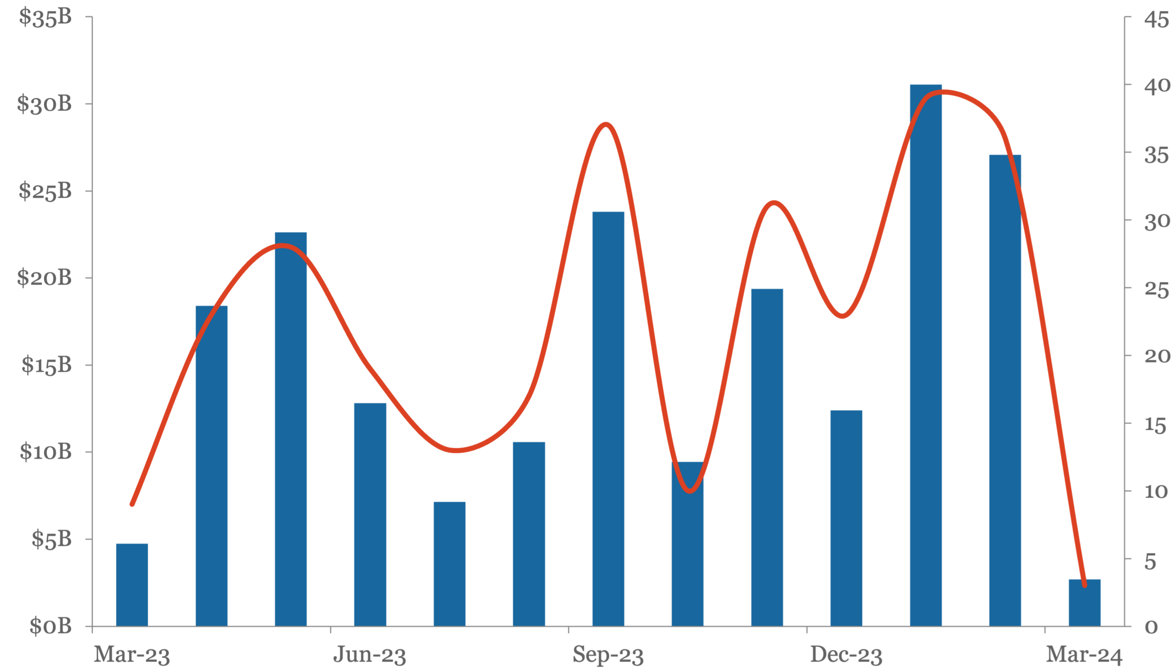
Contact: **[Steven Miller]** / [Covenant Review]

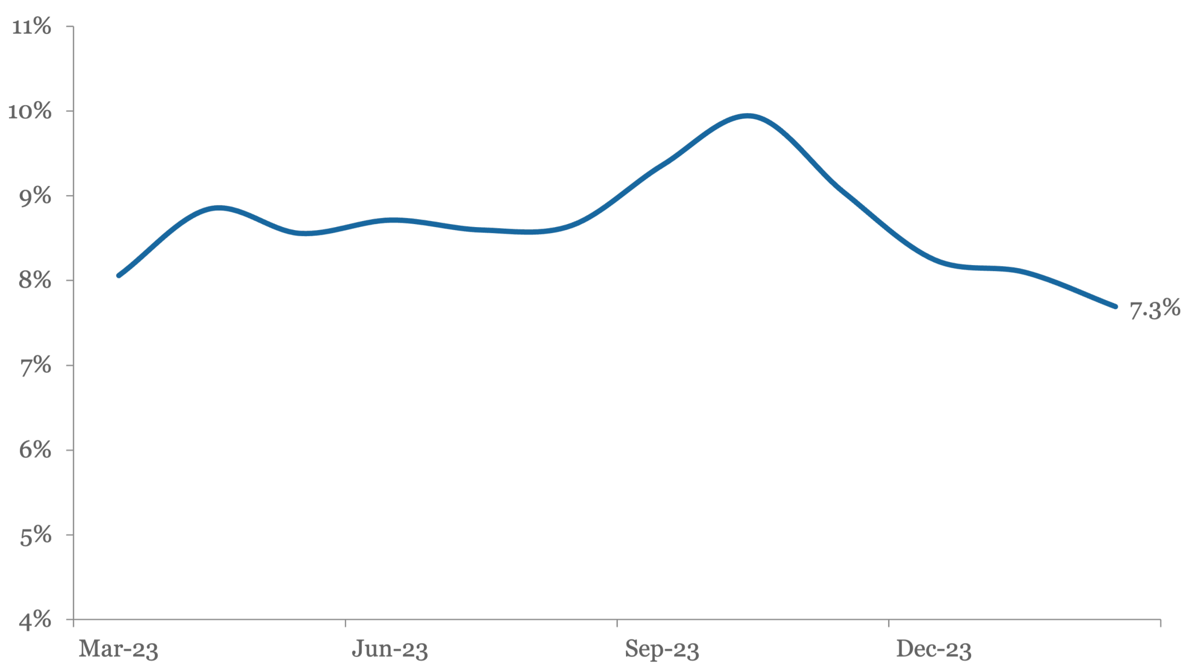
High-Yield Bond Statistics

LEVFIN INSIGHTS

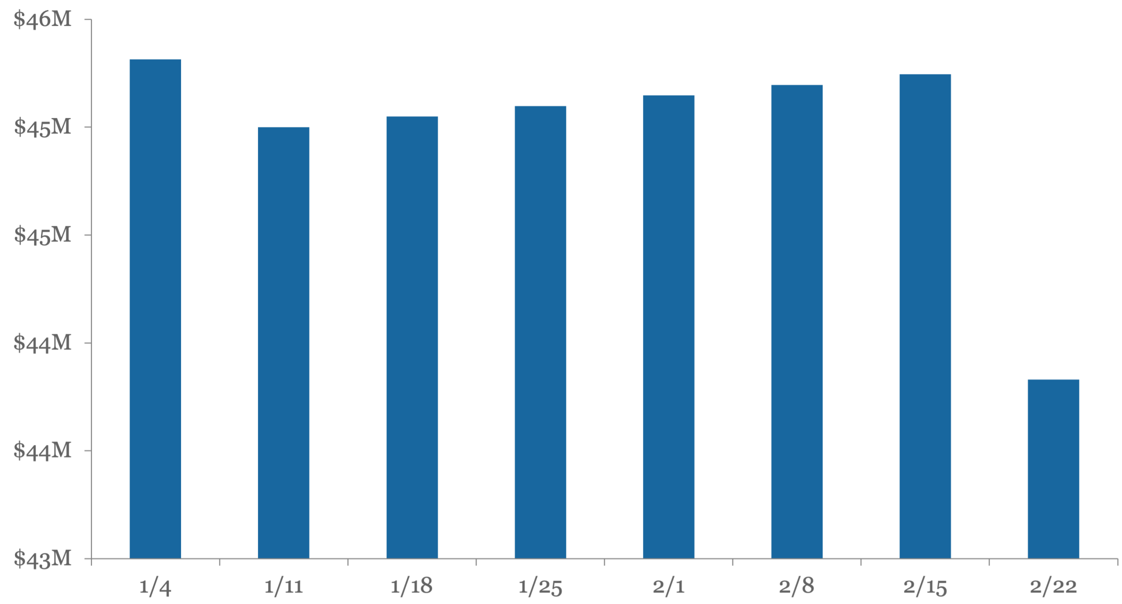
Launched Volume



New-issue Yields



Weekly Fund Flows



Weekly fund flows source: [Lipper]

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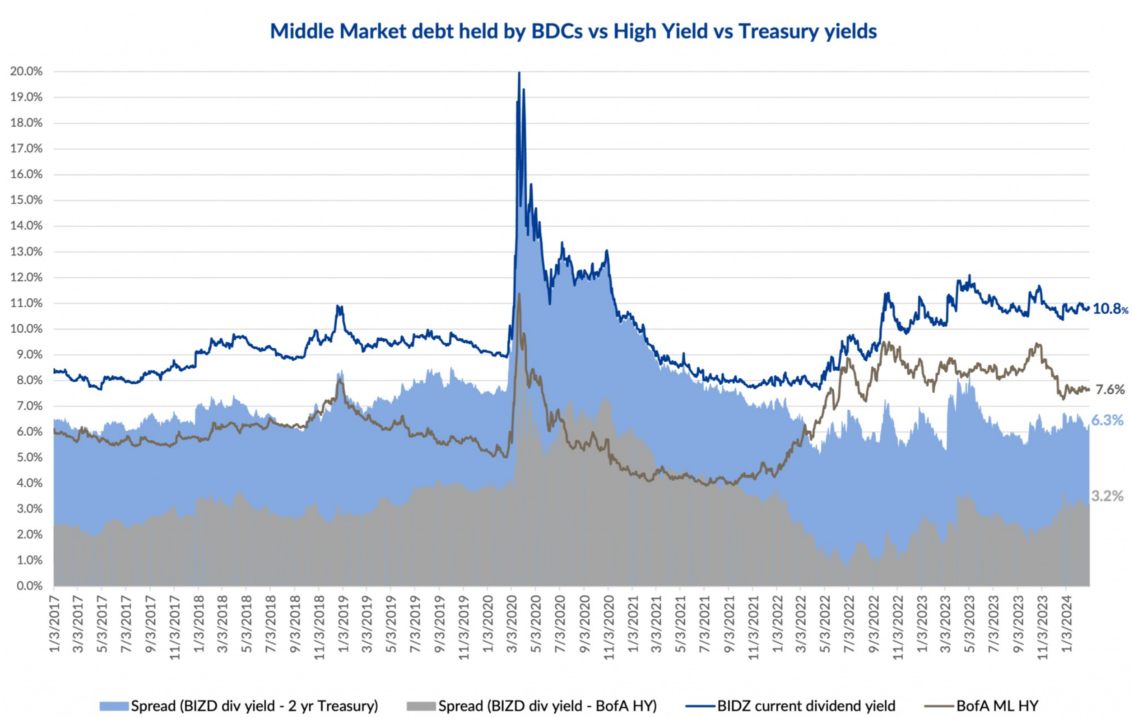
Contact: **[Robert Polenberg]** / [LevFin Insights]

Debtwire Middle-Market

Debtwire



The blue line in the chart is the current dividend yield of the *VanEck BDC Income ETF (currently at 10.8% as of 1 March, 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 7.6% as of 1 March, 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.

With unchanged interest rates on 31 January, along with inflation of 3.1% in January, more than FED's target (2%), rate cuts will be potentially at a slower pace than market expectations. Thus, March rate cuts (meeting on 19 March – 20 March) seem to be unlikely, while the markets anticipate rate cuts no later than June 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 1 March, BIZD dividend yield was at a premium of 320bps to the US High Yield Index, 52bps above the 1-year average of 268bps. 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 629bps as of 1 March, below the 1-year average of 641bps.

**As of 29 February 2024, BIZD's weighted average market cap stands at USD 4.9bn, with PE ratio of 8.28 and PB of 0.99, with the entire portfolio holdings in publicly traded BDCs.Click here for top holdings.*

Download Data

Contact: **Suneet Chandvani** / Debtwire

Private Debt Intelligence

PREQIN

Fundraising concentration remains stable amid 2023's challenging market conditions

Source: Preqin Pro

Despite a difficult 2023, fundraising concentration in private capital markets has remained level for funds and managers in the four years since 2019. Using a Gini co-efficient to demonstrate the distribution of capital across funds shows that fundraising concentration is increasing long-term. However, private capital concentration is impacted by market stresses, such as the dip from the global financial crisis in 2009. Throughout 2023, fundraising was challenged in venture capital and infrastructure, pausing concentration as tougher conditions curtailed larger funds' ability to successfully raise capital. As private capital matures and GPs raise larger funds, taking a greater share of their core asset class, greater fundraising concentration is likely.

For more, read Preqin's Insights+ report: The Concentration of Private Capital

Download Data

Contact: **William Bennett-Lynch** / Preqin

Middle Market Deal Terms at a Glance

SPP CAPITAL PARTNERS

Deal Component	February 2024	February 2023
Cash Flow Senior Debt (x EBITDA)	Micro Cap 1.50x-2.50x Small Cap 2.00x-3.50x Midcap 3.00x-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+3.50%-5.00% Non-Bank: <$10.0MM EBITDA S+5.75%-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+5.75%-7.50% Midcap S+5.25%-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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from nuveen

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