Proskauer» The Private Credit Group

Tr€nd$ in Priv£te Credit

The Industry Speaks

Contents

Executive Summary

The private credit market across the globe finds itself in an interesting position as it entered 2023. Overall, the market has capital and is willing to lend, despite the adverse economic indicators evident in wider economy. Simply put, the private credit market, which represents more than $2.18 trillion in assets under management,[1] is not slowing down in 2023.

The *Proskauer Private Credit Survey 2023*, which gathered responses from private credit firms in the United States and elsewhere[2], showed that even as three-quarters (75%) of respondents were expecting to see more defaults, firms were still prepared to lend, and actively fundraising.

This year's survey also explores what factors are driving deal flow and what are the major challenges for dealmakers, as well as what respondents see as the hottest topics in the year ahead, the most important five-year trends and the current state of the private lending market. This report also looks at data and insight around the broader market, including economic and political factors that might impact dealmaking in the year ahead.

As always, it's critical to contextualize this report with what economic forecasters are saying about the global economy and other global events. While the main impacts on the market by the global pandemic may have largely waned, concern over the general stability of the global economy—especially a worrisome bout of inflation that could tip many nations' economies into recession—is prevalent.

In a recent interview, economist Nouriel Roubini—who correctly predicted the 2008 financial crisis which earned him the nickname "Dr. Doom"—said he sees a "long and ugly" global recession that could last throughout all of 2023 and include a sharp correction in stock prices.[3] "Even in a plain vanilla recession, the S&P 500 can fall by 30%," said Roubini, chairman and CEO of Roubini Macro Associates, adding that in "a real hard landing," which he believes will happen, it could fall 40%.

Roubini explained that those expecting a shallow U.S. recession should be looking at the large debt ratios of corporations and governments. As rates rise and debt servicing costs increase, "many zombie institutions, zombie households, corporates, banks, shadow banks and zombie countries are going to die," he said. "So we'll see who's swimming naked."

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[1] To calculate a total figure for AUM among the respondent base, we identify the most senior respondent per company (so we have 1 response per company) and take the lowest AUM value in the range. For example, if they selected $250m-$499m, then we take $250m as the value for that response. If they chose "Less than $250m," take 0 as the value. Adding them all together then gives us the collective AUM for the market, as represented by respondents to the survey. Similarly, in terms of seniority, Partner is most senior, then Managing Director, and Exec Director/Director; and if you have multiple senior contacts for one company with different responses, we just took the highest response.

[2] For a more complete breakdown of survey respondents by title, see the "Survey Overview" section on page TK.

[3] *See* "Dr. Doom Roubini Expects a 'Long, Ugly' Recession and Stocks Sinking 40%" Bloomberg, September 20, 2022; *available at* https://www.bloomberg.com/news/articles/2022-09-20/roubini-sees-stocks-sinking-40-us-in-a-long-ugly-recession.

Key findings in 2023 research:

The survey yielded multiple key findings in terms of what private lenders were thinking about dealmaking volume, defaults, and pricing, as well as macroeconomic concerns like inflation and recession, and pricing.

Private lenders expect dealmaking to decrease

- On balance, almost twice as many respondents (55%) said they expect deal activity in the market to decrease over the next 12 months as said they expect deal activity to increase (28%) over the next year. And 17% said they expect deal activity in the market to stay the same over the next 12 months.
- Overall, the perceptions of private credit lenders on both sides of the ocean seemed to whither. In the U.S., 54% said they expect dealmaking to decrease in the coming year, compared to 37% that said that in last year's report. Interestingly, positive views of dealmaking were up among U.S. respondents, with 32% saying they expect dealmaking to increase in the coming year, compared to 25% who said that about last year.
- In the U.K. and Europe, sentiment seemed to sour more dramatically, as 60% said they think dealmaking will decrease in the coming year, while just 12% thought that about last year. And just 17% of UK and European respondents say they think dealmaking will increase in the coming year, compared to 50% that said that last year.

Many respondents remain optimistic, though worries over a recession persist

- And this optimism is especially centered around their own fortunes and future opportunities. For example, 88% of respondents described the EBITDA of their portfolio companies as stable or growing, and 99% said they are looking for new lending opportunities.
- However, almost all respondents predict a recession to come at least within the next 12 months. Indeed, one-third (33%) claimed we are already in a recession, and almost half (47%) said they expect a recession in less than 6 months. Less than one-quarter (24%) said a recession was 6 to 12 months away.

What survey respondents are saying about the likelihood of a recession:

We are in a recession

"Economic reporting lags reality, we are already in a recession."

"UK is in recession."

Less than 6 months

"Even though we are not seeing it in the headline numbers, we believe that parts of the country and certain sectors may already be in a recession. Once we see year-end results and the larger wave of layoffs that will occur in the next 3 months, then we shall see unemployment tick up and both top-line growth and earnings turn negative."

"I believe consumer spending is slowing. Consumers are drawing down saving. When savings are depleted then negative consumer spending will occur."

"These rates have a material impact in performance next year."

"We believe we will enter a mild recession shortly. The bigger issue is how long the period of slower growth will last."

"Inflation and the corresponding rapid rise in interest rates will push the US into recession imminently as US consumers have largely spent their previously record level of savings, and as over-levered corporates struggle to meet their debt service needs while they continue to see cost inflation elsewhere."

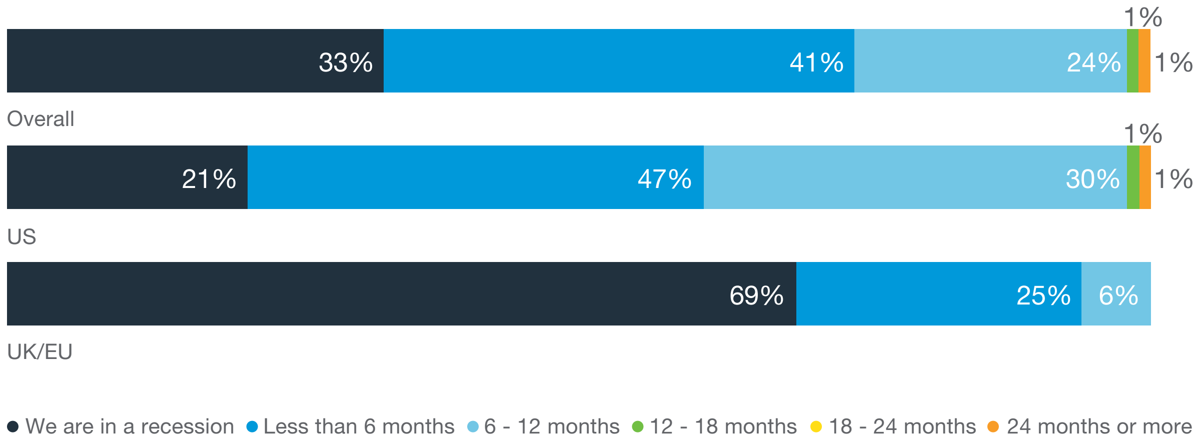
6–12 months

"The current interest rates have not fully impacted borrowers yet. We are just starting to see the early impact of this, and it will become significantly more impactful in the coming quarters, and we will see a lot more companies having to slash costs."

"Back half of 2023."

"Expect it to be a mild recession overall."

UK/EU believe we are in a recession more than the US



Top concerns were for inflation and dry powder levels

- When asking respondents to select from a list the 3 most important drivers of deal flow over the next 12 months, inflation/macroeconomic risk was ranked the most important driver of deal flow overall, but dry powder levels had the most votes among top 3 concerns.
- Respondents in the U.K. and E.U. rank dry powder levels as most important driver of deal flow, and cited it most in overall rankings.
- U.S. respondents cite inflation/macroeconomic risks as most important, with dry powder levels ranked just as much overall.
- Among the biggest challenges for dealmakers, respondents cited inflation/macroeconomic risks, with competition ranking lowest after ranking highest last year.

Predictions for next 12 months

- More than three-quarters of respondents (77%) said they expect higher pricing over the next 12 months, as compared to the past year.
- And a similar percentage (76%) said they expect a higher level of defaults over the next 12 months, as compared to the past year — a sharp rise from 31% who thought that last year.

Demographics of Respondents

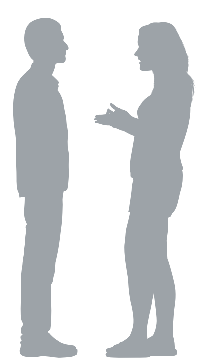
The *Proskauer Private Credit Survey 2023* gathered responses from 151 private credit firms—75% of which were in the United States; and 25% in the United Kingdom & Europe. Almost two-thirds of respondents (62%) were either Managing Directors or Partners at the firm; and 80% of respondents were senior-level executives. *(See full breakdown in chart below.)*

Sixty percent of this year's survey respondents came from firms with $10 billion or more in assets under management (AUM), and another 30% came from firms with between $1 billion and $9.99 billion AUM. The remaining percentage (10%) came from firms with less than $1 billion UAM.

Overall, the total amount of capital deployed in credit strategies by respondents over the past 12 months was approximately $338.5 billion[4].

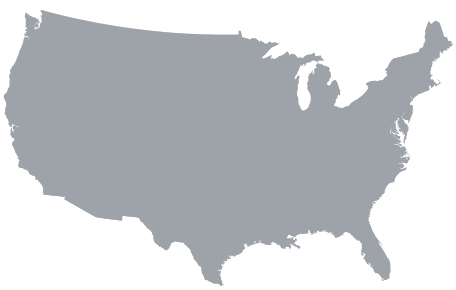
[4] Respondents also reported they managed more than $2.18 trillion of credit-focused assets. This compares to the roughly $1.3 trillion in outstanding U.S. leveraged loans, according to the S&P/LSTA Leveraged Loan Index.

Managing Director	**42%**
Partner	**20%**
Director	**15%**
Executive Director	**3%**
Vice President	**9%**
Principal	**4%**
Internal Counsel	**3%**
Senior Associate	**3%**
Other	**1%**



151 Respondents in total

75%



United States

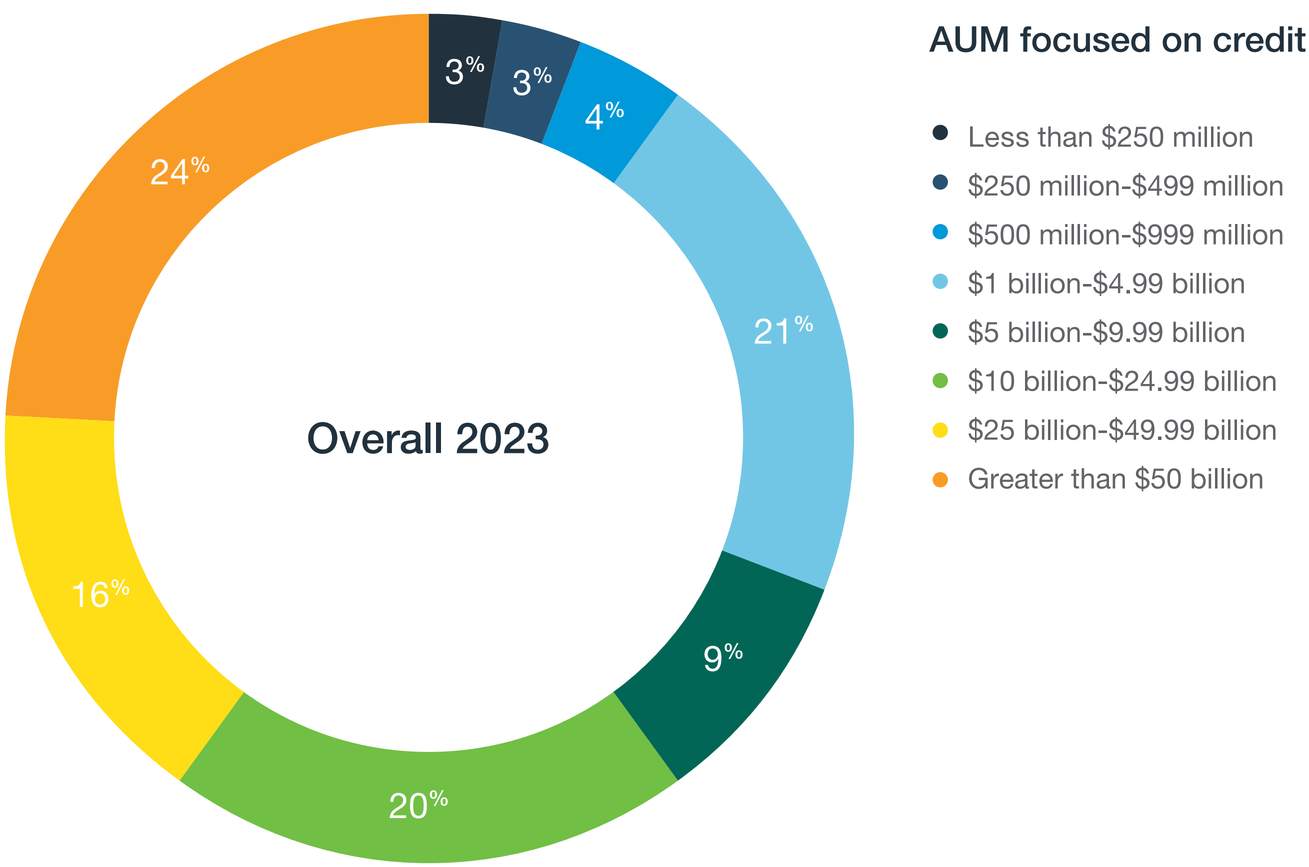
25%

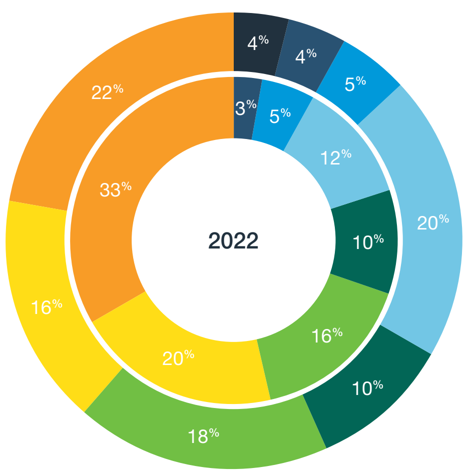
United Kingdom & Europe

Demographics of Respondents

Total capital as deployed by respondents into credit strategies in the past 12 months: $338.5 billion

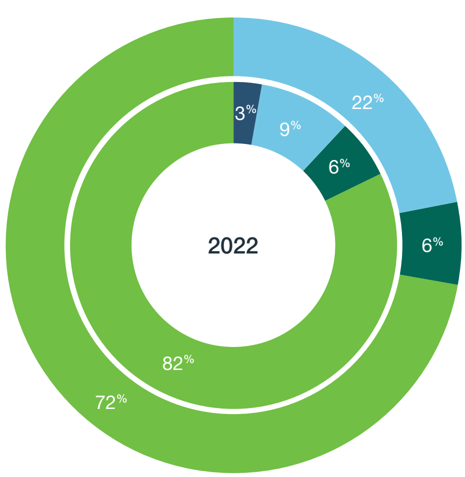
AUM focused on credit





US 2023

- Less than $250 million
- $250 million-$499 million
- $500 million-$999 million
- $1 billion-$4.99 billion
- $5 billion-$9.99 billion
- $10 billion-$24.99 billion
- $25 billion-$49.99 billion
- Greater than $50 billion



UK/EU 2023

- <€250 million
- €250 million-€499 million
- €500 million-€999 million
- €1 billion-€4.99 billion
- €5 billion-€10 billion
- >€10 billion

Current State of Play

Our data reflects predictions made in the context of ongoing world events, such as the start of the war in Ukraine and global economic unease. Despite this, we found that private credit managers are continuing to have a positive outlook on market activity, even while lenders intend to practice more caution and selectiveness going forward.[5]

Overview of key economic and market statistics:

- Bank of England base rate is 4%, after 10 consecutive rate increases.[6]
- 10-Year Treasury Rate is at 3.74%, compared to 1.21% in February 2022[7]
- S&P 500 down 20% in 2022.
- S&P U.S. Treasury Bond Index fell 11%.
- Private debt is forecast to have annual average returns of 8.4% from 2021 to 2027, according to market analysis firm Prequin.[8]
- 80% reduction in U.S. high yield volume between 2021 and 2022; and an 89% reduction in U.S. leverage loan volume between 2021 and 2022.[9]

What forecasters are saying:

Other economic forecasters weighed in on our insights as well, with Goldman Sachs[10] noting that investors have opted for the flexibility that private credit can offer. While traditional debt capital markets have dried up, private credit managers have a record amount of dry powder to deploy. And PwC[11] noted that growth opportunities in Europe and the U.S. in particular will include acquisition of distressed debt and debt-for-equity deals; and by 2025, largely fund-driven private credit in Europe will be minimally bank-driven.

The Alternative Credit Council noted that private credit funds reported a 20% increase in their lending volumes in 2021 and retained a positive outlook towards 2022 and 2023. The Council further cited the U.K. and the U.S. as the national markets with the greatest growth potential, although most expect Europe and Asia to also see significant growth.

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5 "Private credit's appeal grows as economic woes mount" by Michael O'Connor & Peter Brennan; S&P Global Markets (January 10, 2023). *See* https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/private-credit-s-appeal-grows-as-economic-woes-mount-73440985.

6 Bank of England; *See* https://www.bankofengland.co.uk/statistics.

7 YCharts, 10-Year U.S. Treasury Rates; *See* https://ycharts.com/indicators/10_year_treasury_rate.

8 *Ibid*, *See* O'Connor & Brennan; S&P Global Markets.

9 J.P. Morgan, "U.S. Corporate Credit Issuance Monthly" (October 2022).

10 "Preparing for the Rising Tide of Rates" by Stephanie Rader; GSAM Insights (September 1, 2022). *See* https://www.gsam.com/content/gsam/uk/en/institutions/market-insights/gsam-insights/2022/preparing-for-the-rising-tide-of-rates.html.

11 "Prime time for private markets: Private credit", PWC. *See* https://www.pwc.com/gx/en/industries/private-equity/private-markets/private-credit.html.

Given the current economic climate, it appears that the private equity market sits in a key position to offer lending solutions that many other markets will not. As Apollo Global Management explained in its *2023 Economic and Capital Markets Outlook*[12]*:*

> The rout in equity markets has been widely discussed. At the same time, though, credit markets have become increasingly volatile, creating opportunities in stressed and distressed investments. In 2022, the public debt markets have been closed to all but the highest-rated companies. Indeed, high-yield issuance has fallen off a cliff, leaving companies with less-than-investment-grade balance sheets in need of alternative sources of funding. This is why the private credit markets are so active at the moment, presenting numerous opportunities for providers of capital to step in where the public credit markets will not.

[12] *2023 Economic and Capital Markets Outlook* by Torsten Sløk, Apollo Global Management (December 2022); p. 19.

Detailed Results

What survey respondents are saying

The respondents to our survey offered numerous important insights into the state of the private credit market, including:

Majority of respondents say they use private funds and managed accounts as lending vehicles.

Direct lending is the top private debt strategy pursued overall, they say, followed by special situations, mezzanine, and hybrid situations. Venture debt and asset-based lending (ABL) are used significantly less in the U.K. and E.U. markets than the U.S. market.

One-third of respondents say their firm made more than 50 new credit investments last year.

Overall, almost half of respondents said they deployed between $1 billion to $5 billion of capital into credit strategies within the past 12 months.

Almost all (99%) are looking for new lending opportunities, although one-third said they would be more selective.

Respondents in the U.K. and E.U. are more likely to have between 5.5-times – 5.99-times maximum total leverage to underwrite, while the U.S. market sees a more even spread across ranges.

The most common maximum loan size that firms will underwrite is between $50 million to $99.9 million.

The majority of respondents (52%) overall say the size of the check their firm is willing to write has decreased in the past 12 months.

The most common average EBITDA of companies in respondents' portfolios is between $25 million and $50 million, with one-third of portfolio companies' EBITDA above $50 million, and 7% is more than $100 million. Also, the majority of respondents describe EBITDA as stable or growing.

The maximum aggregate amount of EBITDA add-backs permitted are typically within the 20% to 24.9% range, with uncapped add-backs having declined from 10% last year to 3% this year.

More than 70% of respondents say they will not do deals without a covenant, and no respondents are willing to do a deal without a covenant when EBITDA is less than $30 million.

Respondents in the U.K. and E.U. markets said they are more likely to require 40% to 44% equity in their deals, whereas U.S. respondents said they are more likely to require more than 50%.

Overall, respondents say they believe that speed of decision-making is what borrowers value most about the private credit industry.

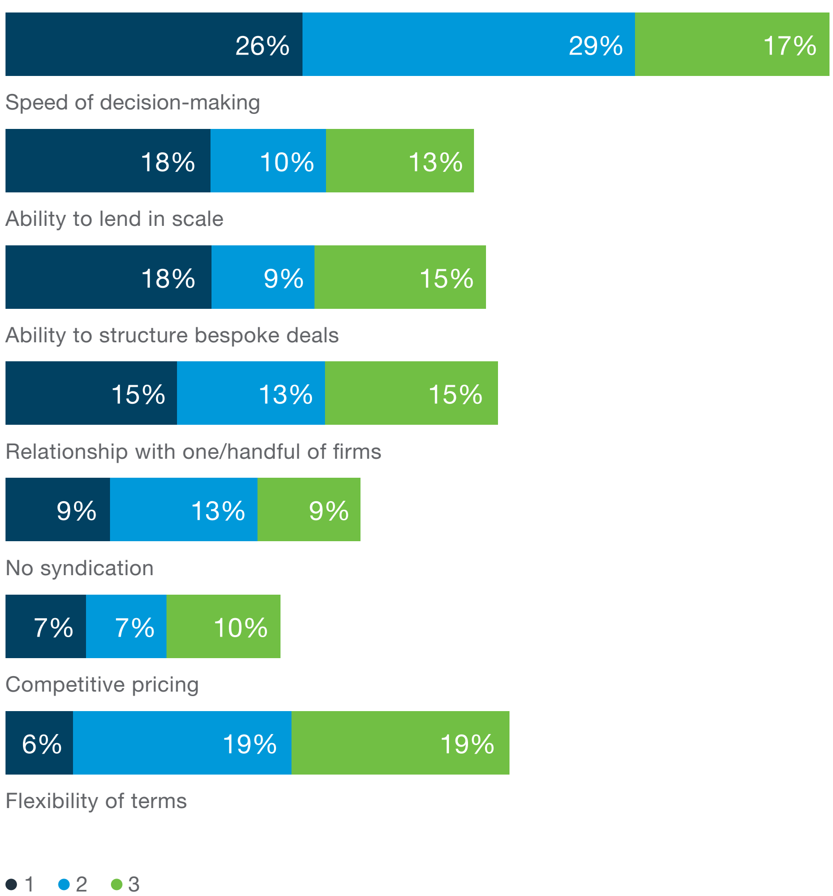
Lenders' Insight

Interestingly, the reason that *respondents* think their borrowers value private credit lending were varied, but offered great insight into what lenders may be thinking. Respondents were asked to select up to five reasons why they believe borrowers value private credit and rank them in order of importance. Not all respondents chose five reasons, but almost all selected at least three.

Lenders thought that the *speed of decision-making* was what borrowers most valued, citing that reason often in the top three and most often as the top reason.

Also, *flexibility of terms* was the next most often cited in the top three but was least likely to be cited as the top most important reason.

What do you believe borrowers value most about private credit?



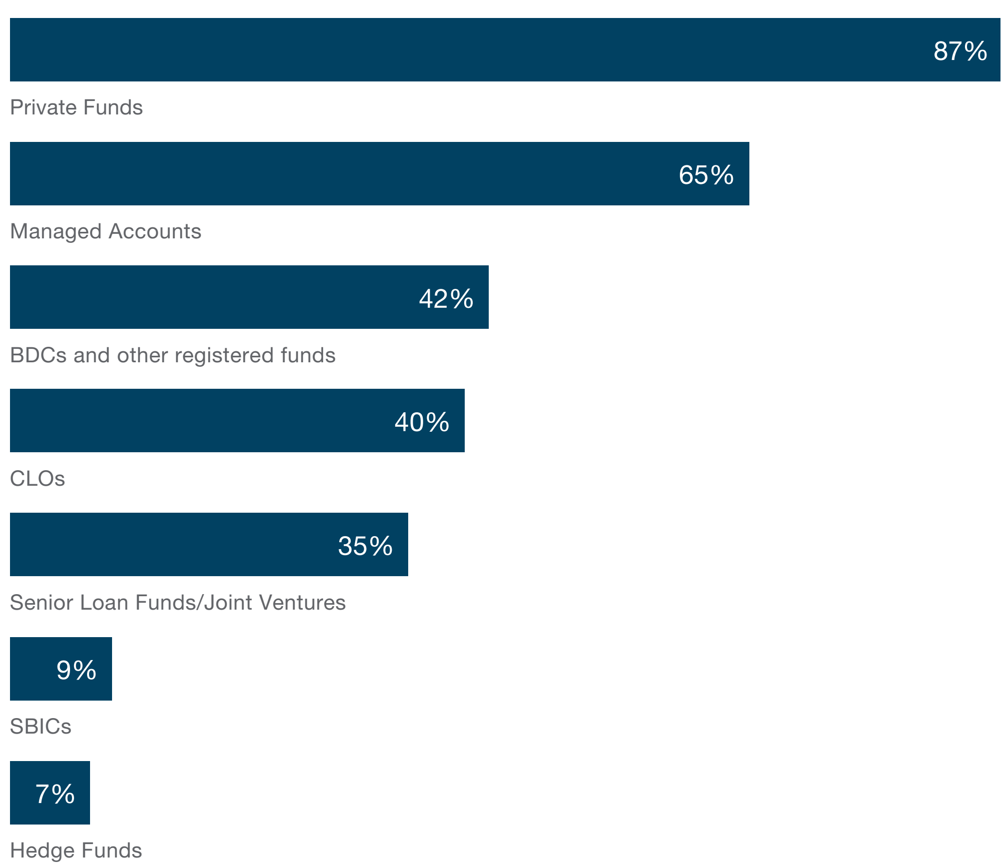
Investment Conditions and Considerations

Lending Vehicles

Overall, a large majority (87%) of respondents said they use private funds as their lending vehicle of choice, with those in the U.K. and E.U. markets making greater utilization of private funds (94%) than U.S. market (84%).

The use of other lending vehicles — such as managed accounts, business development companies, and other — remained more consistent across the regions.

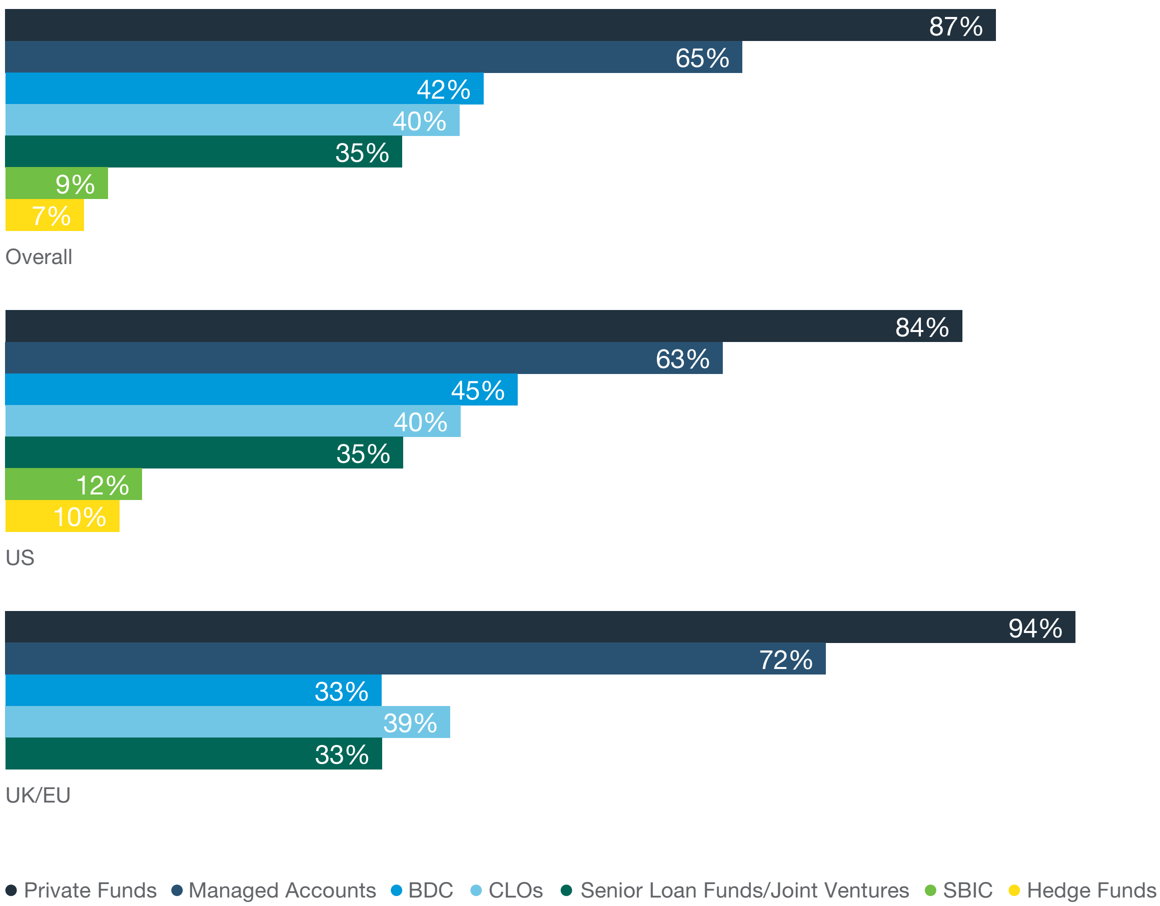
What vehicles do you utilize for your lending activities?



Investment Conditions and Considerations

What vehicles do you utilize for your lending activities?

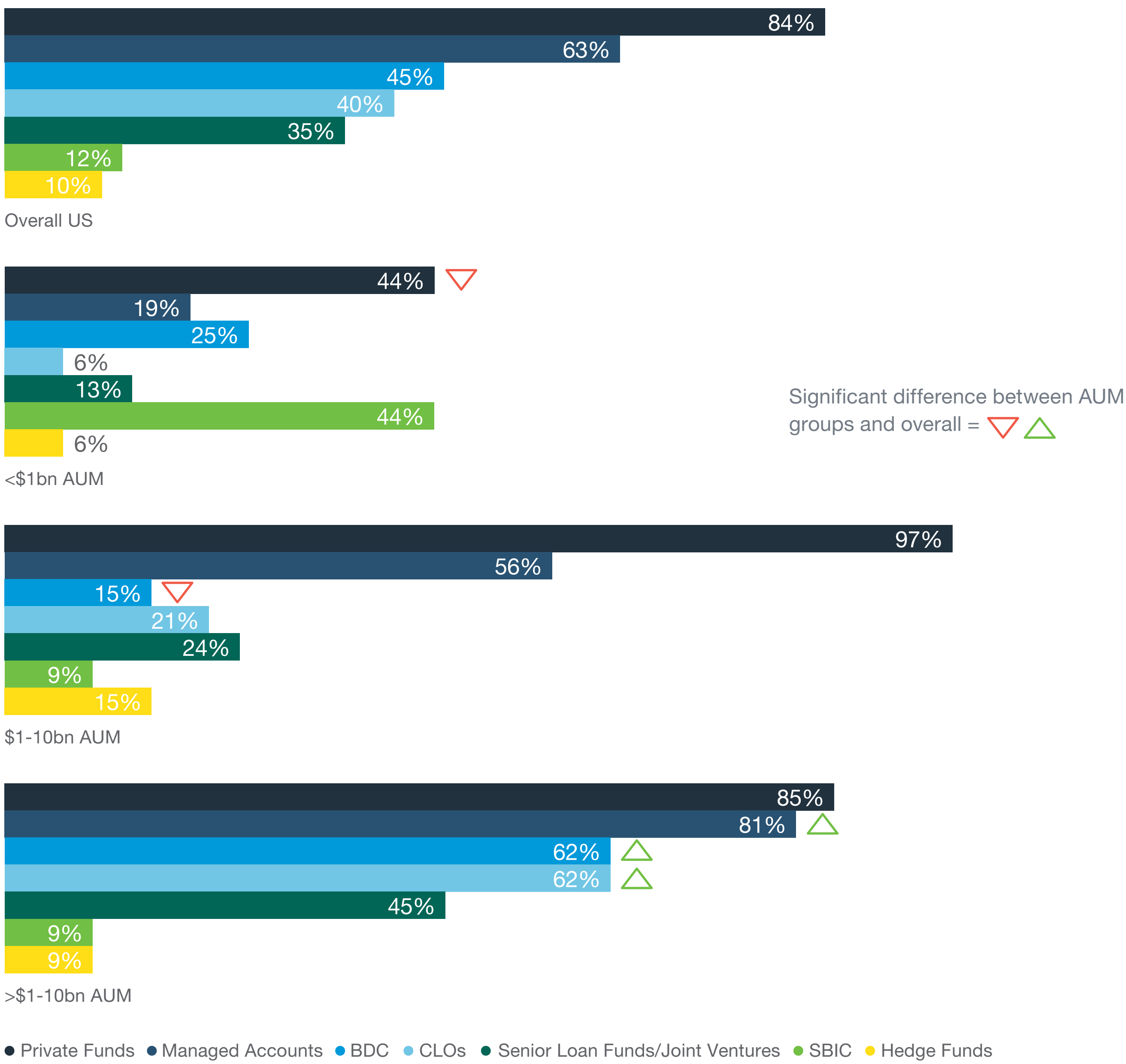
By region: UK/EU more likely than US to use Private Funds and Managed Accounts, but no usage of Small Business Investment Companies (SBIC) and Hedge Funds



And, not surprisingly, respondents from firms with larger assets under management said they were more likely to use multiple lending vehicles, with firms that have smaller assets under management using fewer vehicles.

What vehicles do you utilize for your lending activities?

By US AUM: Increased usage seen by higher AUM groups

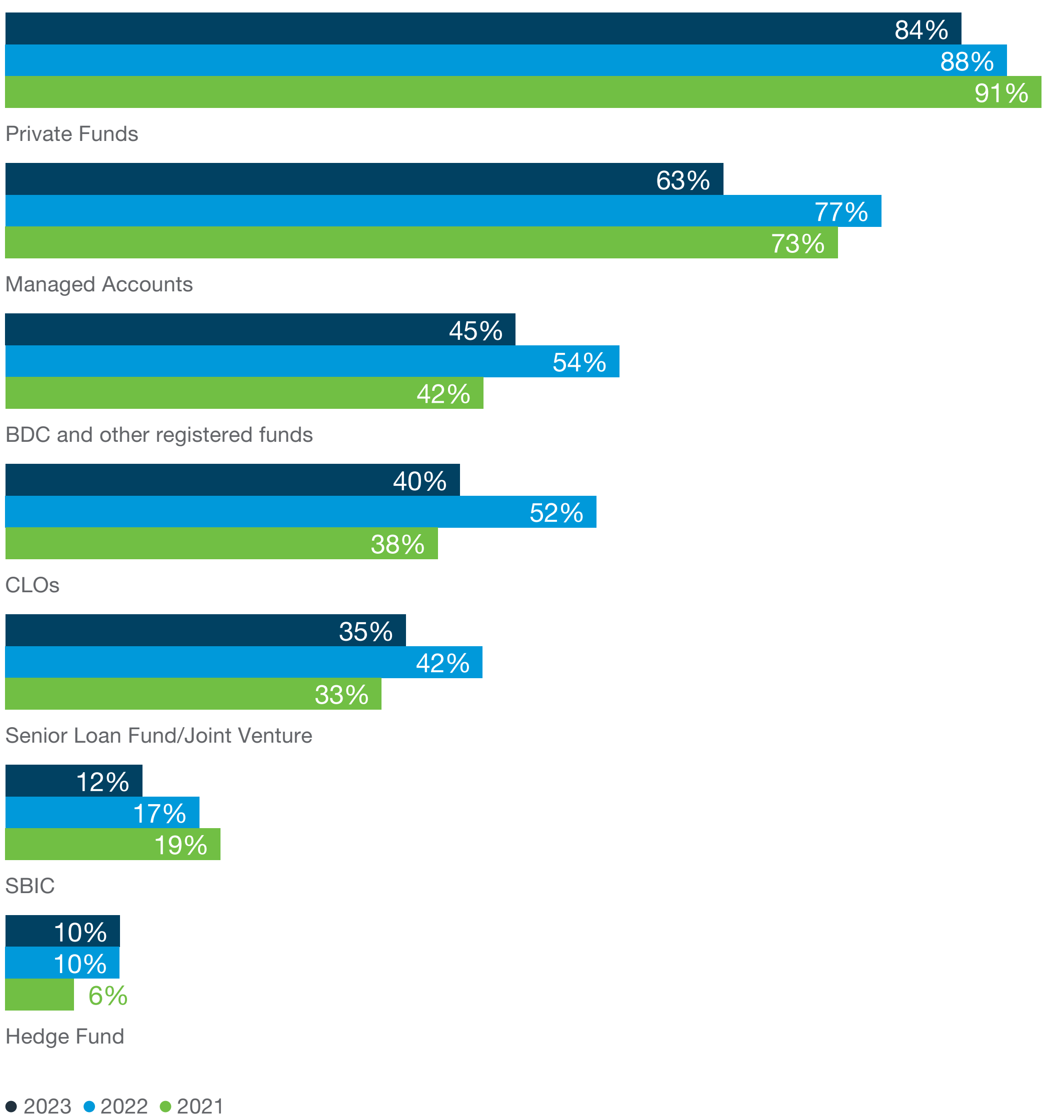


Investment Conditions and Considerations

By region, those respondents in the U.K. and E.U. markets said they were more likely than U.S. respondents to use Private Funds and Managed Accounts, but they had no usage of Small Business Investment Companies (SBICs) and Hedge Funds as lending vehicles.

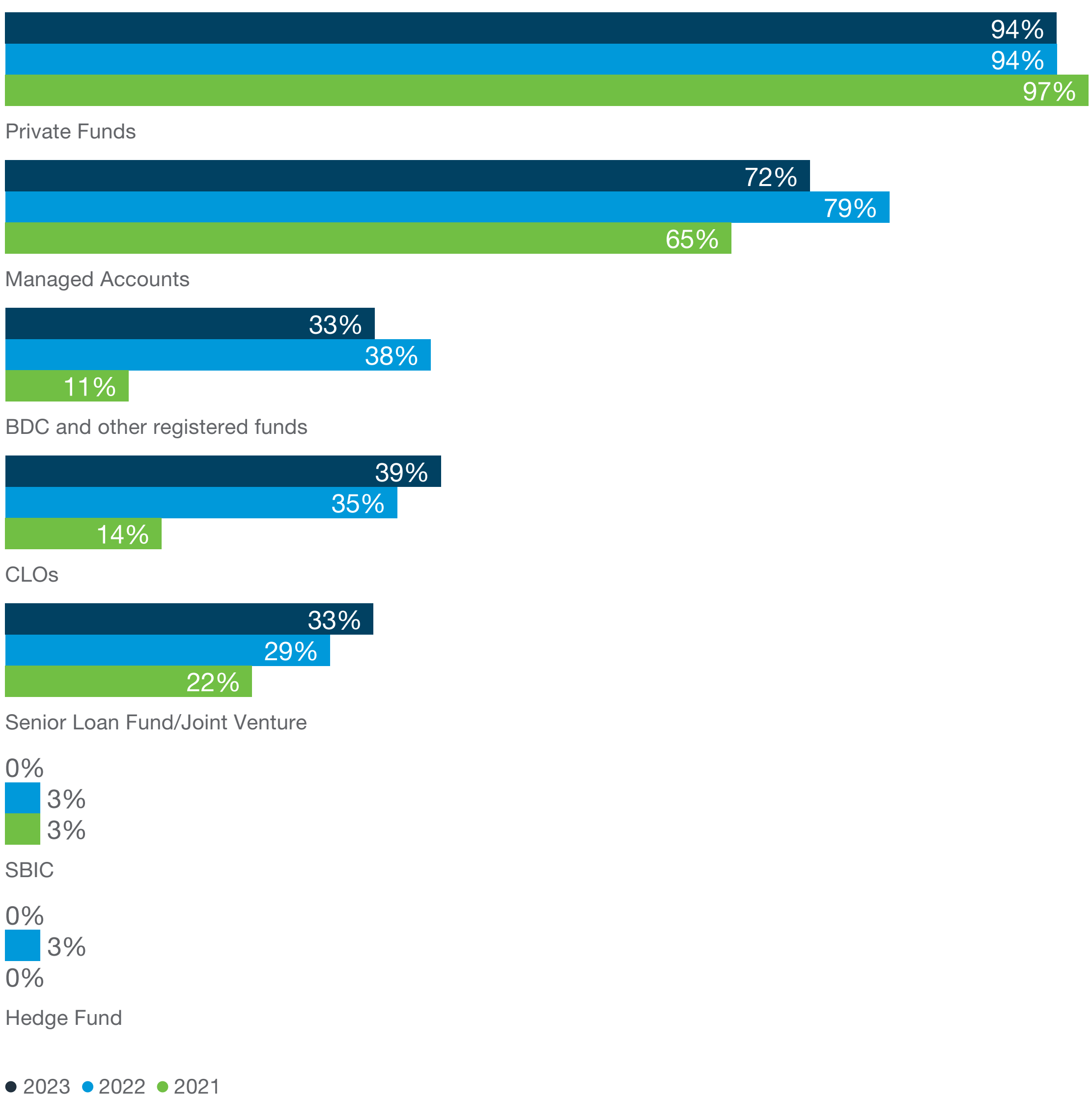
What vehicles do you utilize for your lending activities?

US 2023/2022/2021



What vehicles do you utilize for your lending activities?

UK/EU 2023/2022/2021



Investment Conditions and Considerations

Comparing vehicle usage over the past few years, in the U.S. we see while usage has declined in almost all vehicles categories (except Hedge Funds), compared to the previous year. For example, the portion of U.S. respondents who said they use Managed Accounts fell to 63% this year, compared to 73% in 2021.

Among respondents in the U.K. and E.U. markets, there was a jump in the usage of collateralized loan obligations (CLOs) and senior loan funds as lending vehicles, but SBICs and Hedge Funds were not used at all last year.

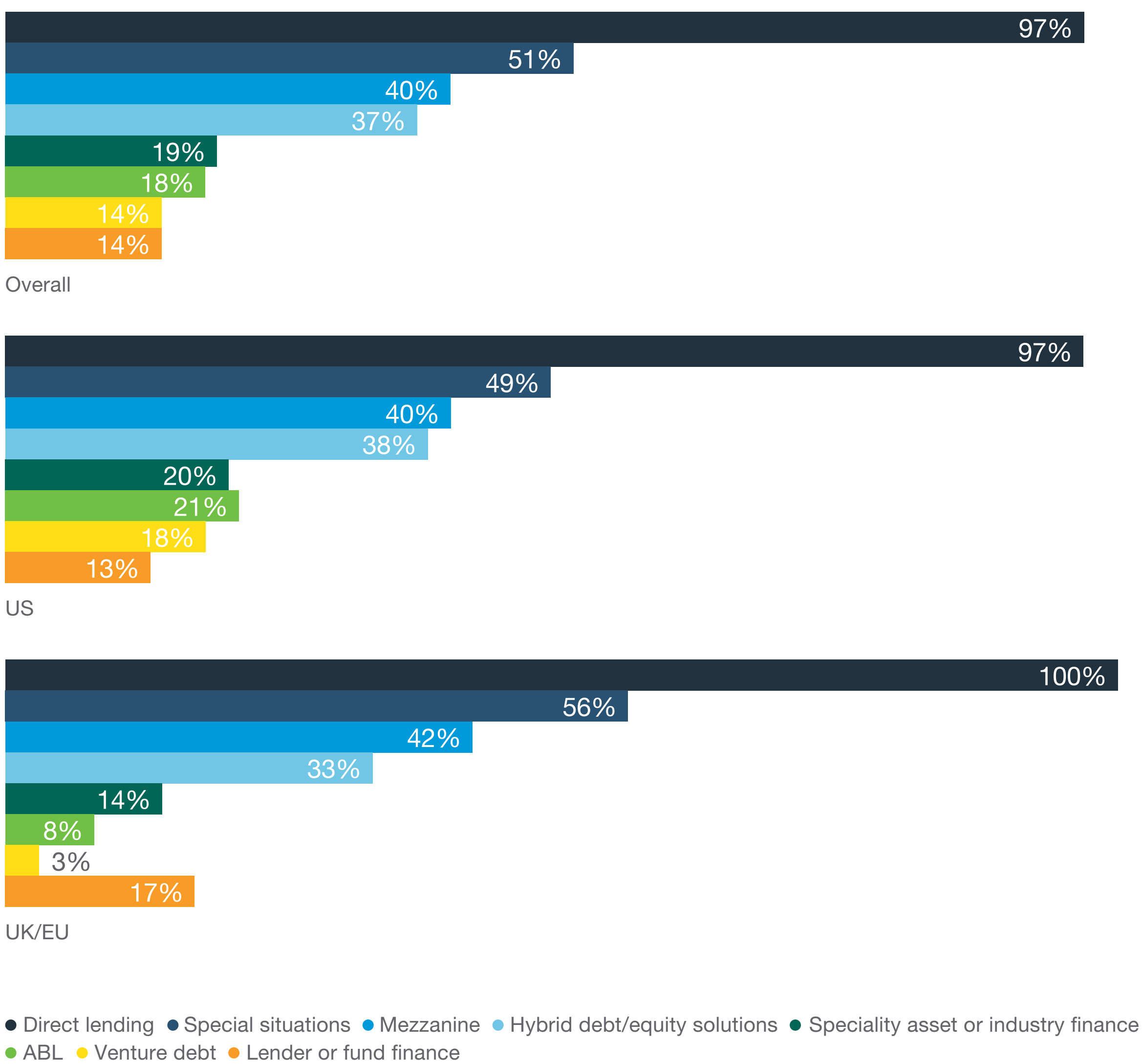
Venture debt and ABL significantly less common in UK/EU

Private Debt Strategies

By a large margin, direct lending is the top private debt strategy in all regions, and is slightly higher in the U.K. and E.U. markets, while venture debt and ABL structures are much more common in the U.S.

What private debt strategies does your firm pursue?

By region: Direct lending is the top private debt strategy in both regions, slightly higher in UK/EU



Investment Conditions and Considerations

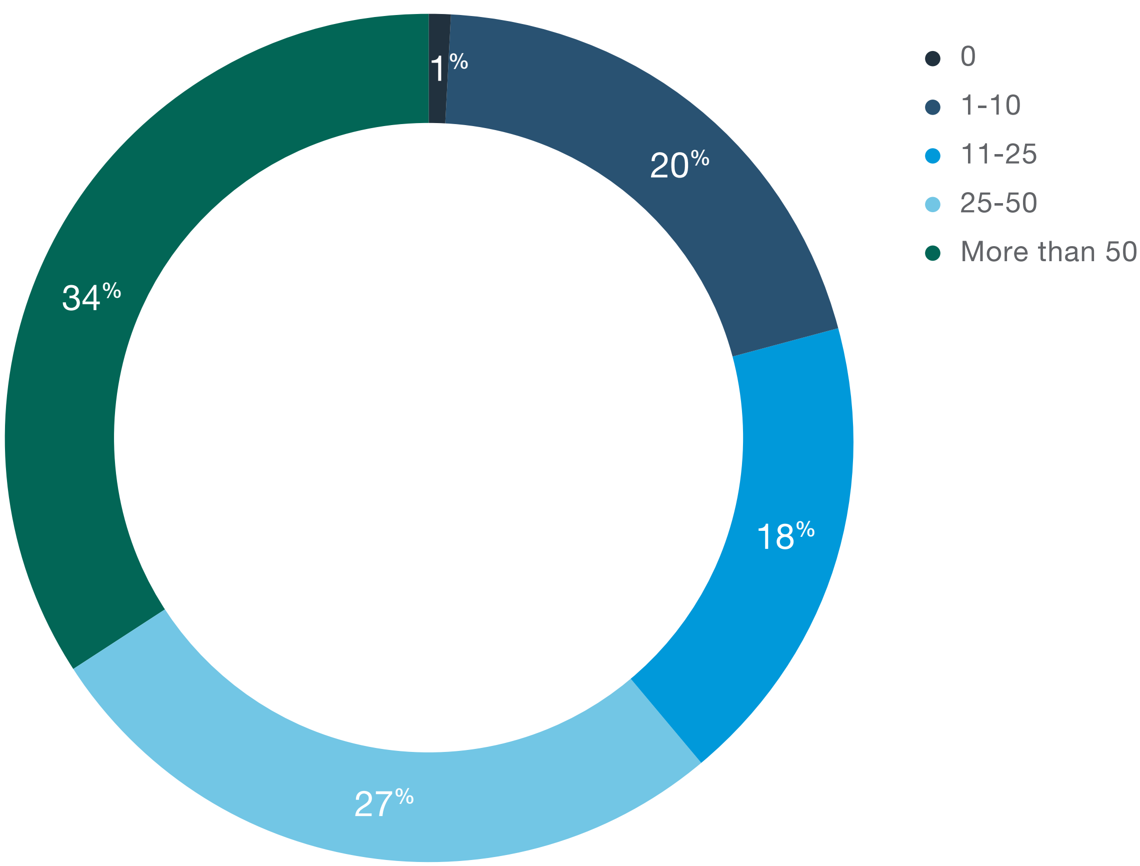
New Credit Investment

Overall, more than one-third (34%) of survey respondents said their firm made more than 50 new credit investments last year.

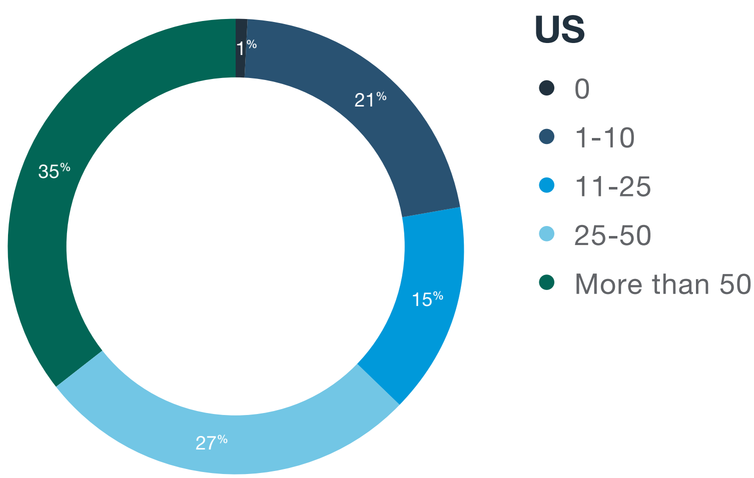
A further 27% of respondents said their firm made between 25 and 50, and only 1% said their firm made no new credit investments last year.

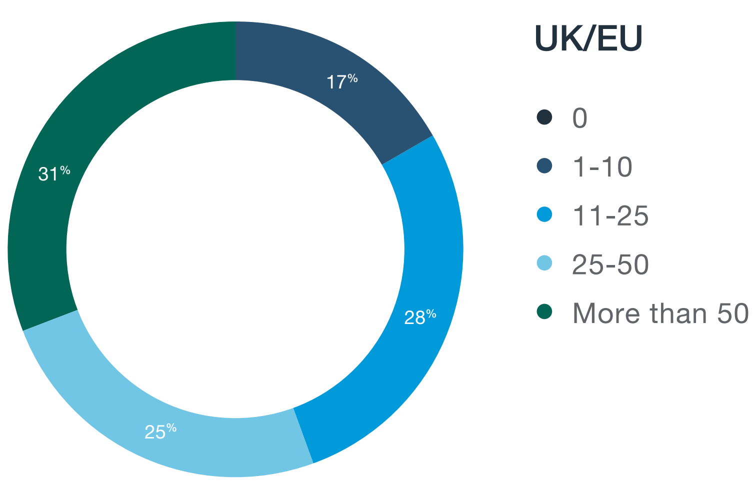
In the U.S., 62% made 25 or more new credit investments, while in the U.K. and E.U. markets, 56% made 25 or more new credit investments.

How many new credit investments did your firm make last year?



How many new credit investments did your firm make last year?





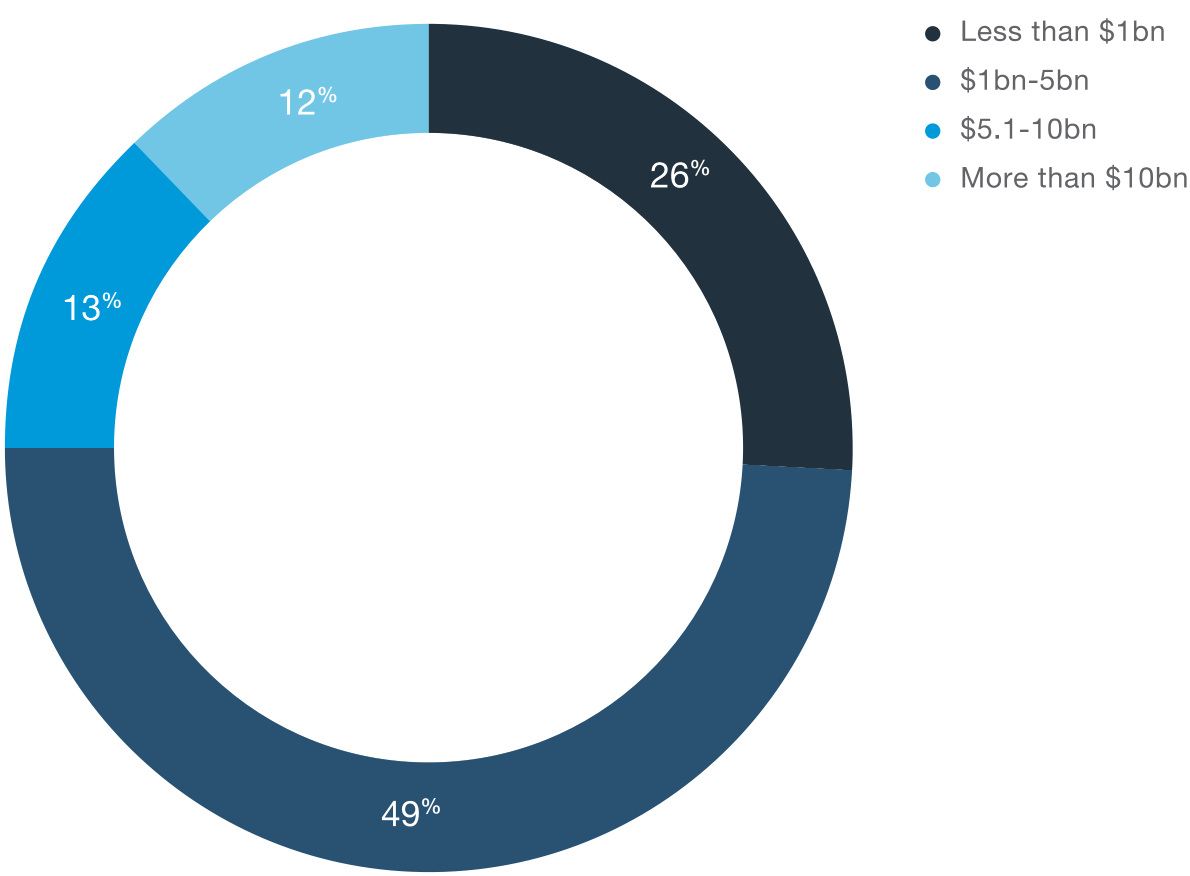
Investment Conditions and Considerations

Deploying Capital

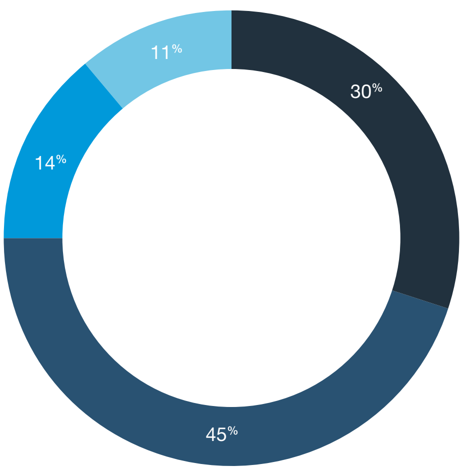
Overall, almost one-half of our survey respondents deployed between $1 billion and $5 billion of capital into credit strategies within the past 12 months.

In the U.S., firms were more likely to have deployed less than $1 billion in capital, compared to those in the U.K. or E.U., with lenders in that region more likely to be in the $1 billion to $5 billion range.

How much capital has your firm deployed into credit strategies in the past 12 months?

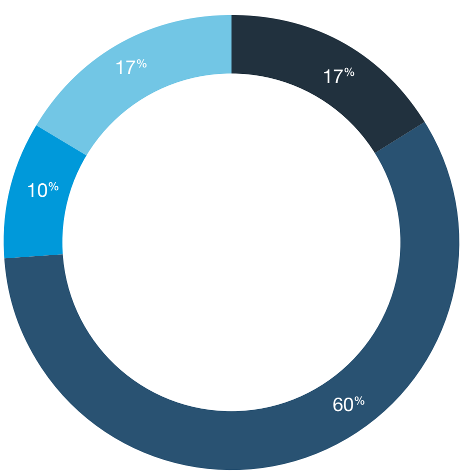


How much capital has your firm deployed into credit strategies in the past 12 months?



Most deployed $1-5bn of capital into credit strategies in US

- Less than $1bn
- $1bn-5bn
- $5.1-10bn
- More than $10bn



More than half deployed €1-5bn of capital into credit strategies in UK/EU

- Less than €1bn
- €1bn-5bn
- €5.1-10bn
- More than €10bn

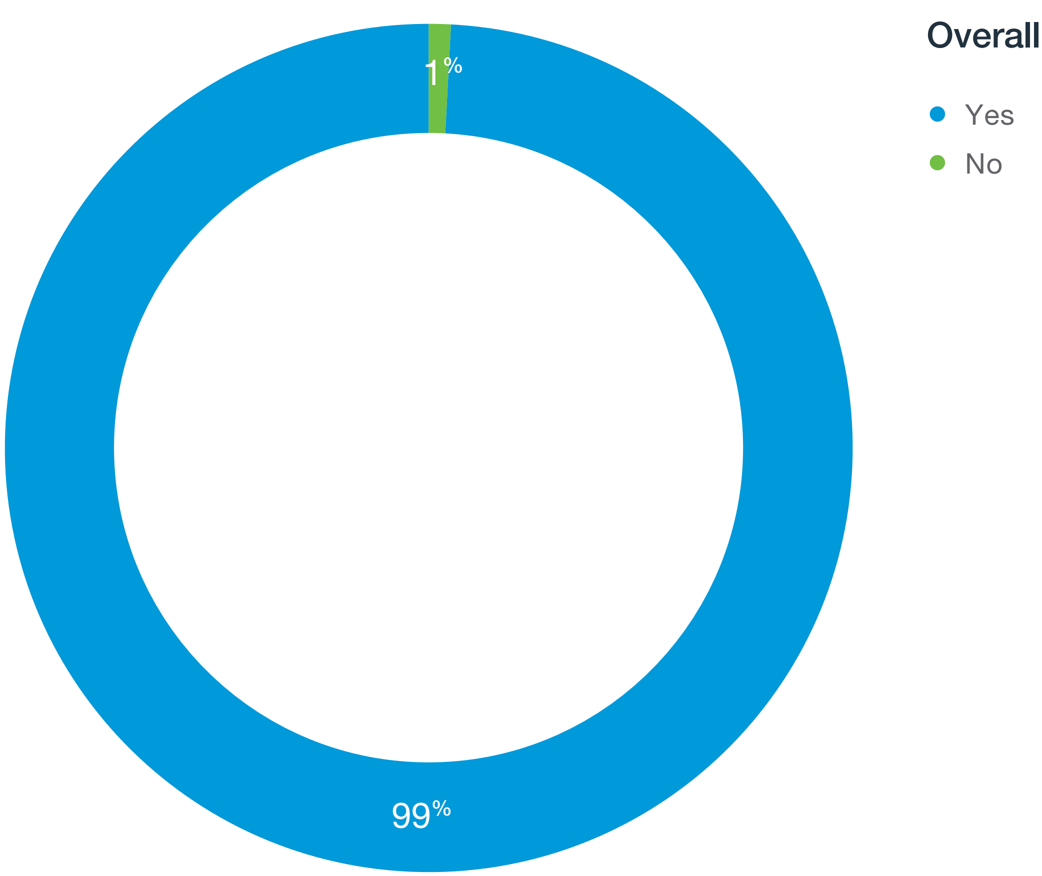
Investment Conditions and Considerations

New Lending Opportunities

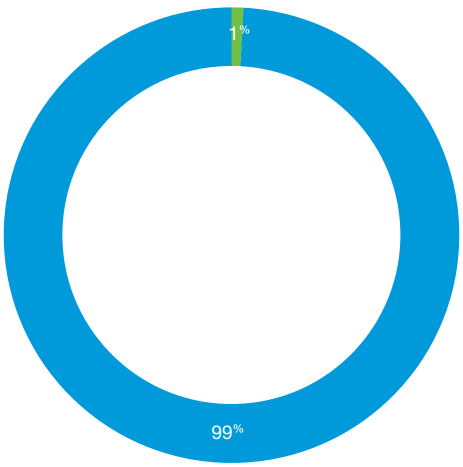
Not surprisingly, almost all respondents (99%) said they are actively looking for new lending opportunities, indicating a robust market that is willing to lend even amid concerns about the overall global economy.

Is your firm looking for new lending opportunities today?

By region: Almost all are looking for new lending opportunities, 100% in UK/EU

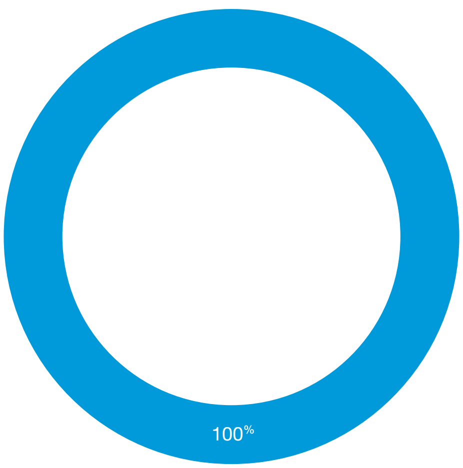


US



- Yes
- No

UK/EU



- Yes
- No

Investment Conditions and Considerations

When asked to comment directly on their responses, many respondents (about one-third) said they are being more selective or cautious than they have been previously.

"We are open for business but proceeding with caution," one respondent said. "Lending terms (spreads, LTV, covenants, etc.) are as favorable as we've seen in more than five years, but we're certainly very mindful of the risks associated with the potential looming recession and the interest burden placed on companies in the rate environment."

Others suggested they were approaching the market with similar caution:

"We went through a five-month period in 2022 in which we were not lending. We are lending now but looking for low (or lower) loan-to-value opportunities in companies that we believe can withstand a recession in 2023."

"Active but cautious in the market — both direct lending and BSL."

Still others noted that deal metrics have changed, and they are making adjustments:

"…hold sizes have been reduced materially and underwriting standards have tightened."

"Becoming more selective and more conservative with leverage."

Still, overall there was a sense of cautious optimism among respondents:

"As we move into 2023, we believe there will be many opportunities for direct lenders given the difficult equity environment and uncertain economic outlook."

Other respondents said the following:

"We are very active, having a record quarter/year."

"As always, we are looking for unique ways to put capital to work that meet our criteria."

"Yes, in a very measured way given the current climate."

"We are still active in the current environment and looking to deploy capital."

"We are being highly selective."

"Yes, but increasingly selective on credit quality."

"Our firm has been very active in the 3rd and 4th quarters."

"We are active yet selectively looking at new opportunities in the current market given the backdrop of all the headlines (market volatility, public and private lender pullback, inflation, pending recession, Ukraine war)."

"Yes, primarily uni-tranche opportunities in the S+650-700 range."

"Highly selective but evaluating some new opportunities."

"Very active and looking to take advantage of market volatility."

"Cautious, but we are open for business."

"Yes, we are still actively deploying capital."

"Actively pursuing new lending opportunities."

"We are actively evaluating new lending opportunities. The current market environment offers the most favorable risk-adjusted returns that we have seen in quite some time."

"We're still active in market."

"Still open for business."

"Selectively, at new market terms after correction."

"Yes, but selectively."

"Selectively, as higher return matters equally to amount deployed."

"We continue to benefit from the backing of significant investor commitments who pay us to invest. Therefore, through the cycle we will continue to look for the best opportunities."

"Mostly focusing on the portfolio, but still open for new LBOs and add-ons for current portfolio companies."

"While economic backdrop is testing and capital scarce, we are actively looking to deploy."

"Very selective."

"Special situations, both sponsor-backed and non-sponsor backed, real estate lending, growth lending, rescue financings."

"No change."

"We have an opportunistic strategy so believe the opportunities today will be a lot more attractive than 12 months ago."

"Plenty of capital available."

"Lower leverage, higher pricing."

"We have available capital and remain active in providing financing solutions to sponsors and corporate borrowers."

Investment Conditions and Considerations

Maximum Leverage

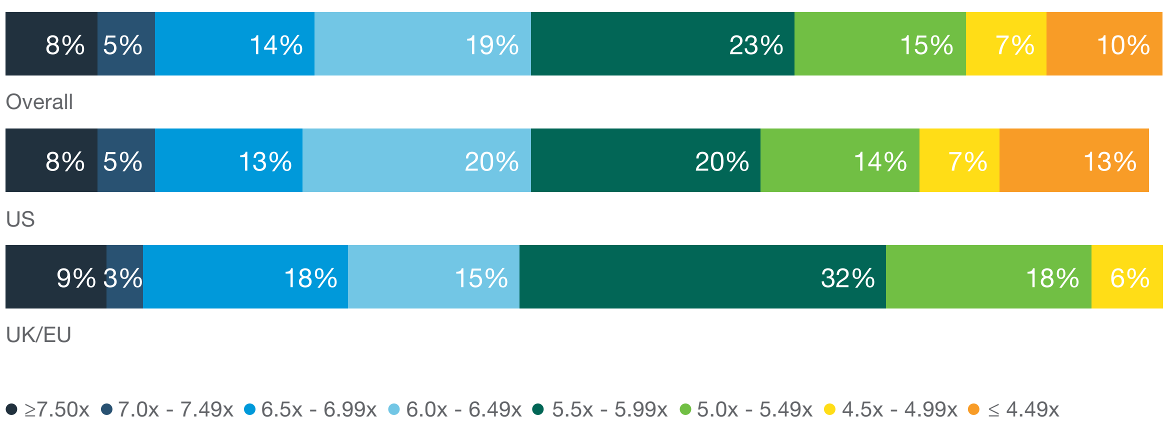
The maximum leverage that private credit lenders were willing to take on centered mostly on the 5.5-times to 5.9-times range, which saw almost one-quarter (23%) of respondents say that this was the maximum leverage level at which they would underwrite.

In the U.K./E.U. market, that portion was at about one-third (32%) of respondents, while the U.S. saw a more even spread across leverage levels.

What's the maximum total leverage that you will underwrite today?

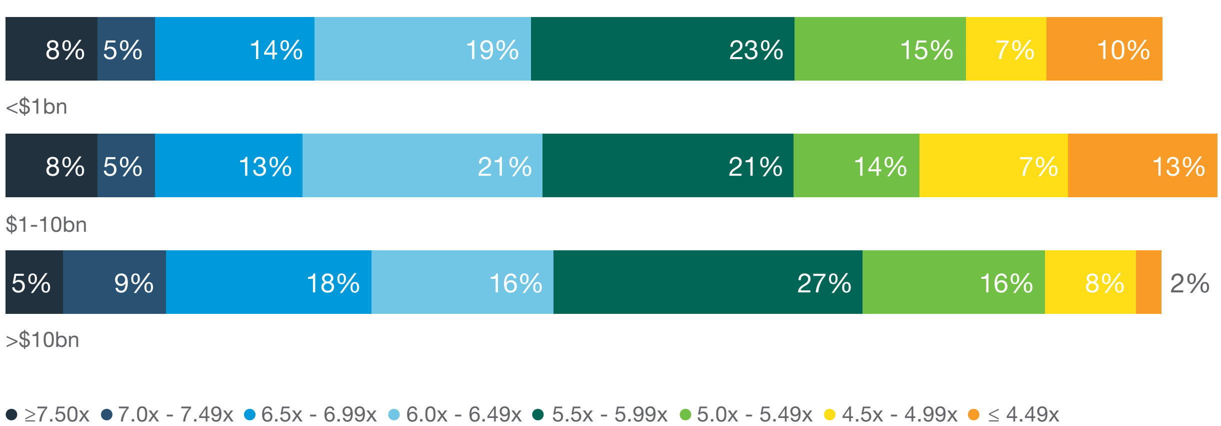
Overall:

UK/EU more likely to be in 5.5x – 5.99x category while US market sees a more even spread across ranges



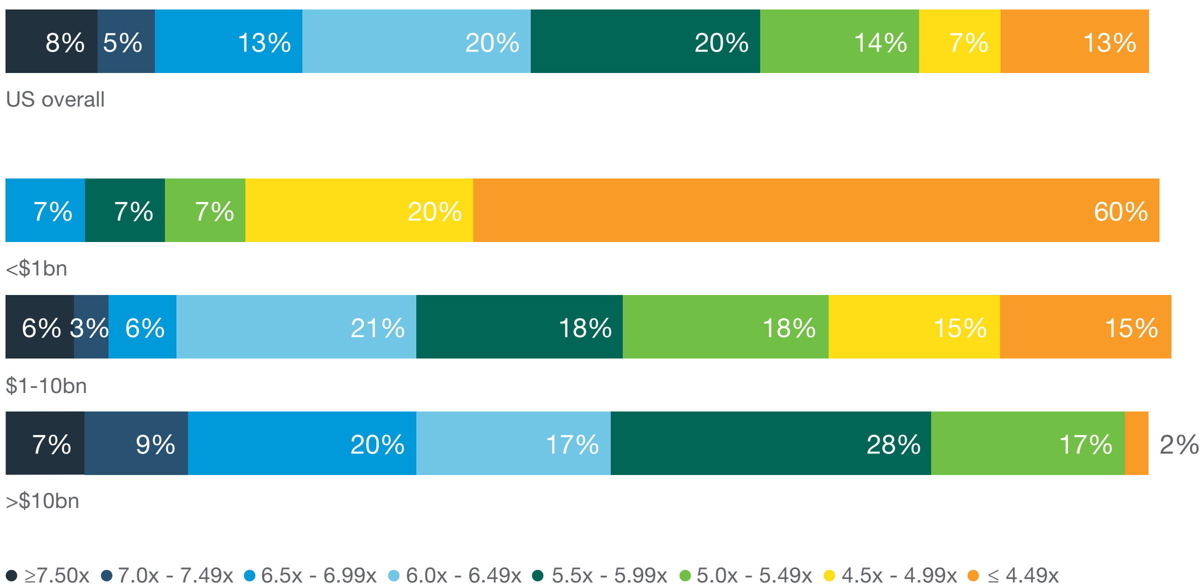
By Overall AUM

All three AUM groupings have a similar spread of maximum total leverage



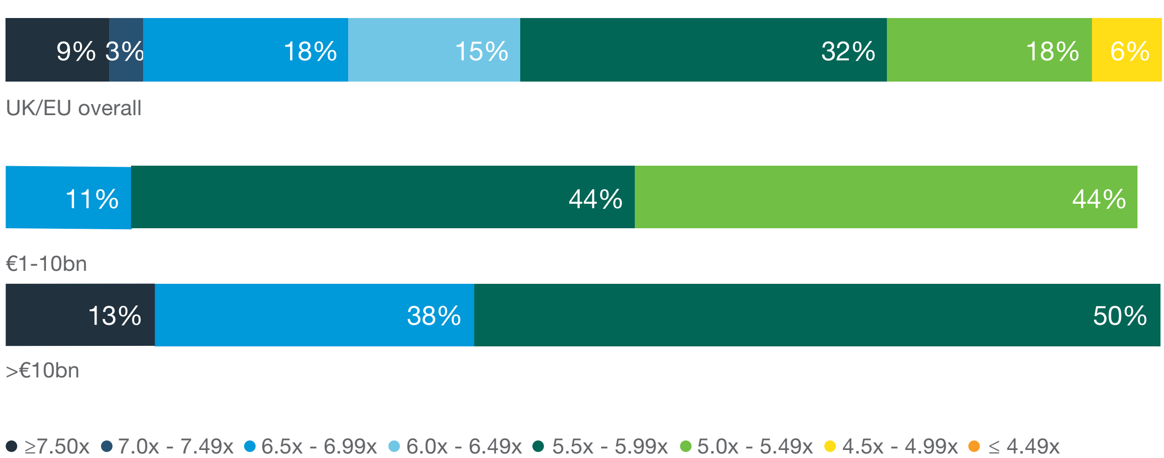
By US AUM

Maximum leverage <$1bn AUM grouping has higher proportion in ≤4.49x category; over half



By UK/EU AUM

Maximum leverage 5.5x – 5.99x is a top category for both €1-10bn and >€10bn AUM grouping



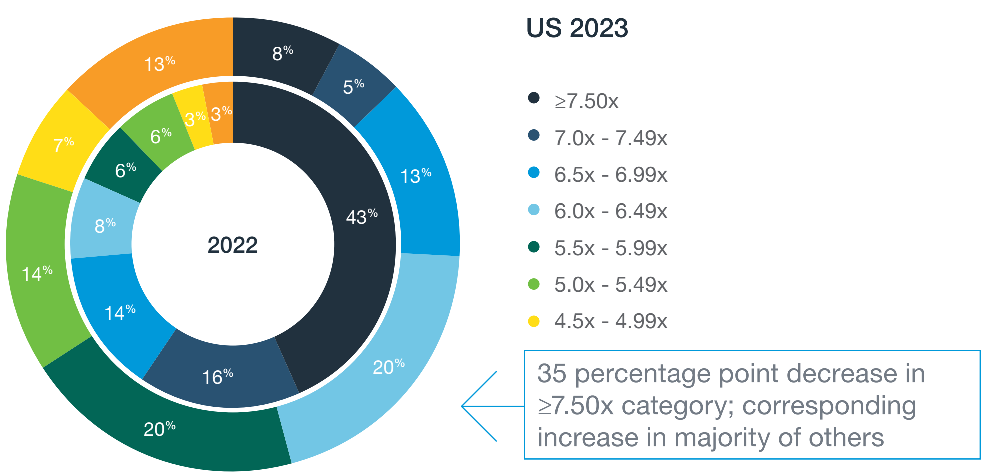
Investment Conditions and Considerations

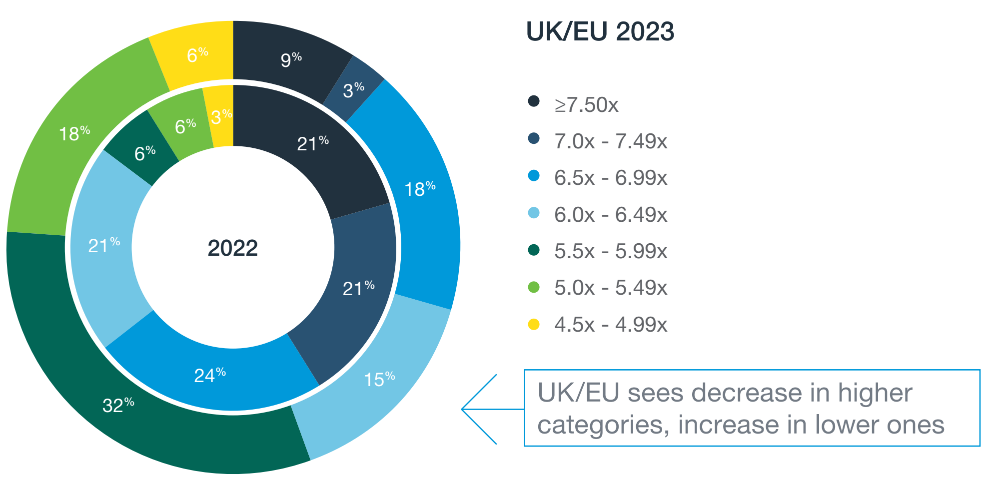
Maximum Total Leverage

All this marks a big change from last year's responses, in which 43% of respondents said they were comfortable underwriting with leverage greater than 7.5-times. Just 6% said that the 5.5-times to 5.9-times range was their maximum leverage level last year.

Clearly, this dramatic shift underscores the caution that the private credit market has voiced about the current environment. For example, those lenders with less than $1 billion AUM responded in a higher proportion (60%) to the less than 4.49-times leverage category, compared to last year when just 25% said that was their maximum leverage level.

What's the maximum total leverage that you will underwrite today?

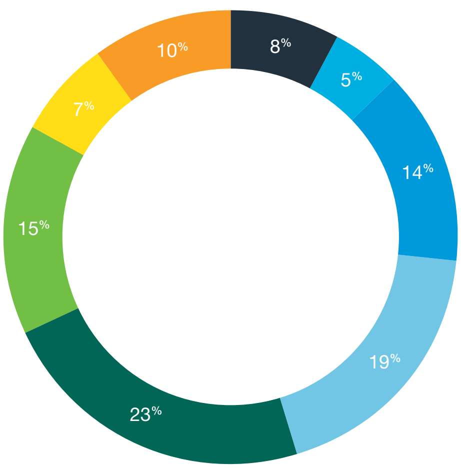




What’s the maximum total leverage that you will underwrite today?

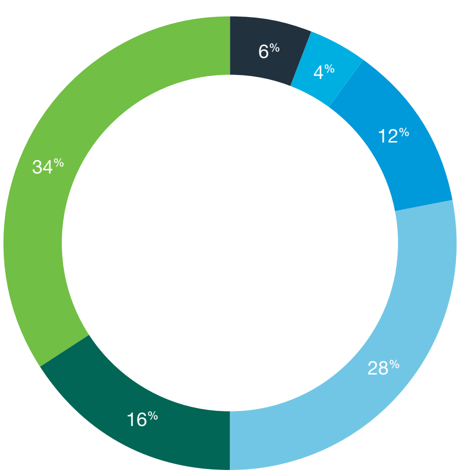
How much equity (on a % basis) does your organization typically require in your transactions?

Overall



Leverage
Largest portion in 5.5x – 5.99x group

- ≥7.50x
- 7.0x - 7.49x
- 6.5x - 6.99x
- 6.0x - 6.49x
- 5.5x - 5.99x
- 5.0x - 5.49x
- 4.5x - 4.99x
- ≤ 4.49x



Equity
≥50% highest category, followed by 40-44.9%

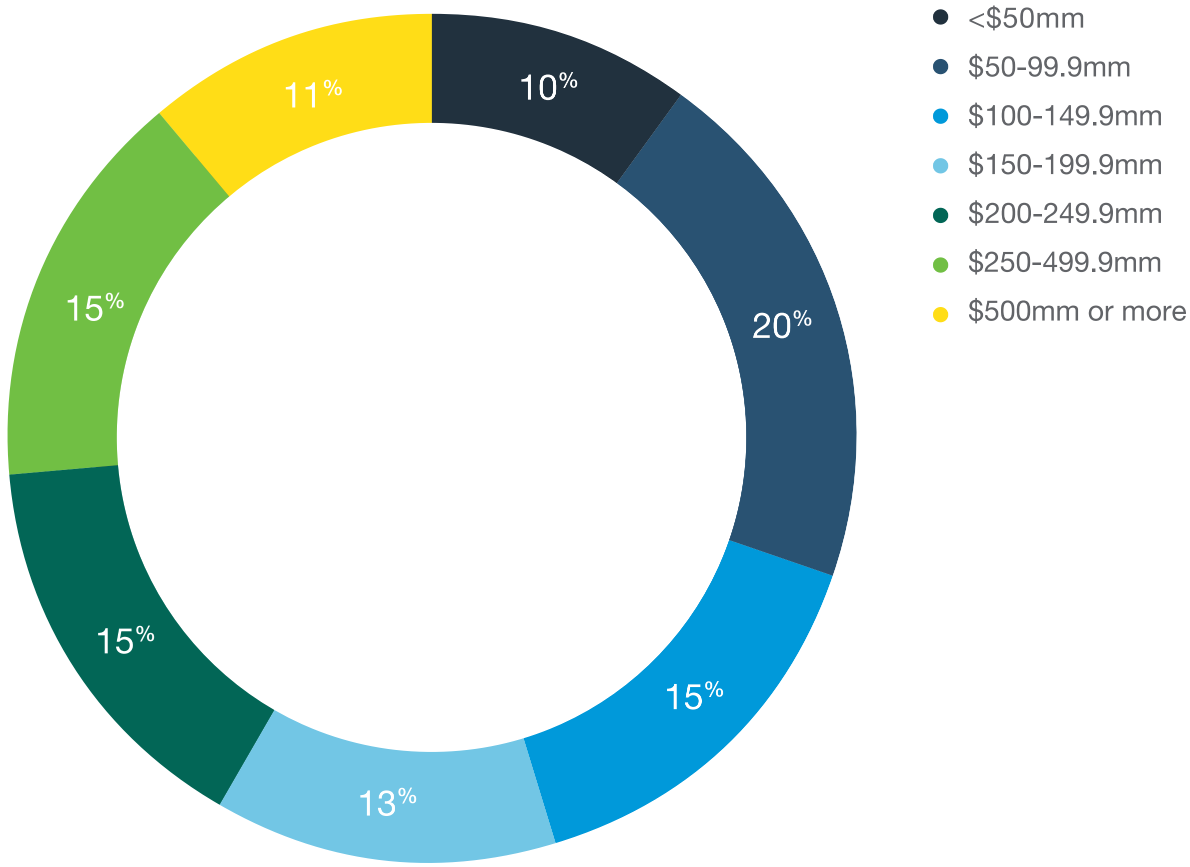
- <30%
- 30-34.9%
- 35-39.9%
- 40-44.9%
- 45-49.9%
- ≥50%

Investment Conditions and Considerations

Maximum Deal Size

The levels of maximum deal size were pretty evenly spread across categories, reflecting the diversity of respondents, with 20% of respondents saying the maximum size deal their firm will underwrite today is between $50 million and $99.9 million. Just 10% said the maximum size deal their firm will underwrite is less than $50 million.

What is the maximum size deal your firm will underwrite today?



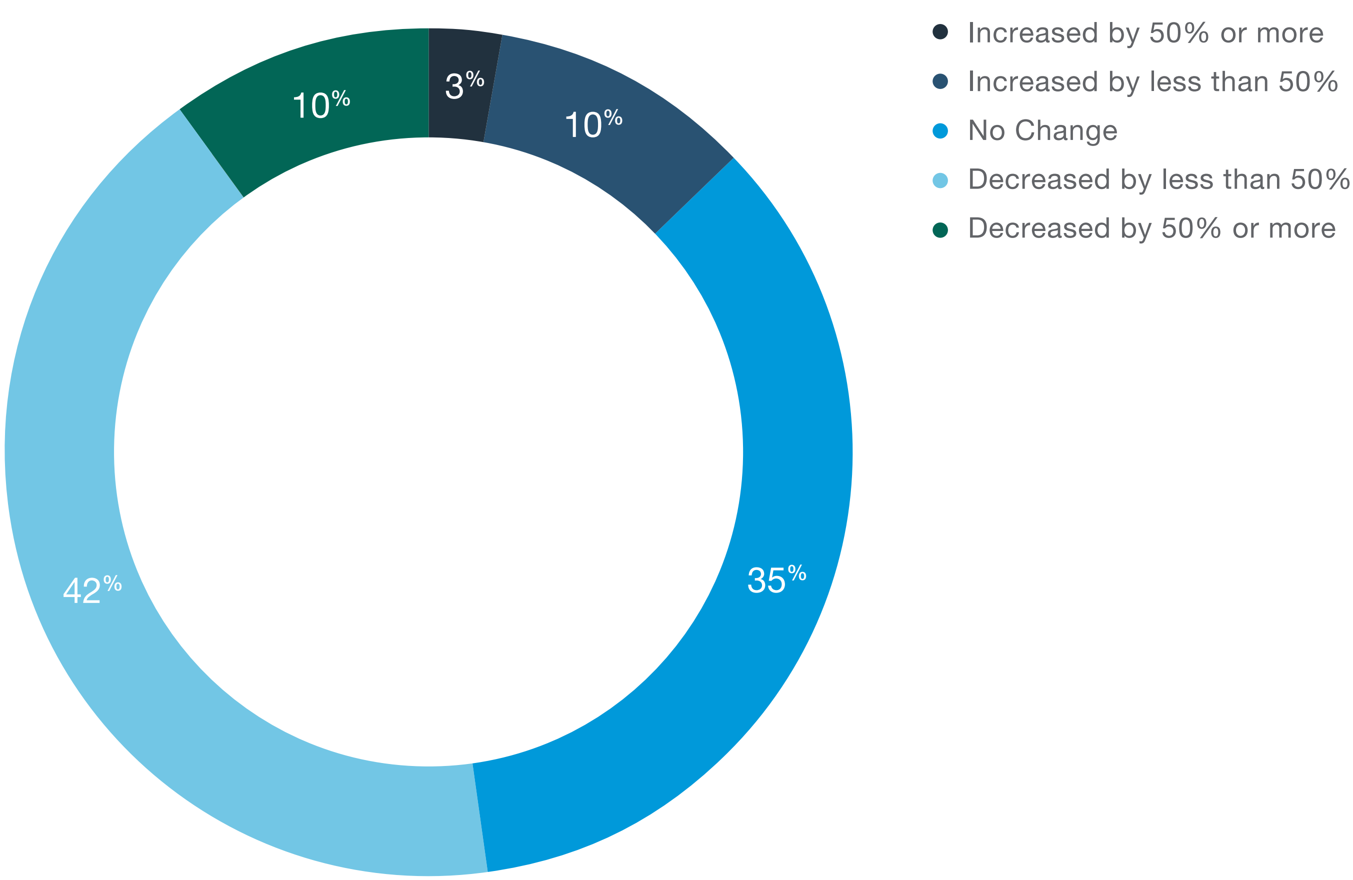
Investment Conditions and Considerations

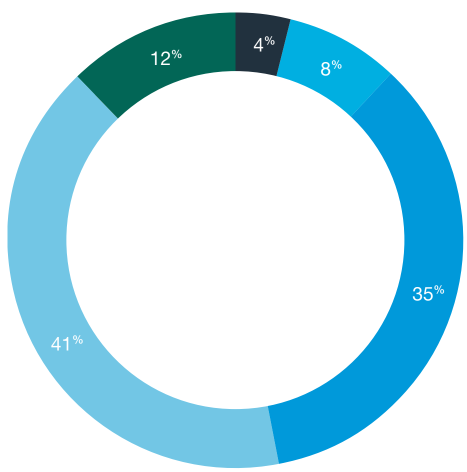
Check Size

The majority of respondents (52%) said the size of the check their firm is willing to write has decreased in the past 12 months, with 10% of those saying their check size decreased by more than 50%. Interestingly, U.S. respondents were twice as likely to say their check size had decreased by 50%.

Only 13% of respondents said their check size has increased, and just more than one-third (35%) stated there had been no change.

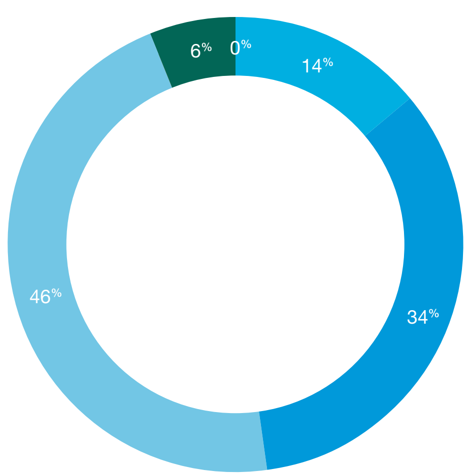
Has the size of the check your firm is willing to write changed over the past 12 months?





Decreased by less than 50% highest vote in US

- Increased by 50% or more
- Increased by less than 50%
- No Change
- Decreased by less than 50%
- Decreased by 50% or more



Similarly, decreased by less than 50% received the highest vote in UK/EU

- Increased by 50% or more
- Increased by less than 50%
- No Change
- Decreased by less than 50%
- Decreased by 50% or more

Investment Conditions and Considerations

When asked to comment directly on their responses, those lenders who said their check size had decreased by 50% or more noted a host of reasons, such as "fundraising concerns" and "limited capital," as well as a "lack of runoff [that] has not allowed us to recycle capital."

They also pointed to changes in strategy, including "preserving capital in choppy market conditions" and "focus[ing] on capital preservation for future troubled credits."

Even those who said their check size decreased by less than 50%, cited "changing risk appetite due to current economic environment and desire to preserve capital given uncertain fundraising environment" and a "reduction in dry powder given tremendous deployment."

Indeed, the levels of uninvested capital reserves able to be deployed (the so-called *dry powder*) seemed to weigh on several respondents' minds. "Our dry powder and liquidity is more limited today vs. 12 months ago," said one. "The fundraising environment is tight — the denominator effect is very real — and we need to be sure we have ample capacity to stay in the market even if our next fundraising is delayed due to market conditions."

Increased activity	%
Availability of capital	60%
Availability/amount of capital	50%
Change in managed accounts	10%
Firm's strategy/focus	10%

Remain the same	%
No change to activity	55%
Economic outlook/ market conditions	27%
Funds/Fundraising	11%
Firm's strategy/focus	27%
More selective/cautious	9%

Decreased activity	%
Availability/amount of capital	40%
Funds/Fundraising	40%
Economic outlook/ market conditions	30%
Risk	17%
Firm's strategy/focus	13%
Dry powder	10%
More selective/cautious	10%
Repayments	10%
Change in managed accounts	3%

Other respondent said the following:

Check size decreased by 50% or more

"Fundraising concerns."

"Lack of runoff has not allowed us to recycle capital."

"Limited capital due to fundraising constraints."

"Preserving capital in choppy market conditions."

"Risk off until credit terms + economics normalize based on interest rates peaking / being in a cycle."

"We are almost fully invested in our available capital."

"Over-deployed when the market was hot + fewer repayments + now in a fundraising year."

"Focus on capital preservation for future troubled credits, fundraising slowing."

Check size decreased by less than 50%

"Capital raising has slowed and there has been almost no repayments of existing loans."

"Decreased due to selectivity, lower capital availability, full managed accounts."

"More focus on pure mid-market and control (rather than club) positions."

"Our dry powder and liquidity is more limited today vs. 12 months ago. The fundraising environment is tight—the denominator effect is very real—and we need to be sure we have ample capacity to stay in the market even if our next fundraise is delayed due to market conditions."

"Decreased to increase granularity in portfolio for diversification purposes, reserve capacity for portfolio activities and our most strategic relationships for new deals."

"Reduction in dry powder given tremendous deployment and in part risk aversion."

"Changing risk appetite due to current economic environment and desire to preserve capital given uncertain fundraising environment."

"Trying to diversify and more limited access to capital."

"Conservatism."

"Less capital coming back to recycle into new opportunities."

"Fund raising cycle + more selective based on market."

"Lack of run-off, credit conservatism, lack of fundraising."

"Very selective."

"Recent decrease with smaller check sizes reflecting desire to club up more - decrease is 10-20%."

"Risk appetite and dry powder."

"Darker macro-outlook/recession concerns."

"Fund size has decreased."

"Pricing volatility."

"Limited repayments, preserving capital for potential changes in market conditions."

"To some extent making final fund investments, to some extent managing risk."

Availability/amount of capital, Funds/Fundraising and Economic outlook/market conditions are the top factors behind the increased/decreased change in activity and remaining the same.

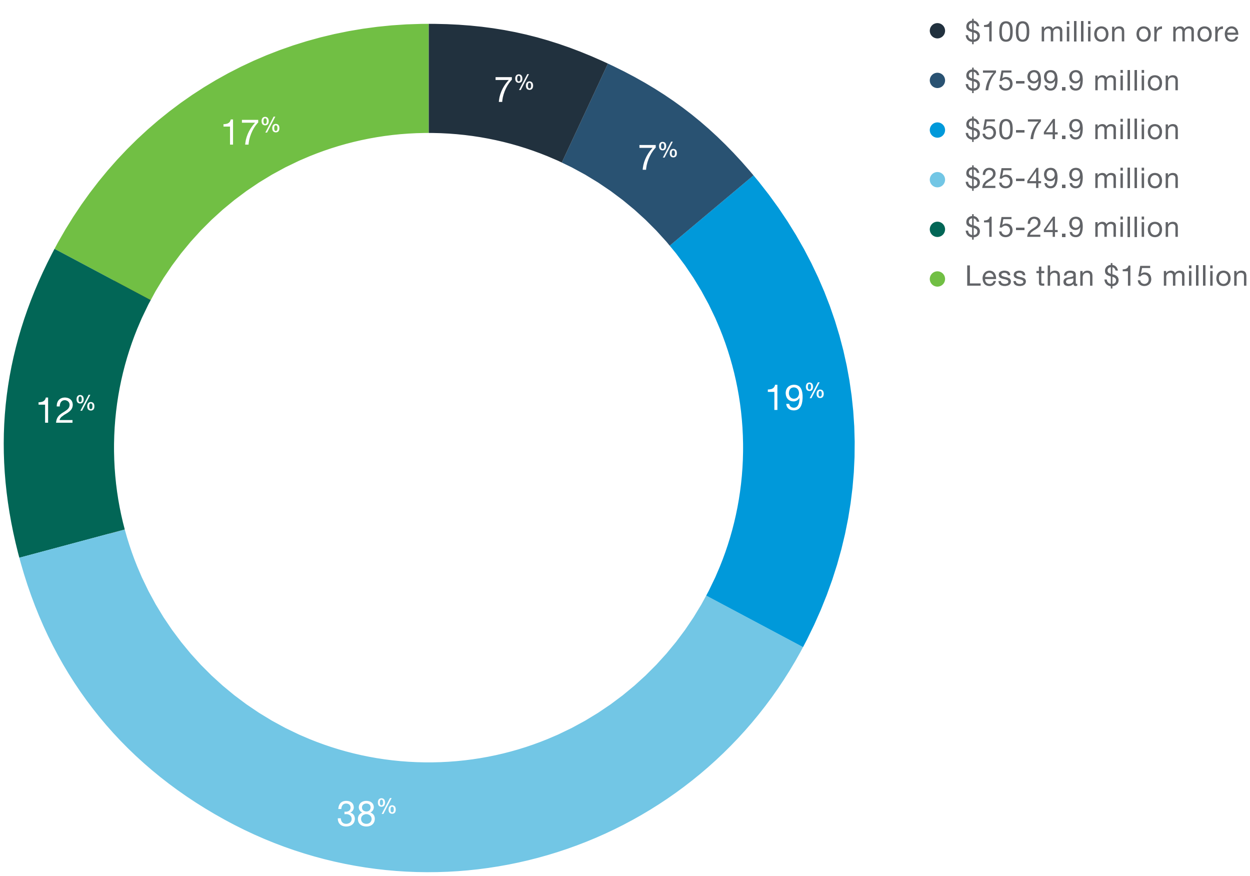
Investment Conditions and Considerations

EBITDA Size of Borrowers

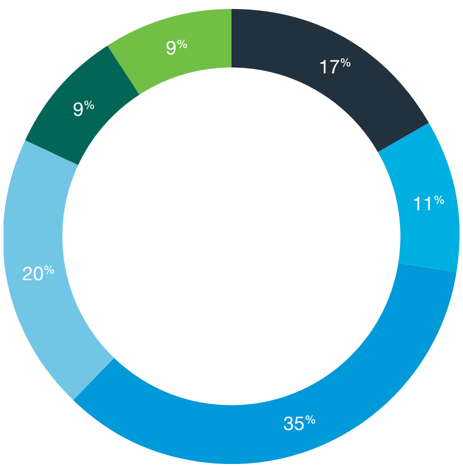
Overall, the average EBITDA of companies in lenders' portfolios is between $25 million and $50 million, with more than one-third (38%) of lenders saying this is the most common EBITDA range for their investments.

Another one-third (33%) reported that the average EBITDA of companies in their portfolios was more than $50 million, with 7% saying it was more than $100 million.

What is the average EBITDA of companies in your portfolio?

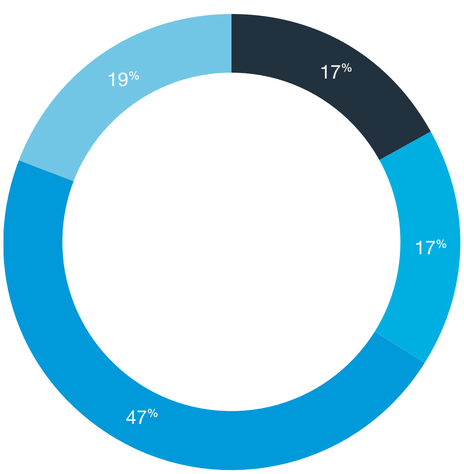


US



- Less than $15 million
- $25-49.9 million
- $75-99.9 million
- $15-24.9 million
- $50-74.9 million
- $100 million or more

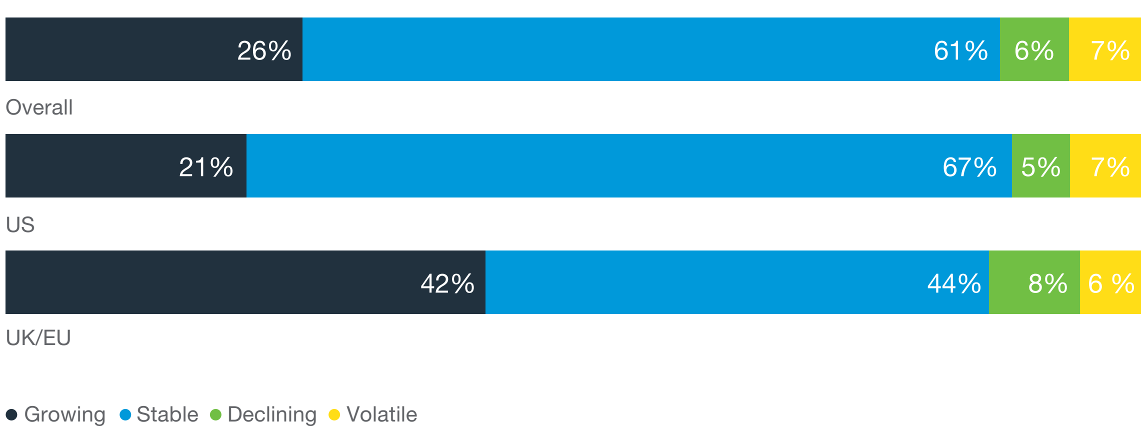
UK/EU



- Less than €15 million
- €25-49.9 million
- €75-99.9 million
- €15-24.9 million
- €50-74.9 million
- €100 million or more

Investment Conditions and Considerations

Majority describe their EBITDA as stable, but more from US than UK/EU



Recent data underscores some of the respondents' more optimistic sentiment. For example, middle market private companies represented in the Golub Capital Altman Index showed year-over-year earnings growth of 9% and revenue growth of 11% during the first two months of the fourth quarter of 2022.[13]

When asked to comment directly on their responses to describe the EBITDA of their borrowers, respondents said that the EBITDA was either stable or growing. *"Pockets of volatility in the portfolio due to supply chain and inflation,"* said one respondent. *"But on average EBITDA is growing across our portfolio."*

Others described similar outlooks, but threw in a note of caution as well. *"Most of the investments are still growing, but there is more volatility in earnings,"* one said. While another added that the average EBITDA of their borrowers was *"still going up — next year, it'll probably be a different story."*

Other respondents who said the average EBITDA of their borrowers was growing commented:

"In particular B2B business have exhibited significant topline resilience, and pricing initiatives from earlier in 2022 are supporting stable to rising EBITDA."

"Through the 3rd quarter we continued to see EBITDA increase modestly across the portfolio."

"The average EBITDA of our borrowing is growing via acquisitions. The acquisition growth may be masking the lack of organic growth. Given I am not in portfolio but listen to and participate in the calls, I believe organic growth is declining."

"Still growing but of course does not factor in interest costs."

Those respondents who described the EBITDA of the companies in their portfolios as stable, also noted some concerns. *"Most borrowers are stable,"* one respondent replied. *"We do have more declining than at this time last year, but the majority remain stable."*

Others cited specific concerns such as that EBITDA growth *"has slowed, [being] partially offset by inflation."* Another suggested things were stable but *"showing some pressure on margins."*

Other respondents who said the average EBITDA of their borrowers was stable commented:

"Invested in resilient/defensive sectors that are still experiencing revenue growth that is offset by margin compression."

"Stable for industrial businesses, margins contracting for tech companies; industrial companies were quicker to tighten their belts on costs, whereas most tech companies had never had to do that before."

"Most of them are growing, especially those still building back from COVID impacts."

"Starting to see some bifurcation between borrowers and industries; historically we'd see pretty consistent high single digit EBITDA growth; today it's a mixed bag with majority still stable or growing."

"Portfolio is performing well albeit growth has been tempered."

"Stable to declining slightly overall."

"More and more adjustments."

"Stable now but expect margin pressure."

[13] *Golub Capital Middle Market Report,* Golub Capital; Q4 2022.

Investment Conditions and Considerations

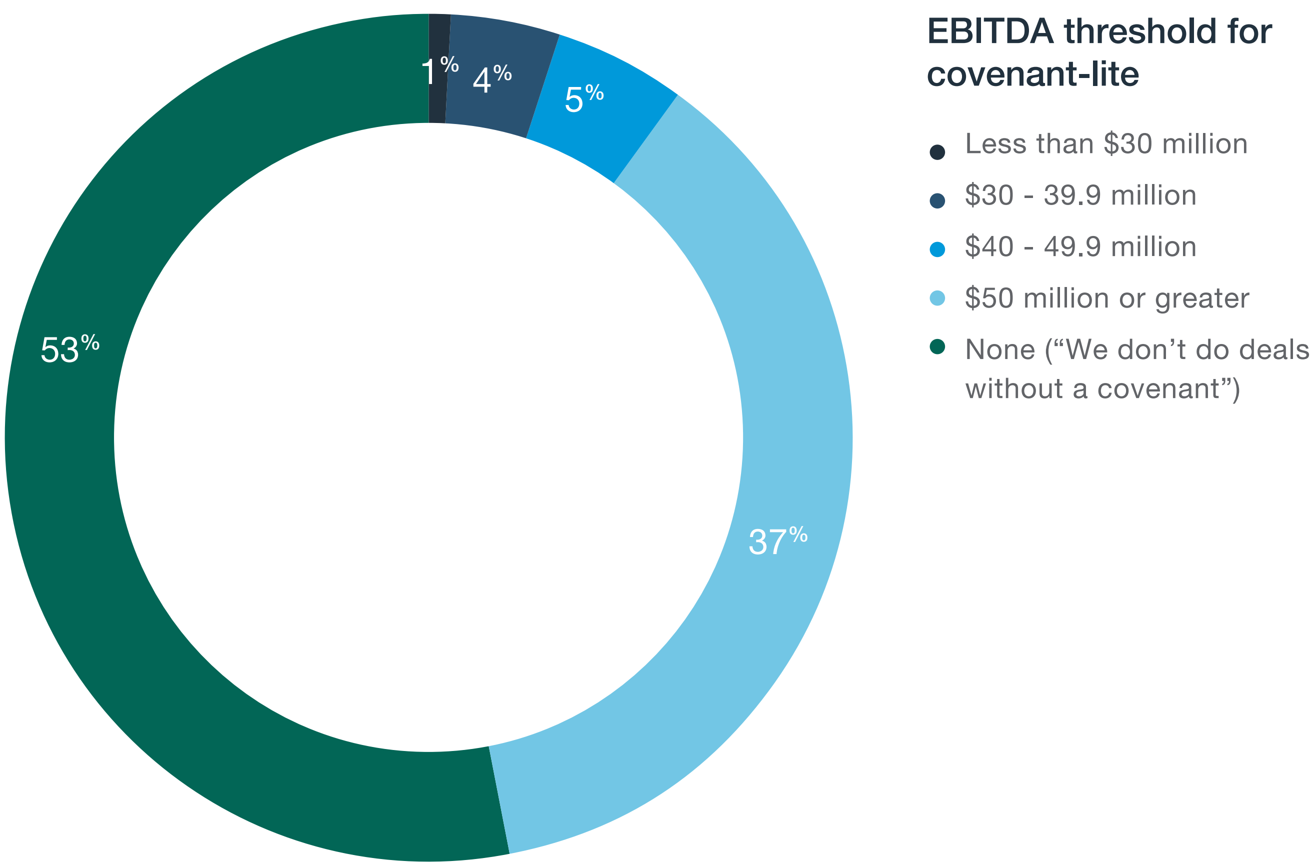
Covenant-lite Transactions

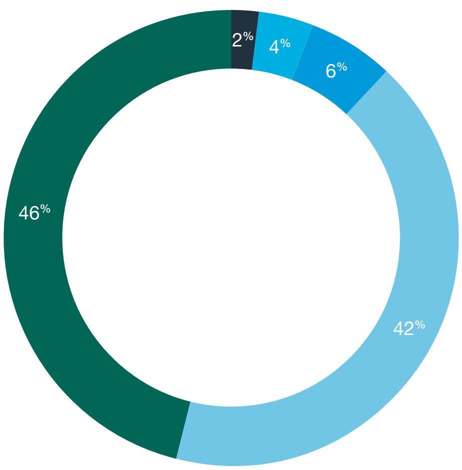
When asked at what EBITDA level would lenders consider a covenant-lite transaction, more than half (53%) said they do not do deals without a covenant. For those lenders that would consider it, 37% said they would need an EBITDA level of more than $50 million to make it happen.

Interestingly, this caution doesn't seem to appear in other markets. For example, a record-setting 86% of the $1.3 trillion in outstanding U.S. leveraged loans are covenant-lite, according to the S&P/LSTA Leveraged Loan Index.[14] Meanwhile, as mentioned, issuance in both the high-yield and syndicated loan markets has slowed, and public market financing — once plentiful and cheap — is now "scarce and expensive," which leaves the "the private market opportunity [...] strong for investors able to deploy capital, according to Apollo Global Management".[15]

[14] *"Covenant-lite deals exceed 90% of leveraged loan issuance, setting new high" by Abby Latour; S&P Global Markets (October 8, 2021).* See *https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/covenant-lite-deals-exceed-90-of-leveraged-loan-issuance-setting-new-high-66935148.*
[15] *Ibid.,* 2023 Economic and Capital Markets Outlook *Apollo Global Management; page 21.*

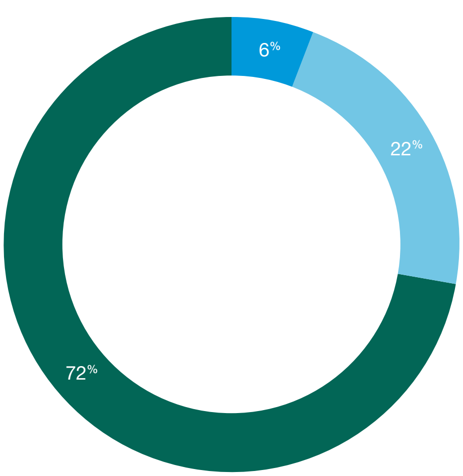
At what EBITDA level would you consider a covenant-lite transaction?





EBITDA threshold for covenant-lite - US

- Less than $30 million
- $30 - 39.9 million
- $40 - 49.9 million
- $50 million or greater
- None (“We don’t do deals without a covenant”)



EBITDA threshold for covenant-lite - UK/EU

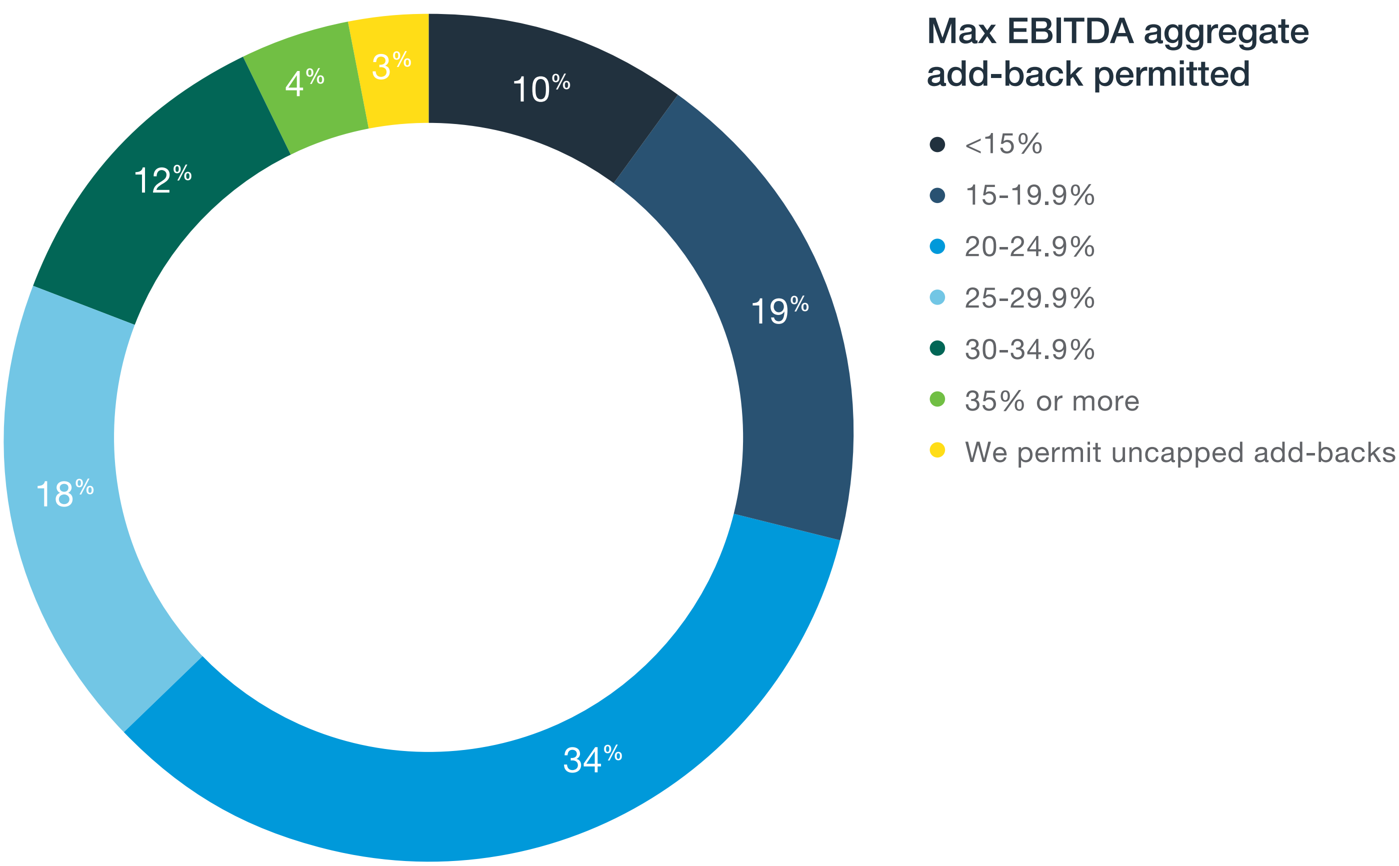
- Less than €30 million
- €30-39.9 million
- €40-49.9 million
- €50 million or greater
- None (“We don’t do deals without a covenant”)

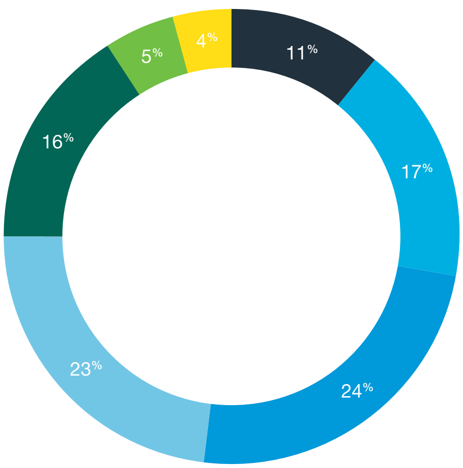
Investment Conditions and Considerations

EBITDA Add-Backs

Similarly, the percentage of lenders who said they would permit uncapped add-backs dropped to just 3% this year, compared to 10% last year, further indicating a stifling of concern over risk.

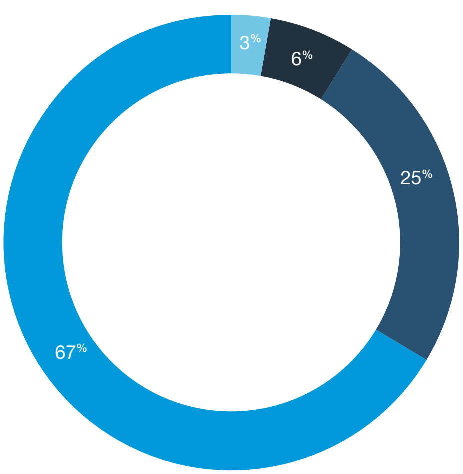
What is the maximum aggregate amount of EBITDA add-backs you will permit for your transactions?





Max EBITDA aggregate add-back permitted US

- <15%
- 15 - 19.9%
- 20 - 24.9%
- 25 - 29.9%
- 30 - 34.9%
- 35% or more
- We permit uncapped add-backs



Max EBITDA aggregate add-back permitted UK/EU

- <15%
- 15 - 19.9%
- 20 - 24.9%
- 25 - 29.9%
- 30 - 34.9%
- 35% or more
- We permit uncapped add-backs

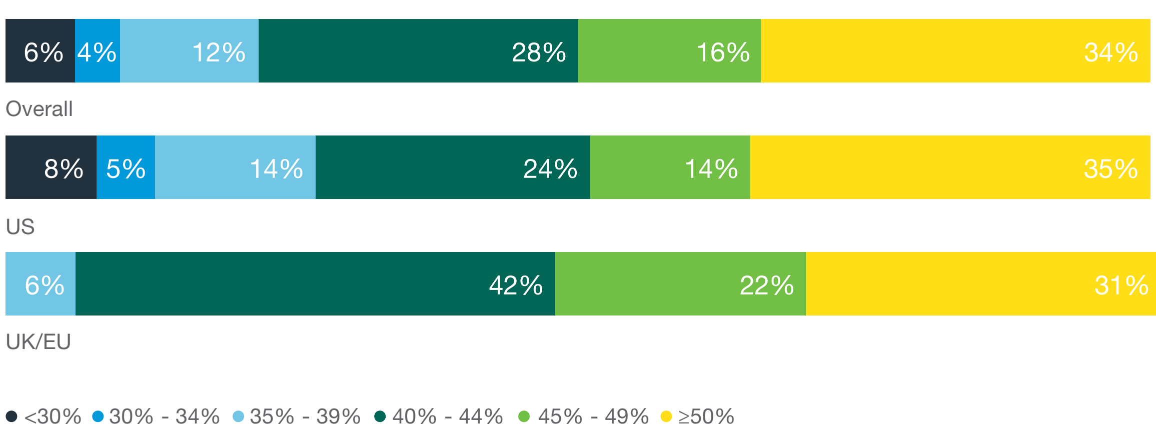
Investment Conditions and Considerations

Equity Contributions

As for the percentage of equity required for a deal, overall and in the U.S., the level most cited was more than 50%, while in the U.K./E.U. more respondents required between 40% and 44% equity.

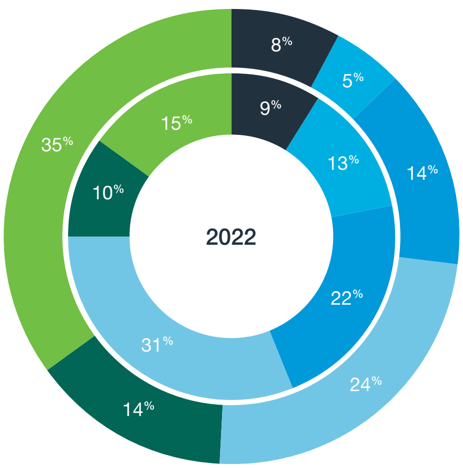
How much equity (on a % basis) does your organization typically require in your transactions?

Equity required UK/EU more likely to require 40-44%, similar to last year's results



US: ≥50% and 45-49% categories increase; others see slight decreases

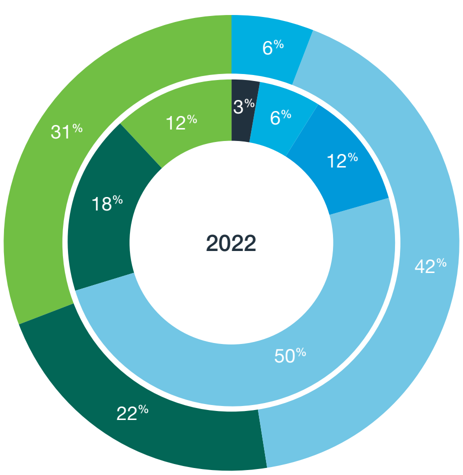
US 2023



- <30%
- 30-34%
- 35-39%
- 40-44%
- 45-49%
- ≥50%

UK/EU: Nothing for <30% and 30% -34% categories, but large increase in ≥50% category, compared to previous year

2023 - UK/EU



- <30%
- 30-34%
- 35-39%
- 40-44%
- 45-49%
- ≥50%

Investment Conditions and Considerations

Geographic Investment-US

Respondents ranked the U.K. among the top 3 jurisdictions where both U.S. and U.K./E.U. firms expect to see the biggest growth opportunities over the next 12 months. None, however, expected to see growth opportunities in the Middle East or Eastern Europe in the coming year.

When asked which regions of the world in which their firms would likely be investing over the next 12 months, 60% of U.S. lenders cited Canada, more than any other foreign region, as the most likely country for their investment, compared to 53% who cited Canada as an investment target in 2022. And one-third of U.S. respondents (33%) named Canada as the region with the biggest growth opportunities over the next 12 months.

This interest is probably due to the perception that Canada is a less competitive environment rather than it is likely to see significant growth. In fact, the Organisation for Economic Co-operation and Development (OECD) predicts Canada's gross domestic product (GDP) volume growth will be just a bit above 1% in 2023.[16]

[16] *See* Organisation for Economic Co-operation and Development statistics, available at https://stats.oecd.org/.

Biggest growth opportunities for your firm over the next 12 months

US	**99%**	Eastern Europe	**5%**
UK	**38%**	Southern Europe	**5%**
Canada	**33%**	France	**2%**
Asia	**8%**	Other Europe	**1%**
DACH	**5%**	Middle East	**0%**

Which locations are your organization considering investing in over the next 12 months?

Investment Conditions and Considerations

Geographic Investment-UK/EU

Among respondents based at firms in the U.K./E.U. region, European countries such as Germany (cited by 80% of respondents) and France (54%), as well as the U.K. (60%) were named as the regions with the biggest growth opportunities over the next 12 months. No U.K./E.U. firm cited Canada as a big growth opportunity. This interest in Europe, again, comes even amid the OECD's 2023 predictions of low GDP volume growth of 0.6% in France, -0.3% in Germany, and -0.4% in the United Kingdom.[17]

[17] Ibid., *OECD statistics.*

Biggest growth opportunities for your firm over the next 12 months

DACH	**80%**
UK	**60%**
France	**54%**
US	**34%**
Asia	**17%**
Other Europe	**11%**
Eastern Europe	**9%**
Canada	**0%**
Middle East	**0%**
Latin America	**0%**

Which locations are your organization considering investing in over the next 12 months?

Investment Conditions and Considerations

Key Industries

Almost all respondents (94%) said they would consider investing in Business Services and Software & Technology over the next 12 months.

Broken down by region, several notable differences appear. For example, just 50% of U.S. lenders said they were interested in investing in the Education industry, compared to 89% of lenders in the U.K./E.U. region.

In which industries is your organization interested in/considering investing in over the next 12 months?

94%
Business Services

94%
Software & Technology

90%
Health Care

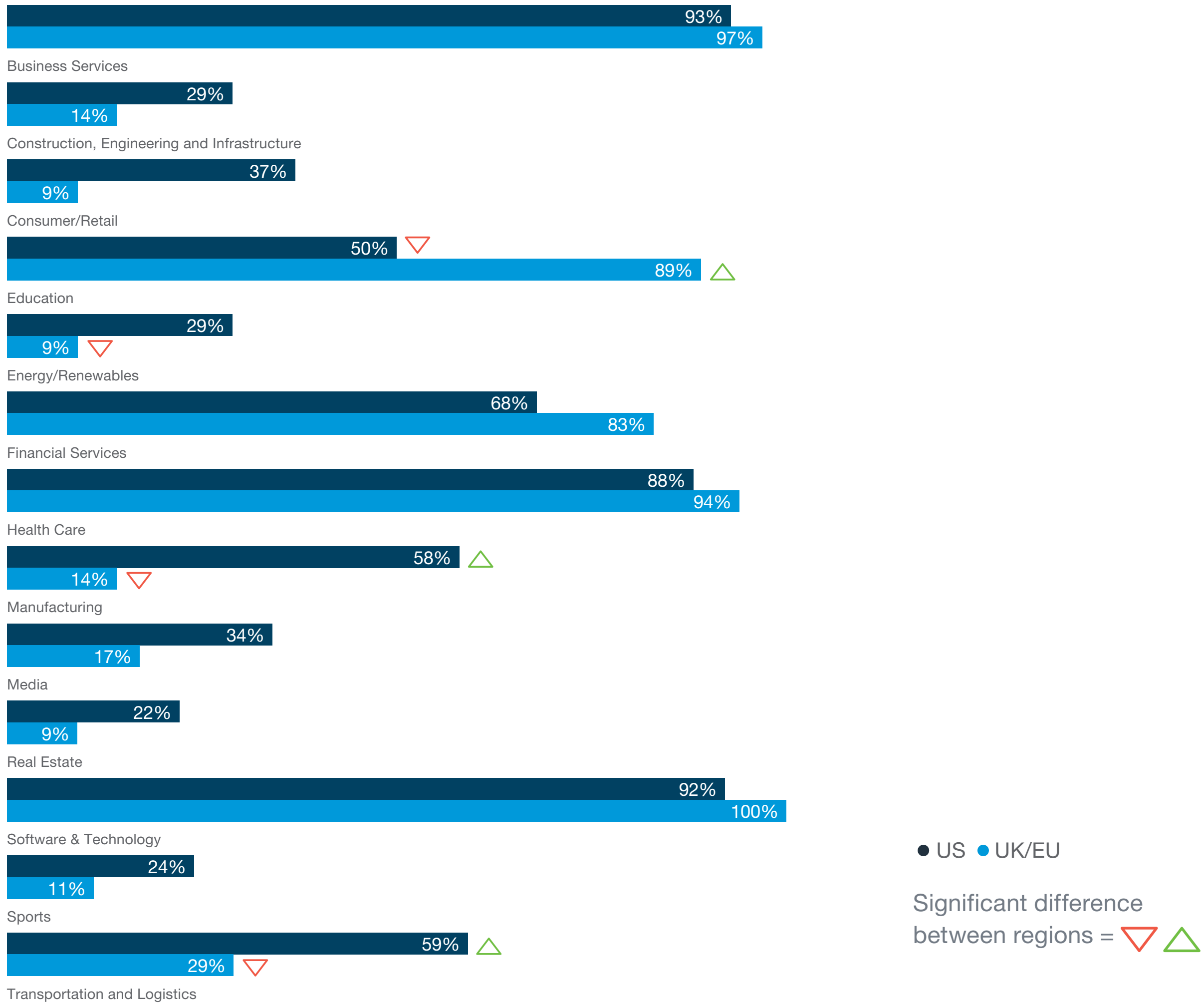
71%
Financial Services

30%
Media

30%
Consumer & Retail

25%
Construction, Engineering & Infrastructure

24%
Energy & Renewables



59%
Education

52%
Transport & Logistics

48%
Manufacturing

19%
Real Estate

21%
Sports

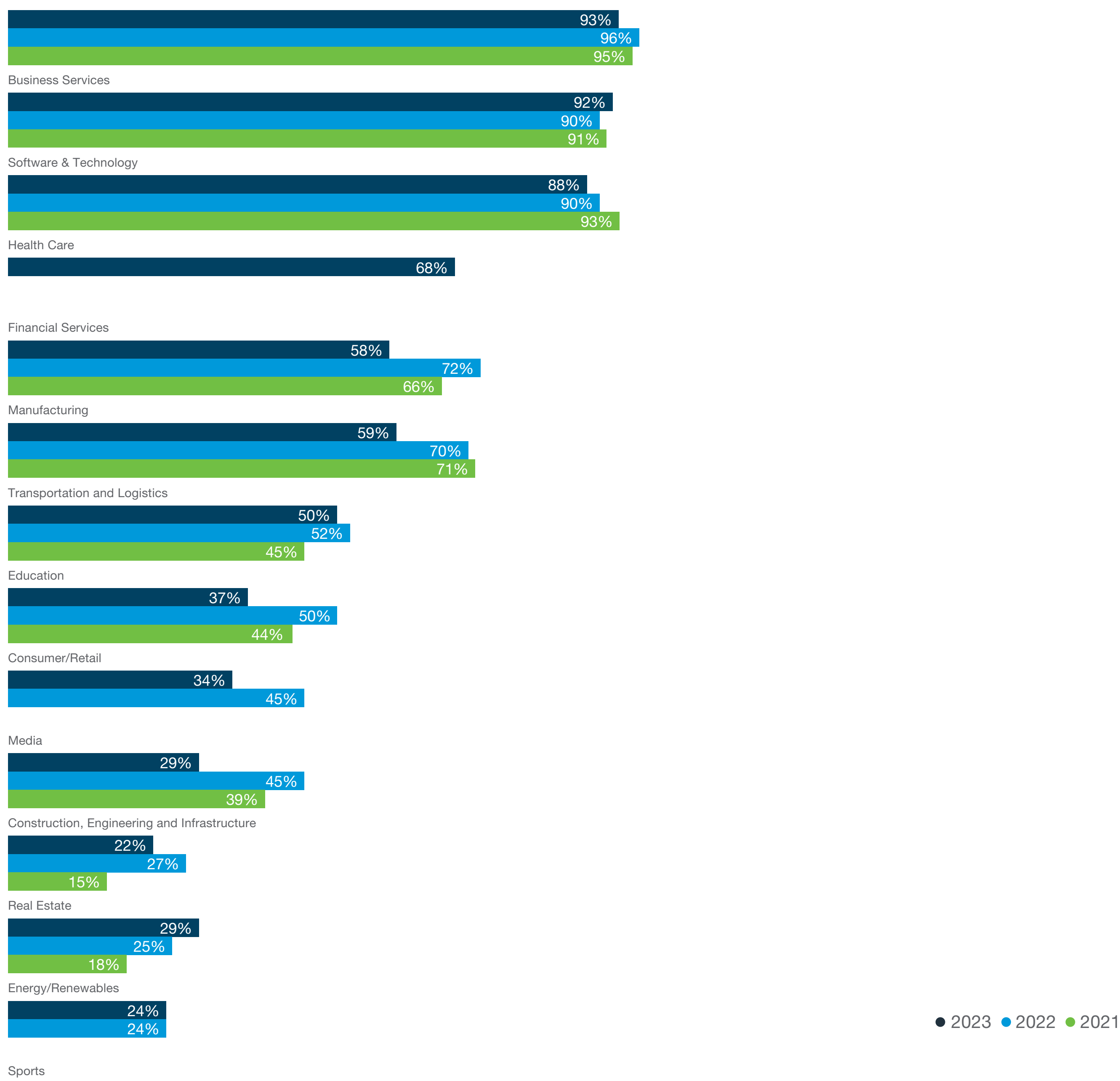
1%
Other

Investment Conditions and Considerations

When looking at U.S. firms' investment in industry over the past two years, we see a relatively consistent level of interest in investing in sectors year to year, with exceptions for manufacturing, transporation and logistics, consumer/retail and media, where we observed a significant decline.

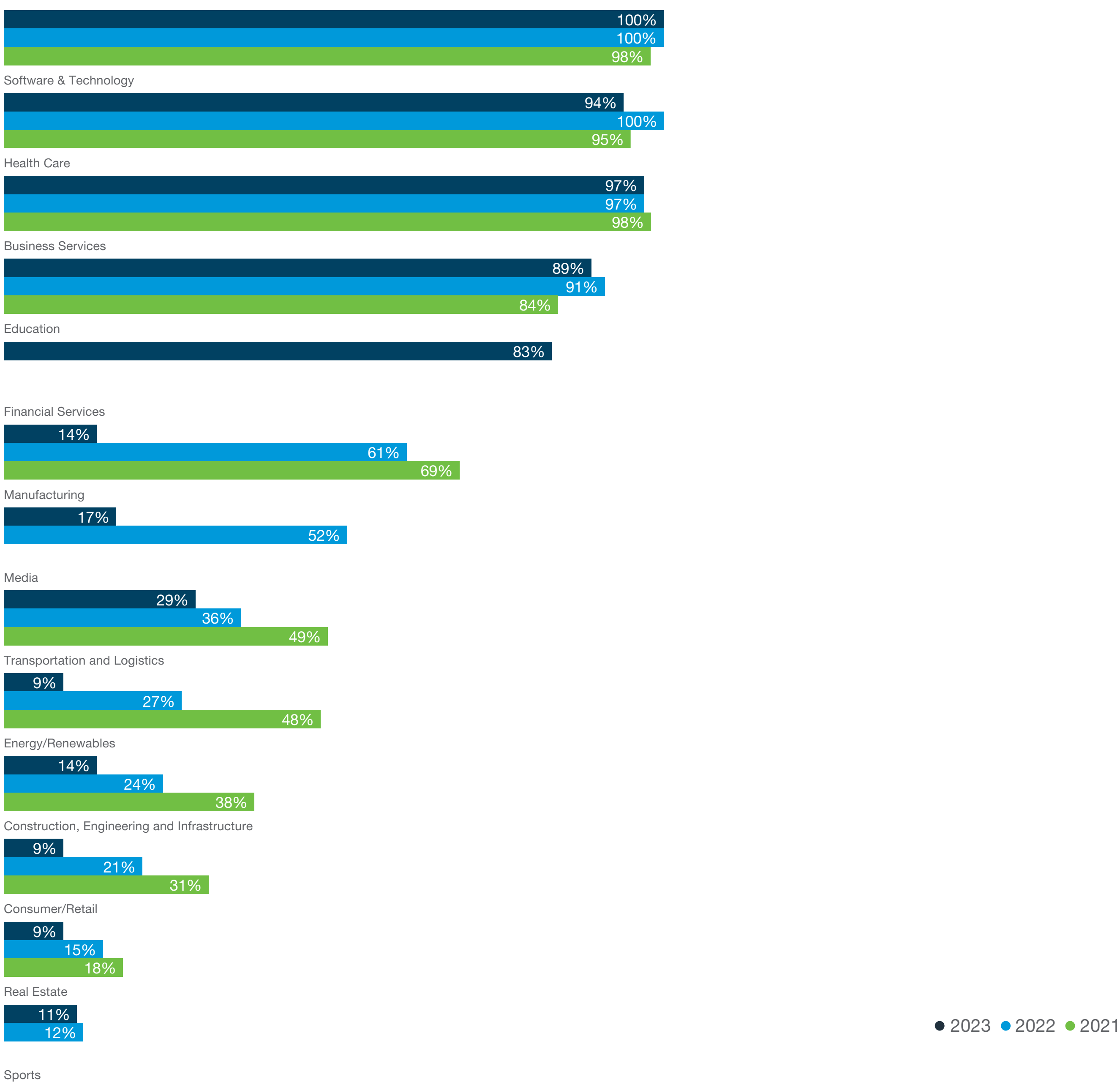
In which industries is your organization interested in/considering investing in over the next 12 months?

US 2023/2022/2021



Comparing the past two years of U.K./E.U. firm investing, we observe large declines in investment areas such as Manufacturing, Media, Energy/Renewables, Construction, Engineering and Infrastructure and Consumer/Retail, compared to 2022. Most sectors remained relatively consistent year to year.

UK/EU 2023/2022/2021



Investment Conditions and Considerations

Fundraising

The total amount of private capital raised dropped significantly by the end of 2022, falling about 20% to roughly $1.170 trillion, raised by 2,549 funds, according to numbers from PitchBook Data, Inc.[18] That compares to a record-setting 2021, in which nearly $1.5 trillion was raised by 4,806 funds.

In our survey of private credit lenders, nearly all respondents (90%) said their firms were engaged in fundraising plans for 2023.

[18] *2022 Annual Global Private Market Fundraising Report,* PitchBook Data, Inc.

Is your organization currently raising a debt fund?

Investment Plans

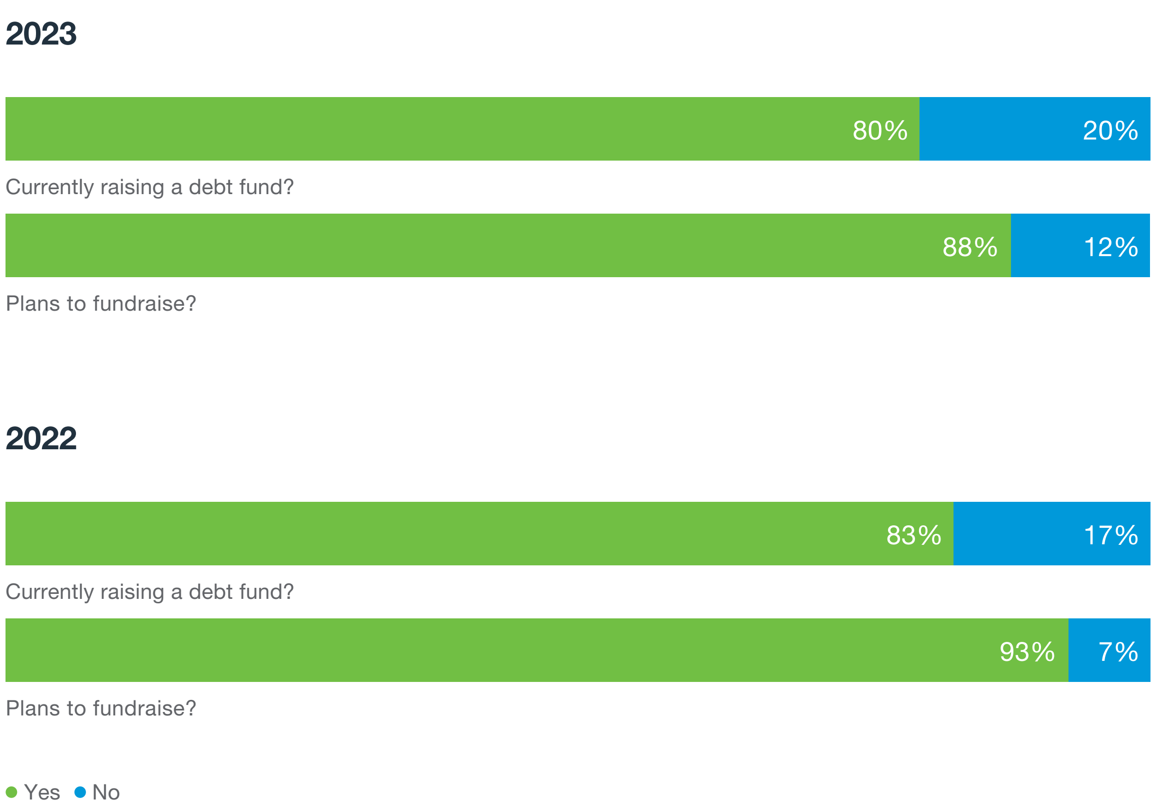
Does your firm have plans to fundraise in the next 12 months?

Investment Plans

Investment Conditions and Considerations

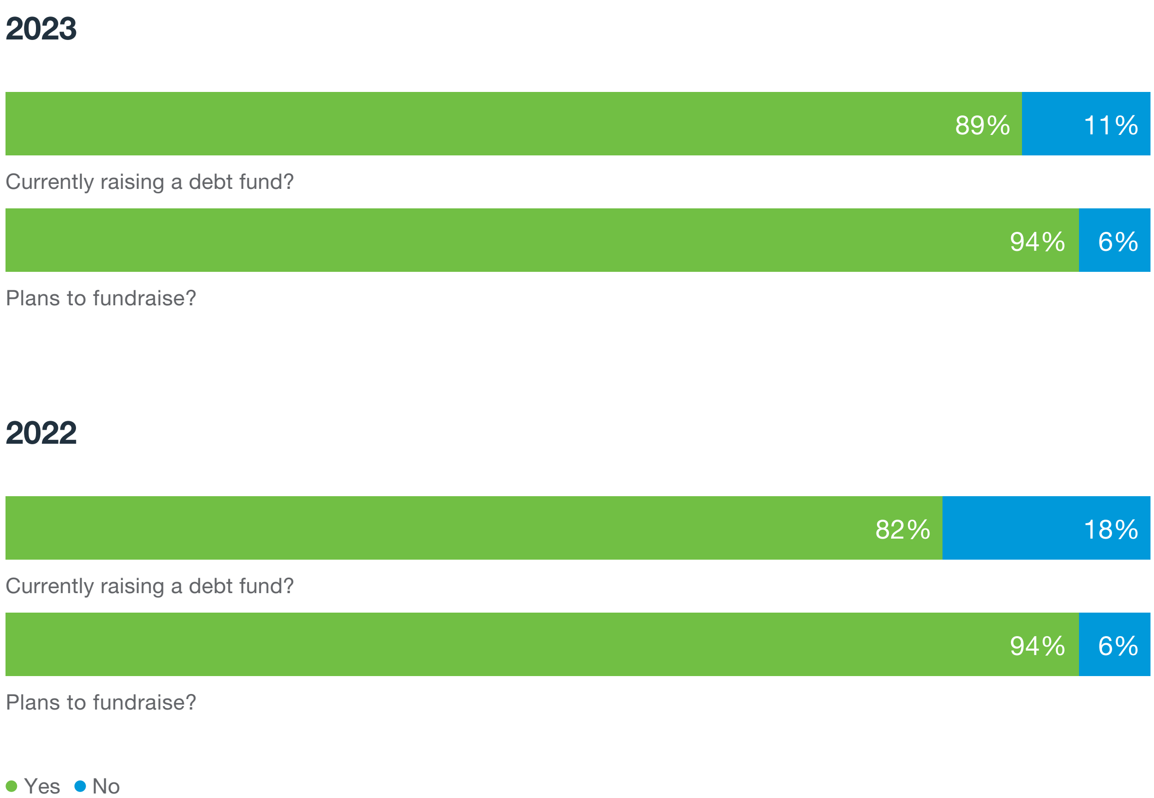
Investment Plans

US 2023 v 2022



Investment Plans

UK/EU 2023 v 2022



Investment Conditions and Considerations

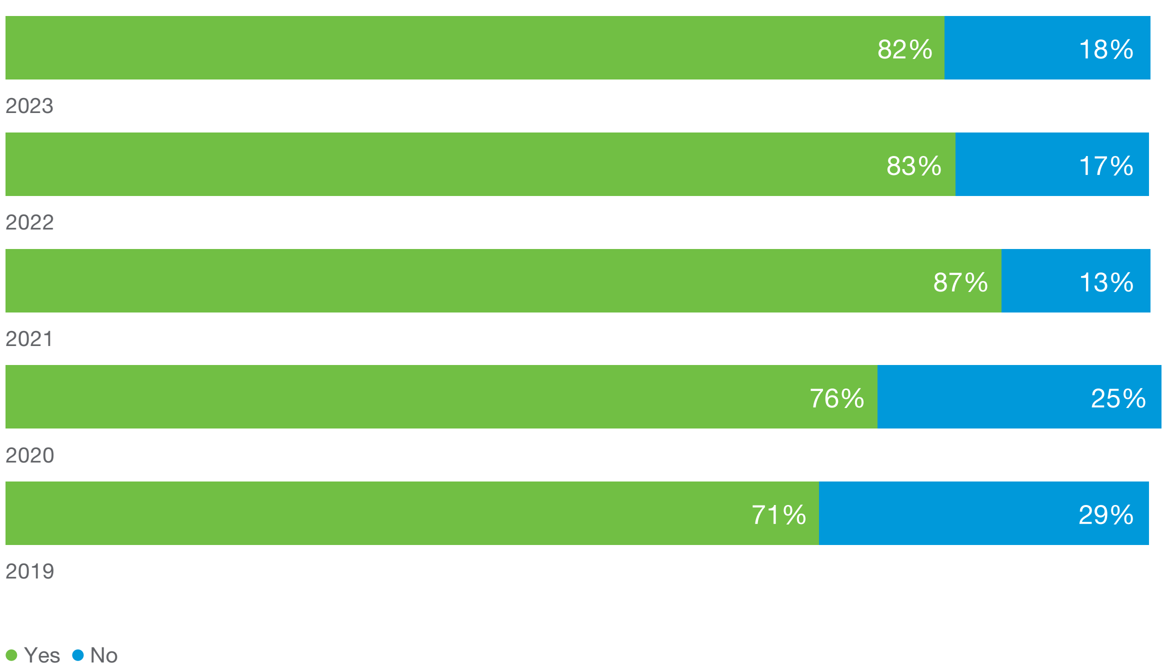
Actively Raising Funds

When respondents were asked if their organizations were currently raising a debt fund, the vast majority (82%) said they were. Indeed, at least 70% of respondents said they were raising debt funds each year of the survey.

Similarly, nearly all respondents said their firms were engaged in fundraising plans for 2023, with 90% of respondents said their firms were. Over the last five years of the survey, at least 80% of respondents said they were planning to raise funds each year.

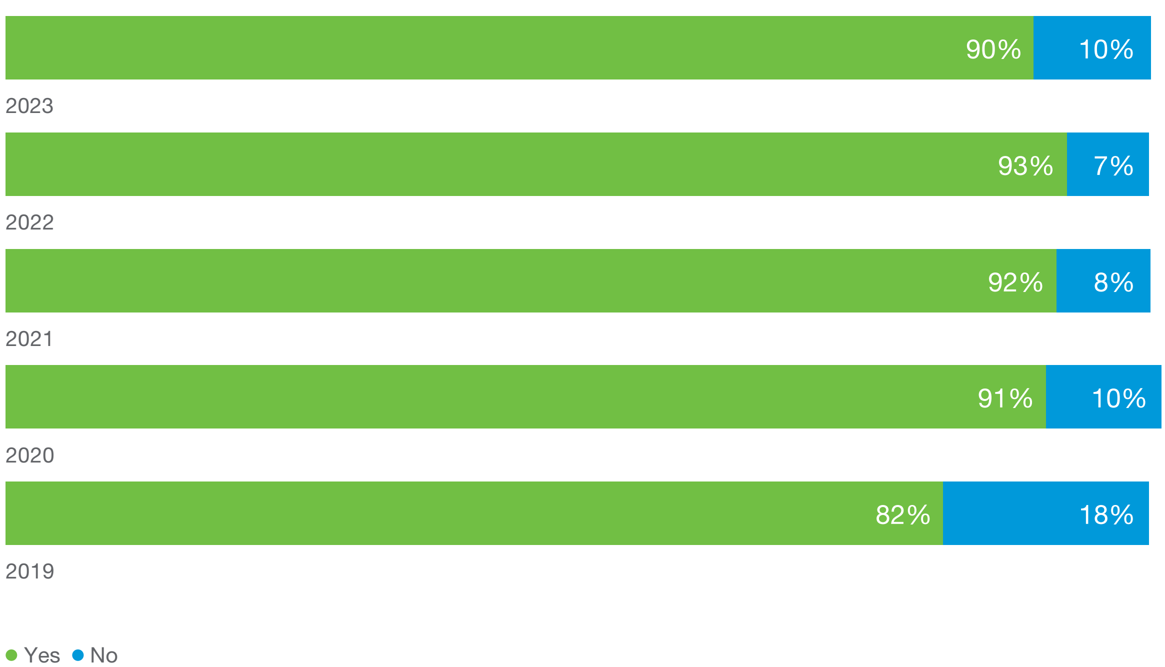
Raising a Debt Fund

More than 70% reported that their firm was raising a debt fund each year



Plans To Fundraise

Over the past 5 years, more than 80% have had plans to fundraise



Market Predictions

Decreased activity expected on balance

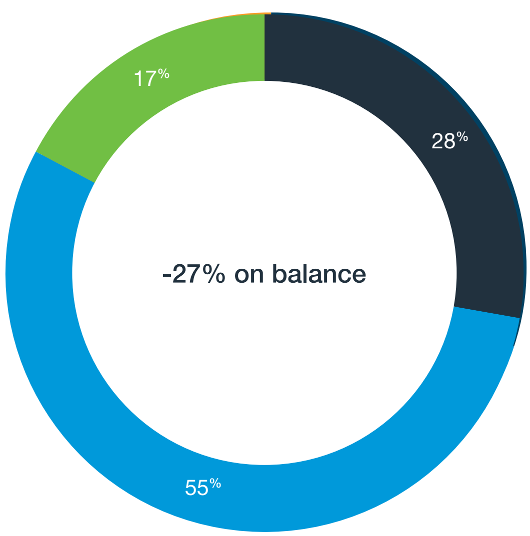
Looking Forward

Respondents also shared their predictions for the private credit market and the overall global economic outlook, underscoring a more cautious perspective with specific concerns over the next year.

For example, more than half of respondents (55%) said they expect to see decreased deal activity in the market over the next 12 months, and more than half also believe loan documentation will become less favorable to borrowers in that time.

What are your expectations for deal activity in the market over the next 12 months? Why do you think deal activity will increase/decrease or remain the same?

Remain the same	%
Economic outlook/ market conditions	43%
Dry powder levels	29%
No/limited catalyst either way	29%



Market activity expectations

- More active than previous 12 months
- Less active than previous 12 months
- No change

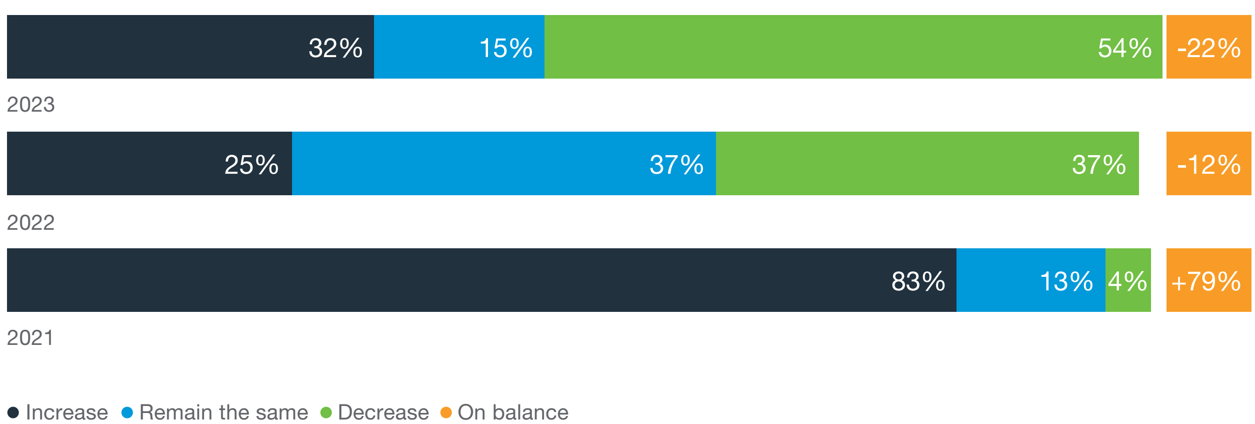
Increased activity	%
Economic outlook/ market conditions	39%
Availability/amount of capital	31%
M&A activity	15%
Pent-up demand	15%
Firm's strategy/focus	15%

Decreased activity	%
Economic outlook / market conditions	65%
M&A activity	32%
Stage of economic cycle	16%
Availability/amount of capital	16%

On balance, predictions lean towards decreased activity

What are your expectations for deal activity in the market over the next 12 months?

US 2023 v 2022 v 2021



Increased activity	%
Economic outlook/ market conditions	27%
Availability/amount of capital	27%
M&A activity	18%
Firm's strategy/focus	18%

Remain the same	%
Economic outlook/ market conditions	43%
Dry powder levels	29%
No/limited catalyst either way	29%

Decreased activity	%
Economic outlook / market conditions	65%
M&A activity	39%
Availability/amount of capital	17%
Stage of economic cycle	17%
Deal activity	17%

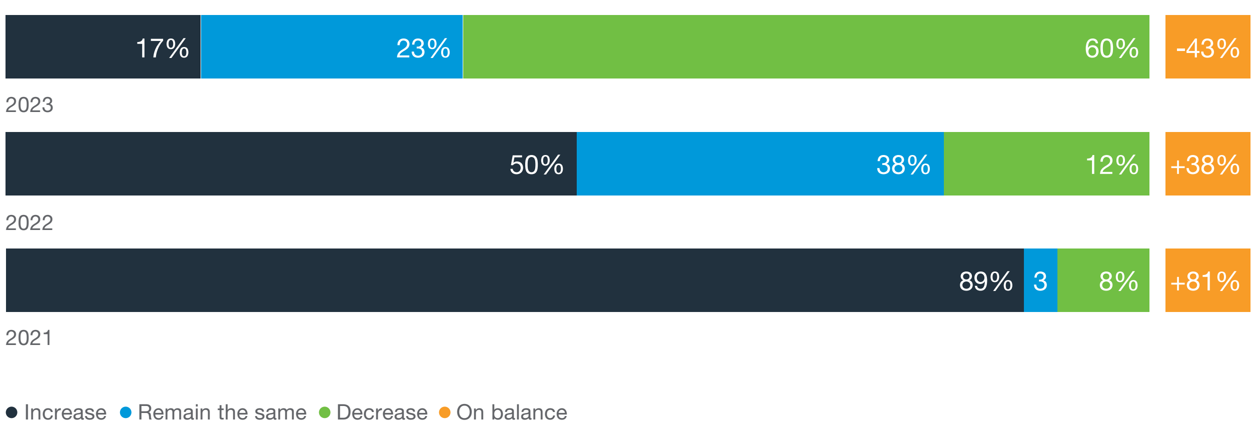
Market Predictions

In the European market, respondents overwhelmingly predict a decline in deal activity. Still, a quarter expect an increase regardless.

On balance, predictions lean towards decreased activity

What are your expectations for deal activity in the market over the next 12 months?

UK/EU 2023 v 2022 v 2021



Increased activity	#
Economic outlook/ market conditions	2
Availability of capital	1
Pent-up demand	1

Decreased activity	#
Economic outlook/market conditions	5

19

Curiously, “economic outlook/market conditions” was cited by respondents as the top reason for their belief in the direction of deal activity, regardless of whether they thought activity would increase, decrease or stay the same.

Multiple respondents offered comments on the direction of deal activity in the coming year:

Those respondents who think deal activity will be more active than in the previous 12 months:

“Typically, when the economy undergoes a recession, there is a lot of credit fallout that needs to be put back together; this leads to increased deal activity.”

“Activity will come back on the upper mid-market and more traditional mid-market hasn’t been affected as much as larger cap deal.”

“Given the pullback in the public, syndicated and private markets, borrowers will need to reach out to lenders to refinance and/or provide growth capital. M&A activity is still slow and will be expected to be slow for the first half of 2023, but flow will be offset by refinancings, growth capital and A&E.”

“Our strategy tends to be countercyclical in that volume increases when banks and direct lenders get more conservative. We expect more opportunities to attach higher in the structure over the next 12-18 months.”

Those respondents who think there will be no change in deal activity in the coming 12 months:

“Think activity will remain the same level, but the mix will change, less sponsor LBOs, more refinancings and similar situations.”

“For lower middle market, it will remain unchanged.”

“I expect that elevated interest rates will weigh more heavily on portfolio company cash flows and push us into recession in 2023. This will result in widespread portfolio underperformance and impact deal flow in 2023.”

“Less new financings and more add-ons to portfolio companies.”

“I believe it will remain relatively slow until there is clarity around where interest rates will settle and where the economy stands/is heading.”

Those respondents who think deal activity will be less active than in the previous 12 months:

“Valuations will decrease, so PE firms will hold investments for longer.”

“Availability of debt capital and buyer/seller mismatch on valuations.”

“M&A activity is slowing as a result of economic conditions.”

“U.K. economic environment remains volatile resulting in a slow start to 2023 and through Q1 and Q2.”

“Deal activity required equilibrium in valuation expectation — given market volatility and economic uncertainty, buyers and sellers will remain apart on valuation.”

“I think it will increase for opportunistic lenders and decrease for more middle of the fairway lenders.”

“Economic headwinds will hamper M&A activity, particularly in cyclical sectors.”

“Interest rate hikes will likely cause borrowers that can wait for rate decreases to wait for a better pricing environment.”

“Less exuberance in capital markets will mean fewer M&A transactions from PE sponsors.”

“Refinancing will halt while rates remain elevated and as rate hedges roll off.”

“Higher bar to invest $ + less M&A activity in the market + more time spent on issues in the portfolio.”

“If for nothing else, simply the pace of the calendar. 1Q22 will be non-existent for new deals of any volume as books are not in the market in any significant way now. So, if sell-side increases tepidly by April, summer will quickly arrive and create a natural slowdown. So, slower deal flow.”

“Rates are too high for most LBOs to generate the same returns as 6 months ago so multiples will need to compress for M&A to pick up again.”

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[19] “On balance” in the above graphic means the difference between the percentage of respondents who said deal activity would increase and those who said it would decrease. For example, if 32% say deal activity will increase, while 54% say it would decrease, it would leave *on balance,* a 22% net percentage that see activity decreasing.

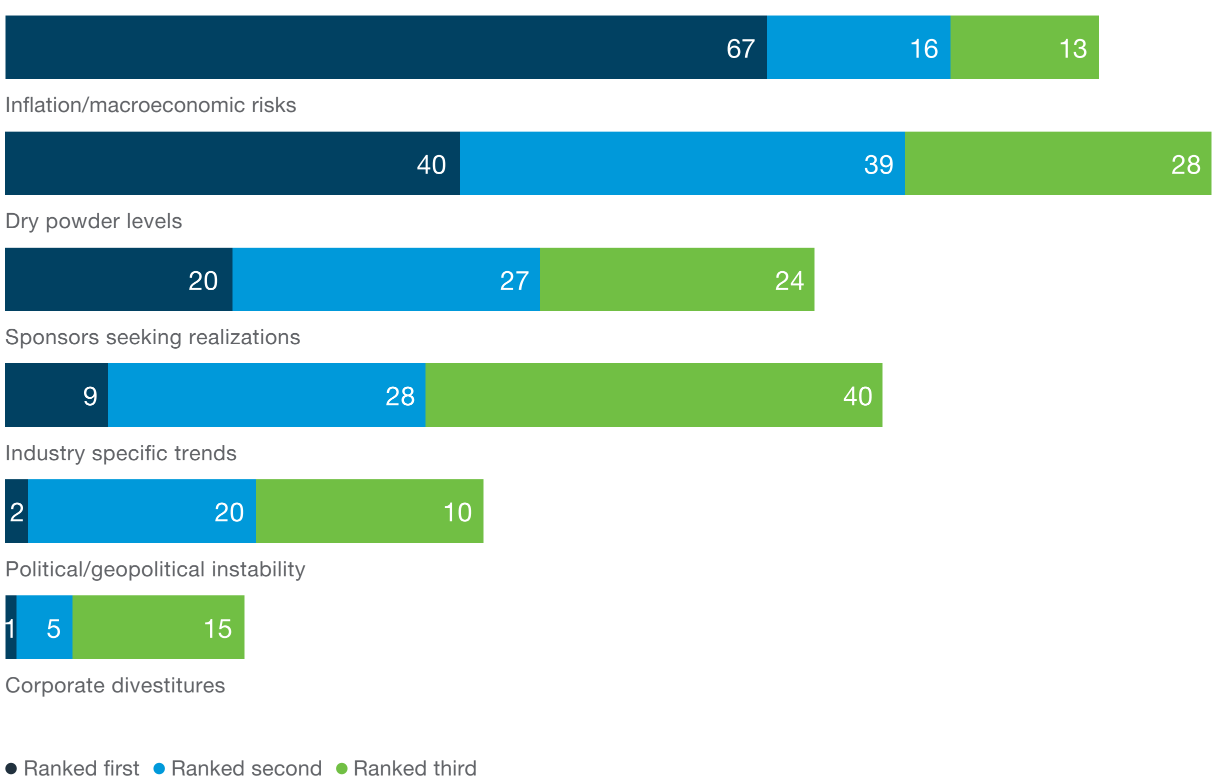
Market Predictions

Drivers of Deal Flow

Respondents cited the more dour economic outlook and market conditions as the top factor behind this decrease in deal activity, with inflation and macroeconomic risks ranked as the most important driver of deal flow. However, dry powder levels had the most overall rankings as a driver of deal flow.

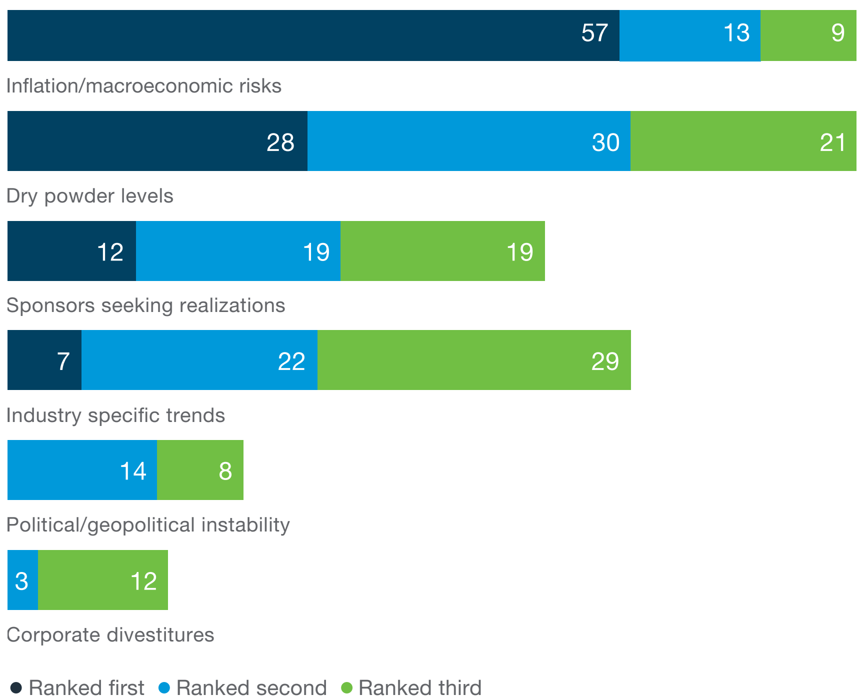
What do you expect to be the most important driver of deal flow in the next 12 months?

Overall - Sorted by overall rankings



US respondents cite inflation/macroeconomic risks as most important

US respondents



UK/EU respondents rank dry powder levels as most important and most overall rankings

UK/EU respondents

Market Predictions

Challenges For Dealmakers

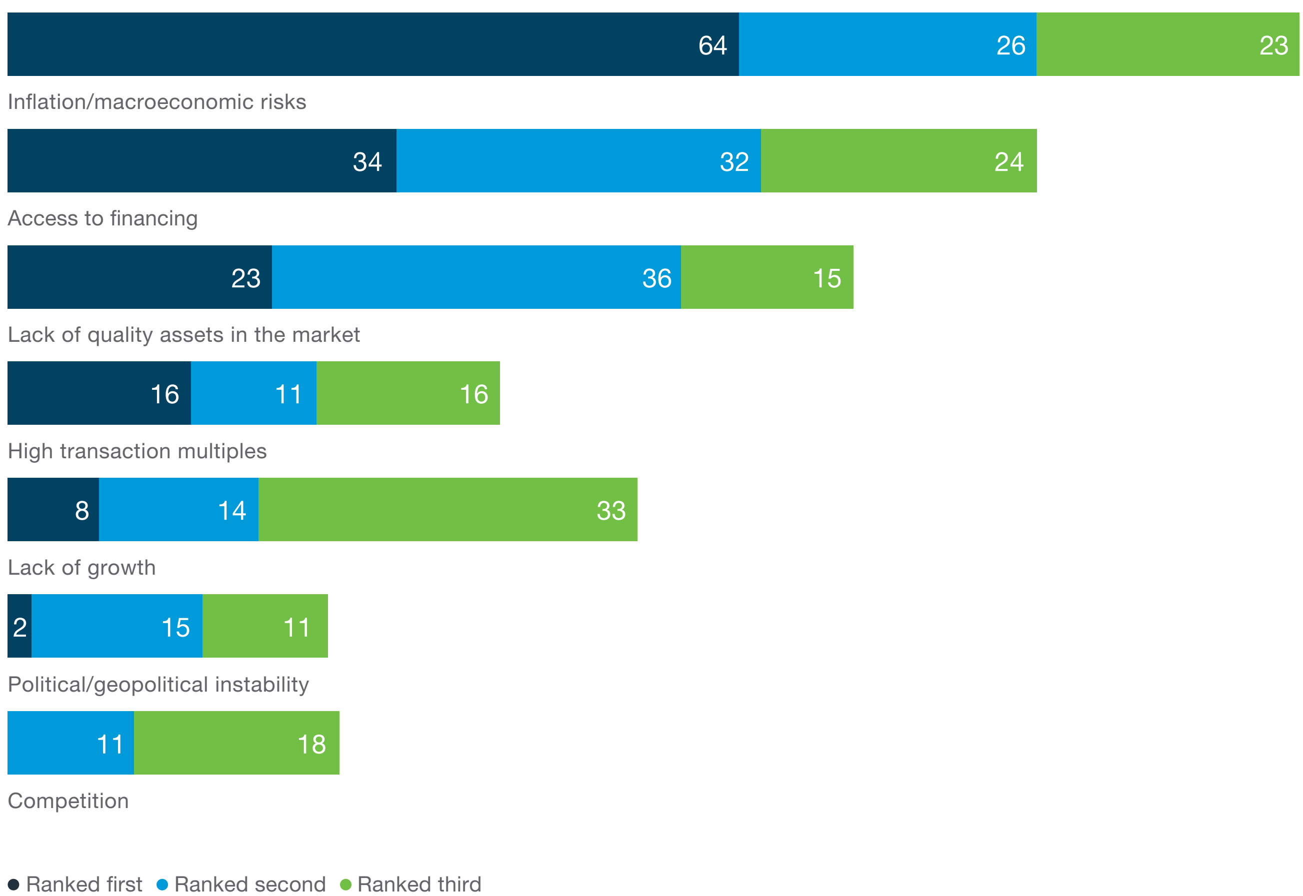
When asked what challenges they see as their largest concern over the next 12 months, almost two-thirds of dealmakers (64%) cited *inflation/macroeconomic risks* as their top challenge. *Inflation/macroeconomic risks* also received more votes (ranked 1st, 2nd, or 3rd) than any other challenge.

Other challenges receiving a larger percentage of 1st ranked votes was *Access to financing* (34% citing it as their top concern) and *Lack of quality assets* in the market (23%). In fact, respondents in the U.K./E.U. region had the same the top 3 most important ranking and overall ranking as did respondents in the U.S.

What do you anticipate to be the biggest challenge for dealmakers in the next 12 months?

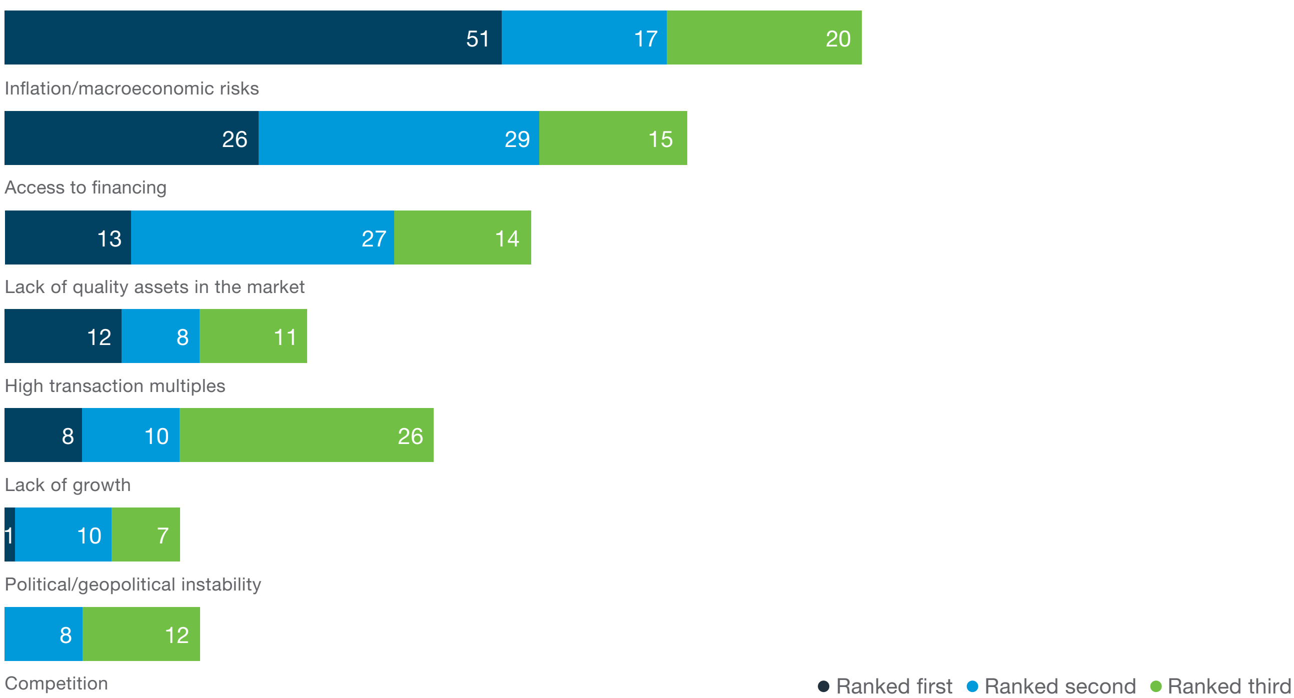
Overall - Sorted by overall rankings

Inflation/macroeconomic risks most ranked first for importance, and most ranked overall



What do you anticipate to be the biggest challenge for dealmakers in the next 12 months?

US respondents



UK/EU respondents

Market Predictions

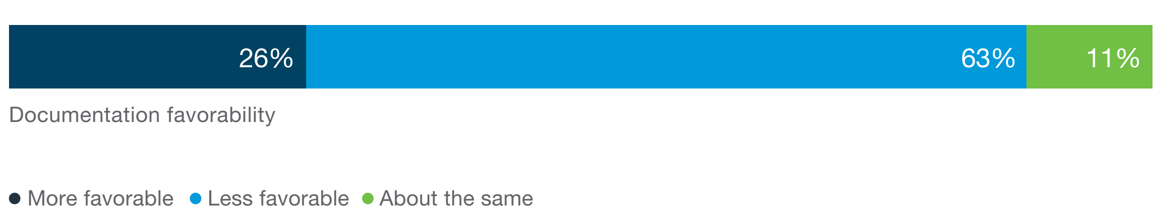
Document Favorability

More than half or survey respondents said that they believe documentation will become less favorable to borrowers over the next 12 months. In both the U.S. and the U.K./E.U. region, more respondents thought documentation will become less favorable to borrowers over the next 12 months.

More than half believe documentation will become less favorable to borrowers

Do you expect loan documentation to become more or less borrower-favorable over the next 12 months?

Overall



Less favorable has largest portion across both regions

Has loan documentation become more or less favorable to borrowers since the pandemic?

US v UK/EU

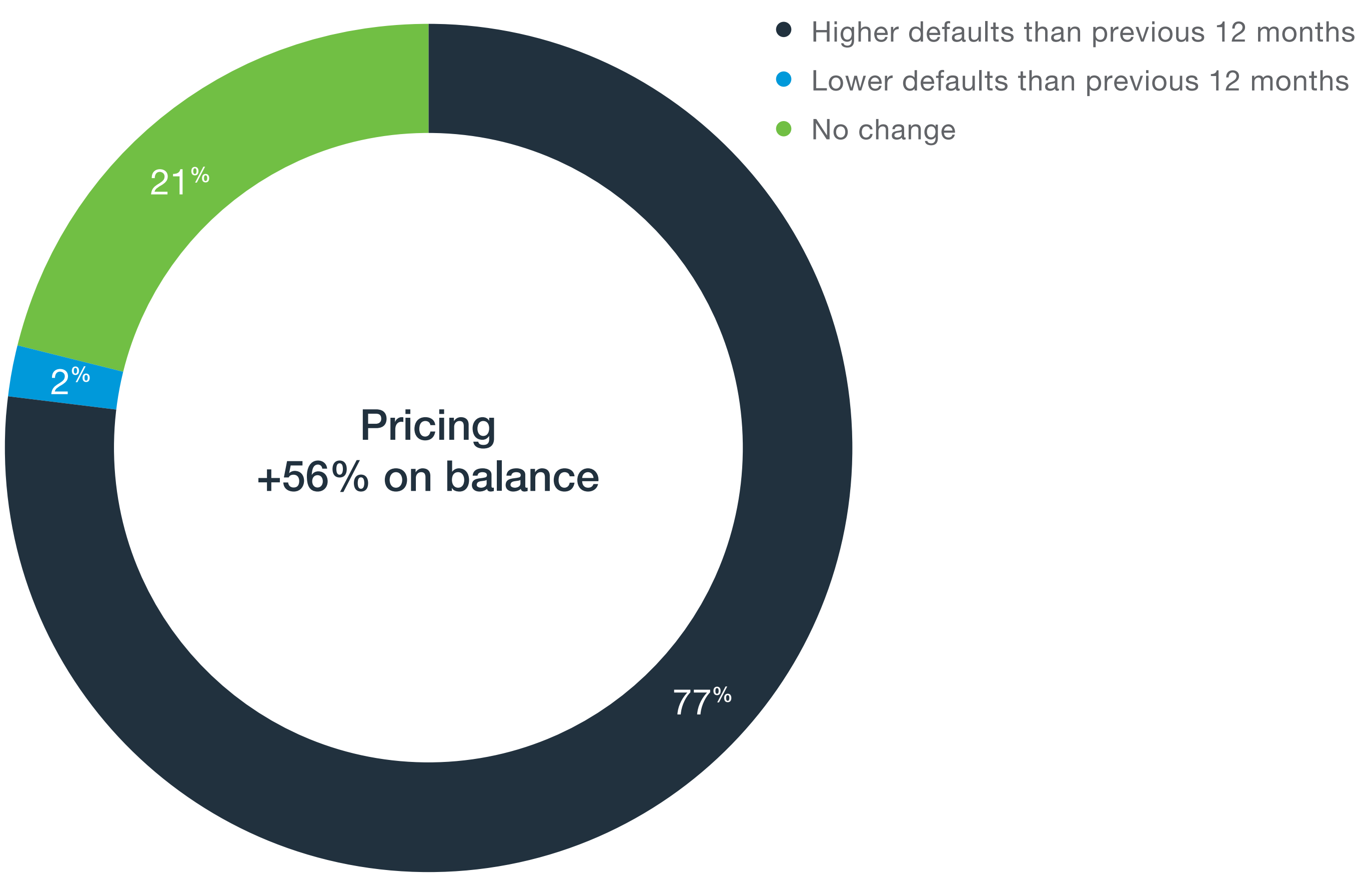
Market Predictions

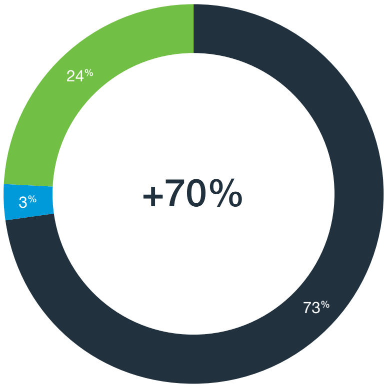
Pricing Predictions

More than three-quarters (77%) of respondents said they expect higher pricing than in the previous 12 months, meaning on balance, more than half of all respondents are expecting higher pricing.

This expected pricing increase is not surprising given the increase in risk-free rates and the belief by most that we are in, or will soon be in, a recession.

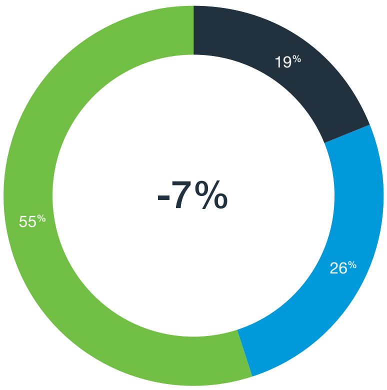
What are your expectations for pricing over the next 12 months?





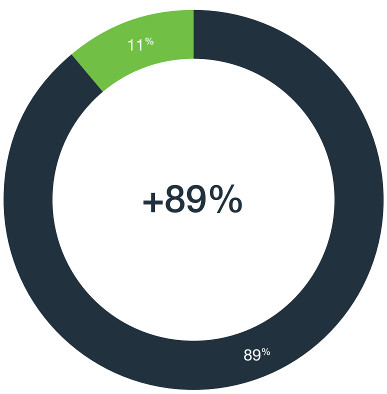
2023 US Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change



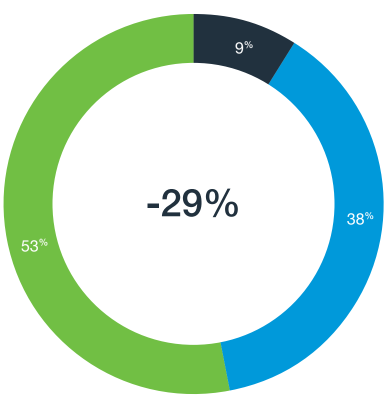
2022 US Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change



2023 UK/EU Pricing

- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change



2022 UK/EU Pricing

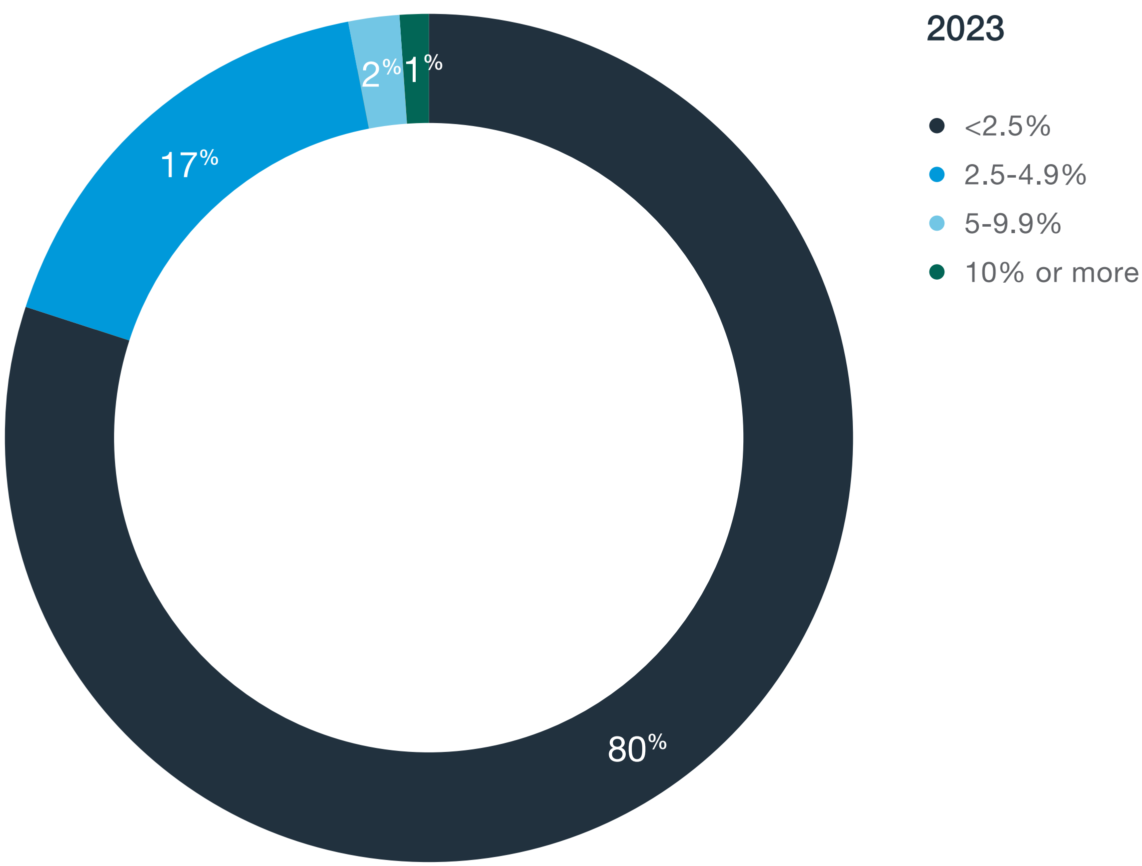
- Higher pricing than previous 12 months
- Lower pricing than previous 12 months
- No change

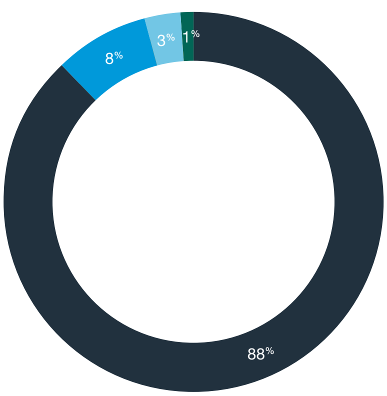
● 2023 ● 2022 ● 2021

Market Predictions

What percentage of your portfolio is in default?

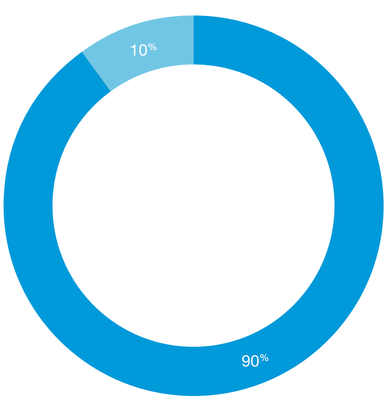
US only





2022

- <2.5%
- 2.5-4.9%
- 5-9.9%
- 10% or more



2021

- ≤5%
- 5-9.9%
- 10-19.9%
- ≥20%

● 2023 ● 2022 ● 2021

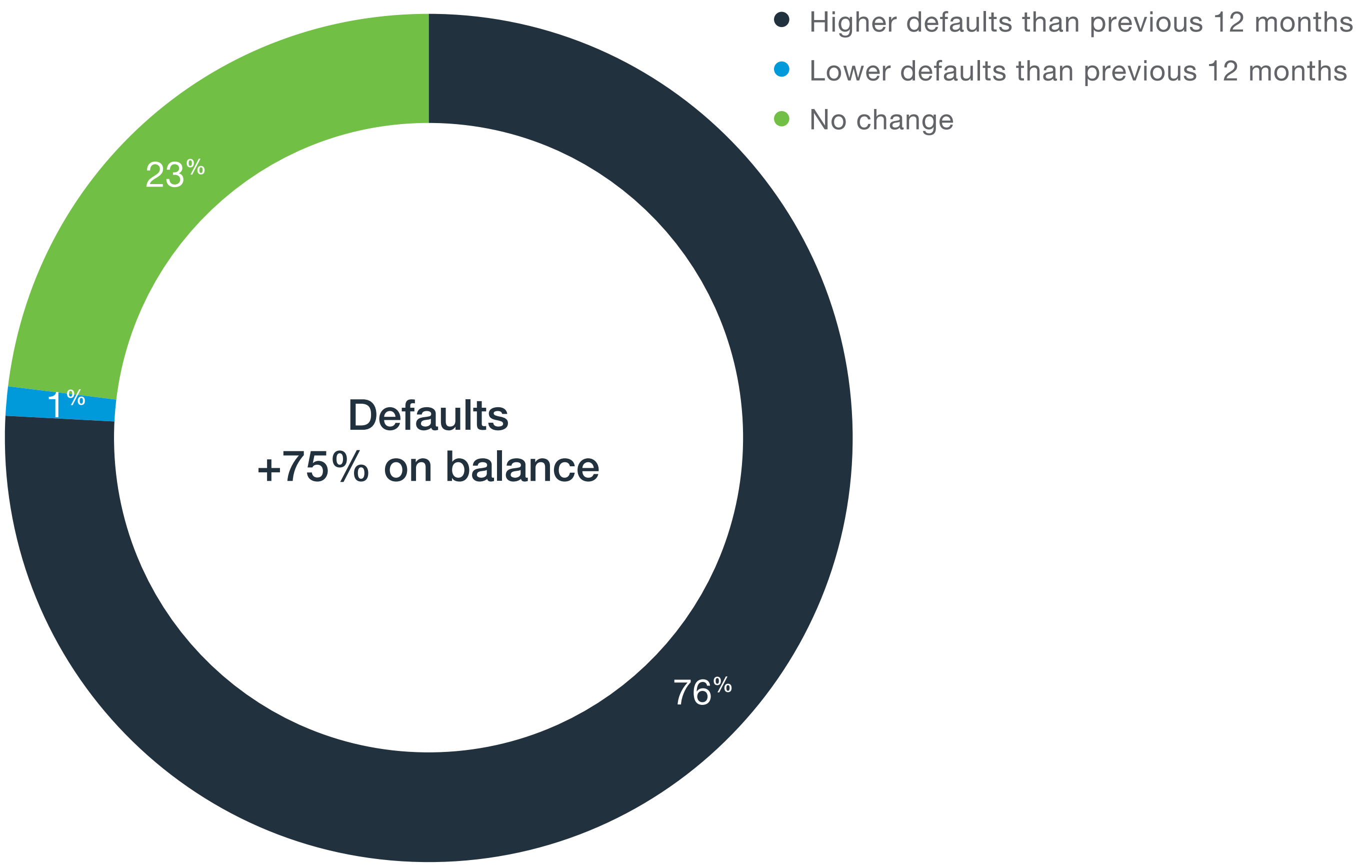
Market Predictions

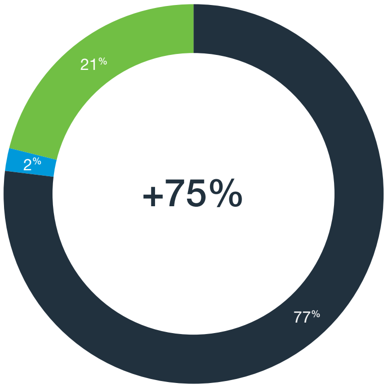
Default Expectations

More than 75% of respondents expect more defaults in their portfolio over the next 12 months. (In fact, a majority claim that a small portion of their portfolio is already in default.)

The overall default rate of the 973 loans included in the Proskauer Private Credit Default Index was 2.06% in the fourth quarter of 2022, an increase from 1.56% just a quarter earlier.

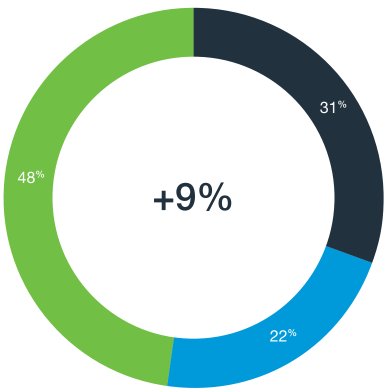
What are your expectations for your portfolio over the next 12 months?





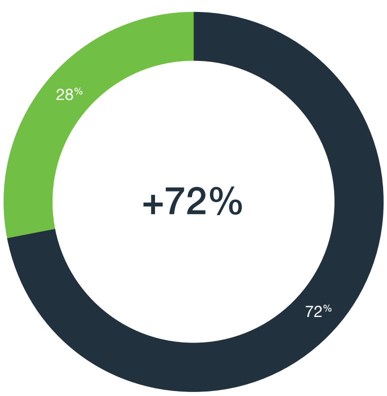
2023 US Defaults

- More defaults than previous 12 months
- Less defaults than previous 12 months
- No change



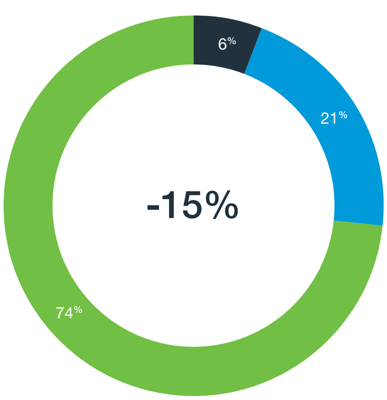
2022 US Defaults

- More defaults than previous 12 months
- Less defaults than previous 12 months
- No change



2023 UK/EU Defaults

- More defaults than previous 12 months
- Less defaults than previous 12 months
- No change



2022 UK/EU Defaults

- More defaults than previous 12 months
- Less defaults than previous 12 months
- No change

● 2023 ● 2022 ● 2021

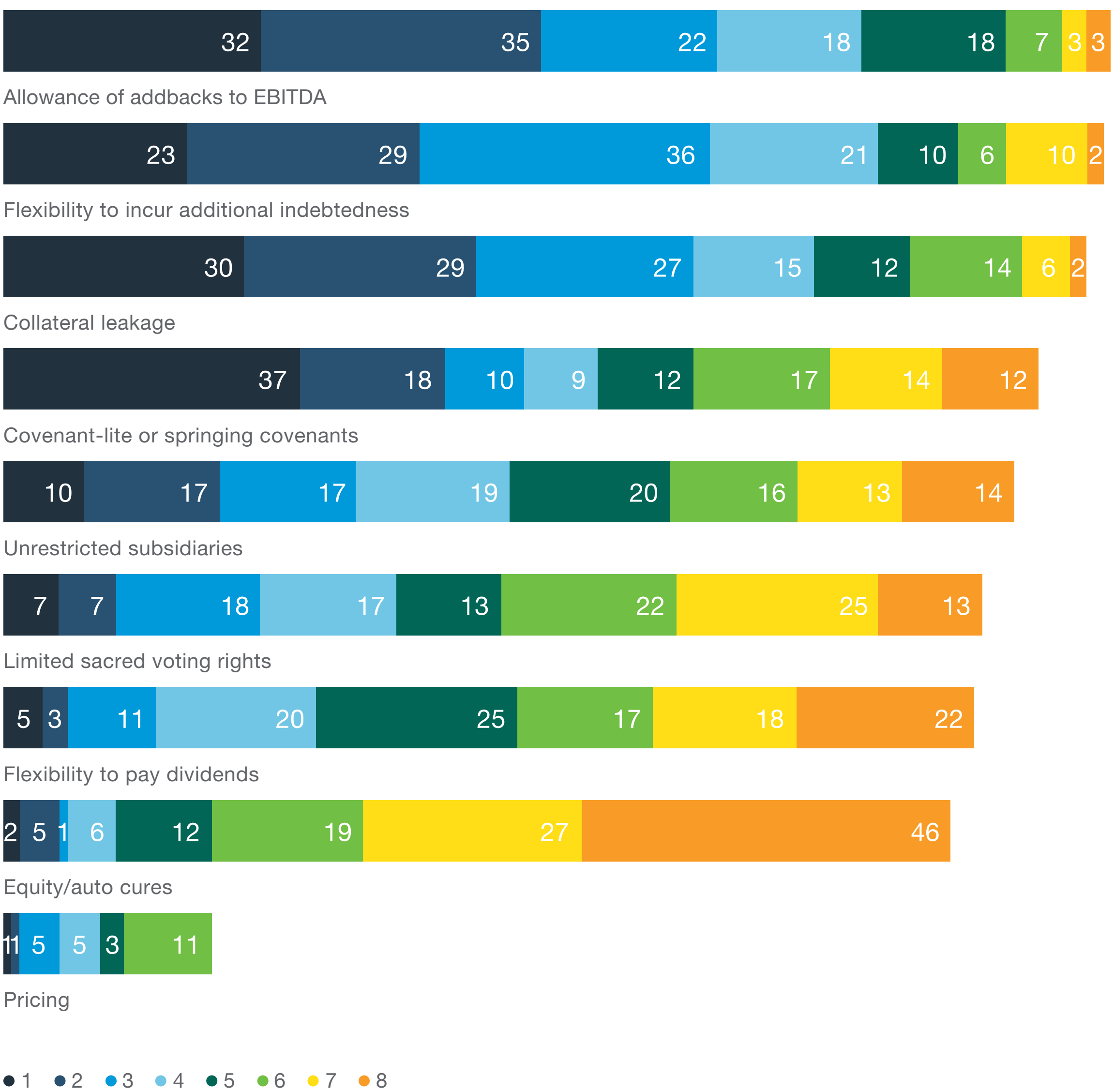
Market Predictions

Lender Risks

When all respondents were asked to rank which concessions by lenders they believe presents the greatest risk to lenders, most ranked the following — *i)* allowance of add-backs to EBITDA; *ii)* flexibility to incur additional indebtedness; *iii)* collateral leakage; and *iv)* covenant-lite or springing covenants — among the greatest risks.

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

Overall — sorted by overall rankings

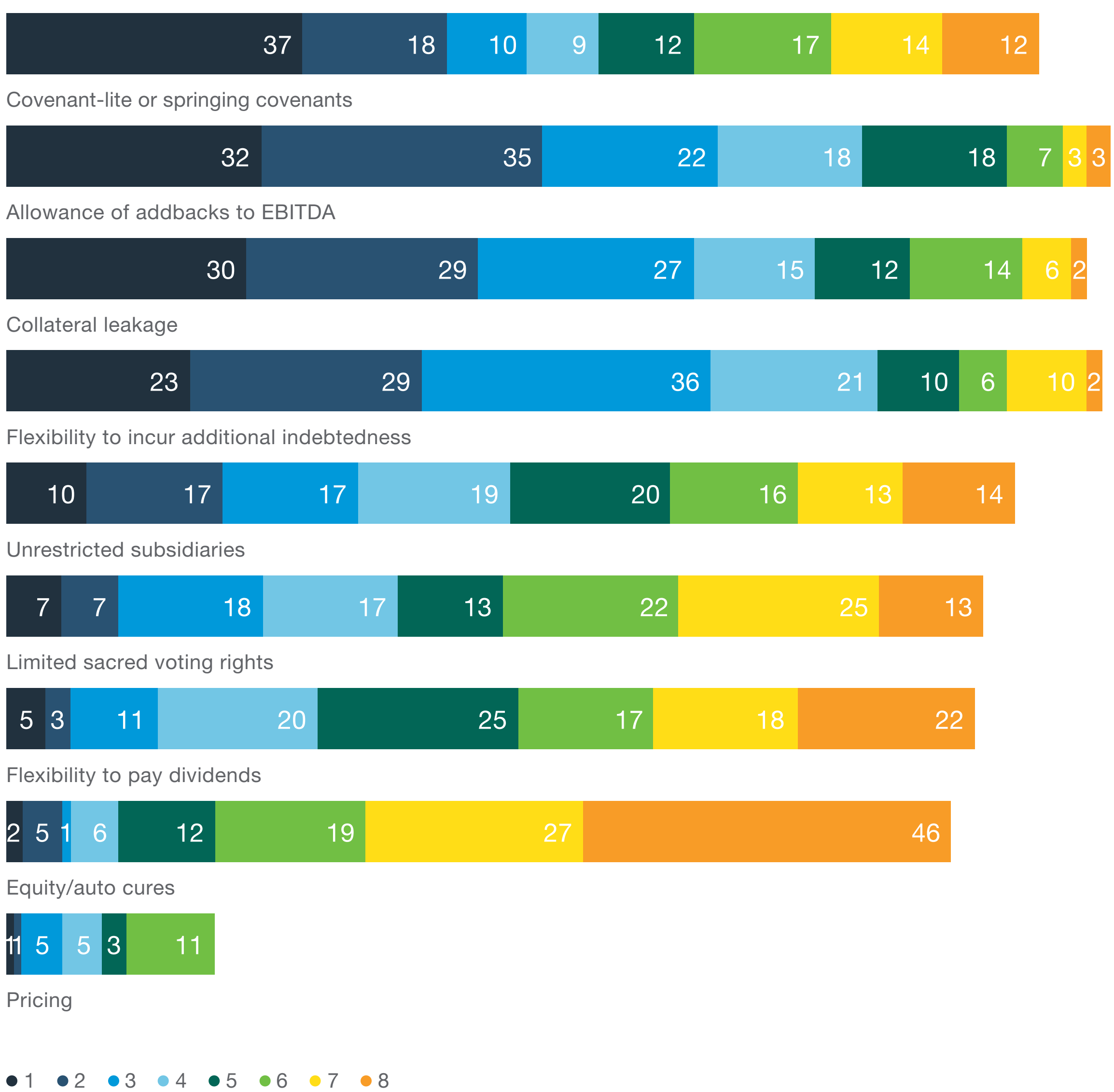


In fact, no matter how the data was diced, by ranking or by region, those four risks were ranked by lenders among the top 3 risks in every iteration of the data.

A few factors may be contributing to this. First, an increase in liability management transactions in the syndicated loan market (e.g., J. Crew, Chewy, Trimark, Revlon, etc.), raising lenders' concerns about collateral leakage and the ability to incur additional indebtedness. Second, an increased focus on unpacking the true earning power of borrowers as a recession becomes more likely, causing lenders to scrutinize EBITDA add-backs and the strength of their financial covenants.

Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

Overall — sorted by 1st rankings



Market Predictions

After ranking each risk, numerous respondents offered comments on reasons behind their rankings.

Those who ranked allowance of add-backs to EBITDA as their top risk

"EBITDA addbacks that were allowed over the past few years are going to come back and haunt those lenders that agreed to excessive adjustments."

"Lenders will be late to the table on some assets, which will limit downside options."

"Quality of EBITDA drives everything."

Those who ranked covenant-lite or springing covenants as their top risk

"Sponsors aren't likely taking dividends when the company is in the tank. If there isn't a covenant, then lenders aren't ever at the table and that opens all the other document aggressive behaviors. Once you have a covenant, then the borrower can't do much because they'll always be up against a default."

"Company being able to underperform and not take action as a lender is concerning. Sponsor taking chips of the table while our debt is outstanding is concerning."

Those who ranked collateral leakage as their top risk

"PE playing games will drive the worst outcomes. A lot of the other bad stuff will be limited by a lack of FCF [free cash flow]."

"Collateral leakage (of any kind) and flexibility to incur additional debt by far the most."

Those who ranked flexibility to incur additional indebtedness as their top risk

"Incurrence of debt and baskets are key risks to be over-levered and with an EBITDA being so adjusted and far from the real cash number, you have weak cash flow profile. Those are the most toxic elements; the rest are protection sponsors and their aggressive counsels have been carefully weakening over the last decade."

"Anything that allows for more debt, priming or distributions of cash when performance is not strong creates major risks that should be reduced in a well-structured transaction. This is especially true as base rate rises will pressure interest coverage in the near term and make refinancing more challenging than anticipated."

Those who ranked limited sacred voting rights as their top risk

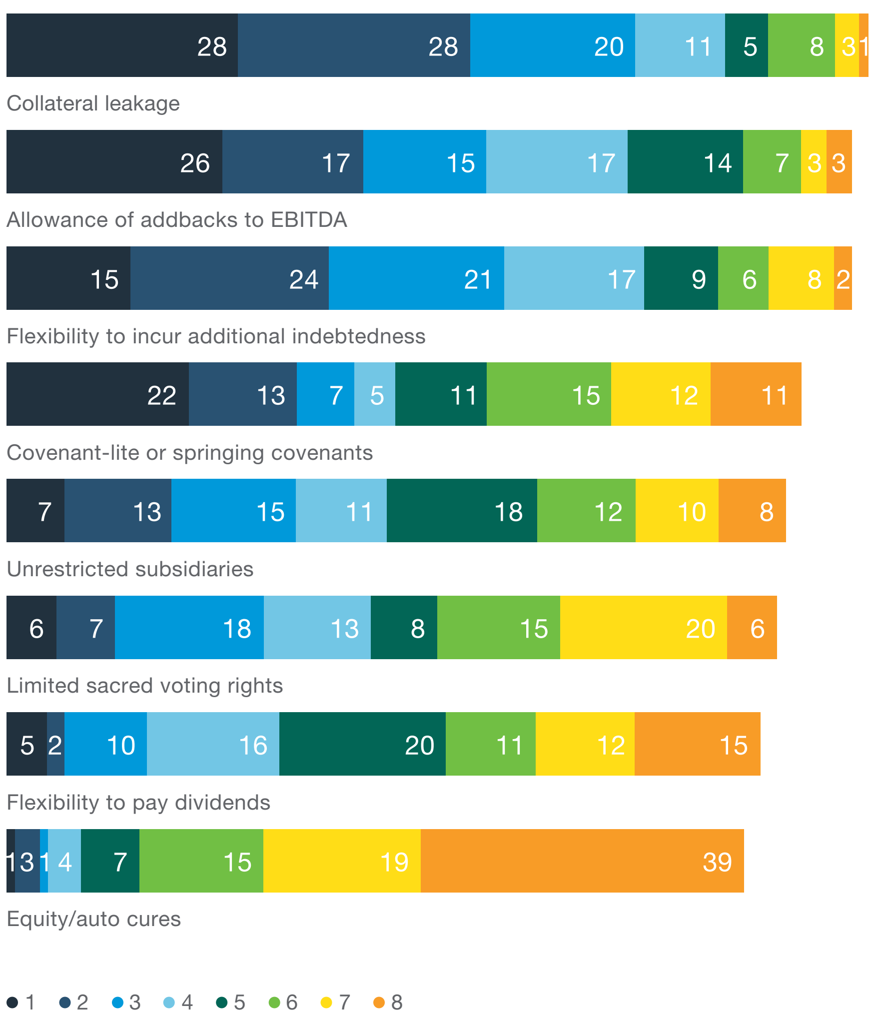
"Direct lending should be a safe asset class; trouble happens when fundamentals can deteriorate significantly before lenders have a seat at the table. Loose/no covenants, meaningless EBITDA definitions, and a lack of rights are generally the most prominent reasons a company could see significant value degradation before a lender can enforce its rights."

"Documentation particularly for syndicated and larger direct transactions has become VERY loose. This will come back to haunt the lenders who reluctantly agreed to (or failed to review) the documents."

Market Predictions

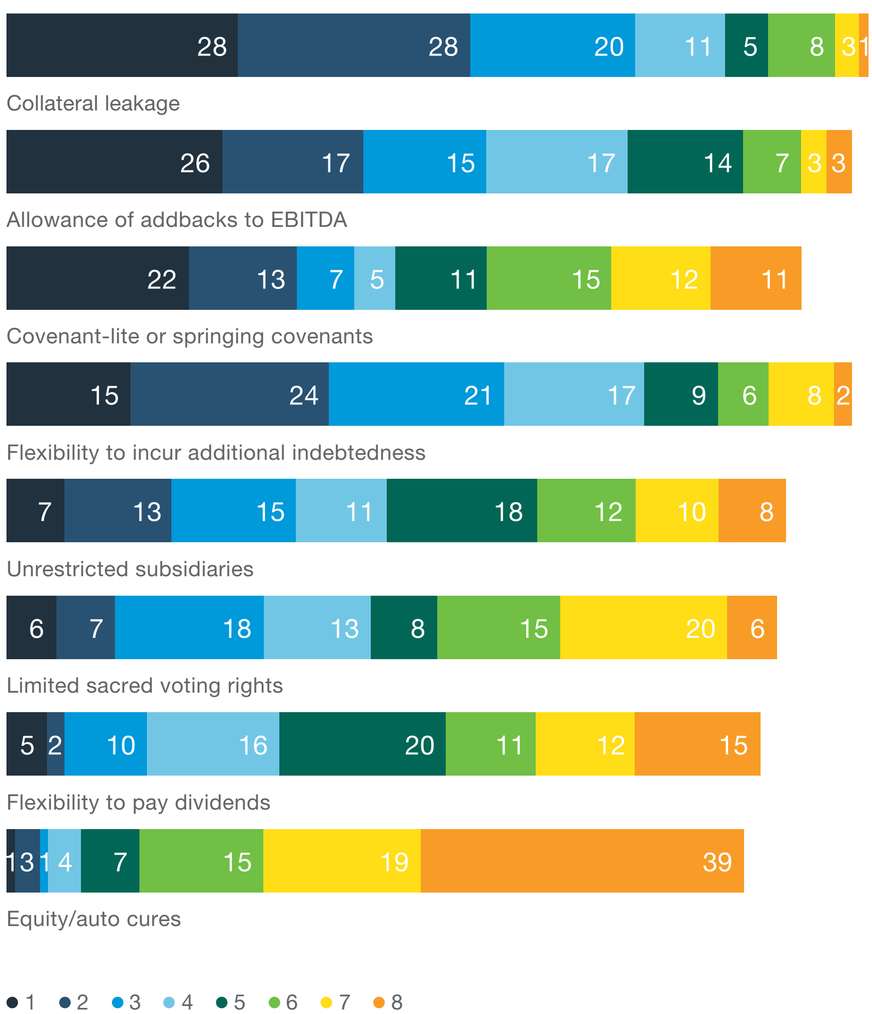
Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

US – sorted by overall rankings



Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

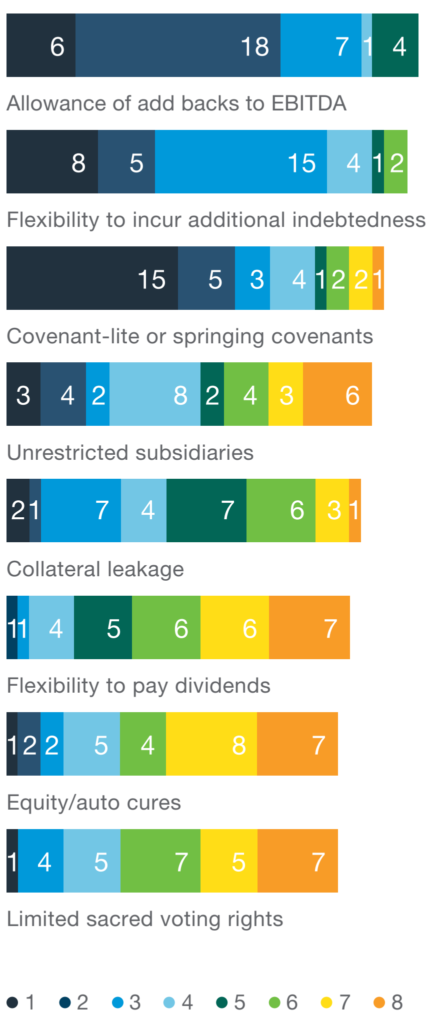
US – sorted by 1st rankings



Market Predictions

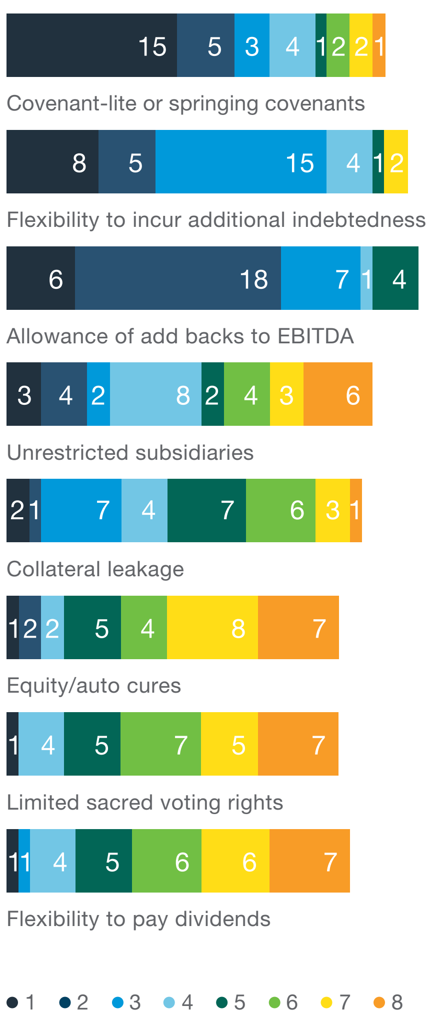
Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

UK/EU – sorted by overall rankings



Which of the following concessions by lenders do you believe presents the greatest risk to lenders?

UK/EU – sorted by 1st rankings



Market Predictions

Five-year Trends

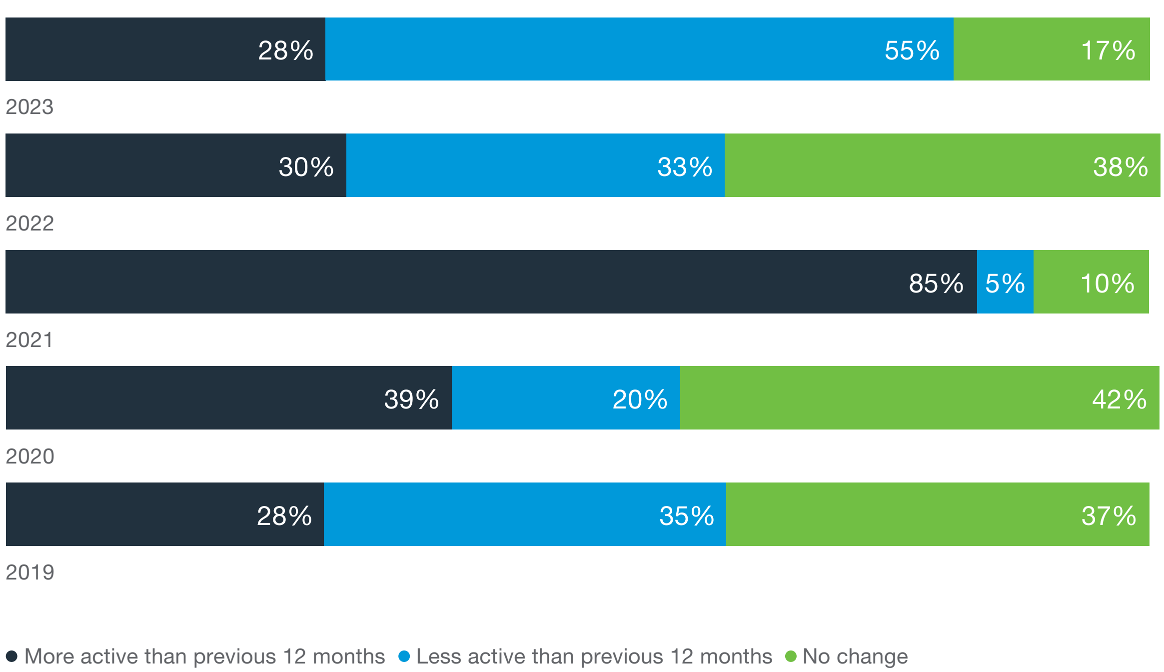
Respondents were asked about their predictions for volume and pricing in the market in the coming year, and then their answers were compared to responses gathered in past surveys, beginning in 2019.

Volume of dealmaking

In the latest survey, a majority of respondents (55%) said they expect dealmaking to decrease, with 28% expecting more deal activity, and 17% expecting no change.

In all the previous years, most respondents expected dealmaking activity to either increase or stay the same.

Deal activity expectations

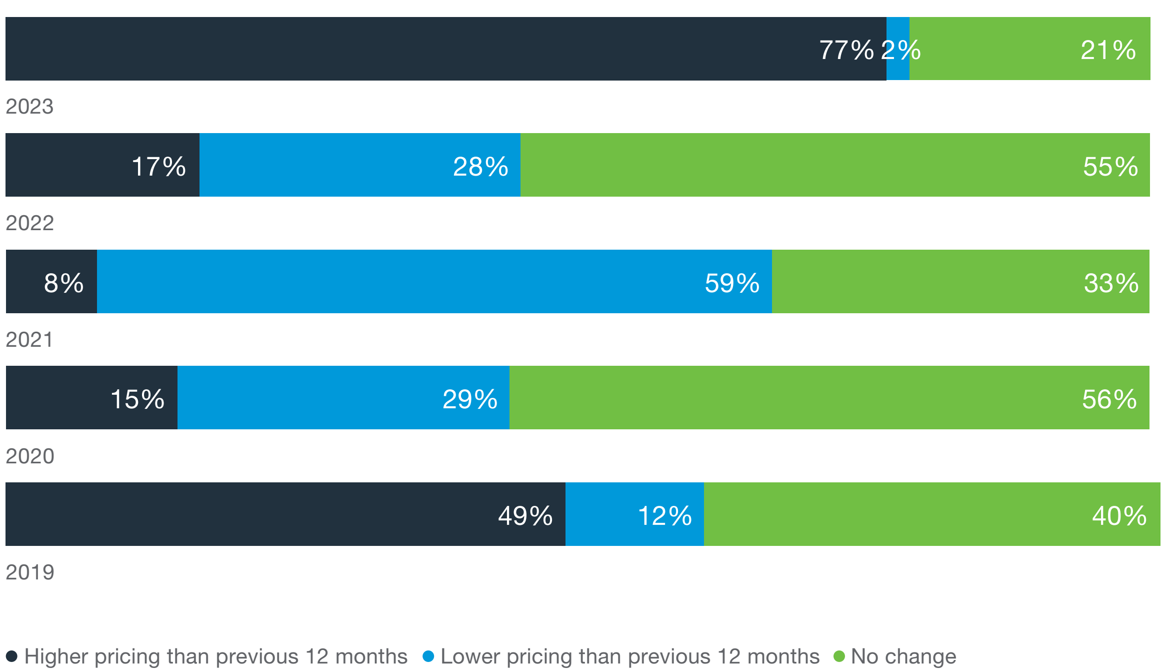


Market Predictions

Pricing Predictions

When asked about pricing expectations, more than three-quarters of respondents (77%) said they expect higher prices this coming year — the largest percentage in the five years of the survey. In 2022, for example, only 17% expected higher pricing, and 55% thought it would stay the same. The only other year that showed the largest percentage expecting price increases was 2019, when 49% said that.

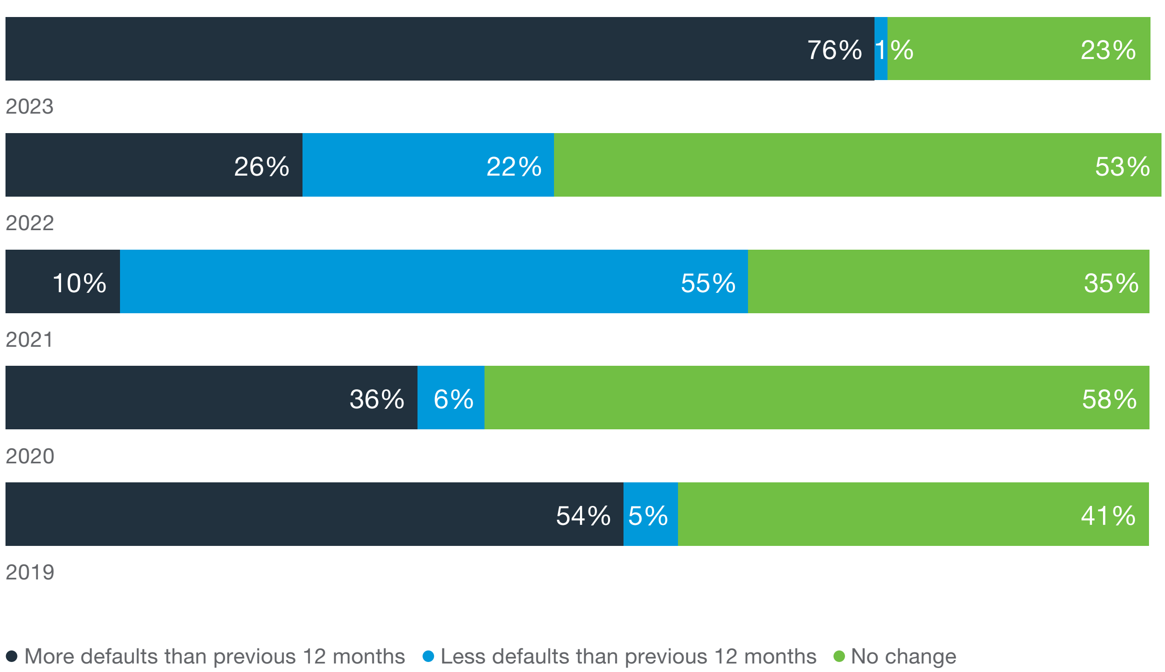
Sharp increase in expecting higher pricing this year, largest jump over the 5 years



Default Expectations

Similarly, there is a significant jump in respondents predicting increased defaults in their own portfolios compared to last year with 76% predicting more defaults. The only other year when a majority of respondents predicted rising defaults in their own portfolios was, again, 2019, when 54% said that.

Significant rise in expecting more defaults this year and at its highest over the past 5 years



Hot Topics

Respondents shared their views on two current hot topics: *Readiness for the Transition from LIBOR* and *ESG Considerations.*

Transition from LIBOR

As private credit lenders are aware, the cessation of LIBOR is expected to occur on June 30, 2023. Nearly all private credit transactions closing in the last three quarters of 2022 that had floating rates were priced in SOFR, the rate that has replaced LIBOR. Many older vintage deals, which initially priced in LIBOR, had been amended to SOFR by the end of 2022. Others remain to be amended.

In 2022, there was a range of outcomes on credit spread adjustments, which are intended to compensate lenders for the discount at which SOFR typically trades to LIBOR. Many new transactions included at least some form of that adjustment, often 10 basis points or a range between 10 and 25 basis points depending on the interest rate tenor. Others had no adjustment at all. SOFR amendments were more likely to include an adjustment.

Our survey also bore out this strong level of preparedness among private credit lenders. Respondents indicate that their preparation for the oncoming transition from LIBOR is high, with 92% of U.S. firms and 97% of U.K./E.U. firms reporting that they are "very prepared" or "somewhat ready" for the changes.

Other lending markets may not be as prepared as the private credit market. Approximately 80% of institutional loans and CLOs remain on LIBOR and need to transition in the next few months before the transition deadline, according to the Loan Syndications and Trading Association (LSTA), which cited data from LevFin Insights and JP Morgan.[20]

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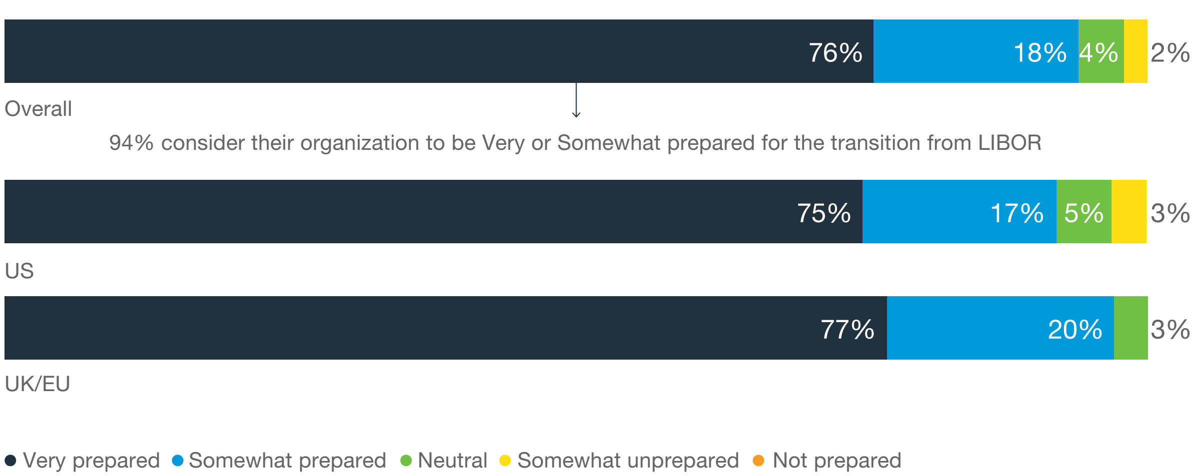
[20] *LIBOR's Ending! Act Now!* Meredith Coffey & Tess Virmani; LSTA, (January 18, 2023); *available at* https://www.lsta.org/news-resources/libors-ending-act-now.

How prepared is your organization for the transition from LIBOR?

By region

Three in four feel 'very prepared' for the transition from LIBOR



Hot Topics

ESG Considerations And Private Lending

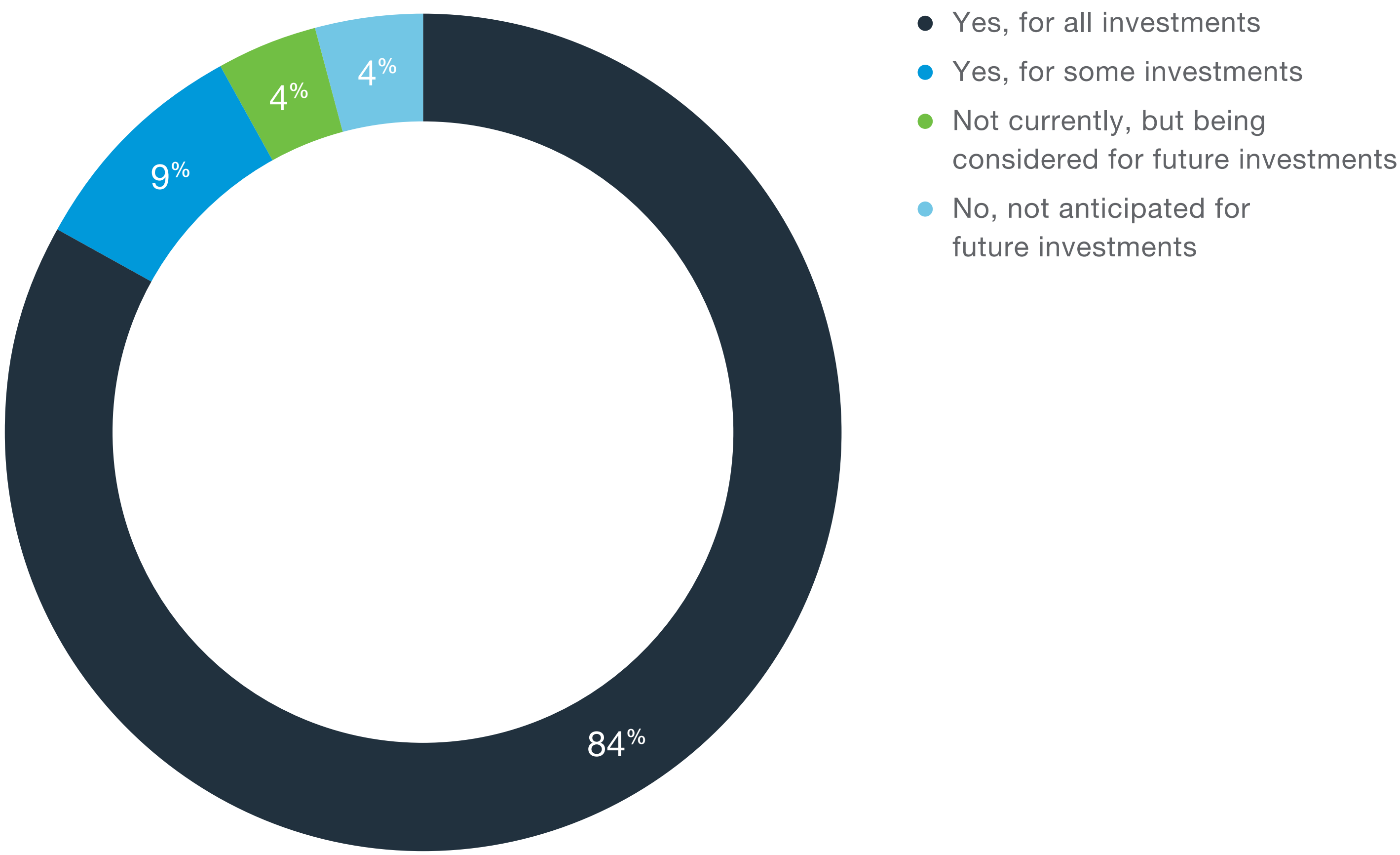
The focus on environmental, social & governance (ESG) factors in the private credit industry has accelerated in recent years, and it continues to gain momentum as best practices develop. There has been a shift to socially conscious investors who demand transparency, and climate change and diversity, equity & inclusion (DEI) considerations remain priorities for managers. While ESG initiatives are primarily being driven by investors who are outlining detailed ESG agendas, lenders have also set up ESG-dedicated funds or impact funds in order to be proactive and competitive. Sustainable investing has proven to generate financial gain while achieving social and environmental progress at the same time.

When survey respondents were asked whether they consider ESG factors in their investments, a clear consensus emerged. A large majority (84%) said ESG considerations entered into decision-making for all their deals, and another 9% said ESG was important for some deals. This is consistent with other market studies, including one by Thomson Reuters, that see ESG as an enduring and even growing part of lenders' activities. However, the Thomson Reuters report showed that financial services companies, among others, were finding it a challenge to collect and measure data amid problems of data quality and consistency.

Over 80% consider ESG on all investments, however, it is not specified whether this is on a formal or informal level.

ESG Consideration

Overall



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For U.S. respondents, 90% of respondents said ESG considerations were present for all or some cases; and among U.K./E.U. respondents, that percentage was 100%.

However, almost three-quarters of U.S. respondents (73%) said they were not offering interest rate ratchets to borrowers to meet ESG goals, while 17% said they were offering such incentives. By contrast, among U.K./E.U. respondents, offering interest rate rachets to borrowers to meet ESG goals was much more common, with 94% of respondents saying they do, and only 6% saying they do not.

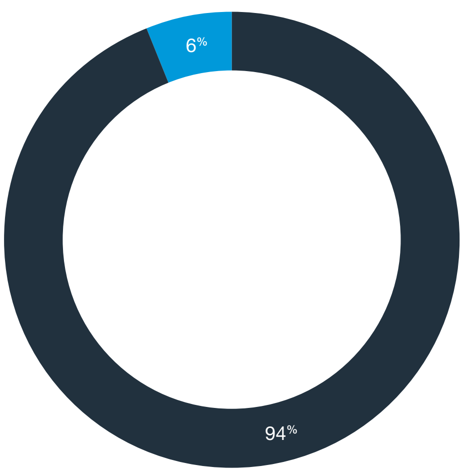
ESG considerations and interest rate ratchets

US only

Interest rate ratchets to meet ESG targets

ESG considerations and interest rate ratchets

UK/EU only



ESG consideration

- Yes, for all investments
- Yes, for some investments
- Not currently, but being considered for future investments
- No, not anticipated for future investments

Interest rate ratchets to meet ESG targets

Conclusion

Overall, the private credit market finds itself at a crossroads of sorts as 2023 begins. It's flashing warning lights on many key metrics, with worries about the wider economy, deal activity, defaults, check sizes and dry powder dominating lenders' concerns. Yet, according to respondents in our survey, the market is still very resilient with lenders willing to lend, lenders raising capital, EBITDA stability growing, leverage levels (for the right credits) remaining at or near historic levels and lenders strategically seeking new investment opportunities, despite these adverse concerns.

Clearly, while there are storm clouds gathering over the $2.18 trillion private credit market, lenders do not seem to be tapping the brakes too hard… yet.

Principal Contacts

US Principal Contacts

Gary J. Creem
Partner | Co-Head
Boston/New York
+1.617.526.9637
+1.212.969.3062
gcreem@proskauer.com

Peter J. Antoszyk
Partner
Boston/New York
+1.617.526.9749
+1.212.969.3416
pantoszyk@proskauer.com

Stephen A. Boyko
Partner
Boston/New York
+1.617.526.9770
+1.212.969.3451
sboyko@proskauer.com

Justin Breen
Partner | Head of Global Finance
New York
+1.212.969.3055
jbreen@proskauer.com

Steven M. Ellis
Partner | Chairman of the Firm
New York/Boston
+1.617.526.9660
+1.212.969.3557
sellis@proskauer.com

Marc B. Friess
Partner
New York
+1.212.969.3038
mfriess@proskauer.com

Stephen P. Gruberg
Partner
New York
+1.212.969.3004
sgruberg@proskauer.com

Michael M. Mezzacappa
Partner | Co-Head
New York
+1.212.969.3037
mmezzacappa@proskauer.com

Daniel W. Hendrick
Partner
New York
+1.212.969.3534
dhendrick@proskauer.com

Matthew W. Levy
Partner
New York
+1.212.969.3398
mlevy@proskauer.com

Sandra Lee Montgomery
Partner
Los Angeles
+1.310.284.4573
smontgomery@proskauer.com

Bharat K. Moudgil
Partner
Los Angeles
+1.310.284.4537
bmoudgil@proskauer.com

Adam R. Nelson
Partner
New York
+1.212.969.3647
anelson@proskauer.com

Evan Palenschat
Partner
Chicago
+1.312.962.3561
epalenschat@proskauer.com

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US Principal Contacts

Frederic L. Ragucci
Partner
New York
+1.212.969.3023
fragucci@proskauer.com

Patrick Walling
Partner
Boston
+1.617.526.9732
pwalling@proskauer.com

Benjamin E. Rubin
Partner
Boston
+1.617.526.9411
brubin@proskauer.com

Ji Hye You
Partner
New York
+1.212.969.3039
jyou@proskauer.com

Scott Patrick Thurman
Partner
New York
+1.212.969.3374
sthurman@proskauer.com

European Principal Contacts

Alexander L. Griffith
Partner
London
+44.20.7280.2145
agriffith@proskauer.com

Faisal Ramzan
Partner
London
+44.20.7280.2075
framzan@proskauer.com

Daniel Hendon
Partner
London
+44.20.7280.2150
dhendon@proskauer.com

Harriet West
Partner
London
+44.20.7280.2080
hvwest@proskauer.com

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Private Market Talks

A Proskauer Podcast

Conversations and insights on the private markets with private capital's leading figures

Peter J. Antoszyk
Partner

Boston
+1.617.526.9749
pantoszyk@proskauer.com

Private Market Talks

Conversations and insights on the private markets with private capital's leading figures

Since the Global Financial Crisis, private capital has transformed the U.S. economy and, increasingly, the global economy. Private capital is now a key source of liquidity that fuels the growth of middle market businesses, and the development of infrastructure, real property and other asset classes.

In fact, today the private market accounts for almost $6 trillion of assets under management in the U.S. alone and is growing. Meanwhile, the private market, how it works and what's driving this growth, is still not generally well-known or understood.

That is why we are thrilled to introduce Private Market Talks. In this podcast, hosted by Peter Antoszyk, we feature leading asset managers, investors, and other capital allocators to discuss their strategies and stories, explore this fast-growing industry and learn the secrets of their success.

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