PitchBook

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Q2 2023 Public BDC Venture Lender Earnings

Venture debt looks for stable ground as interest rates continue to rise

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Key takeaways

- Public BDC lenders engaged in venture debt continue to drive strong earnings amid repeated increases in interest rates. The floating-rate nature of a majority of venture loans passes increased costs on to the borrowers, increasing returns for the lenders. Many of the credit facilities or other borrowings used by the lenders to leverage investments are fixed rate, so the increasing spread continues to drive value for shareholders.

- Credit quality of portfolios continued to be a point of emphasis for public BDC lenders. As the venture market has continued to slow, asset quality has deteriorated on some investments, and the poor nature of the equity financing market will likely put more pressure on startups in the coming quarters. Diligent lenders continue to work with portfolio companies that are finding the market challenging to navigate before their runways run out. TriplePoint Venture Growth saw VanMoof, a company that had raised more than $225 million in financing, file for bankruptcy during Q2.

- Venture lending continues to search for its footing since the collapse of Silicon Valley Bank and amid the broader market volatility. Three of the lenders increased their liquidity from the prior quarter through extensions of their credit lines, or through equity sales, to better position themselves to fund current or new commitments as the market stabilizes. As a whole, venture lending will likely continue to be a slow market in the coming quarters, with annual loan value falling well below the $30 billion mark of the past few years.

Q2 earnings themes

Revenue beats

The public business-development companies (BDCs) engaged in venture debt—Hercules Capital, Horizon Technology Finance, Runway Growth Capital, Trinity Capital, and TriplePoint Venture Growth (TPVG)—continue to push records from an earnings perspective. Net investment incomes grew on the back of rising interest rates, benefiting from the floating-rate products that a majority of their debt investments carry. The Federal Reserve (the Fed) hiked rates once in Q2 and has already hiked once in Q3, albeit both increases were just 25 basis points. Though inflation has slowed, there are indications that another hike, or several more hikes, are possible.

Because BDCs are able to pass these increases along to customers, there have been several knock-on effects of the interest rate pressures. Prepayments have risen as investors look to refinance loans or pay off loans to move past the rising payments. Hercules Capital received nearly $300 million in early payoffs, the highest since the market slowdown began in 2022 and the fourth consecutive quarter-over-quarter increase.

But increasing interest rates have continued to drive returns. Trinity Capital's weighted average coupon rate for the quarter was 13.7%, nearly 2.5 percentage points higher than a year prior. Hercules' loan coupon rate remained level at 12.0%, though this is an increase from 9.0% in Q2 2022.

Net interest margins have also increased significantly for several of the lenders due to the fixed-rate notes that have been issued for financing commitments. These dynamics are likely to continue through at least another quarter until the Fed begins to lower rates, which will be very deliberate, slow decreases.

The BDCs have also used the strong market to sell equity stakes at a premium to net asset value to further bolster their financial position and fund future commitments. Though the broader venture debt market has slowed significantly since the beginning of 2023 and fell further into turmoil with the collapse of Silicon Valley Bank (SVB), BDCs continue to see heavy interest in debt products. The slow venture equity market has turned companies into borrowers if their credit profile allows. While not specifically discussed in the BDCs' earnings calls, high-quality companies are not only generating strong revenues but also showing strong capital positions with longer cash runways than previously needed for debt financings.

Dividends reached new highs for each of the BDCs, with several exceeding expectations.

Credit-quality shifts

Another aspect of the BDCs' earnings has been the shifting credit quality of their portfolios. Each of the lenders grades their investments on a scale, moving companies depending on the risk marks on the loan. Q2 saw several BDCs reshuffling the credit ratings of their portfolios due to the challenging environment as well as the loan prepayments that took out low- or even high-performing companies.

TriplePoint Venture Growth portfolio company VanMoof, which had raised more than $225 million in its lifetime, went bankrupt in Q2, demonstrating the precarious nature of the current market, even for companies that had been standing on seemingly steady ground in recent years. That bankruptcy pushed TPVG to net losses, realized and unrealized, of nearly $40 million for the quarter. The credit score of TPVG's portfolio increased slightly from 2.07 to 2.12 despite moving several companies into category 5, which is the lowest rating for the BDC.

The credit score for Trinity Capital's portfolio was unchanged despite an increase of loans in categories 4 and 5, labeled "watch" and "workout," respectively. An increase in loans moving into these lower categories should be expected over the next few quarters unless the VC market begins to improve. Equity raises are difficult in the current market, leading many companies to find ways to extend runway, including layoffs. We have estimated that nearly 51,000 companies are currently VC backed in the US and more than 120,000 companies are VC backed globally. Each of these figures grew significantly in recent years as the market was flooded with an overcapitalization. As capital has fled the market, many companies are left with few options unless they can shift to a profitable business model. The credit-quality issues will likely impact only older loans. The increased capacity for lenders to originate high-quality companies in recent quarters should keep younger loans in higher tiers of scoring.

Down rounds are becoming a larger piece of VC. Our Q2 2023 US VC Valuations Report estimates that 15.2% of the completed deals in Q2 were at a lower valuation than previous company financings. An interesting note from lenders is that down rounds do not necessarily have a heavy impact on their loans. Refinancings may increase with new raises, but equity interest in portfolio companies is still a positive for lenders. Not only does the added capital provide a higher ability to service loan payments, but it also shows the company is still generating positive interest from equity investors when other companies simply must shut down or further extend runway artificially. The senior nature of a majority of venture loans protects the downside to a degree.

Venture debt outlook

Venture debt has been a murkier market since the collapse of SVB in March. Through Q2, just $6.3 billion in borrowing had occurred in the US, well below the pace of the past several years when more than $30 billion was borrowed annually. Late-stage and venture-growth-stage companies have outpaced earlier-stage companies in terms of loan counts, though this is an expected outcome of banks pulling back from the debt market for the time being. BDCs and other nonbank lenders are much more active in later stages, and they will continue to be regardless of the void in lenders for the earlier stages.

BDCs have placed themselves in a position to capitalize when the opportunity presents itself, likely when the venture market is able to stabilize and fundings pick up. On August 7, 2023, Hercules priced an upsized offering of equity shares that it will use to fund new commitments and manage its leverage ratio. During Q2, Horizon expanded its borrowing capacity and also raised $44 million in equity through a follow-on offering and its at-the-market (ATM) offering program, all so that it would be financially stable for further lending.

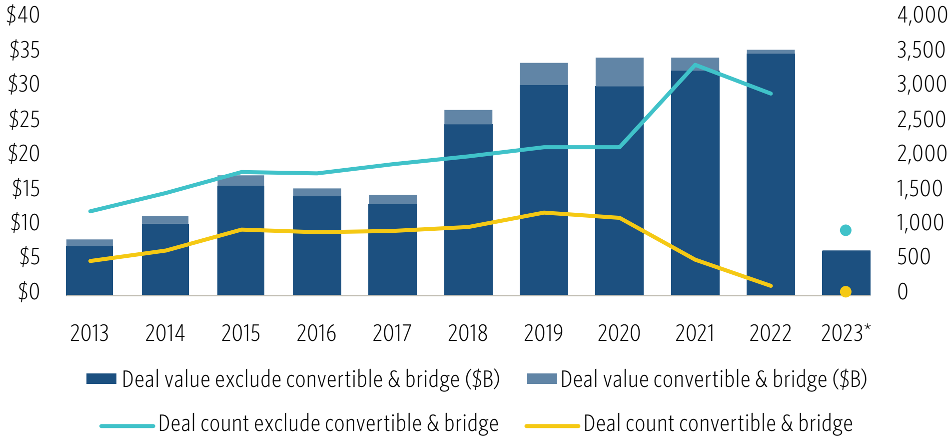
Unfunded commitments continued to decrease for the lenders during the quarter. While this speaks to the relative increase in portfolio quality because of performance benchmarks that need to be met for loan tranches, it also points to the possible boost to the equity financing market that the debt market generally follows.

A soft landing for the US economy now looks more likely than it did a few months ago. This is good from a credit-quality standpoint, increasing the likelihood that economic factors will not pressure returns. A soft landing would likely also come with a return to more active M&A and IPO markets, which have been major pressures on the venture market.

Interest rates, as mentioned before, look primed to continue incremental increases for another quarter, again boosting incomes for lenders. The slow return to a more moderate rate will pull down monthly revenues from loans, but it will also lead to a wider set of potential borrowings from companies that are currently opting out of debt due to high rates.

Bank lenders have slowed deployment considerably. Proposed banking-risk regulations may inhibit a resurgence from banks into venture lending, which will better position BDCs and nonbank lenders in the market.

Venture debt activity



Source: PitchBook • Geography: US
*As of June 30, 2023

Commitments

In Q2, new commitments were relatively low for the group of BDCs, indicative of the cautious approach that the current market has dictated when diligencing new opportunities. Unfunded commitments, the portion of commitments that have yet to be drawn by borrowers, fell for most of the group. While higher amounts of unfunded commitments are not necessarily a drag on performance, this proportion of the portfolio needs to be managed in order to preserve availability to make new commitments, as well as to reserve enough liquidity to fund existing commitments, especially if market conditions create an environment where higher-than-expected reserves are drawn.

We expect new commitments to remain relatively low for the coming quarters, especially as lenders manage the credit quality of their portfolios and the market continues to adjust. All the BDCs have noted the increased quality of their loan pipeline, but there is likely caution on both sides to not commit to a loan until the market becomes more predictable.

New commitments ($M) of select BDCs by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$526.0	$541.5
Horizon Technology	$187.0	$52.7
Runway Growth Capital	$0.0	$0.0
Trinity Capital	$43.2	$218.5
TriplePoint Venture Growth	$3.7	$114.0

Source: PitchBook • Geography: US
*As of June 30, 2023

Unfunded commitments ($M) of select BDCs by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$562.1	$381.1
Horizon Technology	$1.5	$1.4
Runway Growth Capital	$302.7	$234.3
Trinity Capital	$338.7	$345.2
TriplePoint Venture Growth	$254.5	$205.3

Source: PitchBook • Geography: US
*As of June 30, 2023

Net income and interest rates

As interest rates have quickly risen over the past 18 months, investment yields have climbed to records or recent high-water marks for the lenders. The Fed has positioned itself to likely raise rates further—it already increased rates by 25 basis points in Q3—but at more modest levels than the larger hikes of the current tightening cycle. A large majority of venture loans, up to 100% in the case of some BDCs, offer a buffer against the rising risks that interest rate increases can have on startups. Coupon rates have propelled the increasing incomes, but even for loans that are prepaid, exit fees prevent the lenders from realizing significantly lower returns from any single loan. Loans originated now will have floor rates, keeping returns high should interest rates lower more quickly than planned.

Total investment income ($M) of select BDCs by quarter*

Company	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Hercules Capital	$65.2	$72.1	$84.2	$100.2	$105.1	$116.2
Horizon Technology	$14.2	$18.6	$23.3	$23.1	$28.0	$28.1
Runway Growth Capital	$19.3	$25.2	$27.3	$36.8	$39.3	$41.9
Trinity Capital	$31.8	$33.5	$38.7	$41.5	$41.5	$46.0
TriplePoint Venture Growth	$27.3	$27.4	$29.7	$34.9	$33.6	$35.2

Source: PitchBook • Geography: US
*As of June 30, 2023

Investment yield of select BDCs by quarter*

Company	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Hercules Capital	11.5%	11.5%	12.9%	14.7%	15.1%	16.0%
Horizon Technology	12.4%	14.2%	15.9%	14.5%	16.3%	16.3%
Runway Growth Capital	12.2%	15.1%	14.4%	15.5%	15.2%	16.7%
Trinity Capital	16.3%	13.8%	15.2%	15.5%	15.2%	16.2%
TriplePoint Venture Growth	15.5%	14.5%	13.8%	15.3%	14.7%	14.7%

Source: PitchBook • Geography: US
*As of June 30, 2023

Net investment income ($M) of select BDCs by quarter*

Company	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Hercules Capital	$35.8	$40.1	$50.0	$62.1	$65.5	$75.7
Horizon Technology	$5.7	$8.6	$11.1	$10.7	$13.0	$16.1
Runway Growth Capital	$12.5	$14.5	$14.5	$18.4	$18.2	$19.7
Trinity Capital	$15.6	$15.7	$18.6	$21.6	$19.3	$22.1
TriplePoint Venture Growth	$13.5	$12.7	$16.7	$20.5	$18.6	$18.8

Source: PitchBook • Geography: US
*As of June 30, 2023

Net investment income per share of select BDCs by quarter*

Company	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Hercules Capital	$0.30	$0.32	$0.39	$0.47	$0.48	$0.53
Horizon Technology	$0.26	$0.35	$0.43	$0.40	$0.46	$0.54
Runway Growth Capital	$0.30	$0.35	$0.36	$0.45	$0.45	$0.49
Trinity Capital	$0.57	$0.51	$0.56	$0.62	$0.55	$0.61
TriplePoint Venture Growth	$0.44	$0.41	$0.51	$0.58	$0.53	$0.53

Source: PitchBook • Geography: US
*As of June 30, 2023

Gains/losses

The global venture market has slogged through the past few quarters as capital availability from equity investors has pressured cash runways and caused startups to manage burn rates more thoughtfully. Unrealized losses on BDC portfolios are likely to be seen over the next few quarters, but those may derive more from equity or warrant positions than from loans. Recovery rates for venture loans tend to be high because these loans sit senior to other forms of capital.

Realized losses should also be expected to increase. Bankruptcies and down rounds are increasing, and the high number of VC-backed startups stuck in the private market will likely lead to further problems. Warrants taken as part of loan packages during the past few years may not be able to cover these losses, however, as the high strike price due to the high-valuation market of the time will make it more challenging to see a return that covers high realized losses. In order to mitigate these realizations, the BDCs will need to be proactive in adjusting loans and working with their portfolios to sidestep problems until the market can turn around.

Net realized gains (losses) from investments ($M) by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$8.0	$0.2
Horizon Technology	-$0.2	-$16.5
Runway Growth Capital	-$1.2	$0.0
Trinity Capital	-$0.4	-$26.6
TriplePoint Venture Growth	$0.0	$1.9

Source: PitchBook • Geography: US
*As of June 30, 2023

Net unrealized appreciation/depreciation from investments ($M) by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$21.1	$18.9
Horizon Technology	-$7.5	$0.6
Runway Growth Capital	-$5.1	$2.6
Trinity Capital	$3.5	$24.4
TriplePoint Venture Growth	-$10.9	-$41.6

Source: PitchBook • Geography: US
*As of June 30, 2023

Available capital

In Q2, available capital for lending increased almost across the board. A combination of equity sales, ATM sales, and credit line increases positions BDCs to take further advantage of increased pipelines for loans. The venture market, especially late-stage and venture-growth-stage companies, will continue to need capital injections until the exit market is able to return to a sense of normalcy. The high number of unicorns, both in the US and globally, will not be able to rely on venture equity investors alone at the risk of losing too much equity prior to a potential IPO. The nondilutive nature of venture debt can be a strong supplement to cash on hand for companies preparing for an IPO but needing more time to structure their business to be attractive to public market investors.

Total available liquidity ($M) of select BDCs by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$553.1	$670.7
Horizon Technology	$112.3	$107.1
Runway Growth Capital	$131.3	$227.7
Trinity Capital	$174.8	$130.3
TriplePoint Venture Growth	$187.6	$199.4

Source: PitchBook • Geography: US
*As of June 30, 2023

Portfolio

Portfolio at fair value ($M) of select BDCs by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$3,130.0	$3,112.8
Horizon Technology	$715.3	$715.4
Runway Growth Capital	$1,125.3	$1,095.3
Trinity Capital	$1,091.5	$1,148.0
TriplePoint Venture Growth	$982.8	$942.0

Source: PitchBook • Geography: US
*As of June 30, 2023

Debt portfolio at fair value ($M) of select BDCs by quarter*

Company	Q1 2023	Q2 2023
Hercules Capital	$2,968.0	$2,937.9
Horizon Technology	$684.6	$683.3
Runway Growth Capital	$1,125.3	$1,036.7
Trinity Capital	$929.3	$1,100.1
TriplePoint Venture Growth	$890.1	$853.2

Source: PitchBook • Geography: US
*As of June 30, 2023