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2022
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GLOBAL

Private Debt Report

PitchBook

Contents

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Click here for PitchBook's report methodologies.

Key takeaways

2022 cumulative returns by asset class

Loans outperformed stocks and bonds for just the third time in 25 years

Sources: LCD, Morningstar, S&P Dow Jones Indexes | **Geography:** Global
*As of December 31, 2022

- Following a weak start, private debt fundraising finished the year on a strong note. The asset class saw steady sequential gains throughout the year, culminating with $60.7 billion in total fundraising in Q4 and surpassing the $200 billion full-year fundraising mark for the third consecutive year. While institutional fundraising was down from 2021's record, private debt managers leaned on the retail channel to erase much of that decline.

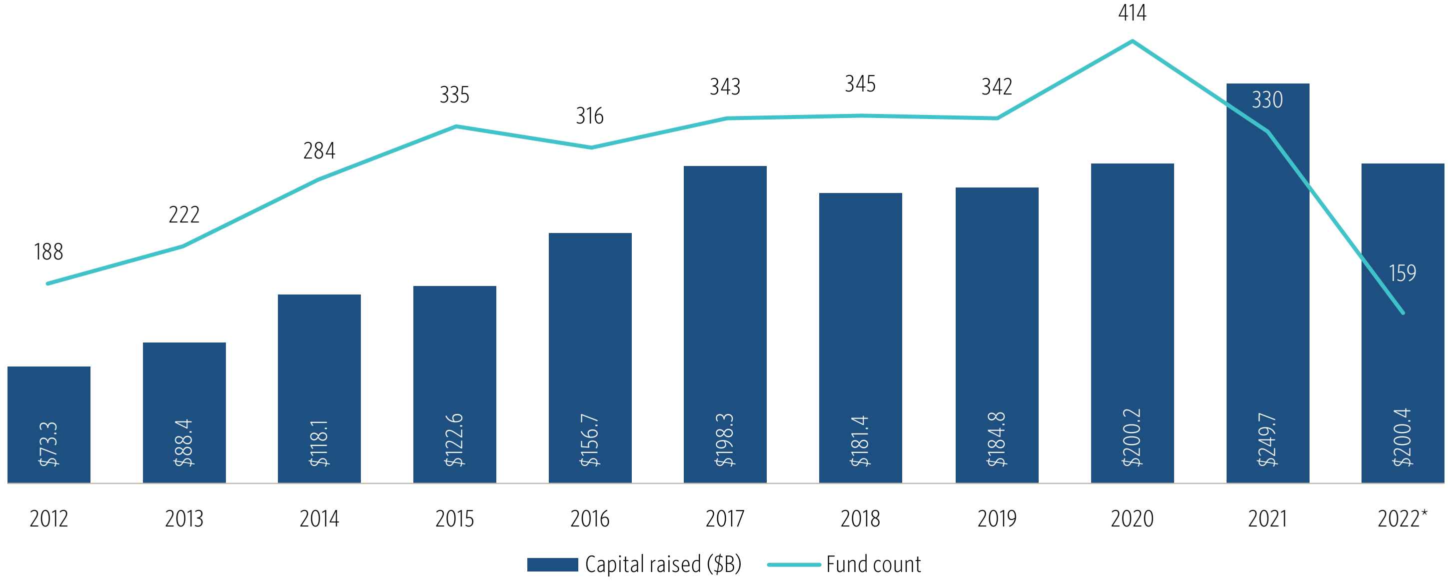
- Direct lending continues as the most sought-after private debt substrategy by far among capital-starved borrowers and yield-hungry investors, with the latter seeking a hedge against rising interest rates and the former combating a wholesale retreat by bank lenders. Mezzanine also had a stellar year of fundraising and contributed several of the largest funds.

- Floating-rate debt, which characterizes much of private debt as well as the more liquid leveraged loan market, held up well and proved its mettle in one of the worst years on record for fixed-income investors and 60/40 allocators. The Morningstar LSTA US Leveraged Loan Index returned -0.6% for the year compared to -15.7% for high-grade corporate bonds and -18.1% for the S&P 500. This is just the third time loans have ever outperformed stocks and bonds in the 25-year life of the LSTA loan index.

Fundraising and dry powder

Private debt fundraising activity

Institutional flows to private debt funds exceeded $200 billion for the third straight year; retail flows were also significant

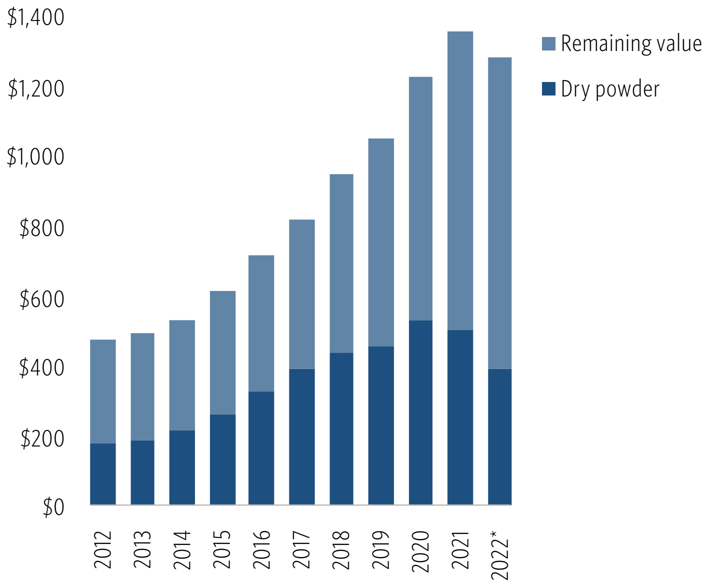


Source: PitchBook | **Geography:** Global
*As of December 31, 2022

Following a weak start, private debt fundraising finished the year on a strong note. The asset class saw steady sequential gains throughout the year, culminating with $60.7 billion in total fundraising in Q4. Private debt has surpassed the $200 billion mark for the third consecutive year but fell short of 2021's record pace by 19.7%. That shortfall was fully offset by the enormous growth in fundraising from nontraded business development companies (BDCs) and credit-oriented interval funds marketed to individual investors, which are not found in the call-down universe we draw upon for this report. Fundraising for these vehicles is estimated to have exceeded $40 billion in 2022, up 47.2% from 2021. The largest retail vehicles have overtaken their institutional brethren, such as Blackstone's Private Credit Fund at $22.7 billion under management, and Owl Rock's six nontraded BDCs, which combine for more than $16 billion. This has not gone unnoticed by other managers looking to break into the retail market for high-yield alternatives. Fidelity, T. Rowe Price, PGIM, Bain, and Angelo Gordon all either are pre-effective or have recently launched their own private debt funds for the mass market.[1]

Private debt AUM ($B)

AUM exceed $1.2 trillion with $395.2 billion in dry powder

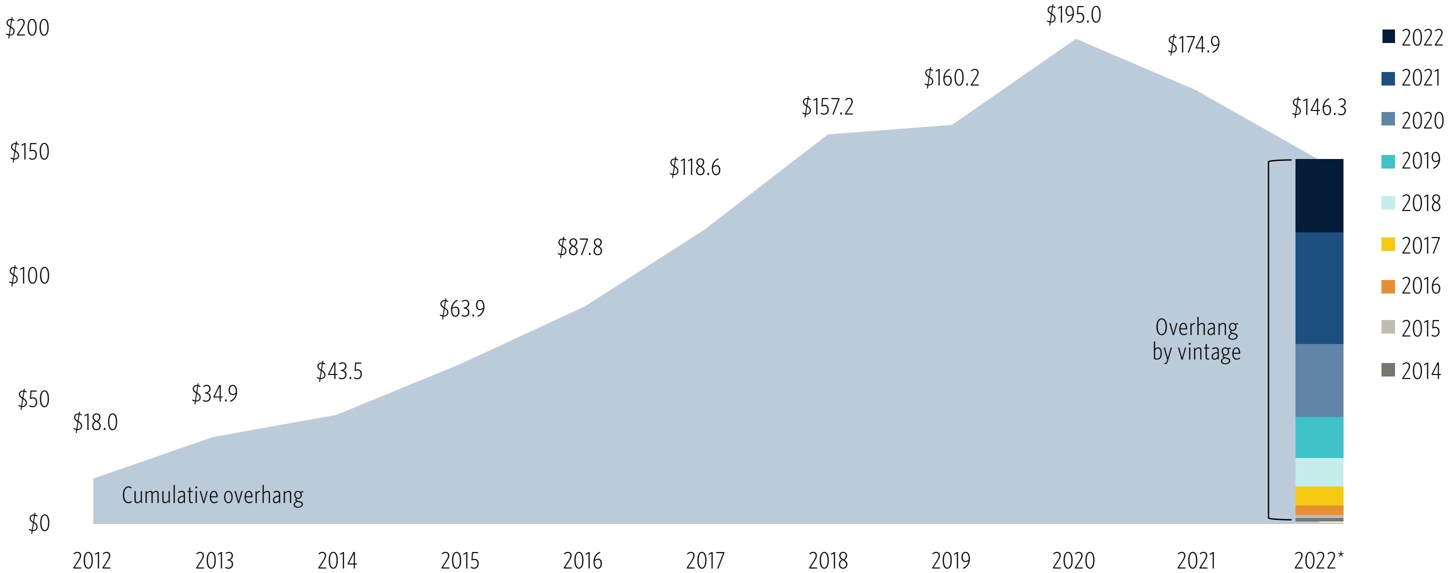


Source: PitchBook | **Geography:** Global
*As of December 31, 2022

1: "Non-Traded Alternative Investments Raised Record $104 Billion in 2022," The DI Wire, Kinsley Lively, January 20, 2023.

Direct lending dry powder ($B) by vintage

The $146.3 billion in direct lending dry powder fills the void left by the inactive syndicated loan market



Source: PitchBook | **Geography:** Global
*As of December 31, 2022

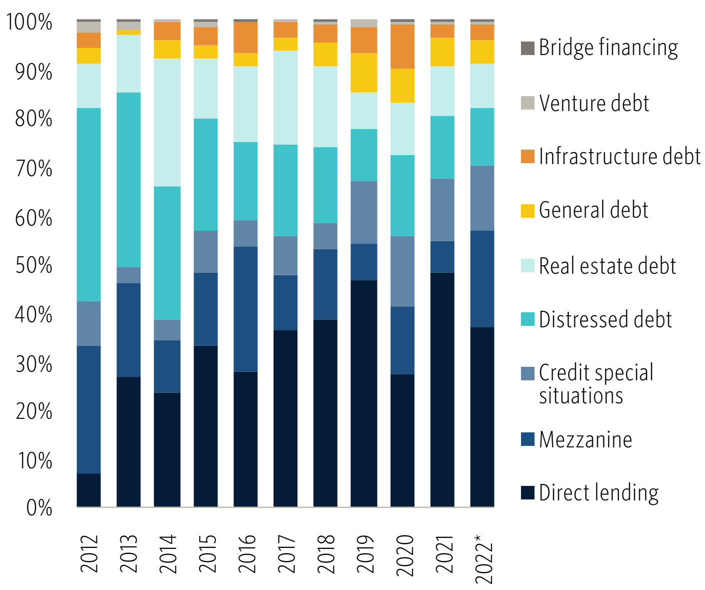
Due to significant fundraising in recent years, private credit providers have been at the ready to step in with loans for a full range of uses, including for buyouts and M&A.

As with other strategies, larger, more experienced managers crowded out smaller managers, with the top 10 funds accounting for just over 30% of all fundraising. 2022's crop of mega-debt funds also revealed a shift in substrategy. Whereas direct lending funds dominated 2021, accounting for four of the top five funds, mezzanine funds were the hot ticket in 2022. This reflected strong demand for infrastructure and real assets more broadly, which tend to rely more on mezzanine and subordinated debt structures.

That said, the 2022 vintage of large mezzanine funds was focused on the corporate opportunity. It provided sponsors the means to increase leverage in transactions without adding more senior debt. With new issuance of high-yield bonds still sluggish and the direct lenders swamped with demand for first lien loans, the market for subordinated loans has fallen to the mezzanine lenders to fill. Another likely driver is the resurgence of paid-in-kind structures, to which many mezzanine lenders are amenable. These loans allow borrowers to make interest payments in the form of additional loan principal and preserve cash in the process. For GPs that run buyout strategies, mezzanine is a complementary strategy and natural extension. It allows those managers with superior deal flow access to

Share of private debt capital raised by type

Mezzanine makes a move, but direct lending still rules



Source: PitchBook | **Geography:** Global
*As of December 31, 2022

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Top private debt funds closed in H2 2022*

2022 was the year of mega mezzanine funds

Fund	Fund value ($M)	Fund type	Location
West Street Mezzanine Partners VIII	$11,700.0	Mezzanine	New York City, US
ICG Europe Fund VIII	$8,246.3	Mezzanine	London, UK
Barings European Private Loan Fund III	$7,360.0	Direct lending	Charlotte, US
Ares Special Opportunities Fund II	$7,100.0	Distressed debt	Los Angeles, US
CVC Credit Partners European Direct Lending Fund III	$6,828.1	Direct lending	Saint Helier, UK
Ares Infrastructure Debt Fund V	$5,000.0	Infrastructure debt	New York City, US
Ardian Private Debt V	$4,932.1	Direct lending	London, UK
Churchill Middle Market Senior Loan Fund IV	$4,560.0	Direct lending	New York City, US
Ares Sports, Media & Entertainment Finance Fund	$3,700.0	Mezzanine	Los Angeles, US
Tikehau Capital Direct Lending Fund V	$3,368.8	Direct lending	Paris, France

Source: PitchBook | **Geography:** Global
*As of December 31, 2022

deploy more capital in different manners while also leveraging their core competency in sizing up high-growth, cash-hungry targets.

Direct lending still represents the largest strategy by far within the debt fund product stack, both in terms of fundraising (37.7%) and AUM (37.0%). At $146.3 billion, direct lending is also where the greatest store of dry powder can be found across all debt strategies. That is a good thing, given that the market for broadly syndicated loans (BSLs), which originated a nearly identical $146.0 billion in 2021 for PE-backed leveraged buyout (LBO) deals, went missing for most of 2022. That trend seems to be continuing into 2023.

As demand for private debt, and direct lending funds in particular, pushes higher among yield-hungry investors and capital-starved borrowers, experienced managers are returning to the market to build up their war chests and raise even larger funds.

2022's largest debt fund came at year's end, with the $11.7 billion close by West Street, Goldman Sachs' subsidiary, of its eighth mezzanine flagship fund. Just three months earlier, West Street closed on $9.7 billion for its eighth flagship buyout fund. Both funds will target middle-market companies for either equity or debt investment, and while they are unlikely to double up on the same targets, it demonstrates the synergies of a dual-tracked approach.

In terms of geographical focus, private debt funds continue to be concentrated in North America. The region accounted for 74.1% of all fundraising, a level not seen since 2008. After setting its own record for private debt in 2021, with more than $89.1 billion in funds raised, Europe retrenched to almost half of that level, or $42.5 billion, in 2022. The retreat in Europe reflects a cooling of PE and debt fundraising in general, given the overhang of the Russia-Ukraine War, while in North America, it was more about a rotation out of growth and into floating rates in a higher-interest-rate environment. Asian-headquartered funds raised more than $5.5 billion, a slight dip from each of the last three years. A growing demand exists for nonbank lending in Asia, given the uptick in sponsored deal activity in recent years, but the creditor-debtor regimes vary greatly and can make it difficult for direct lending funds to establish a foothold.

While North American-headquartered funds have accounted for the lion's share of fundraising, some of this capital is earmarked for deployment elsewhere, as many of the largest US-based managers raise capital with a global mandate.

US and European market stats

Quarterly yield-to-maturity and spread on LBO loans

Borrowing costs for LBO deals doubled in 2022

Sources: PitchBook and LCD | **Geography:** US
*As of September 30, 2022

European direct lending market activity*

As Europe shows, direct lending is no longer confined to middle markets

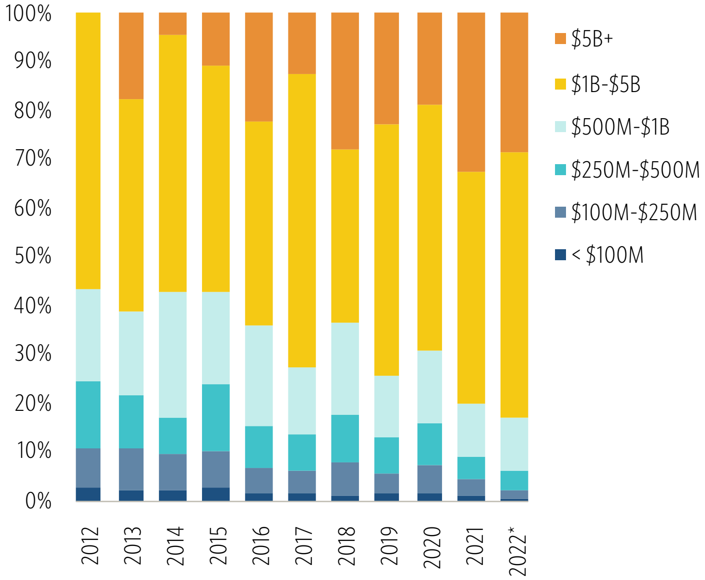
Period	Median deal value (€M)	Median EBITDA (€M)	Median leverage
Q1 2020	€75.0	€17.0	3.8x
Q2 2020	€107.4	€20.5	4.7x
Q3 2020	€60.0	€20.0	4.5x
Q4 2020	€89.7	€18.0	5.5x
Q1 2021	€120.0	€20.0	5.5x
Q2 2021	€129.9	€27.0	5.8x
Q3 2021	€68.7	€22.5	6.0x
Q4 2021	€109.0	€35.5	6.0x
Q1 2022	€260.0	€35.4	5.2x
Q2 2022	€177.5	€20.0	5.6x
Q3 2022	€96.3	€22.5	4.6x
Q4 2022	€260.2	€90.0	5.8x
Average	**€129.5**	**€29.0**	**5.3x**

Sources: PitchBook and LCD | **Geography:** Europe
*As of December 31, 2022

Private debt fund stats

Share of private debt capital raised by size bucket

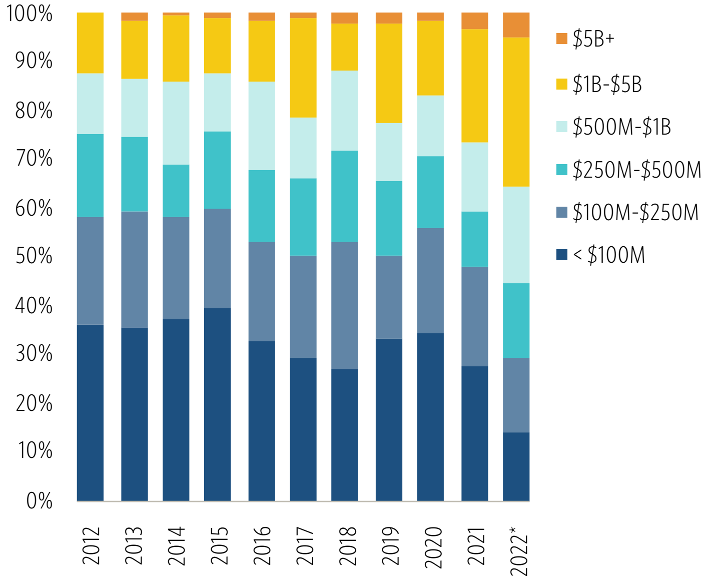
Mega-funds ($5B+) increasingly dominate dollars raised



Source: PitchBook | **Geography:** Global
*As of December 31, 2022

Share of private debt fund count by size bucket

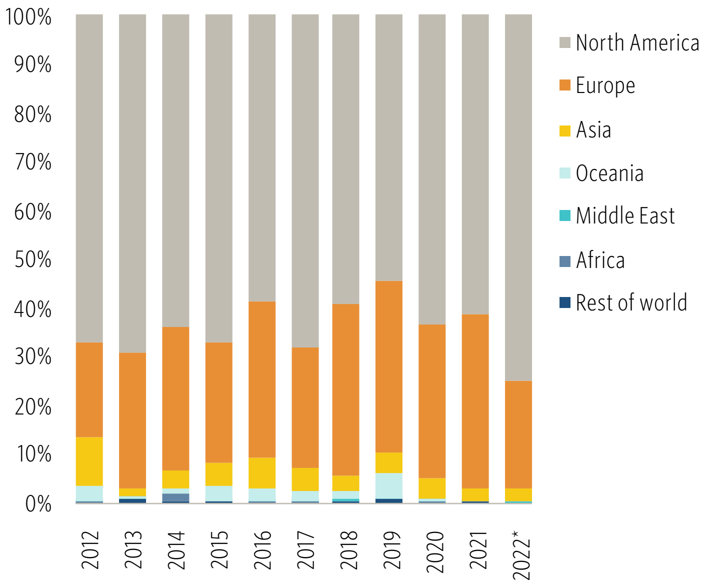
Mega-funds ($5B+) are far more numerous now than before



Source: PitchBook | **Geography:** Global
*As of December 31, 2022

Share of private debt capital raised by region

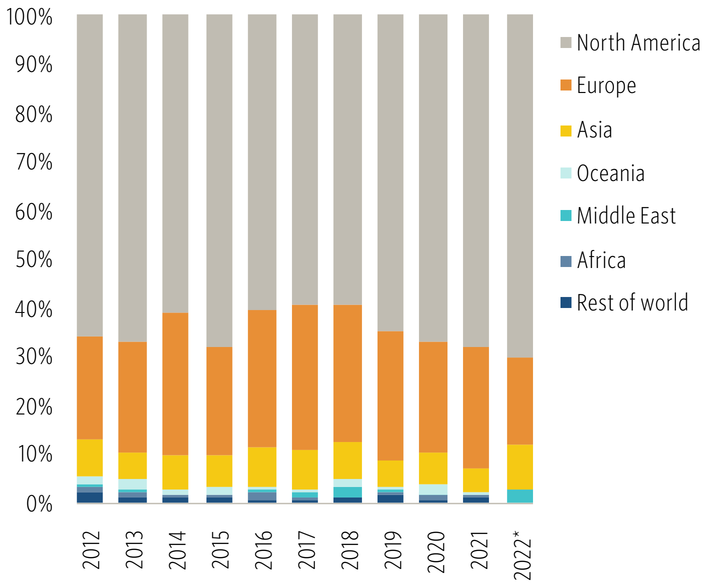
North America grabs vast majority of fundraising



Source: PitchBook | **Geography:** Global
*As of December 31, 2022

Share of private debt fund count by region

North American funds in the market outgrew every region



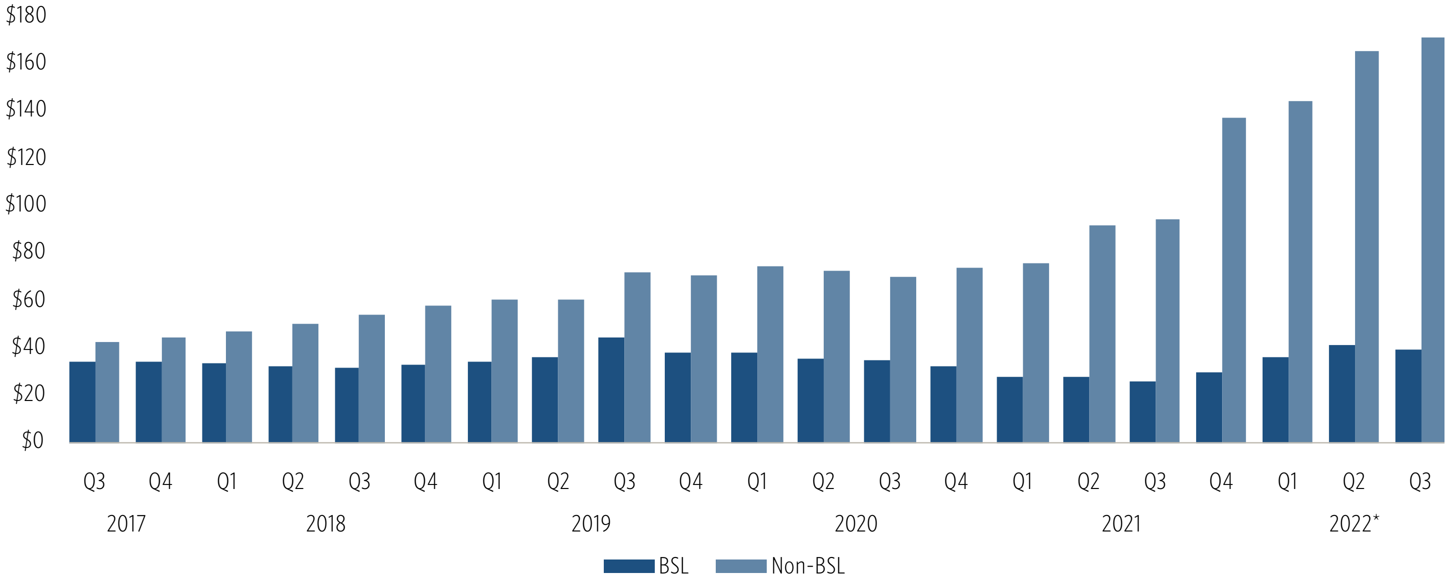
Source: PitchBook | **Geography:** Global
*As of December 31, 2022

SPOTLIGHT

Private credit growth marched on in Q3, taking more BSL share

BDC par amount: BSL versus non-BSL ($B)

US BDCs increasingly originate their own loans instead of buying syndicated loans



Sources: PitchBook and LCD | **Geography:** US
*As of September 30, 2022

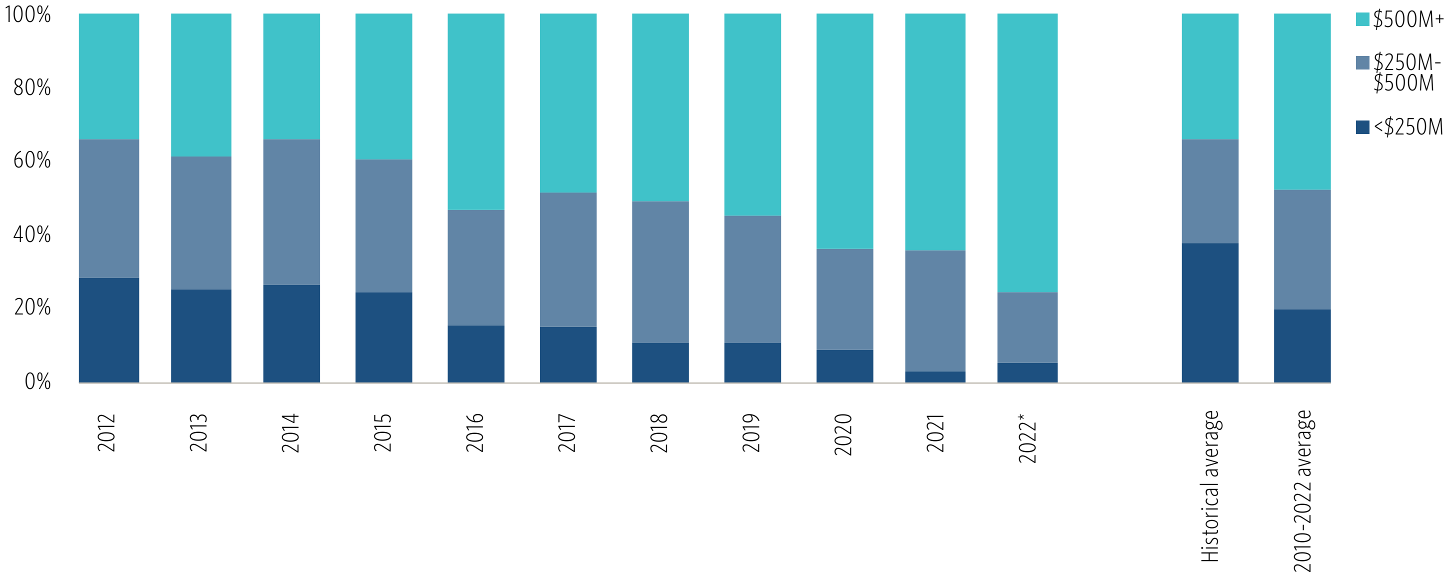
Abby Latour
Editorial Lead, LCD

Private credit loans took an increasing share of investment portfolios of business development companies (BDCs) in the third quarter of 2022, nearly doubling their share since the outbreak of the COVID-19 pandemic, LCD data shows. This gain came at the expense of BSL investments. The data illustrates the continuation of a prolonged trend, coinciding with the growth of the private credit market generally.

The trend accelerated during the pandemic and during the market volatility that began in Q1 2022 on the back of rising interest rates and Russia's invasion of Ukraine. During those periods, syndicated loan new issuance declined precipitously, ceding market share to private credit. Private credit providers initially started taking deals from the smaller end of the market before moving upmarket to larger deals.

Share of BSL market by institutional deal size bucket

The syndicated loans that BDCs do own are rapidly growing in size, suggesting the same for their direct lending portfolio



Sources: PitchBook and LCD | **Geography:** US
*As of December 31, 2022
Note: Chart excludes add-ons, repricings, and second liens.

In 2021 to 2022, private credit providers all but cornered the market for large buyouts, deals that traditionally would have been done in the syndicated loan market. Private credit also likely took transactions that would have been done in the high-yield bond market.

LCD tracks investment portfolios of 77 BDCs, an increase of five since Q2 2022. BDC holdings, while only a portion of the total debt market, are a lens into the private credit market, an opaque corner of credit. Private credit providers typically allocate loan holdings across entities such as BDCs, private funds, collateralized loan obligations (CLOs), and separately managed accounts. BDCs may be the only one of these entities with public reporting obligations. For lenders, they can provide reliable access to public capital markets.

As the overall credit market has grown, so has debt in BDCs. The total volume of loans in BDC portfolios grew to $210.7 billion in Q3 2022 from $109.0 billion at year-end 2019, an increase of 92.2%. For comparison, the size of the syndicated loan market, as tracked by the Morningstar LSTA US Leveraged Loan Index, grew by 16.0% over roughly the same period, to $1.4 trillion as of year-end 2022.

In another measure of increased preference of private credit by borrower companies, the total number of issuers held by BDCs has climbed to 5,686, a 29.0% increase. In the syndicated loan space, issuer count remained steady, based on the Morningstar LSTA US Leveraged Loan Index. Due to significant fundraising in recent years, private credit providers have been ready to step in with loans for a full range of uses, including for buyouts and M&A.

Yields initially remained competitive with pre-pandemic levels as lenders piled in for the most attractive borrowers. However, spreads on private credit loans have widened since then, particularly in the second half of 2022. Hold sizes have also shrunk. Private credit lenders had been willing to provide ever-larger loans, but now more lenders are needed to close a deal.

Despite this increased risk aversion, private credit activity remained active, although at lower levels than in late 2021, when many firms experienced record deal volumes. By count, LBOs completed via the private credit sector have far exceeded transactions done with syndicated loans.

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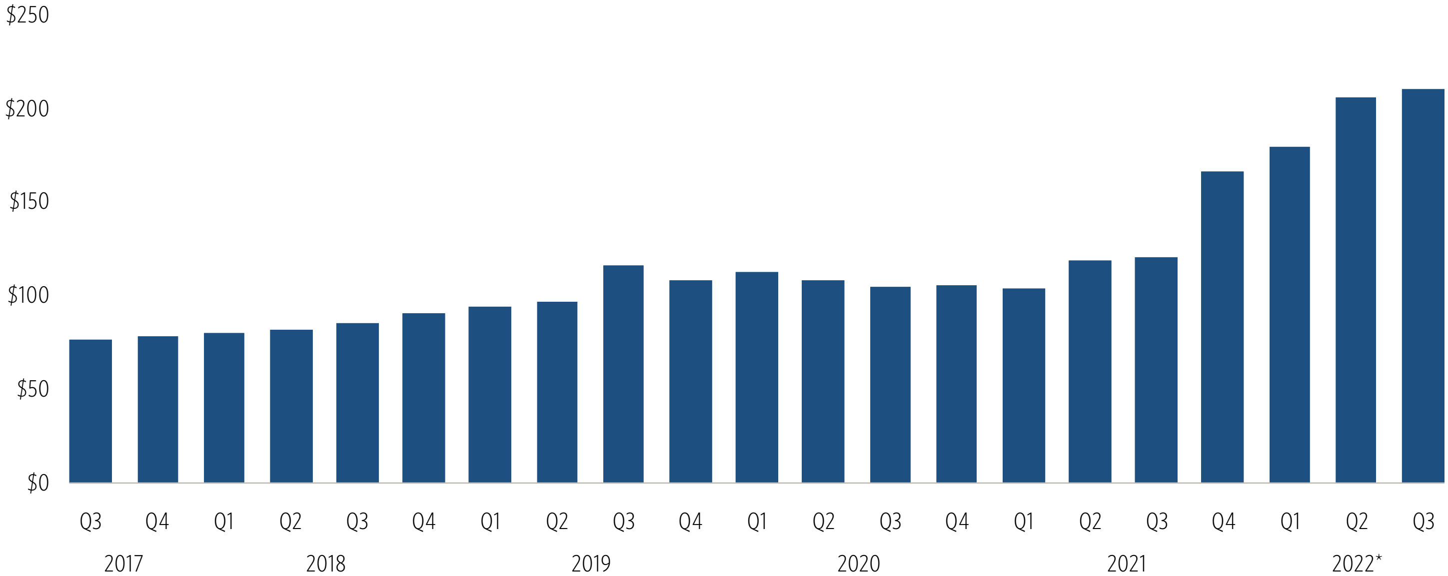
Total par amount of debt in BDCs ($B)

Since 2019, BDC portfolios have nearly doubled in size to $210.7 billion, far outstripping growth in the BSL market



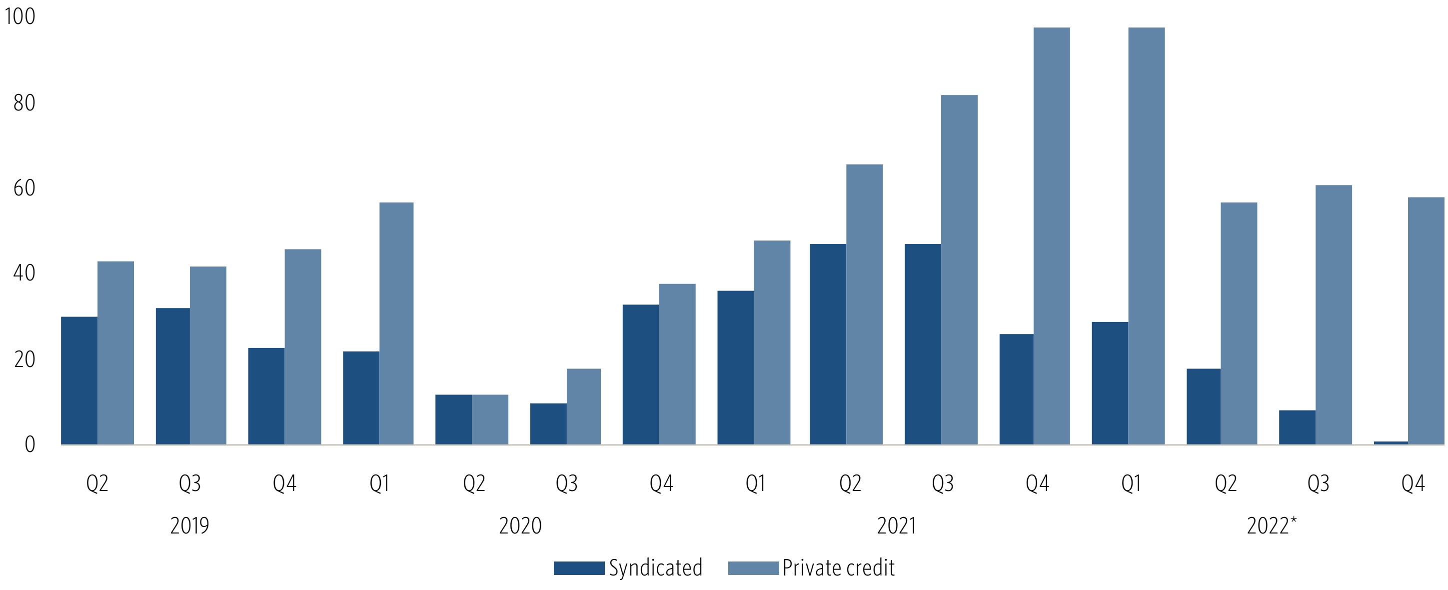
Sources: PitchBook and LCD | **Geography:** US
*As of September 30, 2022

Private credit providers have championed the unitranche loan, arguing the simplified structure was more efficient than a complex structure typically available in the syndicated loan market with senior and junior tranches.

Another appeal of private credit is the recurring revenue structure. Private credit providers have been willing to underwrite loans based in recurring revenue, rather than EBITDA. This has been particularly useful to pre-EBITDA borrowers in growth mode. In contrast, recurring revenue loans have not traditionally been available in the syndicated loan market.

Count of LBOs financed in BSL versus private credit markets

Direct lending is the only game in town as of Q4 2022

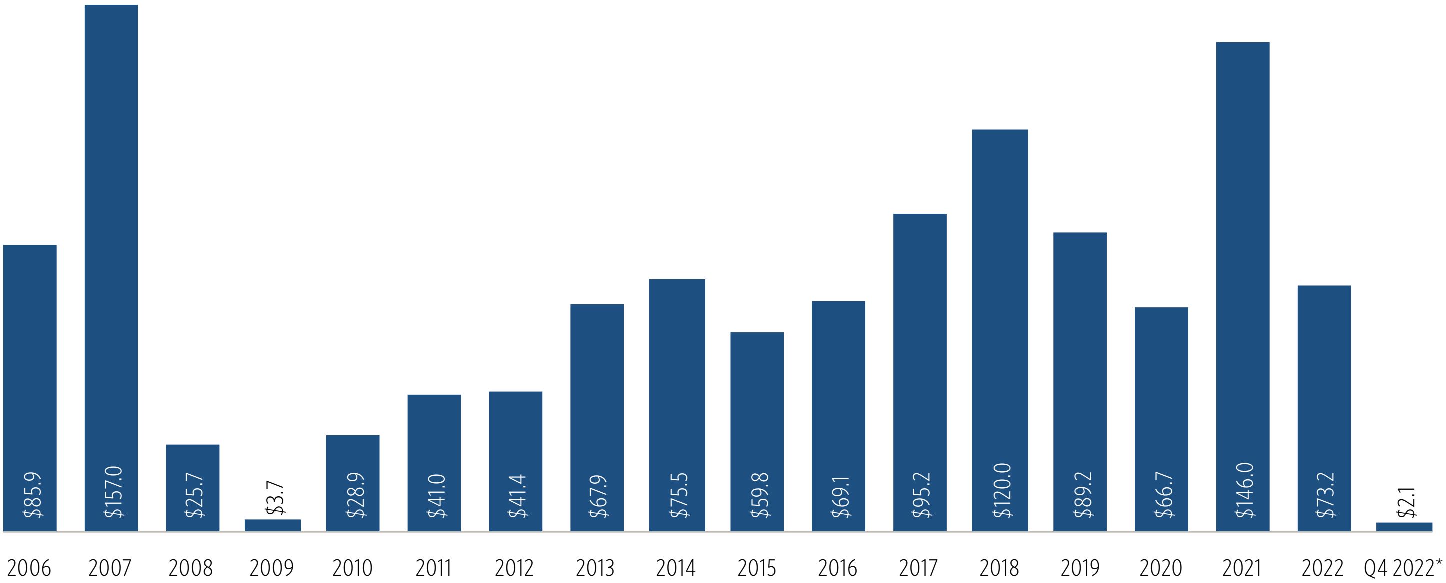


Sources: PitchBook and LCD | **Geography:** US
*As of December 31, 2022
Note: Private credit count is based on transactions covered by LCD News.

LBO and leveraged loan update

New-issue LBO loan volume ($B)

Bank-led syndicated loans backing LBOs fall back to 2009 levels



Sources: PitchBook and LCD | **Geography:** US
*As of December 31, 2022

The LBO has been the main stock-in-trade of the PE industry for generating outsized returns to investors. However, it was dealt a serious blow when the Federal Reserve embarked upon one of fastest tightening cycles in more than 40 years, which was concentrated in the back half of 2022. This turned off the spigot of what had become the main vehicle for financing LBOs: the bank-led leveraged loan market. That market was on a tear in 2021, setting a 14-year high for US loan volume backing LBO deals at $146.0 billion. However, the market came to a virtual standstill in H2 2022, with just $13.2 billion in US LBO-related volume, down 80.2% YoY.

Direct lenders that had spent the last several years amassing capital in the form of business development companies and private debt funds moved in to fill the void. Many involve the same sponsors that are leading these buyouts on the equity side of the capital structure. These funds have been taking share of the LBO lending market ever since. At the same time, banks have been busy offloading old loans, or the so-called "hung" deals, hampering new commitments. This can best be seen in the flow of large LBOs of public companies. Of the 28 take-privates announced since early June 2022 in the US and Europe, totaling more than $54.0 billion in aggregate value, not a single deal that we know of has been funded by banks; they are relying instead on private debt funds or all-equity structures.

That said, the leveraged loan market is showing signs of life. Secondary prices jumped by 2.7% in January 2023, its strongest start to a year since 2009. Strong market gains usually stimulates primary activity. Should that occur, it will eventually translate to more competition for private funds. But for the time being, they are in a very enviable position.

Public-to-private LBOs announced in H2 2022*

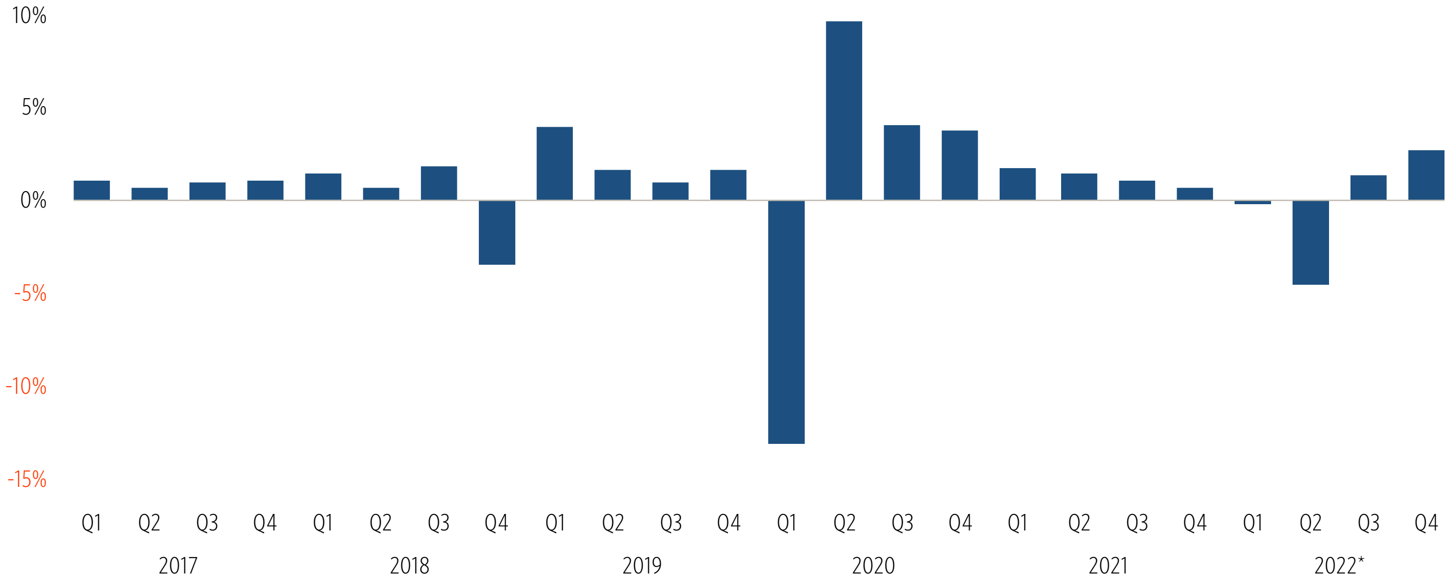
Banks were closed for LBO business in the back half of the year

Company	Announced date (2022)	Loan type	% discount 52-week high
Trean Insurance Group	December 15	Nonbank	-35.1%
Maxar Technologies	December 14	Private debt	30.9%
Coupa	December 12	Private debt	-51.3%
UserTesting	October 27	Equity only	-53.1%
Weber Inc.	October 24	Private debt	-54.0%
AgroFresh Solutions	October 24	Private debt	28.8%
KnowBe4	October 12	Private debt	-15.6%
ForgeRock	October 11	Equity only	-35.4%
Billtrust	September 28	Private debt	-13.7%
Semcon	September 26	Nonbank	-6.4%
ChannelAdvisor	September 4	Private debt	-21.5%
Computer Services	August 20	Nonbank	-4.9%
Ted Baker	August 16	Nonbank	-28.2%
Avalara	August 8	Private debt	-51.2%
Atlas Air Worldwide	August 4	Private debt	2.6%
Ping Identity	August 2	Private debt	-5.8%
Bobst Group	July 25	Nonbank	-25.0%
Hanger	July 21	Private debt	-26.3%
Sharps Compliance	July 12	Private debt	-16.4%
Prima Industrie	July 10	Nonbank	-3.9%
Oncodesign Services	July 10	Nonbank	15.2%
Median			**-16.4%**

Sources: PitchBook and LCD | **Geography:** North America and Europe
*As of December 31, 2022
Note: This table includes only deals of $100 million or more. "Nonbank" indicates deals using private debt or all-equity structures or those not broadly syndicated by banks.

US leveraged loans quarterly returns

A quick snapback in the liquid leveraged loan market would likely diminish flows to private credit

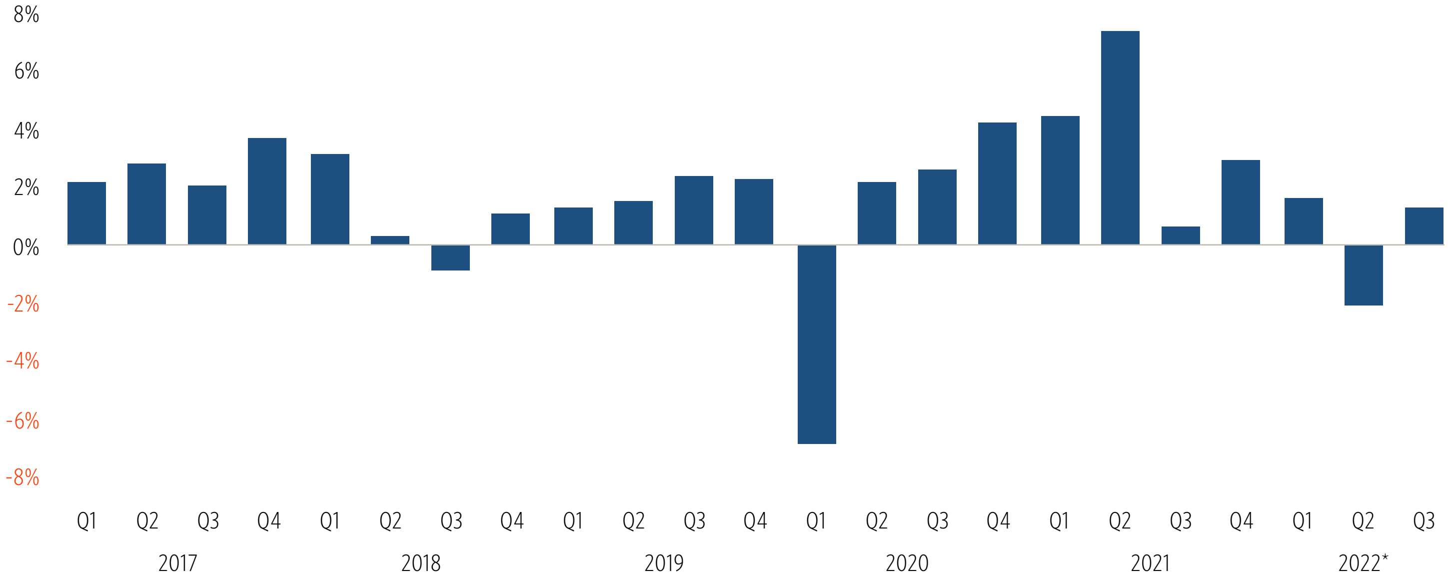


Sources: PitchBook, LCD, Morningstar | **Geography:** US
*As of December 31, 2022

Private debt fund performance

Private debt funds quarterly IRR

Private debt returns rebounded in Q3 2022



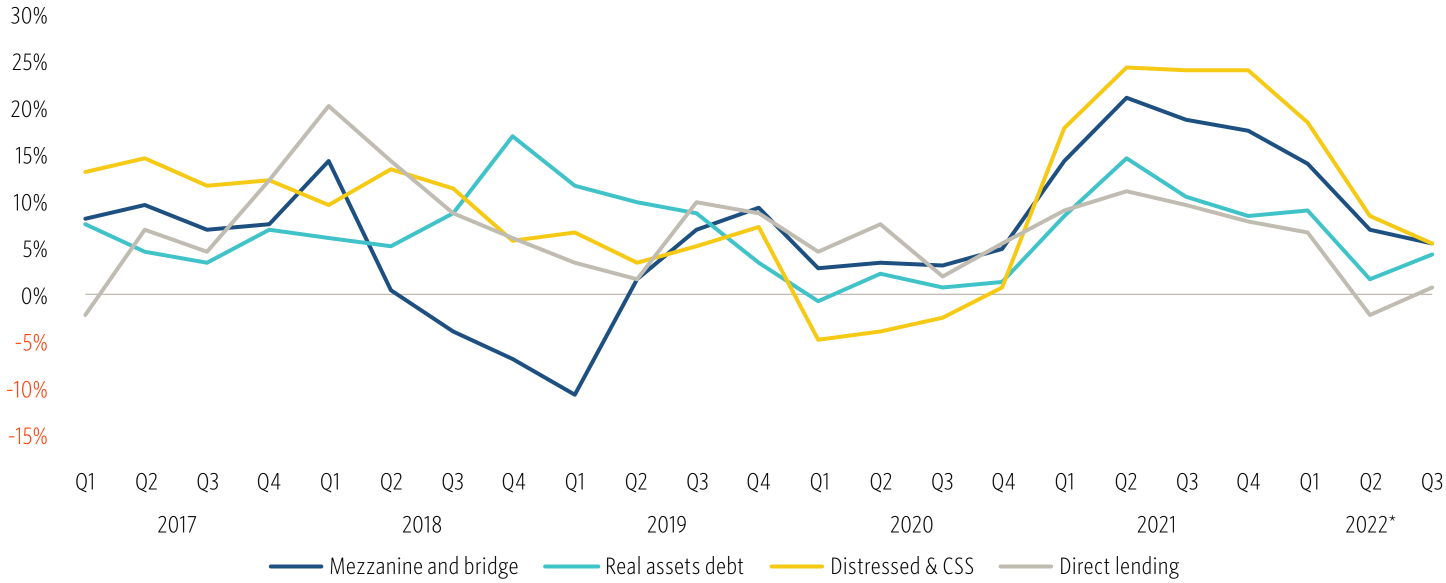
Source: PitchBook | **Geography:** Global
*As of September 30, 2022

Q2 2022 private debt performance came in at -2.0%. This was the first quarter of negative returns for the strategy since the global COVID-19 pandemic lockdown in Q1 2020. The culprit this time was the Federal Reserve shifting into high gear with interest rate hikes to combat inflation, which sent all fixed income assets tumbling.

Our preliminary data for Q3 2022 points to a rebound of 1.3%, which is below private debt's median quarterly return of 2.2% but enough to rank it as the third-best performer relative to other private market strategies. Ranking toward the top of the private markets league table is unfamiliar territory for private debt, which has lagged its equity alternatives for most time periods. The setup for private debt, however, is promising going forward. Since mid-2022, sourcing debt via public markets has been highly constrained—particularly the syndicated loan market that PE has used for years to back large LBO deals. Private debt has almost entirely replaced the traditional lending markets for originating these loans. This could reverse in the short term. Longer term, market participants expect private debt to take permanent market share from banks.

Private debt rolling one-year horizon IRR by type

One-year returns stay positive despite the rout in public markets



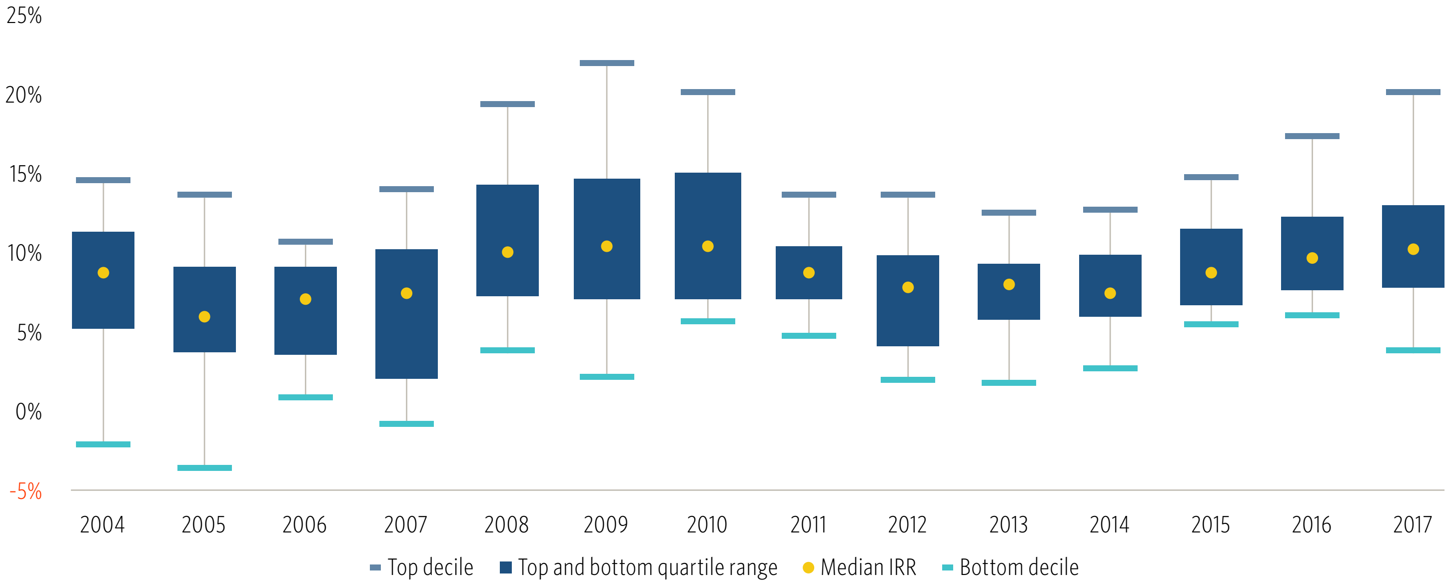
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

The floating-rate nature of the loans provided by direct lending funds is an appealing feature, attracting new investors in a rising-interest-rate environment and boosting returns relative to fixed-rate alternatives. Yields averaged 9.9% in the syndicated LBO market during Q3 2022 and pushed even higher in Q4 on loans that attempted to go to the market. Direct lending funds are fetching similar or higher yields on new loans, resulting in double-digit current cash flow to LPs in many instances.

The primary risk to future returns—as was discovered during the -6.8% return delivered by private debt during the pandemic-induced correction of Q1 2020—is that valuations can go down even when interest rates are falling, largely because of declining credit quality and increasing loan defaults. LCD research shows that credit default ratios have stayed low and stable, but to some extent, the leveraged loan market has been able to push the day of reckoning via "amend and extend" transactions, reducing the so-called "maturity wall" in 2023 by 68%. A high prevalence of covenant-lite loans has also served to dampen loan defaults. So, it may be a while before we see a material rise in credit defaults, but the metric bears close scrutiny while collecting those higher yields.

Private debt dispersion by vintage year*

Newer funds doing better than older funds, with dispersion weighted to the upside



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Fund type definitions

Direct lending: Generally senior loans made to middle-market companies without the use of an intermediary but may include revolving credit lines and second lien loans. Unitranche facilities, which combine different debt instruments under a single umbrella, are also becoming more common.

Real estate debt: The most common real estate debt strategy is direct lending for real estate acquisitions but may also include the buying and selling of securitized real estate loans in the secondary market. Risk profiles vary based on the nature of the underlying assets.

Infrastructure debt: Debt used for infrastructure development (for example, greenfield) and investment in existing assets (for example, brownfield), generally with longer terms (30+ years) due to the extended useful life of the assets.

Mezzanine: Subordinated debt, generally with features similar to preferred equity, such as warrants. Often used in LBO transactions.

Special situations: Debt or structured equity investments (such as convertible debt, convertible preferred, and debt with warrants) made with the intent of gaining control of a company, generally one in some type of financial distress. Special situations can include trading in the secondary market, direct origination, or distressed debt in which the manager believes price dislocation is present.

Distressed debt: This debt type differs from special situations in that it generally involves the purchase of securities in the secondary market, rather than new origination of debt or structured equity. Distressed strategies likely involve identification of the "fulcrum" security, or the most subordinated part of the capital stack to be paid back in a bankruptcy or other restructuring, which can trade at steep discounts to net asset value.

Venture debt: Debt financing extended to companies with VC backing. For entrepreneurs, venture debt serves as a way to extend the runway to exit without further diluting ownership.

Bridge financing: Private debt funds that provide short-term loans, also called swing loans, made in anticipation of intermediate-term or long-term financing.

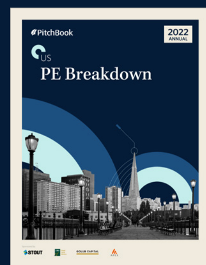
General debt: General-purpose private debt funds with broad mandates to invest across the debt capital structure, substrategies, and verticals in order to capture the entire private debt opportunity set.

Additional research

Private markets

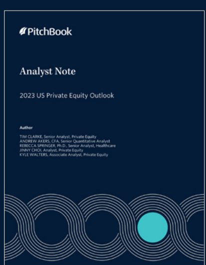
2022 Annual Global Private Fundraising Report

Download the report here



2022 Annual US PE Breakdown

Download the report here



2022 US Private Equity Outlook

Download the report here

Q3 Middle Market Lending League Table

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