PitchBook

2023 ANNUAL

GLOBAL Private Debt Report

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AMERICAN INVESTMENT COUNCIL

Contents

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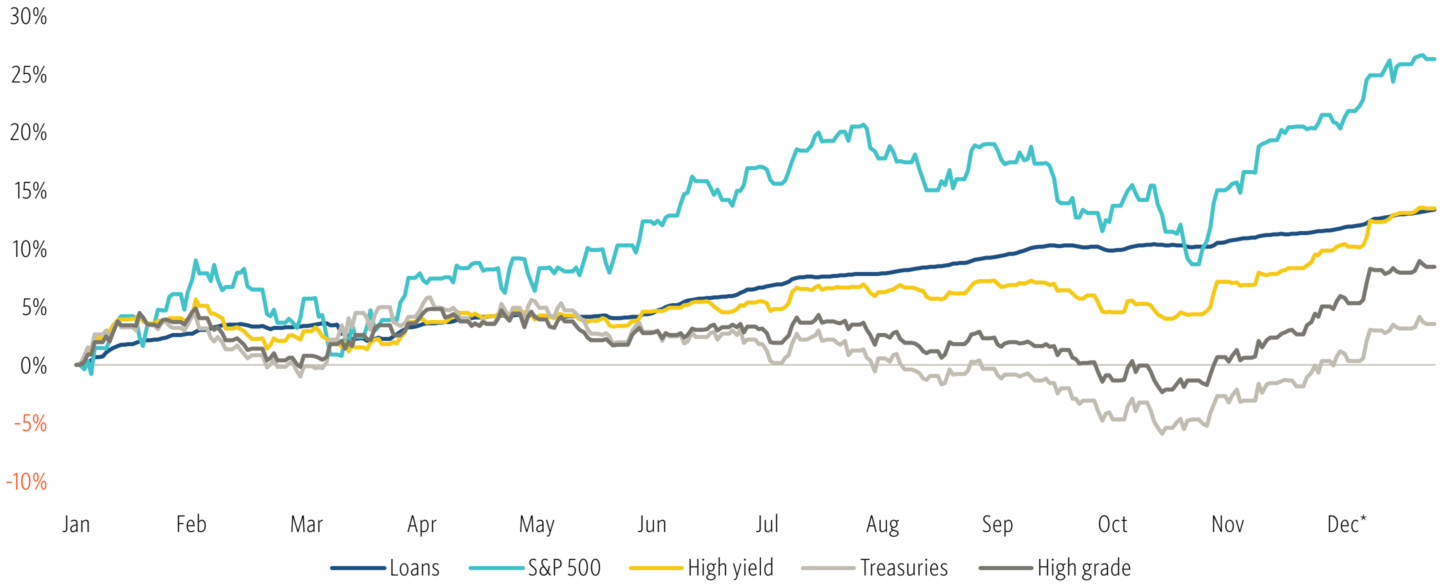
Key takeaways

2023 returns by asset class

Loans trail stocks but continue to outperform bonds



Sources: PitchBook | LCD; Morningstar; S&P Dow Jones Indexes • Geography: US • *As of December 31, 2023

It was an exceptionally strong year for private debt fund performance and its primary underlying asset class, floating-rate corporate loans. As measured by the US Morningstar LSTA Index, leveraged loans gained 13.3% for the year, and the European equivalent was almost identical at +13.4%. This was the highest annual reading of the US index since the global financial crisis and the second-strongest return ever. Through Q3 2023, our estimate of one-year horizon returns for private debt funds globally was 8.2%, the second-highest return of all asset classes within private markets.

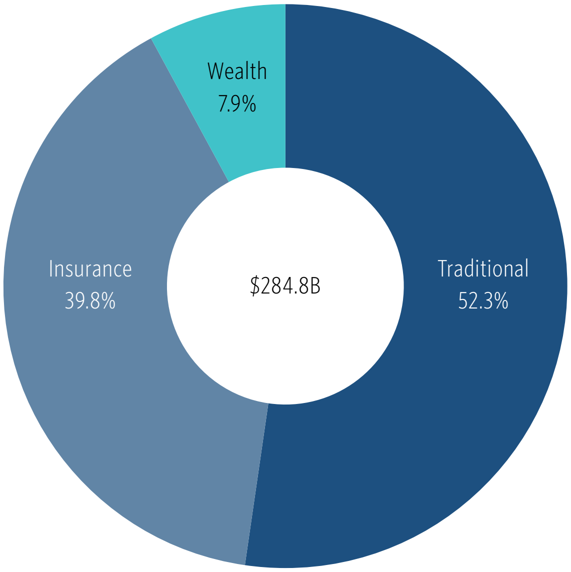
Private debt fundraising momentum in the traditional institutional channel slowed in H2. Demand was undoubtedly siphoned off by a rebound in more liquid alternatives with comparable yields. During H2, an estimated $76.7 billion in committed capital was closed in private debt funds, down from an estimated $112.6 billion in H1 2023. When the dust finally settles, we expect the total haul for 2023 will likely exceed $200 billion for the fourth consecutive year. Private debt is now the second-largest private market strategy by annual fundraising, having overtaken venture capital.

As the traditional channel slowed, fundraising for private credit strategies from nontraditional vehicles and sources, such as semiliquid funds for retail and separately managed accounts for insurers, picked up steam in H2. These inflows run outside of the universe that we track, but in the case of the seven largest managers that trade publicly, they account for nearly half of all fundraising for credit strategies. These are new addressable investor markets that these larger managers are doing a good job penetrating. There was also an unexpected wave of fundraising for BDCs that completed IPOs.

Direct lending continues to be the preferred substrategy in private debt and accounted for 31.8% of the overall mix of funds closed in 2023, with mezzanine and infrastructure debt recording the greatest gains on a relative basis. Similar to the trend in private debt's investor base, the product set is also diversifying. Private debt is broadening well beyond its traditional roots in direct lending and distressed investing to encompass new opportunity sets in investment grade. Asset-backed finance is the next frontier that private credit managers are pursuing, picking up share from banks as they are forced to give ground.

2023 share of credit capital raised by top seven public US alternative asset managers by channel*

Retail and insurance investors account for nearly half of all credit fundraising at the top seven US-listed alternative asset managers



Sources: PitchBook, company reports • Geography: Global • *As of December 31, 2023

Completed IPOs and direct listings of business development companies (BDCs) in 2024 YTD*

In a role reversal, there are more private credit IPOs this year than private equity IPOs

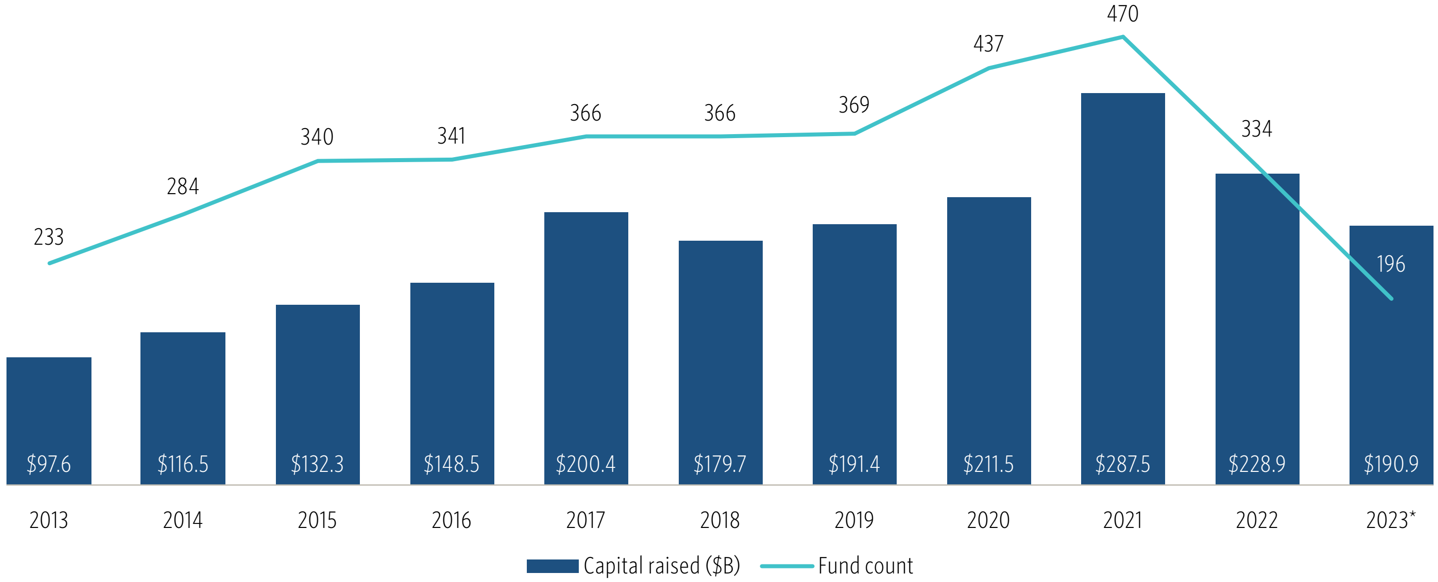
Fund	IPO/listing date	Proceeds ($M)	Market cap ($M)	Net asset value ($M)
Blue Owl Capital Corporation III	January 25	N/A	$1,840.8	$1,915.9
Nuveen Churchill Direct Lending	January 24	$99.3	$935.3	$1,004.3
Morgan Stanley Direct Lending	January 23	$103.4	$1,732.9	$1,816.8
Palmer Square Capital BDC	January 17	$89.7	$529.3	$535.5

Sources: PitchBook, company reports • Geography: Global • *As of February 29, 2024

Fundraising and dry powder

Private debt fundraising activity

When the dust finally settles, institutional flows to private debt funds will likely exceed $200 billion for the fourth consecutive year



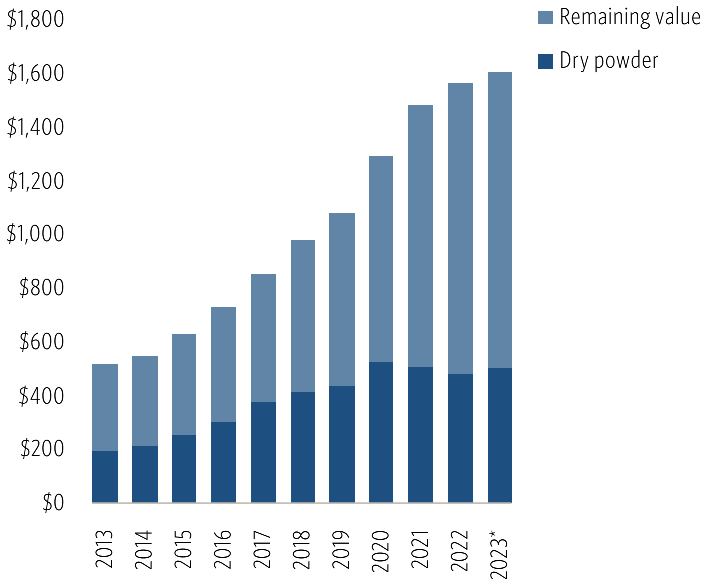
Source: PitchBook • Geography: Global • *As of December 31, 2023

In the private debt space, institutional funds closed on an estimated $76.7 billion in total committed capital in the second half of 2023, a sharp slowdown from the first six months of the year when closings totaled an estimated $112.6 billion. 2023 had been on track for the fourth consecutive year of $200 billion or more in global private debt fundraising. We think we will still get there, as late reporting funds will often trickle in on a lag basis, causing upward restatements. Even factoring that in, we expect the year to be flat at best and more likely down by 10% once the data fully settles.

Still, $200 billion in capital raised is substantial. Private debt has overtaken venture capital as the highest fundraising strategy in private capital markets, second only to private equity. Outside of the traditional complex of institutional drawdown funds, there is reason to believe that fundraising was materially higher. Semiliquid funds for retail and separately managed accounts for insurers accounted for one-third of gross inflows at the top seven US-listed private market managers and nearly half of all fundraising for credit. We are even seeing new life in the universe of publicly traded BDCs, thanks to the flurry of new public offerings. In quite the plot twist, there were many more private credit IPOs in 2023 than private equity IPOs. Including these new channels and vehicles, fundraising for private debt was alive and well heading into 2024.

Private debt institutional fund AUM and dry powder ($B)

Institutional AUM exceeds $1.6 trillion with $506.2 billion in dry powder



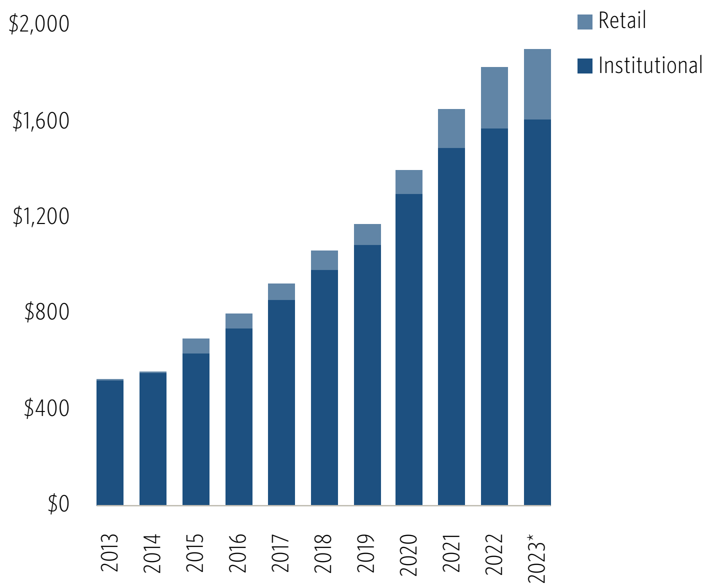
Source: PitchBook • Geography: Global • *As of June 30, 2023

The H2 dip can be attributed in part to large funds staying open for longer. Whereas the average time to close a debt fund was just 13.5 months in 2016, it stretched to 20 months in 2023. Additionally, there is a much larger crop of megafunds that have stayed open and rolled into the new calendar year than during prior years. That cohort includes two large direct lending funds—Ares Capital Europe VI in Europe and Blackstone Senior Direct Lending in the US—that have nearly reached or surpassed the $10 billion mark. Collectively, the top 10 open funds rolling into 2024 have already raised $62.8 billion, more than three times that of the top 10 open funds that rolled from 2022 to 2023. Many of these rollover funds will likely close in the next few months and boost the recorded H1 2024 fundraising totals.

As with other strategies, in 2023, more experienced managers crowded out emerging managers, which we define as those with three or fewer funds to their name. The share of fundraising by emerging managers bounced from an anemic 7.6% in 2022 to approximately 10.1% in 2023. Experienced managers ran away with market share in 2022 as their larger platforms were better positioned to capture the sudden spike in demand arising from higher interest rates. While emerging managers regained some lost ground in 2023, the share of fundraising is well off the high-water mark of 19.0% coming out of the onset of the pandemic in 2020. First-time managers fared a bit better but are unlikely to amount to more than 5% of share. While there has been a large influx of new managers chasing robust demand for floating-rate product, we have not yet seen a material change in whom that money is flowing to.

Private debt institutional and retail fund AUM ($B)

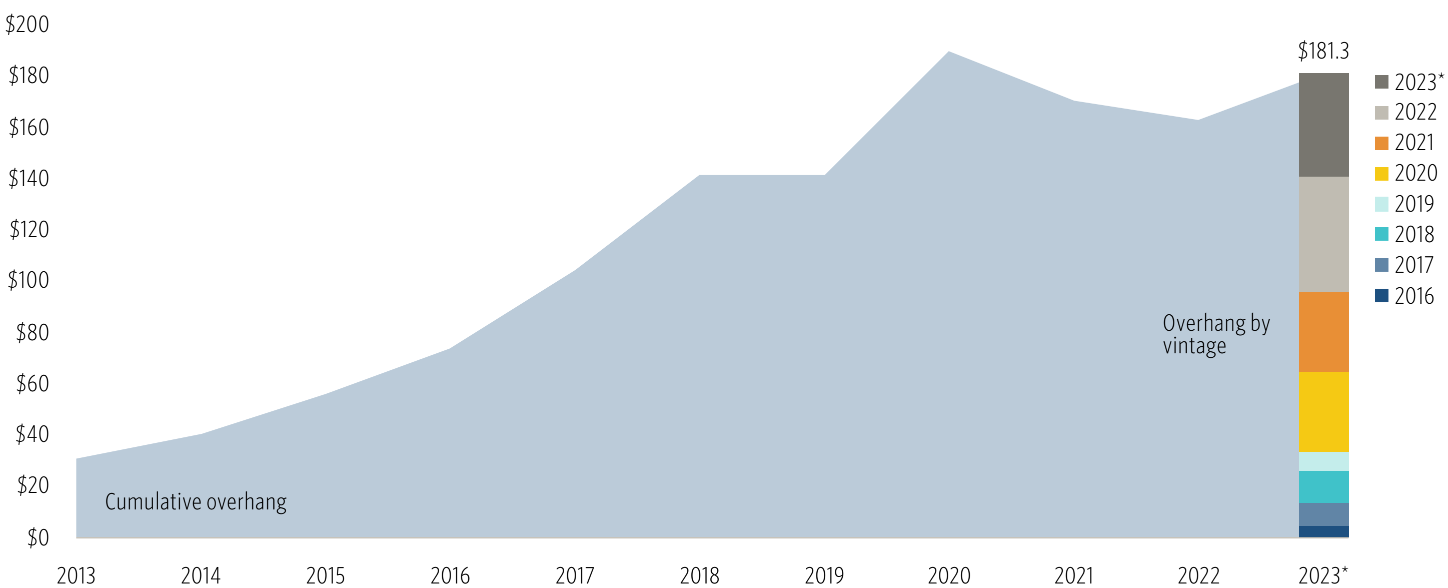
Private debt AUM approaches $1.9 trillion inclusive of nontraded BDCs, interval funds, and other retail-oriented vehicles



Sources: PitchBook, company reports • Geography: Global • *As of June 30, 2023

Direct lending dry powder ($B) by vintage

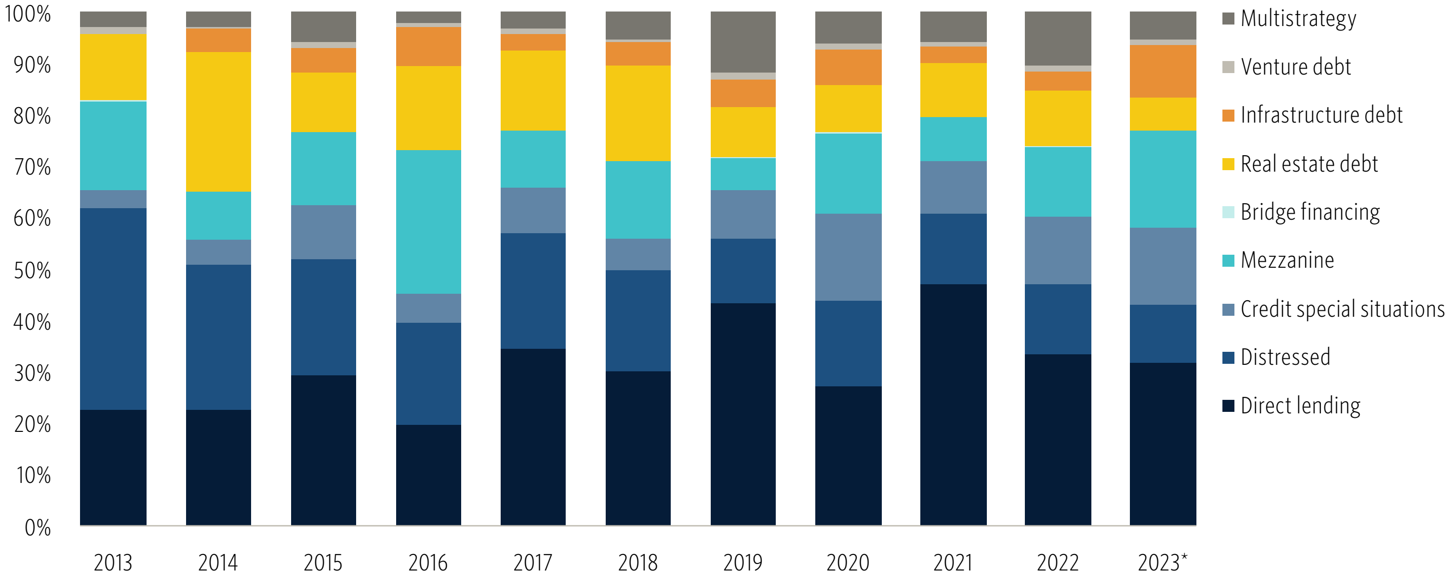
The $181.3 billion in direct lending dry powder filled the void left by an inactive syndicated loan market



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

Share of private debt capital raised by strategy

Direct lending leads, while mezzanine and infrastructure gained the most share



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

Private debt AUM crossed the $1.6 trillion mark as of Q2 2023 and landed just shy of $1.9 trillion inclusive of semiliquid funds for the retail channel. Looking at just institutional drawdown funds, growth has been most explosive in direct lending, private debt's largest substrategy, which surpassed $540 billion in AUM in 2023, up from $70.8 billion 10 years ago. That is a CAGR of 22.7% versus 10.6% for PE AUM growth during the same span. Some observers fear that is too far too fast. However, absolute AUM in PE still far exceeds that of direct lending at $5.2 trillion and $546.9 billion, respectively. This implies ample opportunity for private debt funds to grow into the PE footprint, especially as the bank-led market for sourcing debt continues to contract.

Fundraising for retail-oriented vehicles such as nontraded BDCs, interval funds, and tender-offer funds picked up in H2. An estimated $29.7 billion in retail capital was reportedly raised by private debt sponsors in H2 2023, reaccelerating from H1 2023 fundraising of $17.1 billion. An estimated $46.8 billion was raised for credit strategies from these vehicles in 2023, down 9.4% from 2022. Nontraded BDCs took over as the top-selling category among alternative investments in 2023 in the retail channel, eclipsing nontraded REITs, which saw fundraising plummet.

At 31.8%, direct lending held on to its position as the top fundraising substrategy within private debt. However, it has edged lower over the last two years as the asset class continues to diversify. As recently as 2021, direct lending accounted for nearly half of all fundraising for private debt. Now, other strategies are coming on strong, most notably mezzanine and infrastructure debt.

Mezzanine funds have responded to the unmet need for subordinated debt. Mezzanine's junior position in the capital structure means that it does not count against limits on senior loan ratios—an appealing option for borrowers that need an extra turn of leverage. Additionally, mezzanine lenders are more comfortable with paid-in-kind structures—a popular feature in today's market in order to conserve cash flow. Despite this high demand, supply is constrained. 2023 marked the first year in 20 that second-lien loans were completely absent from the US leveraged finance market.

$36.1 billion in committed capital was closed for mezzanine funds in 2023, up 16.5% from 2022. Mezzanine claimed the top three spots of 2023, including the eight flagships of Crescent Capital and Goldman Sachs under the West Street brand and HPS Investment's fifth flagship fund.

Infrastructure debt fundraising more than doubled from 2022, with eight fund closings in 2023, including two of the top 10 private debt funds on the year. In August 2023, Blackstone announced the final close of Blackstone Green Private Credit Fund III at $7.1 billion, making it the largest energy transition private credit fund ever raised. In November 2023, Brookfield announced the closing of its global infrastructure debt program, Brookfield Infrastructure Debt Fund III, for $6.0 billion.

Largest private debt institutional funds closed in 2023*

Mezzanine takes the top three slots as private debt megafunds diversify beyond direct lending

Fund	Fund size ($B)	Fund type	Strategy	Fund HQ
HPS Strategic Investment Partners V	$12.0	Closed-end	Mezzanine	New York, US
West Street Mezzanine Partners VIII	$11.7	Closed-end	Mezzanine	New York, US
Crescent Credit Solutions VIII	$8.0	Closed-end	Mezzanine	Los Angeles, US
HPS Core Senior Lending II	$7.3	Closed-end	Direct lending	New York, US
Blackstone Green Private Credit III	$7.1	Closed-end	Infrastructure debt	New York, US
Ares Pathfinder II	$6.6	Closed-end	Credit special situations	Los Angeles, US
Hayfin Direct Lending IV	$6.4	Closed-end	Direct lending	London, UK
Antares Senior Loan II	$6.0	Closed-end	Direct lending	Chicago, US
Brookfield Infrastructure Debt III	$6.0	Closed-end	Infrastructure debt	Toronto, Canada
Permira Credit Solutions V	$4.5	Closed-end	Direct lending	London, UK

Source: PitchBook • Geography: Global • *As of December 31, 2023
Note: Fund size represents total committed capital.

Rounding out the top five was HPS Core Senior Lending Fund II, the year's largest direct lending fund, at $7.3 billion in equity capital raised plus another $2.7 billion in debt capital raised for a total of $10 billion in investable capital. The fund will be global in scope and has already deployed 57% of its capital across 54 investments. Direct lending is still in high demand by private equity sponsors, which saw access to senior-secured loans significantly curtailed in 2023, even in the unitranche space.

Pure distressed strategies have tailed off again, garnering an 11.2% share of fundraising in 2023, more than four points below their five-year average of 15.3%. However, their close cousin, special credit situations, saw elevated fundraising at 15.0% of the total. This strategy provides structured debt and structured equity alternatives, which are also gaining popularity among borrowers. Lastly, real estate debt fundraising declined by 50.3% to $12.4 billion, its lowest level in 10 years, as storm clouds gathered over the commercial real estate market and investors shied away.

In a newer strategy development, private debt sponsors are increasingly taking aim at asset-backed finance (ABF), another lending market traditionally dominated by banks with addressable market estimates ranging between $5 trillion and $20 trillion. Just as they have done in a disrupted leveraged loan market, nonbanks are looking to take share of the ABF market. These are loans collateralized by cash flows from both real assets and financial assets such as receivables. Some are repackaged and offloaded into securitized instruments by investment banks, while others are simply originated and held on the balance sheets of commercial banks such as equipment finance and commercial real estate loans. What they all have in common is a financial intermediary or lender, namely banks, that needs to free up regulatory capital to comply with tougher rules in the wake of Silicon Valley Bank and Basel III.

With $45 billion of its $78 billion in private credit AUM tied to asset-backed finance, KKR positions itself as the current leader in the ABF space. The firm has deployed $6 billion across 54 investments since 2016 and seeks to leverage that experience.[1] In July 2023, it announced the final closing of KKR Asset-Based Finance Partners, the firm's first asset-based finance fund, which raised $2.1 billion in capital. The firm also expects to launch a new nontraded BDC later in 2024, which will focus on ABF and direct corporate lending.[2]

Other major alternative asset managers have launched new strategies or funds targeting the ABF space. In July 2023, Angelo Gordon, now part of TPG, closed on $1 billion of commitments for its AG Asset Based Credit Fund, exceeding its $800 million target. The firm reported it was 60% deployed as of year's end and that it expects to scale over

1: "KKR Closes $2.1 Billion Asset-Based Finance Fund," Business Wire, July 13, 2022.
2: "KKR & Co. Inc. Second Quarter 2023 Earnings," KKR, August 7, 2023.

Largest nontraded BDCs and private debt interval funds offered in 2023*

New breed of retail-oriented vehicles has allowed private debt sponsors to gather an additional $300 billion in AUM since 2020

Fund	Net assets ($B)	Fund type	Strategy	Fund HQ
Blackstone Private Credit	$26.1	Nontraded BDC	Direct lending	New York, NY
Cliffwater Corporate Lending	$13.9	Interval fund	Direct lending	Marina del Rey, CA
HPS Corporate Lending	$4.6	Nontraded BDC	Direct lending	New York, NY
Blue Owl Technology Finance	$3.5	Nontraded BDC	Direct lending	New York, NY
Apollo Debt Solutions BDC	$3.2	Nontraded BDC	Direct lending	New York, NY
Variant Alternative Income	$3.0	Interval fund	Multistrategy	Portland, OR
Cion Ares Diversified Credit	$2.9	Interval fund	Multistrategy	New York, NY
PIMCO Flexible Credit Income	$2.8	Interval fund	Multistrategy	New York, NY
Cliffwater Enhanced Lending	$2.2	Interval fund	Direct lending	Marina del Rey, CA
Stone Ridge Trust V	$1.9	Interval fund	Multistrategy	New York, NY

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

time.[3] Apollo is believed to be preparing to launch its own ABF fund targeting $5 billion in capital. Carlyle recently formed its Credit Strategic Solutions strategy and fund to focus on ABF, followed by a $450 million student loan portfolio in January 2024.

Some of these activities run outside of funds and are structured as partnerships with banks or other investors to provide asset management expertise, while others involve outright portfolio sales with funds as buyers. In June 2023, Ares acquired a specialty-finance loan portfolio from PacWest Bancorp consisting of senior-secured asset-backed loans with $3.5 billion in commitments and $2.1 billion in funded investments. The portfolio will be allocated among various funds within Ares' Alternative Credit segment.

In December, Blackstone and some of its funds entered into a joint venture with CPP Investments and Rialto Capital to acquire a $17 billion portfolio of commercial real estate loans held in FDIC receivership from the failure of Signature Bank in 2023.[4] The transaction resulted in a $10 billion gross inflow to Blackstone's asset management business in Q4 and deployment opportunities for BREIT and its latest real estate debt flagship, BCRED V, which is in the market targeting $8 billion in investor capital. More recently, Blackstone announced a forward sale with Barclays that offloads a $1.1 billion portfolio of credit card receivables.[5] The agreement, entered into on behalf of insurance clients managed by Blackstone's Asset Based Finance group, will reduce Barclays' risk-weighted assets for its US-regulated entity.

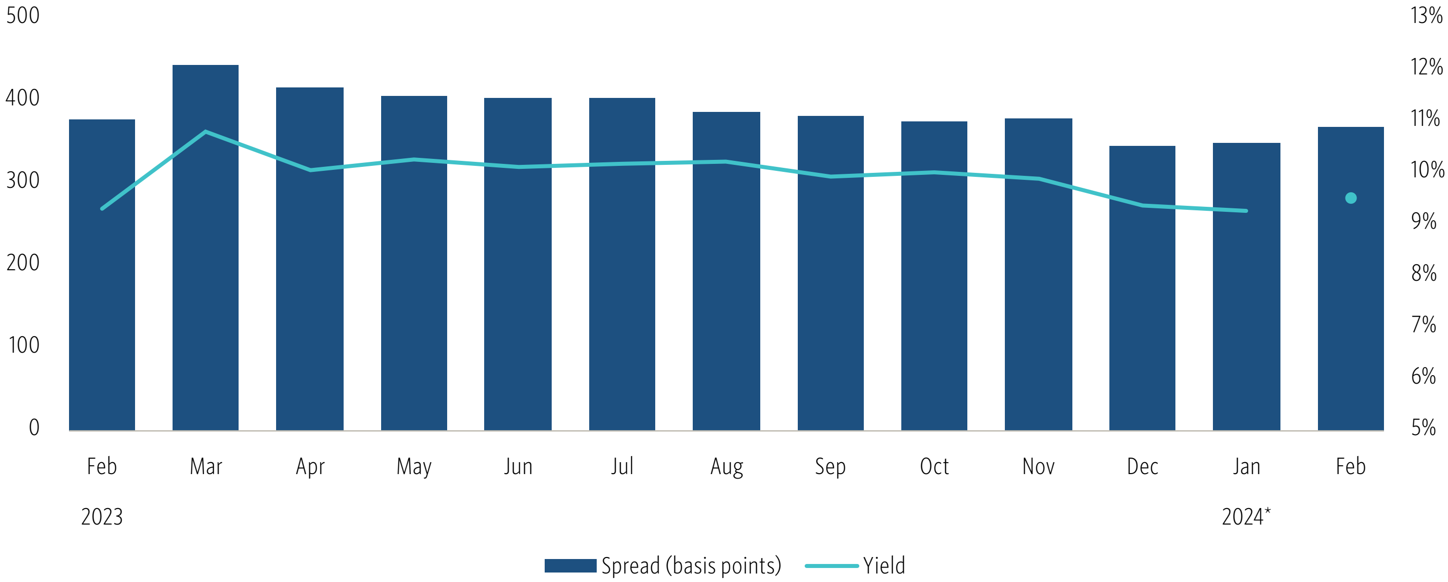
In June 2023, Apollo's ATLAS SP unit—the securitization business acquired from Credit Suisse in 2022 and subsequently combined with Apollo's ABF franchise—received anchor commitments from the sovereign wealth fund ADAI, which can support $15 billion in warehouse financing solutions to mortgage originators and other specialty finance companies. This expands on the $40 billion of previous commitments under management by ATLAS SP.

3: "TPG (Q4 2023 Earnings Call)," TPG, February 13, 2024.
4: "Blackstone Real Estate Debt Strategies, Blackstone Real Estate Income Trust, CPP Investments and Rialto Capital Acquire a 20% Equity Stake in a Venture Holding Approximately $17 Billion Commercial Real Estate Loan Portfolio of Former Signature Bank," Blackstone, December 14, 2023.
5: "Barclays and Blackstone Credit & Insurance Agree to Sale of Credit Card Receivables," Blackstone, February 27, 2024.

US and European market stats

Spread and yield to maturity on new-issue US leveraged loans

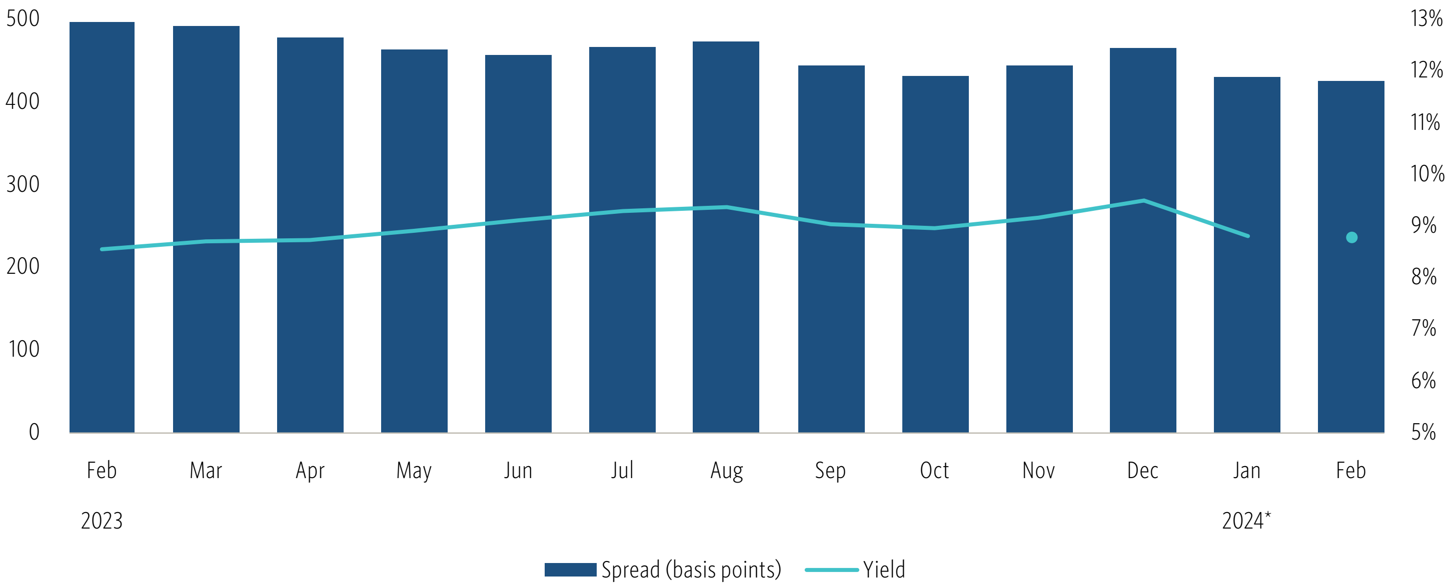
US loan yields on new issues have dipped below double digits since October



Source: PitchBook | LCD • Geography: US • *As of February 15, 2024

Spread and yield to maturity on new-issue European leveraged loans

European loan yields are still slightly lower than US yields, though spreads remain higher

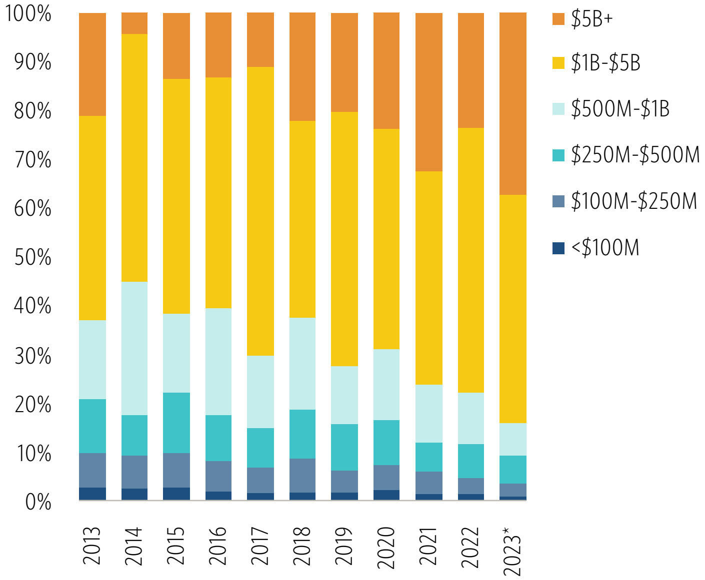


Source: PitchBook | LCD • Geography: Europe • *As of February 15, 2024

Private debt fund stats

Share of private debt capital raised by size bucket

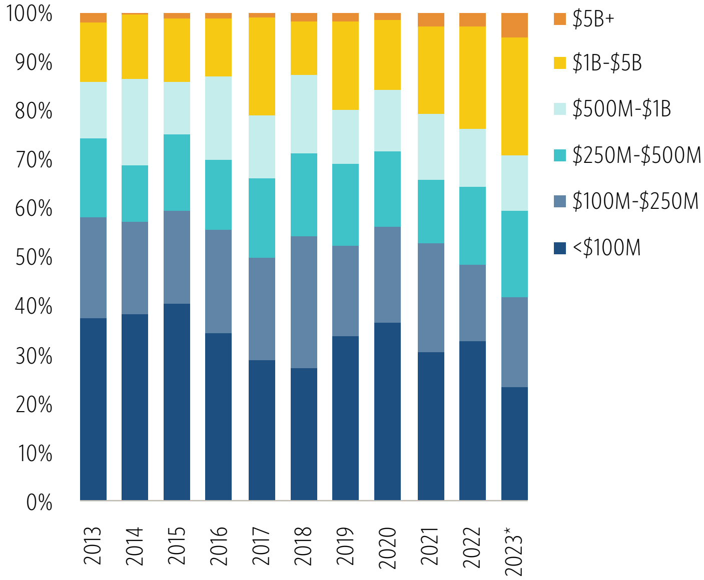
$5 billion-plus funds are becoming much more common in the private debt space



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

Share of private debt fund count by size bucket

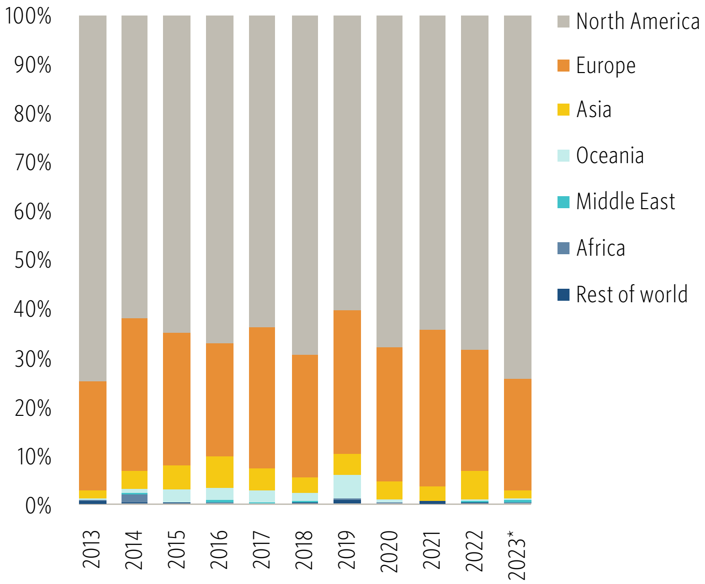
Most fund size buckets have expanded at the expense of the sub-$250 million category



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

Share of private debt capital raised by region

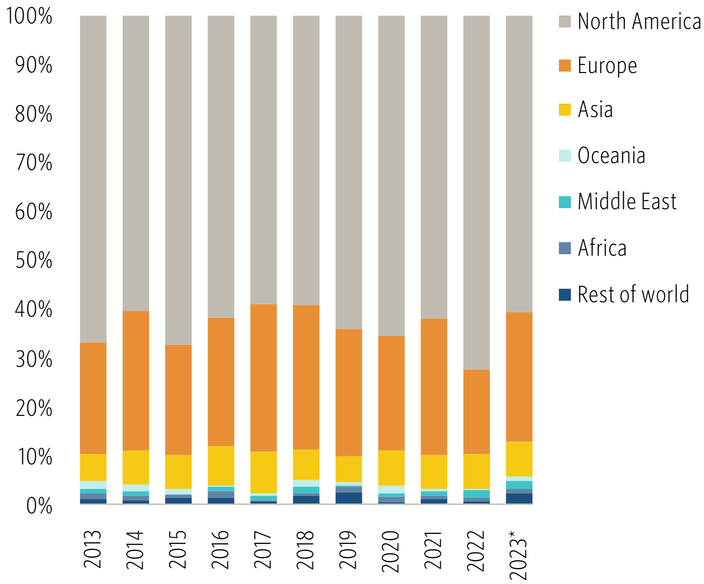
North America has grabbed the vast majority of fundraising



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

Share of private debt fund count by region

The number of European vehicles has bounced back



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

A WORD FROM AIC

Private debt continues to be strong

Jamal Hagler
Vice President of Research
American Investment Council

Jamal Hagler serves as the Vice President of Research at the American Investment Council. In this role, he leads the AIC's research department. Previously, Jamal served as Director of Research at the AIC. Prior to joining the AIC, Jamal worked at the Center for American Progress, where he researched a range of policy issues.

2023 was a great test for private debt, and it passed with flying colors. When the Federal Reserve (Fed) began a series of interest rate hikes in 2022, some market commentators predicted the rapid rise in interest rates would cause a host of borrowers—particularly those with private debt—to default due to increased interest expense. Loans provided by private debt managers tend to have floating rates, which rise and fall according to a predetermined reference rate—meaning that an increase in rates causes the interest rate of a private debt loan to increase. Those predictions of doom have not come true. A wave of defaults has not materialized, and the performance of private debt has remained strong. In fact, in recent quarters, private debt has outperformed private equity. According to Proskauer's Private Credit Default Index, the overall default rate for private credit loans in Q3 2023 was 1.4%, while according to S&P Global, the default rate for speculative-grade debt was 4.1%.[6] Despite the host of challenges facing borrowers, such as high inflation, increased interest expense, and geopolitical concerns, private credit remained resilient. These results speak to the strong underwriting capabilities of private debt managers, as well as the important relationships that these managers develop, which allow borrowers and lenders to work out any issues should they arise.

In the past decade, private debt has gone from a niche asset class that provides critical capital solutions to small and medium-sized businesses (SMBs) to an important alternative asset that produces significant yield to investors—while also providing an important alternative to traditional bank financing. Private debt comes in many forms—from rescue financing, to helping a struggling company restructure and right size, to loans to fund an acquisition, to loans to fund capital expenditures or operating expenses. Private debt offers financing tailored to the borrower's specific needs and circumstances.

The importance of private debt has come into focus over the last year and a half as rising interest rates, the regional bank crisis, and considerable distress in the commercial real estate sector have constrained the ability of traditional lenders to extend credit. Banks have been particularly constrained from lending due to a variety of issues, including deposit flight, losses on commercial real estate loans, increased regulatory scrutiny, and potential updates to Basel III. Fortunately for borrowers, private debt vehicles tend to lock up capital from sophisticated institutional investors for a predetermined time, thereby allowing them to provide loans through credit cycles. This, in turn, expands access to credit and ensures that capital is available for businesses to grow and thrive.

Investors continue to see the importance of adding private debt to their portfolios. Over the past ten years, capital committed to private debt vehicles has grown from $97.6 billion in 2013 to $190 billion by 2023. Until the Fed recently began raising interest rates, fixed-income markets produced little income. As a result, investors' search for yield led them to private debt, which offered higher yields than traditional fixed income and insulated investors from interest rate risk.

6: "Proskauer's Q3 2023 Private Credit Default Index Highlights the Resilience of Private Credit in a Turbulent Economy," Proskauer, October 24, 2023.

While interest rates are higher today, investor appetite for private debt remains because in addition to the income generation, these funds provide diversification benefits, high risk-adjusted returns, and a hedge against inflation, among other benefits.

In Washington, the conversation around nonbank lending continues as policymakers seek to better understand how risk can be introduced into the financial system. For example, the Financial Stability Oversight Council briefly mentioned private debt in its annual report.[7] At the American Investment Council, the leading advocacy organization for the private debt industry, we actively protect the industry's license to operate. We educate policymakers on the benefits that the asset class brings to a variety of stakeholders and their constituents. In November, in partnership with PitchBook, we released Partners to Private Companies: How private credit strengthens the American economy, a report that introduces private credit to policymakers by explaining what it is, how it works, and why it is important for thousands of American companies and their employees.

As the asset class continues to grow, the AIC will continue its efforts to ensure that policymakers do not impede access to this important source of capital. SMBs are the economic engine of the US, and policymakers should not cut off the capital they need to grow.

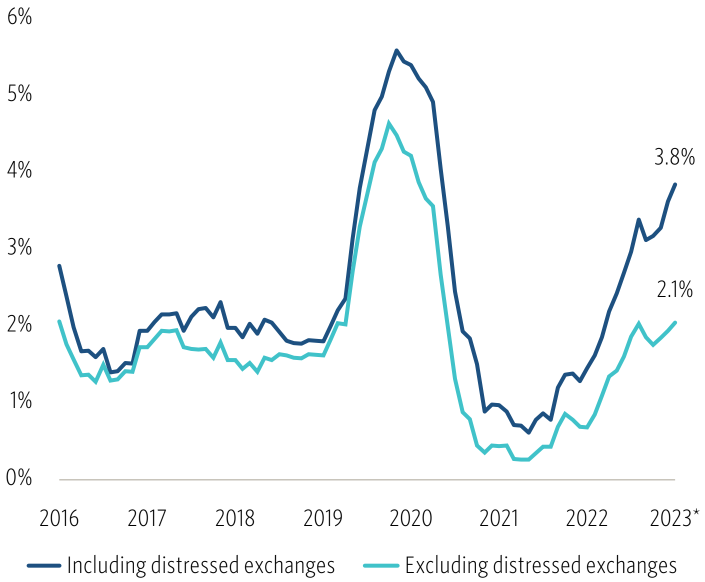
7: "Annual Report 2023," Financial Stability Oversight Council, n.d., accessed February 20, 2024.

SPOTLIGHT

Introducing LCD's dual-track default rate: Sponsors drive distressed exchanges

Dual-track loan default rate

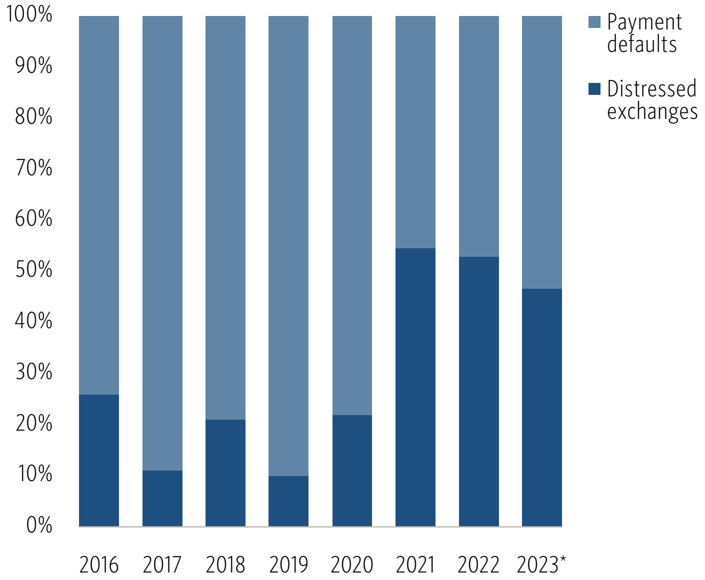
Inclusive of distressed exchanges, default rates are headed back to the bad old days of 2020



Source: PitchBook | LCD • Geography: US • *As of December 31, 2023

Share of dual-track defaults by type

Distressed exchanges as a share of leveraged loan defaults have risen sharply since the 2020 downturn



Source: PitchBook | LCD • Geography: US • *As of December 31, 2023

Rachelle Kakouris
Lead Analyst, US Credit Research, LCD

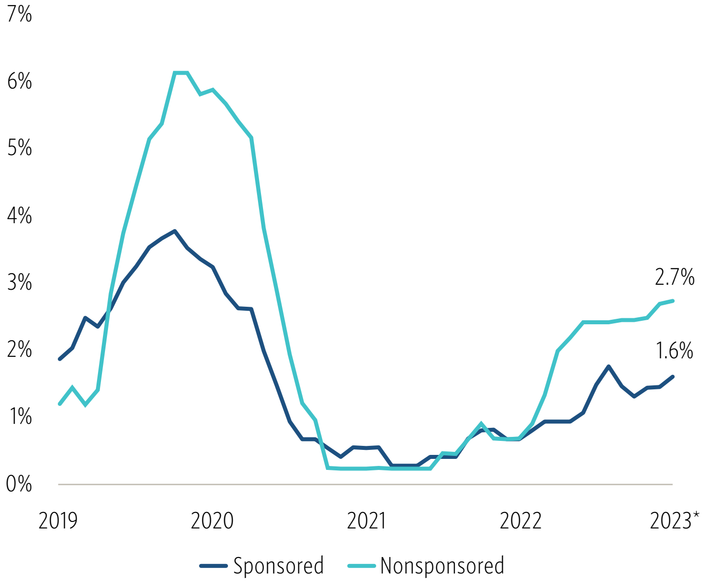
In tandem with LCD's legacy criteria capturing general defaults of missed payments and bankruptcy filings, LCD is now tracking a separate rate that includes distressed transactions stemming from out-of-court restructurings, exchanges, and subpar buybacks, or so-called "distressed exchanges."

The current payment default rate (excluding distressed exchanges) by issuer count was 2.05% at the end of December. However, LCD's newly unveiled dual-track default rate (DTDR), which includes payment defaults and distressed exchanges, was 3.8% by issuer count at the end of 2023, up from 1.5% at the end of 2022. Default rates are measured as the TTM calculation of defaults among performing companies in the Morningstar LSTA US Leveraged Loan Index.

Distressed exchanges as a share of leveraged loan defaults have risen sharply since the 2020 downturn, gaining in popularity among troubled companies and their lenders seeking to avoid more costly bankruptcy proceedings. In 2019, for example, distressed exchanges represented just 10% of default activity. Since then, distressed exchanges are making up an even larger slice of the default landscape. During the relatively low default period of 2021, these transactions as a share of defaults jumped to 55% and remained elevated at 53% of defaults in 2022 and 47% in 2023.

Loan payment default rate by issuer count and issuer type

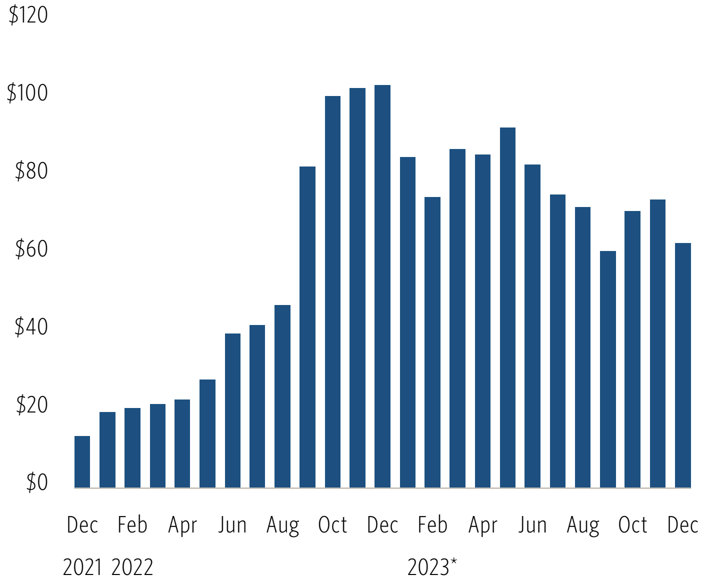
PE-backed companies have done a better job holding default rates down than nonsponsored companies without a PE firm to turn to



Source: PitchBook | LCD • Geography: US • *As of December 31, 2023

Distressed loan volume ($B)

The total investable market for distressed managers is one year past its peak, suggesting that conditions have eased



Source: PitchBook | LCD • Geography: US • *As of December 31, 2023

Why the rise in exchanges?

In addition to preserving ownership and control for issuers, the appeal of distressed exchanges is also evident on the other side of the restructuring table. For investors, recovery rates are proven to be higher via distressed exchanges than via bankruptcy filings, as the time in restructuring is significantly shorter, and asset preservation is higher. As demonstrated in LCD's July 2023 recovery study, "LossStats: Recovery rates improve with dominance of distressed exchange," the average discounted recovery for distressed exchanges is 79%, 19 points higher than the average of 60% for bankruptcies lasting less than six months, and 26 points higher than the average of 53% for those lasting less than one year. For bankruptcies lasting one to three years, the average discounted recovery drops to 47%. The pattern is the same for term loans: Recoveries are considerably higher following a distressed exchange than following a prolonged bankruptcy process.

Can-kicking

Despite the increased popularity of distressed exchanges, LCD's data shows that of the issuers that participated in a distressed exchange process during the pandemic default wave of 2020, nearly 25% returned with a conventional default of missed interest payments or a bankruptcy filing within the next three years. More recently, troubled companies conducting distressed exchanges are still confronting higher interest rate burdens on their floating-rate debt, and more expensive credit conditions in refinancing or extending obligations. In 2022, despite the shorter timeline, the share of companies returning with a payment default or bankruptcy jumped to 33%.

Where will these exchanges come from?

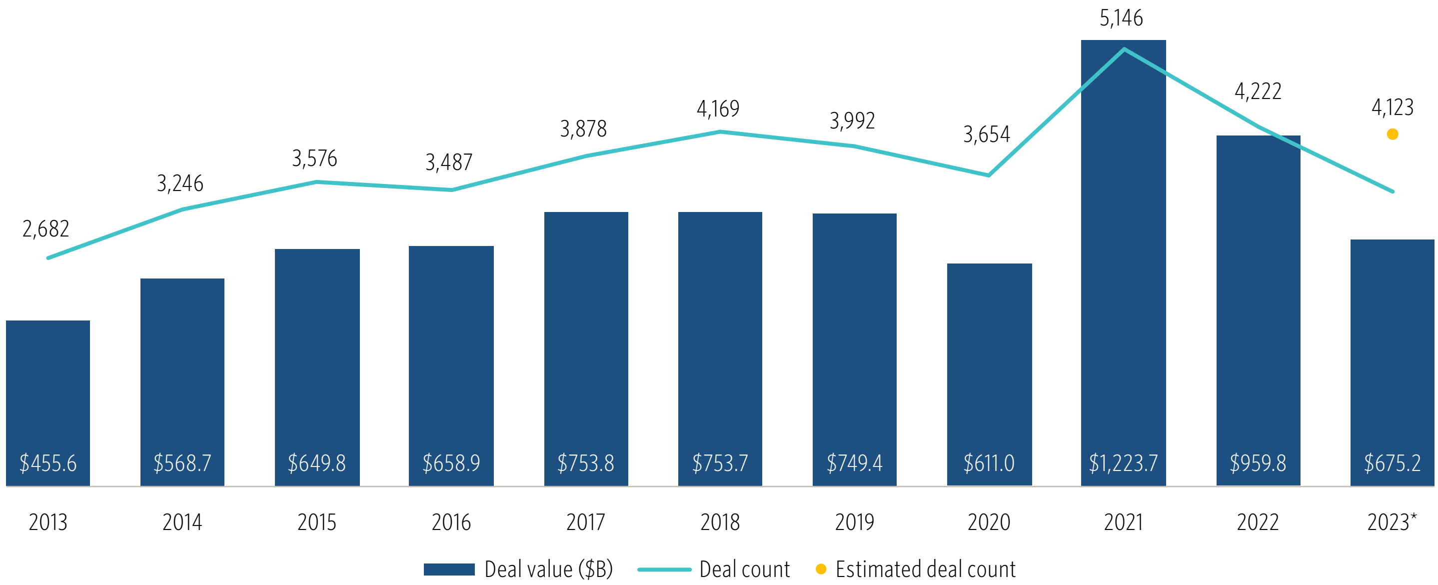
In 2023, sponsored companies drove 90% of distressed exchanges. This compares to 80% in 2020, another active year for restructurings. Drilling down by sector, pockets of stress point to potential activity. Software represents 25% of index loans below the "distressed" threshold of 80 cents on the dollar, despite being less than 12% of all outstanding index loans. Healthcare providers & services follows with 17% of distressed loans.

Overall, however, the distressed ratio suggests that the risk of default activity has eased. That ratio—defined as the share of performing loans priced below 80—declined to 4.5% at December's close, representing $62.8 billion of distressed loans. This was down from 5.3%, or $74.0 billion, at the end of November, and a postpandemic high of 7.4%, or $103.4 billion of distressed loans, in December 2022.

LBO dealmaking and take-private update

LBO deal activity excluding add-ons

Private credit deployment is strongly linked to PE LBO deal value, which was down 29.2% in 2023 excluding add-ons



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

Take-privates provide a good window into the world of financing LBOs because they involve public companies as acquirees. Take-privates are more transparent than LBOs, and as a result, they can point to broader trends in direct lending, at least at the top end of the market.

Historically, private credit was shut out of large financings of take-privates. That all changed in 2022 from the disruption wrought by the steepest rate hike cycle in more than 40 years. This left big banks with hung deals, which at one point totaled more than $40 billion—deals that were supposed to be offloaded through the broadly syndicated loan (BSL) market. After peaking at $146.0 billion in new-issue volume and a 14-year high in 2021, the BSL market came to a virtual standstill in Q4 2022, with just $2.1 billion in completed US LBO-related volume, down 95.4% from the Q3 2021 peak. One year later, we are still feeling the aftereffects. Institutional capital raised for new LBOs financed in the BSL market stagnated at $2.2 billion in Q4 2023, virtually unchanged from the year prior.

For the full year, syndicated LBO loan volumes were down 58% in 2023 on top of the 50% decline suffered in 2022. Banks have not completely abandoned the BSL market. They are much more active in refinancings, where volumes soared by more than twofold in 2023. Historically, refinancings represented just one-third of BSL new-issue volume, but in 2023 their share expanded to 58.4%. This was enough to tip the scales in favor of BSL versus private credit in 2023. Looking at US new-issue loans to PE-backed borrowers, and excluding high-yield bond financing, we estimate that BSL-funded volumes were just over half of the total, at $135.9 billion versus $121.1 billion in private credit. Still, for private credit to have anything close to 50% of the leveraged loan market was virtually unheard of prior to 2022. Private credit has grabbed its share and is hanging on.

New-issue spread and yield to maturity of loans backing LBOs by quarter

Borrowing costs for new LBO deals closed out 2023 at their highs and more than doubled since the beginning of 2022

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

Note: There were not enough observations in Q4 2022 to provide a meaningful average.

In terms of PE-led take-privates and how they are being funded subsequent to the initial deal announcement, the picture shifts much more in favor of private credit as a preferred source of financing. Of the 38 take-private deals announced in the back half of 2023, just three were subsequently funded in the BSL market, another 19 are undecided or unknown, and 16 were subsequently funded by private credit. Among these 16 were some noteworthy take-privates, including the $6.5 billion acquisition of New Relic by Francisco Partners and TPG, the $13 billion deal for Adevinta by Blackstone and General Atlantic, the $4 billion takeover of EngageSmart by Vista Equity, and the $4.4 billion take-private of Alteryx by Clearlake Capital and Insight Partners. There may well be more take-privates funded by BSL among the 19 that are still undecided—PE buyers are taking 2.5 months on average to line up debt financing for previously announced take-private deals and are dual tracking for a best price in the interim—but private credit has dominated the recent wins and headlines.

Public-to-private LBOs announced since July 31, 2023*

Private credit's share of large take-private financings in H2 2023 far outnumbered BSL-funded deals at 16 to 3

Announced date	Company	Loan type	Enterprise value ($M)	Premium (discount) to 52-week high
December 22	Theseus	Undisclosed/undecided	$216.3	-71.2%
December 19	Permascand	Undisclosed/undecided	$100.0	-41.5%
December 18	Alteryx	Private credit	$4,400.0	-31.7%
December 13	Impellam Group	Undisclosed/undecided	$679.3	14.0%
December 7	Smart Metering Systems	Undisclosed/undecided	$1,624.1	-0.5%
November 29	Rover Group	Private credit	$2,300.0	-0.9%
November 16	DX Group	Undisclosed/undecided	$384.8	-11.1%
November 15	EQS Group	Private credit	$425.6	29.1%
November 8	Q4	Undisclosed/undecided	$188.1	39.4%
October 23	EngageSmart	Private credit	$4,000.0	1.1%
October 22	Textainer Group	Undisclosed/undecided	$7,400.0	16.3%
October 16	Logistec	Undisclosed/undecided	$1,079.1	-3.1%
October 13	Spark Power	Undisclosed/undecided	$102.3	26.9%
October 8	National Western Life	Undisclosed/undecided	$3,061.2	4.9%
October 8	The Restaurant Group	Private credit	$1,393.5	25.7%
September 28	Chico's FAS	Private credit	$1,000.0	4.0%
September 21	Adevinta	Private credit	$13,079.5	16.5%
September 20	Self Storage Group	Undisclosed/undecided	$458.0	30.6%
September 20	Finsbury Food Group	Undisclosed/undecided	$187.0	2.5%
September 11	Avantax	BSL	$1,200.0	-13.1%
September 8	Round Hill Music	Undisclosed/undecided	$469.0	0.9%
September 6	NextGen Healthcare	Private credit	$1,800.0	1.5%
September 4	Ergomed	Private credit	$926.2	-16.0%
August 30	Instem	Private credit	$257.9	-89.9%
August 28	Thorne Research	Undisclosed/undecided	$680.0	1.6%
August 9	Avid Technology	Private credit	$1,400.0	-19.0%
August 9	Computer Task Group	Undisclosed/undecided	$170.0	1.9%
August 7	Veritiv	BSL	$2,300.0	0.1%
August 7	Tabula Rasa Healthcare	Private credit	$570.0	1.3%
August 7	Fiesta Restaurant Group	Private credit	$225.0	-7.1%
August 2	Blancco Technology Group	Private credit	$225.5	1.2%
July 31	New Relic	Private credit	$6,500.0	1.2%

Source: PitchBook • Geography: Global • *As of December 31, 2023
Note: For complete H2 data from July 1 onward, please see the summary XLS file.

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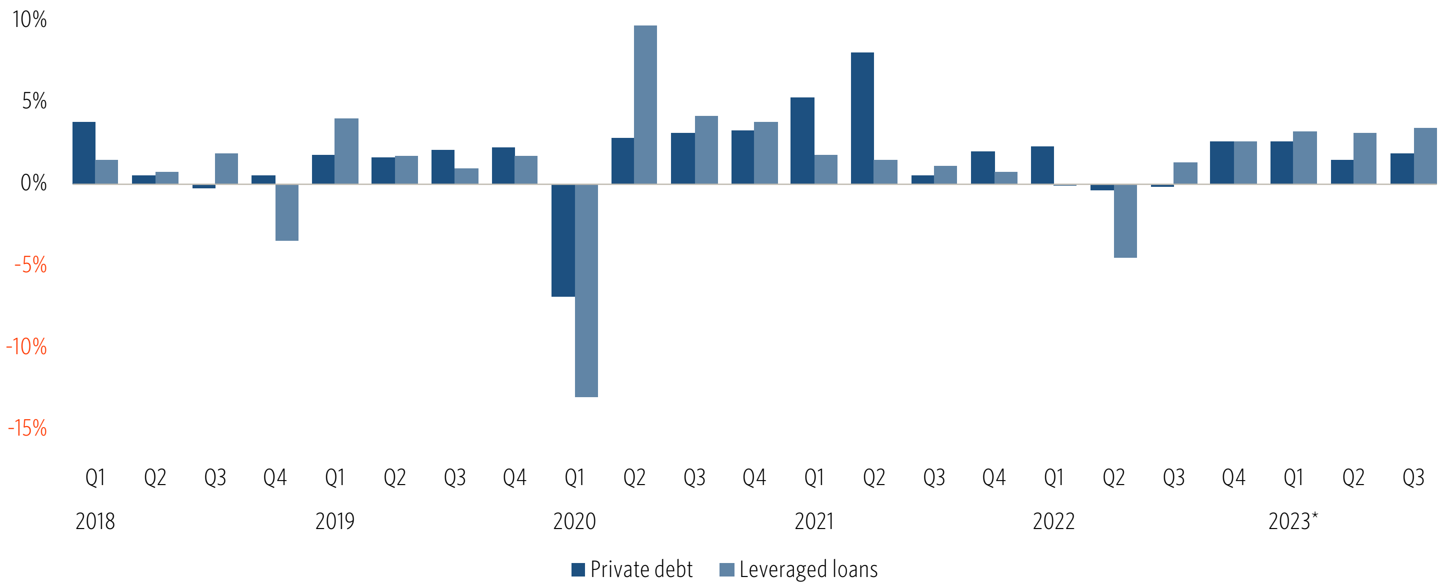
Private debt fund performance

Private debt fund versus leveraged loans returns by quarter

When markets turn, leveraged loans capture more of the upside than private debt funds, but also more of the downside



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

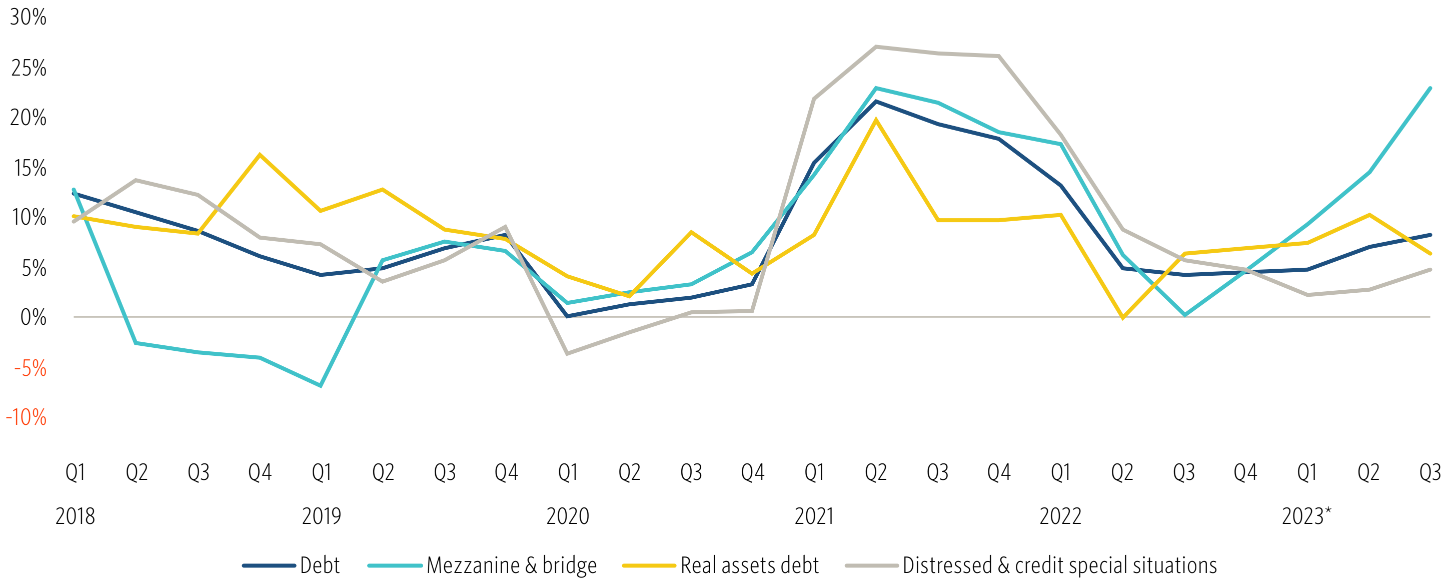
It was an exceptionally strong year for floating-rate leveraged loans, which represent the bulk of private debt fund holdings. A good proxy for how these loans performed, the US Morningstar LSTA Index gained 13.3% in 2023. This was the highest annual reading since the global financial crisis (GFC) and the second-strongest return ever. The equivalent index for Europe posted a nearly identical 13.5% return, also a post-GFC high. The interest return component of the LSTA Index gain was 73.2%, or 9.7%. This roughly equates to the blended yield to maturity on newly issued LBO loans in the broadly syndicated market, which rose from 6.7% in 2022 to 10.4% in 2023 and closed out the year at a quarterly high of 11.6%.

These persistently high yields explain the continued attraction and strong relative performance of private debt funds. Many are originating loans at yields that are equal to or higher than the bank-led syndicated market, which has retrenched significantly outside of refinancing and repricing activity. As a result, private debt continues to inch up the performance league table relative to other private capital strategies and ranks as the second highest with a one-year horizon return of 6.9% through Q2 2023. Our preliminary estimate for Q3 2023 points to a three- and 12-month trailing return of 1.9% and 8.2%, respectively, with less than half of our typical population of funds yet to report.

Drilling down to the major substrategies, mezzanine funds kicked into high gear with a one-year horizon return of 22.8% as of Q3 2023. This compares to a one-year return of 4.7% for distressed/special situation funds. Both are the riskiest of the substrategies within private debt and historically the highest returning, but for the time being, distressed has been held back by a target-starved environment. The distressed subset of the LSTA Index has contracted by 39.5% in investable value from the March peak during the bank mini-crisis. Additionally, default rates have defied expectations by dipping in August and September in the private credit and syndicated loan markets, and although they are rising again, many loan workouts are happening behind the scenes and preempting involvement by distressed funds. As for direct lending, private debt's largest strategy with more than half of all AUM, performance was solid at 7.1% for the 12 months ended Q3 2023. The main headwind at this point is a constrained loan origination backdrop. With global M&A value down 15.7%, including a 25.2% decline in global PE deal value, private credit funds are hard-pressed to deploy capital as quickly as they are raising it.

Private debt rolling one-year horizon IRR by type

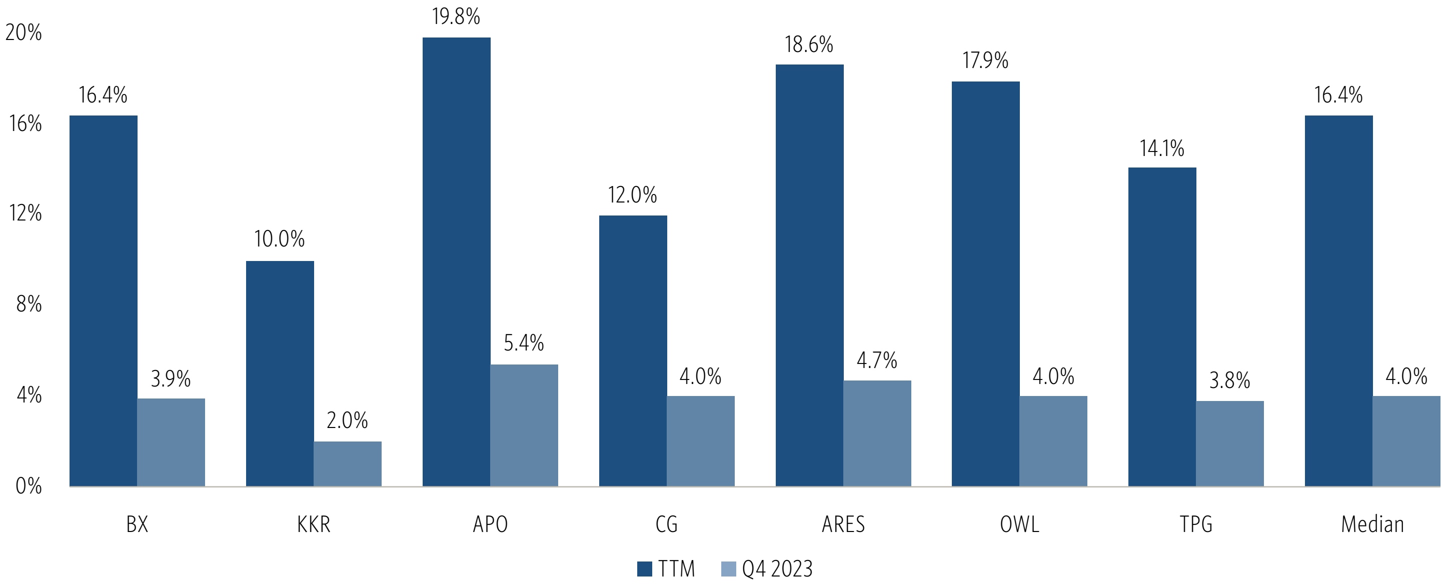
One-year returns stayed mostly positive across all private debt strategies, with multistrategy and mezzanine leading the way



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

Private debt gross returns reported by manager*

The "big seven" US-listed alternative asset managers with private credit strategies all reported double-digit 2023 returns



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

Note: All returns are before the deduction of fees.

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 involve direct origination with these hybrid structures or trading in the secondary market where 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 venture capital 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.

- **Multistrategy:** General-purpose credit funds with broad mandates to invest across the debt capital structure, substrategies, and verticals in order to capture the entire opportunity set in private credit. These funds will often invest in public debt as well as private debt on a dynamic and opportunistic basis.

Additional research

Private markets

2023 Annual Global Private Market Fundraising Report

Download the report here

Q2 2023 Global Fund Performance Report (with preliminary Q3 2023 data)

Download the report here

2023 Annual Global M&A Report

Download the report here

2023 Annual US PE Middle Market Report

Download the report here

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