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Q1 2023 Public BDC Venture Lender Earnings

Venture debt amid liquidity stress and the banking crisis from public lenders' perspectives

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

- Major events that led to the recent banking turmoil, most prominently the fallout of SVB, will significantly and likely permanently alter the venture lending landscape. Lenders are ready to take full advantage of the void left by a major market participant by garnering more venture debt market share, and several BDCs saw increased deal flow in their pipelines following the collapse of SVB.

- Total and net incomes remained high or at record levels for these BDCs, as interest rates continued to climb during the quarter with two hikes of 25 basis points. The floating-rate nature of the majority of the venture loans these institutions provide places the burden of rising rates onto the borrower. Despite rising rates being an increased risk to companies, pricing continues to experience upward pressure due to market conditions.

- Lenders observed that their portfolio companies had been raising smaller amounts of capital at a slower pace in Q1 2023 amid a market downturn but see opportunities for growth in the current valuation reset, as debt financing remains an attractive solution for companies seeking nondilutive capital.

- The outlook for the broader venture market remained positive. While it was noted that the high amount of equity dry powder in the market continued to be patient, lenders were optimistic that once a pricing frontier was found, deal activity would rebound, adding further stability to portfolio companies.

Introduction

Q1 2023 earnings calls for the five business-development companies (BDCs) that are among the most active venture lenders—Hercules Capital, Horizon Technology Finance (to be acquired by Monroe Capital), Runway Growth Capital, Trinity Capital, and TriplePoint Venture Growth—touched on a common theme: The market has changed since Silicon Valley Bank (SVB) failed and volatility arose in the banking sector. The calls also noted the slowing venture market, which these firms rely on for future equity investments for their portfolio companies. However, each of these institutions remains optimistic on the outlook of venture lending and sees its position as strengthened due to the changes that have occurred within the broader economic climate.[1]

As mentioned in our analyst note Venture Debt as the Market Turns, venture lending has become a growing piece of the VC market, with approximately $30 billion made each year during the past four years. SVB was known for its low-interest-rate loans to early-stage companies, along with its expertise in working with young startups and the venture community. BDCs make up a large portion of mid- to late-stage venture lending, carrying the ability to put large amounts of capital to work in a single deal. Being public, these firms also provide a window into the opaque venture debt market.

High investment incomes, continued commitments, high yields due to rising rates, and low losses fueled these lenders in Q1 2023. The increased activity in venture debt has enabled lenders, both public and private, to increase their scrutiny when evaluating new deal opportunities to find the highest-quality investments without compromising on pricing or terms. While these Q1 earnings may not provide the full picture of the new-look market without SVB, they suggest that venture lending stands on strong footing, even though idiosyncratic challenges will arise due to the slowing venture equity market and retreating valuations.

Net asset value/total net assets ($M) of select BDCs*

	2022				2023
	Q1	Q2	Q3	Q4	Q1
Hercules Capital	$1,333.4	$1,327.7	$1,362.7	$1,401.5	$1,499.0
Horizon Technology	$280.0	$290.6	$307.7	$318.4	$321.7
Runway Growth Capital	$597.5	$579.4	$573.7	$576.1	$569.8
Trinity Capital	$469.7	$459.6	$482.5	$458.3	$424.0
TriplePoint Venture Growth	$429.5	$404.3	$447.9	$419.8	$414.0

Source: PitchBook • Geography: US
*As of March 31, 2023

Net asset value per share of select BDCs*

	2022				2023
	Q1	Q2	Q3	Q4	Q1
Hercules Capital	$10.8	$10.4	$10.5	$10.5	$10.8
Horizon Technology	$11.7	$11.7	$11.7	$11.5	$11.3
Runway Growth Capital	$14.5	$14.1	$14.1	$14.2	$14.1
Trinity Capital	$15.2	$14.6	$13.7	$13.2	$13.1
TriplePoint Venture Growth	$13.5	$13.0	$12.7	$11.9	$11.7

Source: PitchBook • Geography: US
*As of March 31, 2023

1: Nonbank lenders' outlook on venture lending is discussed further in the Q2 2023 PitchBook Analyst Note: Takeaways From the Venture Debt Conference.

Commitments

A consistent theme from all earnings calls was a firm stance on being highly selective when evaluating opportunities, and all lenders expressed a shared focus on credit quality. In light of increased uncertainty about the venture ecosystem, all the BDCs announced that they are taking a disciplined and patient approach to loan originations, with rigorous investment criteria and underwriting processes in place. Trinity posited that it funds only companies that "will receive funding from equity investors in any market conditions," making up only about 5% of the companies that it sees. To mitigate risks, lenders typically take a senior secured, first lien position on loans with structural protections—as well as warrants—allocating capital only to high-quality and sufficiently liquid, mature companies that operate in recession-resistant industries, either with the ability to attract follow-on financing or, ideally, a clear path to profitability.

During the Q&A session, Hercules stated that it is passing on the "vast majority of the transactions" it sees because they fail to meet its credit underwriting screens. TriplePoint has been seeking out companies that are positioned to grow fast with a durable business model and have recently raised capital. Trinity took pride in running a rigorous due-diligence process and made a remark of having a standalone credit team, a unique feature in the industry, where the sole job of employees there is evaluating incoming credits.

Many lenders deploy capital in tranches, often requiring portfolio companies to overcome certain hurdles to unlock subsequent funding commitments.

While some lenders expected to see increased follow-on fundings to existing portfolio companies—in some cases, strengthening their incumbency position in high-quality portfolio companies—it is worth noting that many lenders deploy capital in tranches, often requiring portfolio companies to overcome certain hurdles to unlock subsequent funding commitments. For instance, more than 90% of Horizon's committed backlog is contingent upon key milestones being met continually before portfolio companies can access funding that is set up in multiple tranches. In the past quarter, Horizon deployed funding to companies that successfully surpassed the planned inflection points and experienced "some expired draws where companies didn't meet milestones by a certain date." Hurdles take a different shape at Trinity, where unfunded commitments are subject to the diligence, review, and approval by the investment committee.

New commitments by select BDCs in Q1 2023*

	New commitments ($M)
Hercules Capital	$526.0
Horizon Technology	$187.0
Runway Growth Capital	$0.0
Trinity Capital	$43.2
TriplePoint Venture Growth	$3.7

Source: PitchBook • Geography: US
*As of March 31, 2023

Unfunded commitments by select BDCs in Q1 2023*

	Unfunded commitments ($M)
Hercules Capital	$562.1
Horizon Technology	$166.2
Runway Growth Capital	$302.7
Trinity Capital	$338.7
TriplePoint Venture Growth	$254.5

Source: PitchBook • Geography: US
*As of March 31, 2023

Net income and interest rates

In Q1 2023, net incomes produced by each of the BDCs outpaced their distributions provided to investors. Hercules generated $65.5 million of net investment income, nearly $30 million more than it did in Q1 2022. Hercules is the largest of the group; though Horizon's figures may be smaller, its net investment income more than doubled YoY, and the net investment income for each of the other lenders increased YoY between Q1 2022 and Q1 2023, highlighting the current tailwinds venture lenders are experiencing.

Increasing rates flowed directly to borrowers, as the majority, if not all, of the loans that originated from these lenders are floating-rate instruments with a floor.

While increasing investment incomes are a positive, it is important to incorporate the backdrop of interest rate hikes into the picture. Increasing rates flowed directly to borrowers, as the majority, if not all, of the loans that originated from these lenders are floating-rate instruments with a floor. 100% of Runway Growth Capital's loans carry a floating rate, which increases alongside the hikes in the reference rate of the loan.

The Federal Reserve (the Fed) raised rates twice in Q1 2023, each at an increase of 25 basis points, bringing the federal funds rate up to 5.00% as of March 31, 2023. Another hike occurred in Q2, and the current rate stands at 5.25%. However, the fed funds rate is not the reference point for the venture loan spreads. Many lenders use SOFR or the US prime rate as the base rate, the latter of which had bumped up to 8.00% by the end of Q1.

Due to rising interest rates, each of these firms saw quarter-over-quarter (QoQ) yield increases. Hercules pushed its effective yield to 15.1%, up from 14.7% in Q4 2022, and with a coupon rate of 12.0%. TriplePoint's high returns were generated on the back of an 11.8% coupon income. Lenders, both public and private, have noted that the market volatility and banking crisis will continue to push pricing to the favor of the lender. Equity capital has also become scarcer for private, venture-backed companies, further pushing them to look into debt as an alternative source of nondilutive financing for growth.

For venture-backed companies, rising interest rates pose a risk, increasing the payments and taking away capital that can flow back into the company. We have noted in the past that some venture loan structures, including interest-only periods, can reduce the pressure that rising rates create. So far, rates have not hit a point of placing downward pressure on pricing. Higher pricing combined with increased benchmarks of creditworthiness will continue to push incomes moving forward.

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

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

Source: PitchBook • Geography: US
*As of March 31, 2023

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

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

Source: PitchBook • Geography: US
*As of March 31, 2023

Net investment income per share of select BDCs by quarter*

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

Source: PitchBook • Geography: US
*As of March 31, 2023

Quarterly investment yield/effective yield percentage on investments of select BDCs by quarter*

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

Source: PitchBook • Geography: US
*As of March 31, 2023

Gains/losses

Despite the market volatility and a lack of equity capital in the venture ecosystem, these five BDCs continued to realize low losses during the quarter. Venture debt has traditionally been a relatively low-loss strategy, but much of that market history has come during the decade-plus bull market and hypergrowth of the venture industry. Though some lenders saw portfolio companies in the middle of bankruptcy procedures, secured positions of these loans will likely protect those lenders from massive losses. Runway noted realized losses of $1.2 million on equity investments, while Hercules reported realized gains of $8.0 million on investments.

Unrealized losses are likely to pick up over the next few quarters, especially in the venture market, as investment pricing remains a barrier between investors and target companies. The runup in valuations over the past few years, and subsequent deflating multiples—as well as the increased occurrence of down rounds—will have an impact on equity holdings and warrants that have been included in loan packages. However, unrealized losses did not show up across the board. Trinity reported an unrealized gain of $3.5 million, while Hercules showed an unrealized gain of $21.1 million.

The continued increases in equity and warrant holdings are a positive sign, even though these remain a small piece of the investment portfolio of these BDCs. In general, these positions are not meant to be return drivers as much as protection against potential losses. The macroeconomic environment remains tricky, so increasing unrealized gains will provide future protection against higher-than-expected losses. TriplePoint holds warrants on 124 companies as of Q1 2023, and the value of those warrants has an unrealized gain of 53.7%. A full realization of that amount would cover a full loss on roughly 1.7% of the firm's debt investments at current fair value. Together, the unrealized gains in equity and warrants for TriplePoint amount to $21.3 million as of March 31, 2023.

Net realized gains/losses from investments of select BDCs in Q1 2023*

	Net realized gains/losses from investments ($M)
Hercules Capital	$8.0
Horizon Technology	-$0.2
Runway Growth Capital	-$1.2
Trinity Capital	-$0.4
TriplePoint Venture Growth	$0.0

Source: PitchBook • Geography: US
*As of March 31, 2023

Net change in unrealized appreciation/depreciation from investments of select BDCs in Q1 2023*

	Net change in unrealized appreciation/depreciation from investments ($M)
Hercules Capital	$21.1
Horizon Technology	-$7.5
Runway Growth Capital	-$5.1
Trinity Capital	$3.5
TriplePoint Venture Growth	-$10.9

Source: PitchBook • Geography: US
*As of March 31, 2023

Available capital

Equity dry powder was an important topic of conversation due to its high level and the perceived ability for it to be unlocked when the valuation correction reaches a terminal point and equity dealmaking regains strength. For now, lender liquidity also remains in a strong position, allowing these institutions to stay vigilant and aggressive in a market that has tilted in their favor. In total, the firms together had roughly $1.2 billion in available liquidity via cash and credit facilities.

While holding sufficient liquidity to fund current commitments is essential, in a market downturn such as the current one, having the ability to grow the credit quality of an overall portfolio without compromising on pricing presents a major opportunity for growth. The competition for capital among VC-backed startups has already pushed the equity market toward high investor-friendly terms, and we should expect the debt landscape to turn increasingly lender friendly in the next few quarters, especially if the current capital shortage in the venture equity market drags on further and the IPO market remains shut.

Total available liquidity of select BDCs in Q1 2023*

	Total available liquidity ($M)
Hercules Capital	$553.1
Horizon Technology	$112.3
Runway Growth Capital	$131.3
Trinity Capital	$174.8
TriplePoint Venture Growth	$187.6

Source: PitchBook • Geography: US
*As of March 31, 2023

Portfolio

Amid the ongoing financial market volatility and the banking turmoil, portfolio-level monitoring has increased across the board. All lenders emphasized that they are taking a proactive approach to portfolio management, actively communicating with portfolios on a frequent basis and working closely with equity investors to help startups navigate a harsh financing environment. To avoid potential losses, lenders focus on ensuring portfolio companies have ample liquidity, as well as the ability to raise additional capital when needed.

Despite ongoing macroeconomic headwinds for raising equity from a portfolio perspective, lenders observed that high-quality companies continue to be able to secure funding, albeit at lower levels.

Despite ongoing macroeconomic headwinds for raising equity from a portfolio perspective, lenders observed that high-quality companies continue to be able to secure funding, albeit at lower levels. According to Horizon, whereas in previous quarters, portfolio credit issues were primarily caused by company-specific events, the VC and venture lending market as a whole was impacted by macro challenges. A combination of reduced venture investments, difficulty in exits, a looming recession, and the banking crisis made it more difficult for venture-backed startups to raise equity or debt. Collectively, lenders remain confident in the durability and strength of their overall portfolios. Runway did not observe an uptick in amendment or relief requests from portfolio companies, and Trinity posited that it is not seeing a liquidity crunch but rather a repricing of past valuations.

Lenders unanimously alluded to the paramount importance of cash runway for portfolio companies. For instance, 71% of Hercules' portfolio companies have more than 12 months of liquidity, and a mere 0.3% have liquidity that lasts for three months or less. On a positive note, multiple lenders communicated that their portfolio companies understand the importance of cutting costs and extending liquidity and have shifted toward operating efficiently as well as being more creative in raising liquidity. Investors are also engaged in the process of running lean. According to TriplePoint, most of its portfolio companies plan to continue to grow, "but to do so thoughtfully, while optimizing their cash burn rates to extend their runway to either achieve profitability or for a future equity raise."

Portfolio at fair value of select BDCs in Q1 2023*

	Portfolio at fair value ($M)
Hercules Capital	$3,130.0
Horizon Technology	$715.3
Runway Growth Capital	$1,125.3
Trinity Capital	$1,091.5
TriplePoint Venture Growth	$982.8

Source: PitchBook • Geography: US
*As of March 31, 2023

Debt portfolio at fair value of select BDCs in Q1 2023*

	Debt portfolio at fair value ($M)
Hercules Capital	$2,968.0
Horizon Technology	$684.6
Runway Growth Capital	$1,125.3
Trinity Capital	$929.3
TriplePoint Venture Growth	$890.1

Source: PitchBook • Geography: US
*As of March 31, 2023

Venture debt following SVB's collapse

All lenders discussed potential implications from macro challenges, heightened market volatility, and the recent banking crisis resulting from the fallout of SVB and Signature Bank in Q1 2023 and First Republic Bank in Q2 2023. The consensus among lenders is that those major events had, and will continue to exert, monumental and potentially permanent impacts on the venture lending landscape. TriplePoint pointed out that startups and investors have recognized "the importance of separating the commercial bank and the lending relationship," and the BDC observed increased deal flow during the past quarter, partially resulting from companies seeking to replace loans previously taken out from banks. Prior to SVB's failure, most of the top BDC lenders had partnered with or competed against the leading venture debt bank for many years. Collectively, they expressed their disappointment with how the event unfolded but were ready to take full advantage of the void left by a major market participant by taking up more venture debt market share.[2] Several BDCs discussed expansionary plans for existing deal teams, including bringing ex-SVB top talents on board. In the past two months, Hercules hired a few people who were previously employed at SVB.

Lenders perceived abundant opportunities to replace bank debt with senior secured venture debt, with nonbank lenders being the primary source of term debt lending to the VC ecosystem. Indeed, the market dynamics have changed, especially with increased concerns over the US banking sector. According to Trinity, the number of companies that are looking for alternative lenders has continued to "increase more now than ever." Loan demand and pricing are projected to ascend, as cheap bank debt is predicted to become significantly less available. Looking ahead, lenders are focused on credit quality to selectively and opportunistically approach deals.

Multiple BDCs noted that they saw an increased number of high-quality companies in their pipelines following SVB's fall and took it as a positive signal for continued growth. Hercules referred to the SVB incident as "a tremendous opportunity for HTGC," as the BDC planned to add market share via deals it previously partnered

2: For more on SVB's collapse, read our Q1 2023 PitchBook Analyst Note: The Collapse of Silicon Valley Bank.

with, or were contemplating collaborating with, SVB on. TriplePoint echoed a similar sentiment, adding that it has not yet seen other market participants, including banks, "enter the venture lending market in a meaningful way." Not only is venture lending an intricate business model that requires years of experience and a set of highly specialized expertise, but the banking turmoil also led to declined interest from banks to engage in venture lending. Together, the barriers to entry have likely deterred banks from following SVB's steps to actively lend to risky, early-stage venture-backed startups. According to TriplePoint, banks that did step in to fill the void left by SVB largely focused on "traditional bank services such as depository, credit card, investment management," and so on.

Forward-looking thoughts on the venture ecosystem

All lenders commented on the ongoing market volatility during their earnings calls, noting that valuations and multiples for both public and private companies have remained under pressure, leading to a decline in venture investment activities. Across their portfolios, raising equity financing has become more challenging due to less available capital in the market. Although many lenders saw durability and strength in their portfolios, they observed a slowdown in the dealmaking pace. In Q1 2023, portfolio companies were raising smaller amounts of capital at lower valuations. TriplePoint characterized the current cycle as "a period of valuation resets" for growth-stage startups. In addition, Runway predicted to see more "fracturing of equity syndicate" in a harsh financing climate, citing a recent restructuring case for their portfolio company, Gynesonics, as an example. For startups sitting near the end of the venture lifecycle, it is normal to see shifts in the equity syndicate, where investors with less liquidity may get their position heavily diluted.

Overall, demand for venture debt remains strong.

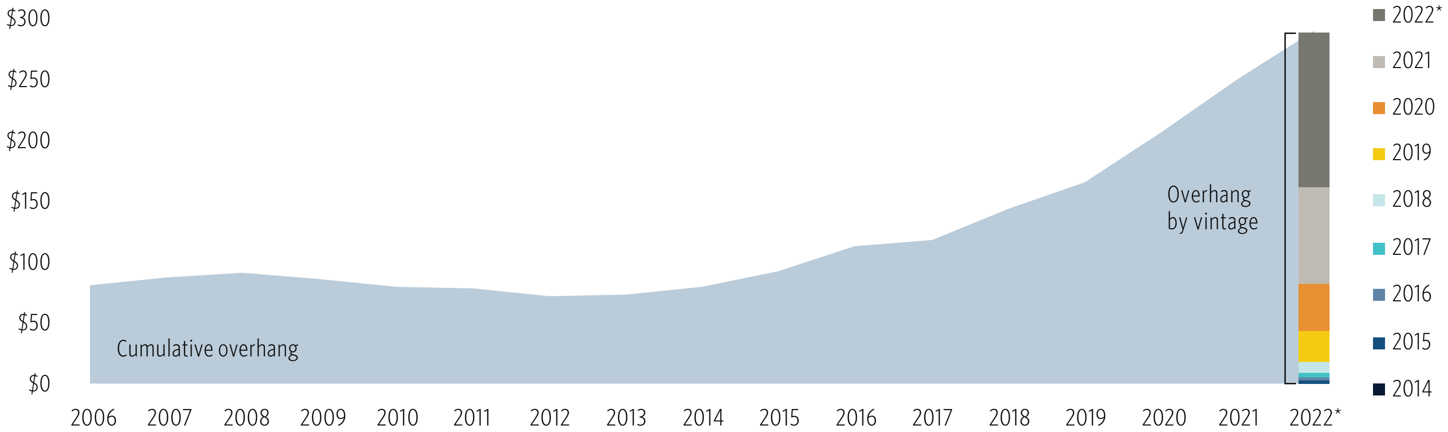
Nonetheless, lenders view the current market downturn as an opportunity. "If down rounds persist," Trinity posited, "debt financing remains a crucial solution" for venture-backed startups to continue funding growth while avoiding dilution. Overall, demand for venture debt remains strong. TriplePoint summarizes incentives for taking venture debt as follows:

- Companies seeking financing for opportunistic acquisitions.
- Previously equity-only companies looking to layer in debt as part of their future capital structure plans.
- Growth-stage companies trying to avoid dilution from raising down rounds.
- Need for additional runway between equity rounds as the timeline for going public has extended.

Certain deal types and industry sectors identified potential signs of a tailwind. Horizon noted a slight uptick in strategic transactions and knowledge-based deals led by VC firms with deep industry knowledge, stating that compressed valuations in the life science and public bio sector have attracted strategic pharmaceutical PIPE companies, as well as investors specializing in biotechnology. In addition, according to Horizon, companies with "strong IP positions" in select industries, sustainability and life science as an example, continue to attract ample liquidity.

Lenders share an optimistic outlook for the state of venture, projecting investment momentum to pick up later this year and into 2024, citing the record $289.0 billion of dry powder as of Q4 2022 observed in the [Q1 2023 PitchBook-NVCA Venture Monitor](). Meanwhile, several BDCs noted a gap between where founders and investors think valuations for late-stage venture-backed startups should be, and it could take as long as several quarters to bridge this divergence before investment velocity fully restores. Several lenders alluded to a disconnect between founders and VC investors from a valuation perspective, where a significant amount of capital is patiently waiting on the sidelines and will only be deployed when expectations on valuations converge. Hercules expects to see a period of "a slow delicate dance" before deals start getting done.

VC dry powder ($B) by vintage



Source: PitchBook • Geography: US
*As of December 31, 2022