March 2023 | Mesirow Investment Banking

Mesirow

Private debt market update

Eugene Weissberger
Managing Director
Investment Banking

Market Jitters Continue, but Private Credit Investors Seek Opportunity

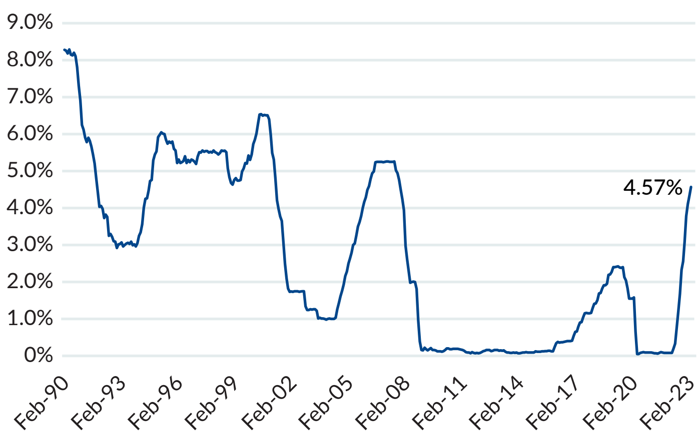
The market has taken a step back this past week in light of considerable uncertainty in the banking sector. However, private credit investors will be quick to point out that they remain insulated from the volatility in the banking world given their funding sources (institutional investors, pension funds, high-net-worth individuals, sovereign wealth funds, etc.) are typically very diverse and long-dated. Most private credit funds are typically locked up for 6-10 years, eliminating the risk of volatility-driven “runs” we’ve seen in the banking universe.

While we’d all be naïve to think the recent bank stress and failures won’t have both short-term and long-term ripple effects, deals continued to get completed this week (such as the $450 million transaction Silver Point provided to Momentive for their LBO) and lenders continued to put out term sheets for new transactions.

Interest Rates and the Overall Economy

All eyes continue to remain squarely on the Fed. Prior to the recent drama, markets were betting the Fed would get more hawkish and have a 50-bps rate hike at their next meeting on March 21/22. However, the markets are now expecting a 25-bps increase from 4.5-4.75% currently with a small minority including Goldman Sachs expecting no hikes at all. Additionally, the odds of rates going up to 5.75-6% (as they were following Jerome Powell's hawkish comments on March 8th) have also come down considerably.

CHART 1: **FEDERAL FUNDS EFFECTIVE RATE: 2.28.1990 – 2.28.2023**



Data through February 28, 2023 | Source: Federal Reserve Bank of St. Louis (FRED)

What Does All This Mean for Credit

Credit will remain tight, but available for the foreseeable future. Volume continues to be light across the credit world, with private credit off ~14% year-over-year and broadly syndicated loans off a much more significant ~80% in January.

In the middle market and lower middle market, lenders will only offer above 50% loan-to-value for the best credits, with 40-50% being the norm. Pricing continues to be stable in the S+650-750 area, but borrowers continue to try to get creative on how to fill the gap.

Mezz financing continues to be a popular option as pricing hasn't increased nearly as much as floating rate senior products. A year ago, mezz pricing was 10% cash pay plus 2% PIK. Now it may have increased by ~2%, but nowhere near the 5% SOFR has increased. Additionally, mezz hasn't been in vogue for a while, so funds still sit on significant dry powder. Mezz financing and unitranche pricing are very similar these days, especially considering mezz is junior.

Preferred equity also continues to be a popular solution. For example, Carlyle's bid for Cotiviti was supported with $1 billion in preferred equity in addition to a record $5.5 billion unitranche. While obviously less desirable than an all-debt solution, this option allows bidders to round out the financing without giving up control.

Not surprisingly, lenders continue to emphasize covenant packages, especially fixed charge and interest coverage ratios with all-in rates in the 12% ballpark.

The broadly syndicated market has finally shown signs of life with refinancings and extensions for Agiliti, Renaissance Learning, Topgolf Callaway, and others all getting launched. Additionally, Ineos Enterprises launched a cross-border deal to acquire MBCC Admixture.

Conclusion

Lenders remain in the driver's seat, especially in harrier situations. However, they are facing competition for better credits and continue to sit on significant dry powder. And while the broadly syndicated market has been all but dead since mid-2022, recent activity has given borrowers hope.

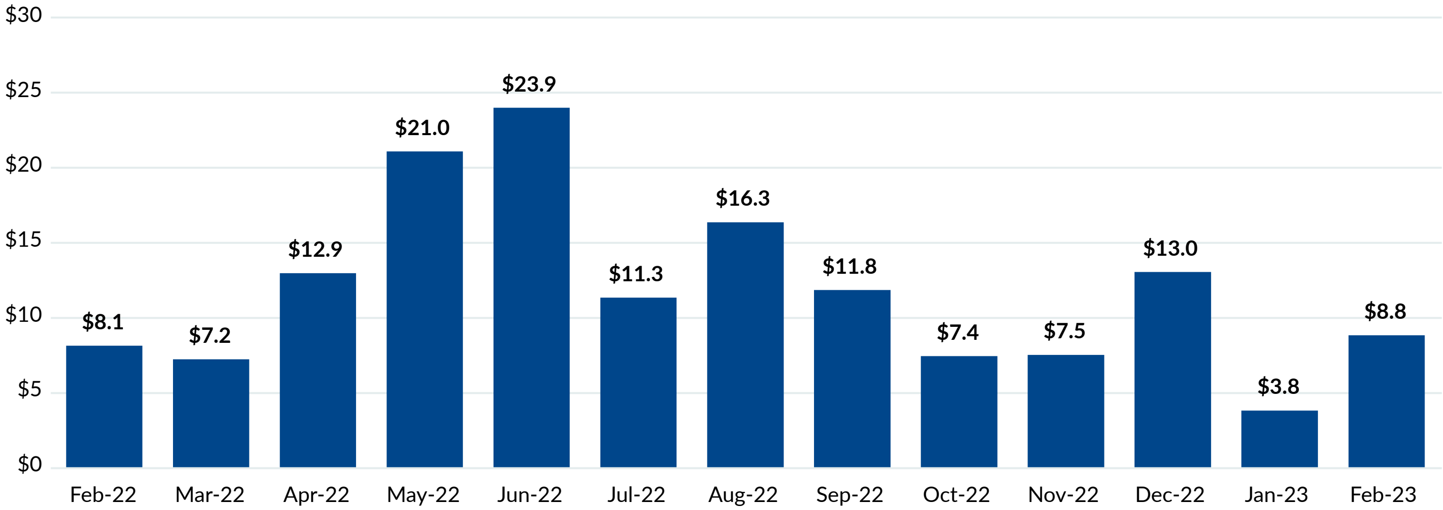
TABLE 1: KEY STATS: FY 2022 / FOURTH QUARTER

	2022	2021	4Q22	4Q21
Total Volume	$144.8	$110.3	$27.9	$47.4
# Deals	615	422	99	127
Average EBITDA	$44M	$52M	$50.5M	$50.0M
Unitranche Volume	$90.5	$75.9	$16.9	$33.5M
Unitranche Spread Average	591	571	642	540
LMM Volume	$10.5	$4.5	$0.910	$1.9
LMM # Deals	197	47	27	18
LMM Spread Average	586	536	617	514
LMM Sr. / Total Leverage Average	3.9x / 4.1x	4.2x / 4.6x	3.7x / 3.8x	4.6x / 5.2x

Data through December 31, 2022 | Source: DLD Private Data | Geography: U.S. | Billions ($B) except # of deals and where noted otherwise; Total Volume = new money raised; Deals = transaction; Jumbo defined as >=$1B loan size; LMM = Lower Middle Market defined as <$20M EBITDA

Financing perspectives: Private credit market environment

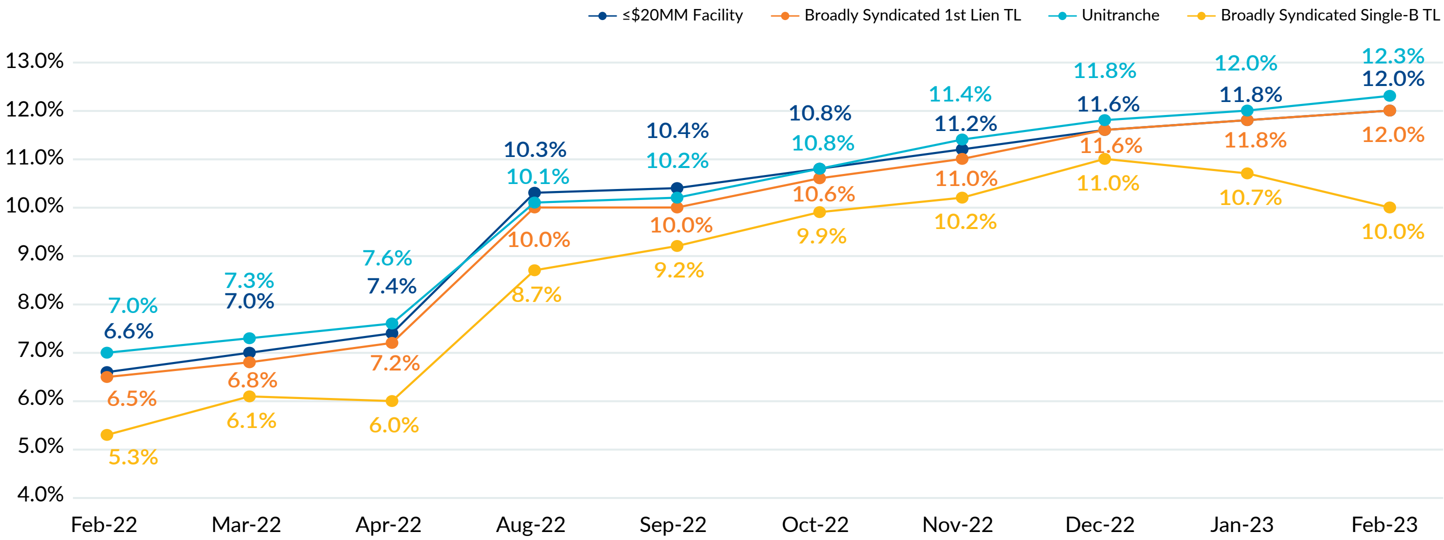
CHART 2: **MONTHLY PRIVATE LOAN ORIGINATION VOLUME**



Data through February 28, 2023 | Source: DLD Private Data | Geography: U.S.

.

CHART 3: **PRIVATE VS. LIQUID DEBT | USING 3M LIBOR RATE**



Data through February 28, 2023 | Source: DLD Private Data | Geography: U.S.

.

About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with locations around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture.

To learn more, visit mesirow.com/investmentbanking.

Eugene Weissberger
312.595.6921
eugene.weissberger@mesirow.com

Mesirow