Mesirow

Debt Advisory Market Update

Private debt market update

Private debt markets continue to chug along despite headwinds surrounding the public debt and equity markets and overall uncertainty surrounding the economy, the Fed, and inflation.

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Commentary

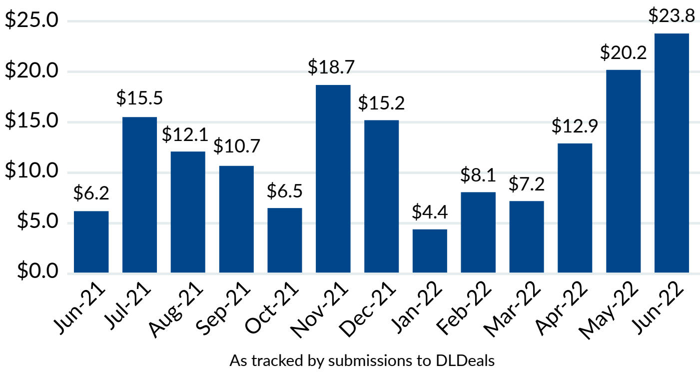
- The private debt markets continue to take advantage of dislocation in the broadly syndicated markets
  - 2Q'22 was a record for deal volume with DLDeals tracking $56.9 billion of origination volume compared to $19.7 billion in Q1'22 and $40.4 billion in Q4'21 (the previous record)
  - A good chunk of this record number came from a handful of jumbo unitranches including $5 billion for Zendesk and $4.5 billion for NFD/Info Resources (over 40% was composed of just 11 transactions all totaling $1 billion or more)
  - Issuers continue to shift from the broadly syndicated market into the privately placed market preferring the certainty of execution and the reduced number of lenders to negotiate with.

    Additionally, given these assets rarely trade, lenders are much more patient and view relationships on a 5–7 year basis, creating less volatility during recessions and other market turbulence
  - However, it is safe to say that this bifurcation will only last for a short period of time as some credit funds are using their money to pick up discounted assets in the secondary market (with average prices in the low-90s) as opposed to making new issue loans
- Additionally, with continued rate hikes by the Fed, borrowing continues to get more expensive
  - 3-month SOFR currently sits at ~2.5% from ~0% earlier this year; expectations are it will peak at ~3.25% in January 2023
  - Credit spreads haven't increased nearly as drastically with the average unitranche margin increasing 54 bps to S+589 since last December

Source: DLDeals and Mesirow.

CHART 1: **MONTHLY PRIVATE LOAN ORIGINATION VOLUME**

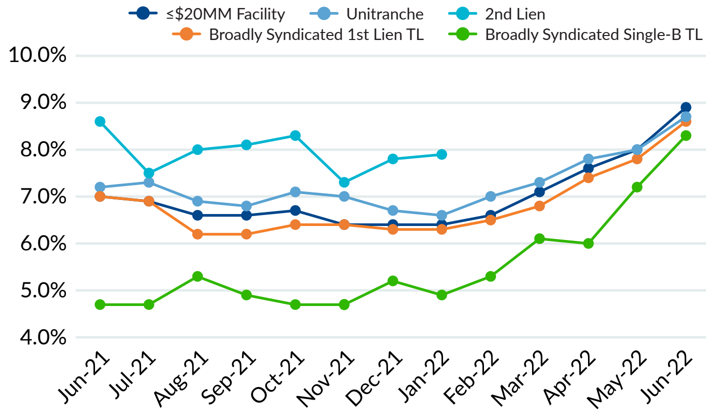
($ billions)



Sources: DLD Private Data.

CHART 2: **PRIVATE VS. LIQUID DEBT**

Using 3M LIBOR Rate



Sources: DLD Private Data.

Financing perspectives: Private credit market environment

Current conditions

PRICING

- Average unitranche pricing is in the high-L+500s to low-L+600s with a 1% SOFR floor and 1-2% upfront
- Junior and mezz debt pricing remains in the low-double digits

LEVERAGE

- 3x–5x leverage standard for middle market credits
- Deals over 6.0x possible for larger credits especially in the tech and software space
- 50% loan-to-value is standard for performing credits

CALL PROTECTION

- 103 or 102 in first year and some prepayment penalty through year 3

COVENANTS

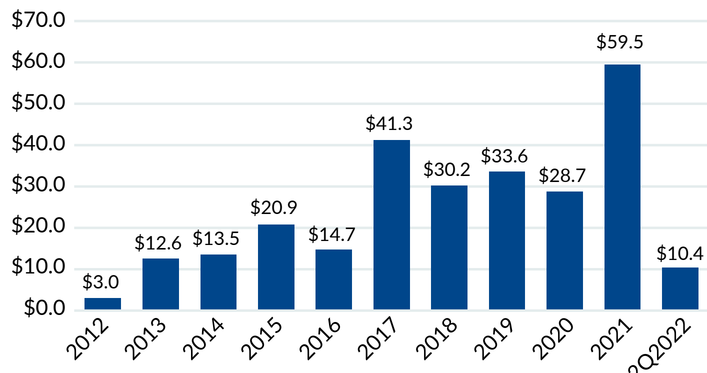
- Often two financial covenants with cushions limited to 25–30%

Other Notes

- Loan-to-Value approaching 60%–70% for the best credits
- Delayed draw terms loans continue to be available
- Lenders continue to be patient with problem children given they only make up a small portion of their portfolio for the time being
- Despite being moderately aggressive, direct lenders and commercial banks are keenly aware of what is going on in the public markets and note currently favorable conditions aren't likely to last

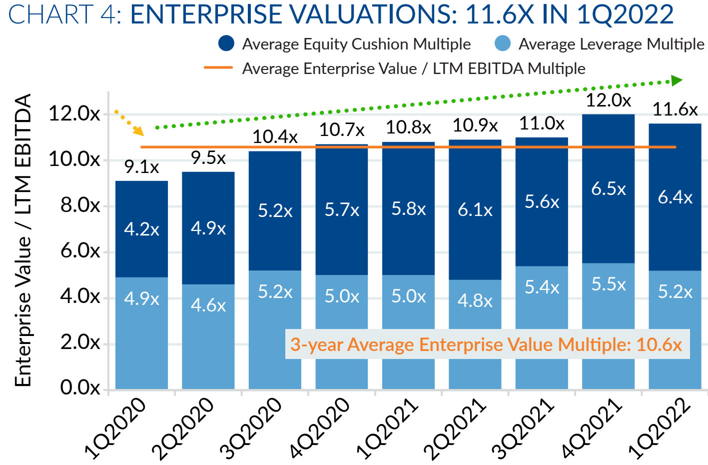
CHART 3: **DIRECT LENDING RAISED IN NORTH AMERICA**

($ billions)



Sources: Pitchbook.

CHART 4: **ENTERPRISE VALUATIONS: 11.6X IN 1Q2022**



Sources: Sources: DLD Private Data; Pitchbook.

Source: DLDeals and Mesirow.

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 and follow us on LinkedIn.

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