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The Private Credit Landscape

MAY 2024

A message from Drew Maloney

Much has been written about private credit's rise as banks retreated from major segments of lending markets throughout the 2010s. American Investment Council research has detailed the rise and current role of private credit in the US economy.[1] For example, a study for AIC estimated that it supported companies that accounted for 545,000 US workers in 2022, generating $90 billion of GDP.[2] Now, as the year gets into full swing, we can take stock of how 2023's year-end data hints at what is to come and also examine how private credit financiers continue to support and fill any funding gaps for businesses around the country.

While the language of financial markets can be complex and confusing, it is important to understand that private credit exists to fill a gap in the market that banks no longer can serve. As we noted in a recent Op-Ed, private credit has been serving small businesses with customized solutions for decades because no two loans can be exactly the same.[3] Since then, its growth and maturation—AIC research indicates private credit could account for over 30% of the overall US credit market—have been fueled by the needs of the US middle market and the benefits of bespoke financing that private credit can provide, especially to small to midsized businesses.[4]

In this likely tumultuous election year, private credit's word of the year will likely be "caution." With mixed data that is prompting complex economic readings, the variables of an election year, and geopolitical instability's ripple effects, private credit fund managers are adapting so they can continue lending. Private credit dealmakers are focused on strong underwriting standards to accommodate potential risks. They are not only getting creative, but also engaging in more refinancings, negotiating existing debt packages with companies that are still trudging through material hits to their business, and more. In short, they are doing what private credit's role traditionally has been, just at much greater scale—even in the reaches of the upper middle market and much further downstream.

2024 will be a year of finesse: navigating what could still be choppy financial markets even if sentiment is finally on the upswing, yet boardrooms are still marked with cautious themes.

Drew Maloney
President & CEO,
American Investment Council

Such finesse requires customization, and customization is what private credit does—carefully. Fortunately, with hundreds of billions of dollars to deploy, private credit firms will be able to keep supporting US businesses throughout 2024 and beyond.

1: "Private Credit Strengthens Small Businesses," American Investment Council, n.d., accessed March 22, 2024.
2: "Economic Contribution of Private Credit to the US Economy in 2022," EY, prepared for the American Investment Council, October 2023.
3: "Small Businesses Are Turning to Private Credit—But Overregulation Threatens to Cut Off That Lifeline," Fortune, Drew Maloney, January 24, 2024.
4: "Economic Contribution of Private Credit to the US Economy in 2022," EY, prepared for the American Investment Council, October 2023.

What is private credit?

Private credit firms raise independent funds that are used to loan capital to private companies. That may not seem like a big deal, but it is. In years past, private equity firms mostly worked with investment banks and other major institutions to help finance their investments. Today's private equity market is different, and private credit firms are a big part of that change. Private credit firms raise independent funds that are used to loan capital to private equity deals. While that may not seem like a big difference, it is. By lending out of dedicated funds, private credit investors: help stabilize the American economy by loaning capital that would otherwise have to be sourced from "too big to fail" institutions; increase access to capital for struggling or unprofitable companies that often have a difficult time convincing traditional lenders to work with them; provide peace of mind to PE firms, regulators, and the companies themselves, because private credit firms keep a close eye on their loans and will not sell them off in small pieces to the highest bidders.

Not all private credit is the same. Different lenders have different areas of expertise, risk tolerance, and transaction experience.

One of the biggest types of private credit is "direct lending." These types of lenders work directly with thousands of private companies and give them tailored financing to help them grow.

Another type of private credit is "distressed debt," which is often synonymous with "special situations debt." These lenders also partner with PE firms, but the companies they work with are usually unprofitable, struggling, or too complex for traditional lenders to loan to them. These types of lenders are vital to a wide swath of the American economy. Not every company performs at its best every single year. Distressed lenders are comfortable working with these companies and offering lifelines to give them another chance at success. Because of the risk involved, distressed lenders are often the last resort to obtain financing. Not only are distressed lenders willing to lend to them, they are also very good at it and keep a close eye on their performance and can adjust their terms if needed.

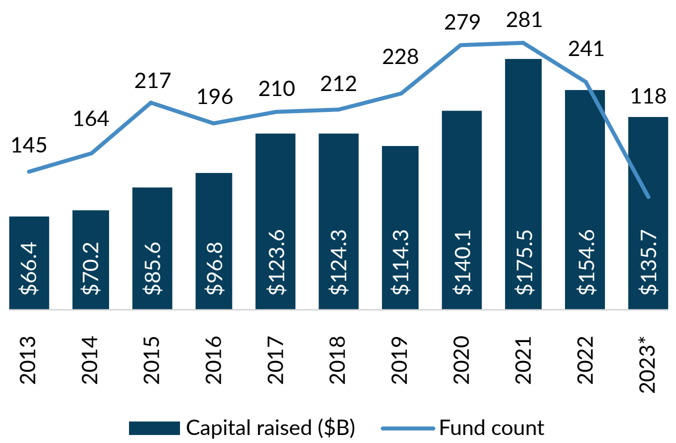
There are also industry-specific lenders that have expertise in complicated sectors, including real estate, venture capital, infrastructure projects, transportation, insurance, agriculture, and consumer. They fill roles that other lenders cannot, and they play an integral part in making sure projects and specialized companies fulfill their potential.

The state of private credit

Since 2019, financial markets have experienced considerable volatility. The global pandemic, increasing geopolitical tensions, high inflation, and rising interest rates have caused a decline in dealmaking as firms seek to navigate an increasingly complex environment. However, despite these disruptions and their effect on dealmaking, private credit firms stand ready to lend.

Over the past decade, private credit managers have raised nearly $1.3 trillion. In 2023 alone, private credit managers raised $135.7 billion—well over double the annual total that was raised one decade ago. Currently, there is approximately $340.8 billion in “dry powder,” or capital that is available to lend but yet to be deployed.[5]

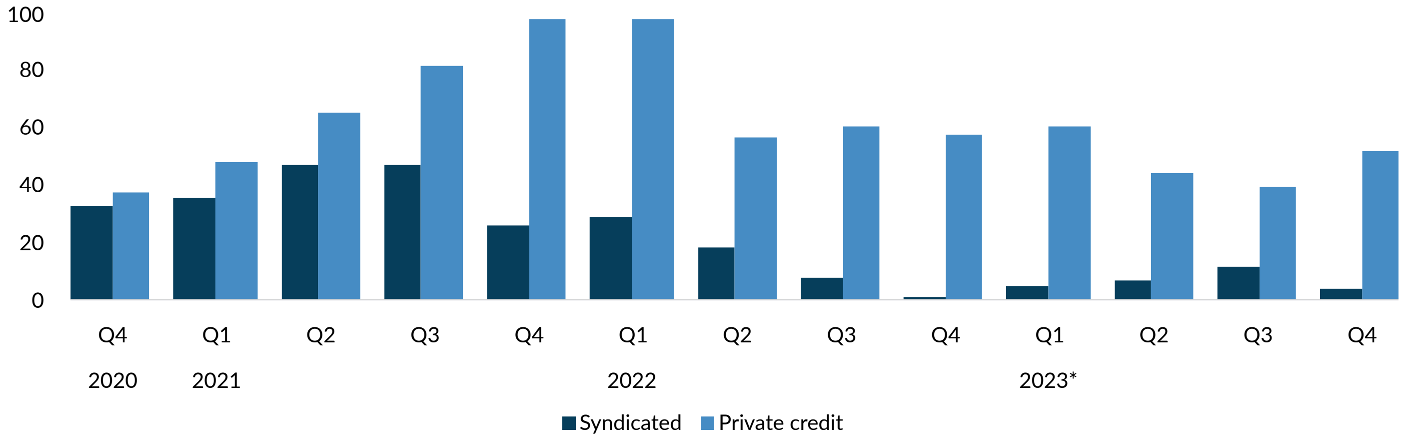
Private credit fundraising activity



Source: PitchBook • Geography: US
*Data through December 31, 2023

Middle-market and larger US companies can still tap private credit as banks continue to retreat, but slowed dealmaking volume is leading to lower loan flow. However, as the data suggests, once an opportunity arrives private credit is ready and available to provide financing. Borrowers appear to increasingly desire the speed and flexibility that private credit provides as financing by private credit for both PE-backed and non PE-borrowers has outpaced syndicated loans over the past year.

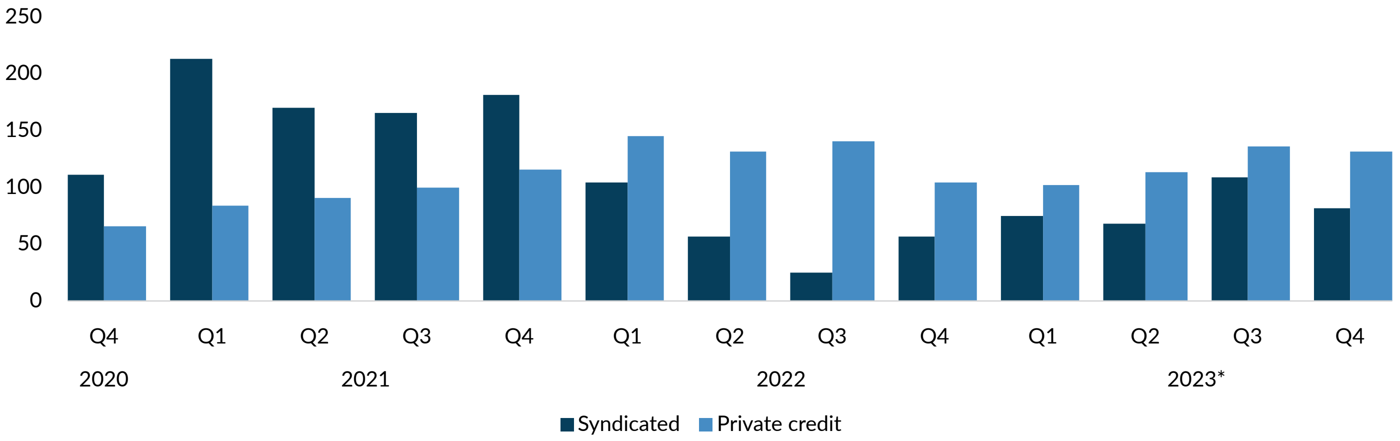
Quarterly count of buyouts financed via the broadly syndicated loan (BSL) market versus private credit



Source: PitchBook • Geography: Global
*Data through December 31, 2023

5: Note: All charts in this report are drawn from PitchBook-LCD datasets that pertain to companies/issuers that garner $50 million or less in EBITDA on an annual basis, unless otherwise noted. As a result, these charts reflect primarily loan and private credit activity in the middle market.

Quarterly count of non-PE M&A financed via BSL versus private credit



Source: PitchBook • Geography: US
*Data through December 31, 2023

As noted in the most recent edition of the American Investment Council's report series on private credit, the asset class remains popular due to its ability to customize to company and investor needs, even during downturns.[6] For 2023, direct lending, a subset of private credit, was estimated at $120 billion. This estimate is nearing the level of institutional leverage loans, which are issued by banks and then syndicated to borrowers, and high-yield bonds.

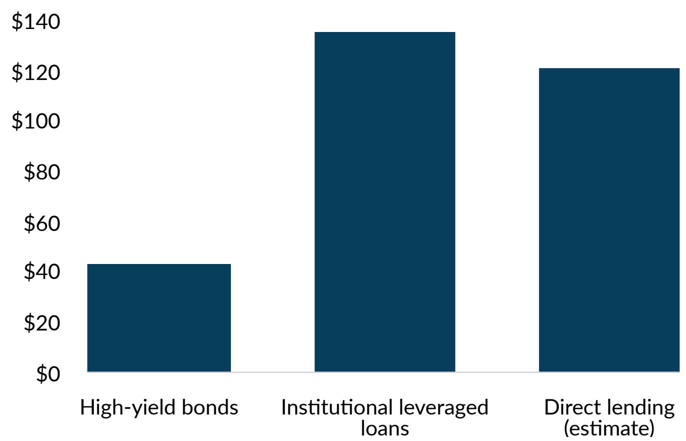
Moreover, since the height of the bull market for buyout dealmaking in 2021, PE borrowers have continually financed their investments using private credit. These borrowers in particular like to opt in to private credit if possible due to the speed and flexibility offered by private credit firms in a customized loan package.

In a sign of tightness in credit conditions weighing on companies, however, private credit deal share by use of proceeds data ticked up noticeably in 2023. Sponsors and companies are tapping private credit to improve their fiscal and business situations by figuring out flexible, sustainable solutions—hence the decline in default rates, as indicated in Proskauer's latest Private Credit Default Index.[7]

Private credit managers are eager to deploy the massive sums of capital raised in the recent lucrative period for collecting commitments. 2021 saw no less than $175.5 billion committed while 2023 saw $135.7 billion closed as investors continue to see value in allocating to private credit vehicles, despite global uncertainty in financial markets and economies.

PE firms and companies are still fans of private credit in financing deals due to private credit's customizability and accessibility, but a general air of caution pervades.

New-issue loan value ($B) for PE-backed borrowers in 2023*

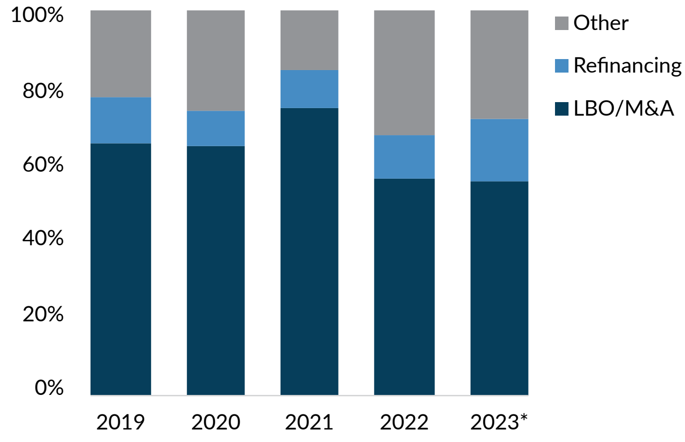


Source: PitchBook • Geography: US
*Data through December 31, 2023

6: "Partners to Private Companies," American Investment Council, November 2023.
7: "Proskauer's Private Credit Default Index Reveals Rate of 1.6% for Fourth Quarter of 2023," Proskauer, January 19, 2024.

They are still incentivized to retain exposure given private credit's returns: North American private credit vintages of 2017 and 2018 are already showing distributed/paid-in multiples exceeding 0.5x, meaning more than half of their total value has already been distributed back to investors. More specifically, the 2017 vintages are nearly matching the 0.69x metric of North American PE overall, while the 2018 vintages are outpacing North American PE handily at 0.53x to 0.36x. For another comparison, private credit remains strong relative to other private asset classes—and in fact has performed even better as of late. As noted in the most recent PitchBook Global Fund Performance Report, "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."[8]

Share of private credit deal count by use of proceeds



Source: PitchBook • Geography: US
*Data through December 31, 2023

Private credit remains a viable, lucrative strategy for asset allocators like public pension funds to help diversify and bolster their returns.

Access to private credit is aiding US businesses in navigating choppier economic conditions and a wave of unique challenges such as high labor costs, stubborn inflation, and high costs of capital.

Private credit return multiples and public market equivalents by vintage*

	Pooled multiples			Morningstar US High Yield			
Vintage year	TVPI	DPI	RVPI	Pooled IRR	Index return	KS-PME	Fund count
2013	1.27x	1.16x	0.12x	7.34%	4.18%	1.07	29
2014	1.27x	0.95x	0.32x	6.37%	3.83%	1.05	38
2015	1.19x	0.80x	0.40x	5.80%	4.03%	1.04	45
2016	1.36x	0.81x	0.56x	10.24%	5.59%	1.21	43
2017	1.25x	0.68x	0.57x	8.39%	3.39%	1.14	48
2018	1.30x	0.53x	0.77x	10.71%	3.02%	1.22	56
2019	1.23x	0.47x	0.76x	11.76%	3.08%	1.19	45
2020	1.15x	0.23x	0.92x	10.37%	2.41%	1.16	45
2021	1.11x	0.19x	0.92x	9.57%	-1.32%	1.12	66
2022	1.07x	0.17x	0.90x	7.59%	-3.24%	1.07	52

Source: PitchBook • Geography: North America
*Data through June 30, 2023
Note: TVPI: The total value to paid-in capital for a fund, meaning the total value of the fund's investments and distributions, relative to paid-in capital.
DPI: The distributed capital to paid-in ratio, meaning the capital that has been distributed back to investors relative to paid-in capital.
RVPI: The remaining value of the unrealized investments in the fund relative to paid-in capital.

8: "Q2 2023 Global Fund Performance Report (with preliminary Q3 2023 data)," PitchBook, Hilary Wiek, CFA, CAIA, et al., February 5, 2024.

Case studies

Aligned Data Centers

A provider of modular datacenter and mechanical cooling infrastructure systems and services, Aligned Data Centers is seeing opportunities in the endless demand for computing resources. Initially backed in summer 2013 by a consortium of buyers including One Equity Partners, the company has since had Macquarie Asset Management join its roster of owners. Aligned Data Centers has secured several rounds of capital infusion over the past few years, most recently culminating in a couple installments of hundreds of millions of dollars apiece to fuel growth—in particular, the development of a datacenter in Utah. The most recent infusion was provided by AIC member Blackstone's Infrastructure & Asset Based Credit Group, which lent an initial $600 million senior secured credit facility. This transaction represents a timely confluence of market trends, including the inexorable demand for datacenters and computing resources as industries continue to digitalize, while larger firms that are active in private credit can fuel significant growth.

Kaizen Auto Care

Founded in 2013 and based in Scottsdale, Arizona, Kaizen Auto Care operates 48 locations of full-service collision repair shops throughout the American Southwest and Midwest. Kinderhook Industries pulled on debt financing from Twin Brook Capital Partners to close an acquisition of Kaizen in mid-March 2024; LNC Partners had previously backed Kaizen. This case study and transaction is a classic example of private credit-PE partnership with another US middle-market business, yet in a different sector. As part of the deal, a new CEO who previously worked with Kinderhook Industries to grow a collision repair company from eight to 45 locations will join existing Kaizen leadership to assist them in growing the company.

Velosio

Cloud-based business management services platform Velosio is relatively young, but there is a twist: It was formed by the merger of SBS Group and Socius in 2017 in a merger of equals in order to achieve greater economies of scale and grow total market share. Feeding into the burgeoning ecosystem of digitalization of professional services, Velosio still focuses on helping companies across the middle market in particular with a suite of services spanning project management, automation, analytics, and more. With 450 employees, the company is looking to grow further and thus was recently acquired by Court Square Capital Partners from former sponsor Harren Equity Partners. Churchill Asset Management served as lead left arranger and administrative agent on the first-lien financing, and AB Private Credit Investors was joint lead arranger. Considered a sponsor-to-sponsor transaction, the deal exemplifies the way private credit funds are helping companies reach higher stages of growth via an acquisition by a PE firm with additional resources and reach.

G&A Partners

G&A Partners provides human resources outsourcing services spanning administration, employee benefits, risk management, and recruitment. A few years ago, AIC member The Riverside Company acquired a stake backing G&A Partners as it continued to grow throughout the market volatility that ensued, ultimately leading to management striking a deal with TPG to give the latter majority backing. MidCap Financial held a variety of roles on the transaction, serving as administrative agent, joint lead arranger, and joint book runner for the senior secured facility that underwrote the deal. G&A Partners is based in Houston and employs approximately 600 people in that burgeoning metropolitan area. This deal exemplifies the partnership of private credit and experienced buyout shops that helps companies that are closely tied to labor markets help weather the recent period of volatile supply and demand labor dynamics.

The Purple Guys

AIC research has discussed the waves of digitalization that have swept the US middle market for years, but at the intersection of that digitalization, entrepreneurship, accelerated growth postpandemic, and potential PE partnership, private credit plays a key role in financing such deals at times of opportunity. This deal is a case in point: The Purple Guys offers a bevy of managed IT services, hosted cloud options, and overall cybersecurity. It employs 280 people and is based out of Shreveport, Louisiana. It supported multiple middle-market companies over the years in digital transformation, with its growth ultimately leading to an acquisition in early 2020 by ParkSouth Ventures and Kian Capital Partners. Since then, it has continued to grow, garnering a recent infusion of debt financing from its partner Kian Capital in a package of subordinated debt and equity to be able to add on MBS and Salvus, two managed service providers. The deals helped The Purple Guys expand its capabilities and entrenched its geographic reach into Kansas City and Texas.

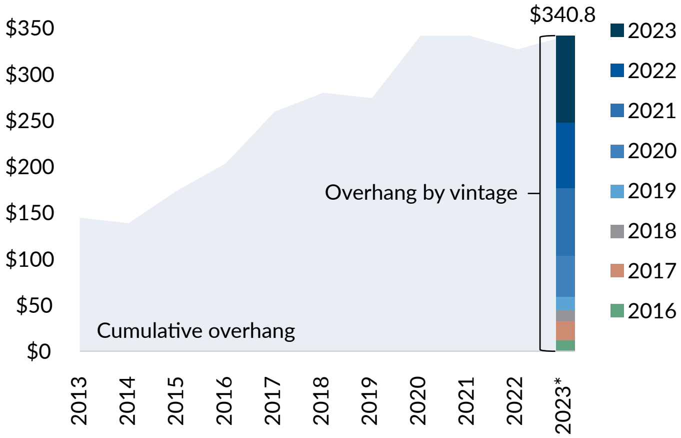
Music catalog securitization

Private credit's flexibility and suitability to different asset classes was on full display in a deal in March 2024 involving AIC member KKR, 3-year-old HarbourView Equity Partners (which is backed by AIC Member Apollo Global Management), and a catalog of music royalties. Since its inception in 2021, HarbourView has acquired an estimated $1.6 billion in what some dub "regulatory managed assets" but is most often licensed intellectual property (IP) from artists, though the firm also tackles other equity investment opportunities.[9] In this latest deal, HarbourView secured about $500 million in debt financing from KKR, which led the deal, and Kuvare Asset Management as a participant. The transaction was backed by a private asset-backed securitization of HarbourView's catalog of music royalties, which includes artists such as Pat Benatar, Nelly, Wiz Khalifa, and Jeremih. Asset-based finance has been in the headlines lately, as it often has ebbs and flows of focus due to market volatility. It was not quite as common for IP to be utilized as an asset in such strategies, but given the growing profusion of art in portfolios, private credit and such asset-backed finance plays will likely venture into further bespoke securitizations. For example, in this particular deal, artists are able to monetize back catalogs further to secure revenue streams that may be more predictable than licensing deals, and investors are able to diversify portfolios with noncorrelated assets.

9: "HarbourView Raises $500M in Debt Financing Led by KKR," Music Business Worldwide, Murray Stassen, March 13, 2024.

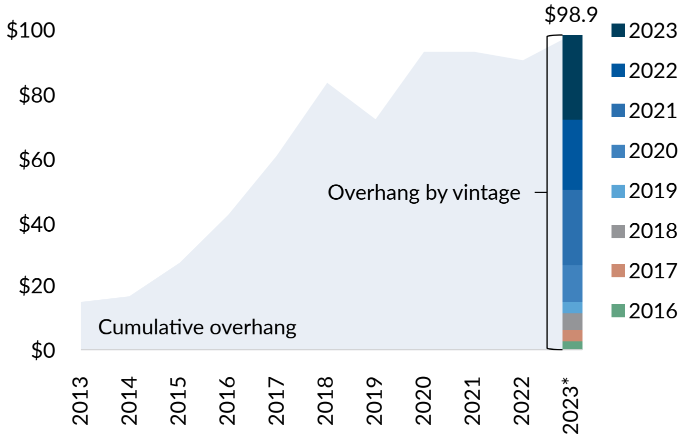
Looking forward

Private credit dry powder ($B) by vintage



Source: PitchBook • Geography: US
*Data through June 30, 2023

Direct lending dry powder ($B) by vintage



Source: PitchBook • Geography: US
*Data through June 30, 2023

There may be a current slowdown in PE or even general M&A dealmaking, but prospects are brighter for private credit players to aid companies. S&P Global estimated that speculative-grade maturities will rise more than fourfold between 2024 and 2028, reaching $1.1 trillion.[10] Borrowers have been reducing their debt loads, but working with companies to navigate complex credit scenarios with flexible terms is an opportunity for private credit. The nuances of the economic environment, with mixed to contrary indicators of both growth and troubling portents (for example, strong hiring juxtaposed against costly inflation in key segments), further complicate any forecasts. However, PitchBook data shows that private credit players and the US PE industry hold near-record reserves of capital commitments to tap into dealmaking—in whichever form those deals may take, with bespoke features and cautious amendments. US private credit capital overhang stands at a near-record $340.8 billion, with over $100 billion concentrated in fund vintages from 2020 and earlier, which suggests their fund managers are avidly looking for deals.

Marked with creativity, the dealmaking environment for private credit is growing more favorable. Given that private lenders have been able to step into the place of banks to service PE firms and companies in buyout volume to a record extent, some banks are actually opting to serve as intermediaries for their smaller business clients and private credit funds, according to Bloomberg.[11] Moreover, private credit is diversifying further, especially with newer entrants. In part because of private credit's strong returns and ability thus far to navigate economic choppiness, insurance companies are also increasing exposures, with 62% already doing so.[12]

As asset-backed financings like the aforementioned music securitization deal show, as even more firms enter into private credit, such a rush and the near-record capital overhang bode well for both private credit fundraising and dealmaking going forward. Private credit dealmaking may grow more competitive and complicated, but players are already evolving their strategies, and in the short term are adapting tactics, all to better work at a critical junction between private businesses, credit markets, and overall growth.

10: "Credit Trends: Global Refinancing: Maturity Wall Looms Higher for Speculative-Grade Debt," S&P Global Ratings, Evan M. Gunter, et al., February 5, 2024.
11: "Wall Street Takes New Role as Matchmaker to Private Credit," Bloomberg, Ellen Schneider and Kat Hidalgo, April 17, 2024.
12: "Private Credit Remains a Hot Item for Insurance Companies," Institutional Investor, Michael Thrasher, April 2, 2024.

Methodology

The datasets within this report were drawn from a variety of reports and unique datasets produced by PitchBook-LCD. The private credit fundraising and overhang data was drawn from PitchBook's standard reports and utilized PitchBook's standard report methodologies. The lending datasets were derived from a variety of PitchBook-LCD publications. The case studies were based on select transactions covered in Q1 2024 editions of the US Private Credit and Middle Market Weekly Wrap. PitchBook's fund performance data was based on the most recently available edition of its Benchmarks at time of writing, with data as of June 30, 2023, due to fund reporting cycles.

About AIC

The American Investment Council (AIC) is the leading advocacy and resource organization established to develop and provide information about the private investment industry and its contributions to the long-term growth of the U.S. economy and the retirement security of American workers. Member firms of the AIC consist of the country's leading private equity, private credit, and growth capital firms united by their successful partnerships with limited partners and American businesses. More information about the AIC can be found at www.investmentcouncil.org.