



Houlihan Lokey

Portfolio Valuation and Fund Advisory Services

# Direct Lending Update

SUMMER 2022



# Introduction

Dear Clients and Friends,

Houlihan Lokey's Portfolio Valuation and Fund Advisory Services team is pleased to present the summer 2022 edition of the Direct Lending Update.

We have included key trends for more than 100 business development companies (BDCs) to help you stay ahead in this constantly evolving industry. We hope you find this update to be informative and that it serves as a valuable resource to you in staying abreast of the market. If there is additional content you would find useful for future updates, please do not hesitate to call or email us with your suggestions. We look forward to staying in touch with you.

Regards,

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# Key Trends

## Major Themes at Play in the Economy Are Impacting Direct Lending

- Based on research from PitchBook/LCD, the second quarter of 2022 saw \$55.1 billion of institutional loan volume, representing the lowest quarterly output since the second quarter of 2020, when the loan market was navigating the early stages of the COVID-19 pandemic.<sup>(1)</sup>
- Private credit providers are subject to the same risks that all capital providers are facing, including inflation, supply chain issues, rising interest rates, tight labor markets, potential for an economic recession, and global geopolitical unrest. Despite that backdrop, private credit providers continued to not only deploy capital, but also to take market share from the syndicated loan market.

## Bifurcation of Syndicated Loan/Leveraged Loan/Private Credit Markets

- 2022 has demonstrated that major differences exist between the syndicated loan market and the private credit market. The volatility experienced by public equity markets in 2022 has been felt in the syndicated loan market, leading to lower issuance levels compared to 2021. In contrast, the private credit market has remained robust and open for business, as market participants have placed enhanced value on the distinguishing factors of the private credit market, such as flexibility and customization of deal terms, typically no rating requirement, a higher degree of financing certainty, and an efficient process with fewer parties involved.
- Competition among direct lenders has remained robust going into Q3 2022, keeping pricing on new loans generally flat relative to the first half of 2022. This contrasts with the broadly syndicated market, which has seen significant spread widening since the first half of 2022. Given the high levels of fundraising for direct lending over the past several years, there is still significant undeployed capital chasing new deals.
- Despite pricing on new loans being generally flat for direct lending deals, lenders have been able to get more favorable terms such as reduced leverage levels, more conservative EBITDA adjustments, enhanced covenant documentation, and other structural protections, relative to deal execution over the past 12–18 months.
- According to proprietary data from BMO Sponsor Finance, EBITDA adjustments have declined from 24% of adjusted EBITDA in Q4 2021 to 15% for the year-to-date period ended June 2022, suggesting that sponsors are placing more scrutiny on EBITDA adjustments and perhaps becoming more conservative in their underwriting.<sup>(2)</sup>
- Major beneficiaries of the slowdown in the broadly syndicated market have been large asset managers with the scale and capital to take on deals at the high end of the direct lending/private credit market.
- Middle-market direct lending platforms—including middle-market CLOs, BDC public equity, private debt funds, and mezzanine funds—raised approximately \$87 billion so far in 2022, representing a 22% increase compared to prior year.<sup>(3)</sup> As 2023 approaches, the macro themes of Federal Reserve interest rate policy, inflation concerns, a looming recession, and geopolitical uncertainty will remain in the spotlight. Direct lenders and private credit providers will also keep an eye on tight labor markets, supply chain disruptions, commodity prices, and pricing power concerns for their portfolio companies. Furthermore, considering the rising interest rate environment, direct lenders will be focusing on the debt service levels and interest coverage ratios for their portfolio companies.

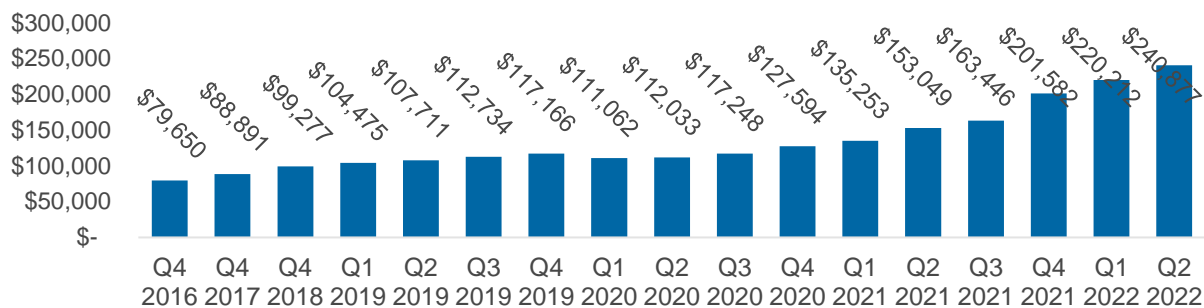
Sources: Advantage Data, PitchBook, LCD Comps, Refinitiv.

(1) Pitchbook "LCD – Middle Market Review (Second Quarter, 2022)."

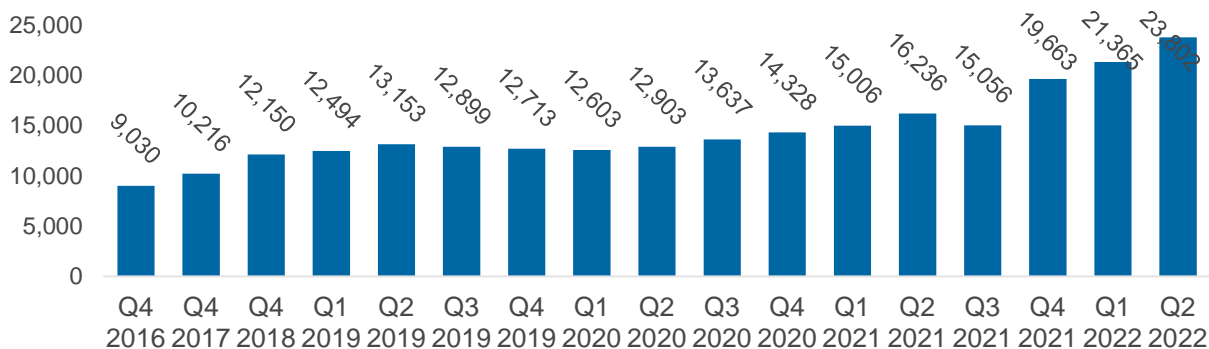
(2) BMO Sponsor Finance "Transaction Trends" Q3 2022.

(3) Refinitiv LPC and Debtwire Middle Market Piper Sandler 2Q22 Joint Private Credit Report (7/25/22).

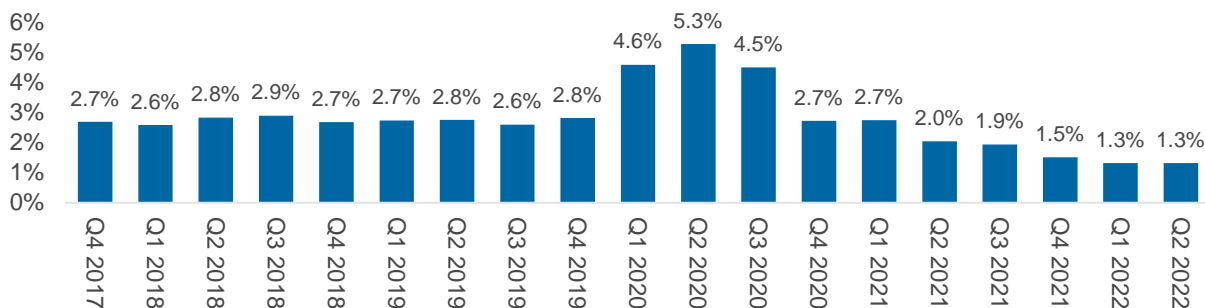
## Fair Value of BDC Portfolios<sup>(1)</sup> (\$ in millions)



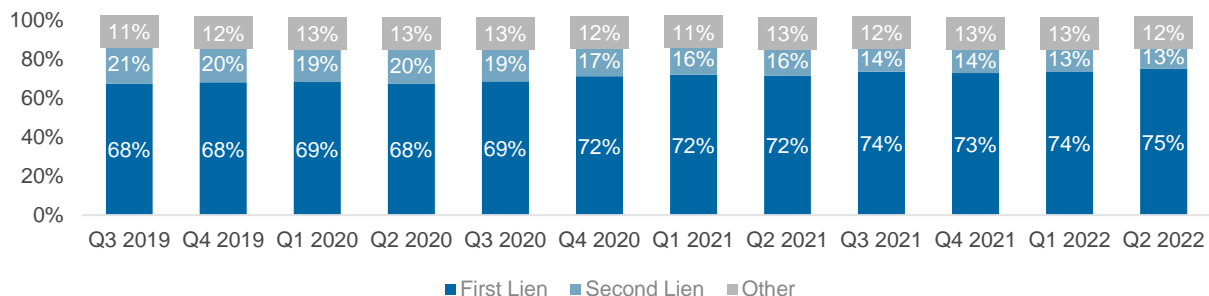
## Total Number of Investments in BDC Portfolios<sup>(2)</sup>



## Nonaccrual Investments as a Percentage of Total Portfolio<sup>(3)</sup>



## BDC Portfolio Composition by Seniority Based on Fair Value<sup>(4)</sup>



Source: Advantage Data.

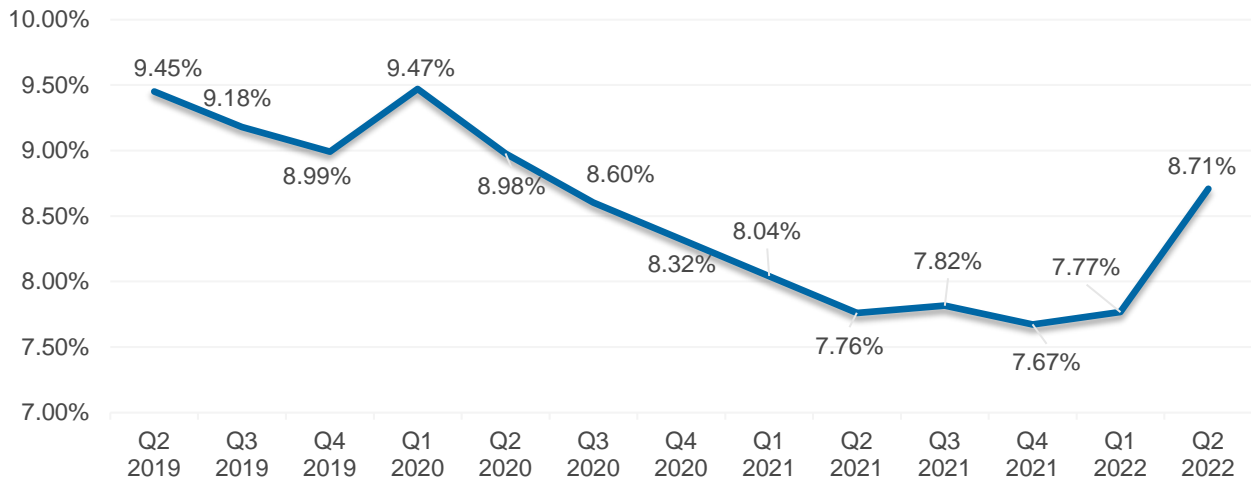
(1) Reflects the fair value for BDC portfolios tracked by Advantage Data.

(2) Reflects the total number of investments for all BDCs tracked by Advantage Data.

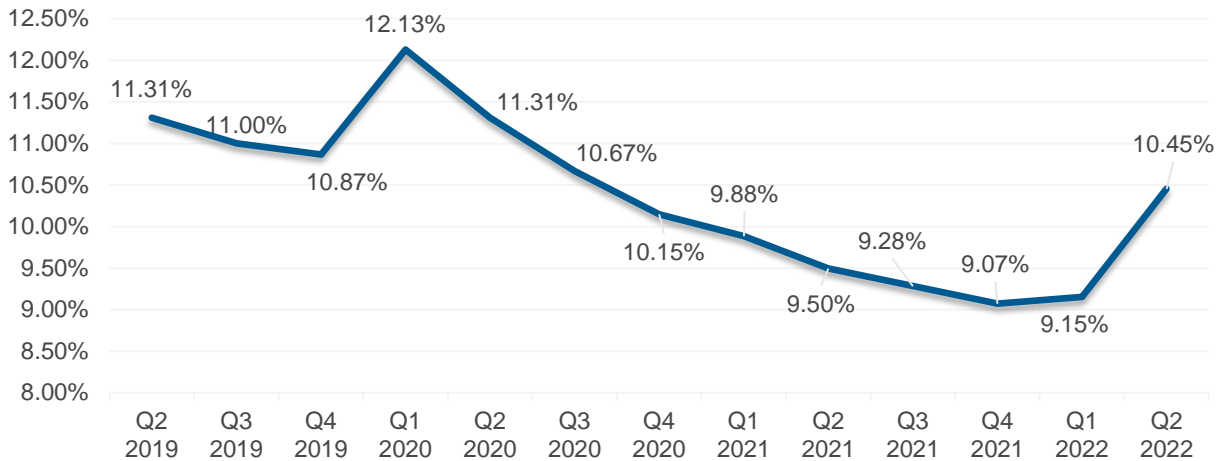
(3) Reflects cost of nonaccrual investments as a percentage of total portfolio cost for BDCs tracked by Advantage Data.

(4) Represents the aggregate composition of all BDC portfolios tracked by Advantage Data.

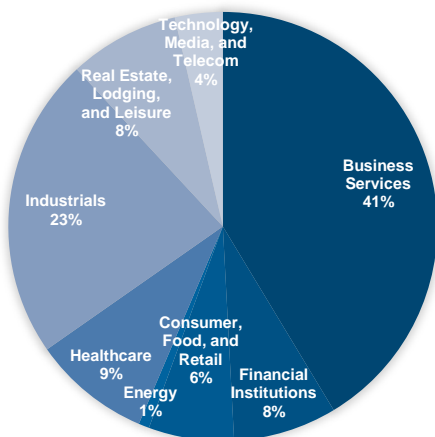
## Average First Lien Yield—BDC Investment Portfolios<sup>(1)</sup>



## Average Second Lien Yield—BDC Investment Portfolios<sup>(1)</sup>



## Industry Breakdown by BDC Portfolio Company—Q2 2022<sup>(2)</sup>



## Industry Breakdown by BDC Investment Yields—Q2 2022

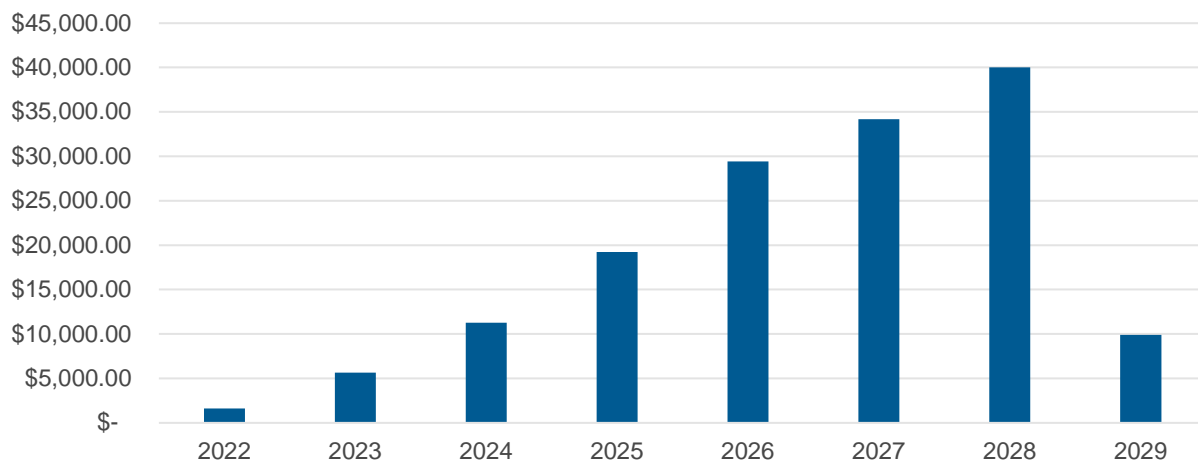
Industry	First Lien	Second Lien
Business Services	8.81%	10.08%
Financial Institutions	8.06%	10.22%
Consumer, Food, and Retail	9.13%	11.39%
Energy	8.75%	10.48%
Healthcare	8.48%	10.05%
Industrials	8.74%	10.78%
Real Estate, Lodging, and Leisure	8.65%	9.88%
Technology, Media, and Telecom	8.48%	11.28%

Source: Advantage Data.

(1) Yield is based on reported fair value, stated maturity, and stated interest rate. Represents data for all BDCs tracked by Advantage Data. Excludes outliers.

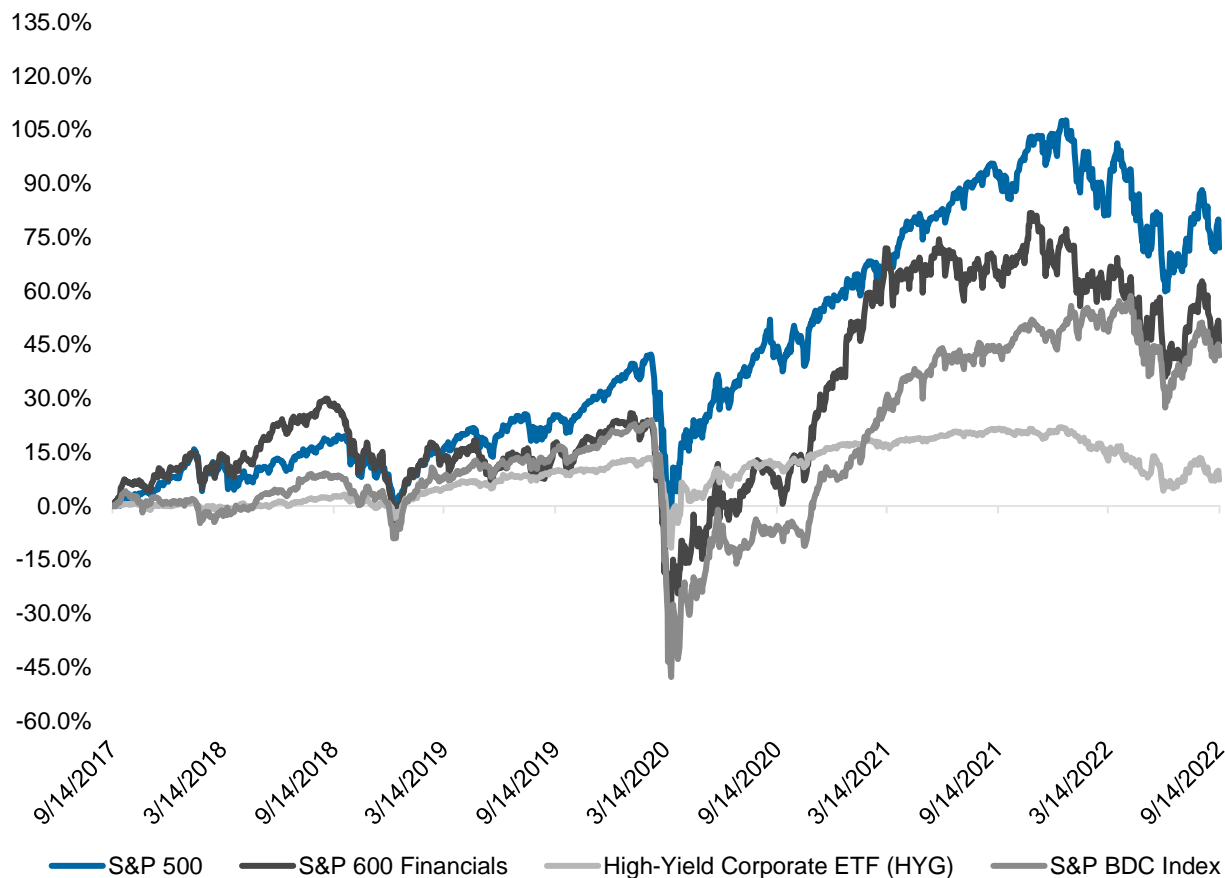
(2) Industry is based on the industry of each BDC portfolio company and is broken down by aggregate principal for each BDC investment.

## Maturity of LIBOR-Based Debt Securities for BDC Portfolio Companies by Year<sup>(1)</sup> (principal in \$ millions)



## Cumulative Total Return (%) as of September 14, 2022

	1 Year	5 Years
S&P 500	-1.9%	79.7%
S&P 600 Financials	-9.1%	48.4%
High-Yield Corporate ETF (HYG)	-7.7%	11.3%
S&P BDC Index	7.0%	33.9%



Sources: Advantage Data, Bloomberg.

(1) Represents the principal balance of maturities for debt securities with a LIBOR component for all BDCs tracked by Advantage Data.

# Publicly Traded BDC Market Snapshot

(Dollars in millions, except per share data)

Company Name	Ticker	Market Cap.	Price at 9/12/2022	Price/52 wk High	LTM Price Change	Price as a Multiple of NAV	LTM ROA	LTM ROE	Div. Yield	Debt/Equity
<b>Large Cap</b>										
Ares Capital Corp.	ARCC	\$ 10,189.64	\$ 20.16	88%	-0.8%	1.07x	7.1%	11.9%	8.5%	1.3x
FS KKR Capital Corp.	FSK	\$ 6,148.97	\$ 21.65	92%	-1.8%	0.82x	5.5%	8.0%	11.4%	1.2x
Owl Rock Capital Corp.	ORCC	\$ 5,123.64	\$ 13.01	85%	-7.9%	0.90x	4.4%	5.6%	9.5%	1.2x
Blackstone Secured Lending Fund	BXSL	\$ 4,181.20	\$ 24.64	64%	NM	NM	NM	NM	NM	NM
Main Street Capital Corp.	MAIN	\$ 3,067.24	\$ 40.76	86%	-0.8%	1.61x	9.3%	14.9%	6.7%	1.0x
Prospect Capital Corp.	PSEC	\$ 3,020.16	\$ 7.65	84%	-0.6%	0.73x	10.0%	13.3%	9.4%	0.6x
Golub Capital BDC, Inc.	GBDC	\$ 2,348.11	\$ 13.74	85%	-13.1%	0.91x	5.6%	8.5%	8.7%	1.2x
Hercules Capital, Inc.	HTGC	\$ 1,780.12	\$ 14.12	74%	-15.0%	1.34x	2.6%	1.0%	14.2%	1.1x
Goldman Sachs BDC, Inc.	GSBD	\$ 1,756.16	\$ 17.19	83%	-6.3%	1.11x	5.4%	8.4%	10.5%	1.3x
Sixth Street Specialty Lending, Inc.	TS LX	\$ 1,546.98	\$ 19.10	77%	-14.0%	1.17x	6.7%	10.1%	12.0%	1.0x
New Mountain Finance Corp.	NMFC	\$ 1,349.61	\$ 13.40	95%	0.7%	1.00x	6.1%	9.4%	9.0%	1.5x
Oaktree Specialty Lending Corp.	OCSL	\$ 1,268.95	\$ 6.92	89%	-2.0%	1.00x	3.6%	4.1%	9.8%	1.1x
Barings BDC, Inc.	BBDC	\$ 1,061.69	\$ 9.72	84%	-11.8%	0.85x	2.8%	2.2%	9.9%	1.2x
Mean				84%	-6.1%	1.04x	5.8%	8.1%	10.0%	1.14x
<b>Mid Cap</b>										
Bain Capital Specialty Finance, Inc.	BCSF	\$ 948.42	\$ 14.69	90%	-1.0%	0.86x	5.9%	8.8%	9.3%	1.1x
SLR Investment Corp.	SLRC	\$ 840.76	\$ 15.35	77%	-19.8%	0.83x	1.8%	0.6%	10.7%	1.0x
MidCap Financial Investment Corp.	MFIC	\$ 823.84	\$ 12.97	93%	0.0%	0.84x	4.4%	5.5%	11.1%	1.6x
BlackRock TCP Capital Corp.	TCPC	\$ 777.55	\$ 13.46	93%	-0.8%	0.96x	5.0%	6.9%	8.9%	1.3x
TCG BDC, Inc.	CGBD	\$ 734.77	\$ 14.17	95%	5.7%	0.84x	7.4%	12.6%	11.6%	1.2x
CION Investment Corp.	CION	\$ 578.70	\$ 10.16	67%	NM	0.64x	4.6%	5.2%	12.2%	1.0x
Crescent Capital BDC, Inc.	CCAP	\$ 559.06	\$ 18.10	84%	-5.4%	0.87x	5.5%	7.3%	9.1%	1.0x
PennantPark Floating Rate Capital Ltd.	PFLT	\$ 555.48	\$ 12.25	85%	-4.2%	1.00x	3.9%	4.1%	9.3%	1.5x
Capital Southwest Corp.	CSWC	\$ 533.54	\$ 19.38	68%	-23.0%	1.17x	5.4%	7.4%	13.7%	1.3x
Trinity Capital Inc.	TRIN	\$ 532.95	\$ 15.23	75%	-5.3%	1.04x	10.6%	15.6%	11.0%	1.3x
Mean				84%	-6.1%	0.89x	4.9%	6.5%	10.6%	1.22x
<b>Small Cap</b>										
Gladstone Investment Corp.	GAIN	\$ 475.50	\$ 14.32	83%	3.2%	1.07x	11.6%	15.5%	8.4%	0.6x
Fidus Investment Corp.	FDUS	\$ 468.22	\$ 19.16	91%	9.9%	0.97x	13.6%	21.5%	9.5%	NM
TriplePoint Venture Growth BDC Corp.	TPVG	\$ 468.03	\$ 13.44	70%	-15.2%	1.03x	8.0%	10.9%	10.7%	1.2x
PennantPark Investment Corp.	PNNT	\$ 426.50	\$ 6.52	81%	0.5%	0.68x	4.7%	5.5%	9.2%	1.2x
Gladstone Capital Corp.	GLAD	\$ 345.45	\$ 10.07	79%	-10.9%	1.10x	11.0%	15.7%	8.0%	0.9x
Saratoga Investment Corp.	SAR	\$ 323.55	\$ 27.12	90%	-5.6%	0.95x	5.3%	7.0%	8.0%	1.8x
Horizon Technology Finance Corp.	HRZN	\$ 317.28	\$ 12.50	66%	-23.1%	1.07x	7.2%	10.2%	10.0%	1.3x
WhiteHorse Finance, Inc.	WHF	\$ 317.27	\$ 13.65	84%	-10.3%	0.91x	5.8%	7.3%	11.4%	1.2x
BlackRock Capital Investment Corp.	BKCC	\$ 291.32	\$ 3.98	91%	3.4%	0.87x	5.5%	6.2%	10.1%	0.7x
Stellus Capital Investment Corp.	SCM	\$ 261.52	\$ 13.38	91%	2.5%	0.93x	5.2%	10.7%	8.5%	2.1x
Portman Ridge Finance Corp.	PTMN	\$ 212.54	\$ 22.14	85%	-9.1%	0.81x	2.6%	1.0%	11.4%	1.4x
Oxford Square Capital Corp.	OXSQ	\$ 194.57	\$ 3.91	87%	-3.5%	1.06x	-6.4%	-18.9%	10.7%	1.0x
Monroe Capital Corp.	MRCC	\$ 188.50	\$ 8.70	73%	-16.3%	0.81x	4.0%	3.2%	11.5%	1.4x
Medallion Financial Corp.	MFIN	\$ 183.73	\$ 7.82	78%	-0.3%	0.62x	4.6%	17.1%	4.1%	4.7x
OFS Capital Corp.	OFS	\$ 143.70	\$ 10.70	79%	3.3%	0.73x	8.4%	15.9%	10.8%	1.8x
First Eagle Alternative Capital BDC, Inc.	FCRD	\$ 98.74	\$ 3.30	67%	-25.2%	0.62x	-3.3%	-13.9%	13.3%	1.4x
Great Elm Capital Corp.	GECC	\$ 92.44	\$ 12.16	56%	-41.9%	0.95x	-6.4%	-36.9%	14.8%	1.5x
PhenixFIN Corp.	PFX	\$ 82.38	\$ 37.50	86%	-12.6%	0.64x	-1.5%	-5.9%	0.0%	0.6x
Investcorp Credit Management BDC, Inc.	ICMB	\$ 66.46	\$ 4.62	78%	-15.2%	0.67x	1.0%	-5.0%	13.0%	1.7x
Logan Ridge Finance Corp.	LRFC	\$ 53.50	\$ 19.74	74%	-23.2%	0.53x	-1.6%	-11.7%	0.0%	NM
Rand Capital Corp.	RAND	\$ 37.94	\$ 14.70	78%	-8.9%	0.66x	2.0%	1.7%	4.1%	NM
Equus Total Return, Inc.	EQS	\$ 26.63	\$ 1.97	72%	-15.1%	0.72x	6.3%	6.8%	0.0%	NM
Firsthand Technology Value Fund, Inc.	SVVC	\$ 10.20	\$ 1.48	27%	-68.7%	0.20x	-66.5%	-73.2%	0.0%	NM
Mean				77%	-12.3%	0.81x	0.9%	-0.4%	8.2%	1.47x
High				95%	9.9%	1.61x	13.6%	21.5%	14.8%	4.68x
Mean				80%	-9.3%	0.89x	3.2%	3.6%	9.2%	1.31x
Median				84%	-6.0%	0.90x	5.3%	7.0%	9.8%	1.23x
Low				27%	-68.7%	0.20x	-66.5%	-73.2%	0.0%	0.57x

Source: S&P Capital IQ.

Note: As of September 12, 2022.

NM refers to not meaningful.

ROA = (Net Change in Net Assets + Interest Expense)/Average Net Assets.

ROE = Net Change in Net Assets/Average Equity.

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Houlihan Lokey's Portfolio Valuation and Fund Advisory Services practice is a leading advisor to many of the world's largest asset managers, who rely on our strong reputation with regulators, auditors, and investors; private company, structured product, and derivative valuation experience; and independent voice. We value illiquid assets on behalf of hundreds of hedge funds, private equity firms, financial institutions, corporations, and investors. We rapidly mobilize the right team for the job, drawing on our expertise in a wide variety of asset classes and industries along with our real-world transaction experience and market knowledge from our dedicated global Financial and Valuation Advisory business.

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Houlihan Lokey is the trusted advisor to more top decision-makers than any other independent global investment bank.

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2021 M&A Advisory Rankings All U.S. Transactions		
Advisor	Deals	
1 Houlihan Lokey	301	
2 Goldman Sachs	285	
3 JP Morgan	282	
4 Jefferies	199	
5 Morgan Stanley	185	

Source: Refinitiv.

No. 1 U.S. M&A Advisor

Top 5 Global M&A Advisor

Leading Capital Markets Advisor

## Financial Restructuring

2021 Global Distressed Debt & Bankruptcy Restructuring Rankings		
Advisor	Deals	
1 Houlihan Lokey	63	
2 Rothschild	38	
3 Moelis	34	
4 PJT Partners	33	
5 Lazard	24	

Source: Refinitiv.

No. 1 Global Restructuring Advisor

1,500+ Transactions Completed Valued at More Than \$3.0 Trillion Collectively

## Financial and Valuation Advisory

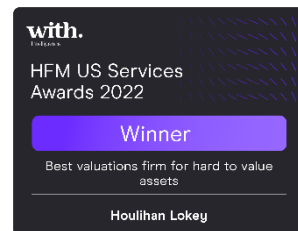
2002 to 2021 Global M&A Fairness Advisory Rankings		
Advisor	Deals	
1 Houlihan Lokey	952	
2 JP Morgan	890	
3 Duff & Phelps, A Kroll Business	882	
4 Morgan Stanley	602	
5 BofA Securities	531	

Source: Refinitiv. Announced or completed transactions.

No. 1 Global M&A Fairness Opinion Advisor Over the Past 20 Years

1,000+ Annual Valuation Engagements

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