Private Debt Intelligence – 7/2/2018

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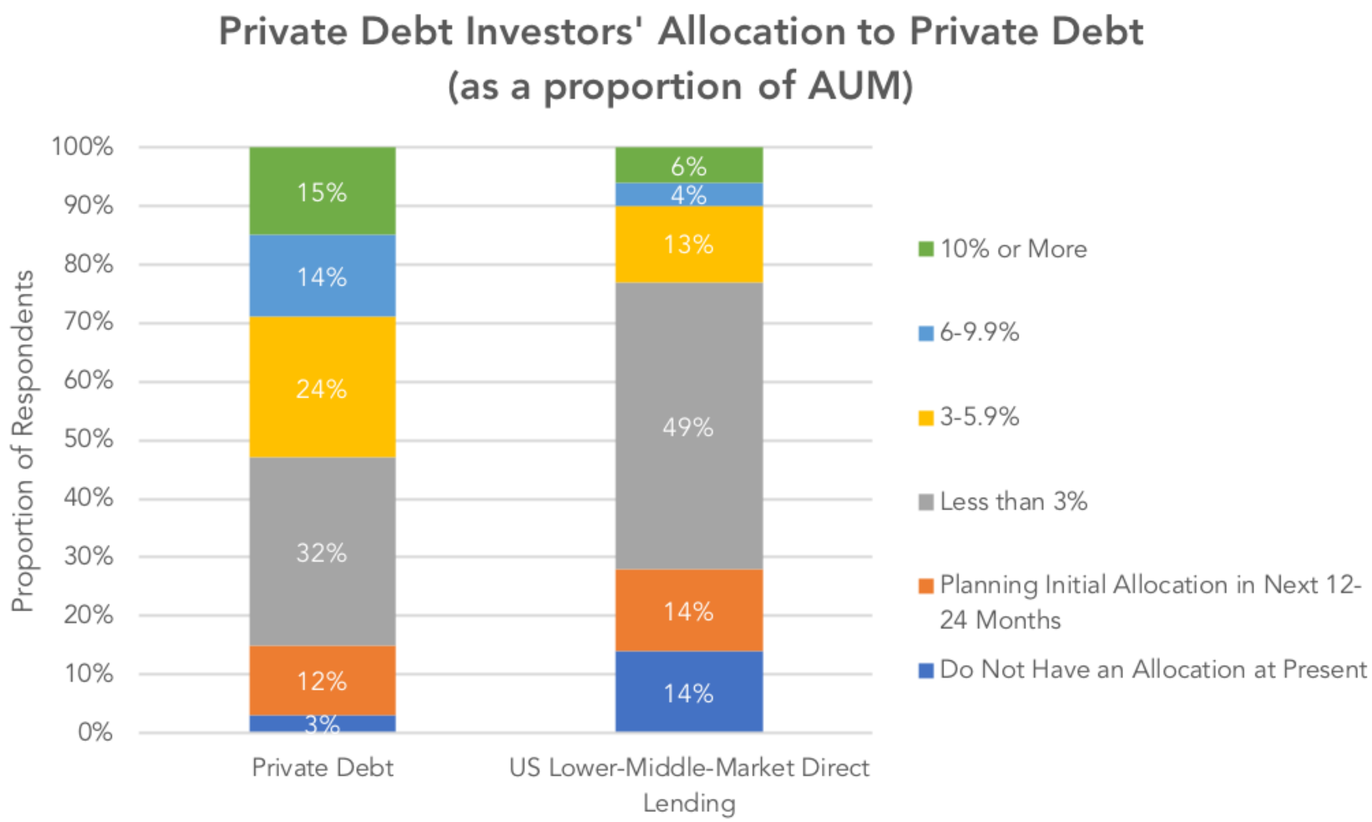
Investors Flock to US Lower-Middle-Market Private Debt

Chart



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A Preqin/NXT Capital survey of 78 institutional investors investing in private debt found that 45% believe that the private debt market is at a peak and that assets are overvalued, leading investors to believe that the coming months will see a correction. In response, investors are looking increasingly to US-lower-middle-market direct lending and counter-cyclical strategies. The lower middle market is here defined as focusing on companies with less than $50mn in EBITDA, and making transactions with a typical size of $30-150mn.

The survey revealed that many investors believe that US lower-middle-market direct lending will be less affected by a cycle change and other macroeconomic trends than private debt as a whole. Beyond seeing US lower-middle-market direct lending as a potentially less volatile sector, the majority respondents cited relatively high returns (57%) and diversification (55%) as its key appeals. Return expectations for the sector are higher than for private debt as a whole: 59% expect unlevered lower-middle-market direct lending funds in the US to return 8% or more, compared to 39% that expect the same for broader unlevered private debt funds.

As a result, appetite for lower-middle-market direct lending in the US has been growing, and a majority of investors plan to increase their allocations to the sector in 2018. In fact, 86% of investors have a dedicated allocation to US-lower-middle-market direct lending, and 56% are set to increase their exposure over the next 12 to 24 months. Fourteen percent of investors also are planning an initial allocation to US lower-middle-market direct lending in the next 12 to 24 months.

Counter-cyclical strategies are also sought-after. Forty-six percent of investors now view special situations funds as presenting the best opportunities in the next 12 to 24 months, and 37% of investors feel the same towards distressed debt funds. Thirty-four percent of respondents identified straight senior debt as presenting the best opportunities over the same timeframe.

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