

Key Market Stats^{1,2}

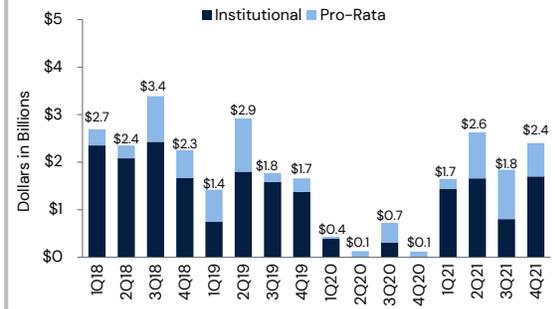
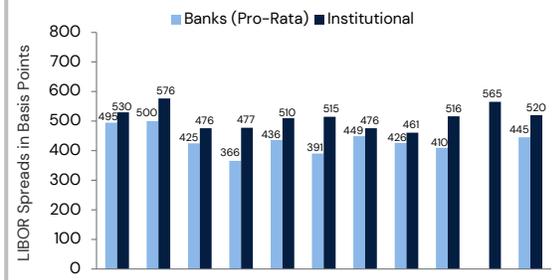
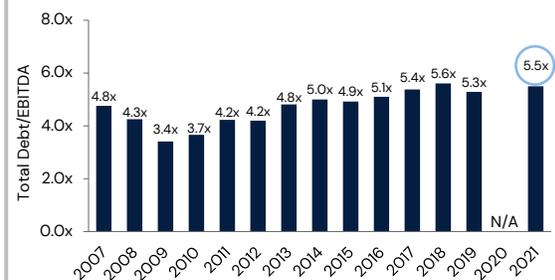
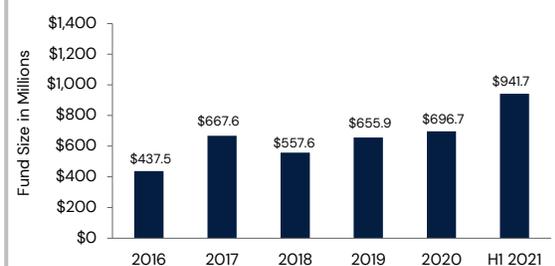
- **Strong loan volumes.** Annual middle market (MM) loan volume through year-end increased substantially, year-over-year, as the broader global economy continues to rebound from the COVID-19 pandemic. LBO (33% of total volume) and acquisition (31%) transactions have greatly increased as Biden's tax policy has pulled 2022 M&A deals forward into 2021. Refinancing activity (25%) remained strong throughout 2021 as rates are nearing historic lows and competitive processes for strong private equity sponsored transactions continued to push volume forward. Corporate purposes and mergers (~1%) accounted for the remaining balance.
- **Leverage remains elevated.** As of December 2021, Total Debt/EBITDA multiples for larger loans remained steady at 5.5x, the highest recorded level since 2018. A robust M&A environment and a continued supply/demand imbalance for middle market transactions caused lenders to increase available leverage in order to win deals. Equity contributions of ~45% are still required in most cases; however, elevated purchase multiples and excess dry powder with lenders and sponsors have driven leverage multiples higher.
- **Pricing throughout 2021 remained stable.** Average LIBOR spreads remained near 500 with all in expected yields of ~6.0% for large, marquee deals and L+575 for smaller deals. Capstone continues to expect yields to hold in this range going into 2022 as competition for deals remains robust.
- **Private credit fund dry powder sits at record highs.** Private credit funds still maintain their record investable capital and will continue deploying through multiple vehicles heading into 2022.

Quarterly Market Observations^{2,3,4}

- **Middle market M&A activity remains robust, driven by potential tax changes.** Supported by improving economic conditions, inexpensive debt capital, ample PE dry powder and the possibility of a capital gains tax hike, Middle Market M&A activity approached its highest levels on record in 2021. In a recent survey of M&A professionals, SRS Acqiom found that the proposed tax changes, in particular, have accelerated 2021 deal velocity with more than half (63%) of respondents indicating that their clients' or their own deal activities are accelerating before the close of 2021 in anticipation of proposed tax changes. As we look forward to 2022, just over half (52%) of respondents believe that deal activity will remain flat, with 43% of respondents anticipating a slowdown. Only a small percentage (5%) expect acceleration to continue in 2022.
- **Unitranche migrating up market.** Middle market private equity investors have long favored the unitranche structure for its flexibility and ease of use. However, over the past six years, direct lenders' average hold sizes have expanded from \$25-30 million to well over \$100 million. This growth and the continued adoption of the unitranche structure have given managers a competitive instrument to deploy more capital. In 2017, per Refinitiv LPC, only 28% of unitranche facilities were above \$250 million in size. Today, that number is up to 77%, reflecting a significant shift away from the broadly syndicated market.
- **ESG growing in importance to debt capital providers.** Conventional wisdom had private debt managers lagging behind their private equity counterparts in their commitment to ESG investing. With new systematic approaches to ESG lending, that is no longer the case. In its recent survey of over 110 Debt Capital Markets institutional investors, SS&C Intralinks found that 91% of respondents expect to issue more sustainable/ESG focused debt over the next year. Capstone has found that investments with an "ESG angle" attract strong lender interest, particularly from institutional investors like pension funds and insurance companies.

Required Reading

- Oaktree's Insights, "Performing Credit Quarterly 3Q 2021" discusses current credit trends through the third quarter of 2021, providing an outlook through year-end and early 2022 based on current market conditions – [Oaktree Q3 Quarterly Update](#)

Leverage Loan Volume per Quarter¹

LIBOR Spreads (bps) – Larger Loans¹

Total Debt/EBITDA Multiples (MM) – Larger Loans¹

Average Size of Private Debt Funds²


Built for the Middle Market

Capstone Partners' **Debt Advisory Group** specializes in providing debt placement services to middle market companies in connection with senior credit facilities, second-lien loans, unitranche facilities, and mezzanine debt across a range of industry sectors. The firm is one of the few national investment banks that maintains a debt-only placement (non-lending) practice staffed by leveraged finance veterans focused solely on the debt funding needs of mid-sized companies and the sponsors that invest in them. The majority of our engagements involve raising debt for acquisitions, recapitalizations, refinancings, and growth/expansion financings with a particular focus on special situations where non-traditional debt capital is required.

CAPSTONE'S DEBT ADVISORY GROUP



**Kent Brown, Head of Debt
Capital Advisory**
Managing Director
303-951-7127
kbrown@capstonepartners.com



Brad Harrop
Director
303-531-5007
bharrop@capstonepartners.com



Brian Schofield
Managing Director
508-561-8799
bschofield@capstonepartners.com



Adam Morris
Director
720-407-6270
amorris@capstonepartners.com

ENDNOTES

1. S&P Global Market Intelligence, "MM_Quarterly_4Q21 WEB MM Archives," www.lcdcomps.com, accessed January 11, 2021.
2. The Lead Left, "All Ahead Full: Private Credit Outlook 2020 (Fourth of a Series)," www.theleadleft.com, accessed December 13, 2021.
3. SRA Acquiom, "The Impact of Current U.S. Tax Proposals on M&A," www.srsacquiom.com, accessed December 23, 2021.
4. SS&C Intralinks, "2022 DCM Investor Report," www.intralinks.com, accessed December 23, 2021.

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