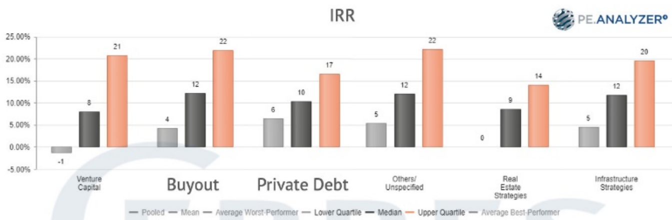
Private Debt Cycles Analysis: Private Debt in the Crisis

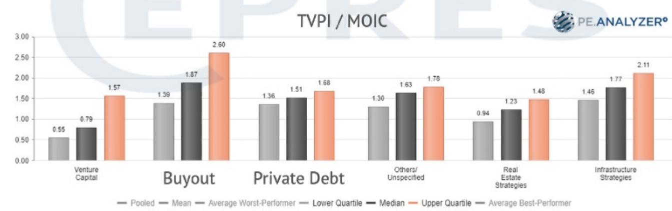
Buyouts vs Private Debt

How does Private Debt perform relative to Buyout - the largest segment in the Private Market universe?

It is interesting to see as comparison of Private Debt to equity risk, whereby Buyout fund median IRRs outperform Private Debt by only 200bps over the past 18 years which includes 2 cycles. As we would expect, the median multiples are higher for Buyout but it should be noted that this comes at a different risk, with much larger spreads between the upper and lower quartiles. These are significant take-away that can result in notable implications at times where cycle duration may suggest a more conservative approach for private market investment portfolios.

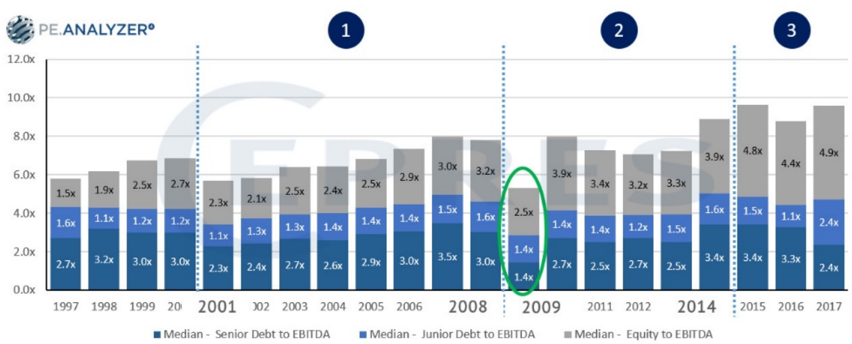
This is also confirmed when comparing those segments over time to appreciate the benefits of Private Debt: whilst in the long run returns are comparable to Buyout, a look at certain vintage years reveals how robust Private Debt returns are when “the going gets tough” – showing substantial outperformance to Buyout during the crisis years 1998-2001 and 2005-2008. This makes Private Debt extremely attractive for institutional investors with a strong fixed income DNA and preference for running yields.





Private Debt Financing Structures

Revolving patterns



Financing structures show a similar pattern to loss rates – they typically peak just before crisis as investors are prepared to pay record prices and show lack of underwriting discipline, i.e. accepting both looser covenants and higher leverage levels. When looking at leverage levels, we can see they reached their peak just at the same time with around 4.2x at dotcom, 4.8x at GFC and 5.0x at end of QE. Today at around 4.8x, we have to be very careful as high equity multiples may suggest that the market is overbought, and therefore, effectively lower equity cushion is available in a market set-back – leading to possibly even higher leverage levels in such a scenario.