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Private Equity Newsletter

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SG Analytics' premier private equity monthly newsletter and your window to the latest trends, deals, and strategies reshaping the industry. Each edition of Axia will bring you an exclusive feature article and topical news developments with our experts dissecting critical topics, offering insights and commentary that go beyond the headlines.

Asset-based Finance: The Next Move for Private Credit

The private credit market in the US, valued at approximately $1.6 trillion according to Bloomberg, primarily consists of corporate lending. However, with asset managers such as Apollo, Blackstone, and KKR hailing asset-based finance (ABF) as a dominant strategy heading into 2024, this asset class has emerged as an evolving and powerful branch of private credit.

Despite the recent surge in interest, ABF is not a new asset class. Historically, it was the banking sector that primarily dealt with ABF. Following the 2008 financial crisis, the consolidation, tightened regulations, and limitations in loan origination capabilities within the banking sector propelled the growth of direct lending in private credit. Concurrently, there was a decline in bank lending in ABF (refer to Fig. 1), even as demand continued to rise. Moreover, the regional bank crisis in 2023 resulted in a further pullback in traditional lending and prompted banks to adopt a more strategic approach to their balance sheets. A more critical consideration for factors such as capital availability, liquidity positions, and the core nature of assets has led many banks to shed off assets, which are often super-prime loans.

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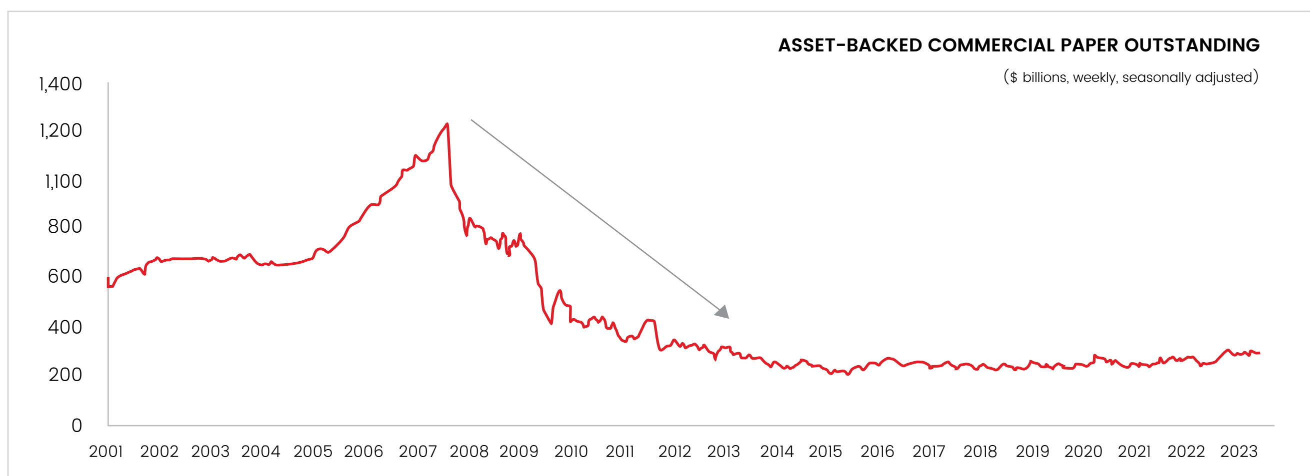
Prominent private creditors recognizing the substantial opportunity (estimated by KKR to be a $5 trillion global market) have stepped in to address the market gap. In recent months, Blackstone finalized an agreement to acquire $1.1 billion in credit card debt from Barclays; KKR acquired a $7.2 billion portfolio of super-prime recreational vehicle loans from BMO Bank; and Apollo purchased a $920 million portfolio of secured aviation loans from Standard Chartered.

Figure 1: Sharp Decline in Asset-backed Commercial Paper Since 2008

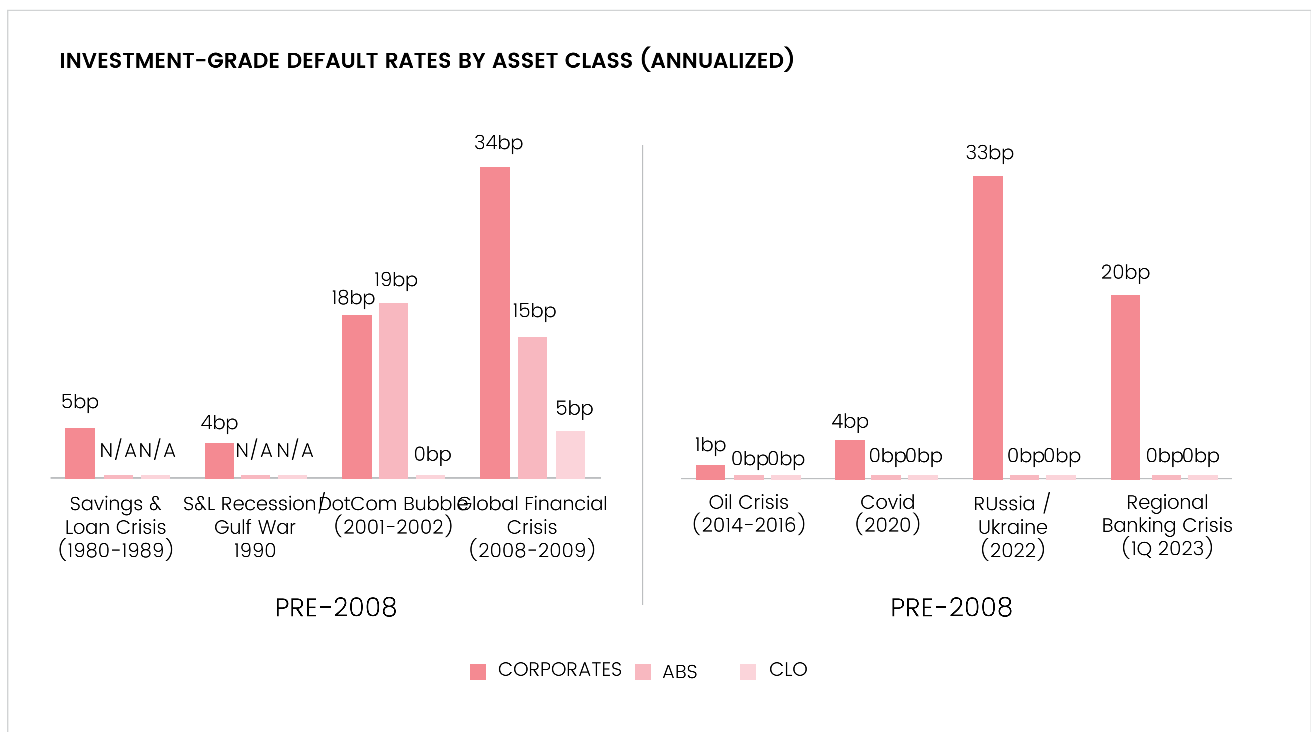


Source: Apollo Global

The opportunity in ABF for private creditors extends beyond the banking sector. Notably, KKR made a significant move by acquiring $43.71 billion of "buy now, pay later" loan receivables from PayPal. ABF covers a wide range of credit types, including consumer credit, mortgages, receivables, and aviation leasing, and extends to any asset that ensures a contractual cash flow. For instance, music intellectual property has emerged as a segment where KKR perceives opportunities. Recently, it led HarbourView Equity Partners' $500 million debt financing raise through a private securitization backed by its portfolio of music royalties.

A key characteristic of ABF is the resilience of the asset classes during periods of market volatility. According to Apollo Global, investment-grade asset-backed securities have shown almost no defaults, contrasting with corporates which tend to be more susceptible to idiosyncratic or sector-specific risks (see Fig. 2). Furthermore, the appeal of these investments is enhanced by their attractive returns, estimated by KKR to have a weighted average IRR of 14%.

Figure 2: ABF Demonstrated Resilience Across Periods of Market Stress



Source: Moody's as of 1Q 2023. Note: Investment grade ABS defaults are based on US ABS as defined by Moody's. Investment grade CLOs represent US CLOs as defined by Moody's; except 1Q23, where the global CLO defaults from Moody's due to lack of available data on US-only CLOs. ABS & CLO default data remain unavailable for savings and loan crisis and recession period due to the limited ABS/CLO market at the time.

The integration of ABF into investment portfolios offers several advantages, including diversification, low correlation, and stable cash flows. ABF assets are exposed to a wide array of sectors and risk profiles to mitigate single points of failure and diversify investors' portfolios. Moreover, ABF assets typically demonstrate lower correlation to traditional corporate credit and other asset classes (see Fig. 3). The combination of collateral diversification, structural protections, and contracted cash flows fortifies cash-flow profiles, reducing reliance on faith and credit for repayment as with corporate credit.

Figure 3: ABF has Low Average Correlation to a Range of Relevant Asset Classes

	Private Credit	Global PE	U.S. Loans	U.S. High Yield	Infra-structure	Real Es-tate	Private ABF
Private Credit	-	0.9	0.87	0.82	0.83	0.78	0.75
Global PE	0.9	-	0.75	0.83	0.77	0.67	0.63
U.S. Loans	0.87	0.75	-	0.93	0.68	0.55	0.69
U.S. High Yield	0.82	0.83	0.93	-	0.67	0.51	0.61
Infrastructure	0.83	0.77	0.68	0.67	-	0.82	0.56
Real Estate	0.78	0.67	0.55	0.51	0.82	-	0.71
Private ABF	0.75	0.63	0.69	0.61	0.56	0.71	-
Average Correlation	0.83	0.76	0.74	0.73	0.72	0.67	0.66

Correlations are calculated with quarterly remains between 7/12 and 30:22. The average correlation for each lined amet class represents the average correlation with the other six listed asset classes. Data asat September 30.2022. Each asset class is modeled as follows: Global Private Equity (Cambridge Private Equity Index) Real Estate (Cambridge Real Estate indies), infrastructure (Cambridge infrastructure index), Private Credit (Cambridge Plate Credit no US High Vind BCE BofA Us High Yield Index), US Loans (Momingitar LISTA US Leveraged Loan TH USUL KRR ABE JOUR Private Credit All Composite Investments originated post-January 1, 2017) The Cambridge Private Credit Index includes 738 funds in the Credit Opportunities. Senior Debt, Subordinated Capital messed Securities and Control-Oriented Drsned Securities

ASSET-BACKED SPREADS TRAILING 12-MONTH CORRELATION TO US CORPORATES				
Rating	US BSL CLO	US Conduit CMBS	US Private Student Loan ABS	US Prime Auto ABS
AAA	0.51	0.69	0.63	0.4
AAA	0.59	0.65	0.7	0.56
A	0.69	0.7	0.72	0.67
BBB	0.74	0.73	0.7	0.65
BB	0.66	NA	NA	NA
Average	0.64	0.69	0.69	0.57

Sources: IP. Morgan and Bank of America from January 1, 2012, through May 5, 2023. US Corporates are represented by the ICE BotA US Corporate Index; US broadly syndicated loan (851) CLOy from JP. Morgin - CLO spread data; US Conduit CMBS from Bank of America spread data (OTR LOF 10-yese fored rate conduit spreads): US Prime Auto ABS from historical spreads reported by J.P. Morgan Research; US Student Loan ABS from historical spreads reported by J.P. Morgan Research. There can be no assurance that historical trends will continue.

Source: KKR, Apollo Global

A significant boost comes from the insurance industry that demands long-term high-grade investments to match its liabilities. PE-backed insurance companies increase their holdings of ABS by two-thirds of the industry average, or 16% of their overall portfolio, compared to 10% for traditional insurers, highlighted by a paper published by the University of Pennsylvania. In recent years, insurers have increasingly ventured into PE and private credit, with major PE firms now owning nearly 9% (approximately $774 billion as of 2Q23) of the US life insurance industry's assets, a substantial rise from just 1% in 2012, according to AM Best. Blackstone asserts that these evolving dynamics have heightened the importance of ABF holdings for the firm.

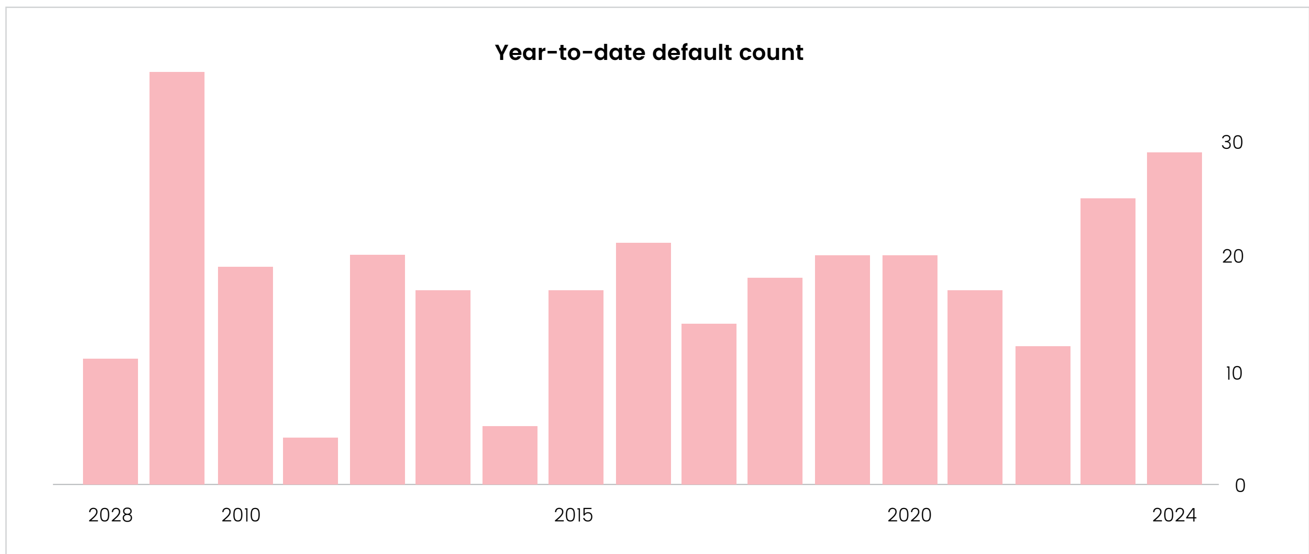
In conclusion, the burgeoning prominence of ABF within the private credit market heralds a significant shift in investment strategies, propelled by leading asset managers. Heightened demand, particularly from insurers, along with tightened regulations and constraints in loan origination within the banking sector have spurred private creditors to fill the market void for ABF, which has been traditionally dominated by banks. Incorporating this asset class into investment portfolios offers the opportunity to capitalize its resilience during crises, as well as its potential for diversification, low correlation, and consistent cash flows, presenting an opportunity to tap into a potentially $20 trillion market.

Monthly News and Analysis

Corporate Defaults at Highest Since Financial Crisis

According to S&P Global, the tally of companies defaulting on their debt in 2024 has reached its highest point for the beginning of any year since the 2008 financial crisis – rising to 29 compared to 36 in 2009 for the same period. This trend has been fueled by subdued consumer demand, rising wages, and elevated interest rates. Consumer-sensitive stocks as well as chemical and healthcare companies are particularly vulnerable due to the concentration of poorly rated incumbent firms with negative cash flow within the two sectors.

Figure 4: Global Corporate Default Tally at the Start of the Year



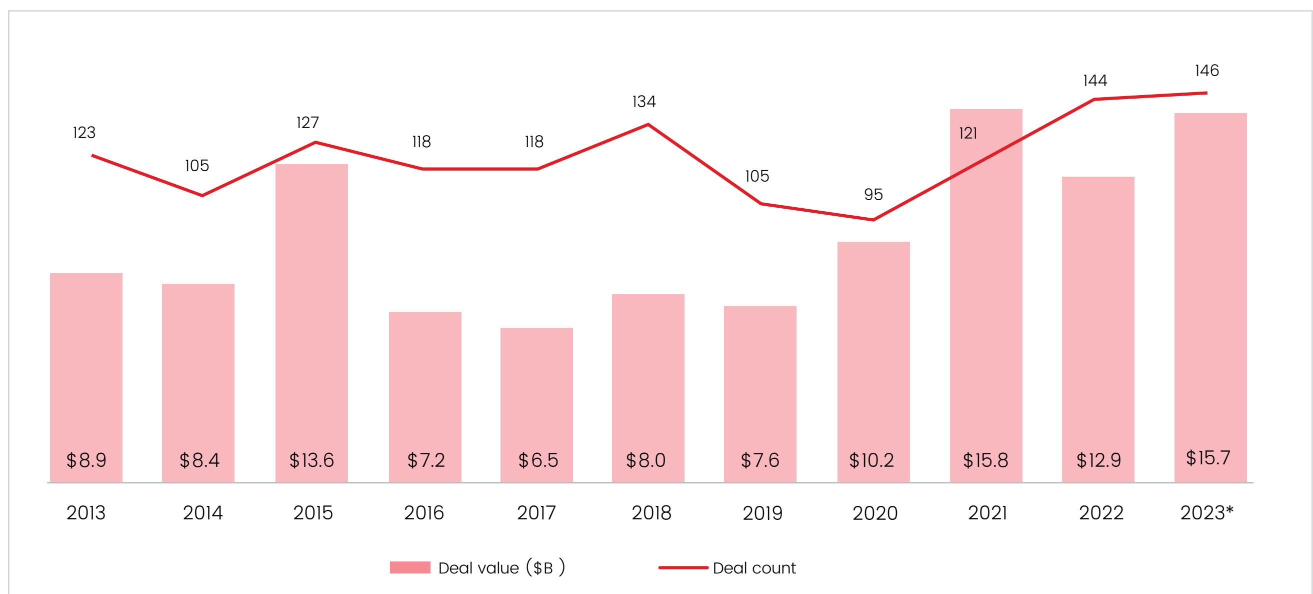
Source: Financial Times

Corporate defaults have been on a steady rise in recent years with 11 interest rate hikes since March 2022. According to Fitch Ratings' Top Market Concern Bonds report, the aggregate total reached $65.5 billion as of January 24, 2024, marking a substantial 42% surge from $46.2 billion in December 2023. Further, S&P Global predicts that default rates for below investment-grade bonds will likely reach 4.75% by the close of 2024. Despite the Fed maintaining interest rates at 5.25–5.50% for the past three committee meetings and maintaining its signals for three potential rate cuts for the year, inflation unexpectedly spiked to 3.2% annually in March, deviating from its previous downward trajectory. This unexpected surge has dampened hopes for an early rate reduction.

PE's Move to the Middle East

In contrast to the challenging conditions witnessed in the US and European markets, the PE industry in the Middle East has exhibited remarkable resilience and expansion throughout 2023, prompting numerous GPs, including Ardian, Tikehau Capital, and General Atlantic to establish a presence in the region. Deal value for the Middle East and North Africa surged by 21.2% year-over-year reaching $15.7 billion, with Saudi Arabia and the UAE accounting for the major share, as reported by Pitchbook.

Figure 5: PE Deal Activity in the Middle East and North Africa



Source: Pitchbook

Over the years, the oil-rich economies of the Middle East region have accumulated substantial wealth, much of which has been deposited into sizable sovereign wealth funds. A key driver behind this expansion has been government-led initiatives aimed at diversifying away from reliance on oil and gas revenues. This diversification strategy involves expanding into various assets such as infrastructure, technology, and alternative investment strategies offered by private fund managers. Saudi Arabia's Public Investment Fund manages around $700 billion in AUM and aims to increase this figure to $1 trillion by 2025. Other notable sovereign wealth funds in the region include the Abu Dhabi Investment Authority, estimated to have around $1 trillion in AUM, and the Kuwait Investment Authority, which manages approximately $800 billion. The industry appears to be in its early stages with burgeoning opportunities and the potential for substantial growth. Preqin's forecasts suggest that the industry could expand to reach $7.6 trillion by 2027.

Apollo Offers $11 Billion for Paramount's Hollywood Studio

According to Bloomberg, PE firm Apollo Global Management has tendered an $11 billion proposal to acquire Paramount Global's film and TV studio. This bid coincides with an independent committee of the company's directors assessing an alternative offer from Skydance Media for a complete merger with Paramount, which has been a longstanding acquisition target.

Investments from PE and VC in the media and entertainment sector reached their lowest point in at least six years in 2023, attributed to various factors such as persistently weak advertising, an actors' strike, and increased regulatory scrutiny, according to S&P Global. However, projections from PWC suggest a resurgence in the global industry in 2024, with expectations of reaching a valuation of $2.9 trillion by 2027. Consumer behavior within the industry is indicating signs of saturation with paid streaming services, with most research concluding that consumers are reluctant to subscribe to more than three paid services, according to Variety. Consequently, the focus is shifting toward service bundling and cross-brand partnerships. The current landscape of over 80 streaming platforms globally is unsustainable and the market is poised for consolidation in 2024. The streaming market is expected to become dominated by 4–5 major players, with a winner-take-most dynamic.

NYCB Receives Over $1 billion from PE Consortium

New York Community Bancorp (NYCB) recently received a lifeline exceeding $1 billion from a consortium of PE firms, which includes Liberty Strategic Capital, Reverence Capital Partners, and Hudson Bay Capital. This financial support arrives amid a drastic decline in NYCB's stock, plummeting by over 80% in 2024. As part of the agreement, the investors will receive company stock valued at $2 per share, along with convertible preferred stock.

The regional banking crisis deterred interest from strategic investors, creating an opportunity for PE firms to step in and capitalize on a rare chance to invest in a sector often perceived as challenging. Over the past year, PE firms have made investments in at least 11 commercial banks in the US, as reported by Pitchbook. Notable examples include the sale of TIAA Bank to a consortium including Reverence Capital, Warburg Pincus, Stone Point Capital, and Sixth Street. Additionally, Warburg and Centerbridge Partners have also provided backing for Banc of California. Traditionally, PE firms have approached the banking sector with caution due to its highly regulated nature, pronounced cyclicality, demanding technical skill requirements, and comparatively narrow profit margins. The primary challenge lies in identifying banks whose value has declined enough to be acquired at a reasonable price, without being so distressed that they face insolvency. The banking crisis experienced in 2023 has created interesting opportunities for the PE industry to explore.

Mid-market PE Funds Defy Fundraising Challenges

Despite challenges in the overall PE fundraising landscape, PE funds focusing on the middle market had a successful year. According to Pitchbook, middle-market funds amassed $141.1 billion in 2023, marking the second-highest annual fundraising total on record. In 2023, these funds accounted for 48% of the total value of buyout funds closed. In 2023, 162 middle-market funds concluded their fundraising efforts.

Figure 6: 2023 Recorded the Second-highest Annual Fundraising Sum

Source: Pitchbook

In a high-interest rate environment, deal making activity in smaller funds is generally expected to be more manageable and sustainable, as confirmed by trends observed in the middle markets throughout 2023. A primary advantage is the smaller funds' capacity to deliver higher capital returns to investors compared to mega-funds. In 1H23, middle-market PE funds distributed a total of $88.7 billion to their investors while only calling for $66.3 billion, resulting in a net inflow of $22.4 billion to LPs. In contrast, mega-funds had capital calls that exceeded their distributions by $30 billion, resulting in negative cash flow for investors. Moreover, with the median fund size increasing from $410 million in the previous year to $590 million in 2023, over 92% of the middle-market funds experienced a step up. A notable example is Incline Equity Partners' sixth buyout fund which raised $1.9 billion, marking a substantial 63.1% increase from its previous vehicle. As the exit landscape remains challenging, the utilization of continuation funds has emerged as a significant component of exit strategies and is expected to persist as a critical liquidity alternative to conventional exit routes.

Deals Flash

BlackRock Acquires Solar Portfolio from Excelsior

BlackRock's Evergreen Infrastructure Partners Fund acquired a 38-project solar-plus-storage portfolio from Excelsior Energy Capital, a New Jersey-based PE firm. These projects were part of the Excelsior Renewable Energy Investment Fund I LP initiated in 2017, which has garnered over $500 million in investments to bolster solar, wind, and storage ventures across 10 states in the US. This transaction signifies Excelsior's inaugural divestment from the fund, which underpins the generation of more than 3,000 GWh of renewable energy annually. The acquired portfolio comprises operational solar and battery storage distributed generation projects boasting a collective capacity of 89 MW. This acquisition adds to BlackRock's ongoing initiatives in climate infrastructure, following its recent acquisition of infrastructure investor GIP for $12.5 billion and an investment in Recurrent Energy for $500 million.

Stonepeak Acquires Textainer

Stonepeak, a New York-based investment management firm, acquired Textainer, a Bermuda-based leasing company specializing in intermodal containers, for $7.4 billion. As part of the take-private, common shareholders will receive $50 per share in cash, totaling approximately $2.1 billion for all common shares. This purchase price reflects a premium of around 46% compared to Textainer's closing share price on October 20, 2023. Established in 1979, Textainer is one of the largest lessors of intermodal containers globally, boasting a fleet of over 4 million TEU owned and managed, serving a diverse customer base exceeding 200 clients. The company operates via a network of 14 offices and approximately 400 independent depots worldwide. Textainer launched its IPO in 2007 and raised $148.5 million.

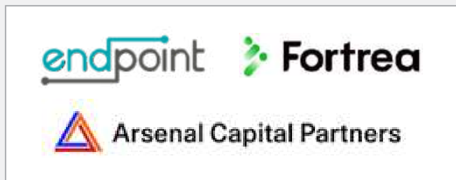
Campbell Buys Sovos from Advent

Campbell Soup Company, a New Jersey-based food business, completed its acquisition of Sovos Brands, a Colorado-based consumer-packaged food company, from Advent International, a Boston-based PE firm, for $2.4 billion. Shareholders of Sovos will receive $23.00 per share in cash as part of the transaction. To integrate Sovos within its structure, Campbell's has established a new business unit named Distinctive Brands within its Meals & Beverages division. Sovos' product portfolio includes premium items such as pasta sauces, dry pasta, soups, frozen entrées, frozen pizza, and yogurts marketed under the brand names Rao's, Michael Angelo's, and noosa. In 2023, the company reported net sales of $1 billion, marking a notable organic net sales increase of 25% year-on-year.

KKR Acquires Mdf Commerce

KKR acquired mdf commerce, a Canadian SaaS company focused on digital commerce technologies, in a take-private for a valuation of CAD 225 million or $189.2 million. Shareholders of mdf will receive CAD 5.80 in cash per share, representing a significant premium of approximately 58% over the closing price on March 8, 2024, which was CAD 3.68 per common share. This guarantees shareholders certainty of value and immediate liquidity. The company initially raised CAD 50.01 million during its IPO launched in 2000. In terms of financial performance, mdf reported a total revenue of $91.21 million for the FY23, with an EBITDA of $6.21 million. mdf commerce operates a North American eProcurement platform that optimizes and accelerates commercial interactions between buyers and sellers and caters to over 6,500 government agencies and more than 650,000 suppliers across Canada and the US.

Arsenal Buys Endpoint from Fortrea



Arsenal Capital Partners, a New York-based PE firm, will acquire Endpoint Clinical, a Massachusetts-based interactive response technology company, and Fortrea Patient Access business from Fortrea, a North Carolina-based contract research organization for approximately $345 million. The divestiture by Fortrea is aimed at advancing the growth strategies and solutions of the two businesses, enabling increased investment to accelerate their technology roadmap and enhance operations. Following the divestiture, Fortrea will concentrate its efforts on its core business, focusing on clinical development phases 1 through 4. This strategic move aims to streamline its operations as a specialized contract research organization. Endpoint Clinical specializes in providing solutions to biopharmaceutical and contract research clients, while Fortrea's Patient Access business offers solutions in patient support, product access, affordability, and adherence.

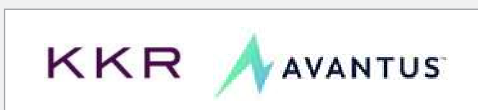
Actis to Buy Swiftnet from Telkom

Actis, a UK-based PE firm, is in talks to buy Swiftnet, the mast and tower business owned by Telkom, a South African telecommunications company, according to Bloomberg. Swiftnet is currently valued at R6.3 billion, or $332 million. Telkom announced its intention to sell Swiftnet, which boasts a portfolio of 6,200 towers, in November 2023. With Africa witnessing rapid population growth, particularly the youth, coupled with a rising inclination toward technology, firms are increasingly investing in digital infrastructure assets to meet the growing demand for broadband services, driven by the widespread adoption of smartphones. This potential acquisition aligns with Actis' strategy of expanding its digital infrastructure portfolio in South Africa, following its acquisition of fiber company Octotel in 2020.

Bain to Buy Two Software Platforms

Bain Capital Tech Opportunities agreed to acquire two software platforms serving the mortgage originations and servicing market. The firm will acquire a majority stake in finova, a UK-based provider of cloud-based mortgages and savings software, from Norland Capital, a San Francisco-based private equity firm. Additionally, it will acquire the UK mortgage sales and origination software business of Iress, an Australian software company. Iress has agreed to sell this division for a total cash consideration of $108.6 million. With a combination of both platforms, Bain Capital aims to provide a comprehensive range of products to its existing and prospective customers in the fast-paced mortgage market. The firm plans to continue investing in both platforms to enhance their offerings and capabilities.

KKR Acquires Majority Stake in Avantus



KKR acquired a majority stake in Avantus, a California-based company specializing in the development of large utility-scale solar and solar-plus-storage projects. Upon completion of the transaction, KKR, alongside existing investor EIG, a Washington-based private investment management firm, will become the sole equity investors in Avantus, with combined commitments totaling over $1 billion. Established in 2009, Avantus boasts a substantial project pipeline encompassing 30 GWp of solar capacity and 94 GWh of battery storage, capable of supplying clean and reliable power to approximately 20 million individuals. The company has established a significant presence and demonstrated a successful track record in the southwestern US and California power markets. Since its inception, Avantus has developed and sold 6.5 GWp and 6.3 GWh of solar and storage projects, respectively.

H.I.G. to Buy Alight's Payroll and Professional Services Business

H.I.G. Capital, a Florida-based PE firm, will acquire the Payroll and Professional Services Business of Alight, an Illionois-based IT service management company, for up to $1.2 billion. The acquisition will involve $1 billion in cash and up to $200 million in seller notes with $150 million contingent upon the Payroll & Professional Services business' financial performance in 2025. This valuation represents approximately 10 times the estimated 2023 adjusted EBITDA and 24 times the estimated unlevered free cash flow of the business. Upon completion of the transaction, Alight and the acquired business will establish a commercial partnership aimed at enhancing their collective competitiveness. Currently, the acquired business employs over 8,000 individuals globally and provides mission-critical solutions to more than 1,500 enterprise clients across 185 countries.

Oaktree to Acquire LPW from Wynnchurch

Oaktree Capital Management, a California-based PE firm, is set to acquire LPW Group, a Texas-based manufacturer of industrial supply parts, from Wynnchurch Capital, an Illinois-based PE firm. LPW has raised $9.92 million in debt so far and its last valuation was reported at $62.50 million as of January 2020, according to Pitchbook. The company's product portfolio includes specialty valves, fittings, flanges, and other flow control products, catering to a wide range of industrial applications such as chemical, petrochemical, LNG, refining, renewable energy, naval, pulp & paper, among others. These products are marketed under leading brands like Ladish Valves, Smith Valves, Penn Machine, and Western Forge & Flang. With a workforce of over 500 employees, LPW operates across seven locations spanning Texas, New Jersey, and Pennsylvania.

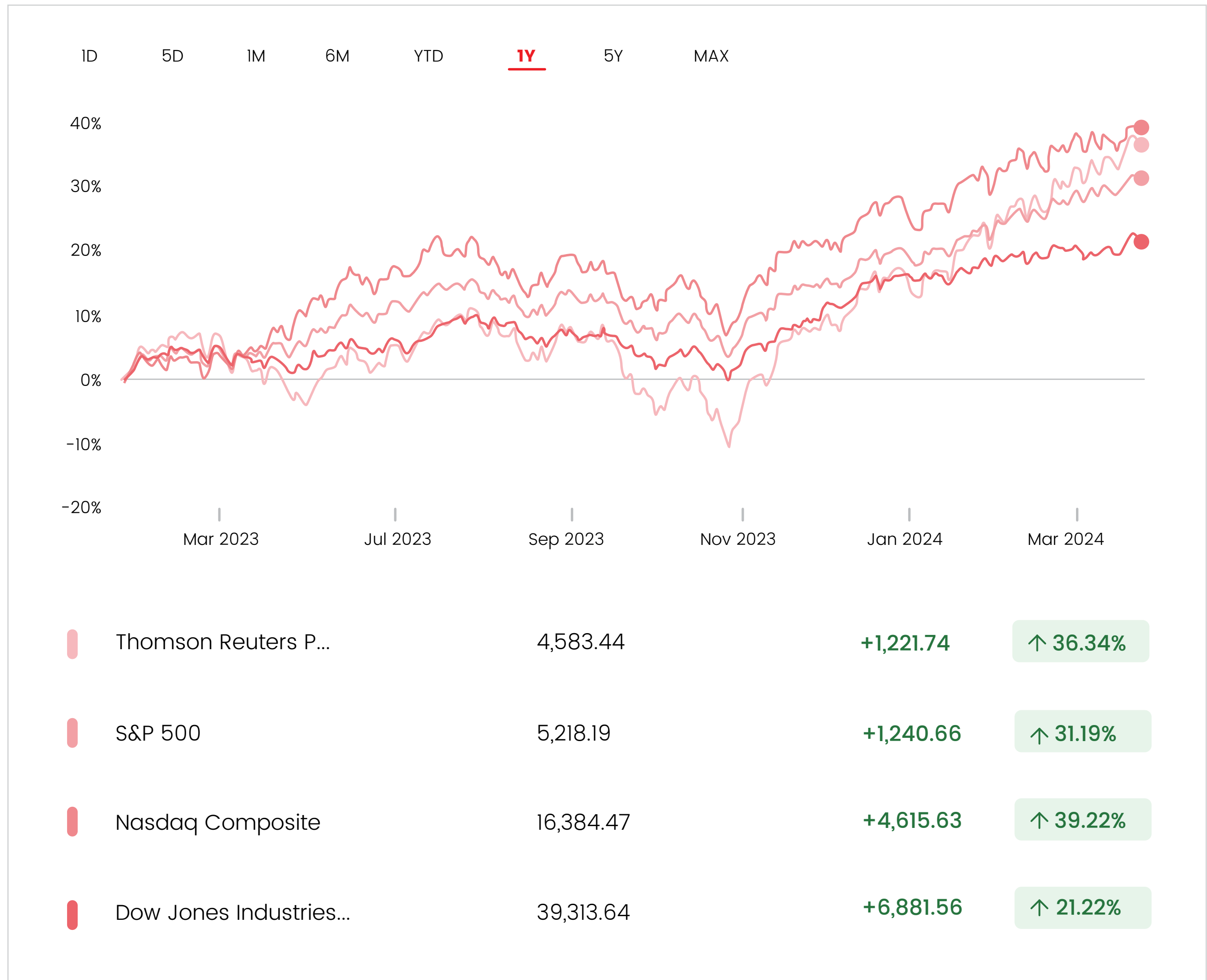
Upcoming Events

SuperReturn US West	**April 9, 2024**	**Hilton Los Angeles Universal City, California**
DealMAX	**April 29 – May 1, 2024**	**Aria Resort & Casino, Las Vegas, Nevada**
Women in Private Markets Summit North America 2024	**May 15–16, 2024**	**Convene, 117 West 46th Street, New York**

TRENDS AND STATS

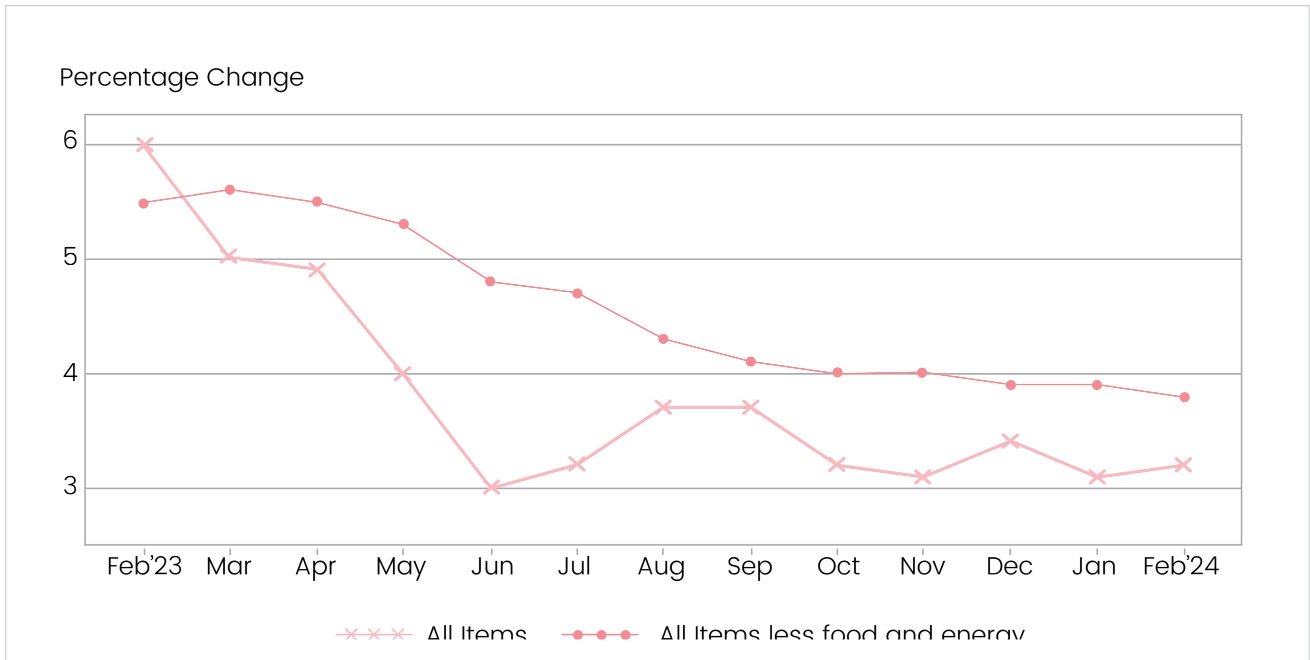
Data as of March 26, 2023

Thomson Reuters Private Equity Buyout Index



Index	Month-over-Month	YTD
Consumer Price Index	0.4%	3.2%
Producer Price Index	0.6%	1.6%

Figure 7: 12-month Percent Change in CPI For All Urban Consumers, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Figure 8: 12-month Percent Change in Selected PPI Final Demand Price Indexes, Not Seasonally Adjusted

Source: US Bureau of Labor Statistics

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