



HOULIHAN LOKEY

DIRECT LENDING UPDATE

SPRING 2021



Introduction

Dear Clients and Friends,

Houlihan Lokey's Portfolio Valuation and Fund Advisory Services team is pleased to present the spring 2021 edition of the Direct Lending Update.

We have included key trends for more than 80 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

Private Credit Valuation: A Light at the End of the Tunnel

- After a volatile 2020 due to the impact of the COVID-19 pandemic, credit markets have surged back as companies have weathered the storm and economies have begun to reopen with the rollout of the vaccine worldwide.
- Increased M&A dealmaking and the Federal Reserve's guidance toward low interest rates for the foreseeable future have resulted in a shift in deal dynamics as issuers have regained pricing power, resulting in tighter interest margins and looser covenants on new issuances.

Observations From the Houlihan Lokey LIBOR Cessation Advisory Team

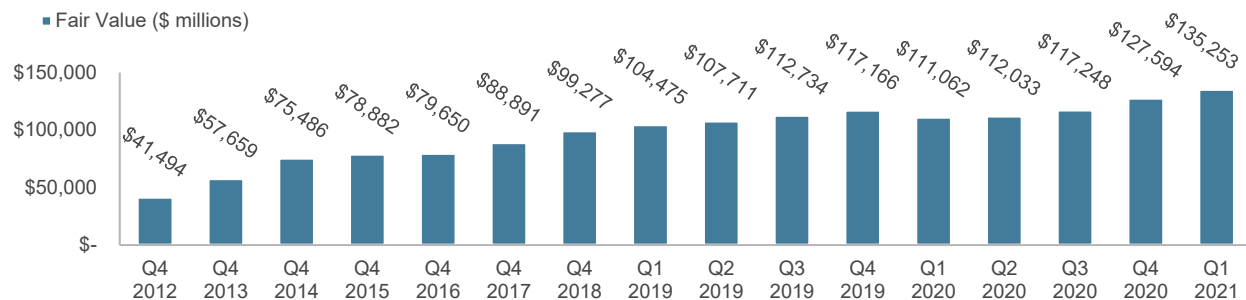
- **Alternatives to the Alternative Reference Rate:** While daily SOFR is the standard from ARRC, LSTA, and ISDA, several other rates are entering the market to meet specific objectives. BSBY, Term SOFR (CME), Ameribor, and ICE Bank Yield Index all have characteristics that meet the needs of some lenders and borrowers better than daily SOFR in arrears. However, these rates are also worse for some lenders and need to be well understood in order to determine their real economic effects. They are not just different flavors of the same thing, but react differently to stress and require different spreads to be considered equivalent.
- **Coexistence of USD LIBOR and SOFR:** While the U.S. has encouraged market participants to cease using LIBOR in any new contract at the end of this year, LIBOR will still be published for another 18 months after that. During this time, the two rates and curves will not behave identically, which will cause risk and valuation differences. As a result, more than just ISDA fallback spread will be necessary to avoid value transfer. Also, the new issue market will be smaller than the legacy market for quite some time unless regulators drive the SOFR swap market volume.
- **CLO Asset Liability Management Risks:** Nearly every direct lending portfolio that is funded in a CLO (and BSL CLO as well) will experience dislocation as the underlying loans are amended to new rates at different times than the funding notes. Understanding that risk requires a thorough understanding of the rate and related provisions of every loan document and a strategy to amend in concert with any changes in the funding note. This process can be assisted by artificial intelligence and Houlihan Lokey to create priorities for a direct lender in their amendment and new loan origination.
- **LIBOR Floors:** While this is often an opaque component of valuation, the truth is that the value of the floor can be significantly changed during an amendment, cessation, or even by using the same floor rate with the new index. Houlihan Lokey quantifies this to determine the right floor rates in these situations that will minimize value transfer.

BDC Trends⁽¹⁾

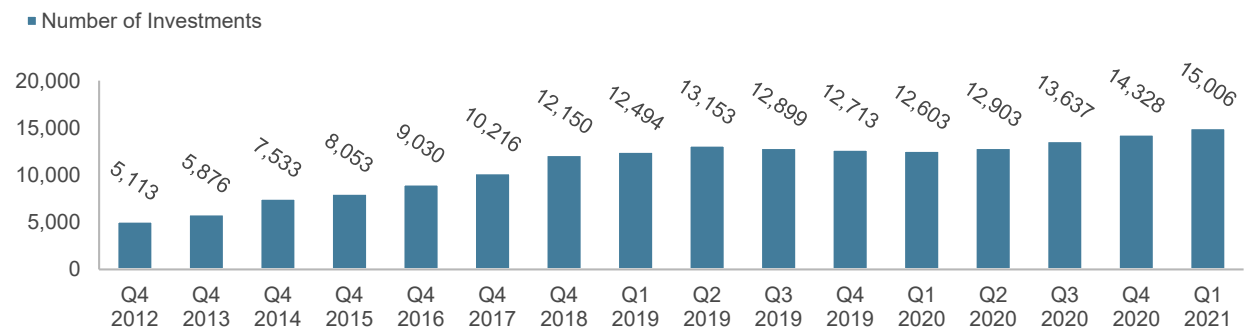
- BDC portfolios grew from \$41.5 billion in Q4 2012 to \$135.3 billion at the end of Q1 2021, an increase of more than 3x. The number of investments held by BDCs grew from 5,113 to 15,006 over the same period.
- The percentage of BDC assets categorized as nonaccrual was 2.7% as of the end of Q1 2021, representing a decrease from the 5.3% observed for Q2 2020 during the height of the COVID-19 pandemic.
- Average first lien fair value yields were 8.04% as of the end of Q1 2021, down 95 and 28 basis points from Q4 2019 and Q4 2020 yields, respectively. Average second lien fair value yields were 9.88% as of the end of Q1 2021, down 98 basis points from Q4 2019 and down 26 basis points from Q4 2020.
- From before the COVID-19 pandemic in Q4 2019 to Q1 2021, the portfolio company industry with the biggest change in first lien fair value yields was business services, which decreased 138 basis points.

⁽¹⁾ Sources for data in these sections are Advantage Data and S&P Capital IQ.

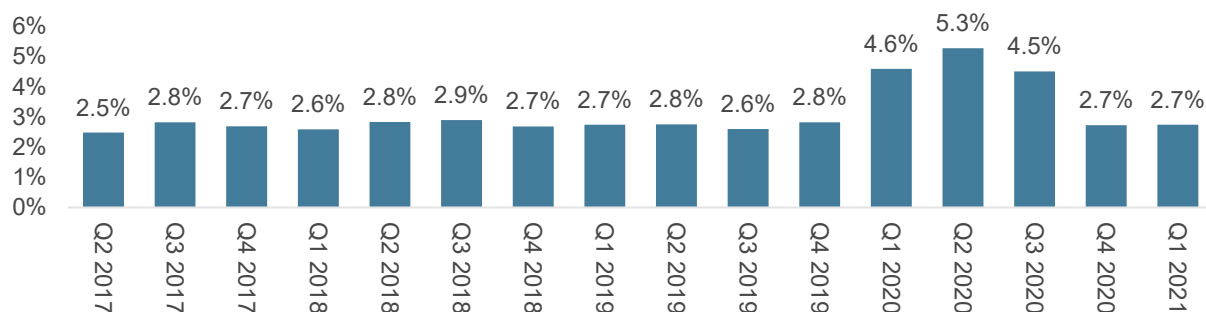
Fair Value of BDC Portfolios⁽¹⁾ (\$ in millions)



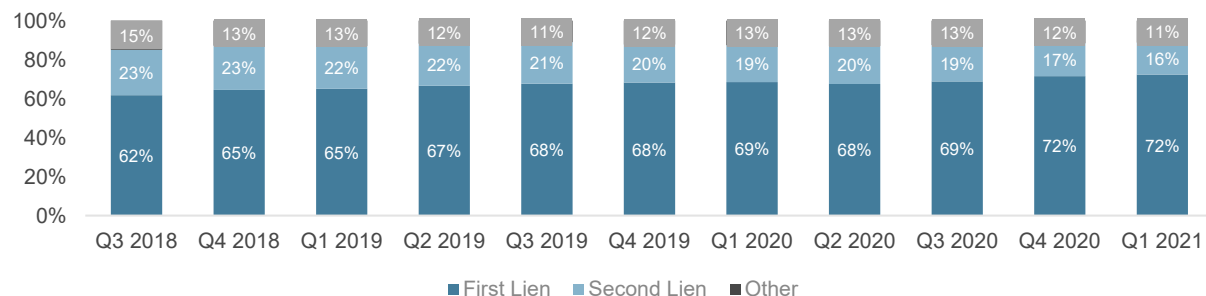
Total Number of Investments in BDC Portfolios⁽²⁾



Nonaccrual Investments as a Percentage of Total Portfolio⁽³⁾



BDC Portfolio Composition by Seniority Based on Fair Value⁽⁴⁾



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 BDC Fair Value Yields by Seniority⁽¹⁾

	Q4 2018	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Change From	
								Q4 2019	Q4 2020
First Lien	9.86%	8.99%	9.47%	8.98%	8.60%	8.32%	8.04%	-0.95%	-0.28%
Second Lien	11.41%	10.87%	12.13%	11.31%	10.67%	10.15%	9.88%	-0.98%	-0.26%

Average BDC Fair Value Yields by Industry—First Lien⁽¹⁾

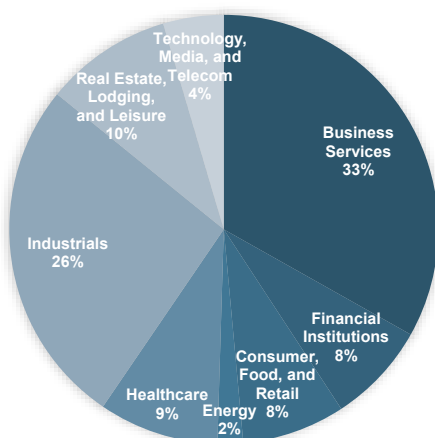
Industry	Q4 2018	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Change From	
								Q4 2019	Q4 2020
Business Services	10.41%	9.45%	9.69%	9.31%	9.05%	8.73%	8.07%	-1.38%	-0.65%
Financial Institutions	9.13%	8.32%	8.74%	8.28%	7.44%	7.20%	8.09%	-0.23%	0.89%
Consumer, Food, and Retail	9.68%	9.06%	9.50%	9.15%	8.79%	8.43%	8.01%	-1.05%	-0.43%
Energy	9.85%	8.95%	9.99%	8.95%	8.73%	7.68%	7.93%	-1.02%	0.25%
Healthcare	9.46%	8.59%	9.25%	8.43%	7.94%	7.83%	8.11%	-0.48%	0.28%
Industrials	9.76%	8.82%	9.53%	8.91%	8.58%	8.27%	8.04%	-0.78%	-0.22%
Real Estate, Lodging, and Leisure	9.45%	8.41%	9.09%	8.61%	8.30%	8.39%	7.90%	-0.51%	-0.49%
Technology, Media, and Telecom	9.75%	9.01%	9.28%	9.08%	8.49%	8.18%	7.96%	-1.05%	-0.21%

Average BDC Fair Value Yields by Industry—Second Lien⁽¹⁾

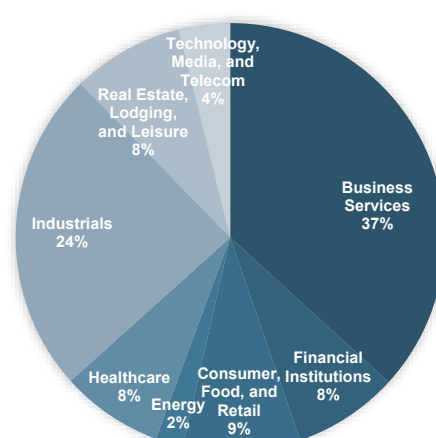
Industry	Q4 2018	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Change From	
								Q4 2019	Q4 2020
Business Services	11.33%	10.62%	11.61%	10.67%	9.87%	9.64%	10.26%	-0.36%	0.62%
Financial Institutions	11.29%	10.37%	11.42%	10.31%	10.15%	9.63%	10.03%	-0.34%	0.40%
Consumer, Food, and Retail	11.72%	11.60%	11.55%	11.02%	10.94%	10.27%	9.63%	-1.97%	-0.64%
Energy	10.76%	11.26%	13.48%	13.25%	12.30%	10.82%	11.74%	0.49%	0.93%
Healthcare	10.80%	10.52%	12.12%	11.63%	10.92%	9.99%	9.49%	-1.02%	-0.49%
Industrials	11.56%	11.00%	12.58%	11.92%	11.17%	10.60%	9.66%	-1.34%	-0.94%
Real Estate, Lodging, and Leisure	11.63%	10.65%	12.06%	10.85%	10.24%	9.94%	9.64%	-1.01%	-0.30%
Technology, Media, and Telecom	11.39%	11.24%	14.27%	12.08%	11.92%	11.13%	9.54%	-1.70%	-1.59%

BDC Investments by Industry as of Q1 2021⁽²⁾

First Lien



Second Lien

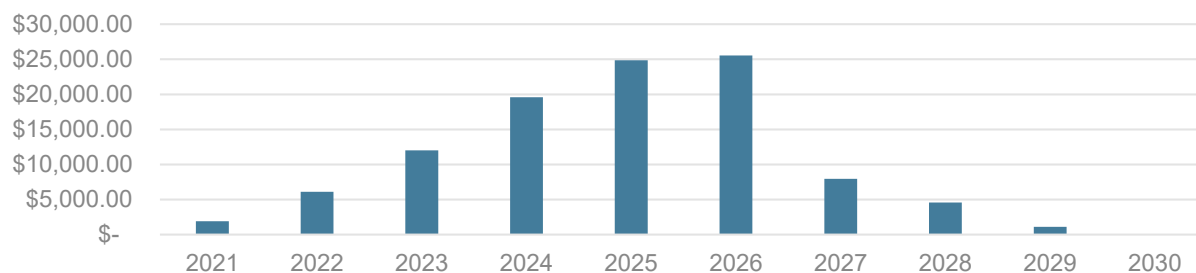


Source: Advantage Data.

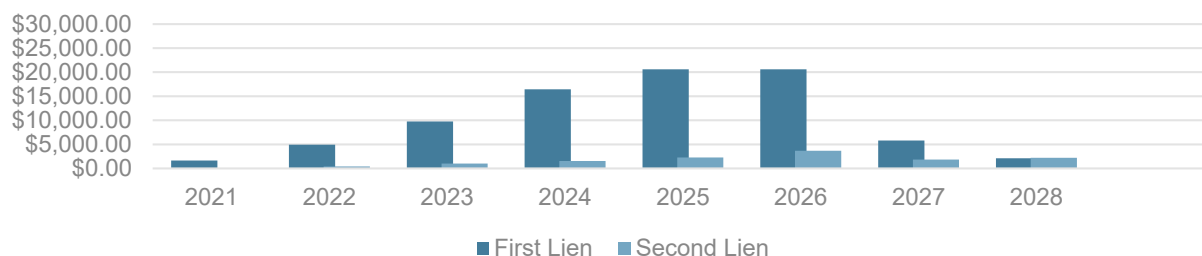
(1) Fair value yield is based off of reported fair value, stated maturity, and stated interest rate. Represents data for all BDCs tracked by Advantage Data. Excludes outliers.

(2) Based on the fair value as of Q1 2021.

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

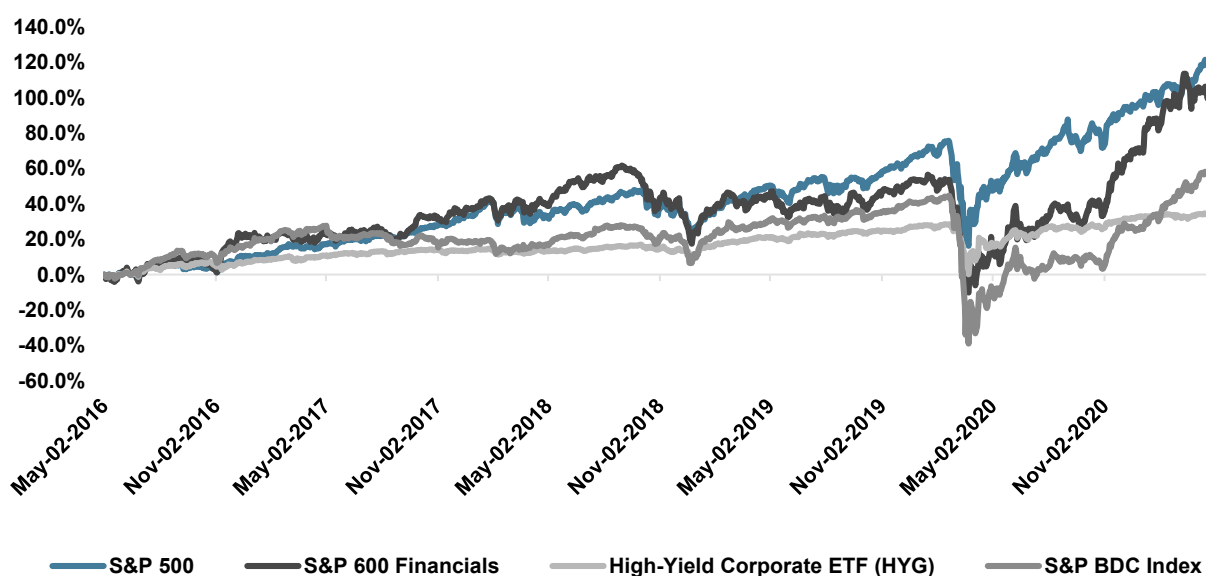


Debt Maturity for BDC Portfolio Companies by Year⁽²⁾ (principal in \$ millions)



Cumulative Total Return (%) as of May 1, 2021

	One Year	Five Years
S&P 500	50.2%	121.4%
S&P 600 Financials	84.2%	106.0%
High-Yield Corporate ETF (HYG)	16.0%	34.6%
S&P BDC Index	79.9%	59.2%



Source: Bloomberg.

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

(2) Represents the principal balance of maturities for all BDCs tracked by Advantage Data.

BDC Market Snapshot

(Dollars in millions, except per share data)

Company Name	Ticker	Market Cap.	Price at 5/1/2021	Price/ 52-Week High	LTM Price Change	Price as a Multiple of NAV	LTM ROA	LTM ROE	Div. Yield	Debt/ Equity
Large Cap										
Ares Capital Corp.	ARCC	\$ 8,419.15	\$ 19.25	97%	30.5%	1.10x	11.1%	20.7%	8.3%	1.1x
Owl Rock Capital Corp.	ORCC	\$ 5,655.76	\$ 14.45	99%	17.1%	0.97x	9.8%	15.2%	8.6%	1.0x
FS KKR Capital Corp. II	FSKR	\$ 3,477.92	\$ 20.47	98%	NM	0.81x	7.2%	10.9%	10.7%	0.8x
Prospect Capital Corp.	PSEC	\$ 3,115.31	\$ 8.05	98%	58.8%	0.90x	10.5%	13.6%	8.9%	0.6x
Main Street Capital Corp.	MAIN	\$ 2,894.77	\$ 42.59	98%	36.5%	1.88x	11.5%	18.0%	5.8%	0.8x
Golub Capital BDC, Inc.	GBDC	\$ 2,619.28	\$ 15.66	99%	29.0%	1.05x	10.9%	19.0%	7.4%	0.8x
FS KKR Capital Corp.	FSK	\$ 2,572.89	\$ 20.79	98%	40.1%	0.80x	9.2%	15.9%	11.5%	1.1x
Hercules Capital, Inc.	HTGC	\$ 2,002.02	\$ 17.41	98%	56.3%	1.52x	15.6%	26.5%	7.8%	0.9x
Goldman Sachs BDC, Inc.	GSBD	\$ 1,989.31	\$ 19.58	95%	16.5%	1.22x	14.1%	27.0%	9.2%	1.0x
Sixth Street Specialty Lending, Inc.	TS LX	\$ 1,610.09	\$ 22.28	97%	21.1%	1.35x	14.6%	25.9%	13.6%	0.9x
New Mountain Finance Corp.	NMFC	\$ 1,273.28	\$ 13.15	98%	38.4%	1.02x	11.4%	24.0%	9.1%	1.4x
Oaktree Specialty Lending Corp.	OCSL	\$ 1,201.20	\$ 6.66	98%	47.0%	0.94x	18.8%	33.9%	7.2%	0.9x
Bain Capital Specialty Finance, Inc.	BCSF	\$ 1,031.06	\$ 15.97	99%	48.8%	0.96x	7.9%	14.7%	8.5%	1.2x
Mean				98%	36.7%	1.12x	11.7%	20.4%	9.0%	0.97x
Mid Cap										
Apollo Investment Corp.	AINV	\$ 948.22	\$ 14.53	97%	43.9%	0.91x	6.2%	10.9%	9.9%	1.4x
BlackRock TCP Capital Corp.	TCPC	\$ 844.56	\$ 14.62	97%	43.3%	1.08x	12.4%	24.1%	8.2%	1.3x
SLR Investment Corp.	SLRC	\$ 780.56	\$ 18.47	94%	9.8%	0.91x	7.5%	13.5%	8.9%	0.8x
TCG BDC, Inc.	CGBD	\$ 754.21	\$ 13.76	98%	54.4%	0.88x	9.7%	19.2%	10.0%	1.0x
Barings BDC, Inc.	BBDC	\$ 677.98	\$ 10.38	99%	33.8%	0.93x	11.6%	24.4%	7.3%	1.4x
Crescent Capital BDC, Inc.	CCAP	\$ 514.05	\$ 18.25	91%	48.7%	0.92x	7.7%	11.3%	9.0%	0.8x
Mean				96%	39.0%	0.94x	9.2%	17.2%	8.9%	1.12x
Small Cap										
TriplePoint Venture Growth BDC Corp.	TPVG	\$ 494.73	\$ 16.02	99%	59.9%	1.23x	8.7%	13.1%	9.0%	0.8x
PennantPark Floating Rate Capital Ltd.	PFLT	\$ 487.75	\$ 12.58	98%	51.2%	0.99x	7.6%	14.0%	9.1%	1.2x
Capital Southwest Corp.	CSWC	\$ 486.36	\$ 24.48	98%	75.1%	1.53x	10.4%	16.7%	8.5%	1.1x
Gladstone Investment Corp.	GAIN	\$ 472.51	\$ 14.23	98%	28.3%	1.24x	9.4%	11.3%	6.5%	0.6x
PennantPark Investment Corp.	PNNT	\$ 441.83	\$ 6.59	97%	100.9%	0.71x	12.2%	23.7%	7.3%	0.9x
Trinity Capital Inc.	TRIN	\$ 385.71	\$ 14.56	91%	NM	1.12x	3.8%	-5.1%	7.7%	1.3x
Gladstone Capital Corp.	GLAD	\$ 357.96	\$ 11.03	99%	57.3%	1.36x	15.5%	24.1%	7.1%	0.8x
SuRo Capital Corp.	SSSS	\$ 352.19	\$ 14.55	90%	126.6%	0.81x	59.6%	68.0%	4.5%	0.0x
Horizon Technology Finance Corp.	HRZN	\$ 325.17	\$ 16.54	94%	51.9%	1.49x	5.5%	6.4%	7.3%	1.1x
WhiteHorse Finance, Inc.	WHF	\$ 316.20	\$ 15.39	92%	57.7%	1.01x	11.7%	20.3%	10.0%	1.1x
BlackRock Capital Investment Corp.	BKCC	\$ 288.45	\$ 3.89	97%	43.5%	0.89x	-2.4%	-8.3%	10.3%	0.4x
Saratoga Investment Corp.	SAR	\$ 282.94	\$ 25.33	95%	66.9%	0.93x	5.1%	4.9%	6.8%	0.9x
Stellus Capital Investment Corp.	SCM	\$ 259.94	\$ 13.34	97%	65.7%	0.95x	12.1%	27.7%	7.5%	1.7x
SLR Senior Investment Corp.	SUNS	\$ 251.33	\$ 15.66	95%	22.4%	0.98x	8.4%	16.6%	7.7%	0.4x
Oxford Square Capital Corp.	OXSQ	\$ 245.51	\$ 4.95	97%	66.1%	1.01x	34.7%	50.6%	8.5%	0.4x
Monroe Capital Corp.	MRCC	\$ 229.65	\$ 10.78	99%	38.7%	0.97x	10.8%	20.6%	9.3%	1.3x
Medallion Financial Corp.	MFIN	\$ 210.48	\$ 8.55	98%	267.0%	0.90x	0.0%	-10.9%	0.0%	4.3x
Portman Ridge Finance Corp.	PTMN	\$ 178.96	\$ 2.38	97%	83.1%	0.81x	19.1%	40.4%	10.1%	1.4x
First Eagle Alternative Capital BDC, Inc.	FCRD	\$ 130.98	\$ 4.35	100%	42.6%	0.71x	-6.3%	-17.7%	9.2%	0.9x
OFS Capital Corp.	OFS	\$ 117.62	\$ 8.77	94%	75.8%	0.73x	11.9%	27.6%	9.8%	1.9x
PhenixFIN Corp.	PFX	\$ 93.91	\$ 34.48	88%	157.3%	0.65x	-19.7%	-41.9%	0.0%	0.5x
Investcorp Credit Management BDC, Inc.	ICMB	\$ 80.29	\$ 5.77	92%	42.8%	0.73x	4.3%	6.4%	12.0%	2.0x
Great Elm Capital Corp.	GECC	\$ 78.75	\$ 3.35	61%	3.4%	0.86x	7.2%	19.8%	11.9%	1.3x
Harvest Capital Credit Corp.	HCAP	\$ 54.01	\$ 9.05	99%	125.1%	0.81x	7.5%	9.0%	10.6%	0.6x
Capitala Finance Corp.	CPTA	\$ 53.27	\$ 19.65	83%	13.7%	0.44x	9.5%	17.3%	0.0%	1.6x
Rand Capital Corp.	RAND	\$ 48.23	\$ 18.68	63%	64.0%	0.90x	13.1%	15.5%	2.1%	0.2x
Firsthand Technology Value Fund, Inc.	SVVC	\$ 44.12	\$ 6.40	87%	76.0%	0.39x	32.1%	33.9%	0.0%	NM
Equus Total Return, Inc.	EQS	\$ 25.68	\$ 1.90	82%	75.9%	0.75x	-9.6%	-13.2%	0.0%	NM
Mean				92%	71.8%	0.93x	10.1%	14.0%	6.9%	1.11x
High				100%	267.0%	1.88x	59.6%	68.0%	13.6%	4.33x
Mean				94%	58.1%	0.98x	10.4%	16.2%	7.7%	1.07x
Median				97%	48.8%	0.93x	9.8%	16.7%	8.5%	0.96x
Low				61%	3.4%	0.39x	-19.7%	-41.9%	0.0%	0.00x

Source: S&P Capital IQ.

Note: As of May 1, 2021.

NM refers to not meaningful.

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

ROE = Net Change in Net Assets / Average Equity.

About Portfolio Valuation and Fund Advisory Services

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.

Our Service Areas

Derivatives Valuation and Risk Management

Fair Valuation for Financial Reporting

Fund Manager Valuation

Fund Opinions

LIBOR Transition Advisory

Portfolio Acquisition and Divestiture Services

Securitization and Regulatory Compliance

Structured Products Valuation Advisory

Valuation Governance and Best Practices

Our Office Locations



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

Corporate Finance

2020 M&A Advisory Rankings All U.S. Transactions

	Advisor	Deals
1	Houlihan Lokey	210
2	Goldman Sachs & Co	172
3	JP Morgan	132
4	Evercore Partners	126
5	Morgan Stanley	123

Source: Refinitiv (formerly known as Thomson Reuters)

No. 1 U.S. M&A Advisor

Top 5 Global M&A Advisor

Leading Capital Markets Advisor

Financial Restructuring

2020 Global Distressed Debt & Bankruptcy Restructuring Rankings

	Advisor	Deals
1	Houlihan Lokey	106
2	PJT Partners Inc	63
3	Lazard	50
4	Rothschild & Co	46
5	Moelis & Co	39

Source: Refinitiv (formerly known as Thomson Reuters)

No. 1 Global Investment Banking
Restructuring Advisor

1,400+ Transactions Completed
Valued at More Than \$3.0 Trillion
Collectively

Financial and Valuation Advisory

2001 to 2020 Global M&A Fairness Advisory Rankings

	Advisor	Deals
1	Houlihan Lokey	956
2	JP Morgan	876
3	Duff & Phelps	802
4	Morgan Stanley	599
5	BofA Securities Inc	542

Refinitiv (formerly known as Thomson Reuters). Announced or completed transactions.

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

1,000+ Annual Valuation
Engagements

Awards



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