CARLYLE

GLOBAL RESEARCH

By **Matt Savino**
February 18, 2025

---

*Welcome back to **The Carlyle Compass**, your weekly newsletter that brings together the latest research and market insights from our global team. This week's edition features guest author Matt Savino, Global Head of Carlyle's Capital Markets team.*

The New Golden Age of LBO Financing

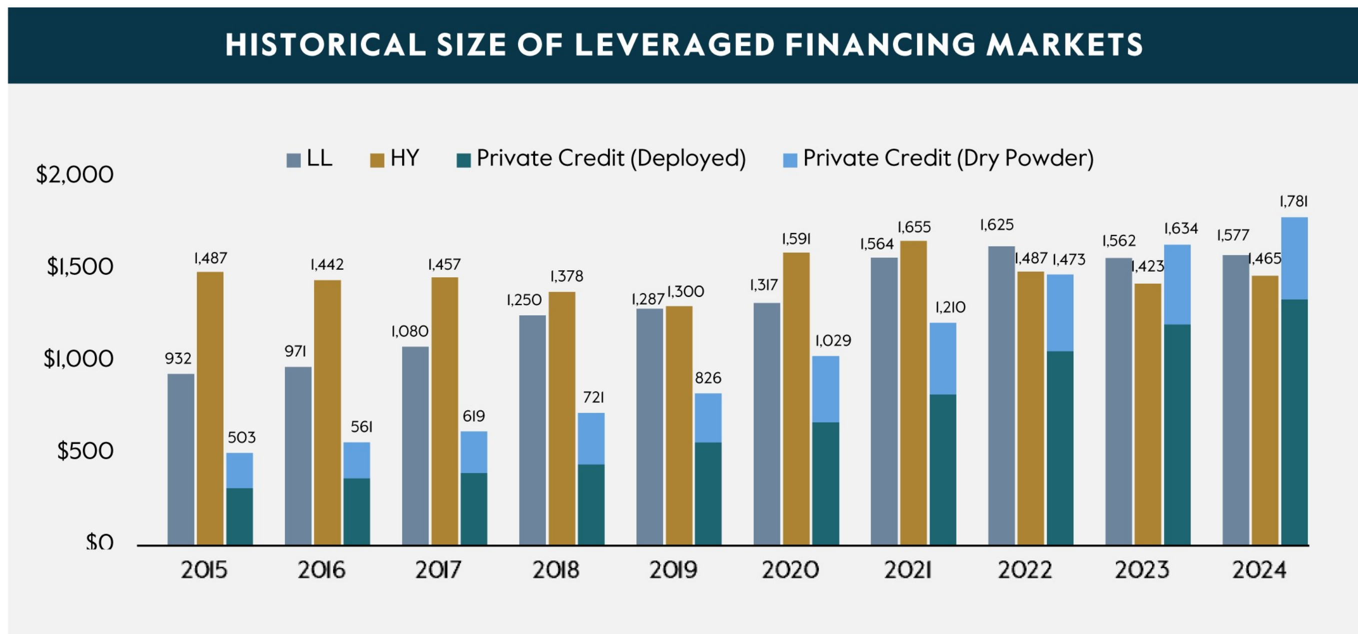
Financial markets experienced meaningful volatility over the past several years as inflation surged and central banks quickly adjusted monetary policy, tightening financial conditions dramatically. Traditional public financing markets staggered under the weight of rapidly changing risk-free rates and increasing credit risk in 2022 and 2023. Public markets became dislocated, shutting down primary supply and impairing the ability of investment banks to underwrite new financing commitments. As a result, financial sponsors faced substantial barriers to traditional means of financing new deals that they would otherwise have been willing to do. Transactions in the healthcare and technology sectors continued to occur despite broader volatility, but traditional financing from public markets was hard to come by.

Conveniently, around the same time, private credit had already begun to move up market from its historical focus on financing small and medium-sized businesses. When the broadly syndicated leveraged loan market traded off, demand for private capital went into overdrive and private credit began providing financing to larger transactions that would have historically been financed in the broadly syndicated loan and high yield markets. A handful of private credit funds began investing huge sums ($500 million to $1 billion+) in single transactions, and several multibillion-dollar debt deals were financed privately. As a result, many prognosticators saw the growing market overtaking traditional liquid markets for leveraged loans and high yield bonds, and in some venues, spoke of the "convergence" of markets. The concept of market "convergence," however, does not do justice to the material sea change in financing optionality provided to financial sponsors looking to fund the next generation of buyouts. For financial sponsors, it is not that private credit has replaced or surpassed broadly syndicated markets, but rather that we now have more choices and flexibility.

In a very short time period, private credit has grown to rival the size and depth of traditional public markets (Figure 1). In 2021, the private credit market surpassed $1 trillion in value, with growth of deployment and available dry powder accelerating dramatically

through 2024 to ~$1.8 trillion in size while the syndicated markets contracted from their respective peaks.

Figure 1



Source: Carlyle Analysis; J.P. Morgan, February 2025. There is no guarantee any trends will continue.

Financial sponsors considering new buyouts now have three deep markets for financing, each with distinct drivers of demand that result in a welcome asymmetry to market behavior in times of disruption. In other words, while volatility never ceases, access to primary capital will vary across each market depending on the nature or cause of the disruption. Furthermore, while deal structures are similar within each market, there are key differences. Rather than speaking of a "convergence" of markets, we prefer to view these markets as "converging" on the same users of capital. While macro drivers will always impact markets, financial sponsors have dramatic flexibility to optimize the capital structures of portfolio companies and address financing issues that require unique solutions. The distinct drivers of demand underlying each market also provide more overall stability, enhancing the ability to arrange financing throughout market cycles and making borrowers less subject to the opening and closing of market windows that have historically defined public markets.

The Durable Benefits of Private Credit

As noted earlier, the growth in private credit received a major boost from the volatility of the last several years because of the technicals underlying demand in that market. Private credit investors have locked up capital, primarily from business development corporations (BDCs) and separate accounts, so they are not subject to daily fund flows that can immediately impact asset managers investing in leveraged loans and high yield bonds. Private credit also does not require public corporate ratings, which is in stark contrast to the broadly syndicated leveraged loan market. Approximately 65% of demand in the loan market comes from collateralized loan obligations (CLOs), which are highly leveraged structured credit vehicles that rely heavily on ratings to measure and grade the individual loans that make up the collateral pools underlying their structures. In periods of extended market volatility, negative ratings actions by the rating agencies can have a material impact on the financing prospects of lower rated companies, potentially locking them out of the loan market at precisely the time they need to enhance liquidity or address a maturity. In times of macro stress, private credit players have capital and can rely on their own research and pricing expertise to finance deserving businesses.

Private credit, however, is not only an attractive option in times of market volatility but has other characteristics that make it attractive in any environment. Price certainty, for instance, is received at signing of a new transaction. When accessing public markets in the context of a new acquisition, investment banks underwrite a financing package at the time of signing to provide certainty of financing but not pricing. Banks typically commit at backstop levels meaningfully wider than current market rates and then market the deal to public market institutions later—sometimes several months later. For those deals, the sponsors and companies retain the ultimate risk of pricing up to the backstop level. Private credit can provide price certainty at signing, which materially mitigates risk for highly leveraged structures that may be expecting a long sign to close period due to regulatory reviews or otherwise.

Private credit may also be an ideal solution for buy and build investments where companies become serial acquirers. Rating agencies sometimes take a punitive approach to acquisition-related pro forma adjustments to earnings before interest, taxes, depreciation and amortization (EBITDA), which can depress ratings relative to credit quality. As noted earlier, private credit does not require or value public ratings. Private markets are also much more accommodative with delayed draw term loan availability and cost, which can allow companies to pre-wire capital availability to pursue acquisitions even in market dislocations when more targets are available at attractive valuations and capital is scarce for other buyers. In the private setting, delayed draw term loans are typically available for longer time periods and cost less than what may be available in public markets.

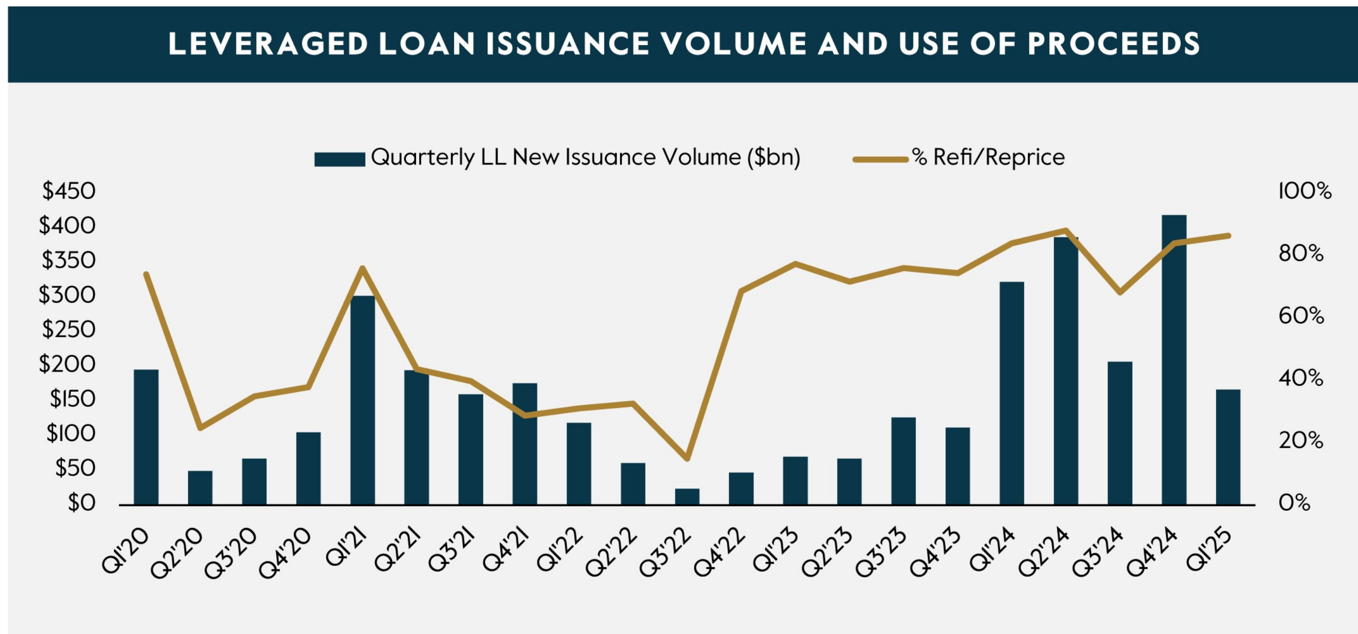
Lastly, private credit is frequently an ideal solution for complicated corporate carveout investments. Such investments may deal with a greater amount of uncertainty as new businesses are stood up to operate on a standalone basis. These companies may also have investment stories that are more challenging to explain in a traditional public marketing process. A private credit financing allows investment teams to focus on the carveout during the sign-to-close period rather than immediately preparing materials and a new management team for a public marketing process. With limited call protection, these portfolio companies can later access the public markets after carveout risk has been mitigated. They can also better prepare their marketing pitch and opportunistically choose their market window. Private credit also offers additional flexibility not available in the syndicated markets that may be helpful in carveouts or other contexts—such as financing in multiple currencies. Broadly syndicated loan markets are generally denominated in US dollars and Euro currencies, but private credit can finance transactions in multiple other currencies, including Canadian dollars, pound sterling and yen.

The Return of Public Markets

The death of public markets, however, has been greatly exaggerated. The syndicated leveraged loan market has historically been the life blood of the leveraged buyout business and remains one of the lowest cost financing markets available. Market conditions have returned to a very favorable place for borrowers. With a strong economy and low default

rates, demand for the asset class has increased, driven primarily by historically high new CLO issuance and positive net retail flows—all at a time that net new supply has been depressed by low M&A activity. This has resulted in a significant sustained repricing opportunity.

Figure 2



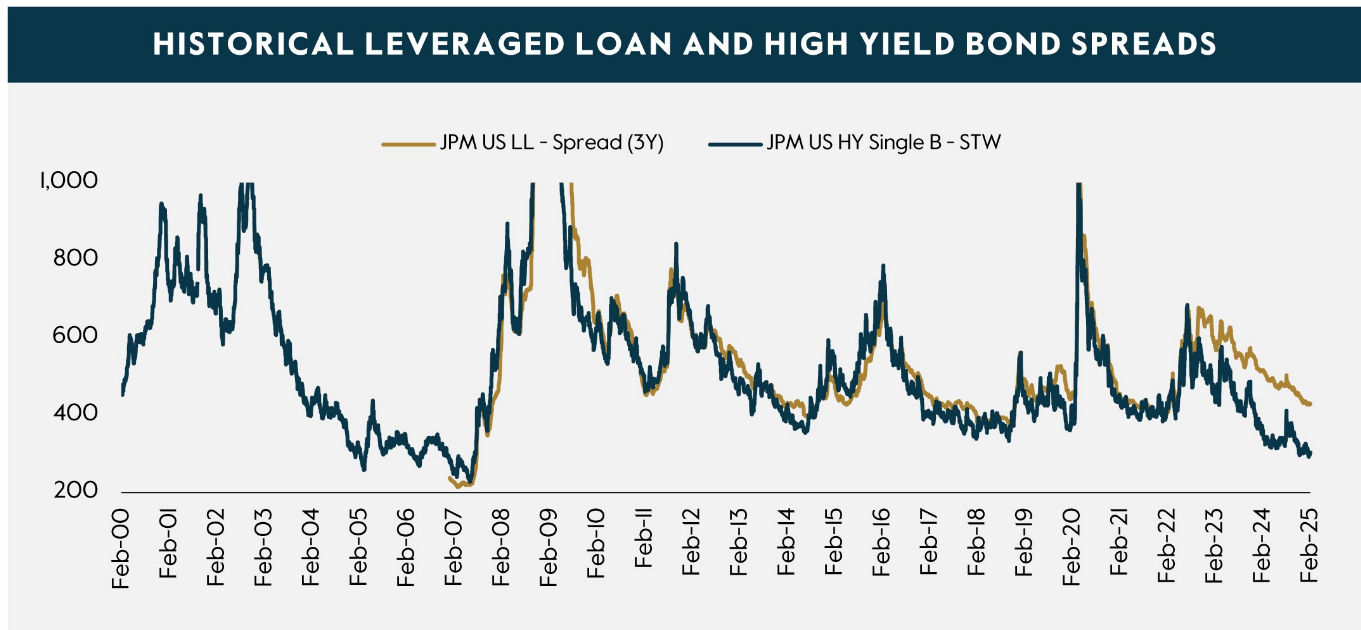
Source: Carlyle Analysis; J.P. Morgan, Pitchbook, February 2025. There is no guarantee any trends will continue.

Anecdotally, average new issue spreads for issuers with B2/B3 ratings are currently in the S+250-350 basis points (bps) area for on-the-run credits and acceptable maximum first lien leverage has increased from 5.0x-5.5x to 5.5x-6.0x as the syndicated leveraged loan market competes more with private credit for deals. That is comparable to new issue costs of S+450-500bps area in private credit—somewhat without regard to leverage. While blended pricing may be comparable between private credit unitranches and full leverage broadly syndicated deals that have junior tranches, private credit may not be an efficient solution for lower leveraged borrowers. Even with today's compressed spreads, pricing for unitranches rarely dips below S+450bps. Bank-led broadly syndicated financings also offer other advantages for borrowers, including looser covenant structures, greater letter of

credit availability and relative ease of obtaining hedging capacity given bank involvement in the credits.

High yield spreads have also tightened as well, with spreads compressing to their tightest levels since the Global Financial Crisis. While the high yield market has become less relevant to financial sponsors, who typically look to avoid the heavy call protection that bond investors demand, less sponsor supply relative to history has created substantial scarcity value for performing, low-rated high yield bonds. This means there is no question that the depth of market is robust for the larger leveraged buyouts that need to access larger pools of capital.

Figure 3



Source: Carlyle Analysis; J.P. Morgan Markets, February 2025. There is no guarantee any trends will continue.

Barring macro disruption, most market participants expect leveraged buyout activity to increase over the next few years. With the economy strong, the Federal Reserve on hold, and geopolitical risks increasing, we believe there is simply nothing left for sellers to wait for anymore. The good news for buyers in the next leveraged buyout cycle is that the availability and creativity of financing is likely to be exceptionally strong.

MATT SAVINO

Global Head of Capital Markets

This material is provided for educational purposes only. Nothing herein constitutes investment advice or recommendations and should not be relied upon as a basis for making an investment decision. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors.

Economic and market views and forecasts reflect our judgment as of the date of this presentation and are subject to change without notice. In particular, forecasts are estimated, based on assumptions, and may change materially as economic and market conditions change. Carlyle has no obligation to provide updates or changes to these forecasts. Certain information contained herein has been obtained from sources prepared by other parties, which in certain cases have not been updated through the date hereof. While such information is believed to be reliable for the purpose used herein, Carlyle and its affiliates assume no responsibility for the accuracy, completeness or fairness of such information.

Past events and trends do not imply, predict or guarantee, and are not necessarily indicative of, future events or results. This material should not be construed as an offer to sell or the solicitation of an offer to buy any security, and we are not soliciting any action based on this material. If any such offer is made, it will only be by means of an offering memorandum or prospectus, which would contain material information including certain risks of investing including, but not limited to, loss of all or a significant portion of the investment due to leveraging, short-selling, or other speculative practices, lack of liquidity and volatility of returns.
Recipients should bear in mind that past performance does not predict future returns and there can be no assurance that an investment in a Carlyle fund will achieve comparable results. The views expressed in this commentary are the personal views of certain Carlyle personnel and do not necessarily reflect the views of Carlyle. Investment concepts mentioned in this commentary may be unsuitable for investors depending on their specific investment objectives and financial position; each recipient is encouraged to discuss such concepts with its own legal, accounting and tax advisors to determine suitability. Tax considerations, margin requirements, commissions and other transaction costs may significantly affect the economic consequences of any transaction.

In connection with our business, Carlyle may collect and process your personal data. For further information regarding how we use this data, please see our online privacy notice at https://www.carlyle.com/privacy-notice.