PEMBERTON

Outlook 2025

January 2025

Foreword

In 2024, private credit markets demonstrated continued robust growth. In parallel, Pemberton recorded several milestone achievements as we continued to expand our platform and offering.

In our Direct Lending strategies, we successfully closed the third vintage of the Strategic Capital strategy and the fifth vintage of the Mid-Market Debt strategy. It was a landmark year for investment, with €4.6 billion of capital deployed across these three strategies and over 650 opportunities reviewed—making 2024 our second-highest year for Direct Lending investments.

Further expanding our capabilities, we launched a Private Debt ELTIF with Zurich and introduced our NAV Strategic (GP Solutions) strategy anchored by the Abu Dhabi Investment Authority (ADIA). Reflecting the evolving trend of collaborations between banks and private credit managers, Pemberton announced a strategic partnership with Santander to launch *invensa*, a global inventory management and solutions company.

Additionally, we continued to scale our Risk Sharing (SRT) strategy, completing a number of attractive SME and large corporate transactions—an important step in strengthening our diversified platform.

Another key highlight was the successful launch of Indigo II, a c.€405 million European CLO transaction. These milestones are just a few highlights of a transformative year.

Looking ahead to 2025, we remain optimistic about the opportunities within private credit. Lower European base rates are poised to support M&A activity, reduce borrowing costs, and drive defaults toward historic lows. We anticipate continued growth in the European Direct Lending market, fuelled by the ongoing shift from levered bank lending to long-term asset managers backed by pension funds and insurance capital.

Private credit continues to be a highly attractive asset class for investors, supported by a broad range of offerings and diversification of strategies—a trend we expect to persist. Demand for outcomes-focused solutions is set to grow, as private credit managers expand their capabilities, and enhance their offerings to meet the needs of a dynamic market.

On behalf of the team at Pemberton, I would like to extend our thanks to our clients and partners for their trust and collaboration. We look forward to working closely and building on this success with everyone in 2025.

Symon Drake-Brockman

Founder and Managing Partner

Outlook 2025

Executive Summary

Yields remain materially higher than pre-2023 despite tightening margins. European all-in returns continue to exceed those seen in the U.S.

After a subdued 2023, we saw a resurgence in European M&A deal activity in 2024 with volumes considerably up across both private and syndicated debt. Yield compression came hand-in-hand with the benign market conditions, with European High Yield spreads reducing by ~80bps throughout the year[1] and private credit yields also facing similar compression[2]. That said, European Direct lenders continued to generate double digit returns and maintained their 200-300bps premium to public markets.

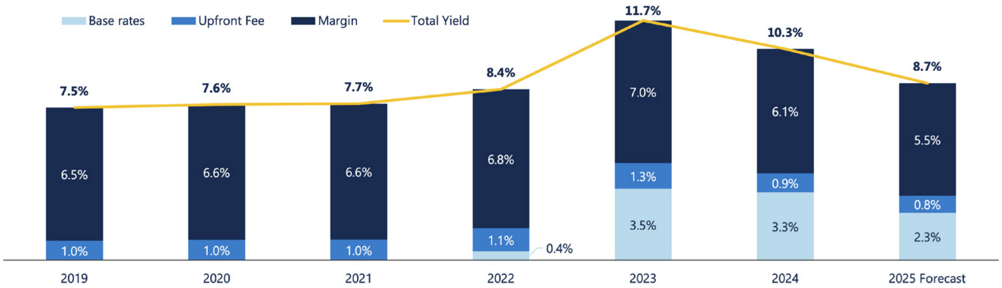
In our view, credit investors will continue to earn higher spreads in Europe versus the U.S. given the more developed and commoditised nature of the U.S. market. We believe that the pro-growth Trump government will underpin an ongoing divergence between European and U.S. base rates, with lower growth in Europe but also lower all-in borrowing costs for European borrowers.

Key Themes

1. Pricing

All-in yields remained above 10% (euro returns) throughout 2024 (c.12% in U.S. dollars). 2024 saw some tightening both on margin spreads and upfront fees, driven by a less volatile backdrop than what we saw in 2022/23 and increased competition from a lending community with capital to deploy. However, with yields still in double-digit territory across our mid-market portfolio, there is still a healthy premium to levels seen historically. Looking into 2025, we expect further base rate compression and tightening margins but at a slower pace than in 2024 and to remain above levels seen in pre-2023. U.S. dollar investors into Europe should still benefit from double-digit returns on loans after capturing the current 2.0% U.S. dollar uplift in the swap market.

Figure 1: Historic Yield Development in Euros based on Pemberton's Mid-Market Debt Strategy (MDF)[3]

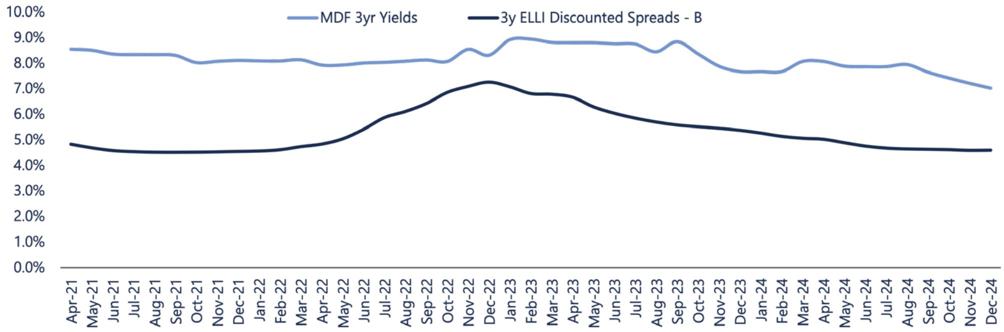


[1]Source: BAML Leveraged Finance Review 2024.
[2]Source: Pemberton internal portfolio data.
[3]Source: Upfront fees are illustrated based on 3-year repayment basis. Bloomberg as at 20 Jan 2025 (base rates).

2. Returns and Relative Value

Direct Lending yields and returns continue to offer significant yield pick-up vs. its syndicated counterpart with a premium of c.175bps.

Figure 2: Pemberton Mid-Market Debt Strategy Discount Spreads vs ELLI 3yr Discount Spread B[4]

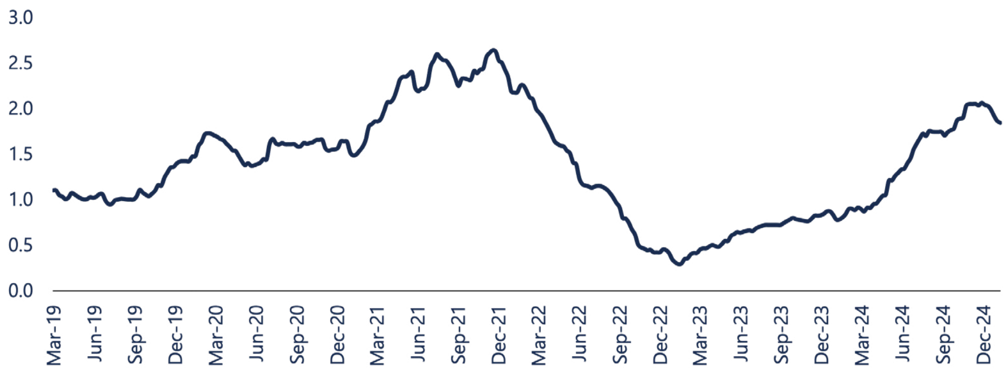


Looking back over the last four years since the COVID pandemic, the Direct Lending market has consistently delivered a 200-300bps premium above the syndicated market and kept default rates low through a number of shocks including the Ukraine crisis, a high inflation macroenvironment and a challenging backdrop for many businesses. We see Mid-Market Direct Lenders continuing to get a c.100bps premium versus larger Direct Lending deals while still maintaining covenants and a disciplined approach on documentation and structuring.

3. Increasing Relevance of Private Large Cap Financings

2024 saw the resurgence of the European leveraged loan and high yield markets with record total issuance volumes just shy of €300bn[5], albeit more than 70% of issuances relate to refinancings and recaps. The graph below shows the continued return of high yield issuance, which has been supported by strong technicals including the largest inflow into European high yield in over 5 years (€15bn) and the largest annual CLO primary issuance volume on record at €46bn[6].

Figure 3: European High Yield Issuances, in €B, Trailing Twelve Months[7]



[4]Source: Bloomberg as at 20 Jan 2025.
[5]Source: BAML Leveraged Finance Review 2024.
[6]Source: BAML Leveraged Finance Review 2024.
[7]Source: Debtwire; "Going private: direct lending overtakes syndicated debt as LBOs' most reliable funding source | DebtDynamics EMEA".

Although the syndicated space is expected to remain buoyant, we believe 2025 will continue to see a further expansion in private credit market share. Market data[9] suggests that Direct Lending has become the preferred funding source for LBO financings due to the reliability and flexibility that lenders can offer. Large cap transactions, whereby one or more Direct Lenders provide €750m+ financings, have become commonplace, whereas these would have historically belonged in the syndicated space, illustrating a shift in the market and in private equity funding source preference. Equally, hybrid structures where Direct Lenders sit alongside the syndicated market or bank solutions are becoming more common. These larger transactions are typically cov-lite and are documented very much in line with BSL conventions. Pricing on these large-cap deals has converged towards syndicated loan levels to reach sub-500bps spreads with fees in the 2-2.5% range[9].

Notwithstanding this trend, the core mid-market space continues to exhibit its traditional traits and we expect this space to continue to be single lender, largely covenanted, with a pricing premium to the larger market and dominated by the incumbents sourcing in regional markets.

4. Deal Volumes

We reviewed over 650 potential Direct Lending deals in 2024; slightly up on 2023 but with higher quality and a more stable M&A environment leading to a doubling of deployment volume year-on-year. 2024 was our second highest ever year of investment in Direct Lending, after 2021, which was notably marked by a substantial post-COVID catch up.

We believe overall M&A activity in 2025 will continue the path seen last year and show a modest increase year-on-year. A notable trend in 2024 was the sale of assets to Continuation Vehicles (“CVs”). Through these structures, private equity sponsors are looking to achieve both a partial realisation while retaining the future upside by keeping the asset in a vehicle they manage. We expect to see this trend remain an ongoing feature of the market but note that lending into these processes needs heightened due diligence to corroborate the real cash equity “skin in the game”, underlying borrower performance, and the existence of any unconsummated sales processes that failed to meet exit multiple expectations.

5. Sector and Geographic Trends

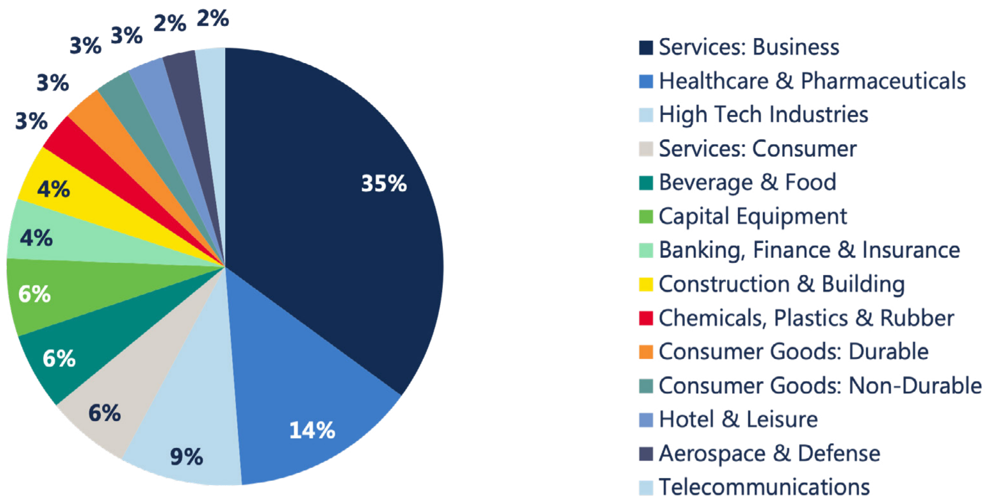
We have experienced a pickup in deal activity across all regions in 2024 with the services sector leading the way accounting for 35% of all Pemberton introductions followed by healthcare at 14%. Within business services, the IT services space continues to be a key sector for Pemberton as sponsors remain attracted by strong tailwinds around cloud migration and digital transformation as well as the high cash flow levels and attractive consolidation opportunities. Notable recent investments include: Kingsbridge Healthcare Group (UK, hospital operator), Groupe André Chenue (France, art logistics), AndraTech (Netherlands, semiconductor supplier), and RelyOn Nutec (Nordics, specialist safety training).

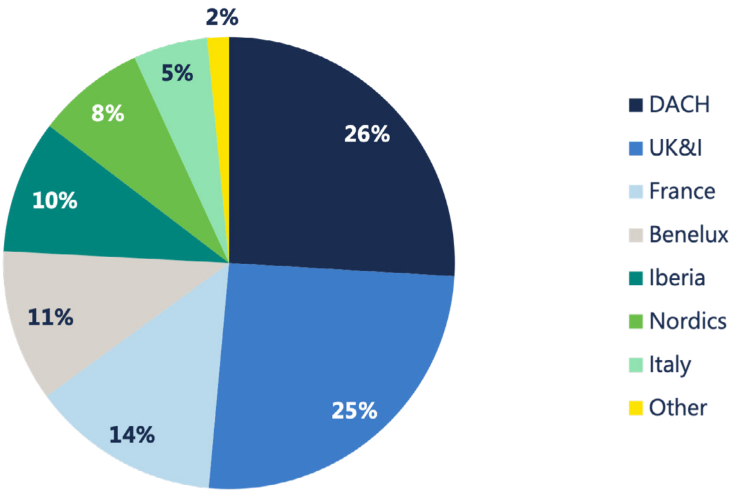
The wider Direct Lending market[8] has been particularly active in TMT, services, and healthcare. Highly cyclical industries such as consumer and leisure have traditionally seen low participation from the private debt space and instead pivoted towards the syndicated or bank market.

[8] Debtwire.
[9] Pemberton Internal Data.

For 2025, we expect a similar pattern with direct lenders leaning towards defensive and non-cyclical businesses. Favourable interest rate movements and broader improvement of the macro picture could enable growth opportunities in under-indexed verticals like energy, utilities and consumer. We believe the UK will lead in terms of deal activity due to the well-developed PE landscape and associated realisation pressures. This, together with an improving economic outlook, may help mitigate the pressures from increases in wages and national insurance costs, albeit closer scrutiny on staffing costs will be required during due diligence processes in this jurisdiction. Headwinds stemming from the political situation and prevalence of traditional bank solutions may provide a challenging backdrop for deal making in the DACH region and France. Local origination capabilities remain key across Europe to unlock opportunistic situations, particularly in historically underpenetrated Direct Lending markets like Spain and Italy. Pemberton's pan-European network of local origination offices is crucial to accessing high quality investment opportunities across the continent.

Figure 4: Pemberton Introductions by Sector and Region - 2024[9]





[9]Pemberton Internal Data.

6. Economic Outlook

The 2025 economic outlook is an improving one in Europe and the UK, with GDP growth projections ranging between 1-2%. Headline GDP growth numbers, however, hide some of the shining stars such as Spain where GDP grew by over 3%. That said, challenges for incumbent politicians in Germany and France are projected to keep both growth and ECB interest rates at low levels.

While growth projections are higher in the U.S., particularly after the inauguration of the pro-growth Trump government, it remains to be seen how some borrowers will cope with the higher cost of borrowing caused by higher base rates.

2025 is projected to see continuing good news around inflation, where it remains below the 2023 spike on both sides of the Atlantic. However, whilst the U.S. seems poised for higher growth, the tighter U.S. labour market and potential impact from tariffs increase uncertainty and the potential for both inflation and base rates to increase in the U.S.

Figure 5: Real GDP % YoY for selected economies[10]

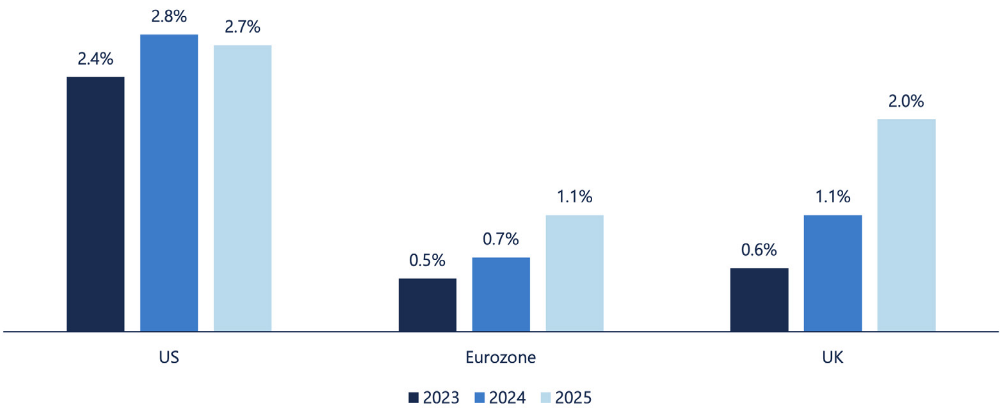
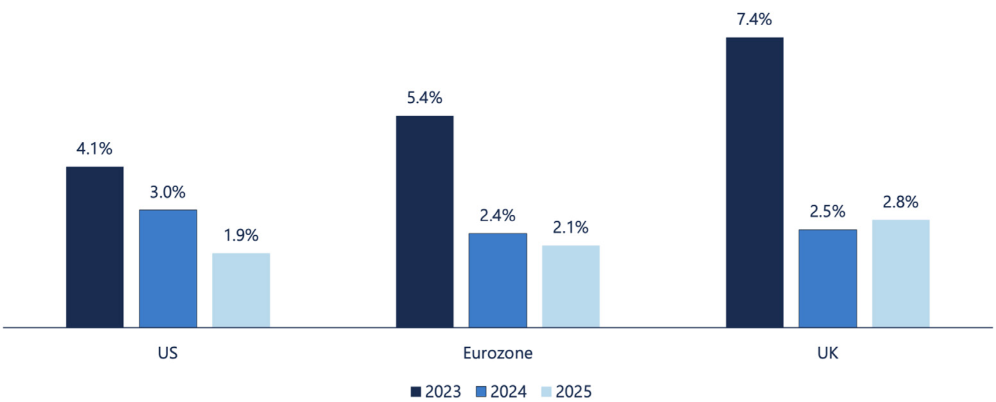


Figure 6: Inflation YoY for selected economies[11]

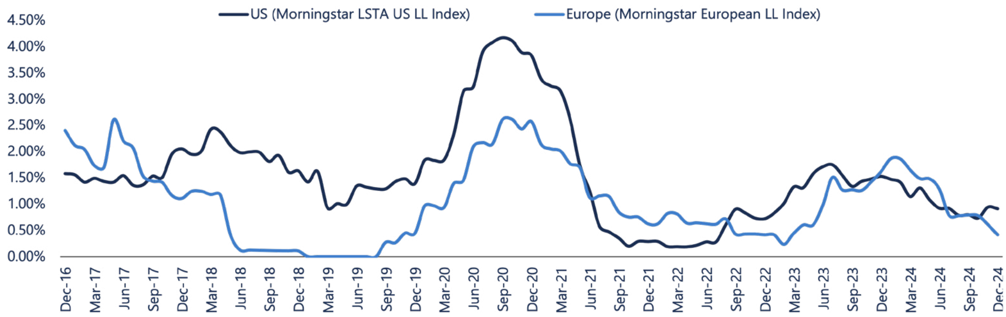


[10]Source: Oxford Economics, IMF, ECB, Commons Library.
[11]Source: Oxford Economics, ONS, Morningstar.

7. Defaults

The benign market backdrop in 2024 led to consistently low default rates in Europe, while the U.S. market experienced higher volatility. Historically, U.S. loan default rates (LDR) tend to be higher, as evidenced by the average U.S. LDR at 0.91% and the European LDR at 0.42%. Default rates are back at near historic lows in Europe.

Figure 7: U.S. and Europe Trailing Twelve Months (TTM) Loan Default Rates (Principal amount)[12]



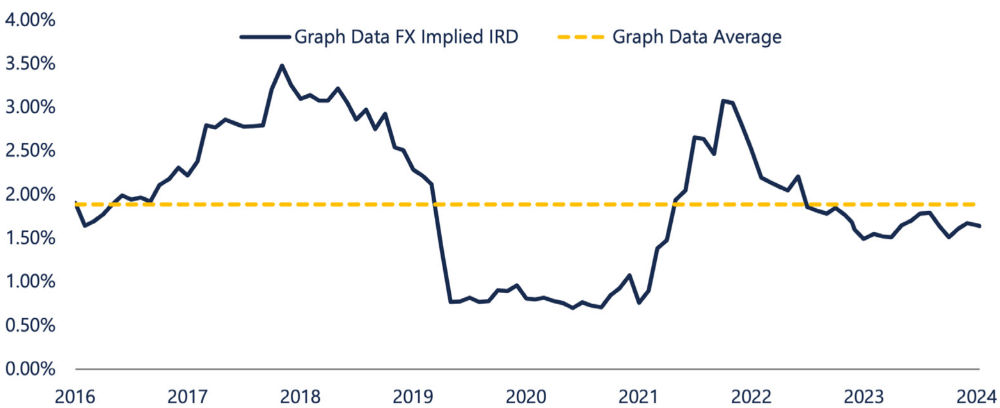
As a result of the lower probability of defaults, we may start to see the return of higher leverage levels and in turn fuel multiple expansion for assets. We would expect this acceleration to lead to higher M&A volumes as sponsors optimise exits.

8. U.S. Dollar Returns for Investors into European Direct Lending

We believe that USD investors will continue to benefit from a significant uplift in returns through 2025 when they invest in European Direct Lending. Current FX forwards are showing a 2.0%[13] uplift over 1–3 years, taking an illustrative 10.0% net return in EUR to a 12.0% net return in USD if hedging strategies are executed smoothly.

This is in-line with the c.2% uplift that we have seen in recent years.

Figure 8: EUR USD FX Uplift – 3 month forwards[14]



[12]Source: Morningstar, Dec-24.
[13]Source: Record Financial Group as of 20 January 2025.
[14]Source: Record Financial Group as of 20 January 2025.

Conclusions

We expect 2025 to be another year of continued growth in the European Direct Lending market, with the ongoing systemic migration of lending away from levered European bank balance sheets towards long-term asset managers funded directly by pension funds and insurance capital.

We believe that reducing base rates in Europe will allow for continued support for M&A, with all-in borrowing costs reducing and a further reduction in defaults towards all-time lows.

For investors, private credit returns remain very compelling versus equity both from a volatility and all-in perspective. European Direct Lending returns are expected to continue providing a c.100bp uplift versus their U.S. equivalent and c.175bps uplift vs. European syndicated loans.

Disclaimer

This document references the Pemberton Mid-Market Debt Strategy, Strategic Capital Strategy, Senior Loan Strategy, the Working Capital Solutions Strategy, Net Asset Value Financing, GP Solutions Strategy, Risk Sharing Strategy and CLO Strategy. It is intended only for the person to whom it has been delivered and is solely for discussion / information purposes.

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