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High Five – 2025 Outlook (Fourth of a Series)

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Next up is the second of our five themes for the year ahead: *"A busier market: Providers of creative and flexible capital solutions will find favor."*

As a brightening macro picture releases pent-up demand for private capital dealmaking – there was $2.6 trillion of dry powder among global buyout and venture capital firms waiting in the wings at the end of H1 2024, per S&P Global – issuers and private equity firms will seek bespoke financings.

Private debt has consistently proven its capacity to achieve this. Over the past decade direct lending, for example, has taken a greater share of LBO acquisition finance. By the end of the first three quarters of 2024, it was the debt funding source of choice in 92% of US LBO deals, per LSEG LPC (See our *Chart of the Week*).

Institutional investors are planning to increase their commitments to private capital. A recent Private Debt Investor's survey study found that 57% of LPs are expecting to invest more in private debt during 2025 than last year, the highest proportion since 2020. Our own survey tells a similar story: 65% of investors are planning to increase allocations to private debt this year. With more capital flowing to private debt, high quality issuers and sponsors should have plenty of options.

In a busier private capital market, winning assets with the strongest risk-return characteristics for investors is a tricky balance. It also demands laser focus providing creative and competitive capital solutions helping businesses achieve their current and future objectives.

For a start, private capital providers with tight relationships with their private equity owners will find high-potential opportunities by mining their existing positions. A firm's own portfolio (what we call "shopping in your closet") can be its greatest asset. Nothing beats the visibility and familiarity of an existing manager/investor in meeting portco's refinancing and other upcoming capital needs.

Further, as exits come through in higher volumes and sponsor-to-sponsor deals return to the market in force (excluding public listings, they accounted for 51% of exits in Q3 2024, up from 47.4% the previous quarter, per PitchBook), incumbent private capital investors are well positioned to support the new transaction's requirements.

Asset managers with deep-rooted PE relationships forged via a range of touchpoints beyond private debt, including through fund commitments and as co-investment partners and secondary deal investors, have unique insights into the likely capital needs of sponsors and their portfolio companies. Taking a whiteboard approach to capital structures, they can bring new ideas to sponsors for creative financing solutions tailored to a specific set of circumstances.

And, in what we expect to be a faster-paced deal environment in 2025, speed of execution, transparency and the capacity to provide capital up and down the capital stack will be essential to securing the highest quality deals. Those without the scale to move swiftly and commit a deal's whole financing need are likely to be on the outside looking in.