

## **BlackRock Private Debt**

Direct Lending

# **Core Middle Market vs. Upper Middle Market**

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November 2023

**BlackRock**

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# Core middle market focus for 20+ years

	Lower Middle Market	Core Middle Market	Upper Middle Market	Broadly Syndicated Loans
EBITDA	\$0 – 25 million	\$25 – 75 million	\$75 – \$150 million	\$150 million+
Market Dynamics	<ul style="list-style-type: none"> <li>Underwritten by smaller asset managers or community banks</li> <li>Typically either a sole lender or member of a small club</li> <li>Borrowers can be less sophisticated due to smaller businesses or no Private Equity partner</li> <li>Least efficient segment; Limited to no liquidity; cost of capital mixed because dependent on banking relationship</li> <li>Business may not be able afford bankruptcy due to high costs</li> </ul>	<ul style="list-style-type: none"> <li>Underwritten by institutional asset managers</li> <li>Typically either a sole lender or member of a club of 1-5 direct lenders</li> <li>Typically stronger total covenant package <u>plus</u> prepayment protection and ability to customize reporting</li> <li>Less efficient segment; higher cost of capital, robust lender protections</li> <li>Managers less focused on middle market league tables</li> </ul>	<ul style="list-style-type: none"> <li>Underwritten by an agent</li> <li>Typically arranged and distributed by mid-market lender</li> <li>Often covenant-lite or a single maintenance-based test</li> <li>More efficient segment; lower costs of capital and less lender protections</li> <li>Most complete segment of middle market.</li> <li>Manager focused on middle market league tables</li> </ul>	<ul style="list-style-type: none"> <li>Typically arranged and distributed by a large bank</li> <li>Most efficient segment; lowest cost of capital and borrower-friendly terms</li> <li>Primarily covenant-lite (75%+ of market)</li> <li>Trades daily in high volume in a normal, functioning market</li> </ul>

BlackRock US Direct Lending Strategy

Focus on the Core Middle Market, with a **flexible strategy** targeting select opportunities in both the Lower and Upper Middle Market

Source: BlackRock as of September 30, 2023. All \$ are in U.S. Dollars. Lending market overview provided for illustrative purposes only.

## The Core Middle Market offers enhanced protections and increased efficiency in the event of a downturn

	Core Middle Market	Large-Cap / Upper Middle Market
<b>Lenders</b>	Sole lender or small group	Possible syndication among numerous lenders
<b>Influence</b>	Involved early-on to drive terms	Less opportunity to drive terms; lenders may accept loose terms to appease sponsors
<b>Downside mitigation</b>	Able to negotiate stronger lender protections, typically 1-2 covenants	Typically covenant-lite
<b>Liability management</b>	Increased efficiency when managing through amendments / workouts	Competing creditor initiatives; more complexity in a restructuring due to number of stakeholders involved

<sup>1</sup>Estimated by BlackRock as of September 30, 2023.

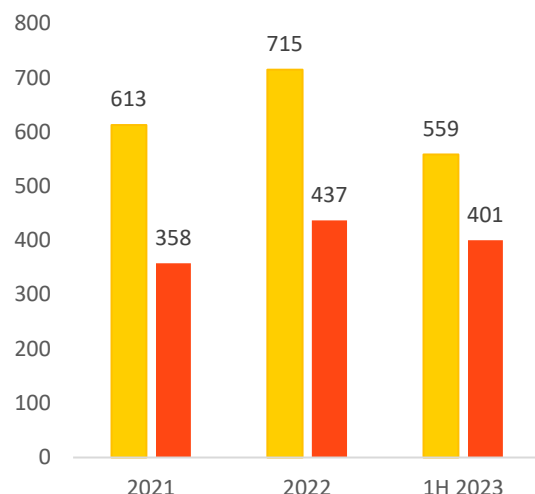
# Attractive Risk/Return in U.S. Core Middle Market

Our investments in Core Middle Market U.S. companies have historically delivered stronger risk-adjusted returns than loans to upper middle market and large cap companies:

- As shown below, our Middle Market investments have delivered a **pricing premium of ~230 bps** on average over the U.S. upper middle market and large cap private debt transactions since the start of 2021.
- Our investments' **leverage is approximately 33% lower** on average than that seen in larger transactions.
- Our U.S. Middle Market investments have generated **~58% higher pricing per unit of leverage on average**, delivering superior returns for less risk.

## Higher pricing ...

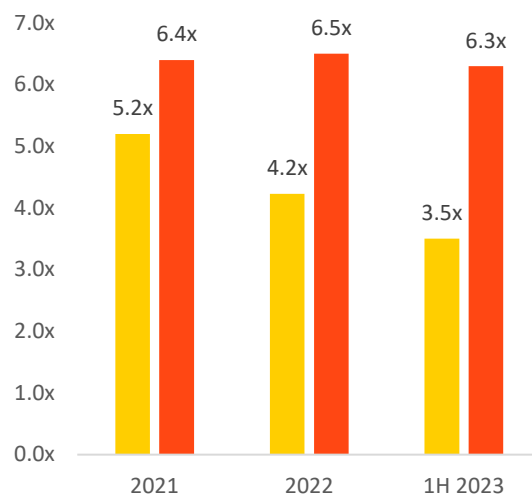
Investment spread at underwriting (bps)



U.S. Core Middle Market (DLF IX)<sup>1</sup>

## ... and lower leverage ...

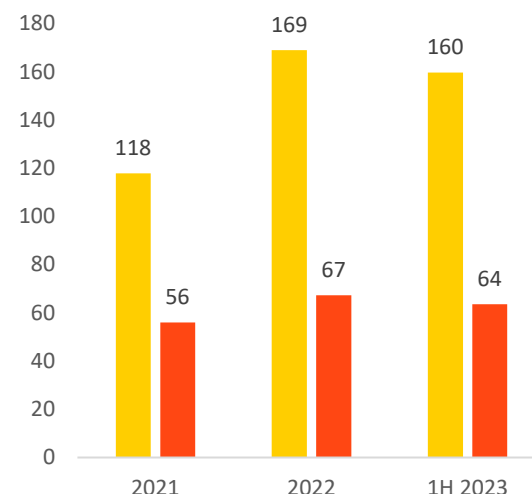
Investment total gross leverage at underwriting (x)



U.S. Upper Middle Market and Large Cap<sup>2</sup>

## ... for better risk/return

Investment spread / leverage at underwriting (bps/1x)



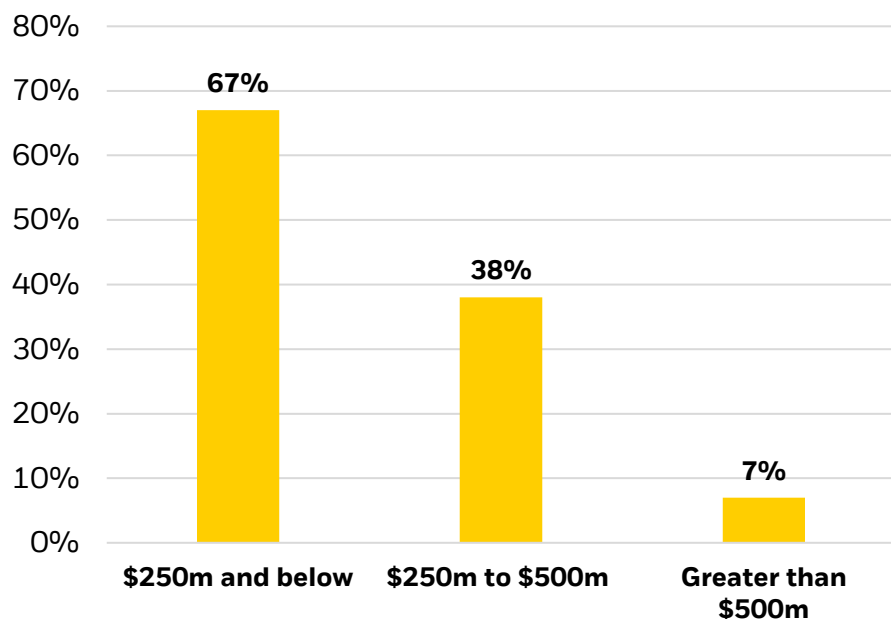
The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Source: BlackRock as of June 30, 2023. For illustrative purposes only. The information above is not a prediction of current or future performance or any assurance that comparable investment opportunities will be available to the manager at the time of investment. <sup>1</sup> Source: BlackRock, US Direct Lending Fund IX ("DLF IX") Strategy's investments, as of June 30, 2023. Includes transactions funded between January 1, 2021-June 30, 2023 in the Direct Lending Fund IX portfolio. Excludes deals with tranche sizes above \$250m and excludes any deal based on something other than borrower cashflow. <sup>2</sup> Source: Pitchbook LCD U.S. upper middle-market and large cap deals above \$250m, as of June 30, 2023. Spread per turn of leverage is calculated as spread at underwriting divided by total gross leverage at underwriting. All data represents investments completed within respective period of time. Please note the BlackRock Direct Lending Fund IX is closed to new investors.

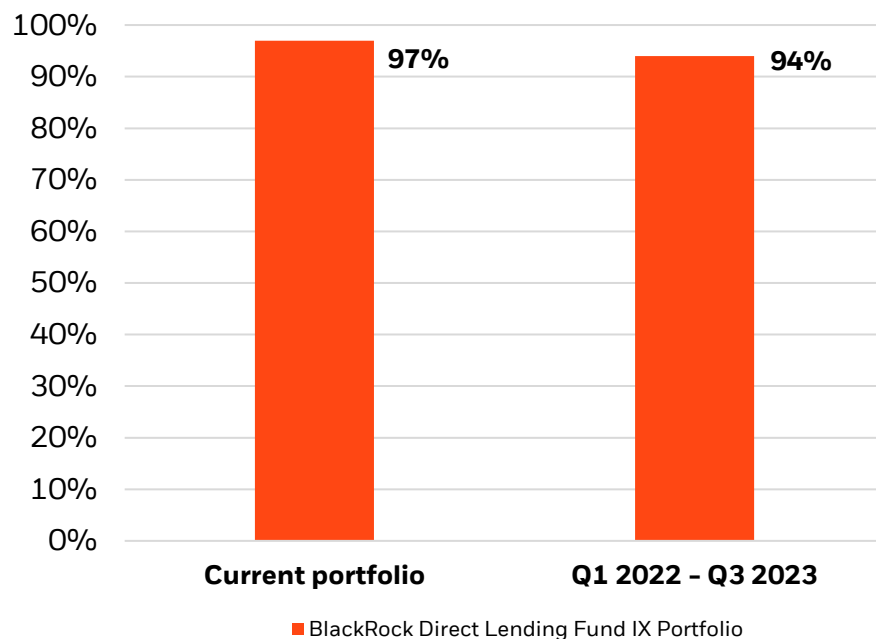
# Covenants go away as private loans get bigger

- Direct lenders have been taking market share from the broadly-syndicated leveraged loan market in recent years.
- Private credit firms have **loosened structural protections** in an effort to compete with bank financings for larger cap firms.
- Exhibit 1 below illustrates that **covenants tend to weaken as the size of the transaction increases**.
- Despite covenant erosion in the broadly-syndicated market, BlackRock's U.S. Direct Lending strategy, which focuses on the core-middle market, has **maintained tight covenant documentation for the deals in the portfolio today**. (See Exhibit 2)

**Exhibit 1: Percent of deals with maintenance covenants by deal size<sup>1</sup>**



**Exhibit 2: Percent of BlackRock's US Direct Lending portfolio with covenants<sup>2</sup>**



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

For illustrative purposes only. The information above is not a prediction of current or future performance or any assurance that comparable investment opportunities will be available to the manager at the time of investment. <sup>1</sup>Source: Moody's Investors Service as of 30 September 2023. Represents a survey Moody's conducted analyzing 28 private credit loans made by business development company lenders issued between January 2022 through September 2023. <sup>2</sup>Source: BlackRock as of 30 September 2023. Represents portfolio data from the most recent BlackRock US Direct Lending strategy, the Direct Lending Fund IX (Levered and Unlevered). Data shown for the current portfolio represents the percent of the Direct Lending Fund IX portfolio with at least 1 covenant. Data shown for "Q1 2022 - Q3 2023" represents the percent of deals with at least 1 covenant for deals funded between January 2022 through September 2023 in the Direct Lending Fund IX portfolio. Please note the BlackRock Direct Lending Fund IX is closed to new investors.

# Risks warnings

Capital at risk.

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