

# Valuation Considerations in Private Debt

Chew Kwan Eng, Partner

Ernst & Young Advisory Pte Ltd

■ ■ ■  
The better the question. The better the answer.  
The better the world works.



**EY**

Building a better  
working world

# Table of Content

---



**Overview of Private Debt Market**



**Private Debt Valuation Issues and Potential Solutions**

# Private Debt: A Growing Financial Solution Post-GFC

**Private debt**, also known as private credit, involves direct lending to companies by funds instead of traditional banking or public markets

**Market Shift:** Regulatory changes increased bank capital costs for high-risk assets, leading banks to arrange rather than on-balance sheet holding of certain assets providing opportunity for private debt funds stepped in to provide capital

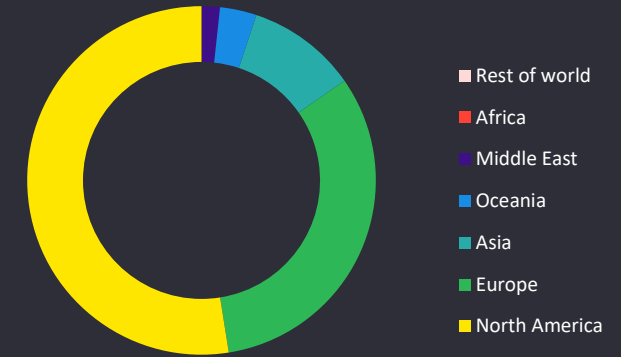


*In its latest five-year private markets outlook, Preqin forecasts that private credit will nearly double in size reaching \$2.8 trillion by the end of 2028, after most investors it surveyed confirmed that they expect to invest even more money in this asset class.*

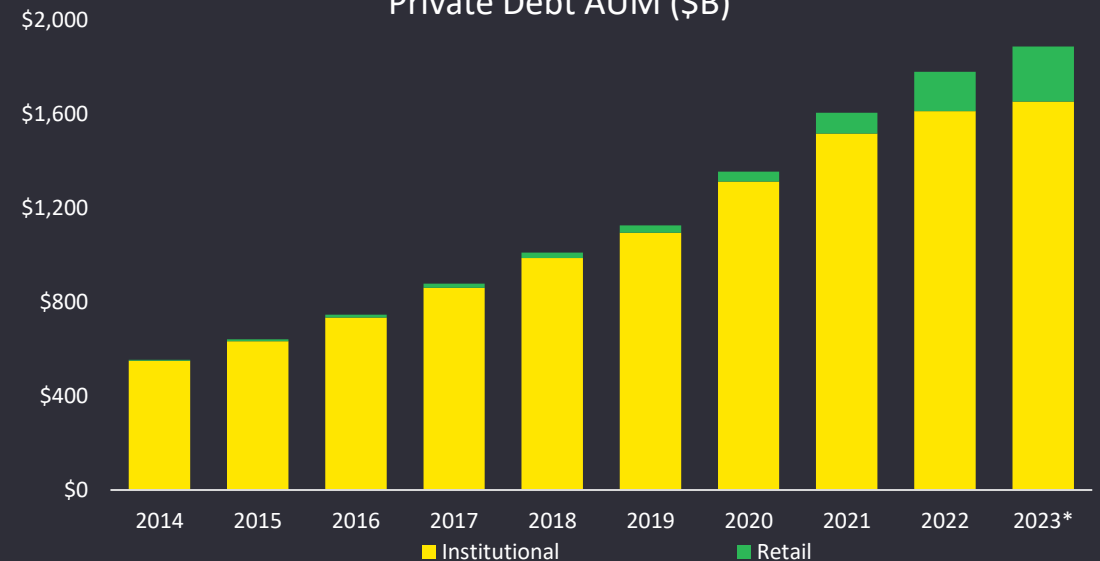
**Ernst & Young**

*Private Debt – An Expected But Uncertain “Golden Moment”?*

Private debt fund count by region

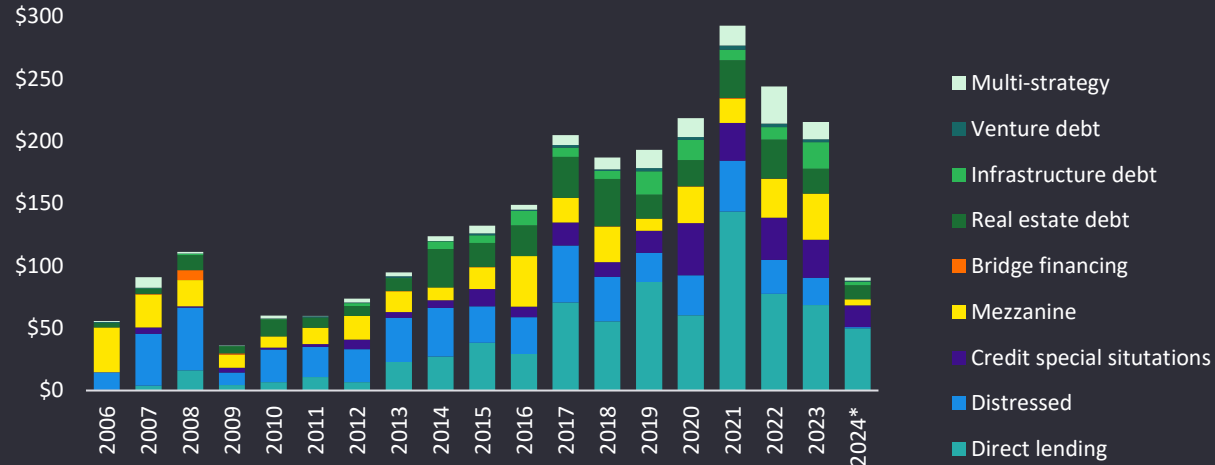


Private Debt AUM (\$B)



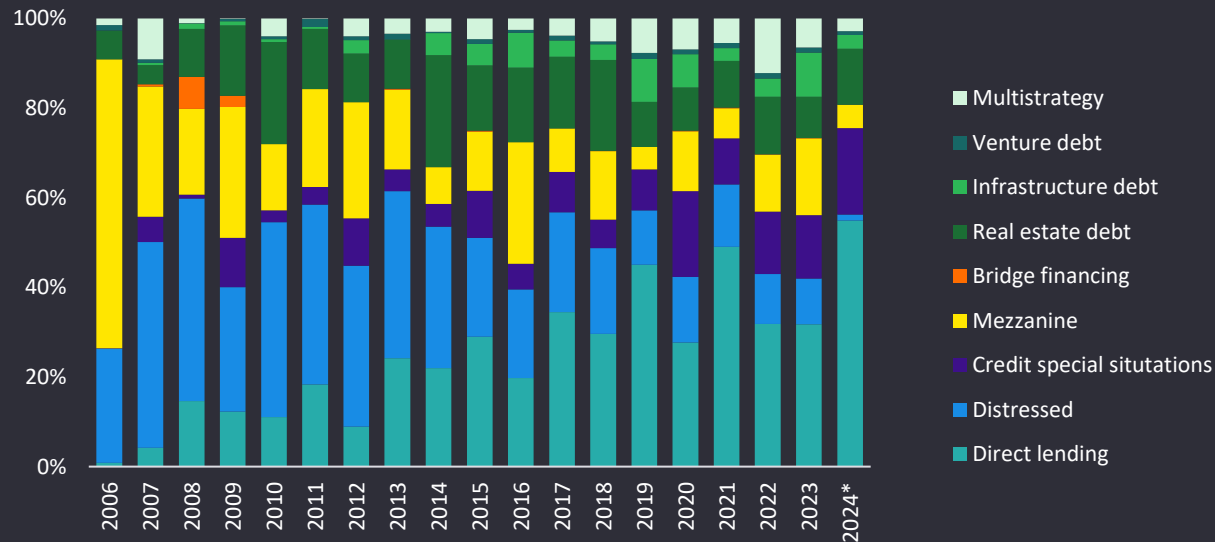
# Private Debt by Type

Private Debt Capital Raised (\$B) and Share of Private Debt by Strategy respectively as of 30 June 2024 (Pitchbook)



**Strong Performance:** Continues robust fundraising, ranking as the second most favored strategy after private equity

**Direct Lending Dominance:** Accounts for 54.9% of funds closed in H1 2024, leading the private debt strategies



**Stabilizing Trends:** Mezzanine and infrastructure debt funds have reached a plateau after previous strong interest

**Distressed Lending Decline:** Now represents a minor 1.3% of the private debt market in H1 2024. Possibly due to increase in default rate observed in 2022-2023.

# What we see in the market



## Common issues identified observed

**Simple Valuation Approach:** Reliance on simple methods like Principal plus Interest (P+I)

**Monitoring Issues:** Dependence on cash coupon receipts for valuations is problematic when interest is paid-in-kind (PIK)

**Inadequate Collateral Assessment:** Insufficient evaluation of collateral quality and enforcement risks can undermine debt security

**Market Adjustments Shortcomings:** Fixed coupon loans often lack timely adjustments to reflect prevailing market interest rate changes

**Liquidity Considerations Gaps:** Liquidity risks, particularly in stressed market conditions, are frequently underestimated, posing potential financial stability concerns



## Best practices

**Establish more robust valuation approaches:** such as yield analysis and recovery analysis, details [in next page](#)

**Appropriate monitoring process:** Develop a consistent framework for evaluating a borrower's financial health, industry position, and the quality of any collateral securing the debt

**Consistent Recovery Analysis:** For asset-backed debt, estimate the value of underlying collateral (e.g., real estate, machinery) and consider enforcement and legal risks to determine the recovery amount

**Appropriate Discount Rate Assessment:** Evaluate critical factors including instrument terms, credit risk, liquidity, and regulatory or legal changes to determine the right discount rate

# Private Debt Valuation Approaches



## Yield Method

- 1) Determine Cash Flows: Estimate expected cash flows, especially when they're not based on fixed amounts
- 2) Establish Discount Rate: Calculate the required return to offset the time value of money and associated risks, considering:
  - Terms and conditions of the instrument e.g. subordination
  - Credit risk i.e. uncertainty about the ability of the counterparty to make payments when due
  - Liquidity and marketability of the instrument
  - Risk of changes to the regulatory or legal environment etc.



## Broker Quote

- 1) Brokers focus on trading; their indicative quotes may not be as researched as executable quotes. A valuer is required to understand whether the broker quote is a binding, executable quote or a non-binding, theoretical quote
- 2) Be aware of potential conflicts when the broker is also the counterparty
- 3) Brokers have an incentive to encourage trading



## Asset Recovery Analysis

- 1) Assess the value of collateral backing asset-backed debt, such as real estate or machinery, and account for enforcement risks
- 2) Determine an appropriate discount rate that reflects credit risk and market conditions
- 3) Recovery proceeds are allocated in a specific order based on the seniority of claims



## Binomial Lattice Model

- Applicable for complex debt instrument such as convertible loan
- 1) Determine the expected value at each node by discounting across subsequent nodes for one time step
  - 2) At each node, consider issuer call actions and holder conversion choices
  - 3) Set the node value to the optimal outcome, comparing the rollback amount, call price, or conversion value

## EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via [ey.com/privacy](https://ey.com/privacy). EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit [ey.com](https://ey.com).

© Ernst & Young Advisory Pte. Ltd.  
All Rights Reserved.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

[ey.com](https://ey.com)

