

# **Private Credit Education**

February 8, 2023

### Private Credit core investment fundamentals

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### **Attractive risk-adjusted returns**

- Trading liquidity for incremental return to compliment broader fixed income portfolios
- 2

#### **Income generation**

- Recurring distributions or compounding and de-risking returns through reinvestment
- 3

### **Downside protection**

- Through placement in borrowers' capital structures and structuring/documentation
- 4

### Alignment of interests

- Source, structure, and hold vs allocation through market syndication; Control documents
- 5

### **Lower correlation**

Floating rates and low Loan-to-Value lessen correlation to fixed income and equity markets

### **Evolution of the U.S. banking system and Private Credit**

>> Historically, banks were meaningful underwriters and lenders to middle market companies; however, their presence in the market has significantly diminished over the years due to a variety of factors

Bank consolidation coupled with stringent banking regulations have significantly curtailed bank underwriting

Pre-crisis 1989-2007

Credit crisis and fallout 2008-2012

Bank regulation and Private Credit acceptance 2013+

Increased role of Private Credit present day

- Consolidation wave large banks acquire smaller banks
- Diminishing lending capabilities of midmarket banking platforms
- Rise of non-bank lenders and institutional investors

- Regulators increase capital and risk standards
- Banks refocus towards lower risk lending
- Growing borrower acceptance of nonbank lenders

- Growing demand from borrowers underserved by current banking system
- Global demand from retail and institutional investors supported by low global interest rates
- Absolute returns in pursuit of yield

- Companies value
   consistency and reliability
   of capital, particularly
   during periods of volatility in
   traditional capital markets
- Direct lending dry powder is only 18% of private equity buyout dry powder<sup>1</sup>
- Private Credit has become the stable source of capital for small, medium and large cap companies

For illustrative purposes only.

Source: Pregin. As of December 2022.

### Private Credit is a large and rapidly growing market

\$568

2016

\$500

\$0

\$341

2011

Private Credit is quickly approaching the size of the leveraged loan and high yield bond markets. Strong demand and reduced supply from traditional lending sources may drive further growth



**Relative Private Credit market size** 

<sup>1</sup>Preqin Special Report: The Future of Alternatives in 2027. <sup>2</sup>Market size of the global USD leveraged loan market. Source: J.P. Morgan Credit Strategy Weekly Research, data as of December 31, 2021. <sup>3</sup>Market size of the global USD high yield market. Source: J.P. Morgan Credit Strategy Weekly Research, data as of December 31, 2021.

2021

2027E

2022 Leveraged 2022 High Yield <sup>3</sup>

Loans<sup>2</sup>

## **Current market analysis – Private Credit**

### Private Credit offers a proactive approach in the current market

#### Recession risk

- Strong documentation
- Tighter covenants
- Ongoing portfolio management
- Low defaults
- High recoveries

### Impact of rising rates

- Floating rate
- Focus on companies with:
  - Strong asset coverage
  - Ample liquidity
  - Access to financial & operational support from PE sponsors

### Inflationary pressures

- Attractive returns
- Illiquidity premium
- Capture full upfront fees (OID)
- Buy-and-hold investors
- Low volatility