BRIARCLIFFE
CREDIT PARTNERS

The Private Credit Compass

Charting the broad and bright horizon

MAY 2023

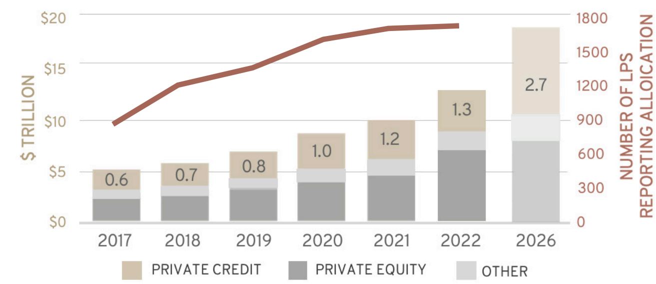
Private Debt Investor
AWARDS 2022
Advisory and Placement Agent of the Year: Americas
WINNER

It's a bull market

Private credit has grown substantially over the past decade into a mature, $1.5 trillion asset class and continues its expansion at more than 20% per year.[1]

Current macroeconomic uncertainties do, and should continue to, support institutional demand for private credit as it provides returns that allow investors to meet – and exceed – their typical return hurdle of 7%. Today, private credit offers broad and myriad strategies typically seeking double-digit net returns and strong downside protection. Additionally, private credit strategies are generally floating rate, so provide attractive relative value across rate environments.

AUM Growth & Number of LPs Allocating[1]



And, this momentum is expected to see significant growth. Within the next decade, the $100 trillion institutional market is projected to increase its average portfolio allocation to private credit from 3.8% today to 5.9%.[2] That, combined with the $178 trillion private wealth universe – in its early stages of allocating to alternatives – could bring total private credit AUM to more than $5 trillion, or nearly the size of the private equity asset class today.[1]

1. Preqin, 2023.
2. The Wall Street Journal, "Pension investments in Private Credit Hit Eight-Year High", January 29, 2023.

Following the implosion of yields post the Great Financial Crisis of 2008 (GFC), individual investors have flocked to vehicles likes Business Development Corporations (BDCs) (increasingly private vs. traded), listed closed-end funds, and interval funds investing in private credit in search of yield. The high profile success of a few mega asset managers early to the game has sparked a growing frenzy in the channel among managers eager to replicate it.

To diminish concentration risk, some major brokerages and wealth managers are seeking to diversify their offerings, opening opportunities for the many other managers and strategies in market. As success in the retail channel requires many factors to align, managers must have a strategy that resonates and have institutional buy-in at the highest levels given the need to commit significant resources – time, staffing, capital – to navigate complex '40 Act rules, and for product development and distribution.

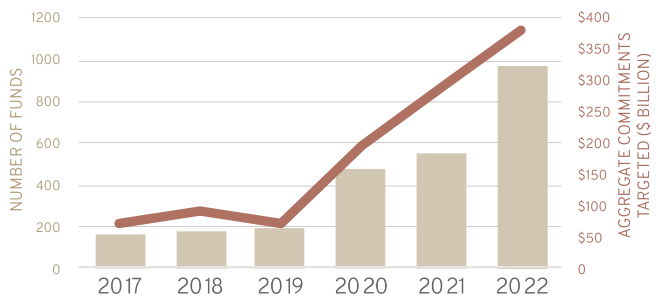
Private credit managers are eyeing other investors, as well. Given their respective sizes, reliance on yield, and relative under-allocation to private credit currently, insurance investors are expected to be part of the industry's exponential expansion.

For insurers, the income obligations to policy and annuity holders are buoyed well by historical income premia that private credit strategies, such as direct lending, asset-based lending, and specialty finance provide. To address the strict, risk-based capital requirements, managers have accelerated their development of insurance solutions, often by hiring dedicated staff with technical knowledge directly from insurers.

Some suitable solutions for insurers include rated notes, collateralized fund obligations ("CFO"), and separately managed accounts ("SMA"). Both rated notes and CFOs involve issuance of a note subordinated by an equity tranche that invests into a single fund, or multiple funds in the case of CFOs. With this structure, the note receives an investment grade rating and pays a fixed coupon.

More recently, the insurance standard-setting organization, namely, the National Association of Insurance Commissioners, has scrutinized these structures to ensure the investment grade rating aligns with the underlying risk. Though expensive to establish and more complex to operate, SMAs where each investment is rated can also be viable solutions for large insurers. Insurers are also showing a strong appetite for investment grade-rated private assets, such as private placements, whole loans (e.g., residential mortgages and renewable energy), infrastructure debt, and private collateralized debt as higher yielding complements to public investment grade debt.

Private credit in funds in market & target commitments[1]



The demand for private credit solutions from all these investors will bring significant capital to the asset class in the near- and long-term, which is already visible. Today, there are 934 funds in the market, seeking an aggregate $380 billion of commitments.[1]

One thing is clear: it's a good – and right – time to invest in private credit!

Navigating choppy waters

Over the last year, Briarcliffe has held dialogues with more than 2,100 private credit LPs, from new investors allocating to a single fund, to veterans with dedicated allocations across multiple sub-strategies and fund vintages. The macroeconomic environment is top of mind, as are several other trends, as outlined in more detail here.

Significant disruptions

Last year witnessed many significant disruptions. On the heels of COVID-19 lockdowns, markets faced the confluence of military conflict in Europe, the greatest inflation rate in 40 years, eight Fed rate hikes, and the specter of recession.

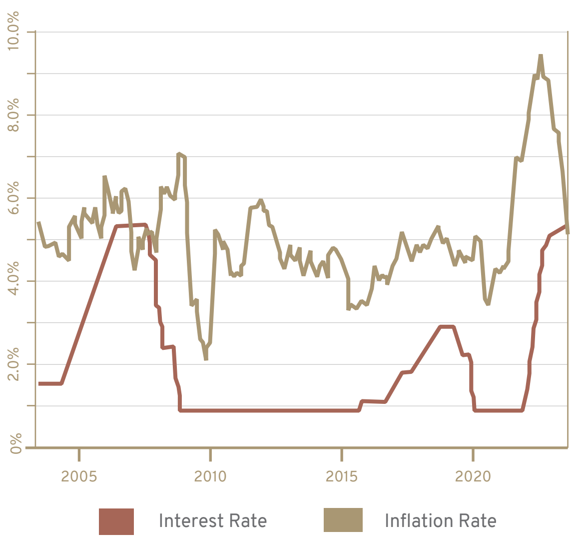
The resulting fallout in capital markets was the worst market performance in recent memory as investors went emphatically "risk-off." US equities experienced their sharpest declines since 2008, in tandem with bonds, taking away an historic safe haven. This caused many experts to proclaim the traditional "60/40" stock-bond allocation guidance dead and to recommend pivoting to alternative investments.

63%

Will increase allocation to private credit strategies

Preqin Investor Survey, 2023

Inflation and interest rates 2003–Present[3]



Focus on reups

The wave of backlogged 2020 deals and the volatility of the new issue syndicated loan market significantly accelerated the deployment rate of 2019-2020 vintage funds, bringing private credit managers back to market much quicker than expected. As a result, investors are spending more time and capital on re-underwriting and potentially re-committing to existing managers 12 to 18 months ahead of plan which creates more challenges for new managers.

Denominator effect

Sharply lower public and private equity valuations in 2022 scuttled many investors' carefully planned asset allocations as illiquid private credit commitments swelled above targets, preventing some LPs from making new allocations. Of course, this effect will eventually correct as equity markets reflate, especially when combined

3. US Fed Funds Rate. Consumer Price Index. Effective March 2023.

Briarcliffe Bellwether

Our Proprietary Institutional Investor Survey

In 2022, Briarcliffe polled institutional investors on their sentiments around private credit. Visit our website to read the full findings.

with the continued trend of LPs reallocating from traditional fixed income and equity to private credit in their perpetual search of better risk-adjusted returns.

Evergreen fund structures

Evergreen structures offer investors the benefit of only one primary underwriting. The funds are traditional commingled funds that can invest / recycle / distribute income and capital in perpetuity, and periodically, can accept new commitments and accept redemptions. These funds are growing in popularity, particularly for two strategies: i) direct lending, as it has become a "permanent" allocation for many investors, and ii) those that derive cash flows from long-dated assets with no stated maturity (e.g., royalties and specialty finance). Though evergreen funds generally have higher administration requirements and place greater scrutiny on valuations, the structure breaks the constant fund-raising cycle that is resource- and time-intensive.

Co-investments

Access to high quality co-investment flow has become a gating item to a fund commitment for some large and sophisticated global investors. These LPs typically invest directly and seek co-investment to accelerate deployment, lower total management fees, and strengthen the acumen of internal staff. Managers like the additional buying power a network of co-investors (ideally, philosophically-aligned and fast-moving) provides to control a larger portion of a debt tranche.

These developments, and the ongoing macroeconomic and geopolitical environment generally, have proved beneficial to private credit as a reliable solution for both investors and borrowers. Growth is set to continue as traditional lenders (i.e., banks and finance companies) face rising provisions from slowing economies, the fallout from the Silicon Valley Bank, Signature Bank, and First Republic Bank collapses, and private credit's relentless push into all aspects of the global financial system. In sharing his bullish outlook for private credit, one institutional investor told us: "I'll have a lot of performance calls with my managers in early 2023. But those with my private credit managers will be the last I make."

> **"I'll have a lot of performance calls with my managers in early 2023 – but those with my private credit managers will be the last I make."**

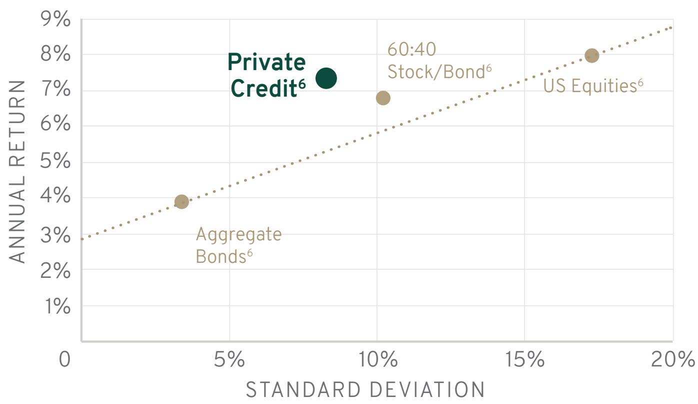
Institutional investor on his confidence in private credit

Private credit adds value

Private credit strategies provide value and should be included in a diversified investment portfolio. They can deliver both income and capital appreciation return profiles. In fact, private credit performance delivers the tightest distribution of returns of any private asset class by a factor of two.[4] And, on a risk adjusted basis, private credit can be more attractive than public equity, having captured 92% of the S&P's returns with only half of its volatility over the past decade.[5]

There are several beneficial characteristics of private credit, which include:

Risk vs. return map[5]



Predictability

Investment assets are generally senior in the capital structure, so valuations are less volatile. This leads to more predictable performance.

Downside protection

Private credit strategies are often senior secured against hard or financial assets, providing stronger downside protection than private equity, for example.

Liquidity

Fund durations are typically shorter than other private market strategies, averaging six to eight years.

Income

Assets generate regular, often contractual, cash flow that is distributed to investors.

Returns

Potential returns range from high single digit to upper teens.

Diversification

The diversity of strategies can succeed over market cycles: countercyclical strategies, such as special situations and distressed through one lens; all weather strategies, such as opportunistic credit through another; and stable market strategies, such as direct lending and asset-based lending, through yet another.

4. McKinsey Global Private Markets Review, 2022.
5. Forbes, "Private Markets and the Liquidity Tradeoff", January 6, 2023.
6. US equities: S&P 500. Aggregate bonds: Bloomberg Aggregate Bond Index. Private credit: Preqin Private Debt Index. All January 2008 – September 2021.

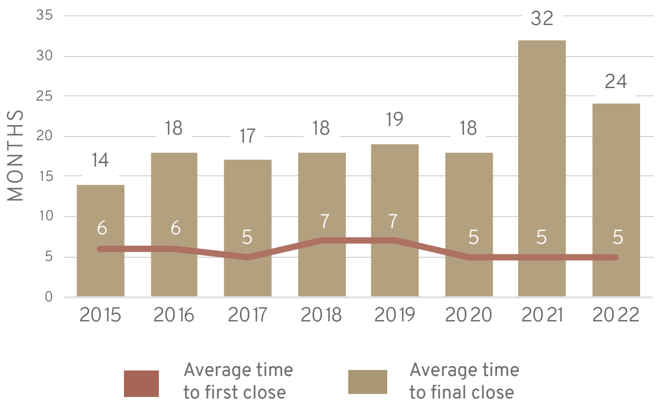
As noted earlier, managers – existing and new – are seeking to capitalize on LP interest in private credit, making a much more competitive fundraising environment. There are now 934 credit funds in market globally – a 30% increase over the first half of 2022.[1] Approximately one third of credit funds spent more than two years fundraising and fewer funds reached their final close in 2022 in the US and globally than in any of the past five years.[1] As a result, fundraising today requires altered expectations, greater stamina, and perhaps most importantly, dedicated expertise.

With a trend of investors coalescing around larger, more established managers with broad offerings – the ten largest credit funds represented approximately half of all private credit capital raised through 3Q 2022[1] – it is critical for small- and mid-sized firms to offer differentiated investment strategies, whether through market segments, asset types, risk / return profile, or specific "edges."

To help guide the industry, we recently published the Briarcliffe Field Guide to Private Credit™ which outlines in more depth details about each of the 26 sub strategies within our Four Pillars of Private Credit™. To offer further guidance, we tag each with one of the three categories for portfolio construction consideration: income, total return, and diversification.

We believe private credit provides a versatile solution delivering attractive risk adjusted returns in a wide range of market conditions and should be included in any portfolio.

Fundraising duration[1]



Briarcliffe's Four Pillars of Private Credit™

1. Corporate Credit

Direct Lending
Distressed
Mezzanine
Non-Performing Loans (NPL)
Opportunistic
Secondaries
Special Situations
Venture Debt

2. Specialty Finance

Asset Based Lending
Consumer Lending
Insurance Linked
Litigation Finance
Net Asset Value (NAV) Lending
Regulatory Capital Relief
Royalties
Trade Finance

3. Structured Credit

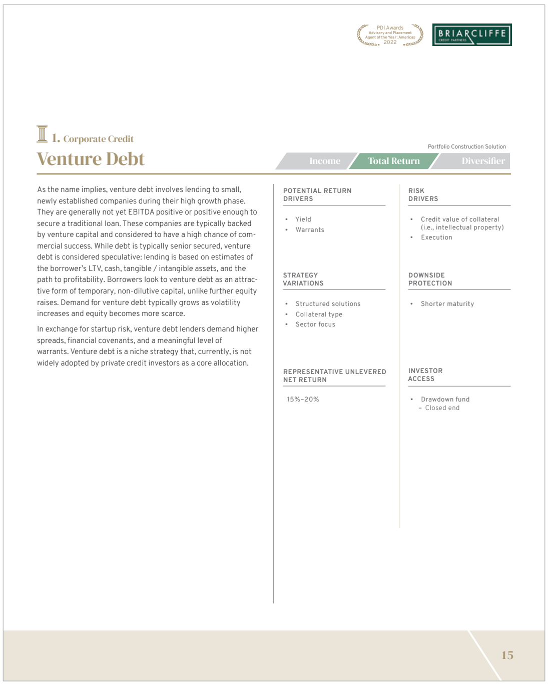
Asset Backed
Collateralized Loan Obligations
Commercial Real Estate
Residential Real Estate

4. Real Assets Credit

Agriculture
Energy
Infrastructure
Metals & Mining
Real Estate
Transportation

BRIARCLIFFE Field Guide TO Private Credit

POTENTIAL RETURN DRIVERS	RISK DRIVERS
STRATEGY VARIATIONS	DOWNSIDE PROTECTION
REPRESENTATIVE UNLEVERED NET RETURN	INVESTOR ACCESS


PDI Awards Advisory and Placement Agent of the Year: Americas 2022

BRIARCLIFFE CREDIT PARTNERS

1. Corporate Credit

Venture Debt

Portfolio Construction Solution

Income | Total Return | Diversifier

As the name implies, venture debt involves lending to small, newly established companies during their high growth phase. They are generally not yet EBITDA positive or positive enough to secure a traditional loan. These companies are typically backed by venture capital and considered to have a high chance of commercial success. While debt is typically senior secured, venture debt is considered speculative: lending is based on estimates of the borrower's LTV, cash, tangible / intangible assets, and the path to profitability. Borrowers look to venture debt as an attractive form of temporary, non-dilutive capital, unlike further equity raises. Demand for venture debt typically grows as volatility increases and equity becomes more scarce.

In exchange for startup risk, venture debt lenders demand higher spreads, financial covenants, and a meaningful level of warrants. Venture debt is a niche strategy that, currently, is not widely adopted by private credit investors as a core allocation.

POTENTIAL RETURN DRIVERS

- Yield
- Warrants

RISK DRIVERS

- Credit value of collateral (i.e., intellectual property)
- Execution

STRATEGY VARIATIONS

- Structured solutions
- Collateral type
- Sector focus

DOWNSIDE PROTECTION

- Shorter maturity

REPRESENTATIVE UNLEVERED NET RETURN

15%–20%

INVESTOR ACCESS

- Drawdown fund
  – Closed end

15

Income

For income seekers, direct lending remains the "go-to" strategy as it has been proven cross cycles. With core managers largely set, investors are spending time refining their portfolios, adding diversification through sector specialists and investment managers with specific sourcing and underwriting advantages. These investors are also seeking to diversify corporate risk through other income oriented private credit strategies, like specialty finance, which offers exposure to credit backed by large, diversified pools of hard and/or financial assets. These are intrinsically diverse and encompass a wide variety of underlying exposures such as consumer debt, single family rental homes, and transportation assets.

Total Return

Investors seeking total return are experiencing more opportunities stemming from market volatility, primarily through special situations and opportunistic credit strategies. They are willing to accept greater risk (credit, structuring, event) to achieve returns potentially on par with, or above, equity. Investors value these strategies for their inherent flexibility across asset types, geographies, and paths to value creation.

Diversifier

Lastly, niche strategies seeking to exploit credit imbalances and sourcing barriers in specific sectors are rapidly gaining investor interest as core private credit portfolios mature. Among many others, some diversifying strategies include NAV lending, media royalties, litigation finance, consumer lending, NPLs, and insurance-linked. These can deliver attractive, uncorrelated returns with structural downside protections.

A bright horizon

In today's dynamic environment, prudent investors should take a panoramic view across the full range of private credit strategies to ensure portfolios that can perform across market cycles. This can be accomplished through managers that have proven track records and demonstrable edges.

Through the first quarter already, 2023 is off to a strong start during which many weeks private credit fundraising exceeded private equity allocations.[7] And, as noted earlier, investors continue to indicate their expectations to increase allocation to the asset class, both with existing and new manager relationships.

Investors continue to see a "very resilient market" with sustained lending and capital raising, "EBITDA stability growing, and leverage level (for the right credits) remaining at or near historic levels."[8]

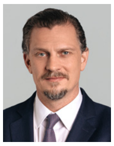
Easily repeatable: it's a great time to be investing in private credit! ■

Just 18 months after its founding, in March 2023, Briarcliffe was recognized by private credit investors and managers through its selection as the *Private Debt Investor* 2022 Advisory and Placement Agent of the Year (Americas).

7. Alternatives Watch, 2023.
8. Proskauer Trends in Private Credit, April 2023.

Deep expertise

FIRM



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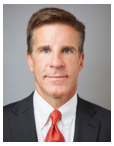

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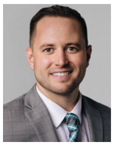

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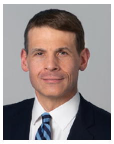

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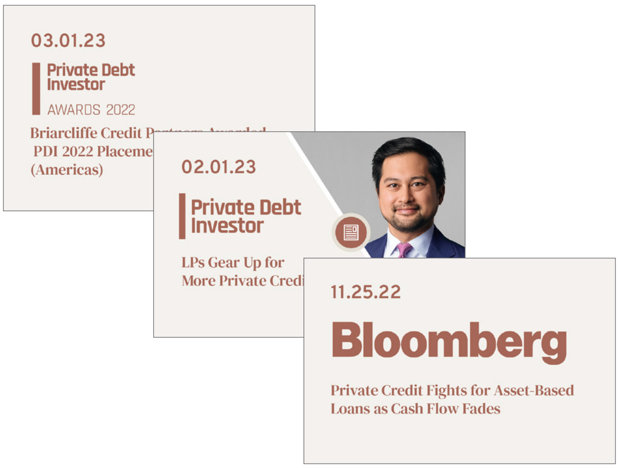
CAIA ASSOCIATION®

UniFi by CAIA Private Debt MICROCREDENTIAL

Briarcliffe helped coauthor the curriculum of the newly launched private debt credential administered by the Chartered Alternative Investment Analyst Association (CAIA). The certificate covers private credit fundamentals, corporate and asset-based lending, and portfolio implementation.

Our insights are sought throughout the industry, which includes speaking regularly at private credit and alternatives conferences and with global media.



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