

An Overview of the Leveraged Finance Market

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What is Leveraged Finance?

- The funding provided to companies that have high levels of debt, are considered speculative-grade, or are undergoing transactions that require significant debt, like leveraged buyouts (LBOs).

The 3 Main Instruments Used in Leveraged Finance

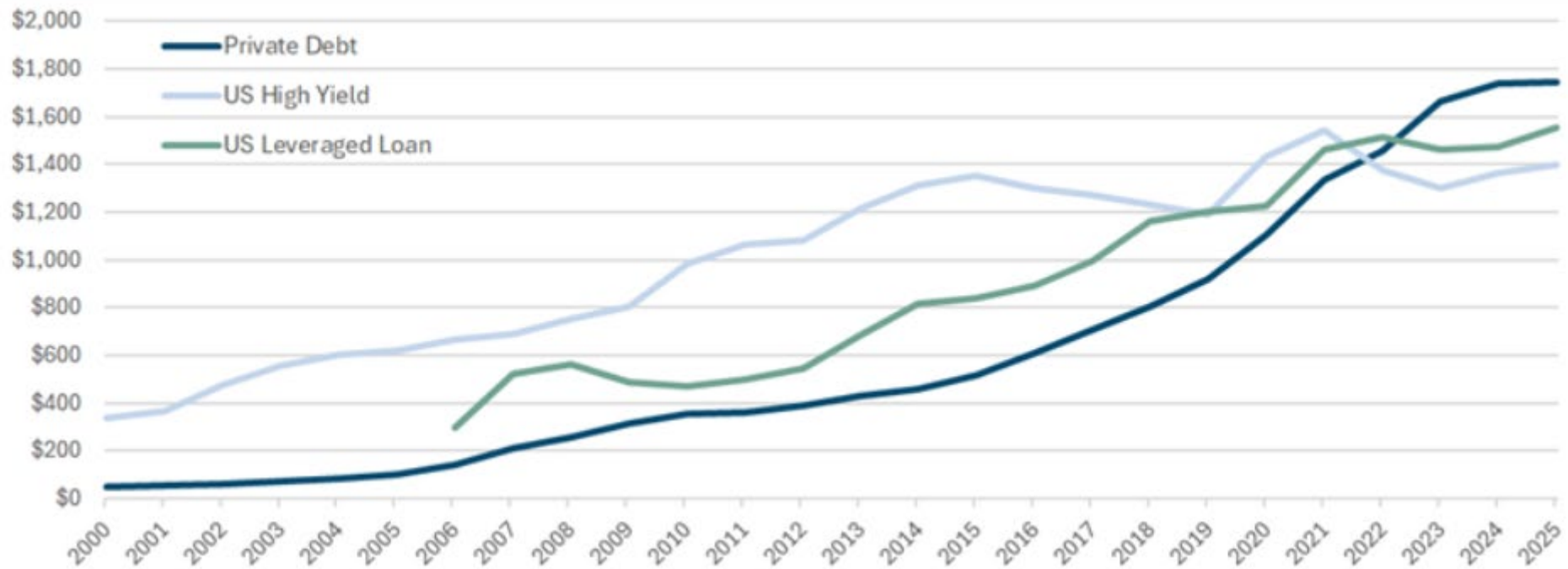
| What we do | What we <u>don't</u> do | |
|--|---|--|
| High Yield Bonds | Broadly Syndicated Loans (BSLs) | Private Credit |
| <ul style="list-style-type: none">A bond issued by a company that has credit ratings below investment grade. | <ul style="list-style-type: none">A type of large commercial loan provided to a corporation by a group of investment banks and institutional investors. | <ul style="list-style-type: none">A direct loan made to a business by non-bank lenders such as private debt funds and Business Development Companies (BDCs). |

Comparing and Contrasting the 3 Instruments

| Feature | High Yield Bonds | BSLs | Private Credit |
|-------------------------------------|--|---|---|
| Security | Secured, unsecured, subordinated | Senior secured | Primarily senior secured |
| Coupon | Fixed | Floating | Primarily floating |
| Term Structure | 5-10 years | 4-7 years | 5-7 years |
| Liquidity | More liquid; trade on public markets | Limited to medium | Highly illiquid; long-term commitment |
| Borrower profile | Large, established corporations | Large, established corporations | Historically mid-market/smaller companies but moving larger |
| Transparency | Most transparent; public credit ratings, financial disclosure requirements, real-time market pricing on public markets | Medium; syndicated process leads to some public disclosure, often has public credit ratings, does have a secondary market | Opaque; privately negotiated terms, no public ratings, no required public disclosures, "marked-to-model" valuations |
| Pricing | Varies widely | 250-450 bps over SOFR | 450-650 bps over SOFR |
| Lender protections/covenants | Less stringent/incurrence-based | Typically covenant-lite | Higher; commonly maintenance-based and more direct engagement with borrowers |
| Lender workout control | Limited to none | Limited to none | Strong |

The Shifting Market Share in Leveraged Finance

Assets Under Management (\$B)

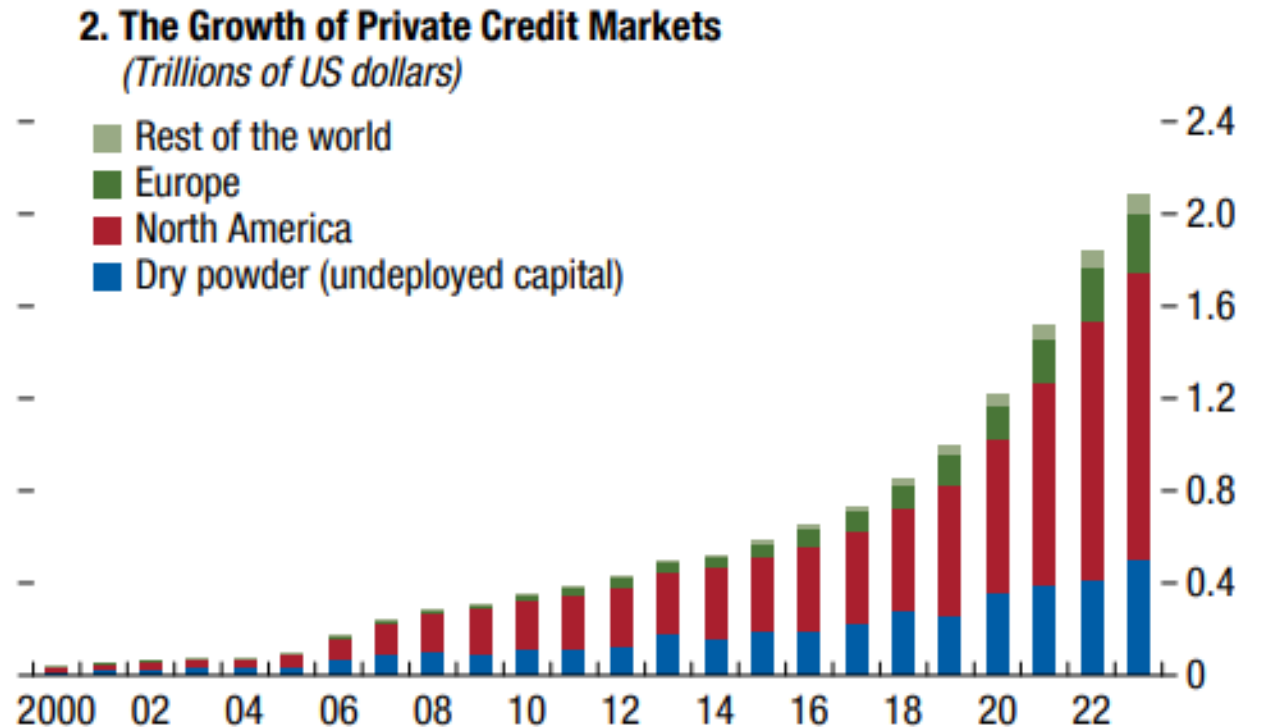


The Rise of Private Credit

- Post-Great Financial Crisis Regulation: Increased capital requirements and lending costs for banks
- Banks Retreat: Lending to mid-market and leveraged companies became less profitable and overly burdensome
- Funding Gap Created: Left many companies without access to traditional loans
- Private Credit Steps In: Unregulated, non-bank lenders, unconstrained by these new stricter rules, stepped in offering a direct lending alternative
- Interest Rate Environment Remains Low: Institutions, starved for yield, allocated to private credit for the yield premium over public markets
- Result: Private credit grew from a niche market into one of the fastest growing segments in finance

Private Credit Overview

- Predominantly alternative asset managers who raise capital from institutional investors using closed-end funds
- Lend capital directly to mostly middle-market firms although growth in the asset class has led to lending to larger firms



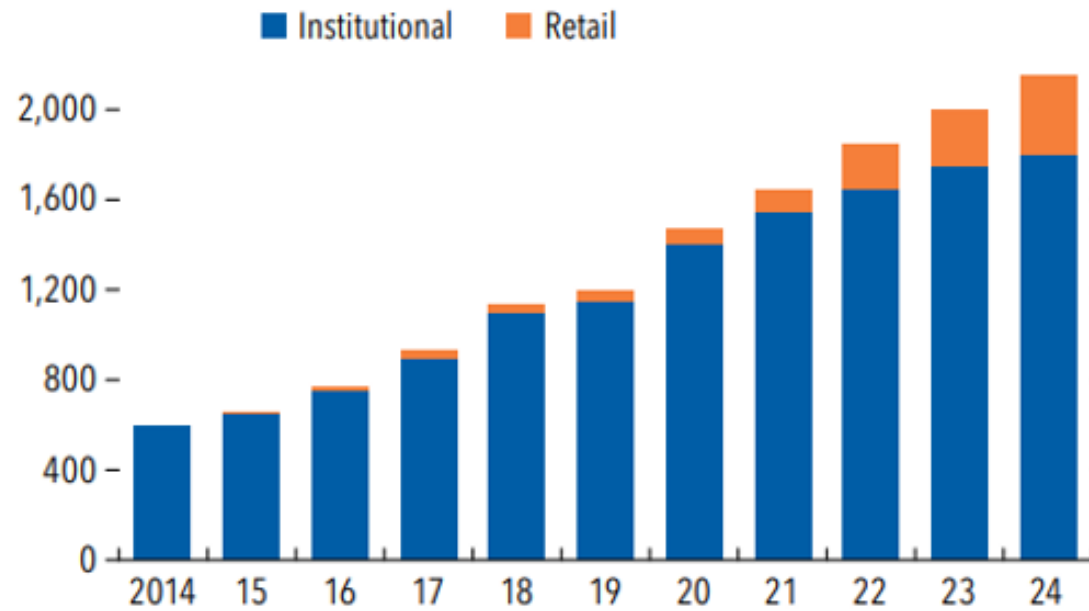
Why Do Borrowers Choose Private Credit?

- Fewer counterparties which means...
 - Easier/faster origination process
 - No broad syndication
 - No waiting on ratings
 - Certainty of execution
 - Greater confidentiality
 - More flexible and customizable terms/amendments
- Lack of access to traditional sources of capital

Private Credit Landscape & Trends

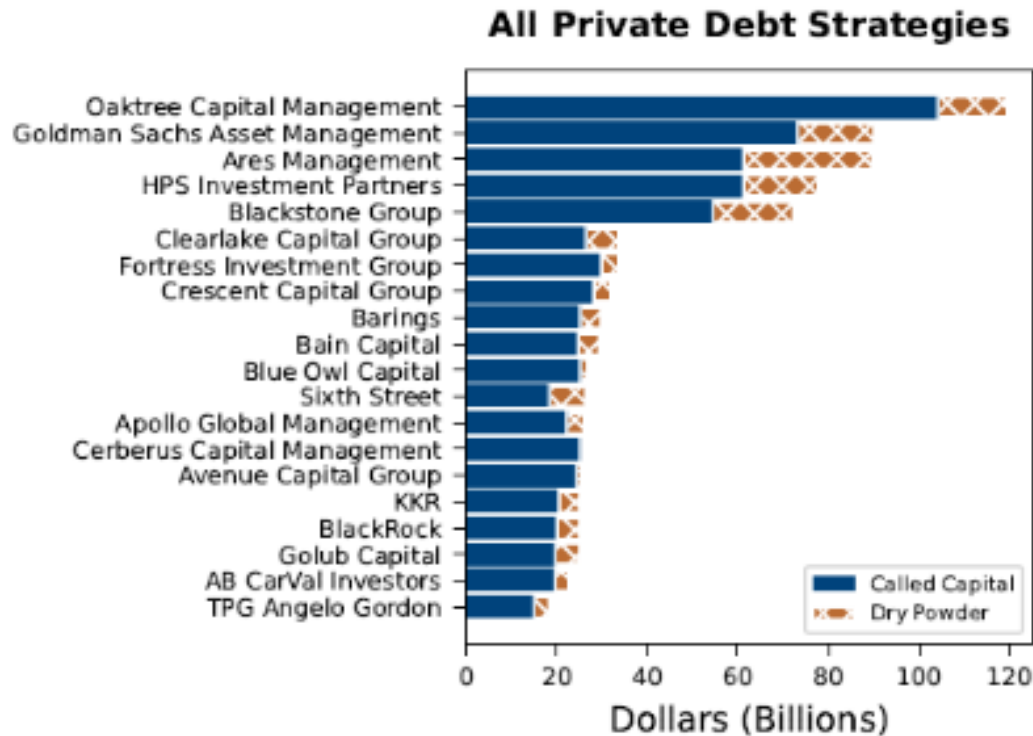
- As of 2025, 94% of US institutions are invested in private credit up from 62% in 2021
- Retail funds are becoming a bigger part of the investor base

1. Assets under Management for Private Credit Funds
(Billions of dollars)



Private Credit Landscape & Trends

Top 20 Private Credit Managers
(by AUM as of June 2023)



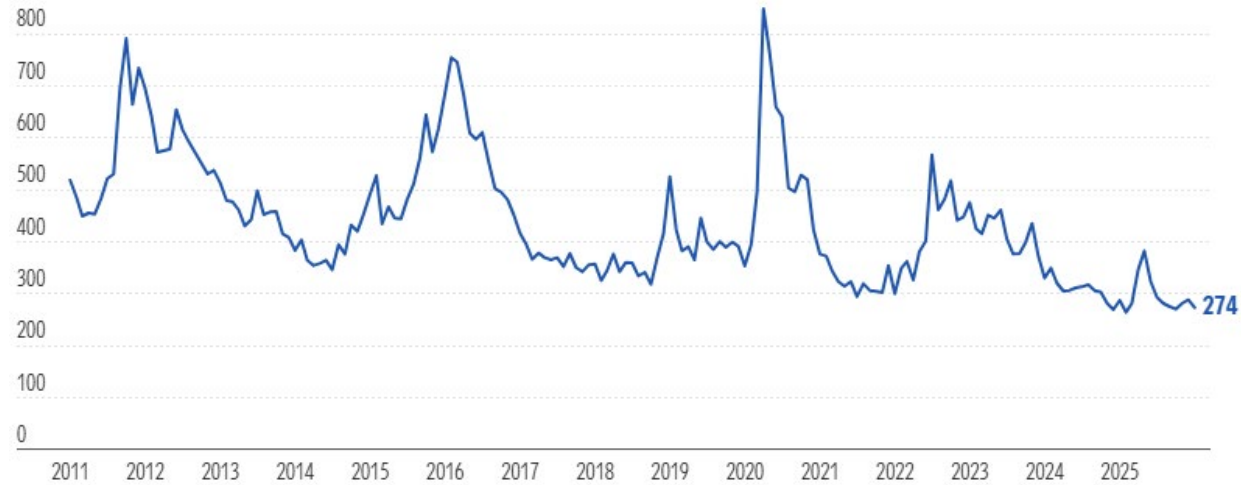
Connection to Private Equity

- 81.2% of private credit fund assets under management are managed by firms that also manage private equity funds
- ~70% of private credit deals involve borrowers sponsored by private equity firms

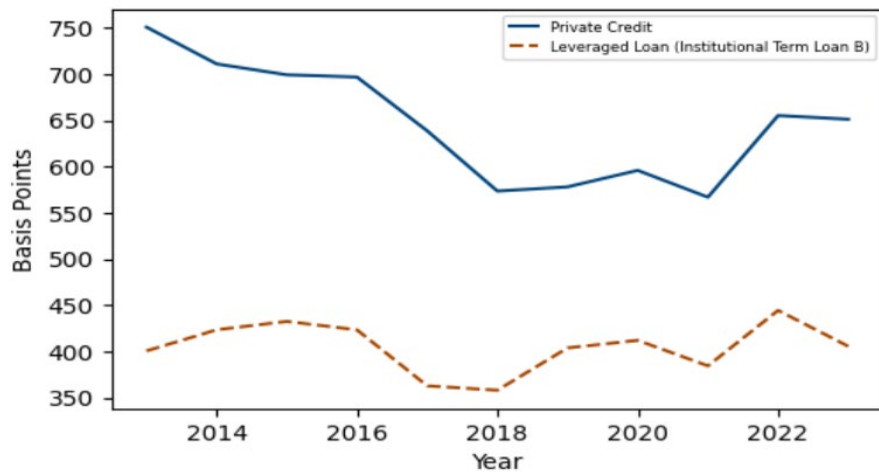
Comparing the Metrics

Spreads

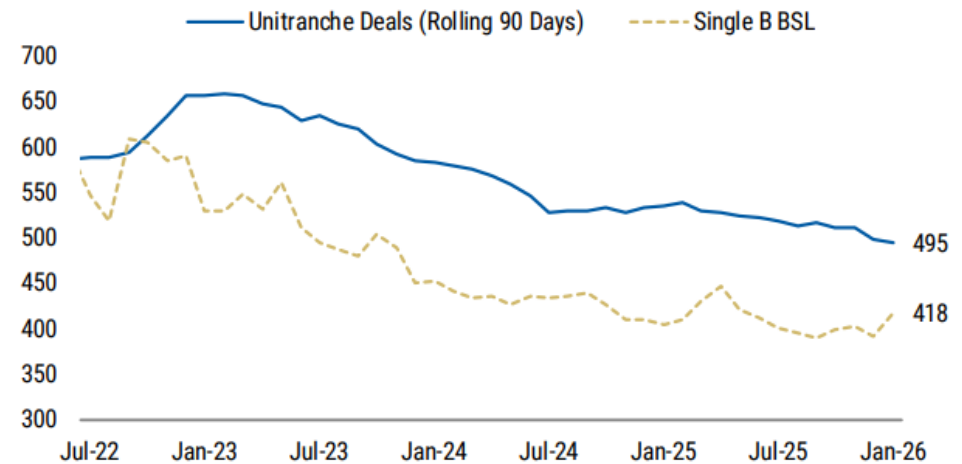
High Yield Option-adjusted Spread



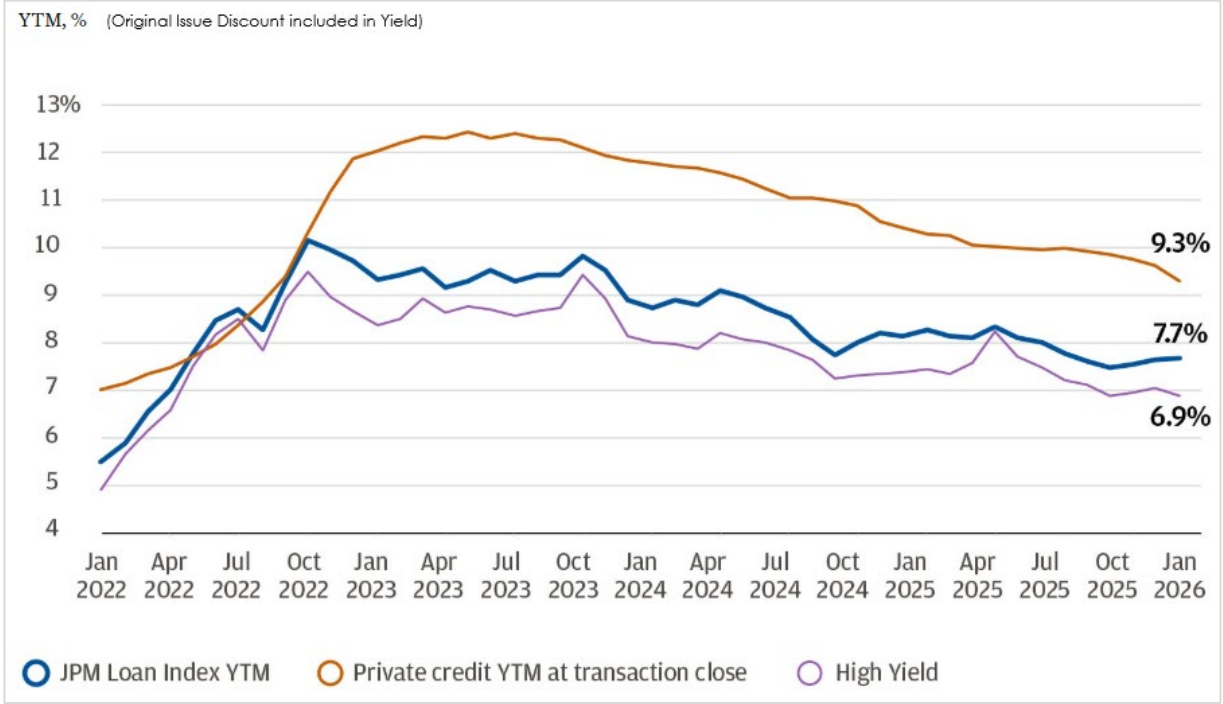
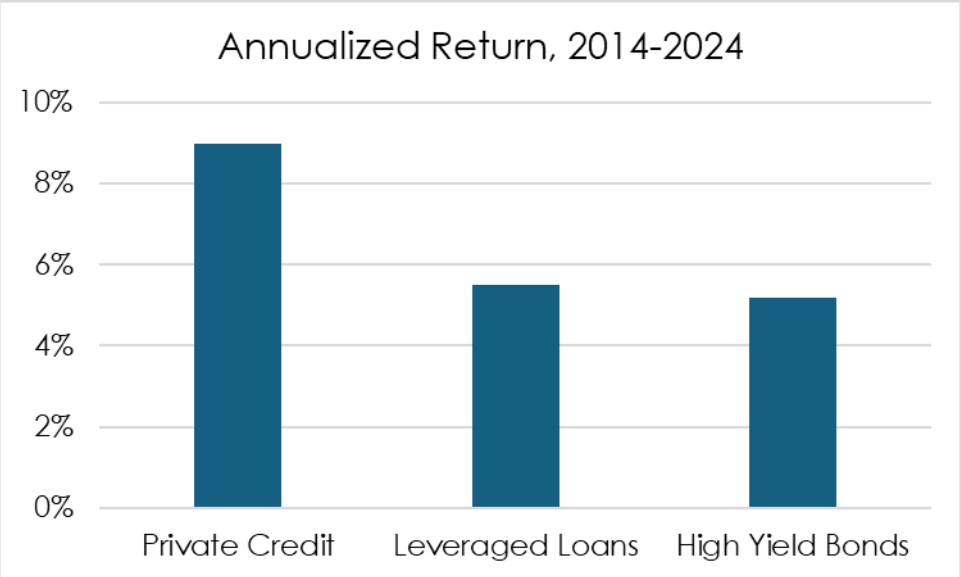
Credit Spreads over LIBOR/SOFR



Direct Lending New Origination Spreads



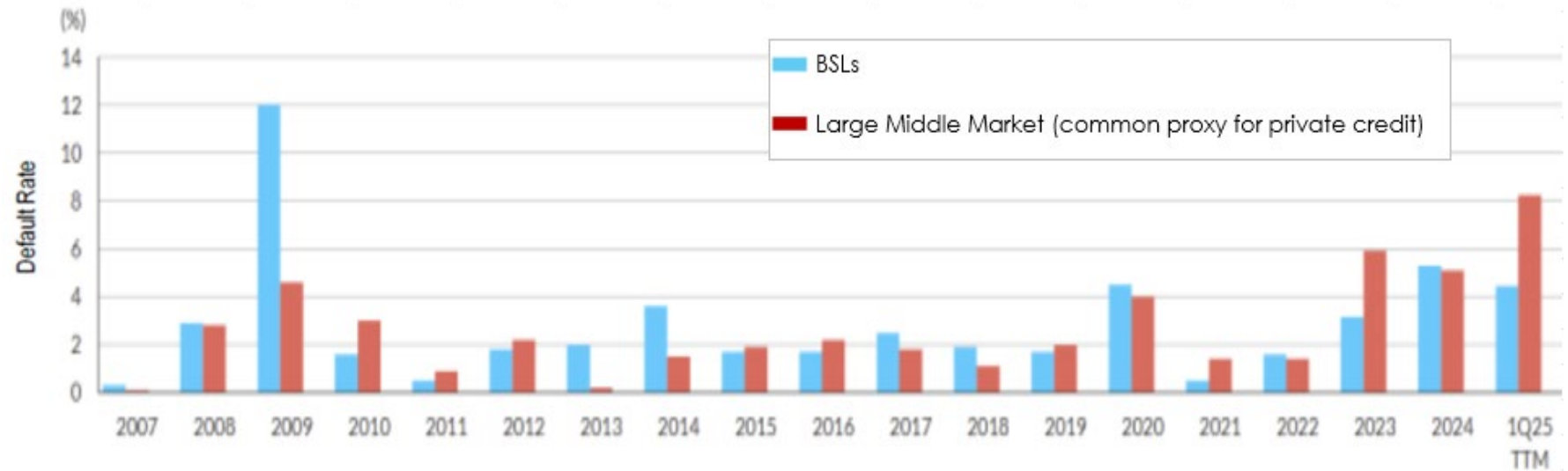
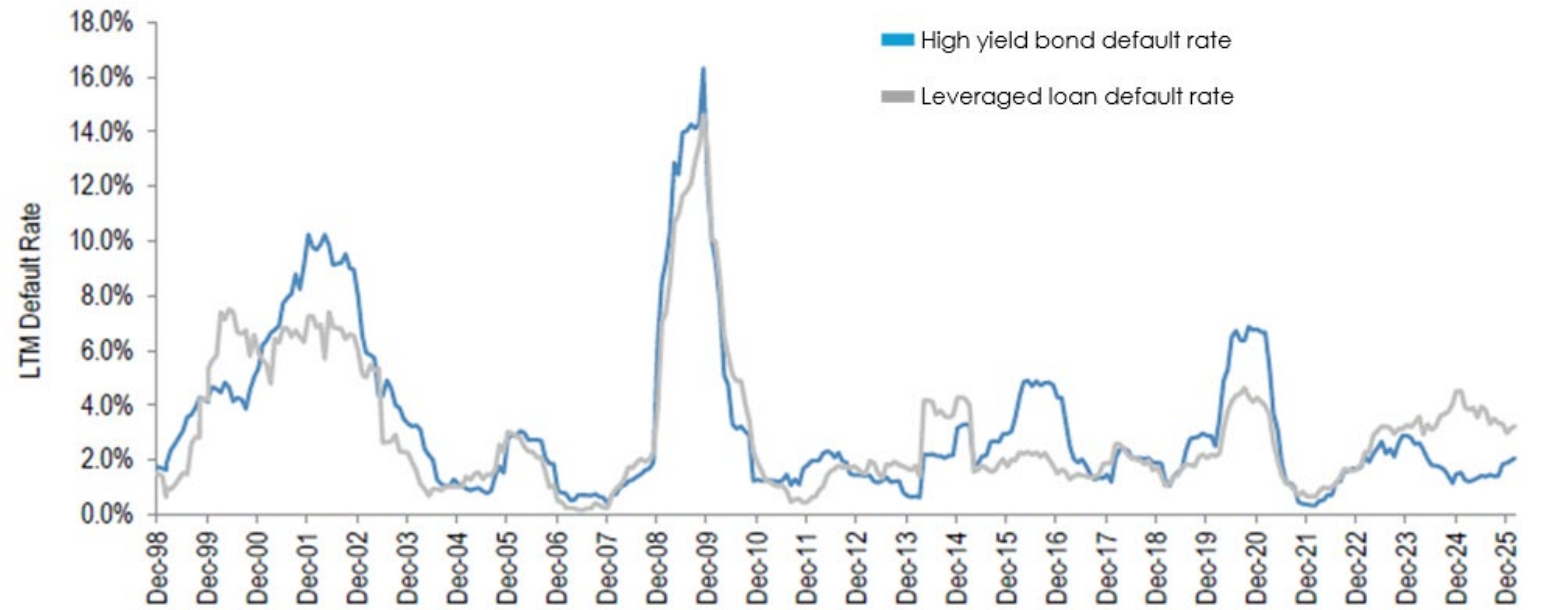
Returns and Yields



Estimated Fees on Actively Managed Funds

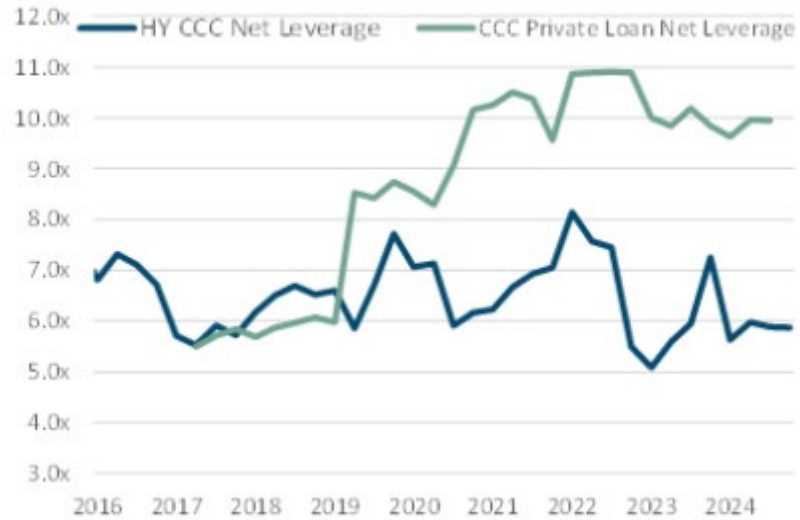
| | High Yield | BSLs | Private Credit |
|----------------------------|------------------|-------------|--------------------------|
| Management Fee | 0.5%-1.0% | 1.3% | 1.5% |
| Incentive Fee | rare | sometimes | 15% (after 6%-8% hurdle) |
| Administrative Fees | 0.3% | 0.8% | 0.5% |
| Total Expense Ratio | 0.8%-1.3% | 2.1% | 3.75%-4.25% |

Default Rates



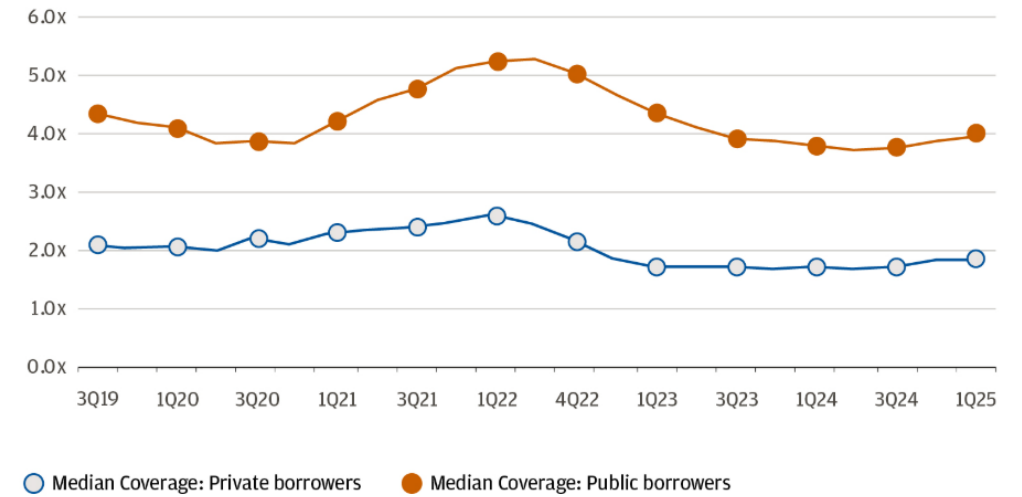
Credit Metrics

Net Leverage

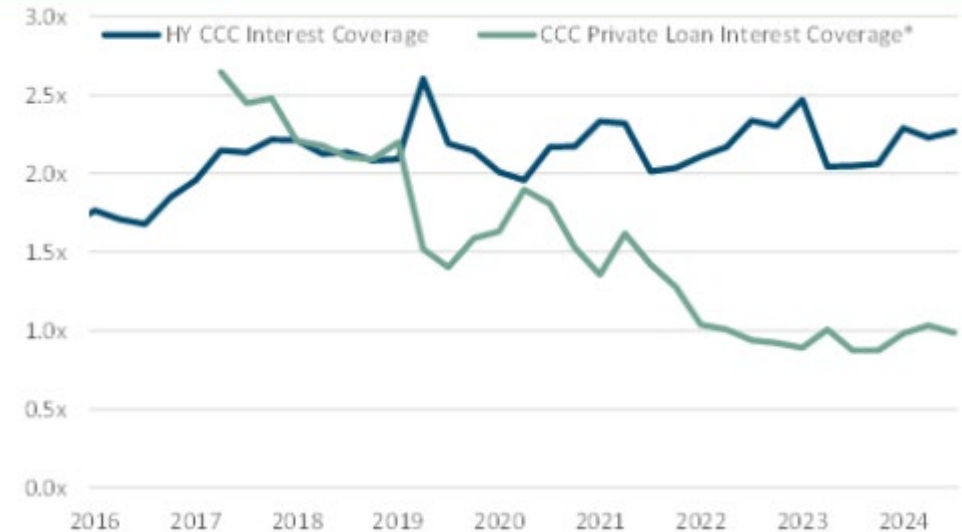


Private credit borrowers almost exclusively use floating rate loans whereas only ~29% of high yield corporate bond issuers' total debt is variable rate.

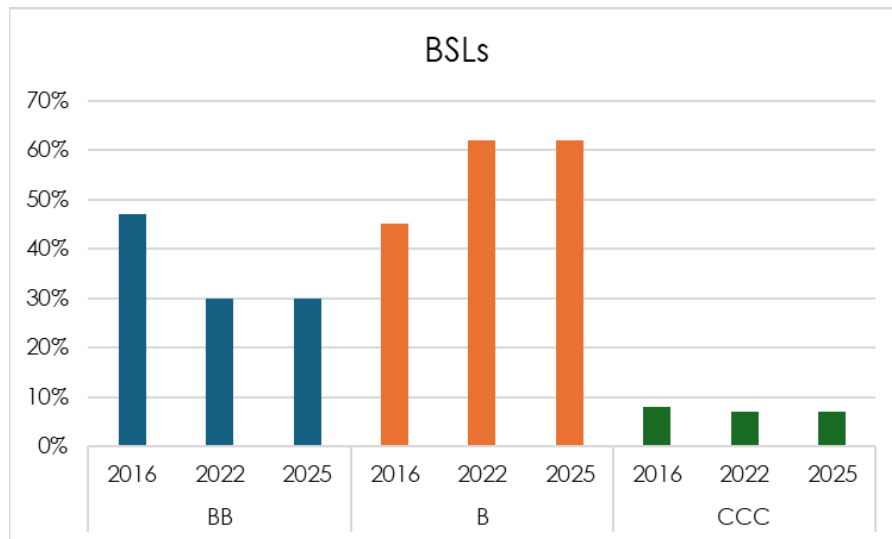
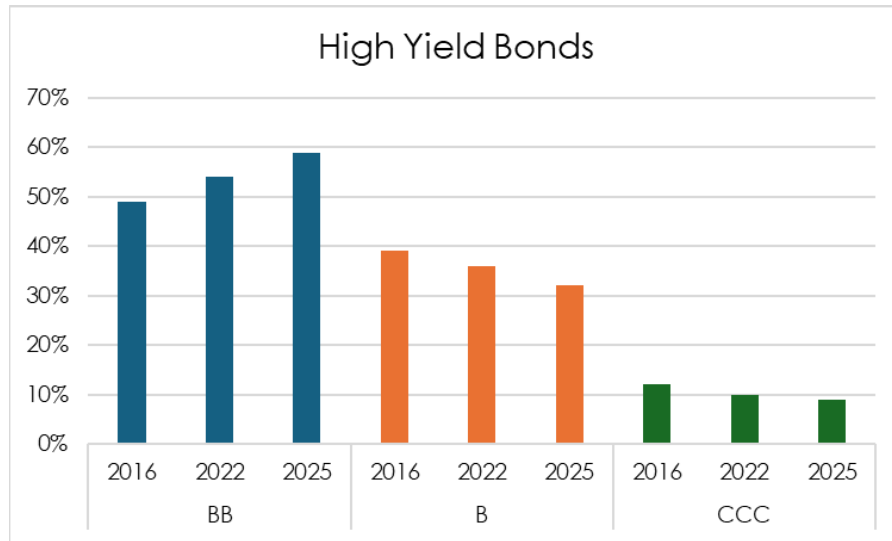
EBITDA/interest expense



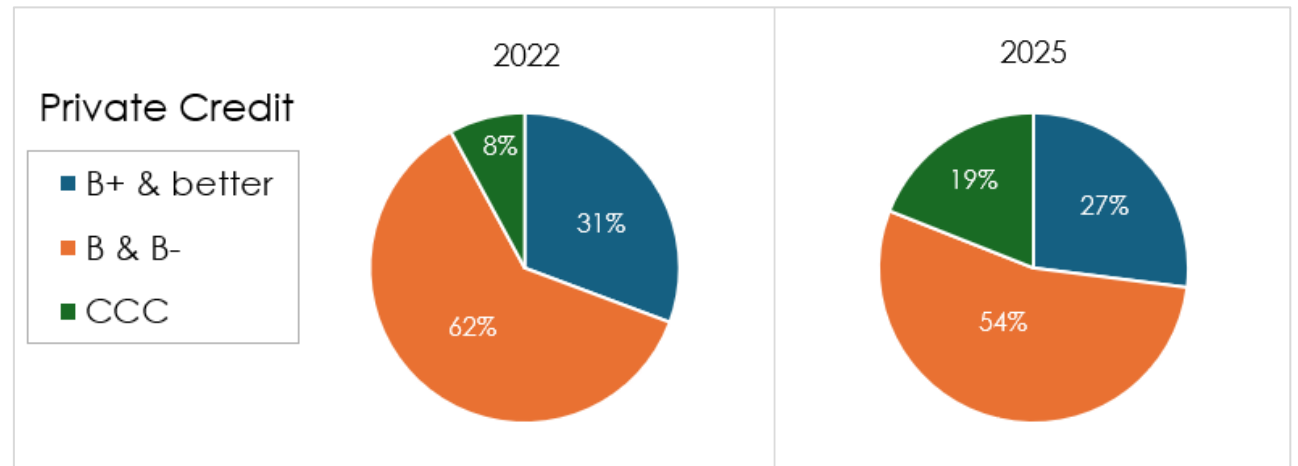
Interest Coverage



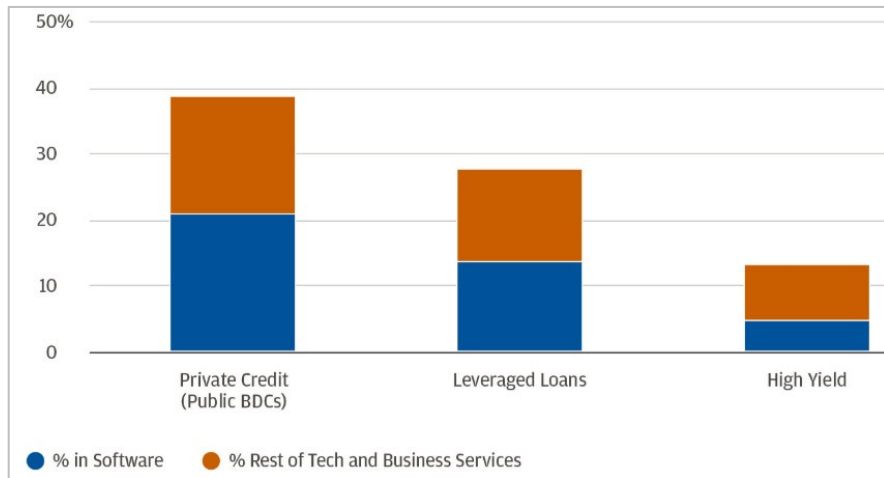
Evolving Ratings in Leveraged Finance



Riskiest debt has moved to the BSL and private credit markets.

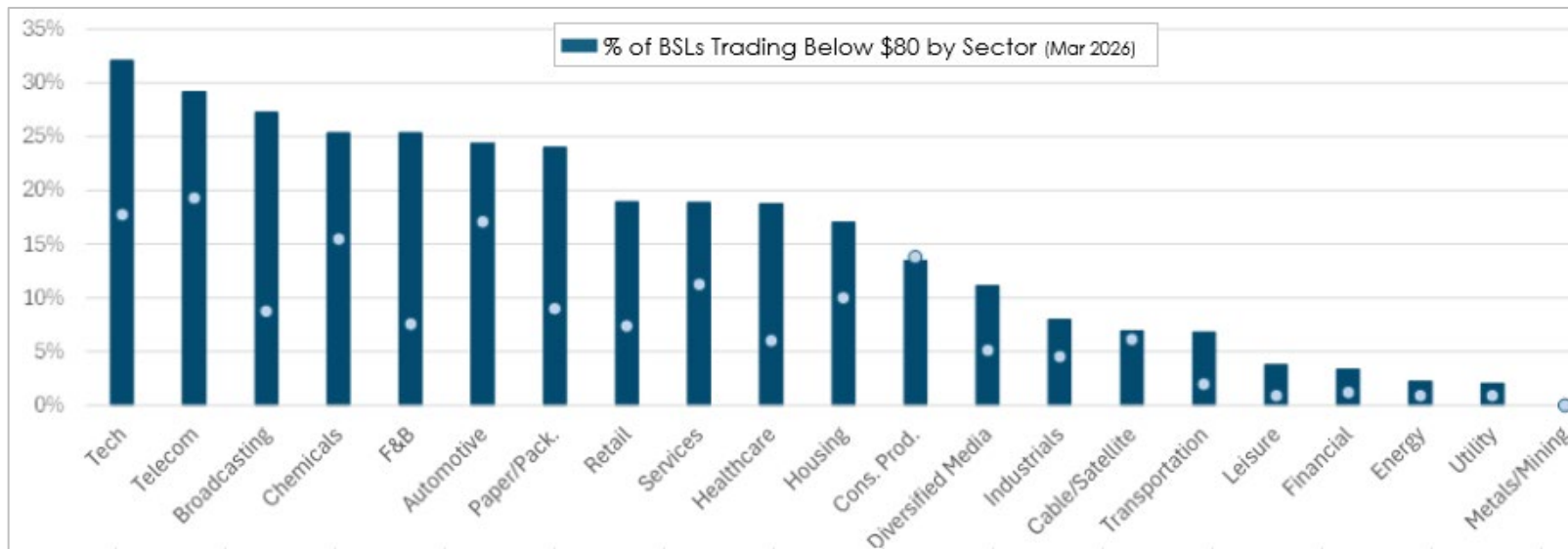


Industry Exposure



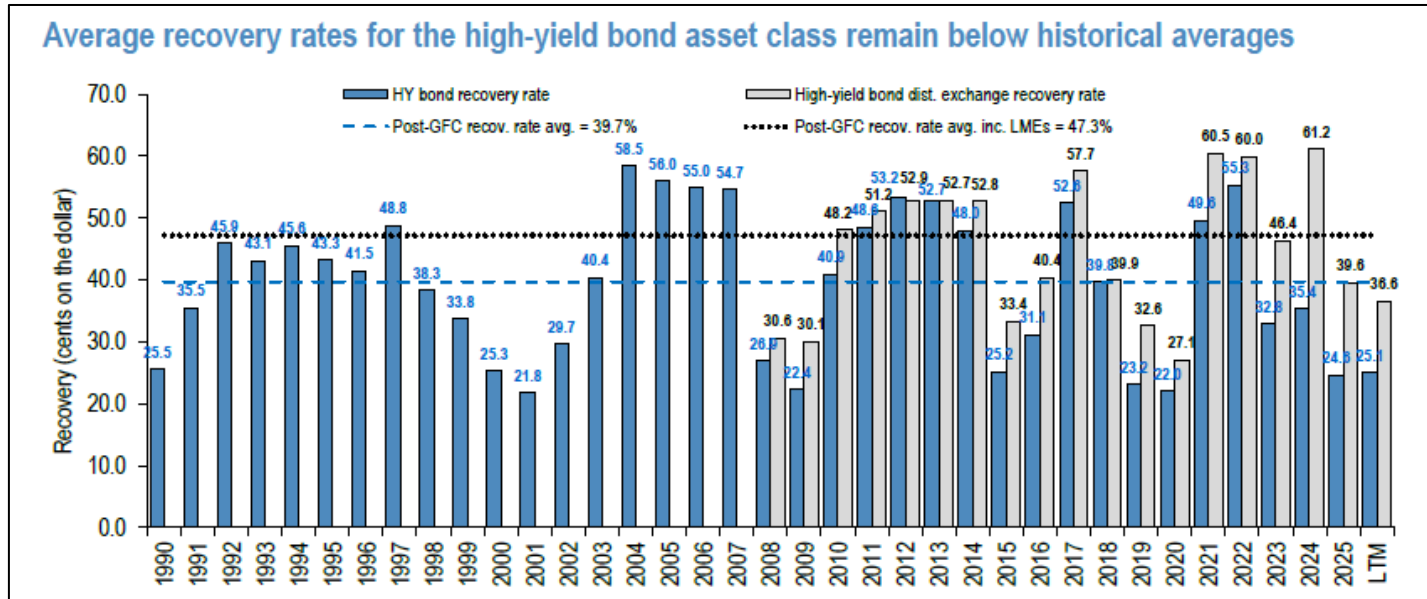
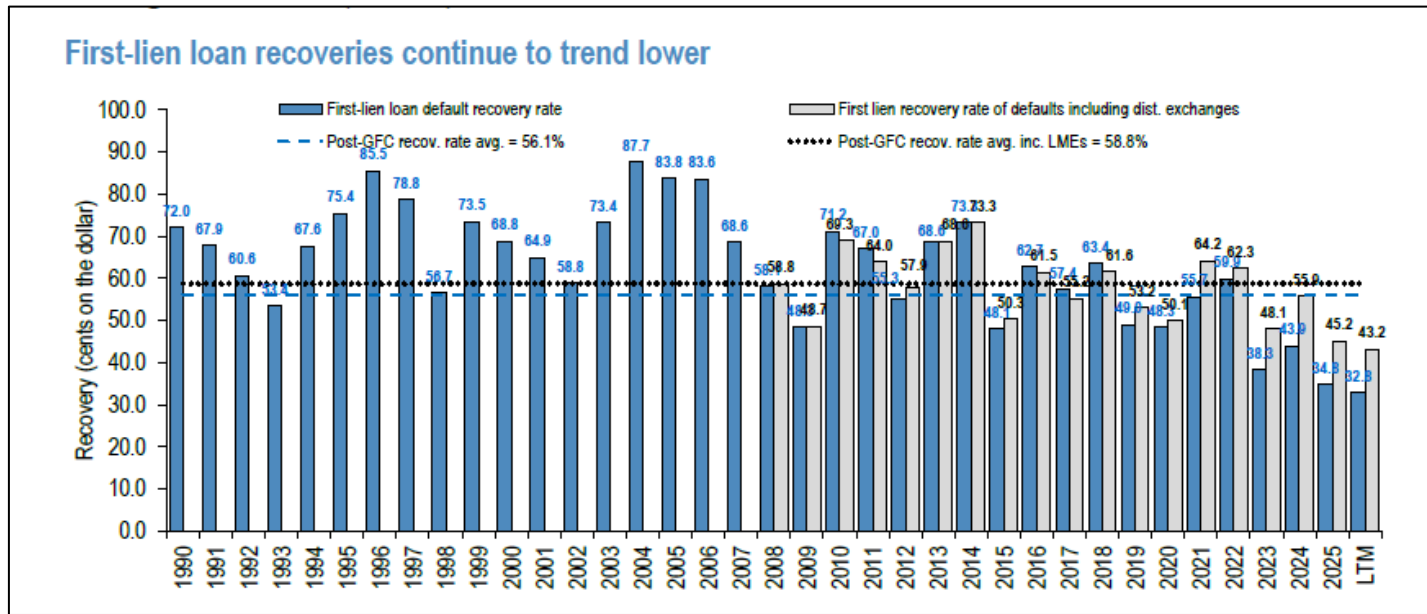
High yield bond issuers are frequently concentrated in industries characterized by substantial collateral or tangible asset bases.

Private credit and leveraged loan borrowers tend to be more concentrated in software, financial services, or healthcare services.

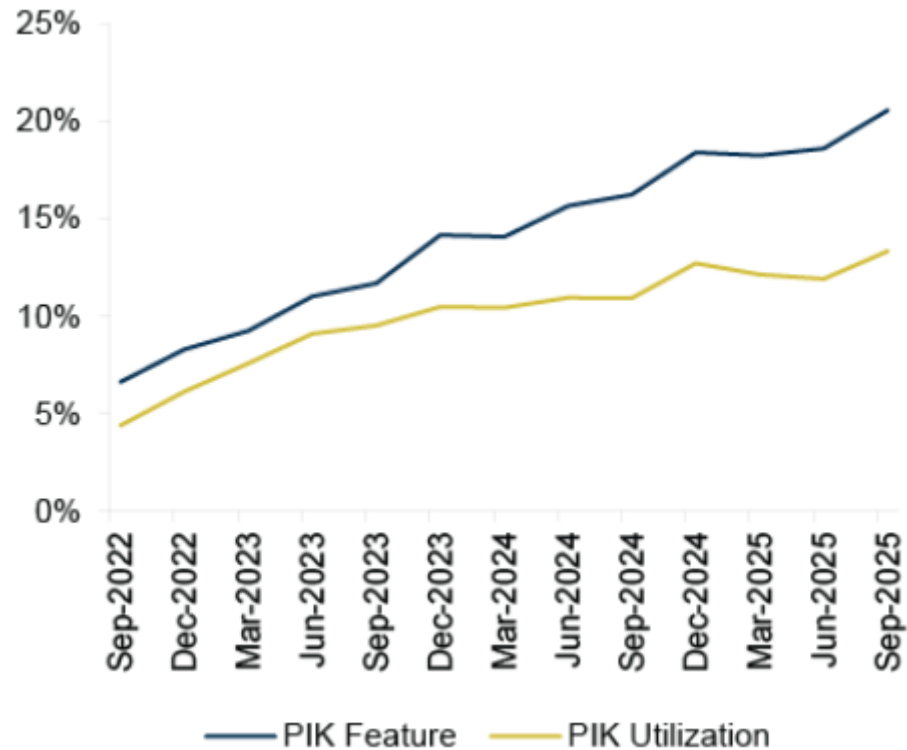


Markets are concerned about higher exposure in private credit and BSLs to AI replacement risk.

Recovery Rates



A Sign of Stress in Private Credit



A Payment-In-Kind (PIK) clause allows a borrower to pay interest with more debt, rather than cash.

- Gives borrower more flexibility when facing challenges during the loan lifespan
- Increasingly being used in private credit
- PIK clauses are rare in high yield and BSLs

Reasons We Prefer High Yield Bonds

- Settlement
 - Bonds settle in 1 trading day; BSLs settle in 7-20+ trading days
 - BSL trades require executing non-standard assignments and participation agreements
 - Borrower has the right to disapprove of a lender
- Liquidity
 - BSL secondary market is a lot less liquid
- Transparency
 - Bond issuers face stringent public disclosure mandates
 - Limited public disclosure requirements for BSLs
- Technical Factors
 - CLO's hold ~74% of the BSL market, so pricing driven more by CLO supply/demand than company fundamentals

Private Credit: Even More Cumbersome

- Administrative and legal burden
- Private loans are highly illiquid
- Transparency
 - Loans are marked-to-model quarterly
 - Limited information for fund investors
- Interconnectedness to private equity

Loan Investments in SDIC HY Portfolios

- Have received a handful of loans from companies exiting bankruptcy
- Partnered with HPS on one direct lending loan to an energy company

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