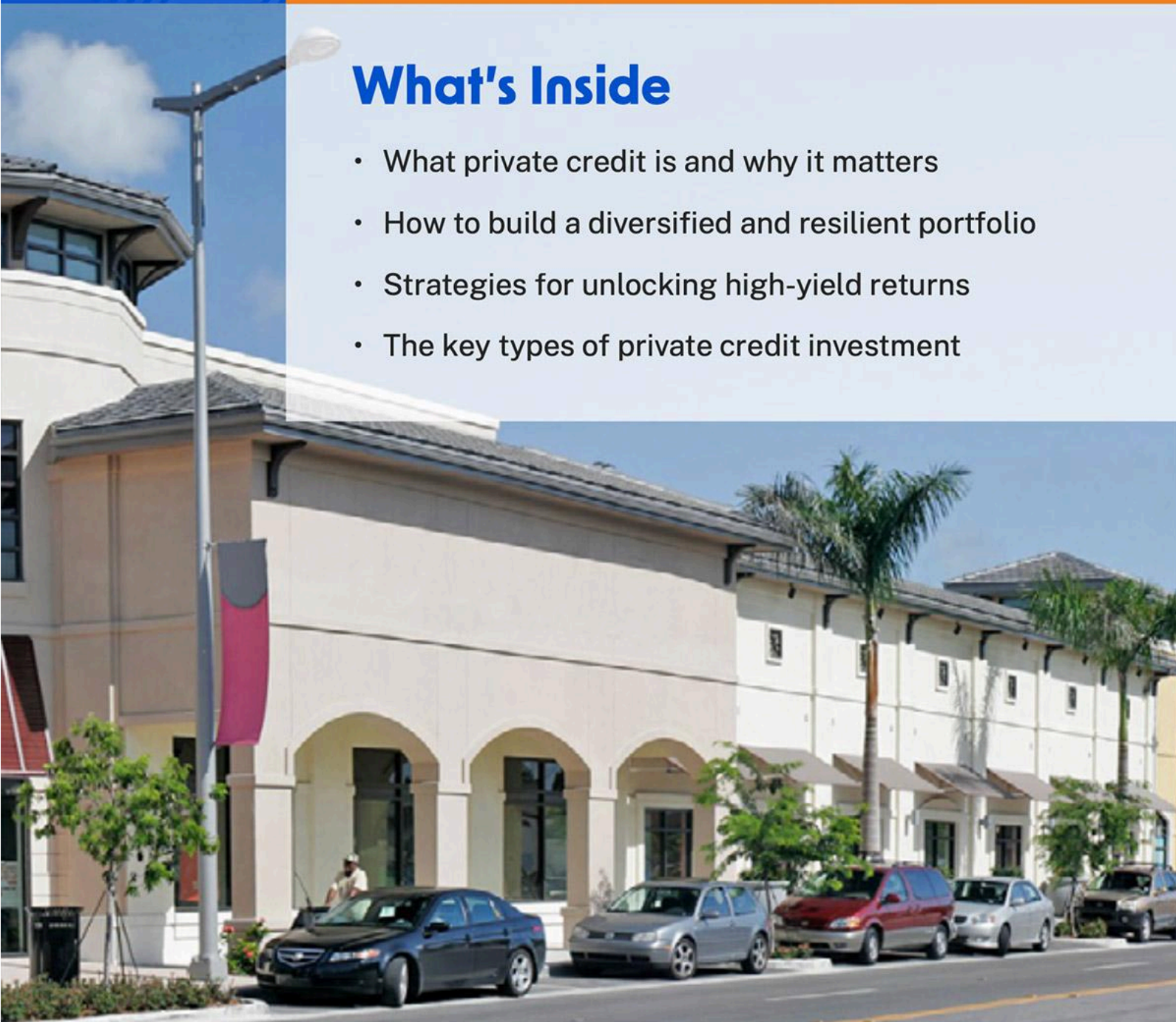


YOUR MONEY, MAKING MONEY

A GUIDE TO GLOBAL PRIVATE CREDIT

What's Inside

- What private credit is and why it matters
- How to build a diversified and resilient portfolio
- Strategies for unlocking high-yield returns
- The key types of private credit investment





Your Money, Making Money

A Guide to Global Private Credit

Global investments leader, Mercer, provides TermPlus with access to a diversified portfolio of some of the best global private credit opportunities available.

Mercer has over 2,000 investment professionals around the globe, and more than 30 years' experience in private markets, with 260 alternatives professionals based in approximately 30 offices around the world.

This association with Mercer enables us to deliver a diverse portfolio of best-of-breed global private credit opportunities for our customers.



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Overview of Global Private Credit

Private credit is an asset class that consists of non-bank lending to counterparties where the debt is not issued or traded on public markets. These counterparties may be companies operating industrial businesses, or companies who are non-bank originators of pools of assets (e.g. residential mortgages, auto finance, trade finance, commercial loans).

In the US and Europe, private credit lenders, funded by institutional investors like insurance companies and pension funds, have grown in importance and significance to both investors seeking income generation, capital resilience, return enhancement and diversification; and to borrowers who are willing to pay a premium for the certainty, speed and customisation private credit lenders offer.

What is Private Credit?

Private credit is a subset of the corporate credit market. The corporate credit market consists of a diverse universe of securities which enable both large and small businesses to borrow money from lenders, including banks, non-bank financial institutions and fund managers. Corporate entities typically borrow to finance expansion of their businesses or to use as capital alongside equity investments when buying a new business.

A debt security represents a principal amount borrowed by a borrower with a commitment by the borrower to pay the lender an agreed rate of interest on the amount borrowed over a set time period. When that time period ends, the borrower repays the principal amount to the lender in full. Depending on the underlying arrangement of each transaction, the interest rate on the debt may be paid during or at the end of the period and may be either fixed or floating rate. Fixed interest rates require the borrower to pay a fixed rate of interest for the term of the loan. Floating rate securities require the borrower to pay an interest rate that is tied to a benchmark that will vary over the length of the term, such as the RBA Official Cash Rate ('RBA Rate').

Different types of debt securities pay different interest rates that are determined by the following:

- **Term** – how long the principal is outstanding;
- **Capital security** – debt can be secured or unsecured and can vary in seniority from senior to subordinated. Senior debt ranks first in terms of payment of interest and principal while subordinated debt ranks just above equity but below debt that ranks senior to it; and
- **Credit assessment** – the lender will perform its own or rely on a third-party assessment of the probability that the borrower will be able to meet its interest payment and principal repayment obligations.

There are two types of credit markets available for borrowers to borrow, traded credit and private credit.

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Traded credits are typically loans, bonds or other debt securities issued by larger companies and are syndicated (syndicated loans are corporate loans large enough to be broken into smaller parcels and syndicated to a group of similar investors, typically managed, and arranged by a bank) to a group of lenders or issued in public fixed income markets. Syndicated securities, also referred to as Leveraged Loans, can also be traded in the public markets.

Traded credit markets, both public and syndicated, are typically only available to borrowers with large businesses (i.e., those with \geq USD\$300 million Earnings Before Interest, Taxes, Depreciation and Amortisation (“EBITDA”)). At this size or greater, the volume of the debt being offered is sufficient to justify the effort required to assess the loans and the liquidity required for investors in these markets to finance them.

Public debt securities are rated investment grade or sub-investment grade by independent credit rating agencies who perform credit assessments of the borrower. The ratings are used by investors to properly assess the interest rate they require to take on the risk that a borrower may default. Sub-investment grade securities (sometimes referred to as ‘high yield’ debt) pay higher interest rates than investment grade securities.

Private credits are typically bilateral loans between a lender and a borrower with little or no syndication. These securities are not typically traded but are held by the lender until maturity. Private credit markets may be accessed by any size company with the lender using their own proprietary credit rating models to determine the appropriate interest rate required to compensate them for the risk of default. Medium-sized and smaller corporates (<USD\$250 million EBITDA) can access private credit from banks, institutional investors and specialty fund managers but are generally too small to access public and syndicated loan markets.

Private credit encompasses a range of different instruments which have different risk and return characteristics as summarised below:

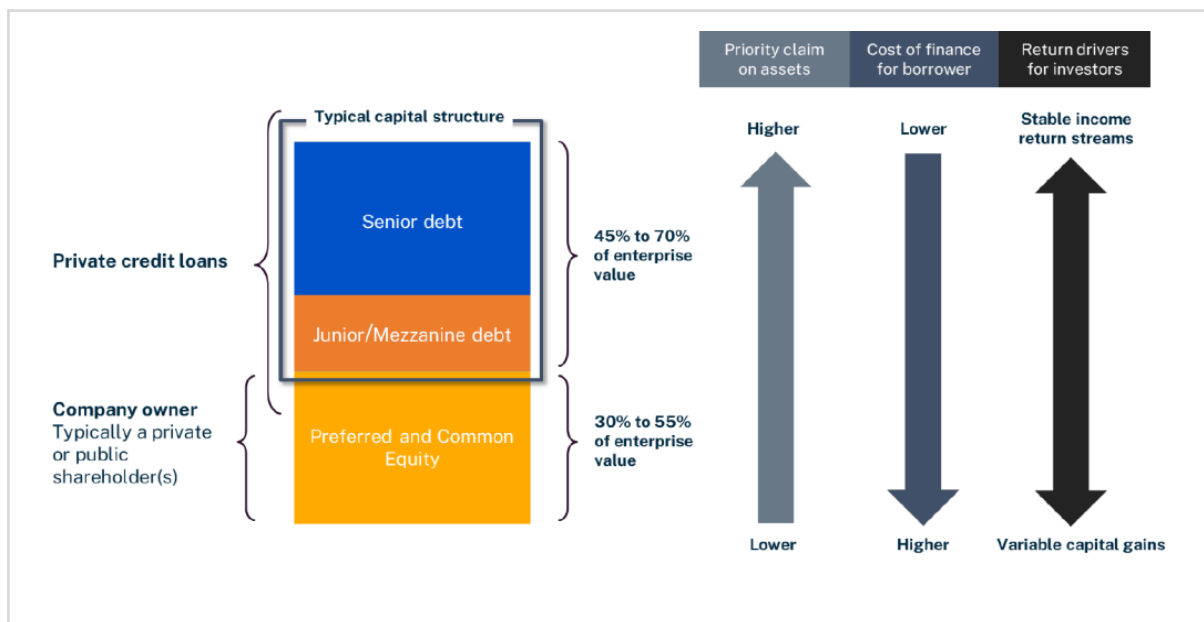
- Senior debt – debt that has priority over other debts in case of bankruptcy or liquidation. It includes loans that have a first claim on assets and/or

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earnings of a borrower before other debt and equity returns are paid (first lien loans) or have a second claim (second lien loans). In some cases, first and second lien loans are combined into one facility (called unitranche loans); and

- Junior/mezzanine debt – debt that ranks below senior debt (and is therefore referred to as ‘subordinated’) and above equity in the capital structure. It usually pays a higher interest rate but has lower security than senior debt, offering higher returns and potential equity participation for lenders.

The figure below depicts where private credit typically fits within a company capital structure.



In addition to the corporate instruments above, private credit encompasses loans that apply similar principles of seniority, subordination and equity, but rather than lending against operating cash flows of a business and taking security over business assets and enterprise value, the loans structures will be against assets and cash flows generated by those assets.

Background To The Private Credit Market

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For most of the 20th century, loans to companies were almost exclusively provided by banks. The commencement of non-bank private credit lenders can be traced back to the 1980s, when private equity firms started to use mezzanine debt and other forms of subordinated loans to finance leveraged buyouts and acquisitions. As this debt was beyond the risk appetite of traditional commercial banks, it was financed predominantly by high-yield bonds issued to public markets by investment banks.

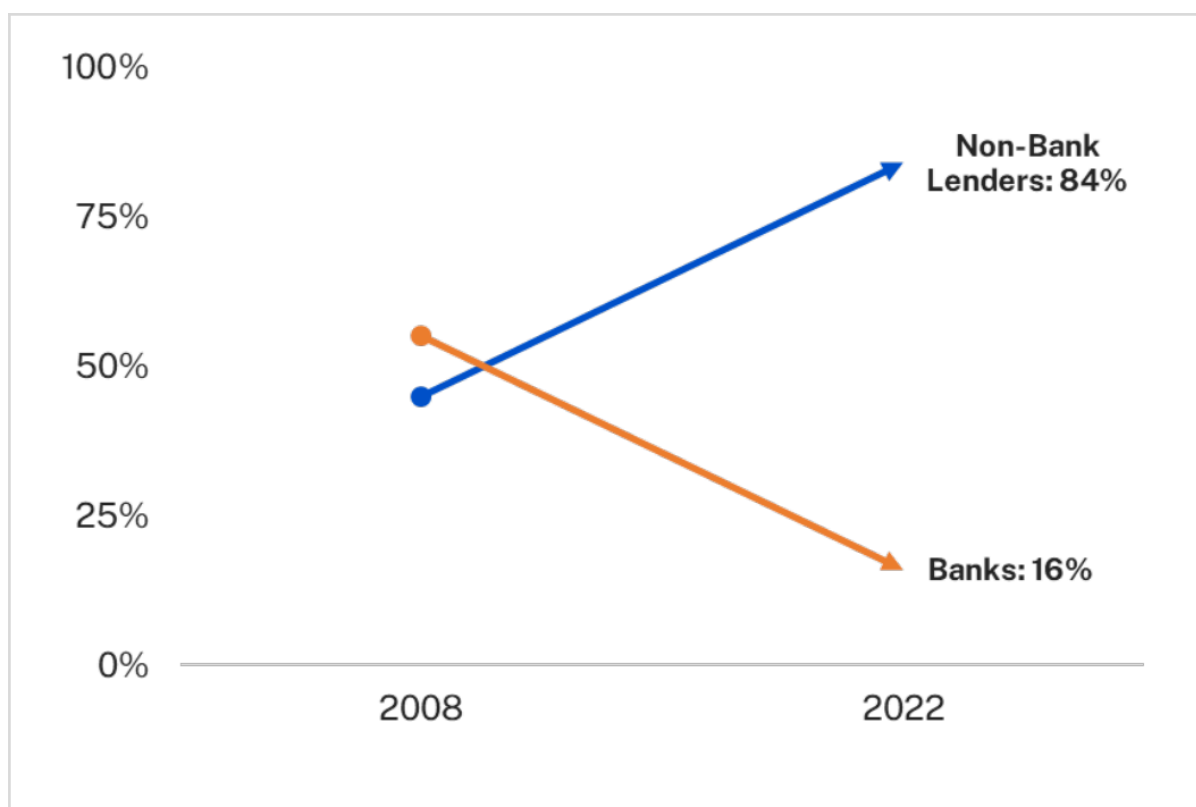
In the late 1980s and early 1990s, private equity firms faced a shortage of available credit to finance their transactions leading to the creation of private credit funds by private equity firms themselves, independent private credit fund managers and non-bank financial institutions that are not regulated as banks but provide similar services (e.g., insurance companies).

Despite the growing private credit market, it remained nascent prior to 2007. Until this time, the financing of companies remained the domain of commercial banks, however, the Global Financial Crisis (“GFC”) of 2007-2008 significantly changed the market for corporate credit.

Post the GFC, regulatory reforms were implemented to prevent the recurrence of another systemic liquidity and credit crisis. In particular, the introduction and implementation of Basel 3 banking regulations resulted in increased bank capital and liquidity requirements and decreased leverage. This caused banks to retreat from many types of corporate lending, resulting in companies not large enough to issue broadly syndicated loans or issue bonds into public markets needing to find alternatives, creating a systemic shift of private credit risk from banks to long-term institutional investors through their funding of private credit managers as shown below.

Bank Share of US and European Primary Loans

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Source: LCD Global Leveraged Lending Review Q3 2023 and Mercer analysis. Calculated as an average between US and European markets. LCD has not provided consent to the inclusion of statements utilising their data.

The market for global private credit is expected to continue to experience strong growth into the future due to:

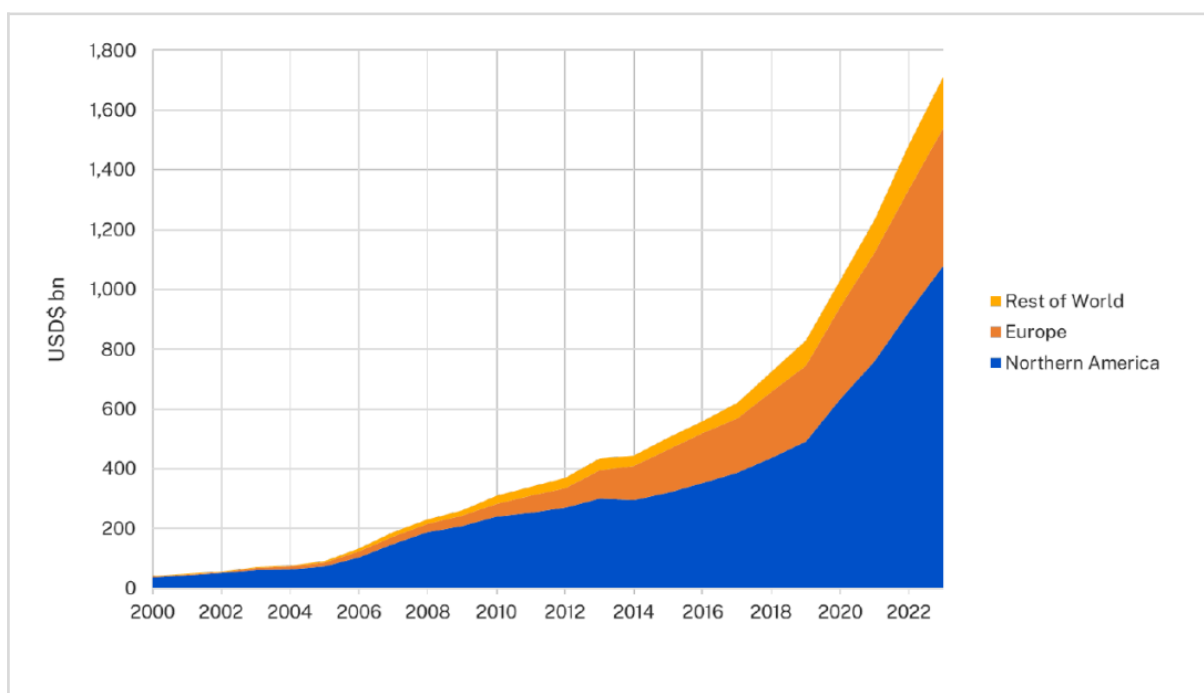
- ongoing regulatory scrutiny of bank liquidity and lending practices, reducing bank lending directly to corporates;
- volatility and dislocation in traded credit markets which create borrowing uncertainty for large company issuers; and consequently,
- increasing borrowers' demand for the unique value proposition that private lenders can offer, including:
 - greater customisation of structures, flexibility, and longer maturity profiles than traditional bank lending, allowing borrowers to better match their financing needs with their cash flow projections and business plans;
 - certainty of terms, faster speed of execution, privacy, and simplicity;

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- avoidance of the volatility and uncertainty of bank syndicated loans and public bond issuance; and
- access to capital for borrowers who are too small to access liquid capital markets.

The growing demand for global private credit, which has approximately quadrupled in the past decade is shown as follows.

Growth in Private Credit Assets Under Management

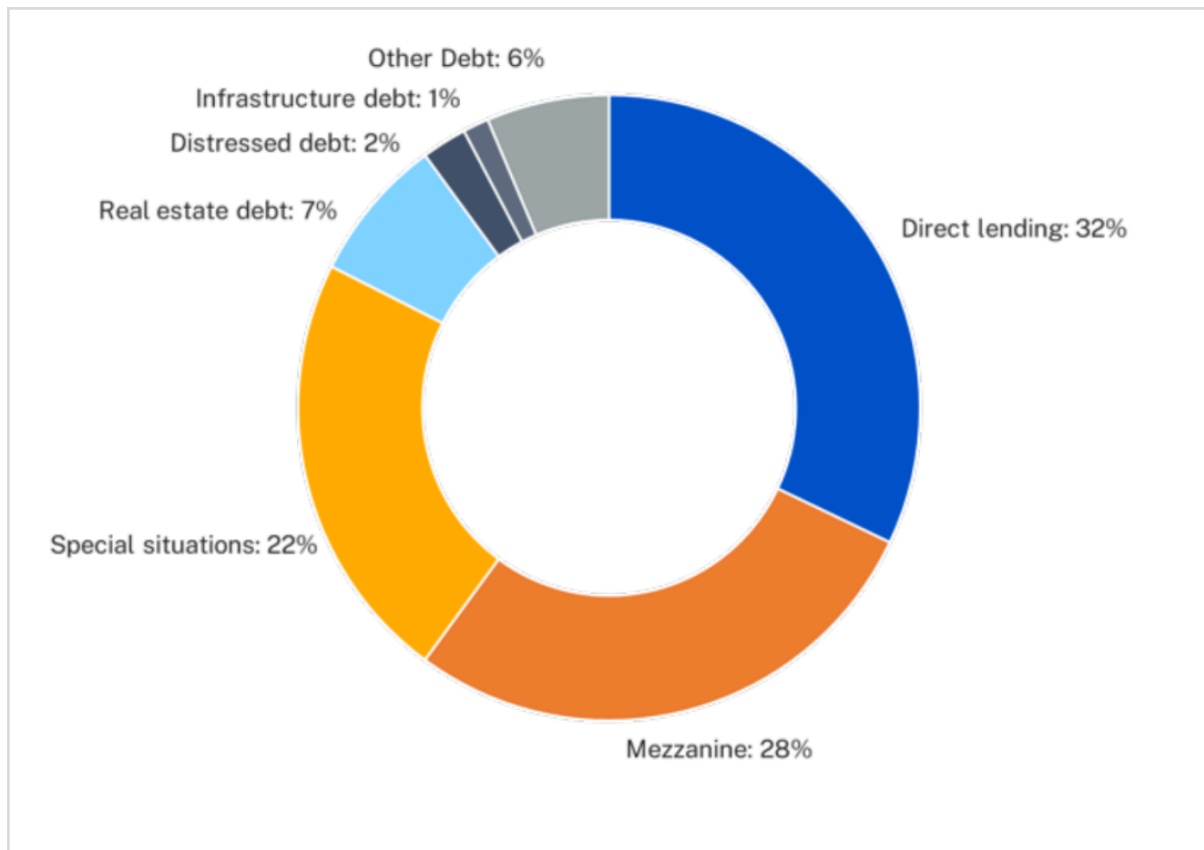


Source: Preqin.. The horizontal axis covers the period between 31 December 2000 and 30 June 2023. Preqin has not provided consent to the inclusion of statements utilising their data.

With this growth has come an increase in the number and sophistication of private credit managers as well as the development of a wide range of private credit investing strategies. The diversity of strategies, as shown below, provides investors with the choice of varying risk, return and liquidity profiles.

Private Credit – Global AUM Split by Strategy Type

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Source: PitchBook Data, Inc. 'H1 2023 Global Private Debt Report Summary'. Data as of 30 June 2023. PitchBook Data, Inc. has not provided consent to the inclusion of statements utilising their data.

Characteristics of Private Credit

Typical features of private credit instruments include the following:

Unlisted – private credit instruments are illiquid since they are held on the balance sheet of the lender until maturity and are not listed on public markets, so cannot be traded. Lenders are provided with a level of due diligence information that is typically not available to public debt lenders, such as detailed financial projections. The transactions are bilateral (negotiated directly between the borrower and the lender).

Floating rates – private credit borrowers usually pay interest on a floating rate basis. The floating rate is determined by applying a margin above a market indicator rate such as the RBA Rate. Therefore, in a rising interest rate environment, the interest payment will go up while in a falling rate environment it will go down. However, lenders typically have some protection from a decline in rates provided by base rate floors which limit how low the coupons can fall.

Income payment flexibility – In the case of subordinated or mezzanine loans, some or all the interest payments may be in the form of a Payment-In-Kind (“PIK”), which accrues on a current basis but is generally paid later, often at the maturity of the loan. PIK interest may be combined with regular cash payments or otherwise tailored to address the specific circumstances of the borrower. The flexibility to achieve these goals through combinations of floating rates, fixed rates and/or PIK interest is one of the main advantages of private credit.

Seniority – seniority is a form of protection which provides the private credit lender with priority in the payment of interest and principal. When a borrower is distributing cash flow to meet its obligations, the most senior creditor will be the first to receive distributions, or have capital repaid. Remaining funds are then distributed to other lenders in the borrower’s capital structure with the last receiver of distributions or capital being the holders of ordinary equity. This feature is particularly important during insolvency events, where a borrower may have insufficient funds to repay all of its financial obligations. Senior secured

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loans have the first or second ranking priority of payment from the borrower. Subordinate or mezzanine loans rank below senior secured loans in the priority of distribution of funds after an insolvency event.

Security – security provides lenders with the legal right of enforcement over some or all assets of the borrower should the borrower be unable to meet its repayment obligations. In this event, the lender may have the right to take control of the assets subject to the security, which may enable the lender to directly apply cash flows to payment of interest and principal or sell the asset. Senior secured loans have security over the assets of the borrower, while subordinated loans may be secured (but subordinate to senior secured) or unsecured.

Structural protections – lenders are provided with structural protections called covenants, which protect the lender by providing a mechanism for monitoring the financial profile of the borrower against certain benchmarks and by restricting the borrower's ability to perform certain activities without the lender's permission, e.g., taking on additional debt, making acquisitions or paying dividends to ordinary shareholders.

If covenants are breached there can be a range of potential consequences, including the right to demand early repayments of a loan, charge a higher interest rate or appoint a receiver to take control of the business and protect the interests of lenders.

Covenants and other loan terms and conditions can enhance a lender's ability to monitor and influence the credit profile of a company. In addition, lenders typically receive prepayment protections via fees and other penalties on early repayments.

Income enhancements – the income returns of private credit investments are sometimes enhanced through other mechanisms like upfront fees, which are generally in the form of a discount between the issue price of the loan and its maturity value typically referred to as an Original Issue Discount ("OID"). Some forms of private credit can also provide lenders with equity exposure through

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warrants, preferred equity or common equity shares that may be incorporated as additional upside to the lender in certain transactions. The value of such equity participation is typically realised through a trade sale, IPO, or dividend payment.

Investment Attributes of Private Credit

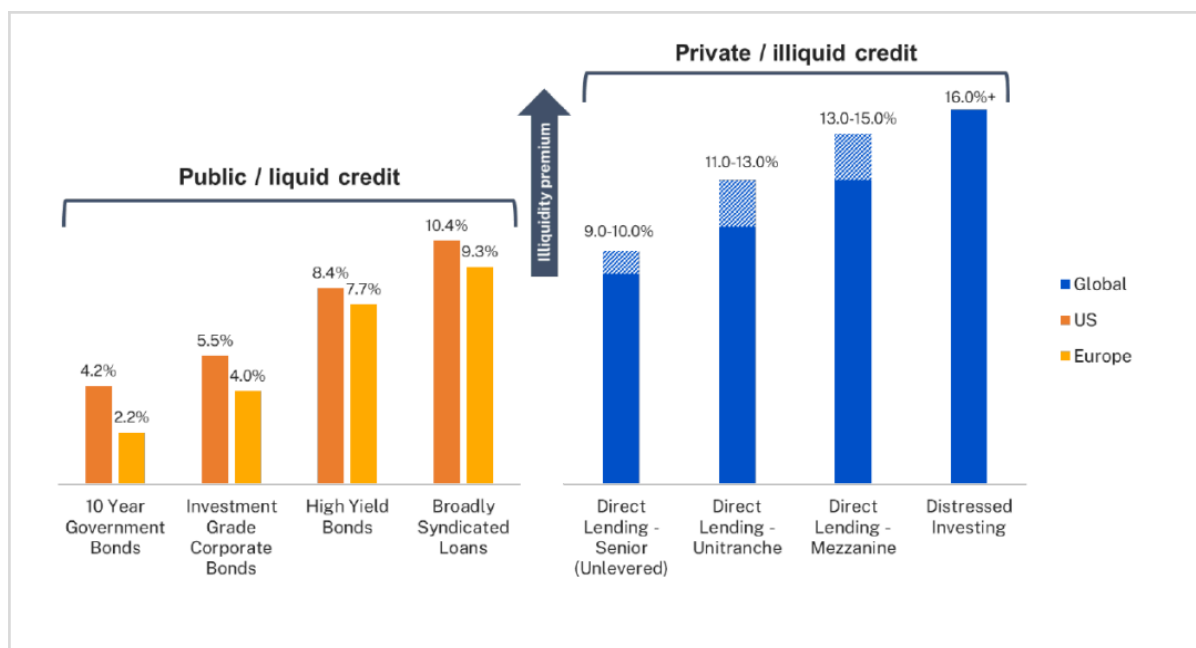
The characteristics of private credit described above underpin the investment attributes that make it a popular alternative, or complement, to traditional fixed income investment strategies and other traded credit investments.

Despite the different risk/reward profiles offered by private credit strategies, there are three attributes that particularly attract investors: the attractive historical returns, resilience and diversification.

Historical Returns: Attractive Yield and Potential Return Enhancement

Investors in global private credit generally receive a yield premium over traditional fixed income. This yield premium, or excess spread, is often referred to as an “illiquidity and complexity premium”. The illiquidity premium is required to compensate lenders for their inability to trade the debt. Borrowers have also been willing to pay a premium for the complexity involved in originating, underwriting, and structuring private loans and the customisation offered by private lenders.

The following chart illustrates the premia global private credit has earned over liquid credit alternatives across various private credit instruments.



Source: DataStream and S&P LCD, as at 1 December 2023. 10 year government bond: Bloomberg Barclays US Treasury Bellwether 10 year and Germany Government Stored Yield Curve 10 year, Investment Grade Corporate Bond: Bloomberg Barclays US Corporate Investment Grade and Bloomberg Barclays Euro Aggregate Corporates, High Yield Bonds: Bloomberg Barclays US High Yield 2% Issuer Cap and Bloomberg Barclays Pan European High Yield, Broadly Syndicated Loans: S&P Leveraged Loan Index and S&P European Leveraged Loan Index. Private credit annualised yields to maturity are estimates based on Mercer analysis on the basis that such loans are held to maturity. DataStream and S&P LCD have not provided consent to the inclusion of statements utilising their data. **No assurance can be given that any investment will achieve its objectives or avoid losses. Past performance is not necessarily a guide to future performance.**

In addition to illiquidity and complexity premiums, private credit can provide enhanced returns due to its resilience characteristics and floating rate nature, particularly in a rising rate environment. Private credit instruments are typically tied to floating rates (such as the RBA Rate and Secured Overnight Financing Rate ('SOFR')). When interest rates rise, increases are automatically reflected in the private credit interest payments. This dynamic makes floating rate debt less sensitive to interest rates compared to fixed-rate bonds, which typically lose value as interest rates rise.

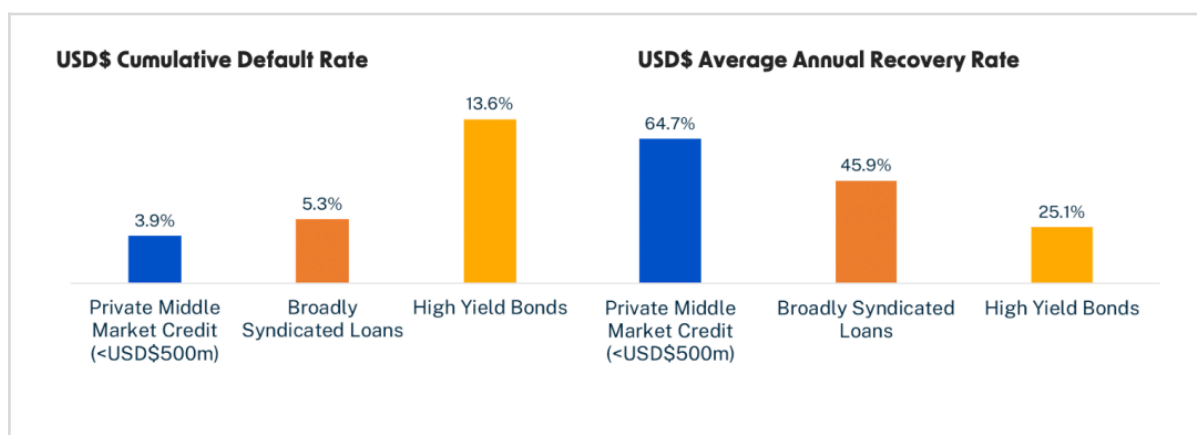
Resilience

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The resilience of private credit is evident in two ways, through lender protections and the way loans are valued.

Lender protections arise out of bespoke structuring and bilateral negotiation and include contractual limitations and covenants on the borrower. Enhanced protections are also provided in relation to the priority of repayments to lenders in a default scenario. Deep access to company records received by private lenders also enables strong due diligence and documentation. The typical bilateral relationship can make for a quicker and more efficient workout (i.e., renegotiation of a loan in default) and potentially greater recovery in the case of a default, when compared to publicly syndicated debt placements and public bonds that feature multiple lenders with potentially competing priorities.

These enhanced protections have resulted in lower default rates and higher recovery rates for private credit assets relative to other credit alternatives as shown following.



Sources:

- USD\$ Cumulative Default Rate 1995 – 2021: S&P LCD & CreditPro (1995 to 2021), as at 31 December 2021. The cumulative default rate is the percentage of commercial borrowers within a certain category that have defaulted on their obligations by a specific point in time. It is the total number of defaults accumulated over a period, expressed as a percentage of the initial loan pool. This metric helps investors and analysts to assess the historical default likelihood of borrowers within a specific category over different timeframes. The S&P LCD cumulative default rate has a one-year lag since it assumes a

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loan will not default within one year of origination. Past performance is not a reliable indicator of future performance and may not be repeated.

- USD\$ Average Annual Recovery Rate 1995-2022: S&P LCD & CreditPro (1995 to 2022). The Annual Recovery Rate is the average percentage of the loan principal amount recovered by lenders following a default event within a specific year. This metric provides insight into the expected loss in case of a default, showing how much lenders might recoup on their investments on average. Middle market loans defined as those <\$500m in size. Past performance is not a reliable indicator of future performance and may not be repeated.

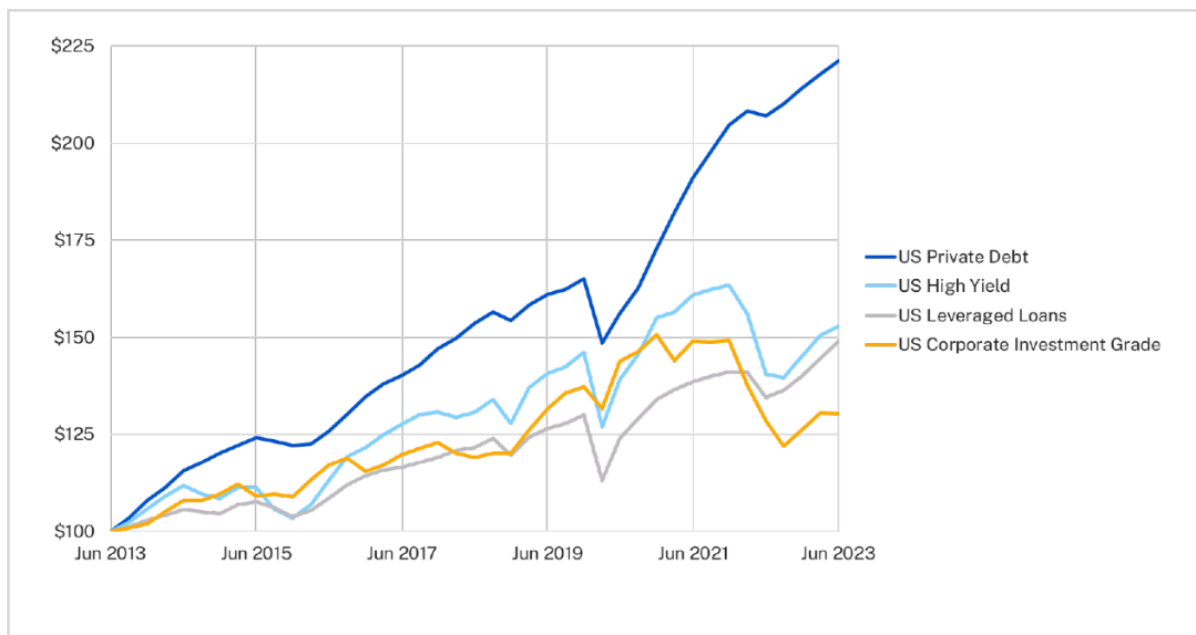
S&P LCD & CreditPro have not provided consent to the inclusion of statements utilising their data. **No assurance can be given that any investment will achieve its objectives or avoid losses. Past performance is not necessarily a guide to future performance.**

In respect of valuations, private credit is not traded and, therefore, valuation methodologies can look through shorter-term market volatility and focus on true fundamentals. Although valuation methodologies can vary, in aggregate this characteristic has generally smoothed private credit portfolio return profiles when compared to other traded credit investments, which are more directly exposed to market price volatility.

The resilience of private credit relative to a wide range of traded investment options can be seen in the figures below, which illustrate the strong relative historical performance of global private credit as an asset class during periods of both economic growth and turbulence, with shallower drawdowns and lower volatility.

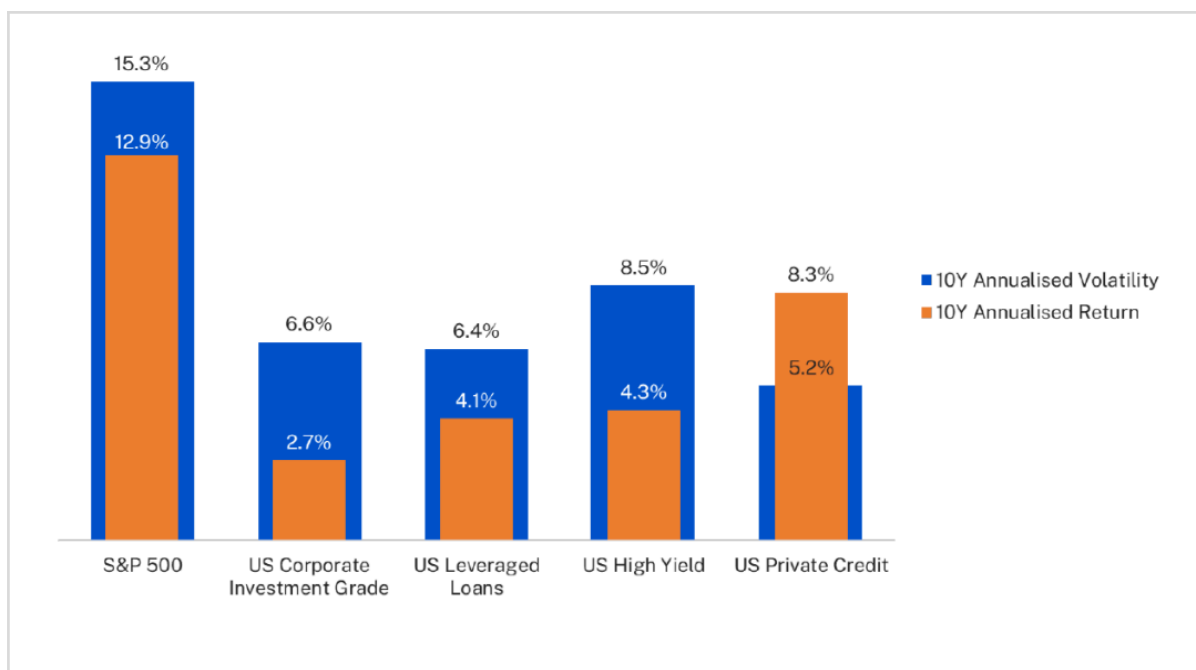
Growth of USD\$100

Resiliency and downside protection of private credit vs. more volatile growth fixed income asset classes



Returns in USD. 10-year period from 1 July 2013 to 30 June 2023. Sources: Bloomberg (Bloomberg US Corporate Total Return Value Unhedged USD), Burgiss (Burgiss – Private Debt (North America)), and Thomson Reuters Datastream (ICE BofAML US High Yield Master II, S&P Leveraged Loan). Bloomberg, Burgiss and Thomson Reuters have not provided consent to the inclusion of statements utilising their data. **No assurance can be given that any investment will achieve its objectives or avoid losses. Past performance is not necessarily a guide to future performance.**

Higher annualised historical returns than other debt asset classes, with no significant realised increase in risk as measured by volatility (with volatility measured by the Annualised Standard Deviation of quarterly returns)



Returns in USD. 10 year period from 1 July 2013 to 30 June 2023. Sources: S&P (S&P 500 Total Return Index), Bloomberg (Bloomberg US Corporate Total Return Value Unhedged USD), Burgiss (Burgiss – Private Debt (North America)), and Thomson Reuters Datastream (ICE BofAML US High Yield Master II, S&P Leveraged Loan). S&P, Bloomberg, Burgiss and Thomson Reuters have not provided consent to the inclusion of statements utilising their data. **No assurance can be given that any investment will achieve its objectives or avoid losses. Past performance is not necessarily a guide to future performance.**

“Annualised Standard Deviation” is a measure of how much the price of an asset or the return of a portfolio of assets has fluctuated (both up and down) over a certain period. If an asset or portfolio of assets has a high Annualised Standard Deviation, the price of the asset or return of the portfolio of assets has historically fluctuated vigorously. If an asset or portfolio of assets has a low Annualised Standard Deviation, the price of the asset or return of the portfolio of assets has historically moved at a steady pace over a period of time.

Diversification

Private credit can offer diversity through a range of strategies that target different parts of the capital structure and market segments. The strategies can be broadly characterised as “capital preservation” or “return maximisation”.

Strategies with defensive characteristics, like traditional senior debt funds, seek to deliver predictable returns while protecting against losses. These portfolios

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tend to be negatively skewed, i.e., they focus their analysis and terms on repayment of principal, with few losses and even fewer unexpected gains.

Return-maximising strategies include distressed corporate credit funds and funds that focus on capital appreciation. These funds offer the prospect of larger gains and often have positively skewed portfolios, i.e., while there is a focus on repayment of principal, the lender expects to be compensated with a degree of equity appreciation resulting from its efforts to recapitalise a borrower.

Strategies that do not easily fall into one of these categories are either opportunistic (investing across the credit spectrum as market opportunities permit) or niche/specialty finance strategies, like aviation finance or health care royalties. Opportunistic and specialty finance strategies must be evaluated individually to determine the appropriate expectations for risk and return.

So, while the premise of private credit is straightforward, complexity arises when considering the number of different strategies across many dimensions, including geography, sector, currency, seniority, security, collateral type, structure, and tenor. The benefit of this complexity is diversification, within the asset class and also relative to other alternative and traditional asset classes.

Private Credit Investment Strategy Types

The macroeconomic environment has caused investors to face numerous bouts of volatility and market dislocation since the GFC. Private credit has attracted increasing interest, with a very wide range of investment strategies available to investors subject to their risk, return and liquidity requirements. These strategies can be broadly categorised into five types, as follows:

Strategy Type	Description	Return Profile	Loan Type
Direct Lending	Lending directly to companies, generally secured against assets and earnings	Income	Floating rate
Structured Credit	Consists of loans dependent on performance of asset pools	Predominantly income, may have some capital appreciation	Floating rate
Specialty Finance	Includes niche lending that requires specialised knowledge	Predominantly income, may have some capital appreciation	Floating rate
Real Asset Lending	Lending to companies that own and operate real assets. Includes real assets such as real estate and infrastructure	Income	Floating rate, fixed rate

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Credit Opportunities	Potential benefit from dislocations in the credit or equity markets	Income and capital appreciation	Floating rate, fixed rate, and equity exposure
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Within each of the five strategies, there are numerous sub-strategies which allow for further diversification of risk, return and level of downside protection subject to an investor's investment objective. The wide range of sub-strategies can be characterised into three types of investment attributes as set forth below, each of which possesses a distinct risk/reward.

- **Income:** Sub-strategies with an Income attribute derive returns from contractual cash interest payments, e.g., Direct Lending. Capital preservation is critical so there is a focus on seniority in the capital structure and widely diversified portfolios (e.g., large number of individual loans, 100+), which are predominantly focussed on delivering stable income with strong downside protection provided by security over assets and/or the enterprise value of the business;
- **Balanced:** Sub-strategies with a Balanced attribute seek to exploit the wider private credit opportunity set beyond Direct Lending. These strategies provide mainly contractual returns and seek further diversification to reduce corporate credit market correlation and to exploit credit imbalances and sourcing barriers in specific sectors, which may allow for capital appreciation through sharing in potential capital appreciation provided by the provision of credit. Investment managers in this category may specialise in a single strategy (typically Structured Credit or Specialty Finance), or have capabilities to execute multiple strategies within a single fund; and
- **Total Return:** Sub-strategies with a Total Return attribute predominantly focus on opportunities stemming from market volatility, liquidity mismatch or episodes of stress/distress. They typically accept greater risk (e.g., credit, structuring and/or event) than Income and Balanced investments to

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achieve returns which are in line with or above equity. Opportunities for these funds are more abundant during periods of market stress. The Credit Opportunities sub-strategies that comprise Total Return include Distressed, Opportunistic and Special Situations.

- **Enhanced Cash:** Sub-strategies with an Enhanced Cash attribute derive floating rate returns from income on shorter term senior corporate credit. Such strategies exhibit very low defaults and interest rate risk, and stability in volatile markets. Their shorter term allows more favourable liquidity terms and they do not employ leverage.

Direct Lending Sub-Strategies

Direct Lending encompasses directly originated senior secured debt of middle market corporate borrowers across a wide range of industries and sizes. Direct loans are generally structured as first lien, second lien or unitranche. Direct Lending is the largest and most mature asset class within private credit. It has been adopted as a defensive source of floating rate income with an attractive illiquidity premium. This strategy is generally levered, meaning the fund manager will fund its loan to a borrower through a combination of fund subscriptions from investors and its own external borrowings (typically the loan portion will be 1x to 2x the fund manager's subscriptions) to enhance returns. The return drivers are contractual yield, fees for arranging the debt, OID and prepayment and covenant-breach fees. Direct Lending has an Income attribute.

Mezzanine is subordinated debt that is predominantly used for growth or transaction purposes (e.g., funding acquisitions). It is a particularly important source of credit for corporates during periods when bank lending is constrained and borrowers need sources of junior capital to fill gaps in their balance sheets. They often employ PIK structures.

Given their unsecured nature, they earn higher returns than Direct Lending to compensate for the higher risk and can have access to equity upside through equity warrants. Mezzanine typically has a Total Return attribute.

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Venture Debt involves lending to small, newly established companies during their high growth phase. Generally, they have not reached EBITDA positive or are not positive enough to secure a traditional loan. These companies are typically backed by venture capital firms and considered to have a high chance of commercial success. While the debt is senior secured, it is considered to be speculative with lending based on estimates of the borrower's loan to value, cash, tangible and intangible assets and pathway to profitability.

In exchange for startup risk, venture debt lenders demand higher contractual spreads, covenants, and a meaningful level of equity warrants. Venture debt has a Total Return attribute.

Structured Credit Sub-Strategies

Asset Backed investments consist of debt backed by cash flowing portfolios of hard assets (e.g., equipment, autos, aviation) or financial assets (e.g., consumer loans, trade receivables). Private asset backed investments are special purpose vehicles that are set up to acquire assets. To finance the acquisition of the assets, they simultaneously issue various tranches of debt and equity secured by those assets. These structures, like Direct Lending, must adhere to numerous covenants which provide governance and structural downside protection for investors. These investments appeal to a wide range of investors, including those who require investment grade assets (so the senior tranches) and those seeking higher returns through junior tranches and equity. The return drivers are contractual yield and principal repayments. This sub-strategy possesses an Income, Balanced or Total Return attribute depending on the fund manager's focus and return objectives.

Collateralised Loan Obligations ('CLOs') are special purpose vehicles with eight to ten year lives established to purchase senior secured loans (referred to as "collateral") through the issue of tranches of debt and equity (so a corporate form of Asset Backed). Typically, the collateral is a diversified pool of 150 to 200 or more large and/or mid cap loans actively managed by the collateral manager. The manager's goal is to exploit the spread between income earned by the collateral and the cost of debt financing. The CLO manager is typically a credit

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asset management firm with expertise in sub-investment grade debt. The capital structure of the typical CLO contains a senior tranche which is AAA, or highest investment grade (typically 65% of the total), mezzanine which range from AA to BB at (typically between 5% to 15% of the total), with the balance being equity (typically 8% to 10% of the total). CLOs benefit from numerous structural downside protection features which help preserve capital in periods of loan market volatility. These include ongoing interest and asset coverage tests and rules that redirect cash flows from subordinate to senior tranches in periods of credit stress. The return drivers are contractual yield and capital appreciation. Depending on the strategy employed by the fund manager these investments can be Income, Balanced or Total Return.

Specialty Finance Sub-Strategies

Asset-Based Lending within the context of the Specialty Finance strategy involves senior loans made to companies that have assets they use as collateral such as hard assets (e.g., equipment, inventory) or financial assets (e.g., accounts receivable). As a result, the recovery of asset-based loans is based on the value of borrowers' assets and not on financial performance of the borrower. Unlike asset-backed lending, asset-based lending does not involve the use of securitisations. The loan to value of an asset-based loan is measured against the liquidation value of specific assets. Lenders often seek to maintain a diverse asset pool in the form of correlated and/or non-correlated assets to protect their principal. In some cases, asset-based lenders will obtain warrants in the borrower as an additional form of compensation. The return drivers are contractual yield, OID and occasionally equity warrants. These sub-strategies are typically Balanced in nature but can be Total Return.

Royalties are a broad asset class that involves cash payments to the owner of a financial asset in exchange for the right to use the asset for commercial purposes. Asset types may include patents, mineral rights, trademarks, pharmaceuticals, music, and entertainment rights. Pharmaceutical is one of the largest, most established royalty sub-strategies whereby asset managers acquire the royalties (typically from hospitals, universities, and research

laboratories), invest significantly to commercialise them through product development and monetise their value through drug sales. The yield is based on the exploitation of the underlying asset and so is based on detailed assumptions of future demand and revenue that can be earned, with the security being based on the assumed value of the asset. The return driver is yield. Royalties possess Balanced or Total Return attributes subject to the underlying assets, risk, and cash flow characteristics.

Real Asset Lending Sub-Strategies

Infrastructure lending refers to investments in debt tranches backed by infrastructure development projects rather than directly into a corporate entity. The projects are generally monopolistic or semi-monopolistic, regulated and very stable as their demand is generally inelastic. Example sectors include energy, utilities, social infrastructure, and telecommunications infrastructure. These projects are typically long term (e.g., 10-20 years), illiquid and have strong downside protection given they are essential and monopolistic. The debt tranches provide the opportunity for different risk/reward characteristics based on where investors fund into the capital structure.

Real estate primarily targets major commercial and residential property types including industrial, multifamily, office, retail, lodging and aged care properties. Strategies can focus on stable properties, redevelopments and new developments and investment types can include senior secured first mortgages, mezzanine financing and/or equity.

Transportation is lending that is typically used to fund the acquisition of assets for leasing including shipping, aircraft, and railcars. The assets typically generate cash flows from long-term contracts and downside protection from the tangible assets. The assets are typically managed by servicers owned by the fund manager or outsourced to experienced third parties that manage the daily lease operations while aiming to maximise the lease and asset value of the portfolio.

Credit Opportunities Sub-Strategies

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Distressed typically offers the greatest potential for outsized returns and is the highest risk private credit sub-strategy. The sub-strategy involves gaining influence over, or taking control of, a good company in a stable industry that is financially or operationally distressed. When a private credit manager seeks to gain control of a company to affect a turnaround, it may do so by converting a deeply discounted debt instrument (e.g., senior secured loan) into all, or a majority equity position through a bilateral negotiation or a bankruptcy process.

To be successful, a distressed manager must orchestrate many complex steps: identifying the target company and debt instrument that will provide the negotiation leverage, equitising the credit asset through a bankruptcy proceeding, implementing an operational and financial turnaround as may be required and orchestrating a successful exit of the equity to realise an outsized return. This process is competitive, time intensive and expensive and carries market and execution risks.

Distressed managers typically have deep legal, valuation, financial and restructuring skills. The return drivers are high contractual yield and capital appreciation through equity ownership. Distressed has a Total Return attribute.

Opportunistic sub-strategies seek the most attractive relative value across multiple credit types (e.g., private versus traded debt, senior versus junior, structured versus non-structured, performing through stressed credit and investment strategies). Managers are multi-strategy and have the proven management experience and proprietary investment processes and platform advantages to target returns above relevant indices, particularly during dynamic and stressed market environments. Given the broad and flexible nature of the sub-strategy, there is a wide range of return and risk profiles. The return drivers are contractual yield and capital appreciation from buying credit below par. Opportunistic managers may be Balanced or Total Return.

Special Situations sub-strategies typically involve an event-driven catalyst (or multiple catalysts) to unlock value and drive capital appreciation of performing or stressed credit. Investments can involve complex, negotiated facilities and terms agreed bilaterally with borrowers or other capital providers.

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Other examples are credit assets purchased at a discount to intrinsic value that are facing financial stress due to near term challenges (e.g., upcoming debt maturity, liquidity crunch) or operational stress (e.g., supply chain disruption). Borrowers can also have strong business models but inappropriate capital structures. Investment managers seek to influence a company via board seat or a restructuring committee membership, but not to control it through ownership.

Special situations can perform well across all market environments given cyclical and non-cyclical sources of borrower stress, though generally outperforms during periods of market volatility and stress given an expanded opportunity set during these times. The return drivers are typically contractual yield and capital appreciation through some form of equity participation. This sub-strategy may be Balanced or Total Return.

Accessing Private Credit Investments

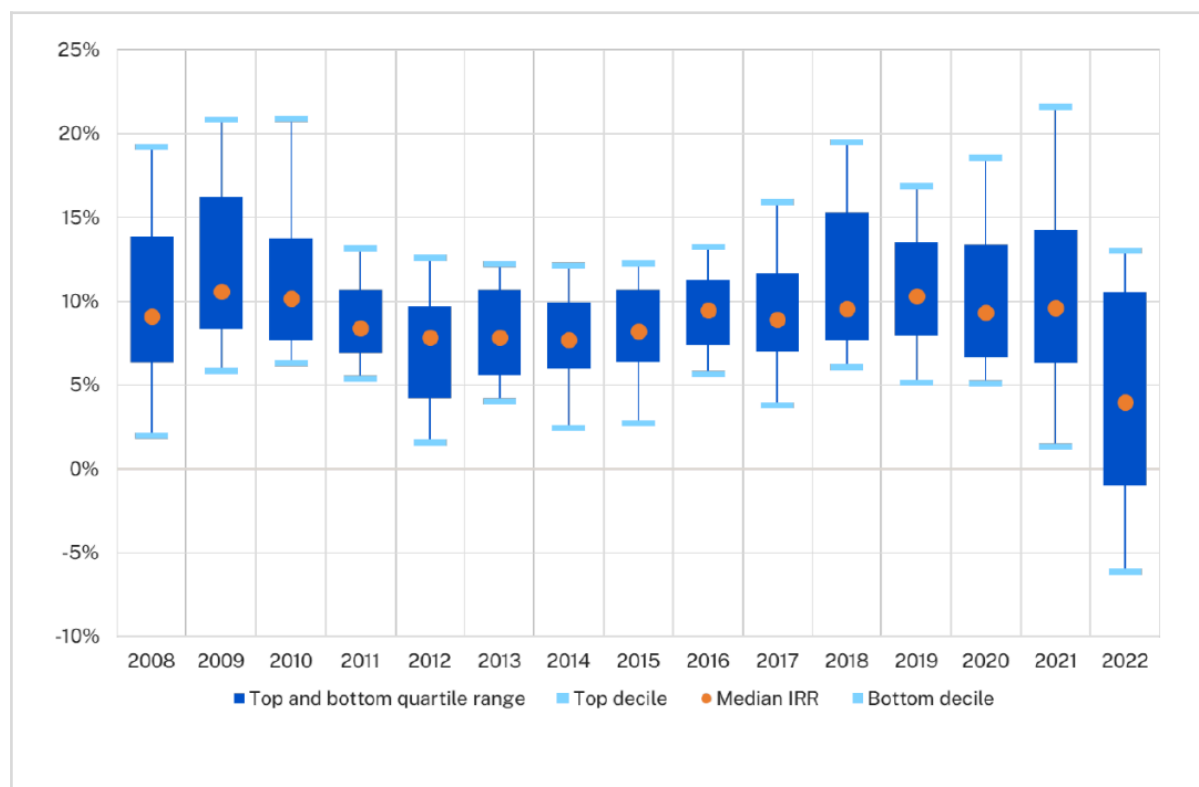
To access global private credit typically requires an investment in a private credit fund managed by a professional private credit manager. There are a number of criteria investors need to consider when seeking to access professionally managed private credit funds, some of which are discussed below.

Manager selection

With the significant growth in global private credit there has been a significant increase in the number of private credit managers. North American and European based private credit vehicles make up around 90% of the private credit assets universe and 82% of the 2,097 private credit investment managers.

Identification and selection of quality managers, being those with demonstrated experience and consistent track records of performance, can be challenging for Australian investors in the absence of having access to global networks and resources. This is particularly important given the performance dispersion of managers as shown below:

Global Private Credit IRR Dispersion By Vintage Year



Source: PitchBook Data, Inc. 'PitchBook Global Benchmarks: Q1 2023'. Underlying data is net of fees and carry and based on pooled cash flow data and is based on Pitchbook classifications, which may differ from those of Mercer. As of 31 March 2023. The vintage year refers to the year the private credit vehicles were formed. PitchBook Data, Inc. has not provided consent to the inclusion of statements utilising their data. **No assurance can be given that any investment will achieve its objectives or avoid losses. Past performance is not necessarily a guide to future performance.**

Manager subscriptions

Minimum subscription commitments for investors who want to subscribe to private credit funds vary depending on the fund's size, strategy and structure. The typical minimum subscription amounts for offshore institutional commingled funds range anywhere from USD / EUR 5-10 million. These minimum subscription amounts may serve as a constraint for some investors seeking to access private credit and/or diversify across varying strategy types and managers.

Fund Structure

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Private credit managers use different types of fund structures and provide varying liquidity for those investments which determine the time periods an investor can invest and redeem. How often income from underlying investments is paid to investors (e.g., monthly, quarterly, semi-annually) may also vary. There are three predominant fund structures:

- **Closed-Ended Funds:** These are funds that have a fixed term (usually 7 to 10 years) and raise capital commitments from investors during a limited period (typically 6 to 12 months) after which it is then closed to new investors. Closed-end funds then call capital from investors as investment opportunities arise and distribute proceeds to investors as investments are realised. They typically have a limited investment period, usually 2 to 5 years, during which capital is called and invested and a harvest period, usually 5 to 10 years when they realise proceeds from investments and return proceeds to investors. Closed-end funds are suitable for strategies that required long-term capital lock-up such as Credit Opportunities strategies. They typically charge management fees based on committed or invested capital and performance fees based on performance over a specific hurdle rate.
- **Open-Ended Funds:** These are funds that have no fixed term and allow investors to subscribe and redeem their capital at certain intervals, usually monthly or quarterly, subject to notice and lock-up periods. Open-ended funds invest in assets that are relatively more liquid and can be valued more frequently, such as Direct Lending and Structured Credit. Open-ended funds charge management fees based on net asset value and performance fees based on high-water mark or hurdle rate mechanisms that prevent the manager from earning fees on previously lost capital or below a minimum return threshold. Open-Ended Funds can offer an unlimited number of units.
- **Evergreen Funds:** These are funds that have an indefinite term and reinvest a portion of the proceeds from realised investments into new opportunities, while distributing the remaining portion to investors.

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Evergreen funds provide a balance between long-term capital commitment and periodic liquidity to investors. Investors are periodically given the opportunity to divest, in which case their investment typically goes into “run off”, whereupon no new investments are made on behalf of the investor and the proceeds are distributed back to investors as they are received by the fund. Evergreen funds are suitable for a wide range of private credit strategies, depending on the reinvestment policy and the distribution frequency. Evergreen funds typically charge management fees based on net asset value and performance fees based on high-water mark or waterfall (a waterfall mechanism typically begins with the payment of management fees to the fund manager, followed by the payment of preferred returns to investors and then the payment of carried interest to the fund manager) mechanism.

Generally, closed-end funds offer lower liquidity than open-ended and evergreen funds, as investors cannot redeem their capital until the end of the fund’s term or through secondary market transactions. However, closed-ended funds may provide some liquidity through current income distributions or interim distributions of realised gains.

Open-ended funds offer higher liquidity than closed-ended funds, as investors can redeem their capital periodically, subject to certain restrictions. However, open-ended funds may face liquidity challenges if they invest in assets that are less liquid than their redemption terms or if they face large redemption requests in times of market distress.

Step Into the World of Global Private Credit with Confidence

Global private credit offers a world of opportunities, and TermPlus is here to help you achieve better returns on your savings through simple fixed-term accounts. Open your account today and let your money work for you.

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