



Private Credit – Opportunities and Risks

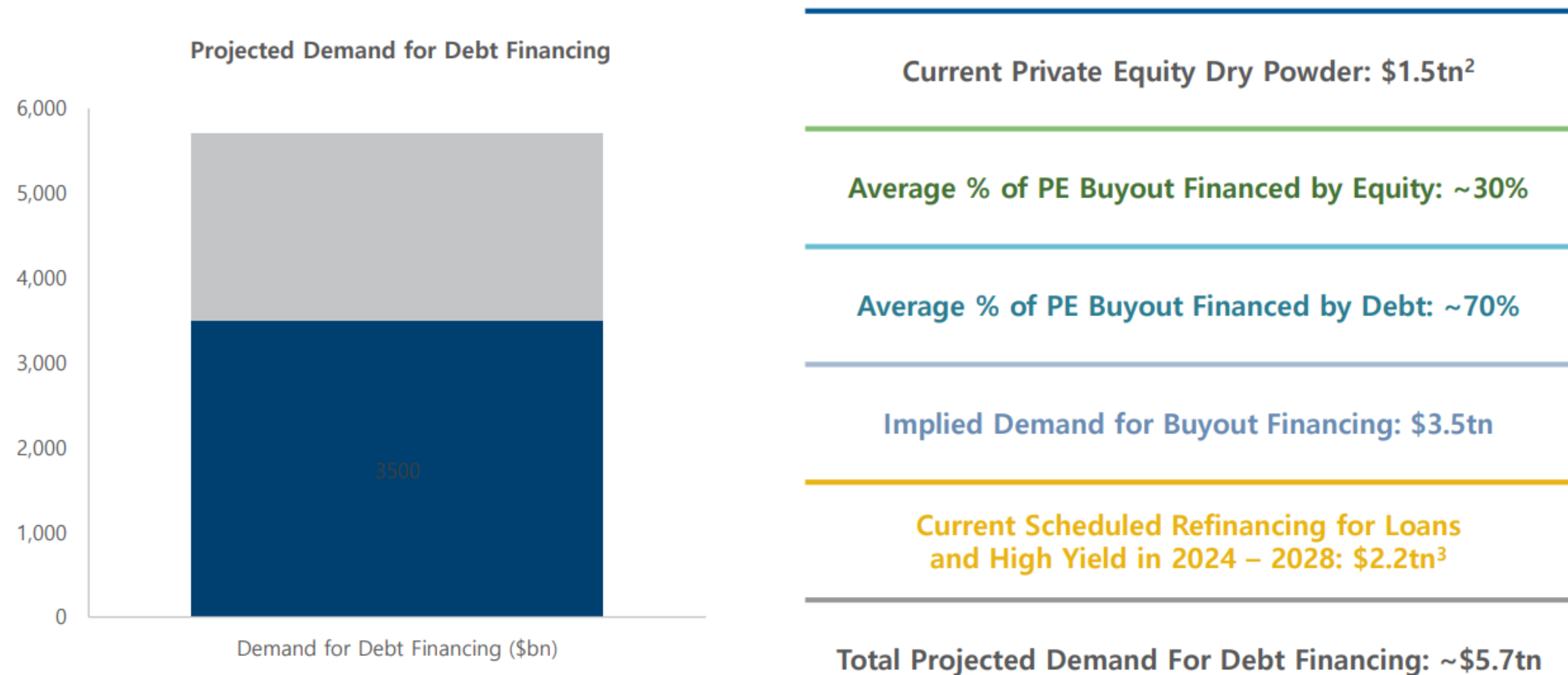
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Deputy CIO
August 26th, 2024



WYOMING STATE
TREASURER'S OFFICE

Private Credit Tailwinds

- There is an estimated \$5.7trn in demand for corporate debt financing alone in the next few years just based upon PE dry powder and refinancing of high yield and leveraged loans...



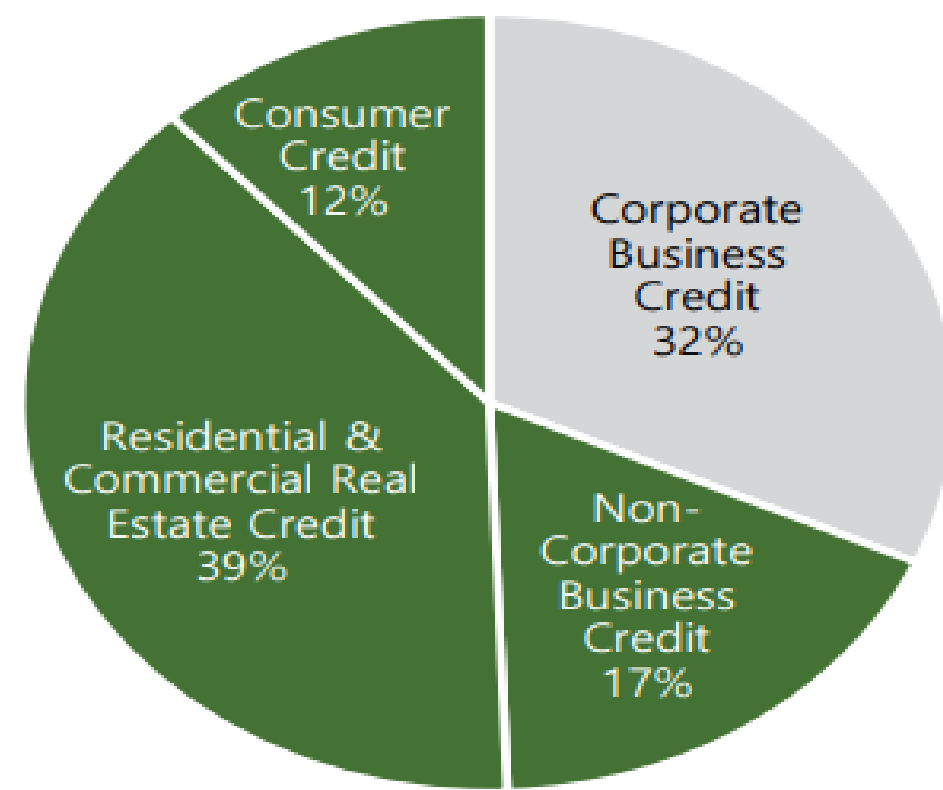
*Source: TPG



Private Credit Tailwinds

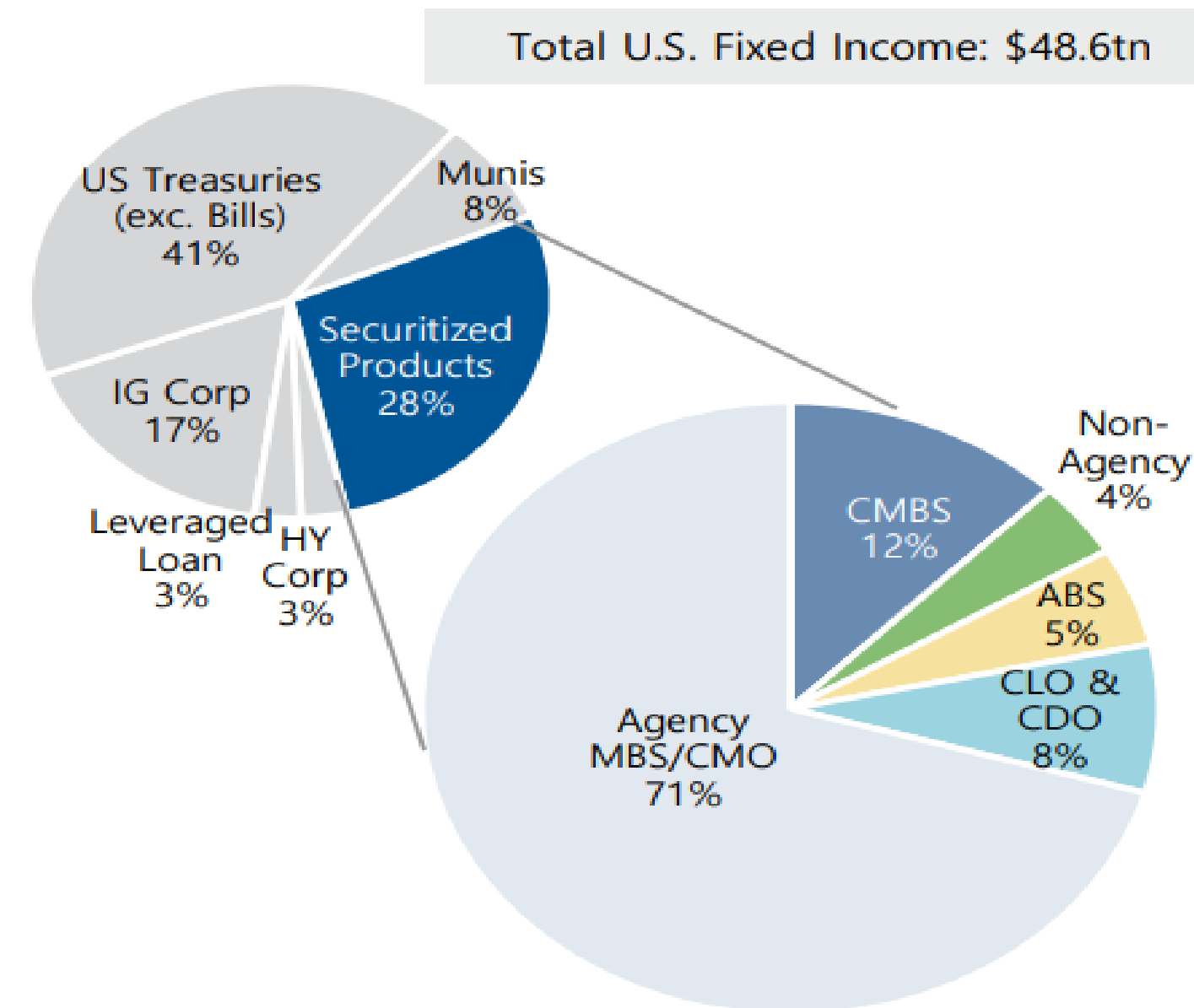
- Structured credit and specialty finance represents a market significantly larger than Direct Lending yet it is at the most nascent stage of private credit adoption.

U.S. Nonfinancial Credit¹



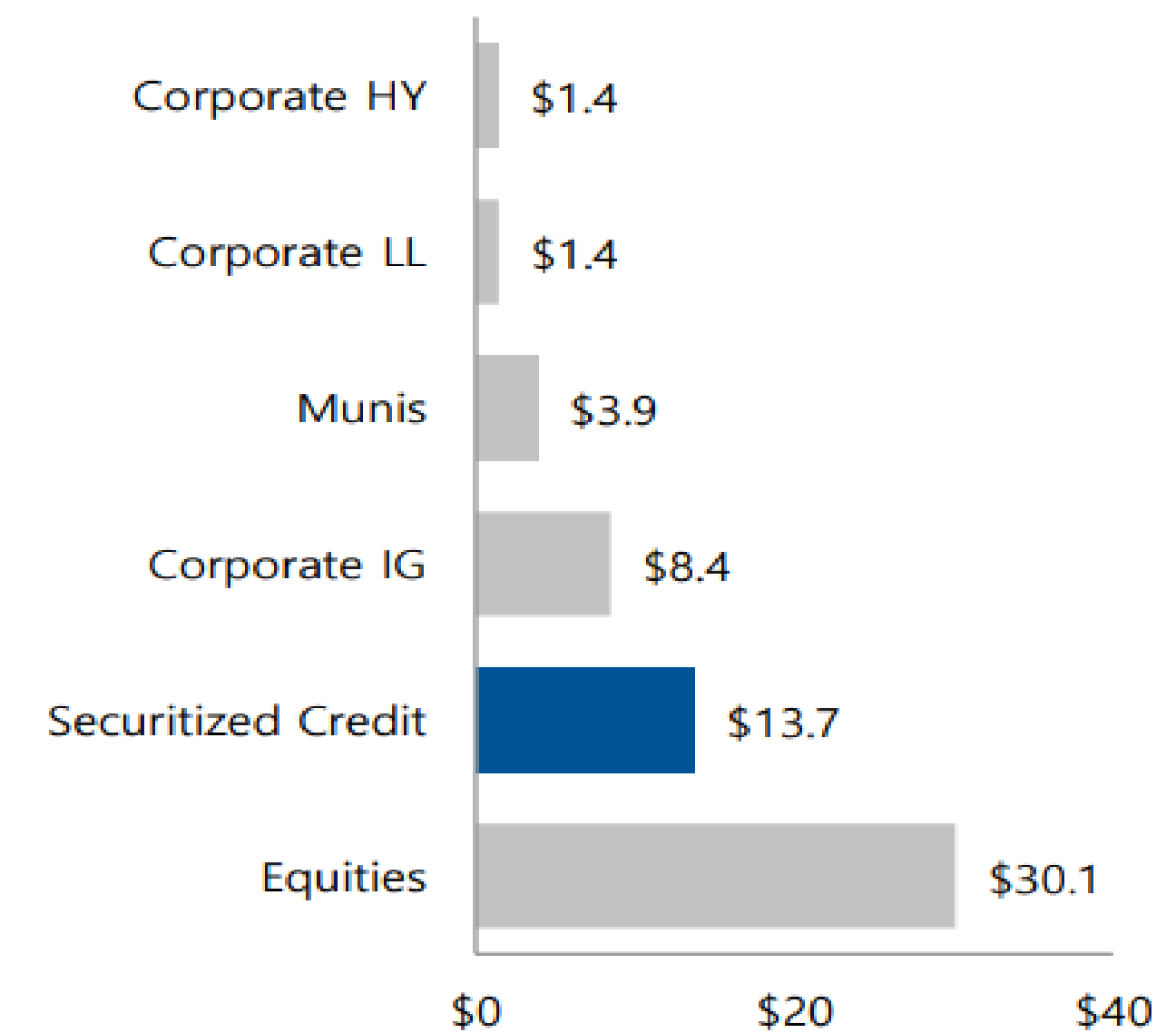
Less than 1/3 of total comprised of corporate business credit.

Structured Credit as a Percentage of Total U.S. Fixed Income Assets²



Structured credit is a material percentage of total U.S. Fixed Income, representing \$13.5tn+ of assets.

Structured Credit vs. Key Risk Asset Classes (\$tn)²



Structured credit is large compared to other major U.S. credit sectors.

*Source: TPG

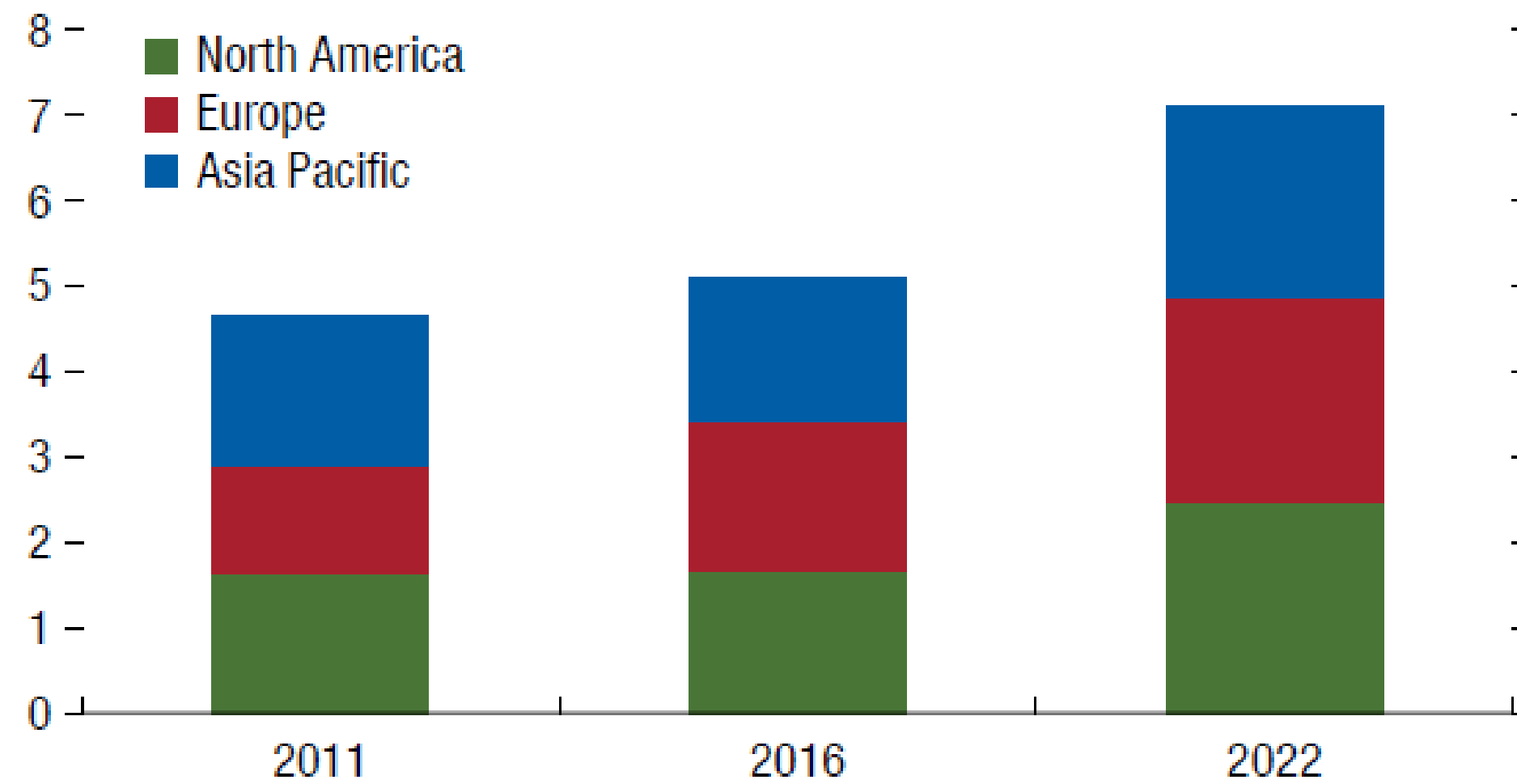
Opportunity Knocks: Secondaries

Figure 2.13. Pension Funds with Financial Leverage and Illiquid Investments

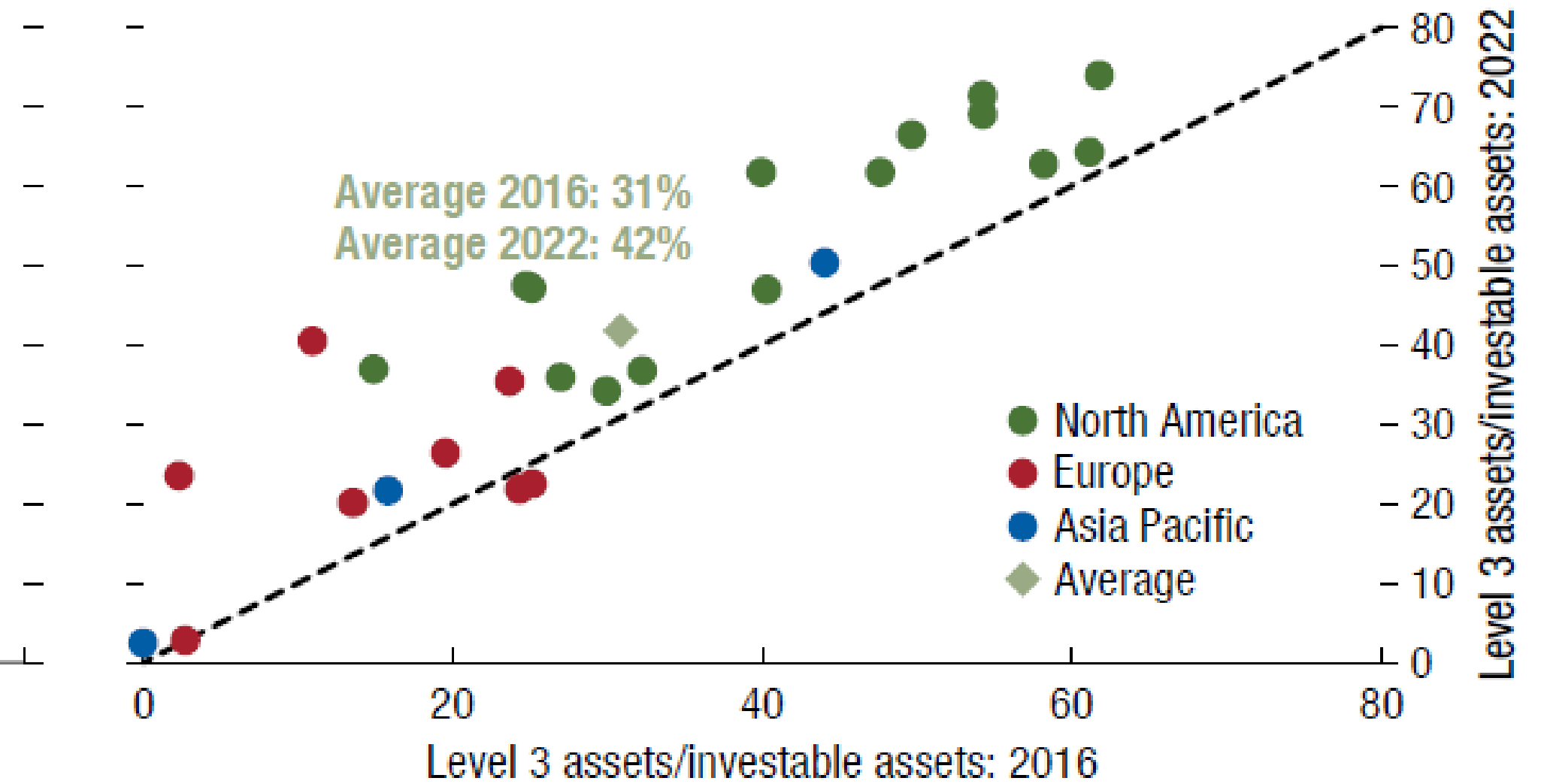
The assets of a sample of pension funds with derivatives embedded leverage have risen to more than \$7 trillion ...

... and have significantly increased their share of illiquid investments ...

1. Assets Under Management of Pension Funds with Derivatives Embedded Leverage
(Trillions of US dollars)



2. Share of Level 3 Assets
(Percent)

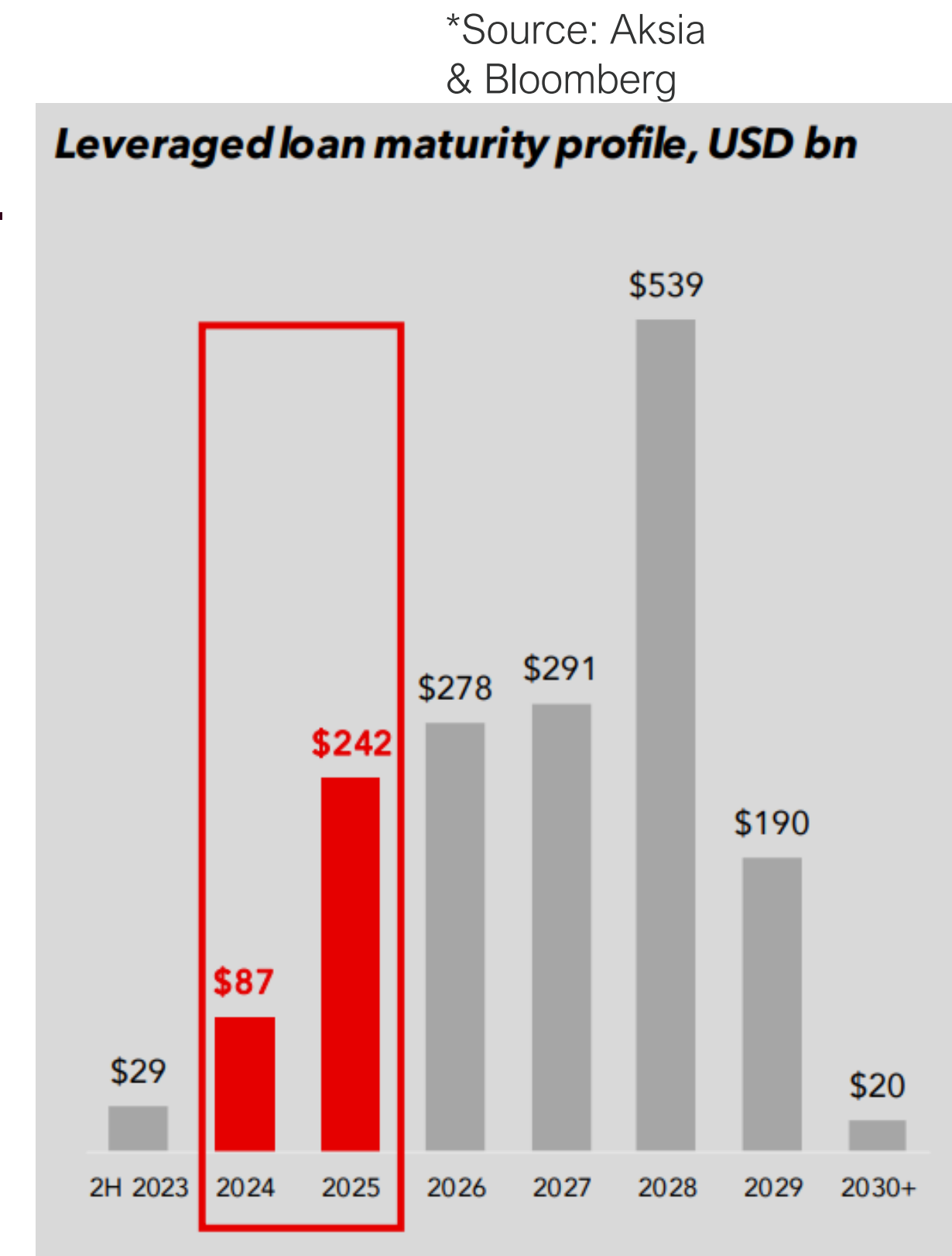
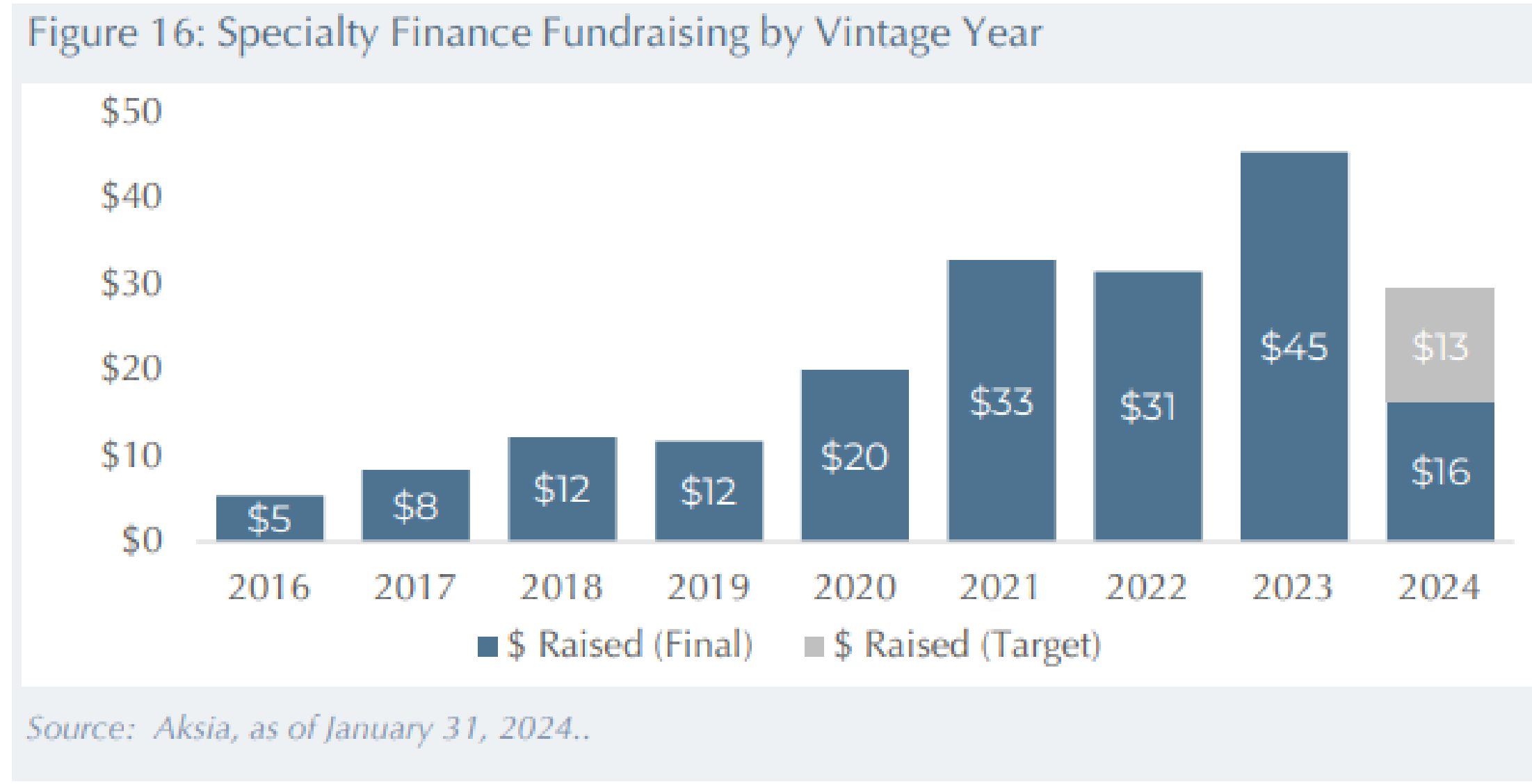
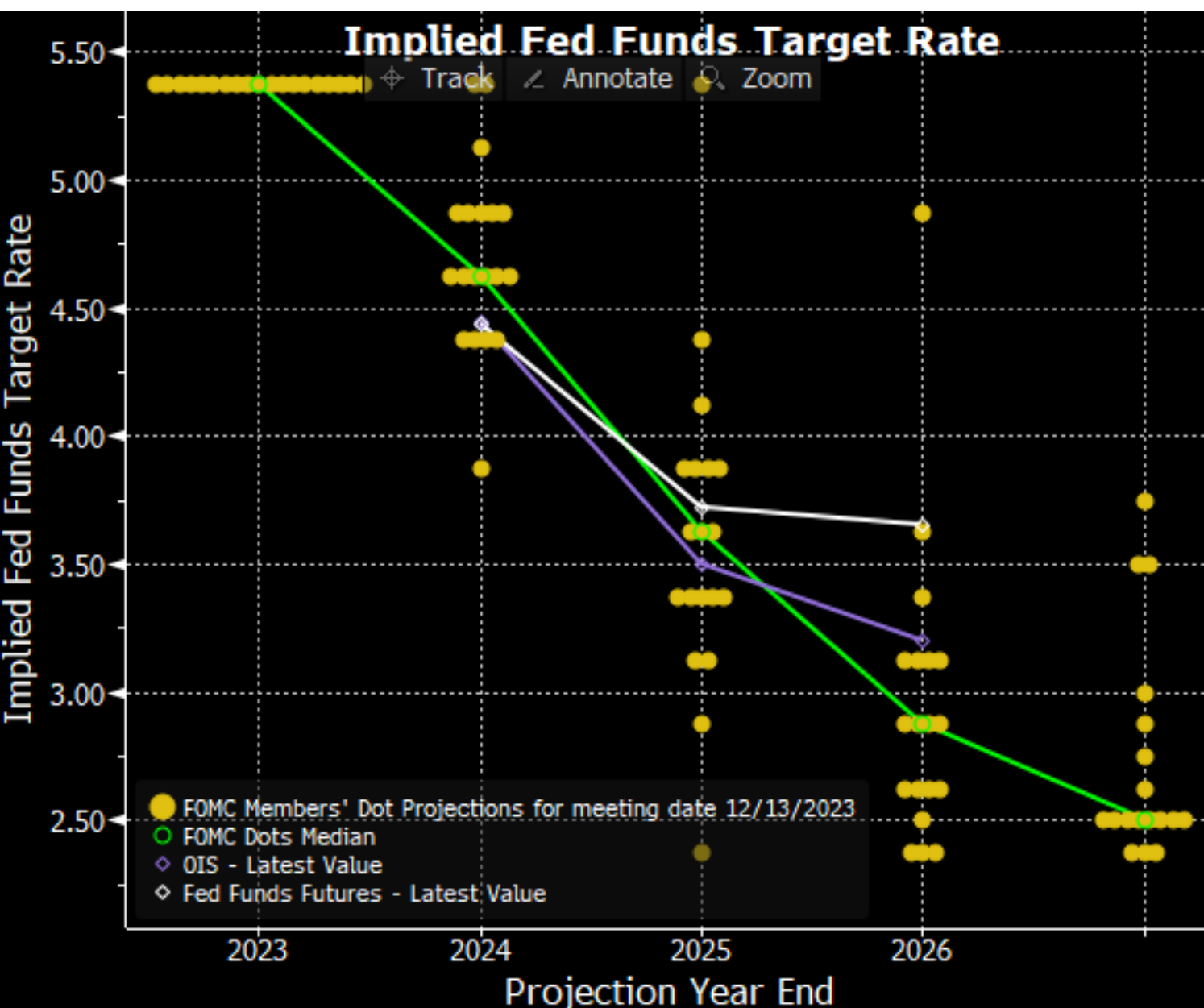


*Source: Apollo



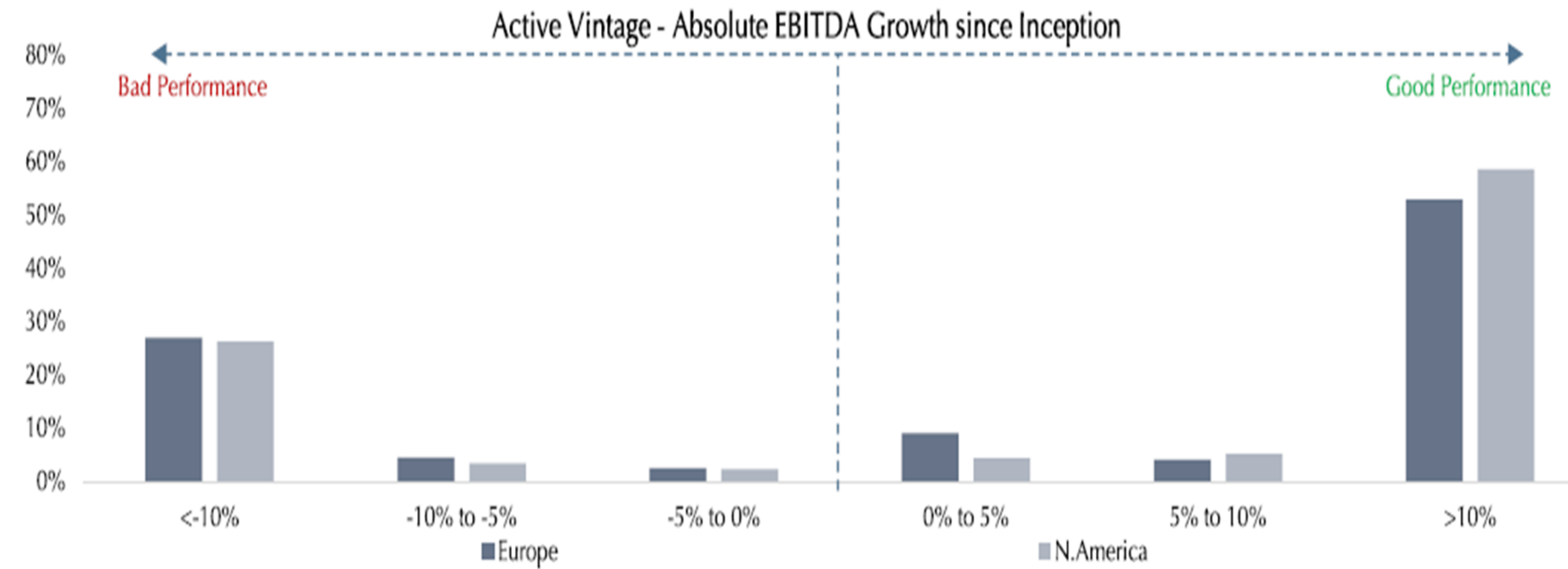
Actionable Opportunities

- Secondaries: Focus on liquidity constraints arising from GP's and LP's liquidity needs.
- Alternative Credit: Figure 16 highlights the significant dispersion between available capital and the addressable universe.
- Capital Solutions: Companies are facing a maturity wall in 2025 & 2026.
- Fixed vs. Floating: Allocate more capital to fixed product given rate expectations.



Concern: Dispersion in Quality

- Avoiding poor quality, cyclical sectors is paramount in delivering consistent returns.
- Private Credit is an asymmetric asset class.
- Revenue and earnings growth has begun to deteriorate across cyclical sectors, mainly consumer.



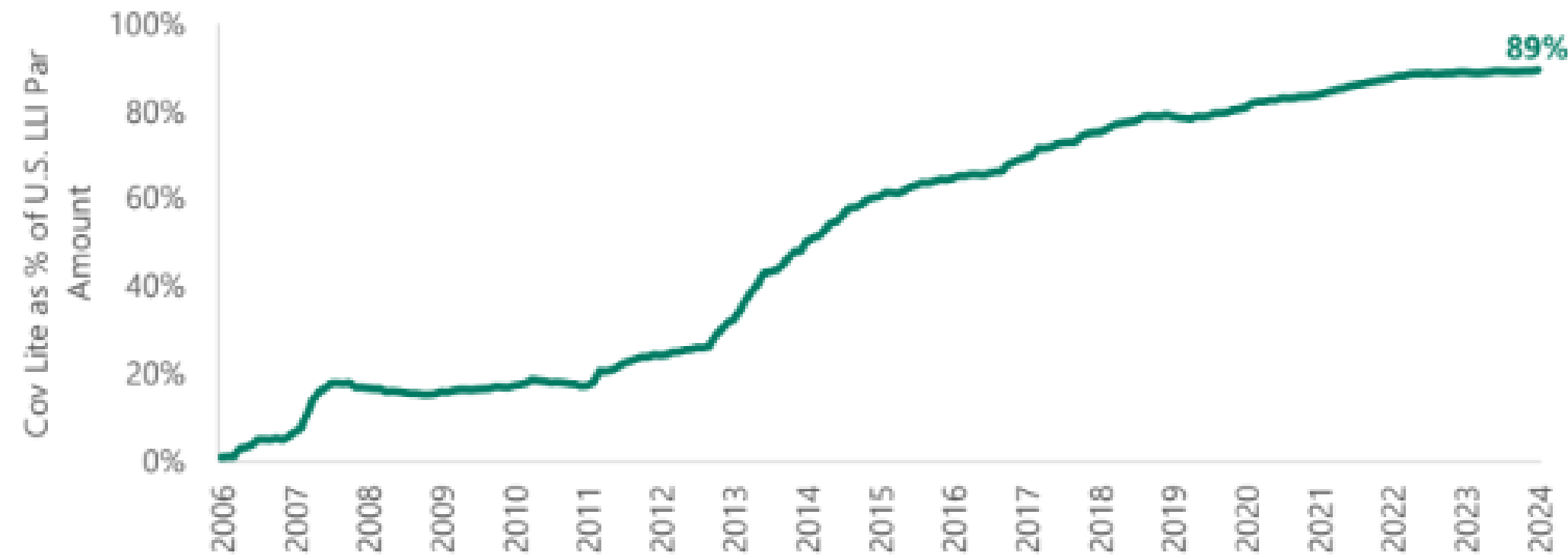
GOLUB CAPITAL ALTMAN INDEX HIGHLIGHTS

Year-Over-Year (YoY) Growth	Revenue	Earnings
Q2 2024	7.0%	10.5%
Key Sectors Q2 2024 (YoY)	Revenue	Earnings
Consumer	4.1%	2.5%
Healthcare	8.7%	11.1%
Industrials	15.3%	13.6%
Technology	9.8%	19.0%

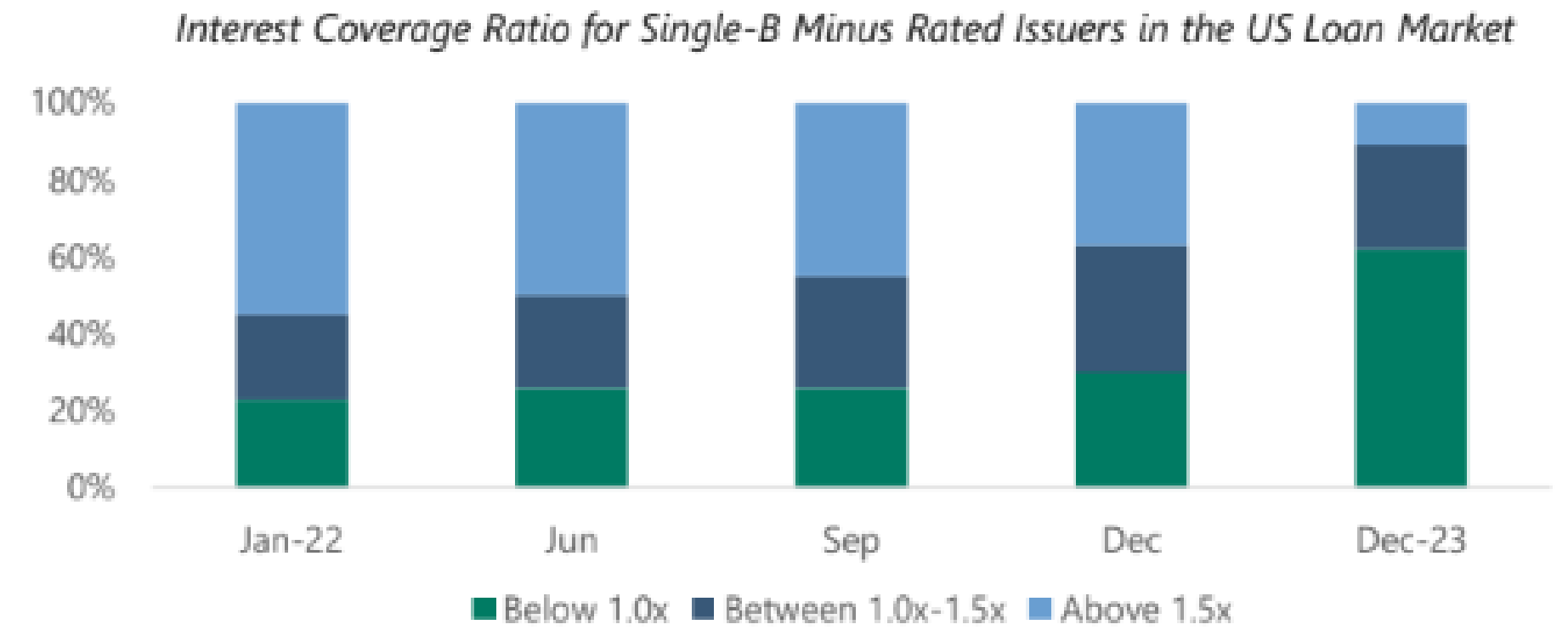
*Source: Golub & Stepstone

Concern: Beware of Zombies

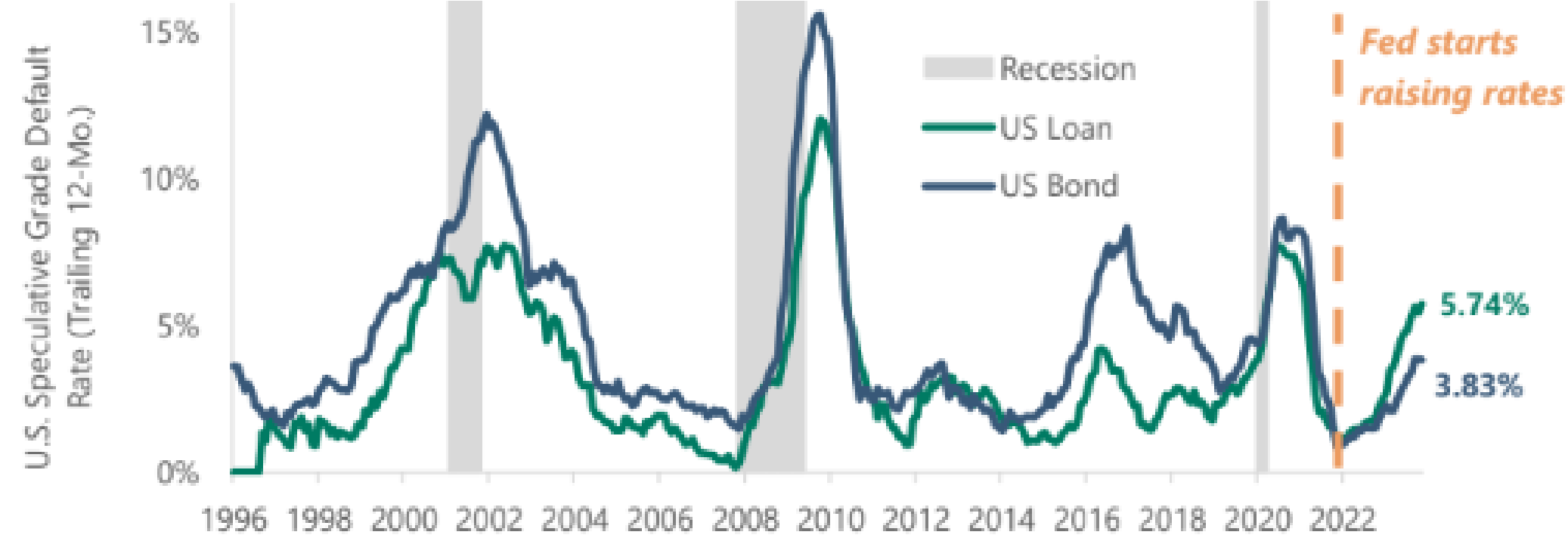
Deterioration in Credit Documents



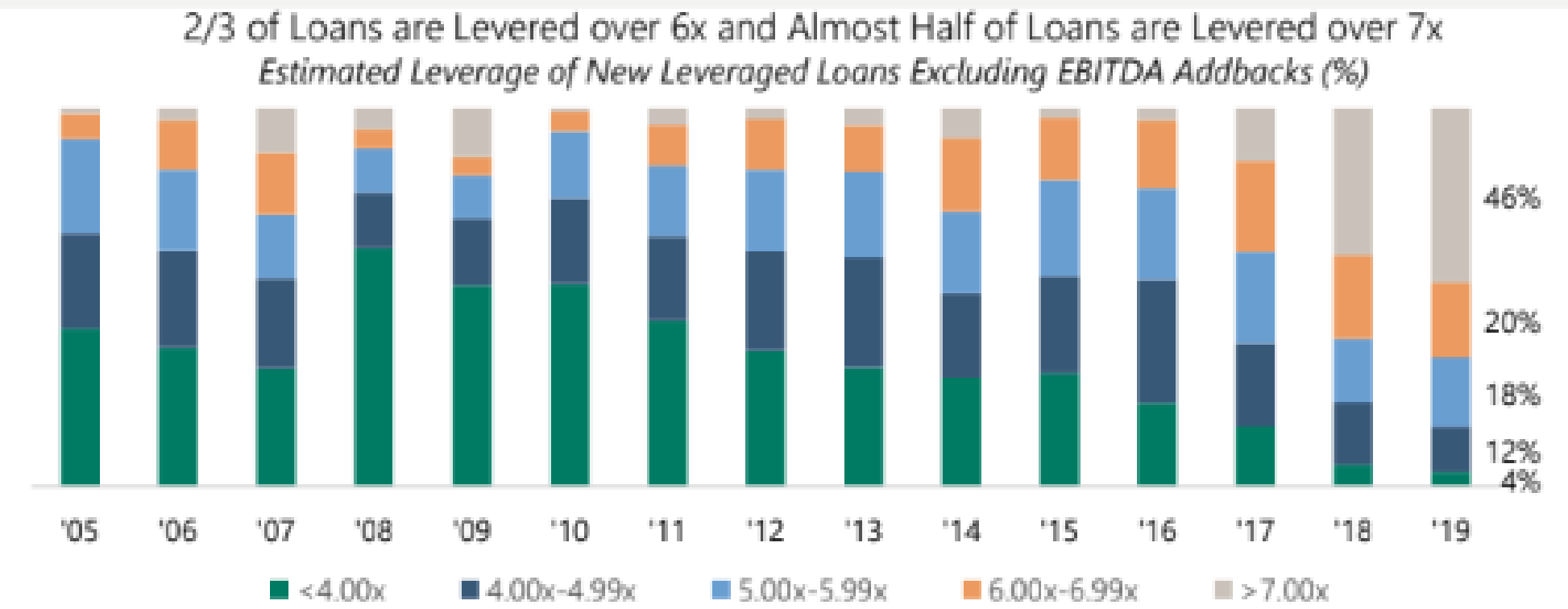
Increased Share of "Zombie" Companies May Accelerate Bankruptcies



Default Rates Already Rising



Adjusted EBITDA Metrics Understate True Leverage

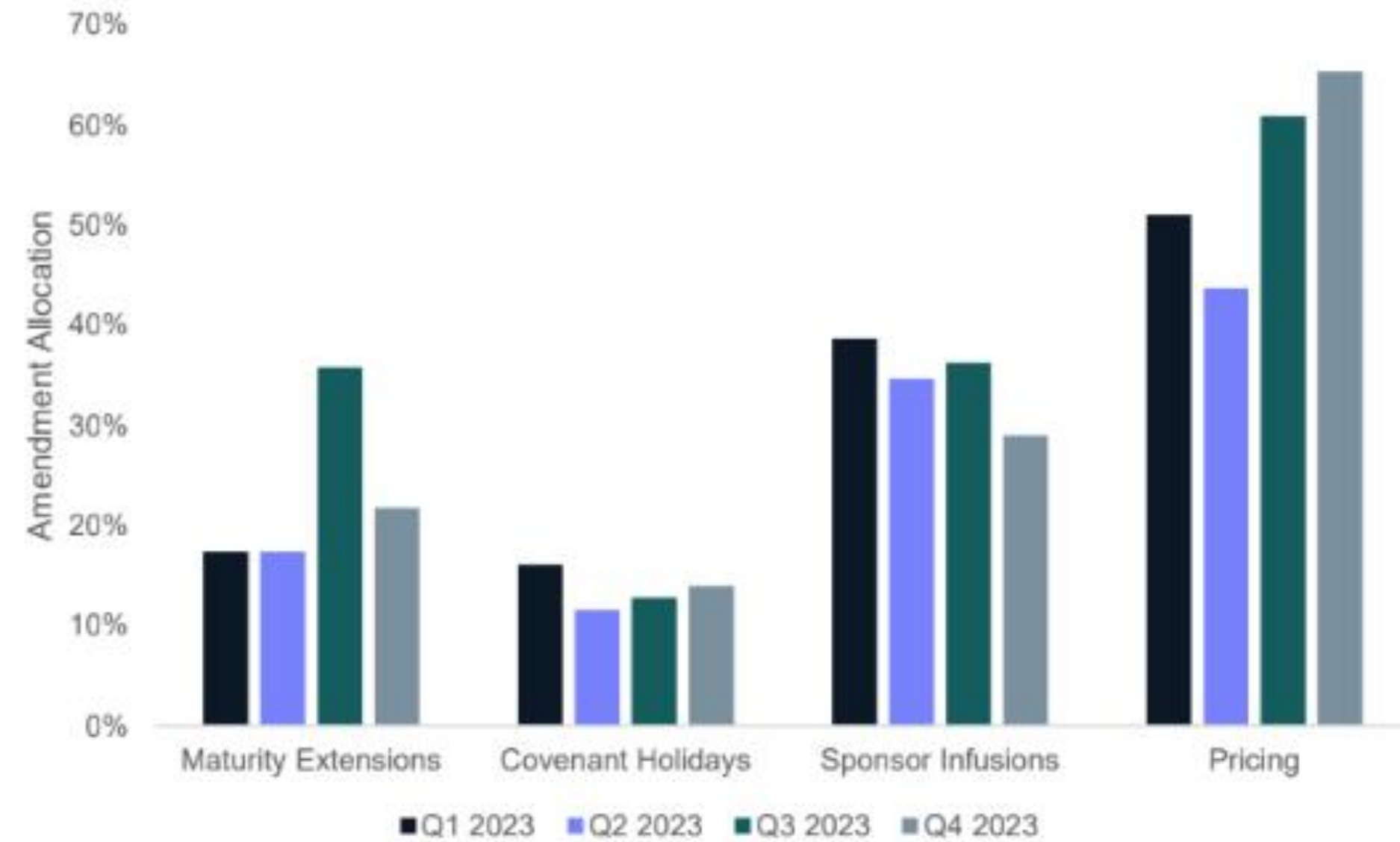


*Source: Golub & Stepstone

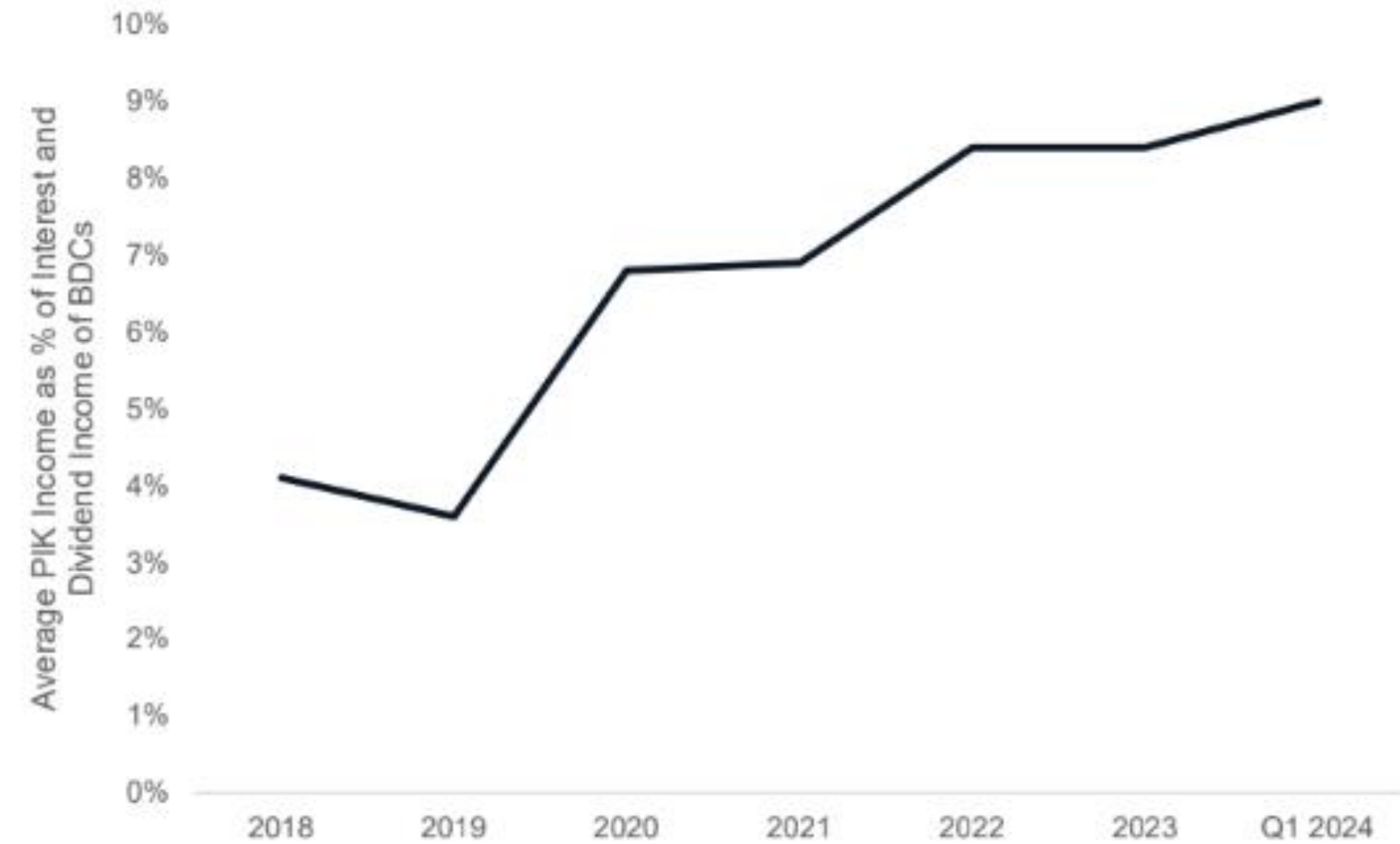


Concern: Amend, Extend, Pretend

MAJORITY OF AMENDMENTS FEATURE PRICING STIPULATIONS, SPONSOR INFUSIONS AS BORROWERS AND LENDERS PROACTIVELY ADDRESSED POTENTIAL ISSUES



PIK ACTIVITY CONTINUES TO RISE, AND HAS BEEN HEAVILY FAVORED IN AMENDMENTS



Source: Left chart: Lincoln International, as of Q1 2024. Amendment allocation is calculated based on the amendment type over the sum of total number of amendments to the deal terms. % of Pricing Changes via Amendments is the payment stipulations breakdown of price-changing amendments. Right chart:

*Source: Golub & Stepstone



Concern: Direct Lending Leverage

Table 2.2. Characteristics of Leverage in Private Credit Vehicles

Private credit investment vehicles deploy leverage in different forms.

	Closed-End Funds	BDCs	Middle-Market CLOs
Debt-to-equity ratios	~0 to 1.3×	~0.8 to 1.2×	All debt-to-equity: ~6× AAA to other classes: ~1×
Leverage sources	Portfolio financing, NAV loans, subscription lines, derivatives	Secured bank lines of credit and secured/unsecured bonds	Term leverage through structured notes
Rollover risk	Yes	Yes	No
Collateral call frequency	Varies (typically quarterly)	Varies (typically quarterly)	None (cash-flow structure)
Main lenders	Banks, insurers, pension funds	Banks, insurers, pension funds	Insurers, pension funds, hedge funds, banks
Total AUM (United States)	~\$1.2 trillion	~\$300 billion	~\$100 billion

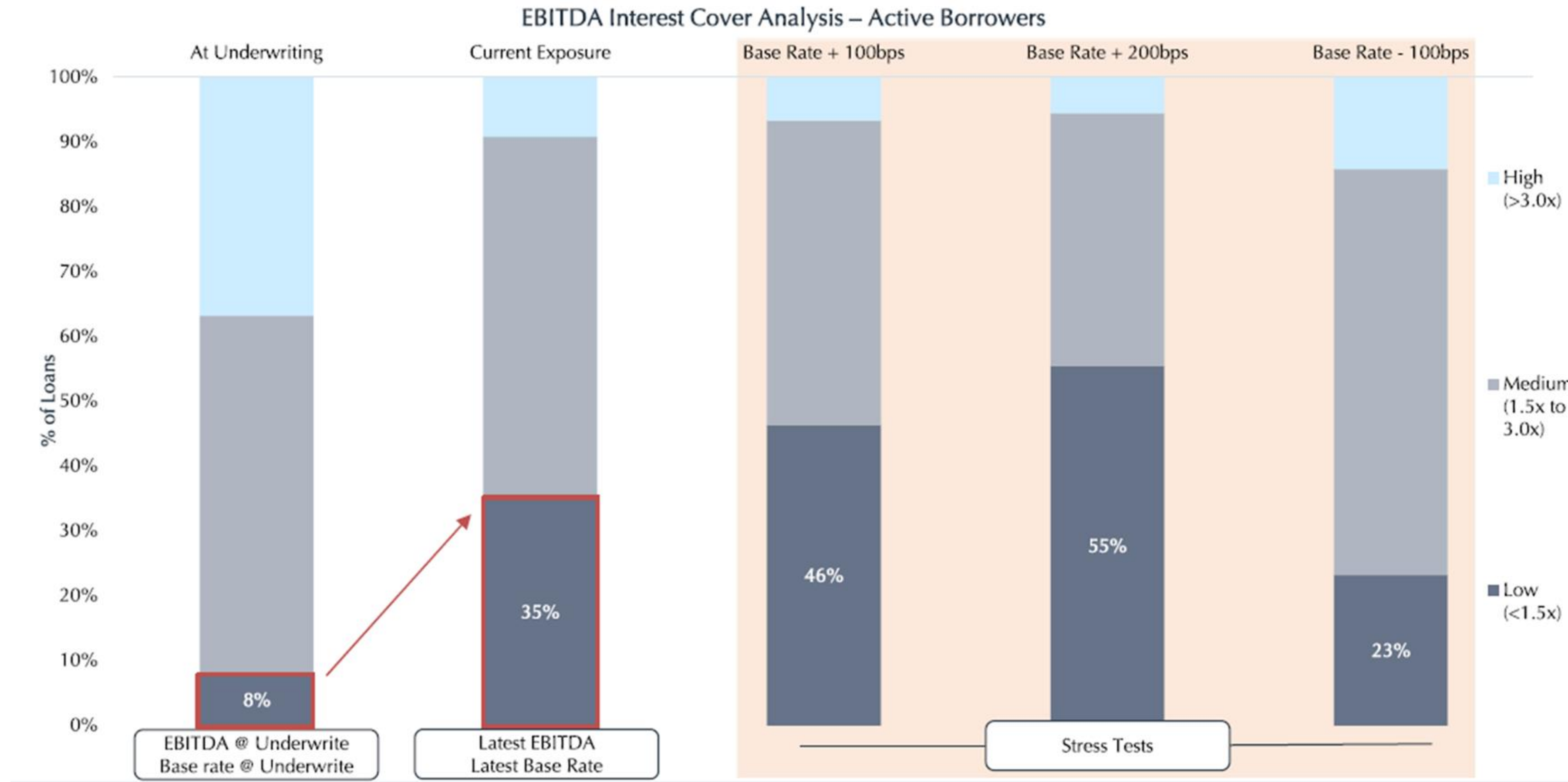
Sources: IOSCO 2023; and IMF staff.

Note: AUM = assets under management; BDCs = business development companies; CLOs = collateralized loan obligations; NAV = net asset value.

*Source: Apollo



Concern: Direct Lending Debt Servicing



Appendix



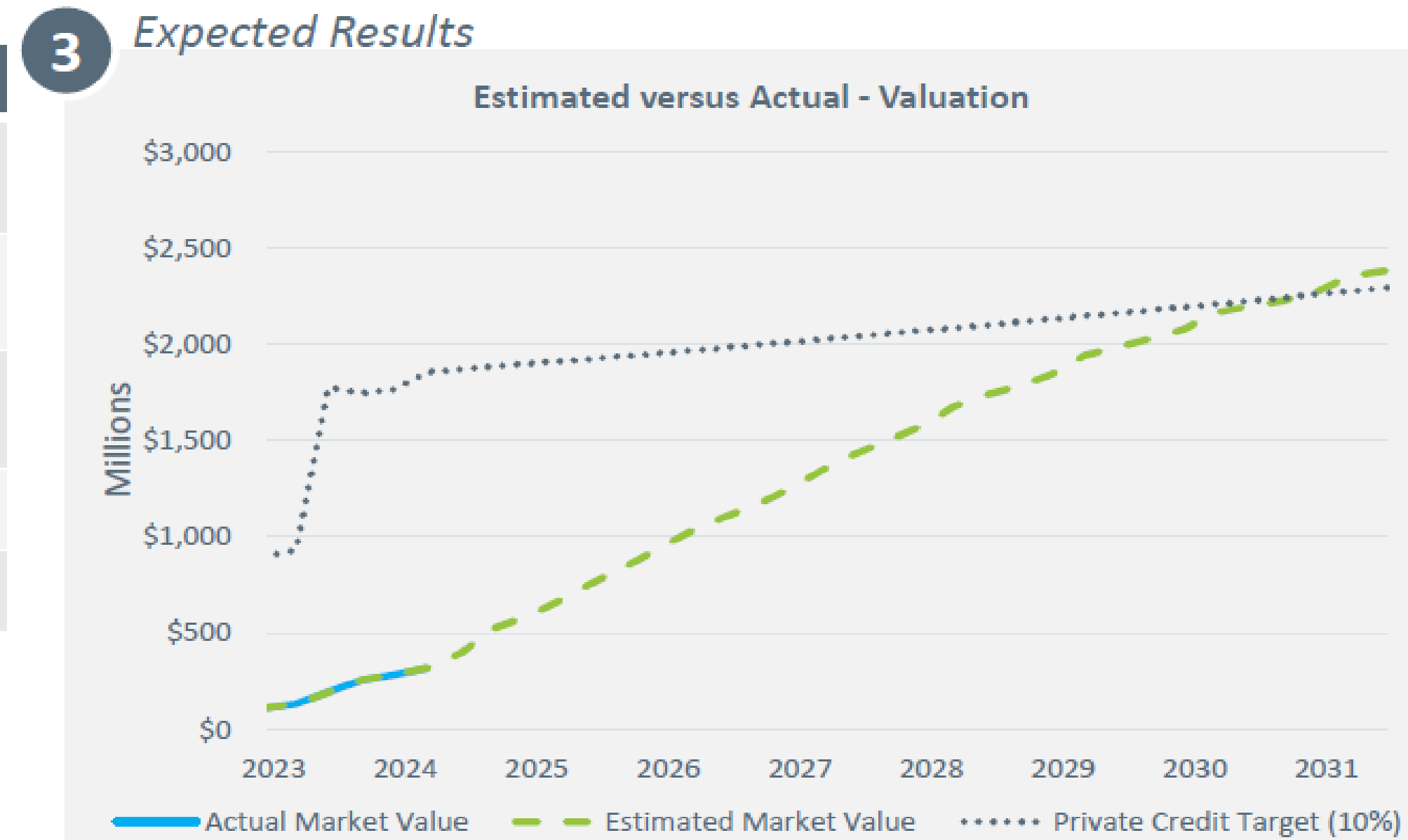
Future Pacing

- Due to the increased target and growth rate, the 2024 pacing model anticipates reaching the target allocation by about 2030. It will be updated next calendar year.
- 3-5 new commitments/re-ups per year
- November IFC: Likely to be two Opportunistic Funds.

2 Recommendation

Year	Commitments
FY 2025	\$200 million (closed-end) \$250 million (evergreen)
FY 2026	\$300 million (closed-end) \$100 million (evergreen)
FY 2027	\$300 million (closed-end) \$100 million (evergreen)
FY 2028	\$400 million (closed-end)
FY 2029	\$400 million (closed-end)

RVK recommends annual private credit commitments of \$400M-\$450M to achieve the target allocation by approximately FY 2030.



*Source: RVK



CMA vs Expectations

- Below is a comparison of RVK's vs Meketa's 2024 CMAs.
- Median returns for the last 10 years are 8.7% for Direct Lending. Given the forward base rate is modeled to be higher, returns should be higher than the forecasted CMAs.

Asset Class	2023			2024			Change (2024 - 2023)		
	Nominal Return (Arith.)	Risk (St. Dev.)	Nominal Return (Geo.)	Nominal Return (Arith.)	Risk (St. Dev.)	Nominal Return (Geo.)	Nominal Return (Arith.)	Risk (St. Dev.)	Nominal Return (Geo.)
Private Credit	8.00%	13.00%	7.23%	8.00%	13.00%	7.23%	0.00%	0.00%	0.00%
Senior Secured Direct Lending	7.00%	9.00%	6.62%	7.00%	9.50%	6.58%	0.00%	0.50%	-0.04%

*Source: RVK

Private Debt	9.2	9.0	0.2	
Direct Lending	8.4	8.3	0.1	Lower assumed leverage
Asset Based Lending	9.4	9.0	0.4	Lower average fees
Special Situations Lending	9.9	10.2	-0.3	Less extreme distressed pricing

*Source: Meketa



Return Factors: Mind the Fees

- The Direct Lending Vertical: fees will be strongly correlated to investment outcomes and quartile rankings.
- Control the Known Knowns...

Management Fee	0.88%
Incentive Fee	12.50%
Hurdle Rate	5.00%

Management Fee	0.65%
Incentive Fee	0.00%
Hurdle Rate	0.00%

Fund Return(gross)	12%	13%	14%
Carry Distribution	0.88%	1.00%	1.13%
Management Fee	0.88%	0.88%	0.88%
Flat fee equivalent	1.76%	1.88%	2.01%
	10.2%	11.1%	12.0%

Fund Return(gross)	12%	13%	14%
Carry Distribution	0.00%	0.00%	0.00%
Management Fee	0.65%	0.65%	0.65%
Flat fee equivalent	0.65%	0.65%	0.65%
	11.4%	12.4%	13.4%

*Source: RVK

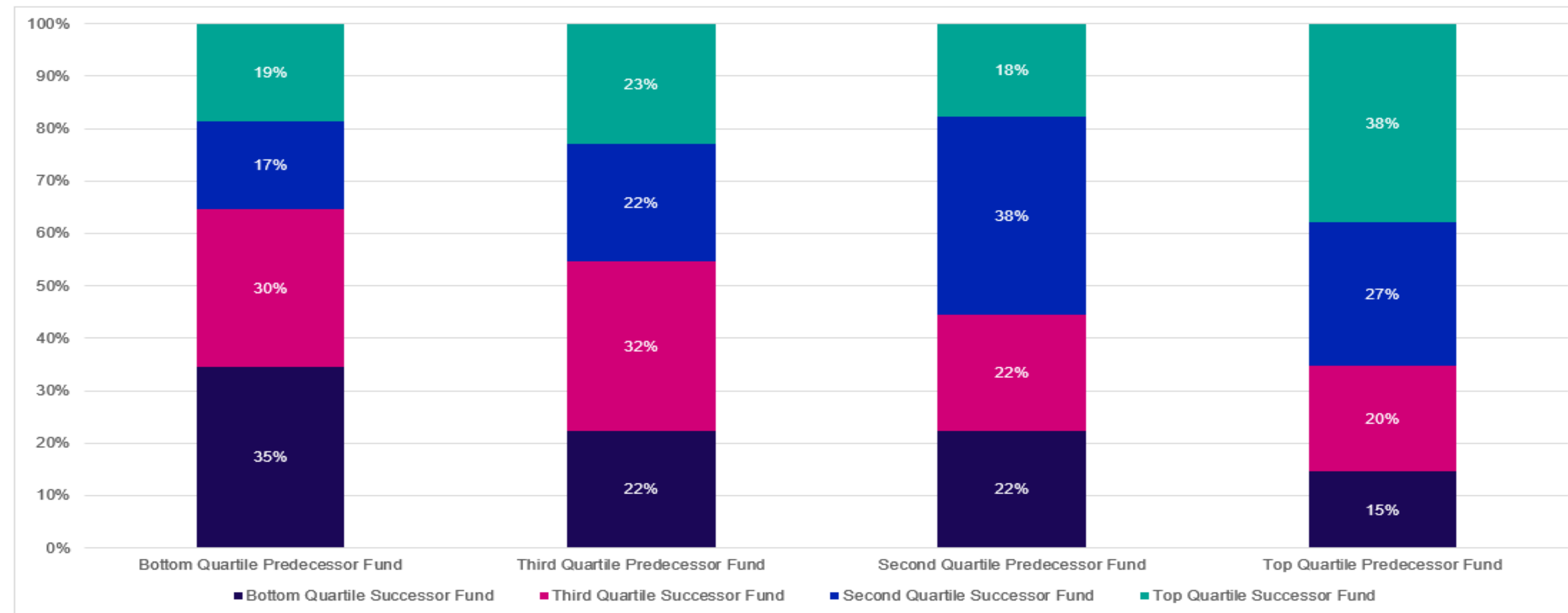


Due Diligence: Mind the Gap

- "Politicians use statistics in the same way that a drunk uses lamp posts—for support rather than illumination" – Andrew Lang
- A substantial gap exists in the breadth, depth and quality of PC statistics vs. private equity...Only 17 funds reported both multiple and IRR in the 2020 Preqin Universe.

Relationship between Predecessor and Successor Fund Preqin Quartile, Strategy: Private Debt

Preqin Quartile	Bottom Quartile Successor Fund	Third Quartile Successor Fund	Second Quartile Successor Fund	Top Quartile Successor Fund
Bottom Quartile Predecessor Fund	35%	30%	17%	19%
Third Quartile Predecessor Fund	22%	32%	22%	23%
Second Quartile Predecessor Fund	22%	22%	38%	18%
Top Quartile Predecessor Fund	15%	20%	27%	38%



*Source: Preqin

