



StepStone Academy

Private Debt

For Educational Purposes Only

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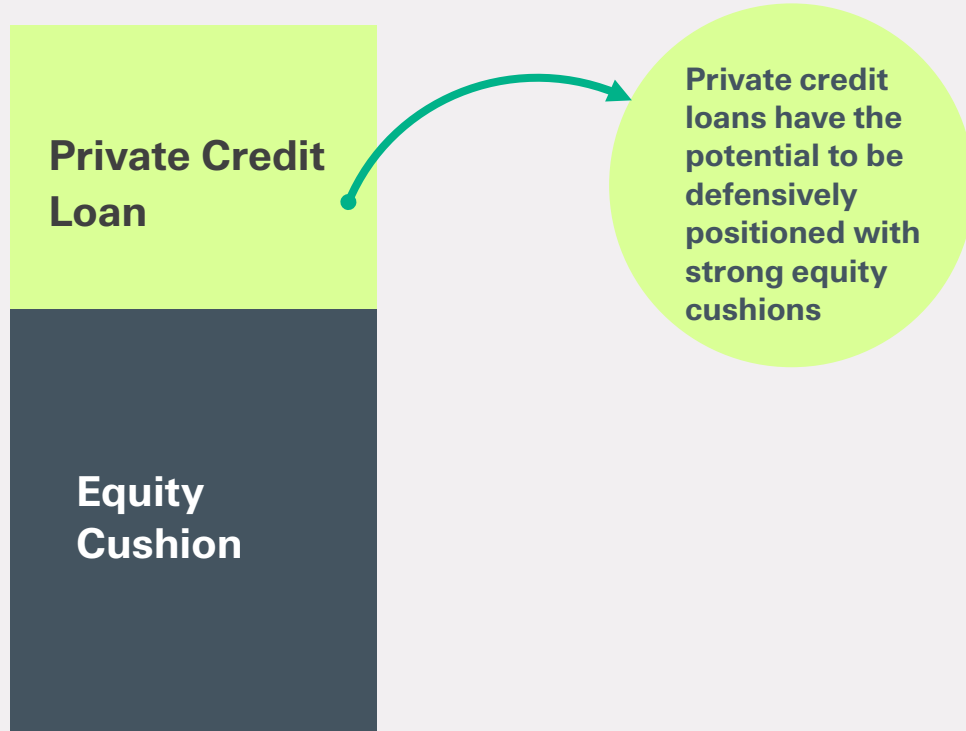
All data is as of October 2024, unless otherwise stated



What is Private Debt?

The motivation behind private credit

Private credit is a form of debt financing offered by non-bank lenders that is not issued or traded within the traditional public markets

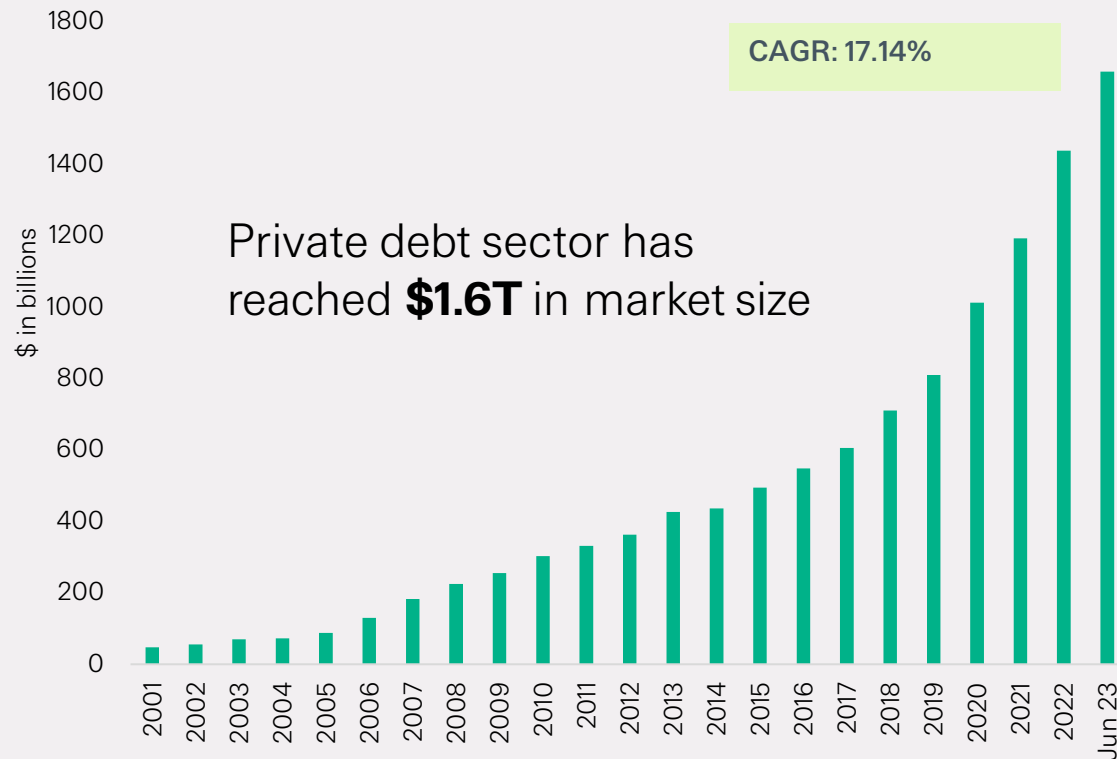


Potential borrower benefits of private credit

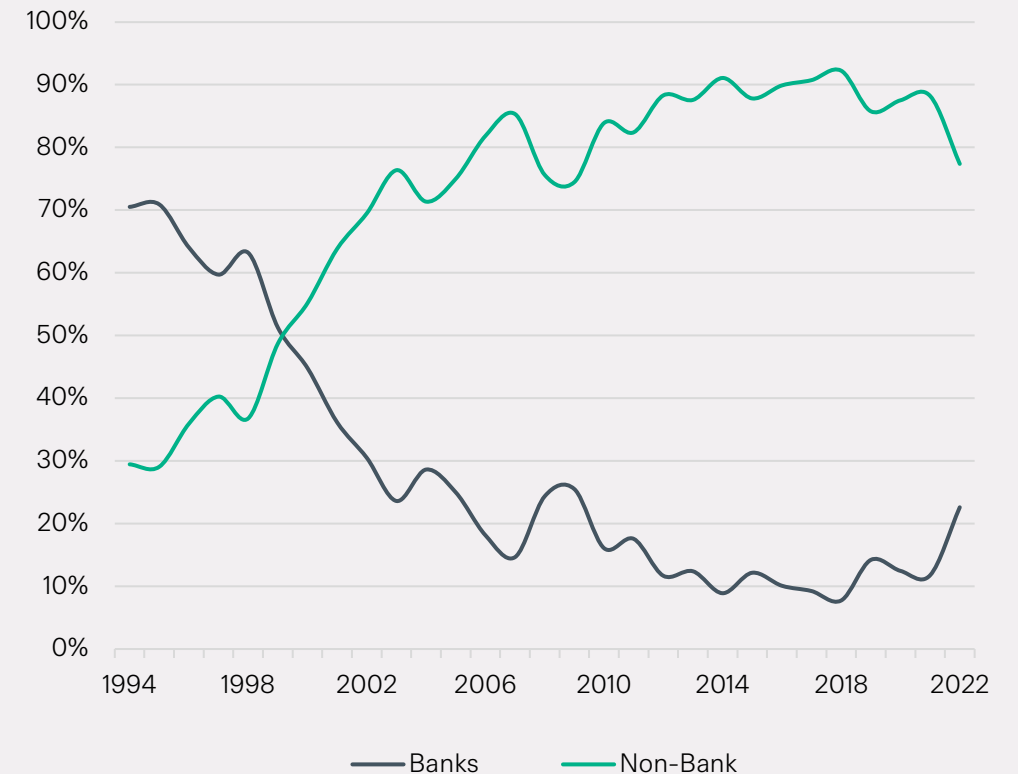
- ✓ Flexibility in financing
- ✓ Speed of execution
- ✓ Access to capital
- ✓ Customized solutions
- ✓ Confidentiality and privacy
- ✓ Relationship-based approach

Significant expansion of private debt market

Private lenders growth¹



Share of global leveraged loan market²



1. Source: Preqin, as of January 2024.

2. Source: LCD, as of December 2023.

Global private debt market expansion as bank lending declines

USA

\$806B

High yield bonds²

\$1,314B

Syndicated loans²

\$1,080B+

Private debt¹



Bank (~15%)

Europe

\$288B

High yield bonds²

\$290B

Syndicated loans²

\$459B+

Private debt¹



Bank (~40%)

Asia

\$124B

High yield bonds³

\$240B

Syndicated loans⁴

\$75B+

Private debt⁵



Bank (~60%)

Data as of September 2022, unless otherwise noted.

1. Total Market Size Private Debt - Preqin. Total Market Size for Private Debt covers Direct Lending, Mezzanine, Special Situations, Distressed Debt, Fund of Funds and Venture Debt as of June 2023.

2. Source: High Yield Bonds based on Credit Suisse High Yield index, Bloomberg as of June 2023. Syndicated Loans – LCD. Total Market Size for Syndicated Loans covers senior secured term loans with minimum initial term of one-year, minimum initial spread* of 125 basis points, with original funding amount of at least \$ 50M and bought and held by an institutional investor as of June 2023. *Spread refers to the difference in yield between syndicated loans and high yield bonds. The spread is typically expressed in basis points (bps), where 1 basis point equals 0.01%.

3. Source: Bloomberg Asia High Yield Bond Index.

4. Source: SSG estimates.

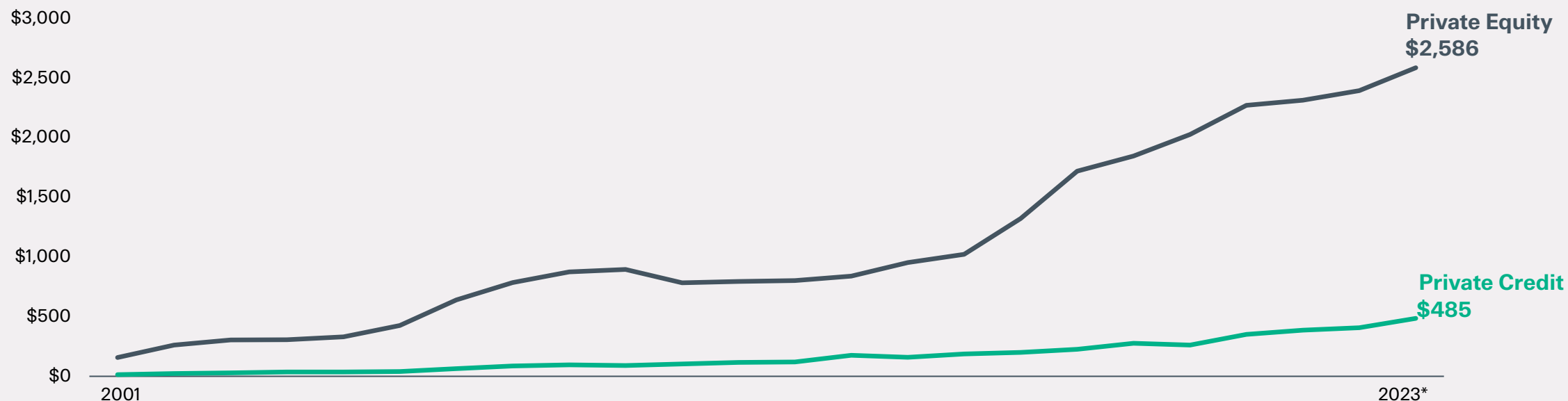
5. Based on SSG's observations and Preqin market size for Asia Direct Lending, data as of September 2022.

Growing demand for private financing

The ratio of private equity to private credit dry powder¹ signals strong future demand dynamics.

Dry powder¹

(\$ in billions)

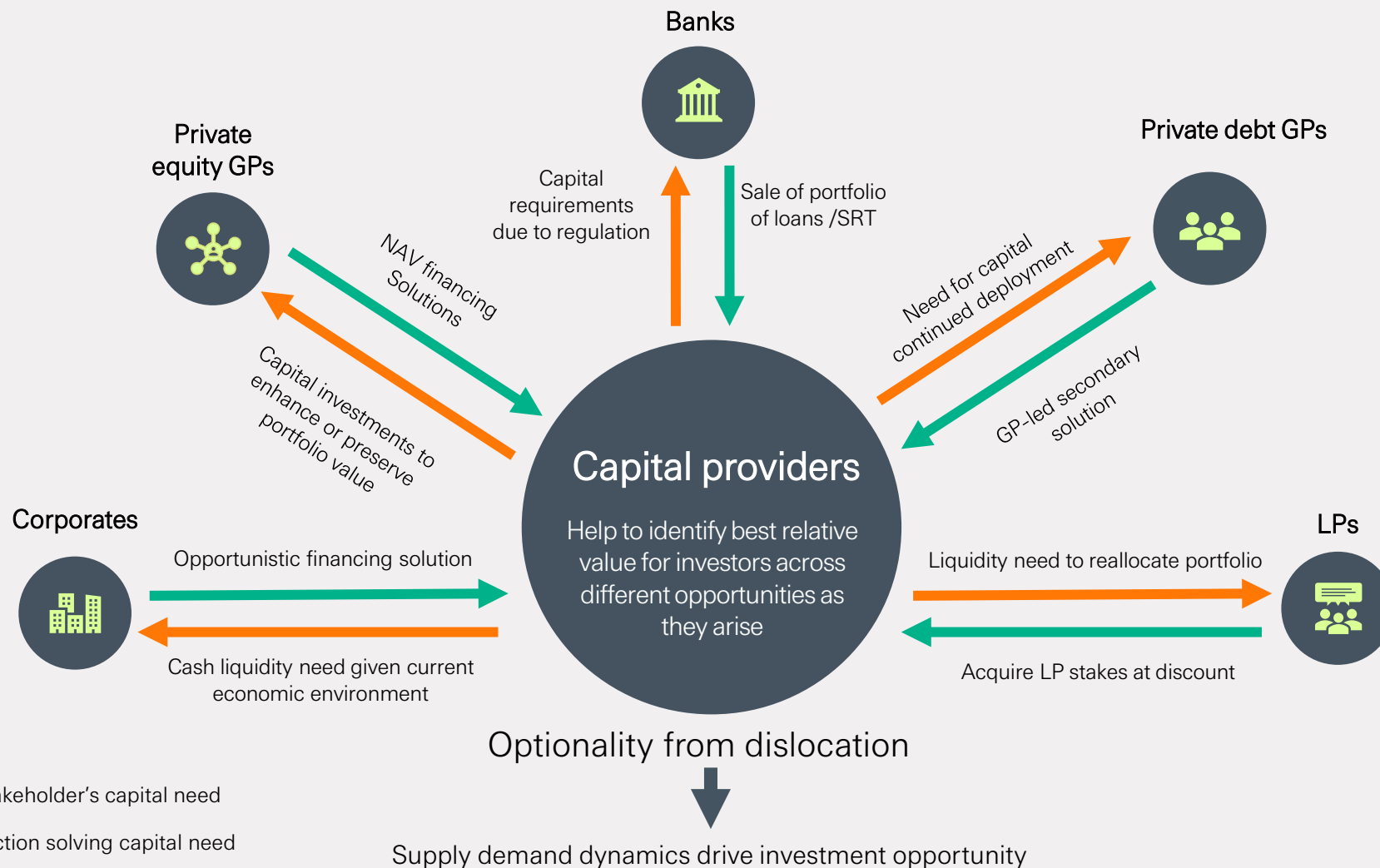


1. "Dry powder" refers to cash reserves or liquid assets that are readily available for investment. The term is often used in the context of private equity, private credit, venture capital, or investment funds. As of December 1, 2023.

*Year to date through December 1, 2023. Analysis includes aggregate dry powder of global private equity funds with vintage year between 2000 and 2023. Dry powder data is supplemented by Preqin.

Source: S&P Global Market Intelligence

Growing need for liquidity



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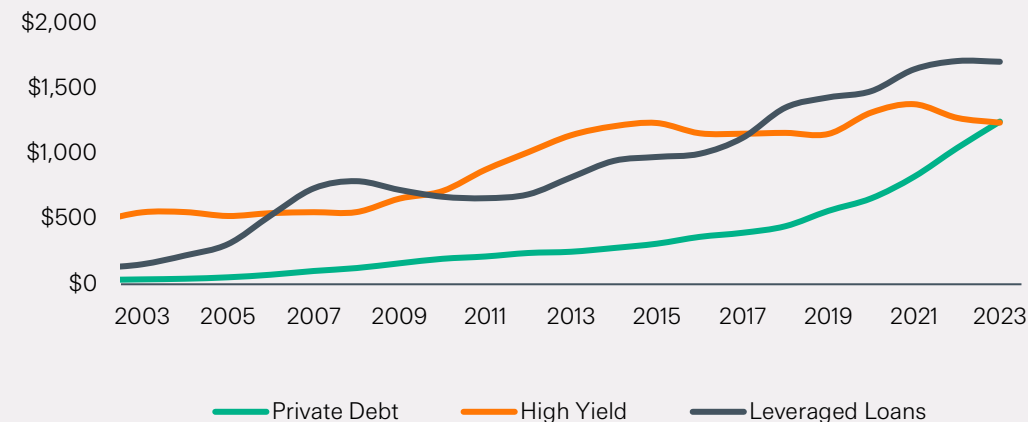
Addressing Potential Risks



Too much too quickly?

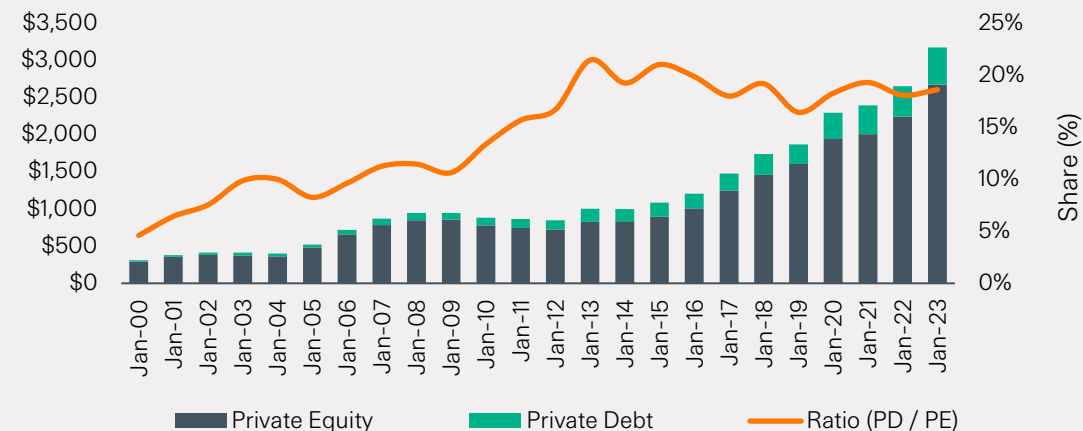
Growth of global credit market¹

\$ in billions



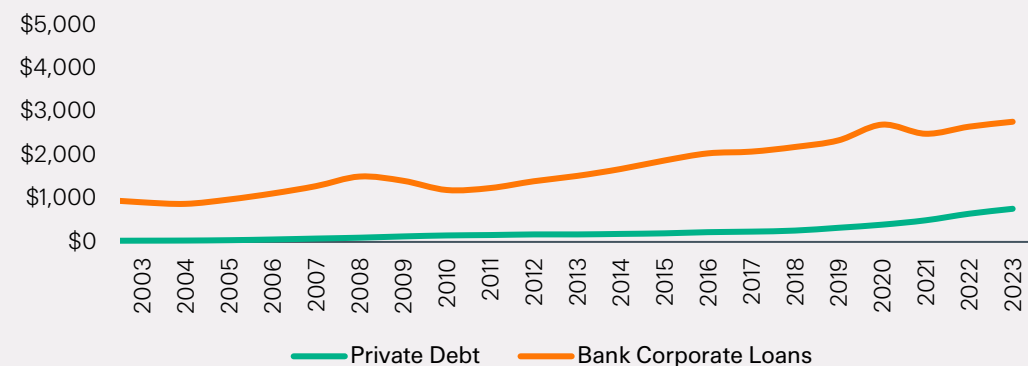
Relative to private equity²

Drypowder in the market, \$ in billions



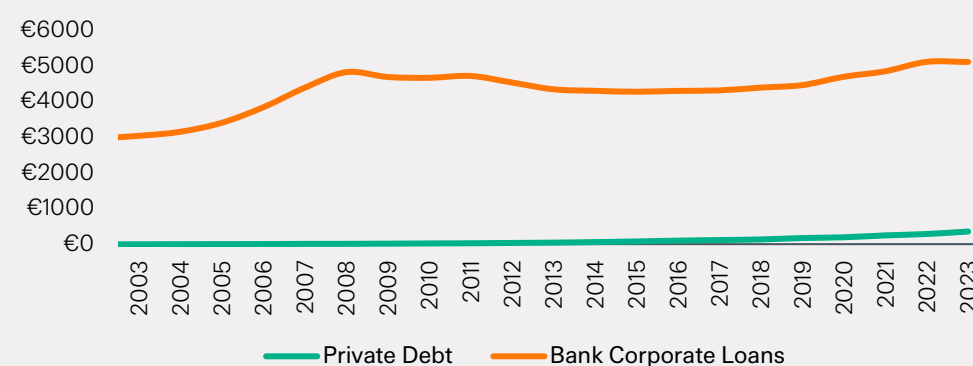
Relative to bank corporate lending across regions³

United States*, \$ in billions



Relative to bank corporate lending across regions³

Europe**, € in billions

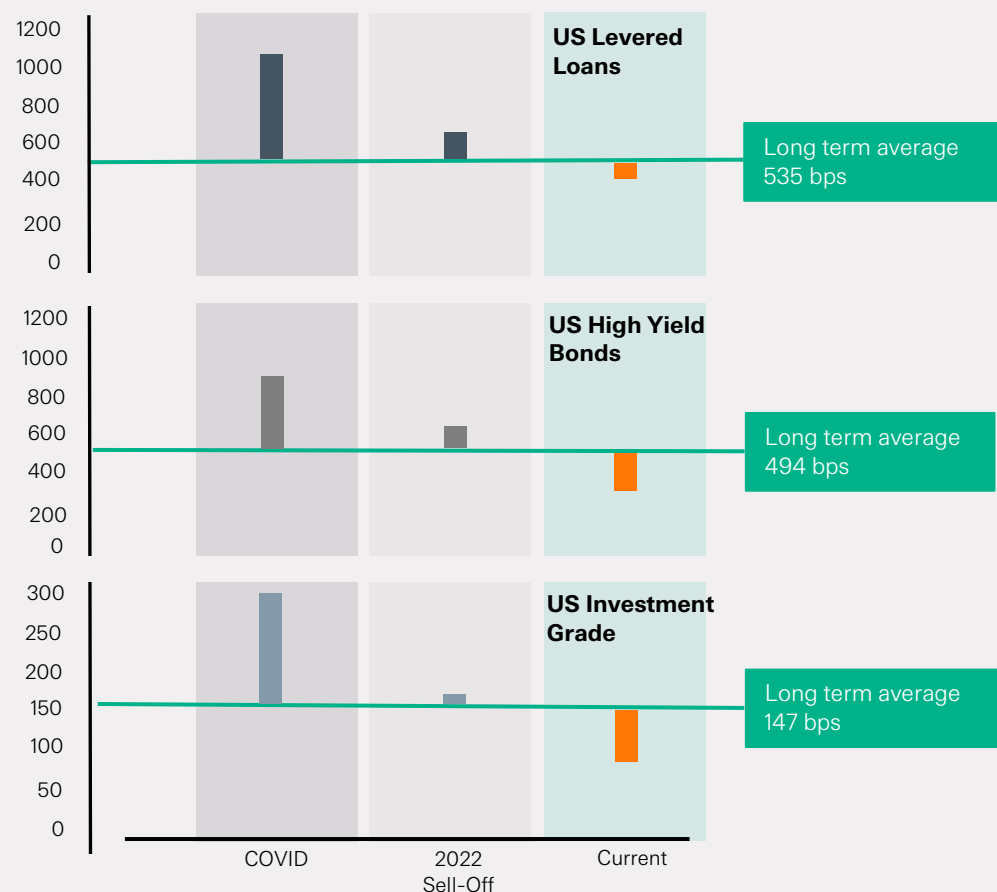


Source(s): 1. Preqin, Credit Suisse, Pitchbook LCD, Bloomberg, StepStone Group, as of June 2024. * Refers to United States and Europe combined. 2. Preqin, As of July 2024. 3. Preqin, Federal Reserve Board, ECB, as of July 2024. * "Bank Corporate Loans" refer to "Commercial and Industrial Loans", as defined by the Federal Reserve Board. ** "Bank Corporate Loans" refer to "Loans vis-à-vis Euro-Area NFCs reported by MFIs excl. ESCB in the Euro-Area", as defined by the European Central Bank.

Relative attractiveness compared to public markets

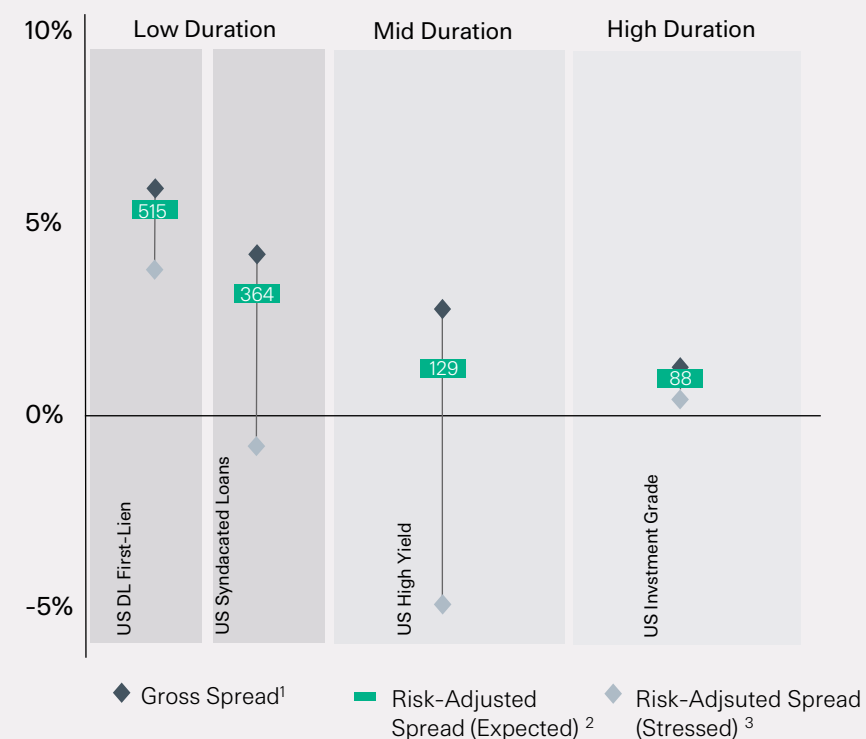
Public market: Spreads below historical average

Public markets are priced for perfection



Private market: Superior credit spreads

US Direct Lending 1st lien: Low duration with attractive risk-adjusted spreads

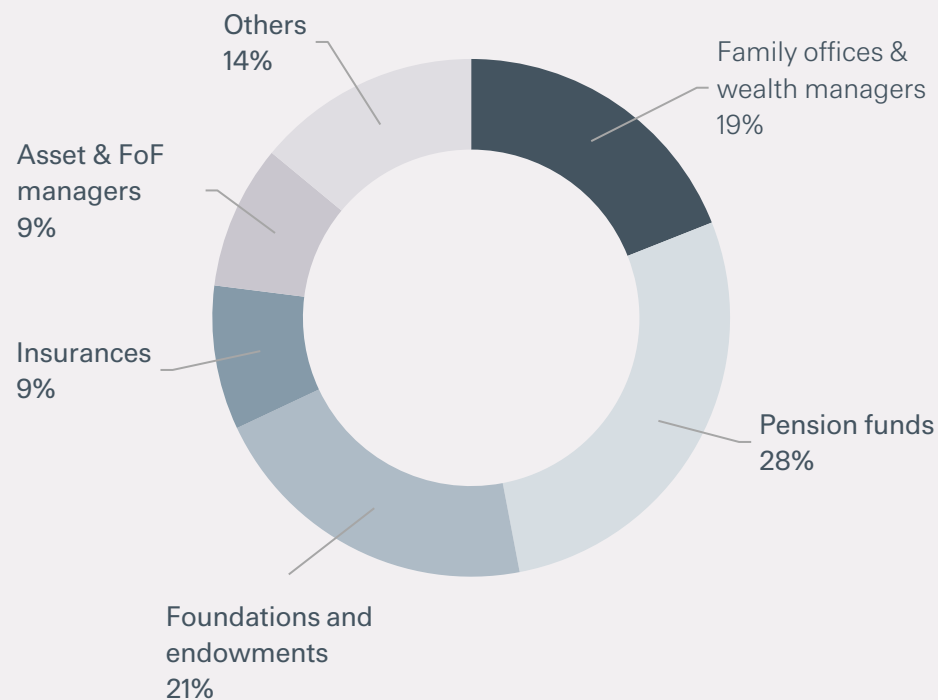


Source: Bloomberg, Pitchbook LCD and Refinitiv, as of June 2024. Long term average is calculated between 2003 and Q2 2024

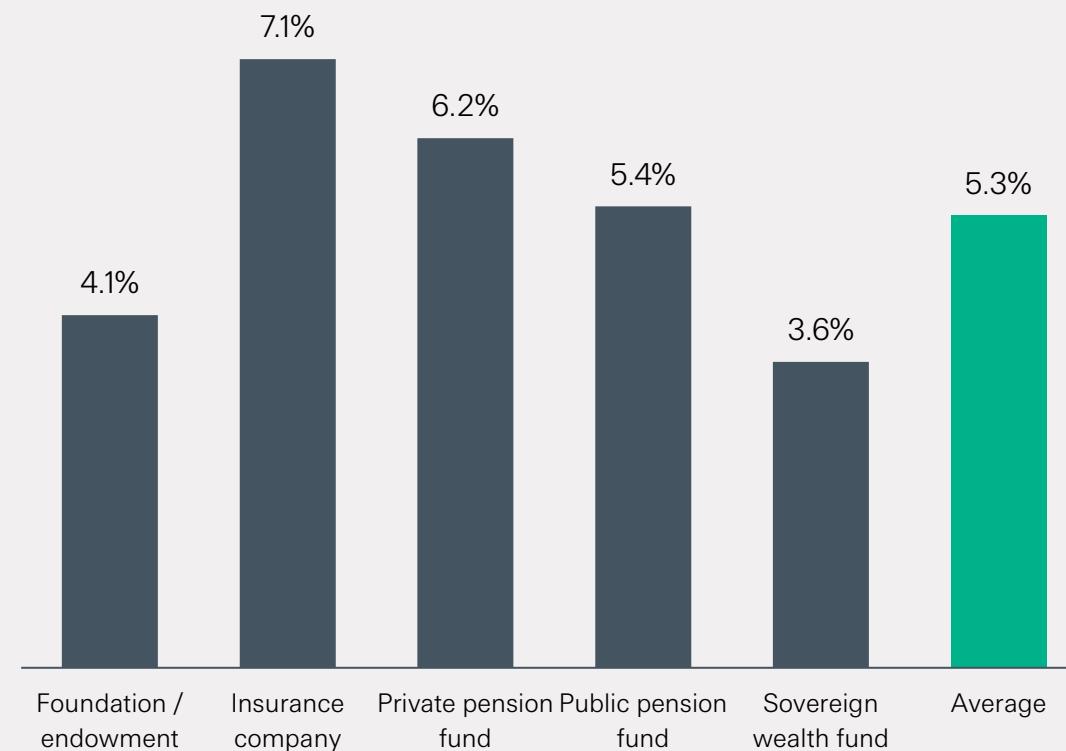
1. Gross Spread includes original issued discount (OID) 2.Expected long-term risk-adjusted spread after deducting expected and stressed loss rates 3. Stressed spread during GFC

Contagion risk and source of funding

Share of private debt investor base¹

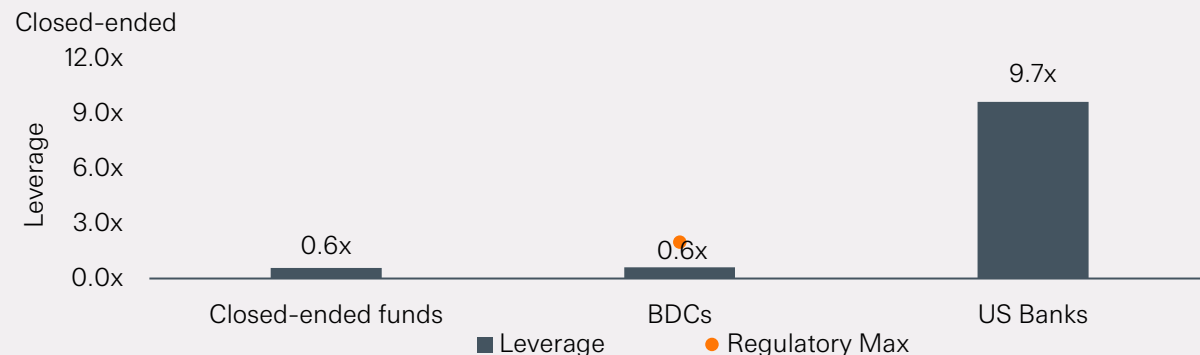


2023 average private debt allocation by institutions²

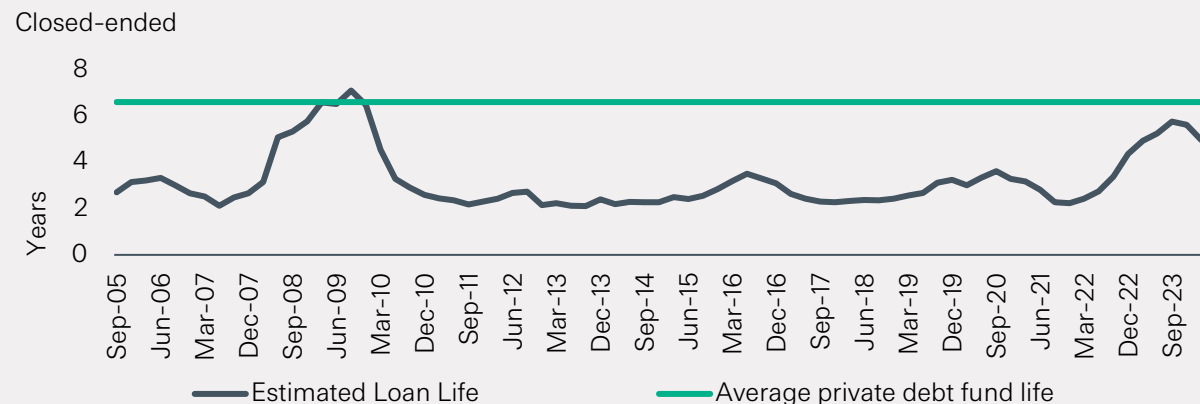


Liquidity risk and leverage

Limited leverage in private debt funds¹

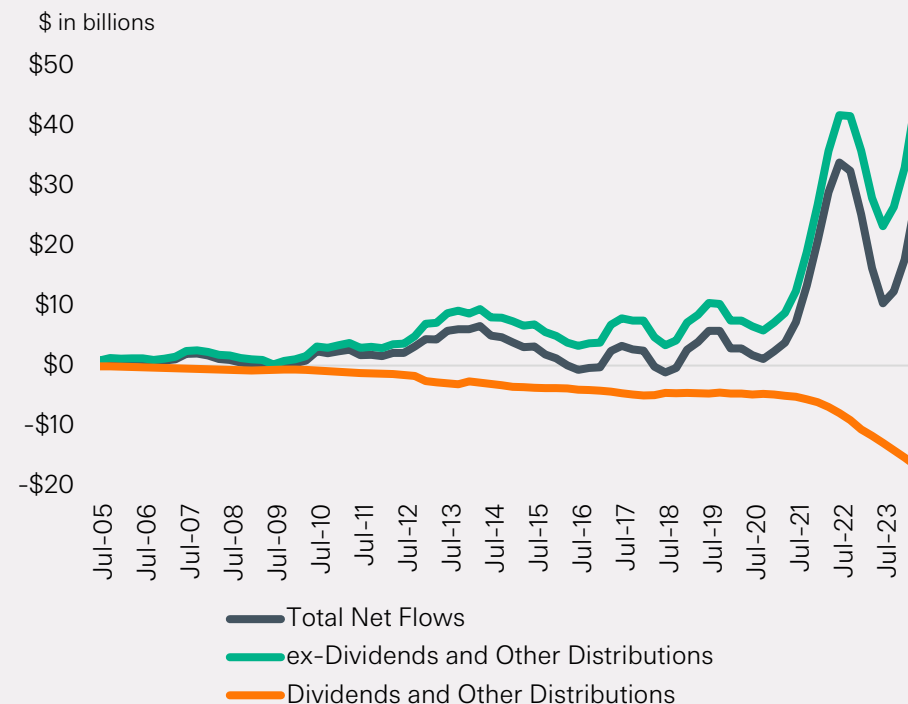


Limited duration mismatch in private debt funds²



Do BDCs face liquidity risk?

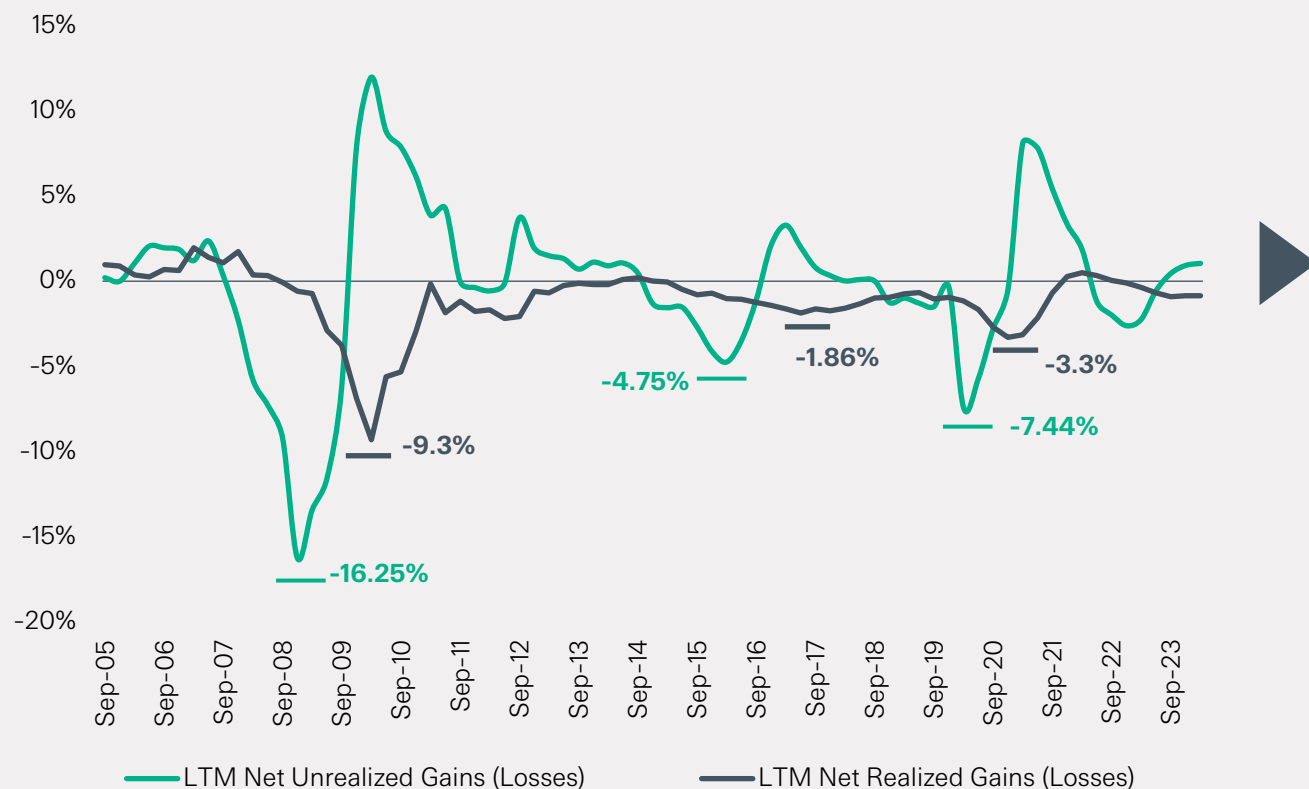
BDCs net asset inflows/outflows³



Source: 1. StepStone Group, BDCs Factsheets, FDIC, as of 31.03.2024. 2. StepStone Group & Cliffwater, as of 31.03.2024. Estimated Loan Life is equal to: Total investments at cost / cash inflows from maturing loans, prepayments, and sales, as reported by Cliffwater. 3. Cliffwater as of 31.03.2024

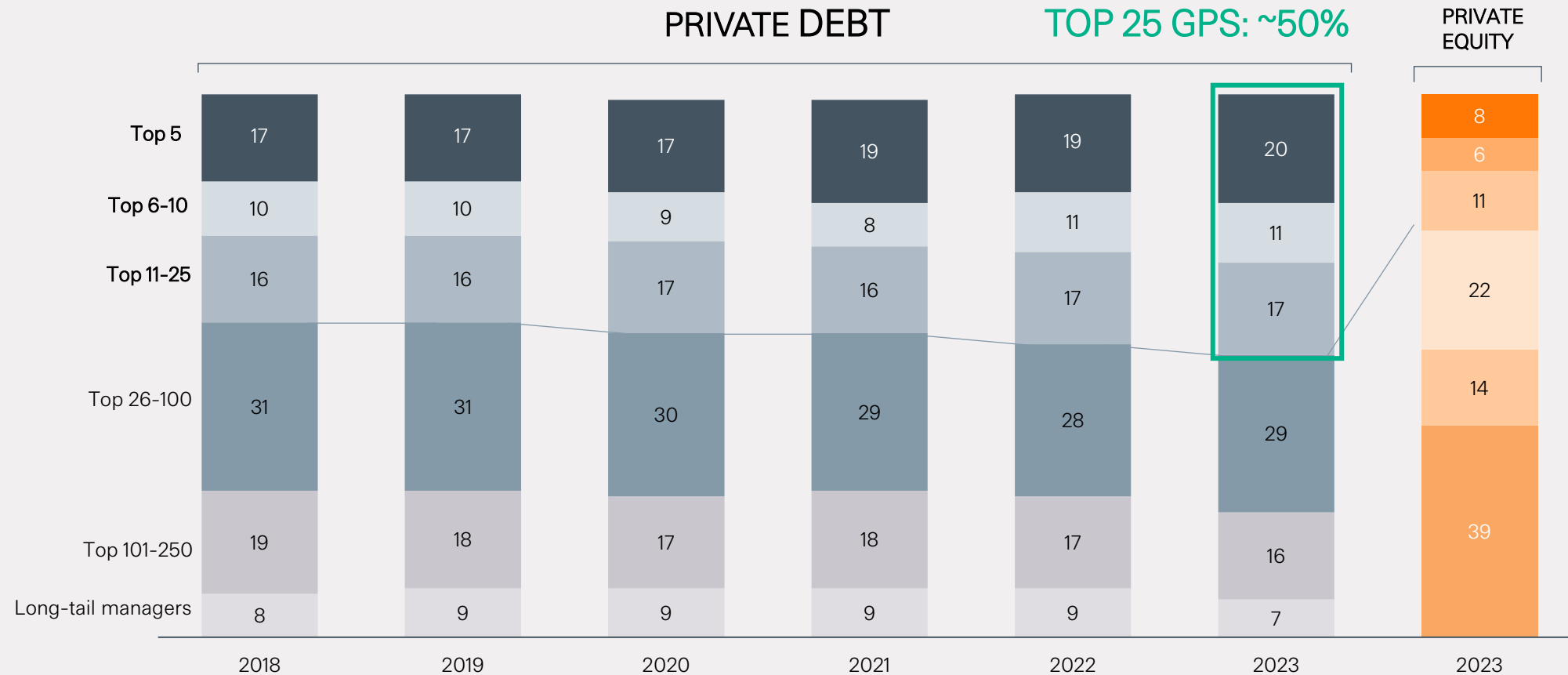
Are loan valuations reliable?

4-quarter trailing historical unrealized and realized losses in private debt BDCs¹



- ✓ Conservative realization
- ✓ Post-crisis recoveries
- ✓ Disciplined valuation

Increasing market concentration

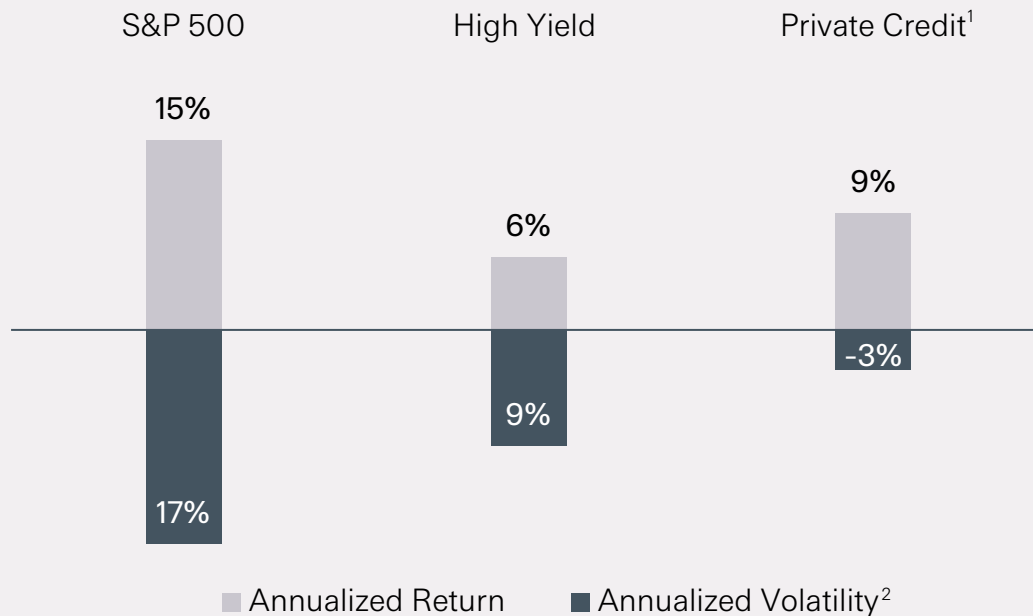




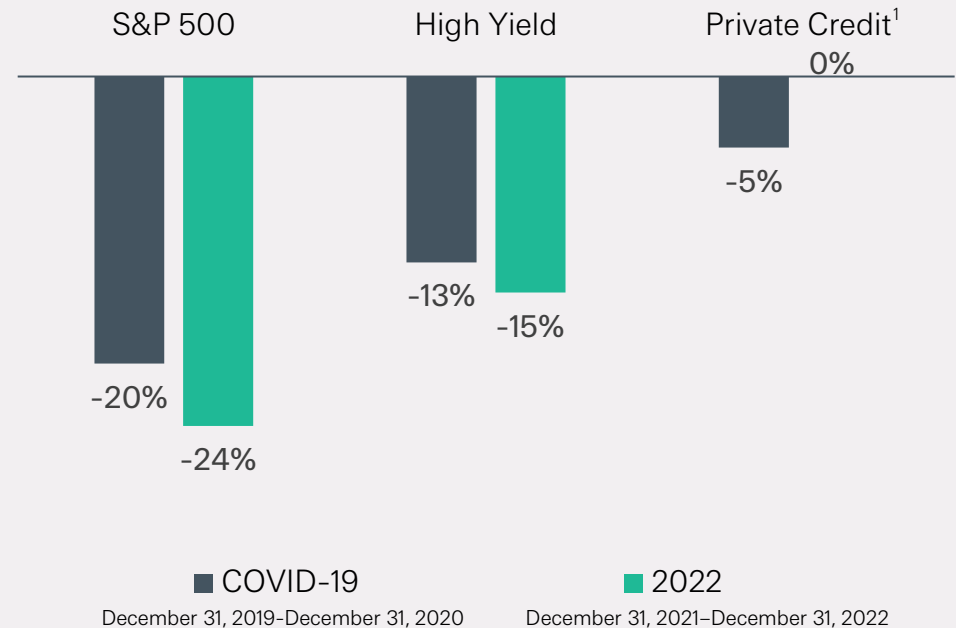
Benefits

Attractive returns through multiple market cycles

Equity-like returns...



...with limited historical volatility/downside.

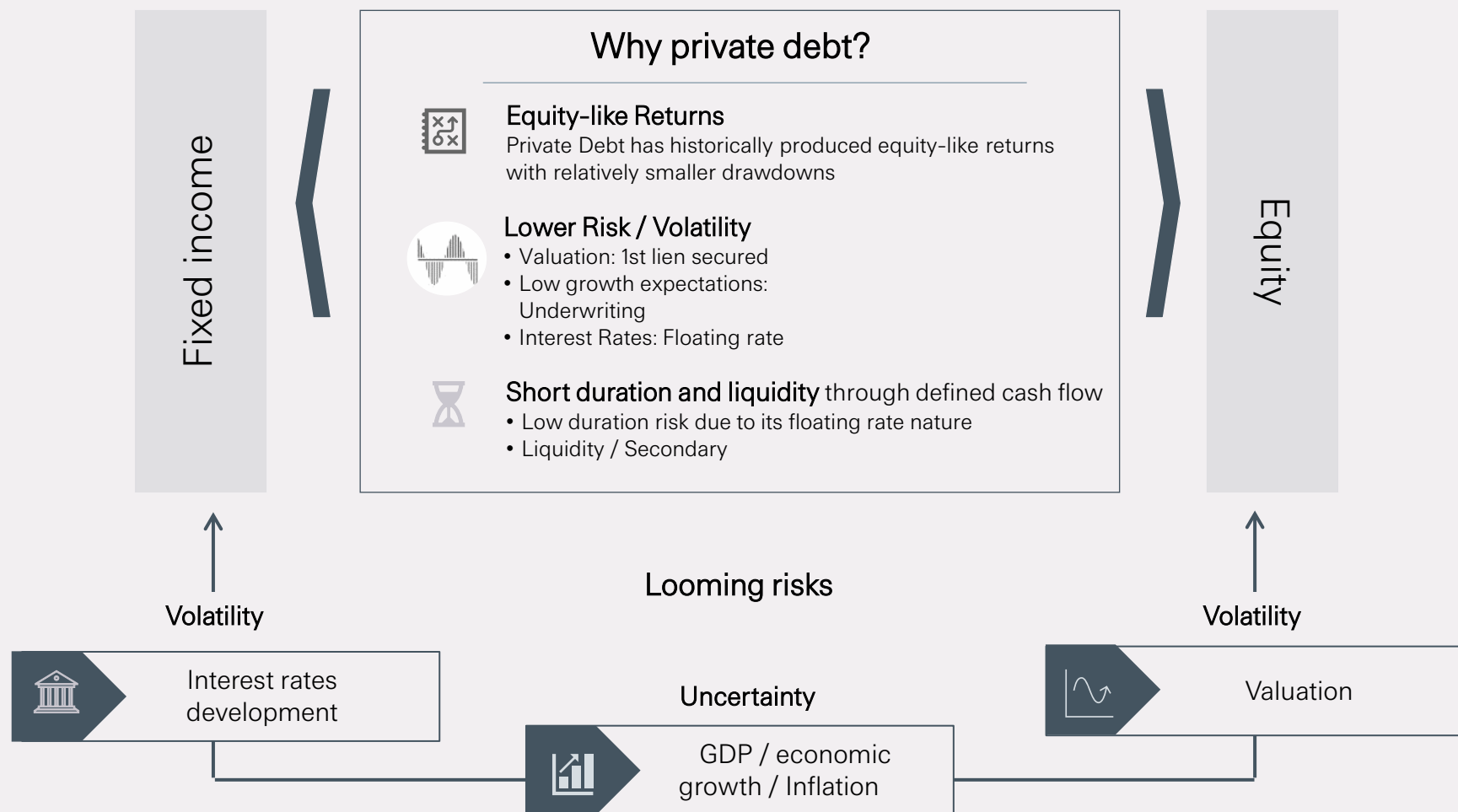


Time period September 30, 2015 – March 31, 2024.

1. "Private Credit" is represented by the Cliffwater Direct Lending Index. "High Yield" is represented by the Bloomberg US Corporate High Yield Index. Please refer to slide 27 for a complete list of definitions for each index.

2. Volatility is measured using standard deviation. All of the quarterly standard deviations are then annualized.

Private debt as replacement alternative to public debt and equity



Private credit strengths

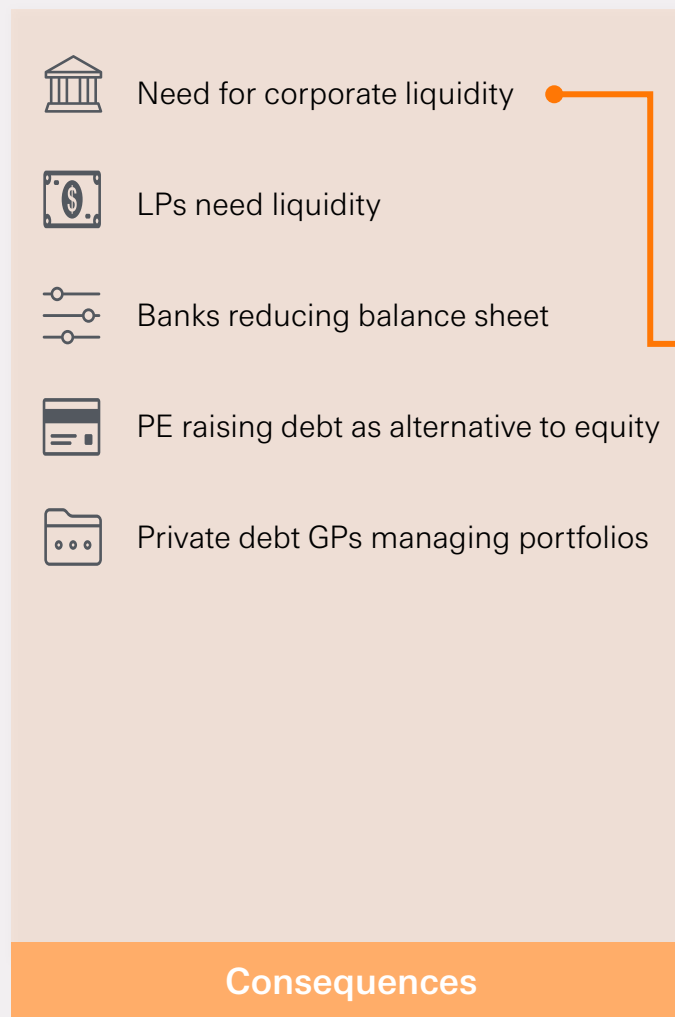
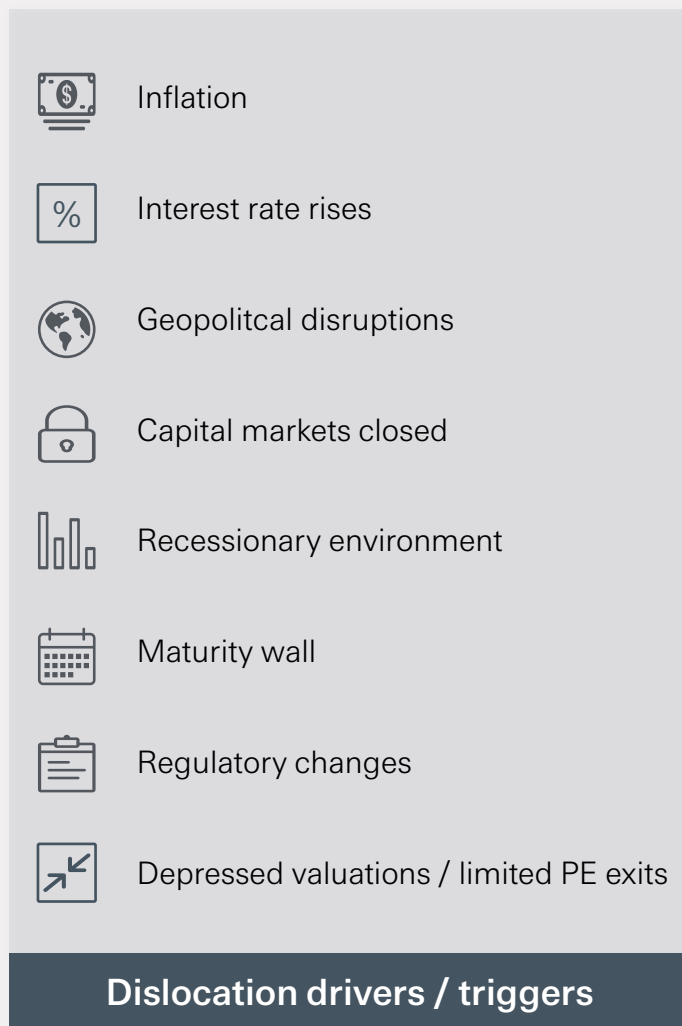
Private credit filling the gap

Supply / demand of credit	<i>Private Credit fills the gap left by banks' retrenchment. Alternative Lenders are not just taking share from banks but also from the public markets (syndicated loans)</i>
Quality of assets and lending terms	<i>Private Credit firms lend to middle market businesses that are crucial to economies, like the US, at attractive lending terms benefiting LPs</i>
No asset-liability mismatch	<i>Fund terms ensure that investor "Equity" capital and underlying investments match, in contrast to banks that lend with longer maturities financed with short term deposits</i>
Alignment of interest	<i>Loans originated by Private Credit Managers are held in the Manager's investment vehicle in contrast to the bank syndication model (bank balance sheet holdings are minimal)</i>
Leverage	<i>Alternative Lenders generally have minimal (1:1) leverage, whereas bank balance sheets are often levered in excess of 1:6</i>
Downside mitigation	<i>Private Credit investments, particularly those with secured collateral or asset-backed structures, may offer a greater level of downside protection during market downturns compared to public equity or unsecured debt</i>

Other Opportunities



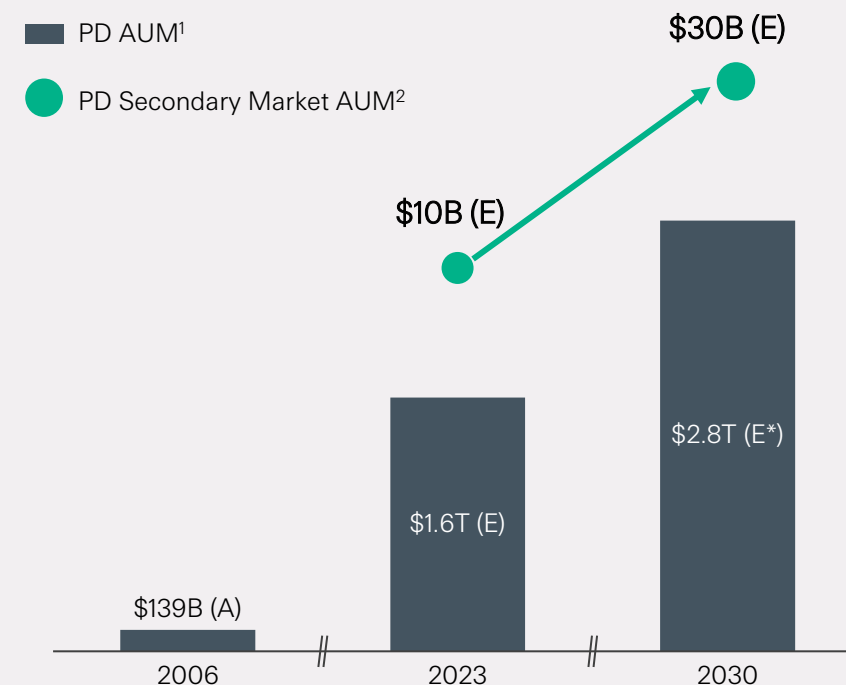
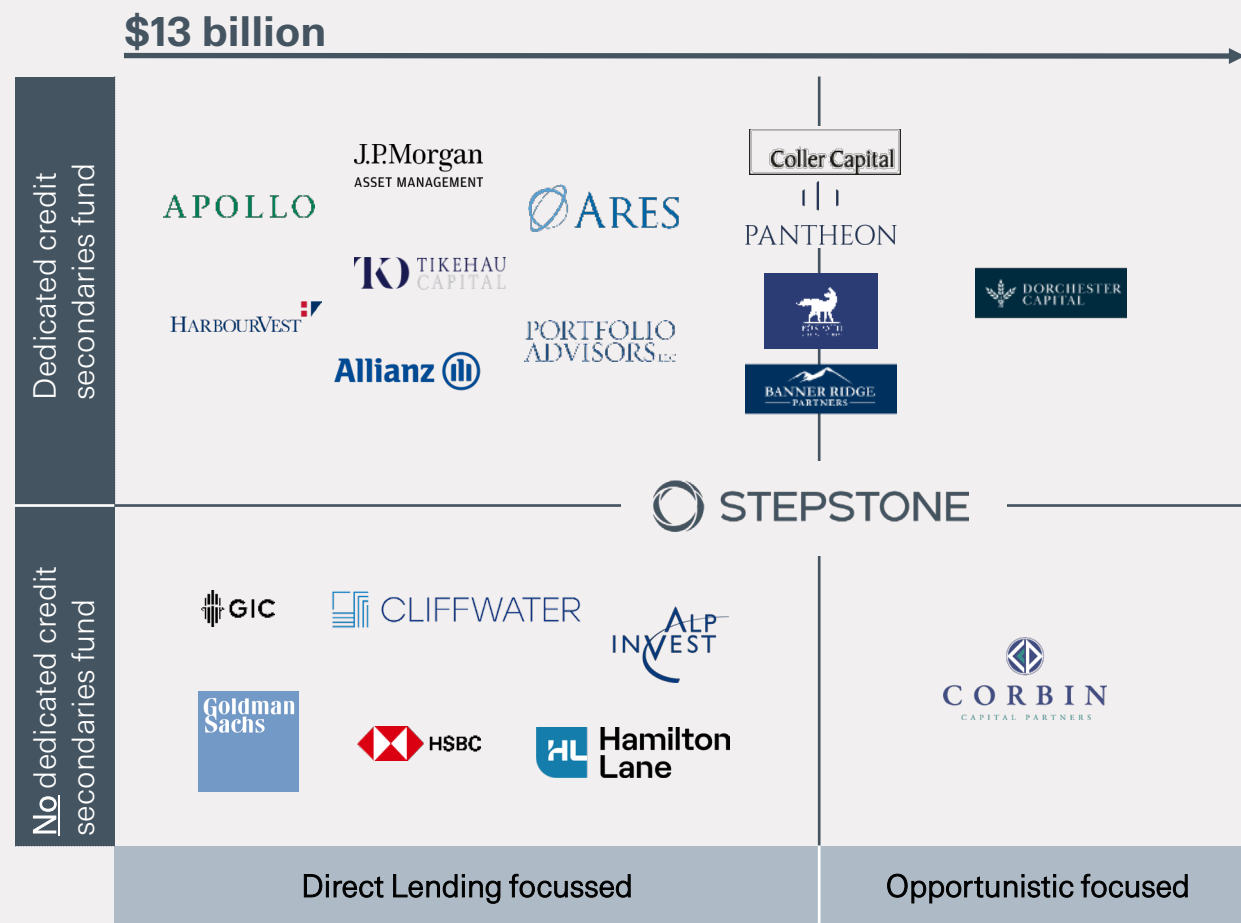
Evolution of potential opportunity sets – and focus on secondaries



Return driver	
Capital solutions: opportunistic lending, rescue financing Good company, stretched balance sheet	OID, base rate, margin, non-call, warrants
Secondary portfolios LP or GP in search for liquidity	Discount (capital gain), running yield, equity upside, realization catalysts
Public market Market sell-off, pull to par	<ul style="list-style-type: none"> • Pull to par (capital gain) • Base rate, margin
Hung syndications Sudden closure of public markets	<ul style="list-style-type: none"> • Discount (capital gain) • Base rate, margin
Restructuring / distressed	<ul style="list-style-type: none"> • Discount (capital gain) • Running yield • Debt to equity • Restructuring / amendment fees

Opportunities

Private debt secondaries opportunity

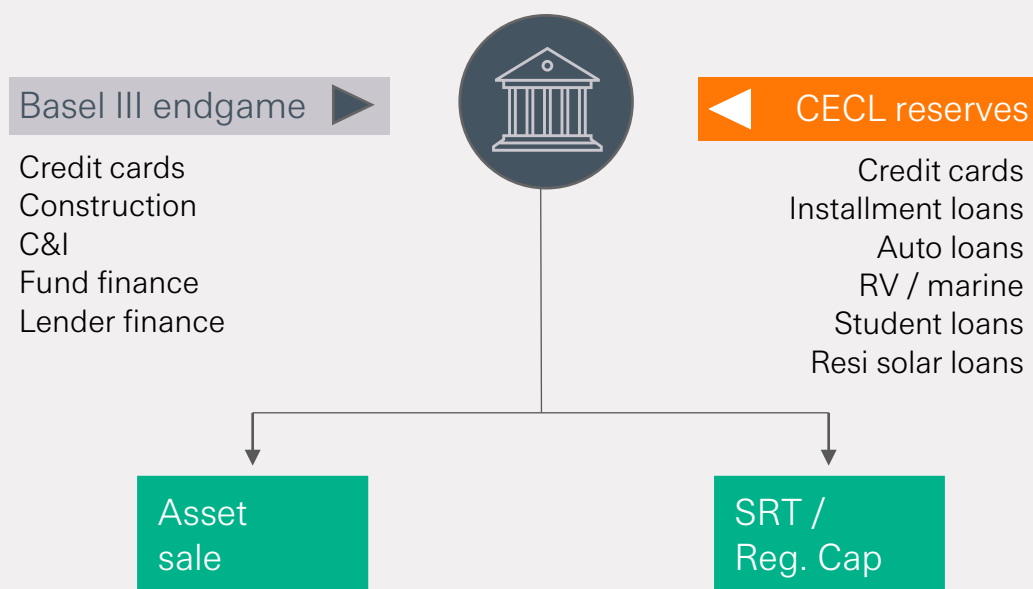


Indicative per StepStone Research and SPI by StepStone. Values represent fund-level LP-commitments. Preqin and First Avenue Analysis, May 2023.

* 2006 actual figure per Preqin, and 2028 estimate figure provided by Preqin estimates. The opinions expressed herein reflect the current opinions of StepStone as of the date appearing in this material only. There can be no assurance that views and opinions expressed in this document will come to pass.

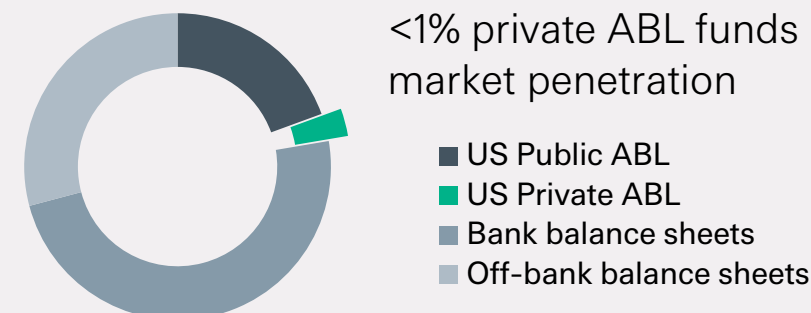
Drivers of bank retrenchment in the asset-backed space

Banks facing dual pressure

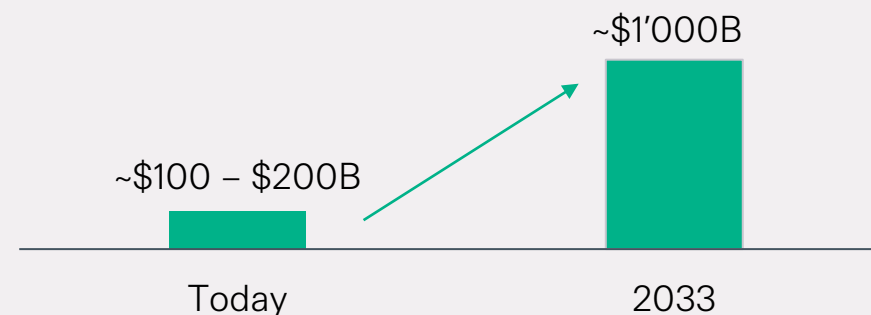


Potential from banks retreating

Total addressable US asset-backed market - Today

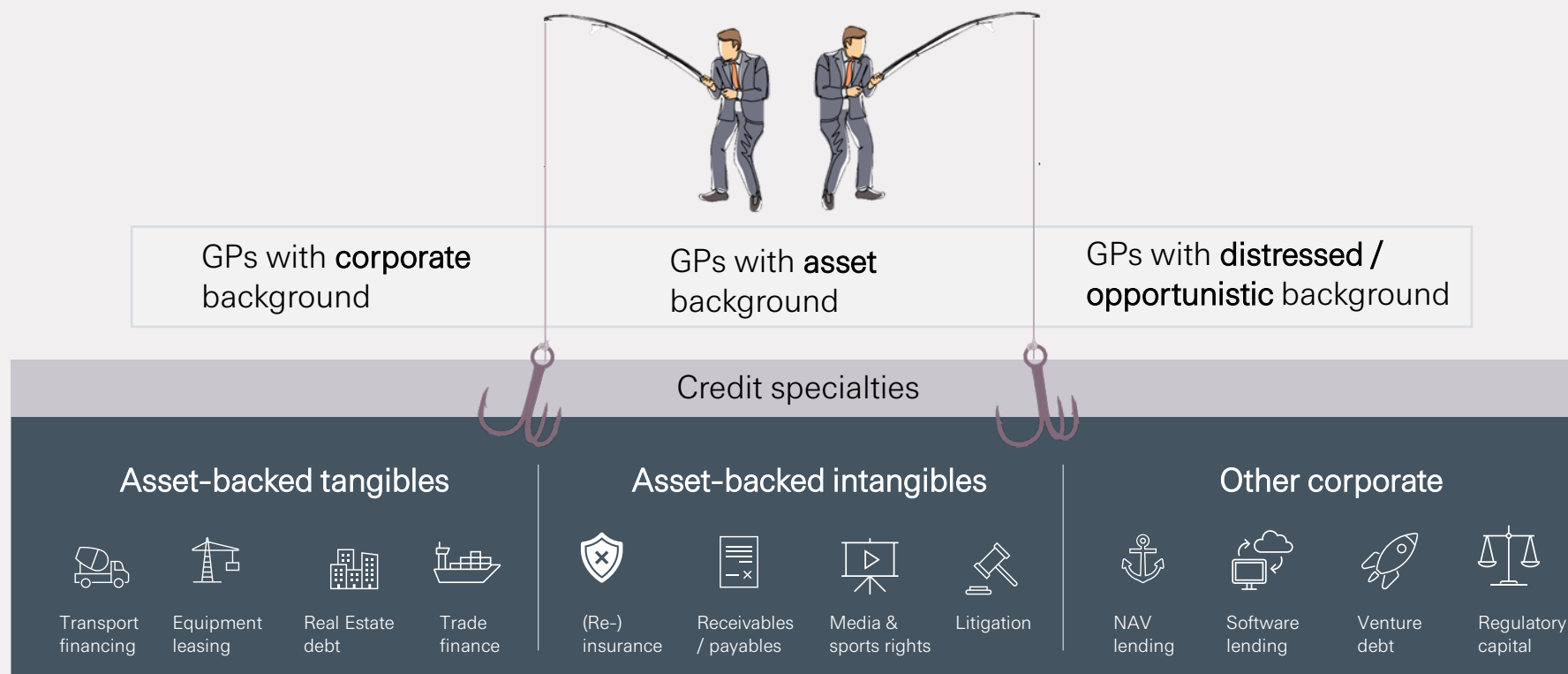


Growth projection – AUM of private ABL Funds¹



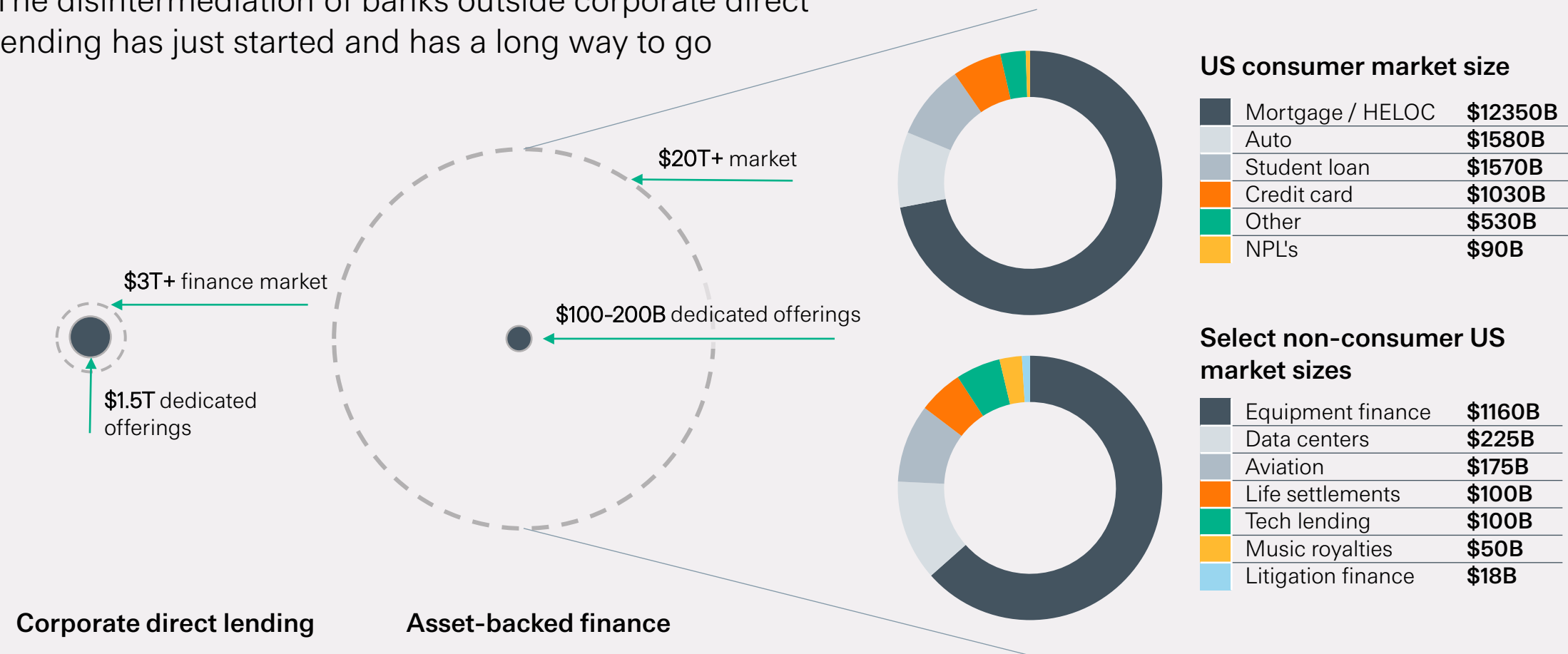
GP's expanding to fill the void

GPs expand heavily into the “Credit specialties” space, leveraging their experience to explore new avenues, and broadening their 'fishing pond' for opportunities due to the absence of a pronounced distressed cycle in the last 12 years

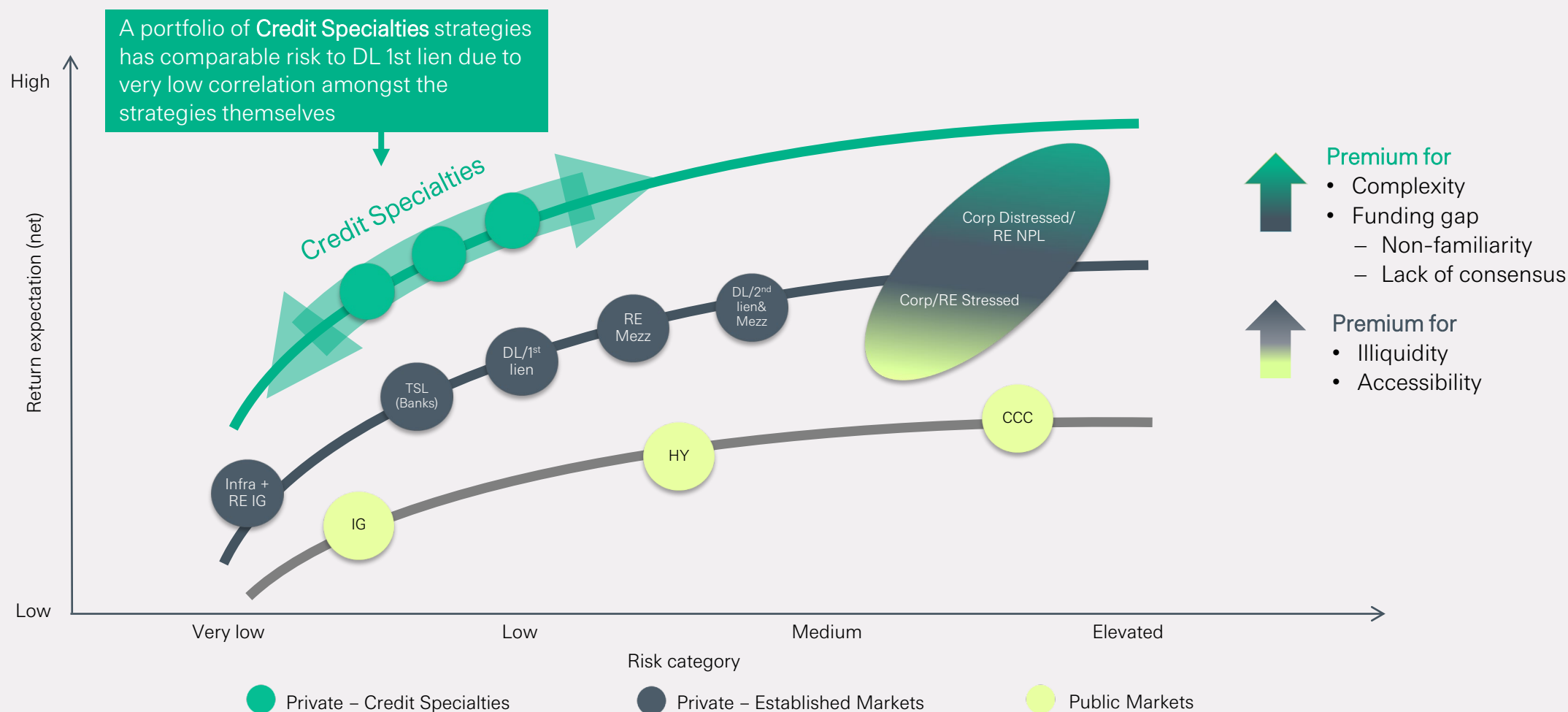


Disintermediation: "the next generation"

The disintermediation of banks outside corporate direct lending has just started and has a long way to go



Credit specialties: Higher return potential / similar risk



For illustrative purposes only. Target returns are hypothetical and are neither guarantees nor predictions or projections of future performance. Future performance indications and financial market scenarios are no guarantee of current or future performance.



Thanks for joining!

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