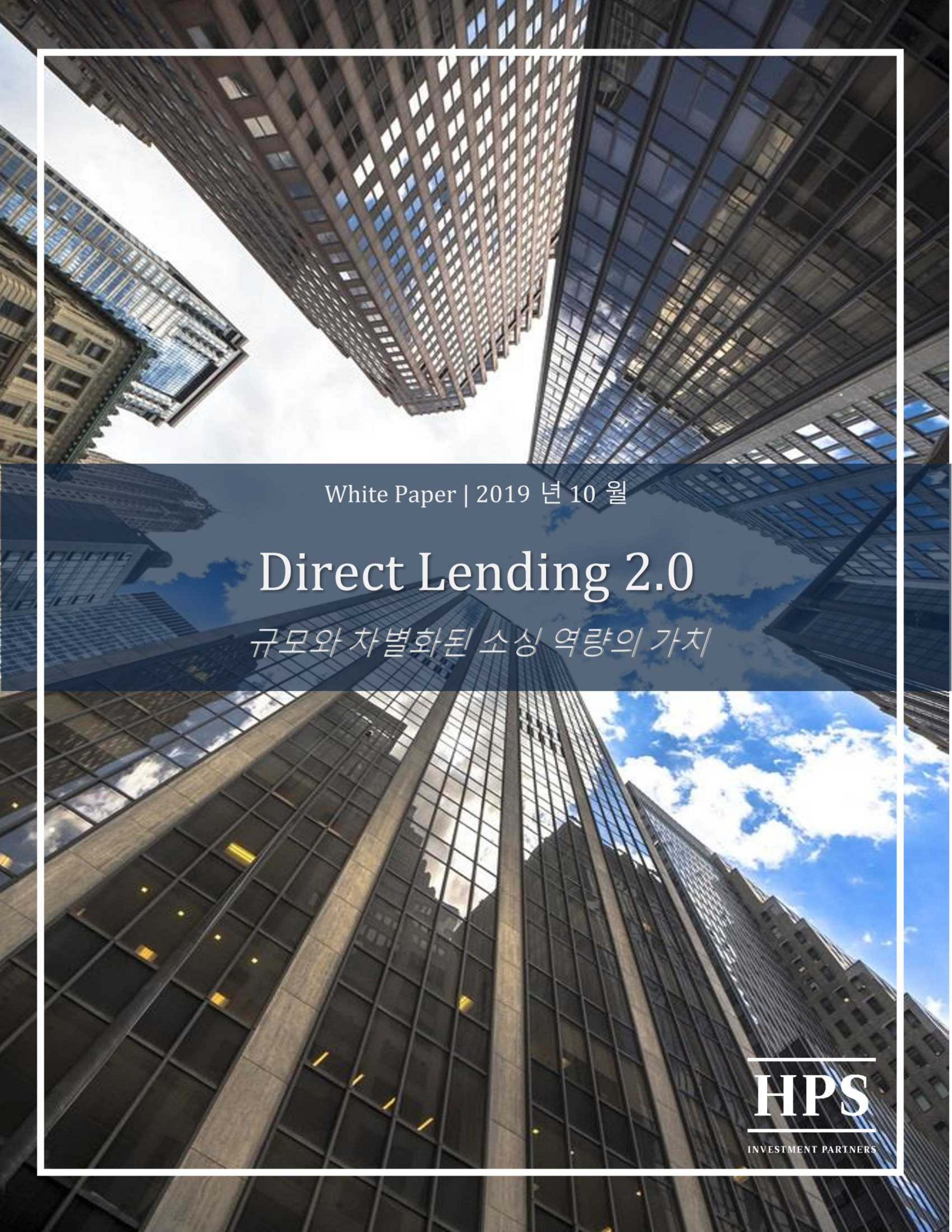


White Paper | 2019 년 10 월

Direct Lending 2.0

규모와 차별화된 소싱 역량의 가치

HPS
INVESTMENT PARTNERS

규제 변화로 인한 직접 대출 시장의 진화

기관 자산으로써의 Private debt 은 금융위기 이후 급격하게 성장해왔습니다. 2018 년말 기준 전세계 Private debt 약정은 $770bn[1] 이상으로 추산됩니다. 그러나 과거를 돌이켜보면 Private credit, 특히 직접 대출이 항상 주류였던 것은 아니었으며 역사적으로는 오히려 높아진 시장 변동성에 따라 생겨나는 경기순환적 기회의 틈새 전략으로 간주되었습니다. 경기 침체 기간 동안 기존 은행들로부터의 자금 공급과 중소 기업들의 자금 수요간에는 불균형이 발생 합니다. 이러한 자금부족 상황이 직접 대출을 위한 기회의 창을 제공하며, 이 기회는 은행이 재무 건전성을 회복하고 시장에 재 진입하여 신규 대출을 발행하게 되어 직접 대출에 대한 촉매가 사라지기 전까지 침체 후 약 2-3 년간 유지됩니다. 당사는 2008 년 금융위기 이후 이러한 패턴이 반복될 것으로 보았지만 규제 변화로 인하여 은행의 비유동적이고 투자부적격 기업에 대한 대출은 대차대조표에 덜 매력적인 자산으로 만드는 변화를 불러왔습니다.

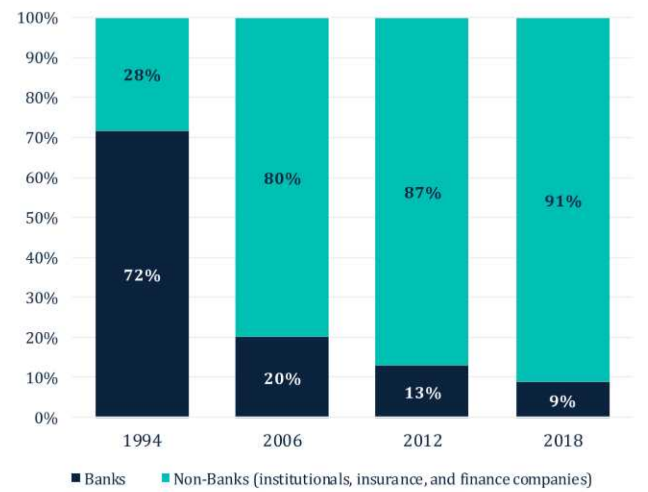
직접 대출은 단기적, 주기적인 기회에서 레버리지 자금조달 생태계의 체계적인 일부분으로 변화 하였습니다.

자료: 2019년 3월 31일 기준. US Bureau of Economic Analysis.

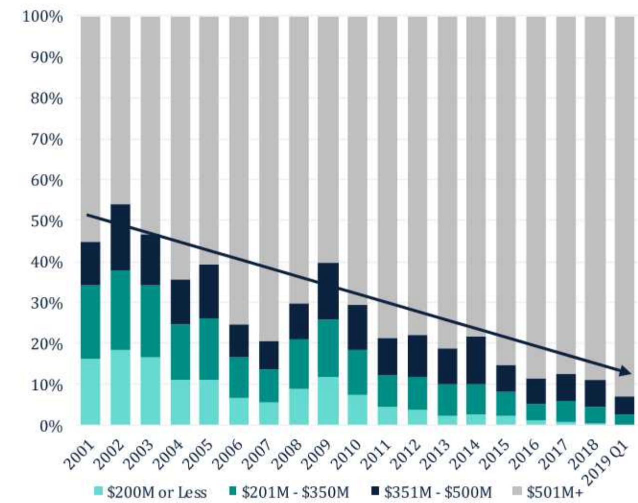
2008 년 금융위기 이후의 규제들은 상업은행들의 자기자본요구 비용을 급격하게 증가시켜 상업은행이 비유동 자산에 대한 대출을 발행 및 보유하려는 의지를 제한 했습니다. 은행들은 대형 Borrower 들의 자금 수요를 맞추기 위해 더욱 큰 시장에 집중하게 되었으며 "Underwrite-and-Distribute" 접근을 사용하게 되었습니다. 2018 년 말 상업은행은 레버리지 론 시장의 약 9%를 차지하였습니다. 게다가 일부 Middle 및 Upper middle market 발행자들은 일부 대출 제공자들에게 그들의 규모가 더 이상 최적합 발행자 조건에 부합하지 않는 것을 알게 되었습니다. 2019 년 3 월 말 기준, 신규 발행 시장에서 트렌치 규모 $500mn 이하의 발행자는 약 7.1% 로, 2001 년 약 45% 이상이었던 것과 대비 되는 수치입니다.

[1] The $ 770 Billion Private Debt Market Is Ready for Consolidation", Sarah Syed & Ruth McGavin, 2019 년 2 월 28 일.

지속적으로 감소하는 레버리지 론 시장의 은행 참여 비율*



미들 마켓 Syndicated Debt의 감소세**



출처: * S&P LCD's US Quarterly Leveraged Lending Review: 2Q 2019. ** S&P Global Market Intelligence Factsheet; 1Q 2019.

수요 관점에서 수많은 Middle market 발행자들이 자금을 필요로 하고 있으며 전통 자금 시장 및 은행 대출에 접근하는데 어려움을 겪고 있습니다. 이러한 Borrower 들은 리파이낸싱, Growth, 인수 및 리스트럭처링을 위한 자금을 필요로 합니다. 발행자들이 신디케이트 시장에 접근할 수 있더라도, 소규모 대출, 복잡한 배경 혹은 신규 발행 등의 이유로 신디케이트 레버리지론 시장에 적합하지 않을 수도 있습니다. 시장의 전체 주기 동안 이 발행자들의 공모 자본 시장 접근 능력은 변동적일 것 입니다. 자본 시장이 공격적이고 위험이 싸게 측정될 때에는 일부 큰 규모의 Middle market 발행들이 전통적인 신디케이트론 시장에 접근할 수 있습니다. 반면 경제 심리가 악화되고 시장의 변동성이 커질 때에 Borrower 들은 자금 확보에 불확실성을 가지게 됩니다. 이러한 상황에서 기관 투자자로부터 장기간의 자금 약정을 받아서 몇 년간 자금을 제공하는 Private debt 운용사는 더욱 안정적인 부채 자금 조달의 원천이 될 수 있습니다. 이는 많은 Borrower 들에게 Private debt 을 매력적인 대안으로 만듭니다.

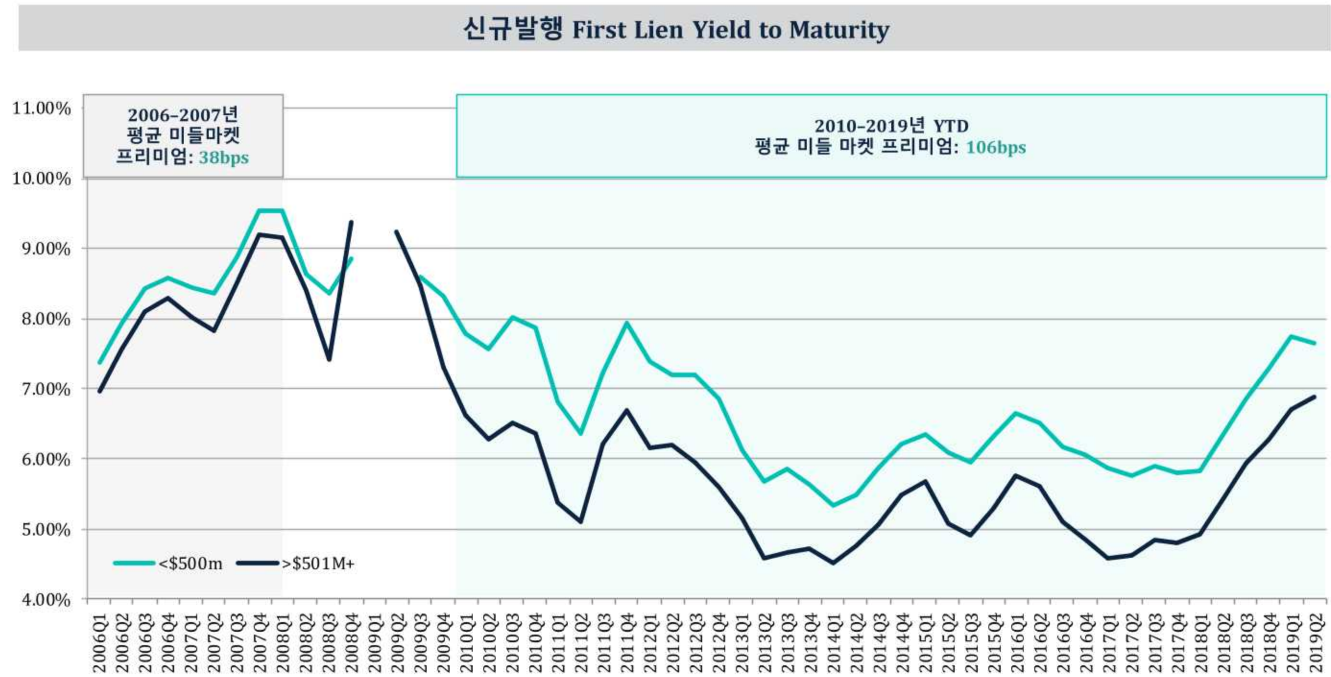
주류화 되고 있는 사모 시장

지난 20 년 이상 공모에서 사모 자본으로의 지속적인 이동이 있었습니다. 예를 들면, 미국 내에서 Private equity 자금을 제공받는 기업은 2006 년에서 2017 년 사이 두 배로 증가하였으며, 상장기업의 수는 16%[2] 로 감소하였습니다. 또한 미국 내 Private equity 자금을 제공 받는 기업의 수는 상장기업의 수를 약 2 대 1 로 능가하였습니다.[3] 2017 년 말 기준, Private equity 기업들은 $2.8tn 의 자산을 운용하고 있습니다.[4]

또한, Private equity 의 성장은 Private credit 시장의 성장을 촉진시켰으며, Sponsor 가 지원하는 기업들은 Private lender 들의 소규모 신디케이트 거래를 더 선호하였습니다.

[2] Private markets come of age", McKinsey Global Private Markets Review 2019
[3] "Private markets come of age", McKinsey Global Private Markets Review 2019
[4] "The Rise and Rise of Private Markets", McKinsey Global Private Markets Review 2018

기관 투자자의 관점에서는 대형기업 대출과 비교하여 Middle market 대출의 상대적인 수익률은 여전히 매력적입니다. 2010 년부터 2019 년 2 분기까지 Middle market (트렌치 규모 $500mn 미만) 대출은 대형 기업 (트렌치 규모 $500mn 이상) 대출에 비해 평균 1.06%의 프리미엄을 제공하였습니다.[5] 이는 금융위기 전인 2006 년에서 2007 년 사이 프리미엄인 0.38%와 비교 되는 수치 입니다.[6]



자료: 2019년 2분기 기준 S&P Capital IQ LCD. 트렌치 크기로 구분됨. YTM은 6개월 Rolling basis임. 미들 마켓 프리미엄은 $500mm미만 트렌치 크기의 투자 프리미엄 대비 $500mm 초과 트렌치 크기의 투자 프리미엄으로 정의.

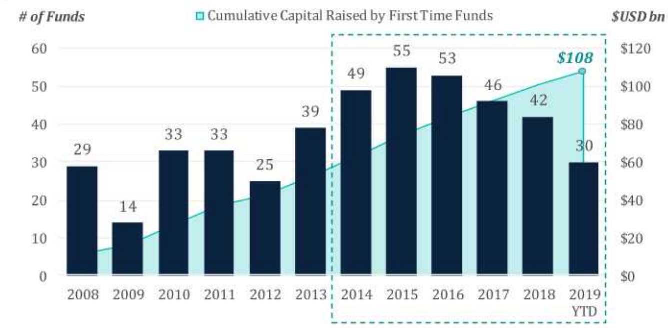
당사는 비유동성 프리미엄이 기관 투자자 및 Borrower 기업 모두에게 Private debt 을 매력적인 자산으로 부각시키는데 기여하였다고 생각합니다. 현재 Private debt 시장의 규모는 대략 $770bn[7]으로 추정되며, 지속적으로 증가할 것으로 예상됩니다. 이러한 자금 흐름의 증가는 신규 Private credit 운용사들의 진입 시기와 일치합니다. 2014 년 이후 시장에는 275 개의 First-time Private credit 펀드가 설정되었습니다. 당사는 이와 같이 급증하는 신규 진입자들이 전통적인 Middle market 대출 기회들의 계약을 약화시키고 가격을 낮춰 왔다고 생각합니다. 반면 신규 운용사들의 출현에도 불구하고, 자금 흐름은 비대칭적으로 소수의 대형 직접 대출 운용사에게 수혜를 주는 것으로 나타났습니다. 제한된 경쟁으로 인해 상위 규모 대출 시장에서 매력적인 위험조정 수익률을 찾는 기회는 지속되고 있습니다.

[5] 출처: S&P Capital IQ LCD as of Q2 2019. 트렌치 사이즈로 구분됨. 보여지는 만기 수익률은 롤링 6 개월임. Middle market 프리미엄은 $500 million 이상 트렌치와 비교하여 $500 million 미만의 트렌치에 투자했을 때 프리미엄으로 정의됨

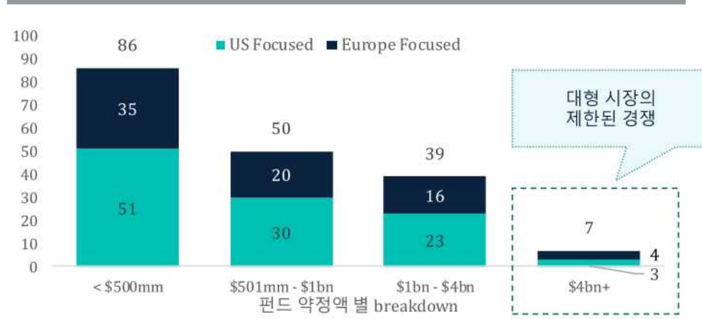
[6] 출처: S&P Capital IQ LCD as of Q2 2019. 트렌치 사이즈로 구분됨. 보여지는 만기 수익률은 롤링 6 개월임. Middle market 프리미엄은 $500 million 이상 트렌치와 비교하여 $500 million 미만의 트렌치에 투자했을 때 프리미엄으로 정의됨.

[7] "The $ 770 Billion Private Debt Market Is Ready for Consolidation", Sarah Syed & Ruth McGavin, 2019 년 2 월 28 일

First Time Private Credit 펀드*



북미 및 유럽 집중 직접대출 펀드**



2019 년 3 월 기준. * 자료: Preqin First Time Private Credit 자금 모집 자료. Private Credit 은 Preqin 에 의해 Direct Lending, Mezzanine, Special Situations, Venture Debt, Private Debt Fund of Funds 를 포함하는 것으로 정의. 2019 년 10 월 8 일 기준 자료. ** 자료: 2010 년 이래로 설정된 직접대출 펀드 Preqin 자료. Preqin 의 지역 표기는 각 펀드들의 주요 지역 초점을 나타냅니다. 운용사들의 가장 최근 빈티지 펀드 약정을 기준으로 합니다. 해당 자료는 HPS 혹은 제 3 자 기관에 의해 확인되지 않은 자료 입니다.

Sponsor 대출 : 초과상태인가?

당사는 현재의 시장에서 특정 분야, 특히 중형기업 Sponsor 거래에서 경쟁이 심화되고 있는 것을 목격하고 있습니다. 당사는 대부분의 운용사가 낮은 진입장벽 및 더 효율적인 소싱 모델로 인하여 Private equity sponsor 에게 대출을 목표로 하고 있다고 생각합니다. Lender 의 관점에서, Sponsor 는 잠재적 Lender 에게 사업 설명, 기업 재무, 영업지표 및 양질의 이익 보고서 등을 포함한 잘 구성된 실사 요약 패키지의 제공을 통해 투자 절차를 도울 수 있습니다. 더 나아가 Sponsor 들은 지속적으로 신규 거래를 집행하며 신규 대출 기회를 꾸준히 제공합니다. 이렇듯 요구되는 노력에 비해 좋은 결과를 제공하기에 중형기업 Sponsor 거래 대출 시장의 경쟁은 점차 심화되고 있습니다.

2014 년 이후 설정된 275 개의 신규 Private credit 펀드 중, 당사는 경험적으로 다수의 펀드들이 Private equity 채널을 확보하기 위해 그들의 플랫폼을 할애하는 것을 목격해 왔습니다. Sponsor 채널에 증가된 관심의 결과로 경쟁이 심화되어, 당사는 레버리지가 확대되고, 스프레드가 낮아지며 전반적인 Credit 계약 및 문서화 절차가 약화되는 것을 보아 왔습니다. 당사 의견으로는 Middle market 에서의 이러한 시장 행동들은 자본 시장이 연장된 스트레스 기간을 겪게 되면 회복을 더디게 만들 것이라 생각합니다.

역사적으로 Lender 들이 Sponsor 거래를 하며 이러한 작은 양보를 용인하는 이유는 "더 안전한 손" (예. 경영 성과가 악화되면 Private equity sponsor 가 추가적인 지분을 투입 할 것이라는 추측)에 맡겨졌다는 인식이 있었기 때문입니다. 반면 당사의 경험에 따르면, 이 자금이 그들의 주주에게 매력적인 수익률을 가져다 주지 않는 한, Sponsor 가 추가적인 자금을 투입할 능력이 있음에도 자금을 투입하는 경우는 드뭅니다. 이러한 결과로 Borrower 의 지분에 Sponsor 가 존재 한다는 것에 대한 혜택은 명확하지 않으며 시니어 Creditor 로서의 비용은 의심할 여지없이 명확 합니다: 불리한 가격책정, 느슨해진 Covenant, EBITDA 의 더 광범위한 조정 및 구조적 보호장치의 약화 등 입니다. Private equity 와 연계된 대출이 매력적일 수 있는 시점은 대개 가격 이탈이 증가하는 시기로, Borrower 가 가격 민감도를 직접 대출 솔루션의 확실성, 규모 있는 자본, 신속한 시행 등을 통하여 얻을 수 있는 비경제적인 이득으로부터 분리할 수 있는 더 강한 능력을 가질 때 입니다.

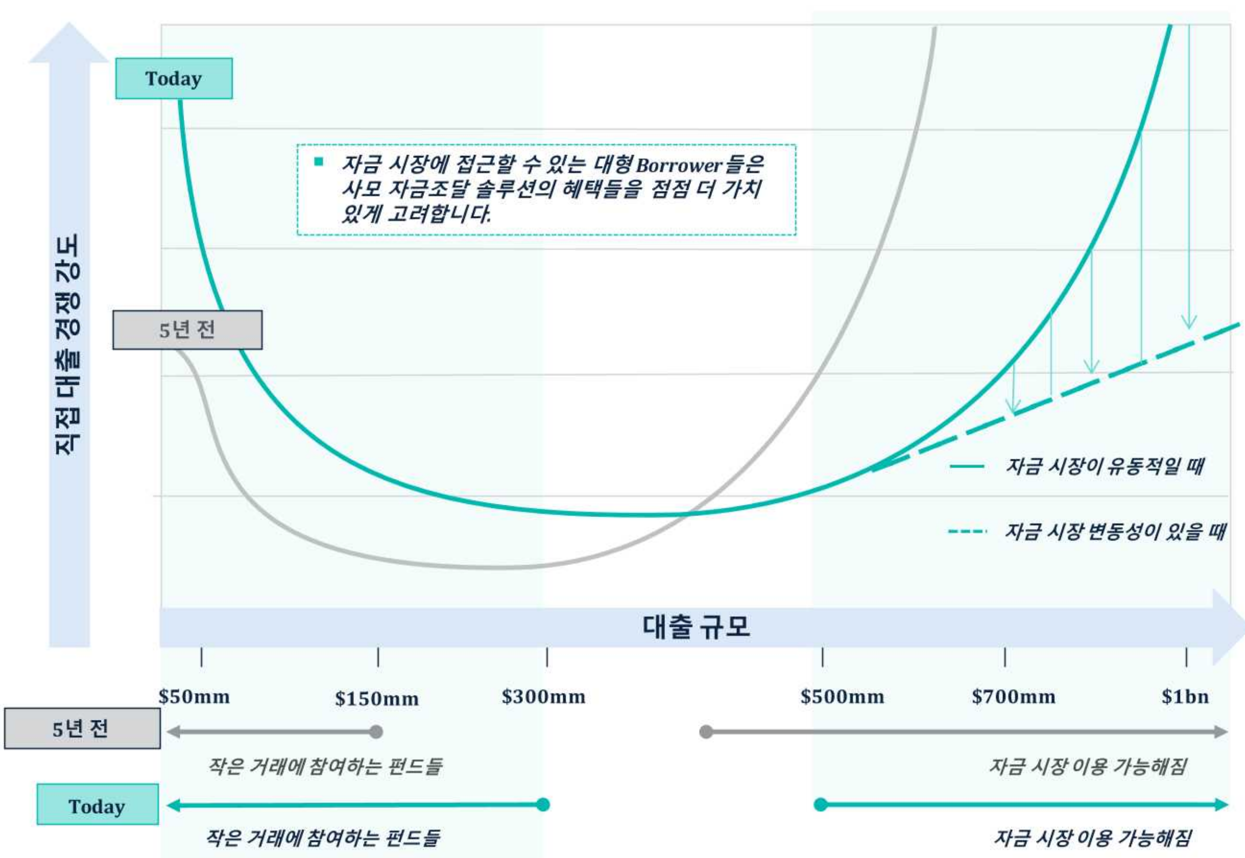
당사는 Direct lender 중 전통적인 Private equity sponsor 거래 이외의 소싱 능력이 탁월하다고 생각합니다. Non-private equity sponsor 거래에 집중하는 것은 자원과 시간이 필요하지만 (예. 차별화된 소싱 채널, "Private equity 스타일" 실사, 기업 지배구조의 철저한 검토, 필요 시 경영 팀의 강화 등), 당사는 Non-sponsor 및 (Non-sponsor 포트폴리오 투자 수준의 위험 조정 수익을

내는) Sponsor 거래에 모두 투자할 수 있는 분산화 및 유연성을 가지는 것은 양질의 조건과 가격책정의 높은 일관성을 보여주는 트랙 레코드를 제공할 수 있을 것 이라고 생각 합니다.

대형 규모의 영향력

중소형 Borrower 의 자금 수요에 맞춰 대출을 제공하기 위해 다수의 펀드들이 설립되고 있는 가운데, 당사는 향후 Private credit 의 성장 기회는 Upper-end 시장에 있다고 생각 합니다. 당사는 큰 규모, 경험 있는 운영 팀, 다양한 사업 모델 및 넓은 소비자 층 및 공급망을 갖춘 대형 Borrower 대출의 방어적인 특성을 좋아할 뿐만 아니라, 실제 큰 규모를 소화할 수 있는 당사의 능력이 경쟁력을 가지는 차별화 요소라 생각하며, 이는 당사의 가격책정 및 계약 철칙을 유지하도록 해줍니다. 대형 기업들이 신디케이트 자본 시장에 접근할 수는 있지만, 변동적인 국제 거시 경제 트렌드와 뉴스에 따라 매일 흐름이 달라지는 환경에서 자본 시장은 변덕스러운 파트너가 될 수 있습니다.

대형 규모는 낮은 위험과 더 나은 조건을 제공할 수 있는 대형 거래를 가능하게 합니다.



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역사적으로, 직접 대출 시장의 비교적 작은 규모를 고려할 때, 제한된 수의 펀드만이 Upper middle market borrower 에게 확실성을 제공할 수 있었습니다. 당사가 직접 대출 전략을 개시한 2010 년에는 단일 거래에 대한 $100mm 의 약정으로 다른

경쟁자들로부터 차별성을 가질 수 있었으며, Borrower 에게 일부 Borrower 들이 기꺼이 대가를 지불하고자 하는 자금 확실성을 제공하였습니다. 한편 Private credit 시장이 성장함에 따라 (Preqin 에 따르면 직접 대출, 메자닌, Distressed debt fund 를 포함한 글로벌 Private credit 시장의 규모는 2007 년 $200bn 에서 2018 년말 $800bn 규모로 성장)[8], Direct lender 들이 차별성을 가질 수 있는 약정 규모도 이에 비례하여 증가 하였습니다. 경험적으로 현재의 시장은 투자 건당 $400bn 이상을 약정할 수 있는 능력이 경쟁력 있는 차별성을 가진다고 생각합니다. 해당 규모 수준의 약정은 소수의 능력 있는 경쟁자들만 가능하기 때문에 당사의 관점에서 이러한 공급은 희소하며 적절하게 보상되어야 한다고 생각됩니다. Upper end 시장에서는 혼잡한 직접 대출 시장의 영역에서 볼 수 있는 가격 압박과 구조적 부실을 부르는 경쟁이 동일한 수준으로 나타나지 않습니다. 당사는 직접 대출 시장이 성장함에 따라 지금까지는 Direct lender 와 양자계약을 맺기에는 너무 큰 규모였던 Borrower 들이 Private credit 시장에서 어떤 것들을 제공받을 수 있는지를 탐색하는 모습을 더 많이 볼 수 있었습니다.

엄격한 비밀유지, 효율성, 확실한 실행 등을 제공할 수 있고 규모 있는 자본을 갖춘 직접대출 플랫폼은 소수의 자본 제공자로 인한 우호적인 경쟁구조와 중소형 및 Core-Middle 분야의 제공자들에 비하여 차별화 되는 위험조정 수익률을 가져오는 능력으로부터 수혜를 받을 수 있을 것입니다.

Direct Lending 2.0

직접 대출 기회들의 진화로 버전 2.0 에 진입하며, 당사는 덜 붐비는 길을 찾는 것이 매력적인 위험 대비 수익률을 얻을 수 있는 기회라고 생각합니다. 기업 Borrower 들은 전략적 금융 파트너로부터 Private capital 이 제공할 수 있는 혜택들을 점점 더 신중하게 고려하고 있습니다. 당사는 당사의 플랫폼이 Borrower 들에게 (a) 불확실성과 신디케이트 자금조달을 위한 비용이 증가하는 것으로부터 막아 주고 (b) 그들의 사업 성격에 따른 맞춤형 금융 솔루션을 협의하고 (c) Borrower 의 사업 성장에 따라 자금 규모를 확대할 수 있는 능력을 가진 장기간의 금융 파트너로서 전략적 대화를 구축하고 (d) Borrower 요구에 따라 상대적으로 짧은 기간에 자금을 확보하며 (e) 재무 및 영업 정보의 비밀을 유지하며 공시 요구사항을 최소화하며 (f) 신디케이트 자금조달과 관련한 경영진의 인력 및 시간소비 최소화를 제공 가능할 것으로 생각합니다. Borrower 들이 필요로 하는 큰 규모의 구체적인 자금 수요를 파악하고 신속하게 맞춤형 자본조달 솔루션을 제공하는 능력은 나머지 Lender 들과는 다른 저력을 갖게 하는 차별화된 요소가 될 것입니다.

[8] 2018 년 말 기준. Preqin 이 추적하는 펀드 데이터에 기초함. Preqin 데이터는 HPS 혹은 다른 기관에 의해 확인되지 않았습니다.

English Version

Evolution of Direct Lending Markets Driven by Consolidation and Regulatory Changes

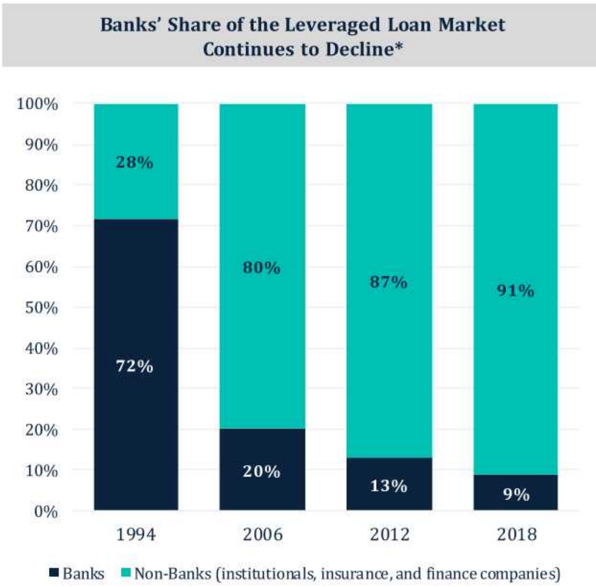
Private debt as an institutional asset class has grown considerably since the global financial crisis. It is estimated that, as of the end of 2018, global commitments to private debt were more than $770 billion[9]. However, looking back, private credit, particularly direct lending, was not always as mainstream but rather, it was historically deemed to be a niche strategy that would emerge as a cyclical opportunity set following heightened market volatility. In turn, these recessionary periods would create an imbalance between availability of capital from traditional bank providers and the demand from middle market companies in need of financing. This scarcity effect would open a window for direct lending opportunities to prevail for approximately 2-3 years post-recession before the catalyst for direct lending disappeared and banks re-entered the market following balance sheet repair and returned to originating new loans. While we initially envisioned this pattern to repeat itself following the global financial crisis of 2008, regulatory changes caused a secular shift that have made illiquid, non-investment grade corporate lending a less attractive asset for bank balance sheets.

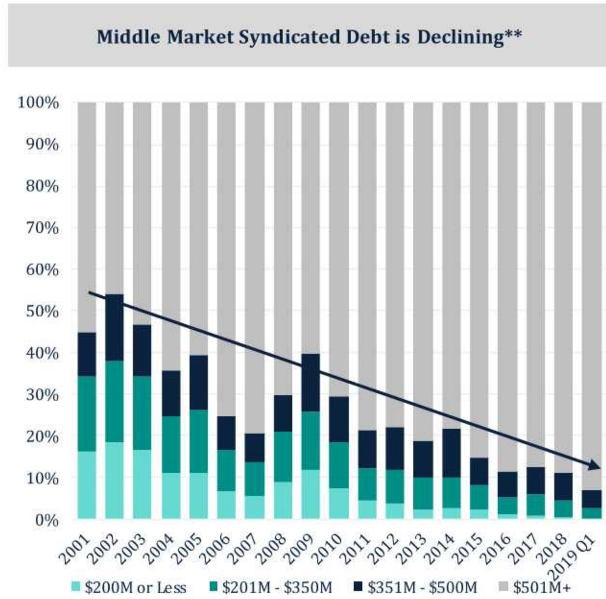
Source: US Bureau of Economic Analysis as of 3/31/19.

Regulatory actions in the aftermath of the 2008 financial crisis have significantly increased the cost of capital requirements for commercial banks, limiting the willingness of commercial banks to originate and retain illiquid investments. Banks have since shifted their focus further up-market to meet the financing demands of larger borrowers and have adopted an "underwrite-and-distribute" approach. As of the end of 2018, commercial banks represented approximately 9% of the leveraged loan market. Furthermore, a number of middle and upper middle-market sized issuers are finding that their size no longer meets the optimal issuer profile for certain debt providers, with issuers of

[9] "The $ 770 Billion Private Debt Market Is Ready for Consolidation", Sarah Syed & Ruth McGavin, Feb 28, 2019

tranche sizes representing less than $500 million accounting for approximately 7.1% of the new issue market as of March 31, 2019 as compared to over 45% in 2001.





Source: * S&P LCD's US Quarterly Leveraged Lending Review: 2Q 2019. ** S&P Global Market Intelligence Factsheet; 1Q 2019.

From the demand perspective, many middle market issuers seeking capital, have had difficulty in accessing traditional capital markets or bank financing. These borrowers require capital for re-financings, growth, acquisitions and restructurings. Even if issuers can access the syndicated market, they may not be well suited for the syndicated leveraged loan market (for example, in the case of smaller issue size, more complicated stories or first-time issuers). Over a full market cycle, the ability of these issuers to access public capital markets will vary; when the capital markets are aggressive and risk is priced cheaply, a selection of larger middle market issuers can access the traditional, syndicated loan market. When economic sentiment turns, and the markets become more volatile, these borrowers can be left with funding uncertainty. Private debt managers, who have long-term funding commitments from their institutional clients and who have several years to deploy capital can be a more stable source of debt funding. This makes them an attractive alternative for many borrowers.

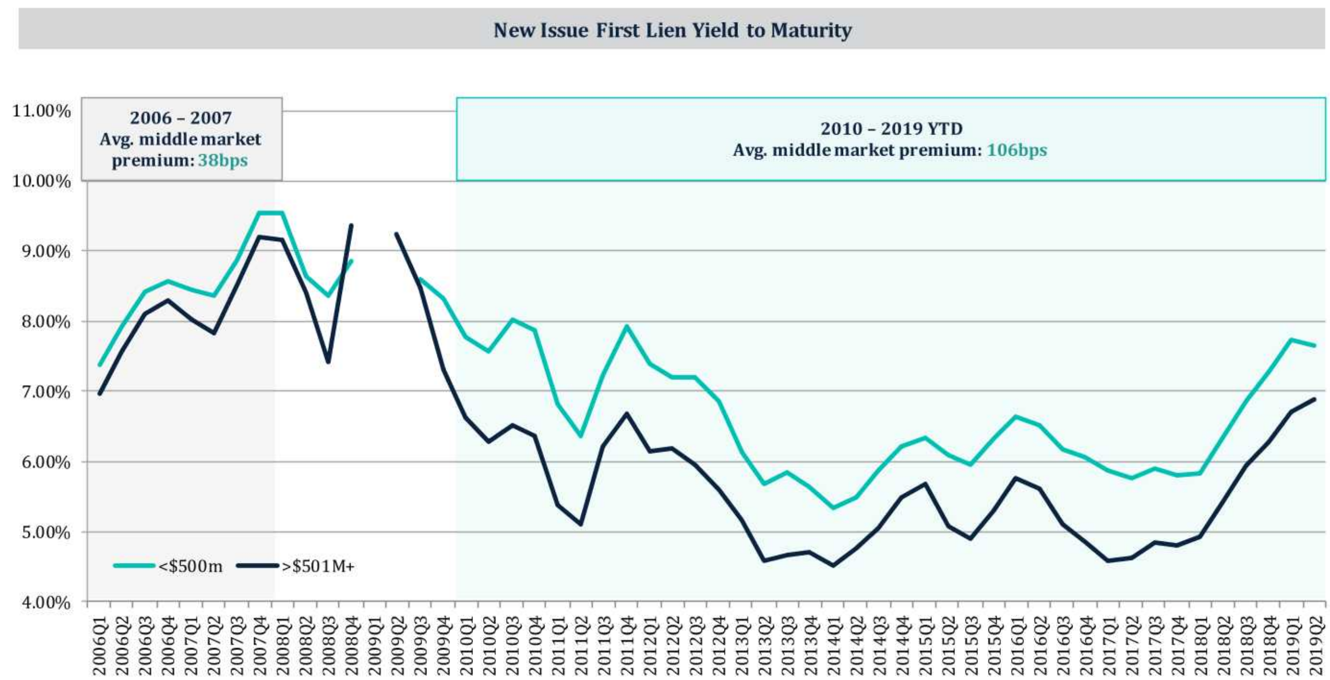
Private Markets are Going Mainstream

Over the past twenty years, there has been a continual shift from public to private capital. The number of private-equity backed companies in the US, for example, doubled between 2006 and 2017 while the number of publicly listed companies declined by 16%.[10] US private equity backed companies now roughly outnumber listed companies by two to one[11]. As of the end of 2017, private equity firms managed $2.8 trillion of assets.[12]

[10] "Private markets come of age", McKinsey Global Private Markets Review 2019
[11] "Private markets come of age", McKinsey Global Private Markets Review 2019
[12] "The Rise and Rise of Private Markets", McKinsey Global Private Markets Review 2018

Not surprisingly, the growth in private equity has fueled growth in private credit, with sponsor-backed companies preferring to deal with small syndicates of private lenders.

From an institutional investor's standpoint, relative yields generated by middle market loans compared to large corporate loans have remained attractive. Between 2010 through the second quarter of 2019, middle market loans (defined by tranche sizes less than $500 million) delivered on average a 1.06% premium compared to large corporate loans (defined by tranche sizes greater than $500 million).[13] This compares to a premium of 0.38% in 2006 through 2007 prior to the financial crisis.[14]



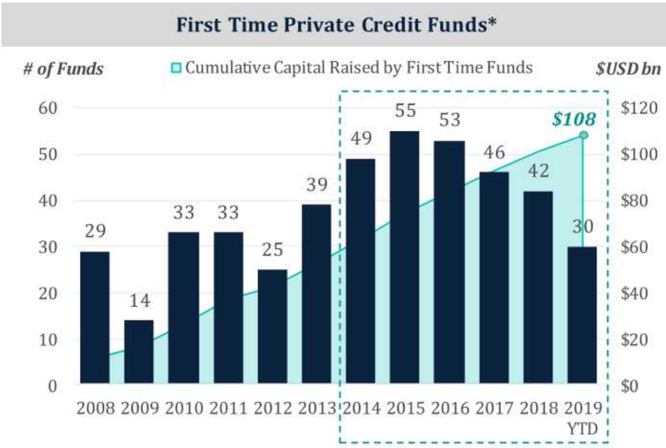
Source: S&P Capital IQ LCD as of Q2 2019. Distinction is by tranche size. YTM shown on a rolling 6-month basis. 1Middle market premium is defined by the premium to invest in tranche sizes less than $500mm compared to tranche sizes over $500mm.

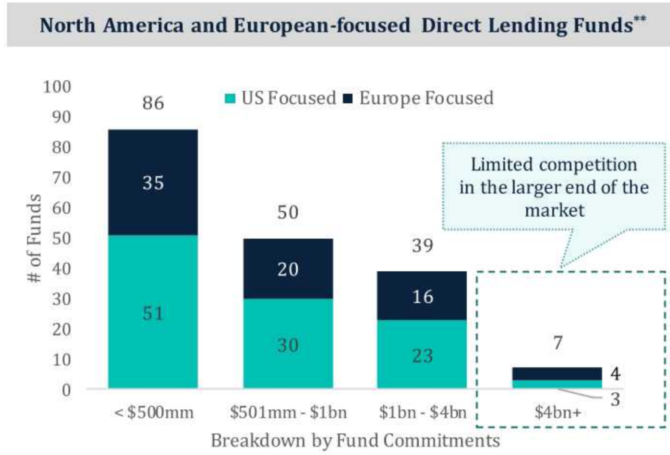
We believe this illiquidity premium has contributed to the emergence of private debt as an attractive asset class for both institutional investors and corporate borrowers. The size of the private debt market is currently estimated to be $770 billion[15] and is likely to continue to grow. This rise in capital flows has coincided with an influx of new private credit managers. Since 2014, there have been 275 first time private credit funds that have been raised in the marketplace. We believe that this wave of new entrants has driven weaker documentation and lower pricing in the traditional middle market lending opportunities. Despite the emergence of new managers, capital inflows have appeared to disproportionately benefit the largest private direct lending managers, which is made up of small handful of managers. With limited competition, the opportunity to find attractive risk adjusted returns at the upper-end of the lending universe continues to persist.

[13] Source: S&P Capital IQ LCD as of Q2 2019. Distinction is by tranche size. Yield to maturity shown on a rolling 6-month basis. Middle market premium is defined by the premium to invest in tranche sizes less than $500 million compared to tranche sizes over $500 million.

[14] Source: S&P Capital IQ LCD as of Q2 2019. Distinction is by tranche size. Yield to maturity shown on a rolling 6-month basis. Middle market premium is defined by the premium to invest in tranche sizes less than $500 million compared to tranche sizes over $500 million.

[15] "The $ 770 Billion Private Debt Market Is Ready for Consolidation", Sarah Syed & Ruth McGavin, Feb 28, 2019





As of March 2019. * Source: Preqin data based on First Time Private Credit Fundraises. Private Credit as defined by Preqin includes Direct Lending, Mezzanine, Special Situations, Venture Debt, Private Debt Fund of Funds. Data as of October 8, 2019. ** Source: Preqin data based on Direct Lending funds with final closes since 2010. Note region focus denoted by Preqin represents the majority of such funds' geographic focus. Based on managers' most recent vintage year fund commitments. Note that Preqin data has not been verified by HPS or any other party.

Sponsor-Backed Lending Community: Overcrowded?

In today's market, we have witnessed fierce competitive behaviors in certain areas of the market, specifically in sponsor-backed transactions to middle market companies. We believe most managers target lending to private equity sponsors as it has lower barriers to entry and is a more efficient sourcing model. From a lender's perspective, sponsors help shepherd the investment process by providing potential lenders with a well-packaged due diligence summary that contains business description, company financials, operating metrics, quality of earnings report, etc. Furthermore, sponsors are consistently executing new transactions, providing a steady stream of new lending opportunities. This part of the lending market has become immensely competitive as it provides for a good return relative to the effort required.

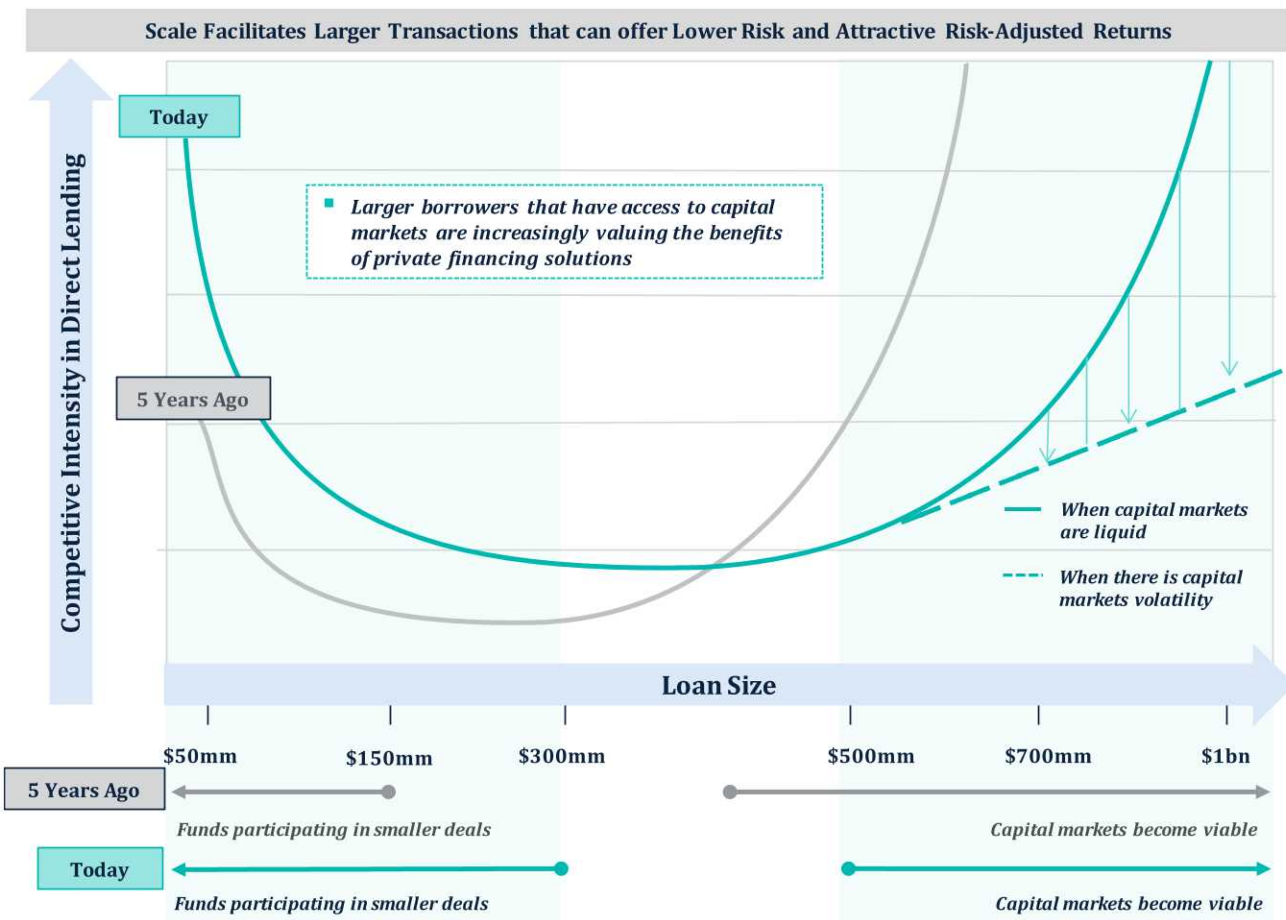
Of the 275 new private credit funds that have been raised since 2014, we've seen empirically a majority of this new cohort dedicate their platforms to covering the private equity channel. As a result of increased coverage on the sponsor channel, we've seen leverage deepen, spreads tighten, and a general deterioration in credit documentation as competition has risen. In our opinion, these market behaviors in the middle market will likely weigh on recoveries when the capital markets experience an extended period of stress.

Historically, the rationale for why lenders were willing to accept these small concessions for doing a sponsor deal was the perceived notion you were lending into "safer hands" – e.g., a private equity sponsor should be willing to inject more equity if operating performance were to deteriorate. While sponsors do have the ability to inject additional capital, in our experience, they will rarely do so unless the additional capital achieves an attractive equity-like return for their underlying shareholders. As a result, the benefit of having a sponsor in the borrower's equity is unclear, but the costs as a senior creditor are undoubtedly definitive: tighter pricing, looser covenants, wider adjustments to EBITDA, and weaker structural protections. The times by which lending to the private equity community can be attractive are usually during times of increased dislocation, when borrowers have a stronger ability to bifurcate price sensitivities from the non-economic benefits to be gained such as providing certainty, scaled capital, and speed of execution of a direct lending solution.

We believe that the ability to source transactions outside of the traditional private equity sponsor community is distinctive amongst other direct lenders. While a focus on non-private equity sponsored deals is resource and time-intensive (i.e., differentiated sourcing channels, "private-equity style" due diligence, a forensic review of corporate governance, strengthening of management teams where appropriate, etc.), we believe having the diversification and flexibility to do both non-sponsor and sponsor investments (which hold up to the risk adjusted returns of the non-sponsor portfolio of investments) can deliver a track record that reflects greater consistency on higher-quality terms and pricing.

The Impact of Large Scale

With the number of nascent funds that have emerged servicing the demand by the small to medium sized borrowers, we believe the future growth of the private credit opportunity lies at the upper-end of the market. Not only do we like the defensive nature of lending to larger borrowers – greater critical mass, experienced management teams, more diversified business models and broader base of customers and suppliers, but the ability to speak for real size is a competitive differentiator that typically allows us to maintain pricing and document discipline. Larger companies have access to the syndicated capital markets and all that implies in terms of pricing and documents, but the capital markets can be fickle partners in a world where global macro trends are often choppy and political headlines drive daily flows.



Source: HPS. For illustrative purposes only and represents HPS's subjective opinions and views as of the date hereof subject to change depending on market environment, it should not be relied upon as advice or interpreted as a recommendation. Competitive intensity is based on HPS's qualitative view of the market and not quantitative data.

Historically, given the relatively small scale of the direct lending market, limited funds, if any, could provide certainty to upper middle market borrowers. When we started the direct lending strategy in 2010, committing to $100mm in a single transaction could differentiate a firm from its competitors and provide a borrower with certainty of financing that some borrowers were willing to pay for. As the private credit markets have grown (according to Preqin the global private credit markets, which includes direct lending, mezzanine and distressed debt funds, have grown from approximately $200 billion in 2007 to $800 billion at the end of 2018)[16], the size of a commitment typically required to differentiate a direct lender has grown commensurately. Empirically, in today's market, we see competitive differentiation in the ability to commit $400 million or more to an investment. Importantly, because that size of commitment is currently only available from a handful of established and sophisticated competitors who, in our view, believe the offering is rare and deserves to be compensated appropriately, in the upper end of the market, we have not observed the same level of competition that can lead to pricing compression and structural erosion that we have seen in the more crowded areas of the direct lending market. As the direct lending market grows, we are seeing more large scaled borrowers – who historically were simply too large to have a bilateral relationship with a direct lender – explore what the private credit markets can offer them. Direct lending platforms with scaled capital who can offer confidentiality, efficiency, and execution certainty will benefit from favorable competitive dynamics with fewer capital providers and an ability to deliver differentiated risk-adjusted returns compared to those trafficking in the smaller-end / core-middle market segment.

Direct Lending 2.0

As we enter version 2.0 in the evolution of the direct lending opportunity set, we believe finding avenues that are less trafficked is an opportunity to unpack attractive returns relative to the economic risks. Corporate borrower behavior has increasingly shifted to a more conscious assessment of the benefits that private capital from strategic financing partners can offer. We believe our platform is able to provide borrowers the ability to: (a) avoid uncertainties and increasing costs associated with obtaining syndicated financing commitments, (b) negotiate customized, bespoke financing solutions tailored to their business characteristics, (c) build a strategic dialogue with a long-term financing partner that has the ability to scale its capital as borrowers experience business growth, (d) secure financing in a relatively short period of time if necessary due to an imminent catalyst or borrower need, (e) minimize public reporting requirements while maintaining confidentiality of financial and operating information, and (f) minimize management team distraction and time associated with a syndicated financing. The ability to identify the specific needs of borrowers in need of scaled capital and react quickly with a bespoke financing solution is what will be the differentiating factor elevating those direct lenders with staying power from the rest of the pack.

[16] As of 12/31/2018. Based on fund data that is tracked by Preqin. Note that Preqin data has not been verified by HPS or any other party.

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This material does not constitute an offering of any security, product, service or fund, including the Fund, for which an offer can be made only by the Fund's Confidential Offering Memorandum (the "Confidential Memorandum"). The terms and risk factors of the Fund are set out in its Confidential Memorandum which is available to qualified prospective investors upon request. The contents hereof are qualified in their entirety by the Confidential Memorandum and subscription agreements of the Fund.

The purchase of interests in the Fund is suitable only for sophisticated investors for which an investment in the Fund does not constitute a complete investment program and who fully understand and are willing to assume the risks involved in the Fund's investment program. Generally, the Fund would include investors who are "Accredited Investors" under the Securities Act of 1933, "Qualified Purchasers" under the Investment Company Act of 1940, and "Qualified Eligible Persons" under Regulation 4.7 of the Commodity Exchange Act.

The interests have not been and will not be registered under the Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws or the laws of any foreign jurisdiction. The interests will be offered and sold under the exemption provided by Section 4(a)(2) of the Securities Act and Regulation D promulgated thereunder and other exemptions of similar import in the laws of the states and other jurisdictions where the offering will be made. The Fund will not be registered as an investment company under the Investment Company Act of 1940.

The interests are subject to restrictions on transferability and resale and may not be transferred or resold except as permitted under applicable statutes. In addition, such interests may not be sold, transferred, assigned or hypothecated, in whole or in part, except as provided in the Fund's organizational documents. Accordingly, investors should be aware that they will be required to bear the financial risks of an investment in the interests for an indefinite period of time. There is no secondary market for an investor's interests in the Fund and none is expected to develop. There is no obligation on the part of any person to register the interests under any statutes.

The performance results of certain economic indices and certain information concerning economic trends contained herein are based on or derived from information provided by independent third party sources. The Fund believes that such information is accurate and that the sources from which it has been obtained are reliable. The Fund cannot guarantee the accuracy of such information, however, and has not independently verified the assumptions on which such information is based.

Certain information contained in this material constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue" or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance of the Fund may differ materially from those reflected or contemplated in such forward-looking statements.

In the U.K., this is an unregulated investment scheme and as such it may only be promoted to limited categories of persons pursuant to the exemption contained in Section 238 of the Financial Services and Markets Act 2000 (the "Act"). Information contained herein may only be promoted to persons that are sufficiently experienced and sophisticated to understand the risks involved and who satisfy certain other criteria, as specified by regulations made under the Act and Financial Conduct Authority ("FCA") rules. If you are in any doubt as to whether or not you fall within one of the categories of permitted persons, you should not solely rely on any information herein and should contact HPS.

Past performance is not necessarily indicative of future results. Performance is estimated and unaudited. While this summary highlights important data, it does not purport to capture all dimensions of risk. The methodology used to aggregate and analyze data may be adjusted periodically. The results of previous analyses may differ as a result of those adjustments. The Fund is an actively managed portfolio and regional, sector and strategy allocations are subject to ongoing revision. HPS has made assumptions that it deems reasonable and used the best information available in producing calculations above.

Please note the following Risks: Investors are strongly urged to carefully review the sections in the Confidential Memorandum titled "Risk Factors" and "Conflicts of Interest." Among the risks involved in an investment in the Fund are as follows:

General/Loss of capital. An investment in the Fund involves a high degree of risk. There can be no assurance that the Fund's return objectives will be realized and investors in the Fund could lose up to the full amount of their invested capital. The Fund's fees and expenses may offset the Fund's trading profits. **Limited liquidity.** An investment in the Fund provides limited liquidity since withdrawal rights are limited and interests are not freely transferable or redeemable. There is no secondary market for the interests in the Fund and none is expected to develop. **Dependence on manager.** The fund manager has total trading authority over the Fund. The use of a single advisor could result in lack of diversification and consequently, higher risk. Decisions made by the fund manager may cause the Fund to incur losses or to miss profit opportunities on which it would otherwise have capitalized. **Volatility.** Investment techniques used may include the use of leverage and derivative instruments such as futures, options and short sales, which amplify the possibilities for both profits and losses and may add volatility to the Fund's performance. **Potential conflicts of interest.** The payment of a performance based fee to the fund manager may create an incentive for the fund manager to cause the Fund to make riskier or more speculative investments than it would in the absence of such incentive. **Valuation.** Because of overall size or concentration in particular markets of positions held by the Fund or other reasons, the value at which its investments can be liquidated may differ, sometimes significantly, from the interim valuations arrived at by the Fund. **Non-U.S. securities.** The Fund will invest in foreign securities, which may include exposure to currency fluctuation, reduced access to reliable information, less stringent accounting standards, illiquidity of securities and markets, higher commissions and fees and local economic or political instability. **Absence of regulatory oversight.** The Fund will not register as an investment company under the U.S. Investment Company Act of 1940 or similar laws or regulations. Accordingly, the provisions of such laws and regulations will not be applicable.

The foregoing risk factors do not purport to be a complete explanation of the risks involved in an investment in the Fund. Investors should read the entire Confidential Memorandum before making investment determinations with respect to the Fund.

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HPS

HPS Investment Partners is a global investment firm with approximately $58 billion of assets under management. HPS was founded in 2007 and manages various strategies that invest across the capital structure, from syndicated leveraged loans and high yield bonds to privately negotiated senior secured debt and mezzanine investments, asset-based leasing and private equity. The scale and breadth of the Firm's platform offers the flexibility to invest in companies large and small, through standard or customized solutions. HPS is headquartered in New York with ten additional offices worldwide and has 139 investment professionals and over 340 employees globally*.

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