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Manager Perspectives: Brad Marshall

Brad Marshall

Co-head of Performing Credit, Senior Managing Director, Portfolio Manager

Startup executive, portfolio manager, private lender, leveraged loan analyst: Each of the vantages Brad Marshall has enjoyed in his 25-year investment career underscores the role of a long-term, risk-managed and returns-oriented mindset. The Blackstone Private Wealth Solutions Team sat down to hear Brad's views on the rapidly growing, $811 billion field of private credit,[1] which shows few signs of slowing. As banks retreat from lending (bank participation in U.S. loans has decreased from 25% at the end of 2005 to 13% at the end of 2020),[2] borrowers may look for partnershiporiented lending relationships, as investors also seek higher yields. Brad sees private credit as something of a sweet spot for continued borrower demand and attractive risk-adjusted returns.

- Tenure with Blackstone Credit: 16 years (since 2005)
- Education: Masters of Business Administration, McGill University (Montreal, Canada); Bachelor of Arts (Honors) in Economics (Queen's University, Kingston, Canada)
- Interesting Fact: Before his career in asset management, Brad co-founded a microchip verification software company where he was CFO

Q: You've said you believe risk is one of the most important things to watch in private credit transactions. Tell us how you came by that view.

A: We try to take a very long-term view in credit, which requires an intense focus on downside risk protection. In credit, you make money chiefly by not losing anything. The loans we make are contractual in nature. Every quarter, we collect interest payments from companies we lend to and pass them to our investors. If things go as planned, we get our payments along with some fees. Then, over time, our principal is returned. Mistakes tend to happen when you take a short-term view about the company's earnings potential or how their sector may evolve over time, among many other potential risks.

Q: The growth of private credit over the last several years is nothing short of phenomenal.[3] In your view, what's behind the trend?

A: Investors today live in a very low interest-rate environment. The public markets have not given credit investors the returns they used to enjoy. I think low rates are the number one thing spurring more investors to examine private credit. But investor conservatism has also fueled its rise. Years ago, private asset classes were seen as a place of high risk and high return potential. It wasn't until seven or eight years ago that institutional investors realized they could aim for lower risk by being further up the capital structure, but still enjoy relatively attractive return potential.

Q: You don't view the sector as frothy in the way that some observers do. Why?

A: The view that there is too much capital coming into private credit generally assumes the U.S. loan and high yield markets are one big $3.7 trillion pie.[3] It's taken for granted that a single pool provides the financing for public companies, for private leveraged buyouts, and other types of below-investment grade companies. But what we've seen over the past ten years is private credit's slice of the market rise from around 15% to 22%,[3] which we believe still leaves room for growth. Private credit is able to take on progressively larger deals, and it has proven to be a popular asset class in its own right. Its growth in the last 10 years is evidence that it is a financing source that companies and sponsors are increasingly inclined to use.

Q: What is your view on the middle market segment of private lending?

A: The middle market stands at a fascinating crossroads. As of right now in 2021, we continue to see healthy businesses recover from early 2020 in a strong rebound.

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We're seeing that private equity sponsors are looking to deploy their large amount of unfunded capital. More generally, we believe U.S. middle market companies require substantial capital investment to grow their businesses. They continue to be underserved, despite presenting what are often very compelling lending opportunities. The middle market represents a large and growing portion of the U.S. economy (the middle market accounts for about 33% of domestic GDP).[4] Despite the demand for capital, traditional bank lenders have largely exited the space due to consolidation and regulations. Several new private capital providers have entered to meet this demand, but we firmly believe that an established and experienced lender is an ideal partner for middle market companies. Lending and originating private loans generally require a great amount of expertise, resources and time. Many investment firms do not have the breadth and scale necessary to source high quality transactions, underwrite and negotiate the most attractive terms, and add value to these businesses after becoming a lender.

Q: Why would borrowers be willing to pay higher rates in private credit transactions?

A: Certainty of execution, the ability to work with only one partner, the capability to do these transactions in size, and the flexibility of deal structure — these are the real attractions for borrowers.

Going to public markets means you hire a bank, lawyers, and a ratings agency to structure and rate a transaction. Then the bank ultimately sells it to the public market, which is predominantly CLOs and mutual funds. There are expenses; there is uncertainty. Borrowers don't know for sure where their debt is going to price until they actually take it to market and their debt ends up being held by numerous buyers.

In private credit, you know your terms with a high degree of exactitude when you sign the deal. There are no changing terms depending on market conditions between signing and closing. We stand by our terms because, again, we're long-term investors.

I'd also point out the terms and structure can be more flexible to suit any borrower's specific capital needs. Additionally, a deal can get done very quickly. Speed is valued by many companies. Furthermore, the deal can be done under-the-radar compared to the process in public markets. Some borrowers don't want information in the open. For these advantages, they are willing to pay a premium and live by a tighter credit agreement. We may not have the ability to sell the debt — situations where we own it for the duration of the term — so these richer terms are where borrowers and lenders can meet.

"Having a well-rounded perspective of risk is the key to managing credit. We try to think of every way to protect our downside because, in credit, that's how you measure success. The best risk-reward over an extended period of time is what we're looking for and delivering."

Q: How are assets in private credit distinguishable compared to public credit instruments?

A: In a private credit portfolio, meaningful covenants can allow investors to hold on to high-performing and high income-generating assets without having to worry about these companies refinancing immediately. On a singleasset basis, there are a few reasons private assets may be appealing. First, there are typically maintenance and financial covenants in place, which allow lenders to identify problems early. These covenants can decrease the likelihood of a default and improve recovery potential in the event of one. As a result, the likelihood of a default may go down and your recovery potential may go up. Second, in the event that a company defaults, it interfaces with only one counterparty who can act as a partner to determine the best path forward, instead of negotiating with a large pool of different lenders who may have different interests and goals. These two features can help us to avoid being in a position where there is not a lot of recovery in the event of default.

Q: Can you describe the type of companies you prefer to lend to?

A: A typical transaction for us is with a performing middle market to upper middle market company with approximately 50% loan-to-value. We target businesses with a leading, defensible market position; sustainable barriers to entry; stable and strong free cashflow generation; liquidity to withstand market cycles; high quality management team; and often times backed by private equity / financial sponsorship. We aim to have a diversified portfolio in terms of the companies that we lend to, since diversification can help reduce downside risk. We try to be invested across a large range of sectors, most of which will we think have some defensive characteristics and a diversified base of customers and suppliers. We tend to avoid sectors that are experiencing secular shifts, such as changes in technology, brick and mortar retail, and companies with high customer concentration, limited collateral value or regulatory overhang.

Q: How is Blackstone's credit platform different?

A: We sit at a busy intersection between various parts of the loan market, whether it's Europe versus the U.S., private versus public, senior versus junior, mid-sized versus large-cap — we see all of it in our ecosystem. We're invested in over nine hundred companies in various strategies. As a result, we can take a step back at any particular time and ask, where do we think we should be allocating capital and how should we price risk?

I'd argue we have a unique ability to be a value-add partner to owners and private equity sponsors of businesses through what we call the Blackstone Advantage program, which is available to Blackstone's portfolio companies. The program creates a platform for Blackstone portfolio companies to cross-sell products and services to each other and provides access to resources and expertise within the Blackstone platform. We believe this can help generate value beyond just capital.

Furthermore, in the event a company defaults, we may become the owner and operator of the business. While that is not a position we want to be in, it is one we are well-equipped to handle. With an established private equity business, Blackstone has the internal resources and mindset to own, operate and drive value. Ultimately, what that does for us is protect our downside. It helps us potentially maximize recovery.

Q: To sum up — why private credit now?

A: At a time when yield is scarce and rates are ultra-low, we've seen a number of investors turn to private credit as a substitute for high yield. We've also seen some investors with low equity return expectations consider an allocation in place of reduced equity holdings. To the extent investors expect interest rates and yields to remain ultra-low, or if they want to diversify outside of public markets in search of return potential, I would expect private credit to continue to draw plenty of interest.

Credit at a Glance

379
employees globally[5]

>1,800
corporate issuers invested across portfolio[6]

$149B
assets under management[7]

$27B
senior secured direct lending[7]

Note: There can be no assurance that any current or future Blackstone fund will achieve results comparable to those of any of Blackstone's prior funds or that such fund will be able to implement its investment strategy or achieve its investment objectives. Please see Endnotes and Important Disclosures.

Endnotes

1. Source: Preqin as of September 30, 2020. The $811B size of the private credit market is calculated by the total dry powder and assets under management of U.S.-based managers.
2. Source: LCD, Preqin. Period measured is December 2005 through December 2020.
3. Source: Preqin, Credit Suisse as of September 30, 2020.
4. Source: National Center for the Middle Market – 4Q 2020 Middle Market Indicator as of December 31, 2020.
5. As of March 31, 2021.
6. Issuers across portfolios include all corporate issuers covered by both the Liquid Credit Strategies and Alternative Credit research teams across Alternative Investment Funds and Liquid Credit Funds, including, but not limited to, broadly syndicated assets, middle market assets, high yield bonds, investment grade assets, and mezzanine transactions. As of March 31, 2021.
7. As of March 31, 2021. The assets under management ("AUM") for Blackstone or any specific fund, account or investment strategy presented in this document may differ from any comparable AUM disclosure in other non-public or public sources (including public regulatory filings) due to, among other factors, methods of net asset value and capital commitment reporting, differences in categorizing certain funds and accounts within specific investment strategies and exclusion of certain funds and accounts, or any part of net asset value or capital commitment thereof, from the related AUM calculations. Certain of these differences are in some cases required by applicable regulation. Past performance is not necessarily indicative of future results.

Summary of Risk Factors

Blackstone Private Credit Fund ("BCRED") is a non-exchange traded business development company ("BDC") that expects to invest at least 80% of its total assets (net assets plus borrowings for investment purposes) in private credit investments (loans, bonds and other credit instruments that are issued in private offerings or issued by private companies). This investment involves a high degree of risk. You should purchase these securities only if you can afford the complete loss of your investment. You should read the prospectus carefully for a description of the risks associated with an investment in BCRED. These risks include, but are not limited to, the following:

- We have limited prior operating history and there is no assurance that we will achieve our investment objectives.
- This is a "blind pool" offering and thus you will not have the opportunity to evaluate our investments before we make them.
- You should not expect to be able to sell your shares regardless of how we perform.
- You should consider that you may not have access to the money you invest for an extended period of time.
- We do not intend to list our shares on any securities exchange, and we do not expect a secondary market in our shares to develop prior to any listing.
- Because you may be unable to sell your shares, you will be unable to reduce your exposure in any market downturn.
- We intend to implement a share repurchase program, but only a limited number of shares will be eligible for repurchase and repurchases will be subject to available liquidity and other significant restrictions.
- An investment in our Common Shares is not suitable for you if you need access to the money you invest. See "Suitability Standards" and "Share Repurchase Program" in the prospectus.
- We cannot guarantee that we will make distributions, and if we do we may fund such distributions from sources other than cash flow from operations, including, without limitation, the sale of assets, borrowings, return of capital or offering proceeds, and we have no limits on the amounts we may pay from such sources. A return of capital (1) is a return of the original amount invested, (2) does not constitute earnings or profits and (3) will have the effect of reducing the basis such that when a shareholder sells its shares the sale maybe subject to taxes even if the shares are sold for less than the original purchase price.
- Distributions may also be funded in significant part, directly or indirectly, from temporary waivers or expense reimbursements borne by the Adviser or its affiliates, that may be subject to reimbursement to the Adviser or its affiliates. The repayment of any amounts owed to our affiliates will reduce future distributions to which you would otherwise be entitled.
- We expect to use leverage, which will magnify the potential for loss on amounts invested in us.
- We qualify as an "emerging growth company" as defined in the Jumpstart Our Business Startups Act and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our Common Shares less attractive to investors.
- We intend to invest in securities that are rated below investment grade by rating agencies or that would be rated below investment grade if they were rated. Below investment grade securities, which are often referred to as "junk," have predominantly speculative characteristics with respect to the issuer's capacity to pay interest and repay principal. They may also be illiquid and difficult to value.
- We do not own the Blackstone name, but we are permitted to use it as part of our corporate name pursuant to the investment advisory agreement between BCRED and an affiliate of The Blackstone Group Inc. (together with its affiliates, "Blackstone"). Use of the name by other parties or the termination of the use of the Blackstone name under the investment advisory agreement may harm our business.

Neither the Securities and Exchange Commission nor any state securities regulator has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense. This sales material must be read in conjunction with the BCRED prospectus in order to fully understand all the implications and risks of an investment in BCRED. This sales material is neither an offer to sell nor a solicitation of an offer to buy securities. An offering is made only by the prospectus, which must be made available to you prior to making a purchase of shares and is available at www.BCRED.com. An investor should consider the investment objectives, risks and charges and expenses of BCRED carefully before investing. Prior to making an investment, investors should read the prospectus, including the "Risk Factors" section therein, which contains a discussion of the risks and uncertainties that we believe are material to our business, operating results, prospects and financial condition.

Numerical data is approximate and as of December 31, 2020, unless otherwise noted. The words "we", "us", and "our" refer to BCRED, unless the context requires otherwise.

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Certain information contained in this document constitutes "forwardlooking statements," which can be identified by the use of forwardlooking terminology such as "may," "will," "expect," "intend," "anticipate," "estimate," "believe," "continue" or other similar words, or the negatives thereof. These may include our financial projections and estimates and their underlying assumptions, statements about plans, objectives and expectations with respect to future operations, and statements regarding future performance. Such forward-looking statements are inherently uncertain and there are or may be important factors that could cause actual outcomes or results to differ materially from those indicated in such statements. BCRED believes these factors include but are not limited to those described under the section entitled "Risk Factors" in its prospectus and any such updated factors included in its periodic filings with the Securities and Exchange Commission (the "SEC"), which will be accessible on the SEC's website at www.sec.gov. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included BCRED's prospectus and other filings. Except as otherwise required by federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of newinformation, future developments or otherwise.

Note: There can be no assurance that any current or future Blackstone fund will achieve results comparable to those of any of Blackstone's prior funds or that such fund will be able to implement its investment strategy or achieve its investment objectives. Please see Endnotes and Important Disclosures.

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