Evolution of Private Credit: Views from Brad Marshall

Brad Marshall

Co-head of Performing Credit, Senior Managing Director, CEO of Blackstone Private Credit Fund (BCRED)

As part of Blackstone's leading credit platform since 2005, Brad Marshall has had a front-row seat to the evolution of private credit, driven in part by yield seeking investors and borrowers looking for strong lending partnerships. With his perspective as CEO of BCRED, Blackstone's institutional-caliber private credit solution for income-focused investors, Brad sat down with Blackstone Private Wealth Solutions to discuss:

- Trends in private credit such as the rise of larger transactions,
- Persistent themes such as borrowers' search for certainty, efficiency, flexibility, and
- How investors are allocating to the private credit within their portfolios

Q: Private credit is continuing to grow rapidly as a part of credit markets. What's driving this?

A: We're seeing healthy drivers of growth in the private credit market on both the supply and demand sides. When it comes to supply, more investors are attracted to private credit because it has offered more attractive yield historically than certain other segments of the credit markets, such as leveraged loans and high yield.[1] With private credit, we're senior in the capital structure and typically the borrower's sole lender. Additionally, we believe private lenders can command a premium compared to the public markets for a similar company seeking capital.

Q: You mentioned this growth is driven by both the supply and demand side. What's the demand side?

A: The demand side is driven by companies, as the borrowers, and by private equity sponsors, who are the main users of private credit in making the equity investments in those companies. We believe both borrowers and private equity sponsors are looking to private financing options for reasons such as speed of execution, certainty of commitment, fewer public disclosures, and more flexible solutions that we view as long-term drivers for enterprise value.

Blackstone was one of the pioneers in the market back in 2005 when private credit was about 7% of the almost $1.4 trillion overall below-investment grade financing market in the US. Today, that figure is around 22% of a now $3.7 trillion market.[2] We expect this growth to continue, even accelerate, primarily driven by the increasing number and size of large-scale transactions moving into private markets.

Q: What's behind the increase in the number and size of these large loans?

A: To me, this is the most interesting change in the market this year—the number of large loans that would have historically been done in public markets that are now gravitating toward private financing. We think this is happening because private lenders can be much more flexible in solving capital needs of companies and sponsors compared to counterparts in the public markets. For these larger transactions,

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sponsors are looking for a lending partner who can make a large commitment while moving quickly and quietly so confidential information does not leak to the public. Additionally, with private credit, companies and sponsors do not need to go through a lengthy ratings agency process or a management roadshow. Lastly, there is no syndication process for the debt. They can partner with one large-scale private credit manager who can take on the full deal and complete the financing in a quiet and efficient process.

Q: Are these larger deals taking place in any particular sectors or industries?

A: We've seen the growth broadly but more so in higher-growth businesses in fast-growing sectors. We are thematic investors across Blackstone, focused on investing in what we'd characterize as "good neighborhoods," sectors that are experiencing favorable tailwinds, including technology, software, distribution and logistics, and certain parts of healthcare.

We look to structure our loans to these larger companies at below 40% loan-to-value[3], so in our opinion, they are well-covered from a capital structure perspective given the equity cushion beneath our loan that must be lost before our capital is impacted.

Private lending creates what we think is a better and more complete experience for private equity sponsors who may feel limited by the public markets. For them, having additional funding available for acquisitions is an important part of the growth strategy, and we can provide that in a flexible structure.

"Scale has been the only thing holding private credit back from these larger deals — until now. Blackstone Credit and BCRED are leading the market towards being able to do these larger deals."

Q: How is Blackstone Credit able to source these larger deals?

A: Blackstone Credit is one of the largest non-bank lenders globally. So, if there is a transaction of scale, we are top of mind for the company looking for financing. Typically, it's private equity sponsors looking for capital to help fund a portfolio company they are acquiring. We cover about 500 sponsors globally, including 300 in the U.S. Our senior investment team has close conversations with sponsors daily. Also, we are one of the largest leveraged loan manager in the world so we're working with these firms in other ways across the firm. At the end of the day, the common theme is the connectivity that we have with the private equity community and the broader corporate market who know Blackstone and its reputation. Because of this, we are often borrowers and sponsors' first call.

Q: How does Blackstone differentiate itself from other private lenders?

A: Blackstone differentiates itself from other private lenders in the market by being a truly value-added partner. We have a Blackstone Advantage Program that helps our portfolio companies increase revenues, save costs, and provide them with operational support. We work with portfolio companies and their management teams to support them operationally where we can. We leverage our scale not just with our capital base, but also with resources to help companies become more profitable by leveraging the collective scale of Blackstone in procurement, cross-selling initiatives, whatever way we can to help our companies. So those areas that pull private equity sponsors toward Blackstone Credit even though our capital may be a little bit more expensive.

Q: Being focused on minimizing risk, walk us through how you evaluate risk at the company and portfolio-level.

A: As we think about risk in today's environment, we think about inflation and pockets of volatility and weakness. The first thing we evaluate are risks to the underlying business, the business model, and the sector, because failure in credit is punitive. We price and structure our transactions based on risk assessment and due diligence. We tend to avoid sectors that are hypercyclical and areas with secular, long-term headwinds. We also avoid credit that has a single point of failure. For example, a company with high customer concentration that would run into difficulties if one large customer were to take their business elsewhere. We work toward building a diversified portfolio such that if there is any issue in one company, it does not overly impact the overall portfolio. We think about trying to mitigate risk in as many ways as possible.

Q: How should investors think about private credit in the context of their fixed income allocations? What about the comparison to high yield bonds?

A: As an income-focused asset class which has exhibited less volatility and relatively low correlation to other fixed income asset classes[4], private credit can fit well into a range of portfolio types from a portfolio construction standpoint. We believe private credit is an attractive alternative to traditional fixed income, including high yield, for several reasons. High yield is a fixed-rate instrument, which in rising interest rate environment will likely lose value if all else held equal. Private credit, in contrast, is primarily floating rate, meaning the interest rate is structured as a spread over a base rate so greater protection from rising interest rates. Additionally, private credit is senior secured in the capital structure with stronger covenants and protections, so it could better shield investors in the event of economic weakness. High yield is more junior in the capital structure, so it is more exposed to credit risk in the event of a default.

Endnotes

1. Source: Morningstar, Cliffwater Direct Lending Index, and S&P/LSTA Leveraged Loan Index, as of June 30, 2021. Annualized Yield (12-Month) for Private Credit (CDLI) was 8.8%, 4.2% for leveraged loans, and 4.0% for high yield.
2. Source: Preqin, Credit Suisse as of December 31, 2020. Total credit market defined as the aggregate of the high yield bond, senior loan, and private credit markets. Senior loans refers to broadly syndicated loans.
3. Weighted average loan-to-value is calculated as the total net debt through each respective loan tranche that the BCRED portfolio is invested in divided by the estimated enterprise value of the portfolio company at the time of commitment.
4. Morningstar, Cliffwater Direct Lending Index, as of June 30, 2021.

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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 have implemented 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 in the best interest of or suitable for you if you need access to the money you invest. See "Suitability Standards" and "Share Repurchase Program" in the prospectus.
- You will bear substantial fees and expenses in connection with your investment. See "Fees and Expenses" 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 the sale of assets, borrowings, return of capital or offering proceeds, and although we generally expect to fund distributions from cash flow from operations, we have not established limits on the amounts we may pay from such sources.
- 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 use and continue to expect to use leverage, which will magnify the potential for loss on amounts invested in us.
- 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 Blackstone 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 the 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 August 31, 2021, 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 "forward-looking statements," which can be identified by the use of forward-looking 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 in 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 new information, future developments or otherwise.

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