APOLLO

Private Credit's Primetime: The Large Corporate Direct Lending Opportunity

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The Leveraged Finance Market Today

The global leveraged finance market is roughly $4.7 trillion in size as of September 2022, of which private credit has become an increasingly significant part **(Exhibit 1)**. As of mid-2022, the direct lending market had grown to $580 billion in size to meet the needs of middle market borrowers post the 2008 Great Financial Crisis (GFC). However, Apollo believes there is a dearth of available alternative financing solutions for large corporate issuers outside of the broadly syndicated and high yield markets, despite a growing demand for flexible solutions.

KEY TAKEAWAYS

- **We believe the time is now for large corporate origination**: The opportunity exploded in 2022 as conventional forms of public financing shut down, leaving borrowers with few options apart from the private market.
- **Amid an unprecedented market backdrop**—a global pandemic, enhanced geopolitical risks, rising inflation and market volatility—borrowers over the last few years have increasingly sought strategic financing alternatives that offer the chance to forgo market risk and benefit from certainty of size, pricing and execution offered by transacting with private lenders.
- **We believe the risk/return dynamics in large corporate private credit appear particularly attractive**, with the potential for enhanced yields from senior secured debt with robust lender protections.
- **We believe large corporate origination** acts as a complementary component in a credit portfolio and lending to large corporate borrowers offers a level of stability as we move into an increasingly volatile and uncertain environment.

Exhibit 1: Direct lending is a growing component of the global leveraged finance market

Overall Market Size: $4.7 Trillion

High Yield Bonds (HY)	Broadly Syndicated Loans (BSL)	Direct Lending
Public	Public	Private
Liquid, publicly traded securities with a **fixed coupon** that are **rated** by agencies and syndicated through **banks**	**Liquid, publicly** traded loans with a **floating coupon** that are **rated** by agencies and syndicated through **banks**	**Illiquid, privately** originated loans with a floating coupon that are generally **unrated** by agencies
$2.4T Market Size	$1.7T Market Size	$580B Market Size
• **Arranged** by banks • Mainly **senior unsecured** • Largely **institutional investor** base	• **Arranged** by banks • **Senior secured** in capital structure • **CLOs** tend to be the largest buyer	• **Direct, bilateral negotiations** • **Senior secured, private** originations • Held to maturity by **alternative and institutional investors**
Rated	Rated	Unrated

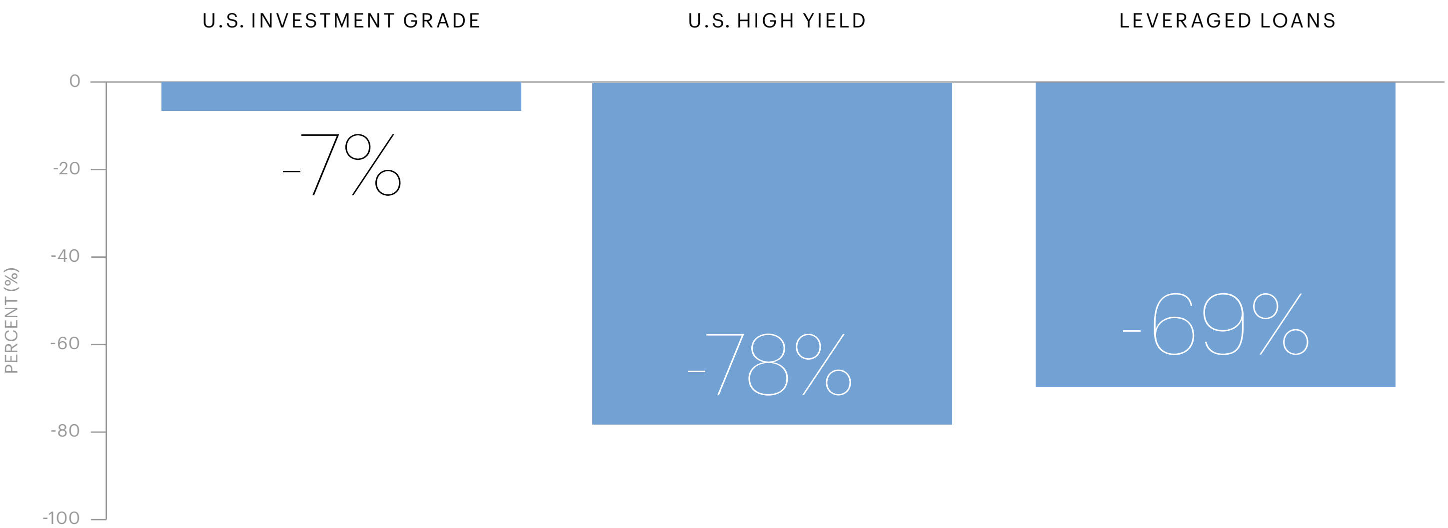
Source: Preqin as of March 2022; Bank of America Global High Yield Index and S&P Global Leveraged Loan Index as of September 2022.

Large companies historically utilized banks to tap the public high yield and leveraged loan markets in order to meet their financing needs. Before the GFC, banks typically held these bonds and loans on their own balance sheets, but over the last 15 years moved to an originate-to-distribute model because of increased regulatory burdens and capital charges. Today, banks generally arrange the financing for a company for a fee and syndicate the debt out to institutional investors. This mechanism for raising capital became increasingly stressed over the past few years as unstable market conditions and the uncertain economic backdrop caused investors and arranging banks to retrench from the market, meaning that only the highest-rated companies could access reliable financing.

Primary public debt markets for sub-investment grade companies are sensitive to market conditions and bank appetite to provide funding to many large issuers falters in volatile markets. Following the macro uncertainty and declines in prices of publicly traded debt at the onset of 2022, investors demanded steep discounts on paper that banks underwrote in previously more benign market conditions. Accordingly, banks were forced to take markdowns on these positions, curbing their appetite to underwrite additional deals. Consequently, 2022 saw sharp year-over-year declines in both leveraged loan and high yield primary issuance, leaving the private market as the only viable financing option for a swath of large borrowers (**Exhibit 2**).

Exhibit 2: Only the highest-rated companies have been able to access the public debt markets in 2022

2022 VS. 2021 YTD PERCENT CHANGE IN ISSUANCE VOLUME



ISSUANCE VOLUMES

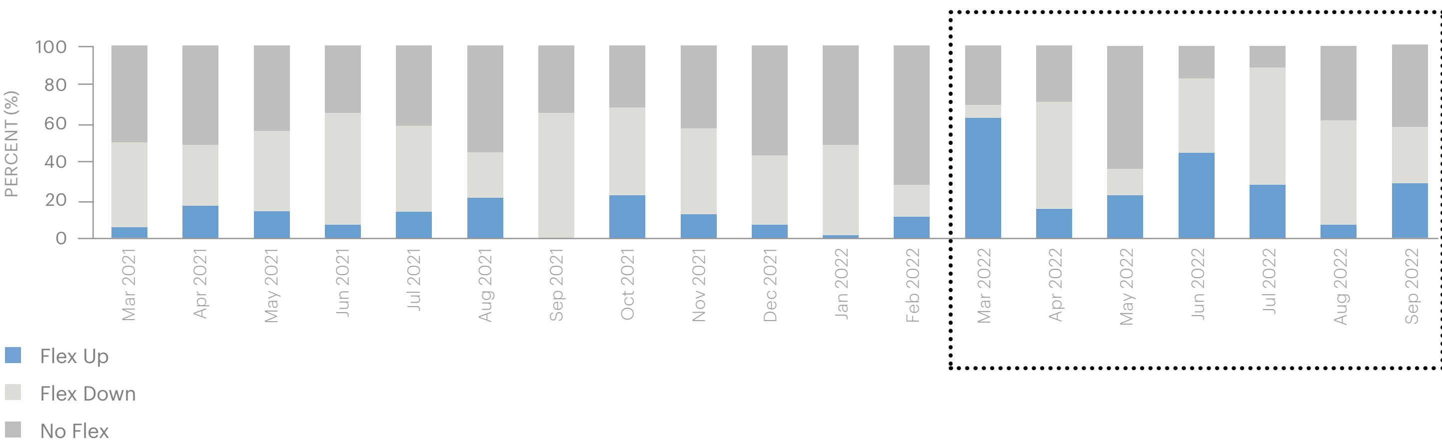
	U.S. Investment Grade	U.S. High Yield	Leveraged Loans
2021	$1.09 Trillion	$410 Billion	$642 Billion
2022	$1.02 Trillion	$90 Billion	$205 Billion

Source: J.P. Morgan, "U.S. Corporate Credit Issuance Monthly: September and 3Q22."

In addition to reliable execution, private debt solutions tend to be more flexible than the public markets and there are structural reasons why borrowers are choosing to partner with non-bank lenders. Many sponsors drive value by executing on buy-and-build strategies over the length of their hold periods and require contingent capital that the public markets are unable to provide. Additionally, many larger sponsor-backed software companies require a flexible approach in the form of annual recurring revenue (ARR) loans. Lenders who understand the dynamics of these businesses, with strong customer retention rates, robust organic growth rates, high gross margins, low loan to value (LTV), sponsors pre-funding interest expense to the balance sheet and significant sponsor equity checks can offer solutions that the public markets are unable or unwilling to provide. Moreover, sponsors and borrowers tend to value working with one lender or a small club of lenders (as opposed to dozens or sometimes hundreds) with whom they have meaningful relationships and can have direct, strategic conversations.

Additionally, forgoing a loan syndication process in favor of a private, directly originated financing solution offers a compelling value proposition to borrowers. Companies may avoid the costs and burdens inherent in public offerings, including those associated with regulatory filings and disclosures, rating agency processes and roadshows that are oftentimes scheduled with limited notice in an effort to sell into a supportive market environment. Even then, successful syndications remain contingent upon a positive reception from institutional investors. If there is one thing that financial markets participants could do without, it's uncertainty, and it has been difficult for sponsors and Chief Financial Officers (CFOs) to discern where their debt financing packages were going to price this year **(Exhibit 3)**. The price certainty that private debt can offer is another reason why companies choose to partner with private originators.

Exhibit 3: Market turbulence leads to pricing uncertainty for issuers



Source: S&P LCD as of September 2022.

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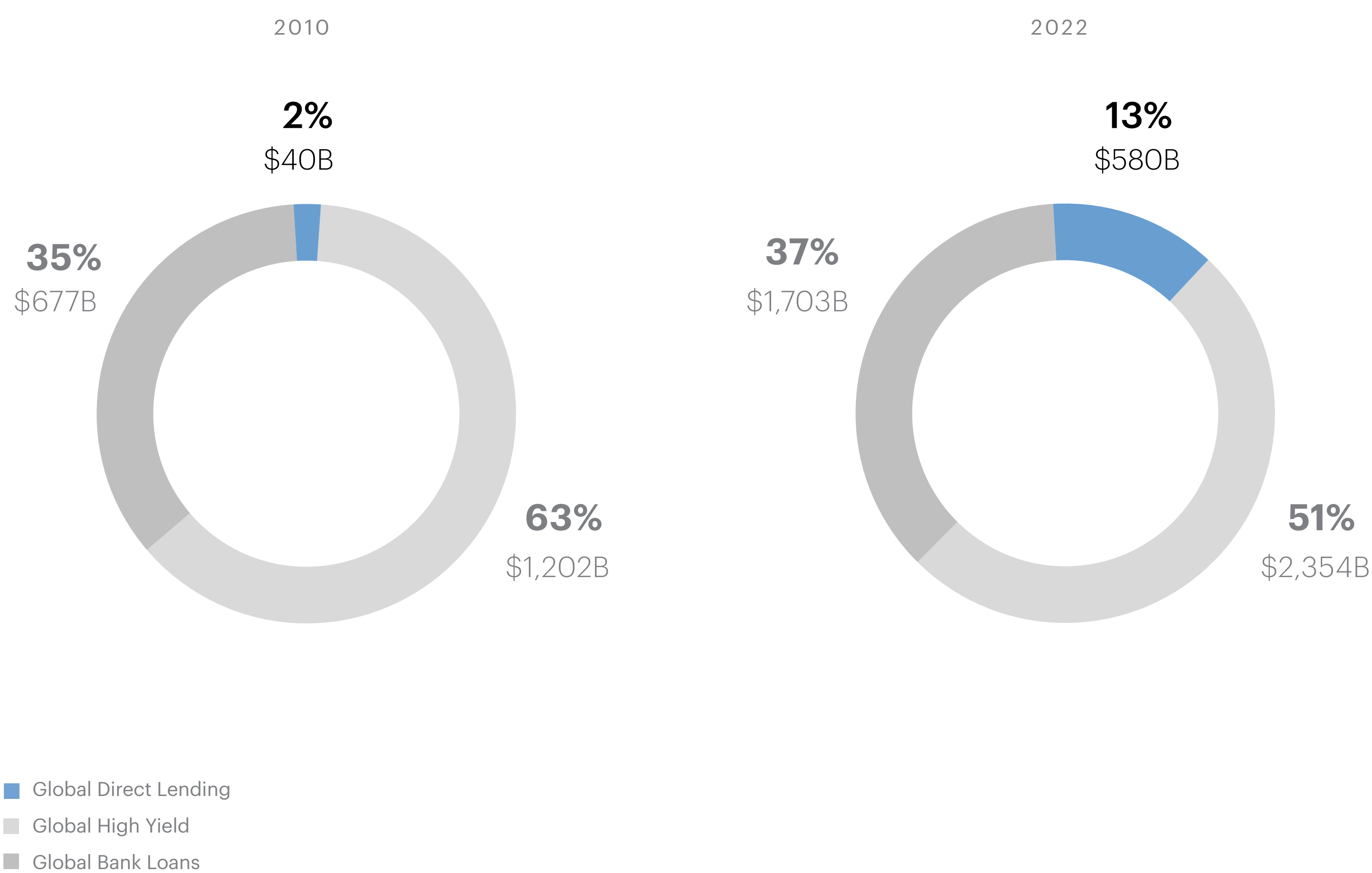
We regard the rigidity and uncertainty of public markets as increasingly precluding many sponsor-backed issuers from accessing public markets and thus driving demand for alternative financing solutions **(Exhibit 4)**. Non-bank lenders can underwrite according to the unique circumstances of each transaction rather than forcing a mold upon each issuer.

Apollo believes this confluence of cyclical and structural factors will continue to enable scaled alternative asset managers with significant relationships to continue to grow share in the once bank dominated leveraged finance market.

Exhibit 4: Direct lending market share has grown over 6x in the past decade to 13% of the global leveraged finance market



Source: Preqin as of March 2022, Bank of America Global High Yield Index, S&P Global Leveraged Loan Index as of September 2022. Totals may not sum to 100% due to rounding.

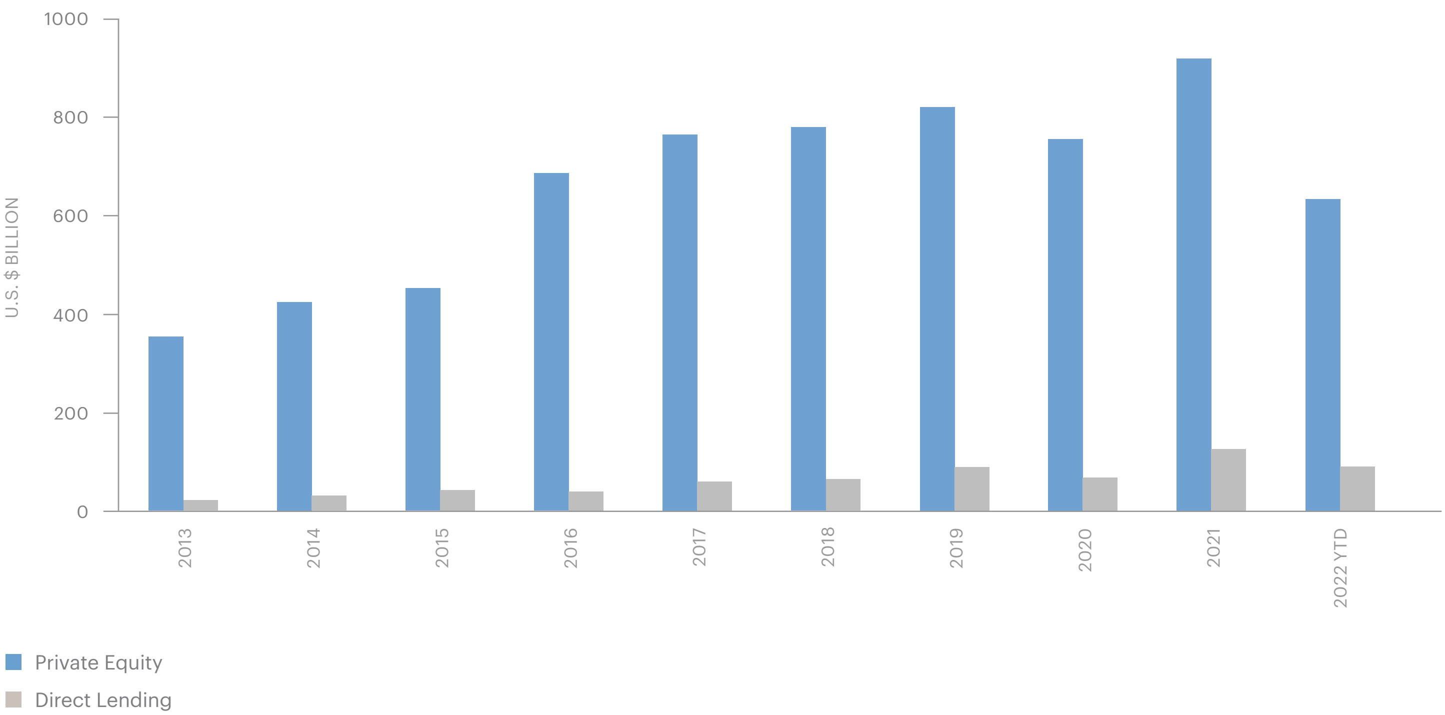
Supply/Demand Dynamics

In addition to the tailwinds on the demand side, it is also important to understand the supply dynamics influencing the large corporate origination opportunity. Although it is undisputed that private debt experienced significant inflows over the past 10 years, this has been meaningfully outpaced by the amount of money raised in private equity to the tune of 10 to one **(Exhibit 5)**. In addition, private equity funds are increasing in size, with many managers raising funds in excess of $10 billion, necessitating that these funds target bigger businesses and thus need greater quanta of debt capital. Accordingly, the average deal size for buyouts in 2021 topped $1.0 billion for the first time, up from less than $600 million in 2020.[1]

Exhibit 5: Fund raising for private equity has dramatically outpaced private debt

INDUSTRY CAPITAL RAISED SINCE 2015

Private Equity: $6.6 Trillion
Direct Lending: $0.6 Trillion



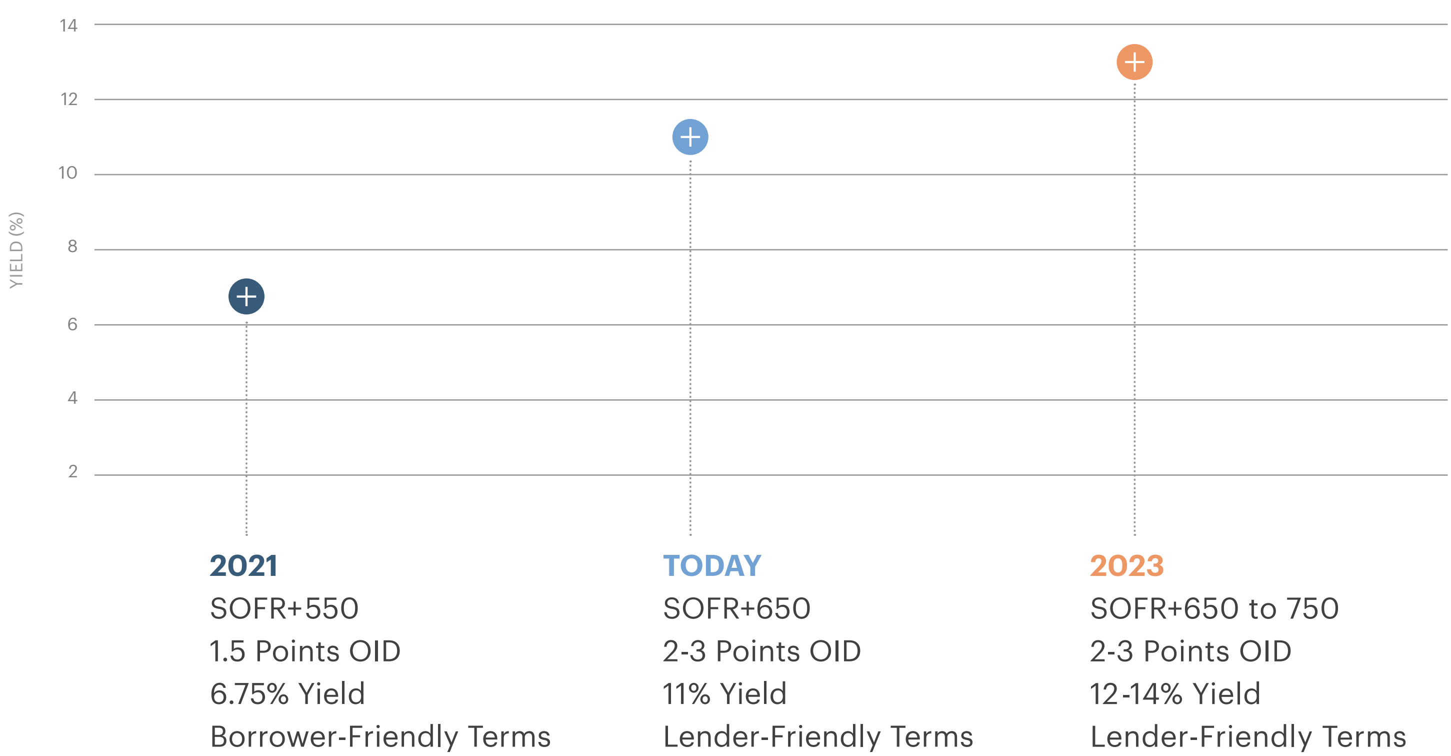
Source: Preqin as of September 2022.

1. Dealogic as of December 2021.

Additionally, lending privately to large businesses generates a consistent illiquidity premium relative to the syndicated markets. In early 2021, capital was plentiful and businesses were able to finance themselves at favorable terms. However, even in this accommodating environment, spreads of Apollo's large corporate originations were consistently higher than where liquid markets priced because of the lack of competition at the larger end of the direct origination market. Fast forward to 2022: capital became scarcer and investors were more discerning about who they lent to. Spreads in both the public and private markets widened; the illiquidity premium remained intact.

Furthermore, as global central banks moved from a dovish to hawkish monetary policy regime, all-in yields for private debt in late 2022 were substantially higher than at the start of the year. Given persistently high global inflation, yields are expected to continue to rise as a result of further interest-rate hikes and continued spread widening. A dearth of available capital for large issuers has also led to improved lender protections and deeper subordination as sponsors are "over-equitizing" deals in order to put money to work. Large corporate direct lending may offer investors the opportunity for high income in an asset class with strong structural protection **(Exhibit 6)**.

Exhibit 6: We expect large corporate credit yields to continue to rise and spreads widen further into 2023



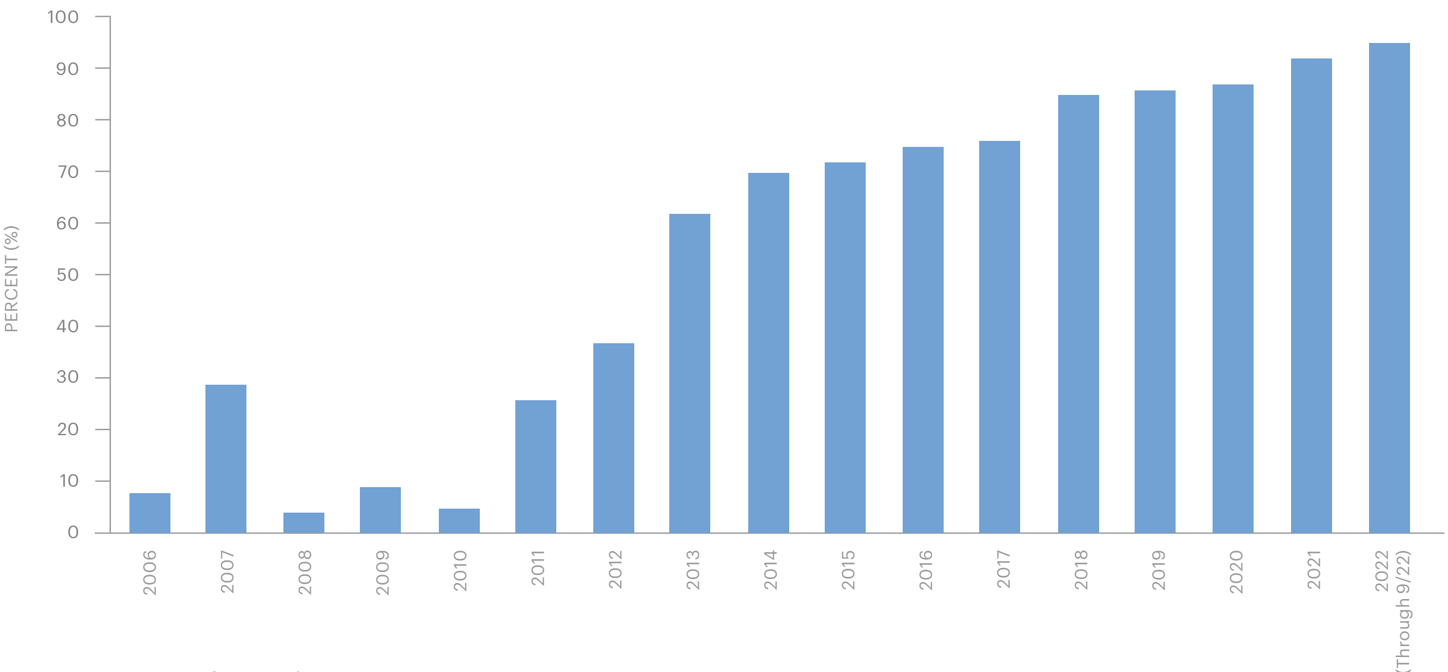
The Secured Overnight Financing Rate (SOFR) is a broad measure of the cost to borrow cash overnight collateralized by U.S. Treasury securities. It is a benchmark interest rate that replaces the London Interbank Offered Rate (LIBOR). Original Issue Discount (OID) is the difference between the face value of a bond and price at which it is initially sold by the issuer. Essentially, it is the discount to the par value of a bond that can provide investors with extra interest income during the life of the bond and a gain at the bond's maturity.

Source: Apollo Analysts as of September 2022. The information above represents market rates currently or previously quoted by Apollo's Global Corporate Credit team. The information provided herein is based on the views and opinions of Apollo Analysts and is subject to change at any time without notice. Past performance is not indicative of future results. Expected yield and credit spreads presented are based on historical information of large corporate lending investments and our current market outlook. Apollo's credit spread and yield expectations for a potential investment are not a guarantee as to the quality of the investment or a representation as to the adequacy of Apollo's methodology for estimating returns.

In addition to the illiquidity premium, since private transactions are negotiated on a bilateral basis, lenders are typically able to structure more rigorous legal and contractual protections than the deals in the public markets. These protections usually include either a maintenance or incurrence covenant as well as restrictions on payments to equity holders, mandatory amortization, and excess cash flow sweeps. In contrast, investor protections in the leveraged loan markets steadily declined post the GFC, with 95% of new market issues now considered "covenant lite," offering less protection to lenders and investors **(Exhibit 7)**. We believe that this deterioration should not be underestimated, as these covenants are increasingly important for lenders in a volatile market.

Exhibit 7: Investor protection in the U.S. leveraged loan market has steadily declined post GFC

PERCENT OF NEW-ISSUE U.S. LEVERAGED LOANS CLASSES AS COVENANT-LITE



Source: S&P LCD as of September 2022.

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Conclusion

We see a long-term secular shift as sponsors and corporations of increasing size seek tailored solutions and execution certainty that are increasingly difficult to come by in the strained, traditional lending markets. The opportunity has increased dramatically in 2022 as syndicated markets have shuttered amid the volatile environment, leaving private capital as a viable option for many large businesses who need to access the debt markets.

Record levels of private equity dry powder mean that large corporates and sponsors are going to need access to debt capital over the medium and long-term. The speed and certainty that private debt can offer amidst turbulent markets can support it to help grow market share in place of the syndicated markets. There are only a handful of scaled managers who can capitalize on the secular shift to the private markets, and meaningful barriers to entry will insulate the asset class from competitive pressures. Due to the favorable supply/demand dynamics, structural constraints of access and bigger, stable and more mature companies, we believe an allocation to large corporate lending can be prudent at this point in the economic and business cycle.

About the Authors

John Zito

Partner, Deputy CIO of Credit

Mr. Zito is a Partner and the Deputy Chief Investment Officer of Credit at Apollo Global Management. As Deputy CIO, Mr. Zito is responsible for overseeing the investment activities for the Firm's $373 billion credit platform.* He serves as a voting member on all of the Firm's credit investment committees and is the Chair of the Large Credit Investment Committee, which approves all of Apollo's largest investments for both third party and proprietary balance sheet capital. Mr. Zito joined Apollo in 2012 after five years as a Managing Director and Portfolio Manager at Brencourt Advisors, a multi-strategy hedge fund, where he oversaw all the firm's credit investments including the Brencourt Credit Opportunities Fund. Prior to that, Mr. Zito was at Veritas Fund Group for five years where he co-managed the flagship capital structure focused high yield fund and the short-only credit vehicle. Mr. Zito is a Chartered Financial Analyst charterholder, and he graduated cum laude from Amherst College with an AB in Economics.

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Mr. Vanek is a Partner and the Co-Head of Apollo's Global Performing Credit business. Mr. Vanek joined the firm in 2008, and before that he was Associate Director, Loan Sales & Trading in the Leveraged Finance group at Bear Stearns. He is a board member of the Loan Syndications and Trading Association, a leading advocate for the U.S. syndicated loan market. Mr. Vanek graduated from Duke University with a BS in Economics and a BA in Computer Science and received his MBA from Columbia Business School.

Akila Grewal

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Credit Product

Akila Grewal is Managing Director, Co-Head of Product and Head of Credit Product at Apollo's Client and Products Solutions (CPS) team, where she serves as Lead Product Specialist for the Firm's Credit platform. Ms. Grewal has been promoted to Partner effective in January 2023. She also serves on several committees including Apollo's Credit Allocations Sub-Committee. Prior to joining in 2016, Ms. Grewal was on the Proprietary Trading and Risk Management team at Mariner Investment Group. Previously, she was in the Business Development group at MKP Capital. Ms. Grewal started her career at Credit Suisse on the Portfolio Management and Product Delivery team and previously served on the Principle of Responsible Investment's Hedge Fund Steering Committee and its Fixed Income Outreach Committee. Ms. Grewal graduated from New York University's Stern School of Business with a BS in Finance and is a CFA charterholder.

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From page 10. Our AUM equals the sum of:

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- the fair value of the investments of the equity and certain hybrid funds, partnerships and accounts Apollo manages or advise, plus the capital that such funds, partnerships and accounts are entitled to call from investors pursuant to capital commitments, plus portfolio level financings;
- the gross asset value associated with the reinsurance investments of the portfolio company assets Apollo manages or advises; and
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