

Market Reflections & Outlook

Continued Opportunity for Yield

Last year saw a notable shift in the capital markets and interest rate landscape as inflation fears, higher interest rates, and geopolitical conflict weighed on economic confidence and M&A volume. Despite these factors driving negative returns in major publicly traded classes, the Cliffwater Direct Lending index posted a gain in 2022, once again demonstrating the resilience of the asset class. Select segments of the lower middle market (“LMM”), the focus segment of Capital Dynamics Private Credit (“CDPC”), delivered further relative outperformance. Contrary to the first half of 2022, the shift towards more conservative investor sentiments and outlooks in the second half of 2022 drove the pricing and credit protection pendulums back in lenders' favor, reversing a longer-term trend where borrowers held the upper hand.

Regarding pricing, aggressive Fed rate hikes combined with wider spreads and deeper original issue discounts (“OIDs”) gave rise to middle market loans yielding 10% or more becoming market standard. Alongside this, less cooperative capital markets coupled with greater lender discipline resulted in more conservatively levered new LBOs with tighter documentation, including, for example, a greater focus on financial maintenance covenants. These factors, including lower loan-to-values (“LTVs”), higher sponsor equity contributions, magnified yields and enhanced investor protections, were generally more pronounced in the LMM relative to the core and upper-middle markets, offering investors focused on the LMM further relative risk-adjusted return advantages. For example, average middle market unitranche spreads widened by approximately 20 basis points over the year, while LMM spreads widened by 50 basis points. Over the same period, average leverage for middle market unitranche loans remained above 5x, while LMM loan leverage retreated to 4x or below¹.

Our Views: The Capital Dynamics Private Credit team remained active in 2022 and sought to take advantage of the improving market dynamics. The team closed 11 deals during the year, accelerating deployment in the latter half of the year as the aforementioned enhanced risk adjusted return advantages started to matriculate in the pipeline. Moving into 2023, we expect favorable market conditions in the LMM to persist, and the team remains focused on prudently deploying dry powder into new LBO opportunities, while continuing to support our sponsors and portfolio companies by financing accretive add-on transactions. Dislocation in broadly syndicated markets, coupled with a general pull back and greater discipline among direct lenders, sets the stage for enduring market tailwinds that include an expanding opportunity set and a greater ability for market participants to control both structure and pricing. Leveraging the relationship networks of our colleagues in Capital Dynamics' Primaries and Co-Investment businesses, the CDPC team has constructed a diverse pipeline of actionable loan investments, many of which are shown on a proprietary basis and outside of traditional auction processes, providing for a healthy deployment cadence while remaining selective in our investment decisions and diversified in our portfolio construction.

(1) Per KBRA DLD 2023

About Capital Dynamics Private Credit

Capital Dynamics has been investing in middle and lower middle market private assets for over 30 years. The Private Credit group within Capital Dynamics provides tailored, one-stop financing solutions to private equity-backed lower middle market companies, focusing on financings that support leveraged buyouts, acquisitions, business expansions, re-financings, and short-to-medium term liquidity needs. Capital Dynamics Private Credit offers directly originated, senior secured loans, including first lien, unitranche, and second lien, as well as other flexible capital solutions.

Comprised of over ten investment and platform professionals based in New York, London, and Zug, Capital Dynamics Private Credit draws upon its vast experience investing across the capital structure and in a wide array of industries to deliver flexible, value-added solutions customized to fit the unique needs of each borrower.

DISCLOSURE STATEMENT

Capital Dynamics Group is an independent asset management firm focusing on private assets and comprises Capital Dynamics Holding AG and its affiliates.

For investors based in the **United Kingdom**, and **Dubai International Financial Centre (DIFC)**, this presentation is being communicated to you by Capital Dynamics Ltd (CDL). CDL is a firm authorized and regulated by the UK Financial Conduct Authority, and a regulated entity by the Dubai Financial Services Authority for the provision of advisory and arranging services.

For investors qualifying as professional investors (as that term is defined under the AIFMD) based in **European select countries (Austria, Belgium, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Republic of Ireland Liechtenstein, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Spain, Sweden)** this presentation is being communicated to you by Capital Dynamics Ltd (CDL) in agreement with the external AIFM, Alter Domus Management Company S.A. The AIFM is authorized and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg as an Alternative Investment Fund Manager. Capital Dynamics Ltd is authorized and regulated by the Financial Conduct Authority (FCA). Any Recipient not interested in the analysis described herein should return this document to Capital Dynamics Limited, Whitfield Court, 2nd Floor, 30-32 Whitfield Street, London W1T 2RQ, United Kingdom and contact Capital Dynamics as soon as possible (t. +44 20 7297 0200).

For investors based in the United States, this presentation is being communicated to you by Capital Dynamics Broker Dealer LLC, a registered broker-dealer with the SEC, and a member of the Financial Industry Regulatory Authority (FINRA) and Securities Investor Protection Corporation (SIPC). Such registration does not imply in any manner whatsoever that Capital Dynamics Broker Dealer LLC has been sponsored, approved or recommended or that its abilities or qualifications have in any way respect been passed upon by the United States or any agency or office thereof.

For all other investors, the presentation is being communicated by the firm entity acting as the manager or general partner, adviser to the client or such other firm entity authorized to make this communication as appropriate.

This presentation is a general discussions regarding the market or market conditions represent the view of either the source cited or Capital Dynamics. Nothing contained herein is intended to predict the performance of any investment. There can be no assurance that actual outcomes will match the assumptions or that actual returns will match any expected returns. The information contained herein is as Feb. 2023 unless otherwise indicated, is subject to change, and Capital Dynamics assumes no obligation to update the information herein.

This presentation is intended only for sophisticated institutional investors who have sufficient understanding of the types of investments described herein and the ability to bear the risks associated with such an investment.

This presentation does not constitute an offer of any Capital Dynamics Fund, it is for informational purposes only, is confidential and may not be reproduced in whole or in part (whether in electronic or hard-copy form).

