

March 2023

The future of private credit



Anthony Fobel, CEO

 Arcmont
from nuveen

Private credit is now widely recognised as an alternative asset class that can deliver stable, uncorrelated returns for institutional investors.



Ken Kencel, CEO

CHURCHILL
from nuveen

With banks rarely participating in the direct lending business since the global financial crisis, private credit plays a vital role in facilitating economic activity and growth by providing capital to companies unable to access public markets.

SUMMARY

- Private credit has become a well-established asset class for institutional investors since the global financial crisis; supply and demand dynamics should continue to support its growth.
- As interest rates rise and public market volatility increases, investors are attracted to private credit as a diversified source of steady income and uncorrelated returns.
- Private equity sponsors, and businesses more broadly, are gravitating to private credit solutions.
- The current environment of higher and more volatile interest rates will reveal the weaker lenders; leading managers can be selective in this environment.
- Expect strong demand from borrowers and LPs for top private credit managers who have scale, well-established sponsor relationships and proven track records.

In this paper, we highlight how private credit markets have developed. We discuss why size, scale and expertise will be increasingly important for successful investors — key factors for Nuveen’s expansion of its private credit capabilities. We also explain why current conditions could offer the best vintage yet.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

PRIVATE CREDIT FUELS ECONOMIC ACTIVITY

A significant consequence of the global financial crisis (GFC) was the growth in demand for private credit. Legislation and regulatory pressures to shore up balance sheets compelled banks to retrench, leaving a sizable gap in the capital markets. This withdrawal by traditional banks from sub-investment grade lending reduced the main source of funding for many small- to medium-sized firms. These companies are not yet at the scale where they can tap public capital markets but they still require funds.

This demand for capital from businesses is also matched by institutional investors' need to invest for yield and diversification.

How private credit can help institutions achieve their investment objectives:

Income

Private credit can deliver a diversified source of income.

Risk-adjusted returns

Highly selective diversified portfolios with low losses can contribute to attractive risk-adjusted returns.

Inflation protection

Floating rate feature of senior loans can protect returns in rising rate and inflationary environments.

Diversification

Private market asset returns have low or negative correlations with public market returns.

Volatility management

Private market assets are generally not marked to market, so less exposed to headline and other risks that can rock public markets.

SIZE, SCALE AND EXPERTISE MATTER

With private credit now an established part of capital markets, and syndicated loan markets essentially closed to new issuance, larger deals are coming to direct lenders.

This is one reason why we believe size and scale will be increasingly important. According to Refintiv LPC, the volume of leveraged buyout (LBO) deals financed by direct lending was 8.2 times higher than the volume of syndicated LBOs in the fourth quarter of 2022. Only a few private credit managers have the ability to underwrite these bigger deals on a consistent basis.

Businesses along with private equity sponsors are gravitating to proven private credit managers with scale like Churchill and Arcmont for several reasons:

- Greater speed, reliability and certainty of execution, particularly when liquid markets are volatile or closed
- More flexible financing solutions that can be tailored to bespoke business requirements
- The ability to provide follow-on capital to facilitate future organic growth

The key to success in private credit is deal flow, which is a function of the deep sponsor relationships and expertise that Churchill and Arcmont have. Access to a steady flow of new opportunities from high-quality companies empowers managers to maintain selectivity and investor-friendly loan structures.

Our combined capabilities extend our networks, enhance deal flow and expand the variety of financial solutions can we offer. Furthermore, Nuveen can now offer investors greater diversification opportunities with a wider set of investments and exposure across geographies. Investors can benefit from the different dynamics in European and U.S. private credit markets.



Churchill and Arcmont focus on industry-leading middle market businesses.

INVESTMENT THEMES IN PRIVATE CREDIT

Churchill and Arcmont focus on industry-leading middle market businesses. These companies have stable cash flows and earnings in the region of \$10 to \$100 million/€20 to €200m. They usually operate in defensive sectors, providing products and services that are in demand no matter the stage of the economic cycle. These are often highly cash generative with a large and reliable customer base and good supplier relationships, making them well placed to service interest payments and pay back loans.

Recent themes are companies benefiting from the shift in personal and business behaviour as a result of the pandemic, notably in the logistics, health care, business services and software sectors.

Diversification is a cornerstone both firm's investment philosophies as are disciplined underwriting standards.

IDEAL CONDITIONS FOR PRIVATE CREDIT

Higher and more volatile interest rates have been a shock for many investors after years of rates steadily anchored at or near historic lows, leading to questions about the viability of private credit in the current environment.

Private credit managers with capital and access to strong deal flow are in a prime position. They can afford to be extremely selective. It is also likely that higher rates and the challenging environment show up the weaker lenders — those who may have been less conservative with their deal selection, underwriting and structuring.

Often the most challenging fundraising conditions can be the best time to invest. We believe that we could see the best vintage yet in private credit for the following reasons:

Private credit taking share

Demand for private credit is strong with small- to medium-sized businesses seeking capital while leveraged loan and high-yield markets effectively closed to new issuance and banks reluctance to underwrite loans.

Pricing is much more attractive

The increase in base rates and wider spreads, reflecting increased market volatility, have improved pricing.

Leverage multiples are lower

Higher interest costs and more conservative capital structures have resulted in new deals being structured at materially lower leverage multiples.

Terms have improved

The shortage of players with size and scale to underwrite new transactions have improved financing terms for lenders.

Better quality businesses to finance

Companies coming to market are higher quality businesses whose operating models enable them to more successfully battle today's macroeconomic challenges.



Often the most challenging fundraising conditions can be the best time to invest.

About Nuveen

Nuveen, the investment manager of TIAA, offers a comprehensive range of outcome-focused investment solutions designed to secure the long-term financial goals of institutional and individual investors. Nuveen has \$1.1 trillion in assets under management as of 31 Dec 2022 and operations in 27 countries. Its acquisition of Arcmont expands Nuveen's private capital expertise and presence in Europe and complements its North American private debt and private equity investment specialist Churchill Asset Management.

About Churchill Asset Management

CHURCHILL
from nuveen

Churchill, an investment-specialist affiliate of Nuveen (the asset manager of TIAA), provides customized financing solutions to middle market private equity firms and their portfolio companies across the capital structure. With US\$46 billion of committed capital, we provide first lien, unitranche, second lien and mezzanine debt, in addition to equity co-investments, private equity fund commitments and secondaries. Churchill has a long history of disciplined investing across multiple economic cycles and our unique origination strategy, best in class execution and investment are driven by more than 150 professionals in New York, Charlotte, Chicago, Dallas and Los Angeles. More information can be found at www.churchillam.com.

About Arcmont Asset Management

 **Arcmont**
from nuveen

Arcmont, an investment-specialist affiliate of Nuveen (the asset manager of TIAA), is a market-leading private debt asset management firm, providing flexible capital solutions to a wide range of European businesses. Established in 2011, Arcmont has raised over \$26 billion in assets to date, provides capital to a diverse range of European companies and aims to deliver bespoke, flexible and innovative financing solutions across the entire capital structure. Arcmont currently has approximately 100 employees in its six European offices, in London, Paris, Munich, Milan, Madrid and Stockholm. More information can be found at www.arcmont.com.

For more information, please visit nuveen.com.

Endnotes

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Past performance does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

Important information on risk

Investing involves risk; principal loss is possible. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Please note investments in private debt, including leveraged loans, middle market loans, and mezzanine debt, are subject to various risk factors, including credit risk, liquidity risk and interest rate risk.

This information represents the opinion of Nuveen, LLC and its investment specialists and is not intended to be a forecast of future events and or guarantee of any future result. Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. There is no assurance that an investment will provide positive performance over any period of time.

Nuveen, LLC provides investment advisory services through its investment specialists. Churchill Asset Management is a registered investment advisor and an affiliate of Nuveen, LLC. This information does not constitute investment research as defined under MiFID.

nuveen

A TIAA Company