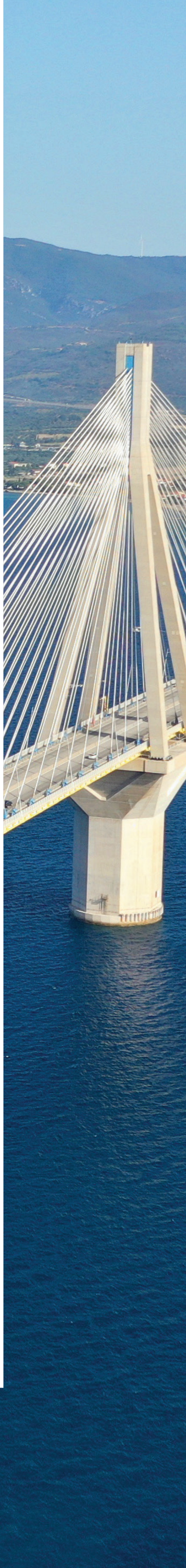


Morgan Stanley

INVESTMENT MANAGEMENT

Q&A with Jeff Levin and Mark Jochims of Morgan Stanley Private Credit

MORGAN STANLEY PRIVATE CREDIT | Q&A | 2023

Appetite for opportunities in private debt investing has been on the rise. In this dialogue, members of Morgan Stanley Investment Management's Private Credit leadership team, Jeff Levin (JL) and Mark Jochims (MJ), offer their perspective on the market. Jeff Levin is the Co-Head of Morgan Stanley's North America Private Credit team, where he serves on the Investment Committee and is the Portfolio Manager and the Head of Direct Lending. Mark Jochims serves as Head of European Private Credit and is a member of the Private Credit & Equity Executive Committee of Morgan Stanley.

FEATURED PARTICIPANTS

JEFF LEVIN
Co-Head of North American Private Credit and Head of Direct Lending

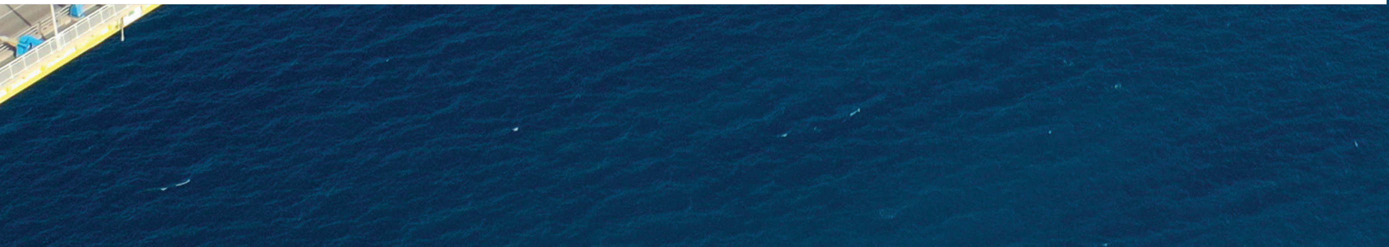
MARK JOCHIMS
Mark Jochims, Head of European Private Credit

Can you detail your backgrounds as it relates to private debt investing?

JL: I was a founding member of Morgan Stanley's Private Credit platform back in 2009, and worked at the Carlyle Group prior to re-joining Morgan Stanley in 2019. Today, I co-lead Morgan Stanley's North American Private Credit business, which consists of approximately $16Bn of assets under management.[1] Our team consists of over 40 investment professionals in the US, as well as our recently established European team, which my colleague Mark has been brought on to run.

MJ: I was a founding member and Partner at Arcmont Asset Management (previously BlueBay Private Debt), where I helped to build their European direct lending platform. I

[1] As of March 31, 2023.



joined Morgan Stanley in 2022, after seeing the successful franchise Jeff and team had executed in North America. Morgan Stanley Investment Management's ("MSIM") leadership's vision at the time was to extend into Europe, and I saw this as a tremendous opportunity given the strength of the Morgan Stanley brand. We have since established a 10 + person team of investment professionals to help us accomplish that vision.

What are the key themes that you're seeing in the private debt market currently?

JL: Private debt is an increasing piece of the institutional market's asset allocation. Given ongoing volatility across liquid public markets, the traditional financing market is currently restricted in its ability to execute. We believe institutional investors are willing to direct more dollars to the private debt space, as they have observed skilled managers utilize the expertise, networks and data they have aggregated over many years to efficiently diligence and execute transactions and ultimately achieve attractive risk-adjusted returns.

MJ: From the European perspective the private debt market continues to develop, providing financing to both a larger proportion of the overall debt market and via larger transactions. Investors in Europe have similarly added to their asset allocations with experienced private credit managers of scale. This includes both local investors as well as interest abroad for those looking to diversify their geographic private debt allocations.

To what extent do you see Europe as a growth market for private debt?

MJ: In terms of market dynamics, there are a few reasons to be constructive on the private debt markets in Europe. First, European private equity dry powder stands at an all-time high today, and we believe that large and growing reserve of dry powder will fuel European M&A activity for several years to come. That potential demand is further bolstered by a large number of debt assets expected to reach maturity through 2026.

Second, beyond the demand/supply gap for financing, we see secular trends continuing to underpin borrower appetite for private credit, while leveraged finance market dislocations will accelerate that demand. Significant white space remains, enabling strong managers to grow and take market share. Direct lenders can now provide a full alternative solution to syndicated markets. As a result, European lenders are moving up the size spectrum and investing in bigger and more stable businesses.

JL: Our perspective is that there remains significant potential for growth in the private credit space generally and across European markets, hence Morgan Stanley's strategic commitment to it. From a business perspective our goal is to build the European platform on elements of our U.S. structure and for Mark's team to seek to leverage a number of established procedures and resources. We strongly believe that local presence, understanding and relationships drive origination and investment opportunities, and we observe that the European market has remained more fragmented, providing opportunities to scale.

What are the key considerations for private debt as we head deeper into a difficult macroeconomic environment?

JL: The industry hasn't really experienced a period of sustained macro weakness like we are now experiencing. We expect to see more dispersion across managers, and that prior experience and underwriting capabilities will be closely scrutinized. We also expect that institutions with wider investment platforms, stronger track records investing in private assets and larger networks should generally be better positioned during such a period. Conversely, private debt teams with a number of problem assets in their portfolios are likely to find themselves spending considerable resources on workouts, to an extent not experienced over the past decade.

MJ: We believe that we are in a somewhat fortunate position as "new" capital providers for Europe. We will seek and do expect tighter requirements from debt providers and improved contractual protections, including but not limited to:[2]

- More restrictive debt incurrence, notably with the exclusion of side-car debt
- Tighter EBITDA definitions including caps on EBITDA adjustments/synergies
- Stricter cash leakage clauses ('baskets'), including permitted payments
- Selectively upward margin ratchets
- Improved information rights

What makes you constructive for the future of private debt?

JL: Broadly there are attractive tailwinds for Private Debt. First, we see Private Debt as a large and growing opportunity set with demand/supply dynamics favouring the private debt provider, and second it is situated currently in an attractive investment environment given current volatility.

We believe that the direct lending asset class remains attractive to borrowers and investors alike and is well poised for growth. It is now our role to continue what we are doing, seeking to find and select attractive investment opportunities and managing credits held to promote robust performance.

MJ: I'd echo Jeff's sentiments, and to give you some context for Europe, we've seen terms in the direct lending market shift in favor of lenders. At the end of last year, we've seen high original issue discounts offset margins in syndicated markets, whereas private markets have benefited from the supply/demand dynamic via yields of 9-10% and OIDs in normal ranges of 2%-3%. Increased margins can be a more permanent driver of yield whereas syndicated market original issue discounts can be more volatile.

[2] Protections are exemplary and may not be present in every loan.

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