WHITE OAK
GLOBAL ADVISORS

The Private Credit Market
2012

Summary

Private credit, also known as "private debt," is the sub-segment of fixed income that supports the financing objectives of middle-market companies. These loans or credit facilities are not publically traded and have traditionally been supplied primarily by banks but more recently a variety of factors have caused many traditional providers of capital to reduce their willingness to lend to this segment of the market. The result is an opportunity for non-traditional sources to deploy capital on terms and conditions designed to provide higher yields than many other fixed income investment opportunities with comparable or improved security and should offer investors attractive risk-adjusted returns in an investment format that mitigates many of the disadvantages encountered in the public or private equity and public debt markets. This paper discusses:

The Opportunity:
A notable imbalance exists today between the demand and supply of credit to middle-market borrowers. Structural dislocations, in part caused by stringent risk-based capital restrictions, are forcing banks and other large financial institutions to reduce their exposure to in middle-market lending, even as borrowers' appetite for credit is growing. This excess demand creates attractive terms for those willing and able to lend and provides an attractive investment opportunity.

Product mix:
Middle-market firms require capital for refinancing, growth, trade, merger and acquisition activities, and working capital. Historically, local and regional banks provided financing to these firms but these traditional suppliers of capital have either vanished or drastically reduced their exposure to these companies, largely due to changes in the regulatory environment. New sources of capital are filling the supply/demand imbalance, creating the opportunity to invest in products such as directly originated loans, participation interests in syndicated loans, asset-based lending (ABL), trade financings and factoring.

Expected returns:
Private credit strategies provide opportunities for yield enhancement to existing portfolios. The supply/demand imbalance and illiquidity premium available to private credit investors produces returns several hundred basis points higher than those available from publicly traded fixed income investments with similar risk levels such as high yield bonds or levered bank loans.

Risk:
The risk characteristics of each product vary but there are important factors that investors need to keep in mind: loan to value, leverage, seniority, covenants and collateral. In the current environment, lenders are able to obtain attractive terms in all of these areas that create a risk profile comparable or superior to publicly traded high yield debt.

Asset allocation:
Private credit can be positioned as either a part of the fixed income allocation, as opportunistic credit or as an absolute return investment, due to the private nature of these investment opportunities and the investment terms required.

The Opportunity: Driven by Supply/Demand Imbalance

Private credit refers to loans and other credit facilities supplied directly to middle-market businesses. For the purposes of this paper we define "middle-market" as companies with EBITDA between $5 million and $50 million and enterprise values between $50 million and $500 million. Smaller companies may qualify for small business loans, accounts receivable financing or venture financing. Larger companies typically have access to bank loan financing or the debt capital markets.

Banks, and to a lesser extent thrift institutions, have historically been the primary lenders to middle-market borrowers. Some alternative lenders, including but not limited to permanent balance sheet lenders such as GE Capital Corp. and other specialty finance companies (business development companies, referred to as "BDCs") are also notable commercial lenders. GECC has substantially reduced its exposure and the BDC market is a relatively small one (the aggregate market capitalization of the thirty largest BDCs is approximately $20 billion). The only other alternative lenders are specialty finance companies or managers that offer access to the private credit market via a private funds, separately managed accounts or hybrid structures.

According to Deloitte LLP's middle-market research there is approximately $1.2 trillion in debt outstanding serving middle-market companies. If one were to combine all of the private equity capital raised for mezzanine-level investment, the debt portfolio for GE, CIT Group and the other specialty lenders (including BDCs), it would only make a small dent in the current debt outstanding. *The lion's share of this loan market is bank lending.*

Supply. As of Q1 2012, there were 6,176 commercial banks in the U.S. compared to almost double this number two decades ago (see Exhibit 1) and the trend of consolidation seems likely to continue. A breakdown by size shows that 89% of commercial banks and savings institutions have $500 million or less in assets (see Exhibit 2).

Exhibit 1: Commercial Banks in the U. S.

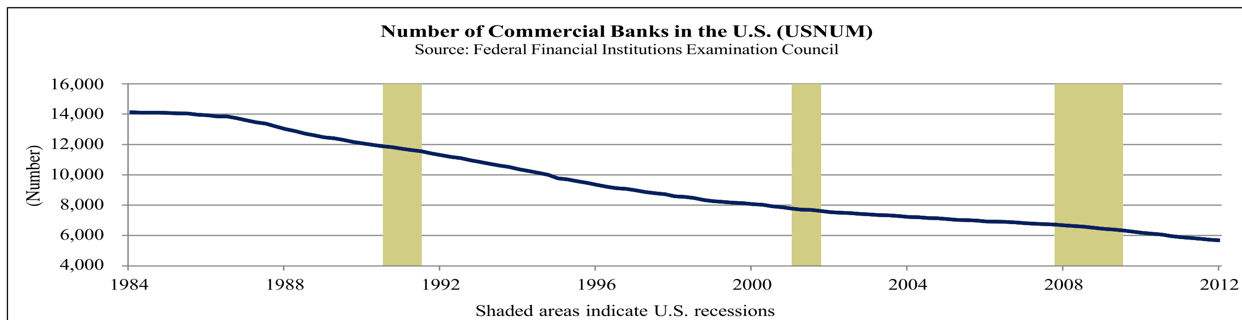
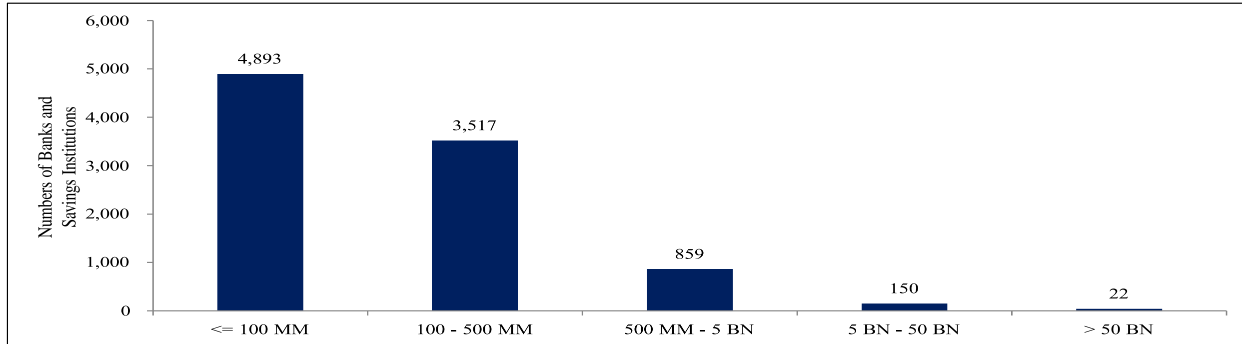
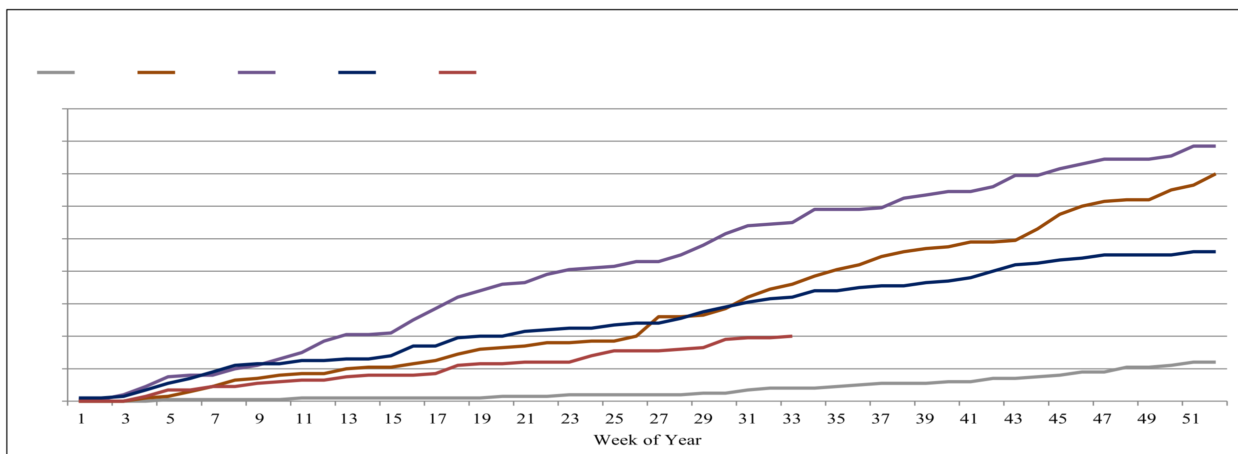


Exhibit 2: Breakdown of Commercial Banks and Savings Institutions by Size of Assets



Basel II and III. The Basel II Accords, initially published in June 2004, established risk and capital management requirements designed to ensure that a bank has adequate capital for its lending and investment practices. The greater the risk to which the bank is exposed, the greater the amount of capital the bank needs to hold. *The result of these Accords is that a non-rated corporate loan will require substantially more risk- weighted capital than a rated corporate loan.* Therefore, it is substantially more expensive from a capital charge perspective for banks to lend to middle-market businesses that do not have a rating for their loan, and it is not the most efficient way for a bank to manage its balance sheet or depositary capital. Under Basel II (and the Dodd-Frank legislation), banks that had under $1 billion in assets were not required to comply fully with the same regulatory restrictions as larger banks but under Basel III that appears likely to end. According to a recent article, "Small banks received an unexpected blow this month that could drive more transactions. The Federal Reserve approved a proposal ordering even the smallest lenders to comply with comprehensive international capital requirements known as Basel III. Many bankers had expected regulators to exempt some small lenders from the new rules, which are aimed at shoring up the biggest global banks whose troubles fueled the financial crisis." [1]

Exhibit 3: FDIC Bank Failures



[1] Robin Sidel, *Small Banks Put Up "For Sale Sign"* (WSJ, June 2012)

Demand. At least $550 billion of non-investment grade credit facilities and bonds will mature in 2013-14, with additional maturities coming in subsequent years. Regulatory realities have reduced traditional lenders' appetite to refinance existing debt or extend new credit to the same or new borrowers. This demand and supply imbalance has created a friendly lending environment for new entrants into the marketplace.

Exhibit 4: Rated Speculative-Grade Bank and Bond Maturities

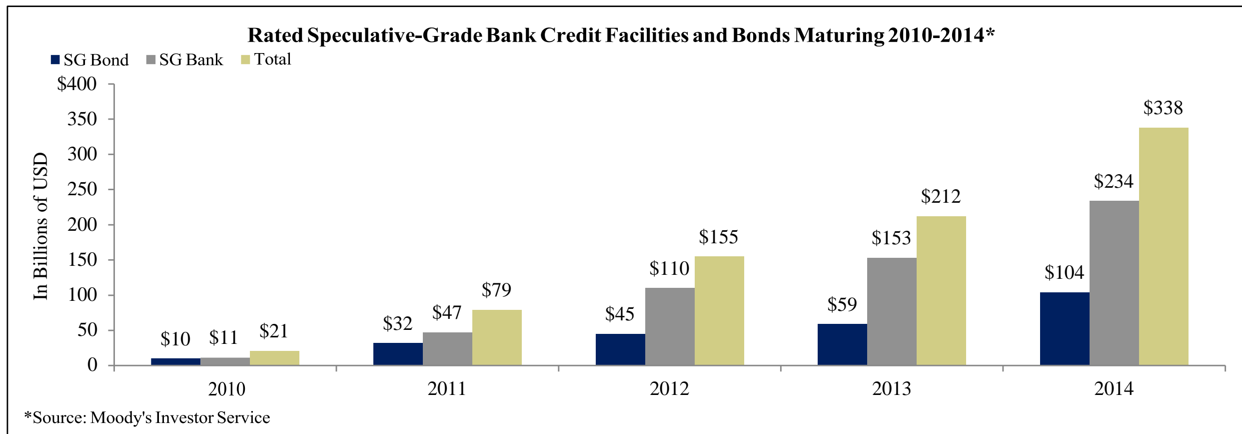


Exhibit 5: High-Yield Maturities

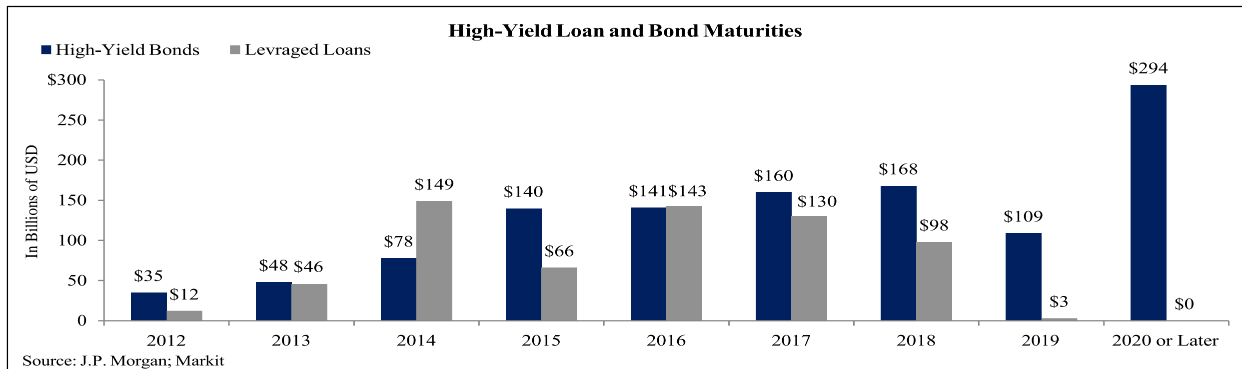
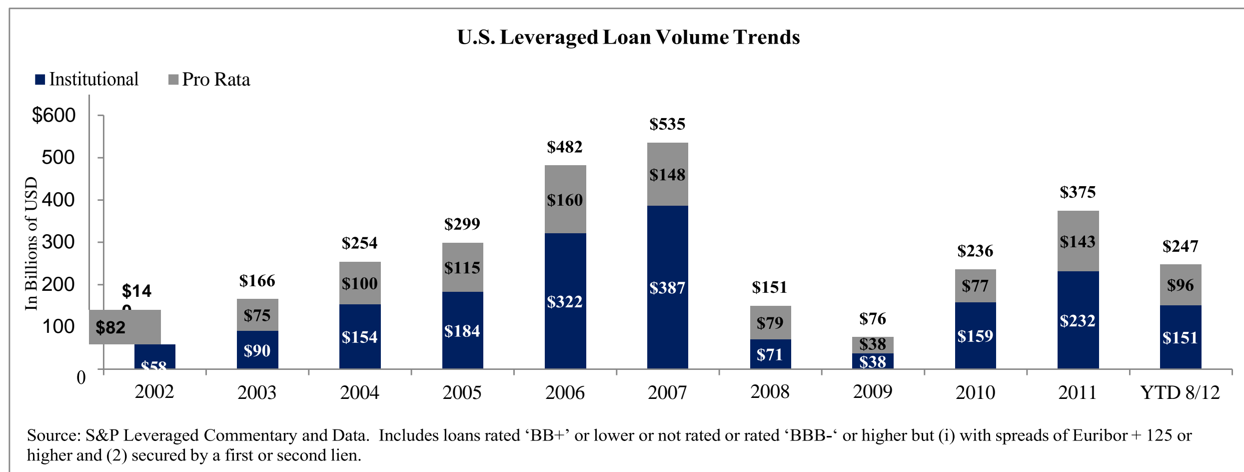


Exhibit 6: U. S. Leveraged Loan Volume



Source: S&P Leveraged Commentary and Data. Includes loans rated 'BB+' or lower or not rated or rated 'BBB-' or higher but (i) with spreads of Euribor + 125 or higher and (2) secured by a first or second lien.

Private Credit: The Portfolio Context

Private credit is inherently most like the fixed income component of most institutional investors' portfolios but, because of the vehicles through which the investments are made and the liquidity provisions of those vehicles, private credit can also be included in the "alternative investments" allocation. Private credit vehicles can be structured in a variety of ways, including separately managed accounts, open-ended funds, and funds that are structured similarly to private equity investments.

Unlike most hedge funds and some private equity funds, the performance of private credit does not primarily depend on robust securities markets to achieve expected returns. In fact, returns may even be enhanced when public markets are at their most challenging since volatile markets tend to accentuate private lenders' competitive advantages. Investors also typically begin receiving returns almost immediately upon investment, unlike private equity investors in particular who must usually wait a significant period of time before receiving any returns on their investment (the "J curve"). Private credit also differs from private equity by enabling borrowers to grow their business without giving up control or having their ownership diluted. Although managers of private credit vehicles may provide oversight and assistance to borrowers, their core function is to provide companies the opportunity to meet their financing objectives without diluting their ownership.

Private Credit vs. Public Credit Instruments

Private credit should always provide a meaningful incremental return over public market alternatives, but in the current very low interest rate environment this spread can be particularly helpful to improve overall portfolio returns. Exhibit 7 contains a snapshot of current yield relationships and Exhibit 8 shows the composition of total returns for various types of loans:

Exhibit 7: Current Market Yields

1-Year CD (CDARS)	0.25%
1-Year Treasury U. S.	0.18%
30-Year Treasury U. S.	2.81%
10-Year Treasury	1.67%
Corporate High Yield	6.40%
BB Index Yield	4.76%
CCC Index Yield (Junk)	10.80%
HY CDX Spread	499
B Index Spread (Loan/Spread)	549
Private Credit 3 year loan (total	12%

Information as of 9/7/12 (AMG Data Services, UBS High Yield Capital Markets, Bloomberg, Capital IQ)

The yield in private credit yields may be generated from a combination of sources, including but not limited to:

1. Up-front points, which are customarily charged by banks to defray their underwriting expenses;
2. Current cash yield or coupon;
3. Payment-in-kind (PIK) interest or original-issue-discount (OID), paid upon the maturity of the loan and are in addition to the coupon;
4. Equity upside or warrants; and/or
5. Other fees such as commitment fees (customary in ABL or factoring lines of credit).

Exhibit 8: Industry Average Yields

Industry Average					
Product Options	**Up-Front Points**	**Current Cash Yield**	**PIK, OID Or Other**	**Equity Or Warrants**	**Expected Return**
Levered Bank Loan	0.00 – 2.00%	5.00 – 7.00%	NA	NA	7.00 – 9.00%
Senior Secured Self-Originated	0.00 – 3.00%	8.00 – 12.00%	0.00 – 5.00%	NA	12.00 – 17.00%
Secondary Loans (1st or 2nd Lien)	NA	7.00 – 10.00%	0.00 – 5.00%	NA	9.00 – 15.00%
Unitranche	0.00 – 2.00%	7.00 – 10.00%	0.00 – 5.00%	NA	7.00 – 10.00%
Mezzanine Loans with Warrants	0.00 – 2.00%	10.00 – 12.00%	NA	0.00 – 5.00%	7.00 – 11.00%
Asset-based Lending	0.00 – 1.25%	3.00 – 8.00%	2.00 – 4.00%	NA	10.00 – 15.00%
Venture Lending	0.00 – 3.00%	10.00 – 12.00%	NA	0.00 – 5.00%	7.00 – 12.00%

Each type of loan in the private credit market has different liquidity, seniority and level of control:

Exhibit 9: Credit Product Options and Features

Product Options	Liquidity	Seniority	Control
Levered Bank Loan	Medium	Medium	No
Senior Secured Self-Originated	Low	Very High	Very high
Senior Secured Secondary Loans	Low	Medium	Medium
Unitranche and Second Lien Loans	Low	Low	Medium
Mezzanine Loans with Warrants	Low	Low	Low
Asset-based Lending	Medium	High	High
Venture Lending	Low	High	High

There are additional sub-categories of the above highlighted products, including but not limited to: debtor-in- possession (DIP) and rescue financing loans, special situation "loan to own" opportunities, publicly traded finance companies including but not limited to business development companies (BDCs), and a combination of the product options noted above with or without the use of leverage to get up to a targeted return. The tenor of the investments, the number of borrowers participating in the various tranches and the riskiness of the credit may also vary.

Risk. As with any type of lending, private credit loans are subject to defaults and lenders must then attempt to recover as much of their capital as is possible based on the collateral they hold against the loan. Unlike high yield bonds, where there are good statistics available to quantify default rates (see Exhibit 11 below), there is much less information for defaults and recoveries on private corporate credit. Most of the lenders to private companies are banks which account for losses via loan loss reserves on their balance sheets while non-bank lenders such as specialty finance institutions, private equity and hedge funds and other investment managers apply losses directly to their funds or separately managed accounts. When properly underwritten, investing in private credit, which may include fewer lenders and higher standards for covenants, should typically produce a higher recovery percentage than that produced by publicly traded high yield bonds and bank loans.

Exhibit 10: Credit Investment Considerations

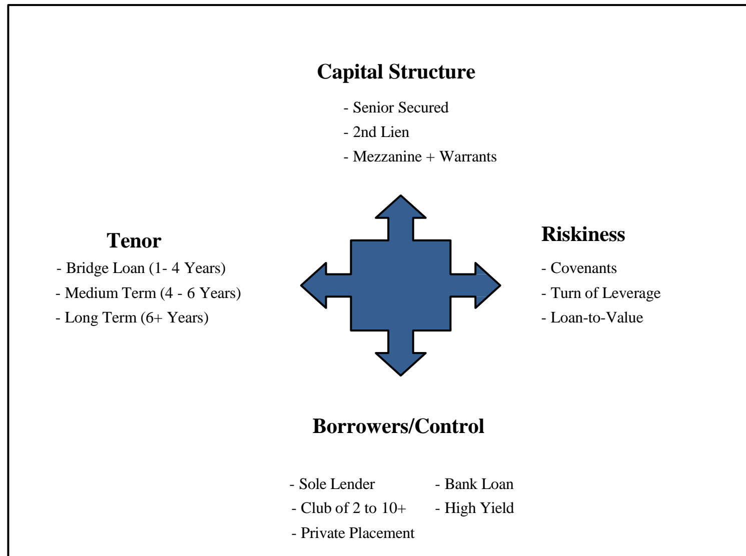
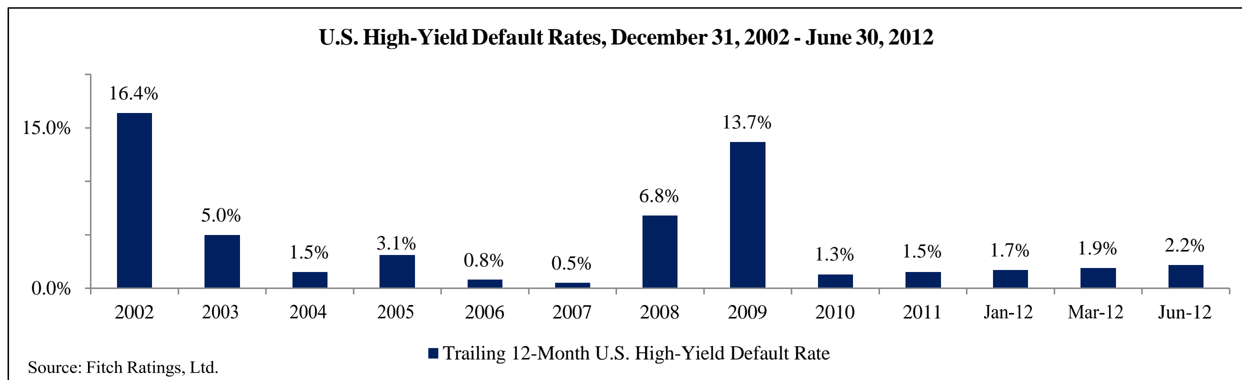


Exhibit 11: U. S. High-Yield Default Rates



Source: Fitch Ratings, Ltd.

Additional considerations: Whether originating loans in the private credit market directly or using a manager to do so, investors will also want to consider the following due diligence items:

(1) **Access to deal-flow.** Understanding where loans are originated is a key differentiator in this market. The dynamics are very different in loans to companies with private equity sponsors relative to those that are non-sponsored; direct origination will produce significantly different economics than purchasing a piece of a syndicated transaction.

(2) **Credit underwriting.** Private credit requires fundamental credit underwriting and on-going monitoring and portfolio management.

(3) **Infrastructure and operations.** Private credit underwriting requires a significant investment in operations and infrastructure tied to this business.

(4) **Historical track record**. An investment manager should demonstrate a consistent and repeatable investment process.

(5) **Work-out experience**. An investment manager needs to have experience in work-outs, restructurings, managing a business, the bankruptcy process, hiring new management and selling a business.

(6) **Legal**. Having the right team with legal and documentation experience.

(7) **Valuation**. How does the manager value the investments in their portfolio? Private credit investments are Level 3 investments and can be more difficult to value than publicly-traded bonds and loans.

(8) **Fees**. What is the structure of the manager's performance fee, and is there a market-rate hurdle?

(9) **Leverage and tax implications**. Private credit managers that apply leverage to their investment returns may be subject to UBTI. Their historical track-record may not take into account the *after-tax* yield realized by their investors.

Analysis of the direct lending product

Direct lending is a sub-set of private credit that refers to loans made by non-financial companies directly to middle-market companies. Direct lending is the fastest growing segment of the private credit market.

Senior Positions: Private debt includes senior and super-senior loans, fully secured by corporate assets, which are designed to provide investors with both a high current coupon rate and high recovery rates in the event of default. Coupon rates are usually quoted as a spread over LIBOR. This spread is a function of market liquidity and loan duration. During the boom from 2003 to 2007, spreads were typically in the 3%-5% range, while LIBOR was around 5%. Following the 2008 credit crisis, however, spreads have more typically ranged from 7% to 10% above LIBOR, with LIBOR around 0.75%. On average, the cost of debt for smaller to midsize firms has been hovering around 14%, which includes a 10% coupon rate and 3-5% PIK.

Short Durations: The terms and duration of these loans vary from borrower to borrower; however, there are three main categories. First, many businesses require short-term credit lines for working capital, with typical maturities of 1-2 years. Second, some borrowers require financing for mergers, acquisitions, or to fund organic development; these loans tend to be longer in duration, with typical maturities of 3-7 years. Finally, a large portion of borrowers require new lenders to refinance their existing loans; the maturity of these loans varies from 2-7 years.

Lower Risk: The current supply/demand imbalance has also enabled lenders to obtain more favorable terms. For example, in 2007 first lien debt/EBITDA multiples averaged 4.76x; by the first quarter of 2011, the average was around 3.73x, a decline over 21% (see Exhibit 12 below). In addition, senior secured lenders have been able to demand loan-to-value (LTV) ratios of 50% or lower, measured against what we believe are more conservative asset values, tighter covenants and additional undertakings (*e.g.*, to perfect the lenders' security). Conservative LTV ratios, combined with broad collateral revaluation, strongly protect lenders against losses. We believe this imbalance is likely to persist and should enable investors to earn higher returns with a larger margin of safety in the years to come. Investors should enjoy the downside protection of a senior position in the borrower's capital structure with returns comparable to providers of mezzanine capital.

Exhibit 12: U. S. Middle-Market Credit Statistics

Pro Forma Credit Statistics of Middle-Market Transactions

(Defined as issuers with EBITDA of $50 million or less)

	Debt / EBITDA	Senior Debt /	EBITDA / Cash	(EBITDA - CapEx) / / Cash Interest	(EBITDA - Mainten CapEx) Cash Interest
1997	4.82	3.69	2.37	1.64	1.88
1998	4.55	3.49	2.75	1.84	2.30
1999	4.11	3.32	3.03	1.77	1.80
2000	4.01	3.14	3.10	1.70	1.94
2001	3.56	2.65	3.22	2.23	2.47
2002	3.75	2.81	3.64	2.37	2.50
2003	3.86	3.02	3.67	2.71	2.87
2004	4.11	3.51	3.92	3.12	3.34
2005	4.31	3.97	3.34	2.80	2.91
2006	4.40	4.03	2.82	2.12	2.22
2007	4.76	4.52	2.79	2.35	2.50
2008	4.25	3.61	3.17	2.72	2.74
2009	3.41	2.90	3.36	2.37	2.37
2010	3.77	3.28	3.77	3.20	3.39
1Q11	3.73	3.50	4.00	3.70	3.75

Source: S&P Q1 2011 High-End Middle Market Lending Review

CONCLUSION

Private credit investing satisfies a real and growing dislocation in the United States between the need for middle-market financing and traditional funding sources. Investors may position private credit in their portfolios as a strategy to supplement their existing fixed income allocation, opportunistic credit, or absolute return in order to take advantage of excess spreads that are available for the illiquidity premium and private nature of these investment opportunities.

Appendix: The White Oak Global Advisors Approach to Private Credit

White Oak is an SEC-registered independent investment firm established in 2007 to provide advice and support the financing needs of middle-market businesses. We have established a record of generating attractive risk-adjusted performance with low default rates. Our objective is to provide investors a premium above the rates of return available in the traditional high yield market with lower risk.

White Oak has a fundamentals-based credit platform and an innovative origination strategy. Its 39-member team includes highly experienced origination, underwriting, portfolio management, legal and restructuring/work out professionals.

Our direct lending business targets U.S.-based businesses with enterprise values between $50 million and $500 million or EBITDA values between $5 million and $50 million. Borrowers include hard-asset intensive businesses with experienced management teams. White Oak finances business growth and enables capital structure optimization and rationalization, as well as corporate asset utilization, and provides both growth and acquisition advisory services.

To generate excess returns for investors while managing their risk exposure, White Oak requires seniority in borrowers' capital structure. It maintains conservative LTV and leverage ratios, obtains strong negative and affirmative covenants and other forms of credit protection, and keeps tenors short (1-5 year maturities). The example below is a representative of the types of borrowers we have worked with in the past.

White Oak - Representative Transactions

Credit Overview			
Company Code Name:	Hurley	**Status as of August 2012:**	Repaid in full all principal and interest
Business:	Private aircraft leasing and executive jet	**Sponsor:**	TPG and Tasmeem Group (Dubai Govt.)
Priority Position:	Senior Secured Term Loan	**Risk Grade:**	Positive
GICs Sector:	Aviation	**Covenant Breach:**	None
Census Region:	National	**Principal Outstanding:**	$20,000,000
Collateral Package:	First priority lien on all assets including existing aircraft, future delivery of aircraft, cash, A/R and	**Enterprise Value:**	$180,000,000
Loan to Value **Loan to Liquidation**	50% 75%	**Interest Rate:** **Final Investment IRR:**	17.00% 18.36%
Tenor	3-years	**Sourcing:**	Sponsor and management

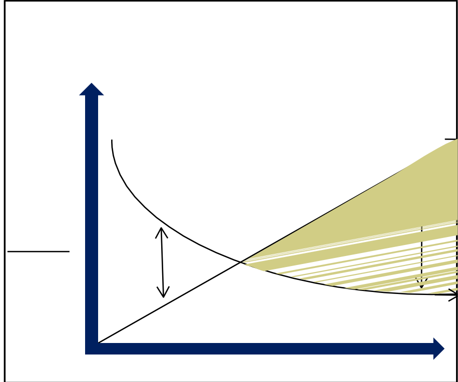
Citation 10 Aircraft and Hanger Photos

Deal Highlights

Innovative Business Model in Private Jet Aviation

- Offers ownership, leasing and on-demand options on a single aircraft type fleet of the world's fastest super mid-size jet, the Cessna Citation X
- Maximizes aircraft utilization using an innovative approach derived from yield management theory and a new dynamic allocation scheduling model that optimizes fleet capacity among customers with guaranteed access and schedule-available access
- Model significantly lowers costs for high volume users (100 to 1,000 hours per year) over fractional and independent ownership alternatives in the market
- Significant testing over 15,000 hours with 300 customers and $36 million in revenue in 2006
- Significant sponsors: Texas Pacific Group and Tasmeem Group (part of the Dubai Sovereign Wealth Fund)
- In process of expanding the fleet from the current 8 Citation X aircraft to over 134 aircrafts in 5 years

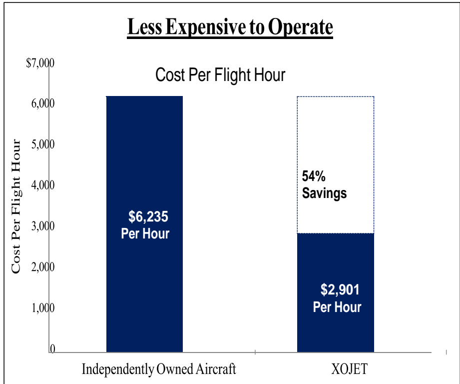
Hurley's Competitive Advantage:



<u>Less Expensive for Customers</u>

- Commerical airline safety standards
- All-new fleet, modern equipment
- High reliability service levels of 99.4%

	Based on 200 hours per year		
	Fractional Ownership	**Independent Ownership**	**XOJET Block Lease**
Upfront	$5.0MM	$20.5MM	$300k
Monthly	$42.0k/Mnth	$62.4k/Mnth	$74.5k/Mnth
Hourly	$3,600/Hr	$2,779/Hr	$2,779/Hr
Residual Value Risk	Yes	Yes	No



DISCLAIMER

This document is for informational purposes only. This document is not an offer to sell, or a solicitation of an offer to buy, any security. Any such offering may be made only by a private placement memorandum (Memorandum) related thereto and the information contained herein will be superseded in its entirety by such final Memorandum. The information contained herein is confidential and may not be reproduced in whole or in part. The private investment opportunity (the Investment) described herein will not be registered under the Investment Company Act of 1940, as amended (the 1940 Act), and the interests therein will not be registered under the Securities Act of 1933, as amended (the 1933 Act), or any state or foreign securities laws. These interests will be offered and sold only to "qualified purchasers" for purposes of Section 3(c)(7) of the 1940 Act, who also are either "qualified institutional buyers" (as defined in Rule 144A under the 1933 Act) or "accredited investors" as defined in Regulation D under the 1933 Act, or non-U. S. persons who purchase outside the United States pursuant to Regulation S under the 1933 Act. Past performance is no guarantee of future results. Longer term performance may not meet the levels achieved to date. References set forth herein are subject to change without notice. There is no representation or guarantee regarding the reliability, accuracy or completeness of this material, and White Oak Global Advisors, LLC, will not be liable for any damages, including loss of profits, which may result from reliance on this material. Because investment performance is expected to be volatile and an investor could lose most or all of his investment, an investment in this structure is very speculative and involves a high degree of risk and is not suitable for all investors. Further, an investment made herein is strictly illiquid, there are restrictions on transfer, and there is no current or expected secondary market for fund interests. The investment strategy, where permitted, may include non-performing, distressed and illiquid assets and non-US assets and may employ leverage and shorting strategies. High management fees and incentive compensation may create an incentive for the manager to take greater risks than it ordinarily would without such fees. This is not a complete description of the risks associated with an investment. For full details of the investment, investors should consult the investment's offering circular for a complete description of risk factors and tax consequences before investing.

This document is dated as of September 12, 2012. The information set forth herein is provided as of this date, unless otherwise noted.