

PENGANA DIVERSIFIED PRIVATE CREDIT FUND

12 February 2024

Dear Investor,

We are pleased to provide you with our inaugural quarterly newsletter for the Pengana Diversified Private Credit Fund (the “Fund”).

This report is atypical due to the recent commencement of the Fund and the lag associated with private credit reporting. Global private credit managers typically report quarterly with a lag of one quarter. As the Fund commenced on 1 October, formal performance reports for the quarter ending 31 December 2023 will be available from our underlying managers in March 2024, from which time our quarterly reports will include detailed performance information.

In this letter, we provide you with:

- An update on the Global Private Credit investing landscape,
- A recap of the Fund's strategy and review of the underlying managers' performance (derived from our regular performance update discussions with them in January 2024), and
- Our outlook for the sector.

An update on the Global Private Credit investing landscape

Global Private Credit remains attractive, delivering stand-out floating rate yields, strong capital protection from both information and contractual rights; and low volatility from actively managed loans that are held to maturity. Current opportunities are enhanced by the economic uncertainty in the US and Europe and the geopolitical uncertainty in many other parts of the world.

There are three key macro factors currently affecting credit market sentiment, and by extension, volatility and the demand for and availability of capital:

1. **Tighter Bank Regulation** following the bank failures of early 2023. This has resulted in main street banks withdrawing further from middle-market lending. There is a significant debt maturity wall looming, much of which sits on bank balance sheets, that requires refinancing from sources other than banks;
2. **Growing optimism** that the US economy has achieved a soft landing and contained inflation. This is providing investors and businesses with the confidence to invest, which has resulted in an increase in both the demand and supply of credit since the end of 2023; and

3. **Ongoing vigilance.** Notwithstanding this optimism, caution remains given the global macro economic and geopolitical uncertainty. While there is consensus that with interest rates what goes up must come down, there is no consensus on “when”, “by how much”, “how rapidly” and “to what level”.

So the takeaways:

- Until the direction of inflation and the level of future interest rates become clearer, economic uncertainty is likely to prevail albeit with cautious optimism. As a consequence, traded credit markets are likely to continue to be volatile, amplifying the relative attractiveness of private credit;
- The increasing demand from borrowers for private credit solutions will be met by investors attracted to the relative risk return characteristics of this asset class.

A recap of our Fund's strategy

A strategy designed to deliver consistent “through the cycle” returns needs to invest in all three predominant Global Private Credit strategies:

Direct Lending	Structured Credit	Credit Opportunities
Bilateral loans to middle market managers predominantly on a senior secured basis	Asset-based lending with strong structural protections	Capital solutions for borrowers with liquidity constraints or in distress (i.e. good company, bad balance sheet)
Income....	Total Return

All of these strategies are currently very well positioned with substantial investment opportunities.

Direct Lending, provides the foundation of the portfolio, generating very attractive yields, currently with lower leverage, and tighter documentation.

Structured Credit opportunities have been enhanced by the banks’ withdrawal, and the reduction in risk appetite of those remaining banks that now seek to partner with private credit providers to create Structured Finance Vehicles to refinance stretched balance sheets.

Credit Opportunities providers have a much wider opportunity set, with (i) many quality companies over levered or stressed from the rapid interest rate rises of the last 2 years and requiring creative solutions to solve capital needs at very favourable terms to lenders, including more equity upside at lower equity valuations; and (ii) high quality companies suffering liquidity stress in first lien debt that needs to be refinanced, providing tactical opportunities for nimble, multi-strategy private credit managers to step into the breach with bespoke capital solutions at very attractive terms.

The Fund is fully hedged to prevent currency volatility from impacting investment returns and all investor capital has been deployed, a unique feature in newly established private asset funds, that is very beneficial to investors.

Portfolio Update

Our highly skilled and differentiated managers are achieving excellent results in the favourable conditions described above, enhancing portfolio resilience and returns.

- **Originations.** Across all managers and strategies, deal flow continues to grow in volume and quality. Pricing is very attractive given high base rates and attractive credit spreads, leverage is low with loan-to-value ratios below 40% in Direct Lending, and tight documentation provides additional layers of protection. M&A activity is growing rapidly following a slower deal environment in 2022 and 2023, companies are investing given improved confidence and dislocation is driving attractive deal flow to our Balanced and Total Return managers.
- **Credit performance.** The credit quality of the portfolio is sound. Overall, revenue and EBITDA have each grown at over 10% across the portfolio, loan-to-value ratios in Direct Lending are below 40%, there have been no credit losses, and the attractiveness of credit protections and terms has been maintained.
- **Underlying Manager Returns.** Income-focused managers are generating net running yields of between 12-14%. Those focused on Structured Credit are in the mid-teens and the IRRs accruing to managers running Credit Opportunity strategies are between 11 to 30%. Regarding Structured Credit and Credit Opportunity managers, it is important to note that fund performance typically improves as they mature. Restructuring benefits can take time to come to fruition and transactions often present lucrative future financing options or other event-driven opportunities.

In all cases, our managers are optimistic about achieving above-target returns given the overall performance of existing investments against their planned expectations and the quality of new opportunities in their pipelines.

Conditions won't always be as favourable, but with multiple managers pursuing different strategies we expect to continue to generate resilient returns in more challenging environments as well.

Outlook for the sector

- In the current environment, Global Private Credit remains compelling, offering a combination of high risk-adjusted yields, strong protections and low volatility;
- Our managers are:
 - Meeting or exceeding their target returns;
 - Growing their pipeline of opportunities at attractive terms despite maintaining a conservative stance to investing given the uncertainty around a hard or soft landing; and
 - Experiencing strong underlying portfolio company performance because of their disciplined underwriting and active portfolio management.

- With the return of the bank syndicated loan and traded bond markets, competition in the large-cap space has increased significantly, leading large-cap private credit managers to experience deteriorating spreads and terms. Our focus on the mid-market, where borrowers have limited alternatives, is experiencing the opposite. This trajectory is expected to continue for the foreseeable future given the ongoing bank withdrawal from this market;
- As competition increases in the Direct Lending space to accommodate the funding gap, our core tenets remain:
 - **Diversification** – multi-manager approach reduces individual manager performance risk, ensuring a wide diversity of investments by number of borrowers, geography, strategy and industry, and low concentration;
 - **Flexibility** –to generate attractive risk-adjusted returns through market dislocations and uncertainty, while maintaining credit discipline; and
 - **Robust manager selection** – only including managers with demonstrated track record of performance; comparative advantage in origination to source the best transactions - select the deal makers not takers; consistent and proven credit underwriting, portfolio management, and workout capabilities; and who avoid the temptation to chase yield at the expense of terms

Overall, the outlook is very attractive with strong borrower demand, a more certain economic backdrop, attractive credit and pricing terms, and flexibility to enhance returns in periods of market dislocation.

Thank you again for providing us with the opportunity to be a custodian of your capital.

Yours sincerely,



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