Introduction to Private Credit

What is Private Credit?

Debt is a form of financing where companies borrow money from a bank or private lender with the promise to repay the principal amount along with interest over a set period of time. Private credit, also known as private debt, refers to lending and borrowing outside the traditional banking system. In contrast to public credit, such as a bank loan, private credit isn't listed on public exchanges or available in the public markets.

Private credit lenders, such as private market managers, provide the borrowing company with access to capital that they may not be able to obtain through traditional sources. This includes funding for growth, acquisitions, and working capital needs. Private credit lenders are often able to provide more flexible loan structures than traditional banks, such as longer repayment terms, and the ability to take on more risk.

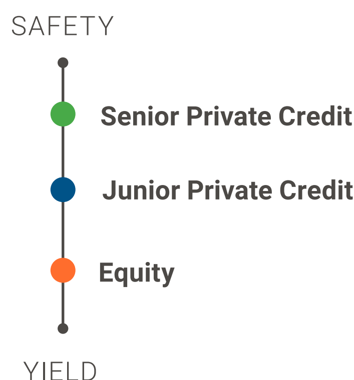
In return, lenders use debt financing, including loans, bonds, or other credit instruments to acquire and invest in private companies, referred to as portfolio companies. Some private markets managers have launched investor-friendly funds (I.e., evergreen funds) that have made private credit more accessible to a wider group of investors.

The makeup of a company's debt and equity is called its capital structure. The capital structure defines the order in which each type of investment is paid back to investors. This is important for private credit as it also lays out the interest paid by investment type. To learn more about capital structure, watch our video.

WHAT YOU SHOULD KNOW:

- Private credit is the investment of capital, in the form of loans, bonds or other credit instruments that are issued to private companies by a non-bank lender.
- Private credit may offer portfolio diversification, attractive yields, lower volatility, and downside protection versus other investment vehicles.
- Private credit can be a good option for investors who are looking to preserve capital or generate regular income.

Within the private credit space, there are different types of debt, each with their own benefits and tradeoffs. Companies tend to use multiple layers of debt, in addition to equity, in order to obtain financing. For example, sitting at the top of the capital structure is senior private credit, which offers the highest protections for investors and the lowest level of risk. As you move further down the capital structure to more junior debt, yields increase while protections decrease. Learn more about senior private credit here.



What are the benefits of private credit?

Private credit investments can offer several benefits for borrowers, lenders, and investors. For borrowers, private credit can provide access to capital without the constraints of traditional bank loans. Lenders in turn receive interest payments in addition to repaid capital throughout the life of the investment. Finally, private credit can potentially offer end investors portfolio diversification, more attractive yields, lower volatility, and downside protection compared to other investment vehicles.

How does private credit fit in investors' portfolios?

As you consider whether private credit aligns with your portfolio strategy, bear in mind that it can both be used for either capital preservation or income generation. Capital preservation strategies aim to provide predictable returns while protecting against losses. Return-maximizing strategies, on the other hand, focus on capital appreciation. No matter your goal, a private credit investment aims to provide the following benefits to an investor's portfolio:

- Portfolio diversification, by expanding a portfolio's investment mix
- Attractive yields, in the form of regularly paid distribution income
- Low volatility, as these investments seek smooth, consistent returns throughout the life of the investment
- Downside protection – private credit sits senior to equity in the capital structure, and is paid back first in the event of a company default

If you're interested in learning more about risk/return profiles of private credit, click here

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