Zenith INVESTMENT PARTNERS

RECOMMENDED

Product Assessment

KKR Credit Income Fund

Report data as at 31 Jan 2023
Rating issued on 09 Mar 2023

VIEWPOINT

The Trust, managed by KKR, accesses two discrete portfolios of US and European High Yield Bonds and Loans. Using an active, value-based approach, KKR invests across the full spectrum of sub-investment grade securities, from traditional performing bonds to deeply discounted, distressed opportunities. Zenith notes that KKR's proven expertise in managing the underlying strategies underpins our conviction in the Trust, and in our opinion, is an attractive option in the Listed Investment Trust (LIT) segment, for those investors seeking more aggressive fixed income returns with attendant drawdown risk.

In terms of the Trust and its underlying investment strategies, San Francisco-based, Chris Sheldon, Co-Head of Credit and Markets, is the Lead Portfolio Manager for the Global Credit Opportunities Fund (GCOF), while London-based, Matthieu Boulanger, Key Business Head and Investment Committee member, is responsible for the European Direct Lending (EDL) portfolio. In Zenith's opinion, Sheldon is highly experienced with specific skills in investing in lower quality credit securities, where his ability to understand the intrinsic value of businesses is a key source of value-add.

The Trust invests into the US-centric GCOF strategy and a European Direct Lending (EDL) portfolio, representing approximately 61% and 39% of the underlying portfolio, respectively (31 January 2023). GCOF is KKR's flagship 'traded' credit strategy, representing the 'best ideas' from across its credit platform with the investable universe including High Yield, Bank Loans, Structured Products and Opportunistic Credit.

Zenith highlights that KKR's focus on sub-investment grade securities is a point of differentiation, adding a layer of specialisation to its process. In our opinion, the approach is more resource-intensive and requires a contrarian mindset where the focus is on understanding the default risk of a business. This differs to traditional investment grade investing where the assessment is generally more relative-value based and understanding the relationship between spread and the potential for ratings migration.

Achieving diversification across regions, issuers and different interest sub-sectors, Zenith highlights the complementarity between the two strategies, with the EDL allocation smoothing the mark-to-market volatility of the GCOF portfolio and ultimately the Trust.

The final portfolio is managed with a credit spread duration range of between two and five years with a bias to senior secured securities which includes both loans and bonds. Consistent with the opportunity set, KKR typically invests in lower quality credit securities with a typical credit rating of B and CCC (based on S&P's rating methodology), noting that EDL assets are not rated.

Zenith notes that this cohort of securities is subject to a high level of mark-to-market volatility and potential default risk, particularly during stressed equity periods or cyclical downturns. Accordingly, investment outcomes will be closely tied to the quality and depth of KKR's bottom-up due diligence process.

Zenith highlights that post-listing, the Trust has consistently traded at a discount to Net-Tangible-Assets (NTA) (15.7% as at 31 January 2023), which is disappointing and above our expectations. While it is difficult to decompose the contributing factors to the discount (noting that market sentiment can be a large contributing factor), we highlight that KKR continues to implement a range of initiatives to manage this.

FUND FACTS

- Deep and highly-experienced investment team
- Focus on sub-investment grade securities
- Resource intensive investment process
- Responsible Investment Classification of **Aware**

ABSOLUTE RISK (SECTOR)

VERY HIGH
HIGH
MODERATE
LOW
VERY LOW

RELATIVE RISK (FUND WITHIN SECTOR)

Emerging Market Debt
High Yield
Multi-Sector
Opportunistic Credit
Syndicated Loans

INCOME DISTRIBUTIONS PER

MONTH QUARTER 6 MONTH ANNUM

INVESTMENT TIMEFRAME

1-2 YRS 3-4 YRS 5-6 YRS 7+ YRS

APIR Code

ASX:KKC

Asset / Sub-Asset Class

International Fixed Interest
High Income

Investment Style

Active

Investment Objective

To deliver a net distribution yield of 4% to 6% p.a., with a total return of 6% to 8% over the medium-term, by investing in US Traded Credit and European Private Credit.

Zenith Assigned Benchmark

Bloomberg AusBond Bank Bill Index
KKC Net Portfolio Returns

Net Returns (% p.a.)

	3 yrs	2 yrs	1 yr
Fund	-3.35	-1.91	-8.32
Benchmark	0.61	0.77	1.52

Income (% p.a.)

	Income	Total
FY to 30 Jun 2021	5.17	30.79

Fees (% p.a., Incl. GST)

Management Cost: 0.90%
Performance Fee: 5% of any excess return of the net portfolio return over the RBA Cash Rate plus 4% p.a.

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Listed Investment Trusts (LITs)

In assessing the performance of LITs, it is vital to understand how their structure affects the final performance figures as it is materially different to unlisted funds. As listed vehicles, the portfolio returns generated are exposed to additional volatility from unit price movements and can trade at significant premiums or discounts to Net Asset Value (NAV).

As an indication however, a series of return data can be viewed on the basis of the returns generated by:

- Unit price and distributions
- Change in NAV and distributions
- Returns generated internally by the investment portfolio

For comparison purposes, the use of the internal portfolio returns versus the benchmark gives the closest measure of the investment manager's skill in generating returns. However, these returns may not be able to be fully crystallised for holders given the potential for unit price movements on the ASX.

At various times when assessed on a purely quantitative basis, a LIT can trade away from its NAV which may represent good buying or selling opportunities. While these instances may boost investment returns, there is no guarantee that the discount or premium will converge to NAV, therefore, gains cannot be crystallised.

LITs differ in several important ways from Listed Investment Companies (LICs). Of particular note, owing to the trust structure used by LITs, 100% of net trust income must be paid as a distribution in the year it is earned. As a company, LICs will pay dividends at the election of the Board in accordance with the LIC's dividend policy. LIC profits may be retained in order to create a more even flow of dividends.

International Fixed Interest

The Zenith 'International Fixed Interest – High Income' sub-sector consists of all funds that invest predominantly in the higher-yielding sectors of the global fixed interest market. These sectors typically include high-yield, securitised loans and emerging market debt. The category includes funds that invest in specific underlying markets or a combination of each. Given the idiosyncratic nature of the sectors, managers commonly add value through security selection and/or sector rotation.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Bank Bill Index. However, Zenith only uses this benchmark as a common reference point and it may not be reflective of the underlying benchmark used by many managers in this category.

Given the funds in the 'International Fixed Interest – High Income' sector typically invest in lower-rated securities, they will potentially display higher downside volatility relative to more investment grade based strategies.

PORTFOLIO APPLICATIONS

KKR employs a credit-focused fixed income strategy, investing in sub-investment grade securities on an opportunistic basis.

Zenith believes the Trust may be suitable for investors seeking exposure to a higher yielding portfolio with 'equity like' return expectations which may improve a portfolio's potential risk/return profile. However, given the Trust can invest in sub-investment grade and unrated assets, it may not be suitable for the more risk-averse investor.

From a portfolio perspective, the Trust may be suitable as a component in the income-producing portion of a well-diversified portfolio. The Trust is considered appropriate as a component of a defensive allocation; however, given the higher return and volatility profile of the strategy, Zenith believes that investors may partly fund the allocation from the growth portion of a portfolio.

Zenith does not believe the Trust is appropriate as a core holding within the defensive allocation of a portfolio. Due to the anticipated moderate to high levels of volatility, with the potential for capital losses, Zenith recommends taking a medium to long-term investment time frame. Investors also need to be aware that as a listed Trust, the units will have their own trading patterns and may trade away from their NTA which at times may impact the effectiveness of KKR's investment process and/or expected risk-return profile.

The Trust seeks to pay distributions of between 4% p.a. to 6% p.a. (net of fees and expenses), and total returns of between 6% p.a. to 8% p.a. over the medium term. The distribution yield may be lower than the net profit of the Trust due to unrealised gains on loans/bonds which are marked at fair value.

To access the underlying investment strategies, KKR employs a master/feeder structure with the Australian Trust investing in a Singapore domiciled partnership (referred to as a feeder fund), which in turn, invests in the GCOF strategy, a Cayman based company (the master fund).

The Trust gains its exposure to the underlying investment strategy via a Profit Participating Note (PPN) which is issued by the Singapore-based entity. The PPN is a debt instrument paying a variable investment return based on the underlying performance of the GCOF and EDL portfolios.

Zenith highlights that the investment structure is complex, including the use of an interposed entity to manage potential Controlled Foreign Company (CFC) obligations. While our preference is for a more simplified approach, in our opinion, the structure effectively creates the same investment and tax outcomes as a direct investment, albeit with less risk of being taxed on an accruals basis under the CFC provisions.

CFC is a complex area of tax legislation and Zenith recommends investors seek their own personal tax advice with respect to the suitability of the structure.

Despite the relative attractiveness of the strategy, Zenith highlights that the performance of the Trust reflects the movement in the underlying portfolio, as well as the performance of the ASX vehicle. The latter being subject to the impact of market sentiment, which can result in the Trust trading at a significant discount/premium to net tangible assets.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the International Fixed Interest – High Income sub-sector are exposed to the following broad risks:

MARKET RISK: Changes in economic, technological, environmental or political conditions and market sentiment may lead to a decline in general security prices and overall market volatility. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

INTEREST RATE RISK: Fixed interest securities are generally sensitive to changes in interest rates. An increase in interest rates may result in a fall in the value of these securities, while a decrease in interest rates can result in an increase in value.

CREDIT SPREAD RISK: In addition to being sensitive to general interest rate changes, non-government securities are also sensitive to changes in credit spreads (commonly the difference in yield between a government bond and a corporate security). A widening of spreads results in a fall in the value of these securities.

DEFAULT RISK: Given fixed interest securities represent loans to borrowers (including governments, banks and companies) there is a risk that these borrowers may default on interest or principal repayments. Credit risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

CURRENCY RISK: In addition to being exposed to general market risk, investments in international markets are exposed to changes in value of the Australian dollar relative to other foreign currencies. This may lead to increased volatility, independent of market moves. While fixed interest funds typically hedge their foreign investments back into Australian dollars, there can be no guarantee that the funds will be hedged at all times or that a manager will be successful in employing the hedge.

LIQUIDITY RISK: Fixed interest markets can experience periods of illiquidity, which can result in difficulties in buying or selling securities without adversely impacting the price.

DERIVATIVE RISK: Derivatives are commonly employed by fixed interest managers to hedge currency and other risks and/or as an alternative to direct purchases or sales of underlying assets. There are multiple risks associated with the use of derivatives; for example, the value of the derivative may not move in line with the underlying asset, counterparties to the derivative may not be able to meet payment obligations or a particular derivative may be difficult or costly to trade.

LEVERAGE RISK: Many derivatives have a leverage component. While leverage offers the opportunity to magnify gains, it may additionally magnify losses. An associated risk with leverage and magnification of gains/losses is that the portfolio's volatility may increase as a result. Investors need to be cognisant that the Fund may exhibit more volatility than one that is unlevered.

FUND RISKS

Zenith has identified the following key risks of the Trust. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

KEY PERSON RISK: Given the collegiate nature of the business, Zenith considers key person risk to be low. However, if Sheldon was to depart, this would warrant a reassessment of our rating.

DISCOUNT TO NTA RISK: Investors are exposed to the performance of the underlying portfolio and movements in the share price of the ASX vehicle. The latter being subject to the impact of market sentiment, which can result in the Trust trading at a significant discount/premium to net tangible assets. Zenith highlights that the Fund has persistently traded at a discount to NTA, resulting in sub-optimal performance outcomes for those investors that participated in the initial listing.

STRUCTURING RISK: The Trust invests in a Profit Participating Note (PPN) structure, which is issued by a separate KKR entity and effectively provides the Trust with an economic interest in the underlying GCOF and EDL portfolios. The use of interposed entities introduces additional structuring risk including complexity, regulatory risk and the inability of the Responsible Entity to effectively monitor the underlying investment portfolio.

LEVERAGE RISK: The underlying KKR funds to which the Trust is exposed may use financing to manage their lending commitments and ultimately achieve their investment objectives. This may magnify gains and losses on underlying holdings

VALUATION RISK: Given the idiosyncratic nature of loans investing coupled with the limited secondary market, valuation risk is considered moderate for the Trust. While KKR has a robust and clearly defined valuation policy, there is a risk that the realisable value of securities may not align with the mark-to-market value carried by KKR.

LIQUIDITY RISK: As an over-the-counter 'private market', liquidity can vary significantly through different market conditions. While the listed structure obviates most of the liquidity risk, this can have an effect on market pricing and the mark-to-market of specific assets.

SUB-INVESTMENT GRADE CREDIT RISK: By its nature and as reflected by its rating, sub-investment grade debt has a higher potential of default. Although investors have historically been compensated, in the form of excess returns, there is the potential for the strategy to experience more defaults than the broader market. Additionally, defaults tend to cluster in certain years and therefore investors should expect periodic episodes of higher defaults. Nevertheless, given the Trust holds a significant proportion of sub-investment grade debt, investors should be aware of the increased risk involved in this allocation.

RELATIVE PERFORMANCE RISK: Investors should also acknowledge that the Trust may underperform traditional bond funds and those benchmarked against domestic or global bond indices in a falling interest rate environment, or in an environment where credit performs poorly relative to government bonds.

UTILISATION RISK: The Trust will invest in loans whose level of draw down may vary over time. Returns to the Trust will vary according to the level of utilisation by borrowers of such revolving credit facilities.

QUALITATIVE DUE DILIGENCE

ORGANISATION

KKR was founded in 1976 by Jerome Kohlberg, Henry Kravis and George Roberts with its origins as a private equity firm. Over time, the firm has expanded its business activities and currently includes the following divisions: Private Markets; Public Markets; and Capital Markets. While each business unit operates autonomously, a range of support functions are shared across the business including: KKR Capstone - a dedicated business unit that works closely with portfolio managers to extract operational efficiencies across portfolio companies; and a Stakeholder Management team, which is responsible for ensuring that all investment transactions are executed and managed in accordance with best practice.

As at 31 December 2022, KKR managed approximately $US 504 billion, which includes $US 194 billion across its credit platform, KKR Credit. The division was established in 2004 and is comprised of 190 investment professionals based in eight countries. The team manages a suite of strategies encompassing leveraged loans, high yield bonds, direct lending and collateralised loan obligations (CLOs).

In terms of its Australian operations, KKR has maintained a presence since 2006 investing in a number of private equity, real estate, infrastructure and credit transactions. In addition, KKR manages $US 4.5 billion (as at 31 December 2022) on behalf of Australian superannuation funds, family offices and endowments. Due to the nature of the asset classes (i.e. limited liquidity), KKR has primarily focused on the institutional market, with the Trust representing its first entry to the retail/wholesale market.

Zenith highlights the depth of KKR's Credit platform, which extends across origination, execution and deal servicing. Consistent with the firm's heritage in private equity, co-alignment of interest is a consistent feature across all of KKR's investment capabilities. To this end, KKR's Balance Sheet and Employees have approximately $US 3.6 billion invested across a number of strategies (as at 31 January 2023). Zenith is supportive of this approach, which in our opinion, ensures the interests of shareholders are closely aligned with portfolio managers.

KKR currently manages $US 3.6 billion in the GCOF strategy (as at 31 January 2023).

INVESTMENT PERSONNEL

Name	Title	Tenure
Chris Sheldon	Co-Head of Credit and Markets	19 Yr(s)
Frances Lim	Co-Portfolio Manager & Member of Global Macro and Asset Allocation Committee	12 Yr(s)
Matthieu Boulanger	Co-Head of Private Credit	6 Yr(s)
Jeremiah Lane	Head of US Leveraged Credit	18 Yr(s)

KKR's credit platform is comprised of 190 investment professionals, principally located in San Francisco and London.

In terms of the Trust and its underlying investment strategies, Chris Sheldon, Co-Head of Credit & Markets, is the Lead Portfolio Manager for the GCOF strategy, while Matthieu Boulanger, Co-Head of KKR's Private Credit business, is responsible for the EDL portfolio. Sheldon is based in San Francisco and responsible for a number of KKR's traded credit and private credit strategies. In Zenith's opinion, Sheldon is a highly experienced and well-credentialed investor. In our opinion, his contrarian mindset and ability to understand the intrinsic value of a business is a key contributor to the success of the underlying strategy.

London-based, Boulanger is a portfolio manager for a number of KKR's private credit funds and ultimately responsible for the composition of the EDL portfolio. Prior to joining KKR, Boulanger was employed at HPS Investment Partners and Citigroup, where he held a number of senior investment roles, focusing on private credit, special situations and infrastructure/energy opportunities.

KKR's investment teams are supported by a well-defined governance structure, with a number of investment committees responsible for both approving investments and monitoring the composition and performance of underlying portfolios. At the highest level, a Credit Portfolio Management Committee is ultimately responsible for the performance of all KKR funds including adherence with investment guidelines and limits. The seven-person committee meets on a weekly basis and is comprised of the aforementioned portfolio managers.

At the strategy level, a U.S. Leveraged Credit Investment Committee is responsible for approving and maintaining eligible securities for the GCOF portfolio, while the European Direct Lending Investment Committee, reviews and approves all lending proposals. Zenith is supportive of KKR's investment structure, noting the additional layer of governance from the committee approach. While each committee is effectively a sub-set of senior investment professionals, the centralised decision-making structure ensures that all proposals are rigorously tested prior to investment.

An Investment Committee (IC) of four senior portfolio managers from KKR Credit has been established to oversee the implementation of the Trust's investment strategy and ensure the portfolio is managed in accordance with its stated investment objectives. The IC comprises of Sheldon and Boulanger, who are supported by Portfolio Managers, Frances Lim and Jeremiah Lane.

In addition to the analyst team, a Portfolio Monitoring Unit (PMU), comprising 16 investment professionals (as at 31 January 2023) is responsible for ongoing credit monitoring and providing an independent assessment of each issuer/borrower. The team leads the quarterly valuation process and monitors company performance versus KKR assumptions, which includes covenant compliance. In our opinion, the PMU introduces an important layer of separation between the research team and the portfolio monitoring/valuation process, which is important given the nature of the underlying assets (e.g. potentially illiquid) and the level of subjective inputs in the valuation process.

KKR's remuneration structure is based on a global approach where firm-wide profitability is used as the basis for all incentive payments. Senior members of the investment team receive an industry-benchmarked salary and are also eligible for a cash bonus and equity. The cash bonus/equity component is largely discretionary and reflects a combination of firm and business unit performance, individual contribution and the performance of underlying funds managed.

To retain staff over the long-term, bonus payments are vested over multiple years and also include a portion that invests in underlying KKR funds under a system internally referred to as 'Dollars at Work'. In simple terms, the 'Dollars at Work' structure means that the economic return derived from the KKR investments changes over time, in line with each employees' overall contribution to performance. In our opinion, the approach embeds a strong co-alignment of interest, ensuring investment performance and remuneration are closely tied.

In sum, Zenith is supportive of the resourcing structure, effectively combining specialist bottom-up investors with a strong governance framework and a range of ancillary support functions.

INVESTMENT OBJECTIVE, PHILOSOPHY AND PROCESS

The Trust's investment objective is to deliver an absolute return of 6% p.a. to 8% p.a. (net of fees and expenses) over the medium-term, which includes a target distribution of 4% p.a. to 6% p.a. paid on a monthly basis. This is achieved by investing in a mix of global credit strategies (both private and publicly-traded) with low correlation to traditional investment grade bond markets, and an emphasis on diversification across asset classes, regions and issuers.

KKR's investment philosophy is premised on the belief that intensive credit analysis is a sustainable source of excess returns, particularly when implemented with a capital preservation focus. In particular, KKR's approach is anchored by its fundamental analysis of a company/issuer, including detailed historical and projected financial modelling. In our opinion, given KKR's presence across public and private markets, the firm is well positioned to assess the enterprise value of a company with both a private and public lens.

Zenith highlights that KKR's focus on sub-investment grade securities is a point of differentiation and adds a layer of specialisation to its investment process. In our opinion, the approach is more resource-intensive and requires a contrarian mindset where the focus is on understanding the default risk of a business. This differs to traditional investment grade investing where the assessment is generally more relative-value based and understanding the relationship between spread and the potential for ratings migration.

The Trust invests into the following investment strategies:

- Global Credit Opportunities Fund (GCOF) - 45% to 100%
- European Direct Lending (EDL) - 0% to 45%

The underlying strategy mix has been constructed to achieve diversification across regions, issuers and different fixed interest sub-sectors. For example, GCOF is a US-centric strategy investing primarily in corporate bonds and loans, while the EDL portfolio invests in European loans. Further, the key return drivers of each strategy are complementary, extending across credit quality, interest rate sensitivity, risk premia etc.

In practical terms, GCOF invests in publicly traded bonds and loans and therefore will exhibit greater variability of performance, whereas the EDL strategy comprises a portfolio of private loans which is priced less frequently, with performance variations generally representative of the credit worthiness of the pool of borrowers. Zenith highlights the embedded level of diversification between the two strategies, with the EDL allocation expected to smooth portfolio volatility (as measured by Standard Deviation) at the Trust level.

The following section includes a detailed overview of each of the underlying strategies.

GCOF Portfolio

The GCOF strategy is KKR's flagship credit portfolio, representing the 'best ideas' from across KKR's traded credit platform. The investable universe is relatively broad, including high yield bonds, bank loans, structured products and opportunistic credit. Opportunistically, KKR can invest in more bespoke investment opportunities including warrants, exchange-traded funds, equity or debt tranches of collateralised debt and loan obligations.

In constructing the portfolio, the portfolio managers employ a range of bottom-up strategies, which are classified based on the following:

- **Event driven** - identifying securities with short-term catalysts for price appreciation which can include mergers and acquisition activity, restructuring and/or positive ratings movements
- **Dislocation/relative value** - high yielding securities from companies experiencing earnings/revenue challenges and/or its underlying sector is facing structural challenges
- **Proprietary sourcing** - leveraging the firm's industry networks to access niche financing opportunities, which can include cornerstone or large block trades
- **Stressed credits** - distressed companies that require refinancing or restructuring of debt arrangements. Typically these companies operate in structurally challenged industries or sectors going through transition
- **Structured products** - can include a range of structured credit opportunities, including investing in lower tranches of CLOs

The event driven and dislocation strategies are expected to account for the majority of portfolio risk, however the underlying portfolio weightings will change over time and reflect the prevailing opportunity set.

In sum, the GCOF portfolio is a mature investment strategy, drawing on the extensive network of the broader KKR business. In our opinion, the quality and depth of KKR's bottom-up due diligence allows it to invest lower down the risk continuum to generate strong risk-adjusted returns.

EDL Portfolio

The EDL portfolio is a pool of loans, that have been incrementally sourced and funded, following the initial capital raising. Zenith highlights that a common feature of investing in direct loans, is the ramp-up period while loans are sourced and executed. Given the time and resource intensive nature of the asset class, portfolios are generally sourced loan-by-loan, which can take up to three years to complete. As a consequence, there is the potential for greater issuer concentration risk until the portfolio reaches final maturity.

As a lender, KKR prioritises larger transactions, where the borrower has a minimum of $EUR 25 million of EBITDA (Earnings Before Interest, Depreciation and Amortisation), coupled with strong credit fundamentals and high quality private equity sponsors. A typical tranche size is generally between $EUR 100 million and $EUR 250 million, with a preference for being the sole lead lender on the majority of deals.

The majority of loans are floating rate in nature, with borrowers paying a spread above Euribor (European Inter-Bank Offered Rate), generally in the range of 5% p.a. to 7% p.a., subject to market pricing. Further, KKR typically invests in senior and senior stretch loans (which is a form of combining senior and subordinated loans to generate a blended exposure), with a lower exposure to second lien loans.

Prior to investing in a loan, all lending proposals need to be unanimously approved by KKR's Credit European Direct Lending Investment Committee which is responsible for all private credit investments made by the team, including privately originated senior and subordinate lending opportunities.

The position sizing of loans across the portfolio is subject to the underlying Trust's diversification guidelines. Further, this can be an outworking of the origination pipeline and the maturity profile of the Fund.

Zenith notes that investing in loans is a highly specialised skill set, that extends well beyond traditional credit investing. For example, this includes a detailed understanding of the origination process, funding structures (i.e. revolving facilities), term loans with different amortisation features, and the ability to manage impaired assets. In addition, KKR's approach is augmented by its vast networks and business relationships which should ensure a strong pipeline of lending opportunities.

In sum, Zenith is supportive of the stabilising role that the EDL portfolio plays in the Trust structure. Notwithstanding this, the underlying loan exposures are expected to cover the full continuum of risk assets including senior secured borrowers to deeply subordinated loans / mezzanine debt financing and first and second lien loans. Therefore, the Trust is expected to exhibit both equity and debt properties, with the potential for meaningful drawdowns.

SECURITY SELECTION

The security selection process involves traditional bottom-up credit analysis which applies across both the GCOF and EDL strategies. Each approach has a number of discrete steps, which varies depending on the nature of the opportunity (i.e. buying a bond in the secondary market versus originating a direct loan). The following section outlines the key steps of KKR's security selection process.

The first step involves sourcing potential investment opportunities which can be identified across a range of channels and networks. KKR's global network of CEO's of large companies, co-investors, advisory firms and other intermediaries all provide a source of investment ideas. As detailed earlier, investment opportunities can range from companies experiencing short-term liquidity needs, seeking M&A financing and/or industries facing transient challenges.

Each opportunity is supported by deep diligence analysis, where a clear investment thesis is identified and formalised in a proposal. While the approach varies based on the nature of the investment (i.e. loan or bond), it typically includes traditional financial statement and pro forma analysis and qualitative research with a focus on understanding a borrower's operating environment.

The analysis also includes a comparison with the broader peer group, both in terms of pricing and risk. With respect to qualitative research, some of the key metrics assessed include industry structure, management strategy, corporate structure, capital structure of the firm (i.e. level of subordination and equity support) and the level of operational risk. In terms of durability of earnings, each proposal includes earnings stress tests under a number of downside scenarios.

Prior to investment, all credit submissions are reviewed and ratified by an external investment committee. In the case of GCOF, the U.S. Leveraged Credit Investment Committee is responsible for approving and maintaining eligible securities on an approved credit list. For the EDL portfolio, all European private credit investments are approved by a European Direct Lending Investment Committee, which meets twice per week or more frequently if required.

In our opinion, the quality and depth of KKR's bottom-up research process is a key competitive advantage, particularly when assessed relative to the nature of the underlying investments (i.e. sub-investment grade or potentially dislocated assets). Further, the role of each committee in reviewing and approving all credit submissions adds a layer of oversight.

PORTFOLIO CONSTRUCTION

The portfolio construction process involves combining the two underlying investment strategies, while managing the funding and liquidity requirements of each portfolio. The process is overseen by the IC (detailed earlier) which meets on a quarterly basis, to review the underlying performance of each portfolio and address any funding or asset allocation decisions.

The Trust inter-funds into the US-centric GCOF strategy and a European Direct Lending (EDL) portfolio, representing approximately 61% and 39% of the underlying portfolio, respectively (31 January 2023).

Given that loan settlements may take up to 30 days, a funding or leverage facility is in place, to manage cashflows between the two underlying strategies. In practice, the facility is used to manage potential mismatches between GCOF's redemption terms and funding new loans. While the investment exposure can be leveraged on a short-term basis, this is limited to 30% of NAV.

In terms of portfolio composition, the GCOF portfolio comprises 60 to 80 core holdings (including bonds and loans) with position sizes ranging between 1.5% and 4.0%. The final portfolio is managed with a credit spread duration range of between two and five years with a bias to senior secured securities which includes both loans and bonds. Consistent with the targeted opportunity set, KKR typically invests in lower quality credit securities with an indicative credit rating of B and CCC based on S&P's rating methodology.

Zenith notes that this cohort of securities is subject to a high level of mark-to-market volatility and potential default risk, particularly during stressed equity periods or cyclical downturns. Accordingly, investment outcomes will be closely tied to the quality and depth of KKR's bottom-up due diligence process. To this end, Zenith highlights that KKR has consistently outperformed the CCC component of the broader high yield indices, achieving higher returns and at the same time, demonstrating superior capital preservation qualities i.e. lower default experience.

The EDL portfolio is a portfolio of loans, that continues to evolve in terms of issuer and industry diversification. As at 31 January 2023, the portfolio comprises 43 loans with the largest counterparty exposure representing 5% of the total portfolio.

The Trust's currency exposure is expected to be hedged back to Australian dollars with the process supported by a proprietary currency management tool. This system allows KKR to monitor foreign exchange exposures against derivatives and liability-based hedges at the currency, portfolio and asset levels.

Overall, Zenith considers KKR's portfolio construction process to be well structured and consistent with attaining the Trust's investment objective. While there are structural challenges with managing two asset classes with differing liquidity profiles, KKR has a long and proven track record in managing sub-investment grade portfolios and the attendant risk and liquidity profiles.

RISK MANAGEMENT

Portfolio Constraints	Description
EDL Portfolio (at Full Investment)	
First Lien Senior Secured Debt	Minimum 70% of Portfolio
Non-European Portfolio Exposure (%)	0% to 15%
Single Issuer Limit (%)	Up to 20% of Portfolio NAV
Maximum Exposure to KKR Affiliates	Up to 15% of Portfolio NAV
Responsible Investment Constraints - Sector Exclusions	Nuclear and Coal

KKR's risk management process is largely an outworking of the firm's application of its credit and investment selection process, which is complemented by issuer and diversification limits detailed in the above table (applying to the EDF portfolio).

Zenith highlights that the GCOF portfolio is managed with no formal limits or restrictions, albeit in practical terms, the portfolio is highly diversified across issuers and sectors. In our opinion, this aspect of the process could be enhanced with the inclusion of a range of position, asset class, sector, industry and credit quality limits.

The process is supported by the PMU team which is a separate body within KKR, responsible for monitoring all private credit investments. This team is most active through the post-investment phase with its remit including: monitoring company performance versus KKR assumptions; compliance with covenants; leading the quarterly valuation process and managing a 'Watch List' of underperforming companies. In terms of the latter, this is list of distressed or impaired companies that is subject to more intensive scrutiny and monitoring by the Credit Portfolio Management Committee.

Zenith is supportive of the role of the PMU, highlighting the separation from the investment team. In our opinion, this ensures that underlying investments are monitored with a dedicated focus, and at the same time, minimises the risk of any personal biases or relationships influencing the monitoring process.

The Risk team is comprised of four Risk Managers with a reporting line to KKR's Market Risk Committee. The team utilises a number of risk management tools and is integrated with the investment team to promote real-time discussions between portfolio managers, analysts and traders. The firm uses a range of external tools including FactSet, Black Mountain, Risk Metrics and Credit QB.

In terms of valuation, the portfolio is valued externally by Lincoln International with each valuation comprised of the following: 50% based on the pricing of comparable bonds (including credit quality, tenor etc) and 50% based on a standardised discounted cash flow (DCF) methodology. The DCF approach is coordinated by Lincoln in consultation with the responsible analyst.

Zenith highlights the quarterly valuation frequency of the EDL portfolio versus the proposed monthly quoting of the Trust's Net Tangible Assets (NTAs) on the ASX. While this creates a potential mismatch between the underlying value of the portfolio versus the NTA, this is common for these strategies where an illiquidity premium is being harvested. Notwithstanding this, Zenith is confident that the quoted NTA will be representative of the most recent valuation of the underlying portfolio.

In terms of external oversight, the Trust is subject to the governance and compliance structures designed by the Responsible Entity (RE) (Perpetual Group). The RE has formulated a monitoring and review process to ensure adherence to service agreements, including minimum standards. The Trust will be externally audited by Deloitte Touche Tohmatsu, including an audit of KKR's' adherence to its obligations under its AFS Licence.

In Zenith's opinion, the most significant risk to the Trust pertains to valuation risk of the EDL portfolio, or more specifically the determination of fair value of each underlying loan. While KKR has a clearly defined set of valuation policies, the nature of the underlying asset class means that there is an absence of observable market data, which can make it problematic to accurately value securities. Zenith will continue to monitor this going forward, noting that KKR has a well-documented process, that is subject to external review.

Overall, Zenith believes KKR's' risk management framework is robust and consistent with best practice.

Responsible Investment Approach

KKR has been a signatory to the United Nations Principles for Responsible Investment (PRI) since 2009 and last submitted materials for assessment in 2020.

KKR has an established Responsible Investment Policy (RIP) that was last updated in May 2020. KKR's senior leadership provides ultimate oversight of its responsible investment efforts, with KKR's Global Public Affairs team representing the core of the ESG-related expertise. Where applicable, Investment Committees oversee ESG issues that are material to an investment when making a decision to invest.

ESG considerations are not formally assessed, however, where ESG risk has the potential to impact a company's earnings and profitability, this will be considered as part of the due diligence process. When material ESG issues are identified, they will typically be explored and discussed at the Investment Committee, with the option of appointing specialist ESG advisors to undertake additional due diligence. In the instance where ESG-related risks have been identified, a detailed remediation plan will be outlined and agreed upon, and remain a standing item for the Investment Committee until resolution.

While acknowledging that KKR undertakes extensive incorporation and oversight of ESG elements within their private equity business (which forms the majority of assets), Zenith believes that their incorporation of ESG issues in credit is an area that is currently less developed than peers.

From a classification scale of:

- Impact
- Thematic
- Integrated
- Aware
- Traditional

Zenith has assigned the Fund a Responsible Investment Classification of **Aware**.

INVESTMENT FEES

Management Cost

The management cost of the Fund is 0.90% p.a. and there is a performance fee of 0.37% p.a.

Zenith highlights that while the performance fee structure includes a number of threshold tests that must be satisfied prior to fees becoming payable (i.e. recouping any previous losses), it will generally apply on the absolute return generated by the Trust (subject to achieving the RBA Cash plus 4% return hurdle). In our opinion, while the quantum of the performance fee is highly competitive, we would prefer that it was only applied to the excess return component.

Zenith considers the overall cost structure to be consistent with the specialised nature of the asset class and investment approach.

(The fees mentioned above are reflective of the flagship version only, fees may differ when the product is accessed through an alternate investment vehicle such as a platform.)

PERFORMANCE ANALYSIS

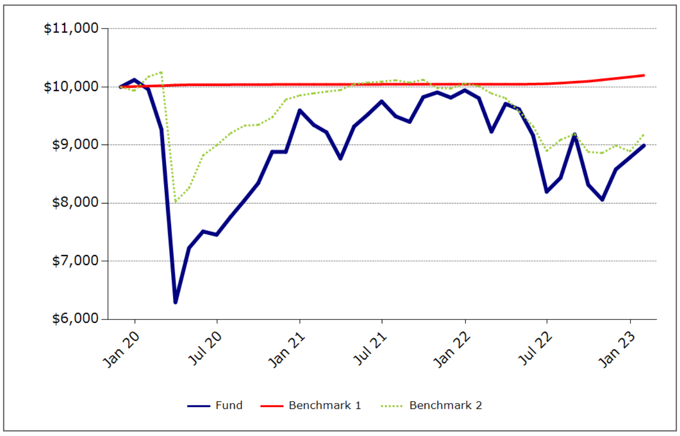
Report data: 31 Jan 2023, product inception: Dec 2019

Monthly Performance History (%, net of fees)

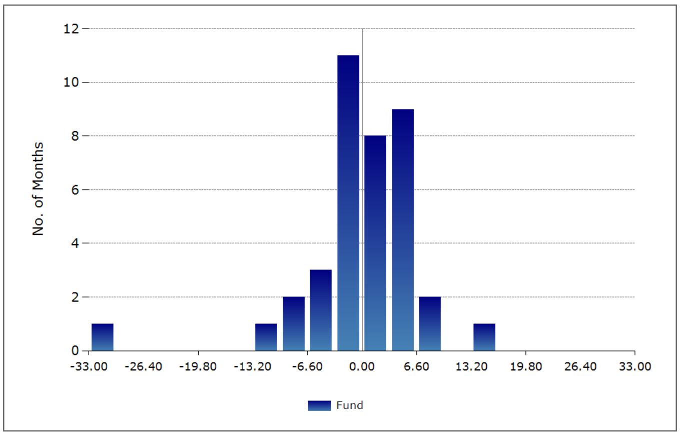
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	FUND YTD	BM1 YTD	BM2 YTD
2023	2.34												2.34	0.27	3.30
2022	-1.37	-5.88	5.19	-0.96	-4.68	-10.57	2.97	8.79	-9.43	-3.08	6.48	2.37	-11.64	1.25	-11.62
2021	-2.62	-1.35	-4.90	6.28	2.27	2.32	-2.63	-1.01	4.53	0.83	-0.91	1.29	3.60	0.03	2.09
2020	-1.60	-6.91	-32.11	14.84	3.93	-0.75	4.13	3.70	3.63	6.47	0.00	8.04	-5.18	0.37	-0.81
2019												1.21	1.21	0.07	-0.65

Benchmark 1: Bloomberg AusBond Bank Bill Index, Benchmark 2: KKC Net Portfolio Returns

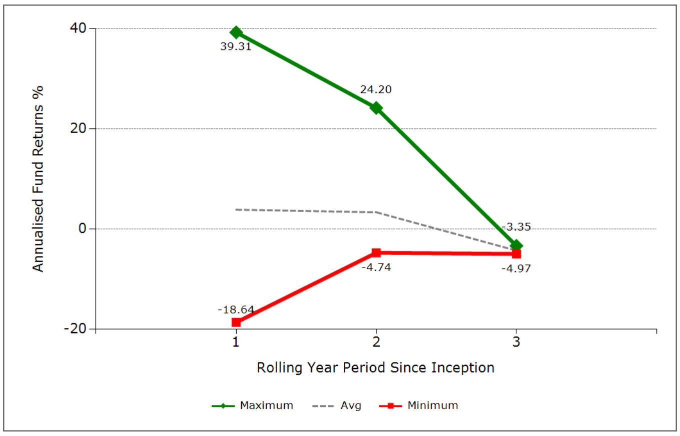
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	3 yr	2 yr	1 yr
Fund (% p.a.)	-3.30	-3.35	-1.91	-8.32
Benchmark 1 (% p.a.)	0.63	0.61	0.77	1.52
Benchmark 2 (% p.a.)	-2.65	-3.36	-3.64	-8.27
Ranking within Sector	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund Ranking	4 / 5	18 / 23	12 / 26	22 / 29
Quartile	3rd	3rd	2nd	3rd
Standard Deviation	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund (% p.a.)	25.25	25.92	16.47	20.74
Benchmark 1 (% p.a.)	0.28	0.29	0.33	0.36
Downside Deviation	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund (% p.a.)	20.97	21.53	12.33	16.35
Benchmark 1 (% p.a.)	0.01	0.01	0.01	0.02
Risk/Return	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Sharpe Ratio - Fund	-0.16	-0.15	-0.16	-0.47
Sortino Ratio - Fund	-0.19	-0.18	-0.22	-0.60

Readers should note that unless otherwise indicated, all performance, consistency and risk/return data is referenced to the Zenith assigned benchmark (as represented by Benchmark 1 in the above table) with the LIT returns representing those attributable to shareholders (i.e. unit price + dividends). Zenith typically includes the ongoing net returns of a LIT's investment portfolio as we believe this is the best measure of the investment manager's skill.

Zenith benchmarks funds in the 'International Fixed Interest - High Income' peer group against the Bloomberg AusBond Bank Bill Index. While this benchmark may not be consistent with the one adhered to by all rated participants, it has been adopted to provide investors with a common reference point against which similarly structured strategies may be assessed.

The following commentary is effective as at 31 January 2023.

The Trust's investment objective is to deliver an absolute return of 6% p.a. to 8% p.a. (net of fees and expenses) over the medium-term, which includes a target distribution of 4% p.a. to 6% p.a. paid on a quarterly basis.

Since inception, the Fund has lagged its investment objectives, placing it in the lower quartiles of returns relative to peers. However we note it has outperformed its secondary benchmark over the past two-year period.

Zenith ratings applied to LITs do not explicitly take into account share prices vs. NAV and do not represent a buy/sell recommendation based on a LITs valuation. Potential investors should make their own determination of the appropriateness of prevailing premiums or discounts to NAV when acquiring or disposing of a LIT.

RELATIVE PERFORMANCE ANALYSIS

Alpha Statistics	Incpt.	3 yr	2 yr	1 yr
Excess Return (% p.a.)	-3.93	-3.96	-2.69	-9.84
% Monthly Excess (All Mkts)	52.63	52.78	50.00	50.00
% Monthly Excess (Up Mkts)	54.29	54.55	52.38	54.55
% Monthly Excess (Down Mkts)	33.33	33.33	33.33	0.00
Beta Statistics	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Beta	-4.59	-4.51	8.29	19.86
R-Squared	0.00	0.00	0.03	0.12
Tracking Error (% p.a.)	25.27	25.93	16.42	20.62
Correlation	-0.05	-0.05	0.17	0.34
Risk/Return	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Information Ratio	-0.16	-0.15	-0.16	-0.48

The following commentary is effective as at 31 January 2023.

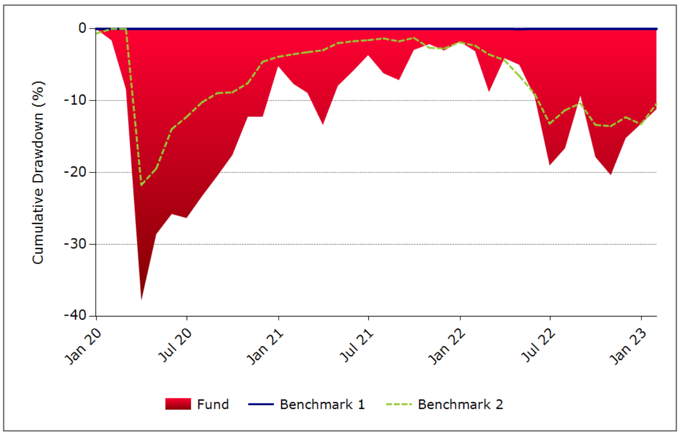
Zenith typically seeks to identify funds which can outperform their index in greater than 50% of months as we believe this represents a persistence of manager skill. The Trust has been successful in outperforming the benchmark in more than 50% of 'all' markets over the medium to longer term.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.

Drawdown Analysis	Fund	BM1	BM2
Max Drawdown (%)	-37.81	-0.02	-21.72
Months in Max Drawdown	3	1	1
Months to Recover	-	1	-

Worst Drawdowns	Fund	Benchmark 1	Benchmark 2
1	-37.81	-0.02	-21.72
2		0.00	-0.65
3		0.00	
4			
5			



The following commentary is effective as at 31 January 2023.

The Fund's drawdown profile has been commensurate with the broader risk/return profile of the strategy. To date, the Fund's largest drawdown has been 37.8% through the COVID period (as at 31 January 2023) which represents the movement in the listed price (as opposed to the performance of the underlying portfolios).

Zenith reiterates that despite the relative attractiveness of the strategy, the performance of the Trust reflects the movement in the underlying portfolio, as well as the performance of the ASX vehicle. The latter being subject to the impact of market sentiment, which can result in the Trust trading at a significant discount/premium to net tangible assets.

Income / Growth Returns	Income	Growth	Total
FY to 30 Jun 2021	5.17%	25.62%	30.79%

Distribution Policy

The Trust's investment objective is to deliver an absolute return of 6% p.a. to 8% p.a. (net of fees) over an economic cycle. The Responsible Entity intends to pay distributions to Unitholders quarterly and is expecting a distribution level in the range of 4% p.a. to 6% p.a.

To access the underlying investment strategies, KKR employs a master/feeder structure with the Australian Trust investing in a Singapore-domiciled partnership (referred to as a feeder fund), which in turn, invests in the GCOF strategy a Cayman's-based company (the master fund).

The Trust gains its exposure to the underlying investment strategy via a Profit Participating Note (PPN) which is issued by the Singapore-based entity. The PPN is a debt instrument paying a variable investment return based on the underlying performance of the GCOF and EDL portfolios.

Zenith highlights that the investment structure is complex, including the use of an interposed entity to manage potential Controlled Foreign Company (CFC) obligations. While our preference is for a more simplified approach, in our opinion, the structure effectively creates the same investment and tax outcomes as a direct investment, albeit with less risk of being taxed on an accruals basis under the CFC provisions.

CFC is a complex area of tax legislation and Zenith recommends investors seek their own personal tax advice with respect to the suitability of the structure.

Despite the relative merit of the underlying investment strategies, investors should give consideration to the method of access. Accessing through a LIT can result in capital volatility due to the Trust's own trading movements, as opposed to the investment performance of the underlying portfolios.

REPORT CERTIFICATION

Date of issue: 9 Mar 2023

Role	Analyst	Title
Author	Rodney Sebire	Head of Alternatives & Global Fixed Interest
Sector Lead	Rodney Sebire	Head of Alternatives & Global Fixed Interest
Authoriser	Bronwen Moncrieff	Head of Research

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RATING HISTORY

As At	Rating*
9 Mar 2023	Recommended
2 Mar 2022	Recommended
2 Jun 2020	Recommended
30 Sep 2019	Recommended

Last 5 years only displayed. Longer histories available on request.

*In March 2021, Zenith implemented a new ratings methodology for products classified as Traditional Index. Any rating issued from this date forward for Traditional Index products only reflect this change in methodology, with the relevant Traditional Index ratings being Index Approved, Index Recommended and Index Highly Recommended. Ratings issued for Traditional Index products prior to March 2021 are retained for historical purposes in line with our regulatory requirements and were issued in line with Zenith's Fund Research Methodology. Further information in relation to Zenith's Traditional Index Research Methodology and Traditional Index Ratings can be found on the Zenith website.

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