



## KKR CREDIT INCOME FUND (ASX: KKC)

The KKR Credit Income Fund aims to provide Australian and New Zealand investors with attractive, risk-adjusted returns and access to a diversified portfolio of income generating alternative credit investments

# KKC Investment Update

17 April 2023

Dear KKC Investor,

KKR Credit is pleased to announce its Q4 2022 Market Review has been released. The Market Review outlines the pivot from markets seeking yield to capital and the appeal of credit over equities in the current environment.

Read the full update [here](#), or the summary below.

The start of 2023 saw a risk rally and some signs of improvement in the Credit markets following the deep freeze in 2022, however an asset-liability mismatch in the banking sector caused another bout of volatility. The Hunt for Yield has become a Hunt for Capital, and amid tighter financial conditions, now appears to be a very good time to be a lender with ready capital.

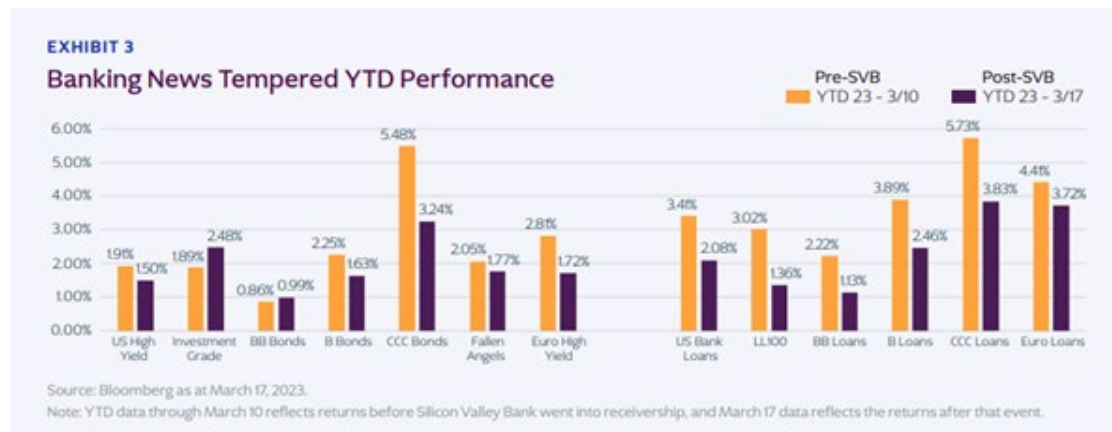
The KKR investment team believe a jogging pace strikes the right balance between the risk of moving too slowly in a market on the brink of change and the risk of diving too aggressively into risk in a volatile environment.

## The Hunt for Capital

The hunt for capital is now the driving factor in credit performance, with loan issuance and leveraged buyout activity limited. Yet, some businesses still require financing or refinancing.

Prior to the banking sector upheaval in March 2023, there was a rally in risk assets, driven by a stabilisation in the dollar's upward trajectory and signs of slowing inflation in January (see Exhibit 3).

However, banks have been hesitant to originate loans due to increased underwriting risk, and a crisis in the banking sector is unlikely to change this. Concerns about the financial system may also make it harder to raise capital. On the other hand, private equity firms have over \$1 trillion of dry powder waiting to do deals. When these potential deals become attractive enough to entice syndicating banks back into the market, risk will be on again, quickly. This may happen too fast for investors who have been reactive rather than proactive in their allocations. We think market participants may be surprised to see how fast the market equilibrium can shift from frozen to flowing given the extended lack of supply.

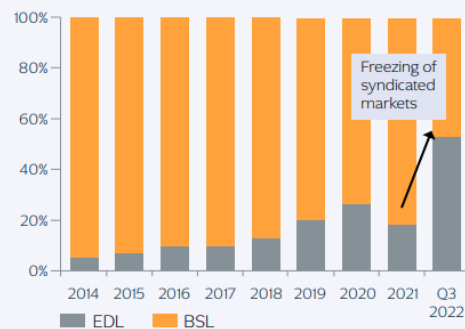


With the loan market shut, Private Credit has filled the financing gap for borrowers. While Exhibit 4 specifically addresses the European direct lending market, we think it is a good proxy for the global trend. We estimate that European direct lending accounted for more than 50% of new loan issuance in Europe. Extraordinary events may have precipitated the shift to private credit, but we think there are other, more evergreen advantages attracting borrowers, including greater certainty of execution and the potential to provide more bespoke solutions that meet borrowers' specific financing needs.

#### EXHIBIT 4

### Private Direct Lending Took Share from Syndication in Europe

Broadly Syndicated Loans vs. European Direct Lending Issuance (Based on Value)



Source: Ion Analytics, PitchBook LCD as at September 30, 2022.

### Credit Over Equities

KKR's Global Macro & Asset Allocation team believes that we are entering a new era of higher inflation, supported by labour and housing shortages, the inflationary effects of the energy transition, and the rethinking of the global supply chain. Floating-rate credit and credit with embedded inflation protection, such as asset-based finance, are attractive in a higher-rate environment. Compared to equities, KKR believes credit markets offer a compelling risk/return opportunity, with returns above 10% in senior debt and mid-teens in junior debt, and lower risk due to debt's position in the capital structure. KKR's Global Macro and Asset Allocation teams' research suggests the S&P 500 is likely to return 5.2% annually over the next five years, while Private Equity is forecasted to return 12%.

Investors should consider the drivers of value in Credit and Equities when comparing the two asset classes. Credit returns are mostly contractual, meaning investors should achieve their target returns once a borrower pays interest and returns the principal of the loan, while equity returns require EBITDA growth or multiple expansion.

### Hunting Season Has Already Begun

The market is currently experiencing volatility, but the need for capital is expected

to persist. While many investors are still waiting for a better entry point before re-engaging with the market, we think there are reasonable ways that investors can help to address their fears and get involved before its too late.

#### **Risk 1: Economic recession**

Mitigation: Focus on large, high-quality borrowers with high margins of safety and deep equity cushions.

#### **Risk 2: Inflation**

Mitigation: Focus on larger, market-leading businesses in defensive sectors, which should be better equipped to pass through price increases to customers and defend their margins.

#### **Risk 3: Rising interest rates**

Mitigation: Focus on assets with shorter duration, floating interest rates, or both.

#### **Risk 4: Dislocated capital markets**

Big companies, strong cash flows, high EBITDA, and defensive sectors and industries: We are in favour of keeping it simple.

### **Conclusion**

Looking forward, KKR has identified six trends driving Credit markets and a way to play them all depending on investors' time horizon and risk preferences.

1. KKR believes it's a **great time to be a lender**. Total returns are extremely attractive, new issue Private Credit is a good way to take advantage of this trend
2. KKR expects **higher inflation and higher long-term rates** going forward, which should continue to make floating rate assets and strategies with a degree of inflation protection such as asset-based finance attractive
3. It is a time to **keep it simple** rather than stretching for leverage or risk. It seems likely that borrowers are going to come under increasing stress and defaults are expected to rise. High quality, larger businesses that can defend their margins are as simple as it gets and where KKR will focus
4. The other consequence of ongoing market volatility is that pockets of **increased dispersion** are appearing in liquid markets, and this is a cycle that is likely to repeat several times more as limited supply contributes to volatility. Investors will have to be flexible enough to take advantage of these moments quickly

5. Finally, **flexibility is key**: Being a problem-solver with flexible capital is a way to show leadership in this market

Thank you for your ongoing support.

KKR Credit Investment Team

## KEY BENEFITS AND RISKS

### BENEFITS

The key benefits of investing in the Fund include:

- **Attractive Target Distribution**
- **Attractive Target Return**
- **Diversified exposure**
- **Alignment of interests with Unitholders**
- **KKR product access**
- **Highly experienced KKR Credit team**

### RISKS

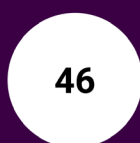
Key risks include:

- **Allocation risk** in relation to the Investment Strategy
- **Illiquid and long term investments** in relation to the Investment Strategy
- **Potential conflicts of interests of the Responsible Entity and the Manager and its affiliates**
- Entities within the **“Perpetual Group”** may also act in various capacities for other funds or accounts, which may conflict with the role the Responsible Entity plays with respect to the Trust.
- **Market and economic risks** in relation to an investment in the Trust
- **Currency risk** in relation to an investment in the Trust
- **Pricing risk** in relation to an investment in the Trust
- **Liquidity risk** relating to Units in the Trust in relation to an investment in the Trust
- **Operational risk** in relation to an investment in the Trust
- **High yield investments risk** in relation to debt investments
- **Credit risk** in relation to debt investments
- **Interest rate risk** in relation to debt investments

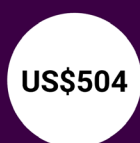
- **Bankruptcy risk** in relation to debt investments

If you are uncertain as to whether an investment in the Trust is suitable for you, please contact your stockbroker, financial adviser, accountant, lawyer or other professional adviser.

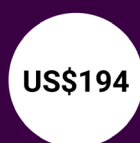
## About KKR



years of  
experience



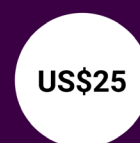
billion total assets  
under management<sup>1</sup>



billion credit assets  
under management



KKR Investment  
Professionals



billion invested  
alongside our clients<sup>2</sup>

(1) Figures as of 22 December, 2022. Represents assets managed by KKR or its strategic partners (on a proportionate basis) as to which KKR is entitled to receive a fee or carried interest (either currently or upon deployment of capital) and proprietary general partner capital. (2) Includes investments/commitments made by KKR's balance sheet, KKR employees and other affiliates. Investments made by current and former KKR employees are retained by those individuals personally. Includes unfunded commitments made by individuals.



### Important Information

#### General

This information has been prepared by KKR Australia Investment Management Pty Ltd ABN 42 146 164 454, AFSL 420 085 (the "Manager" or "KKR") and issued by Seed Partnerships Pty Ltd ABN 32 606 230 639 AFSL 492973 on behalf of the Manager and The Trust Company (RE Services) Limited ABN 45 003 278 831, AFSL 235150 (the "Responsible Entity" or "TTCRESL"). TTCRESL is the responsible entity and issuer of units in the KKR Credit Income Fund ARSN 634 082 107 ("KIC" or the "Trust"). TTCRESL has appointed KKR to act as the manager of the Trust. This update is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not indicative of future performance. This information is believed to be accurate at the time of compilation and is provided in good faith. This information may contain information contributed by third parties. KKR and TTCRESL do not warrant the accuracy or completeness of any information contributed by a third party.

Before making any investment decisions you should consider the Product Disclosure Statement (PDS) and Target Market

Determination (TMD) for the Trust issued by TTCRESL and the Trust's other periodic and continuous disclosure announcements lodged with the Australian Securities Exchange (ASX), which are available at [www.kkcaustralia.com.au](http://www.kkcaustralia.com.au) or can be obtained by calling 1300-131-856 within Australia.

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