CPP INVESTMENT BOARD

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Harvesting return premiums in private credit – a Q&A with John Graham, Managing Director, Head of Principal Credit Investments CPPIB

Q. CPPIB has been a leading investor in private credit for some time now. What attracted you to this asset class and how do you model allocation?

A. Private credit investments are attractive to CPPIB not only because they add to the diversity of the overall CPP Fund, but also because of the solid risk-adjusted returns they provide.

Our Private Credit Investment (PCI) team is focused on investing in sub-investment grade corporate debt through both primary and secondary transactions. With investments across the world, our PCI team provides debt financing across the entire capital structure, including term loans, high-yield bonds, mezzanine lending and other solutions.

Q. What segments of private credit markets are most attractive and why?

A. Our PCI investment portfolio is well diversified across the credit spectrum. One area we have focused more on recently is the sponsored middle market debt sector. Until our acquisition of Antares Capital in August 2015, CPPIB's direct activity in private credit focused on bespoke loans to larger companies where we had the ability to enter and exit the market opportunistically.

By 2015 we had been studying the middle market for several years and concluded that the illiquidity premiums across sub-classes were generally attractive. We specifically liked the relatively lower loss profile and sustainable competitive advantages that certain managers had developed in the middle market private equity-sponsored senior space. Our investment thesis with Antares was that this particular segment of private credit offers more consistent, attractive risk-adjusted returns across market environments over time and has meaningful scale. The class also provides floating rate protection and low correlation with our other strategies, such that we could make it a core, long-term allocation.

Our previous model of entering and exiting the market as we saw fit does not transfer effectively to the core middle market where investment sourcing is highly dependent on relationships with sponsors and borrowers developed over decades and rooted in recurring transactions together. The closeness of these relationships that only a handful of managers possess, and the information advantages that this affords those managers, creates significant and sustainable sourcing and credit selection advantages. We concluded that trying to organically construct a middle market portfolio from marginal deals and participations in others' transactions did not offer an acceptable risk-return profile for us.

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The acquisition of Antares allowed us to get into this market through a market-leading business that is exceptionally well-positioned to deliver value-building investment flows to the Fund.

Q. What attributes are key to success in an investment manager in the middle market?

A. An experienced management team with breadth and depth of sponsor and borrower relationships is absolutely critical to success in the middle market.

When we looked at entering the middle market, it was critical to us to find a partner with a demonstrated ability to navigate the middle market loan environment through tough markets. Long-term viability in this space requires the avoidance of selling at distressed levels and being able to successfully capture the premium economics the middle market offers over liquid alternatives.

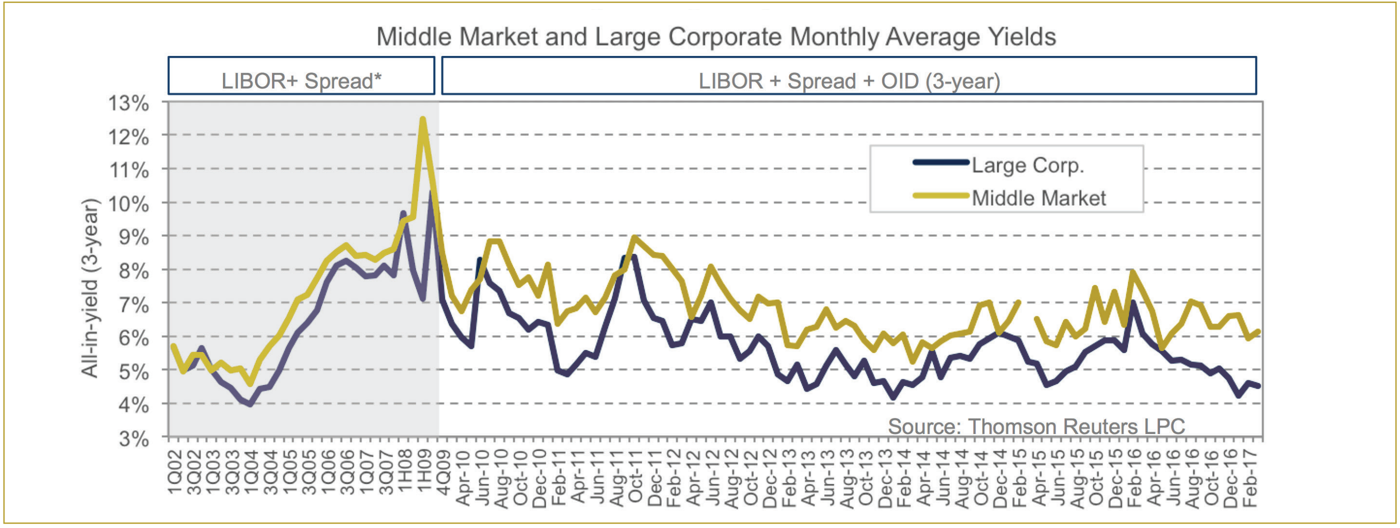
Q. There is a lot written about whether too much money is flowing into the senior middle market today. Is the space still attractive?

A. The availability of institutional capital is certainly something we are seeing across asset classes, and not just in the senior middle market.

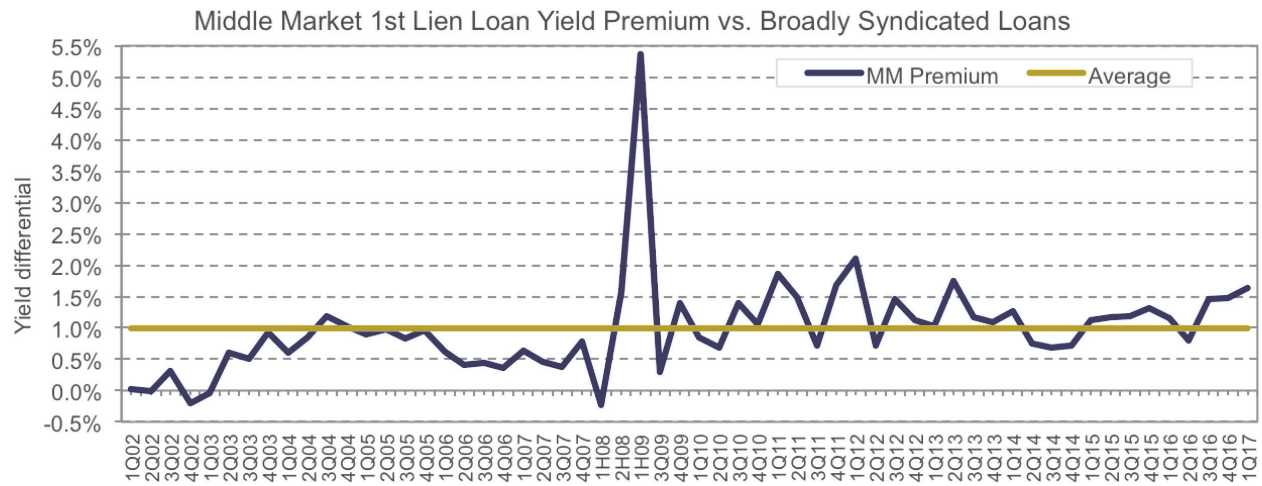
However, through CPPIB's comparative advantages and Antares' expertise, we believe the space is attractive. We look at forward "supply" indicators like the middle market loan maturity wall and private equity dry powder and don't foresee a capacity issue. As a long-term investor, we view the sponsored senior middle market as a core, long-term investment. This is possible because we are aligned with a financial institution with experienced investment professionals who have shown a proven ability to compete successfully for more than 20 years in various market environments.

Over two decades, whether new money and entrants were coming in or out, or whether banks were retreating or advancing, they were able to maintain a lead arranger position on a large and diverse portfolio. This means that when LBO activity rose, they benefited from sponsor-to-sponsor sale activity as the incumbent. When LBO activity fell, they benefited from add-on acquisition financing and recapitalization activity as the incumbent. We view their unique positioning as a hedge against supply and demand changes in market activity, allowing us to take a long-term approach to the asset class, which I'm pleased to report has been proving out for us thus far.

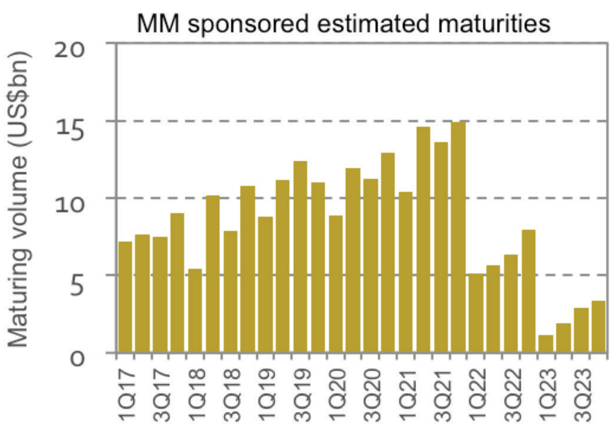
First Lien Middle Market Yields Remain Enticing vs. Large Corporate Loans



Consistent Premium Over Time...and Particularly Attractive Recently



Persistent Supply of Middle Market Loan Opportunities...due in part to rising levels of pending maturities and private equity dry powder



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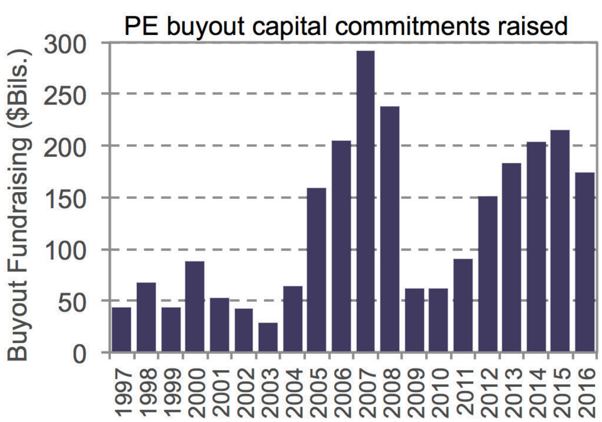

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