Principal Asset Management℠

PRINCIPAL ALTERNATIVE CREDIT

Relationship capital as a competitive edge in private credit markets

In an increasingly crowded direct lending market, relationship capital remains a powerful differentiator, influencing transaction access, execution certainty, and long-term investment outcomes.

In direct lending, sources of origination, competitive market positioning, and the relationships developed over careers are crucial to selecting the best credit opportunities. It is critical in direct lending to avoid adverse selection. It is important to be on the first set of calls that a sponsor makes when looking to finance its deals, not the calls after other primary relationship lenders have passed. To be in the set of first calls, it's essential to develop a reputation of being a reliable partner with sponsors and non-sponsored sourcing channels. Reliability does not mean doing every deal that comes from a sponsor or non-sponsored deal source – they understand there can be reasonable disagreements on the attractiveness of an investment. What's critical is communicating quick "no's" where appropriate and providing a clear due diligence path that gives sponsors and borrowers confidence in execution.

Relationship-driven sourcing reduces adverse selection

Higher-quality opportunities tend to be shown first to a smaller set of trusted lenders; tougher/residual deals move further down the call list.

DEAL QUALITY: HIGH → LOW

Relationship lenders
First call/core sponsor partners

- Small trusted set
- Early access + ability to shape terms
- Select from full opportunity set

Episodic lenders
Selective but not core relationships

- See deals less consistently
- Quality has already been partially filtered
- Moderate adverse-selection risk

No prior relationship
Inbound/reactive/residual flow

- Least information advantage
- Limited influence on structure
- Adverse-selection risk

For illustrative purposes only.

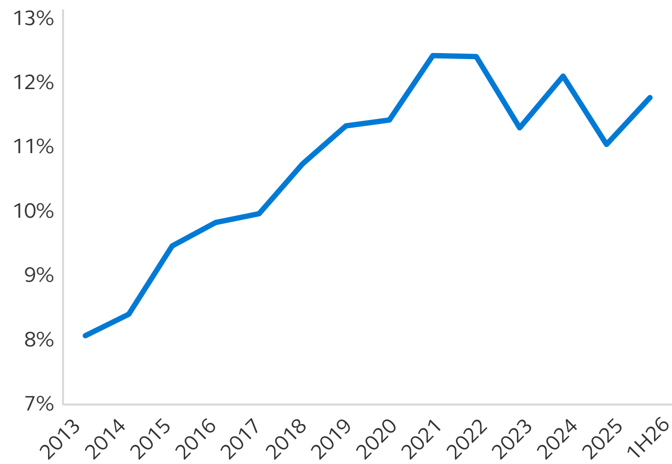
In order to provide a consistent and credible due diligence path, a direct lender must ensure originators are closely aligned with the investment committee. This can become difficult as direct lending groups grow or are acquired and become more hierarchical and bureaucratic. We improve “certainty to close” on desirable transactions by having everyone on the team invited to investment committee presentations so they hear and participate in discussions. Through the discussion each deal team carefully documents key issues, diligence items, and terms approved by the investment committee. Prior experience within a sector is incorporated at the initial screening stage, ensuring relevant insights help shape diligence priorities and investment decisions from the outset. We believe tapping into diverse perspectives across the team makes us a better investor and more reliable partner.

Key drivers of repeat business

Post-close relationships may be even more important to sponsors and borrowers than the initial deal execution. Sponsors often decide on financing partners based on how they have acted or how a sponsor thinks they will act post-close. If a lender is working alongside a sponsor and asking intelligent questions pre-close by diving into key risks and being a pragmatic investor, sponsors tend to trust that lender will act rationally with an economic lens post-closing. The approach a lender takes post-close has become increasingly important to sponsors through time. In the early days of LBOs, private equity sponsors could borrow such a large portion of the purchase price that the borrower only needed to modestly grow, pay down debt, and achieve 20%+ IRRs for their investors.

Today, private equity sponsors are generally paying higher multiples for businesses than historically, and lenders no longer lend 60% - 80% of purchase price. Now, private equity firms often only borrow 35% - 40% of the purchase price, especially in the lower middle market where we focus.

LBO purchase price multiple
Middle Market (synd. + direct)



Source: LSEG LPC, 30 June 2026.

As a result, realizing attractive private equity returns increasingly depends on borrower growth that’s often achieved with financial flexibility provided by lenders that allows for accretive acquisitions, plant and product expansion, investment in salesforce, etc. We spend a significant amount of time during due diligence understanding the owner’s growth plan and whether it aligns with credit de-risking. If the growth plan is also credit enhancing we seek to back those companies and sponsors by providing flexibility they need to grow, while also ensuring proper credit covenants and structure. As shown below, even at a significantly higher spread premium compared to a commercial bank, lower amortization can provide significant excess cash flow to assist in growing a business. If a sponsor believes it can utilize debt service savings to earn 20% - 30% equity returns, that more than compensates for the higher interest rate paid to a direct lender.

	Principal Alternative Credit	Commercial Bank
Leverage (Debt/ EBITDA)	2.5x	2.5x
Loan amount	$18.8 million	$18.8 million
Interest rate	SOFR+ 600 bps	SOFR+ 350 bps
Amortization	1% per annum	Straight line
Monthly debt service	$164,000	$371,000
Annual debt service	$2.0 million	$4.6 million

For illustrative purposes only.

Being a trusted and proven relationship lender, supported by a disciplined underwriting process, contributes to the durability and consistency of investment performance over time. While direct lending has become increasingly crowded, the value of strong longstanding relationships is often underestimated. Firms without well-established connections to private equity sponsors, borrowers, and other deal-source providers may face a greater risk of adverse selection. Strong relationships provide numerous advantages throughout the investment lifecycle, and the following highlights several of the most important benefits, including themes discussed earlier as well as additional considerations.

Earlier access to opportunities

Sponsor and non-sponsored deal sources frequently provide relationship lenders with access to opportunities before broader market introduction begins. Early access allows lenders to conduct deeper diligence, influence transaction structure, and focus resources on the most attractive opportunities.

Improved information flow

Longstanding relationships built through trust and consistency often lead to more transparent communication between sponsors, management teams, and lenders. Better information sharing allows for earlier identification of risks and more thoughtful structuring of financing solutions.

Valuable during challenging markets

Relationship capital is often most valuable during periods of market disruption. Sponsors generally prefer financing partners that have demonstrated consistency through multiple economic and credit cycles.

Ultimately, relationship strength is more than an origination advantage—it is a competitive asset that influences access, selectivity, and investment outcomes. For sponsors and borrowers, certainty of execution and post-close flexibility are often as important as pricing. Throughout our history, we have won transactions despite offering higher spreads and tighter terms than certain competitors because sponsors and borrowers value the consistency, transparency, and reliability of our process. Beyond supporting deal execution, a strong reputation and longstanding relationships provide broader origination opportunities and earlier access to transactions, allowing for greater selectivity and underwriting discipline. Combined with diversified non-sponsored origination channels, these advantages help us avoid adverse selection, identify attractive investment opportunities, and support durable long-term investment performance.

Risk Considerations

Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed. Investments in private debt, including leveraged loans, middle market loans, and mezzanine debt, are subject to various risk factors, including credit risk, liquidity risk and interest rate risk.

Private credit involves an investment in non-publicly traded securities which are subject to illiquidity risk. Portfolios that invest in private credit may be leveraged and may engage in speculative investment practices that increase the risk of investment loss. Investments concentrated in the healthcare industry may be adversely impacted by sector specific market shocks, unforeseen rate controls or regulations, higher than expected costs, or inability to bring new products to market.

The strategy's objective of downside risk reduction/protection may or may not be successful and as a result investors must be prepared to bear capital losses, including a loss of capital invested. Private market investments involve various risks due to illiquidity, lack of transparency, and higher minimum investment requirements. These risks include liquidity risk, market risk, capital risk, and regulatory risk. Additionally, private market investments often involve higher fees and expenses and may have longer investment horizons.

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