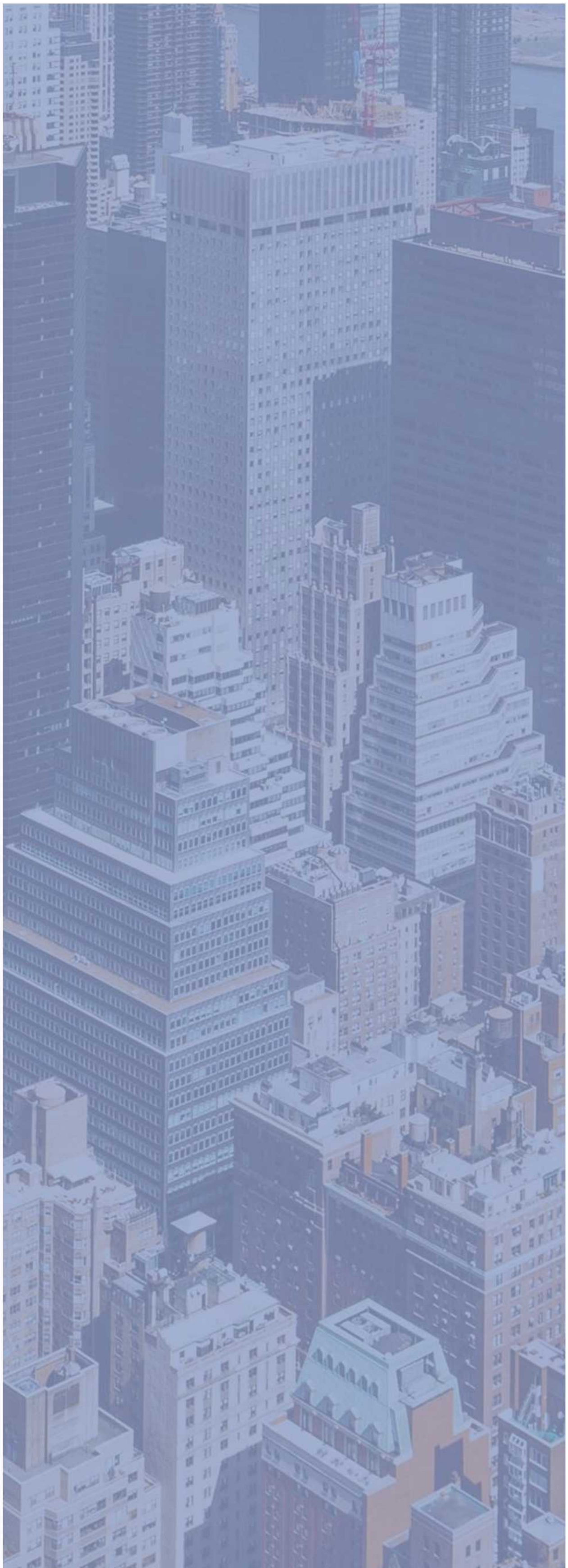

ORIX CORPORATION USA

GROWTH LENDING IN THE CURRENT MARKET

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By Jeff Bede

Recent events impacting the intersection of banking and venture capital have put a larger spotlight on venture and growth lending in recent weeks. Whereas this asset class has long been seen as a niche but growing category for fixed income investors, it has taken center stage with the turmoil within technology bank lending. Growth companies are facing the prospect of less available bank capital, requiring them to either cut costs, raise more expensive equity or face more difficult outcomes. Private credit growth lenders have emerged as alternative and consistent sources of capital, with what we think is a strong value proposition to technology company borrowers and equity investors. They can step into the capital void, providing critical additional liquidity and flexible, less dilutive capital as companies move forward towards further growth, profitability or an exit.

Having been in the growth lending business since 2001, we have seen a number of market cycles that have impacted growth companies and the tradeoffs of debt and equity capital. On the debt side, what is clear is that through strong relationships, solid understanding of products, business models and drivers of growth, prudent leverage and sophisticated portfolio management, growth lenders can have a valuable role to play. Where equity is often a better fit, such as at earlier stages or larger rounds, it is more focused on upside. Debt, on the other hand, is highly complementary and can step in as valuable additional capital, especially in uncertain times like the current environment.

While we expect there could be ramifications from the banking crisis including higher cost of capital or less available capital, growth lenders will be critical players. Many companies will require and deserve to be funded but need an alternative to more equity if and when access to bank lending is reduced. Choosing the right growth lending partner has never been more important, but the rewards for both fixed income investors and the borrowers we support should be high.

The value proposition for investors

Investing in the credit of privately-owned companies in a sector that equity markets have devalued may seem risky, given fixed income investors' prevailing concerns about rising interest rates and the possibility of recession. But a closer look at growth and late-stage, venture-backed software and other tech-enabled companies that are raising debt capital reveals a picture that may be surprising.

Thousands of such companies with innovative and successful products and services and proven customer adoption are, indeed, cashflow negative. It is the very market and product success and the resulting investment in hiring the skilled personnel who create, develop, market and sell the innovations that we see propelling even greater business expansion. A sizeable number of these companies would be cashflow positive at current revenue levels if they were to curtail spending on these vital growth initiatives. For these dynamic companies, raising additional equity capital to fuel growth has become more difficult and more expensive now that valuations have declined. In addition to the dilution and negative impacts of a down round, there is a sudden uncertainty around bank capital as these traditional lenders have faced crises of their own. Growth lending has certain benefits for fundamentally sound business models when access to capital elsewhere is challenging.

For one, adding growth capital through debt isn't dilutive to existing equity owners and avoids valuation repricing while extending the growth runway. Second, the cost of servicing debt capital, even at higher interest rates, has grown much less than the cost of equity and the value of the additional capital is high. The resulting debt service is manageable, especially since these companies tend to be very lightly leveraged, with debt typically representing about 10 to 20% of enterprise value. While demand for debt financing from growth and late-stage tech companies is growing, the question mark for the fixed income investors who would supply it are the unfavorable cashflows. Simply put, why pile debt onto negative cashflow businesses?

The answer is enterprise value. These businesses are valuable and sustainable already, and the capital coming from debt issuance is being earmarked to further fuel increases in enterprise value, which is likely to occur irrespective of macroeconomic conditions. For investors, this means rethinking return of capital. Instead of coming from cashflow, it largely comes from enterprise value when the business is sold or goes public. Even for companies that underperform, the attractive markets, differentiated products and valuable customers often still attract buyers. Further, the predictable recurring revenue and high gross margins result in the operating leverage to drive profitability if needed. Principal protection is not about cash flow at initial investment, it's about the enterprise value of the business and the future cash flow.

For investors, these conditions create an attractive return opportunity. Investors receive an immediate return on their capital in the form of a coupon, with additional return coming from fees and warrants. Given the revenue growth rates driving de-levering, managers can also more readily upsize their investment versus other asset classes to further enhance return.

While similar to cashflow lending, growth lending tends to offer better risk-reward characteristics, in part because cashflow lending has become somewhat commoditized over time. According to PitchBook Data, Inc., growth lending currently offers an internal rate of return in the low teens on average, versus sizably lower returns in cashflow lending. Since loss rates are low and comparable for the two categories, this translates into investors receiving higher nominal as well as risk-adjusted returns from growth lending.

As is usually the case in fixed-income markets, potentially attractive opportunities are likely to come from more complex and relatively underserved and specialized niches. Growth lending is one of these. Managers with experience and track record in the market, who have proven underwriting and portfolio management expertise, who have long-term relationships with management teams and equity sponsors, and who can act with sophistication and dispatch can create opportunities that investors are likely to find rewarding, especially in the current market and macroeconomic environment.

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ABOUT ORIX CORPORATION USA GROWTH CAPITAL

ORIX CORPORATION USA's GROWTH CAPITAL business is a leading growth lending platform that provides flexible debt capital to valuable, high-growth businesses primarily in the technology and healthcare sectors in the U.S. and Canada.

Since 2001, Growth Capital has funded approximately $2.7 billion to 198 companies. Growth Capital is an enterprise value focused lender and provides customized and flexible debt facilities to growth-stage companies that are under-served by traditional lenders. The team is backed by the stable, long-term, and global sponsorship of ORIX Corporation, a publicly traded company with more than $109 billion in balance sheet assets as of December 2022.