DIGITALBRIDGE

In Golden Age of Private Credit, Digital Credit Benefits from a Wide Moat

Introduction

Private credit markets have witnessed a surge in investor demand, driven by higher rates, seniority in capital structure, and robust historical performance. Heightened banking regulations in the post-2008 era steadily fueled private credit's emergence as a major asset class, and since 2021 the Fed's restrictive monetary policy has catalyzed that growth. Having increased from $250 billion in 2010 to ~$1.5 trillion in 2023E, private credit AUM is now expected to reach nearly $3 trillion by 2028.[1] According to a recent survey by Collier Capital, 44% of private market investors plan to increase their target allocations to private credit, comfortably ahead of infrastructure (27%), private equity (25%), real estate (17%) and hedge funds (2%).[2]

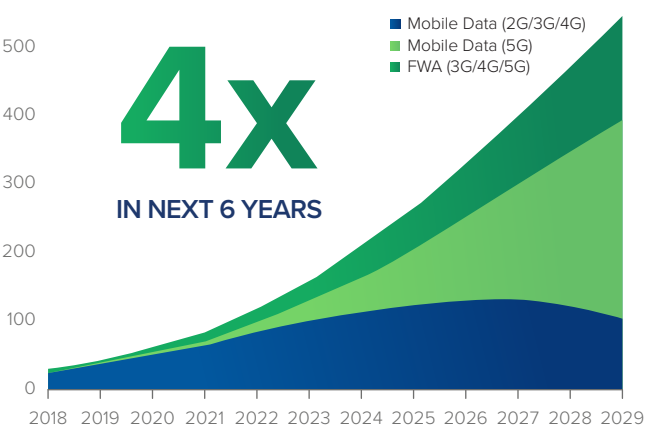
Naturally, the flood of capital entering private credit brings along the risk of overcrowding the market, creating excess supply and weakening structures, and eventually leading to rising defaults and lower returns. In this context, digital infrastructure private credit ("Digital Credit"), the financing of corporate borrowers backed by fiber, data center, cell tower and small cell assets, emerges as a niche category with distinct demand, supply and return characteristics. We believe these attributes create a wide moat that differentiates Digital Credit from traditional private credit.

Demand

M&A is traditionally a major driver of financing for the broader lending market but is often volatile year-to-year. In 2023, global M&A dealmaking dropped to $2.9 trillion, below $3 trillion for the first time since 2013 and roughly half 2021's record volume, driven primarily by access to and cost of capital as well as general economic and inflationary pressures.[3] In contrast to traditional direct lending, Digital Credit is driven more by capital expenditure than M&A, making the asset class more resilient to fluctuations in global dealmaking. DigitalBridge estimates that approximately ~$40B of a ~$60B+ Digital Credit market[4] is created by annual capex, driven by a consistently increasing consumption of data and the resulting need to support that demand with new internet infrastructure. Global mobile network data traffic, for example, has expanded by ~6x in the past 5 years and is expected to increase by another ~4x in the next 6 years.[5] Global data center and broadband growth capex is projected to grow ~8% p.a. from ~$600B+ in 2023 to ~$850B by 2027, driven by investment in

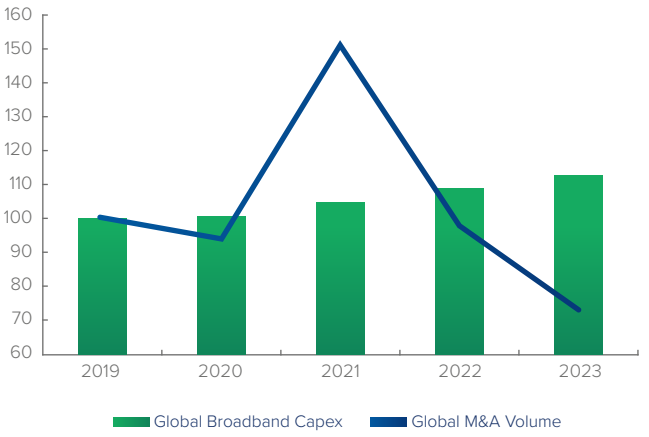
Global Mobile Network Data Traffic[5]

Proj. Exabytes (EB) per month



Global M&A Volume vs. Broadband Capex Index[11]

Indexed to 2019 Levels



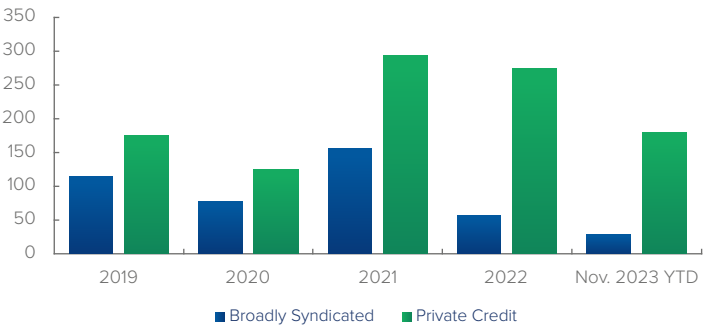
5G and, even more topically, artificial intelligence ("AI").[6] By 2030, AI could contribute up to $16 trillion of economic potential (a 14% increase to global GDP)[7] driven by $1.8 trillion in annual spending across AI hardware, software and services.[8] The market for data center AI microchips is projected to grow nearly 10x from ~$45 billion in 2023 to ~$400 billion in 2027.[9] This swelling demand for AI infrastructure created a record year for data center leasing in 2023 and requires substantial data center development to keep pace.[10] Based on these factors, significant capex requirements across data center, mobile and broadband position Digital Credit to continue to benefit from sustained long-term demand from a diversity of digital end markets, without a reliance on M&A volumes.

Supply

New loan issuance has increasingly favored private credit compared to traditional bank lending. In recent years, private credit has continued to take share from banks and in 2023 represented 86% of leveraged buyout financing transactions tracked by PitchBook-LCD.[12] Banks are subject to strict regulatory requirements that may be further increased after failures of SVB, Signature Bank and First Republic in 2023. Upcoming Basel III requirements, which take effect in 2025, are expected to restrict bank lending abilities further, particularly for unrated credit.

Count of LBO Loans Financed by Private Credit vs. Broadly Syndicated Market[12]

 # in Actuals



As of Sept. 2023, private credit firms have over $400 billion in estimated dry powder available for financing.[13] Banks are slowly beginning to enter the market as well by building up their own private credit units in-house (e.g., JP Morgan, Morgan Stanley, Goldman Sachs) or partnering with alternative firms (Wells Fargo & Centerbridge, Barclays & AGL, Société Générale & Brookfield). Availability of financing capital is thus likely to remain frothy while private credit is in its golden age, resulting in increased competition that could slow the pace of deployment and/or erode structural quality in the broader market.

Digital Credit, however, benefits from a distinct supply landscape. The universe of digital infrastructure-focused credit remains limited, for two major reasons. First, it is a unique asset class that blends elements of corporate, infrastructure and real estate lending but does not fit cleanly into any one vertical. Second, Digital Credit is backed by hard assets that are constantly expanding with growth capex to support ever-increasing data consumption amid insufficient infrastructure supply. Both features require a lender to have deep digital infrastructure sector expertise to properly assess credit risk and loan to value. As a result, many of the largest investors in private credit have minimal to no participation in Digital Credit, as demonstrated in the portfolio holdings of the largest public BDCs (business development companies). The banks, already subject to sector concentration limits and increasing capital constraints, are also limited in their ability to finance a sector that features nontraditional credit metrics. This supply-side scarcity in both private credit and bank markets contributes to Digital Credit's resilience and attractiveness.

Returns

Elevated rates and market volatility have highlighted private credit as a prudent investment opportunity given its relatively stable returns historically and low correlation to public markets. Private credit yield, which has exceeded that of high yield bonds by an average of +4% since 2005, has reached 12.3% (vs. 8.9% for high yield bonds) as of Sept. 2023.[14] At the same time, private credit has also benefited from historically superior default rates (-1.3%) and recovery rates (+21%) compared to high yield bonds.[15] Within the alternatives market, private credit's fundamental advantages of current income, floating rates, return of capital, rapid deployment and lower volatility allowed private credit to outperform buyout and venture capital returns in the last two years.[16]

Private Market Performance by Strategy[16]

	Private Credit	Buyout	Venture Capital	Combined
Q3 2023	1.88%	0.41%	-1.48%	0.19%
Q2 2023	2.61%	2.29%	-0.16%	1.80%
Q1 2023	2.28%	2.73%	0.00%	2.10%
2022	3.43%	-1.04%	-20.47%	-5.54%
2021	21.06%	36.59%	45.71%	37.22%
2020	7.52%	21.08%	55.30%	26.47%

Digital Credit expands upon private credit's historically attractive risk-return profile through digital infrastructure's role as a pillar of the Growth Economy. As highlighted in our prior whitepaper, credit managers are generally underexposed to Growth Economy sectors like telecom, IT, healthcare and financials that are on the forefront of innovation.[17] Comparing historical Growth Economy loan prices to those of the Old Economy (e.g., industrials, manufacturing, real estate) shows an average outperformance of +1.5 points since 2007.[18] Digital Credit benefits from the technology-forward tailwinds indicative of modern Growth Economy sectors but is further shielded from cyclicality due to its infrastructure-like characteristics. For example, commercial fiber, data center and tower borrowers typically provide mission-critical services for hyperscale (e.g., Microsoft) and enterprise counterparties that feature highly recurring revenue, medium- to long-dated contracts and high switching costs. In residential fiber-to-the-home, internet is commonly viewed as the "fourth utility" after electricity, water and gas, which is especially important insulation a U.S. consumer that faces over $1.1 trillion of credit card debt and a credit card loan delinquency rate that has doubled in the past two years.[19] These distinctive digital infrastructure attributes, backed by real assets with high barriers to entry, help offer Digital Credit potential downside protection while benefiting from strong private credit yields.

DIGITAL CREDIT

Digital Infrastructure	Private Credit
Mission-critical services	Rapid growth of asset class
Driven by data demand	Flexible and efficient structuring
Hard assets with high barriers to entry	Private-equity level due diligence
Long-term contracts with low churn	Floating rate
Stability across cycles	High returns relative to volatility[20]
Limited universe of digital infra specialists	Lower correlation to public markets[20]

Conclusion

As the golden age of private credit continues to unfold, we believe Digital Credit benefits from favorable supply dynamics, data-driven demand, and strong historical risk-adjusted performance. In our view, digital infrastructure's resiliency and wide moat, combined with private credit's structural advantages and historically attractive returns, helps distinguish Digital Credit in a rapidly growing asset class.

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Footnotes:

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About DigitalBridge

DigitalBridge Group, Inc. (NYSE: DBRG) is a leading global digital infrastructure firm. With a heritage of over 25 years investing in and operating businesses across the digital ecosystem including cell towers, data centers, fiber, small cells, and edge infrastructure, the DigitalBridge team manages over $80 billion* portfolio of digital infrastructure assets on behalf of its limited partners and shareholders. Headquartered in Boca Raton, DigitalBridge has key offices in New York, Los Angeles, London, Luxembourg and Singapore. For more information, visit: www.digitalbridge.com.

Disclaimer

* $80B AUM as of December 31, 2023