

April 2024

# The Lower Middle Market

## A Compelling Opportunity

### A Brief History of Direct Lending

Direct lending emerged as a solution for middle market companies in the 1990s. The early growth of the space was spurred by consolidation among banks – the traditional lenders to middle market companies – and further accelerated by regulations put in place following the global financial crisis (GFC), which led banks to exit the middle market lending business. This supply-demand imbalance created an opportunity for non-bank lenders, such as asset managers, to capitalize on the robust opportunity set in the U.S. middle market – which consists of nearly 200,000 companies, representing one-third of private sector GDP and employing nearly 50 million individuals.<sup>1</sup> Today, borrower and investor demand for direct lending continues to persist, with the estimated size of the market swelling to approximately \$1.5 trillion<sup>2</sup> and direct lending representing over 45% of total private credit assets under management.<sup>3</sup>

1) National Center for the Middle Market. Data as of December 2023.

2) KBRA DLD as of December 31, 2023 via Private Credit CLO Outstandings (Morgan Stanley); BDCs (Solve); Public Pension Plan Estimate (PublicPlansData.org); DL Funds (Preqin - North American funds targeting senior & unitranche debt, other strategies excluded).

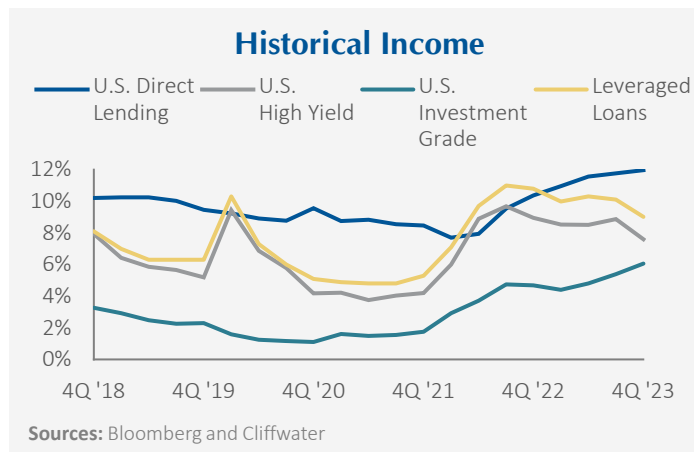
3) Preqin as of December 31, 2023. The Preqin information provided is not transparent and cannot be independently verified. The funds included in the private capital data shown report their performance voluntarily and therefore the data can reflect a bias towards funds with track records of success.

## Attractive Features of Direct Lending

Direct lending has historically offered attractive income compared to public market alternatives, with lower pricing volatility and risk of default.

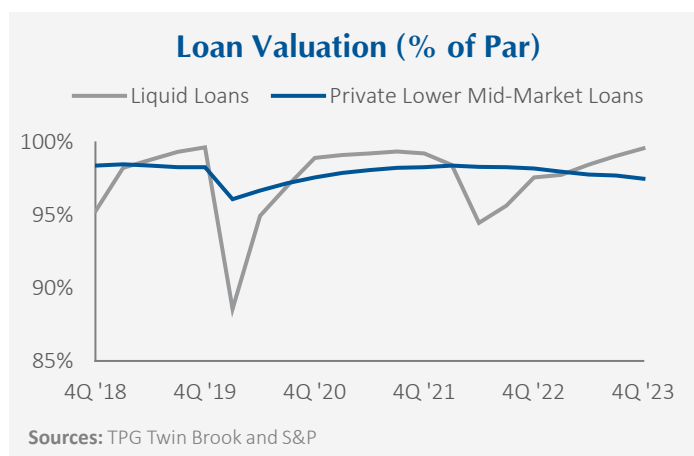
### Income Generation Objective

Since 2004, direct lending has generated an average yield premium<sup>4</sup> of 3% over both U.S. high yield and leveraged loans and 7% over U.S. investment grade credit, driven by factors such as a borrowers' willingness to pay a premium for the benefits offered by private markets. These benefits include, but are not limited to, certainty and speed of execution, potential for customization, and the partnership mentality that private lenders offer.



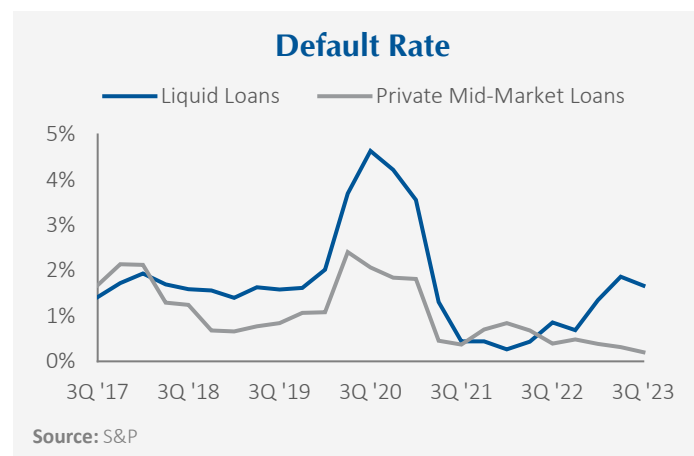
### Strong Credit Quality

Given private loans are non-traded, typically held to maturity, and valued quarterly, they have exhibited lower pricing volatility than liquid loans<sup>5</sup> in terms of standard deviation of loan pricing. TPG Twin Brook's managed portfolio of lower mid-market loans has demonstrated stability of pricing compared to the public markets, which are influenced by market volatility, resulting in loan prices which may not reflect the true credit quality of underlying loans.



### Resilience

Private middle market loans have historically experienced lower default<sup>6</sup> and loss ratios due to structural protections.<sup>7</sup> Loans may hold a senior position compared to unsecured or high yield bonds, are directly negotiated between the lender and borrower, and typically include risk mitigation mechanisms like covenants and limits to adjustments on earnings calculations.



4) Direct lending yield premium is calculated as the difference between the yield on the Cliffwater Direct Lending Index and each the Bloomberg U.S. Corporate High Yield Index and the Credit Suisse Leveraged Loan Index as of December 31, 2023. The indices used are not a full representation of the direct lending market.

5) "Liquid Loans" represented by the S&P LSTA U.S. Leveraged Loan 100 B/BB Rating Index. "Private Lower Mid-Market Loans" represents TPG Twin Brook's managed portfolio of private, illiquid loans. Past Performance is not indicative of future results. Data as of December 31, 2023.

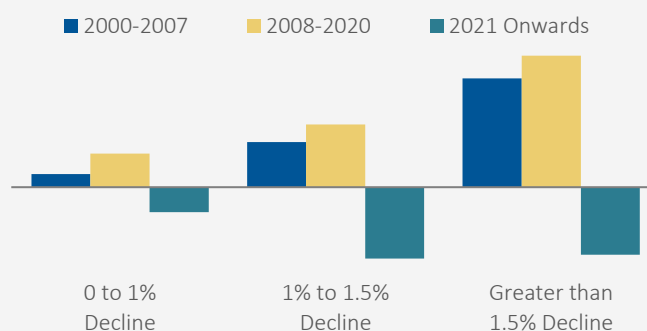
6) "Default Rate" is S&P Global Ratings' one-year lagging default rate, which is calculated as follows: (# of defaults in last 12 months) / (total # of issuers). "Private Mid-Market Loans" default rate is the credit estimate default date with reported defaults. "Liquid Loans" is reflective of the Morningstar LSTA U.S. Leveraged Loan Index. Data as of September 30, 2023.

7) Lender protections are structural elements of a loan investment that serve to strengthen the lender's position. These may include, but are not limited to, first lien perfected security interests on tangible/intangible assets of a portfolio company and covenant packages with both financial and negative covenants.

## The Potential to Increase Return & Decrease Volatility with Direct Lending

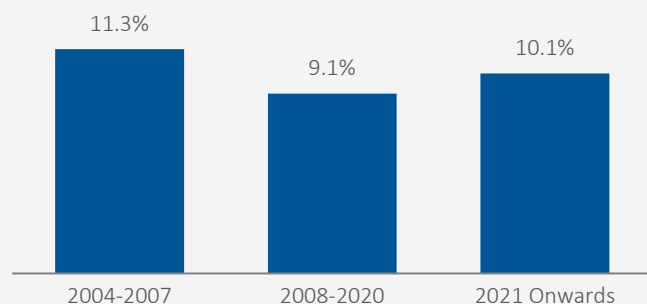
Historically, the 60/40 portfolio<sup>8</sup> – 60% allocated to equity with the objective of capital appreciation and 40% to fixed income for current income – was representative of a sound strategy for an investor with a moderate risk tolerance. Over the last few years, this asset allocation has come under scrutiny as bonds failed to uphold their role as the portfolio ballast. As equity returns fall, bond prices are expected to rise; however, the equity and bond markets demonstrated correlation post-2021. As a result, investors have sought out alternatives to public fixed income. Direct lending has been among those alternatives, as it has demonstrated positive performance during the periods of falling equity returns highlighted in the “Direct Lending Annualized Returns” graph and typically exhibits less correlation with public markets, due to less frequent valuations.

### Bloomberg U.S. Agg Returns on S&P Down Days<sup>9</sup>



Source: Bloomberg U.S. Aggregate Bond Index

### Direct Lending Annualized Returns



Source: Cliffwater Direct Lending Index Annualized Returns

Over the past 10 years, middle market direct loans have returned nearly 9% on an annualized basis, excluding the use of leverage, compared to 1.5% for U.S. fixed income. When re-allocating part or all of their fixed income allocation to direct lending during this period, an investor would have increased their portfolio return with equal or less volatility.

#### 60/40 Portfolio<sup>8</sup>

Over the past 10 years, the 60/40 portfolio would have delivered a 7% annualized return with 11% volatility.

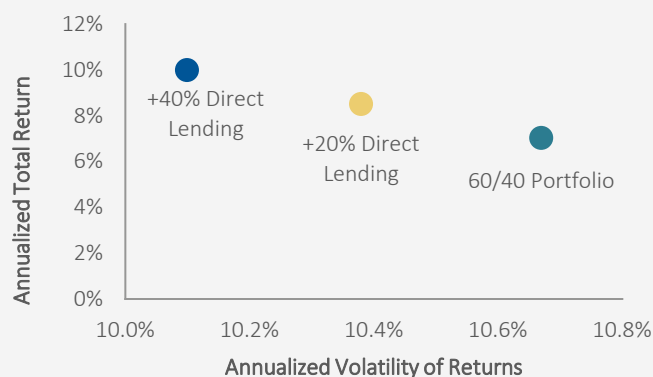
#### +20% Direct Lending

Re-allocating 20% from public fixed income to direct lending, this portfolio would have delivered an 8.5% annualized return with 10% volatility, representing a **150-basis-point return premium over the 60/40 portfolio** with less volatility.

#### +40% Direct Lending

Re-allocating the entire public fixed income allocation to direct lending, this portfolio would have delivered a 10% annualized return with 10% volatility, representing a **300-basis-point return premium over the 60/40 portfolio** without increased volatility.

### 10-Year Portfolio Returns



Sources: Bloomberg and Cliffwater

8) The “60/40 portfolio” represents a 60% allocation to the S&P 500 Index and a 40% allocation to the Bloomberg U.S. Aggregate Bond Index. Past performance is not indicative of future results. Portfolio diversification does not guarantee profit or protect against loss. For more information, please see “Important Disclosure Information – Index Definitions” at the back of this material for more information.

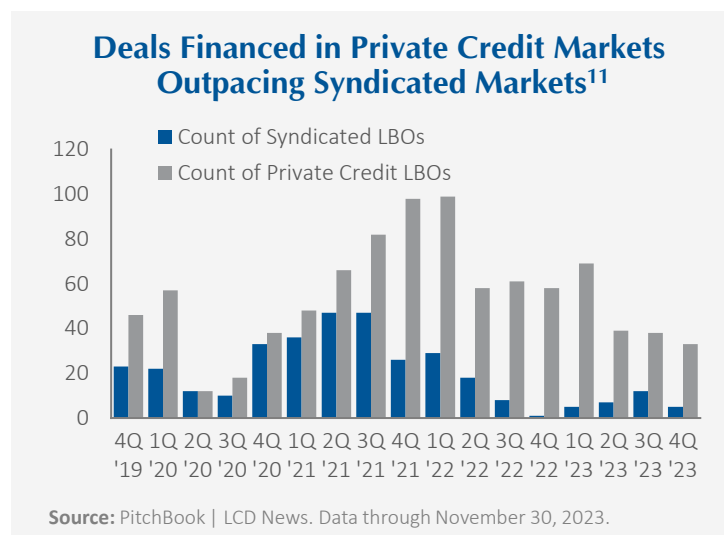
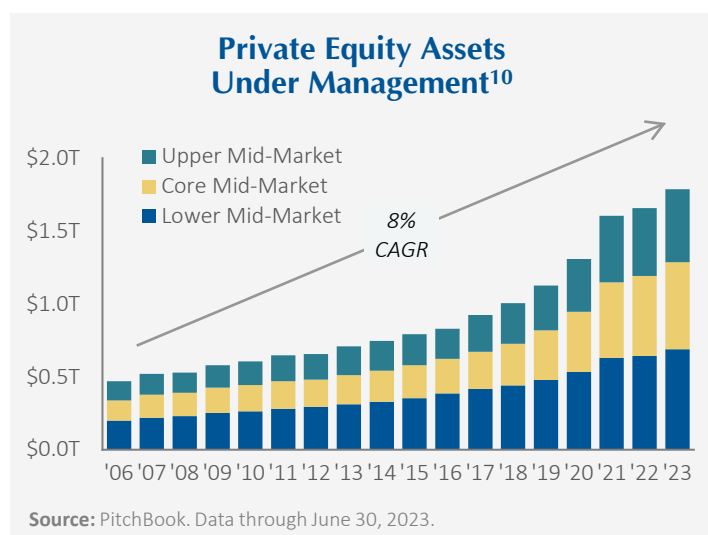
9) Chart shows the average daily return of the Bloomberg U.S. Aggregate Bond Market Index on days when equity prices fell based on the size of the drop in equity prices. The blue bar shows daily returns for the period of 2000 to 2007, the green bar shows daily returns for the period of 2008 to 2020, and the yellow bar shows daily returns for the period of 2021 through December 31, 2023. All periods start in January and end in December.

## Why Now & Why Lower Middle Market?

Despite macro headwinds and general uncertainty in the market, the environment today is attractive for direct lending.

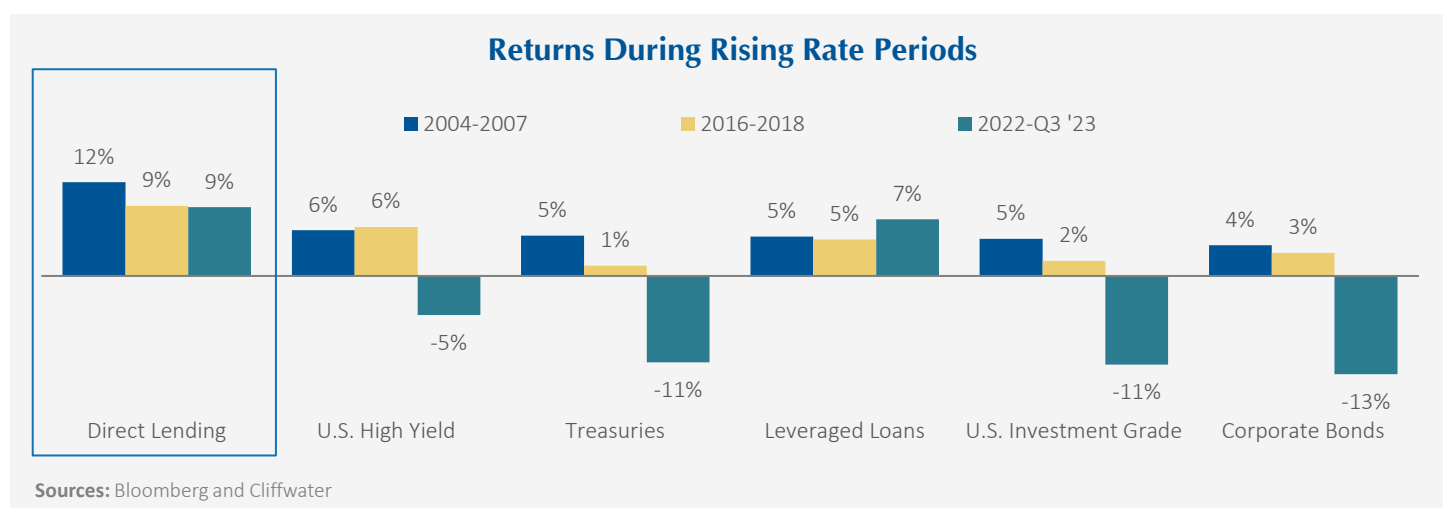
### Increasing Market Opportunities

Private equity as an asset class has grown, and managers are in need of debt to finance their growth plans. Additionally, borrowers are continuing to seek financing from the private markets versus the public markets.



### Potential to Outperform Public Fixed Income in Rising Rate Environments

Direct lending coupons are typically floating rate, meaning that interest is priced at a spread above a reference rate – typically represented by the Secured Overnight Financing Rate (“SOFR”). Therefore, unlike most other debt instruments that have fixed-rate coupons, performing private loans don’t decline in value as interest rates rise. Furthermore, **all-in yields tend to increase with rising rates**, as demonstrated by the below direct lending returns during historical and current periods of rising rates.



10) PitchBook: “Lower Mid-Market” represents private equity fund sizes from \$100 million to \$1 billion, “Core Mid-Market” is \$1 billion to \$2.5 billion, and “Upper Mid-Market” is \$2.5 billion to \$5 billion.

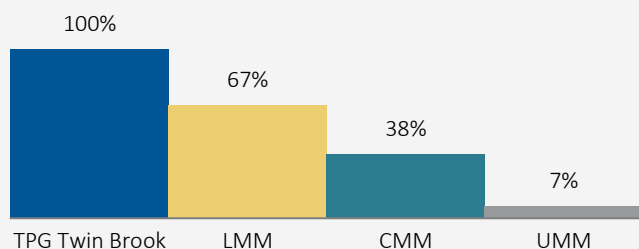
11) Private credit deal count is based on transactions covered by LCD News.

## The Lower Middle Market May Offer Favorable Risk-Adjusted Returns

The middle market is typically segmented by company size, with the lower mid-market consisting of companies with less than \$25 million of EBITDA. The prevalence of lender protections in the lower mid-market, such as covenants and limits on adjustments to EBITDA, may drive the potential for lower loss given default or higher recovery rates.

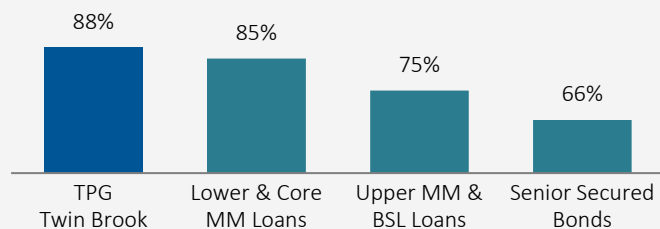
- ✓ **Lender Protections:**<sup>12</sup> Lenders in the lower mid-market may have the opportunity to directly engage with borrowers and sponsors to identify and resolve issues more quickly, benefiting from the prevalence of covenants, more conservative leverage and EBITDA adjustments, and smaller bank groups.
- ✓ **Strong Opportunity Set:** The lower mid-market has historically represented approximately 45% of the total private equity market,<sup>13</sup> which has more than doubled in AUM over the past 10 years, allowing lenders in this space to evaluate a larger opportunity set.
- ✓ **Less Competition:** There are fewer established lenders with scale in this market, with larger lenders typically focusing on larger transactions. Therefore, lower mid-market lenders may be able to receive more favorable pricing and protections.

### Loan Population with Covenants<sup>14</sup>



- **Purpose of Covenants:** Meaningful covenants allow TPG Twin Brook to engage with the sponsor and borrower on potential issues early, while enterprise value still remains. TPG Twin Brook aims for covenants on 100% of its loans, with an average of two covenants per loan.
- **Loans with Covenants:** According to Moody's, covenants are negatively correlated with deal size, with only 38% of core mid-market loans and 7% of upper mid-market loans including covenants.

### Average Recovery Rate<sup>15</sup>



- **Loss Given Default and Recovery Rates:** Average recovery rates for lower and core mid-market loans have historically been favorable compared to larger loans.
- **Factors Impacting Recovery:** Having directly negotiated loan documents that allow for lender protections and conservative underwriting, a senior position in the capital stack, and fewer lenders within the bank group can support recovery.

12) Lender protections are structural elements of a loan investment that serve to strengthen the lender's position. These may include, but are not limited to, first lien perfected security interests on tangible/intangible assets of a portfolio company and covenant packages with both financial and negative covenants.

13) Preqin as of June 30, 2023.

14) Moody's Investors Service. Lower Mid-Market represents private credit loan sizes less than or equal to \$250 million, Core and Upper Mid-Markets are >250 million.

15) S&P Global Ratings, S&P Global Market Intelligence's Credit Pro & Ratings Research. Article: Credit Trends: U.S. Recovery Study: Post-Default Recoveries Improve in 2021 As Challenges Remain. For lower, core, upper mid-market, BSL loans, and senior secured bonds, recovery rates represent the mean, discounted recovery rates of term loans with revolving credit facilities. All recovery rates are from 1987 through September 2021. Includes only debt instruments that defaulted from U.S. issuers. Lower and Core Mid-Market firms defined as firms with \$350 million or less in total debt outstanding at the time of default. Upper Mid-Market and BSL Loans defined as firms with greater than \$350 million of total debt outstanding at the time of default. Recoveries are defined as the ultimate recovery rates following emergence from three types of default: bankruptcy filings, distressed exchanges, and non-bankruptcy restructurings. Recovery rates based at the instrument level and discounted using the effective interest rates. The above represents historical data and is not indicative of the performance of any fund or account. TPG Twin Brook represents a cumulative recovery rate from firm inception in 2014 through 2023.

## Manager Selection is Key

We believe it is important to partner with a manager that has the following capabilities and characteristics in order to produce strong risk-adjusted returns:

### Established Origination Platform

Directly sourcing opportunities – rather than participating in transactions sourced by others – supports a manager's ability to select the deals they believe are of the highest quality, build a differentiated portfolio with minimal overlap with other lenders, and be selected as a lead lender.

### Workout Experience

Given loans are illiquid and held to maturity, being equipped to work through troubled situations is key. Having an experienced, well-staffed team and the established processes to address stressed scenarios is critical.

### Transaction Leadership

Lenders that hold the administrative agent role on the majority of their loans have the benefits of direct communication with sponsors and borrowers, the ability to drive documentation and protections, incumbency for add-on opportunities, and strong PE sponsor relationships.

### Consistent Track Record

Having an experienced investment team that has worked together over time and been executing on a consistent strategy, with no style drift, is valuable.

## TPG Twin Brook: A Leader in the Lower Mid-Market

TPG Twin Brook's strategy is focused on generating attractive, consistent total returns – predominantly in the form of current income and, to a lesser extent, capital appreciation – by targeting investment opportunities with favorable risk-adjusted returns.<sup>16</sup>



Focus on Lower Mid-Market (<\$25 million of EBITDA)



**100%**  
Floating Rate Loans



**100%**  
First Lien Senior Secured<sup>17</sup>



**100%**  
Private Equity Sponsored Borrowers



**100%**  
Loans with Covenants



**99%**  
Transaction Leadership<sup>18</sup>



**0.02%**  
Annualized Loss Ratio<sup>19</sup>

16) There can be no assurance that the Fund's investment objective will be achieved or losses can be avoided.

17) Represents TCAP's senior secured first lien debt as a percentage of total debt investments and excludes TCAP's equity investments.

18) Value represents a percentage of deal count and may be rounded.

19) Represents the annualized loss rate across all of TPG Twin Brook's loan investments across various all managed funds. To date, TCAP has no realized losses. Loss value is calculated as invested capital less repayments. Excludes any interest, fees, PIK payments, or other income received. Data as of December 31, 2023.



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### Index Definitions

**Index Comparison:** The volatility and risk profile of the indices presented in this document is likely to be materially different from that of TCAP. In addition, the indices employ different investment guidelines and criteria than TCAP and do not employ leverage; as a result, the holdings in TCAP and the liquidity of such holdings may differ significantly from the securities that comprise the indices. The indices are not subject to fees or expenses, and it may not be possible to invest in the indices.

**S&P/LSTA U.S. Leveraged Loan 100 B/BB Rating Index:** The index is a sub-index of the S&P/LSTA U.S. Leveraged Loan 100 Index. The full Leveraged Loan 100 Index measures the performance of the 100 largest loan facilities meeting the criteria defined in Eligibility Criteria. The index is market-value weighted. The sub-index is composed of loans with ratings between BB+ and B-, as determined by S&P Global Ratings. TPG Twin Brook believes that the Leveraged Loan 100 B/BB index is the index whose constituents best match the credit profile of our borrowers. Its inclusion is intended to demonstrate how the most liquid of loans with similar credit quality to TPG Twin Brook’s loans have performed over different periods.

**Bloomberg U.S. Aggregate Bond Index:** The Bloomberg US Agg Index a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. In addition to investment grade corporate debt, the index tracks government debt, mortgage-backed securities (MBS) and asset-backed securities (ABS) to simulate the universe of investable bonds that meet certain criteria. To be included in the Agg, bonds must be of investment grade or higher, have an outstanding par value of at least \$100 million and have at least one year until maturity. Its inclusion is intended to demonstrate the performance of the non-leveraged portions of the U.S. bond market.

**S&P 500:** The Standard and Poor’s 500 is a stock market index tracking the stock performance of 500 of the largest companies listed on stock exchanges in the United States. It is one of the most commonly followed equity indices and includes approximately 80% of the total market capitalization of U.S. public companies. The S&P 500 index is a free-float weighted/capitalization-weighted index. Its inclusion is intended to demonstrate the performance of the U.S. equity market.

### Summary of Risk Factors

AG Twin Brook Capital Income Fund (“TCAP”) is a non-diversified, closed-end management investment company that has elected to be regulated as a business development company (“BDC”). TCAP is externally managed by our adviser, AGTB Fund Manager, LLC (the “Adviser”). The Adviser is an affiliate of Angelo, Gordon & Co., L.P. (“TPG Angelo Gordon”). Foreside Financial Services, LLC, an unaffiliated third party, serves as TCAP’s intermediary manager. Investing in TCAP involves a high degree of risk. You should purchase these securities only if you can afford a complete loss of your investment. You should read the prospectus carefully for a description of the risks associated with an investment in TCAP. These risks include, but are not limited to, the following:

- We have limited operating history and there is no assurance that we will achieve our investment objectives.
- We cannot guarantee that we will be able to replicate the historical results achieved by other TPG Angelo Gordon products.
- As required by the Investment Company Act of 1940, as amended, a significant portion of our investment portfolio is and will be recorded at fair value as determined in good faith and, as a result, there is and will be uncertainty as to the value of our portfolio investments.
- If a subscription request, including the full subscription amount, is not received in good order at least five business days prior to the first day of the month, the investor may not be eligible to purchase securities during that month’s offering. Accordingly, if the subscription is not withdrawn, such investor will not know the NAV per share until the following month’s NAV is determined, which will be a significant period of time from the initial subscription. If an investor disagrees with the NAV per share at which a purchase is made and decides to tender such common shares of beneficial interest (“Common Shares”) within a year of such purchase, such investor would be subject to an early repurchase deduction and such Common Shares will be repurchased at 98% of NAV at the time of repurchase (“Early Repurchase Deduction”).
- You should not expect to be able to sell your shares regardless of how we perform.
- You should consider that you may not have access to the money you invest for an extended period of time.
- We do not intend to list our shares on any securities exchange, and we do not expect a secondary market in our shares to develop.
- Because you may be unable to sell your shares, you will be unable to reduce your exposure in any market downturn.
- We have implemented a share repurchase program, but only a limited number of shares will be eligible for repurchase and repurchases will be subject to available liquidity and other significant restrictions.
- An investment in our Common Shares is not suitable for you if you need access to the money you invest.
- You will bear substantial fees and expenses in connection with your investment.
- We cannot guarantee that we will make distributions, and if we do we may fund such distributions from sources other than cash flow from operations, including the sale of assets, borrowings or return of capital, and although we generally expect to fund distributions from cash flow from operations, we have not established limits on the amounts we may pay from such sources.

- Distributions may also be funded in significant part, directly or indirectly, from temporary waivers or expense reimbursements borne by the Adviser or its affiliates, that may be subject to reimbursement to the Adviser or its affiliates. The repayment of any amounts owed to the Adviser or any of its affiliates will reduce future distributions to which you would otherwise be entitled.
- The Fund’s distributions may be funded from unlimited amounts of offering proceeds or borrowings, which may constitute a return of capital and reduce the amount of capital available to the Fund for investment. Any capital returned to shareholders through distributions will be distributed after payment of fees and expenses.
- A return of capital to shareholders is a return of a portion of their original investment in the Fund, thereby reducing the tax basis of their investment. As a result from such reduction in tax basis, shareholders may be subject to tax in connection with the sale of shares, even if such shares are sold at a loss relative to the shareholder’s original investment.
- We use and expect to continue to use leverage, which will magnify the potential for loss on amounts invested in us.
- We qualify as an “emerging growth company” as defined in the Jumpstart Our Business Startups Act and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our Common Shares less attractive to investors.
- We invest in securities that are rated below investment grade by rating agencies or that would be rated below investment grade if they were rated. Below investment grade securities, which are often referred to as “junk,” have predominantly speculative characteristics with respect to the issuer’s capacity to pay interest and repay principal. They may also be illiquid and difficult to value.
- We invest primarily in privately-held companies for which very little public information exists. Such companies may experience substantial variations in operating results.

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