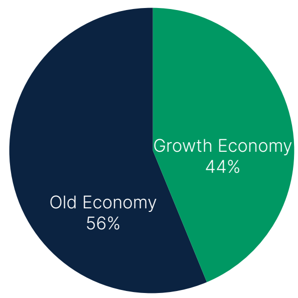
Financing the Growth Economy through Digital Credit

An underlying market trend is gaining momentum — private credit is underexposed to key growth sectors in the economy. The large outperformance in 2020 of newer economy sectors highlights the risks to private credit investors of a significant structural overweighting to more traditional industries. Compared to the equity markets, leveraged loan markets are underweight in assets that reflect the "Growth Economy" (e.g. telecom, IT, financials, healthcare), and overweight in the trailing "Old Economy" (e.g. manufacturing, industrials, real estate). The overall equity and loan markets have dramatically different exposure — equities are 63% allocated to the Growth Economy, while the leveraged loan market is only 44% exposed to Growth Economy assets.

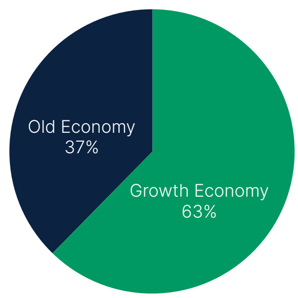
Old Economy assets have historically been associated with lower risk/reward per unit of capital invested relative to growth-oriented sectors. However, COVID-19 and its aftershocks have and will continue to alter Old Economy business models profoundly and radically, accelerating the importance of enhanced exposure to the Growth Economy. "Mission-critical" is much more likely to describe enterprise connectivity or cybersecurity today than access to commercial office space. This leaves sectors that were once perceived as "conservative" and/or "stable" in flux, with Old Economy industries such as commercial real estate, core infrastructure, industrials and manufacturing not necessarily the safe harbor assets they once were. In this new environment, Old Economy yield is derived from harvesting core value while Growth Economy returns are generated through market expansion.

U.S. Leveraged Loan vs. Equity Allocation to the Growth & Old Economies[1]

U.S. LCD Leveraged Loan Index



S&P 500



Note: Limited industry data is available for private funds, but a sampling of the largest BDCs also indicates underexposure to the Growth Economy

Digital Credit Market Opportunity

While this fundamental market shift has created a growing impetus for managers to actively re-align their private credit portfolios toward Growth Economy assets, there remain few industry-tailored options within private credit to achieve this objective. One particularly attractive solution lies in building exposure to Digital Infrastructure, the backbone of the Growth Economy. The global movement to telecommuting, streaming entertainment and remote education in the wake of the pandemic has only accelerated a progression toward ubiquitous access to information and connectivity, the availability of which requires robust Digital Infrastructure. What was already a powerful, multi-decade thematic only furthers the world's reliance on data centers, cell towers, fiber networks and small cell networks. Digital Infrastructure is a particularly attractive sector for credit managers as it embeds several levels of downside protection while capturing attractive risk-adjusted returns:

(i) Digital transformation has only been accelerated by the pandemic and will fuel more demand for access, creation and storage of data. From large multinational technology conglomerates to enterprises and consumers, mega-trend technologies like 5G, artificial intelligence, IOT and cloud-based applications will require substantial investment to keep pace with their increasingly critical role.

(ii) Physical layer infrastructure consists of real assets with recurring revenue underpinned by contracted cash flow, high barriers to entry and high switching costs, providing downside protection to credit investors. Moreover, in periods of sudden and sharp economic downturns such as the 2007-2009 global financial crisis and COVID-19, Digital Infrastructure business models have shown to be defensive, resilient and mission-critical.

The **market opportunity** for "digital credit" is sizeable given that (a) approximately $120 billion in Digital Infrastructure M&A and capex activity was financed by credit in 2019[2] and (b) approximately $300 billion in Digital Infrastructure leveraged loans and high yield bonds need to be refinanced within the next 7 years.[3] Filtering for deal sizes that are digestible to an average credit institution, we estimate the addressable market for digital private credit to be at least $60 billion per year in North America and Europe, comprised of $20+ billion of actionable refinancing opportunities and $40+ billion in annual M&A/capex financing needs.

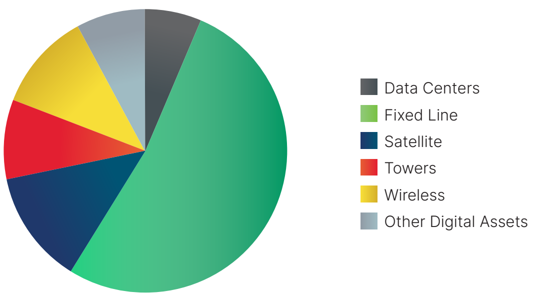
115%

Year-over-year growth to $19 billion in capex for cloud leaders Amazon and Microsoft in Q4 2020.

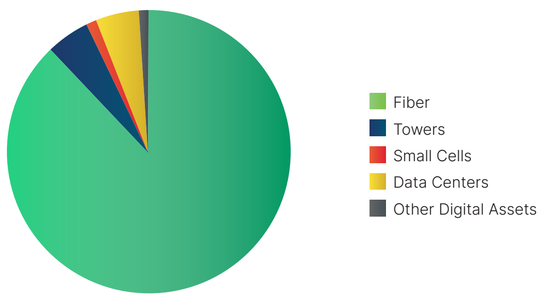
Source: Company Financials

U.S. & Europe Addressable Digital Credit Market Opportunity

Refinancing Opportunity
(~$20B per Year)[4]



M&A and Capex Opportunity
(~$40B per Year)[5]



Conclusion

The pandemic has altered underlying risk assumptions and challenged traditional investing canon, prompting fund managers across the spectrum to reassess portfolio industry allocations. Public and private equity markets offer investors numerous products to tailor exposure to favored industries, while private credit has historically offered few industry-focused alternatives. Digital credit, however, offers private credit managers direct access to the Growth Economy and its supportive secular tailwinds.

A successful digital credit strategy requires the expertise of both a sector specialist and a traditionally generalist private credit manager. Significant digital demand growth, combined with insufficient infrastructure supply, allow private credit lenders with digital expertise to be well-positioned for rapid deal flow, proper assessment of sector-specific dynamics and generation of attractive risk-adjusted returns. The broader DigitalBridge platform has over two decades of operational and investing experience and has forged strong relationships managing mission-critical network infrastructure with some of the world's largest and most profitable companies.

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Footnotes:

1. S&P Leveraged Commentary & Data for Leveraged Loans, S&P 500 for Equities, December 2020. Growth Economy sectors include Communications Services, Financials, Health Care and Information Technology. Old Economy sectors include Consumer Discretionary, Consumer Staples, Energy, Industrials, Materials, Real Estate and Utilities.
2. Bloomberg, October 2020.
3. RBC, SMA, Altman Vilandrie & Company, DigitalBridge estimates. May 2020.
4. $20 billion refinancing market: Issuers of digital infrastructure leveraged loans and high yield bonds in the U.S. and Europe need to refinance $67 billion, $175 billion, and $294 billion of debt in the next 3, 5 and 7 years, respectively.[2] We estimate that approximately 30% of these refinancings are actionable for a digital credit lender, when removing companies with debt of more than $3.5 billion and when requiring an issuer to have at least one debt facility of less than $750 million. As such, we estimate a target addressable refinancing opportunity set to be approximately $20 billion per year. Note that this figure does not include private credit refinancings.
5. $40 billion M&A and capex market: During 2019, $119 billion of digital infrastructure M&A and Capex activity was financed by credit in North America and Europe and we expect that annual level of activity to continue.[3] We estimate that 30% of future M&A and Capex opportunities will be actionable for DigitalBridge Private Credit, in line with the refinancing opportunity set, and we estimate our target addressable M&A and Capex opportunity set to average approximately $40 billion per year.

DIGITALBRIDGE

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 a $50 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.

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