

KKR Credit Income Fund

Rating issued on 07 Mar 2024 | Exchange Code: KKC

Investment objective

To deliver an absolute return of 6% p.a. to 8% p.a. (net of fees and expenses) over the medium-term, which includes a target distribution of 4% p.a. to 6% p.a. paid on a quarterly basis.

Manager	KKR Australia Investment Management
Distributor	KKR Australia Investment Management
Sector	International Fixed Interest \ High Income
Investment Style	Active
RI Classification	Aware
Absolute Risk	High
Relative Risk	-
Investment Timeframe	5-6 Years
Benchmark	Bloomberg AusBond Bank Bill Index
Min Investment Amount	-
Redemption Frequency	Daily
Income Distribution	Monthly
Fund Size (31 Jan 2024)	\$788.10M
Management Cost	0.90% p.a. Incl. GST
Performance Fee	5% of any excess return of the net portfolio return over the RBA Cash Rate plus 4% p.a.
Buy / Sell Spread	N/A
Inception Date	21 Nov 2019

Fund facts

- Deep and highly-experienced investment team
- Focus on sub-investment grade securities
- Ability to opportunistically invest across a range of sub-sectors

Viewpoint

The Trust, managed by KKR, accesses two discrete portfolios of US and European High Yield Bonds and Loans. Using an active, value-based approach, KKR invests across the full spectrum of sub-investment grade securities, from traditional High Yield Bonds to deeply discounted, distressed opportunities. Zenith notes that KKR's proven expertise managing the underlying strategies underpins our conviction in the Trust, and in our opinion, is an attractive option in the Listed Investment Trust (LIT) segment, for those investors seeking more aggressive Fixed Income returns with attendant drawdown risk.

In terms of the Trust and its underlying investment strategies, Chris Sheldon, Co-Head of Credit and Markets, is the Lead Portfolio Manager for the Global Credit Opportunities Fund (GCOF) strategy, while Michael Small, Head of European Direct Lending is responsible for the European Direct Lending (EDL) portfolio. Sheldon is based in San Francisco and maintains responsibility for the firm's Leveraged Credit, Private Credit and Strategic Investments Groups. In our opinion, his contrarian mindset and ability to understand the intrinsic value of a business is a key contributor to the success of the underlying strategy.

The Trust invests into the US-centric GCOF strategy and the EDL portfolio, representing approximately 53% and 47% of the underlying portfolio, respectively (31 December 2023). GCOF is KKR's flagship 'traded' Credit strategy, representing the 'best ideas' from across its Credit platform with the investable universe including High Yield, Bank Loans, Structured Products and Opportunistic Credit.

Zenith highlights that the focus on sub-investment grade securities is a point of differentiation and adds a layer of specialisation to the investment process. In our opinion, the approach is more resource-intensive and requires a contrarian mindset given the focus is on understanding the default risk of a business.

The final portfolio is managed with a credit spread duration range of between two and five years with a bias to senior secured securities which includes both loans and bonds. Consistent with the opportunity set, KKR typically invests in lower quality credit securities with a typical credit rating of B and CCC (based on S&P's rating methodology), noting that EDL assets are not rated.

Zenith notes that this cohort of securities is subject to a high level of mark-to-market volatility and potential default risk, particularly during stressed equity periods or cyclical downturns. Accordingly, investment outcomes will be closely tied to the quality and depth of KKR's bottom-up due diligence process. To this end, Zenith highlights that KKR has consistently outperformed the CCC component of the broader High Yield indices, achieving higher returns and at the same time, demonstrating superior capital preservation qualities (i.e. lower default experience).

Overall, Zenith considers KKR's portfolio construction process to be well structured and consistent with attaining the Trust's investment objective. While there are structural challenges with managing two asset classes with differing liquidity profiles, KKR has a long and proven track record in managing sub-investment grade portfolios and the attendant risk and liquidity profiles.

Zenith highlights that post-listing, the Trust has consistently traded at a circa 8% to 10% discount to Net-Tangible-Assets (NTA), which is disappointing and above our expectations. While it is difficult to decompose the contributing factors to the discount (noting that market sentiment can be a large contributing factor), we highlight that KKR continues to implement a range of initiatives to manage this.



Fund analysis

Fund characteristics

Constraint	Value
EDL Portfolio (at Full Investment)	
First Lien Senior Secured Debt	Minimum 70% of Portfolio
Non-European Portfolio Exposure	0% to 15%
Single Issuer Limit	Up to 20% of Portfolio NAV
Maximum Exposure to KKR Affiliates	Up to 15% of Portfolio NAV

Investment objective and philosophy

The Trust's investment objective is to deliver an absolute return of 6% p.a. to 8% p.a. (net of fees and expenses) over the medium-term, which includes a target distribution of 4% p.a. to 6% p.a. paid on a monthly basis. This is achieved by investing in a mix of global credit strategies (both private and publicly-traded) with low correlation to traditional investment grade bond markets, and an emphasis on diversification across asset classes, regions and issuers.

The investment philosophy is premised on the belief that intensive bottom-up credit analysis is a sustainable source of excess returns, particularly when applied with a capital preservation focus. KKR's approach is centred on its fundamental analysis of a company/issuer, including detailed historical and projected financial modelling. In our opinion, given KKR's presence across public and private markets, the firm is well positioned to assess the enterprise value of a company with both a private and public lens.

Zenith highlights that the focus on sub-investment grade securities is a point of differentiation and adds a layer of specialisation to the investment process. In our opinion, the approach is more resource-intensive and requires a contrarian mindset given the focus is on understanding the default risk of a business. This differs to traditional investment grade investing where the assessment is generally more relative-value based and understanding the relationship between spread and the potential for ratings changes.

The Trust invests into the following investment strategies:

- Global Credit Opportunities Fund (GCOF) - 45% to 100%
- European Direct Lending (EDL) - 40% to 50%

The underlying strategy mix has been constructed to achieve diversification across regions, issuers and different Fixed Interest sub-sectors. For example, GCOF is a US-centric strategy investing primarily in Corporate Bonds and Loans, while the EDL portfolio invests in European Loans. Further, the key return drivers of each strategy are complementary, extending across credit quality, interest rate sensitivity, risk premia etc.

In practical terms, GCOF invests in publicly traded bonds and loans and therefore will exhibit greater variability of performance, whereas the EDL strategy comprises a portfolio of private loans which are priced less frequently, with performance variations generally representative of the credit worthiness of the pool of borrowers. Zenith highlights the embedded level of diversification between the two strategies, with the EDL

allocation expected to smooth portfolio volatility (as measured by Standard Deviation) at the Trust level.

The following section includes a detailed overview of each of the underlying strategies.

GCOF Portfolio

The GCOF strategy represents the firm's 'best ideas' from across KKR's traded Credit platform including High Yield, Bank Loans, Structured Credit and Opportunistic Credit. KKR can invest up to 20% of the portfolio in an 'Opportunistic Bucket' which includes the ability to purchase its Listed Investment Trust (LIT) (KKR Credit Income Trust (ASX code: KKC)) and other opportunities including bilateral lending transactions.

The portfolio managers employ a range of bottom-up strategies, which are classified based on the following:

- **Event Driven** - identifying securities with short-term catalysts for price appreciation which can include mergers and acquisition activity, restructuring and/or positive ratings movements
- **Dislocation/Relative Value** - high yielding securities from companies experiencing earnings/revenue challenges and/or its underlying sector is facing structural challenges
- **Proprietary Sourcing** - leveraging the firm's industry networks to access niche financing opportunities, which can include cornerstone or large block trades
- **Stressed Credits** - distressed companies that require refinancing or restructuring of debt arrangements. Typically these companies operate in structurally challenged industries or sectors going through transition
- **Structured Credit** - can include a range of Structured Credit opportunities, including investing in lower tranches of Collateralised Loan Obligations (CLO's)
- **Illiquidity premium** - typically smaller businesses or industries, that are more illiquid and less frequently traded, thereby offering a market premium

The Event Driven and Dislocation/Relative Value allocations strategies are expected to account for the majority of portfolio risk, however the underlying portfolio weightings will change over time and reflect the prevailing opportunity set.

In sum, the GCOF strategy draws on the extensive network of the broader KKR business. In our opinion, the quality and depth of the bottom-up due diligence process, enables the portfolio management team to invest lower down the risk continuum to generate attractive risk-adjusted returns.

EDL Portfolio

The EDL portfolio is a pool of loans, that have been sourced from across KKR's origination networks. As a lender, KKR prioritises larger transactions, where the borrower has a minimum of \$EUR 25 million of EBITDA (Earnings Before Interest, Depreciation and Amortisation), coupled with strong fundamentals and high quality Private Equity (PE) sponsors. A typical tranche size is generally between \$EUR 100 million and \$EUR 250 million, with a preference for being the sole lead lender on the majority of deals.

The majority of loans are floating rate in nature, with borrowers paying a spread above Euribor (European Inter-Bank Offered Rate), generally in the range of 5% p.a. to 7% p.a., subject to



market pricing. Further, KKR typically invests in senior and senior stretch loans (which is a form of combining senior and subordinated loans to generate a blended exposure), with a lower exposure to second lien loans.

Prior to investing in a loan, all lending proposals need to be unanimously approved by KKR's Credit European Direct Lending Investment Committee which is responsible for all private credit investments made by the team, including privately originated senior and subordinate lending opportunities.

The position sizing of loans across the portfolio is subject to the underlying Trust's diversification guidelines. Further, this can be an outworking of the origination pipeline and the maturity profile of the Fund.

Zenith notes that investing in loans is a highly specialised skill set, that extends well beyond traditional credit investing. For example, this includes a detailed understanding of the origination process, funding structures (i.e. revolving facilities), term loans with different amortisation features, and the ability to manage impaired assets. In addition, KKR's approach is augmented by its vast networks and business relationships which should ensure a strong pipeline of lending opportunities.

In sum, Zenith is supportive of the stabilising role that the EDL portfolio plays in the Trust structure. Notwithstanding this, the underlying loan exposures are expected to cover the full continuum of risk assets including senior secured borrowers to deeply subordinated loans / mezzanine debt financing and first and second lien loans. Therefore, the Trust is expected to exhibit both equity and debt properties, with the potential for meaningful drawdowns.

Portfolio applications

KKR manages a Credit-focused Fixed Income strategy, investing in high yield securities on an opportunistic basis. While the investable universe is relatively broad, KKR's focus is on sub-investment grade securities with a bias to US and European Credit markets.

Zenith believes the Fund may be suitable for investors seeking exposure to a higher yielding portfolio with 'Equity like' return expectations which may improve a portfolio's potential risk/return profile. However, given the Fund can invest in sub-investment grade and unrated assets, it may not be suitable for the more risk-averse investor.

From a portfolio perspective, the Fund may be suitable as a component in the income-producing portion of a well-diversified portfolio. The Fund is considered appropriate as a component of a defensive allocation; however, given the higher return and volatility profile of the strategy, Zenith believes that investors may partly fund the allocation from the growth portion of a portfolio. Due to the anticipated moderate to high levels of volatility, with the potential for capital losses, Zenith recommends taking a medium to long-term investment time frame.

Investors also need to be aware that as a listed Trust, the units will have their own trading patterns and may deviate from NTA and also the actual investment returns generated by KKR.

To access the underlying investment strategies, KKR employs a Master/Feeder structure with the Australian Trust investing in a Singapore domiciled partnership (referred to as a feeder fund), which in turn, invests in the GCOF strategy, a Cayman based company (the master fund).

The Trust gains its exposure to the underlying investment strategy via a Profit Participating Note (PPN) which is issued by the Singapore-based entity. The PPN is a debt instrument paying a variable investment return based on the underlying performance of the GCOF and EDL portfolios.

Zenith highlights that the investment structure is complex, including the use of an interposed entity to manage potential Controlled Foreign Company (CFC) obligations. While our preference is for a more simplified approach, in our opinion, the structure effectively creates the same investment and tax outcomes as a direct investment, albeit with less risk of being taxed on an accruals basis under the CFC provisions.

CFC is a complex area of tax legislation and Zenith recommends investors seek their own personal tax advice with respect to the suitability of the structure.

Fund responsible investment attributes

Key Information	Description
Zenith RI classification*	Aware
Has Responsible Investment Policy	Yes
PRI Status	
PRI Signatory	Yes

*Zenith RI Classification scale:

- Traditional
- Aware
- Integrated
- Thematic
- Impact



Absolute performance

Performance as at 31 Jan 2024

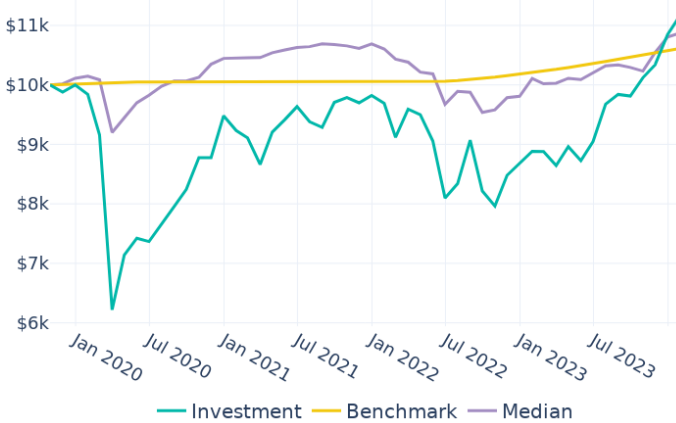
Monthly performance history (% , net of fees)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	BM YTD*	BM2 YTD**
2024	2.95%												2.95%	0.37%	0.11%
2023	2.34%	-0.04%	-2.65%	3.69%	-2.66%	3.69%	6.96%	1.68%	-0.27%	3.14%	2.14%	4.95%	24.99%	3.85%	10.19%
2022	-1.37%	-5.88%	5.19%	-0.96%	-4.68%	-10.57%	2.97%	8.79%	-9.43%	-3.08%	6.48%	2.37%	-11.64%	1.25%	-11.62%
2021	-2.62%	-1.35%	-4.90%	6.28%	2.27%	2.32%	-2.63%	-1.01%	4.53%	0.83%	-0.91%	1.29%	3.60%	0.03%	2.09%
2020	-1.60%	-6.91%	-32.11%	14.84%	3.93%	-0.75%	4.13%	3.70%	3.63%	6.47%	0.00%	8.04%	-5.18%	0.37%	-0.81%

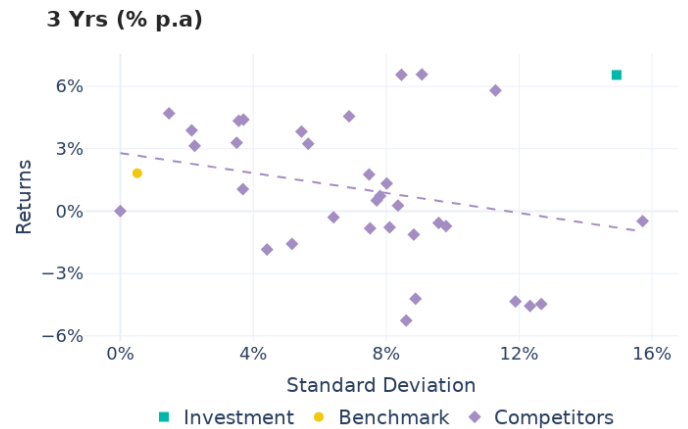
*Bloomberg AusBond Bank Bill Index

**KKC Net Portfolio Returns

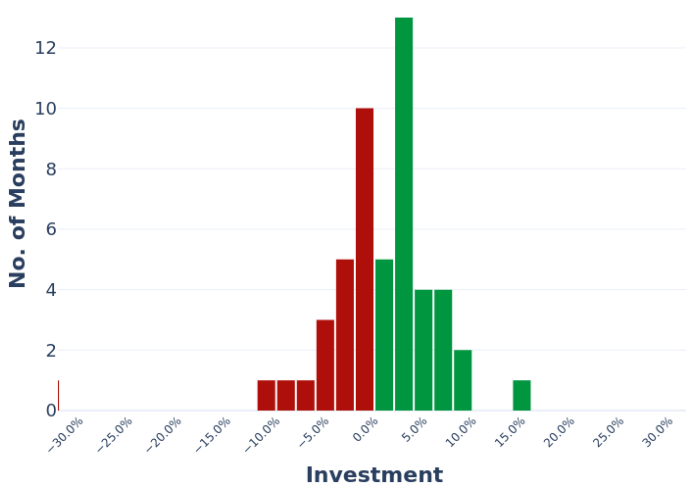
Growth of \$10,000



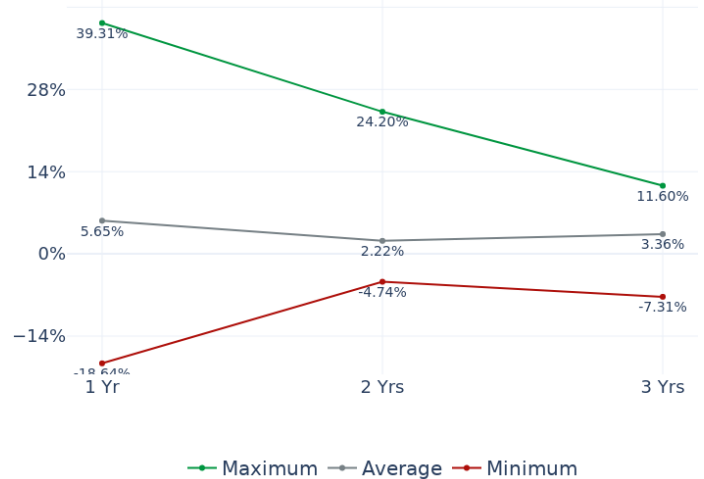
Risk / return



Monthly histogram



Minimum and maximum returns (% p.a.)





Absolute performance analysis

Instrument	6 Mths	1 Yr	2 Yrs	3 Yrs	Inception
Investment	15.42%	25.73%	7.36%	6.55%	2.64%
Benchmark	2.11%	3.96%	2.73%	1.82%	1.41%
Median	5.36%	7.57%	1.27%	1.31%	1.99%
Cash	2.11%	3.96%	2.73%	1.82%	1.41%

Ranking within sector (p.a.)

Ranking within Sector	1 Yr	3 Yrs	Inception
Fund Ranking	2 / 34	2 / 27	8 / 23
Quartile	1st	1st	2nd

Absolute risk

Instrument	1 Yr	2 Yrs	3 Yrs	Inception
Standard Deviation (% p.a.)				
Investment	9.69%	16.76%	14.93%	22.49%
Benchmark	0.13%	0.44%	0.51%	0.47%
Median	3.99%	6.41%	5.31%	6.63%
Downside Deviation (% p.a.)				
Investment	3.76%	11.87%	10.30%	18.20%
Benchmark	0.00%	0.01%	0.01%	0.01%
Median	1.17%	4.70%	3.87%	5.37%

Absolute risk/return ratios

Instrument	1 Yr	2 Yrs	3 Yrs	Inception
Sharpe Ratio (p.a.)				
Investment	2.25	0.28	0.32	0.05
Benchmark	0.00	0.00	0.00	0.00
Median	0.91	-0.23	-0.10	0.09
Sortino Ratio (p.a.)				
Investment	5.78	0.39	0.46	0.07
Benchmark	NaN	0.00	0.00	0.00
Median	3.10	-0.31	-0.13	0.11

Zenith benchmarks funds in the 'International Fixed Interest - High Income' peer group against the Bloomberg AusBond Bank Bill Index. While this benchmark may not be consistent with the one adhered to by all rated participants, it has been adopted to provide investors with a common reference point against which similarly structured strategies may be assessed.

The following commentary is effective as at 31 January 2024.

The Trust's investment objective is to deliver an absolute return of 6% p.a. to 8% p.a. (net of fees and expenses) over the medium-term, which includes a target distribution of 4% p.a. to 6% p.a. paid on a quarterly basis.

Since inception, the Fund has lagged its investment objectives, however, it has consistently ranked in the upper quartiles of the peer group.

Zenith ratings applied to LITs do not explicitly take into account share prices vs. NAV and do not represent a buy/sell recommendation based on a LIT's valuation. Potential investors should make their own determination of the appropriateness of prevailing premiums or discounts to NAV when acquiring or disposing of a LIT.



Relative performance

Excess returns

Statistic	6 Mths	1 Yr	2 Yrs	3 Yrs	Inception
Excess Return	13.31%	21.78%	4.63%	4.73%	1.23%
Monthly Excess (All Mkts)	83.33%	66.67%	58.33%	55.56%	54.90%
Monthly Excess (Up Mkts)	83.33%	66.67%	60.87%	57.58%	56.25%
Monthly Excess (Down Mkts)	0.00%	0.00%	0.00%	33.33%	33.33%

Capture ratios (% p.a.)

Statistic	6 Mths	1 Yr	2 Yrs	3 Yrs	Inception
Downside Capture	0.00%	0.00%	6027.94%	8497.12%	8497.12%
Upside Capture	694.40%	594.64%	281.48%	378.49%	210.85%

Tracking error (% p.a.)

Instrument	1 Yr	2 Yrs	3 Yrs	Inception
Investment	9.62%	16.58%	14.79%	22.45%
Median	3.94%	6.19%	5.15%	6.58%

Information ratio

Instrument	1 Yr	2 Yrs	3 Yrs	Inception
Investment	2.26	0.28	0.32	0.05
Median	0.92	-0.24	-0.10	0.09

Beta statistics

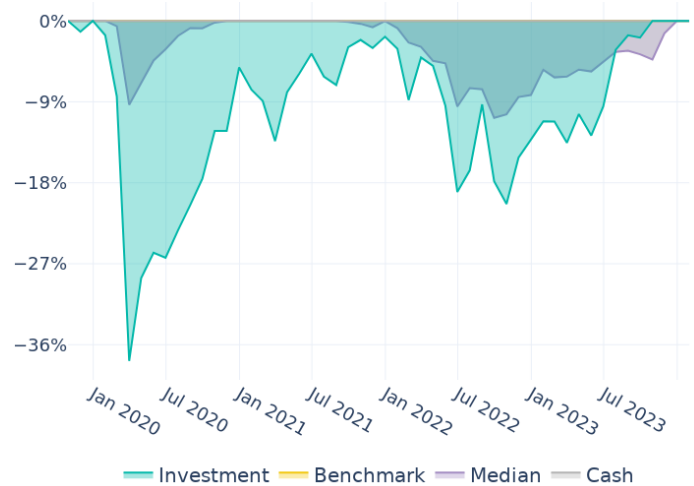
Statistic	1 Yr	2 Yrs	3 Yrs	Inception
Beta	40.16	16.33	8.63	4.75
R-Squared	0.30	0.18	0.09	0.01
Correlation	0.55	0.43	0.29	0.10

The following commentary is effective as at 31 January 2024.

Zenith typically seeks to identify funds which can outperform their index in greater than 50% of months as we believe this represents a persistence of manager skill. The Trust has been successful in outperforming the benchmark in more than 50% of 'all' markets over the medium to longer term.

Drawdown analysis (since inception)

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.



The following commentary is effective as at 31 January 2024.

The Fund's drawdown profile has been commensurate with the broader risk/return profile of the strategy. To date, the Fund's largest drawdown has been 37.8% through the COVID period which captures the movement in the listed price (as opposed to the performance of the underlying portfolios).

Zenith reiterates that despite the relative attractiveness of the strategy, the performance of the Trust reflects the movement in the underlying portfolio, as well as the performance of the ASX vehicle. The latter is subject to the impact of market sentiment, which can result in the Trust trading at a significant discount/premium to net tangible assets.

Product Exposures

Holdings not provided by the manager



Fund commentary

Fund risks

Zenith has identified the following key risks of the Trust. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

Key person risk: Given the collegiate nature of the business, Zenith considers key person risk to be low. However, if Sheldon was to depart, this would warrant a reassessment of our rating.

Discount to NTA risk: Investors are exposed to the performance of the underlying portfolio and movements in the share price of the ASX vehicle. The latter is subject to the impact of market sentiment, which can result in the Trust trading at a significant discount/premium to net tangible assets. Zenith highlights that the Fund has persistently traded at a discount to NTA, resulting in sub-optimal performance outcomes for those investors that participated in the initial listing.

Structuring risk: The Trust invests in a Profit Participating Note (PPN) structure, which is issued by a separate KKR entity and effectively provides the Trust with an economic interest in the underlying GCOF and EDL portfolios. The use of interposed entities introduces additional structuring risk including complexity, regulatory risk and the inability of the Responsible Entity to effectively monitor the underlying investment portfolio.

Leverage risk: The underlying KKR funds to which the Trust is exposed may use financing to manage their lending commitments and ultimately achieve their investment objectives. This may magnify gains and losses on underlying holdings.

Valuation risk: Given the idiosyncratic nature of loans investing coupled with the limited secondary market, valuation risk is considered moderate for the Trust. While KKR has a robust and clearly defined valuation policy, there is a risk that the realisable value of securities may not align with the mark-to-market value carried by KKR.

Liquidity risk: As an over-the-counter 'private market', liquidity can vary significantly through different market conditions. While the listed structure obviates most of the liquidity risk, this can have an effect on market pricing and the mark-to-market of specific assets.

Sub-investment grade credit risk: By its nature and as reflected by its rating, sub-investment grade debt has a higher potential of default. Although investors have historically been compensated, in the form of excess returns, there is the potential for the strategy to experience more defaults than the broader market. Additionally, defaults tend to cluster in certain years and therefore investors should expect periodic episodes of higher defaults. Nevertheless, given the Trust holds a significant proportion of sub-investment grade debt, investors should be aware of the increased risk involved in this allocation.

Relative performance risk: Investors should also acknowledge that the Trust may underperform traditional Bond funds and those benchmarked against domestic or global bond indices in a falling interest rate environment, or in an environment where credit performs poorly relative to Government Bonds.

Utilisation risk: The Trust will invest in loans whose level of draw down may vary over time. Returns to the Trust will vary according to the level of utilisation by borrowers of such revolving credit facilities.

Security/asset selection

The security selection process is based on traditional bottom-up credit analysis with the following section outlining the key steps of KKR's approach.

The first step involves sourcing potential investment opportunities which are identified across a range of channels and networks. KKR's global network of CEO's managing large companies, co-investors, advisory firms and other intermediaries all provide a source of investment ideas. As detailed earlier, investment opportunities can range from companies experiencing short-term liquidity needs, seeking M&A financing and/or industries facing transient challenges.

Each opportunity is supported by deep diligence analysis, with a clear investment thesis identified and formalised in a proposal. While the approach varies based on the nature of the investment (i.e. loan or bond), it typically includes traditional financial statement and pro forma analysis and qualitative research with a focus on understanding a borrower's operating environment.

The analysis includes a comparison with the broader peer group, both in terms of pricing and risk. With respect to qualitative research, some of the key metrics assessed include industry structure, management strategy and governance, corporate structure, capital structure of the firm (i.e. level of subordination and equity support) and the level of operational risk. In terms of durability of earnings, each proposal includes earnings stress tests under a number of downside scenarios.

Prior to investment, all Investment Committee (IC) memos are reviewed and ratified by the U.S. Leveraged Credit Investment Committee, which is responsible for approving and maintaining eligible securities on an approved security list.

In our opinion, the quality and depth of KKR's bottom-up research process is a key competitive advantage, particularly when assessed relative to the nature of the underlying investments (i.e. sub-investment grade or potentially dislocated assets). Further, the role of the committee in reviewing and approving all submissions adds a layer of oversight.

Responsible investment approach

KKR has been a signatory to the United Nations Principles for Responsible Investment (PRI) since 2009.

KKR has an established Responsible Investment Policy (RIP) that was last updated in June 2023. The firm's senior leadership provides ultimate oversight of its responsible investment efforts, while an internal Global Public Affairs team, represents the core of the environmental, social and governance (ESG) related expertise. Where applicable, the IC oversees ESG issues that are material to an investment, both on a pre and post-investment basis.



ESG considerations are not formally assessed, however, where ESG risk has the potential to impact a company's earnings and profitability, this will be considered as part of the due diligence process. When material issues are identified, they will typically be explored and discussed at the IC, with the option of appointing specialist ESG advisors to undertake additional due diligence. In the instance where ESG-related risks have been identified, a detailed remediation plan will be outlined and agreed upon, and remain a standing item for the IC until resolution.

In Zenith's opinion, while ESG is considered as part of the due diligence process, the approach is less invasive relative to the broader peer group.

Portfolio construction

The portfolio construction process involves combining the two underlying investment strategies, while managing the funding and liquidity requirements of each portfolio. The process is overseen by the IC (detailed earlier) which meets on a quarterly basis, to review the underlying performance of each portfolio and address any funding or asset allocation decisions.

The Trust inter-funds into the US-centric GCOF strategy and a European Direct Lending (EDL) portfolio, representing approximately 53% and 47% of the underlying portfolio, respectively (31 December 2023). A leverage facility is in place, to manage cashflows between the two underlying strategies. In practice, the facility is used to manage potential mismatches between GCOF's redemption terms and funding new loans. While the investment exposure can be leveraged on a short-term basis, this is limited to 30% of NAV.

In terms of portfolio composition, the GCOF portfolio comprises 60 to 80 core holdings (including bonds and loans) with position sizes ranging between 1.5% and 4.0%. The final portfolio is managed with a credit spread duration range of between two and five years with a bias to senior secured securities which includes both loans and bonds. Consistent with the targeted opportunity set, KKR typically invests in lower quality credit securities with an indicative credit rating of B and CCC based on S&P's rating methodology.

Zenith notes that this cohort of securities is subject to a high level of mark-to-market volatility and potential default risk, particularly during stressed equity periods or cyclical downturns. Accordingly, investment outcomes will be closely tied to the quality and depth of KKR's bottom-up due diligence process. To this end, Zenith highlights that KKR has consistently outperformed the CCC component of the broader high yield indices, achieving higher returns and at the same time, demonstrating superior capital preservation qualities (i.e. lower default experience).

The EDL portfolio is a portfolio of loans, that continues to evolve in terms of issuer and industry diversification. As at 31 December 2023, the portfolio comprises 36 loans with the largest counterparty exposure representing 5% of the total portfolio.

The Trust's Currency exposure is expected to be hedged back to Australian dollars with the process supported by a proprietary Currency management tool. This system allows KKR to monitor foreign exchange exposures against derivatives and liability-based hedges at the currency, portfolio and asset levels.

Overall, Zenith considers KKR's portfolio construction process to be well structured and consistent with attaining the Trust's investment objective. While there are structural challenges with managing two asset classes with differing liquidity profiles, KKR has a long and proven track record in managing sub-investment grade portfolios and the attendant risk and liquidity profiles.

Risk management

KKR's risk management process is largely an outworking of the firm's application of its credit and investment selection process, which is complemented by issuer and diversification limits (applying to the EDF portfolio).

Zenith highlights that the GCOF portfolio is managed with no formal limits or restrictions, albeit in practical terms, the portfolio is highly diversified across issuers and sectors. In our opinion, this aspect of the process could be enhanced with the inclusion of a range of position, asset class, sector, industry and quality limits.

The process is supported by the Portfolio Monitoring Unit (PMU) which is a separate body within KKR, responsible for monitoring all private credit investments. This team is most active through the post-investment phase with its remit including: monitoring company performance versus KKR assumptions; compliance with covenants; leading the quarterly valuation process and managing a 'Watch List' of underperforming companies. In terms of the latter, this is list of distressed or impaired companies that is subject to more intensive scrutiny and monitoring by the Credit Portfolio Management Committee.

Zenith is supportive of the role of the PMU, highlighting the separation from the investment team. In our opinion, this ensures that underlying investments are monitored with a dedicated focus, and at the same time, minimises the risk of any personal biases or relationships influencing the monitoring process.

The Risk team comprises four Risk Managers with a reporting line to KKR's Market Risk Committee. The team utilises a number of risk management tools and is integrated with the investment team to promote real-time discussions between portfolio managers, analysts and traders. The firm uses a range of external tools including FactSet, Black Mountain, Risk Metrics and Credit QB.

In terms of valuation, the portfolio is valued externally by Lincoln International with each valuation comprised of the following: 50% based on the pricing of comparable bonds (including credit quality, tenor etc) and 50% based on a standardised discounted cash flow (DCF) methodology. The DCF approach is coordinated by Lincoln in consultation with the responsible analyst.

Zenith highlights the quarterly valuation frequency of the EDL portfolio versus the proposed monthly quoting of the Trust's Net Tangible Assets (NTAs) on the ASX. While this creates a potential mismatch between the underlying value of the portfolio versus the NTA, this is common for these strategies where an illiquidity premium is being harvested. Notwithstanding this, Zenith is confident that the quoted NTA will be representative of the most recent valuation of the underlying portfolio.



In terms of external oversight, the Trust is subject to the governance and compliance structures designed by the Responsible Entity (RE) (Perpetual Group). The RE has formulated a monitoring and review process to ensure adherence to service agreements, including minimum standards. The Trust will be externally audited by Deloitte Touche Tohmatsu, including an audit of KKR's adherence to its obligations under its AFS Licence.

In Zenith's opinion, the most significant risk to the Trust pertains to valuation risk of the EDL portfolio, or more specifically the determination of fair value of each underlying loan. While KKR has a clearly defined set of valuation policies, the nature of the underlying asset class means that there is an absence of observable market data, which can make it problematic to accurately value securities. Zenith will continue to monitor this going forward, noting that KKR has a well-documented process, that is subject to external review.

Overall, Zenith believes KKR's risk management framework is robust and consistent with best practice.

Investment fees

	Fund	Sector Average
Total Fees and Costs (RG 97)	Not disclosed	0.89% p.a.
Management Fees and Costs	Not disclosed	0.82% p.a.
Transaction Costs	Not disclosed	0.10% p.a.
Performance fees	Not disclosed	0.00%
Performance fees description	5% of any excess return of the net portfolio return over the RBA Cash Rate plus 4% p.a.	
Management Cost	0.90% p.a.	0.85% p.a.
Buy / Sell spread	N/A	0.16% / 0.17%

All fees and costs are inclusive of GST unless indicated otherwise. The Performance Fee shown is the performance fee disclosed in the PDS. It is calculated by taking the average performance fees charged over the last five financial years (or less if the investment or performance fee mechanism has not been in place for five financial years).

This investment is not required to disclose fees under RG 97.

The sector average is based on the average management fee of all funds within the International Fixed Interest - High Income sector as surveyed by Zenith.

Zenith considers the overall cost structure to be consistent with the specialised nature of the asset class and investment approach.

Zenith highlights that while the performance fee structure includes a number of threshold tests that must be satisfied prior to fees becoming payable (i.e. recouping any previous losses), it will generally apply on the absolute return generated by the Trust (subject to achieving the RBA Cash Rate plus 4% p.a. return hurdle). In our opinion, while the quantum of the performance fee is highly competitive, we would prefer that it was only applied to the excess return component.

(The fees mentioned above are reflective of the flagship version only, fees may differ when the product is accessed through an alternate investment vehicle such as a platform.)

About the fund manager

Organisation

KKR was founded in 1976 by Jerome Kohlberg, Henry Kravis and George Roberts with its origins as a private equity firm. In 2010, the firm listed on the New York Stock Exchange (NYSE) and over time, has expanded its business activities and currently includes a Private, Public and Capital Markets divisions. While each business unit operates autonomously, a range of support functions are shared across the business including: KKR Capstone - a dedicated business unit that works closely with portfolio managers to extract operational efficiencies across portfolio companies; and a Stakeholder Management team, which is responsible for ensuring that all investment transactions are executed and managed in accordance with best practice.

As at 30 September 2023, KKR managed approximately \$US 528 billion, which includes approximately \$US 298 billion across its PE platform. The PE division comprises around 300 investment professionals based in 17 countries.

A key tenet of KKR's value proposition is the level of co-investment with investors, which has exceeded \$US 28 billion (as at 30 September 2023), including both the firm's proprietary investments and capital invested by employees. Zenith is supportive of the level of commitment, which in our opinion, aligns the interests of investors to that of portfolio managers.

KKR currently manages \$US 3.6 billion in the GCOF strategy (as at 31 December 2023). At the same date, the underlying Net Tangible Assets (NTA) of the Trust was \$A 787.3 million.

Investment personnel

Name	Title	Industry Experience (yrs)	Tenure (yrs)	Location
Chris Sheldon	Co-Head of Credit and Markets	26	20	San Francisco, USA
Michael Small	Head of European Direct Lending	28	2	London, UK
Jeremiah Lane	Head of US Leveraged Credit	23	19	San Francisco, USA

KKR's credit platform comprises 190 investment professionals, principally located in San Francisco and London.

In terms of the Trust and its underlying investment strategies, Chris Sheldon, Co-Head of Credit and Markets, is the Lead Portfolio Manager for the GCOF strategy, while Michael Small, Head of European Direct Lending is responsible for the EDL portfolio. Sheldon is based in San Francisco and maintains responsibility for the firm's Leveraged Credit, Private Credit and Strategic Investments Groups. In addition, he is a member of a number of key committees including the US Leveraged Credit and the Global Private Credit Committees. Prior to KKR, Sheldon worked at Wells Fargo as part of the High Yield Group.



In our opinion, his contrarian mindset and ability to understand the intrinsic value of a business is a key contributor to the success of the underlying strategy.

London-based, Small oversees KKR's European Private Corporate Credit platform and is a member of the Global Private Credit Investment Committee and European Direct Lending Investment Committee. Prior to joining KKR in 2021, Small held a number of senior investment roles at Park Square Capital and Dresdner.

Zenith highlights that Small assumed his current role in May 2023 following the departure of the previous Co-Head of KKR's Private Credit platform, Matthieu Boulanger. While Boulanger's departure was disappointing, Small is a highly experienced Direct Lender with an established origination network. Furthermore, KKR's lending platform is well resourced and has multiple governance structures in place, which protect against the impact of any potential key departures.

KKR's investment teams are supported by a well-defined governance structure, with a number of investment committees responsible for both approving investments and monitoring the composition and performance of underlying portfolios. At the highest level, a Credit Portfolio Management Committee is ultimately responsible for the performance of all KKR funds including adherence with investment guidelines and limits. The seven-person committee meets on a weekly basis and comprises of the aforementioned portfolio managers.

At the strategy level, a U.S. Leveraged Credit Investment Committee is responsible for approving and maintaining eligible securities for the GCOF portfolio, while the European Direct Lending Investment Committee, reviews and approves all lending proposals. Zenith is supportive of KKR's investment structure, noting the additional layer of governance from the committee approach. While each committee is effectively a sub-set of senior investment professionals, the centralised decision-making structure ensures that all proposals are rigorously tested prior to investment.

An IC of four senior partners from KKR Credit has been established to oversee the implementation of the Trust's investment strategy and ensure the portfolio is managed in accordance with its stated investment objectives. The IC is comprised of Sheldon and Small, who are supported by Portfolio Managers, Frances Lim and Jeremiah Lane.

In addition to the analyst team, a Portfolio Monitoring Unit (PMU) is responsible for ongoing monitoring of Direct Lending counterparties and providing ongoing assessments of each issuer/borrower. The team leads the quarterly valuation process and monitors company performance versus KKR assumptions, which includes covenant compliance. In our opinion, the PMU introduces an important layer of separation between the research team and the portfolio monitoring/valuation process, which is important given the nature of the underlying assets (e.g. potentially illiquid) and the level of subjective inputs in the valuation process.

KKR's remuneration structure is based on a global approach where firm-wide profitability is used as the basis for all incentive payments. Senior members of the investment team receive an industry-benchmarked salary and are also eligible for a cash bonus and equity. The cash bonus/equity component is largely discretionary and reflects a combination of firm and business

unit performance, individual contribution and the performance of underlying funds managed.

To retain staff over the long-term, bonus payments are vested over multiple years and also include a portion that invests in underlying KKR funds under a system internally referred to as 'Dollars at Work'. In simple terms, the 'Dollars at Work' structure means that the economic return derived from the KKR investments changes over time, in line with each employees' overall contribution to performance. In our opinion, the approach embeds a strong co-alignment of interest, ensuring investment performance and remuneration are closely tied.

In sum, Zenith is supportive of the resourcing structure, effectively combining specialist bottom-up investors with a strong governance framework and a range of ancillary support functions.

About the sector

Sector characteristics

The Zenith 'International Fixed Interest – High Income' sub-sector consists of all funds that invest predominantly in the higher-yielding sectors of the Global Fixed Interest market. These sectors typically include High Yield, Securitised Loans and Emerging Market Debt. The category includes funds that invest in specific underlying markets or a combination of each. Given the idiosyncratic nature of the sectors, managers commonly add value through security selection and/or sector rotation.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Bank Bill Index. However, Zenith only uses this benchmark as a common reference point and it may not be reflective of the underlying benchmark used by many managers in this category.

It should be noted that the Bloomberg AusBond Bank Bill Index is typically used as a benchmark to measure the investment performance of a passively managed Short-Term Cash portfolio. The Index has an average term to maturity of approximately 45 days. It comprises 13 domestic bank bills of equal face value, each with a maturity seven days apart.

Given the funds in the 'International Fixed Interest – High Income' sector invest in longer dated, higher default risk securities, they will potentially display higher downside volatility relative to the Zenith assigned Index (i.e. while the Index is used as a performance benchmark, it should not be used as an indication of the risk involved in investing in the sector).

Sector risks

Funds within the 'International Fixed Interest – High Income' sub-sector are exposed to the following broad risks:

Market risk: Changes in economic, technological, environmental or political conditions and market sentiment may lead to a decline in general security prices and overall market volatility. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

Interest rate risk: Fixed Interest securities are generally sensitive to changes in interest rates. An increase in interest rates may result in a fall in the value of these securities, while a decrease in interest rates can result in an increase in value.



Credit spread risk: In addition to being sensitive to general interest rate changes, non-government securities are also sensitive to changes in credit spreads (commonly the difference in yield between a Government Bond and a Corporate Bond). A widening of spreads results in a fall in the value of these securities.

Default risk: Given Fixed Interest securities represent loans to borrowers (including governments, banks and companies) there is a risk that these borrowers may default on interest or principal repayments. Default risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

Currency risk: In addition to being exposed to general market risk, investments in international markets are exposed to changes in the value of the Australian Dollar relative to other foreign currencies. This may lead to increased volatility, independent of market moves. While Fixed Interest funds typically hedge their foreign investments back into Australian Dollars, there can be no guarantee that the funds will be hedged at all times or that a manager will be successful in employing the hedge.

Liquidity risk: Fixed Interest markets can experience periods of illiquidity, which can result in difficulties in buying or selling securities without adversely impacting the price.

Derivative risk: Derivatives are commonly employed by Fixed Interest managers to hedge Currency and other risks and/or as an alternative to direct purchases or sales of underlying assets. There are multiple risks associated with the use of derivatives; for example, the value of the derivative may not move in line with the underlying asset, counterparties to the derivative may not be able to meet payment obligations or a particular derivative may be difficult or costly to trade.

Leverage risk: Many derivatives have a leverage component. While leverage offers the opportunity to magnify gains, it may additionally magnify losses. An associated risk with leverage and magnification of gains/losses is that the portfolio's volatility may increase as a result. Investors need to be cognisant that the Fund may exhibit more volatility than one that is unlevered.

Zenith rating

Report certification

Date of issue: 07 Mar 2024

Role	Analyst	Title
Analyst	Rodney Sebire	Head of Alternatives & Global Fixed Interest
Sector Lead	Rodney Sebire	Head of Alternatives & Global Fixed Interest
Authoriser	Bronwen Moncrieff	Head of Research

Association & relationship

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Rating history

As At	Rating
07 Mar 2024	Recommended
09 Mar 2023	Recommended
02 Mar 2022	Recommended
02 Jun 2020	Recommended
30 Sep 2019	Recommended

Last 5 years only displayed. Longer histories available on request.

In March 2021, Zenith implemented a new ratings methodology for products classified as Traditional Index. Any rating issued from this date forward for Traditional Index products only reflect this change in methodology, with the relevant Traditional Index ratings being Index Approved, Index Recommended and Index Highly Recommended. Ratings issued for Traditional Index products prior to March 2021 are retained for historical purposes in line with our regulatory requirements and were issued in line with Zenith's Fund Research Methodology. Further information in relation to Zenith's Traditional Index Research Methodology and Traditional Index Ratings can be found on the Zenith website.



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