VICTORY PARK

CAPITAL

VPC Specialty Lending Investments PLC
Annual Letter – Fourth Quarter 2019

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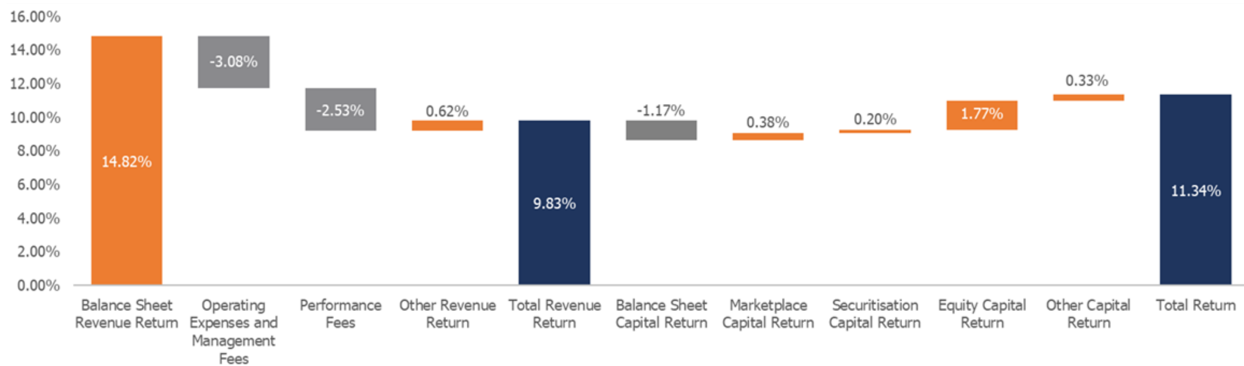
Year in Review

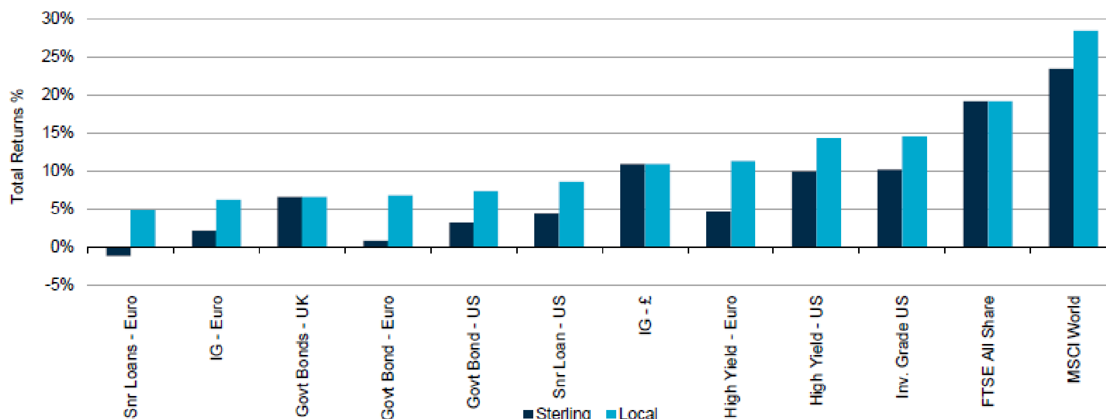
VPC Specialty Lending Investments PLC ("VSL" or the "Company") completed the year with a total NAV return of 11.34% and a total net revenue return of 9.83%, both representing full year return records for the Company. The strong revenue returns were driven by positive performance of our balance sheet investments as our portfolio companies performed in line with underwriting. Capital returns included a mix of strong equity performance offset by foreign exchange hedging costs and some additional reserves.

1 January 2019 to 31 December 2019 Revenue, Capital and Total Return Profile



Overall, we are pleased with the Company's performance and are cautiously optimistic about the coming year. As seen in the table below, the Company's 2019 returns continue to compare favourably to other fixed income. The recent market volatility related to the COVID-19 outbreak (discussed further below) has impacted our public equity exposure which will have relatively minor capital impacts in the near term. However, the majority of our investments are structured with LIBOR floors, which somewhat insulates the portfolio against declining interest rates. In addition, we expect our currency hedging costs to come down in the coming months.

Returns by Debt Asset Class in 2019[1]



[1] Source: Debt Investment Companies, Recommendations Update & 2020 Outlook (Numis – February 2020)

Top 10 Positions

Below is a summary of the top 10 positions, excluding equity exposure, held by the Company as at 31 December 2019.[2]

Investment	Country	% of NAV	Gearing
Applied Data Finance, LLC	United States	15.56%	NO
Elevate Credit, Inc.	United States	14.97%	YES
Caribbean Financial Group Holdings, L.P.	Caribbean	12.33%	NO
West Creek Financial LLC	United States	6.49%	NO
Konfio Ltd.	Mexico	4.77%	NO
ATA-KS Holdings, LLC	United States	4.36%	NO
Counsel Financial Holdings LLC	United States	3.87%	NO
NCP Holdings, LP	United States	3.37%	NO
Oakam Ltd.	United Kingdom	3.08%	NO
Deinde Group, LLC	United States	2.91%	NO

The movement in the top 10 positions relates to the continued growth and scale of our most successful investments. This is particularly true for our largest position, Applied Data Finance, LLC ("ADF"). Like other investments in the portfolio, ADF grew to scale in 2019 after several years of building and testing its credit models. This dynamic depicts the natural evolution of our business model. Specifically, we want our "winners" to grow, ultimately providing us with the opportunity to invest more capital in the portfolio companies that have demonstrated strong performance over a number of years. Our view on concentration at the investment level is slightly different from a typical credit fund, since we receive a natural diversification from the thousands of underlying loans serving as collateral in each investment. As a result, we actively balance allocating capital to new investments which diversifies risk and maximises total returns with allocating capital to existing investments. We look forward to growing our current relationships over the next several years while continuing to source new transactions.

Competitive Advantage

The hunt for yield is extremely competitive in an environment of low interest rates. This means that we compete with some of the largest and most recognised firms in the world when sourcing new investments. However, we believe that we have created a sustainable competitive advantage in our investment strategy, having invested and committed over $7.0 billion across more than 50 financial services investments. With more than a decade of experience lending in this sector, we benefit from sourcing relationships, pattern recognition and an intense focus on process. The Company's performance for 2019 reflects less of a standalone event, but rather the accumulated results of VPC's decade-plus track record of investing in asset-backed, balance sheet investments. Our investment approach has consistently paid off, as we have been successful in backing earlier-stage companies with excellent management and marquee venture capital backing, allowing for locked-up terms that would otherwise be difficult to negotiate at a later stage. Not only does this provide better economics, but VPC can also structure its investments more conservatively than we might be able to negotiate in a more competitive process. VPC benefits from working with companies as they scale under a conservative structure. As investments approach maturity several years later, VPC has an informed opinion to approach an extension and/or upsize negotiations. We believe that the Company's investment performance in 2019 is a reflection of the successful execution of its investment approach over the past decade.

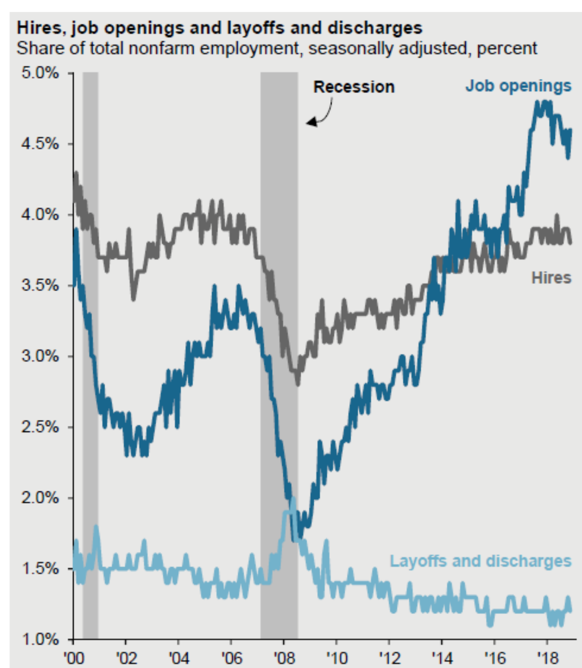
[2] The summary includes a look-through of the Company's investment in VPC Offshore Unleveraged Private Debt Fund Feeder, L.P.

Since the Company invests alongside VPC's private funds into the underlying balance sheet investments, many of the portfolio's investments precede the listing of the Company in 2015 and have grown significantly over time. The Company, alongside VPC's private funds, also receives the benefit of scale from the arrangement. We are in a position to negotiate better terms and grow with the portfolio companies, ultimately resulting in the ability to provide larger facilities. All investors benefit, as we continue to have significant undrawn investment opportunities from longstanding investments, some of which were initiated a decade ago. The scale of the relationships also serves to minimise the cash drag within the Company. Investments are funded based on draw requests received on a weekly basis. As the Company receives a repayment on an investment, capital can be redeployed quickly, and in some cases even the same day.

Macro Update

Over the last six weeks, the market has seen a rapid reversal of consumer sentiment as COVID-19 has continued to spread globally. While the market has reacted sharply and governments have worked to contain the spread, the economic effects in the coming months are highly uncertain. We remain cautious as the situation develops and have instructed our portfolio companies to do the same.

Business Sentiment and Economic Cycles[4]



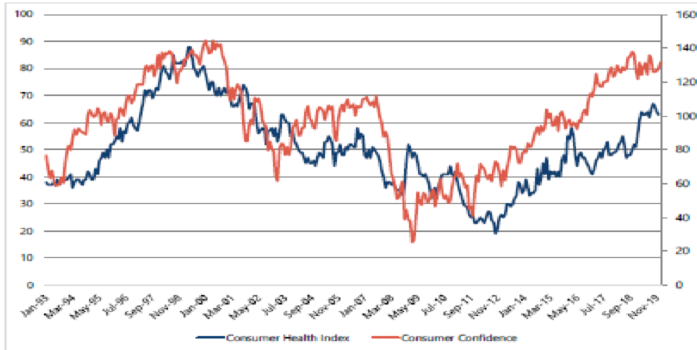
Prior to the recent market events, the business sentiment in the US has continued to build on a decade of strength as the unemployment rate reached new lows, while (and, arguably, more importantly) the participation rate has also begun to increase steadily. This is reflected in our proprietary data (with access to real-time data on our portfolio company loan pools) and broader macro statistics. Despite this, job openings remain at elevated levels relative to new hires and layoffs (as shown to the right), indicating there is possibly more room to run for the employment gains, either through new jobs and/or further wage growth. The economists at one of our brokers, Jefferies, also see reasons to be optimistic about continued consumer resilience. Jefferies produces a proprietary consumer health index based on an aggregate of data points they gather from macro and retail data. Recent readings from the index, show both high absolute readings and historical correlations with gains in consumer confidence and consumer-discretionary stocks[3]. The report by Jefferies was released 12 February 2020, prior to the recent market disruptions that are disclosed in the Conclusion & Forward Thoughts section.

[3] Source: Jefferies Consumer Health Index: Smells Like Burning Plastic (Jefferies – February 2020)

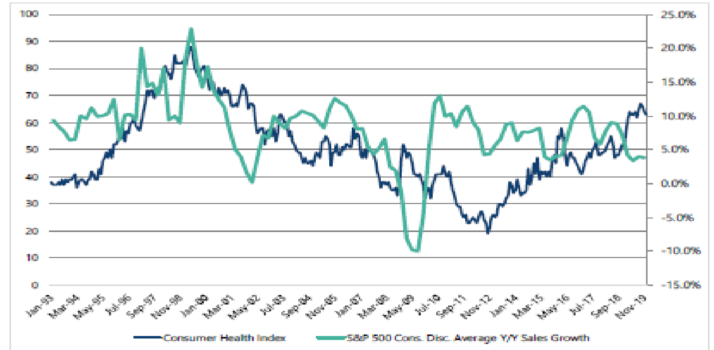
[4] Source: Market Insights - Guide to the Markets (J.P. Morgan Asset Management – January 2020)

Jefferies Consumer Health Index ("CHI") Demonstrated Historical Relationships[5]

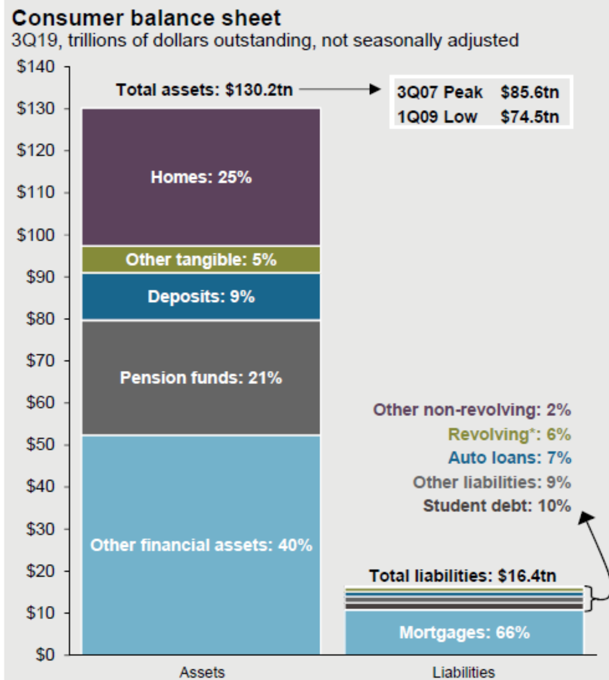
The CHI (3Mo Lag) Has a .71 Correlation to Consumer Confidence[5]

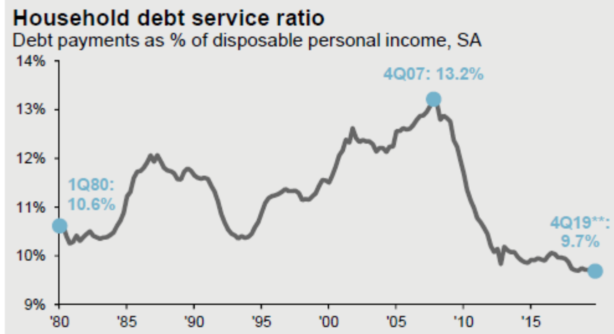


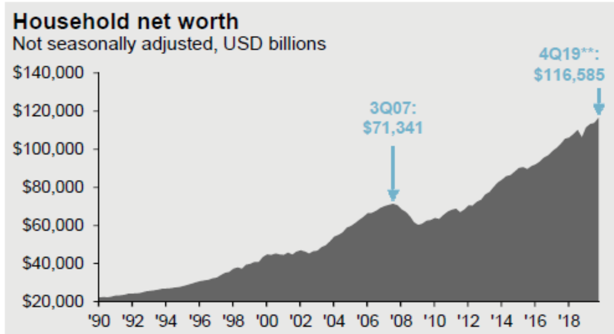
The CHI also Corresponds with (Generally Leads) SPX Consumer Disc. Sales Growth[5]



Consumer Finances[6]







The outlook is also positive from a consumer balance sheet perspective, specifically on the back of historically low interest rates coupled with strong gains across almost all asset classes. While absolute levels of consumer debt are high on a historical basis, they are offset by record levels of consumer assets. Due to low interest rates, debt service levels for consumers have reached historic lows. In our experience when underwriting an individual loan, the debt-to-income ratio, or the ability to service debt from income, is one of the strongest predictors of repayment ability. When applied to the macro level, it provides us with reason to be optimistic about loan performance in the coming months, and hopefully years. The above data also does not reflect what is sure to be a large wave of mortgage refinancing which will almost certainly be coming during the rest of 2020.

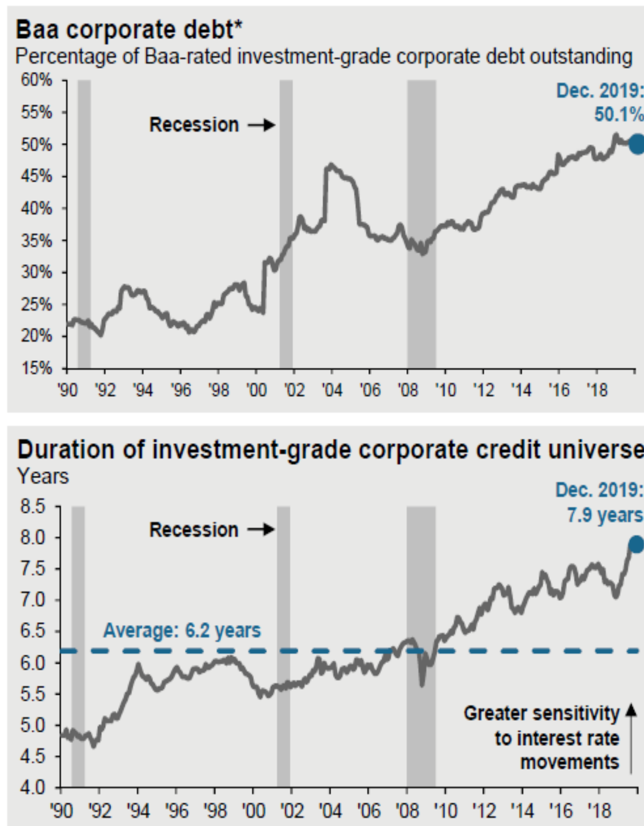
[5] Source: Jefferies Consumer Health Index: Smells Like Burning Plastic (Jefferies – February 2020)

[6] Source: Market Insights - Guide to the Markets (J.P. Morgan Asset Management – January 2020)

Duration Risk

We exercise caution on the macro front, structuring our portfolios with the goal to perform in any economic environment. We structure and underwrite our investments with a focus on downside protection in addition to stress-testing our loan pools across various scenarios. From a purely macroeconomic standpoint, we continue to believe that our current portfolio's main advantages are that it has floating rate, short duration and fully amortising underlying collateral. Specifically, the weighted average duration of VPC's underlying collateral as of year-end was less than one year. We believe that duration is a misunderstood risk, which has been added to fixed income portfolios in recent years as interest rates have come down and borrowers have looked to lock in long duration fixed rate credit. In the extremely competitive credit markets over the past few years, the borrowers have inevitably succeeded, and as a result, investors are largely exposed to long duration covenant-lite loans and bonds. From a credit ratings perspective, this can be demonstrated by the continual degradation of quality of investment grade bonds. For the first time, the lowest rating level needed to achieve an investment grade rating from Moody's (Baa) makes up a ***majority*** of corporate debt outstanding.[7]

Corporate Debt[7]



While covenants have weakened, and credit ratings have come down, duration has continued to push further out. The combination of lower interest rates and longer maturities has corporate borrowers extending their maturities to take advantage. As a result, the weighted average duration in the investment grade corporate universe reached an all-time high of 7.9 years in December 2019, a full 27.0% above the average for the past 30 years. The two main drivers of risk in fixed income returns are: 1) credit risk; and 2) duration risk. Using the corporate debt charts above as a proxy, it shows the broader credit markets continue to be a risky place to invest. Investing, by definition, means you cannot completely avoid risk, but we feel the advantages of our model include the active management of risk at both the micro (process, diligence, monitoring, control) and macro (floating rate, short duration) levels.

Conclusion & Forward Thoughts

In summary, we are pleased with the Company's record total NAV return for 2019 and our focus remains on delivering similar performance in the coming years. We continue to enhance our investment process and maintain strong relationships with existing portfolio companies, while actively sourcing new opportunities that fit our investment criteria.

Separately, given the current state of the market, we believe it is important to address COVID-19 and its current and future impacts on the global economy. It has become clear that the risks are real and have the potential to

[7] Source: Market Insights - Guide to the Markets (J.P. Morgan Asset Management – January 2020)

be severe. While VPC cannot predict what the ultimate impact will be, we are focused on assessing the risks to our business and portfolio companies. We are working with our portfolio company management teams to mitigate risk where possible and develop and implement contingency planning, in addition to taking appropriate steps to minimise disruption and financial deterioration, if needed. While it is still early, to date, we have not seen any portfolio deterioration related to the outbreak (other than the relatively minor impact on our public equity exposure) and credit remains stable with no indicators of impairment at the corporate or collateral levels. Corporate liquidity remains strong, while delinquency and default rates on underlying collateral remain stable and consistent with seasonal averages.

The direct market and societal impacts of COVID-19 are highly uncertain, but all businesses should be prepared to handle the possibility of widespread health issues among employees and/or customers, as well as the possibility of quarantines or other disruptions in day-to-day life and travel. We have begun to see the indirect impacts, which will most likely continue to affect the markets, supply chains and other aspects of the global economy for the foreseeable future. Regardless of the severity of the health crisis, the market seemed due for a pause and this was just the catalyst to shift sentiment.

The Company's current investment exposure is predominantly in the US. We have not yet seen how this situation will ultimately impact our portfolio; however, we understand that events of this scale create both opportunities and threats across the credit market. While the stock market has reacted with renewed volatility and fear, there will be sectors that may benefit as a result of the circumstances. VPC has always focused on protecting our downside when underwriting and structuring our investments. While we may not be completely immune to what could be short or long-term macroeconomic impacts from this crisis, we believe we are well positioned to withstand significant stress in our underlying credits. On a positive note, some market dislocation is likely to provide incremental pricing power, as we have seen in previous times of volatility.

While we hope for the best, we must be prepared for the worst. As such, we will continue to monitor the portfolio very closely and proactively work with our portfolio companies to manage the situation as it unfolds. Specifically, VPC monitors its portfolio's underlying collateral for changes in loan origination volume and composition, to analyse any movements in the collateral's underlying credit profile. VPC also monitors cash collection and delinquency and loss data to identify early signs of changing payment (or non-payment) behaviour. In addition, we continue to coordinate with our portfolio companies to ensure they are equipped to manage the possibility of employee illness/dislocation, react to any impact to borrowers and manage any resulting liquidity needs in the short term.

For VPC, risk management entails being proactive in managing issues as they arise, but also being prudent in those responses. We will have a better understanding of the initial impacts, if any, on the portfolio as we receive additional data from our companies. In the meantime, please feel free to reach out to us if you have any questions.

Kind Regards,
The VPC Team
11 March 2020

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Important Information

All data in this quarterly letter (the "report") is at or to the final day of the calendar month identified in the heading of the report's front page unless otherwise stated.

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