FINANCING THE ECONOMY 2016

The role of alternative asset managers in the non-bank lending environment

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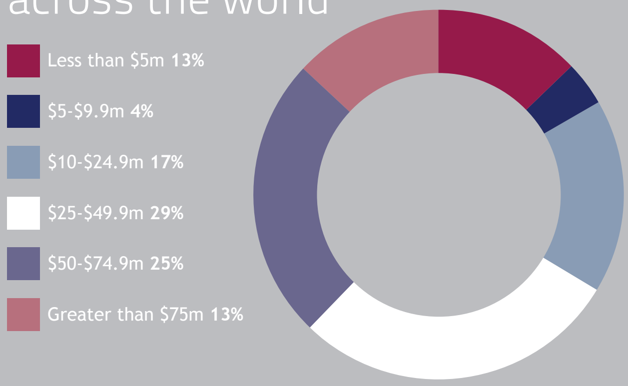
Deloitte.

ALTERNATIVE CREDIT COUNCIL

LENDING FOR GROWTH

At a glance: Private credit funds

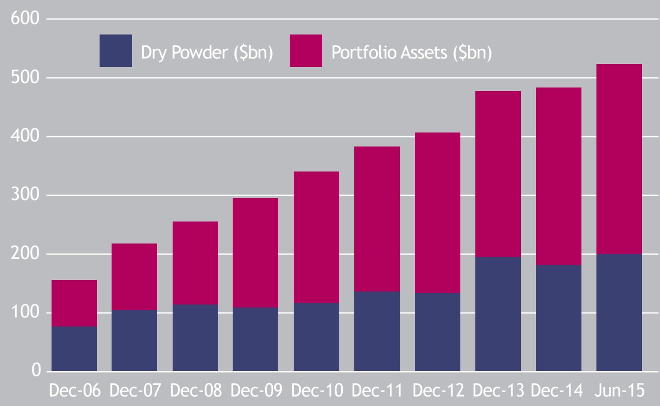
Alternative lenders support medium-sized businesses across the world



Average size of borrowers (EBITDA)

Source: AIMA Research

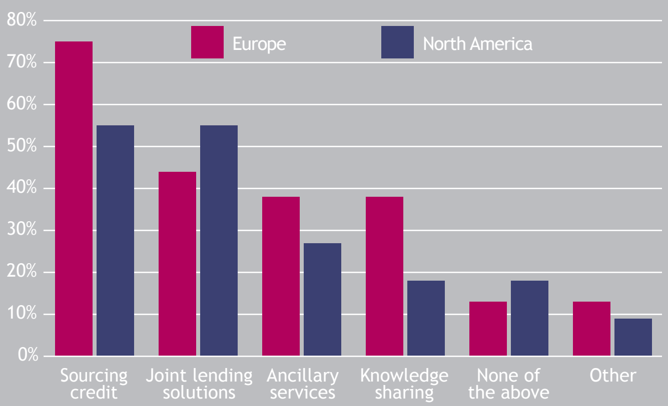
Industry continues to expand



Private credit industry assets under management

Source: 2016 Preqin Global Private Debt Report

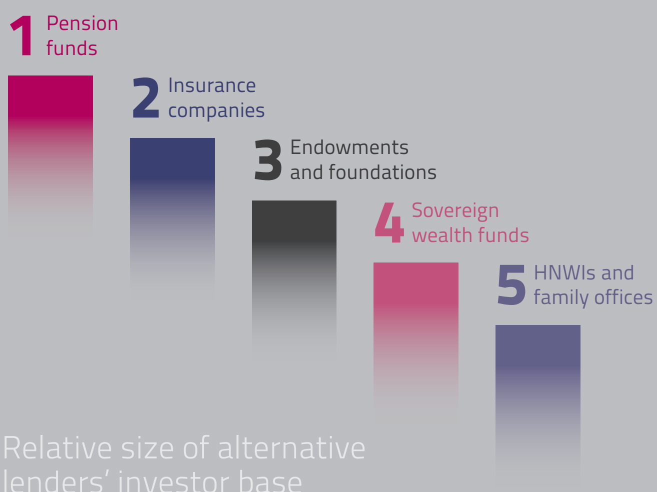
European alternative lenders use banks more often on sourcing of credit



How alternative lenders collaborate with banks

Source: AIMA Research

Institutional investors provide the lion's share of capital



Relative size of alternative lenders' investor base

Source: AIMA Research

Assets under management of private credit funds

$372bn North America

$141bn Europe

$48bn Asia & Rest of World

Source: Preqin

Capital raised by private credit funds in 2015 by region

$46bn North America

$30bn Europe

$6bn Asia & Rest of World

Source: 2016 Preqin Global Private Debt Report

Introduction

Last year the Alternative Credit Council and Deloitte published "Financing the Economy", a paper that provided an introduction to the quiet revolution taking place in the way finance is secured. With additional regulatory pressure on their balance sheets, the report concluded that banks were withdrawing from many businesses and alternative lenders stepped up to fill the financing gap. This year, the reach of our participants has been extended to a more global perspective and focused on the value alternative lenders deliver to borrowers and investors.

While the US continues to dominate in terms of size and activity, Europe has made great strides in opening up to direct lending. For example, it is now possible for funds to lend in both Germany and Italy, with France and many others soon to follow suit. After the UK voted to leave the EU, the European Commission President Jean-Claude Juncker stated that Mr Dombrovskis, the new European Commissioner for Financial Stability, would ensure continuity of the Capital Markets Union initiative. Both AIMA and the Alternative Credit Council will engage with UK and EU authorities to ensure that the transition does not disrupt the development of deeper and more diverse capital markets in Europe at large.

The benefits of alternative finance are clear. Not only are their businesses streamlined and specialised enough to move quickly on behalf of borrowers, they also do so in a way that is beneficial for overall financial stability. The new data shows that levels of fund leverage continue to be negligible and the closed-end structure of the funds means that borrowers will have access to a stable source of long-term finance. This is because investors cannot ask for the return of their monies until the underlying investments have run their course.

Alternative lenders operate in a highly regulated and sophisticated industry where investors ultimately bear the risk of their decisions. They retain hold of the assets they generate and manage. Further, they owe fiduciary duty to their investors resulting in a greater alignment of interests where they are remunerated when they both succeed.

Nonetheless, they continue to be impacted by a range of restrictions leaving them to operate in a more challenging environment. The role of capital markets should be to provide risk capital to the economy. Removing structural barriers over the ability to originate loans outside the banking system will increase diversity of credit markets and enable alternative lenders to provide better outcomes for consumers and the wider real economy.

Floris Hovingh, Head of Alternative Capital Solutions, Deloitte

Stuart Fiertz, Chairman Alternative Credit Council and President Cheyne Capital

Paper's key findings

Alternative lenders are continuing to finance the growth of the economy

Borrowers normally use the funds for the purpose of expansion, supporting a wide range of economic activity. A typical borrower is a mid-market company or real estate developer who make up a large proportion of the workforce in most major economies.

Alternative lenders provide a number of advantages over traditional sources of finance

More flexible terms, such as bespoke repayment schedules and operational covenants, sophisticated deal structures that would be difficult to execute in a banking business, the ability to act with speed and rigour and the long-term partnership offered by the lender are commonly cited advantages of seeking alternative sources of finance. Negligible leverage and closed-end funds also mean that the lending is provided in a manner that is less likely to generate financial stability concerns.

Alternative lenders and banks often compete but also cooperate in many areas of business

Alternative lenders have close ties with traditional banks and many have formed partnerships with one another. Banks are a useful source of credit opportunities for alternative lenders and the latter are able to hold certain investments on their balance sheets that are restrictive for banks. Furthermore, some borrowers actively seek partnerships with both alternative lenders and banks due to the additional expertise and findings they can bring.

Europe catching up with US market for private credit

Currently, European countries are providing the most interesting opportunities to alternative lenders. The US is the largest provider of capital into private credit firms and many of these investors see it as an opportunity to gain exposure to diversifying European investments.

Alternative lenders are providers of long-term capital

Some of the world's largest pension funds and insurance companies are providing capital for private credit firms. Furthermore, they are comfortable with the closed-end, long-term nature of the funds, typically around 8 years.

Private credit explained

What is private credit?

Private credit is credit that is extended to companies or projects on a bilaterally negotiated basis, it is not publicly traded such as many corporate bonds and is originated or held by lenders other than banks. It takes various legal forms including loans, bonds, notes or private securitisation issues. Private credit encompasses various strategies including real estate debt, distressed debt, direct lending, mezzanine financing and structured financing.

What is driving growth in the private credit market?

The main driver of this growth has been twofold. Firstly, the retrenchment of banks from some lending markets following their failure and rescue by governments in the major world economies. Secondly, alternative lenders who provide private credit have now developed sophisticated, streamlined processes tailored to the lending market. They have been able to offer an alternative to traditional lending that is highly flexible, able to be structured in a complex manner and comparatively fast-paced. Furthermore, investors have also been attracted to the strategy as a means of increasing yield from their fixed income allocations.

Where and for what purpose is financing being extended?

Among the most popular borrowers of private credit are mid-market companies or real estate developers. Typically, they are too small to raise financing through the public corporate bond market and have also been negatively affected by the ongoing stresses in the banking world. Borrowers are using the loans for a variety of purposes – all of which are vital in their respective developments. Pursuing acquisition and expansion plans, improving working capital and refinancing are all common uses of this finance.

Who are the alternative lenders?

A large number of private credit firms are made up of industry professionals with banking, private equity, hedge fund and traditional asset management career backgrounds. Their expertise and knowledge of local capital markets has led them to develop businesses tailored to providing finance to the economy. Some have a real estate focus, others are sector specific while some focus only on markets and transactions of specific sizes.

Case studies*

Chenavari loan vehicles supported manufacturer of energy efficient buildings through the crisis

A niche aluminium profile manufacturer based in Belgium, whose products drive energy efficiency of building was financed by Chenavari. Through the use of CLO financing, the business was able to survive the Global Financial Crisis and has since recovered with current organic growth around 7%. Employing 1,600 staff across Belgium, France, Poland and the UK, Corialis Group export to over 20 countries.

Cheyne Capital finances real estate initiative

Cheyne Capital provided an investment loan of £22.35 million to the Fusion Group for the conversion of a 15-storey office building in Bristol known as Froomsgate House into student housing. The funds helped Fusion Group finance the acquisition and will finance the planned development of the property into student accommodation with at least 438 beds. The development will benefit the students of Bristol, where the rent per bed is one of the highest in the UK.

CVC loan vehicles support French real estate growth

Foncia, a French real-estate services company who employs 6,400 people was provided CLO financing by CVC Credit Partners. The company manages leasing and joint property contracts for more than 1.5 million dwellings and is the market leader in a highly fragmented industry. The financing supported potential further growth for the company.

Tikehau invests in French real estate

Tikehau Investment Management was the sole arranger on a €28 million bond issue for a French real estate company. French banks Societe Generale, BNP Paribas and SocFim provided an additional €12 million to pay off the company's senior debt and the company builds around 1,400 properties every year.

KKR invests in UK packaging company

KKR has invested €100 million into UK packaging company Petainer UK Holdings. The investment will be used to assist in the refinancing of the company's capital structure and to grow. Petainer provides sustainable packaging for consumer goods such as alcoholic beverages, soft drinks, water and sauces.

*Case studies were either provided directly by participating alternative lenders or from Private Debt Investor.

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