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, there is strong demand from borrowers following the retrenchment of banks from some lending markets. 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. From an investor perspective, performance across the private credit sector has shown strong yield relative to many other asset classes.

Where and for what purpose is financing being extended?

Among the most popular borrowers of private credit are SME and midmarket companies. 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 operations 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

KKR provide a loan to grow a manufacturer of automobile parts

KKR Credit provided a €175 million loan to Chassis Brakes International Group, one of the world's largest manufacturers of automotive foundation brakes and foundation brake components. Chassis Brakes International employs 5,200 people in 16 countries at 13 manufacturing sites and 11 engineering centres or sales offices in Europe, Asia, South Africa, and North and South America. This debt facility provides a long-term sustainable capital structure to the company, allowing it to pursue organic and strategic growth initiatives.

Cheyne Capital finances affordable residential housing development

Cheyne provided a £37.5 million senior development loan to complete the build of a mid-market residential project in East London. The development is for 152 apartments, of which 32 are social rented and 120 are for private sale. The site is 300 metres from DLR and Overground rail stations and will be next to a new Crossrail terminus which will provide transport to Central London in 20 minutes and to Canary Wharf in 8 minutes.

Pemberton provides acquisition financing facilities for UK pork producer

Pemberton provided the total term debt supporting CapVest's acquisition of Karro Food Group, a leading British pork producer with annual turnover of over £500 million and a high reputation for animal welfare standards and high quality pork produce. Headquartered in Malton, North Yorkshire, Karro employs around 3,100 people across the UK and has divisions in England, Scotland, Northern Ireland and Ireland.

Ares Capital Corporation finances the acquisition of Cozzini Bros

Ares Capital Corporation served as administrative agent and sole lender for the senior secured credit facility to support the acquisition of Cozzini Bros by Birch Hill Equity Partners. Cozzini Bros is a leading provider of subscription-based commercial knife and cutlery sharpening services and related products to customers ranging from local restaurants to large national chains and nationwide kitchen services organisations.

About ACC

The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents over 80 members that manage $300bn of private credit assets. The ACC is an affiliate of the Alternative Investment Management Association (AIMA). ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. To find out more, visit www.lendingforgrowth.org.

About Dechert

Dechert is a global law firm with more than 900 lawyers in 28 offices. Over 200 lawyers are dedicated to funds and financial services and 250 focus on finance matters. The firm has expertise across all major asset classes, fund domiciles and structures and provides expertise at every stage of the investment life cycle. Dechert is one of the most active law firms in the sphere of debt fund formation, representing a range of debt fund sponsors from large platforms to boutique and emerging managers. The firm's internationally recognised finance practice provides complex financings and deal structuring.

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Financing the Economy 2017

The role of private credit managers in supporting economic growth

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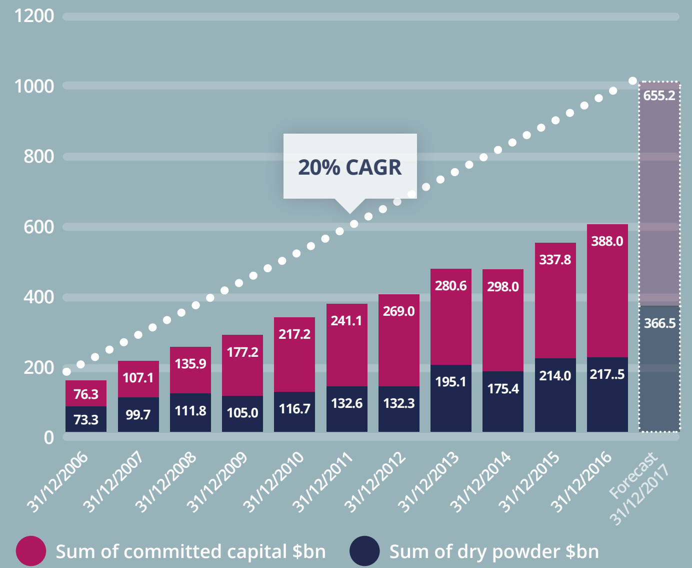
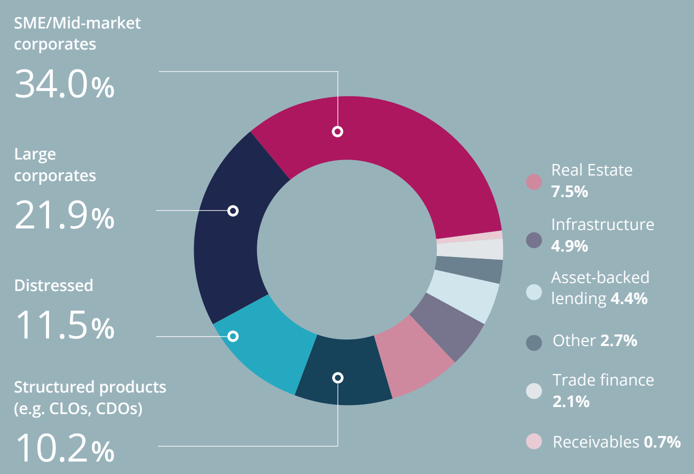
Private credit at a glance

Industry AUM and breakdown of committed capital and dry powder - Preqin FY 2016



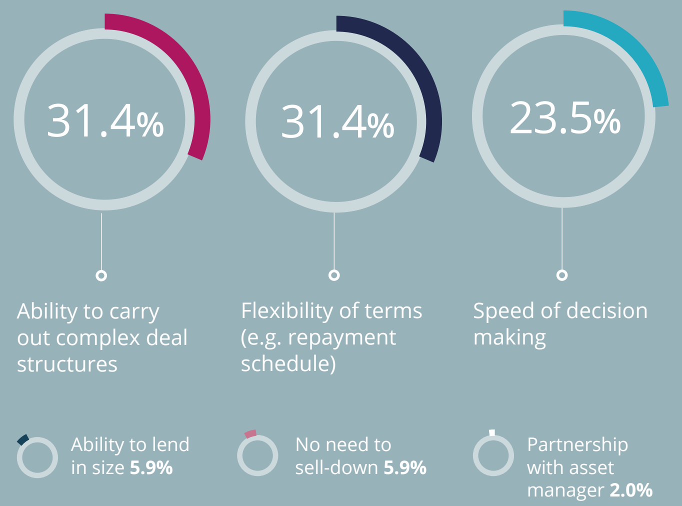
Source: Preqin, ACC research

Percentage of global industry committed capital assigned to individual private credit markets



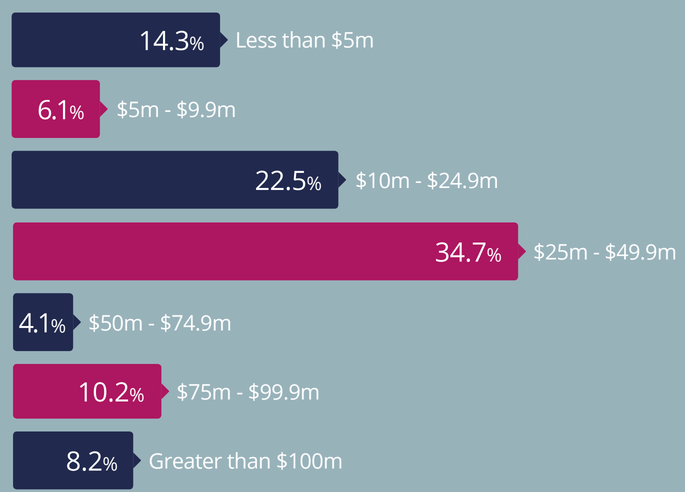
Source: ACC research

What do you believe target companies value most about private credit?



Source: ACC research

What is the average size of the borrowers by EBITDA?



Source: ACC research

Private credit committed capital by region

$249.5bn North America	$104.5bn Europe	$26.1bn APAC

Source: Preqin

Private credit dry powder by region

$141.9bn North America	$62.2bn Europe	$11bn APAC

Source: Preqin

Introduction

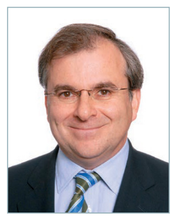
This year's *Financing the Economy* research comes as the private credit industry reaches an important inflection point. Whilst previous editions focused on how the industry–already prominent in the US–was establishing itself around the world as a credible alternative to traditional sources of finance, the past 12 months have seen it cement its place in the global lending landscape.

Our research indicates that the private credit industry could pass the symbolic $1 trillion in assets under management (AUM) milestone by 2020. This growth underscores the increasing influence private credit is having on financing the economy at large.

Having gained momentum from the 2007-8 financial crisis, the private credit industry is now lending to businesses at record levels, creating jobs and supporting economic growth around the world. This has allowed more borrowers than ever to finance their businesses using private credit. The industry continues to provide flexible and attractive finance to businesses.

The flexibility shown by many private credit managers is matched by their focus on lending standards and commitment to robust risk analysis. The preference of private credit managers for senior secured positions within the capital structure means that they are well placed to protect the interests of their investors. Participants in our research also affirmed their commitment to identifying and working with creditworthy borrowers.

From an investor perspective, performance across the private credit sector continues to show strong yield relative to many other asset classes. Heading into 2018, the momentum in the development of the private credit industry shows no sign of slowing. As the value of this form of funding becomes better understood by policymakers, we are seeing the introduction of supportive legal and regulatory reforms. With private credit offerings emerging in new regions, the industry is now truly global.



Stuart Fiertz
Chairman, Alternative Credit Council and President Cheyne Capital

Stuart Martin
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Key findings

Industry growth: The private credit industry is on track to reach around $1 trillion in assets under management (AUM) by 2020, according to ACC and Preqin data. The historic compound annual growth rate of 20% has seen the industry increase in size 14-fold since 2000, reaching over $600 billion AUM by the end of 2016.

Global market: Private credit activity in the US remains strong, and the popularity of the US market is also helping to fuel interest in private credit globally. Our survey indicates that Germany, the UK, the US, France and Canada will offer the biggest opportunities, with Germany scoring most strongly.

Lending to companies of all sizes: Around a third of private credit capital is providing finance to SMEs and mid-market firms. Large businesses receive around a fifth of all lending and this share is increasing.

Borrower satisfaction: Flexibility of terms, speed of decision making by fund managers, and an ability to finance complex deals are regarded as the key attractions of private credit by borrowers.

Expansion of deal origination networks: Managers are diversifying the ways they source potential credit opportunities. One-third source potential opportunities through the relationships they have established within their given industry. Managers also source deals through banks, private equity managers and other industry advisors.

Long-term investment: Nearly two-thirds of managers say their preferred target term for investments is now between two and six years, while almost a quarter have a target term of six years or greater (up from only 8% in 2015).

Fund manager discipline: Creditworthiness and sourcing viable opportunities remain the most resource intensive activity for 85% of private credit managers. Levels of leverage remain low across the sector, with nearly half (44%) of all managers using no leverage at all.

Fund structures to support lending activity: Almost 70% of all participants have closed-end funds, with 52% being closed-end with fixed maturities. For the roughly 30% of managers with open-ended funds, lock-ups or other liquidity management tools restrict or prohibit fund withdrawals under certain circumstances.

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