

FINANCING THE ECONOMY 2020

The role of private credit managers in supporting economic growth

ALTERNATIVE
CREDIT COUNCIL

LENDING
FOR GROWTH

“Private credit managers will have provided SMEs and mid-market business with over \$100bn of fresh finance during 2020.”



Contents

| | |
|--|----|
| Foreword | 4 |
| Executive summary | 5 |
| Research methodology | 6 |
| Chapter 1 – The outlook for private credit | 9 |
| Chapter 2 – Lending after the pandemic | 26 |
| Chapter 3 – Preparing for recovery | 38 |
| Conclusion | 45 |



This PDF has elements
of interactivity included

Foreword

Welcome to the latest edition of the Alternative Credit Council's (ACC) Financing the Economy research, produced in partnership with Allen & Overy LLP (A&O).

This research series was established six years ago to explore the factors supporting the expansion of private credit. In doing so, it has highlighted the benefits of the asset class for businesses and investors, while also making the case that private credit supports economic resilience. This year's paper explores how the sector is still demonstrating its value to businesses and investors.

The Covid-19 coronavirus pandemic has challenged the viability of many businesses and the jobs they provide. Governments around the world have responded by introducing liquidity support and employment protection schemes to support businesses and retain the productive capacity of their economy. The primary beneficiaries of this support were borrowers typically served by traditional lenders, and those with access to the public lending markets. Borrowers unable to access public lending markets or underserved by traditional lenders often found themselves outside the scope of such support. Our research shows that the private credit sector has played a vital role supporting such businesses during this period.

Private credit managers and their investors have demonstrated their commitment to lending and expect to provide businesses with over \$100 billion of new capital during 2020. This is broadly consistent with the amount invested during 2019 and our research indicates they are likely to continue lending similar amounts in 2021. There are numerous examples which illustrate how private credit is financing the real economy throughout this paper.

As well as being a lifeline for businesses seeking new finance, private credit managers have also been a dependable partner to existing borrowers. Private credit managers have worked with businesses facing stress and offered pragmatic support when this was most needed. Resizing financial commitments to reflect changed circumstances has helped stressed borrowers establish a new path towards growth.

Investors have also faced increased volatility across their equity portfolios and reduced yields in their fixed income allocations. Private credit has helped investors address these two challenges by providing diversification, acting as a hedge and offering them assets that can generate income. The ability of private credit managers to deploy new capital and protect value in their existing portfolios during the pandemic has demonstrated that the sector can perform well during a downturn.

While the future is harder than usual to predict, businesses are likely to continue facing short-term disruption during 2021 and any return to growth will require new capital in a variety of forms. At the same time, investors will continue to seek assets that can help them meet the needs of their underlying beneficiaries in a challenging market. Finally, regulatory barriers will continue to inhibit the growth of private credit outside its core markets.

While further challenges undoubtedly lie ahead, private credit has shown itself to be a valuable and resilient part of the financial system during 2020. We believe our research corroborates the view that private credit is beneficial for both borrowers and investors, and that policymakers should seek to maximise the role of private credit in the economic recovery.



Jiří Król

Global Head, Alternative Credit Council



Sanjeev Dhuna

Partner, Allen & Overy

Executive summary

Private credit managers continue to lend:

Private credit managers expect to lend over \$100bn to SMEs and mid-sized businesses during 2020. This is broadly similar to their total lending volume in 2019 and shows that non-bank lenders have continued to provide finance to businesses, despite the economic downturn and disruption caused by Covid-19. Our research shows that the sector also remains optimistic about its prospects and it is likely that similar amounts of capital will be deployed during 2021.

Investor appetite for private credit remains undiminished:

The disruption to the economy during 2020 has created demand among investors for assets that can generate income, provide diversification or act as a hedge during equity bear markets. Private credit is an attractive way for investors to address these requirements at a time when traditional fixed income assets are offering either minimal or negative rates. Monetary policy therefore continues to create strong incentives for investors to maintain or increase their allocation to private credit, supporting the flow of credit to parts of the economy underserved by traditional banking or public markets.

Private credit managers have demonstrated their value to borrowers:

Non-bank lenders have been vital sources of finance to borrowers during 2020, particularly those who are outside the typical risk appetite of banks or were unable to access government liquidity schemes. The ability of private credit managers to provide flexible capital solutions has come to the fore during the pandemic. Our data indicates that there is a general trend among private credit managers favouring a pragmatic approach towards forbearance when required. This is being applied in a targeted manner to reflect individual borrower's circumstances.

Flexibility is a prized asset: As borrowers' finance needs and economic circumstances become more mutable, their position on the spectrum between par and distressed lending opportunities will fluctuate. Investors and private credit managers are positioning themselves to adapt to the greater range of lending opportunities they anticipate in 2021. Performing loans in the SME and mid-market are expected to be the biggest opportunity to deploy capital in 2021, with the sector also anticipating greater investment in liquidity/bridge finance or special situations lending.

Not all private credit managers are created equally:

The impact of Covid-19 has been uneven across different regions and sectors within the economy, but it has also highlighted differences in deal origination, documentation standards and risk management capabilities within the sector. The pandemic has placed a magnifying glass on these differences, with investors seeking greater assurances on risk management and performance reporting. Existing exposure to cyclical or Covid-19-affected sectors is also affecting a private credit manager's ability to take advantage of investment opportunities during the current downturn. These factors are likely to drive dispersion of performance within the sector during 2020 and 2021.

Raising capital to support the recovery:

Private credit managers continued to raise capital effectively during 2020, with newer funds largely being an evolution of existing strategies. Our data indicates that respondents expect this momentum to continue and investor attitudes will remain broadly positive towards private credit. 88% of firms are planning to continue raising capital for existing strategies and 98% of respondents plan to raise capital in some form next year. 89% of respondents expect more allocations to distressed debt strategies. Strategies focussing on infrastructure debt (52%), speciality finance (50%) and SMEs (45%) were also viewed very favourably by respondents. By region, respondents were most favourable towards Europe, the US and APAC (excl. China and India) focussed strategies.

Research methodology

Financing the Economy 2020 is based on data from several sources. The Alternative Credit Council (ACC) and Allen & Overy LLP (A&O) conducted a survey of private credit managers. 49 private credit managers responded to the survey; collectively they manage an estimated \$431bn in private credit investments, across a broad cross-section of jurisdictions and strategies. The survey data was then explored by the ACC and A&O in a series of one-on-one interviews. Private credit managers were also invited to submit case studies of how their firms are contributing to the real economy, which you can find throughout this paper.

The respondents to this survey are drawn from around the world and invest in a diverse range of private credit strategies. This is consistent with previous editions of this research which also represented the breadth of the private credit market. The data indicates that respondents to the survey represent firms with different volumes of deployed capital (see Figure 1) and are primarily making investments in Europe, the UK and US (See Figure 2). There is also a notable presence of firms investing in the Asia-Pacific region (excl. India and

China). As per Figure 3, all respondents to the survey were investing in SME and mid-market businesses, with speciality finance, real estate and larger corporates the next most prevalent strategies amongst respondents. Most respondents typically provide loans of up to \$100 million, however a sizable number of respondents are providing loans of greater value.

Figure 1. What is the estimated deployed capital (i.e. excluding dry powder) allocated to private credit across all vehicles/accounts?



Figure 2. Where does your firm currently make private credit investments?[†]

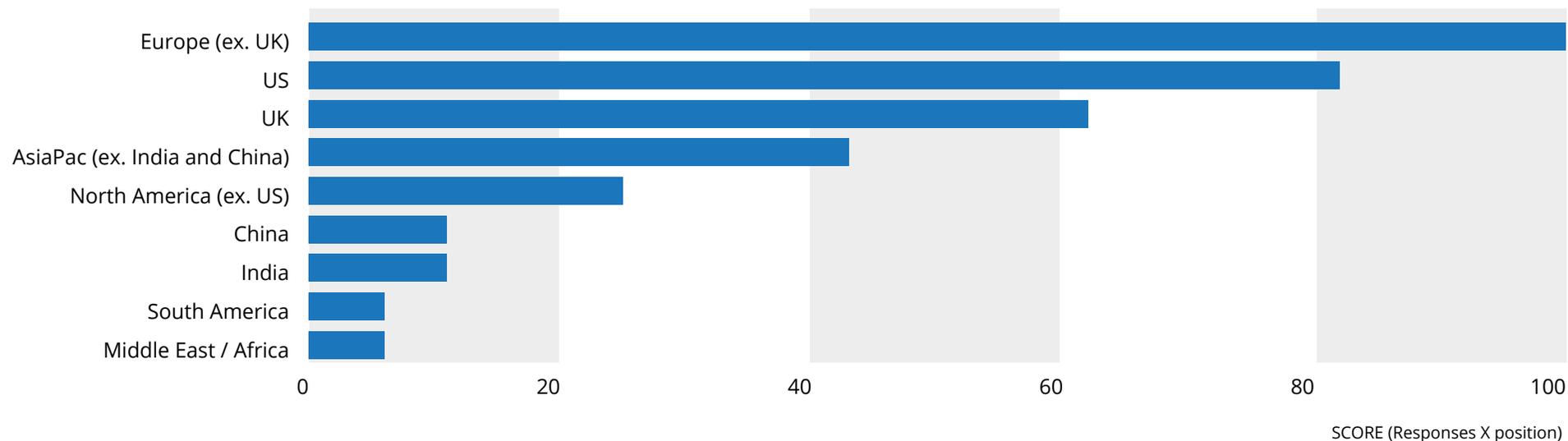
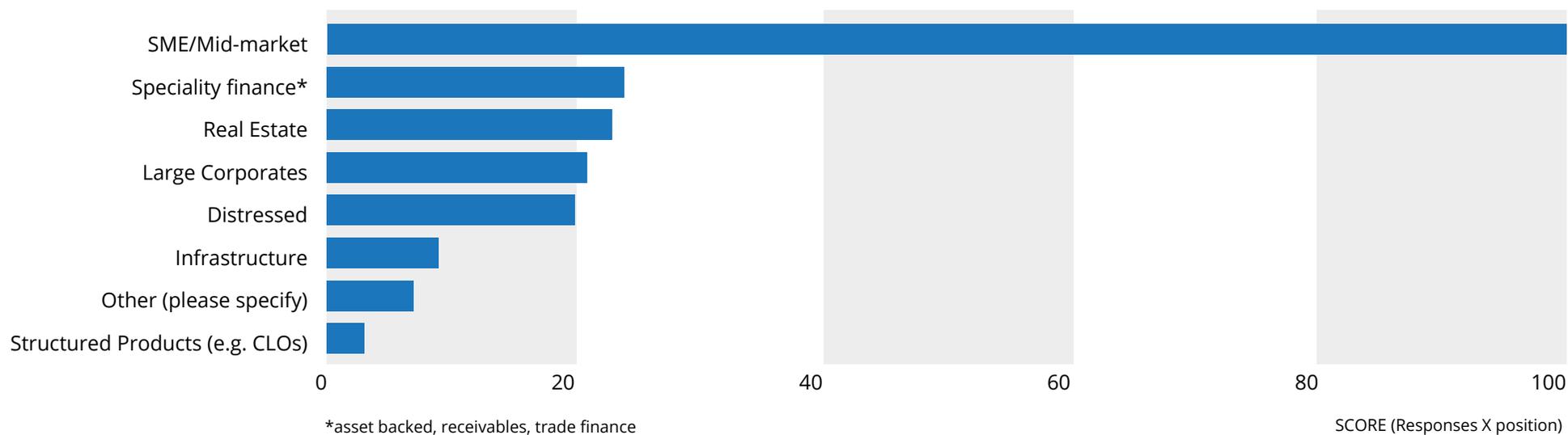
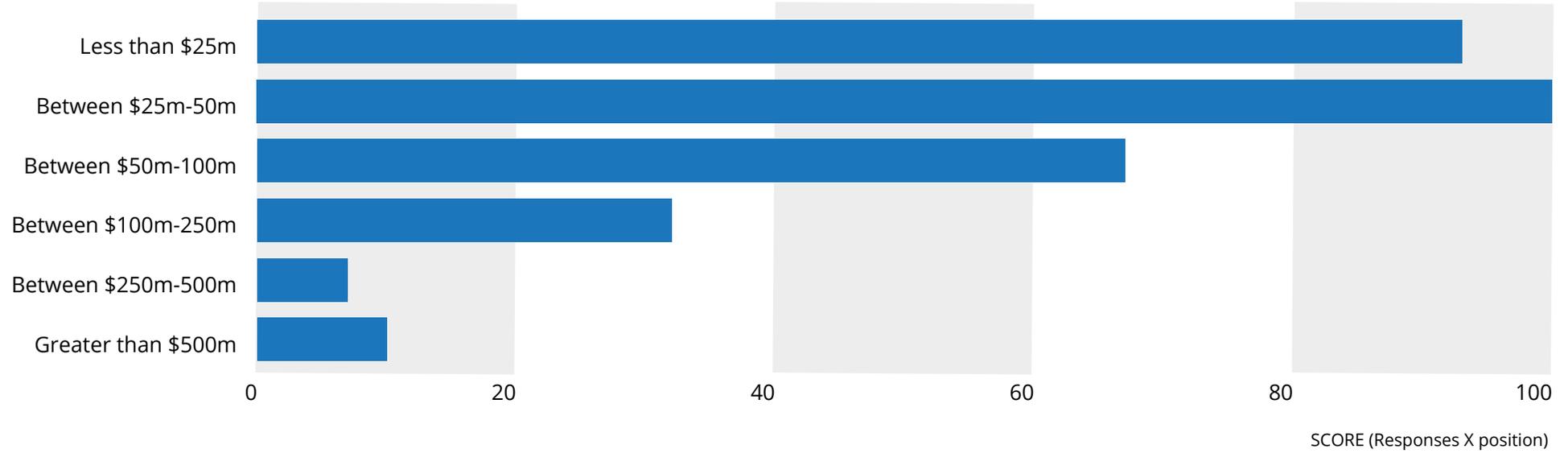


Figure 3. To which of the following private credit strategies are you currently deploying capital?[†]



[†] Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

Figure 4. What are the most common loan sizes in your portfolio?†‡



| | Between \$100m-250m | Between \$250m-500m | Between \$25m-50m | Between \$50m-100m | Greater than \$500m | Less than \$25m |
|-----|---------------------|---------------------|-------------------|--------------------|---------------------|-----------------|
| 1st | 6.3% | 0.0% | 37.5% | 18.8% | 4.2% | 33.3% |
| 2nd | 12.0% | 8.0% | 28.0% | 28.0% | 0.0% | 24.0% |
| 3rd | 38.5% | 7.7% | 7.7% | 30.8% | 7.7% | 7.7% |

† Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

‡ Respondents were asked to rank their top three preferences when answering this question. This table shows the distribution of their preferences between positions 1,2 and 3.

Chapter 1 – The outlook for private credit

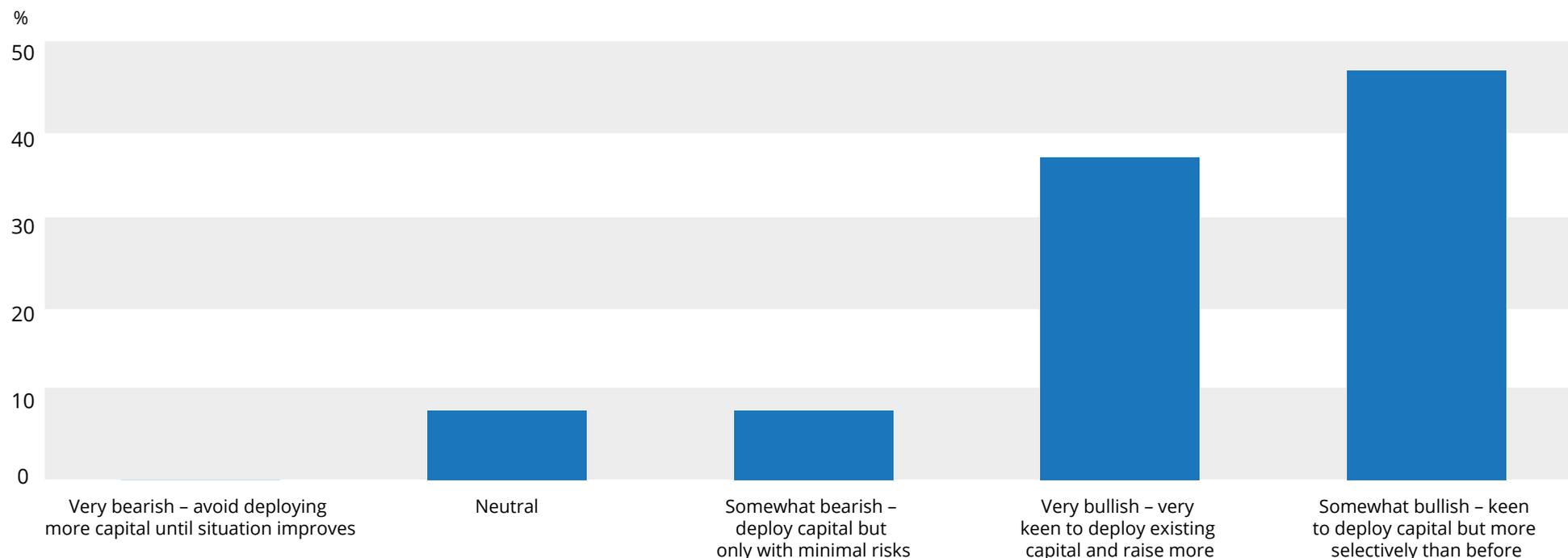
The growth of the private credit industry over the past decade took place during a long credit cycle and period of relatively consistent economic growth. While many within the industry have been actively preparing for a turn in the credit cycle or economic downturn for some time, the impact of the Covid-19 pandemic on the global economy was beyond the scale of what almost all firms envisaged. As one private credit manager commented: ‘no-one modelled for revenues dropping to zero’. This unprecedented disruption to the economy has

created substantial and unique challenges for borrowers, private credit managers and investors.

Our research indicates that the private credit market has proved resilient in the face of this initial shock to the economy, and managers remain optimistic about the prospects for the asset class despite the uncertain economic outlook. This optimism is evident in Figure 5 which shows that more than 80% of respondents are either somewhat bullish or very bullish about their appetite to deploy capital over the next 12 months.

This view is anchored in the belief that private credit as an asset class is relatively well placed to continue performing, irrespective of whether the economy recovers quickly or experiences ongoing and potentially more substantial turmoil. While some strategies or regions are expected to face significant challenges, these are largely seen to be the result of discrete factors rather than those which are common to all private credit funds or strategies.

Figure 5. How do you assess your overall appetite to deploy new capital over the next 12 months?



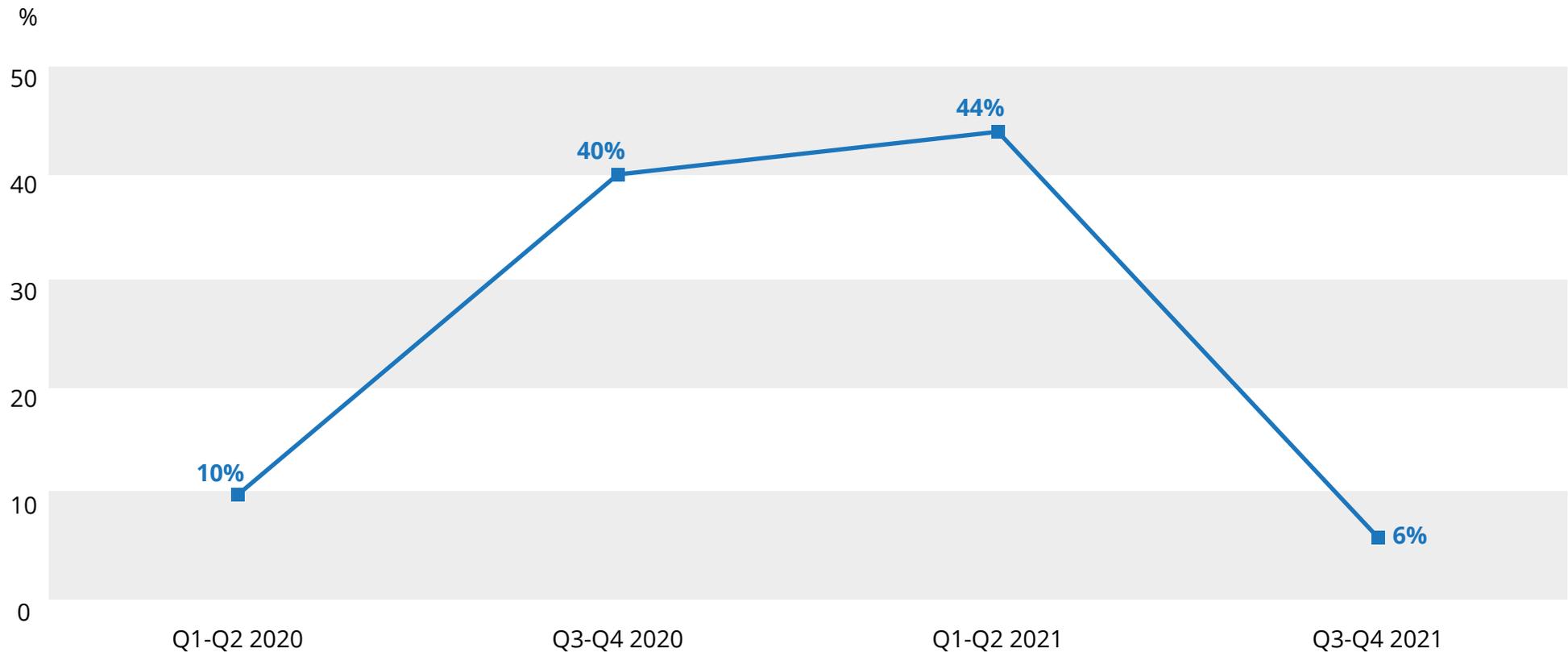
This optimism is, however, not blind. Private credit managers are under no illusions about the general prospects for the economy based on current projections. The severity and swiftness of the initial shock has already required borrowers to draw on a significant amount of liquidity from private credit managers, sponsors, external capital providers and government sources. These measures may have succeeded in mitigating the

worst effects of the pandemic, but there has still been significant damage to the economy. In some instances, consequences have simply been delayed rather than dealt with.

As demonstrated by Figure 6, most private credit managers expect to see a peak in distressed opportunities between the end of 2020 and early 2021.

This suggests that, despite the resilience displayed by private credit managers to date, there is a consensus that challenges for private credit managers lie ahead. Balancing optimism and belief in the fundamentals of the asset class with pragmatism about the prospects for the economy is therefore likely to characterise the market for the foreseeable future.

Figure 6. When do expect to see a peak in distressed debt opportunities?



Our research points towards three key drivers supporting the more positive outlook expressed by our respondents: investor confidence in private credit; the need for borrowers to recapitalise their businesses; and a potentially supportive policy environment. We will address each of these factors in turn before considering the difficulties that private credit managers have faced during 2020 and the challenges that are still to come.

Investor confidence

The long-term factors supporting investor demand and confidence in private credit have remained relatively stable during 2020 and this is likely to continue in the near term. Our previous Financing the Economy research highlighted how private credit allows investors to diversify their exposure and obtain a potential source of non-correlated returns. The longer-term nature of the investment horizon when compared to other asset classes has also been an attractive feature of private credit for investors. These factors continue to shape investors' approaches towards private credit, despite the impact of Covid-19 on the economy.

Institutional investors have been increasing their allocation to private markets for some time. While the pandemic has created significant challenges for investors seeking to maintain a balanced portfolio that delivers the necessary benefits for their beneficiaries, we find evidence that they will continue to allocate capital to private credit strategies.

The growth in allocations to fixed income is often driven by demand for assets that can generate income, provide diversification, hedge against risks during equity bear markets, and offer liquidity. Private credit is extremely well placed to provide the first of these at a time when traditional fixed income assets are offering either minimal returns or even negative rates. Identifying assets

that can do the same in public credit markets at the current time can be much more challenging.

The 'hedging' aspect of liquid fixed income investments has also disappeared. With all the major global markets near or at a zero bound for an extended future, the potential for future price appreciation is very limited. If anything, we could see increased correlation between fixed income and equity markets in risk-on/risk-off episodes. Finally, for long-term institutional investors, while the trade-off with respect to the liquidity/illiquidity of the assets cannot be completely discounted, liquidity is likely to be less of an issue across investor portfolios when compared to the larger problem of finding income generating opportunities.

Absent any significant changes to monetary policy, there are strong incentives at the portfolio level for investors to maintain or increase their allocation to private credit. The impact of lower interest rates on investors seeking fixed income opportunities may be further supporting the flow of credit to parts of the economy that may be underserved by traditional banking or public market financing. This is potentially a new monetary policy transmission mechanism and one which may benefit from further analysis.

Data on the US direct lending market also offers an additional clue as to why private credit remains appealing to investors. As shown in Figure 7, direct lending has an attractive yield to maturity ratio when compared to leveraged loans or broadly syndicated high yield loans. Given historical non-accrual and recovery rates for direct lending are broadly similar to both broadly syndicated high yield and leveraged loans (see Figures 8 and 9) it is understandable why allocators continue to invest in private credit.

CASE STUDY

Apollo Infrastructure Funds Announce Strategic Investment in US Offshore Wind Developer US Wind Inc.

Apollo Global Management, Inc. (together with its consolidated subsidiaries, "Apollo" or the "Firm") today announced that certain funds managed by its affiliates ("Apollo Funds") have made a structured investment in US Wind Inc, an offshore wind energy development company. Apollo Funds have committed to invest through convertible debt and equity up to \$265 million to acquire an equity stake in US Wind and fund development and construction costs associated with a major offshore wind energy project off the coast of Maryland. US Wind plans to sell electricity and Offshore Wind Renewable Energy Credits under the Maryland Offshore Wind Energy Act of 2013, and the project is poised to be a key contributor of renewable energy required under Maryland's Renewable Portfolio Standard. Anticipated to come online in early 2024, the project has a 25+ year useful life and is expected to create thousands of jobs.

- Bloomberg Barclays High Yield Index (YTW)
- Cliffwater Direct Lending Index (3Yr Takeout Yield)
- S&P/LSTA Lev Loan 100 YTM

Figure 7. CDLI, High Yield Bond, and Leveraged Loan Yield-to-Maturity Comparisons, Sep 2004 to June 2020

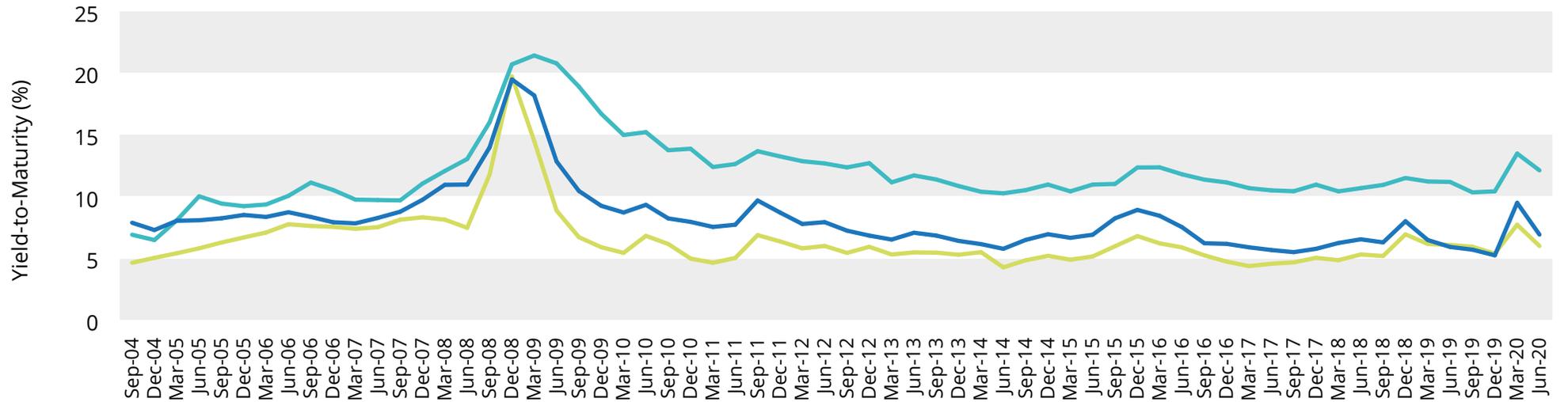
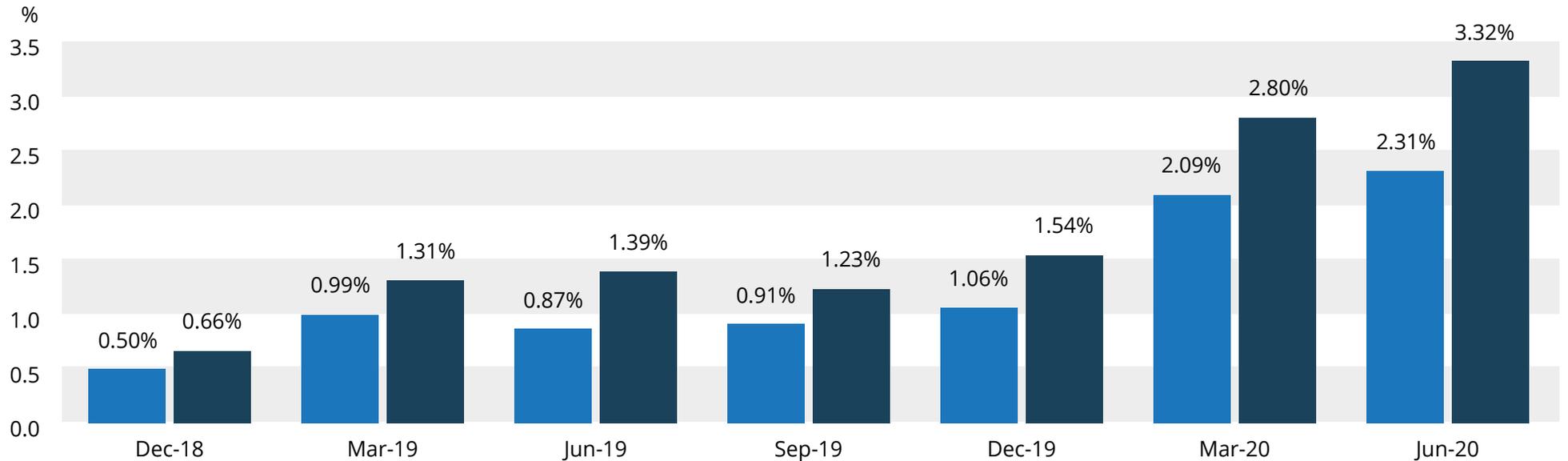


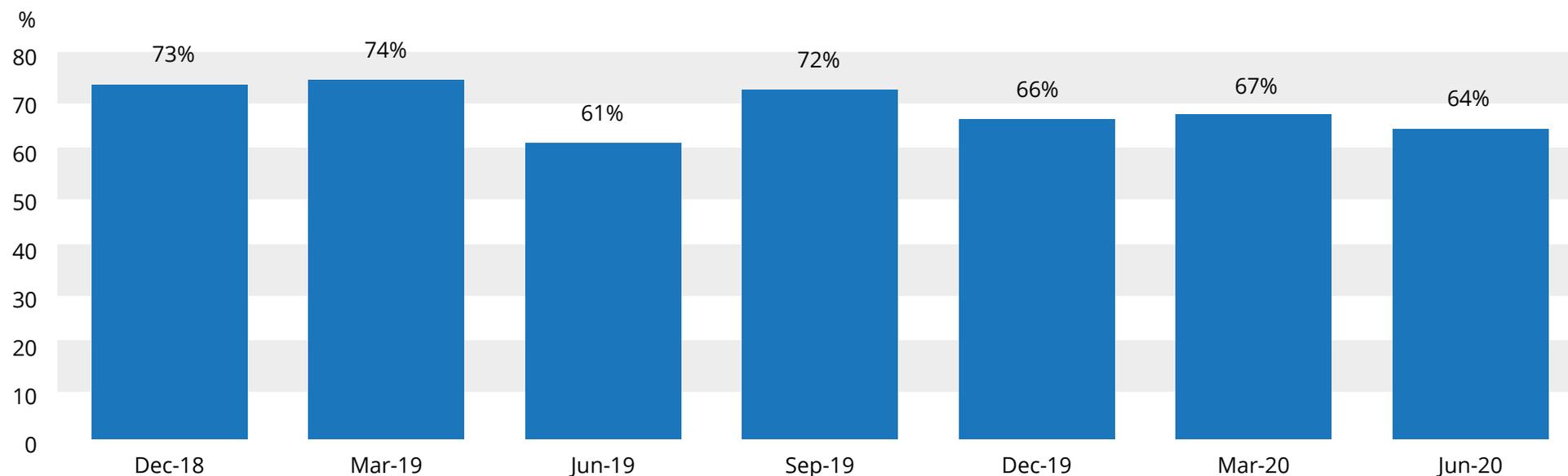
Figure 8. CDLI Non-Accruals

- Non-Accruals at Fair Value (%)
- Non-Accruals at Cost Value (%)



Source: Cliffwater Direct Lending Index

Figure 9. Implied Loan Recovery Rates



Source: Cliffwater Direct Lending Index

When seeking to allocate more capital to private credit, the appeal to investors at the portfolio level will be balanced against practical considerations. The main challenges for investors are typically related to manager selection – whether retaining existing asset managers or when making first time allocations – and the potential for dispersion of performance. The range of returns generated by private credit managers is likely to broaden in 2020 and 2021 due to a combination of factors.

The impact of Covid-19 on the economy has been uneven across different regions and sectors. Private credit managers will find themselves on different sides of these lines. Furthermore, the pandemic will also

magnify differences in deal origination, documentation standards and risk management capabilities that will have undoubtedly existed in the market. Finally, some firms will have different levels of preparedness or capital available to take advantage of any opportunities during the current downturn.

While not a perfect proxy, the range of the price and net asset value ratio for Business Development Companies (BDC)¹ offers some early clues as to how dispersion of performance is likely to be occurring across different firms. The divergence in the price and net asset value ratio for different BDCs has largely been attributed to the respective levels of leverage and documentation standards across deals, and the size of the underlying

borrower, with larger EBITDA companies (those north of \$100m EBITDA) seen to be performing better than smaller ones (those with less than \$25m EBITDA).

The publicly available information on BDCs is not replicated in most other non-bank lending markets, but it is reasonable to assume that there may be similar differences across other strategies.

While investor confidence in existing managers is high, the reassurances sought from investors have intensified over the course of 2020. This has been most apparent in the reporting of risk management and performance factors, with data now requested at more regular intervals and in greater detail. Private credit firms continue to invest in their capabilities to meet investor

¹ <https://www.bdcinvestor.com/screens/price-to-nav/>

reporting requirements but, for the large part, these additional requests have been met through existing systems and in spite of the disruption caused by Covid-19. The response of the sector and ability to meet the challenges presented by Covid-19 has supported investor confidence in the sector and its ability to successfully invest capital. This has also raised expectations across the board and cemented operational infrastructure as a factor by which investors will differentiate both existing and new managers.

We find that investors remain convinced in the merits of private credit as an asset class, but they are increasingly discerning in their approach towards individual managers. This trend is only likely to be encouraged by the sector's performance over the next 12 months, where the same factors driving any dispersion of performance will continue to be tested under greater stress.

Borrower demand

The implementation of public health restrictions has created short and medium-term liquidity challenges for businesses that are now operating under constraints or prevented from trading entirely. For many businesses, a combination of bank lending and government business finance support schemes have been sufficient to meet these challenges, at least for the time being. Several businesses have, however, fallen outside the risk appetite of banks or been unable, or unwilling, to access government liquidity schemes.

Many of these firms have already turned to private credit for liquidity support. Uncertainty around the continued application of public health restrictions and their impact on the economy mean that many firms will face liquidity challenges for longer than initially envisaged. The longer these challenges exist, the more difficult it will be for traditional lenders and governments to continue meeting them. Ongoing liquidity challenges also eventually become solvency challenges, which require different refinancing solutions.

The number of businesses that need capital to either continue operating or adapt their business model is therefore likely to increase. In the UK alone, it is estimated that £35bn of unsustainable debt will arise from the loans issued in response to Covid-19². This illustrates the size of the refinancing challenge that most economies are likely to face in 2021 and the demand for capital that will exist among SMEs and other businesses.

Banking regulations and the commoditisation of the traditional lender business model means that banks will inevitably face constraints in their ability to provide capital to these businesses. Additionally, they may be less able to provide the capital needed to transform such businesses, particularly in a downturn, if this type of lending falls outside their risk appetite. Furthermore, many banks are already provisioning for significant losses arising from the loans issued to businesses in response to Covid-19, which adds leverage to their balance sheet. This points towards borrowers increasingly requiring alternative finance solutions to recapitalise their

businesses which will benefit private credit managers. Respondents to our survey identified performing loans in the SME and mid-market as their biggest opportunity to deploy capital in the coming 12 months (see Figure 10). This is a strong indication of the ongoing demand for finance they expect to see from these types of businesses.

As well as an overall increase in the volume of capital required by businesses, many private credit managers anticipate that the type of capital required will change. Some form of public health restrictions are likely to remain in place for most developed economies in the near to medium term. The shifts in customer behaviour and spending patterns that we have already seen are therefore likely to continue for longer, affecting how economies function and the distribution of activity. While it might be too soon to identify outright winners and losers given the uncertainty about how permanent these shifts might be, these changes will create further need for capital as businesses are forced to adapt.

The ability to meet more complex finance needs or support business growth strategies is an acknowledged strength of private credit. Our data (see Figure 10) also suggests that many private credit managers are already anticipating greater investment in liquidity/bridge finance or special situations lending during the next 12 months.

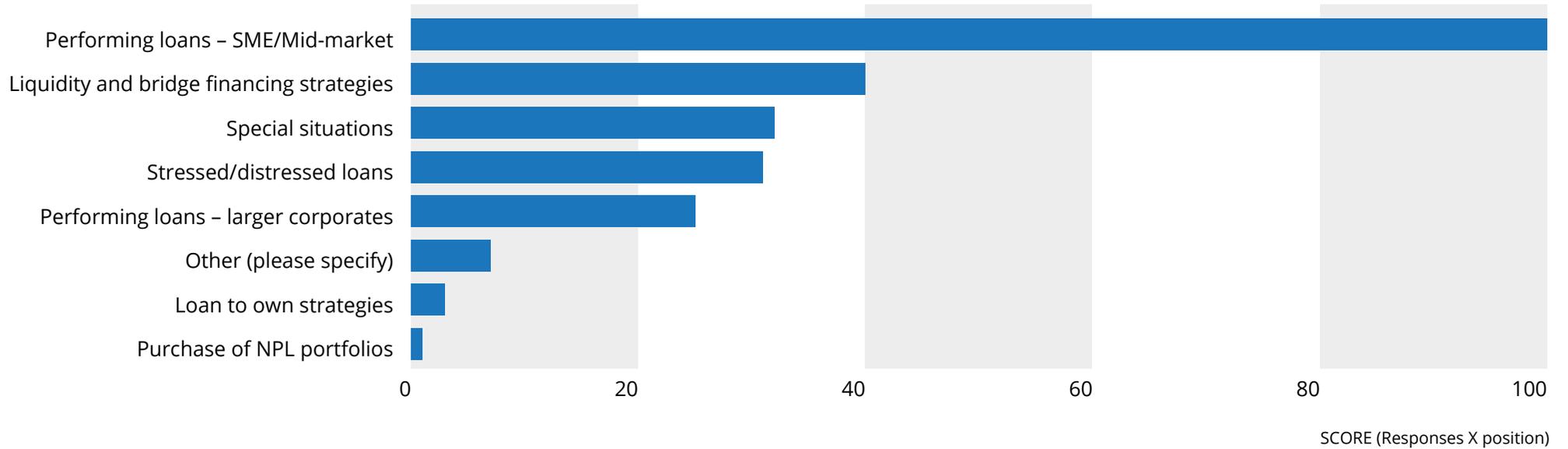
²See <https://www.thecityuk.com/research/supporting-uk-economic-recovery-recapitalising-businesses-post-covid-19/>

CASE STUDY

Ares Management served as the lead arranger for a £1.875bn financing commitment to 'The Ardonagh Group'.

Ares Management served as the lead arranger for a £1.875bn financing commitment to 'The Ardonagh Group', the U.K.'s largest independent insurance broker, through Ares' global direct lending platform. The financing was comprised of a £1.575 bn unitranche loan and a £300m committed capital expenditures facility. The total combined commitment represented the largest ever unitranche financing, which we believe is a testament to the quality of 'The Ardonagh Group' and the capabilities of Ares' global and scaled platform. The financing was part of the company's global refinancing to support its business expansion plans.

Figure 10. Where do you see the biggest opportunities/most likely deployment of your capital in the market in the next 12 months?[†]



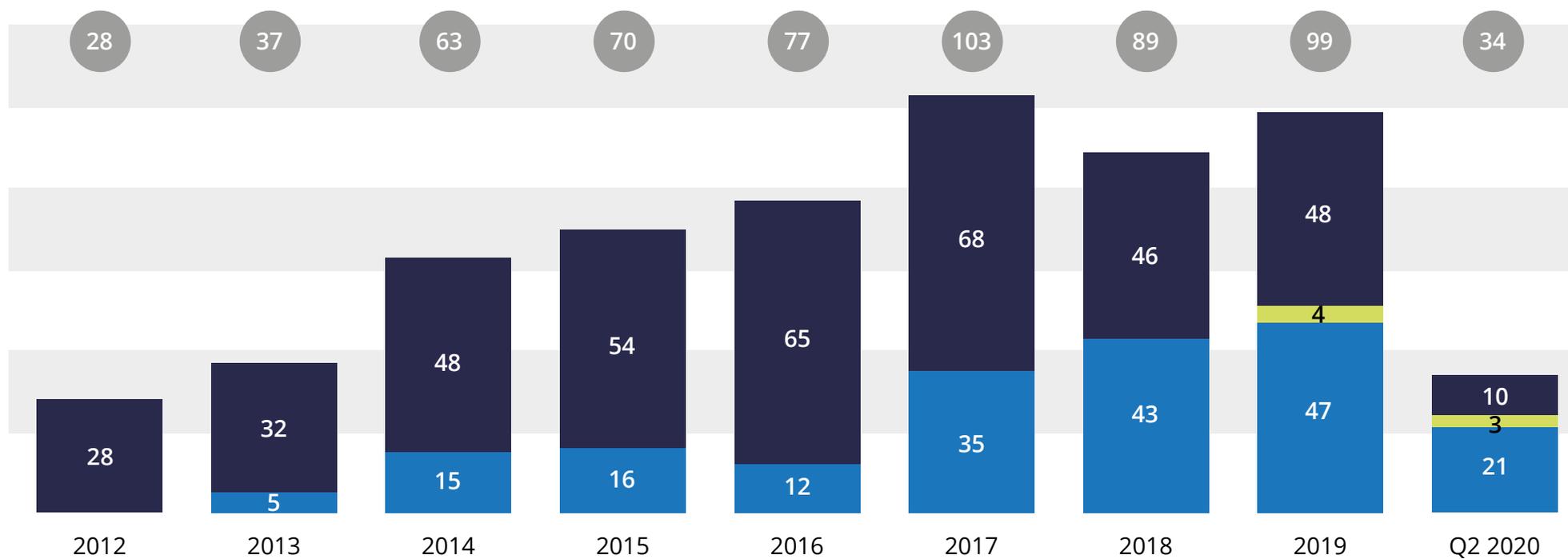
While lending is often discussed in terms of either ‘par’ or ‘distressed’, several of our interviewees highlighted how they expect more lending opportunities to fall between these two pillars. This shift is likely to play to the strengths of credit funds compared to traditional

lenders, given their flexible approach towards borrowers’ credit needs. This trend can already be seen in the German mid-market (see Figure 11), with the share of senior and unitranche deals financed by debt funds accounting for 70% of H1 deal flow, compared to just

over 50% in 2019. While this is only a single data point, we expect this to be reflected across other markets, particularly in Europe, and that private credit will act in a countercyclical way in response to growing demand from businesses for capital.

[†] Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

Figure 11. Total number of deals in the German market (Senior and Unitranche)



Source: GCA Mid-Cap Monitor Q2 2020

● Number of deals ● Debt Funds (Unitranche) ● Debt Funds (Senior) ● Banks

Our interviewees also highlighted the value of certainty for borrowers in the current environment. Several cited examples of corporates choosing private credit over syndicated loans, with the certainty provided by the former valued above the higher finance costs of the latter. The finance needs of these borrowers are typically met by either the public credit markets or by syndicating the debt among a group of lenders. The emergence of

private credit managers in this space has provided these borrowers with a genuine alternative. While this new finance vertical emerged prior to the crisis and has been covered in detail in our earlier reports, the value of the bilateral relationship and the speed and certainty this brings has become even more important for borrowers. This trend is likely to be more pronounced in the large-cap space which has seen greater activity by private

credit managers over the past two years. At the higher end of this market, direct lenders have begun to offer loans in excess of \$1bn. While the number of private credit managers in the space is relatively small at present, this is likely to account for a large volume of the capital deployed by private credit managers overall due to the sums involved.

A supportive policy environment

The scale of government intervention in the economy during 2020 is beyond what many previously considered possible. In addition to supporting businesses through targeted finance schemes, governments have also introduced policies to boost employment and promote economic resilience.

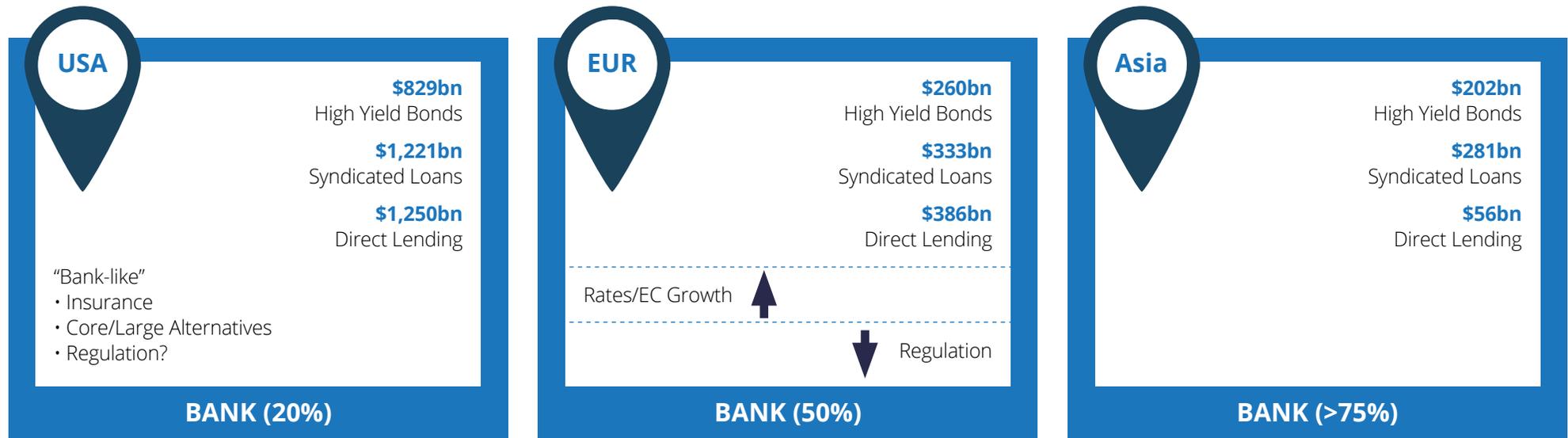
While such measures have assisted in mitigating the initial impact of Covid-19 and created space for businesses and their lenders to adapt, it is not viable for them to continue indefinitely. In response to this challenge, policymakers are now assessing structural factors within their economies that can boost the flow of finance to businesses and support the post-Covid-19 recovery. For many jurisdictions, the absolute and relative amount of non-bank lending activity is lower than that seen in the United States, which is the most developed non-bank lending market (see Figure 12).

This indicates that the sector’s role in the economy for many jurisdictions is below its real potential. Closing this gap by boosting non-bank lending therefore provides policymakers with an effective means to increase the volume and diversity of credit provided to their economies.

There are encouraging signs that policymakers recognise the need to implement structural changes to support the availability of capital in the economy. The Capital Markets Union action plan in Europe, reforms to the UK asset management policy framework and moves in the US to address issues affecting BDCs all contain supportive measures for private credit managers. The implementation of these reforms is not without potential hurdles but they are likely to support rather than hinder the sector during coming years.

In November 2020, the Financial Stability Board (FSB) submitted a report to the G20 on the financial stability implications of Covid-19, and suggested policy recommendations to improve the resilience of the non-bank financial intermediation sector while preserving its benefits. The latter part of the statement is a welcome recognition by policymakers that non-bank lending plays a valuable role connecting capital markets with the real economy. It will be essential that any efforts promoted by the FSB support and enhance the national or regional approaches being taken to enhance the role of private credit in the economy, and maintain a supportive policy environment for the sector to continue thriving.

Figure 12. Bank disintermediation



Source: StepStone Private Debt, COVID-19 Market Survey May 2020; Reuters, Credit Suisse, Bloomberg; Barclays Asia High Yield Index.

CASE STUDY

Carlyle serves as co-lead arranger on a five and a half year, \$125m term loan for New Regency.

In June 2020, Carlyle served as co-lead arranger on a five and a half year, \$125m term loan for New Regency. In addition, New Regency extended the term of its \$700m credit facility led by J.P. Morgan, for an additional five years. The closing of those two deals gave New Regency a firepower of \$825m. Despite the current global health and economic crisis, New Regency's film library continues to maintain robust value and the transaction provided new capital for New Regency to continue to produce differentiated content. New Regency has an established, productive relationship with The Walt Disney Company, which currently distributes its films worldwide through 20th Century Studios.

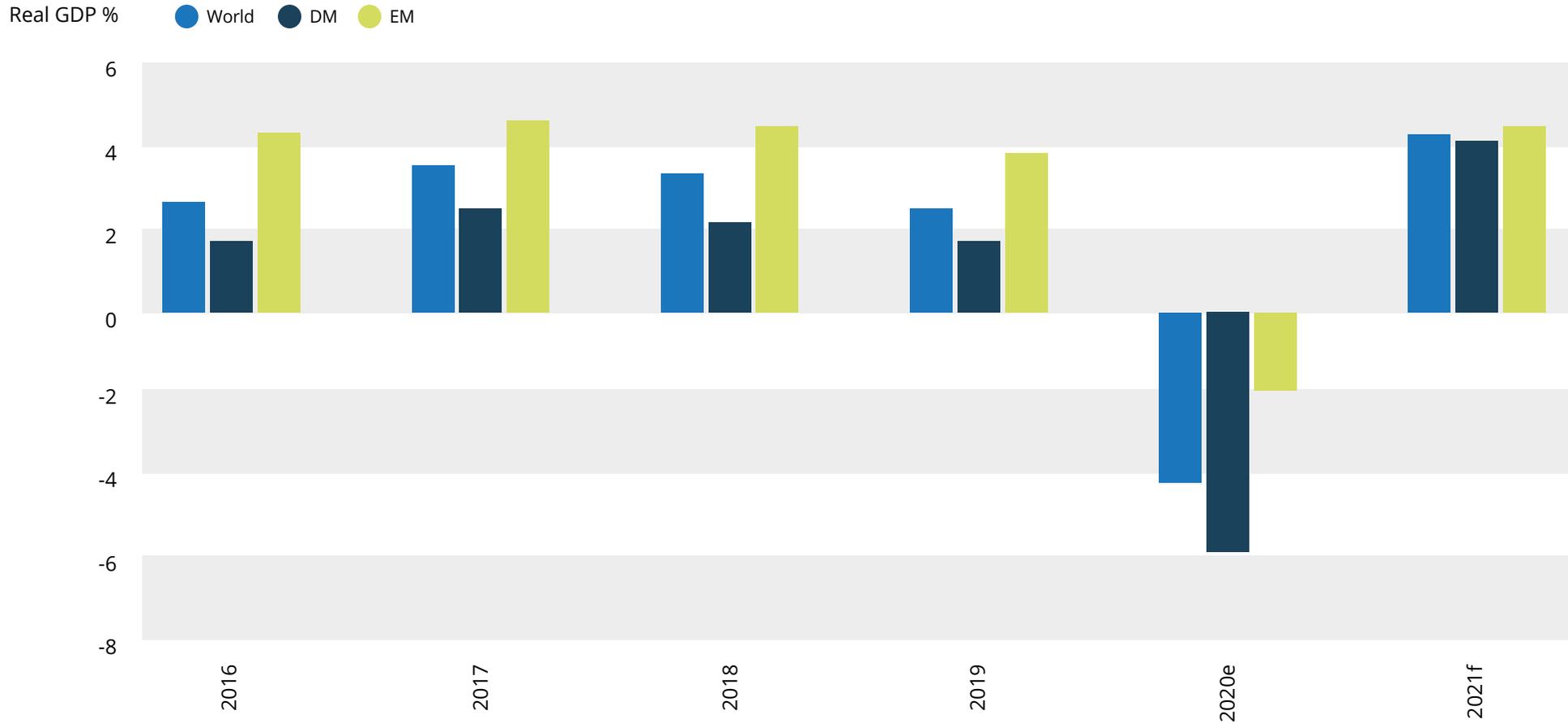
A unique test

The ability of private credit to perform ‘through the cycle’ has been queried by cautious investors and market observers for several years. While previous downturns have had their origins in Wall Street or Main Street, the challenges facing the economy today are the result of an

external factor. These challenges are further complicated by uncertainty regarding the longer-term impact of the virus on consumption patterns, and the length of time public health measures will be needed to control its spread.

This uncertainty is reflected in various indicators (see Figure 13) and there is a consensus that continued disruption is likely to be the rule rather than the exception for the foreseeable future.

Figure 13. Global recovery afoot but bumpy and patchy – global recovery to see real GDP rebound



Source: Fitch Solutions.

CASE STUDY

Oak Hill Advisors (“OHA”) co-led the recapitalisation of Immucor, a manufacturer of critical blood transfusion and transplant diagnostic equipment, by financing a sizable portion of a private second lien loan.

The recapitalisation allowed Immucor to refinance 2021 and 2022 debt maturities in spite of Covid-19-related capital markets disruptions and to provide management the flexibility to execute on its strategic plans. OHA’s private lending experience, sector expertise, strong relationship with Immucor’s financial sponsor, TPG, and the scale of its platform enabled us to play a significant role in the transaction. Our favourable view of the business, its strong market position and long-term value-creation prospects contributed to our conviction to finance a meaningful portion of the privately-placed tranche.

At the outset of the pandemic, private credit managers and their investors were focussed on their existing portfolios and identifying areas of stress. This process involved an assessment of direct impacts, e.g. on retail, tourism and hospitality businesses, as well as potential second and third order impacts, such as supply chain challenges or behavioural changes by customers that may manifest over a longer time horizon.

When asked whether existing risk management and monitoring processes had held up as expected, contributors to this research stated that their systems had generally proved robust, even when working at the greater intensity demanded by investors.

Loan documentation and covenants were closely monitored by investors even before the pandemic. The ACC's own research has tracked the growth of cov-lite alongside a general trend in some markets

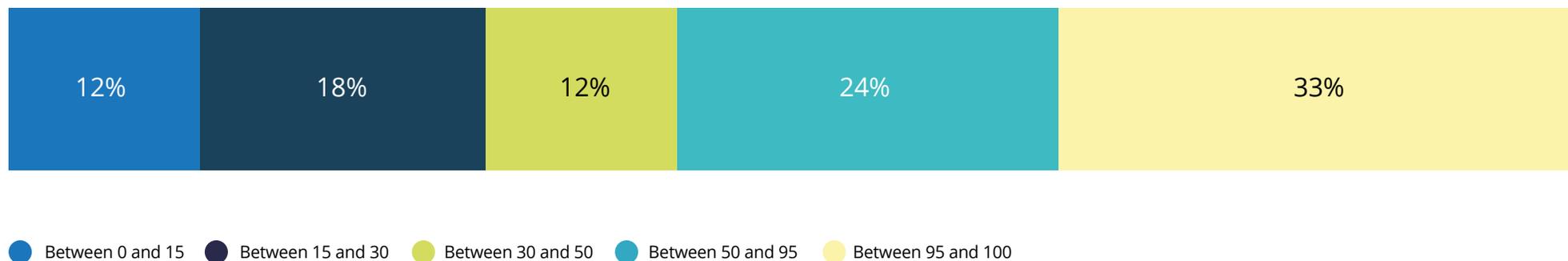
towards more borrower friendly documentation. While this was identified by many as a potential source of weakness in the private credit market prior to the crisis, this does not yet appear to have been the source of specific concern. Our data (see Figure 14) indicates that the prevalence of financial covenants varies across the industry. While one third of respondents indicated that 95-100% of loan agreements in their portfolio have two financial covenants, a similar amount stated that less than 30% of the loans in their portfolio had the same. This is further evidence of the differentiation between private credit managers discussed earlier in this chapter. It also suggests that the expansion of borrower friendly documentation has not been as pervasive within private credit as sometimes described.

CASE STUDY

CAPZA arranges a €40m unitranche financing to support ASPY's organic and external growth.

ASPY, founded in 2006 as a subsidiary of the mutual insurance group ASEPEYO, and independent since 2014, is one of the leading companies in Spain in the occupational risk prevention sector. With c.1,100 employees and 210 centres, ASPY protects more than one million employees and self-employed workers for 43,000 companies. ASPY is now ready for a new stage of growth in which it intends to consolidate itself as one of the leading operators in the sector. This growth will be carried out organically and through acquisitions: the company is currently in discussions with various SMEs in the sector for potential acquisitions.

Figure 14. What proportion of loan agreements (by number) in your portfolio have at least two financial covenants?



The ability to influence outcomes via direct relationships with borrowers and appropriate documentation is central to the 'control premium' that private credit managers offer their investors. While our data indicates the prevalence of financial covenants in loan agreements for many private credit managers, it is silent on the relative strength of these covenants. For example, the metrics against which they are triggered or whether they are a maintenance or incurrence covenant. This will affect how a lender is able to rely on a covenant and whether it can be employed at a sufficiently early stage to take any necessary action. While softer covenants can also support flexible approaches to lending and forbearance, this always needs to be balanced against the potential downside risk – something which has increased considerably in 2020.

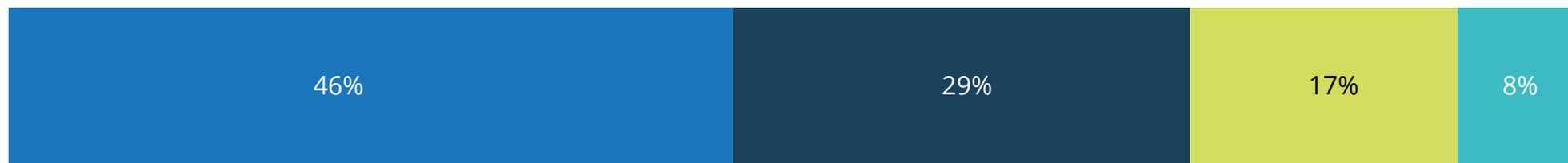
Figure 15 indicates that there is likely to be dispersion across the industry on this front. Nearly half of respondents expect either none or fewer than 15% of their portfolio companies to be in breach of their covenants by the end of 2020. At the same time, 8% of respondents stated that they expect more than 50% of loan agreements to be in breach of their covenants by year end. This further supports the thesis of significant dispersion of performance in the next several years.

CASE STUDY

Cheyne provided a £75,5m whole loan to support London Residential Development financing.

Cheyne provided a £75,5m whole loan to support the redevelopment of a former fire station into a predominantly residential scheme, comprising 199 apartments. The developer will also deliver a secondary school and sports hall as part of the agreement with the Local Authority.

Figure 15. What proportion of loan agreements are currently or expected to be in breach of their covenants by the end of the year?



- Between 0 and 15
- Between 15 and 30
- Between 30 and 50
- Between 50 and 100

CASE STUDY

SeQura closes an agreement with Chenavari for a debt facility of up to €200m.

SeQura, the leading online payment platform in Spain, has reached an agreement with Chenavari to have a debt facility of up to €50m in the first phase and with the possibility to scale it up to €200m. This partnership will be key to supporting its growth, innovation in payment products, and finance new services to its end users.

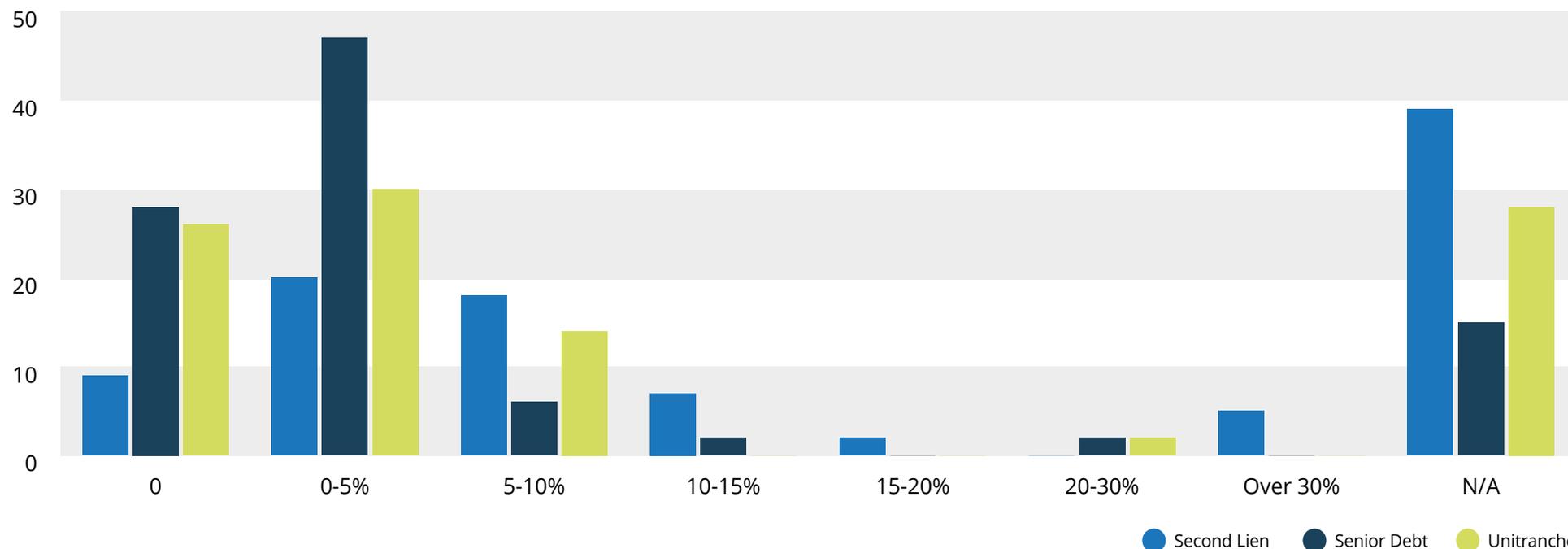


A final aspect to consider is the markdowns that have already taken place or are likely to do in the near term. Figure 16 suggests that while some firms have already taken markdowns on some positions within their portfolio, this has been relatively low considering the state of the economy. Nearly 47% of respondents reported adjusting the marks on their senior positions down by less than 5%, with nearly 30% reporting no downward adjustment at all. While there were more pronounced markdowns lower down the capital stack, most of the downgrades reported for unitranche and second lien positions by our respondents were also below 10%, with relatively few outliers reporting higher downgrades.

While valuation remains a significant challenge, the income generating nature of private credit means that investors often find it easier to verify the valuations provided compared to other assets classes. It can be less challenging to confirm an interest payment than it might be to determine a price for public or private equities. The longer-term investment horizon for many private credit strategies means that there are more ways to smooth the impact from short-term factors over the life of the investment.

Any findings from our data with respect to both covenants and markdowns come with the caveat that the market will face a more stringent examination if the economy fails to continue the recovery that began in the middle of 2020. Should this scenario materialise, the performance of private credit funds will be significantly affected by their ability to protect value for their investors and exercise control – something that will largely be determined by the strength of the loan agreement and relationship with the borrower. Similarly, while there may be reluctance to markdown portfolios if there are credible reasons to believe that the value can still be realised, circumstances may simply curtail whether such optimism can be justified.

Figure 16. What are the average downward adjustments or estimated downward adjustments to par value of the following types of loans within your portfolio during Q1 and Q2, where most relevant?



Chapter 2 – Lending after the pandemic

Prior to the onset of the pandemic, asset owners were increasingly looking for private credit managers who could either deploy in greater volume, in niche areas or, where possible, offer both. Questions of deployment capabilities, deal flow or origination pipelines were central to how firms raised capital and the expansion of the asset class. While many things have been affected by the pandemic, it has not yet materially reduced the importance of this question to private credit managers and their investors. Our data indicates that private credit managers expect to provide borrowers with more than \$100bn of fresh financing in 2020. This would be comparable with their lending levels in 2019, despite the disruption in the economy.

This section will assess how managers are currently deploying capital, the key trends driving their investment decisions and how firms are addressing challenges within their existing portfolios.

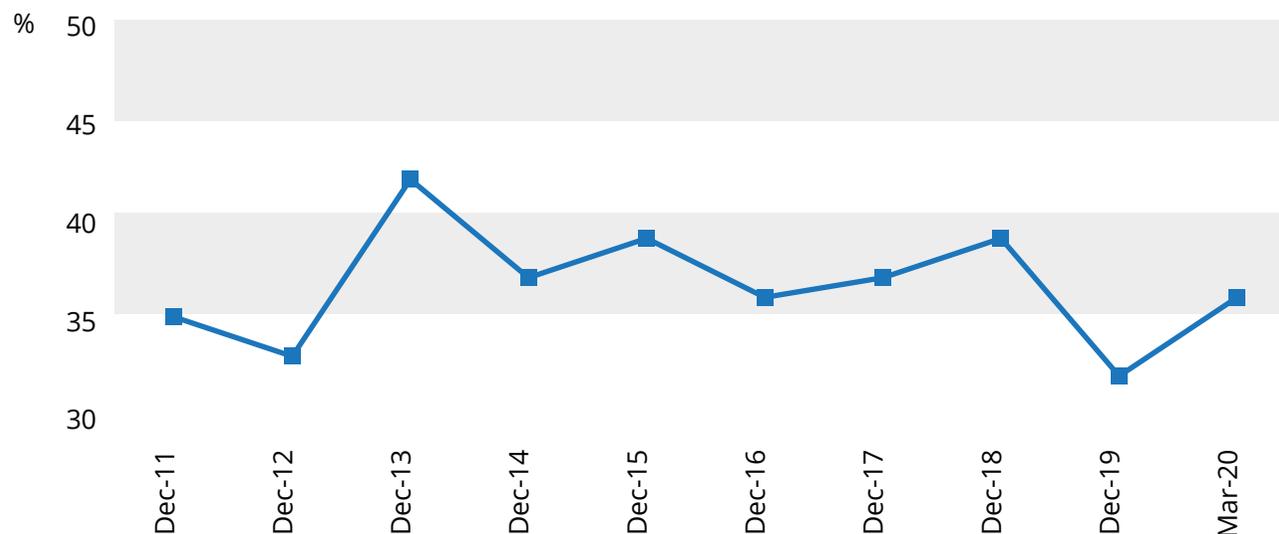
Capital deployment

As we can see from Figure 17, the industry went into the crisis with levels of dry powder that were broadly consistent with previous years. Closer examination of this data indicates that the dry powder was not equally spread across different markets, with direct lending making up the majority as per Figure 18. Similarly, Figure 19 indicates that North America accounts for the most dry powder when broken down by region.

These reserves of dry powder indicate that the sector is well placed to act as a provider of capital to businesses, irrespective of any future capital raising activity which will be covered in the following chapter.

While the volume of dry powder in the market is largely an empirical question, the opportunities to deploy capital in the current market are harder to quantify. To help estimate this our survey asked respondents to state their approximate annual business volume in 2019 and expected business volume in 2020 (see Figures 20 and 21). Aggregating this data indicates that respondents deployed \$53.85bn total in 2019 and intend to deploy \$53.65bn in total by the end of 2020. The respondent base for this survey manage a combined \$431bn of private credit assets or 51% of global private credit assets³. Extrapolating the data from our sample size relative to the global market suggests that private credit managers will invest \$113bn during 2020.

Figure 17. Private credit dry powder as % of committed capital



Source: Preqin

“Private credit managers expect to lend more than \$100bn of fresh financing in 2020.”

³Preqin Q1 2020 data - \$851bn global private credit assets

Figure 18. Private debt dry powder by fund type, 2000-2019 (\$bn)

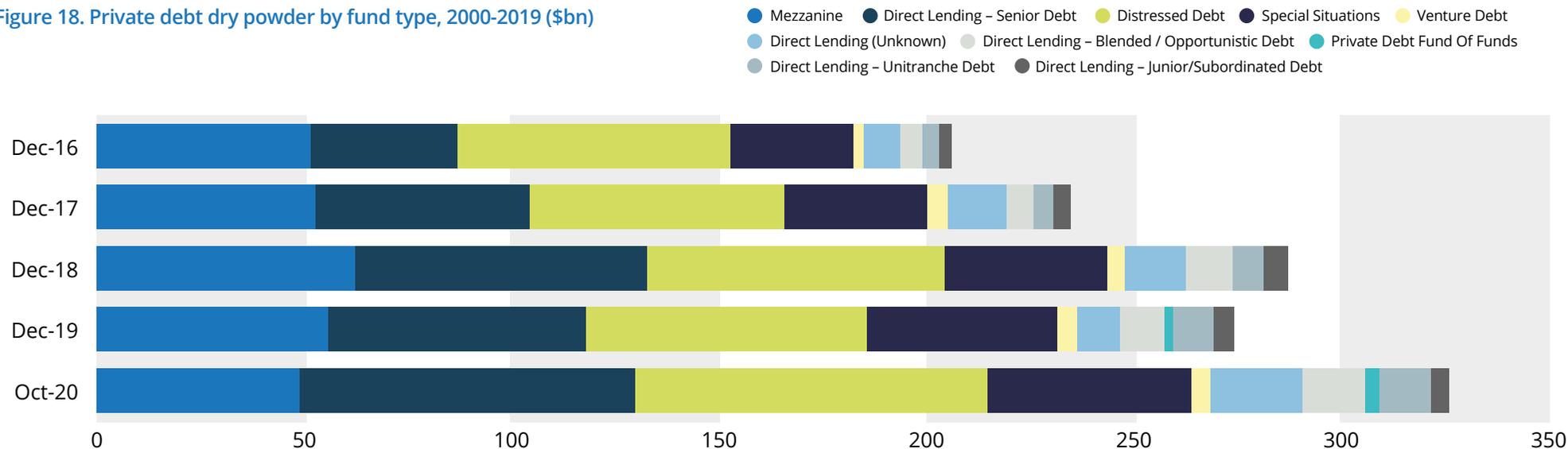
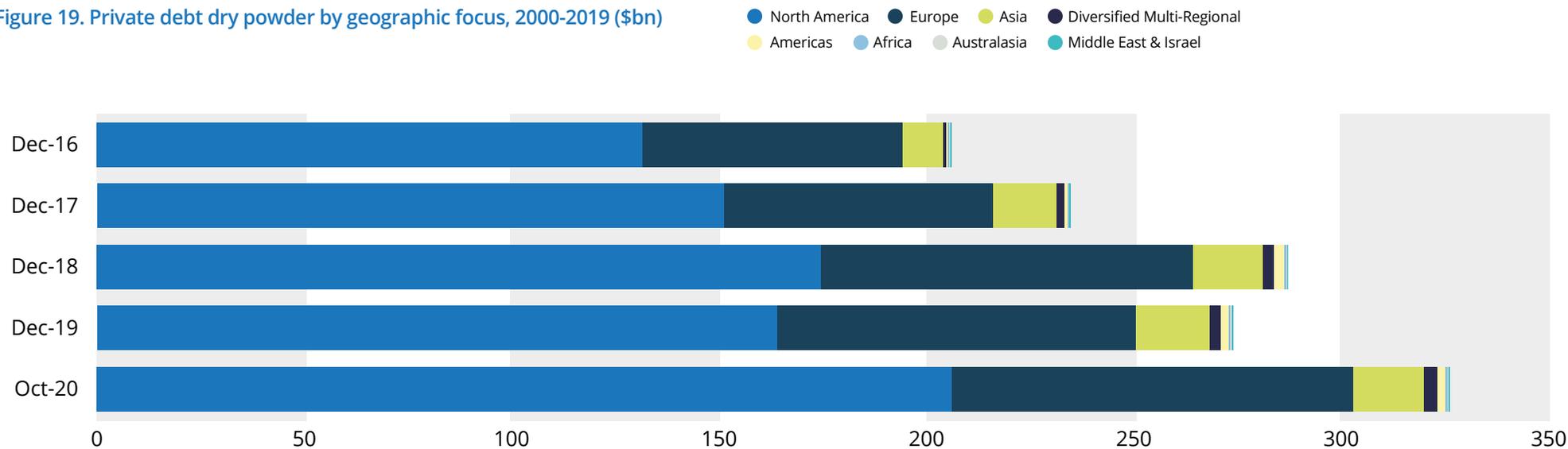


Figure 19. Private debt dry powder by geographic focus, 2000-2019 (\$bn)



Source: Preqin

CASE STUDY

INOKS Capital's funds finance rice production in Ivory Coast

INOKS Capital supports agricultural communities in Ivory Coast to enable local rice production with the aim to improve local rice availability and increase the quantities produced and support more stable market prices. The facility agreement of up to €10m finances the following local activities: purchasing, storing, conditioning, processing and distribution of rice production. Especially due to the impact of Covid-19 it is vital to support financing of smallholder farmers' cooperatives, improve access to better seed inputs and adopt modern agriculture and irrigation techniques to increase yields in production and enhance food security.



Figure 20. What was your approximate annual business volume in 2019?

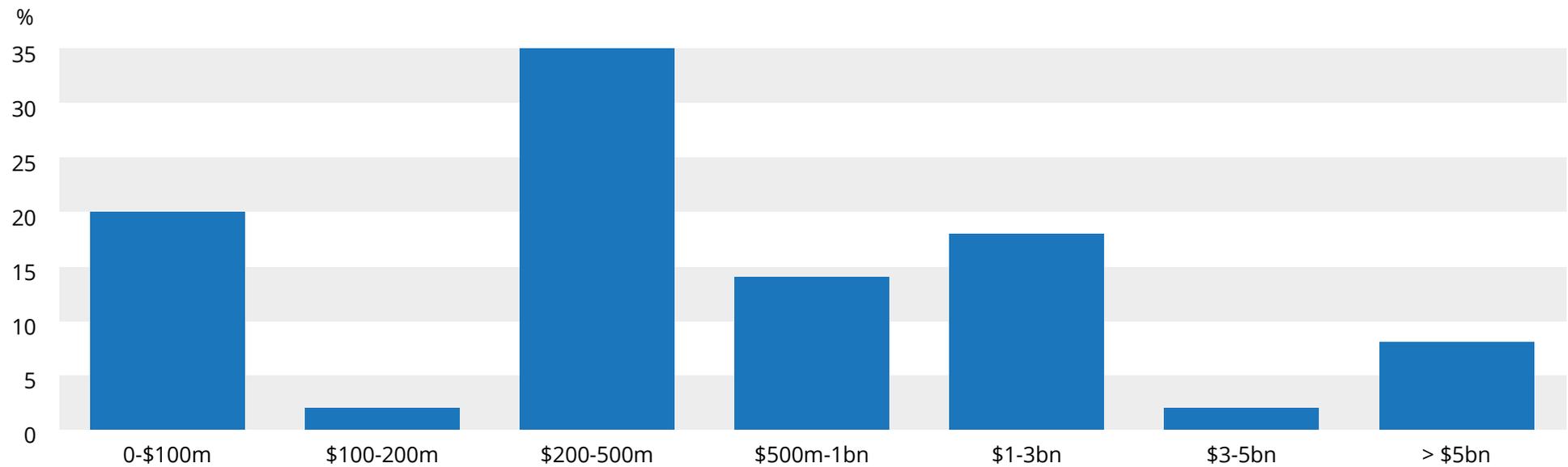
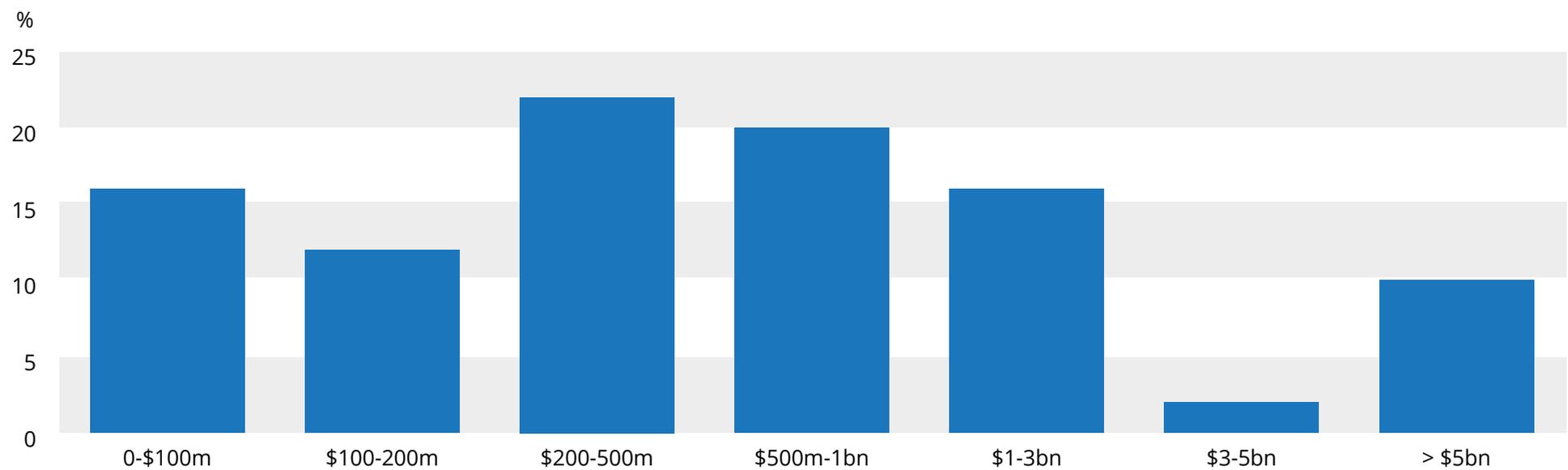


Figure 21. What do you expect to be your annual business volume to be in 2020?



While this would be broadly consistent with investment levels during 2019, our research indicates that the type of the deals that do take place will likely change in character. As described in the previous chapter, the challenging economic environment will give rise to a greater volume of borrowers who need different capital solutions. This is reflected in our data (see Figure 22), with respondents expecting performing loans in the SME and mid-market to be the biggest opportunity to deploy capital in 2021. Our data also indicates that the sector is anticipating greater investment in liquidity/bridge finance or special situations lending. A smaller number of respondents see significant opportunities in stressed or distressed loans, despite other data suggesting distress from Covid-19 may peak in the first half of 2021

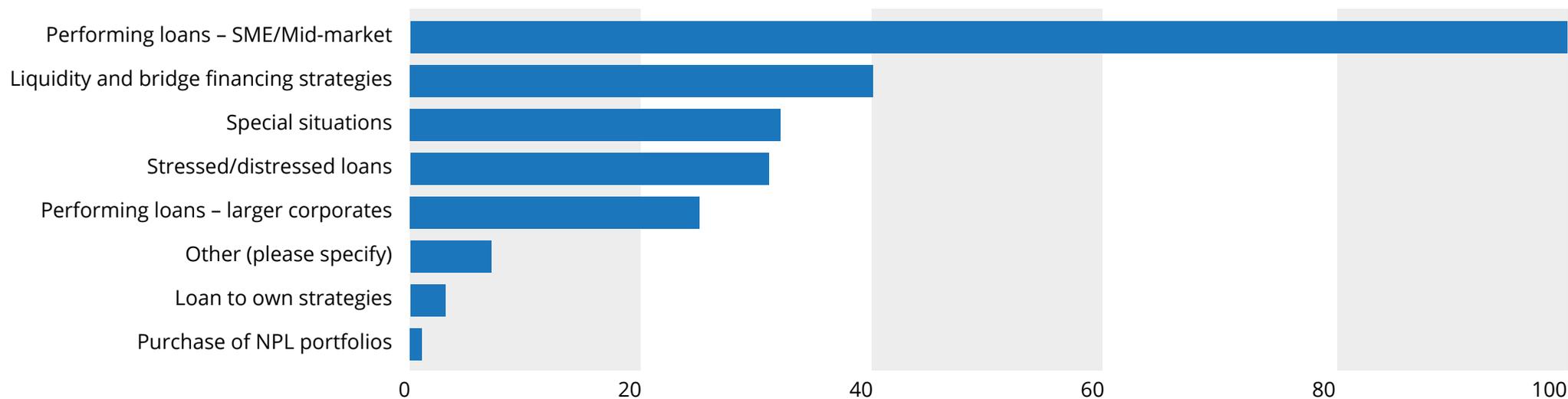
(See Figure 6). This discrepancy may simply reflect the low number of specialist distressed debt firms within our respondent base, or differences in how firms see their lending activity.

CASE STUDY

Prime Capital arranges the largest junior debt financing for renewable energy in Europe to date for MKM Invest Group.

Prime Capital AG has announced that it has arranged junior debt financing of €106m, in cooperation with ENERPARC AG, for a European solar PV portfolio which is owned by the independent power producer MKM Invest Group. The portfolio consists of solar PV projects in Germany, France, and Spain with a total capacity of 579MW. The instrument is cross-collateralised by 94 solar PV projects of mainly operational assets, as well as projects under construction. The transaction is believed to be the largest mezzanine financing in Europe in the renewable energy sector to date.

Figure 22. Where do you see the biggest opportunities/most likely deployment of your capital in the market in the next 12 months?†



† Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

SCORE (Responses X position)

This data highlights how the divisions between par lending, stressed, special situations, bridge financing and distressed debt are less clearly delineated at present. Several interviewees for this research made similar remarks and observed that private credit managers (and their investors) are adapting their approach in anticipation of a market that is likely to be more nuanced. As borrowers' finance needs and economic circumstances become more mutable, their position on the spectrum between par and distressed lending opportunities will fluctuate. Borrowers who know their needs may change are therefore more likely to need lenders who can be there for them in multiple scenarios. Lenders with the flexibility to adapt to this environment and meet specific financing needs are therefore likely to be more attractive to borrowers.

Dealing with shared problems

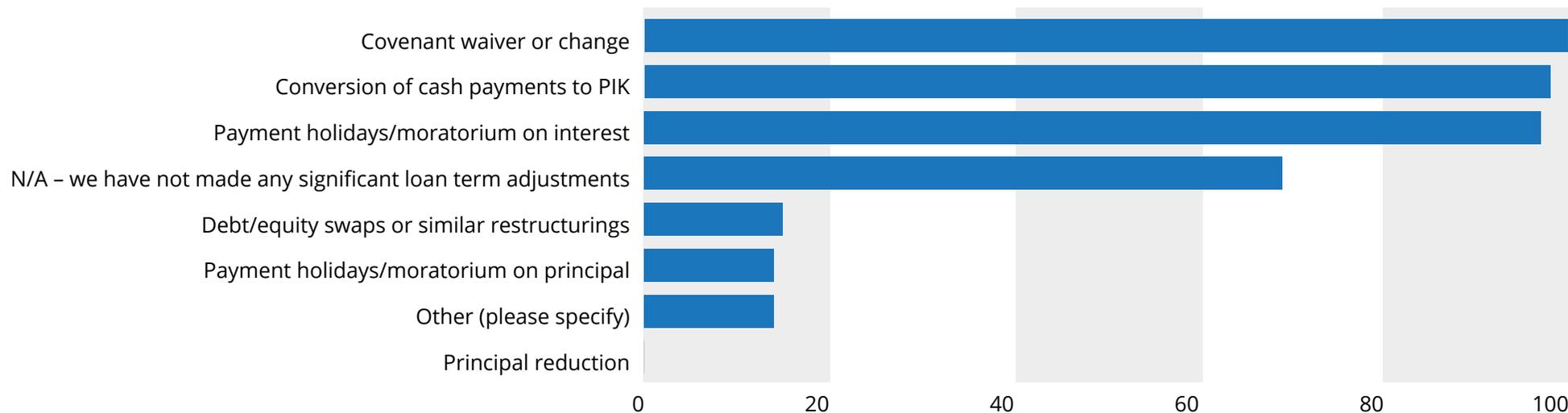
The direct relationship with the lender is frequently cited by borrowers as one of the key reasons why they favour private credit. This is an important factor when it comes to any necessary adjustments that might need to be made should borrowers come under stress. Direct relationships incentivise both parties to be open in their engagement and undertake remedial action quickly, reducing the impact of coordination or principal-agent problems and enhancing the ability of private credit managers to control outcomes.

Our survey sought to examine this aspect of the market in greater detail. Respondents were asked to describe the measures that they were taking when working with borrowers to mitigate the initial impact of the pandemic and, where necessary, ensure the continued alignment of a business's financial arrangements and its business

plan. Our data indicates that while there is a general trend towards pragmatism and forbearance, managers are adopting bespoke approaches to individual borrowers within their portfolios.

As per Figure 21, respondents are implementing or expect to implement several means of forbearance towards their borrowers. The largest segment of respondents stated that they have offered some form of payment holiday or moratorium on interest, this was closely followed by those who have converted cash payments to PIK and firms who have either waived or modified covenants. A smaller number of respondents are also undertaking or considering stronger measures such as payment holidays on principal, or debt for equity swaps. A significant number of respondents indicated that they have not made significant loan term adjustments which indicates that many loans made by private credit managers continue to perform well.

Figure 23. What form/type of significant loan term adjustments have you taken or expect to take by the end of the year as a result of stress in your portfolio?†



† Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

SCORE (Responses X position)

CASE STUDY**Certain Funds and Accounts Managed by Affiliates of Apollo Global Management, Inc. Provide \$800m Term Loan Commitments to New Fortress Energy LLC**

Apollo Global Management, Inc (together with its consolidated subsidiaries, "Apollo") today announced that certain funds and accounts managed by its affiliates provided term loan commitments in an aggregate principal amount of \$800m under a new credit facility to New Fortress Energy LLC. The Term Loan Facility has a three-year term, and loans issued under the facility will bear interest at an annual rate equal to LIBOR plus 6.25%, subject to a 1.50% LIBOR floor and annual increases in the interest rate spread. New Fortress will use net proceeds of the loan to fund the development and construction of the Company's energy infrastructure projects around the world, and to repay its existing \$500m term loan facility in full.

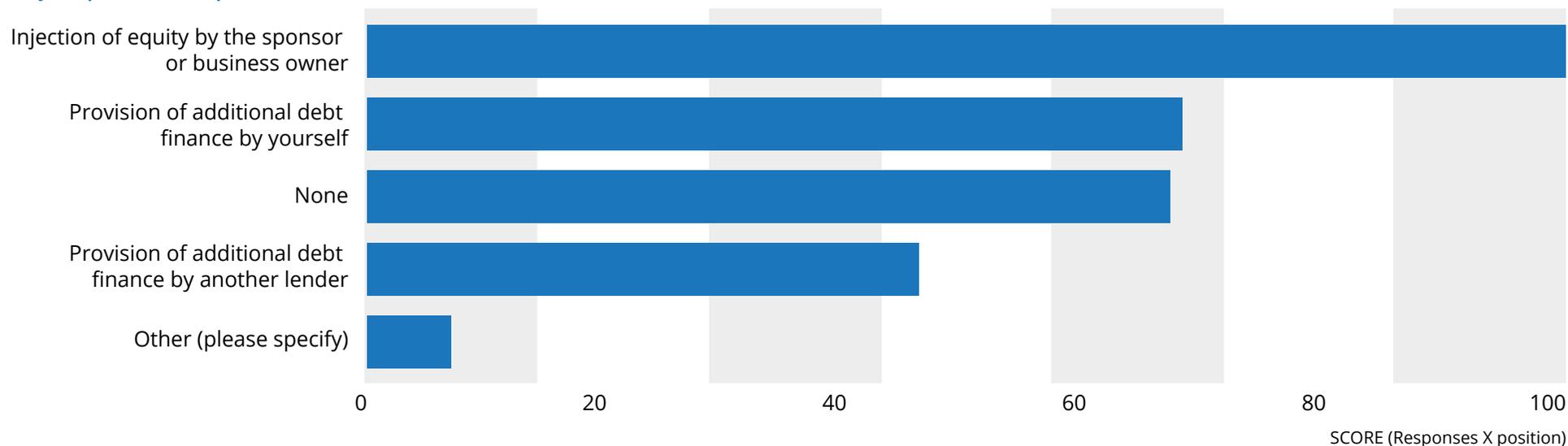


Our survey asked respondents about the actions they expect to take to mitigate the impact of market stress on their portfolio companies (see Figure 24). Perhaps unsurprisingly, there was a broad expectation that additional equity would be provided by either the sponsor

or business owner. 35% of respondents indicated this was their first expectation and 92% of respondents cited this as one of their top three expectations. The provision of additional debt finance by the manager was cited by 39% of respondents as their second preference, with the provision

of additional debt finance by another lender was cited as the third most likely outcome by 44% of respondents. 31% of respondents indicated that their primary expectation was that they would not undertake any of the actions listed before the end of the year.

Figure 24. Which of the following actions have been taken or are expected to be taken before the end of the year to mitigate the impact of the market stress on your portfolio companies?†‡



| | Injection of equity by the sponsor or business owner | None | Other (please specify) | Provision of additional debt finance by another lender | Provision of additional debt finance by yourself |
|-----|--|-------|------------------------|--|--|
| 1st | 35.4% | 31.3% | 2.1% | 12.5% | 18.8% |
| 2nd | 34.8% | 0.0% | 4.3% | 21.7% | 39.1% |
| 3rd | 22.2% | 11.1% | 0.0% | 44.4% | 22.2% |

† Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

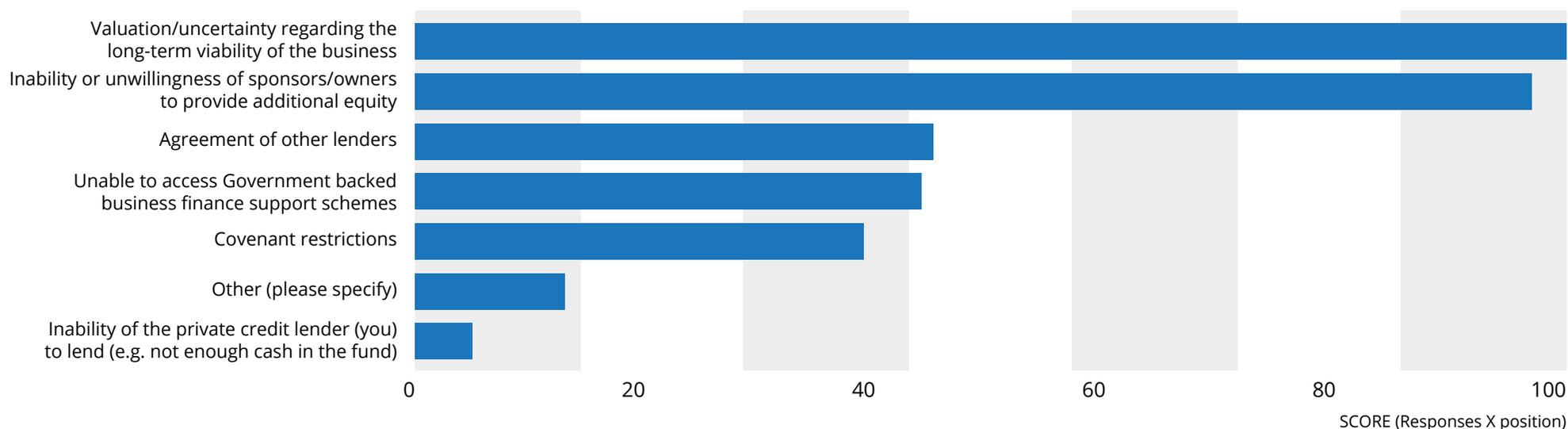
‡ Respondents were asked to rank their top three preferences when answering this question. This table shows the distribution of their preferences between positions 1,2 and 3.

Our research also sought to identify the main hurdles facing borrowers in need of additional credit/liquidity. Responses to the survey indicate that there are three

interlinked issues at the forefront of private credit managers' thinking – valuation, the perceived inability or unwillingness of sponsors/owners to provide more

equity, and the agreement of other lenders (see Figure 25).

Figure 25. What are the biggest hurdles to getting additional credit/liquidity to your portfolio companies?†‡



| | Agreement of other lenders | Covenant restrictions | Inability of the private credit lender (you) to lend (e.g. not enough cash in the fund) | Inability or unwillingness of sponsors/owners to provide additional equity | Other (please specify) | Unable to access Government backed business finance support schemes | Valuation/uncertainty regarding the long-term viability of the business |
|-----|----------------------------|-----------------------|---|--|------------------------|---|---|
| 1st | 14.6% | 10.4% | 2.1% | 20.8% | 4.2% | 12.5% | 35.4% |
| 2nd | 4.0% | 16.0% | 0.0% | 48.0% | 4.0% | 12.0% | 16.0% |
| 3rd | 33.3% | 8.3% | 0.0% | 25.0% | 0.0% | 25.0% | 8.3% |

† Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e. a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

‡ Respondents were asked to rank their top three preferences when answering this question. This table shows the distribution of their preferences between positions 1,2 and 3.

These findings reflect the uncertainty that exists in the economy at present, and the diverse range of loans, borrowers and financing arrangements within private credit - no two loans are exactly alike. The provision of additional capital (whether debt or equity) to a business often requires a similar level of diligence as when making an initial investment, which encompasses everything from the documentation underpinning the loan, deal structure, collateral, industry, location and market position of the underlying borrower, as well as the relative role or otherwise of sponsors. Any assessment of how and whether to add more capital requires a re-assessment of these same factors. Furthermore, firms are having to re-analyse their projections for portfolio companies to ascertain the likelihood and timeframe of their recovery. This then needs to be assessed at the aggregate/portfolio level.

As we have seen, the prevalence and strength of covenants within loan documentation varies across the industry. Where there are fewer or weaker covenants, lenders will be limited in their ability to insist on remedial measures. In these circumstances, there will be fewer clear-cut scenarios where the most appropriate way to provide additional capital can easily be determined.

This also has important implications for future government policy. It is unlikely that seeking to provide uniform solutions to the debtor/creditor issues emerging during the pandemic will provide for an efficient solution in these markets. For example, providing blanket payment holidays may delay necessary restructurings, possibly impair value and slow down the eventual recovery.

A final consideration affecting the current lending environment is the relatively low uptake of government-backed liquidity support schemes by the portfolio companies of private credit managers. Again, our data (see Figure 26) points towards a mix of approaches, with a large amount of dispersion in how private credit managers' portfolio companies participated in government-backed liquidity schemes. Such schemes played a central role in stabilising the economy overall, yet our data demonstrates that many private credit managers' portfolio companies either chose not to use such schemes or were ineligible.

Many government schemes were initially targeted at either micro-businesses or larger corporates. This left a gap for mid-market businesses who typically use private credit. A second element was that the design of the schemes was often based around traditional lending models, whereby simple measures such as existing leverage levels were used to assess eligibility. These features made the schemes less appropriate for many private credit portfolio companies. A further drawback identified by private credit managers was the seniority of the government sponsored loans and political risk attached to participation in such schemes.

These factors illustrate the range of approaches that are being employed by private credit managers to manage their portfolios. While the tools may differ, the risk management and monitoring processes employed by private credit managers have proved sufficiently robust, despite the large economic dislocation that took place in early 2020.

Disruption in the economy and the attendant need for finance among borrowers is likely to continue beyond 2020. This does not mean that all borrowers, lenders and lending opportunities are created equally. Navigating this complexity will require managers to meet the same basic challenges that they have always faced – maintaining discipline in their due diligence and underwriting practices, while maintaining robust and comprehensive risk management processes. The breadth of approaches being taken by private credit managers to deploying capital and managing their portfolios suggests that investment outcomes will follow a similar pattern, leading to greater dispersion in performance between managers.

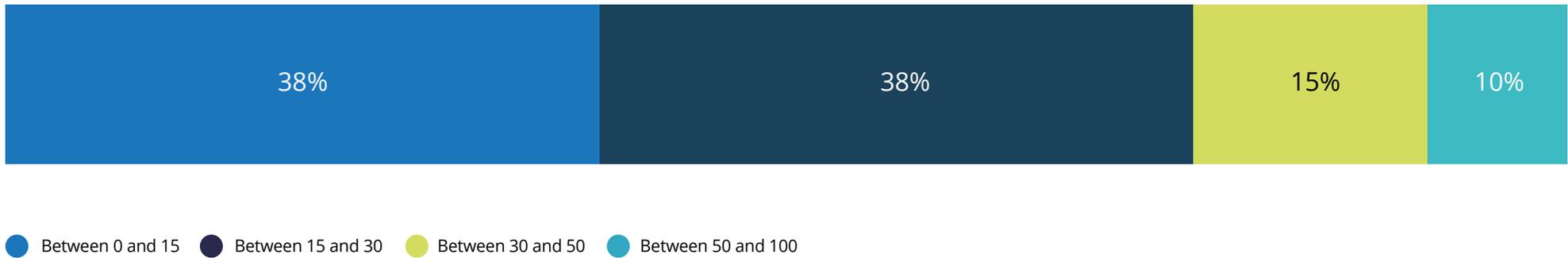
CASE STUDY

Tree Line and CVC Credit increase existing term loan to Ingenio to support add-on acquisition.

Tree Line Capital Partners, LLC ("Tree Line"), and CVC Credit Partners ("CVC Credit") provided an increase to their existing term loan to \$127.3m to Ingenio to support an add-on acquisition. Tree Line served as Administrative Agent and Lead Arranger on the transaction.

Headquartered in San Francisco, Ingenio is the leading online platform that connects advice-seekers with coaches and advisors. The platform has enabled over 40m conversations from around the globe, making Ingenio the leader in phone, chat, and web-based personal advice. Ingenio is owned by Alpine Investors and management.

Figure 26. What proportion of your portfolio companies have participated or are expected to participate by the end of the year in government liquidity support schemes?



CASE STUDY

Keensights Capital become majority stakeholder for Sogelink group

Keensight Capital replaces Naxicap Partners as majority stakeholder of Sogelink group, a leading provider of Software as a Service (SaaS) solutions for infrastructure sector professionals. Founded in 2000, Sogelink group designs, develops and markets software and SaaS solutions intended to simplify and optimise complex business processes in the building sites, infrastructure and property management industry. The transaction structured by Keensight Capital will allow Sogelink group to cement its position as an independent leader in the markets currently addressed, to provide support in developing and diversifying Sogelink's product range, notably by marketing new business-specific solutions, and to acquire growth businesses to extend the group's international footprint and bolster certain areas of expertise.

Chapter 3 – Preparing for recovery

The expansion of the direct lending market, particularly SME and mid-market lending, has been at the forefront of private credit's expansion. More recently, investors in private credit have diversified their exposure by looking at strategies targeting new credit assets and, in doing so, have expanded the private credit universe. Capital raising for private credit has therefore been characterised by both growing volumes – in aggregate and in terms of individual fund sizes – as well as greater targeting of specific strategies or assets. Capital raising for private credit strategies therefore entered 2020 with good momentum and this has sustained fundraising for the asset class, despite the inevitable disruption caused by Covid-19 and any pause for thought this might give some allocators. Our data indicates that respondents expect this momentum to continue and there has not yet been a significant change in investor attitudes towards private credit.

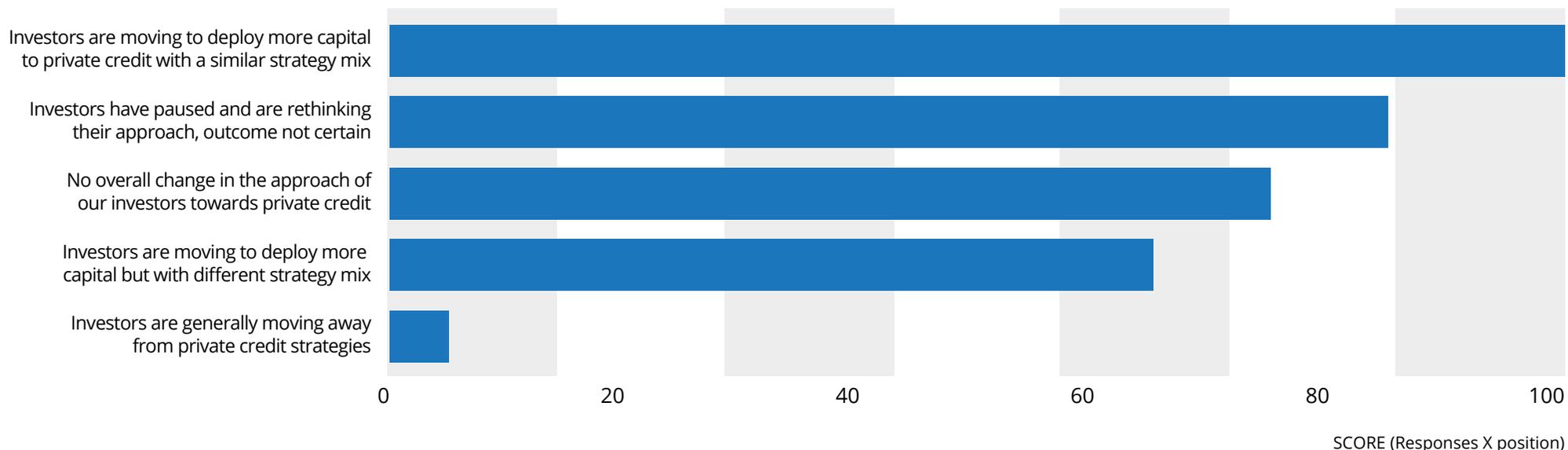
Figure 27 provides an illustration of this momentum, with only a fraction of respondents expecting investors to move away from private credit strategies because of the pandemic. Most respondents opted for the more positive or neutral options offered to them. While the expectation that investors would deploy more capital with a similar strategy mix was the top ranked answer, there was also an even dispersion between the other positive and neutral options. This positivity is also reflected in capital raising plans, with 88% of firms planning to continue raising capital for existing strategies and 98% of respondents planning to raise capital in some form next year (see Figure 28).

CASE STUDY

Tikehau Capital arranges Unitranche financing with an ESG-linked ratchet mechanism

In 2020, Tikehau Capital arranged the first Unitranche financing with an ESG-linked ratchet mechanism in order to support the acquisition of Talan, a French IT services company by Towerbrook and Management. Tikehau Capital arranged a €183.5m financing, including a €123.5m Unitranche and a €60.0m Acquisition Facility. Pricing includes an ESG-linked ratchet mechanism in an effort to push Talan to further improve its ESG score during the life of our financing. This is a first-time feature for a Unitranche financing, evidencing Tikehau's continuous commitment to ESG and pioneer role on this front. Talan, headquartered in Paris and employing over 2,200 FTEs, was founded in 2002 by Mehdi Houas, Philippe Cassoulat and Eric Benamou.

Figure 27. How has the Covid-19 pandemic affected your investors' attitudes towards private credit?^{†‡}



| | Investors are generally moving away from private credit strategies | Investors are moving to deploy more capital but with different strategy mix | Investors are moving to deploy more capital to private credit with a similar strategy mix | Investors have paused and are rethinking their approach, outcome not certain | No overall change in the approach of our investors towards private credit |
|-----|--|---|---|--|---|
| 1st | 0.0% | 20.8% | 37.5% | 22.9% | 18.8% |
| 2nd | 4.8% | 14.3% | 4.8% | 38.1% | 38.1% |
| 3rd | 16.7% | 16.7% | 16.7% | 33.3% | 16.7% |

[†] Answers to this question were ranked in preference order by the respondent. For each answer option a score is calculated using this formula: sum of (no. of responses for each rank position x reverse rank position i.e a higher rank gets greater weight). Total scores for each answer option are then scaled to values between 0 and 100 relative to the most popular preference which is attributed the maximum score of 100

[‡] Respondents were asked to rank their top three preferences when answering this question. This table shows the distribution of their preferences between positions 1,2 and 3.

Figure 28. What are your capital raising plans for the next 12 months?



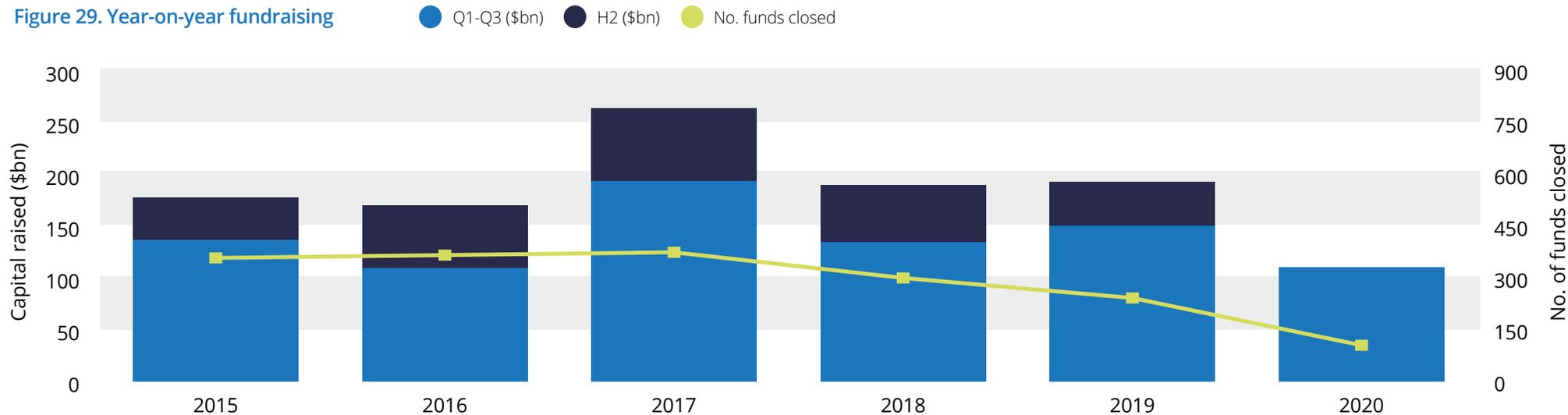
- Planning to raise capital for existing strategy/strategies and will continue to do so
- Planning to raise capital but have changed the focus of the strategy/strategies in light of Covid-19
- Not planning to raise capital
- Was planning to raise capital but will no longer do so in light of Covid-19

Recent fundraising data suggests that there was a reduction in private credit commitments up to Q3 in 2020 compared to the same period in 2019, with \$110bn raised against \$150bn (see Figure 29). Fundraising across all asset classes has been affected by public health restrictions that were introduced in the second quarter of the year (see Figure 30). This has affected the ability of

allocators to undertake due diligence in person and relationship management more generally. While scepticism towards online due diligence was prevalent in the earlier in the year, investors and managers have now identified solutions to the practical challenges presented by online due diligence and become more open to newer methods. With allocators and private credit managers now more

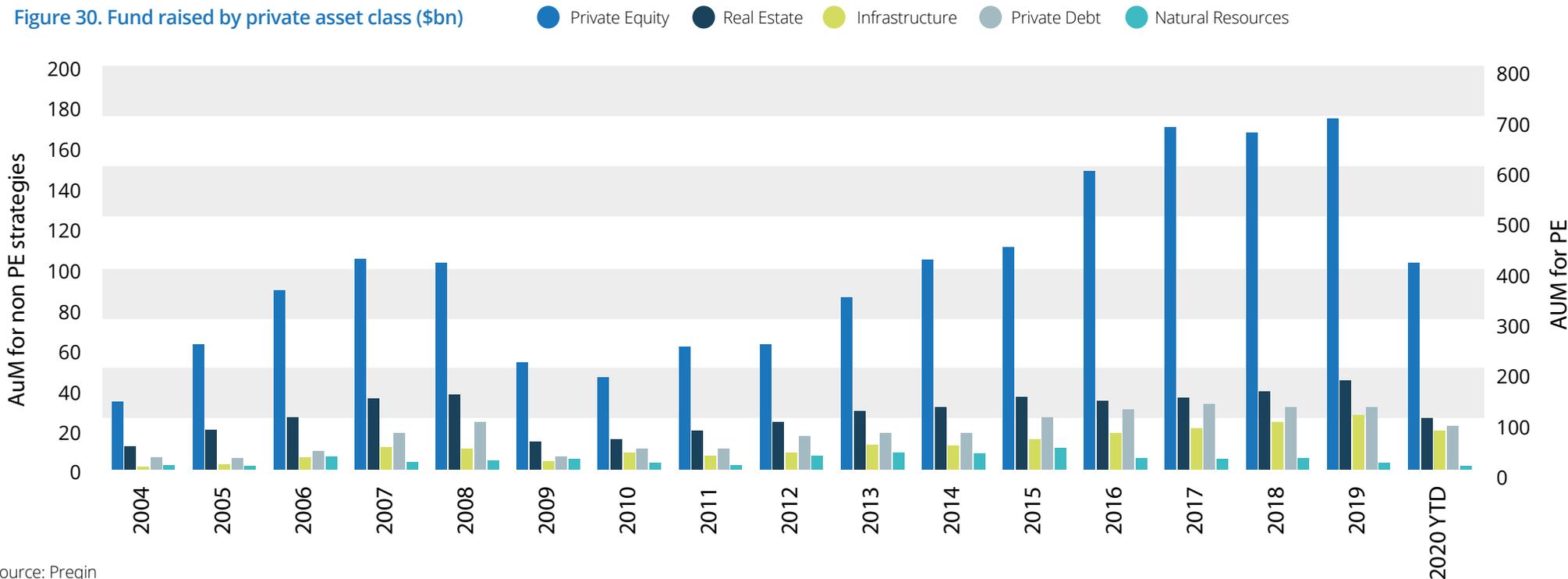
accustomed to the new working environment, we anticipate that allocations to private credit will largely end up being displaced to later in 2020 or early 2021 rather than being directed towards other asset classes.

Figure 29. Year-on-year fundraising



Source: Private Debt Investor

Figure 30. Fund raised by private asset class (\$bn)



Source: Preqin

CASE STUDY

Altavair Airfinance and KKR Announce \$1bn Aircraft Transaction with Etihad Airways.

KKR and Altavair AirFinance (“Altavair”), a leader in commercial aviation finance, announced today the signing of a definitive agreement to acquire a portfolio of commercial aircraft from Etihad Airways (“Etihad”), the national airline of the United Arab Emirates. The acquisition will be made through aircraft leasing investment platform Altitude Aircraft Leasing, which was established by KKR’s credit and infrastructure funds in 2018 to acquire aircraft serviced by Altavair.



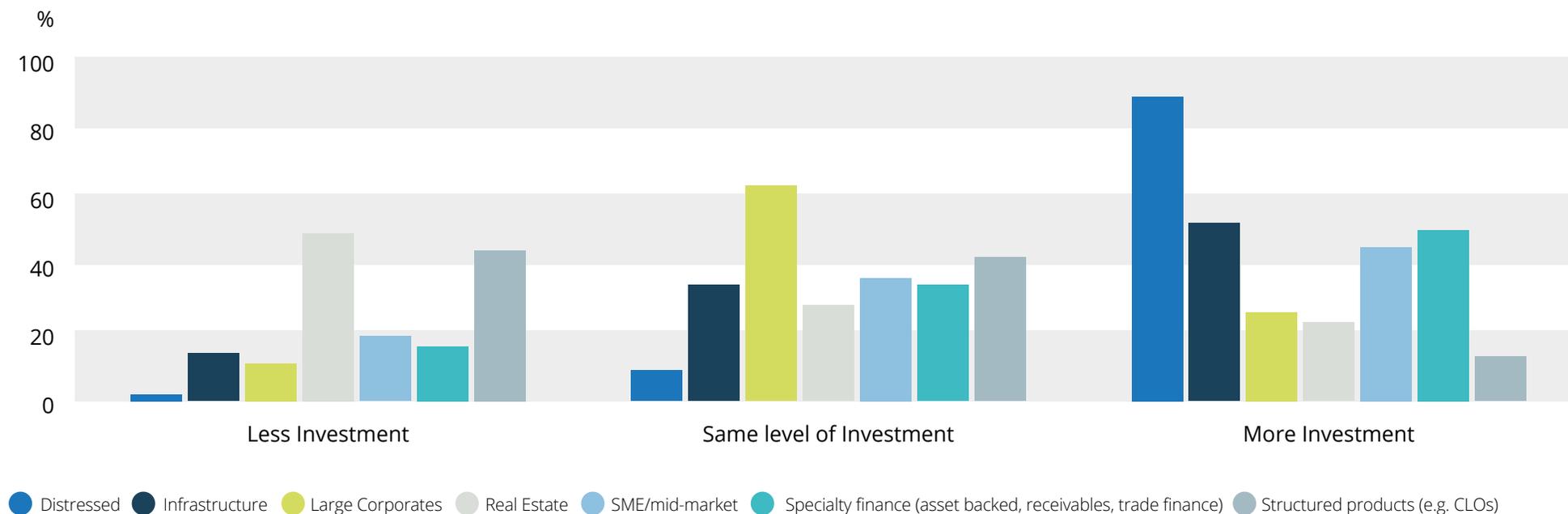
We also invited respondents to submit their views on how they expect allocations to different private credit strategies to change over the next twelve months (see Figure 31). In aggregate, our survey data indicates a net positive attitude among respondents towards more investment in the asset class, which is in keeping with other data points within this research.

Breaking down this aggregate view reveals that this net positive view masks some underlying differences towards sub-strategies within private credit. Many respondents saw good prospects for distressed debt, with 89% of respondents expecting more allocations to such

strategies. Strategies focussing on infrastructure debt (52%), speciality finance (50%) and SMEs (45%) were also viewed very favourably by respondents. While this data suggests broadly similar views on these different strategies, there are likely to be different factors fuelling these sentiments. For SMEs and special situations, the rationale centres on the demand for capital that will exist in the economy and the belief that private credit is well placed to meet these needs. The view on infrastructure is supported by investors looking for longer term investments that are less likely to be impacted by short term pressures.

The only two strategies that saw an overall net negative view from respondents were structured products (Collateralised Loan Obligations (CLOs)) and real estate. A substantial number of our respondents expected a reduction in allocations towards these strategies, with a much smaller number of respondents showing optimism towards either real estate or structured products (23% and 13% respectively).

Figure 31. How do expect allocations by investors to the following private credit strategies to change over the next year?



When we invited views from respondents on the markets, they expect to attract greater private credit allocations in the coming year, we found a similarly net positive view with similar variations across different regions. As per Figure 32, respondents were most favourable towards Europe (41%), closely followed by the US (39%) and APAC (ex. China and India) (39%). There was less consensus on the UK, China and India as destinations for investment, with data suggesting that opinions remain divided on each jurisdiction.

Our findings with respect to regions and strategies most likely to attract allocations are broadly consistent with trends identified in previous ACC research and that

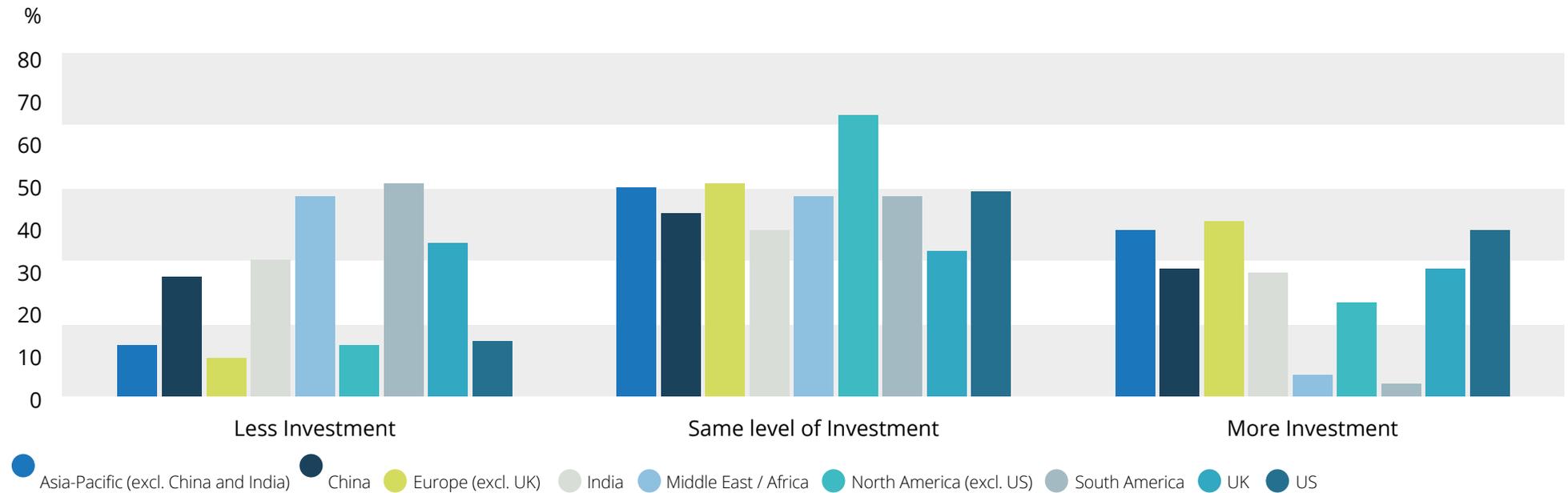
produced by third parties. When capital raising was discussed with our interviewees, they also gave little indication that their outlook, or that of their investors, had been substantially changed as a result of the pandemic. The need for more data to support any potential shifts in their investment strategy, combined with the exceptional nature of the disruption and the absence of clarity about possible treatments or vaccines were all cited as reasons to stick closer to pre-existing strategies. While this matter remains under constant consideration, any shifts in outlook are more likely to be evolutionary rather than revolutionary.

CASE STUDY

CVC Credit Partners backs Calibre Scientific's next phase of growth.

CVC Credit Partners ("CVC Credit") has provided a \$92 million multicurrency first lien credit facility to Calibre Scientific, the life sciences and diagnostics business owned by StoneCalibre. Funding provided by CVC Credit will be used to refinance the existing debt facility and to support the company's global acquisition strategy. Baird Global Investment Banking served as the exclusive debt advisor for the transaction.

Figure 32. How do you expect allocations by investors to private credit strategies focused on the following markets to change over the next year?



Conclusion

Our data shows that private credit providers continued to be a vital source of finance to borrowers during 2020, especially those who required flexible capital solutions and are outside the typical risk appetite of banks. The sector is on track to invest more than \$100bn during 2020 and set to do the same in 2021. Private credit managers have also stepped in to support borrowers facing stress due to the pandemic.

While few anticipated the scale of disruption that has characterised the economy this year, the sector has performed well and demonstrated resilience in the face of significant challenges. It has also continued to offer a valuable alternative to asset allocators seeking to maintain a balanced portfolio and meet their investment needs.

Looking ahead, it is encouraging to see that capital raising for private credit strategies has not slowed down. Investors continue to recognise the attractive qualities of the asset class and its ability to generate income, provide diversification or serve as a hedge during equity bear markets.

Our data also highlighted that the impact of 2020's economic disruption has not been evenly felt across the sector. The pandemic is likely to have magnified existing differences between managers on origination processes, deal structuring and risk management. Some dispersion of performance among managers is therefore to be expected during 2020 and in 2021.

The ACC's Financing the Economy research series has helped support dialogue and collaboration between private credit managers, borrowers, investors and policymakers. This year's edition has once again highlighted the need for the ongoing collection and distribution of data to support an evidence-based discussion on its future.



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 170 members that manage over \$400bn of private credit assets.

The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council.

ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business.

The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.



About AIMA

The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than \$2 trillion in hedge fund and private credit assets.

AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry.

AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 170 members that manage \$400bn of private credit assets globally.

AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

ALLEN & OVERY

About Allen & Overy

At a time of significant market change in the legal industry, Allen & Overy is determined to continue leading the market as we have done throughout our 90-year history. The firm will do this by ensuring we always challenge ourselves to bring new and original ways of thinking to the complex legal challenges our clients face.

We cover the full spectrum of alternative investment, upstream and downstream and across all asset classes, from the structuring and establishment of managers and their funds, to the investments that they carry out. We have dedicated teams in over 40 offices around the world, providing almost complete geographic coverage for our Alternative Investment Manager clients. We act for all types of funds, managers and investors, including global, industry leading managers, younger managers and start-ups/spin-offs, sovereign wealth funds, pension funds and insurance companies, and have deep sector expertise in each of the key asset classes: private equity, real estate, infrastructure, distressed and credit.

We help design and implement some of the most complex and innovative cross-border alternative investment structures, and the deals (domestic and international) that are done via those structures, whether leveraged finance, fund finance, CLOs, structured finance and securitisation, and corporate transactions. In addition our regulatory, compliance, employment and tax teams support our clients' transactional and operational requirements.

Acknowledgements



Anton Balint
Research and Communications Associate, AIMA



Sanjeev Dhuna
Partner, Allen & Overy



Yasmin Bou Hamze
Analyst, Private Credit, ACC



Tim Watson
Partner, Allen & Overy



Nick Smith
Director, Private Credit, ACC



ALLEN & OVERY