ALTERNATIVE
CREDIT COUNCIL

Alternative Credit Council Global Virtual Summit 2020

KEY TAKEAWAYS

ALTERNATIVE CREDIT COUNCIL

How are private credit managers weathering the current storm?

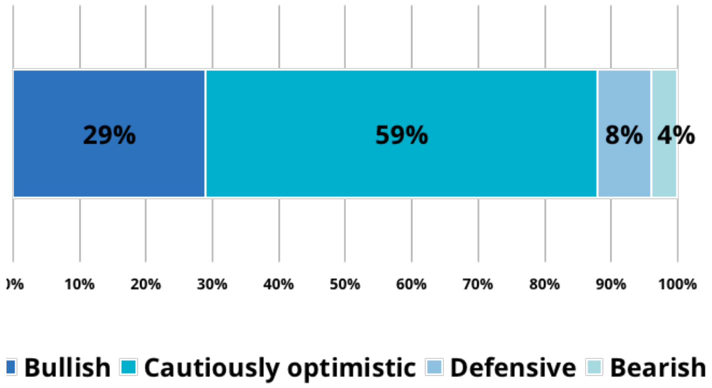
Despite the high anticipation of a turn in the credit cycle, the COVID-19 pandemic was not the downturn the industry expected, and the challenges it presents are unique. During the ACC Virtual Summit, we heard from a diverse set of allocators, managers and service providers about how they are faring in this new normal.

Liquidity remains the main issue many good businesses are facing, despite government support schemes. Private credit managers expect banks to find it harder to supply adequate capital to businesses, leaving opportunities for private credit to pick up the slack. Direct lenders and opportunistic credit managers are well positioned to support healthy businesses by moving quickly to bridge the liquidity gap left by governments and banks.

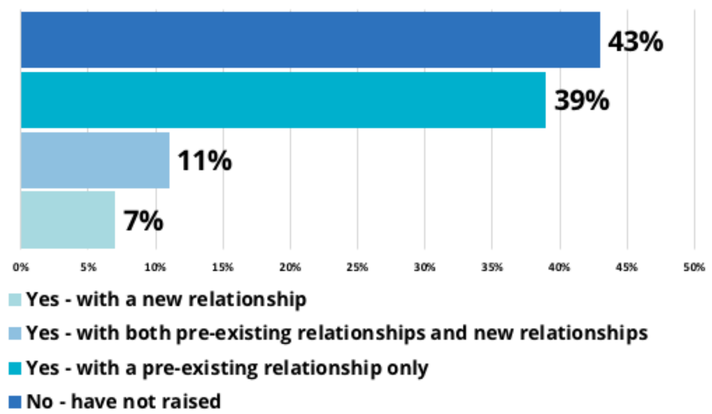
There were mixed views on the shape and speed of recovery but an audience poll indicated that a "W" shape recovery is expected by many, with speakers across the programme advising that allocators are ready to deploy capital in any potential second downturn. In addition, the slow burn of demand destruction and supply disruption will see stressed and distressed loans emerge as the biggest opportunity to deploy capital.

Furthermore, the pandemic will create challenges for managers in the illiquid credit space and test the resilience of individual firms. Not all managers are created equally and many were carrying leverage before COVID-19. This is likely to both shape consolidation of managers within the market and encourage the development of a healthy secondary market to alleviate concentrated risk positions. Lenders will also need to become more flexible and opportunistic – managers who can pivot with credibility will succeed.

How would you describe your sentiment towards private credit returns / opportunities over the next 12 months?



Have you raised capital in the last six months without having any face-to-face interaction?

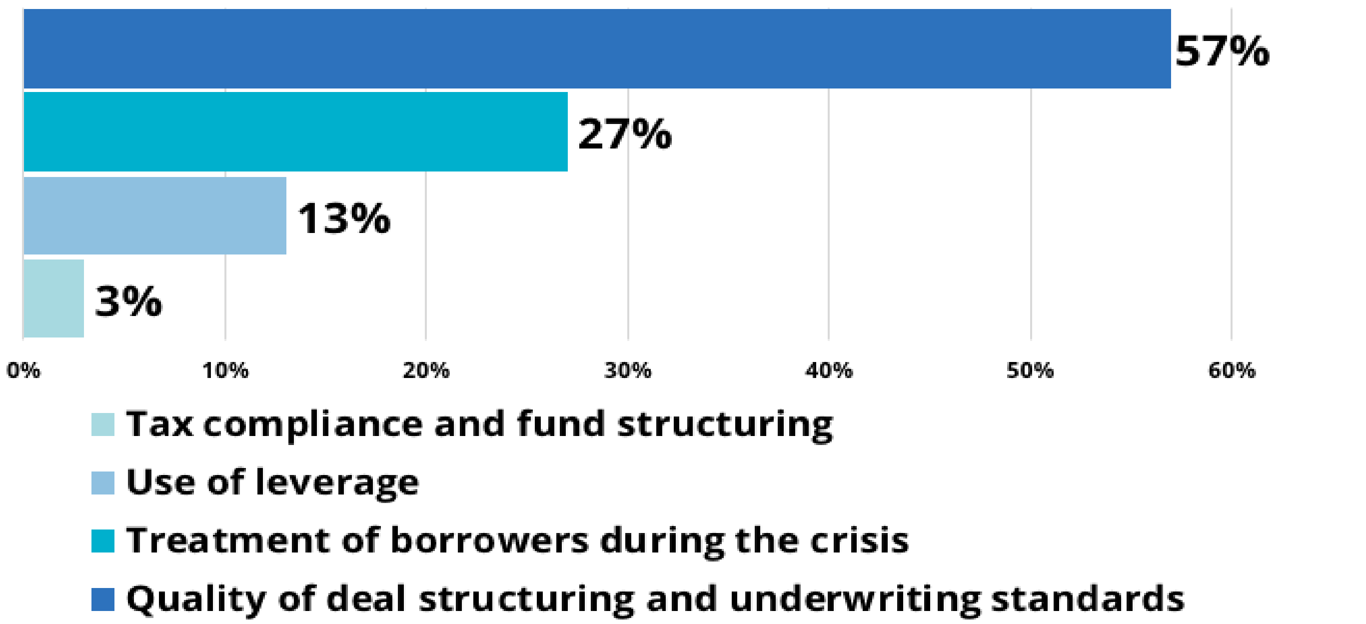


Supporting businesses through the downturn - survival of the fittest?

How do managers balance supporting borrowers with preserving capital for their investors? This is the fundamental question that has been occupying credit firms during Q2. The impact of COVID-19 is creating many novel risk factors in the market, requiring a combination of top-down and bottom-up analysis. A tailored approach, assessing each business on a case-by-case basis is necessary to determine how best to provide support or inject liquidity. The strength of existing relationships and the ability to engage with other lenders and sponsors to enable informed decision making is likely to be key in the efficiency of any recapitalisation or restructuring.

While the first half of the year was characterised by an accommodating approach to forbearance measures, managers are now ready to be more discerning of portfolio companies' requests and push back when necessary. As such assessments are made, a sharpened focus on deal terms has become necessary. Early signs suggest that more conservative attitudes towards leverage may begin to prevail. Cov-lite deals negotiated prior to the crisis are being tested as panellists and the audience agreed that the quality of deal structuring and underwriting standards will have the greatest impact on the reputation of private credit.

Which factor will have the greatest impact on the reputation of private credit over the next 12 months?



ESG – going big rather than going home

ESG is continuing to cement its position as a mainstream investment consideration. As opposed to dulling the focus on environmental, social and governance factors, this crisis has highlighted the importance of ESG analysis to ensure a full assessment of factors material to the financial return on investment. Allocators and regulators alike are no longer viewing ESG as optional.

At the current time, it is the 'social' factor of ESG that has come into particular focus. A pre-COVID tendency to dismiss social issues as endemic only to developing countries has been firmly challenged, as the crisis has highlighted that 'S' factors must also be considered in Europe, North America and other developed regions. Looking ahead, the industry must work with regulators when it comes to the commonly cited issues of harmonised reporting and data gathering efforts across key jurisdictions.

Understanding what allocators want

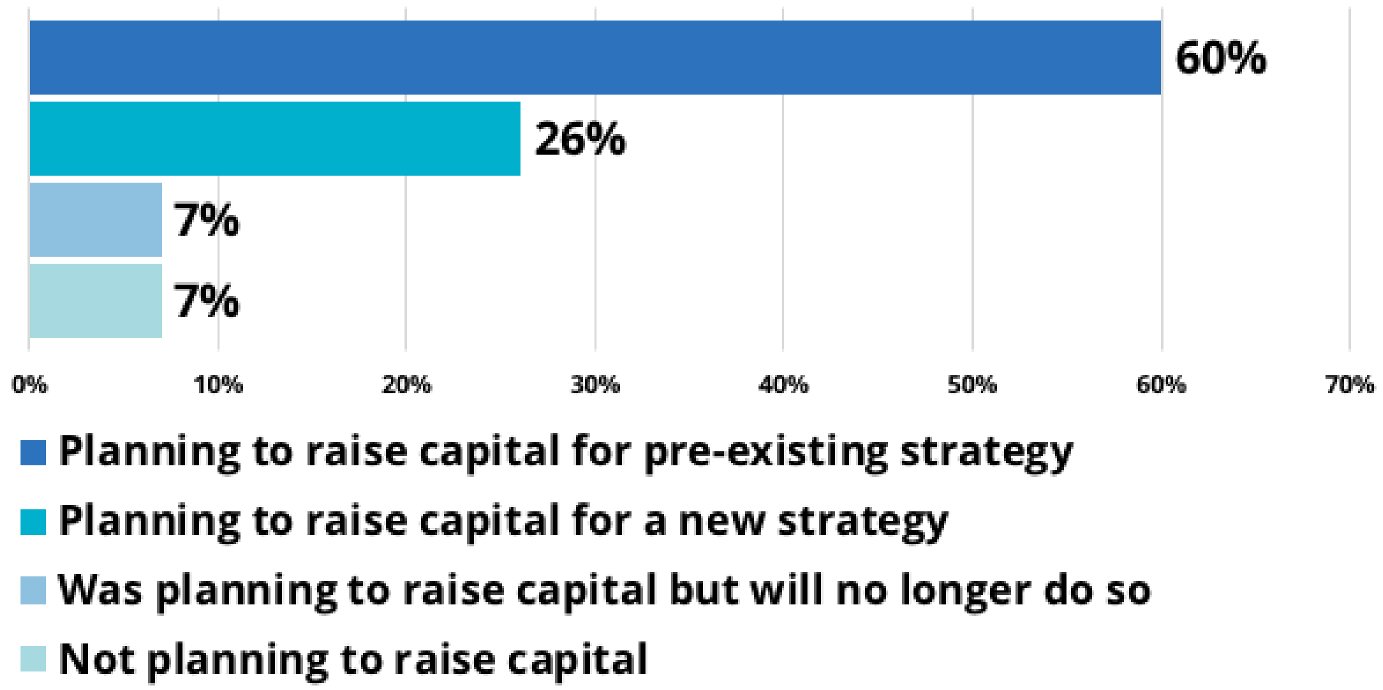
In short - more clarity, more depth and more granularity. Allocators across the programme agreed that their expectations have risen in relation to reporting and communications as they look to navigate the current stresses in the market. Managers have largely risen to the challenge and are reporting more often and with enhanced transparency.

In addition, allocators are revaluating existing allocations and adjusting how performance of managers is compared and evaluated. While homogeneous performance has characterised such comparisons in previous years, factors such as consistency of returns and justified risk-taking are now allowing some managers to distinguish themselves from their peers. Allocators are now looking past the numbers, digging deeper into portfolio construction and deal sourcing processes to understand how their managers have planned for and are dealing with a more challenging market.

Investors remain confident in the ability of private credit to deliver alpha relative to other asset classes but prefer to stay close to home, drawing mostly on managers in their existing portfolio. Here, managers who have more flexibility to provide a wider range of solutions are more likely to succeed in raising capital.

There is an active fund launch environment with some funds being raised at record speed. Indeed, a select few funds have been raised without meeting the investors in person, as many allocators have successfully adapted their due diligence processes to the new normal. Moreover, when it comes to new fund vehicles, allocators caution that existing investors should be offered first refusal before approaching new LPs.

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

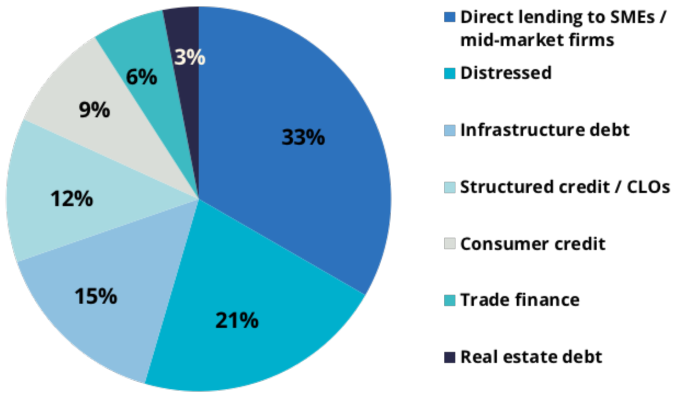


Global view – Looking towards APAC?

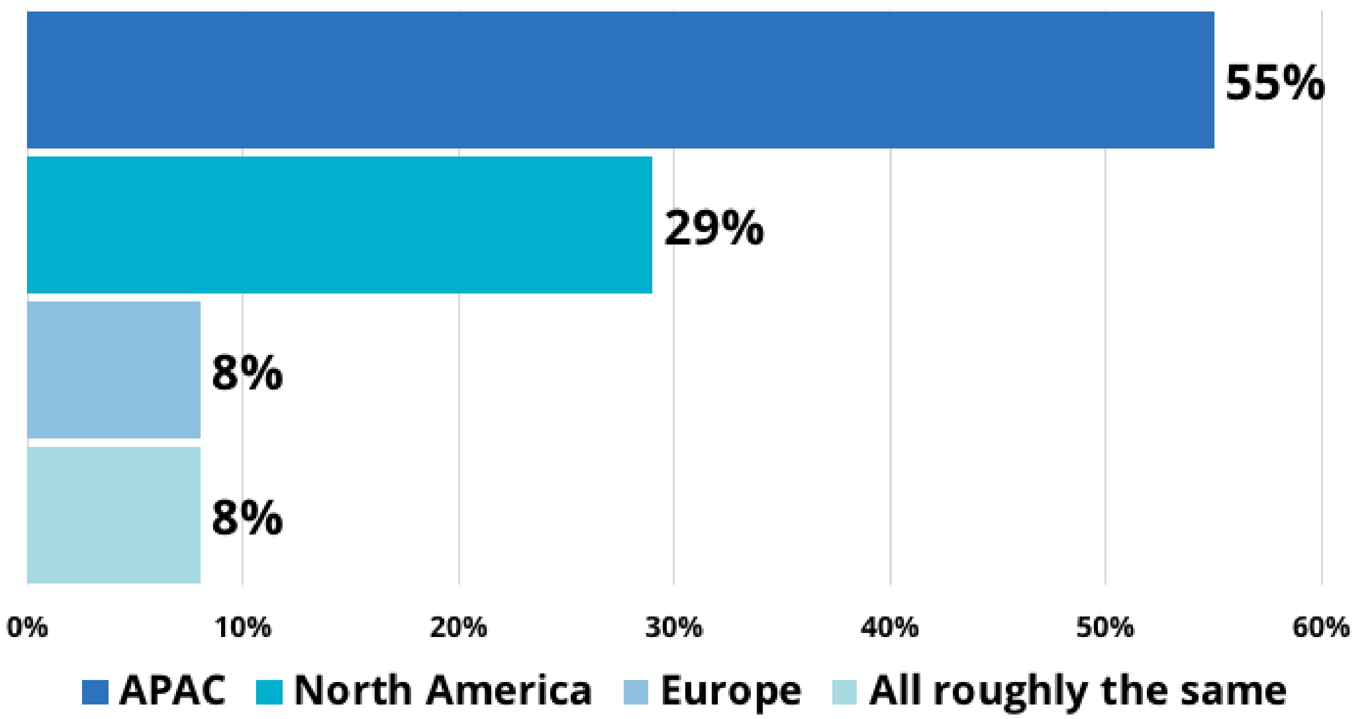
This crisis is a global one and one which requires a global viewpoint. Managers agree that a global footprint is valuable in anticipating the impact of COVID-19 by looking to Asian jurisdictions that have progressed further down the curve. While COVID-19 will accentuate existing trends of income inequality and regionalisation of trading blocks, participants predict that APAC will be the first region to return to pre-COVID GDP levels.

Local managers echoed this sentiment and report that the undercapitalisation of a vast percentage of SMEs and mid-market firms present an excellent opportunity for private credit to provide the flexible, fast and sophisticated capital support required to support the region's recovery. A lack of well capitalised banks leaves room for non-bank lenders to secure senior loans backed by strong collateral. Thus, while lending in Asia can require a strong stomach, risk-adjusted returns may make investment in APAC a worthwhile choice.

Where do you see the greatest deal flow for private credit in Asia over the next three years?



Which region is likely to recover to its pre-covid GDP levels first?

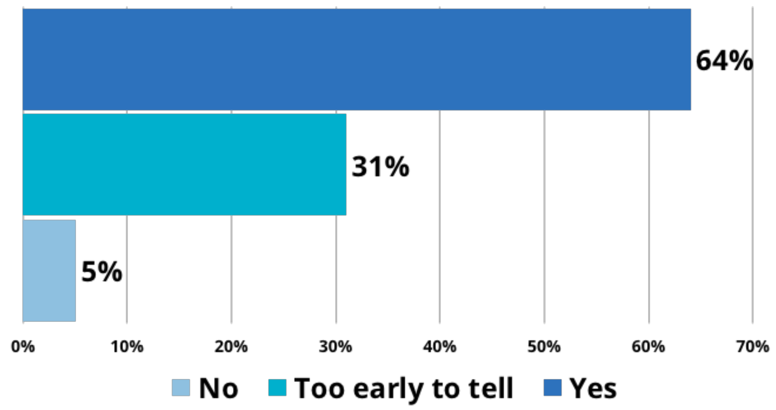


Where do we go from here?

As the pandemic is ongoing, it is too early to learn any meaningful lessons from the response to the crisis. Nevertheless, the valuable insights gathered over the course of the ACC Virtual Summit have allowed us to make three early predictions on how 'business as usual' could (or should) be permanently altered:

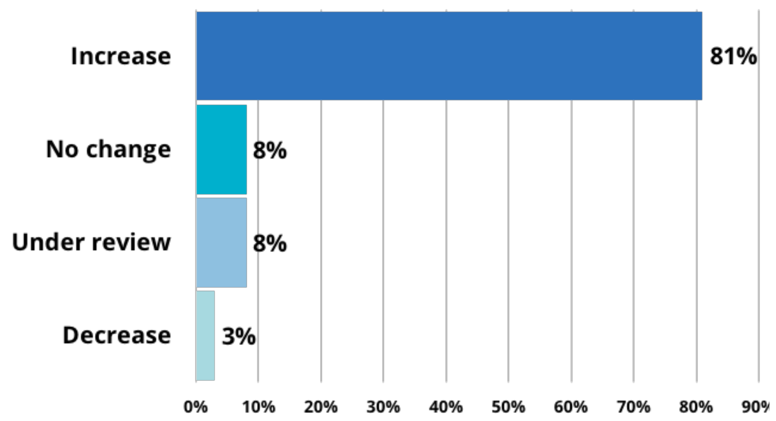
1. The pandemic will bring forth further challenges to the global economy, however private credit managers are optimistic about the ability of private credit to continue growing.

Will the current crisis lead to even faster growth of private credit?



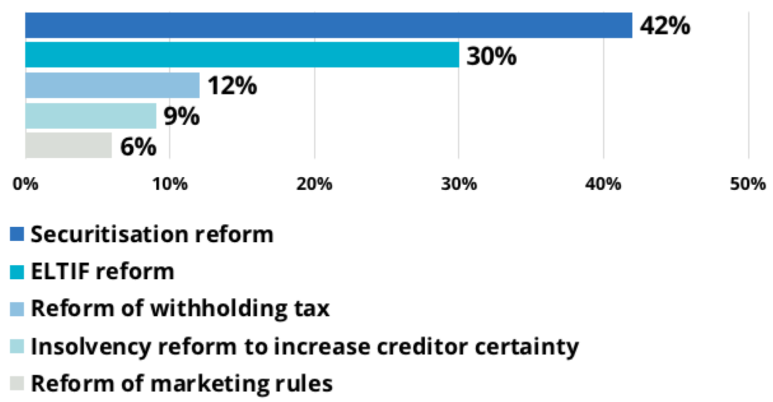
2. Investing in technology will pay off as the way we work has changed permanently, even when the industry eventually returns to working from the office.

How has COVID-19 influenced planned investment in IT / operational infrastructure?



3. Regulators must support the growth of non-bank lending and encourage private credit managers through targeted policy reform.

What policy reforms would you see as supporting the growth of non-bank lending in Europe?



The ACC would like to thank the speakers who have made the Summit possible

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