Private Credit in Asia Pacific

Opportunities for Diversification

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Private markets has experienced tremendous growth in the last five years globally. Despite the pandemic, investors continued to confidently allocate their assets in this sector. However, due to the changing geopolitical environment and recent rate hikes, private equity and venture capital valuations are showing early signs of stress.

As investors seek returns and diversification, they are increasingly investing private credit – a common trend also seen in Asia. We hosted a roundtable to analyze the current macroenvironment and discuss the opportunities for investing in the private credit market in Asia.

Eric Chng
Head of Alternatives and Insurance Client Segments, Asia Pacific, State Street

Wee Yap Yeo
Managing Director, SeaTown Holdings International

Nitish Agarwal
CEO and CIO, Orion Capital Asia

Eric: Following COVID-19, geopolitical tensions worldwide, and rate hikes triggered by the FED, there's a lot of uncertainty in the markets. What is your view on the macroenvironment and how has it helped shape private credit as a strategy?

Wee Yap: The availability of capital in private credit in Asia has generally been much lower compared to the United States and Europe, so Asia remains a good place for private credit as there's much less competition. Pricing in Asia, in general, is also much higher. As Asia is much more complex environment because it's not a homogeneous market, the investment team needs to have deep, local knowledge and the right connections to be able to select the right borrower. Plus, the ability to perform effective due diligence, whether commercial, financial and legal, and craft a deal structure that works in that specific context. Today, lenders have much stronger negotiation power as the capital market is essentially shut down.

Secondly, banks are more cautious and tightening up their credit, and willing to sell with a discount to offload risk to other lenders. We are likely to see more distressed deals in the market, given the increasing interest rates and currency volatilities.

Nitish: Taking a bigger overview in terms of how we are seeing the trend among investors – institutional investors – and how they are looking at Asia compared to North America and Europe, they are seeing more relative value in Asia. Competition has gone up both in the US and Europe over the last few years. On top of this, many of the large institutional investors have very little exposure to Asia, so it also becomes a diversification play for them, taking some risk away from North America and Europe. We are seeing large, sophisticated investors enter the Asia private debt market. The time has come for Asian private debt to really grow and take its rightful place.

Eric: It's a growing practice that credit strategies are able to generate alpha. Focusing on the investor side, how are you differentiating yourselves, and from a fundraising perspective, how easy was this, considering the current environment?

Nitish: One of the key issues is that the Asian private debt market is not well researched, compared to the US and Europe; the consultants/ analysts can get a lot more capital to work with in these regions, as Asia has been relatively small. Second, we don't have any proper market benchmarks to really benchmark performance. As more research comes in, this would make things easier for the investors. On the performing credit side, there is also a short track record unlike some other markets. Investors typically want to see 15-20 years through the cycles. To differentiate ourselves, we are totally focused on performing credit, and we are one of the few regional players to provide these services, that helps us to position ourselves better.

This also helps us on the sourcing side, as we are not seen as a distressed player. We think it's a much better place to be in and are optimistic about future prospects of performing credit.

Wee Yap: We have the ability to tap into Temasek's vast network to source a much more robust proprietary deal flow, so that we tend to be the sole lenders or the anchor lenders. Additionally, when we conduct our due diligence on a company, we can get access to our Group's broader operating companies that are operating in that country and get on-the-ground information in real time.

Through this network, we have been able to find suitable opportunities even during Covid-19, keep a steady pace of investment, and generate a good superior risk-adjusted return. This helps us to continuously be in the market to source deals and execute, positioning us as a first port of call with borrowers or intermediaries due to the availability and continuity of capital availability.

Eric: Asian credit markets behave quite differently to credit markets in the US and EMEA. Deals tend to be sourced using bank syndication desks and are on balance sheet. Generally, Asian Credit is harder to measure because issuers don't like to sell down on the secondary. So, when you think about deal sourcing and deal origination, what are some of the challenges that you face? And how do you factor these considerations into your portfolio construction?

Nitish: We're a big believer in a regional platform and investing regionally, rather than being a country-specific platform, whether it's Australia, China, India, or Southeast Asia – we have about 60 percent invested in India and Southeast Asia. As we focus on medium-term loans, we don't go beyond a five-year strategy as the risk becomes too high. As Asia is not a homogeneous market, there are different legal systems, regulatory approvals and security packages, so the focus is on what works, country-by-country. Execution times are longer due to cross-border jurisdictions involved, which adds to the deal complexity. In Asia, it's bespoke and customized, so that obviously needs more resources, longer time to execute, and is more complex.

Wee Yap: On constructing our portfolios, we focus on each specific transaction, look into the credit fundamentals of borrowers, as well as ESG factors to make sure that they pass certain ESG metrics. We develop a core underwriting thesis for these transactions, and figure a way to verify or test the thesis. Due diligence processes are put in place to cover the commercial, financial and legal sides as well as looking for downside protections against the identifiable and potential risks. Plus, we craft a deal structure to make sure that all the elements needed are put into a tight framework and include a post-deal monitoring process with borrowers. For portfolio construction, we aim to diversify, ensuring that no single country/industry becomes too large in the portfolio. In general, a transaction in Asia in terms of investment, from maturity to exit, typically has a two-year timeframe.

Eric: From an investor point-of-view, looking into private credit, what are the kind of misconceptions you've had to deal with during the course of fundraising?

Wee Yap: One common perception is that private credit return should be lower than private equity fund return. We found that we actually outperformed quite a lot of global private equity fund during benchmarking exercise. In general, the return generated in Asia has been much higher than the US and European market. Many people think that Asia is a developing market, so the risk is higher. However, Asia is a fragmented market. If you understand the market, find the right partners, put in a deal structure that makes sense, understand the regulatory, a relevant enforcement mechanism – and put all these elements upfront into the deal to protect yourself and the principal – the risk is manageable.

Nitish: Investors have a big misconception that Asia is very risky. Yes, there are more distressed special situations, where risks are higher, but there also lower-risk pockets where you can do direct lending, where risk is more manageable. Asia has also changed a great deal. Since the Asian financial crisis, economies are now bigger, robust, and diversified. Many countries have taken significant steps to improve their legal frameworks, making it easier for creditors to enforce, in terms of certainty of judgments, and the timetable in which the judgments can be delivered. This has helped improve our position as creditors.

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Eric: In private equity, direct access remains a challenge. What should investors, or those who haven't invested in private equity before, look out for?

Wee Yap: First, it's the track record of the fund and consistencies over a business cycle – not just good times, but bad times as well. Second, it's trying to identify team members that contribute to the historical track record and the stability of the team's composition to make sure that the underwriting thesis can continue. Finally, look at the team's ability to manage weak or non-performing investment – have they followed it up closely, been timely and taken effective actions to manage debt situations?

Nitish: One of the key factors for our success is sourcing. A team that has sourcing networks will have stronger deal flows, and will do better. Local knowledge is also very important, as what may work on paper may not work in practice. A lack of investment discipline – the pressure to deploy capital, do things that are on the edge – can lead to a slippery slope. Finally, it's all about numbers, as they speak for themselves.

Eric: Thank you Nitish and Wee Yap for your time and valuable input. It was a very interesting discussion which I am confident will resonate with investors.

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State Street Corporation
One Lincoln Street, Boston, MA 02111

www.statestreet.com

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