A perspective on private credit

Ryan Wood-Collier, Greenpoint Capital

Traditionally, gaining access to corporate credit as an investment was either achieved indirectly through investing in fixed income funds or, as an institutional investor, by participating in the syndication of senior secured loans by commercial banks. This meant that, specifically in the South African context, the ability to gain direct access to corporate credit as an investment class has, until more recently, been very limited.

Private credit funds have seen significant growth in developed markets over the past 10 years, but specifically in the last five years. While private credit has existed as a well-established asset class in the US for many years, the UK and EU lending markets were historically relationship bank driven. The global financial crisis of 2007/8 (GFC) and Basel III regulatory changes resulted in senior lenders withdrawing from event-driven funding of medium-sized businesses, and opened the door to private credit funds. Since then, private credit has become a recognised and understood asset class, attracting increasing interest from investors.

According to Preqin's *Q2 2020 Quarterly Update Report*, US$56 billion in private credit commitments was raised across 85 funds in the first half of this calendar year. Despite the effects of Covid-19, investors have retained significant appetite for the asset class, with the number of individual investors committing $50 million or more over the next 12 months increasing to 65% in Q2 2020 from 37% a year ago.

In the South African context, corporate lending is still very much the preserve of the senior lenders, much like the UK & EU markets pre-GFC. There are a few established private credit funds operating in the market, but the market is small and somewhat under-developed. That said, the opportunity for private credit is growing, particularly in the current environment. "Private credit is by no means a replacement to senior debt lending – we aim to supplement the lending market to provide optimal funding solutions for borrowers, where the senior lenders may not have the ability or appetite to participate," says Ryan Wood-Collier, CEO of Greenpoint Capital.

Private credit is an asset class within the non-traditional asset management segment of alternative investments. It typically comprises a group of credit strategies that fall into two broad categories, being i) direct lending and ii) distressed/special situations investing.

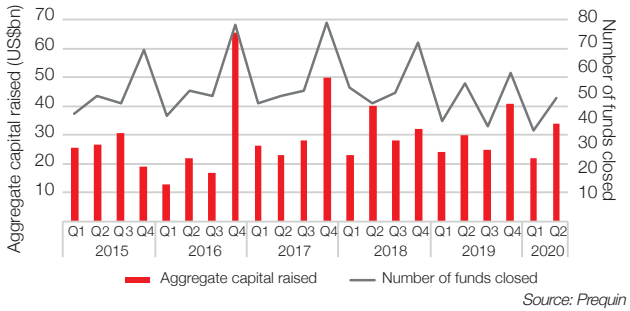
Unlike fixed income, managers of private credit funds typically invest in private companies, where there is a corporate or other idiosyncratic event: this could be a refinancing of the current capital structure of the business, the funding of an acquisition or growth opportunity, or the provision of new capital to effect a restructuring or turn-around of the business. The investments are bespokely structured and privately negotiated to both meet the specific needs of the underlying company, but also provide the return compensation and requisite security for the risk taken in each investment. The investments tend to be illiquid (i.e. not actively traded or widely syndicated) and for durations of between two to five years, but it is that illiquidity that generally allows for a disproportionate risk-adjusted return to be generated.

Unlike private equity, private credit typically sits in a preferred position in the capital structure. This can be anywhere from first ranking, senior secured to a preferred equity position. In most cases, loans will benefit from security and therefore, the investment trades the upside associated with pure equity for downside protection associated with its preferred position in the capital structure and security taken. "The combination of the bespoke structuring, position in the capital structure and security associated with the investment, offers what we believe to be a disproportionate risk-adjusted return, provided the investment is managed correctly," says Wood-Collier.

What should an investor in private credit expect from their investment – typically the majority of the return will be structured as a contractual interest yield, with the potential for some upside through 'equity participation instruments' such as options, warrants or some direct equity. "This largely contractual yield will produce a more consistent return profile, possibly with some cash yield. Investors should expect an illiquidity premium over a fixed income investment with a more stable return profile." says Wood-Collier. "An investment in private credit offers a diversification opportunity for investors as the return profile is uncorrelated to traditional fixed income or listed equity returns, but also to other illiquid investments, such as private equity, as it will not exhibit the typical 'J-curve' of a private equity investment."

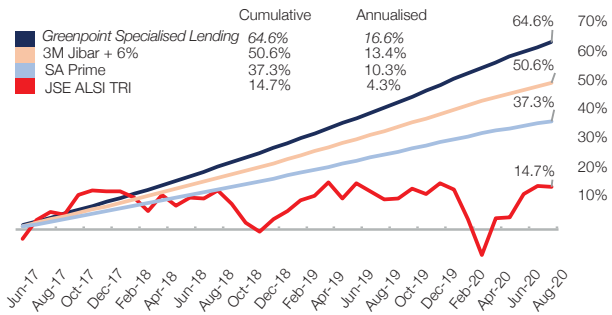
Managing a portfolio of private credit investments does, however, require a very specific skillset. "It is one thing to be able to source the right opportunities and structure and execute a transaction to meet the risk-return characteristics of a specific deal," says Wood-Collier. "But the real value is ensuring that the manager is embedded in the detail of each portfolio company investment, has a very strong understanding of the legal framework they are operating in and has the ability to manage and control the intricacies involved in resolving a situation if things go wrong."

Private debt fundraising (Global)



Source: Prequin

Greenpoint Specialised Lending - net investor returns



Ryan Wood-Collier

Ryan Wood-Collier is the CEO of Greenpoint Capital, a private credit fund manager specialising in both direct lending and investing in special situations/restructuring opportunities, with a nine-year track record of investing in bespoke corporate credit in South Africa. Greenpoint provides constructive capital solutions to either growing or financially challenged businesses, working on a consensual basis with the company and its management team, as well as senior lenders and other stakeholders in the business to effect an optimal capital solution. The team is based in Cape Town and brings over 35 years' combined experience of lending to and restructuring private equity-backed businesses and corporates in both SA and the UK.