

E X P E R T Q & A

Asia-Pacific direct lending still demands borrower education but exciting new markets are opening up, says Andrew Schantz, a partner in credit and special situations, Hong Kong, at Bain Capital



A large and growing direct lending opportunity

Q What has changed in Asia-Pacific direct lending over the last couple of years?

As in life, a lot has changed and a lot has stayed the same. In terms of changes, the opportunity set continues to grow. We see more demand for the products that we offer and the type of lending we do. That is happening not only because markets themselves are growing, but also because borrowers in these markets are becoming larger and more sophisticated, and increasingly recognising the viability of direct lending as a financing option.

Another thing that has changed is global investor awareness of the opportunity in Asia-Pacific. A few years ago, many of the investors we spoke to had

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never spent time in the region, and many who had did not see opportunities outside Australia. That has changed significantly recently.

Many of the larger, more sophisticated investors have now spent time learning about the asset class, they understand how Asia-Pacific works, which countries are and are not relevant from a lending point of view, and what is required to navigate jurisdictional complexity around the region. They now appreciate the attractiveness of the returns on offer, both on an absolute and relative basis.

Global investors increasingly understand how investing in Asia-Pacific direct lending is a potential diversifier in a global portfolio. Where exposures are heavily weighted to the US and Europe, adding Asia-Pacific to that global mix can be attractive.

What has not changed is that it is still a relationship business in Asia-Pacific, with most transactions sourced directly from borrowers. Because we are directly sourcing, we have to be local, which is why we have spent 20 years building a platform of 200-plus investment professionals across 10 different offices. That allows us to capture opportunities at the local level.

It also remains critically important that lenders know how to structure

deals from the ground up, because with so much direct sourcing there is often no bank or intermediary involved. Tailoring structures to each specific market is also important, as with so many different and complex geographies, we believe a one-size-fits-all approach doesn't work.

The importance of asset selection has not changed in this region and, from an LP perspective, manager selection remains key. There are a large variety of managers active in Asia, some with scaled capital and a regional presence and others with more targeted strategies.

We believe a region-wide approach is the best way to capture the direct lending opportunity in Asia, and therefore think a regional platform is a must.

Q Why is there such a large and growing opportunity set in Asia-Pacific?

At a high level, it should not be a surprise that there is a big opportunity for direct lenders in this part of the world. You have a \$60 trillion credit market today in Asia-Pacific, about one-third bigger than the credit market in the US, within which there is a limited supply of capital for levered borrowers.

For example, today the Asia-Pacific high yield market is about 5 percent of the size of the US high yield market, and there really is no established or scaled broadly syndicated lending market. As it is now broadly accepted that private credit, and specifically direct lending, is an important pillar of global finance, it is therefore logical that it should go towards filling the gap for levered capital in Asia.

Financial sponsors, which are large users of direct lending in North America and Europe, are also large users of direct lending in Asia-Pacific, particularly in Australia. While we also see financial sponsor demand for direct lending around the region, that demand has been somewhat muted over the last several years as many global banks have

been fairly aggressive with pricing on senior loans.

With elevated base rates, we think a lot of financial sponsors have stuck with those cheaper bank financing options, even when they offer less leverage and less flexibility than a direct lending solution. If base rates come in, or if bank appetite wanes, we expect sponsors to look again for more levered options.

In addition to sponsors, a lot of the growth in demand we see is coming from corporates – both mid-market corporates and large-cap corporates – which is different than North America and Europe. In the past 20 years, private credit has really gone from being seen as opportunistic and occasional in Australia to being a major component of non-bank credit, first in Australia, then increasingly in India and Southeast Asia, and now in Japan and Korea.

With so much demand, it is perhaps surprising it has not grown faster. We believe that is because direct lending got a running start in the US when, post financial crisis, it simply transferred from bank balance sheets into the private credit markets. In Asia-Pacific, the banks had never done this, and many borrowers had never used this kind of product. So it's really growing into white space and we believe that requires building familiarity and comfort with it.

Furthermore, only about 5 percent of global private credit fundraising is for Asia-Pacific today, so there has been less capital around, less precedent

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for borrowers and therefore less awareness, which we believe contributes to the slow growth.

Q What role do banks play in the market?

The banks provide everyday capital. They dominate the market, but while the capital they offer is relatively cheap, it generally comes with a lot of constraints, and it is not available to everybody. That makes their role vis-à-vis private credit complementary in our view. We're not so much competing as providing different types of credit, with theirs being generally more 'regular way' capital, and ours generally being more levered, bespoke capital.

Q Another theme has been the growth of retail evergreen structures. Is that also happening in Asia-Pacific?

Retail evergreen structures are not yet a significant feature of the Asia-Pacific direct lending market. The market remains primarily institutional and, in many countries, is still at an earlier stage of development than the US or Europe. As a result, the more important theme in Asia-Pacific is not the growth of a particular fund structure, but the continued expansion of the borrower opportunity set, greater investor familiarity with the region and the need for local sourcing and structuring expertise.

Over time, we would expect access models to continue evolving as the asset class matures. But today, investors looking at Asia-Pacific direct lending are generally focused on the underlying credit opportunity, jurisdictional complexity, manager selection and the quality of downside protections, rather than on retail evergreen formats.

Q Do you continue to see a returns premium in Asia and stronger, more resilient structures compared with the US and Europe?

In broad market terms, we continue to see attractive relative value in

Asia-Pacific direct lending compared with more mature markets, although it varies meaningfully by country, borrower and transaction. We would not describe it as simply taking a US or European deal and adding a spread premium. The transactions often look different, and the relative value is often linked as much to structure as it is to headline pricing.

Across much of the region, particularly outside the most mature markets, we continue to see lower leverage, shorter tenors and stronger maintenance covenants than are typical in parts of North America and Europe. In our view, those features can create a more lender-friendly environment and help support downside protection.

That said, Asia-Pacific is not one uniform market. Terms and pricing differ across Australia, India, Southeast Asia, Japan and Korea, and continue to evolve with competition and market cycles. The key for investors is having local origination, structuring expertise and disciplined asset selection because the premium is not automatic – it has to be underwritten transaction by transaction.

Q What are you most excited about at the moment?

I would say new markets present the most exciting opportunities. Markets like Australia have had direct lending opportunities for some time, but now we view Korea and Japan as the most exciting. They are both large, well-developed economies that have historically been quiet for direct lending.

In Korea, we are seeing real change. We have a big presence in Seoul, and our team is getting an increased number of inbound enquiries from corporates, including investment-grade businesses, looking for bespoke financings that they cannot find elsewhere. It is the same movie we saw play out in Australia and India, albeit with local nuances, so while Korea may be a small direct lending market today, we expect it to become much more active.

Q There has been a lot of press around private credit and BDCs in the US. Have there been similar issues in the Asia-Pacific credit markets?

The short answer is no – we believe that is because of the different market structure in Asia-Pacific.

If you look at a high level at what has happened in North American direct lending over the past decade, you see that a number of large fund managers raised significant capital and then had to put that capital to work. This has likely increased competition to deploy and, with that, the potential for loosened underwriting standards and weakened lender protections, which may be negotiated away to win a deal. Where that happens, it increases the risk profile and may lead to adverse outcomes.

We typically do not have that issue in Asia-Pacific because we have not had that same influx of capital. Managers generally do not compete with many other managers on transactions. Often the competition is with other types of financing. As a result, we do not believe we have to make material concessions or loosen underwriting standards to win deals.



Likewise, Japan is small for direct lending today, but the growth there is being driven by a lot more financial sponsor interest. We have seen almost more enquiries from Japan in the last 18 months than in the previous 18 years – it does feel like there is now an increased willingness on the part of corporates there to engage with sponsors to make businesses more efficient and competitive. Hand in hand with that comes a demand for direct lending to provide capital to those opportunities.

Q And finally, what concerns do you have, if any?

The biggest concern I have today is that, with all the macro volatility

around the world, investors may retreat to the perceived safety of their home markets. That would be a shame because it would slow the growth of the asset class here and interrupt the journey that a lot of global investors have been on in terms of getting to know this region.

A retreat could also mean investors may miss out on something potentially beneficial to their portfolios, which is this region's potential to be a strong diversifier. In an environment of high macro volatility, we believe adding something that increases diversification is a positive, so I am hopeful that the circling of the wagons and retreat to home markets does not occur. ■