

Private Debt

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PRIVATE DEBT - AGENDA

- 1 Private Debt
- 2 Market Activity- Spread Observations
- 3 Investment case for SA debt
- 4 Conclusion

BENEFITS OF PRIVATE DEBT PORTFOLIOS

- **Returns can be tailored** according to specific risk profiles
- **Suitable for investors** taking a long term view
- Appropriate **asset class for Asset-Liability Matching objectives and Liability Driven Investments**
- **Offers significant diversification benefits to existing portfolios, especially on LifeCo balance sheets**
- **Predictable returns on Absolute and Risk Adjusted basis; Lower volatility of returns**
- **Low cap rate (SCR) for Insurance Companies; Illiquidity premium harvesting; capital relief for infrastructure assets**

PRIVATE DEBT

What is Private Debt

Private debt:

- any **debt** held by or extended to privately held companies

- comes many forms, but most commonly involves non-bank institutions making loans to **private** companies or buying those loans on the secondary market.

Assess PD; LGD; Tenor; Illiquidity premium; security; structural features

Opportunity Set



Corporates loans



Infrastructure finance



Real estate



Capex Finance



Asset Backed Finance



Public Sector



Risks



Asymmetric risk / reward profile

- Returns are predetermined (i.e. capped), but capital losses may be extreme

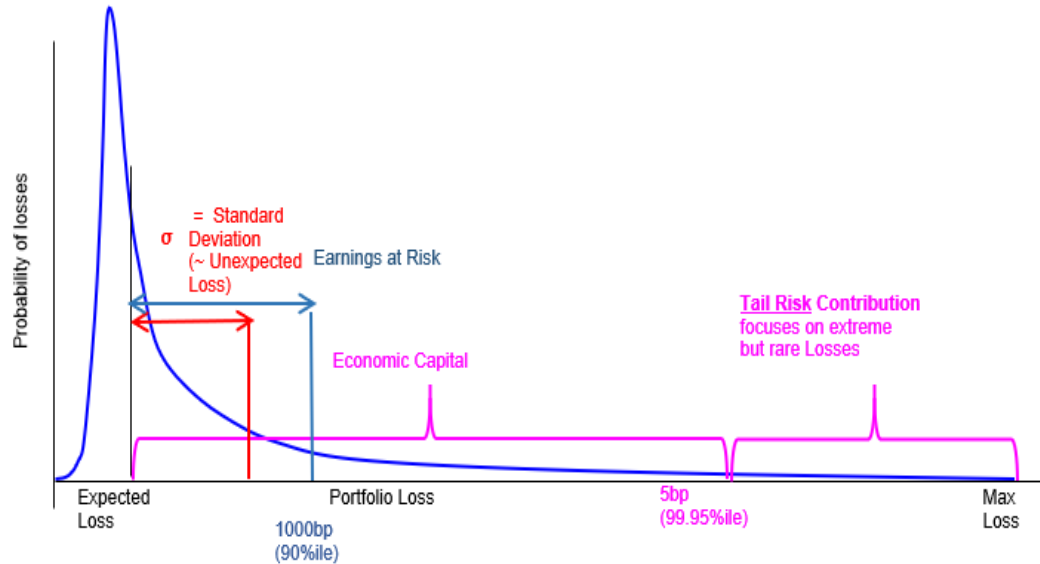


Default risk is the primary concern

- Inability / unwillingness of borrower to repay the borrowed funds
- Experience and logic is critical to mitigating default risk
- Quantitative tools to assess riskiness of borrowers and transactions
- Private debt allows for flexibility in terms of downside risk protection
- Ability to price risk correctly

Credit Portfolio – Quantitative attributes

Loss Distribution



$$UL_p = \sqrt{\frac{\sum_{m=1}^M (L_p(m) - E[L_p])^2}{M-1}}$$

M Monte Carlo trials, $\{L_p(1), L_p(2) \dots L_p(M)\}$

$$E[L_p] = \frac{\sum_{m=1}^M L_p(m)}{M}$$

$$p_i = \frac{RC_i}{UL_i}$$

$$SR_p = \frac{\text{Gross Portfolio Spread} - \text{Expected Loss}}{UL_p}$$

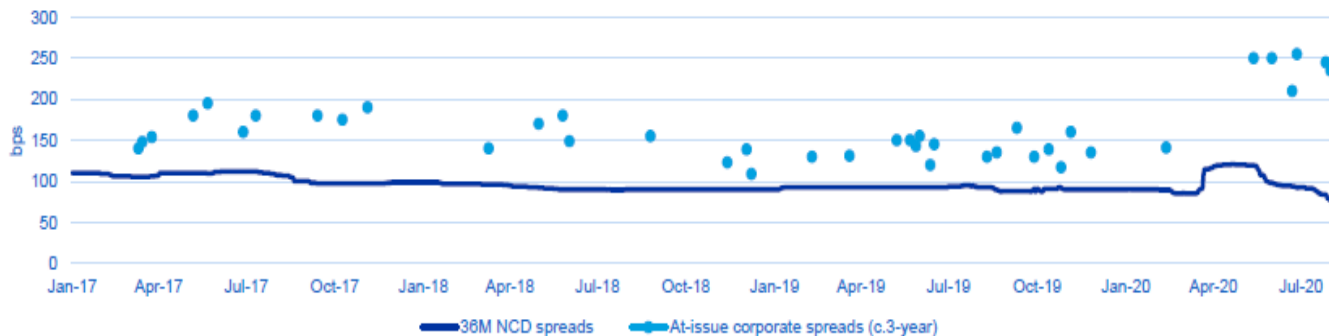
$$SR_i = \frac{\text{Gross Spread} - \text{Expected Loss}}{RC^i}$$

Market Update

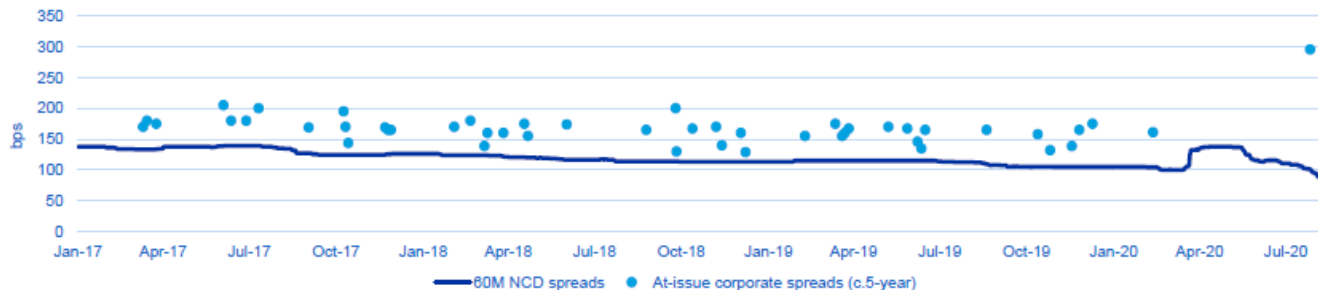
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Primary Market Activity-Bank vs Corporate spread differential

3-YEAR CORPORATE FRN SPREADS VS 36-MONTH NCD SPREADS



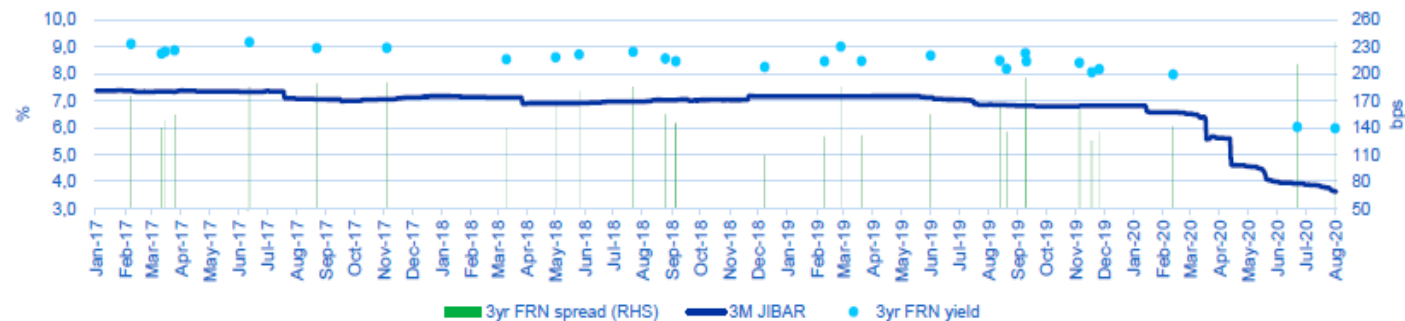
5-YEAR CORPORATE FRN SPREADS VS 60-MONTH NCD SPREADS



Source: SBR, JSE, Bloomberg

Property Sector and YTD Issuance

PRICING ON 3-YEAR FRNs

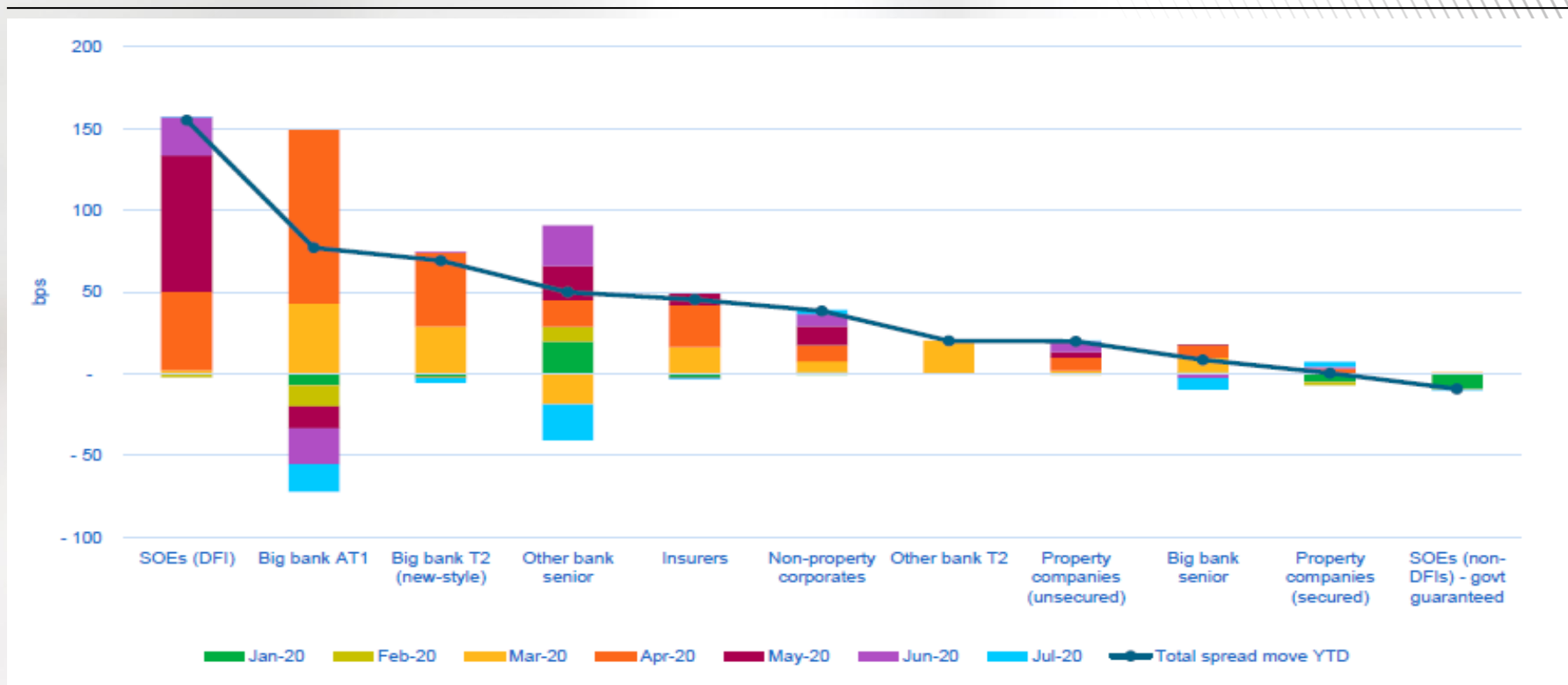


GROSS ISSUANCE PER YEAR (EXCLUDING CP)



Source: SBR, JSE, Bloomberg

Average Spread Movements



Source: SBR, JSE, Bloomberg

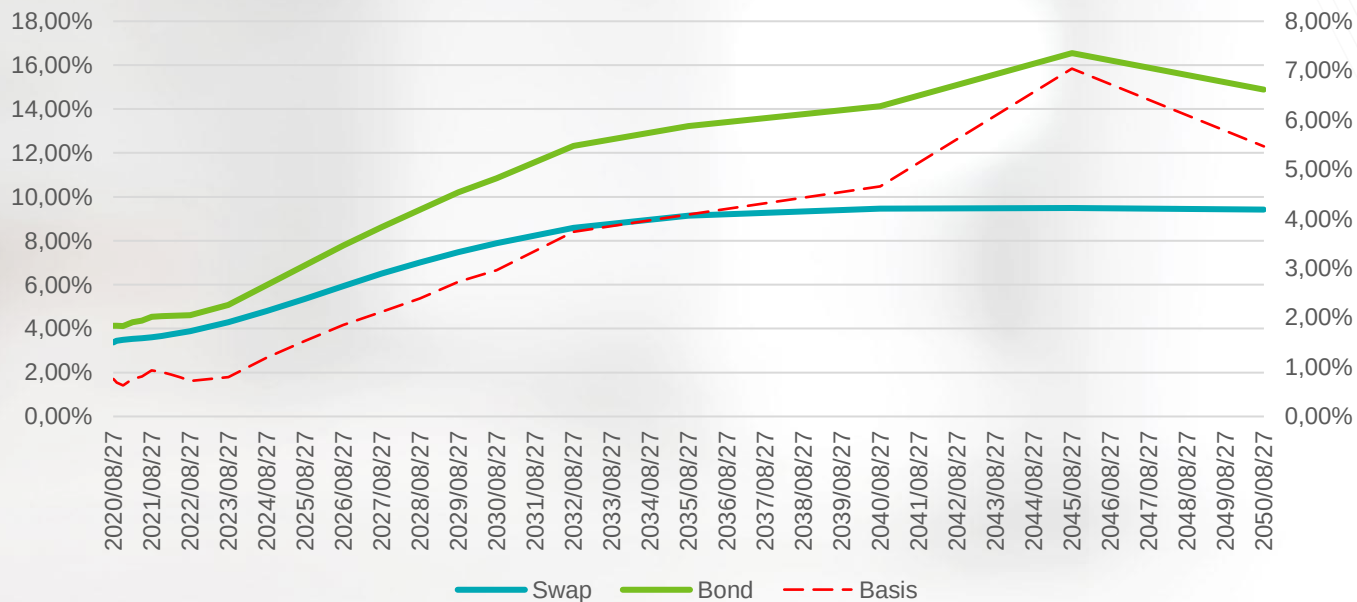
Investment Case for SA debt

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Summary

- In SA we favour:
 - (local) Investment Grade
 - Counter-cyclical sectors
 - Proven track record through crisis
 - Strong Balance Sheets
- Illiquidity confirmed
- Price discovery in SA debt markets remain opaque. Model valuations applied
- Extensive ratings reviews of client portfolios over the period
- Large number of downgrades resulting in the ratings of portfolios shifting down the credit curve
- Wider spreads allow for value extraction!
- Value in SA Government Bonds???

Value in SA Government Bonds?



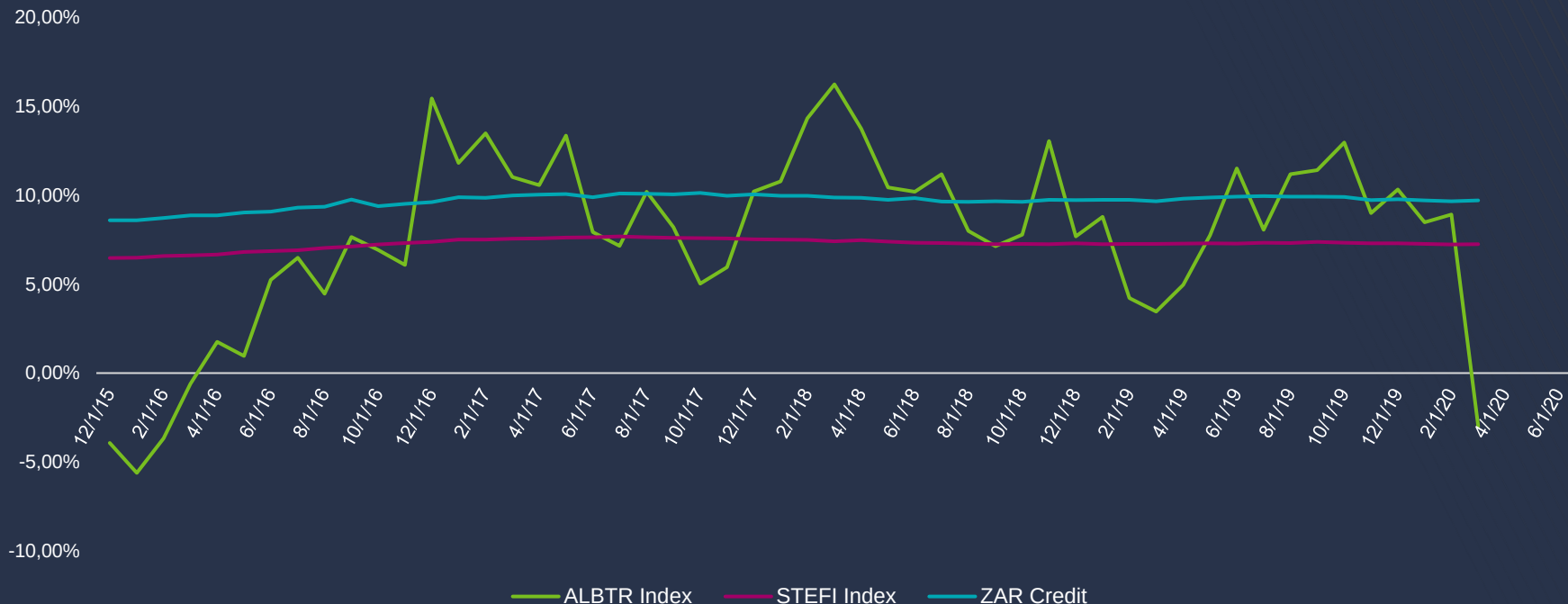
Investment case for SA Debt (not exhaustive)

Banks and FI's		Sector has systemic risk to the economy. For now, the assessment is a well-capitalized banking system. The assessment may change as the depth of the recession is better understood. Banks have reported high impairments > GFC.
Asset Back Finance		Comfort is derived from general level of credit enhancement present in structures to act as first loss absorbers. Participate higher up in capital structure.
Property		Likely higher vacancies, lower rental reversions and further strain. Positive that banks and tier 1 players agreed to preserve solvency and liquidity.
Project Finance		Nature of take or pay contracts insulates this asset class from economic cycles. Recent curtailment by Eskom has been challenged. It is a worrying move by Eskom.
SA Senior		Most large SA issuers well capitalized with acceptable levels of gearing. Favor Telecoms; Telecoms Infra; Food Retailers; Select clothing retailers. Caution on Hotel and Leisure; Tourism; Gaming; Dine in upper end Restaurant chains.
Commodities		Pro-cyclical counters likely to endure volatile trading conditions. Seek less cyclical counters in tier 1 or tier 2 cost quartile. Balance sheet strength remain an important consideration.
Public Sector		Vulnerable if prolonged downturn persists. Will require support from key funders and potentially the state, which itself will be under fiscal pressure. Risk of further sovereign downgrades.
High Yield		Counters with high levels of gearing will likely be problematic exacerbated by low earning environment. Counterparty selection on a very cautious basis.
Commercial Property		Immediate impact of lockdown hardest felt in retail sector. We expect ICR covenants to come under pressure and LTV covenants to remain intact. Interest & principal forbearance requests likely in the short term to preserve liquidity.

- **Multi- banked business**
- **Defensive sector/counters**
- **Gearing Levels and stress tests**
- **Minimize market risks**
- **Large SA Issuers**
- **Product uptake (demand)**
- **Supplier/off taker credit profile**
- **Deal structure**
- **Macro stress test**
- **Integral to economy**
- **Strong management team**
- **Consider performance through lockdown and previous crisis**
- **Strong collections capability (ABF)**
- **Access to capital markets; liquidity**
- **Understanding changes in consumer behavior/patterns!**

COMPARISON TO OTHER ASSET CLASSES

One-year rolling returns



Source: Bloomberg, Stanlib Credit Alternatives Portfolios (ZAR Credit)

CONCLUSIONS

We're seeing increased allocations into Private debt by non-traditional allocators

South African debt market is unique

Investment can be structured along Impact and ESG themes

Private markets represents the future of investing

Valuations – ensure credit risky elements are appropriately considered, market risky elements –marked to market, favor MODEL approach for illiquid credit assets

Credit Alternatives Offerings (> ZAR55bn in AUM):

- Pooled propositions
 - Khanyisa Impact Fund (Live)
 - SA Diversified Credit Fund (Launch Q4 2020)
 - PAN Africa Debt Fund (Launch Q4 2020)
- Segregated Mandates

THANK YOU

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