Private Credit Solutions: A Closer Look at the Opportunity in Emerging Markets

2019

About EMPEA

EMPEA is the global industry association for private capital in emerging markets. An independent, non-profit organization, the association brings together 300+ firms—including institutional investors, fund managers, and industry advisors—who manage more than USD5 trillion in assets across 130 countries. EMPEA members share the organization's belief that private capital can deliver attractive long-term investment returns and promote the sustainable growth of companies and economies. EMPEA supports its members globally through authoritative research and intelligence, conferences, networking, education, and advocacy.

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FIERA CAPITAL

THE ROHATYN GROUP

TRILINC GLOBAL
INVEST WITH IMPACT

VANTAGE CAPITAL

We are also grateful for the generous support we received from EMPEA members and industry participants in producing this publication. In particular, we would like to thank the numerous fund managers active across the world that donated their time and participated in our recent survey on private credit investing. We would also like to thank the numerous global institutional investors who shared their insights with us.

A Letter from EMPEA

Dear Reader,

EMPEA is pleased to share with you *Private Credit Solutions: A Closer Look at the Opportunity in Emerging Markets*, an in-depth study of the private credit investment landscape across emerging and frontier economies. The report gathers the latest EMPEA data on overall industry activity while delving deeper into the details of what makes emerging market private credit qualitatively different from its counterpart in developed markets, as well as private equity in emerging markets.

Since EMPEA's previous *Private Credit Solutions* report (*Mezzanine Financing in Emerging Markets*) was published in 2014, investor interest in private credit broadly defined has grown. Capital raised for private credit vehicles targeting emerging markets reached USD9.4 billion in 2018—the highest level recorded by EMPEA since the inception of our data program in 2006. Meanwhile, the share of global institutional investors surveyed by EMPEA who plan to begin investing or expand their investments in private credit in emerging markets has increased from 24% in 2014 to 47% in 2018. The global search for yield is naturally a key factor in the rise of private credit, but investors are also turning to emerging market credit opportunities because of their favorable risk-return profiles, particularly vis-à-vis heightened competition and deteriorating protections for alternative lenders in North America and Western Europe.

To get a better sense of how private credit transactions in emerging markets stack up relative to their developed market counterparts, EMPEA has conducted a first-of-its-kind survey of private credit firms' target returns and structuring practices by geography and fund strategy. The results suggest that investors can not only expect superior returns from emerging market strategies, but also benefit from enhanced downside protections, which have largely fallen away in developed markets.

Of course, a central component of any successful investment strategy, private credit or otherwise, is the knowledge and experience of the professionals putting capital to work. Thus, we are delighted to include in this report the expert perspectives of dealmakers active across the globe. Their insights on recent market developments, deal structuring, and working with portfolio companies provide us with a cohesive overview of the opportunity set and an appreciation for the nuances of each strategy, be it direct lending, mezzanine, distressed debt, or special situations.

While the number of players and the amount of capital in the emerging market private credit space have grown, small and mid-sized businesses in developing countries still face significant financing gaps. Meanwhile, rising debt levels and distress plague many larger corporates and infrastructure projects, which will require creative solutions and alternative forms of capital to resolve. Given these structural dynamics and the relative advantages of private credit as a cash-yielding, non-dilutive financing solution, we believe it holds immense promise for investors and will play a significant role alongside private equity and venture capital in investors' emerging market portfolios going forward.

We hope you enjoy this report and are encouraged to further explore the potential of private credit in emerging markets. Please contact us with any feedback on this initiative—or with ideas for future in-depth reporting and analysis—at **research@empea.net**.

Sincerely,

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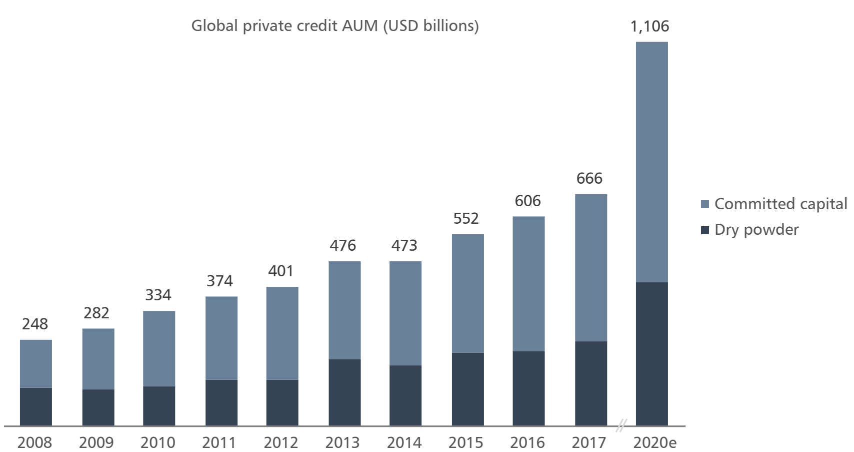
An Introduction to Private Credit in Emerging Markets

The global search for yield is the 'north star' of many institutional investor portfolios. Post-Global Financial Crisis (GFC), a number of institutional investors, or limited partners (LPs) as they are often described, began to dip their toes into new strategies as monetary policies led to extremely low interest rates, resulting in hedge funds across the board delivering declining returns. At the time, the opportunities to invest in private credit transactions were beginning to expand dramatically as banks retreated from the lending space given the need to de-lever their risks and meet new, stronger capital adequacy requirements, such as Basel III. In this process, they began to aggressively dispose of non-core assets and cease a variety of lending activities.

Asset managers across the globe stepped in to fill the resulting gap. The volume of private credit assets under management (AUM) grew roughly 2.5x between 2008 and 2017 (see Exhibit 1). In fact, the Alternative Credit Council estimates that global private credit AUM will reach USD1 trillion by 2020.[1]

Exhibit 1: Private Credit Strategies Are Estimated to Reach USD1 Trillion in AUM by 2020

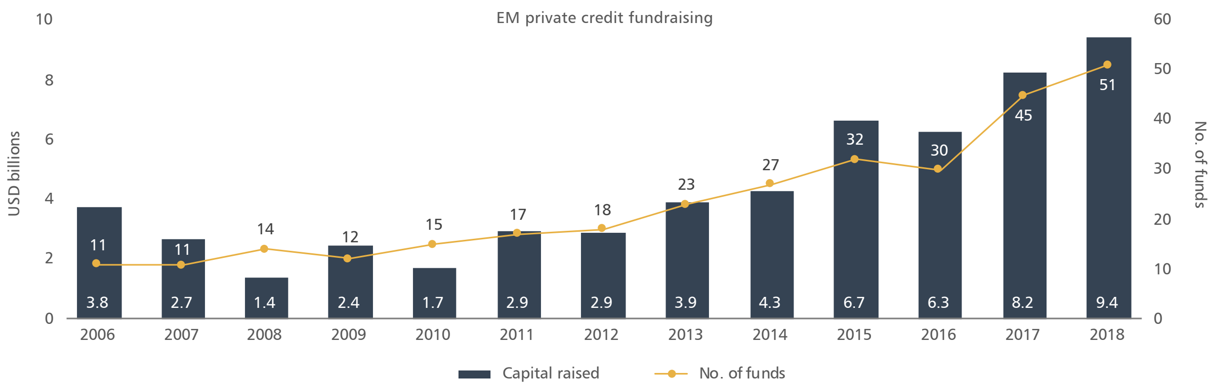


Source: Alternative Credit Council, Financing the Economy 2018.

Emerging market-dedicated private credit funds are no exception to this growth—though admittedly, emerging market (EM) private credit constitutes a small fraction of global AUM. The volume of capital raised for EM strategies grew more than 6.5x between 2008 and 2018, reaching USD9.4 billion, while the number of funds being raised annually has steadily increased from roughly a dozen prior to the Global Financial Crisis to 51 in 2018 (see Exhibit 2). Moreover, EMPEA data demonstrate that 14% of private capital fund managers active in emerging markets—184 firms—have an investment mandate that includes private credit.

1. Alternative Credit Council, *Financing the Economy 2018: The role of private credit managers in supporting economic growth.*

Exhibit 2: Emerging Market Private Credit Funds Are Growing Rapidly



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

Speaking to the blossoming fundraising environment, Robert Petty, Co-CEO and Co-CIO of Asian credit specialist Clearwater Capital, states, "Limited partners are increasingly interested in EM private credit for several reasons. First, market rates are interesting relative to Western returns, particularly as many believe that the credit cycle in the West is at a peak. Second, ten years after the Global Financial Crisis, investors have built out their private credit portfolios in the United States and Europe, and as those teams become increasingly sophisticated on the private credit opportunity globally, they are more open to exploring new markets like Asia. Finally, the third driver is the macroeconomic reality that emerging economies represent a vast and scalable market with attractive growth rates."

A Brief Primer on EM Private Credit Strategies

'Private credit' covers a broad array of debt strategies that can range in tenor, location in the capital stack, and return profile. For instance, a trade finance product that facilitates domestic and international commerce may carry an exposure of 90 days, whereas a direct lender may extend a term loan to a company for seven years. Similarly, a senior-secured lender will sit high in the capital stack while a mezzanine investor may structure transactions with equity or equity-like securities.

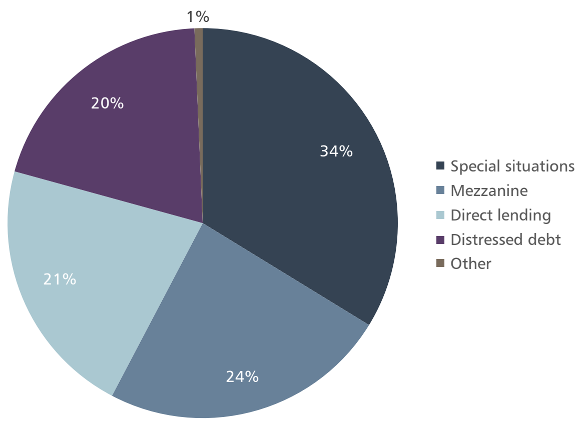
Nevertheless, private credit transactions are often comprised of a combination of two components: contractual and performance-based returns. The contractual component can consist of a negotiated interest rate—or 'cash pay'—which is often tied to senior, subordinated, or unsecured loans. They may also be linked to payable-in-kind (PIK) loans, which simply means the interest accrues and is paid out at the end of the loan's term. Some firms may attach an amortization schedule to their loans, while others may allow borrowers to capitalize the interest and make a bullet payment at the end of the loan's term.

The performance-based component is often an equity kicker, which can take several forms. For example, investors may agree to warrants so that they can purchase equity in the company at a fixed price until a set point in time; or, they may opt for conversions, which enable the investor to convert their bonds into equity. In other instances, investors may use a profit-sharing structure or covenants that guarantee a dividend if a performance threshold is reached.

EMPEA classifies private credit activity based on what is observable across emerging markets. While EMPEA's taxonomy includes trade finance, specialty finance / leasing, and venture debt, in practice there are four predominant private credit strategies in emerging markets, as measured by capital raised over the last three years: direct lending, mezzanine, distressed debt, and special situations (see Exhibit 3).

Methodology Note: Unless otherwise indicated, EMPEA's reporting on private capital fundraising and investment activity covers activity by *long-term, fixed-life, private* direct investment funds backed by institutional investors. For the purposes of this report, 'private credit' constitutes the subset of private capital funds predominantly investing in illiquid debt and quasi-equity securities of private companies and projects. The results of the 'Emerging Market Private Credit Survey' (presented beginning on page 23 of this report)—as well as the 'Sampling of Private Credit Firms Active in Emerging Markets' on pages 36-37—include data from a broader array of private credit firms, including managers of separate accounts, open-ended and/or evergreen funds, and funds marketed to retail investors. For more information on EMPEA's standard reporting methodology, please visit empea.org.

Exhibit 3: Four Private Credit Strategies Are Prevalent in Emerging Markets



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

That said, the EM private credit landscape is richer and more complex than a handful of silos might suggest. Indeed, there is much overlap between strategies, and many managers may incorporate several of them within a fund. More to the point, the deeper one digs into private credit strategies and structures, the more complicated things can become—particularly as one layers in the nuance of different EM geographies. Nevertheless, an awareness of the four principal strategies provides a useful foundation for understanding the types of activities private credit managers are pursuing across emerging markets (see Exhibit 4).

Direct Lending (Senior Debt)

Direct lending is a strategy in which a fund manager extends loans—frequently senior-secured—to companies or assets. In some instances, the contractual coupon of a given loan may constitute the entirety of the investment's return. In others, the interest rate may form only a portion of an investment's total return (see examples of various firms' target return profiles in Exhibit 19 on page 24).

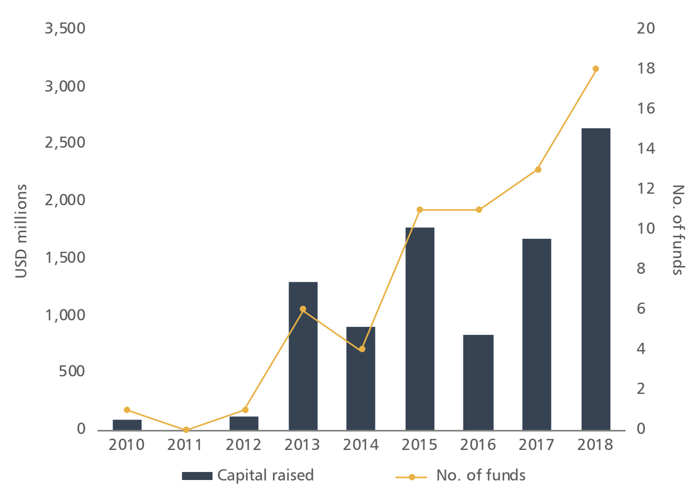
Funds focused on direct lending have become more prevalent in emerging markets since 2012, resulting in it becoming the fastest-growing strategy when measured by number of vehicles achieving a close (see Exhibit 5). The strategy is employed in nearly every EM region, and each market presents its own characteristics. For instance, in China and India, regional and global firms such as Baring Private Equity Asia, Clearwater Capital, and KKR have launched 'onshore' lending platforms that can extend local currency financing to businesses.

Exhibit 4: Overview of the Main Private Credit Strategies in Emerging Markets

Direct Lending (Senior Debt)	• Loans (frequently senior secured) issued directly to EM companies or assets • Contractual coupons may constitute the entirety or a portion of the investment's return
Mezzanine	• Utilizes instruments that sit between senior debt and common equity in a firm's capital structure • Highly customizable with a blend of contractual and performance-based payouts
Distressed Debt	• Discounted debt securities of operating companies or assets • Non-performing loans (individual, pool, or portfolio)
Special Situations (Credit Opportunities)	• Investments in a broad mix of stressed or distressed companies / assets, event-driven or restructuring opportunities, and rescue / turnaround situations • Opportunistic investments in senior debt and mezzanine

Source: EMPEA.

Exhibit 5: Direct Lending Funds Have Become More Popular Since 2012



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

Advancing Innovations in Emerging Market Debt Strategies: Insights from CDC Group plc

Holger Rothenbusch, Managing Director, Debt and Infrastructure

When CDC changed its strategy from operating as a fund-of-funds investor to embracing direct investing in 2012, it did so out of a desire to have greater product flexibility so that it could make a broader impact. At the time, debt was a negligible component of our portfolio. Since then, debt has grown to more than 11% of our total investments (as of 2017), while on a run-rate basis, roughly half of our annual commitments are now in debt. By the end of our investment period in 2021, we anticipate that our debt book will sit between 30% and 40% of our portfolio. Clearly, we believe debt offerings in our target markets of Africa and South Asia can deliver both impact and attractive risk-adjusted returns for investors.

Equally as important as the growth in volume has been the shift in our structuring of debt products. For instance, when we started our debt offerings, I was one of two people on the team working on direct credit transactions. By necessity, we were pursuing plain vanilla lending and not leading on deals—we were sitting in the back of the bus on deals that other firms brought to the table. Today, we have four different teams comprising some 40 staff and are growing by an additional 20 people during 2019. With this deeper bench of talent, we are in a better position to incorporate differentiated products and develop innovative approaches. In particular, we are focused on three debt strategies: project finance, mezzanine, and supply-chain finance.

Project finance provides capital for infrastructure, which is a key sector from a development perspective across Africa and South Asia. While we do have flexibility around tenor and underwriting, the real innovation is that we are looking more at distribution. The DFI lending space, particularly in Africa, is very much a buy-and-hold market with a 10- to 15-year duration. Yet arguably, once construction is complete and the projects are online, you are effectively looking at an annuity stream, which should be a distribution opportunity. Therefore, at CDC, we are looking at the degree to which we can create investable assets—particularly mid-scale renewable power projects—for which we assume the risk in the early stages of a project, and then mobilize private capital once it has been de-risked for commercial investors. This approach has the added benefit of reducing the complexity of projects and facilitating their development. We are currently pursuing two projects along these lines in Kenya.

> “At CDC, we are looking at the degree to which we can create investable assets—particularly mid-scale renewable power projects—for which we assume the risk in the early stages of a project, and then mobilize private capital once it has been de-risked for commercial investors.

Mezzanine is an underutilized form of capital, particularly in Africa. There are very few commercial players focused on the approach, whether they be investment funds or banks. In large part, this is due to the challenges of building a client base that is educated on mezzanine investing. It is not simply structured equity, which many private equity firms are doing; proper mezzanine has strong fixed income components with equity upside. We recently closed our first mezzanine transaction in a West African hotel and real estate group. While it took a long time to structure the deal, we believe that CDC can play a valuable role in developing the mezzanine market by creating examples of structures that others can replicate. We also invest in mezzanine funds focused on Africa.

Supply-chain finance is an innovative way for CDC to help serve the ‘missing middle,’ or small and medium enterprises (SMEs), in our markets. Traditionally, DFIs have provided credit to banks and encouraged them to lend to SMEs, with varying success. As we explored products that are readily available in other parts of the world, but missing in Africa, we identified supply-chain finance as an attractive offering. Through this product, we are providing funding to companies in the supply chains of large buyers—such as Unilever, Diageo, and Shoprite—enabling us to take the credit risk of the buyer, and thereby finance SME growth without the need for collateral. We put this product in place last year, starting off with a risk-sharing arrangement with Standard Chartered. The first results are very encouraging. We have seen strong uptake and have directly supported the financing and refinancing of invoices ranging from USD5,000 to a few hundred thousand dollars.

In aggregate, we believe that advancing innovation around these three products will contribute to our development objectives, while also creating a larger pool of investable assets for commercial investors.

CDC Group plc is the United Kingdom’s development finance institution, whose mission is to support the building of businesses throughout Africa and South Asia, to create jobs, and to make a lasting difference to people’s lives in some of the world’s poorest places.

Exhibit 6: Sampling of EM Direct Lending Transactions, 2016-2018

Fund Manager(s)	Company Name(s) (or Asset Description)	Region	Country	ICB Sector	Investment Amount (USDm)	Investment Date
Darby Franklin Templeton	Abengoa Peru	Latin America	Peru	Electricity	30	Nov-18
Credit Suisse Asset Management	Cobalt Broadband Services	Latin America	Mexico	Telecommunications Service Providers	N/A	Jul-18
Adamas Asset Management	Aptorum Group	Asia	China	Pharmaceuticals & Biotechnology	15	May-18
BlackRock, Ashmore Investment Management	Transversal de Sisga Highway	Latin America	Colombia	Industrial Transportation	90	May-18
Kartesia Advisor	Groglass	CEE & CIS	Latvia	General Industrials	60	May-18
Cordiant Capital	Brazil Tower Company (BTC)	Latin America	Brazil	Telecommunications Service Providers	79	Apr-18
Amerra Capital Management	Grupo USJ (Acucar e Alcool)	Latin America	Brazil	Food Producers	30	Apr-18
responsAbility Investments, SunFunder	d.light design	Pan-Emerging Markets	Pan-Emerging Markets	Renewable Energy	50	Apr-18
responsAbility Investments	M-Kopa	Africa	Kenya	Electricity	25	Oct-17
Cordiant Capital	Hayat Kimya Sanayi	CEE & CIS	Turkey	Personal Care, Drug & Grocery Stores	N/A	Dec-16
Union para la Infraestructura	Pacifico 3	Latin America	Colombia	Industrial Transportation	88	Feb-16

Source: EMPEA Industry Statistics. Data as of 31 December 2018.

SOPHISTICATION IN TERMINOLOGY

Private credit in emerging markets has evolved significantly since EMPEA's first report on the asset class was published in 2014 (*Private Credit Solutions: Mezzanine Financing in Emerging Markets*). At the time, EM private credit funds were raising between USD3 billion and USD4 billion per year in aggregate, and 'mezzanine' was a catch-all phrase for a variety of medium- to long-term structured credit transactions that were qualitatively different than growth equity, which was the predominant form of private equity investing in emerging markets. Since then, the asset class has gradually become more sophisticated and nuanced, and there is greater differentiation between and among both fund managers and investment strategies. Indeed, the definition of what constitutes 'mezzanine' may even differ in each region.

For instance, in CEE, which has a more developed landscape of intermediaries and leveraged buyout firms, mezzanine sometimes takes the form of sponsored transactions as one might find in developed markets. As Thomas Spring, Founding Partner at Central Europe-focused Syntaxis Capital puts it, "When large private equity firms want to buy a company, they start by shopping for the largest amount of debt at the lowest cost. They go to the banks first to see how much they can get from them, and if they need to fill a gap then, historically, that is when they talk to mezzanine players."

With the recognition that this was not the best possible application for the type of capital the firm provides, it refocused on other borrowers. He continues, "While investing our first fund, we would have described ourselves as mezzanine players. But today, that is simply no longer the case. We have become senior lenders, because the reality is that there is a huge demand from corporates for long-term capital that we can provide as the sole lender, and we therefore don't want to be subordinated behind a bank in situations where you are not being appropriately compensated for the risk you are taking."

In Africa, by contrast—apart from South Africa—leveraged lending is quite rare and the banking system remains relatively underdeveloped. Warren van der Merwe, Managing Partner at Vantage Capital, notes, "In many African jurisdictions, banks have pulled back on US dollar lending due to US dollar shortages, and are often very conservative with short tenors and stringent principal repayment requirements. African banks also focus on large corporates, making it difficult for capital-hungry mid-size businesses to access meaningful amounts of senior debt. There is, therefore, still space for mezzanine debt to come in behind senior debt and to fill that gap. We frequently do take first lien security over assets and shares, but in other situations we are subordinated behind senior lenders. Our mezzanine funds support continued growth and, as compensation for risk, we share in equity value creation on the upside."

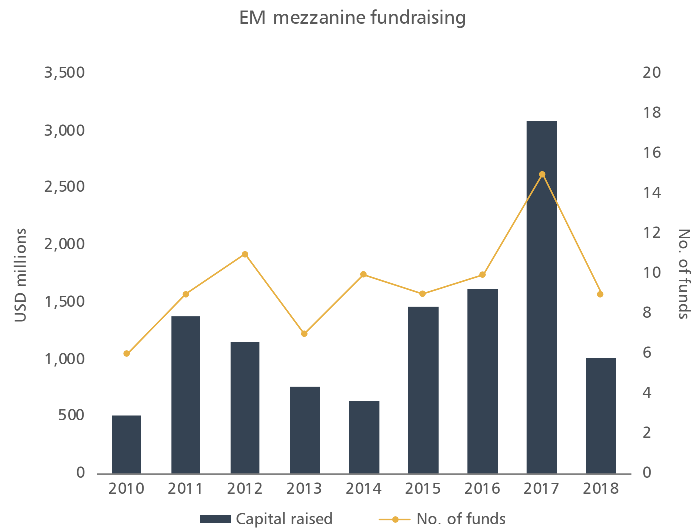
This can present challenges for global institutional investors who may have difficulties figuring out in which 'bucket' to place a strategy. As the market continues to evolve and deepen, investors will likely have to dedicate resources to understanding each individual fund manager's approach to their target geographies and sectors.

Mezzanine

Mezzanine financing utilizes instruments that sit between senior debt and common equity in a firm's capital structure.[2] The strategy is highly customizable, and dedicated mezzanine investors can structure sophisticated transactions that map to the commercial and financing needs of a business. In this regard, mezzanine in emerging markets is quite different than its namesake in developed markets. In the latter, mezzanine has become a commoditized business—financing can be used for expansion capital, recapitalizations, or as leveraged loans. In contrast, in emerging markets, mezzanine typically involves constructing bespoke financing for entrepreneurs and their business plans.

Mezzanine funds are active in each EM region, and it has been a reasonably steady strategy in terms of the volume of capital raised and number of funds achieving a close each year (see Exhibit 7). However, 2017 saw a spike in activity, as China-focused CITIC PE Funds Management and CDH Investments closed on nearly USD2.5 billion for their mezzanine funds, Vantage Capital closed its third Pan-African and Southern African funds (USD153 million and USD135 million, respectively), and NBK Capital raised USD160 million for their second mezzanine fund targeting the Middle East, among others. In 2018, CEE-focused Mezzanine Capital Partners closed its fourth Accession Mezzanine Fund on USD300 million.

Exhibit 7: Mezzanine Has Consistently Attracted Capital in Emerging Markets



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

Exhibit 8: Sampling of EM Mezzanine Transactions, 2016-2018

Fund Manager(s)	Company Name(s) (or Asset Description)	Region	Country	ICB Sector	Investment Amount (USDm)	Investment Date
Vantage Capital	Petro Ivoire	Africa	Cote d'Ivoire	Non-Renewable Energy	22	Dec-18
LAFISE Investment Management	Lagarde (Meat depot)	Latin America	Dominican Republic	Food Producers	3	Nov-18
AfricInvest, Gulf Capital	iSON Xperiences	Africa	Nigeria	Industrial Support Services	51	Nov-18
The EuroMena Funds	Carbon Holdings	Middle East	United Arab Emirates	Non-Renewable Energy	20	Oct-18
Gazelle Finance	Dr. Roger Laundry Service	CEE & CIS	Georgia	Consumer Services	N/A	May-18
NBK Capital Partners, Gulf Capital	Classic Fashion Apparel	Middle East	Jordan	Personal Goods	N/A	Apr-18
Avendus PE Investment Advisors	Ad2Pro Media Solutions	Asia	India	Industrial Support Services	10	Mar-18
OCBC Bank Mezzanine Capital Unit	FE CREDIT	Asia	Vietnam	Finance & Credit Services	50	Jan-18
KKR, Greater Pacific Capital	Enzen Global Solutions	Asia	India	Industrial Support Services	27	Jan-18
Mezzanine Capital Partners	ATM	CEE & CIS	Poland	Software & Computer Services	37	Nov-17
XSML	Gerant d'Eternel	Africa	Democratic Republic of the Congo	Retailers	N/A	Feb-17
BPM Capital	Digitalas Ekonomikas Attistibas Centrs	CEE & CIS	Latvia	Software & Computer Services	N/A	Oct-16
Syntaxis Capital	Trans Polonia Group	CEE & CIS	Poland	Industrial Transportation	11	Jan-16

Source: EMPEA Industry Statistics. Data as of 31 December 2018.

2. For further details on this strategy, see EMPEA's report, *Private Credit Solutions: Mezzanine Financing in Emerging Markets* (2014).

HOW DO YOU STRUCTURE DOWNSIDE PROTECTIONS?

"Our approach through trade finance is to primarily favor over-collateralized (or overly secure) transactions. For instance, let's say you have someone in Kenya who is selling grain that has been produced by local farmers, putting it in containers, and shipping it to a buyer in Dubai. The trade finance transaction provides a loan to the agri-processor in advance of the shipment—but only does so if he can gain comfort in the inventory in the warehouse. For example, the usual ask is for 120% to 150% of what's being financed. If the value of the commodity goes down in that period of time, the borrower needs to post additional collateral or else the transaction goes into default.

–**Serge LeVert-Chiasson**
Sarona Asset Management

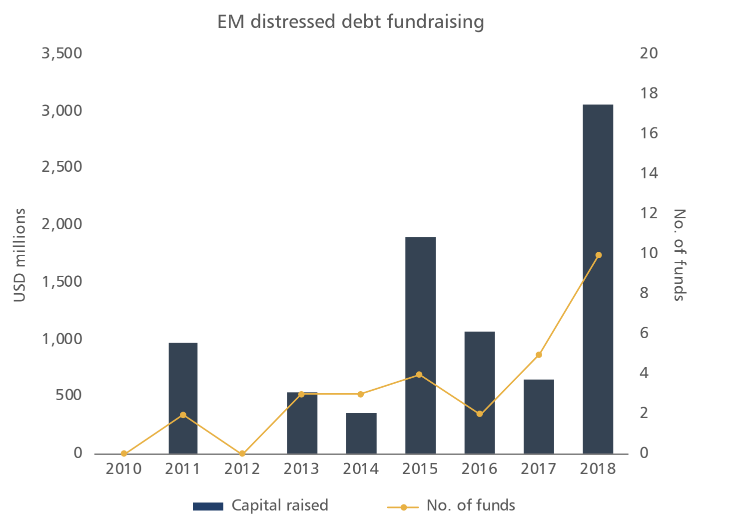
"Most of the time we are secured by a portfolio of loans. For example, if there are USD100 in loans, we would provide capital for USD80 and the platform would contribute the other USD20—even though we would be secured by the full USD100. This gives us some protection against losses and additionally eliminates some of the principal-agent problems with platforms that function like mortgage servicers, which only survive if they continue to originate loans yet don't have any risk in the process. We also often sit on credit committees so that we can ensure that the platform is putting loans in the portfolio that actually fit its mandate. It is better to catch it all on the front end rather than try to do back-end checking.

–**Representative**
Pan-emerging market investment management firm

Distressed Debt

Distressed debt entails the purchase of discounted debt securities. These opportunities may exist on a single credit, pooled, or portfolio basis, and this strategy also includes investors in non-performing loans (NPLs). Over the last three years, 82% of the capital raised for this strategy has been dedicated to Emerging Asia, and 2018 saw firms close on USD3 billion—the largest volume of capital raised for the strategy since EMPEA's statistics began (see Exhibit 9). In part, this is a function of the success of Edelweiss' India Stressed Assets Fund II, a USD1.3 billion vehicle that represents the largest India-focused private credit fund on record at EMPEA.

Exhibit 9: Distressed Debt Attracted Record Flows in 2018



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

The expansion of corporate credit across emerging markets, particularly in Asia, is opening up new opportunities for investors to capitalize upon stressed assets (see Sidebar from Clearwater Capital on page 16). For example, in India, the country's banking system is saddled with non-performing loans. "The government-owned banks are absent from the market because they are struggling to clean up their own books," notes S. Sriniwasan (Srini), Managing Director at Kotak Investment Advisors, "as almost 14% of their credit book—almost USD100 billion—consisted of NPLs. Similarly, the Non-Banking Financial Companies (NBFC) are facing their own asset-liability mismatch. Many had borrowed short from the mutual fund industry and lent long, and this is adding to the distressed opportunity set."

Latin America is another region where the distressed strategy has been gaining traction. To demonstrate, only one distressed debt fund closed in the region in each of 2015 and 2016, while three achieved a close in 2018. Brazil, in particular, has been a target for distressed investors, following one of the deepest recessions in the country's history. For instance, alternative investment manager Canvas Capital and distressed asset specialist Jive Investments achieved closes on their USD- and BRL-denominated distressed debt funds, respectively, in 2018.

Private Debt Transactions and Structures in Latin America: Insights from The Rohatyn Group

George Monserrat, Managing Director—Private Credit

There are three core drivers of the direct lending opportunity set that have persisted in the region: (1) country- and sector-specific cyclicality; (2) structural inefficiencies; and (3) local lending inefficiencies that are market specific. We believe macroeconomic and industry cycles are a continuous source of opportunity because whenever there is a downturn besetting a specific country or vertical in which banks have large exposure, investors are presented with a window to cherry-pick attractive corporates that are credit rationed.

Latin America's structural inefficiencies refers to the low level of domestic corporate credit penetration that characterizes the region—domestic corporate credit to GDP in Latin America is less than 50%, which as a region is among the lowest in the world. Local lending inefficiencies typically take three forms. The first is tenor. Simply put, there is a scarcity of long-term finance in the region, leaving many businesses in a position where they are forced to roll short-term working capital facilities. By contrast, term loans for up to five years enable companies to grow into their capex programs, while eliminating this refinancing risk.

Second, banking systems in most countries in the region are generally characterized as being pretty concentrated with strict credit exposure limits per issuer. This means that typically companies don't have too many bank options and they are on short leashes in terms of credit lines. There is significant potential value in providing the incremental dollar that enables firms to complete their projects and / or consolidate local bank lines.

Third, in general terms, local banks have 'cookie-cutter' underwriting processes and favor plain-vanilla structures. Investors can therefore generally secure a pricing premium for more complex stories with bespoke structures that better align with the credit profile of a business and address the company's commercial needs. This leaves a large number of asset-light companies starved for capital because they don't have hard assets that can be pledged as collateral. For these types of companies, investors should look for businesses with sticky, recurring revenue contracts with high-quality counterparts that can be pledged as collateral.

We believe that these dynamics create the conditions for compelling risk-adjusted opportunities relative to both the direct lending opportunities on offer in the United States, as well as other illiquid strategies in emerging markets. However, fully taking advantage of these opportunities is contingent on the quality of one's deal underwriting and structuring, inclusive of insulating investors from currency risk.

The three most critical underwriting considerations are quality of sponsorship, ability to pay based on free cash flow generation, and robust creditor rights. The first pillar speaks to the need of being comfortable with the reputation of the company's owners and willingness to pay. Quality of sponsorship should be the number one deal killer. Informal reputational checks via local networks and use of a four- to five-month-long 'dating process' to develop a deep understanding of the counterparty's character are critical.

In addition to being comfortable with a firm's *willingness* to pay, it is also important to assess its *ability* to pay based upon free cash flow generation. In practice, this means targeting companies that have free cash flow to debt service coverage ratios greater than 1x. Risk can be mitigated by aligning the debt service payments with free cash flow so that deals are self-liquidating and de-risked through an amortization schedule. Bullet payments at maturity should be avoided.

Robust creditor rights entail highly structured transactions with quality collateral, tight covenant packages, and rigorous reporting requirements. With respect to collateral, using extrajudicial and bankruptcy-remote structures is preferable, which often means the use of trusts. In addition, in our experience it is better to look at collateral from the perspective of its restructuring value rather than its recovery value, so that there could be some pressure to motivate good-faith restructuring discussions if and when things don't go to plan. In general, we believe it is best to avoid judicial processes.

Finally, USD investors should consider including a covenant that requires the company to hedge the currency risk if they generate their revenues in local currency. Hedging need not be on a one-to-one basis, but instead should focus on protecting against tail-risk events. While this covenant can add 200 to 400 basis points on top of contractual coupons—and can therefore be a deal-breaker at times—in our estimation, hedging is in the best interest of both parties.

In sum, the cyclicality and the structural and local lending inefficiencies of Latin America's banking system create continuous risk-adjusted opportunities that global investors can capitalize upon.

Founded in 2002, The Rohatyn Group is a multi-strategy emerging market asset management specialist. Its experience in senior secured direct lending in Latin America dates back to 2004.

Exhibit 10: Sampling of EM Distressed Debt Transactions, 2015-2018

Fund Manager(s)	Company Name(s) (or Asset Description)	Region	Country	ICB Sector	Investment Amount (USDm)	Investment Date
Piramal Fund Management, Bain Capital Credit	Archean Group	Asia	India	Chemicals	156	Nov-18
Jive Investments	Viver Incorporadora e Construtora	Latin America	Brazil	Real Estate Investment & Services	113	Oct-18
Edelweiss Asset Reconstruction Company, Oaktree Capital Management	GTL Infrastructure	Asia	India	Telecommunications Service Providers	276	Oct-18
Bain Capital Credit	NPL Portfolio from China Huarong Asset Management	Asia	China	N/A	200	May-17
PAG	Zhejiang NPL Portfolio	Asia	China	N/A	N/A	Jan-16
Lone Star Funds	Lone Star China NPL Portfolio 1 and 2	Asia	China	N/A	N/A	Jan-16
Shoreline Capital Management, Oaktree Capital Management	NPL Portfolio	Asia	China	N/A	168	May-15

Source: EMPEA Industry Statistics. Data as of 31 December 2018.

HAVE YOU EVER HAD TO DO A WORK OUT, AND HOW DID THAT WORK OUT FOR YOU?

"In a few transactions, we have had borrowers experience a temporary cash shortfall or an actual cash flow impairment in the underlying business. When this happens, our approach is to first understand the reason for the delay. As long as the company is a performing business, and all of our assumptions about its growth are still valid, it really doesn't make sense to take a company through some sort of a court process because you are going to reduce the value of the asset. Our approach is to agree on a plan to ensure the situation is restored at the earliest and the investment is adequately serviced during such period. On the other hand, if the impairment is believed to be long term, or pertains to a significant change in the business fundamentals, or something has changed with the borrower's intent, we obviously have the full legal recourse to protect our interests.

–**Kanchan Jain**
Baring Private Equity Asia

"We had an early-stage venture-backed platform that had some issues raising additional capital and therefore decided to shut down. We worked with them to keep the platform running and servicing the assets, until we were able to reach the point of being able to help them put together a sale of those assets so that we would get back what we expected. We had to move carefully because there is a risk that if borrowers think a platform is shutting down, they may become squirrely and choose not to make their payments. Having a bundled portfolio of decently underwritten assets and knowing the families who are investing in credit and willing to bear some of the risk locally was extremely helpful.

–**Representative**
Pan-emerging market fund manager

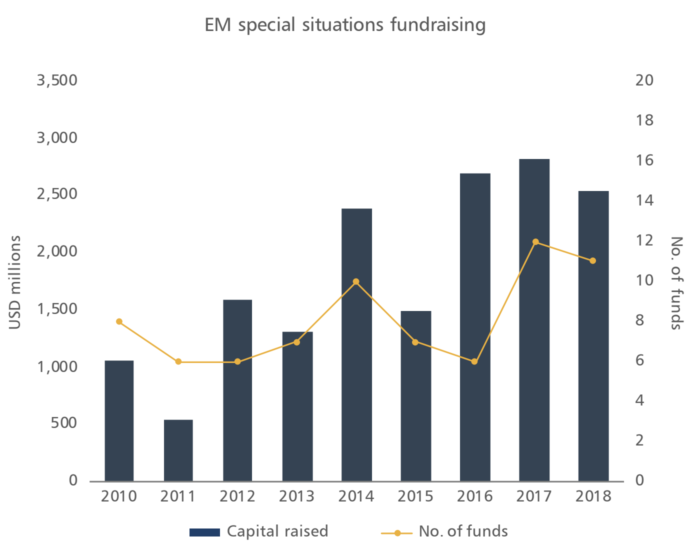
Special Situations (Credit Opportunities)

The term 'special situations' can mean many things to many people, potentially leading to confusion. For instance, it can include investments in a broad mix of stressed or distressed companies or assets, as well as event-driven, restructuring, and rescue / turnaround situations. In addition, opportunistic investments in senior debt or mezzanine can also fall into this category.

Gregory Bowes, Co-Founder and Managing Principal at the global investment firm Albright Capital, synthesizes three defining characteristics for this strategy. "First, special situations entails taking advantage of some inefficiency or complexity in the market that most investors have trouble fully understanding. Second, it is a value-oriented strategy. Third, the transactions are structured to minimize downside while retaining significant upside."

While special situations activity has declined in developed markets over the last 20 years as they became more efficient, the inefficiencies and information asymmetries across emerging markets remain significant. In addition, the sophistication of counterparties and the strength of creditor rights have been improving, both of which are conducive to this strategy (see *Evolution of Creditor Rights* on page 14). Fittingly, special situations has been the most popular private credit strategy in emerging markets, attracting USD16.5 billion in commitments since 2010, a sum equal to 36% of all private credit capital raised (see Exhibit 11).

Exhibit 11: Special Situations Has Been the Most Popular EM Private Credit Strategy



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

While Asia has been the predominant location of special situations activity—with recent notable fundraises including SSG Capital Partners' fifth vehicle (USD1.2 billion) and Bain Capital Special Situations Asia (USD1 billion)—the strategy is visible in all markets.

One of the hallmarks of this strategy is the flexibility of its approach. For example, Diogo Bustani, Director of Investor Relations at Brazil-focused Hemisfério Sul Investimentos (HSI), notes that their firm uses convertible debentures to structure its senior loans. "Under Brazilian tax law, we are able to hold the debentures in a structure that is tax exempt for foreign investors, enabling us to minimize tax bleed. Another reason we use these is that, even though we are lenders, convertible debentures can have equity-like rights, such as board seats, negative controls, and the ability to control the flow of funds in a company."

Another feature of EM special situations is the spectrum of regulatory regimes that impact firms' ability to execute the strategy. On this point, John Yonemoto, Co-Founder and CIO at Albright Capital, adds, "A good business with a bad capital structure is something that we can deal with anywhere in the world. However, when you go down the path of restructuring, there are some countries where it's too difficult to do, some where it is getting better, and some where it is workable."

Exhibit 12: Sampling of EM Special Situations Transactions, 2016-2018

Fund Manager(s)	Company Name(s) (or Asset Description)	Region	Country	ICB Sector	Investment Amount (USDm)	Investment Date
AnaCap Financial Partners	Nova KBM Debt and Loan Portfolio	CEE & CIS	Slovenia	N/A	N/A	Aug-18
SSG Capital Management	Shapoorji Pallonji Finance	Asia	India	Investment Banking & Brokerage Services	20	Apr-18
Lone Star Funds	Atvos	Latin America	Brazil	Renewable Energy	200	Apr-18
ADV Partners	Feedback Infrastructure	Asia	India	Construction & Materials	105	Mar-18
Hemisferio Sul Investimentos (HSI)	Madero	Latin America	Brazil	Travel & Leisure	115	Feb-18
Edelweiss Alternative Asset Advisors	Unitech Machines	Asia	India	Automobiles & Parts	57	Mar-17
Hemisferio Sul Investimentos (HSI)	Madero	Latin America	Brazil	Travel & Leisure	15	Jan-17
Farallon Capital Management	Hindustan Clean Energy	Asia	India	Electricity	N/A	Nov-16
AION Capital Partners	Clix Capital (formerly GE India Commercial Lending and Leasing)	Asia	India	Investment Banking & Brokerage Services	360	Sep-16
Albright Capital Management	Innovattel	Latin America	Latin America Regional Investment	Telecommunications Service Providers	45	Apr-16

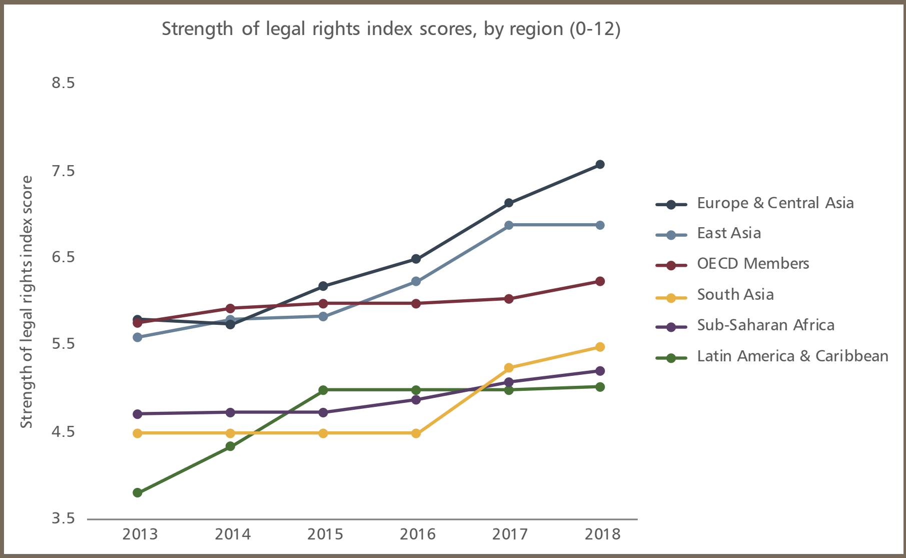
Source: EMPEA Industry Statistics. Data as of 31 December 2018.

EVOLUTION OF CREDITOR RIGHTS

A significant element supporting the development of private credit has been the evolution of creditor rights across emerging markets. While each country has its own regulations and bankruptcy frameworks, and each exists along a continuum of sophistication, the general trend has been positive.

To illustrate, the World Bank constructs a legal rights index that measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders. In general, developing countries in East Asia, Europe, and Central Asia exceed the composite index score for OECD member countries (see Exhibit 13).

Exhibit 13: Creditor Rights Are Improving in Most EM Regions, and Some Exceed OECD Levels



Source: World Bank.
Note: The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending. The index ranges from 0 to 12. Data for each region (except for OECD members) excludes high-income countries.

Meanwhile, other emerging regions are closing in on the OECD members' score, most notably South Asia. India, in particular, has seen a rapid uplift in its score—from 6.0 in 2013 to 9.0 in 2018. In part, this is due to the country's Insolvency and Bankruptcy Code, released in 2016, which is bringing needed reforms.

"It was normal for court cases to last upwards of seven years, and they could be manipulated to be dragged on for a long time," says Kotak's S. Sriniwasan (Srini). "The new Code essentially throws out the existing owners of a company and an independent resolution professional takes over. This is a big deterrent for borrowers. Second, the professional will invite bids to buy the business as a going concern or liquidate it. While the law has prescribed a period of 270 days, experience suggests that it will take at least a year. However, that is a fantastic improvement on five years of litigation."

Other Strategies

In addition to the four prevalent EM private credit strategies discussed previously, there are several niche strategies that are gaining traction:

Venture debt — Often used as a complement to equity, this strategy is typically structured as a term loan with equity kickers. Venture debt funds are a relatively recent phenomenon in emerging markets. In 2018, two local currency funds achieved a close—one each in India and Mexico.

Factoring / trade finance — Entails a variety of short-term financing for businesses in which a company sells its receivables or invoices at a discount.

Specialty finance / leasing — This strategy can target a variety of esoteric assets, such as royalties and catastrophe bonds.

The Emerging Market Landscape

With the steady increase in fundraising dollars and the multitude of ways in which fund managers are deploying capital in emerging markets, some might wonder whether too much capital may be chasing too few deals. The reality, however, is that these markets are far from absorbed. To illustrate, IFC data reveal that nearly 30 million small and medium enterprises (SMEs) confront a formal financing gap that exceeds USD4 trillion.[3] The total capital raised for private credit strategies in emerging markets since 2006 amounts to roughly USD57 billion—not even 1.5% of today's financing gap.

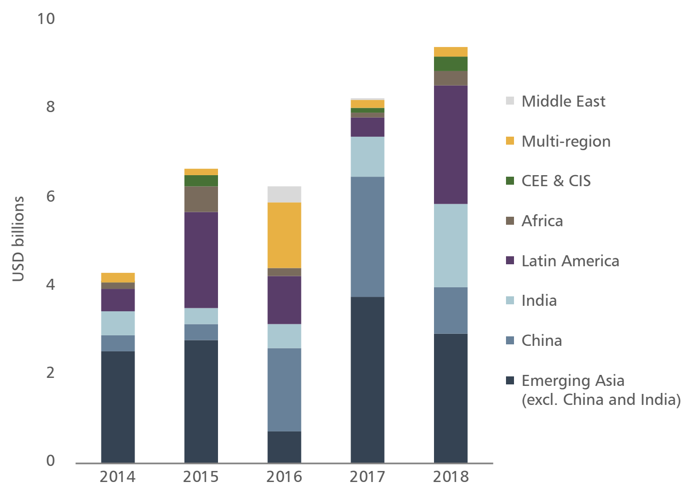
Of course, the investible universe of companies and competitive landscape vary by region. Emerging Asia, led by the sizable market opportunities of China and India, has captured the lion's share of EM private credit fundraising dollars (see Exhibit 14), and consequently has the deepest pool of fund managers. In contrast, the total number of firms operating in this segment in CEE, Africa, and the Middle East remains relatively limited.

This is widely seen as a huge plus for those firms that have been able to gain a foothold in their respective markets. As Vantage Capital's Partner David Kornik explains, "Given the size of the mid-market sector across Africa, the limited availability of private credit, and the depth of our proprietary origination networks, it is seldom that we encounter competition from a competing mezzanine lender on the same opportunity. With mezzanine's limited penetration in Africa, it has also enabled Vantage to pioneer some unique deals on the continent, including a recent transaction with Pétro Ivoire, a distributor of oil and gas products in Côte d'Ivoire, in which we funded the first-ever leveraged management buyout in francophone West Africa."

Even in countries where a surge of new private credit funds have come to market—such as Mexico and India—the competitive pressures are nowhere near as consequential as they are in developed markets, where pricing is aggressive and covenants are deteriorating. "We have seen some new entrants over the last couple of years, which is a welcome development for the asset class," notes Kanchan Jain, Managing Director and Head of India Credit at Baring Private Equity Asia. "There isn't yet the risk that too much capital will flood the market because the opportunity size is so large, and we have just touched the tip of the iceberg. But every year, we see the market growing and, as more transactions take place, corporates gain a better understanding of how private credit can be a solution to some of their needs."

Corporates are not the only organizations learning how private credit can meet their needs; institutional investors are as well. As the next section illustrates, growing numbers of global institutional investors intend to begin or increase their allocations to EM private credit. The competitive landscape is liable to get richer.

Exhibit 14: Emerging Asia Has Accounted for the Lion's Share of EM Private Credit Fundraising



Source: EMPEA Industry Statistics. Data as of 31 December 2018.

> "There isn't yet the risk that too much capital will flood the market because the opportunity size is so large, and we have just touched the tip of the iceberg. But every year, we see the market growing and, as more transactions take place, corporates gain a better understanding of how private credit can be a solution to some of their needs.
>
> **–Kanchan Jain**
> Baring Private Equity Asia

3. IFC, MSME Finance Gap Database.

The View from China: Insights from Clearwater Capital

Robert Petty, Co-CEO and Co-CIO; Sylvia Suen, Director; and Ming-Hau Lee, Director

Pan-Asian credit strategies are garnering greater investor attention given the scale of opportunity they represent. Arguably the world's largest economic zone, Asia is home to a USD55 trillion credit market, the breakdown of which is fundamentally different than what is available in other developed and emerging markets. As a result, Asian credit strategies provide diversification benefits for limited partners. Whereas government debt in the region is de minimis as a percentage of the total, corporate debt, inclusive of both state-owned and private companies, comprises the lion's share of the region's credit opportunity. Another notable difference in Asia is the fact that the corporate loan space accounts for approximately 60% of the market versus less than 40% represented by publicly traded bonds—in China and across the region, the percentage going towards loans, private debt, and alternatives is growing at an even greater pace.

With China constituting 60% of the Asian credit opportunity, we at Clearwater see three compelling ways to gain exposure to the country's large-scale and fast-growing companies, while delivering downside-protected, diversified, and compelling risk-adjusted returns: (1) the offshore credit markets, (2) onshore direct lending, and (3) NPLs.

The first way we think about accessing some of the growth opportunities in the world's second largest economy is simply by playing in the offshore credit markets. The publicly traded companies that comprise China's USD-denominated investment grade, high-yield, and loan markets are world-class and have real scale in terms of revenue and EBITDA. In particular, the Asian high yield market offers a well-established way to invest in the USD-denominated instruments of some of the region's largest companies. Furthermore, on a risk-adjusted basis, this strategy has consistently outperformed the US and European high-yield markets—particularly over an extended period of time.

Second, there are significant investment opportunities in the USD33 trillion onshore domestic market. However, accessing these opportunities requires having large-scale, on-the-ground teams—in Clearwater's case, a 32-person team across three different offices in China—as well as local capital structures capable of investing appropriately in onshore yuan-denominated instruments. The onshore strategies that we currently find most compelling include direct lending, which we implement through a unique onshore licensed lender that Clearwater built from the ground up. We are executing a high current yield, highly secured lending strategy in which we source, underwrite, document, and manage assets ourselves. This offers a compelling risk-adjusted return that is hedgeable back to the US dollar.

On the topic of hedging, it is important to recognize that the Chinese yuan has significantly matured and stabilized over the past decade, and offers diversified hedging opportunities at one of the lowest costs across the emerging markets. For instance, the cost of hedging it from a USD perspective is approximately 1% to 2%—as compared to 5% to 7% in India—and the process of structuring a hedge in the market is very straightforward for onshore deals.

Lastly, the debt-fueled growth of Asian companies has resulted in widespread corporate defaults following the massive consolidation taking place across a number of industries—and China is no exception. The result has been a boom in China's NPL market, which today represents approximately USD300 billion, with special mention loans—meaning those with potential red flags or weaknesses that warrant close attention—accounting for another USD515 billion. Interestingly, this is now the second time that NPLs have played a significant role in the credit markets—the first was over 12 years ago when China made the decision to take their banks public after establishing asset management companies (AMCs or 'bad banks') to clean up the bad loans in the country's financial system. These AMCs have since become very sophisticated players and are actively addressing NPLs in the system.

Of course, it takes time for NPL cycles to turn into good investments. We are now in the third year of the second NPL wave in China, and we believe that the market is beginning to enter a higher-return environment. To illustrate, the increased supply of NPLs and distressed assets, and the 38 bond defaults last year—more than we have seen in the collective prior history of China's credit markets—are driving up real rates.

Credit in China has grown dramatically over the past decade. As the market and Chinese businesses have both broadly matured, there are greater opportunities for companies to borrow capital through the bond markets and access a wide array of investors—these include a deepening pool of asset managers and fixed income credit specialists alongside the traditional bank loan market. Although it is still relatively nascent, the overall market size in China is incredibly large and should merit investors' attention—particularly those seeking diversification and compelling yield relative to the United States and Europe.

Clearwater Capital Partners is a private investment firm founded in 2001 to invest in credit and special situations in Asia with current AUM of USD1.6 billion. In 2018, Canadian independent asset management firm Fiera Capital Corporation (TSX: FSZ), with current AUM of CAD137 billion, acquired Clearwater and became its ultimate parent company.

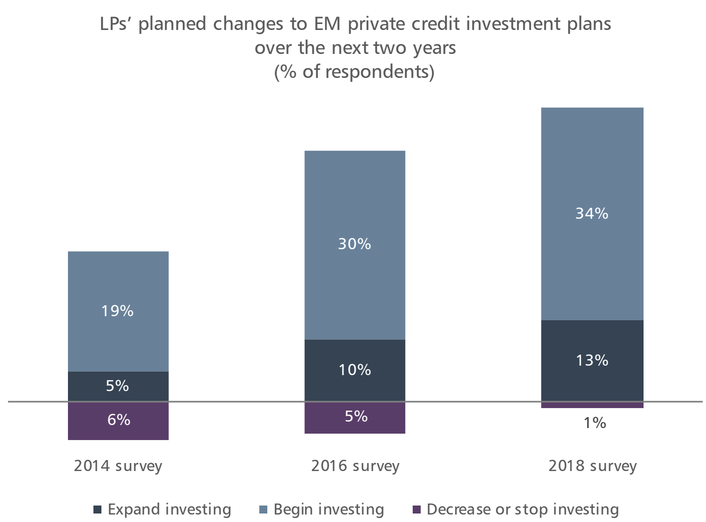
Global Institutional Investor Interest: A Positive Outlook

Private credit's growth trajectory is likely to continue as more investors better understand how credit strategies can be an attractive way to access EM opportunities, and get increasingly comfortable with the risk-return profile on offer. Indeed, EMPEA has recorded this rise in institutional investor interest through its annual *Global Limited Partners Survey*. In the 2018 edition, nearly half of all LP respondents (47%) indicated plans to begin or expand investment in EM private credit strategies, up from 24% in 2014 (see Exhibit 15).

While interest in private credit is demonstrable across all types of investors, the development finance institutions (DFIs) are truly leading the charge. In 2018, 72% of DFIs and government agencies indicated plans to begin investing or expand their investment in EM private credit—the highest proportion of any institution type (see Exhibit 16). Several of the fund managers interviewed for this report noted the crucial role these organizations are playing in the development of this asset class—particularly those who are operating smaller funds that are more challenging for larger investors to access.

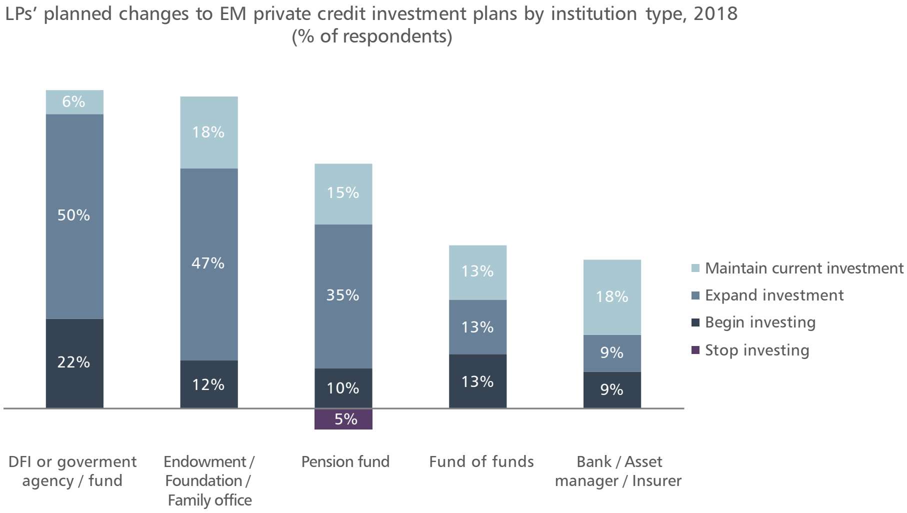
For example, the UK development finance institution CDC Group is ramping up exposure to this strategy and estimates that approximately half of its current commitments on a run-rate basis are in debt in comparison to a negligible percentage in 2012 (see Sidebar from CDC Group on page 7). Specialized investment advisor Obviam, which manages the portfolio of the Swiss Confederation's development finance institution SIFEM, began building out its emerging market private credit strategy four years ago. Adele Tilebalieva, Obviam's Managing Director for Latin America, notes, "The lesson learned from having a portfolio heavily concentrated toward EM private equity funds is that it is quite difficult to smooth cash flows given the dependency on exits—and exits can be fairly unpredictable in light of global market volatility. Consequently, although still focusing on EM private equity, Obviam allocates significant capital to both private credit funds, and direct senior and subordinated debt transactions to financial institutions."

Exhibit 15: Nearly Half of Surveyed LPs Plan to Begin or Expand EM Private Credit Investing



Source: EMPEA Global Limited Partners Survey, 2014-2018.

Exhibit 16: DFIs, Endowments, Foundations, and Family Offices Are Most Keen on Credit



Source: EMPEA 2018 Global Limited Partners Survey.
Note: Numbers do not sum to 100 because this exhibit excludes respondents who selected 'Not invested and no plans to invest.'

The DFIs are also playing an important role in helping other investors navigate the large and diverse universe of EM private credit. Even an impact-focused investment firm such as Calvert Impact Capital, which has been investing for over two decades, finds significant value in working with the DFIs. Chief Financial Officer Derek Strocher explains, "We often invest with like-minded impact partners in funds. DFIs make good partners because they typically have a presence in the country (often including investment officers), relationships within that community, and a standing with the government which all helps provide a 'halo effect' to the transaction."

Endowments, foundations, and family offices are also poised to play a greater role, as 59% indicated plans to begin investing or expand their investment in EM private credit. Speaking to some of the drivers behind one particular family office's interest in this segment, its Portfolio Manager shares, "Nothing is truly uncorrelated, but we are always on the hunt for investment strategies that are not *as* correlated to the exposure we have in North America, which is why we have turned to emerging markets. Private credit is an attractive option given that we are looking for products that reduce the J-curve immediately, and this strategy also minimizes our duration and risk exposures."

However, not all family offices are able to jump in with both feet. Heinz Blennemann, Principal at US-based family office Blennemann Family Investments, explains: "We like private credit in emerging markets because it is a portfolio diversifier, providing income that is less correlated with the rest of our portfolio. As a taxable investor, however, EM private credit has a high hurdle. We are invested in several EM private credit funds with mid-teen returns net of fees, but after federal and state taxes, we are left with around 7%. Currency fluctuations may further impact this value by 100 to 200 basis points, often resulting in about a 5% return, on par with municipal bonds of equivalent maturity. For this reason, we are overweight on private strategies for which part of the return is taxed at a long-term capital gains rate—such as private equity, venture capital, and infrastructure—but continue to invest in niche private credit strategies that diversify our portfolio."

Speaking to the process of searching for capital, one fund manager notes, "There are reasonable-sized endowments that understand the benefits of these strategies from a long-term perspective and don't have to write huge checks. Even some of the large family offices have regional wealth managers who can invest in a smaller fund. It's a tough sell cycle but there is a path—even if it is a long one. Beyond these institutions, there is a wealth of new and nontraditional ways to raise capital, including crowdfunding investment platforms and the issuance of securities backed by portfolios."

WHAT ARE THE KEY CHARACTERISTICS AND / OR SKILLSETS THAT YOU WANT TO SEE IN AN EMERGING MARKET PRIVATE CREDIT FUND MANAGER BEFORE CONSIDERING A COMMITMENT?

"It's been very difficult for us to get comfortable with first-time funds in these markets. We need to see a track record, as well as a cohesive team. It is important that they can demonstrate that they have been through situations where they have had to rely on one another and are not going to crumble under the stress, which you have a lot of in emerging markets. We also need to see a clear plan for how to deal with currency risk.

–**Representative,** Asia-based family office

"It is important that the fund manager has an understanding of the risk profiles of each of its transactions because things can get complicated pretty fast. In private debt, you are essentially lending against the transaction as opposed to a hard asset. In the case of factoring, you are lending against the quality of the receivable. We've seen examples where a company has said that they have sold their product to a high-quality buyer, such as Coca-Cola, Ford, or McDonald's, and is offering to sell its receivable for 97 cents on the dollar. You may think that's a great deal, but if you don't (1) confirm the receivable and (2) verify that this liability hasn't been sold to multiple parties, then you are facing a potential risk of fraud. Funds need to have A+ processes in place to understand, reduce, and remove the key risks inherent in their particular strategies in a way that minimizes a lot of the volatility in the return profile.

–**Serge LeVert-Chiasson**, Partner, MD Impact Investment Advisory, & CCO, Sarona Asset Management

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"We are actively scouring the market for debt deals in relation to our Zero Gap portfolio—a metaphor for closing the Sustainable Development Goals financing gap with the belief that there are not enough financial products out in the market to actually mobilize the necessary level of private institutional and retail capital. Therefore, we are not looking for small, bespoke funds or direct deals but rather opportunities that are both highly innovative and scalable.

–**Mike Muldoon,** Associate Director, Innovative Finance, Rockefeller Foundation

Challenges on the Horizon

Despite the positive trend line regarding LPs' expressed interest in EM private credit strategies, it remains undeniably challenging for credit managers to raise capital—particularly so for the new crop of entrants in fundraising mode. EMPEA data show that in recent years, the average length of time between credit funds' first and final closes has been 30% longer than those for private equity funds (see Exhibit 17).

In EMPEA's estimation, this delta speaks in part to an educational challenge, as many investors are still in the process of understanding the unique challenges of EM private credit investing—particularly in comparison to private equity—at both the sourcing and monitoring stages. As a result, some LPs remain in the early stages of building up a knowledge base on the skill sets required to perform these strategies well.

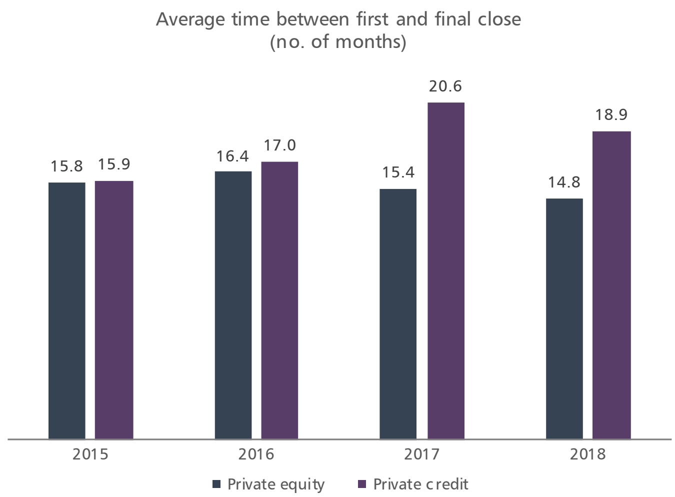
As an example, Holger Rothenbusch, Managing Director of Debt and Infrastructure at CDC Group, explains the difficulties in comparing deal sourcing in private credit to private equity, using mezzanine as an example. "A challenge of the African mezzanine market is that it's very hard to articulate an investment process that's similar to a private equity fund's in terms of starting with a huge funnel that is eventually whittled down to one deal out of 100. In mezzanine, the contracts require loan documentation and therefore necessitate companies with some institutional capacity and the ability to comprehend the structuring. You are also limited to companies that can deal with FX risk. As you go down the list of criteria, the number of companies that can take that funding isn't huge, plus it's hard work to pitch them on the opportunity and convert them into transactions."

Once investments are made, the additional challenge of monitoring the portfolio arises. In private equity, an investor can exert some influence through a board or advisory committee role and get a better sense of what is taking place behind the scenes. While the fund managers are not going to be as involved in the governance and day-to-day operations of their investees as a private equity fund would be, there still needs to be oversight to ensure that investments are structured well from the beginning, covenants are being monitored, and adequate resources are available should a deal go awry.

Serge LeVert-Chiasson, Partner, MD Impact Investment Advisory, & CCO of Sarona, an emerging and frontier market-focused fund of funds, speaks to the potential difficulties in oversight. "From a fund manager's perspective, the volume of transactions within a typical private debt fund can be so high that it's sometimes bewildering to figure out how to ensure all those cash flows are real. You may have a fund that is dealing with hundreds (sometimes thousands) of repayments per month. Following the money and ensuring that it is coming in as expected and on time is a real due diligence challenge. You can't follow every single transaction; instead, you have to find a way to take a sample and follow it in a random way so the fund manager can't game the responses."

While these hurdles are significant, perhaps the biggest constraint to greater growth of private credit financing in emerging markets is investor misperceptions about its risk-return profile. The next section addresses these misperceptions directly.

Exhibit 17: Private Credit Funds Are Taking Longer to Raise Than PE Funds



Source: EMPEA.
Note: Sample excludes funds with a difference between first and final close of less than one month.

Exhibit 18: Sampling of LPs with Prior Disclosed Commitments to EM Private Credit Funds

Development Finance Institutions and Government Agencies	Pension Funds	Banks, Asset Managers, and Insurers	Family Offices, Endowments, and Foundations
African Development Bank (AfDB)	AFP Integra	Adamas Finance Asia	Adolf H. Lundin Charitable Foundation
Agence Francaise de Developpement (AFD)	AFP Prima	Allstate Investment Management	Andrew W. Mellon Foundation
Asian Development Bank (ADB)	Alecta Pensionsförsäkring	Aozora Bank	Auria Capital
Banco Nacional de Desenvolvimento Economico e Social (BNDES)	Arizona Public Safety Personnel Retirement System	Bancoldex	Ceniarth
Belgian Investment Company for Developing Countries (BIO)	Banesprev	Bangkok Bank	Ewing Marion Kauffman Foundation
CDC Group plc	Boeing Company Pension Fund	Calvert Impact Capital	Grantham Foundation
Corporacion Andina de Fomento (CAF)	Caisse de Depot et Placement du Quebec (CDPQ)	Capital Bank	John D. and Catherine T. MacArthur Foundation
DEG	California Public Employees' Retirement System (CalPERS)	Central Bank of India	John S. & James L. Knight Foundation
Development Bank of Southern Africa (DBSA)	California State Teachers' Retirement System (CalSTRS)	China Life Insurance Co. Ltd	Lundin for Africa
DFID Impact Fund	Canada Pension Plan Investment Board (CPPIB)	CITIC Securities	Mohandas Pai
European Bank for Reconstruction and Development (EBRD)	CenturyLink Pension Plan	Edelweiss Asset Reconstruction Co.	Peking University
European Investment Bank (EIB)	City of Detroit Police and Fire Retirement System	Federal Bank	Ranjan Pai
Finnish Fund for Industrial Cooperation Ltd (FINNFUND)	Colorado Public Employees Retirement Association	Hyundai Securities	Robert Wood Johnson Foundation
Future Fund	Eskom Pension Fund	ICBC-AXA	Rockefeller Foundation
IDB Invest (formerly Inter-American Investment Co.)	Fundacao CESP	ICICI Bank	Shell Foundation
Inter-American Development Bank Multilateral Investment Fund (MIF)	Intel Corporation Pension Plan	IFMR Capital	Tsinghua University Education Foundation
International Finance Corporation (IFC)	InverCap Afore	India Life Insurance Co.	University of Louisville Foundation
International Fund for Agricultural Development (IFAD)	Los Angeles City Employees' Retirement System (LACERS)	IndusInd Bank	University of Michigan Endowment (Regents)
Japan Bank for International Cooperation (JBIC)	Maine Public Employees Retirement System	KEB Hana Bank	University of Texas Investment Management Company (UTIMCO)
KfW Entwicklungsbank (The German Development Bank)	Maryland State Retirement and Pension System	Kotak Old Mutual Life Insurance	V Balakrishnan
National Bank for Agriculture and Rural Development (NABARD)	Massachusetts Pension Reserves Investment Management Board	Kyobo Life	W.K. Kellogg Foundation
Netherlands Development Finance Company (FMO)	Montana Board of Investments	Lotte Non-Life Insurance	Walton Family Foundation
Nigeria Sovereign Investment Authority (NSIA)	National Social Security Fund	Metropolitan Asset Management	William & Mary Investment Trust
Nordic Development Fund (NDF)	New Jersey State Investment Council	National Insurance	
Norwegian Investment Fund for Developing Countries (NORFUND)	New York State Common Retirement Fund	New India Assurance	
Obviam	New York State Teachers' Retirement System	New York Life Insurance Company	
Overseas Private Investment Corporation (OPIC)	Paul, Hastings, Janofsky & Walker Retirement Plan	Penn Mutual Life Insurance Company	
Proparco	Pennsylvania Public School Employees' Retirement System	Raiffeisen Zentralbank Osterreich (RZB)	
Small Industries Development Bank of India (SIDBI)	Pennsylvania State Employees' Retirement System	Travelers Companies	
Swiss Investment Fund for Emerging Markets (SIFEM)	Pensioenfonds Zorg en Welzijn (PFZW)	United India Insurance	
United States Agency for International Development (USAID)	People's Insurance Company of China (PICC)		
	Public Investment Corporation (PIC) (South Africa)		
	San Antonio Fire and Police Pension Fund		
	San Diego County Employees Retirement Association		
	San Francisco City & County Employees' Retirement System		
	Santa Barbara County Employees' Retirement System		
	Second Swedish National Pension Fund (AP2)		
	Texas Municipal Retirement System		
	TIAA		
	Transnet Pension Fund		
	Valia		
	Washington State Investment Board		

Source: EMPEA. Data as of 31 December 2018.

The View from India: Insights from Baring Private Equity Asia (BPEA)

Kanchan Jain, Managing Director and Head of India Credit

BPEA takes a pan-Asian approach to investing and, as we look across the region, we see very strong growth prospects across the board in all of the Asian economies. Given the rates of development of the markets, the investment opportunities can range from sizable, well-established corporations operating at scale, to mid- or small-size corporates, SMEs, or more granular asset classes such as microfinance and consumer finance.

Clearly, the way one would address each of these market segments is quite different. We pursue opportunities in the larger segment through our private equity fund—primarily through majority control buyout strategies where we have the ability to control the company and drive value creation. Smaller transactions in Asia have historically been executed through minority private equity strategies, such as growth equity, but in our experience there is a safer way to generate more consistent returns from our investments in these smaller companies, which is through debt. This allows us to exert a level of control over the company and generate a high contractual return without taking many of the risks of a minority equity investor.

Of all the Asian countries, the best opportunities that we've seen on the debt side are in India, specifically in the mid-market. First, the size and structure of the market presents a large volume of scalable opportunities. After China, India stands out as the next-largest economy in Asia. You have very strong macro tailwinds with GDP growing at 7% to 8% per year, and the demographics are favorable—India is one of the few large economies left where you see the youth population increasing.

Despite these features, many mid-market Indian companies only have limited access to organized and flexible capital to facilitate growth. Most bank debt is consumed by the government, large corporates, or priority sectors such as agriculture and SME lending. These loans also come with regulatory restrictions and lack of flexibility for the uses of capital. While public equity markets have provided access to large corporates, they have not been reliable for mid-market companies. Indian promoters also like the non-dilutive nature of private credit over private equity.

We therefore see a significant financing gap in this space, and for the last eight years, we've been focused on building an investment strategy around providing customized capital solutions in the form of secured debt to these fast-growing mid-market businesses. This strategy is lower risk from both a borrower segment and transaction structuring perspective, while the shortage of capital in the mid-market means that we're able to generate contractual yields from highly secured investments of around 18% to 20% per year. This compares very favorably to the returns available from minority growth equity investments in India, yet we take no equity risk and have fixed coupons of 14% to 15% per annum, payable quarterly.

Second, we have seen the development of a much more robust institutional framework when it comes to financial markets, corporate governance, and legal systems. As just one example, India's new Insolvency and Bankruptcy Code is a game changer and has been one of the biggest reforms to take place over the last five years. We now have a code that acknowledges that if a company has defaulted and been admitted into insolvency proceedings, it should be up to the creditors to run that process. Another factor that has helped make debt a viable investment mechanism has been the establishment of the credit bureaus. For the last ten years, India's credit bureaus have been tracking information on borrowers—individuals as well as companies both small and large—which means there's more organized information in the public domain that can be used to help make the right decisions.

We see a lot of investors coming to India and focusing on higher risk strategies in search of higher returns to justify investing in an emerging market. Of course, that argument has some flaws. India is a very large and highly evolved market, and if you want to make over 20% in US dollar terms, you really need to play in an end of the spectrum where there's significantly higher risk and greater volatility, such as special situations with equity-linked returns, venture debt, or distressed debt. In our view, the incremental upside from these strategies does not justify the significant increase in risk by moving away from contractual returns and the potential for defaults and capital loss.

In contrast, a secured debt strategy offers stability, particularly as creditors can use their rights and influence to protect against downside—and we see that happening across India. A significant value we bring to the borrower is flexibility in terms of structuring the debt to match the capacity and cash flow needs of any given borrower. As for the investor, we will look at various types of collateral to secure our investment, including natural business assets or the promoter's hard assets outside the business and encumbrance over shares. We will also structure various mechanisms to access operating cash flows and, in a few cases, create additional upside in the returns by participation in the business growth. Every transaction is different—it depends on the sector and the availability of collateral—but every transaction is secured.

As the market continues to mature and expand beyond what is already a significant size, we believe that direct lending in India will become an increasingly attractive strategy for investors' consideration.

Founded in 1997, Baring Private Equity Asia is an independent private equity firm dedicated to Asia, with total committed capital of over USD17 billion.

The Case for Emerging Market Private Credit

While private credit strategies are beginning to gain traction among global institutional investors, they still represent a relatively small percentage of overall EM private capital activity, and they remain grossly underinvested relative to the opportunity set. In part, this is a function of a lack of knowledge about EM private credit. While an abundance of information exists about private equity in emerging markets and private credit in developed markets, both of these are qualitatively different than EM private credit. In fact, there are persistent misperceptions about the risk-adjusted returns that private credit offers relative to EM private equity and its developed market counterpart.

There are three core drivers for investing in EM private credit:

1. The prospects for compelling absolute and uncorrelated returns in comparison to developed market private credit;

2. Diversification and risk mitigation benefits in contrast with EM private equity; and

3. The role private credit can play in filling the funding gap confronting EM mid-market companies, thereby delivering a broader developmental impact.

In this section, we explore each of these drivers in turn.

Evaluating EM Private Credit Against Developed Market Opportunities

As the private debt markets in the United States and Western Europe matured in response to post-GFC monetary policies, emerging markets became an increasingly attractive place to look—particularly as the pool of players deepened in developed markets, resulting in greater competition. A former US-based pension fund employee notes, "We got more involved with different types of private lending as well as distressed debt in order to achieve better, longer, and more sustainable returns. By going to the emerging markets, we were able to find a way to earn relatively high yields across a diversified portfolio. Given the short duration of the investment (typically a 30- to 90-day asset), we were also able to adjust the portfolio appropriately given the volatility of emerging markets."

Of course, given that private credit strategies in emerging markets remain relatively nascent—barring a few exceptions such as distressed debt in Emerging Asia—reliable data points on the return prospects of this asset class are limited. To help bridge this gap, in March 2019 EMPEA surveyed 38 fund managers active in the EM private credit space. (Additional detail on the survey respondent profile can be found on page 28.) In the survey, EMPEA asked the participants to detail their target gross IRRs and target gross cash multiples for each strategy and market in which they are active (see Exhibit 19).

Exhibit 19: EM Private Credit Target Gross Returns Vary by Strategy and Market

Average target returns of survey respondents in USD (gross IRR, gross cash multiple)

	Direct Lending	Mezzanine	Distressed Debt	Special Situations
Africa	13%, 1.5x	17%, 1.8x	18%, 1.9x	19%, 2.1x
China	17%, 1.3x	20%, 1.4x	20%, 1.5x	21%, 1.8x
India	13%, 1.4x	17%, 1.6x	20%, 1.8x	21%, 1.9x
Other Emerging Asia	14%, 1.3x	17%, 1.6x	20%, 1.6x	18%, 1.6x
CEE / Turkey / CIS	14%, 1.7x	17%, 1.8x	20%, 1.9x	21%, 2.2x
Latin America	14%, 1.5x	19%, 1.9x	20%, 2.1x	22%, 2.0x
Middle East	12%, 1.3x	17%, 1.6x	25%, 2.0x	21%, 1.9x
United States	6.5%, 1.2x	10%, 1.4x	15%, 1.7x	18%, 1.9x
Western Europe	7.0%, 1.2x	12%, 1.2x	17%, 1.7x	18%, 1.8x

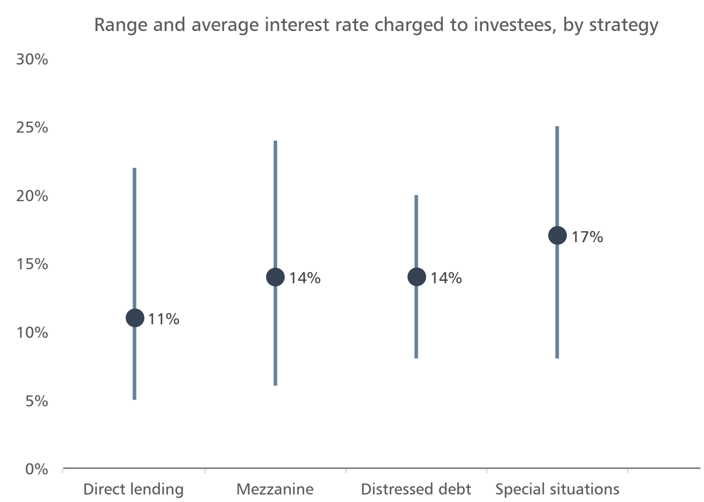
Source: EMPEA Emerging Market Private Credit Survey, March 2019.

Higher Gross Returns

Not surprisingly, return targets vary significantly by geography and strategy. However, there is a general consensus that gross IRR targets for senior debt strategies should fall in the mid-teens range while special situations command a higher return expectation, converging in the low-twenties, on average. Exhibit 20 offers some insights on the average interest rate—or cash pay—component of these returns by strategy (all in USD), as well as the range utilized by the fund managers surveyed.

At face value, these figures do compare favorably to the United States and Western Europe. For example, a Cambridge Associates study on private credit strategies suggests that the total unlevered, fund-level target returns typically range between 6% and 10% for senior debt, 14% and 17% for mezzanine, and greater than 15% for distressed debt and special situations.[4] Notably, the interest rates charged in Exhibit 20 do not include performance-based returns (e.g., equity kickers), so the total target returns of these strategies at the fund level should rate higher. As another proxy for developed market performance, the Cliffwater Direct Loan Index—which seeks to measure the unlevered, gross-of-fees performance of US mid-market corporate loans—has delivered a compound annual return of 9.6% since its inception on 30 September 2004 through 31 December 2018.[5]

Exhibit 20: EM Special Situations Strategies, on Average, Charge the Highest Interest Rates



Source: EMPEA Emerging Market Private Credit Survey, March 2019.
Note: Interest rates were harmonized to USD.

4. Cambridge Associates LLC, *Private Credit Strategies: An Introduction* (2017).
5. Cliffwater LLC, *2018 Q4 Report on U.S. Direct Lending.*

HOW DO YOU RECOMMEND STRUCTURING TRANSACTIONS TO MEET TARGET RETURNS?

> We believe that pricing transactions should take three factors into account: credit risk, the strength of structuring, and jurisdiction risk. To arrive at a base pricing, investors should evaluate where comparable US mid-market companies trade and add on a 'jurisdiction risk premium,' which typically ranges between 300 to 400 basis points. The contractual coupon can be a combination of cash pay and PIK. In the case of structuring bespoke lending packages, investors may consider incorporating yield enhancements, which take the forms of EBITDA kickers, pre-payment premiums, or M&A premiums. These are all additional USD payments that the company has to make if the agreed-upon events transpire, such that the payment hits a capped IRR.
>
> –**George Monserrat**
> The Rohatyn Group

Most LPs naturally expect a higher yield from emerging market-based investments given the prevailing assumption that these countries are much riskier places in which to invest. However, EM private credit fund managers will argue that the risk-return tradeoff is actually more favorable than most investors appreciate, and that there is a fundamental discrepancy between the perception and manifestation of risk in this asset class—a theme discussed toward the end of this section.

Therefore, in addition to a return premium available to investors in EM private credit strategies, many investors and fund managers focus on the diversification benefits and steady return profile they bring. Paul Sanford of TriLinc Global reveals that a focus on diversification was core to the firm's fundraising successes: "We already deliver higher yield than US private debt, so why play into the narrative that investors need to get 20% to be in emerging markets? By creating a diversified portfolio of loans across emerging markets, we can actually harvest an idiosyncratic risk premium while reducing the risks to our investors."

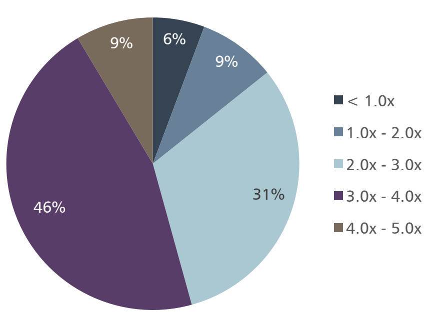
As prospective investors evaluate both sides of the risk-return equation, it is important to note that EM private credit operates, on average, with lower leverage and stronger covenants than its counterpart in developed markets, while benefiting from mispriced risk.

Lower Leverage Levels

EMPEA's survey data suggest that EM private credit funds employ lower leverage at both the investee and fund levels than is observed in developed markets. Approximately 46% of responding fund managers disclose that the average leverage level of their investees is less than 3x debt / EBITDA while another 46% find the ratio sitting between 3x and 4x (see Exhibit 21).

Exhibit 21: Leverage at the Investee and Fund Level Is Lower than in Developed Markets

What is the total leverage level, on average, of your investments (debt / EBITDA)?

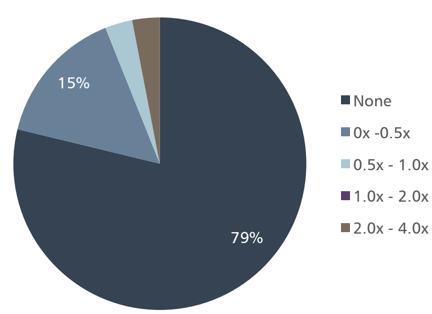


2x-4x
EM investee debt / EBITDA

vs.

~6x
US & W. Eur. investee debt / EBITDA

How much leverage do you utilize, on average, at the fund level?



0x-0.5x
Leverage operated at the fund level for most EM private credit funds

Source: EMPEA Emerging Market Private Credit Survey, March 2019, S&P Global Intelligence, industry interviews.

The View from Africa: Insights from Vantage Capital

Warren van der Merwe, Managing Partner, and David Kornik, Partner

Investors unfamiliar with credit in Africa are often skeptical about the ability of African mezzanine to secure robust downside protections and deliver attractive risk-adjusted returns. However, through our experience of 27 mezzanine investments across three successive funds into nine African countries, we have established that African mezzanine can benefit from meaningful equity participation on the upside, as well as reliable legal protections and security on the downside. Despite the inherent risk within the region, there are a significant number of attractive opportunities in the mid-market space, but the mezzanine investor needs to be disciplined in its selection process and careful in structuring its investments.

It is true that investors face a number of challenges across the region. Valuations have come down in dollar terms as both currencies and commodity prices have weakened following a peak in 2013-2014. In addition to fighting currency depreciation in a number of our markets, we are finding that certain African consumers are also under pressure. Falling commodity prices have led to an economic slowdown in several countries. This has forced governments and consumers to spend less, thereby lowering demand for goods and services. Despite these macro challenges, astute investors are able to identify companies that are taking advantage of micro trends and becoming successful in the process.

Vumatel, a fiber-to-the-home network operator in South Africa, is one such example. We invested in the company in 2016, at a time when it had a small subscriber base of 3,500 but was well-poised to take advantage of tremendous household demand for fiber. With the help of our expansion funding, in a little over two years the company grew its subscriber base to over 90,000 and enjoyed exponential growth in operating profit.

The need and demand for growth capital in fast-growing businesses like Vumatel is certainly present on the continent, but there's often a small window of opportunity for mezzanine, before they become sought after by cheaper capital. In the case of Vumatel, Vantage's mezzanine served as a bridge to senior debt. Our funding helped the business to roll out fiber into more suburbs, proving that its business model was both scalable and profitable. At this point, large banks were clamoring to fund the business and they not only provided Vumatel with further expansion funding, but also assisted the company to cash out Vantage's equity kicker at a highly lucrative valuation.

In another example, we provided mezzanine funding to a diversified holding company, New GX Capital. The company had a portfolio of exciting high-growth businesses in waste management and fiber infrastructure, but was not able to attract sufficient bank debt to support its growth objectives. Within just two years, the company had almost doubled its net asset value (NAV) and was able to attract large amounts of senior debt to exit our mezzanine and support additional growth.

These kinds of investments demonstrate the ability of mezzanine to support strong growth stories in the African mid-market. In order to participate in this value creation, we typically take 5% to 15% of the equity upside. We structure this in a way that gives us preferential ranking, a contractual exit date as well as more protections and rights than we would have had as minority ordinary shareholders.

Investing in Africa does not come without risk, however. If we ever encounter a scenario where the business underperforms—given that we have default rights and security, such as a mortgage or lien over assets—we are in a strong position to compel the shareholders to put more equity into the business, or have it sell one of its assets. This protects the value of our investment. However, the devil is in the detail—while it is great to have legal protections and security on paper, it is far more important to understand how to structure these rights and protections in order to ensure enforceability in downside scenarios. The continent is comprised of 54 legal jurisdictions, and experience in navigating this complex environment is critical to success. We have had experience in enforcing our legal rights and have learnt many lessons along the way—one of which is to structure our investments with security and enforcement rights in both the local market as well as in an investor-friendly offshore holding company jurisdiction, in order to provide different enforcement options in downside scenarios.

People often think of credit in Africa as a risky play, and may not appreciate the downside protection afforded by legal protections and security, as well as the success stories that can be achieved through equity participation. Our experience suggests that one can find mid-market opportunities across Africa, which deliver equity-like returns with significant downside protection, even when the macro-economy may not be booming. And we believe the outlook for the region will only get better.

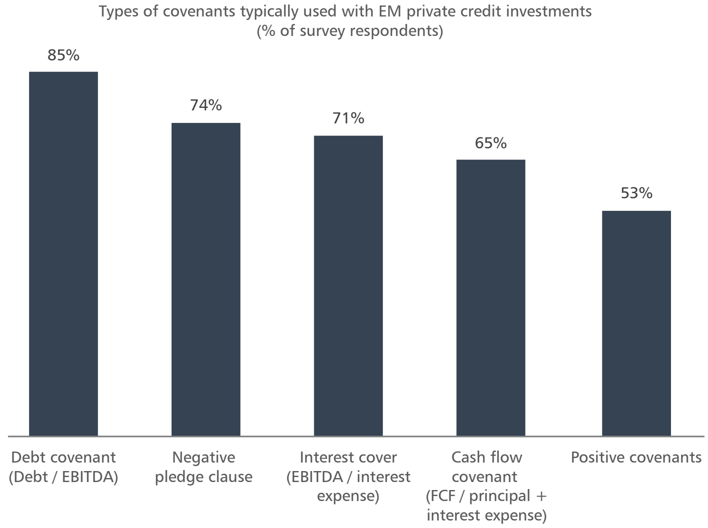
Vantage Capital is an Africa-focused fund manager with over USD960 million under management. Since 2006, its Mezzanine division has made 27 investments across three funds, while its GreenX division has made 14 senior debt investments into South African solar and wind energy projects across two funds.

Compare this to the United States, where S&P Global Intelligence data show the average debt multiple for mid-market loans sat at 6.1x EBITDA as of February 2019. Meanwhile, in Europe, the annual pro forma debt / EBITDA ratio has hit 5.9x—the highest level since 2007. In essence, mid-market borrowers in the United States and Western Europe typically carry at least two additional turns of leverage than their EM counterparts.

In addition, the vast majority of EM private credit funds surveyed (79%) do not utilize any leverage at the fund level—with an incremental 15% of respondents applying up to 0.5x turns of leverage. This is in stark contrast to developed markets, where higher leverage at the portfolio company level is layered with additional gearing at the fund level.

According to Cambridge Associates, "Virtually every senior debt fund currently in the market offers a levered option, with many eschewing unlevered portfolios altogether."[6] Several fund managers interviewed for this study commented that numerous prospective investors are under the mistaken belief that returns from EM private credit are largely obtained by leveraging the funds. This is an unsurprising assumption given the sheer volume of private debt funds operating in developed markets, but in emerging markets, it simply is rarely the case.

Exhibit 22: EM Private Credit Strategies Rely Heavily Upon a Variety of Covenants



Source: EMPEA Emerging Market Private Credit Survey, March 2019.

Stronger Covenants

In the United States and Western Europe, covenant-lite (or 'cov-lite') loans have exploded in popularity. These loans are borrower-friendly structures that offer less security and protective covenants for the lender, including, for example, eliminating the need to meet a certain cash flow or debt / EBITDA covenant. To demonstrate, in 2018 the volume of cov-lite loans as a percentage of total transactions reached 88% in Western Europe—up from zero seven years prior. In addition, 80% of new-issue first-lien loans in the United States rated as cov-lite, compared to only 5% in 2010.[7]

In contrast, the concept of 'covenant lite' is not one that exists in an emerging market context. On the contrary, EMPEA survey respondents indicated that they employ a wide variety of covenants in their deals (see Exhibit 22). Approximately 85% noted that they structure a debt covenant pledge, while negative pledge clauses, interest covers, and cash flow covenants were also frequently utilized by 74%, 71%, and 65% of respondents, respectively.

Sovereign Risk ≠ Credit Risk

It is undoubtedly an extremely difficult task for EM private credit fund managers to shake institutional investors of the notion that EM-based companies exemplify high counterparty risk. And while it is true that the geopolitical and macroeconomic risks may be heightened in a number of these countries, this does not necessarily drive a company's fundamentals. In fact, most industry participants will argue that many private capital-backed EM businesses are often far stronger—with less gearing and higher growth rates—than the average developed market-based business, as well as the government in which the company is located.

Commenting on the challenge of disaggregating the sovereign risk premium from the company risk premium, CDC Group's Rothenbusch states, "What's coming through in the performance and default data is that the sovereign risk is actually a lot worse than the risk you're taking by funding projects that are essential to those countries—such as African power projects—or when you're working with really strong corporates that have a better credit profile than the market in which they are operating. If you pierce the country ceiling, the performance of those private portfolios is a lot better."

He continues, "If you have single B risk in the United States versus single B risk in Kenya, you may be lending to a weak company in a good country, or a good company that is capped by a poor sovereign rating. I would take the latter anytime."

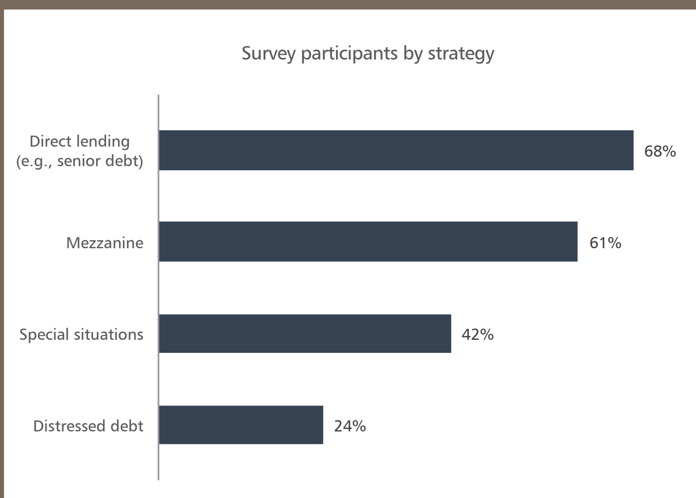
Summing up Calvert Impact Capital's experience in emerging markets versus the United States, Strocher says, "We have very close relationships with our borrowers and the fund managers in which we invest—and we make sure they are close with their borrowers. We have been investing all over the world for the last 25 years and our total loss rate—across both developed and emerging economies—is less than 0.25%. A lot of the reason for that track record has to do with the fact that we're finding the right markets and companies that are ready for credit."

6. Cambridge Associates LLC, *Ex US Private & Venture Capital Index and Selected Benchmark Statistics* (30 September 2018).
7. S&P Global Market Intelligence.

EMPEA'S 2019 EMERGING MARKET PRIVATE CREDIT SURVEY: RESPONDENT PROFILE

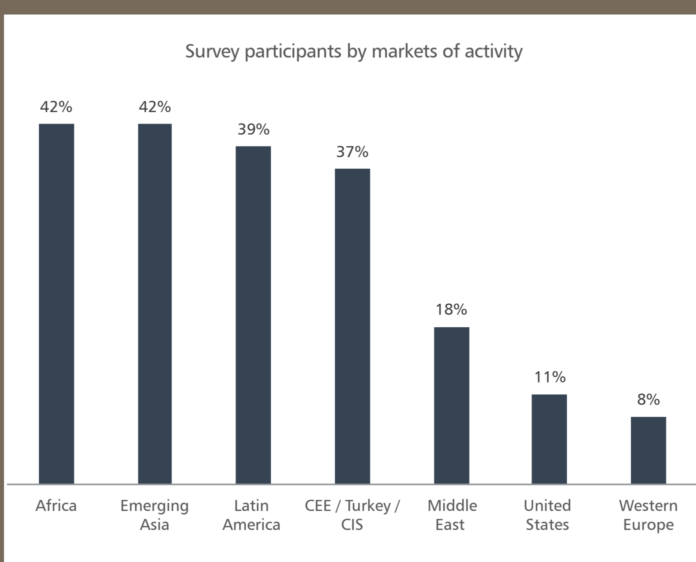
In March 2019, EMPEA surveyed 38 representatives from fund managers active in private credit strategies, including senior debt, mezzanine, distressed debt, and special situations, in order to collect a fact base on the risk-return profile of the asset class. The participating firms have raised over USD50 billion in private capital funds since 2008. These firms are active across all regions. Additional detail can be found below.

Exhibit 23: Survey Participants Invest Across All Private Credit Strategies



Source: EMPEA Emerging Market Private Credit Survey, March 2019.

Exhibit 24: Survey Participants Are Active in All EM Regions



Source: EMPEA Emerging Market Private Credit Survey, March 2019.

Comparing EM Private Credit to EM Private Equity

Numerous fund managers interviewed for this report observe that private credit strategies have historically been dismissed by LPs who are seeking to knock the proverbial cover off the ball through their EM investments, and are thus seeking high returns in exchange for taking on 'EM risk.' As a result, these investors have weighted their portfolios more heavily in favor of equity strategies, from venture capital to buyouts.

According to an EM private credit specialist, "Some people still think that if they wander into emerging markets, then they should be talking about a 20%+ return. Part of this mindset is driven by investors who remember the days when interest rates in Brazil were over 15%, so that's not a giant leap when your base rate is that high. However, the picture becomes a lot different when you have base rates that are now in the single digits. It's become a lot harder to hit those numbers when you don't have the risk-free wind at your back—and even harder yet when you want returns in US dollars."

In addition, when investors allocate to emerging markets through equity strategies, they are frequently imposing a volatile outcome on a volatile asset class. "If you're a traditional private markets investor, and you're not trying to spot the next Tencent or Facebook, you're much better off thinking about emerging markets as an opportunity to buy the benefits of diversification and alpha," notes one fund manager. "When you try to get 30% net returns from emerging markets, you are taking a lot of risk, and I don't know that you get compensated for it."

Distributions

DEG's Carola Bose, Director and Head of Funds, Equity, and Mezzanine in Africa, cautions LPs on how they compare these asset classes: "It is often the case that allocations to EM private credit funds come from the private equity buckets, so they are always competing against equity returns, which I don't think is the right way to look at it. By now, we have been through 1 to 1.5 private equity life cycles in all emerging market regions, so we have data on returns; this isn't the case yet for private credit. But our experience thus far has shown that a private debt portfolio with a lower return than what is anticipated with equity also comes with reduced volatility, which may be more attractive."

Another problem, of course, is that unless institutional investors have allocated to a top-quartile emerging market private equity fund, they may not be seeing the returns that they are expecting from the strategy. To illustrate, Cambridge Associates performance data show that the distributions to paid-in capital ratio (DPI) for EM private equity and venture capital funds is below 1.0 going back through 2008—meaning the funds have not yet returned investors' capital—and one has to go back to 2002 to find a vintage year that has distributed 1.75x.[8] This lack of

Delivering Impact at Scale: An Interview with TriLinc Global's Paul Sanford, Chief Investment Officer

Why is the EM debt opportunity attractive to TriLinc and its investors?

TriLinc's thesis is that the EM private debt opportunity is one of the most significant impact investment opportunities of our lifetimes. Therefore, our business strategy revolves around pairing impact investment opportunities with investment products and structures that are easily consumable and investable by large numbers and types of investors.

The investment opportunity stems from the supply-demand imbalance in financing for credit-worthy small and medium enterprises (SMEs) in emerging markets. IFC's most recent estimate is that the financing gap for EM SMEs is as much as USD4.5 trillion. A supply-demand mismatch of that magnitude cannot help but be a compelling risk-adjusted investment opportunity that is inherently impactful from a developmental economics perspective.

TriLinc has been able to generate double-digit gross yields in its portfolios, with underwriting standards typical of cash-flow lenders but also with the overcollateralization typical of asset-backed lenders—the combination of which can significantly mitigate the risk of default loss.

We believe another attractive trait of the EM debt opportunity is that it easily lends itself to comprehensive diversification. The word 'diversification' is so often over-used that it frequently loses its meaning; yet it is systemically important to risk mitigation generally and to TriLinc's EM private debt strategy specifically. We have been able to create pan-EM portfolios of private debt investments, across four different regions of the world—Latin America, Emerging Europe, Sub-Saharan Africa, and Emerging Asia—in over 30 carefully selected countries. The portfolio is further diversified by industry, investment type (i.e., term lending and trade financing), tenor (60 days to 60 months), and local market investment partners. This level of comprehensive diversification essentially allows TriLinc to create a quasi-index of private debt exposure designed to provide the return premium of idiosyncratic private companies while simultaneously diversifying out the tail risk. Finally, the strategy is non-correlated to public market securities.

How has TriLinc conveyed the value proposition of EM private debt to investors?

We begin with risk mitigation as being fundamental to the strategies we develop. For example, we have seen many opportunities that stretch for returns at the cost of weaker risk mitigation (e.g., subordinated, less collateral, and lighter covenants), but we have stayed committed to our view that most investors are seeking a predictable return over time rather than swinging for the fences with a higher risk of striking out.

Another example of this has to do with exits. One of the biggest complaints we have heard regarding private asset investing in emerging markets is the lack of exits. Because private debt is naturally self-liquidating, we remove that objection from consideration. Through 31 December 2018, TriLinc has had approximately USD668 million, or roughly 57%, of its loans go full cycle and pay off. This emphasis on risk mitigation and self-liquidation has allowed TriLinc to deliver a positive experience to its investors, which often leads to additional commitments, investor referrals, and long-term partnerships.

Next, we understand how investors invest, so we create investment vehicles that seek to match what they are used to investing in, and (importantly) give the investment professional recommending our strategy to their investment committees fewer idiosyncrasies that require explanation.

TriLinc operates a partnership model for accessing EM opportunities. How does this work in practice?

We strive to be very intentional about what will deliver the best results for our investors. A common refrain in investing is that the best investment decisions are often the ones to *not* proceed with certain investments. At TriLinc, decisions to avoid particular risks have been taken just as readily at the strategic level as at the individual investment level. We spent several years researching and analyzing the risks we believed were worth accepting versus the risks that were *not*.

Our investment partner model embodies this approach. We believe strongly that investors in any markets (let alone emerging markets) need to have a local presence and deep local market knowledge to consistently perform over time. There are only a couple of ways to achieve that—build it yourself over time or partner with local market specialists. After extensive research, we chose the latter. Our investment partner model provides local market access and knowledge, coupled with our dual underwriting and structuring, while meeting the exacting compliance standards of US-regulated investment firms. All of this work and intentionality has served TriLinc and its investors well over the last several years.

As you look ahead, what's next for TriLinc and the EM debt opportunity?

We will keep doing what we are doing with our EM private debt strategy, while raising significant additional investor capital—there are still plenty of opportunities. We will continue driving our strategies and processes to seek the best of all worlds with attractive risk-adjusted returns and sustainability (ESG), while also driving positive impacts to the companies, communities, and economies in which we invest.

distributions is a significant factor behind investors' growing interest in private credit detailed in the prior section.

As one DFI representative notes, "We simply haven't seen private equity returns in emerging markets that compare to what can be found in developed markets. For example, we only have one manager in Latin America that has gotten into carry on the PE side. The returns we've seen full-cycle are 15% to 16% gross, which is what a private debt fund is offering. If you can get a similar return profile with more downside protections, then private credit makes more sense."

Alongside a more stable return profile, private credit offers investors a way to generate distributions in a shorter time frame than private equity and thus smooth cash flows. For example, with private credit strategies, investors can see cash flows beginning with a borrower's first interest payment, and the bulk of a return is not solely dependent upon exits, which have proven to be a challenge for many EM private equity firms.

Differentiated Deal Flow

Lastly, private credit strategies can offer differentiated deal flow, as a debt product can, in many cases, be much more attractive to EM companies. Given that mid-market companies are often founder- or family-owned and the primary source of income for entrepreneurs in emerging markets, asking them to give up equity or control becomes a much tougher sell in comparison to a more professionalized and institutionalized company in developed markets. An entrepreneur may easily accept paying a higher interest rate and providing variable upside components in exchange for accessing a significantly longer and cash-preserving term loan than a local bank would offer.

Syntaxis Capital's Thomas Spring explains, "In emerging markets, you will often find entrepreneurs who are fiercely protective of ownership as a share in the value creation of their dynamically growing companies, and who do not therefore want to sell out to a private equity fund, but still need outside capital that is strongly aligned with them. Bank financing may be cheap, but its cash profile is often unsuited for strongly growing businesses, and their approach to risk often leads to outcomes that are not in everyone's interests. We provide a different financing solution. If we are targeting returns of 17% to 18%, then 11% to 12% of that will come from contractual yield in some form, typically a cash element plus an accrual or PIK. This means that the equity component represents a meaningful part of our return, resulting in that alignment of interests."

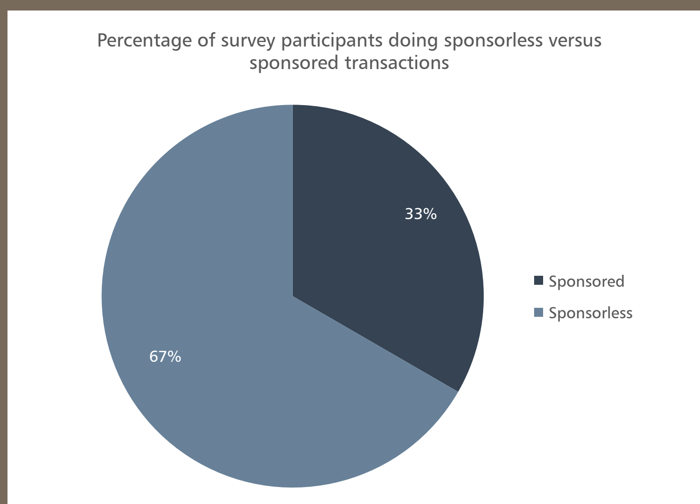
There are other ways in which the complexion of deal flow can differ across private credit and equity strategies. According to Diogo Bustani of HSI, "We can lend at 27% and, in some instances, an owner may look at that rate and prefer to sell to private equity. We're not just money and we can add value in terms of personnel and business strategy, but if an owner believes that their growth potential is such that our debt is more dilutive financially than the equity, then that is a very useful filter for us. We look for partners who are confident that they can achieve growth rates that exceed our cost of capital."

THE ROLE OF SPONSORED TRANSACTIONS

The EM private credit industry appears to be moving away from sponsored deals—transactions in which an investor, such as a PE fund, partners with a credit fund as part of a consortium. For instance, in EMPEA's 2014 report *Private Credit Solutions: Mezzanine Financing in Emerging Markets*, 47% of the deals in the data set collected for the project were sponsored.

In contrast, only 33% of firms surveyed for this report note that they primarily pursue sponsored transactions (see Exhibit 25). Therefore, most managers in EMPEA's 2019 survey are scouring the landscape for proprietary lending opportunities. For those firms that do pursue sponsored deals, financial institutions and corporates may serve as a source of deal flow.

Exhibit 25: Sponsorless Deals Are Executed More Frequently by Survey Respondents



Source: EMPEA Emerging Market Private Credit Survey, March 2019.

8. Cambridge Associates LLC, *Ex US Private & Venture Capital Index and Selected Benchmark Statistics* (30 September 2018).

The View from Central and Eastern Europe: Insights from Syntaxis Capital

Thomas Spring, Founding Partner

If one were to study how frequently the terms 'credit cycle' and 'peak' come up in the news and at conferences, it would be fair to conclude that the credit markets are red-hot right now—at least on the European direct lending side. While, since the beginning of last year, companies have sold at average prices well in excess of their levels of the past 20 years, average leverage is in fact 'only' at circa 99% of the level of the previous 20-year peak in the pre-Lehman year of 2007. What is different now though is that creditor protections for lenders have all but disappeared, as seen in the preponderance of deals done with fewer or looser covenants or weaker security, while interest margins have come down. As private credit competition has intensified, the question of when the cycle will turn has been raised more frequently.

Amidst this hype and skepticism, the challenge for managers such as ourselves, who provide senior growth credit to smaller and medium-sized companies in Poland and other Central European countries such as the Czech Republic or Romania, is how to benefit from this appetite for private debt. For investors that dare to leave the well-trodden path of the mainstream strategies, we can successfully deploy capital into opportunities where the structure and leverage allow us to control the financial risk of the investee company, while avoiding the headwinds of competitive pressures. And that is very much where you want to be when the cycle turns.

The shift in the banking marketplace over the past 10 years has not left our region unaffected. Once dominated by bank lending, alternative credit providers have increased market share continuously by tailoring their loans to borrowers' needs. While in a market such as Poland, banks are still extending loans to their key clients in addition to their other core services, we rarely find ourselves in competition with these banks. Instead, the situations that merit the use of our relatively pricey financing are by and large growth phases that require a tenor of five to seven years, with little debt-servicing along the way—the type of lending that banks typically cannot, and will not, provide. This is even more the case where pay-outs relate to an ownership transition from the founders, or where the companies are asset-light businesses.

For small and smaller mid-sized enterprises, where the market is local, this banking shortfall is not covered by alternative credit providers, resulting in a supply-demand imbalance that is only likely to increase with further banking regulation, while at the larger end trophy deals are being done on broadly Western European terms.

We work directly with entrepreneurs, providing more than just capital to grow their businesses. A typical trajectory for an investment is a company with an enterprise value as little as EUR30 million, which we help to double over four to five years, with the strong performers reaching EUR100 million over the same horizon. While these companies form the backbone of the region's economic success story, it is tough for them to access long-term financing. To illustrate, credit penetration is 136% of GDP in the UK versus 53% in Poland.

It is not only the markets, however, but also the investor universe, that continues to change and bifurcate. LPs consolidate and manage fewer, larger amounts of capital. Naturally, they then have to focus on writing ever larger tickets to ever larger funds, which forces managers to either scale up and abandon an attractive investment segment, or risk dragging out fundraising and losing talent.

These developments are two sides of the same coin, and an opportunity for those with capital, and entrenched and established operations in the region, to generate superior returns.

Syntaxis Capital is a private debt investor dedicated to providing long-term capital to fast-growing medium-sized companies in Central Europe, with a particular focus on Poland.

Of course, private equity and private credit are not mutually exclusive in emerging markets—they often play a partnership role in terms of helping businesses optimize their capital structure and reach new levels of growth.

In fact, this can be an element of value creation that a private credit investor can provide. One fund manager explains, "We institutionalize management teams so that they can grow and become a good counterparty for private equity firms. They go through a rigorous due diligence process, financial covenants, and reporting. That level of institutionalization compared to local lending requirements is a big leap, and it can facilitate their ability to get on the radar screen of private equity firms that may be able to take them to the next level of growth."

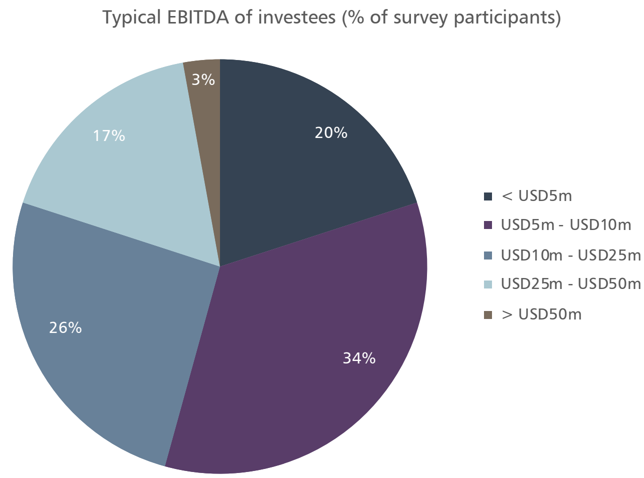
Making an Impact with EM Private Credit

There is growing conviction among a number of industry participants that credit is a better way to reach companies facing a financing gap than private equity—and this is one key driver for the DFI strategy shifts mentioned in the prior section. Beyond the DFIs, this realization is also a motivator for the increasing number of impact-focused limited partners.

Obviam's Tilebalieva notes, "We've invested in over 90 funds over the past 20 years, with an 80% focus on private equity, and a specific mandate to support SMEs. One key lesson we've learned is that a private equity strategy is difficult to execute in the SME segment, and we've found the debt product to be much better suited for SMEs. SME-focused private equity funds, averaging under USD50 million in fund size, have historically struggled with exiting their investees due to a lack of scale. With a self-liquidating debt product, on the other hand, these small family-owned companies can finance their stable growth through smoother amortization repayments over time. Moreover, their sponsors do not need to worry about diluting their ownership or having to give up control of their businesses in the future in case they cannot pay the fund back and are dragged into a sale process."

The survey respondents noted that more than half of their investees have a typical EBITDA of less than USD10 million, placing them firmly in the mid-market segment (see Exhibit 26). In emerging markets, many of these businesses are family-run and / or less professionalized in terms of corporate governance than their larger peers. However, they may still have strong fundamentals, including a long business history, loyal customer base, and favorable growth rates. Private credit offers these companies the ability to obtain longer-term financing without an investor having to incur exit risk.

Exhibit 26: The Majority of Borrowers Have a Typical EBITDA of Less Than USD10 Million



Source: EMPEA Emerging Market Private Credit Survey, March 2019.

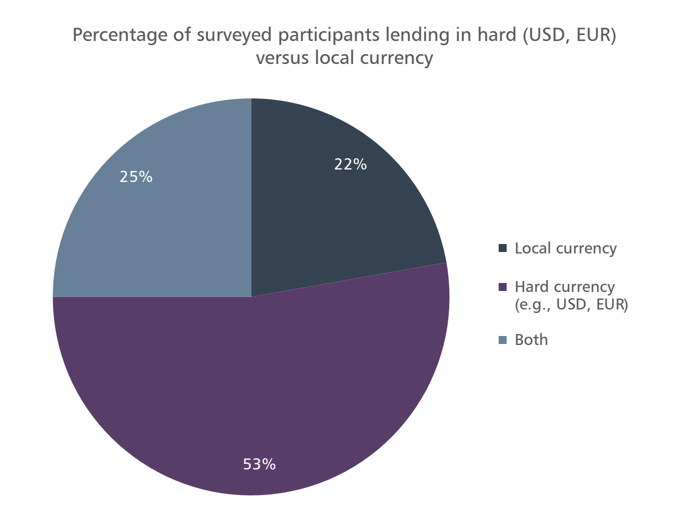
Helping these types of businesses develop is important to impact-oriented firms like Calvert Impact Capital. According to Strocher, "We are pursuing impact and believe that there are lots of opportunities for impact in an emerging market context. Specifically, we want to get credit into SMEs that have a good track record and want to grow in order to assist them in bridging the gap between the early stages of their business, when they are primarily funded with friends and family money, and a place where they are bankable. We have had several companies graduate from us and are now able to go to either their local bank or even an international bank. There are also a few places where we are putting money to work now that are trying to build local bond markets too, so being able to issue bonds in their local market may also be a future possibility."

In summary, the fact that EM private credit offers some significant investor benefits in comparison to developed market private credit and EM private equity from both a risk and return perspective is not always reflected in international investor perspectives. There is a wide range of investment opportunities in the vast space that sits between pure equity plays and investment-grade corporate debt. Investors would be well served to learn more about this broad opportunity set. Paul Sanford, Chief Investment Officer at TriLinc Global opines, "Once investors are educated about the opportunity to lend to cash-flowing, growth-oriented emerging market companies, with significant collateralization, under lender-friendly terms, all while earning higher gross yields than in advanced economies, they become much more interested."

HOW DO YOU MANAGE CURRENCY RISK?

Fund managers and institutional investors interviewed for this report frequently cited currency risk as a leading concern when it comes to private credit investing in emerging markets. Slightly over half of all survey respondents noted that they lend in hard currency—meaning in USD or EUR—while 25% lend in both hard and local currency (see Exhibit 27).

Exhibit 27: The Majority of Survey Respondents Lend in Hard Currency



Source: EMPEA Emerging Market Private Credit Survey, March 2019.

> With the recent experience of sharp devaluations across the region still lingering in the minds of investors and owners of mid-market companies in the region, addressing foreign exchange risk has become more critical than ever before. Our loans are primarily US dollar obligations with the investee companies assuming the foreign exchange risk. That said, from a fund manager perspective, we make sure our lenders are in a strong enough position to weather foreign exchange movements. Long-term hedges are typically cost prohibitive, so we prefer loans amortizing over long periods to avoid funding walls and often seek to invest in companies with a natural hedge, such as exports or contracts denominated in US dollars. This approach has allowed our portfolio to weather the recent storms of currency devaluations in the region.
>
> –**Richard Frank, Jr.,** Darby Franklin Templeton

> While advancing funds in hard currency helps to mitigate against currency risk, it is equally important to ensure that the borrower has the financial resilience to repay these loans even if the local currency depreciates sharply. We therefore look for businesses that earn hard currency revenues at healthy margins and that generate substantial free cash flow. Such borrowers should also not be exposed to high levels of cyclicality or commodity price volatility.
>
> –**David Kornik,** Vantage Capital

> I would rather manage the currency risk so that I know exactly what is happening with my hedge at all times. You can have covenants in place, but people can do things poorly, so why not manage it yourself? Moreover, if you have several loans in a jurisdiction, that can get you better pricing, while aggregating up your exposures can help you manage them in a more efficient fashion.
>
> –**Representative,** Pan-EM credit specialist

> From May 2011 to September 2018, the JPMorgan EM FX Index declined by 45%. That is about as bad of a backdrop for EM private markets as you can imagine. If there's a gale-force hurricane in your face, nobody's running their best mile. Any manager who navigated this adverse macro period relatively well has strong risk management credentials. At our firm, we believe that you have to think about political and FX risk as you're underwriting investments, and we incorporate a view on currency as part of our macro risk management overlay for each transaction.
>
> –**Gregory Bowes,** Albright Capital

The View From Latin America: Insights from Darby Franklin Templeton

Richard H. Frank, Jr., Senior Managing Director

At Darby, we have been lending to well-managed, growth-oriented middle-market companies in Latin America for 20 years. Over that time period, we have seen several important evolutions in the private debt landscape. However, the one constant has been the persistent shortage of long-term debt available to quality mid-market companies. In fact, this financing gap has become worse over time as international banks pulled out of the region following the Global Financial Crisis and heavier restrictions under Basel III regulations. In addition, local banks have retrenched during the recent economic downcycle, focusing their lending on large, blue-chip companies.

One key dynamic that has improved is the understanding among mid-cap company owners of the benefits of private debt over local bank lending and traditional private equity. On the one hand, as private debt providers, we have the flexibility to provide longer-term capital—up to seven years in tenor with a much less demanding principal amortization schedule—in comparison to a bank. On the other hand, we offer a product that provides a lower level of equity dilution and loss of control than private equity, which is an important consideration for the family-owned businesses that are prevalent in Latin America.

In addition, today, many mid-market companies appreciate the benefits that an experienced global investment partner can provide beyond capital. These include corporate governance enhancements, access to global networks, management inputs, assistance in crafting business strategy, and executing critical transactions such as an IPO, roll-up M&A, or even a future sale of the business. At Darby, we have a long-term investment horizon and are financially aligned to bridge the gap between private equity and local banks by playing an active role through our board membership or observer rights and providing value-add services that typical lenders do not.

While private debt markets in Latin America have largely remained under the radar of many investors, private debt strategies in developed markets, particularly in the United States and Europe, have experienced an explosion of growth—albeit in a very different macroeconomic context. This has created confusion about the risk-return profile of our approach in Latin America as compared to US- and Europe-focused lenders. While the commonality is senior secured lending to mid-market companies, the similarities stop there. Our returns not only compare well to top-quartile Latin America-focused private equity funds, but also offer a premium over US senior private debt strategies in terms of returns and a more attractive risk profile that is largely underappreciated.

From a risk perspective, we observe private debt funds in developed markets employing leverage at the fund level and adding leverage to their portfolio companies to enhance returns. In practice, this can mean the funds are levered at 3x, while the portfolio companies are levered at 6x or 7x EBITDA for a significant total leverage exposure. Not only does this add layers of risk, but it puts investors behind the creditors in the fund's distribution waterfall. In contrast, we operate with zero leverage at the fund level, and ensure our portfolio companies carry a conservative debt load, typically 3x to 4x EBITDA. Moreover, when it comes to downside protection, we lend primarily to asset-heavy companies and obtain collateral to cover the majority of our loan, whereas US and Western European 'senior secured' fund lenders are in fact often lending to asset-light companies and may only get collateral coverage of 25% or less.

In our recent fundraise, which was oversubscribed and hit our hard cap of USD300 million, we noted with interest that institutional investors were growing wary that a private debt bubble may burst in developed markets. For those inclined to look, we believe investors would benefit from the diversification and attractive risk-return profile that private debt strategies offer in Latin America.

Darby Overseas Investments, Ltd., founded in 1994 and part of Franklin Templeton since 2003, has business lines in private equity, private debt, and infrastructure fund management in Latin America, Asia, and Central and Eastern Europe, with a total of USD6.5 billion raised in 24 years.

Concluding Remarks

This report represents the culmination of discussions within the Private Credit Council of EMPEA over the last five years and the experience of various EMPEA members over a much longer period. We have sought to address some of the most significant information gaps in the marketplace and provide the global investment community with a better sense of what sets EM private credit apart.

The common challenge of many new asset classes is the delineation of terms in order to help investors better understand and compare the strategies employed by private credit firms, so that they can in turn decide where such investments fit within their portfolios. As more private credit fund managers come to the market and a broader range of investors begin to carve out specific allocations to the space, the dialogue around private credit will continue to improve.

Beyond the terminology, we have made a point of highlighting the differences between private credit in developed and emerging geographies, with a particular focus on the higher gross returns, lower levels of leverage, stronger covenants, and the scarcity of sponsored deals in emerging markets. While the bespoke nature of many EM private credit deals in some sense resembles transactions in the private equity space, the liquidity profile of private credit can make it a valuable addition to investors' EM portfolios. Moreover, in the eyes of business owners, private credit may be a more attractive option for raising capital than selling equity in a fast-growing business.

The issue for many large investors is finding higher-yielding strategies that can be implemented at scale. Creative structuring solutions may be needed to allow the largest global institutions to access rewarding opportunities in the middle market. At the same time, track records and data are beginning to show that lower-yielding strategies are able to handle a degree of leverage at the fund level, and that banks are beginning to lend to such strategies.

Going forward, as more comprehensive performance data becomes available, EM private credit will increasingly be viewed as an attractive investment strategy in comparison to more established asset classes from a risk-return perspective. In addition, investors will seek opportunities to gain exposure to local currencies as a long-term portfolio diversifier. Blended finance structures will open up a broad range of investments that were previously considered too risky.

We hope that this report has provided further clarity on the EM private credit opportunity set, and both the EMPEA team and the Private Credit Council remain at your disposal for further discussion.

David Creighton
Chairman of the Private Credit Council & Senior Advisor, EMPEA

Appendix: Sampling of Private Credit Firms Active in Emerging Markets

Firm	Recent Funds (Vintage Year, Disclosed Capital Raised to Date)	Geographic Focus	Strategy	Website
Abax Global Capital (AGC)	Abax Asian Structured Private Credit Fund II (2015, USD235m), Abax Asian Structured Private Credit Fund III (Fundraising)	Asia, China	Mezzanine	abaxcap.com
Adamas Asset Management	Adamas Ping An SME Fund (2017)	Asia, China	Direct Lending	adamasam.com
ADM Capital	ADM Asia Secured Lending Facility II (AKA 'Somei', 2017, USD178m)	Asia	Direct Lending, Special Situations	www.admcap.com
Adobe Capital	Adobe Social Mezzanine Fund I (2012, USD20m), Adobe Mezzanine Fund II (2017, USD25m)	Mexico	Mezzanine	adobecapital.nvgroup.org
ADV Partners	ADV Opportunities Fund I (2015, USD545m), ADV Opportunities Fund II (Fundraising)	India	Special Situations	advpartnerscapital.com
AION Capital Partners (ICICI Venture and Apollo Global Management)	AION Capital Partners (2013, USD825m), AION Capital Partners Fund II (2017, USD599m)	India	Special Situations	iciciventure.com
Albright Capital Management	ACM Strategic Investment Partners IV (2016, USD150m)	Pan-EM	Special Situations	albrightcapital.com
Alteria Capital	Alteria Capital (2018, USD91m)	India	Venture Debt	alteriacapital.com
Amerra Capital Management	Amerra Agri Fund III (2015, USD820m)	Latin America	Direct Lending, Mezzanine	amerracapital.com
APS Holding	*Undisclosed*	CEE	Distressed Debt	global.aps-holding.com
Ashburton Investments	Ashburton Mezzanine Fund I (2018, USD41m)	South Africa	Mezzanine	ashburtoninvestments.com
Avendus	Avendus Structured Credit Fund (Fundraising)	India	Direct Lending	avendus.com
Avenue Capital Group	Avenue Asia Special Situations Fund (2017, USD450m)	Asia	Special Situations	avenuecapital.com
Bain Capital Credit	Bain Capital Special Situations Asia (2017, USD1B), India Resurgence Fund (JV with Piramal Fund Management, 2018, USD200m)	Asia	Special Situations, Distressed Debt	baincapitalcredit.com
Baring Private Equity Asia	Baring Private Equity Asia India Credit Fund (2017, USD112m), Baring Private Equity Asia India Credit Fund II (Fundraising)	India	Direct Lending	bpeasia.com
BlackRock	Asia-Pacific Private Credit Opportunities Fund I (2017, USD227m), BlackRock Colombia Infrastructure Debt Fund (2017, USD280m)	Asia, Latin America	Direct Lending	blackrock.com
Blue like an Orange Sustainable Capital	Blue Like An Orange Sustainable Capital Latin America Fund I (Fundraising)	Latin America	Mezzanine	bluelikeanorangecapital.com
BlueOrchard Finance	Regional Education Finance Fund for Africa (Fundraising)	Pan-EM	Direct Lending	blueorchard.com
Canvas Capital	Canvas Distressed Credit Fund (2017, USD470m)	Brazil	Distressed Debt	canvascapital.com.br
Capital Indigo	Capital Indigo CKD (2018, USD85m), Indigo 2 PD (Fundraising)	Mexico	Direct Lending	capitalindigo.com
CDH Investments	CDH Mezzanine RMB Fund IV (2016, USD525m), CDH Mezzanine RMB Fund V (Fundraising)	China	Mezzanine	cdhfund.com
CEECAT Capital	CCL SEE SME Lending Facility	CEE	Direct Lending	ceecat.com
Clearwater Capital Partners (Fiera Capital Asia)	Clearwater Capital Partners Fund V (2016, USD129m), Clearwater Capital Yield Fund (Fundraising), Clearwater Capital Partners Direct Lending Opportunities Fund (Fundraising)	Asia	Direct Lending, Special Situations, Distressed Debt	clearwatercp.com, fieracapital.com
Crescent Point	Crescent Asia Consumer & Special Opportunities Fund (2015, USD240m), Crescent Asia Consumer & Deep Value Fund II (Fundraising)	Asia	Special Situations	cgcm.com
Darby Franklin Templeton	Darby Latin American Private Debt Fund III (2017, USD300m)	Latin America	Direct Lending	darbyoverseas.com
DCL Investments	DCL Investments Fund I (2016, USD549m), DCL Investments Fund II (2017, USD218m), DCL USD Fund (2018)	China	Distressed Debt	dclfund.com
Dignari Capital Partners	DCP China Credit Fund I (2014, USD256m), DCP China Credit Fund II (2018, USD476m)	China	Special Situations	dignaricapital.com
Edelweiss Alternative Asset Advisors	Edelweiss India Stressed Assets Fund II (2017, USD1.3B), Edelweiss Infrastructure Yield Plus (2018, USD307m), Edelweiss Special Opportunities Fund III (Fundraising)	India	Distressed Debt, Mezzanine, Direct Lending	edelweissfin.com
Ethos	Ethos Mezzanine Partners Fund III (2018, USD102m)	Southern Africa	Mezzanine	ethos.co.za
Farallon Capital Management	Farallon Asia Special Situations III (2016, USD1.1B)	Asia, Latin America	Special Situations	faralloncapital.com
Gazelle Finance	Gazelle Fund (2017, USD42m)	Georgia, Armenia	Mezzanine	gazellefinance.com
Gulf Capital	GC Credit Opportunities Fund II (2016, USD251m)	Africa, Middle East, Turkey	Mezzanine	gulfcapital.com
Hemisferio Sul Investimentos (HSI)	HSI Special Opportunities I (2014, USD116m), HSI Special Opportunities II (2018, USD426m)	Brazil	Special Situations	hsinvest.com

Appendix: Sampling of Private Credit Firms Active in Emerging Markets (Continued)

Firm	Recent Funds (Vintage Year, Disclosed Capital Raised to Date)	Geographic Focus	Strategy	Website
HMC Capital	HMC Capital High Yield Peru Fund (2015, USD60m), HMC Andean Private Debt (Fundraising), HMC Colombia Credit Fund (Fundraising)	Peru, Colombia	Direct Lending	hmccap.com
IG4 Capital	IG4 Capital Special Situations I (2017, USD309m), IG4 Capital Special Situations II (Fundraising)	Brazil	Special Situations	ig4capital.com
Incofin Investment Management	Fairtrade Access Fund (2014, USD30m)	Pan-EM	Direct Lending, Trade Finance	incofin.com
Innovatus Capital Partners	Innovatus Trade Finance Fund I (2018, USD50m)	Latin America	Trade Finance	innovatuscp.com
Investec Asset Management	Investec Africa Credit Opportunities Fund (2015, USD227m)	Africa	Direct Lending	investec.com
Jive Investments	Jive Distressed II (BRL) (2018, USD363m), Jive Distressed II (USD) (2018)	Brazil	Distressed Debt	jiveinvestments.com
KKR	KKR Special Situations Fund II (2014, USD3.4B), KKR India Alternative Credit Opportunities Fund II (2017, USD201m)	Asia	Mezzanine, Special Situations	kkr.com
Kotak Investment Advisors	Kotak Special Situations Fund (2019, USD625m)	India	Distressed Debt	kotak.com
LAFISE Investment Management	CASEIF III (2014, USD42m)	Central America, Colombia, Dominican Republic	Mezzanine	lafise.com
Latin American Partners (LAP)	Central American Mezzanine Infrastructure Fund II (2014, USD188m)	Latin America	Mezzanine	latinamericanpartners.com
Lone Star Funds	Lone Star Fund X (2016, USD5.5B)	Global	Special Situations, Distressed Debt	lonestarfunds.com
Mezzanine Capital Partners	Accession Mezzanine Capital IV (2017, USD300m)	CEE	Mezzanine	mezzmanagement.com
NBK Capital Partners	NBK Capital Partners Mezzanine Fund II (2016, USD160m)	Middle East, Turkey	Mezzanine	nbkcpartners.com
Nexxus	Nexxus Mezzanine Fund I CKD (2018, USD177m)	Mexico	Mezzanine	nexxuscapital.com
Oaktree Capital Management	Oaktree Emerging Market Opportunities Fund (2013, USD321m), Oaktree Emerging Market Opportunities Fund II (Fundraising)	Global	Distressed Debt	oaktreecapital.com
OCP Asia	OCP Asia Fund III (2018, USD511m)	Asia	Direct Lending	ocpasia.com
PAG	PAG China Special Situations Fund (2018, USD180m), PAG Asia Loan Fund III (2018, USD950m)	China	Direct Lending, Distressed Debt	pagasia.com
Piramal Fund Management	India Resurgence Fund (JV with Bain Capital Credit, 2018, USD200m)	India	Distressed Debt	piramal.com
Pomona Impact	Pomona Impact Fund I (2016, USD2m), Pomona Impact Fund II (Fundraising)	Latin America	Mezzanine	pomonaimpact.com
Promecap Capital de Desarrollo	Fideicomiso Promecap Capital de Desarrollo II CKD (2014, USD240m)	Mexico	Special Situations	promecap.com
responsAbility Investments	responsAbility Energy Access Fund (2015, USD25m)	Pan-EM	Direct Lending	responsability.com
Siguler Guff & Company	Siguler Guff Brazil Special Situations Fund (2017, USD309m)	Brazil	Special Situations	sigulerguff.com
SSG Capital Management	SSG Capital Partners IV (2017, USD1.2B), SSG Capital Partners V (Fundraising)	Asia	Special Situations, Direct Lending	ssgasia.com
Syntaxis Capital	Syntaxis New Europe Fund III (Fundraising)	CEE	Direct Lending	syntaxis-capital.com
Terra Incognita Capital	Terra Incognita Special Situations Fund I (Fundraising)	Pan-EM	Special Situations	terra-incognitacapital.com
The Rohatyn Group	*Undisclosed*	Latin America	Direct Lending	rohatyngroup.com
Tor Investment Management	Tor Asia Credit Opportunity Master Fund (2018, USD175m)	Asia	Special Situations	torinvestment.com
Trifecta Capital	Trifecta Capital Fund - I (2015, USD70m), Trifecta Capital Fund - II (Fundraising)	India	Venture Debt	trifectacapital.in
TriLinc Global	TriLinc Global Impact Fund (2013, USD414m), TriLinc Global Impact Fund II (Fundraising)	Pan-EM	Direct Lending, Trade Finance	trilincglobal.com
Union para la Infraestructura	FCP 4G Credicorp Capital/Sura Asset Management (2015, USD481m)	Colombia	Direct Lending	upli.co
Vantage Capital	Vantage Mezzanine III Pan African Fund (2015, USD153m), Vantage Mezzanine III Southern African Fund (2015, USD135m), Vantage GreenX Note II Fund (2016, USD228m)	Africa	Mezzanine, Direct Lending	vantagecapital.co.za
XSML	African Rivers Fund (2016, USD50m)	Central Africa	Mezzanine	xsmlcapital.com

Note: 'Vintage Year' corresponds to date of first reported close for each fund. 'Geographic Focus' and 'Strategy' refer specifically to each respective firm's private credit mandate in emerging markets, with the exception of firms investing in private credit globally.

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