Australian Private Debt Market Update for 2021

The market reaches a new record size of $133bn and remains a key source of growth funding for Australian businesses

March 2022

Welcome to our EY 2021 year-end review of the private corporate debt market in Australia, which saw the market reach another record level of invested capital. The continued remarkable growth in private debt and complementary private capital market segments provides a backdrop of strong liquidity ready to support Australian businesses raise capital for growth and acquisitions in the coming year.

Our 2021 Australian private debt market review results

In what can best be described as a record year for global debt markets activity in 2021, the Australian private debt market has seen similar growth levels. The market reached a new total market size of A$133bn at the end of calendar 2021 or around 11% of the overall corporate and business lending market. This represents 21% growth over the level of A$109bn at the end of 2020.

Against a challenging broader economic environment, debt markets have experienced a record year of lending activity in support of refinancing and mergers & acquisition activity. This has come with the benefit of strong market liquidity and appetite across key public bond, private placement, bank debt, private credit and alternative funding markets.

In this environment of strong activity, private credit has played a key role with its flexibility of structure and terms proving to be highly attractive across a range of transactions. This flexibility has been well-suited to the more uncertain economic environment which has led to material differences in earnings performance across the business community and in different market sectors.

This year also saw a number of private credit managers in the Australian market grow their available capital, assisting them in playing a more meaningful role in leading and arranging larger ticket financings across a range of corporate, infrastructure, private equity and real estate financings.

EY approach to reviewing the private debt market size

Our EY annual market size result of A$133bn at end of calendar 2021 is based on a bottom-up analysis of active private debt funds and non-bank debt investors, and their privately disclosed or publicly reported AUM. This years' result saw a small number of new local and international market entrants being added to our list of funds.

The key market segments within private debt in Australia include corporate lending, leveraged/private equity, real estate, infrastructure, asset backed, special situations/distressed and SME lending. Lending within these segments can include direct lending and participations alongside banks or with other private debt providers, with some having specialist mandates and others with mandates covering multiple market segments. Given the private nature of many of these funds, we have only provided a market total and a separate estimate for the real estate lending segment later in our report.

Many of the managers included in our review have disclosed AUMs in confidence to enable us to provide an aggregated market picture. It is worth noting that our analysis may not include every global institution active here in Australia.

We've also compared the year end 2021 result to the five-year forecast provided in last years' review, 2020 survey results. On this basis our 2021 market size of A$133bn well exceeds the forecast for 2021 from 12 months ago of A$121bn, reflecting the ongoing growth in the market and continued support from investors.

A bumper year for overall corporate lending in Australia

The Australian corporate lending market, covering both bank and private debt lenders, set a new record in 2021 with total loan volumes of A$165.3bn, a 55% increase from the previous years' volume of A$100.4bn[1]. Activity was supported by strong refinancing and mergers & acquisition activity and benefited from general corporate earnings resilience and healthy balance sheets in most sectors. This year there was a key focus on green and sustainability linked debt raisings as corporates have focused attention to meet their shareholder commitments in this area.

Merger & acquisition specific loan activity grew to A$25.5bn compared to A$12.0bn[1] in the previous year and included a number of large ticket corporate and infrastructure sector acquisitions (see table below). Liquidity levels across the lending market also supported competitive loan pricing as both banks and private debt lenders have mandates for growth.

Deal	Details
Seven Group Holdings	A$5bn (US$4.095bn) bridge loan backing Seven Group Holdings' takeover bid for construction materials maker Boral Ltd
GIP Capricorn	US$2.29bn loan for GIP Capricorn Pty Ltd, which refinanced an earlier deal backing its acquisition of a minority interest in Queensland Curtis LNG facilities
Future Fund Consortium	A$1.025bn loan to purchase a 49% interest in Telstra's network-towers by Commonwealth Super, the Future Fund and Sunsuper, managed by Morrison & Co
PowAR	A$1.23bn loan to part-fund the Australian-business acquisition of renewable-energy company Tilt Renewables by Powering Australian Renewables, a consortium of QIC, the Future Fund and AGL Energy

The highly active market conditions were similarly reflected in the private equity and leveraged financing segments, with private equity sponsors continuing to successfully raise capital and having significant dry powder to bid for assets. These sponsors, including inbound sponsors from offshore, remain on the hunt for new investments in Australia and have been supported by the available debt from banks and private debt lenders in the Australian loan market.

Debt pricing in the corporate loan market reduced significantly compared to 2020 and remained competitive with strong liquidity and credit appetite from lenders. This tightening of pricing resulted in some deals even being refinanced within 12 – 18 months post financial close on reduced pricing. This has since stabilised moving into 2022, with lenders conscious to maintain returns on their portfolios as banks move to cover high wholesale funding costs as central banks around the world unwind their stimulus programmes.

Private debt a major player in this recent transaction activity

In 2021 private debt played an increased role in both general corporate lending and refinancing activity in addition to supporting corporate and private equity backed merger & acquisition and growth funding needs. This was across a range of corporate, leveraged, Unitranche, Term Loan B, asset backed and bespoke bilateral debt structures (see table below).

Private debt managers and institutional lenders continue to have increased appetite for Australian private debt, as they seek to deploy available capital and deliver a good relative return. The private debt market environment in Australia is showing similarities to the strong conditions seen in the US and European private debt markets and is further benefiting from the improving economic conditions in 2022.

Deal	Details
Quadrant	A$120m Unitranche financing to support Quadrant's acquisition of TSA Management
EQT	A$1.17bn Term Loan B to support EQT's acquisition of ICON Group in the largest A$ raising to date
MIRA & Aware	A$1.85bn multi-currency Term Loan B funding for MIRA and Aware Super's acquisition of Vocus Group
Tellus	A$135m 5 year term loan facility to refinance existing debt and accelerate growth
Calibre	A$90m term loan facility to refinance existing debt facilities
ZircoData	A$100m debt funding package to refinance existing debt, fund a special shareholder distribution and support growth capex
Myer	A$215m 4 year Asset Backed facility to refinance existing debt and for strategic initiatives

Private debt managers can assist corporate borrowers and private equity sponsors explore funding structures, provide indicative appetite and terms and then approve a deal in a shorter time frame than traditional lenders. They also offer other benefits in these transactions such as higher leverage, less covenants with more headroom, reduced amortisation, different interest payment structures and greater flexibility in other key terms (i.e., financial indebtedness and permitted acquisitions).

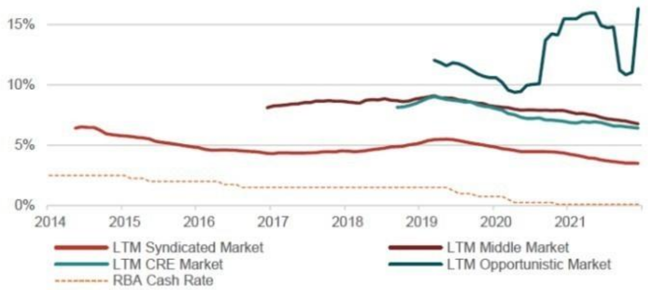
[1] LoanConnector and converted to AUD as at 31 Dec 2020 and 31 Dec 2021

In the case of leverage, we have observed private debt able to support leverage at an increased multiple of EBITDA or alternatively based on Loan to Value ratio against underlying business assets. In many cases, this has enabled an acquisition to proceed, growth to be pursued, shareholders to access a dividend recapitalisation and more headroom to manage the current economic environment. With Australian businesses looking for an edge in a competitive environment, private debt could be just the thing that makes the difference.

Whilst some private debt funds tend to act like traditional banks and can lend in the tightly priced bank market, most fund's mandates are aimed to achieve higher returns for which they are able to provide higher leverage and more flexible deal structures. For larger Term Loan B and Unitranche transactions, these are attracting a higher number of lenders which is increasing the size and frequency of these deals and leading to some pricing improvement, although in general pricing levels in private debt have remained relatively consistent.

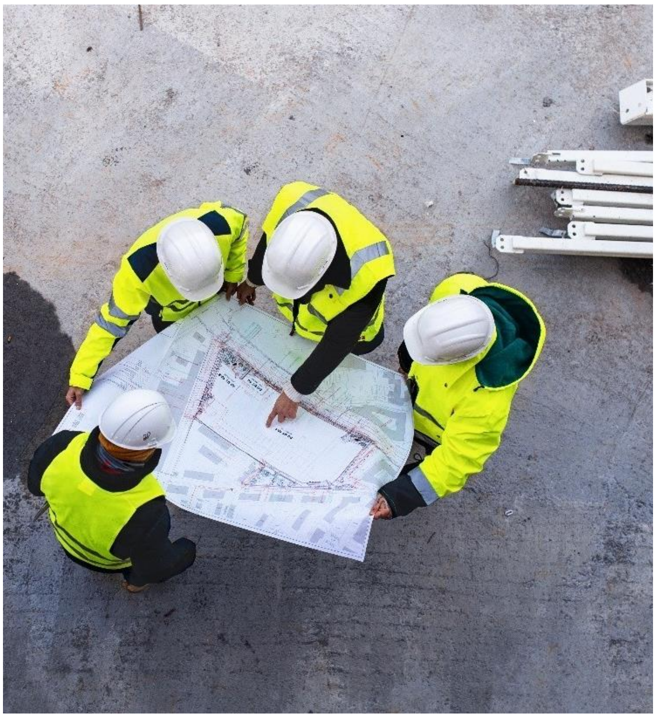
In the mid-market bilateral and club debt financing segments pricing tends to be determined on a deal-by-deal basis. Favoured sectors and more traditional funding structures are often priced at a premium to the bank market, whereas more complex deals with more high yield funds willing to participate pricing wider.

Corporate and Real Estate Private Debt Yields



Source: BondAdviser, Metrics, Qualitas, Altor Capital. As at 9 February 2022. Average tenor ~3.5 years

The pricing analysis provided in the above chart by BondAdviser shows private debt net yields have largely trended downwards in recent years in line with falling interest rates, whilst margins have remained relatively constant in comparison to bank and bond markets. This yield stability has helped to attract more investor capital which has assisted in filling the demand from Australian business and corporate borrowers looking to explore alternative funding options. Even with expected interest rate increases in the coming years, the demand for private debt is expected to continue given the funding capacity and structural flexibility on offer.



Real estate a big growth segment in private debt

As part of our 2021 review, we have estimated that around 38% of AUM or ~A$50bn is allocated to commercial real estate debt, including development and construction financing. Lending to commercial real estate continues to be a fast-growing segment of the private credit market and a core allocation with many funds reflecting the positive long-term growth prospects and the returns available.

Lending to commercial real estate has been attractive to many real estate investors and developers who choose to access the market as a source of growth capital. For example, these real estate groups have been able to undertake development and construction financing on more accommodative terms using private debt (i.e., on higher loan to value and loan to cost and lower presales/leasing), obtain financing more quickly and also explore different debt structures (i.e., junior/mezzanine debt, holdco or portfolio loans). Commercial real estate private debt lenders are also supporting asset owners in opportunistic situations, including repositioning poor-performing assets and value-add strategies.

The lenders in this segment have seen strong interest from their investors to grow their portfolios with private debt managers increasing the size of financings which is providing more competition to the banks active in the space. As this segment has evolved and become more sophisticated, some lenders have also raised equity mandates to enable broader access to the growing property market. Supporting this segment of private debt is also the general resilience in real estate markets across most asset classes with values continuing to grow and cap values tightening.

The broader wave of private capital

For Australian businesses the strong level of appetite from capital providers also extends beyond the private debt market, with private equity and venture capital firms also holding increased dry powder. As at Jun-21 these investors held around A$15.3bn[2] in available capital and were able to further supplement this through their access to both the traditional bank and private debt markets to co-fund their mergers or acquisitions alongside their equity contributions.

Given the alignment of these capital providers to the development of the private debt market in Australia and the complimentary way they can support business growth and acquisitions, we have commented on some of these key capital sources below.

Private equity

Like corporates in the last two years, we have seen private equity firms take the opportunity to realise on their investments and reposition for future investment opportunities which has contributed to the elevated levels of merger & acquisition activity and dry powder accumulation. This strong activity combined with the returns offered by Australian private equity saw the total amount of capital raised increase by 2.4x in FY21 compared to FY19[2].

This year the mix of deal types (by value) changed materially from more public to private or buyout transactions in FY20 to more private investments and growth capital transactions in FY21. Many of these transactions have been larger in size supported by a mix of bank and private leveraged debt structures, with the top 5 deals by value contributing to ~66% of the total deal value[2].

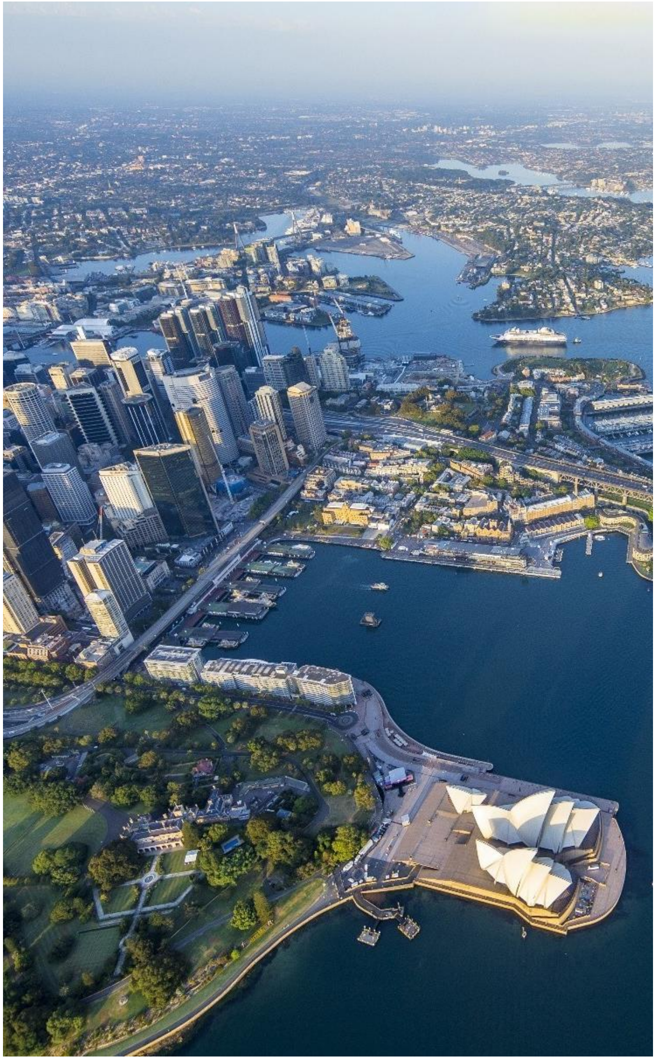
There also remains considerable interest amongst many small to mid-market private equity firms to commit capital to growing businesses, including through minority equity positions. These private equity firms currently use a combination of bank debt and private debt; however, we expect that as the private debt market continues to grow these firms will increasingly use this as a source of flexible acquisition funding.

Government and Industry Funds

Businesses within the Australian market continue to have access to specialist government backed funding agencies, such as the Export Finance Australia, the Clean Energy Finance Corporation (CEFC), the North Australian Infrastructure Fund (NAIF) and the newly formed Australia Business Growth Fund (ABGF), amongst others.

The newest of these funds is the ABGF, a A$540m fund backed by the Australian Government in conjunction with a number of major Australian banks[3]. The funds purpose is to provide growth capital to SME businesses through predominantly minority equity positions to support their growth. The value of this solution is that it offers minority equity capital to growing Australian SMEs providing another alternative option beyond the traditional bank debt market, the private debt market or selling their business to private equity firms.

The CEFC has also remained an active participant supporting businesses with clean energy and/or emissions reductions focusses, with capital in the form of both debt and equity. One such example being the Australian Government's recent pledge to co-invest up to A$1bn in equity capital on low emissions technology businesses, through the Low Emissions Technology Commercialisation Fund which will be administered by CEFC[4]. The CEFC is also participating in broader market debt transactions where a business is delivering an emissions reduction target in line with its specific guidance in different market segments.



Venture capital

[2] Preqin Research
[3] "Mike Baird appointed chair of $540 million federal growth fund", SMH, 13 November 2020
[4] "PM pledged $1b tech fund to help reach net zero", AFR, 9 November 2021

Much like the Australian private equity industry, the venture capital industry has continued its recent growth, driven by the accelerated focus on digitation of the economy and the trend towards working from home enabling technology driven businesses.

In the last couple of years, Australian venture capital funds were not only quick to raise but also to deploy funds to investments to capitalise on the opportunities presented by COVID-19, with these investments reaching a record high of A$2.5bn in FY21[5].

An emerging trend in this area has been the growth in the use of venture debt as an instrument to fund start-up businesses, providing yet another alternative funding structure available in the market. Venture debt offers funding to these firms at a lower cost of capital, helping them to accelerate their growth.

What does the availability of these capital solutions mean for you?

As the Australian economy emerges from a challenging period, the private debt market provides an important solution and source of capital to our business sector as it looks to meet its funding needs.

Particularly with a wave of mergers & acquisition activity underway and the expected growth capital needs of Australian business in coming years, private debt offers leverage and flexibility advantages over more traditional options. It can also complement a range of other emerging private equity and capital solutions as we've identified in this report.

We believe some of the key areas that will benefit from this wave of private capital options includes:

- Funding to accelerate the growth of existing and new businesses
- Acquisition funding at a higher leverage point than more traditional funding sources
- Returns of capital and dividends to shareholders who want to take advantage of past strong business growth
- Funding the very active real estate construction and development market and helping investors and developers to grow their portfolios
- Supporting businesses that have been negatively impacted by recent economic challenges to reposition their funding platform and business models

Whether you fit into one of the categories above or would simply like to learn more about the developing private debt market, EY professionals would be pleased to assist you, so feel free to contact us.

[5] "Australian startup investment up 28 percent in 2020-21", KPMG, 9 August 2021

EY contacts

Here to help your needs in any situation

Jason Lowe
Partner
Mob. 0412 699 778
E. jason.lowe@au.ey.com

Sebastian Paphitis
Partner
Mob. 0402 274 804
E. sebastian.paphitis@au.ey.com

EY Capital and Debt Advisory - Snapshot

The Australian team includes professionals with working experience within institutional and corporate banking, investment banking and structured financing across the debt capital markets spectrum.

The strong advisory EY capabilities support clients end-to-end deal management from debt and capital raising to capital management as well as tailored advice for a range of funding needs including:

- ► Refinance of existing debt facilities on improved terms and flexibility
- ► Structuring and raising debt platforms to help optimise and align funding with strategic business objectives
- ► Exploration of alternative debt markets to diversify capital structure and accelerate growth and acquisition plans
- ► Review of capital structures alongside credit analysis of loan portfolios as well as short- and long-term shadow credit ratings

AU00003975
ED None

EYSCORE 001750-22-AUNZ