H1, 2017

PRIVATE CAPITAL
market view

Direct Lending 2.0 Is Here

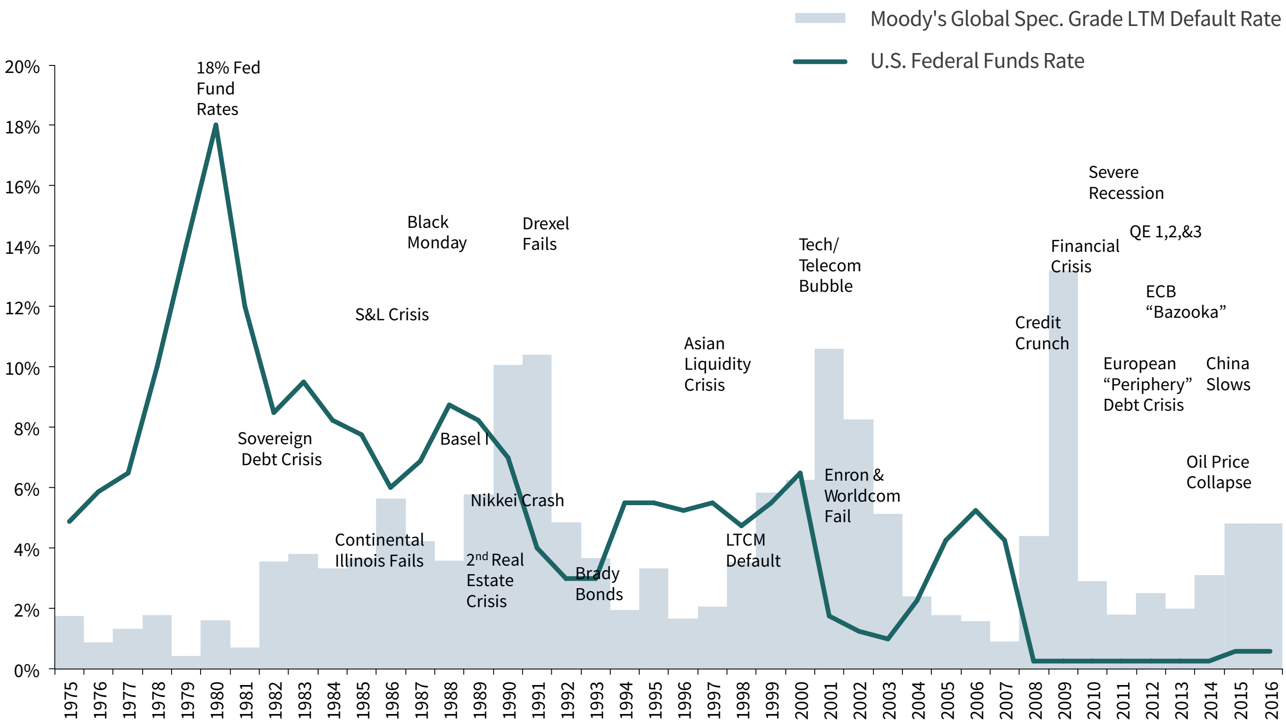
How Platform Lenders are Accelerating the Evolution of Credit Markets

Market Context

Capital market highlights

- Public markets start 2017 at multiple record highs on back of US fiscal stimulus rhetoric
- Fed tightening cycle now assumed, but the speed and quantum considered moderate
- Asset market valuations universally held to be high but no correction catalysts seen
- Loan spreads remain attractive versus high yield due to technical factors
- Speculative grade defaults set to rise but distress not yet visible in the system

History of private credit



Credit Markets: Defaults on the Rise as Commodity Crunch Hits

Source: Arbour Partners

Direct lending strategies — typical features and current returns

	LOWER MIDDLE MARKET			MIDDLE MARKET			FEATURES	
	Return	Term	Cash interest	Return	Term	Cash interest	Additional features	Deal source
Sponsorless mezzanine – Europe	14–15%	5-8 years	6–7% Floating	9–11%	5-8 years	4–8%	PIK, Warrants	Corporates, Advisors
Sponsorless mezzanine – US	15–20%	5-8 years	12–15% Fixed	14–18%	5-8 years	12–14%	Warrants	Corporates, Advisors
Senior corporate loans	5–8%	6-8 years	6–8% Floating	4–7%	6-8 years	4–7% Floating	N/A	Corporates, Advisors
SME Loans < 250.000	9–15%	4 years	9–15%	N/A	N/A	N/A	Amortisation	Marketplace Lenders

Source: Arbour Partners

Market update

Direct lending, in our definition, is the provision of credit directly to companies for growth purposes, acquisitions or refinancing. This is also referred to as 'sponsorless' or 'non-sponsored' lending because the credit is not provided to a private equity sponsor backing a particular transaction. Loans in the direct lending market require strong relationships with middle market companies and their advisors to originate. Borrowers may lack the urgency and the financial 'sophistication' of private equity firms. However, the post-crisis pullback of banks means the potential in the direct lending market is huge for alternative credit groups.

The last two years have seen direct lending begin to establish itself alongside more traditional bank financing as a source of credit for European mid-market corporates. On the lender side, the hunt for quality assets remains difficult, with fund managers often reviewing hundreds of possible credits for each one that is finally selected. Nevertheless, the vanguard of a new wave of sponsorless lenders has managed to assuage investor concerns around origination, leading to a series of new fund closes.

The lower middle market — where loans of €1m to 10m are provided to smaller or faster-growing companies — has emerged as a particularly fertile area for alternative lenders. Firms currently seeking finance in this area tend to be less leveraged than middle market firms and will be more flexible on terms. Fund houses able to build a natural edge in this sector will be able to deploy well if current economic conditions continue.

But it is in the micro SME loan space that the most growth potential currently exists. Loan sizes of €250,000 or less is where banks now seem to have permanently withdrawn from active service. This is where marketplace lenders are using thousands of data points on a credit and providing loans systematically to thousands of borrowers. The yields from these loans are competitive with other forms of direct lending. The loans are shorter-term, however, and funds in this sector can generate significant granularity and diversity across thousands of loans. This is what we are terming "Direct Lending 2.0". Institutional investors are now set to allocate large amounts of capital to the sector, in our view.

Private debt (buyout) strategies — typical features and returns

	LARGE LBO			MIDDLE MARKET			FEATURES	
	Return	Term	Cash interest	Return	Term	Cash interest	Additional returns	Deal source
Mezzanine financing – Europe	9–11%	5-8 years	4–8% Floating	13–16%	5-8 years	4–8% Floating	PIK, Warrants	PE, Investment Banks
Mezzanine financing – US	12–14%	5-8 years	10–12% Fixed	13–17%	5-8 years	11–13% Fixed	Warrants	PE, Investment Banks
Unitranche – Europe	6–8%	6-8 years	5–7% Floating	6–9%	6-8 years	5–7% Floating	PIK, OID	PE, Banks
Senior loan	4–5%	6-8 years	4–5% Floating	5–7%	6-8 years	5–7% Floating	OID	PE, Banks

Source: Arbour Partners

Market update

Private debt is considered by *PCMV* to be the provision of credit by investors to private equity firms to finance buyouts. The various forms of debt, their yields and their structural features are set out in the table above.

The private debt market has been a big beneficiary of the low interest rate environment in Europe and the US, as post-crisis central bank action has suppressed yields in the fixed income asset class. In particular, fixed income investors have been enticed by the floating rate loans and historically high recovery rates available in private debt. Since 2010, non-bank lenders have provided over $600bn to private equity buyouts. These lenders have included independent fund managers raising capital from global institutional investors and also institutional investors such as pension funds doing direct loans in the larger deals.

As a result of this growth in the private debt market, private equity firms in the larger buyout markets of the US and Europe now consider debt to be relatively freely available. The dealflow for ‘sponsored’ — private equity buyout — transactions only kept pace in 2016 with the previous year. But with additional equity and debt capital seeking deals, leverage levels (Debt/EBITDA) and valuations continued to rise globally. There was a continued loosening of covenants for so-called “cov-lite” deals.

Institutional investors, however, perhaps wary of some ‘top of the cycle’ phenomena, committed slightly less to the private debt funds in 2016 than they did in 2015, with around $100bn globally going into new funds.

Growth capital — typical features and returns

	Investment horizon	Investment size	Returns
Structured growth capital	5-7 years	€5-20m	20%
Growth debt	3-7 years	€5-20m	15-20%
Venture debt (Senior)	1-3 years	€1-10m	9-15%
Equity	3-5 years target	Varies (depending on fund size)	15-30%

Source: Arbour Partners

Market update

Growth Capital is the provision of funds to high growth businesses. Typical instruments employed combine features of debt and equity as well as other exotic features that can be tailored to a company's needs.

Growth Capital transactions have long been a relatively small subset of the alternative capital markets. This is somewhat surprising given the returns on offer. Borrowers are typically second-stage firms expecting high growth. They possess a strong-selling product but lack cash to fund the next phase of the business. Each transaction can be tailored to meet the needs of the firm at that particular stage, incorporating bespoke components to better dovetail with business needs.

Last year saw a number of traditional debt and equity managers retool, looking to the quasi-equity strategies typical of growth capital funds to boost returns. Harbert Management, a longstanding manager in the US sponsorless mezzanine sector, closed its European Growth Fund of €150m, Kreos completed its Fund V at the €400m hard cap, while John Sinik's Metric Capital – initially founded after the crisis as a pure debt fund – is currently allocating its most recent €500m vehicle to hybrid debt and equity growth situations.

The pricing pressure that has driven down yields in mainstream private debt and equity markets presents an undoubted opportunity for providers of hybrid capital. The challenge for the growth capital sector lies in the central question of illiquid credit markets: "Am I getting equity return for debt-like risk or debt-like return for equity risk?" As long as they can show a sufficient flow of deal realisations, then the answer is the first one and this is a strategy that will continue to grow.

Direct Lending 2.0 — Going Far Wider and a Whole Lot More Direct?

James Newsome

Tech and data-based lending platforms are now increasingly tapping global pension funds and insurers for capital and serving tens of thousands of SMEs with loans. One marketplace lender is deploying its data systems and over 700 people worldwide to crunch millions of data points to allocate $100m per month directly to SMEs on behalf of its capital subscribers.

Welcome to direct lending 2.0. The diversity and steady income that technology is bringing to credit investors is highly encouraging. If we only ensure that it is a natural evolution, building on the proven principles of credit investing, this potentially vast capital market is a sustainable alternative to the banking system.

Direct lending 1.0: A successful climb to here

Since the financial crisis over half a trillion dollars globally has been deployed by non-tech direct lending funds into hand crafted corporate middle market situations. Some have financed private equity buyouts and some have funded companies looking to grow. Offices have been opened in locations all over Europe and the USA to source and structure face to face high-yielding loans without banks' involvement. Investors have responded and scores of new asset managers have launched to provide the expertise for pension funds to invest in credit.

However, there are signs of plateauing in what is currently the largest sector of private debt 1.0, the financing of private equity buyouts. According to industry watchers PDI, traditional direct lending funds raised $111bn in 2016, down from $120bn the year before. Investors are increasingly concerned about how quickly and how effectively the existing cohort of 'analogue' direct lending funds can source the hand crafted loans of €10m to €100m in size that is their staple diet. Will private equity M&A activity, still the source of most private debt offerings, remain robust enough and of sufficiently high quality to absorb all the new investor capital?

Most private debt funds in direct lending 1.0 have been providing credit to only 10 to 20 firms each per year. In fact, the $600bn of non bank lending deployed in the years since the financial crisis has gone to just a few thousand companies worldwide. This is a tiny fraction of the number of SMEs looking for better credit solutions.

Marketplace lenders — Helping investors reach far further, faster

Meanwhile, as in so many other spheres of life, technology is shaking up the processes by which we make decisions and allocate resources in the capital markets. Alongside the growth of private debt funds there also has been demonstrable progress for technology platform lending, typically known as marketplace lending. Only around $10bn has been deployed so far, a fraction of the total in direct lending 1.0, but this has gone in smaller loans to up to a quarter of a million global SMEs since 2010. Through these data-rich platforms pension funds and insurance companies are allocating directly, without investment banks and private equity firms in between, to much more diverse and granular pools of credit.

A fund served by a marketplace lender (MPL) may allocate credit to tens of thousands of SMEs in loan sizes of less than 1 million euros or dollars, achieving a yield from the loans at similar or better levels to those in the traditional private equity based direct lending. Moreover, marketplace lenders are showing default and recovery experience in many sectors better than that of the banks.

While the platform lenders' machines have themselves been learning and improving their own credit selection algorithms, the business models of the lenders have undergone some crises and some rethinking, which is healthy. Some of the well-publicised difficulties of Lending Club and other US platforms which have mixed consumer and SME loans, for example, have given some equity investors in the sector's firms reason to pause.

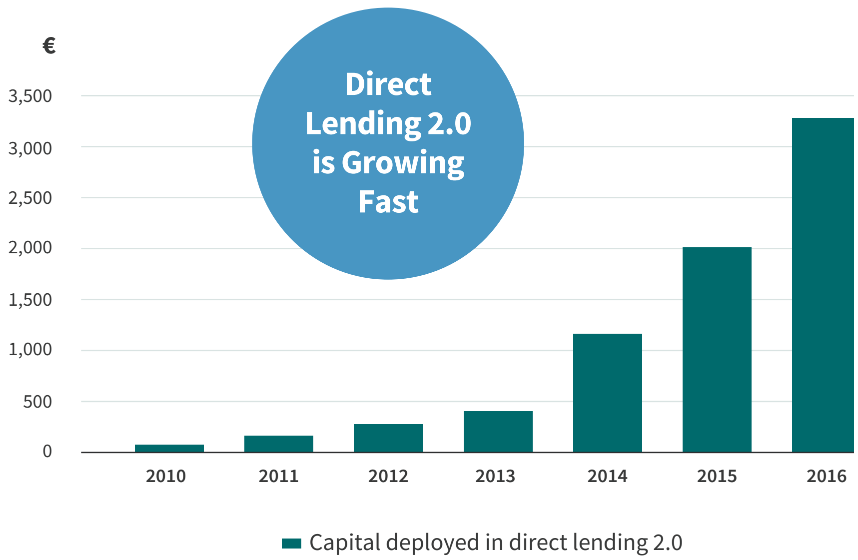
This is to be expected. While the models that work will scale up, lead the sector and attract professional capital, others will consolidate and some will fall by the wayside. One would worry if this were not yet the case.

The platforms which attracted equity capital have been able to build their tech capabilities and their human resources very rapidly. One lender, Funding Circle, has over 500 people worldwide working on credit monitoring, origination, tech, compliance and capital markets functions. This means that they haven't actually needed to 'achieve more with less', the usual tech company mantra. It is the next phase of the MPLs' development — providing a channel for institutional investors in large scale — where they will achieve that operating leverage. The key to that is raising large amounts of pension fund and insurance capital to put to work in their now seasoned lending operations. The best platforms are about to do that, big time.

Pension funds in particular, already familiarised with direct lending through the 1.0 providers, are becoming a larger part of the capital allocation to the marketplace lenders. This is because for certain types of credit underwriting — namely high volume, shorter term SME credit — the powerful new data analytics and communication hubs are bringing about a fundamental shift. Platforms can achieve both tremendous granularity (percentage position size of the fund in each credit) and constant, or even improving, quality of underwriting processes.

The platforms which have kept to the SME focus on the lending side and were early to the institutional investor conversation can now show over 5 years of default and recovery track record. They can also show a good amount of transparency —

Capital deployed by SME lending platforms in Europe (in €m)



Sources: altfi.com, Deloitte

down to loan by loan monitoring data. Typically the leading platforms are facilitating lending to firms that themselves average 10 years of operating history.

All this is music to the ears of institutional investors—they are seeing broad and fast deployment of funds, reduced risk concentration, regular income disbursement and the ability to deploy large funds above €500 million.

Scaling up from here: 4 big lessons we have learned from history...

But let's take a step back and carefully revisit our assumptions. So often at this stage in a cycle, when the demand for credit investments exceeds the supply, people start to stretch the core principles of credit investing. The manufacturers of new investment products (typically old products, with new acronyms) ride into town. The rest of that story is our living history. The most dangerous words in markets are of course "this time it's different". So, while the promise is great, is the technology being deployed by the MPLs really able to shift out the curve that sets volume against quality?

To help us answer these questions, let's do what Einstein's idiots didn't do and look at history to see what we can learn. What are those core principles in credit markets and how do they get compromised? Then we can assess whether the technology now available is able to give us greater width and scale without compromises. We don't want it to be different, we want it to be fundamentally right, but also bigger and better than the financial system which melted down in 2008.

The four horsemen of the credit apocalypse I see as: inverted telescopes; buying the packaging; maturity transformation and leverage on leverage. So let's take these one by one and look at what is going on.

...Don't invert that telescope

When we invert the investing telescope we zoom out rather than in, thinking we will see useful overall patterns. The problem is, once you fail to see what's actually going on in each data point in large samples you don't actually see any patterns — and start to make assumptions, usually over-positive. 'US housing prices don't fall on a nationwide basis' was the most widely-cited fake pattern in the pre-2008 period.

The data-led lenders are, however, able to burrow pretty deep into the SMEs they are lending to and to stay down there. The leading platforms are accessing, analysing and constantly monitoring thousands of data points on each SME borrower. With loan sizes of €50,000 to €1m the leading platforms are typically taking full sight of borrowers' bank accounts (as would a bank of course), and receiving early signs of deterioration which may impact loan payments. Some platforms are crunching data reported to the authorities by SMEs that they are not even lending to, to enrich the data-learning process. This helps to recalibrate more accurate default prediction models.

This modelling is not the inverted telescope of the subprime market pre-2008. They ran wonderfully complex Gaussian macros on hundreds of thousands of mortgages to help create AAA bond ratings, but down at the coal face where the credit was actually created they relied on self-certifying salary data and sketchy financial status information. Every London cab driver can now sum up credit modelling in the City of London by saying, 'if you put crap in, you get crap out'.

The SME-focused platforms of direct lending 2.0, on the other hand, are using data from the official filings of companies which average around 10 years of operating history, to drive their machines' learning.

...Packaging is just packaging

The financial packaging created for investors when mass scale-up of credit investment takes place

Institutional participation in SME loans originated by the largest global MPL

Source: Funding Circle

often exaggerates these fake assumptions. In the subprime bubble of 2005-2007 the packaging of new securitisations and CDOs retained the same AAA attachment points, and, if anything, tighter and tighter spreads on their liabilities — supposedly an indication of less risk — while the poison flooded into the system. In the hunt for yield, buyers loaded up on the shiny financial packets, as has been chronicled in countless SEC investigations, senate hearings and Hollywood movies.

So how are the data-led marketplace lenders of today bringing in their investors? In many cases, large institutions have been committing to the platforms in remarkably simple investor agreements, whereby they commit to capital amounts that are drawn over time and the platform commits to pass through all interest and principal after service fees. The complexity is not in the packaging, it's in the data — and that is being systematically mined and learned from. Yes, some of the lending platforms are doing securitisations. On first principle this is not a bad thing at all. However, the mass adoption of securitisation has in the past driven down yields and, in my view, has led to deterioration in underwriting standards just so that the SPV beasts can be fed. In this respect they should be careful, but as long as the credit origination process remains robust these deals will perform.

Either a lender or a borrower be...

Borrowing short to lend long — maturity transformation — is of course the perennial bogeyman of credit crises who never actually gets killed off. The marketplace lending platforms, however, are not yet deploying this practice. Their own balance sheets are still heavy with venture equity. If they start to play the maturities, either in their own balance sheets or with SPVs, we know the woods are once again becoming less safe to go into. A virtue of the sharing economy ethos which infuses the platform lender model is that little manipulation of financial structures is done between lender and borrower.

While leverage on leverage may not yet be a feature of the marketplace lenders, there may be some lenders on the platforms who are themselves leveraged and borrowing capital to lend to SMEs through the platforms at higher rates. The leading marketplace operators, however, are taking in large pension funds, insurers and funds of funds as direct lenders to the SMEs. Institutional investors of this type are not typically leveraged entities.

Also, these funds' capital, if anything, is longer-term than the loans the platform lenders are making, which are typically less than 5 years in final maturity. Moreover, some platform lenders are able to make amortising loans so that the actual duration is less than three years. The investment vehicles the MPLs are offering to institutional investors are therefore also able to be shorter in some cases than those of the 1.0 debt funds.

Key features of private lending

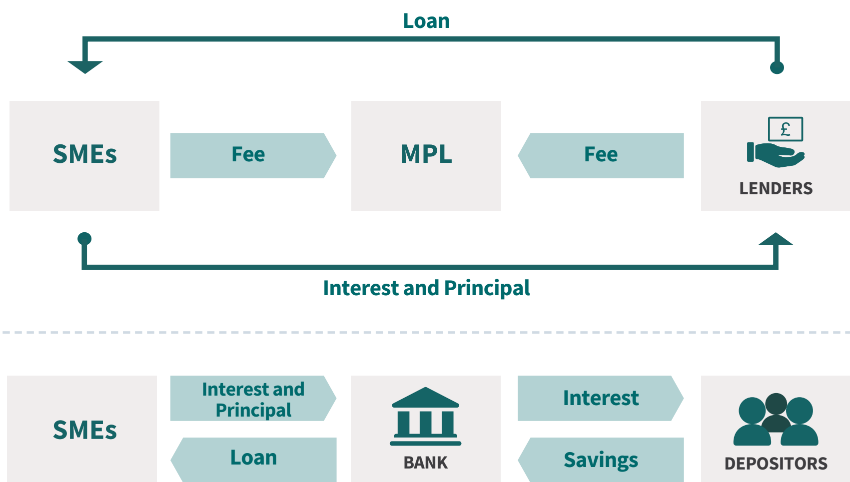
	Direct Lending 1.0	Direct Lending 2.0
Yield	✓✓	✓✓
Cash distribution	✓✓	✓✓✓
Diversification	✓	✓✓✓
Specialist strategy	✓✓✓	✓
Short-term exposure	✓	✓✓

...Check your alignment

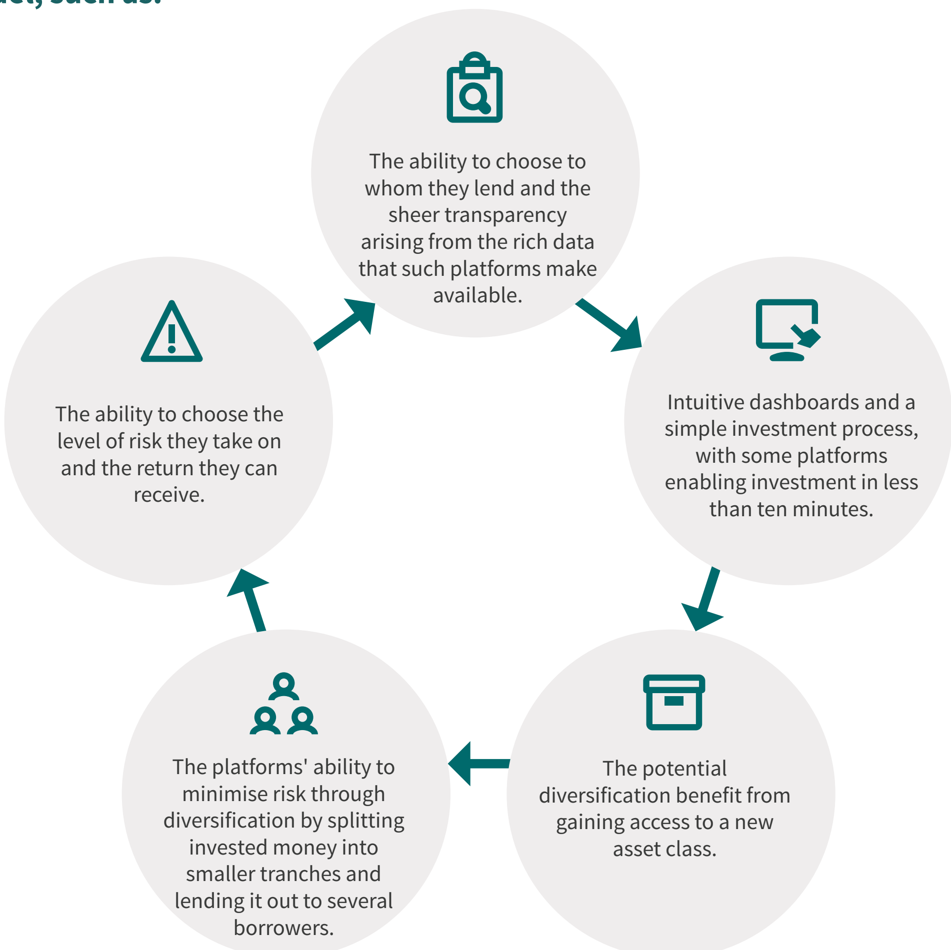
A mantra among investors which has proved important in the past is 'alignment of interest'. It is here that some investors still have concerns about the MPL platforms. When inviting institutions to use the platform to act as direct lenders, the platforms in many cases are not charging the usual annual management and performance fees in the private equity/private debt fund model. The platform will take a one-off payment each time a loan is originated. A borrower will borrow 100 and receive 97, with the platform taking the difference. The investor will have provided 100 and is expecting 100-plus annual interest in return. There may also be an annual servicing charge to the investor for the operation of the platform. Beyond these contractual payments there typically will not be any other direct performance fee charged by the platform to the investor.

So what incentive does the MPL platform actually have to make sure that the loans they make perform well and are managed intensively during their term? Here, some institutional investors more used to the private equity model will be in the mind-set that asset managers only do great if they get rich for doing great. The lending platforms, however, like banks, need above all to be disciplined. The machines need to source and crunch all the right data. The humans need to act on the data they see. Finding 'alpha' and outperforming benchmarks is not the name of the game. For this reason the alignment of interest for investors is in the platforms needing to run the most disciplined operations in the market with the lowest default rates for a given return level, to be able to attract the most investors. Unlike banks, which levered up equity to increase return for shareholders, the platforms' game is to increase size and therefore profitability through operating leverage, not financial leverage. They only increase size by showing as little volatility in their lending as possible to the lenders they bring into the platform.

How are SMEs funded now?



Lenders are also increasingly attracted to several intrinsic qualities of the MPL model, such as:



Incentives are never perfectly aligned in asset management. For credit investors, it seems to me that they have as much of a fit here as they do in where outperforming a hurdle may encourage extra risk taking.

Through evolution, not revolution, this credit market will make progress

Mary Shelley wrote that *'no man chooses evil because it is evil. He only mistakes it for happiness, for the good he seeks'.* As long as we stick to the principles of markets which have been proven indispensable over time, institutional investors can safely 'seek the good' of yield, diversity and a regular income through the well-run tech platforms. This should probably be through investing in a combination of the traditional direct lending funds and the marketplace lenders. Many bellwether institutional investors are already doing so. In the UK in particular the regulators and the government itself are firm supporters of the model.

I think we will therefore see an investor surge into the marketplace lenders this year as direct lending 2.0 takes shape. Growth is sustainable ultimately if it is spurred by evolution, not by revolutions. Financial innovation cannot alter or disregard the fundamentals of credit and of markets.

If we evolve by finding better ways to apply these principles to new participants who previously we couldn't reach with finance, then we may even help the stagnant economies of the West to return to growth.

Negotiated commercial real estate debt

	UK			CORE EUROPE			SOUTHERN EUROPE		
	Return	Cash interest	Additional return	Return	Cash interest	Additional return	Return	Cash interest	Additional return
Senior: 0-60% LTV	2.5–5%	2.5–5%	N/A	2.5–4.5%	2.5–4.5%	N/A	4–6%	4–6%	N/A
Whole loan: 0-75%	4.5–6.5%	3.5–5.5%	Deal fees	4.5–6.5%	3.5–5.5%	Deal fees	6–8%	5–7%	Deal fees
Stretched senior: 60-75%	7–9.5%	6–8.5%	Deal fees	6–10%	5–8%	Deal fees	8–11%	7–10%	Deal fees
Mezzanine: 75-85%	9.5–12.5%	6–8.5%	Deal fees, Capital	11–15%	6–9%	Deal fees, Capital	12–16%	7–10%	Deal fees, Capital

Market update

Real estate funds provide credit secured against an underlying real estate asset. Senior funds lend up to 75% loan-to-value (LTV), while mezzanine funds focus on supplying capital at the 75-85% LTV level. Much as in other private credit sectors, bank retrenchment is being driven by capital considerations and regulatory burdens. This has meant a rise in real estate financing from debt funds and alternative lenders – which now make up around half of all European lenders. Liability-driven investors are drawn to the benefits of the long-duration loans that are on offer; while the higher risk tolerance of institutional investors provides a strategic advantage to debt funds working at higher LTV.

As with many private credit markets, the pricing pressure on real estate transactions built through the second half of 2016. Markets look most frothy at the top end, in sectors such as London prime office and luxury, where rapid capital growth has attracted foreign money. On the fundraising side, real estate debt is still attracting investor attention and a raft of commercial real estate debt funds closed in 2016. Some independent houses such as Venn Partners and GreenOak are establishing good footholds alongside the larger players like Blackrock and Deutsche Bank.

Principal private capital providers, US and Europe

	Asset focus	Sources of fund capital	Owner strategy	Examples
Private debt houses	Private debt: senior and mezzanine, Direct lending, Special situations	Pensions, Insurance, SWFs	IPO, Trade sale	Beechbrook, Monroe, Pemberton Harbert, CORDET
Marketplace / Platform lenders	Micro-loans to diverse SMEs	Pensions, insurance, SWFs	IPO	Funding Circle, Lending Club, ThinCats, MarketInvoice
Alternative investment groups	Private debt: senior and mezzanine, Direct lending, Special situations	Pensions, insurance, SWFs, Parent co-investment, CLOs	Acquisitions, Organic scale-up	Blackstone/GSO, Partners Group, KKR, Bain/Sankaty, CVC
Fund of funds credit sections	Private debts: senior and mezzanine	Pensions, insurance, SWFs, Parent capital	Acquisitions, Organic scale-up	Pinebridge, Portfolio Advisors, Access, SVG
Asset manager credit sections	Private debt: senior and mezzanine	Pensions, insurance, SWFs	Organic scale-up	Standard Life, Babson, John Hancock, TCW, Tikehau
Publicly listed financiers	Private debt: senior and mezzanine, Direct lending	Further listings, Credit facilities	Scale-up, Acquisitions	CIT, ICG, SVG, American Capital
Growth capital funds	Structured equity, Preferred shares, Convertible loans, Minority equity	Pension funds, Funds of funds, Family Offices	Organic scale-up, Trade sale	Harbert, Summitt, IPF, PrefEquity
Business development companies (BDCs)	Private debt: senior	Listed equity, bank facilities	Further listings	Ares, Apollo, Monroe, ACAS
Real estate lenders	Whole loans, Senior debt, Mezzanine	Pensions, insurance, SWFs, Parent banking	Organic scale-up, IPO	Venn, DRC, GreenOak, Longbow
Mezzanine houses	Private debt: mezzanine, Minority equity, Private debt: senior	Pensions, insurance, SWFs, CLOs	IPO, Organic scale-up, Acquisitions	ICG, Mezzanine Mgmt, Park Square, Indigo

Source: Arbour Partners

Private Capital A to Z

Asset liability management (ALM)	An investment strategy that attempts to match future asset payments with future liability payments. It is commonly used in the portfolios of life insurance companies and defined benefit pension funds
Direct lending	Credit finance for companies that are not majority-owned by a private equity fund and where negotiation is with owner-management
Factoring	The provision of finance to a supplier of goods for closing the cashflow gap between the issue of an invoicing and payment of that invoice. Factoring is the more traditional form of Invoice Funding
General partner (GP)	The member of a fund partnership with fiduciary responsibility for the investment management of the fund on behalf of its limited partners (LPs)
Granularity	Number of positions or assets in a managed pool. Pertaining to 'grains' (eg. of sand)
Growth capital	Financing for relatively mature companies to expand operations or to enter new markets while they retain control ownership of the business
Growth debt	Shorter-term debt finance for small to medium-sized growing companies which is repaid relatively quickly as revenue grows
Illiquidity	A measure of the difficulty in trading an asset, typically indicated by the difference between bid and offer prices
Illiquidity premium	The additional yield paid to compensate investors for the illiquidity of an asset, irrespective of its credit quality
Internal rate of return (IRR)	The rate applied to one or more future payments so that these payments have a net present value of 100% of the invested amount. Thereby, a measure of the return expected from the investment
Inter-creditor agreement	An agreement between one or more creditors in a particular borrower
Invoice funding	The financing of a buyer or a supplier of goods or services for the provision of those same goods or services. The lending is collateralised by the invoice exchanged and is normally non-recourse but may include insurance or credit guarantees
Limited partner (LP)	An investor in a fund partnership who is not responsible for the management of the fund
Loan to value (LTV)	The ratio of credit provided in proportion to the purchasing price of the asset
Marketplace lender	Platform that uses large amounts of data to assess, underwrite and service large numbers loans for investors without acting itself as lender. Typically will not have its own balance sheet. Passes through all interest and principal to its investors (lenders) after charging origination fees and servicing fees
Mezzanine finance (European corporate)	A secured loan, typically floating rate, which contracts for additional equity-like exposure including PIK and warrants

Mezzanine finance (Real estate)	A lower-ranked loan backed by real estate up to typical loan value levels of 85%, with a correspondingly-high interest rate
Mezzanine finance (US corporate)	An unsecured corporate credit investment typically with a high fixed-interest rate and often with an attached warrant to purchase equity
Original issue discount (OID)	A bond or loan that is issued at below its face value. The discount is considered additional interest income
Payment in kind (PIK)	A credit contract that does not involve transfer of cash-flows from borrower to lender between drawdown date and maturity. PIK interest accrues until maturity or refinancing
Private credit	An umbrella term for the universe of all non-public debt transactions not financed by banks
Private debt	The provision of credit by investors to private equity firms to finance buyouts
Senior loan	Loans that retain the first claim on all interest and principal repayments from the company or property or project
Sponsorless mezzanine finance	Mezzanine finance for companies that are not owned by private equity funds
Stretched senior loan	A highest-ranking loan that lends up to a slightly higher loan-to-value ratio than a typical senior loan and charges a higher interest rate
Supply chain finance (SCF)	The provision of finance to a buyer of goods, commonly employed in accelerating payments to its suppliers in exchange for better trading terms. SCF is often called Reverse Factoring. To compound confusion, the term Supply Chain Finance or its acronym are often used to refer to the entire Invoice Funding space
Unitranche loan	A debt facility that combines features of both senior corporate loans and mezzanine loans
Warrant	A derivative security that gives the holder the right to purchase interests (usually equity) from the issuer at a specific price within a certain time frame

Source: Arbour Partners

Disclosures

Certain information contained in this paper constitutes “forward-looking statements”, which can be identified by the use of forward-looking terminology such as “may”, “will”, “should”, “expect”, “anticipate”, “target”, “estimate”, “intend”, “continue” or “believe” or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Prospective investors should pay close attention to the assumptions underlying the analyses and forecasts contained in this paper. The analyses and forecasts contained in this paper are based on assumptions believed to be reasonable in light of the information presently available. Such assumptions (and the resulting analyses and forecasts) may require modification as additional information becomes available and as economic and market developments warrant. Any such modification could be either favorable or adverse. Nothing contained in this paper may be relied upon as a guarantee, promise, assurance or a representation as to the future. Certain information contained herein has been obtained from published and non-published sources prepared by other parties, which in certain cases have not been updated through the date hereof. While such information is believed to be reliable for the purpose used herein, Arbour Partners LLP and its affiliates assume no responsibility for the accuracy or completeness of such information. Historical information is not indicative of future results, and the historical information in this paper should not be viewed as an indicator of any future performance that may be achieved as a result of implementing an investment strategy substantially identical or similar to that described in this paper.

PRIVATE CAPITAL
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