The Australian Middle Market Direct Lending Opportunity

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Epsilon Direct Lending Pty Ltd
ACN 636 861 464

Opinion Paper

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Synopsis

This opinion paper provides an overview of the Australian private credit landscape, and specifically, the attractive middle market direct lending strategy which has emerged recently in Australia. The middle market direct lending opportunity is explained in detail, including a discussion on the compelling investment strategy attributes, key considerations in manager selection and ultimately, the reasons why investors should consider allocating to the strategy.

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Key Messages

Middle Market Direct Lending provides an attractive investment opportunity

Investors have been able to access private credit markets for some time. However, middle market direct lending – a specific subset of private credit – has largely been the sole domain of traditional bank lenders, with investors having limited access to this market segment. It has only really started to emerge in Australia in recent years as bank lenders have reduced lending activities to middle market companies, due to regulatory, capital and cost pressures. New alternative lenders have been established to address borrower demand and provide investors access to the opportunity. This evolution in the Australian corporate loan market, particularly with middle market companies seeking growth and event-driven financing, provides for a deeply underserved market providing compelling lending opportunities for investors.

Direct lending funds provide loans to performing middle market companies that are originated, structured and managed directly with corporate borrowers, with loans typically held to maturity (3-5 years terms). Australian based direct lenders targeting performing profitable companies with a predominantly senior loan focus, will typically target mid-to-high single digit net returns to investors across cycles.

Diversification of income is more important than ever

Any discussion about the benefits and characteristics of any asset class needs to include considerations about the current investment environment. As investors consider their investment portfolios in an environment that is dominated by very low (and in some instances, even negative) interest rates and inflated asset prices with generally compressed risk premiums, it has never been more important for investors to consider a broader investment universe to access new sources of return, cash yield and to improve the risk/return profile of portfolios.

Private credit can assist in filling the gap

Given this context, private credit (or debt, the terms are used interchangeably) continues to prove itself as an attractive and growing asset class. Private credit investing has witnessed tremendous growth in the past decade and continues to accelerate as investors seek to optimise the risk/return profile of their portfolios and build diversification in strategies. The growth of private credit investing has been driven by the appeal and familiarity of the asset class to investors, as well as new managers coming to market offering access to differentiated investment strategies.

Not all private credit strategies are born equal

In considering private credit allocations, it is critical for investors to firstly recognise the key differences (as well as the important nuances) of the various private credit strategies on offer to ensure they are being truly rewarded for the risk-adjusted performance being delivered; and secondly build diversification across private credit strategies within their portfolios.

There are more opportunities in private credit now, than ever before in Australia

Whereas in the past, investors have not had a depth of viable options in allocating to Australian private credit strategies, this is not the case anymore. Private credit can be an attractive asset class for investors, offering targeted exposure to various strategies, sectors or investment opportunities that ultimately deliver various risk-adjusted returns – allocating to one private credit manager or strategy does not provide sufficient diversification.

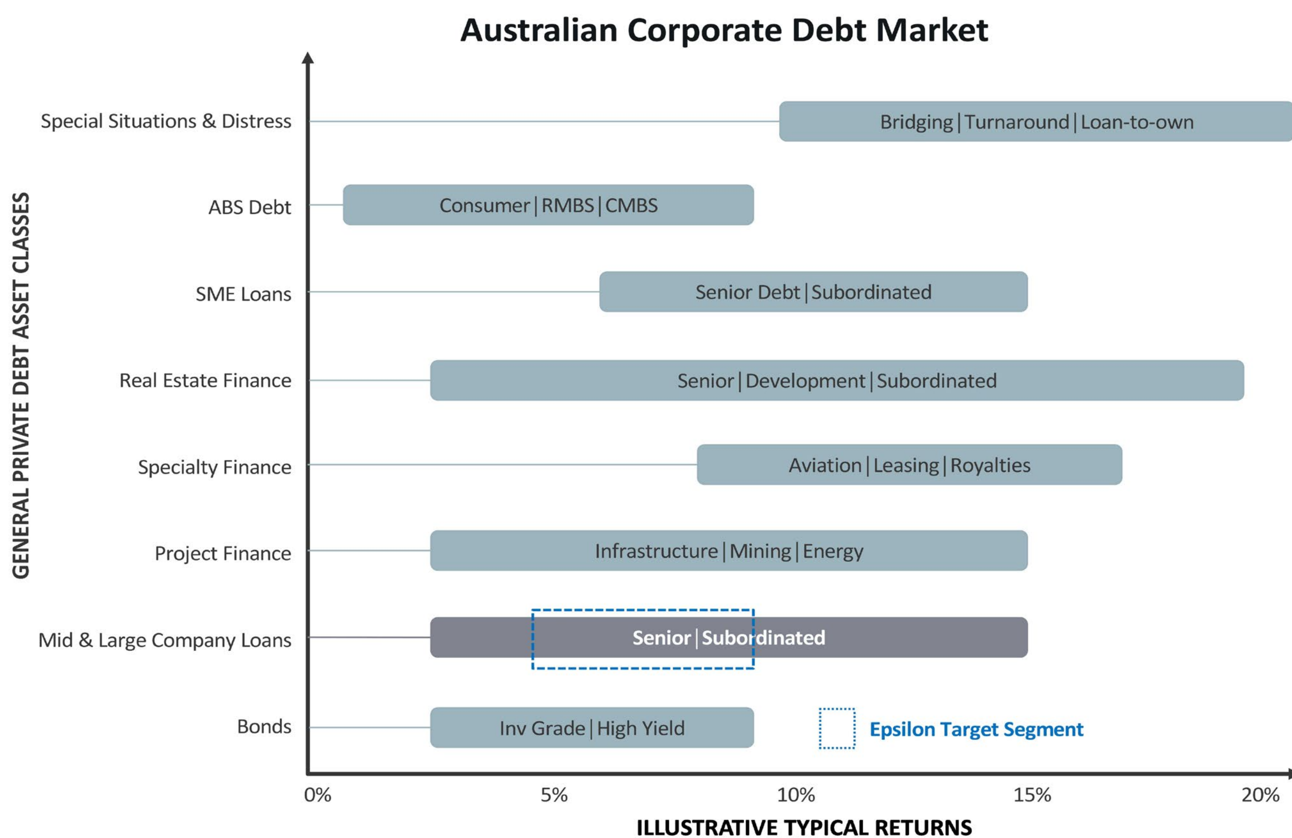
Manager relationships and skill really do make a difference

Middle market corporate loans are predominantly bilateral in nature – that is, there is one borrower and one lender as party to the loan agreement. This has typically made it difficult for investors to access as lending opportunities need to be directly originated, evaluated, individually structured and negotiated, and managed by experienced credit managers. Loan terms and pricing are often idiosyncratic, so mangers with proven track records in providing these loans are better placed to secure the best lending opportunities on the best terms.

The Australian Private Credit Landscape & Australian Corporate Loan Market

In Australia, there are hundreds of managers focused on listed equities, covering a market size estimated to be c.$2.5 trillion. Contrast that with the Australian private credit market which has under 100 managers covering c.$3 trillion of loans outstanding, most of whom are focused on property, consumer and SME lending, and you can see why it presents a growing and exciting allocation opportunity for investors.

The corporate fixed income segment of private credit is c$1.2 trillion in size, and if you exclude bonds, the market is referred to as the corporate loan market, being $1.0 trillion in size. It encompasses a broad range of strategies listed below, providing investors with exposure to various underlying markets, borrower types and investment products that drive material deviations in risk and return for investors.



Source: Epsilon Direct Lending, February 2021. Figures shown are representations of typical return expectations for the asset classes shown. These figures are not forecasts and Epsilon Direct Lending makes no guarantee or representation that any particular asset class will generate any particular rate of return.

- Historically, accessing Australian corporate loan investments was difficult to achieve and limited in strategy selection. This has predominantly been due to Australian banks' dominance in providing c.90% of all loans to these borrowers. However, as has also occurred offshore post-Global Financial Crisis (GFC), market share is shifting to non-banks on a permanent basis, and this has created the opportunity for investors to step in and profit from supplying capital to underserved market segments such as middle market direct lending.
- For institutional investors, the mainstay of the domestic corporate loan market has been largely limited to i) real estate lending and ii) participating in the broadly syndicated loan markets where lending opportunities are arranged, structured and sold-down by commercial and investment banks. Some larger institutional investors have direct access to these markets in their own right, while others invest with managers to build a diversified portfolio. Elsewhere, some investors have indirect exposure to corporate private credit via allocating to funds that provide multi-credit strategies (mix of corporate, real estate, infrastructure, ABS, etc).
- What has largely eluded investors to date, is access to direct or bilateral corporate lending opportunities that provides investors with the potential for high returns and greater influence over loan structure, terms and conditions. This is no longer the case…

Defining the Middle Market Direct Lending Strategy

Middle Market Direct Lending is a $70 billion segment of the $3 trillion Australian private credit market and has many unique features, as described below:

Unique Features of Middle Market Direct Lending

- Lending directly to established middle market companies typically for growth and event-driven financing purposes including leveraged buyouts, acquisitions and growth situations. The strategy excludes real estate loans.
- Australian middle market companies can be defined as companies with annual revenue of $25-500 million (whereas large companies or Large Cap have more than $500m of revenue, and small companies or SMEs have less than $25m of revenue).
- Lending opportunities are typically sourced by going directly to private equity sponsors or owner/operators of middle market companies, to originate and privately negotiate terms.
- The majority of loan investments are senior floating rate loans (meaning the interest rate moves pursuant to a benchmark or index) that are evaluated and secured based on the ongoing, forecast cash flow and enterprise value of the borrower.
- Loans are typically provided by one lender (bilateral), or a small 'club' of lenders.
- Middle market borrowers typically do not have public credit ratings and are considered non-investment grade (i.e. BB+ and below). Physical assets such as property and other fixed assets do not typically form a significant proportion of the security value taken by the lender.
- Given these factors, lender terms are often idiosyncratic and as such lenders typically command pricing premiums and structural enhancements, driving low correlation to Large Cap leveraged loans in the broadly syndicated market, as well as corporate bonds.
- Returns are primarily generated from fees and margin, with equity-like participation being rare.
- Protections afforded by seniority in borrowers' capital structures, security over borrowers' assets, financial covenants, and diversification of loan portfolios mitigates the risk of loss of capital.
- Loans are a primary source of funding growth for most middle market companies, meaning there is always solid borrowing demand.
- Direct Lending strategies typically focus on non-cyclical industries providing additional defensiveness through all market conditions.

Common Features of Corporate Loans

Corporate loans are issued by bank and non bank lenders to public and private companies of various sizes as a core part of financing their capital requirements and for general working capital purposes.

Corporate loans are agreements that incorporate the following typical key features:

- **Privately negotiated** – between one or more lenders, and not traded on public exchanges;
- **Security** – secured or unsecured over all of the assets of the borrower or specific assets only;
- **Priority** – senior or subordinated ranking claim in the capital structure of the borrower;
- **Purpose** – use of loan proceeds ranges from general working capital needs, to growth or event-driven uses such as mergers and acquisition (M&A) finance, leveraged buyouts, capital expenditure funding, dividend recapitalisations and refinancing) or special situations (e.g. funding provided for unique circumstances, typically caused by a one-off event);
- **Term** – the contractual obligation to repay the loan is typically 1-5 years; and
- **Fees and interest charges** – charged, amongst other things, based on a lender's assessment of the borrower's credit quality, market conditions, structure and term of the loan.

The corporate loan market is bifurcated between lending secured by commercial property and other tangible assets, and lending secured by enterprise value.

Commercial property lending mainly comprises loans for investors in commercial office, industrial and retail premises. The total amount of lending exposure to this segment is estimated to be $300 billion. Loans to this segment of the market, have typically been more attractive to traditional bank lenders as lending against a percentage of the property's value simplifies the loan assessment process and also makes it easier to generate an adequate return on regulatory capital.

Compelling Investment Strategy Attributes

With material constraints on the supply of capital to medium sized businesses, combined with strong demand, great lending conditions and structural product advantages, middle market direct lending presents a highly compelling risk adjusted reward opportunity for investors.

Favourable supply / demand dynamics for direct lenders

Bank retreat means the supply of capital to middle market companies is scarce

Whilst corporate lending in Australia is dominated by traditional bank lenders, structural change has occurred and banks now face a number of key challenges in lending to middle market companies which will continue to increasingly restrict their lending activities, and accordingly, limit the supply of capital to these companies, including:

- **Capital requirements and regulatory change**: Tightening of capital adequacy requirements by the Australian Prudential Regulation Authority and other regulation is forcing banks to focus on a narrower band of lower risk (both probability of default, and loss given default) borrowers as risk-based capital charges for non-rated loans, and tier 1 capital ratios increase. This regulatory environment makes it challenging for banks to provide middle market direct lending;
- **Poor customer experience**: For the last four consecutive years to June 2020, the Net Promoter Score for Business customers (a measure of customer advocacy) at each of the four major banks has been negative, reflecting a largely unhappy customer base. As highlighted by the Banking Royal Commission's report, banking processes are often rigid and cumbersome, with legacy systems which are prohibitively expensive to replace. It is typical for borrower expectations to be unfulfilled, especially for time-sensitive event-driven lending opportunities;
- **Inability to provide loan product innovation**: Australian banks are seeking to standardise loan products in order to digitalise lending processes and reduce their cost base. Additionally, their internal ratings-based modelling methodologies usually benefit from offering products which are high in volume and thereby have ratings assigned that are more readily substantiated. Such banks are therefore often less inclined to structure loans to meet their customers' specific needs and risks;
- **Resourcing**: Specialist teams are difficult to retain and incentivise and typically gravitate towards Large Cap transactions ('bigger bang for buck'). The issue is exacerbated with banks shifting to standardised products and tightening of credit appetite.

These factors contribute to a rich environment for agile direct lenders to present as a compelling alternative for borrowers and achieve attractive loan economics.

Diverse and growing universe of lending opportunities

Australian middle market companies are distinctive in that they are large enough operationally to make a meaningful impact on the economy, yet are often small enough to be entrepreneurial in nature, hold leadership positions in market niches, and adjust quickly to prevailing market conditions. They are not typically subject to bureaucratic or hierarchal structures in the way large companies can be, but are also generally larger than SMEs to have sufficient diversification in their operations (e.g. customer, product and supplier diversification, depth and experience in management teams).

Loans are a primary source of funding growth for the estimated 35,000 Australian middle market companies. Most senior loans typically provide for company owners to maintain control of their businesses as they grow. This is an important factor as many middle market companies are generally family-owned or closely-held, and are therefore reluctant to dilute control and decision-making to private equity (PE) sponsors and third-party equity investors. However, many of these companies typically do not have meaningful access to debt capital from offshore or onshore bond markets or the broadly syndicated loan markets, because they lack the scale in earnings, public profile, track record and/or bond issuance size (generally required to be greater than $100-150 million).

Demand for non-bank financing is driven from active, growing middle market companies and PE sponsors seeking bespoke funding solutions as an alternative to (or in some instances to complement) traditional bank financing. It is estimated that:

- there are more than 40 local and international PE sponsors active in Australia and an estimated $11 billion of uncommitted funds is focused on Australian investment of which a substantial amount will be directed to the middle market, and continue to drive transactions across most market segments; and
- PE sponsor driven M&A activity is reported to account for approximately 20% of all middle market M&A activity in recent years.

Limited non-bank lenders – the market is far from being saturated

There are very few alternative or non-bank lenders providing middle market direct lending in Australia. This is particularly the case where a company is considering a significant capital investment (such as an acquisition), and there is insufficient real estate and other fixed assets as collateral, or where the company (and/or its owner(s)) has pledged all of its existing real estate and other fixed assets as collateral to other lenders.

Substantial barriers to entry also exist, making it difficult for non-bank lenders to participate in the market. These include:

- lenders having sufficient capital commitments (individual middle market loans can range between $10 million to greater than $100 million);
- borrower relationships and access to lending opportunities;
- strong working relationships with PE sponsors;
- expertise in loan structuring and ongoing credit monitoring; and
- diversified industry knowledge.

As a result of the limited supply of lender alternatives – and when combined with a reluctance or inability to secure other forms of capital perceived to be more expensive or controlling – some middle market companies and their owners either have to delay expansion or opt not to pursue growth opportunities until such time as it can be funded from retained profits and cashflow.

Advantageous segment attributes vis-à-vis other private credit strategies

Capital preservation – Low default rates & high recovery rates

Recovery rates in the middle market lending are stronger than those seen in large company lending.

Whilst Australian data on default and recovery rates is not available, a reasonable proxy for default rates of Australian sub-investment grade equivalent corporate loans is the S&P average probability of default data for the US leveraged loans asset class. The data illustrates that, on average, lenders should expect that approximately 2.0% per annum of their portfolio will experience a default across credit cycles.

A secured lender can usually demand immediate repayment of the loan and enforce its security if a borrower defaults. Security enforcement involves appointing a receiver as an agent of the lender to dispose of the secured assets and pay the proceeds to the holder of the security interest to extinguish the secured debt. The typical recovery rate for middle market borrowers in the US is 77%, whereas for large companies it is 69%. Comparatively, the average recovery rate of US corporate bonds is approximately 39%, reflecting the importance of security, seniority and structural protections that loans can provide over bonds.

In a typical lending cycle, the market expected annualised portfolio loss for middle market corporate loans can be estimated to be approximately 0.5% of annual return (being 2.0% probability of default x (1-77% recovery rate)). In a severe market downturn, such as those experienced during the GFC, the default rate in US leveraged loans peaked briefly at approximately 8.4%, with the average default rate through the 4-year GFC cycle of approximately 4.0%.

Applying this data to the Australian context, would see the expected annualised portfolio loss for middle market corporate loans during a downturn increase to an average of approximately 0.9% of annual return (being 4.0% probability of default x (1-77% recovery rate)).

Lack of Intermediation provides stronger economics

The impact of intermediaries on any given lending market varies. However, there are two dynamics which tend to perpetuate through the involvement of intermediaries: i) a capture of part of the economics, meaning the end lender receives a lower return for their risk, and ii) a standardisation of terms, resulting from intermediaries using precedents to justify more favourable loan structures and terms for their customers.

Brokers are prevalent through consumer lending, SME lending and property lending. For larger borrowers, investment banks tend to intermediate by arranging and underwriting syndicated loans.

Across both forms of intermediation, there is a questionable long-term alignment of interest with the borrower, as remuneration is typically taken on an upfront basis, and very rarely do intermediaries provide a material proportion of the loan capital required, with investment banks typically selling down their full underwritten position.

Within the middle market in Australia, intermediaries are far less common. Therefore, those direct lenders that have long tenure in the market and strong relationships with sponsors and company owners, will source a greater number of lending opportunities and ultimately, can be highly selective in considering the risk-return equation when assessing intermediated lending opportunities.

Direct Lending is superior to syndicated lending strategies

Compared to broadly syndicated loans, directly originated middle market loans in Australia provide the potential for higher returns, greater influence over loan structure, terms and conditions, and better control through any work-out or restructuring scenario as summarised below:

	Typical Australian Corporate Leveraged Loan Features	
	Bilateral Loans	**Syndicated Loans**
Loan sizes	<$100 million	>$100 million
No. of Lenders	Single borrower and single lender	Multiple lenders will form a 'syndicate' and collectively lend funds to a single borrower
Borrower type	Diversified private companies and smaller listed companies; Sub-investment grade	Diversified larger companies (public & private); Investment and sub-investment grade
Maturity	Up to 5 years	Up to 5 years
Liquidity	Intended to be held to maturity	Intended to be held to maturity
Fees and returns	**Highest return:** All loan economics captured; credit spreads higher given risk premium required for size	**Lower:** Skim by underwriters / arrangers on fees; credit spreads lower given greater depth of credit providers
Sourcing	Directly from private equity sponsors, owner/operators of middle market companies	Reliant on banking syndication desks
Ability to due diligence and relationship with borrower	**High:** Lender determines requirements (and shapes sponsor diligence in most cases); full access to sponsor and management with company visits	**Lower:** Relationship held by underwriter and agent bank; reliant on underwriter / arranger credit process; information flow restricted
Input into loan structure, terms and conditions	**High:** Lender determines appropriate structure; terms are bespoke to lender requirements with robust covenant packages	**Lower:** Required to accept underwritten / arranger deal with a greater degree of standardisation of terms; compete against others for hold level
Ongoing monitoring and information flow	**High:** Receive monthly accounts, regular contact and company visits	**Lower:** Company contact facilitated by agent bank
Ability to control work-out or restructuring process	**High:** No issues linked to majority / unanimous consent requirements when negotiating documentation amendments	**Lower:** Syndicate members typically have very different appetites through work-outs and vary greatly in process protocols and speed to action

Whilst offshore, a syndicated lending fund strategy is typically seen as complimentary to allocating to a direct lending strategy, the benefits of syndicated lending in Australia are not comparable to the US and European markets. The most material differential is seen in liquidity. In the US and Europe, investment banks provide secondary loan pricings on an over-the-counter basis on hundreds of loans, resulting in a market which is reasonably liquid and active. In Australia, the secondary pricing markets on offer are extremely scarce, meaning managers of syndicated loans cannot readily trade.

Key Considerations for Direct Lending Manager Selection

As a private market investment strategy, direct lenders operate in opaque market segments with few industry standard terms and notable differences in manager net return expectations depending on the quality of the team, their strategy focus (including the portfolio composition and loan product type), and their fee structure.

Higher returns correlate with higher risks – it really is that simple

To put it bluntly, in Australia, performing middle market companies undertaking sensible transactions do not need to pay double digit returns in order to obtain a vanilla senior acquisition financing loan. Funds targeting double digit returns are focused on a riskier segment of borrowers or transactions. They are giving up terms or conditions, lending to loss making companies or have a portfolio composition with higher loan leverage and/or a greater skew of subordinated loans. Understanding the risk-return trade-offs is vital in terms of your portfolio allocation as a return of 10%+ is likely to be more alternative in nature than fixed income. The return is also likely to comprise of a greater portion of accrued (payment-in-kind) interest or equity upside, than regular cash paid interest and fees. Inevitably this will mean a higher probability of default in the portfolio and lower recovery in the event of a default.

Relationships and reputation matter

Middle Market Direct Lending is a relationship business. Unlike real estate lending and SME lending, it is not a heavily intermediated market. Managers require strong proprietary origination networks and broad industry contacts to ensure they provide their investors with access to the broadest and most compelling lending opportunities.

Bilateral, cash flow lending skill set required

Middle Market Direct Lenders are required to be corporate cash-flow lending specialists. It is essential that Managers have the expertise to directly originate, evaluate, structure and manage bilateral loans, including strong experience in implementing turnaround and restructuring strategies to avoid loan losses in stressed and distressed scenarios.

Local industry knowledge

A strong local knowledge base on specific industry dynamics, regulations, market players, management teams' expertise, PE sponsor expertise and company growth evolution are essential. This breadth of experience provides critical perspectives and a distinct advantage in screening new lending opportunities, undertaking detailed due diligence and risk assessment, structuring and risk mitigation on transactions.

Team track record

Managers should be able to demonstrate a track record of working together as a cohesive unit as middle market loan originators and also as investment decision makers. Ideally, the team will have a complementary skill sets across lending origination and execution, private equity, and loan funds management. Managers should also be able to demonstrate the ability to manage private credit asset portfolios through a range of market conditions including credit cycles such as the GFC.

Alignment of interest on compensation with fee transparency

Managers should be able to demonstrate that they are aligned with investors on long-term performance. Globally, the vast majority of direct lending funds achieve this by optimising their mix of remuneration across management and performance fees, whilst ensuring performance fee payments occurs once portfolios demonstrate a return of capital to investors. Best practice also suggests it is very rare for fund managers to retain upfront lending fees, whilst also charging investors management fees ('double-dipping').

Quality of investment platform and fund structure

Investors do not get paid for taking operational risk. In order to focus on investment outcomes, Managers should demonstrate partnerships with reputable service providers across all facets of the fund offering, including: loans administration, fund administration, Trustee and Custodian. The Manager's platform should be institutional grade.

Ability to manage problem loans

As middle market lenders provide predominantly senior secured loans, protections afforded by the seniority of loans in the borrower's capital structure, security taken over borrower assets, covenants, and diversification of loan portfolios can assist in mitigating the risk of loss of capital. However, it is also critical that managers have a proven ability to work with underperforming borrowers to protect capital invested.

No Private Equity conflicts

As the European and US markets developed, a number of fund managers sought to participate across both private equity and private credit. In the earlier stages of development such as those currently faced in Australia, this presented real challenges in managing conflicts.

What does Middle Market Direct Lending Provide Investors?

Allocating to Australian middle market direct lending may assist investors in solving the challenges of generating consistent cash yield, with capital preservation and low-volatility, as well as low-correlated returns. Middle market direct lending delivers a diversified risk-adjusted return to complement part of an investor's portfolio that is defensive and designed to generate stable and consistent income.

Attractive, defensive, regular cash income

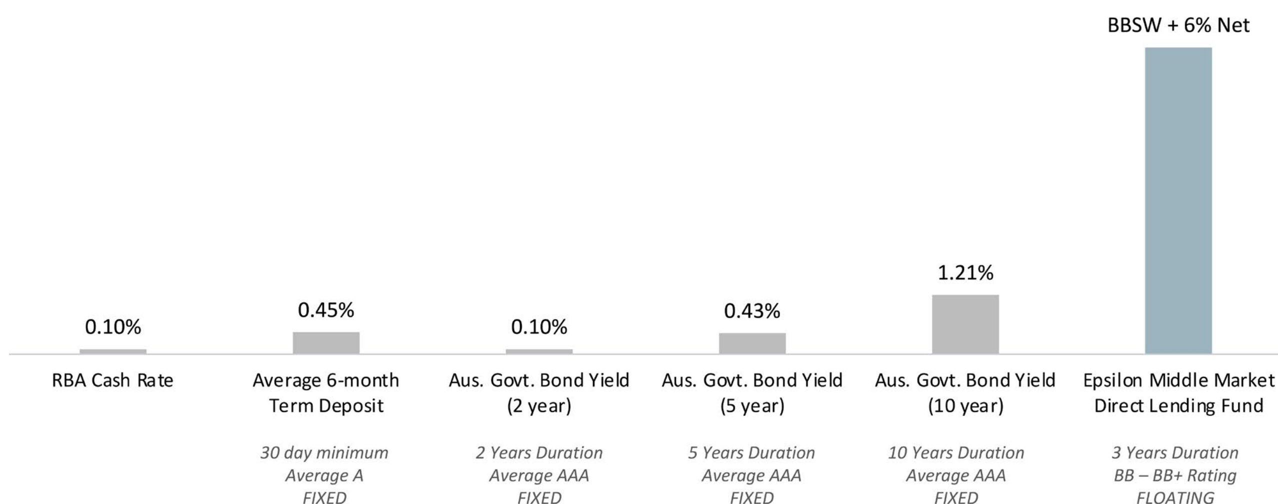
Middle market direct lending delivers investors with predicable, recurring income from upfront borrower fees (or establishment fees) and cash interest payments (typically paid quarterly) which are enshrined by contractual undertakings between the borrower and lender for the entirety of the loan.

A previously mentioned, a distinctive feature of middle market direct lending is that loan terms are private and idiosyncratic, and as such, there is no readily observable benchmark. Australian based direct lenders targeting performing profitable companies with a predominantly senior loan focus, will typically target mid-to-high single digit net returns to investors across cycles.

The strategy is seen as a defensive asset class as investors can benefit from rising interest rate markets given that loans are typically based on floating rate terms, and have some protection in declining interest rate markets as most direct lenders will often have a floor on base rates. Additionally, the interest rate margin may be increased or decreased by certain triggers, such as changes in the borrower's profitability or its total leverage position through the life of the loan. Lenders may also charge ancillary fees throughout the life of the loan for amendments to loan facilities.

Quality substitute or complement for traditional fixed income investments

Middle market direct lending can be a source of additional yield without assuming significantly more risk. In an environment that is dominated by very low (and in some instances, even negative) interest rates and inflated asset prices with generally compressed risk premiums, middle market direct lending provides investors access to a regular source of AUD cash income typically paid on a quarterly basis that more than compensates for some additional liquidity and credit risk.



Source: Bloomberg, ABS (4 February 2021) and Epsilon Direct Lending

As can be seen above, the graph highlights the challenge faced by investors in generating sufficient positive real returns from traditional fixed income investments that are expected to sustain for a number of years to come.

Diversification into investment opportunities typically unavailable to most investors

Private credit can be an attractive asset class for investors, seeking targeted exposure to various strategies, sectors or investment opportunities each delivering differentiated risk-adjusted returns. Investors have the scope to build out private credit portfolios in the same way they would in other asset classes such as equities, whereby, depending on an investor's risk profile, a portfolio can be structured to provide higher or lower expected returns based on a lower or higher risk profile of the underlying strategy being allocated to.

Middle market direct lending is an unsaturated private credit strategy that has only recently emerged in the evolving Australian corporate loan market. The strategy aims to deliver investors the opportunity to further diversify their portfolios into investment opportunities that they typically cannot access themselves – specifically, individually structured and documented, primarily senior bilateral loans to high quality, credit-worthy middle market companies, which require capital for growth and event-driven purposes.

Low correlation to other private credit, public market and fixed income investments

Given that middle market loans are individually structured and documented with idiosyncratic terms and conditions, investment returns and risks are highly transaction-specific rather than market-related, and this therefore provides a different risk profile to other private credit investments, public market investments and traditional fixed income investments.

The addition of a middle market direct lending strategy to a portfolio can be complementary, and not necessarily seen as a replacement for existing private credit allocations.

Additionally, middle market loans typically have an average life of just over three years, which is considerably less than other alternative and private market investments. With loan amortisation a common feature, the opportunity for redemptions can also be present after initial ramp up.

Low volatility of returns

The key risk faced by investors allocating to a direct lending strategy is credit risk. Credit risk is typically expressed using two key data points – Probability of Default and Loss Given Default. S&P has tracked both statistics for this strategy in offshore markets over a broad time horizon which allows investors to make a reasonable assessment of the potential cost of credit risk when allocating to this strategy, unlike SME, special situations or real estate lending. As previously outlined, over the past 30 years, the expected loss for an average middle market senior secured loan is around 0.5% p.a. based on an average default rate of around 2% p.a. and a 77% recovery rate for middle market senior secured leveraged loans.

In the current low interest rate environment, defaults are not typically triggered by a borrower's inability to pay interest as it falls due. It is commonplace for other structural loan protections to trigger a default well ahead of any failure to pay interest. Furthermore, the Australian regulatory and legal framework provides a high level of lender protection, which when coupled with heavily negotiated loan documentation, provides a broad range of remedies for lenders to manage non-performing loans. The combination of low rates and very low expected credit losses further demonstrates the defensiveness of the strategy.

About Epsilon Direct Lending

Epsilon is a non-bank lender and private market asset manager specialising in middle market direct lending, providing bespoke financing to high quality, resilient Australian and New Zealand middle market companies. Epsilon was established in 2019, by Mick Wright-Smith, Joe Millward and Paul Nagy as a purpose-driven and customer-focussed firm.

Epsilon is currently seeking commitments for its $500 million Epsilon Direct Lending Fund, an Australian-domiciled open-ended unregistered unit trust, focused on lending to high quality middle market Australian and New Zealand companies for growth and event-driven purposes.

Epsilon's aim is to support the growth of middle market companies with financing solutions, while delivering stable returns for investors, in all cases operating with the highest levels of integrity, reliability, and transparency.

Epsilon has offices in Melbourne and Sydney, Australia.

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