EXPERT Q&A

Developed APAC

Shane Forster and Justin Hooley, Asia-Pacific portfolio managers at Barings, explain why this segment of the direct lending market offers a compelling growth story

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Q How has APAC direct lending evolved over the last decade, and what are the key drivers and dynamics behind the growth?

Shane Forster: The Asia-Pacific direct lending landscape has undergone considerable transformation, particularly over the last four or five years. This evolution is due partly to the overall growth of the APAC middle market, which has accelerated the funding needs of APAC-based businesses. At the same time, banks – the traditional source of middle market funding – have been tightening their lending criteria and scaling back, similar to what we have seen in the US and Europe. As a result, a new wave of institutional lenders has stepped in to fill the gap.

Justin Hooley: Historically, funds in APAC looked primarily at special situations and opportunistic credit. Over the last few years, as more international private equity (PE) sponsors have entered the market, this has shifted toward traditional senior direct lending.

In many cases, these sponsors have experience in the US and European direct lending markets and are looking for the familiar benefits – like more flexible structures, and speed and certainty of execution – that non-banks can offer.

Q Where do you see the most value, and are there any areas where you don't invest?

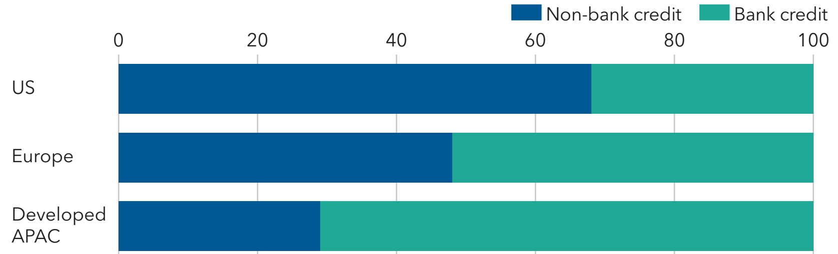
JH: We focus on developed APAC, primarily Australia, New Zealand, Singapore and Hong Kong. These economies exhibit similar risk-and-return profiles as what we would expect to see from a core direct-lending strategy in the US and Europe, with the added benefit of diversification and access to a compelling global growth opportunity. Importantly, the regulations and bankruptcy laws in these countries are comparable to those in other developed markets.

For this reason, we have confidence in the ability of senior secured lenders to engage in enforcement proceedings that are reliable and transparent. Additionally, the sovereign credit ratings in these regions are similar to, and in some cases better than, those in the US and Europe.

SF: We do not invest directly in emerging economies like China, India and Indonesia. By focusing on developed

economies, we're able to gain indirect exposure to the economic growth potential of the broader region with less idiosyncratic jurisdictional risk. Ultimately, as of 30 June 2024, this conservative approach, among other factors, has led to zero losses across senior investments made in developed APAC since we began in 2011.

Developed APAC non-bank lending share has room to grow (%)



Source: Bank of International Settlements. As of March 31, 2024. Developed APAC – Australia, New Zealand, Hong Kong, Singapore, Korea, Japan

Q What are the other key characteristics of the developed APAC market, and how do those compare to the US and Europe?

SF: The developed APAC direct lending market is still relatively nascent compared to the US and Europe, but it offers similar risk and return characteristics. Because these regions are smaller in size and less developed from a capital markets perspective, while the companies have similar EBITDA profiles ($15 million-$100+ million), they tend to be first or second in their fields and have dominant market share.

Leverage levels are generally consistent with the US and European markets, if not slightly lower in some cases. Pricing also tends to be less volatile.

Finally, documentation is relatively conservative. Maintenance covenants and other structural protections exist in almost all middle market transactions.

JH: Middle market companies in developed APAC have remained largely healthy, particularly in the sectors where we concentrate. Defensive sectors like education and healthcare have fared particularly well, with companies exhibiting consistent corporate profits and strong interest coverage. Companies in these sectors also tend to have higher cashflows and lower capital expenditures, and demand tends to be less discretionary or price sensitive and therefore less impacted by changing economic conditions.

Q What makes the opportunity in developed APAC so compelling for investors today?

SF: The current opportunity in APAC direct lending is rooted in the region's growth story. In addition to benefitting from strong economic growth historically, demand for non-bank financing is strong, particularly in Australia and New Zealand, on the back of increased private equity activity from international and local PE sponsors. Hong Kong and Singapore are in their earlier stages of growth in terms of private debt markets but offer significant runway for development.

JH: The increase in non-bank lenders has also helped expand the breadth and depth of the direct lending market. Prior to the market's growth both in size and number of deals, it arguably wasn't deep enough to build standalone diversified portfolios.

But the landscape has evolved, and managers are also better positioned to present PE sponsors with more viable solutions, and to more meaningfully fill the gap left by banks.

Investors' appetite for direct lending has also increased. As the narrative and understanding around these markets continues to grow, particularly among overseas sponsors and investors, we think the opportunity will persist.

Q What should investors look for in a manager when considering APAC private credit?

SF: It is important for investors to partner with managers that have a strong track record and history of successfully navigating the complexities of the APAC private credit market.

Deep, local expertise is also important. The APAC region is diverse, and managers with a thorough understanding of each market's unique dynamics and regulatory environment will be well positioned.

JH: Strong and longstanding relationships with local borrowers and intermediaries are essential. Today, many of the top PE firms prefer to work with fewer lenders, often only with one or two. The ability to underwrite and structure an entire transaction is key.

In some cases, smaller or less experienced lenders may miss out on deals, especially those that are higher-quality and involve tier-one assets and sponsors, which can have significant implications for portfolio performance.

Increasingly, managers are also being asked how they handle workouts and maintain origination while navigating challenges. We have also seen a few cross-jurisdictional restructurings, in which APAC managers needed to have insight into situations unfolding in the US or Europe. A large, global presence can make a big difference when it comes to managing these scenarios.

Ultimately, managers that can provide tailored solutions which support companies' long-term growth trajectories – even as financing needs evolve and change – are in a good position to serve as strategic partners to sponsors and source the most attractive opportunities for investors. ■