

Presentation on:

European Direct Lending

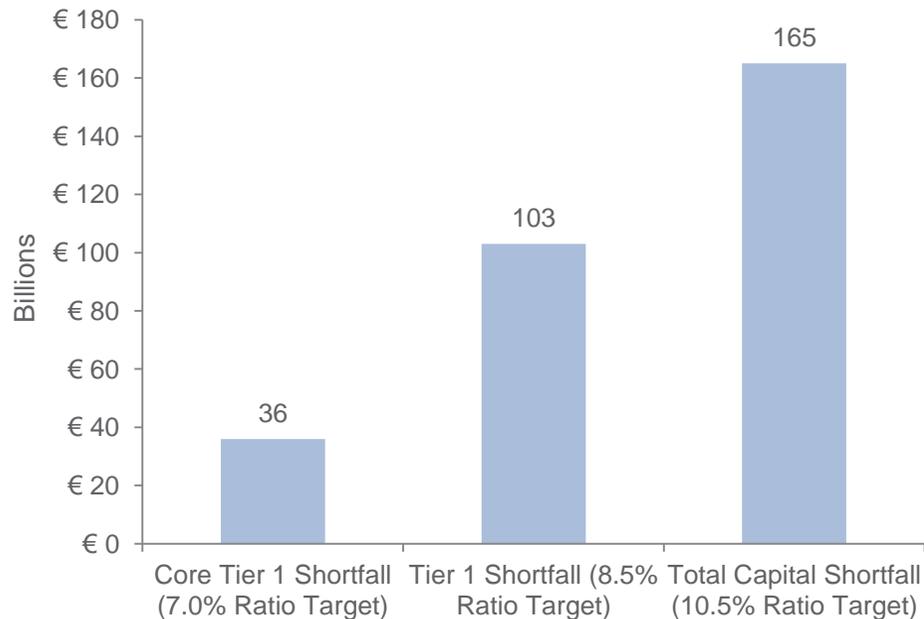


May 2014

Macro-Economic Context: Supply of Capital

Regulations Encourage Banks to Focus on Balance Sheet Size and Composition

Estimated Basel III Compliance Capital Shortfalls¹



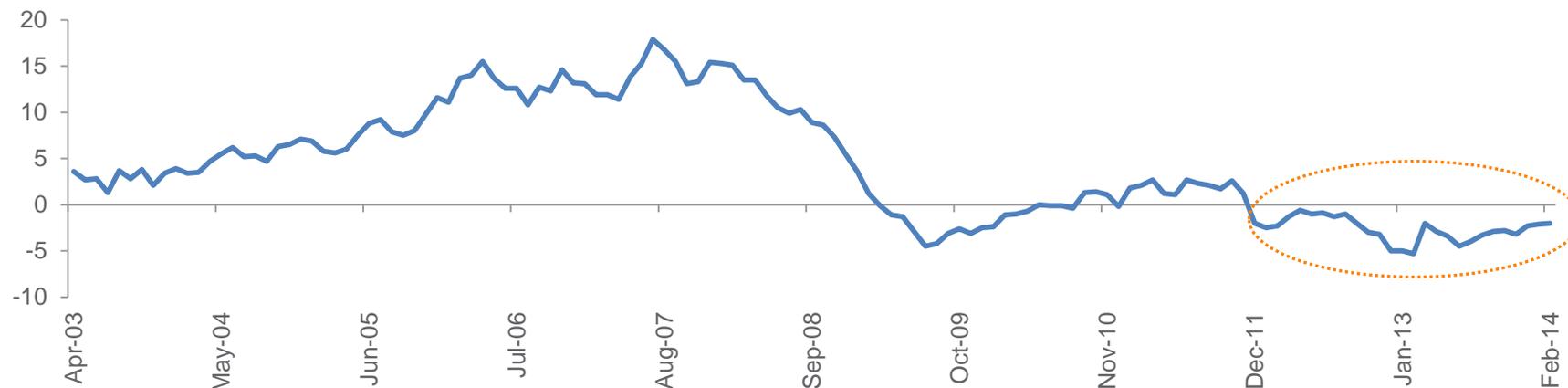
- Banks are under pressure from international and national regulators to meet higher capital ratios and reduce balance sheet risk
- European Banks are far from having deleveraged to the extent required by regulators
- Deleveraging in the European Banking sector is expected to take 5-7 years²
- Based on a conservative estimate banks have a shortfall of liquid assets of €262 billion¹

Retrenchment from lending by Banks creates new opportunities for non-banks lenders

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Banks Lending Cautiously and Reducing Emphasis on Non-Core Activities

Loans to Non-Financial Corporations across the EU¹



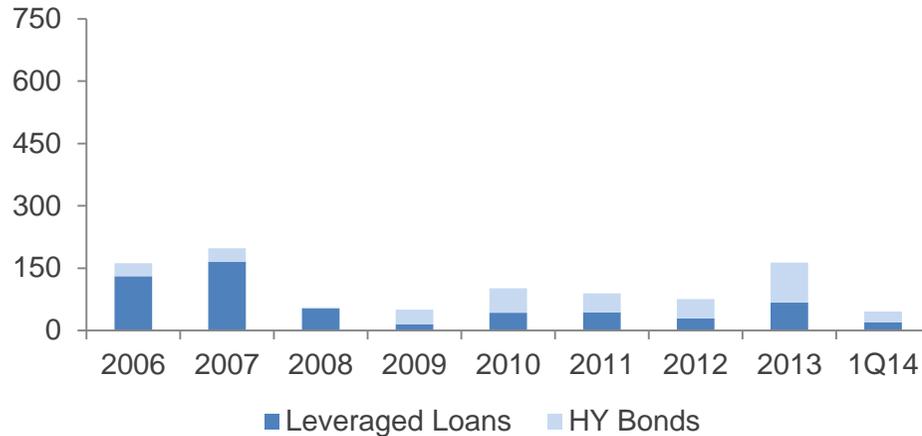
- Faced with regulations and volatile market conditions, Banks are favouring traditional retail and larger corporate credit
- Bank preference towards financing larger publicly traded companies stems from the following:
 - Significant underwriting fees
 - Ancillary business
 - Credit risk is more standardised and typically easier to assess for listed companies

Direct lenders could fill the financing gap left by Banks

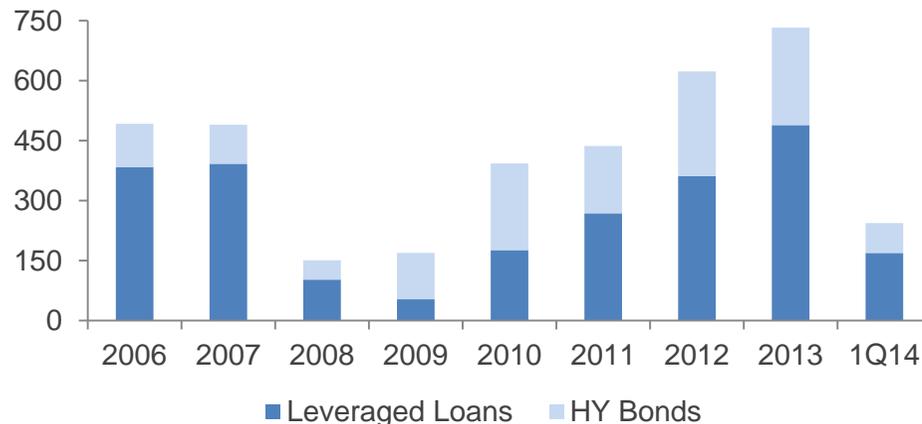
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Lack of Alternative Non-Bank Sources of Financing

European Leveraged New Issuance¹



US Leveraged New Issuance¹



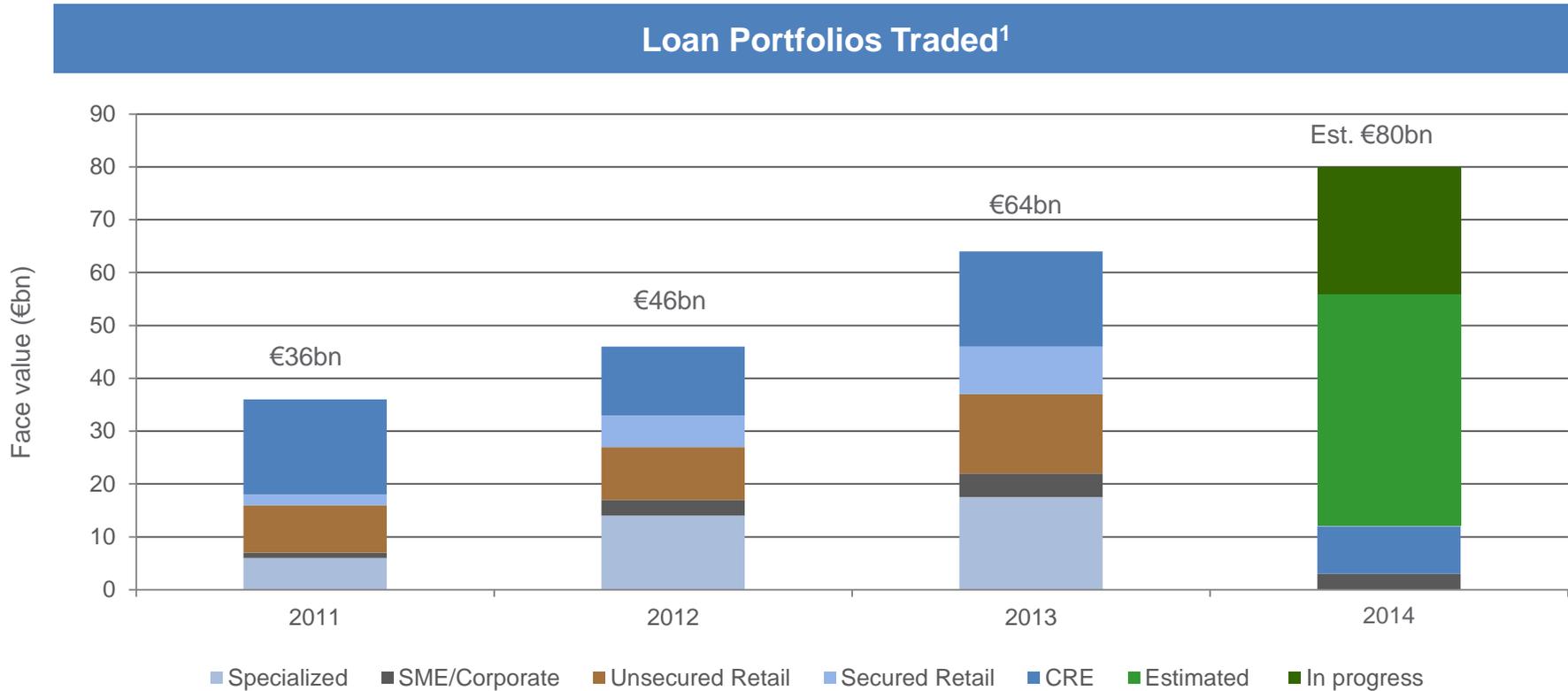
- The high-yield sector in Europe has historically been much smaller than in the US (\$232.5bn² versus \$1,050bn³)

- Institutional leveraged loan new issuance volumes in Europe have declined sharply from pre-crisis levels

- Compounding this, in Europe (unlike in the US) there are no BDCs and only a limited number of private investors

The shortage of capital faced by European companies is further exacerbated

€64bn of loan portfolios traded in 2013¹

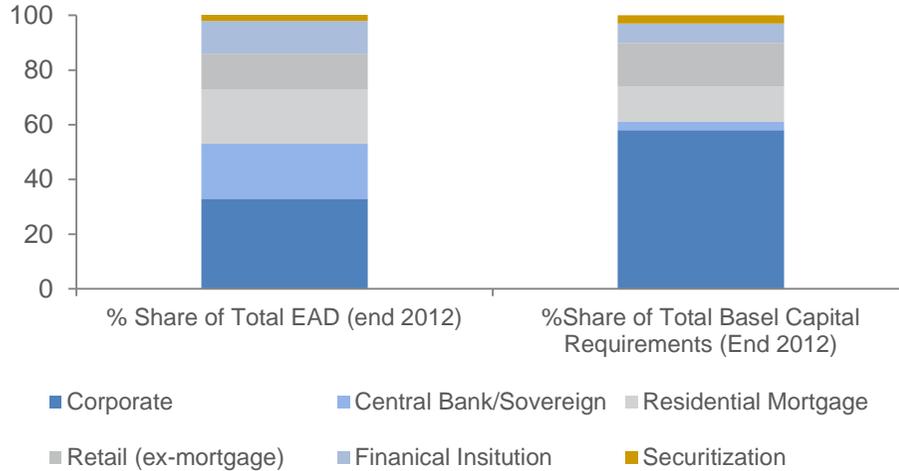


CRE and unsecured retail remain the most actively traded asset class

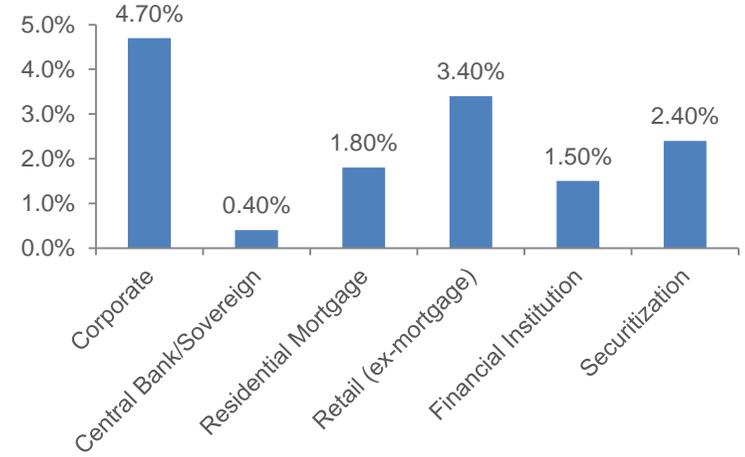
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Banks Are Re-Allocating Across Balance Sheets Ahead of Basel III¹

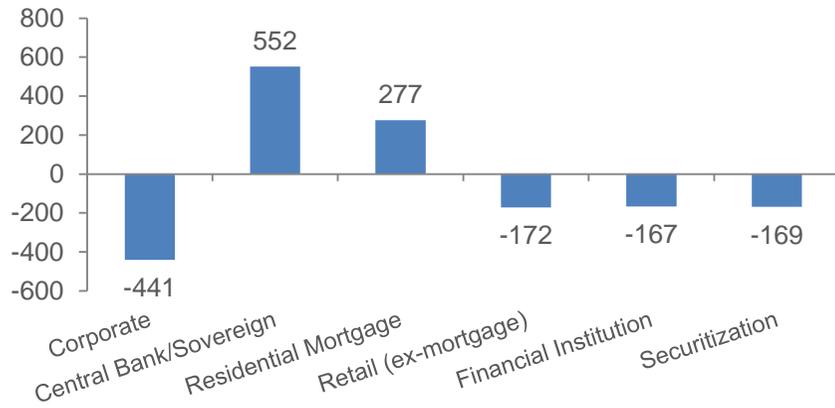
Loan Portfolios Traded



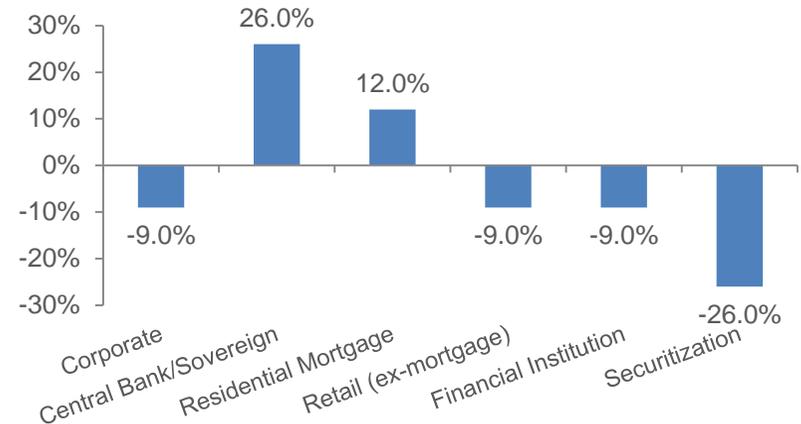
Average Basel Capital Requirement²



EAD, EUR Bil. Change Since 2010



EAD, % Change Since 2010



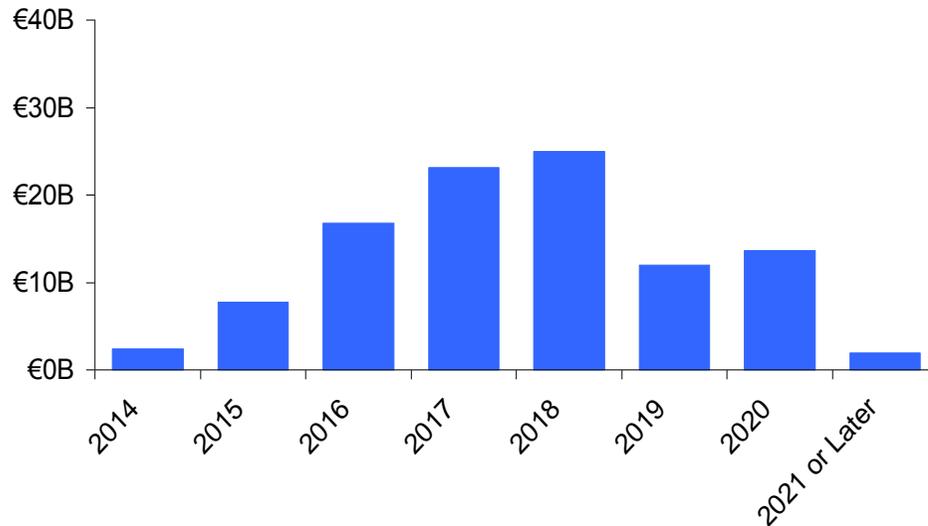
¹Fitch Ratings, December 6, 2013. ²As % of EAD, End 2012

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Macro-Economic Context: Demand for Capital

European Corporates Refinancing Needs Set to Increase

Institutional Leveraged Loan Maturity Wall¹



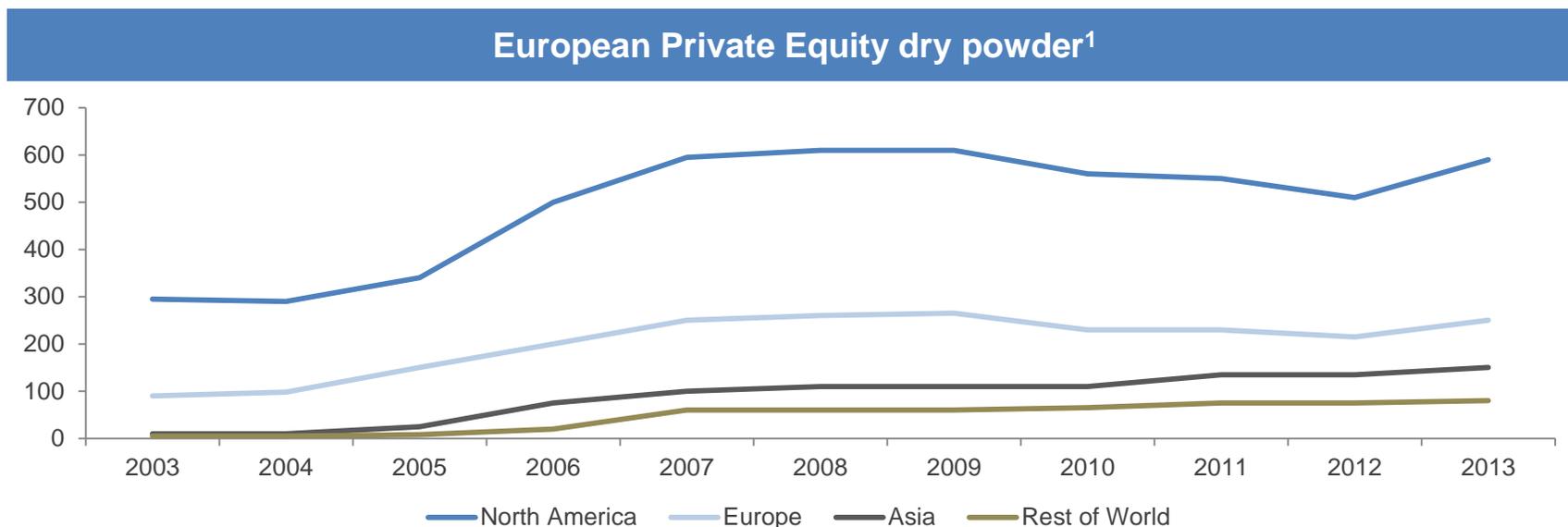
- The recent crisis and economic uncertainty have adversely affected refinancing plans of many corporate borrowers
- As a result, a number of pre-2009 LBOs, supported by debt maturing in 2016-2018, are now facing a so-called "Maturity Wall"
- The maturity peak for institutional European leveraged debt is currently expected to fall in 2018
- In Europe, corporate borrowers have much greater refinancing requirements than the public market is currently capable of absorbing

Direct lenders can help businesses refinance maturing debt or restructure

Please see important disclosures at the end of this presentation.

¹LCD European High-Yield Weekly Review, April 18, 2014

Private Equity Dry Powder in Europe Remains High¹



- The amount of capital committed to Private Equity Funds available for investment remains high (just over \$200bn)¹
- As funds move closer towards the end of their investment periods, Fund Managers are keen to find viable investments and deploy remaining capital in the next few years
- The willingness of Private Equity Managers to invest creates opportunities for direct lenders to be brought in as lead debt arrangers

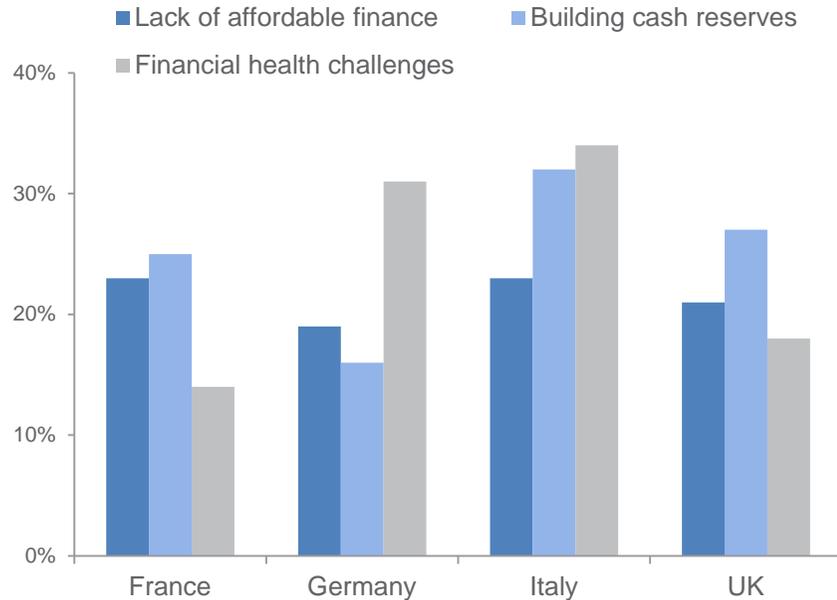
Fund managers keen to invest on the equity side are driving demand for debt

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¹Preqin Global Private Equity Report, 2013

Shortage of Capital Compounded for Middle Market Companies

Financial Obstacles¹



- 60-80% of SMEs in Europe are financed via the banking sector (versus 40-55% in US)
- High yield bond market in Europe is often difficult or impossible to access for middle market companies given an average issue size of €180mm
- Middle market companies typically require flexible lending solutions that are unavailable through public markets
- Euro area SMEs report in net terms an increase in their need for bank loans and a deterioration in the availability of bank loans²
- ECB survey results point to increased rejection rates for euro area SMEs when applying for a loan (12%)²
- The percentage of SMEs reporting access to finance as their main problem remains broadly stable (at 16%)²

Scarcity of alternative sources of capital allow private investors to negotiate better loan terms

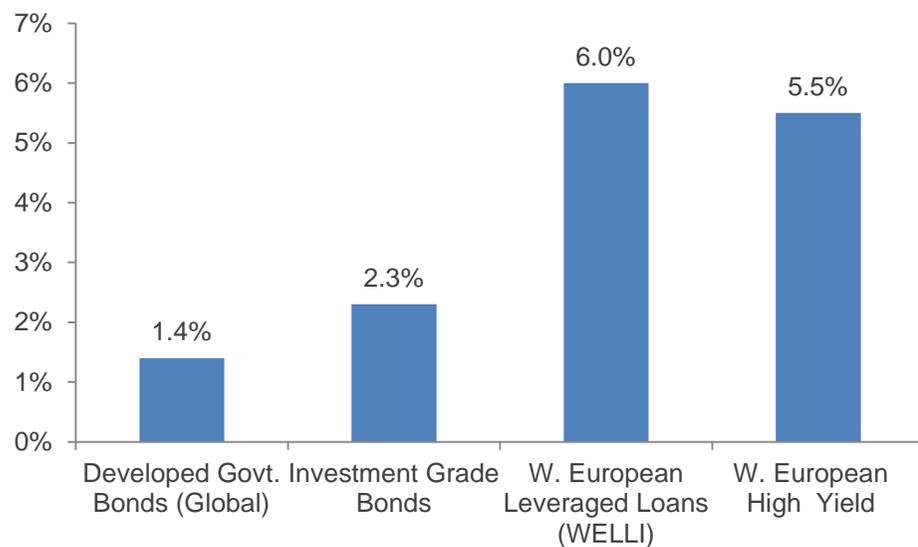
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¹European SME CAPEX Barometer”, GE Capital, June 2012. Research carried out in January 2012, and completed 1st week of February 2012. ²ECB Report on the results of the survey on the access to finance of SMEs in the euro area – April to September 2013, 14th November 2013

Opportunity: Attractive Risk-Adjusted Returns

Private Lenders Able to Access Senior Debt & Capture Illiquidity Premium

Expected Annual Returns of Various Debt Asset Classes¹



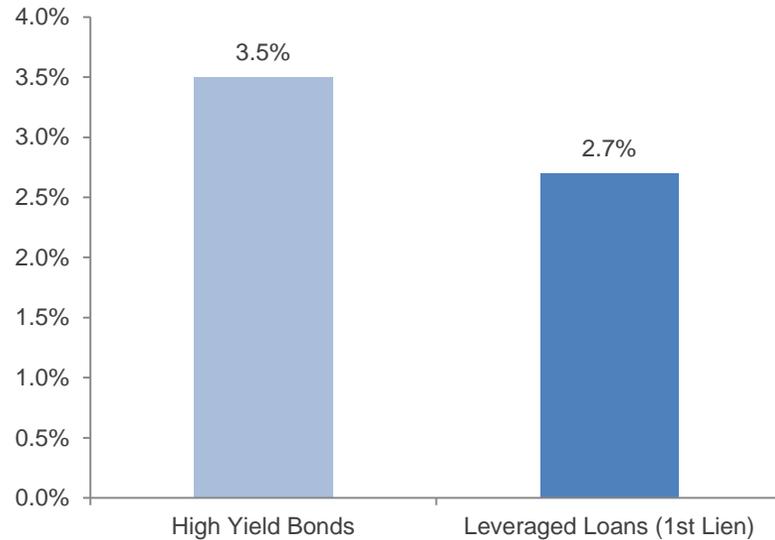
- Yields on Government and Investment Grade credit remain low due to high demand fuelled by market uncertainty and quantitative easing
- HY bonds produced a 9.1% in 2013², however 2014 results are expected to be more modest with total return predominantly income as apposed to price appreciation (vs. 2013) with increased volatility
- Scarcity of capital is forcing some middle market companies to pay a premium to their lenders
- In European Direct Lending Spreads of Mid to High Single Digits are available for Senior and Unitranche loans

Higher returns versus fixed income alternatives

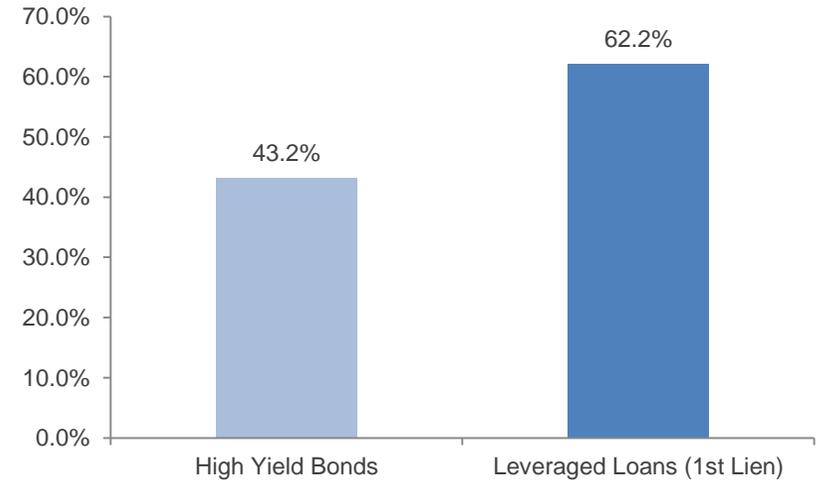
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Historically, Loan Default Rates are Lower & Recovery Rates Higher Than High-Yield¹

Default Rates



Recovery Rates



- First lien loans have experienced lower default rates compared to peer asset classes due to a lower risk profile of senior secured loans
- In the event of default, first lien loan investors are the first to be repaid and can request asset liquidation to generate the cash required
- The retraction of banks from middle market financing created an opportunity for private investors to tap into the safer senior loan market traditionally dominated by Banks

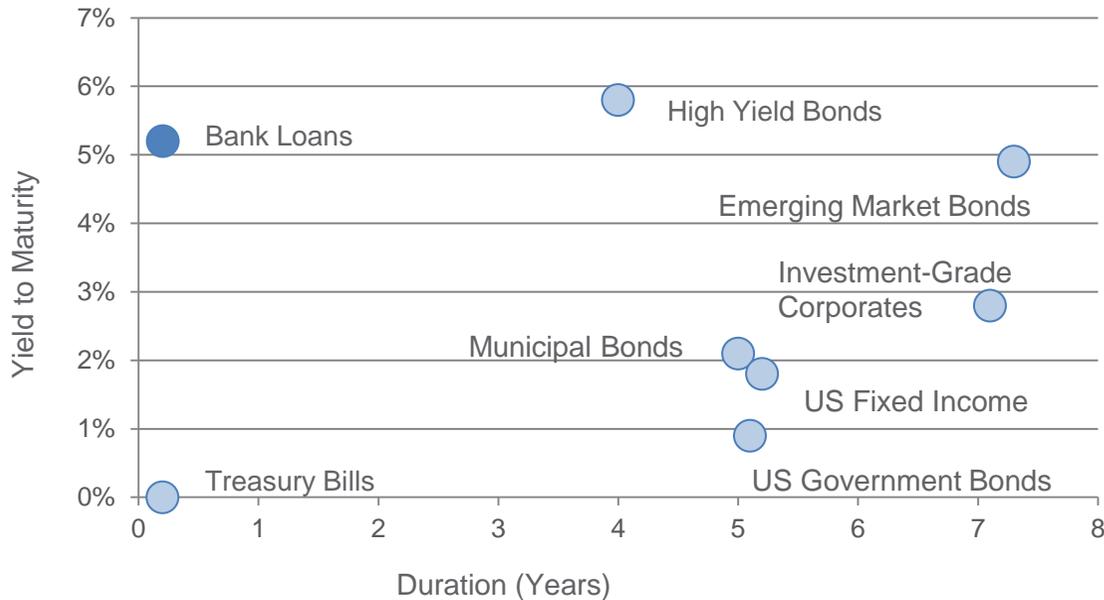
Greater protection in the event of default

¹Credit Suisse (8 April 2014) 1995- March 2014

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Floating Rate Nature of Loans Mitigates Impact of Rising Rates¹

Duration and YTM across Fixed Income Investments (March 2013)



- Empirical evidence suggests that senior loans act as a natural hedge in a rising interest rate environment
- The interest rate on senior loans typically resets regularly resulting in minimal duration risk
- Senior secured loans offer a compelling investment opportunity during flat and rising interest rate markets relative to other fixed income investments

The floating rate nature of loans mitigates interest rate risk

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¹<http://www2.blackrock.com/us/individual-investors/insight-education/featured-insight/point-of-view-with-james-keenan>

European Direct Lending Investments

Investment Characteristics: Geography, Type, Size

- Northern European countries, including the UK, are in Alcentra's opinion favorable jurisdictions for investment
- Companies with strong growth prospects in defensive sectors with no sector greater than 25% of commitments
- Middle market businesses with Enterprise Value less than £500m
- Approx. €5m – €40m lending amount per investment



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Investment Characteristics: Returns, Protection, Approach

Available Returns¹

- Senior debt returns in the range L+5-6%; leverage \leq 4x EBITDA
- Uni-tranche returns in the range L+8-12%; leverage \leq 5x – 6x EBITDA
- Mezzanine returns in the range L+12-20%; leverage \leq 5x – 6x EBITDA
- Transaction fees of 4% typical on current European investments

Protection

- Direct influence over company decisions during the life of the investment
- Direct negotiations with Management Teams, owners and issuers
- Carefully prepared effective covenants with regular monthly monitoring

Flexibility & Control

- Offer financing solutions and assist with strategic company development
- Close proximity to issuer allows debt holder to act faster in challenging times
- Pro-active involvement post transaction (Board observer and voting board member positions)

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Source: Alcentra ¹No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.

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