ALTERNATE CAPITAL

Funding options for business growth and investment

KPMG

Outside of the more traditional bank and bond markets there are a broad range of **Alternate Capital** sources available for businesses to fund growth and investment.

In this report KPMG Deal Advisory spotlights three of these sources:

1 **Private Debt**

2 **Government Agencies**

3 **Structured Finance**

Wholesale funding available to nonbank lenders and challenger banks

Private Debt

KEY THEMES

Broad range of Private Debt Participants

Global asset managers, local credit funds and superannuation funds are all looking to capitalise on a range of opportunities in private debt.

Flexibility in Structures

Options for borrowers include senior and mezzanine debt, and in more recent years, unitranche structures. Asset based lending (ABL) is also becoming more prevalent in Australia.

Growing ESG Focus

Environmental, Social and Governance (ESG) considerations are playing an increasing role in private debt investment decisions, indicating a fundamental shift in attitudes.

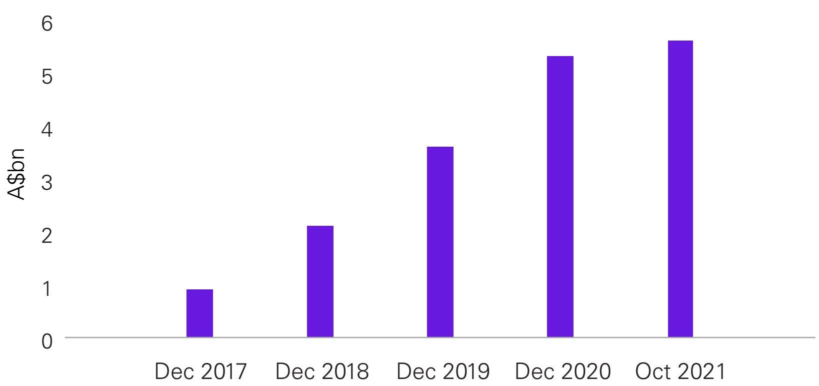
There has been significant growth and activity over recent years in the Australian private debt market. Deal volume tracked by Prequin with an element of private debt increased from $0.9bn in 2017 to $9.6bn in 2021.

Private debt first emerged as a core alternative financing option in the wake of the GFC (Global Financial Crisis) when resulting regulatory restrictions compelled large banks to reduce and redirect their lending capacities.

When Metrics Credit Partners was established back in 2011 the industry was still in its infancy. Now there are numerous local competitors and large offshore fund managers with direct lending capabilities in Australia.

Recent examples include Queensland Investment Corporation (the investment arm of the Queensland State Government) and global asset managers Schroders and Ares establishing private debt capabilities in Australia.

Total Deal Value in Australia with an element of Private Debt Financing



Source: Preqin Pro sourced 28 February 2022.
Data has been converted to Australian dollar equivalent at 1AUD=0.75USD.

Despite strong growth, private debt remains the smallest asset class within private capital assets, with private equity and real estate still making up the majority of the Australia-focused private capital assets under management (AUM)[1].

The number of private debt options for borrowers are broad though, with individual lender tickets ranging from under A$10m to more than A$200M. The cost of debt also varies significantly across transactions, based on the terms of the lending and the borrower's industry and capital structure. Higher leverage and more flexible terms naturally drive a higher cost of debt.

Select Transactions Supported by Private Debt

Borrower	Transaction	Disclosed lenders
Waste Services Group	Unitranche for acquisition by Livingbridge	Ares SSG
Guardian Early Learning Group	Unitranche for refinancing and dividend recapitalisation	Natixis, Aware Super, Barclays, ICG, Macquarie, ROC, CBA
Calibre Group	Refinancing and recapitalisation	Longreach, NAB, Nomura, PEP, Wingate
Myer	Asset based lending (ABL) facilities for refinancing	Gordon Brothers, JP Morgan
Tellus Holdings	Loan to refinance existing debt and accelerate growth	Tor Investment Management
Stanmore Resources	Loan to in part fund proposed 80 percent stake in BHP Mitsui Coal	Varde Partners, Canyon Capital Advisors, Farallon Capital

Source: Public (Borrower, lender, and legal advisor public announcements) sourced 28 February 2022.

The private debt market provides a diverse range of different loan structures and terms that can provide tailored capital solutions for borrowers.

The private debt market can provide a greater degree of flexibility than the traditional bank market. There are some features in common with bank debt, with deals often including similar security, financial covenants, and information requirements.

There are a variety of tenors available from shorter term bridging style loans through to loans with greater than five years in tenor. Some private debt is bilateral and in some cases a group of private debt and bank lenders come together to support a Borrower in the same transaction.

1. Australian Private Capital Market Overview: A Prequin and Australian Investment Council Yearbook 2021 (June 2021).

KPMG is seeing an increase in awareness and prominence of environmental, social and governance (ESG) considerations by debt investors.

A recent survey conducted by CBA and KangaNews of over 35 private debt investors highlighted that close to 80 percent of respondents said ESG has a significant or somewhat of a role in investment decisions[2].

Following a brief market drop-off in response to the COVID-19 pandemic, private debt deal volumes quickly recovered due in large part to swift central bank and government policy responses. The Australian debt market has continued to evolve throughout the pandemic and is attracting considerable attention from global investors in search of yield, ensuring a diversity of funding options and solutions for borrowers in all sectors.

For private debt, the fallout from the pandemic has not been as severe as it was after the GFC.

2. KangaNews Sustainable Finance Oct/Nov 2021 Supplement Vol 16 Issue 127.

Government Agencies

KEY THEMES

Growing financial support

Increased funding is being primarily driven by policy objectives to support Australian job creation, public benefit, emission reduction and global trade.

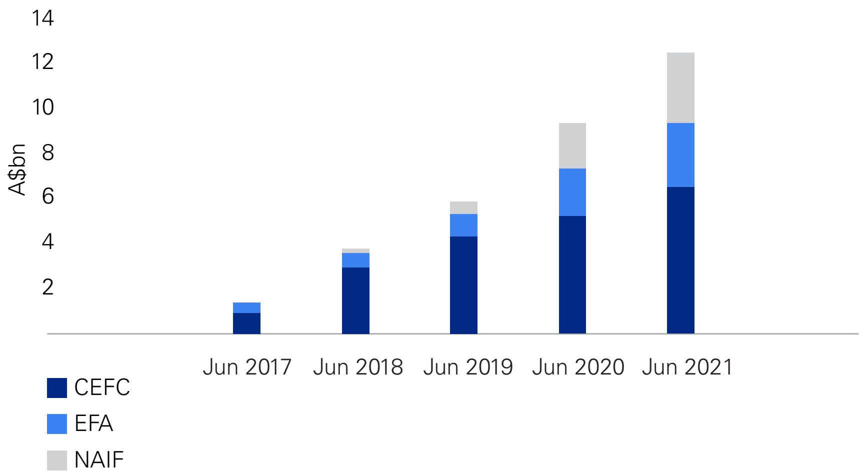
Diversity of options

The presence of several agencies with varying mandates provides borrowers a breadth of funding options that are often complementary to bank debt and private debt funding.

Australian government agencies serve as a key alternative financing option, particularly for new investment into the energy and resources sectors.

Three key Commonwealth Government Agencies, Northern Australia Infrastructure Facility (NAIF), Clean Energy Finance Corporation (CEFC) and Export Finance Australia (EFA), have collectively provided A$12.5bn in funding over the past five years. Other notable funding agencies include Infrastructure and Project Financing Agency, Australian Renewable Energy Agency (ARENA), the Regional Investment Corporation and The National Housing Finance and Investment Corporation (NHFIC).

Cumulative Capital Deployed by NAIF, CEFC & EFA



Source: NAIF, CEFC and EFA Annual Reports 2017 – 2021 sourced 17 November 2021.
Note: June-17 does not include accumulation of funding from prior years.

Northern Australia Infrastructure Facility (NAIF)

NAIF's A$5bn fund can provide concessional pricing, limited to the minimum necessary for a project to proceed. To be eligible projects must be expected to develop or enhance infrastructure and ultimately drive public and economic benefit in addition to having an Indigenous engagement strategy.

As at June 2021, NAIF's total financing commitments of A$3.1bn were forecast to generate A$16bn in economic impact and support more than 10,000 jobs. NAIF support various sectors with A$765m committed to Western Australian mining projects in FY21 alone.

- **21%** Social infrastructure
- **14%** Agriculture & Water
- **24%** Energy
- **37%** Resources
- **21%** Transport

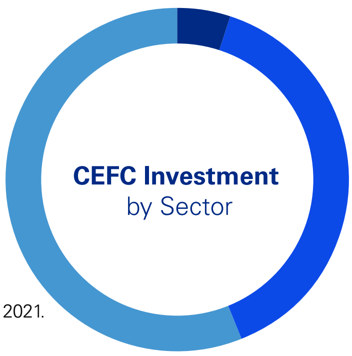
Source: NAIF Annual Report 2021 sourced 17 November 2021.

Clean Energy Finance Energy Corporation (CEFC)

The CEFC's key mandate is to accelerate Australia's transition to a low emission economy. CEFC are seeking to fill market gaps for traditional funding, whether they are driven by technology, development, or commercial challenges. CEFC's A$9.5bn of lifetime commitments (A$6.6bn in five years to June 2021) reflect a concentration towards renewable generation projects at 56 percent or A$5.3bn, which includes solar, energy storage, bioenergy, and wind.

- **5%** Low emissions technologies
- **39%** Energy efficiency
- **56%** Renewable Energy

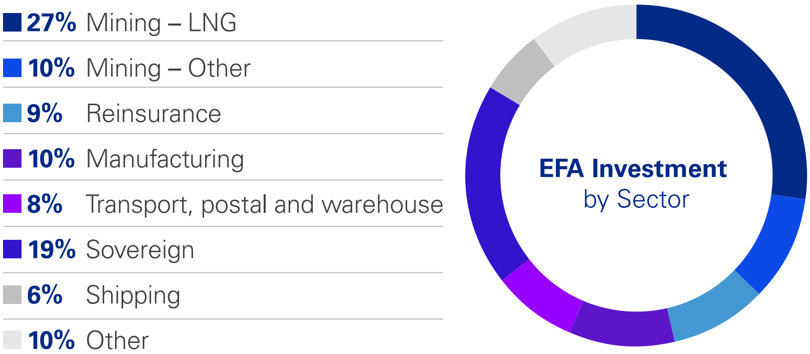
Source: CEFC Annual Report 2021 sourced 17 November 2021.



Export Finance Australia (EFA)

EFA is the Australian Government's export credit agency, providing funding for export-related opportunities and support for infrastructure development. EFA's project finance offering has a particular focus on exporters that have an annual turnover of A$150m and above, with an overarching aim to develop Australia's export supply chain and support sustainable infrastructure in the Pacific region.

EFA has committed a cumulative A$2.8bn over the five-year period ending June 2021. Like NAIF, resources-related financing represents the largest exposure, specifically for the Liquefied Natural Gas (LNG) industry.



Source: EFA Annual Reports 2021 sourced 17 November 2021.
Other includes retail trade, accommodation and food services, financial and insurance services, and sectors<A$30m.

A sample of recent transactions are summarised below.

Recent Selected Government Supported Transactions

Borrower	Project	Federal Agency	Agency Funding Amount	Total Funding	Closing Date
BCI Minerals	Salt and Potash Project	NAIF EFA	A$490m A$110m	A$910m	Oct 21
Lien Lap Wind Power JSC	Quang Tri Wind Farm	EFA	US$32m	US$173m	May 21
Northern Territory Government	Darwin Shiplift Project	NAIF	A$300m	A$400m	Nov 20
TransGrid	Grid Infrastructure for Snowy 2.0	EFA	A$125m	A$160m	Nov 20

Source: CEFC, EFA & NAIF websites, Debtwire, Company websites sourced around 28 February 2022.

Structured Finance

KEY THEMES

Private funding sources are growing

A key source of capital for emerging nonbank lenders is private credit. Private securitisation warehouses are often led by domestic and global banks, with private credit and alternative asset managers holding the mezzanine tranches.

Securitisation market tailwinds

Once nonbank lenders reach scale, the preferred option for funding is public issuance. Recent years have seen an unprecedented volume of public securisation issuance by nonbank lenders, along with continued credit spread compression.

Government support measures

The Australian Office of Financial Management (AOFM) provided structured finance market access support at the onset of the pandemic and continues to support development of greater competition in the SME lending market.

When accessing credit from nonbank lenders, SME's can borrow using alternative collateral such as vehicles, machinery, invoices, and other finance receivables. There are also unsecured SME loans available.

There are also a growing range of nonbank financing options available for consumers.

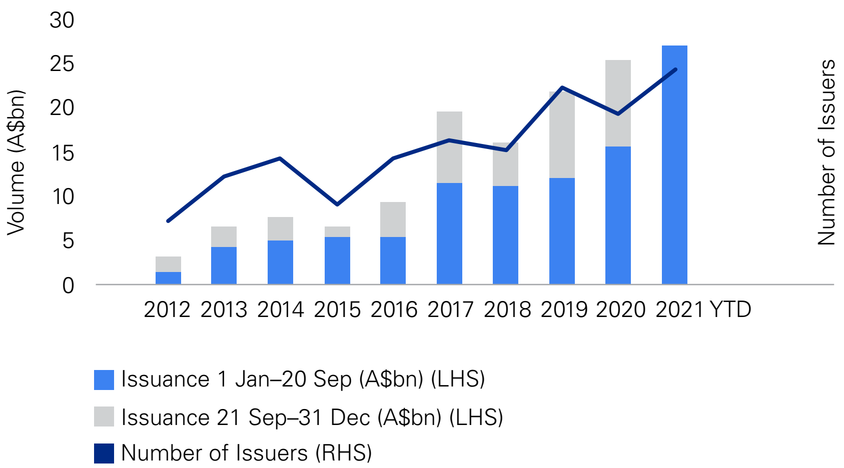
Although Australian banks remain the primary source of lending for small and medium enterprises (SMEs), more flexible and competitive options beyond traditional property-secured loans are becoming available from nonbank lenders and challenger banks.

Without the relevant APRA licence, nonbank lenders can't access deposits from the public so need to fund their businesses using a range of wholesale debt sources.

Local and global credit funds are increasingly participating in junior tranches in private warehouses and public securitisation issuances. Over the last few years, KPMG have seen an overall increase in their appetite for lending to finance companies, including a willingness to support earlier stage finance companies.

The most recent KangaNews Nonbank Yearbook highlighted that Australian dollar securitisation by nonbank issuers in calendar year 2021 from 1 January to 20 September was $26.5bn, up from $15.4bn in 2020 during the same period.

Australian Dollar Securitisation by Nonbank Issuers



Sourcee: KangaNews Nonbank Yearbook Oct/Nov 2021 Supplement Vol 16 Issue 127 sourced 17 November 2021.

While the issuance volume is dominated by nonbank RMBS, there were 24 different nonbank entities bringing transactions to the market in the period to 21 September 2021, an annual record, and a fourfold increase on the post-crisis low from a decade previously[3].

The nonbank mortgage lenders are also finding ways to diversify funding, including La Trobe Financial's retail fund and Liberty's unsecured bond programme.

As recently as late 2020, new triple-A rated prime RMBS was pricing in the low-to-mid 100s basis points over bank bills, in line with the prior half decade. During 2021 this fell, in some instances, below 70 basis points.

Lack of competing supply has been one factor, with Australian big-four bank domestic issuance at historic lows. This spread compression has also benefitted non-RMBS issuers across a much broader range of nonbank lending businesses, including SME equipment financing receivables, consumer green loan receivables, general unsecured personal loan receivables and auto backed loans.

Spread compression is lowering cost of funding for nonbank lenders.

3. KangaNews Nonbank Yearbook Oct/Nov 2021 Supplement Vol 16 Issue 127.

During the pandemic the Australian Office of Financial Management (AOFM) established the Structured Finance Support Fund (SFSF).

The SFSF is a $15bn investment fund established to support lenders who were at risk of losing market access during the pandemic[4]. The SFSF operated across 1) private markets (or warehouses), 2) public markets and 3) the Forbearance Special Purpose Vehicle (fSPV) extending credit to nonbank lenders against loans that had been put into forbearance arrangements.

As of September 2021, private warehouse commitments stood at just over $800m, public deal investments had amortised to $825m and the fSPV balance stood at $36m. Most of the reduction is due to private warehouses restructures, where additional capital moving into the sector replaces the AOFM, particularly lower mezzanine parts of the capital structure.

The AOFM also administers the Australian Business Securitisation Fund (ABSF), a $2bn investment fund established by legislation in April 2019 with the objective of increasing the availability and reducing the cost of credit provided to SMEs.

The ABSF's first investment was a private warehouse sponsored by Judo Bank. The ABSF has stated that they interpret their mandate as primarily one of market development, with the aim of building out the market infrastructure to attract additional private sector investment.

A key element of this has been to encourage the market to coalesce around a standardised data template for the capture of loan performance on SME loans. The ABSF made two additional investments in 2021, $87.5m in a private warehouse sponsored by GetCapital and $30m in a private warehouse sponsored by OnDeck.[5]

4. ABSF/SFSF Funding Update: AFIA Webinar, 11 November 2021.
5. ABSF Update – Second investment round: AOFM website, 14 September 2021.

How KPMG can help

Our KPMG team has real time knowledge of the more traditional debt capital markets and the growing range of alternate capital sources. We advise on a wide range of transactions involving both debt and equity, including raising financing for acquisitions, buyouts, dividend recapitalisations, growth capital, special situations, debtor-in-possession and exit financing in bankruptcies.

We maintain close relationships with debt, mezzanine and equity capital providers including banks, specialty finance companies, insurance companies, superannuation funds, local and global alternative asset managers, family offices, credit and equity funds and other private investors.

Value Added Advisor

- Objective advice
- Local market insight with strong relationships across all tranches of capital
- Experienced deal team
- Flexible and innovative approach
- Fully integrated service offering
- KPMG global advisory network

Contact us

Conrad Hall
Partner
Debt Advisory
T: +61 7 3434 9105
E: conradhall@kpmg.com.au

Linda Blore
Partner
Debt Advisory
T: +61 3 8663 8333
E: lindablore@kpmg.com.au

James Stewart
Partner & National Leader
Restructuring Services
T: +61 3 8667 5728
E: jhstewart@kpmg.com.au

Ryan Eagle
Partner
Restructuring Services
T: +61 2 9458 1559
E: ryaneagle@kpmg.com.au

KPMG.com.au

March 2022. 795982136DTL