25 years of interest rates’ downward move in Europe

Generic German Government 10Y Bond rate
Looking for opportunities in Euro corporate credit markets...

Investors in Euro Corporate Credit can invest in a limited number of companies having access to capital markets as a possible source of funding.

Source: Bloomberg Euro Aggregate Corporate ex-Fin, Bloomberg Euro High Yield ex-Fin, S&P European Leveraged Loans Index, 31/12/2016

Euro Investment Grade
- € 977 bn
- 1232 issues
- 317 issuers

Euro High Yield
- € 222 bn
- 408 issues
- 255 issuers

European Leveraged Loans
- € 113 bn
- 310 facilities
- 247 Group of Borrowers
Looking for opportunities in private placements...

- **Private placements** have been developing over the last years for European issuers, but they still account for a **limited volume**:

  ➔ In 2016, private placements for European issuers represent circa. €40 bn of issuance under three main formats (Schuldscheindarlehen, Euro PP and US PP).

  ➔ In the Schuldscheindarlehen market, the average deal size has ranged between €50m and €300m, with an increasing number of transactions above €100m\(^1\). Some issuers are also active in traditional bond markets.

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**European private placements are sizeable transactions highly concentrated on large companies**

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\(^1\)Source: SG Cross Asset Research November 2016, YTD figures as at 30 Sept 2016
Other investment possibilities to access Corporate debts?

<table>
<thead>
<tr>
<th>Revenues</th>
<th>&lt; € 2 m</th>
<th>€ 2-10 m</th>
<th>€ 10-50 m</th>
<th>€ 50-250 m</th>
<th>€ 250-1,500 m</th>
<th>&gt; € 1,500 m</th>
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<tbody>
<tr>
<td>Micro Enterprises</td>
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<td>Small Enterprises</td>
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<td>Medium Enterprises</td>
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<td>Small Mid-Caps</td>
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<td>Large Mid-Caps</td>
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<td>Large Corps</td>
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</tbody>
</table>

| Company Type    |       |          |          |            |               |             |
| SME            |       |          |          |            |               |             |
| Mid-Caps       |       |          |          |            |               |             |

| Disintermediation Vehicles | SME securitisation | Limited Offer (granted and held by banks) | Private Placements |

SME debt as an asset class could however be a compelling investment case for investors…..

The asset manager for a changing world
An attractive Credit Risk Profile

- Probability of Default (PD)
  - Highly Speculative (B+, B, B-)
  - Speculative (BB, BB-)
  - Cross-Over (BB+)
  - Investment Grade

- Loss Severity

- Credit Risk

1. European Leveraged Loans (B+/B) - Source S&P LCD, European LBO Loan Index (ELLI), WA Rating, as at Nov 15
2. High Yield Bonds (BB-) - Source Merrill, Bloomberg European High Yield Bond Index (HE00) - Avg Composite Rating, Jan 16
3. Investment Grade (A-) - Source Merrill, Bloomberg Jan 16 European Investment Grade Bond Index (ER00) - Avg Composite Rating, Jan 16
4. Senior Secured Loans (34%)
5. Senior Secured Bonds (54%)
6. Senior Unsecured Bonds (64%)

1Source Moody’s European Corporate Default and Recovery Rates, 1985-2015 H1
2Source Merrill/Bloomberg European High Yield Bond Index (HE00) - Avg Composite Rating, Jan 16
3Source Merrill/Bloomberg Jan 16 European Investment Grade Bond Index (ER00) - Avg Composite Rating, Jan 16
4First Lien
Looks like European SME Debt could be an attractive Investment Case

BUT........

How to source assets?

How to diligently select/manage assets?

How to compete with cheap bank rates?
How to source assets?

Access to a large SME client base through banks
Ex. France, Italy and Belgium through BNP Paribas Group

33,400 Corporates
28 Business centers + 7 dealing rooms
472 Relationship Managers

11,650 Corporates
22 Business Centers
210 Relationship Managers

21,000 Corporate
5 Business Centers
398 Relationship Managers
How to compete with cheap bank rates?

Focus on long term financing as a complement to bank financing

Compared to Bank Loans:
• Same Seniority/Security
• Longer Term maturity
• Pick up Yield related to the LT Financing

Additional financing alongside bank lending
How to diligently select/manage assets?

The investment process is designed to deal with the issues raised by SME financing:
- No public rating
- No standard Financial reporting
- Many different credit profiles
- Lack of standard market prices/Lack of liquidity

Preliminary Rating Assignment
(Estimate based on rating providers and scoring models)

Due Diligence
(Level of Due Diligence depends on the credit quality of the borrower - Lower credit quality triggers a deeper level of analysis)

Financing Structure & Pricing
- Define/Review the characteristics of the Financing
- Define covenants
- Fair value pricing of credit margin

Deal validated
Deal rejected
Example of a European SME Debt Fund

- Senior loans granted to SME and small Mid-Caps
- Expected number of borrowers: [100-150]
- Target Portfolio Gross Return: Euribor 3M + [350] bp
- Fund estimated Weighted Average Life: [5-7] years

Expected Weighted Average Life (WAL): 5-7 years

Funds’ AUM

Investment period

Investors’ commitments (Q2-Q3 2016)

Periodic capital calls to investors (2016-2018)

Reinvestment period (2019) and wind down phase (2020-2030)

The asset manager for a changing world
SME Debt Funds can have different types of risk/return profiles:

In all cases, **Sourcing**, **Positioning** and **Investment Process** are key.

The disintermediation trend also brings other opportunities.
Alternative Debt – Important questions to ask

How is the investment valued (pricing issue)?

How are risks calculated (for solvency requirements in particular)?

Extra attention to certain type of risks (operational, legal, compliance, prepayment, ...)

The asset manager for a changing world
Sadly for banks, disintermediation is a trend you cannot reverse....

Under another perspective, this trend is an opportunity for investors!
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