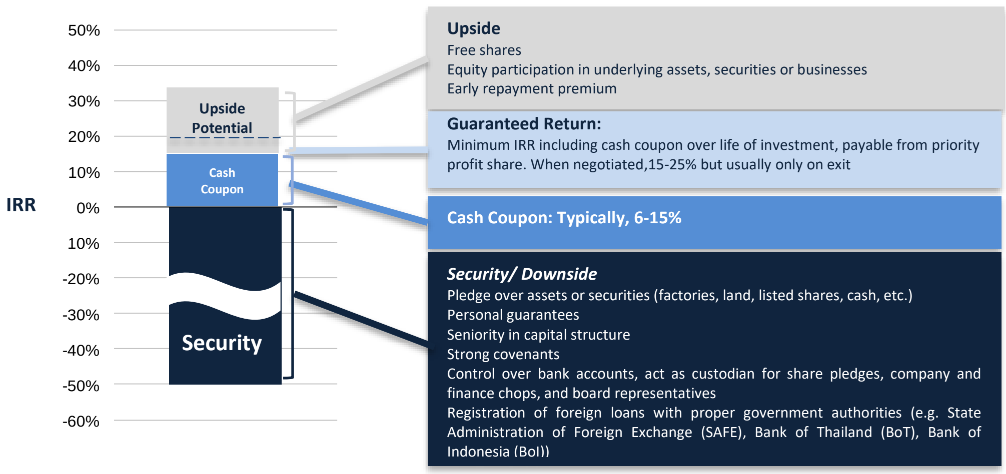
Fund Structures for Private Credit

Fund structures differ depending on the liquidity and maturity characteristics of the asset class they invest in. Most commonly recognised and used are the classic (i) private equity closed-end fund structures which are used to house illiquid equity, and the (ii) open-ended or evergreen hedge fund structures to hold public bonds/public equity.

ADM Capital has used both structures to house our private credit investments. However, the specific features of the private credit asset class do not make it conducive for either of the above structures to work perfectly. For instance, in comparison with private equity, private credit is less illiquid due to much shorter maturities and income distribution in the form of regular cash coupons. Specifically, ADM Capital's private credit investments have an average maturity of 2 years. Therefore, traditional private equity structures, which typically are closed-end structures with an investment period of 5-7 years, harvesting period of another 3-5 years, and limited ability to re-invest principal, are not as income friendly to the investor in that they don't pass on the income to the investor as investments are realised.

If PE structures don't work in investors' favour, hedge fund structures are not ideal for the private credit investment manager either. Private credit is not as liquid as capital market instruments, like bonds and public equity. Therefore, hedge fund structures with conventional redemption terms make it difficult for the investment manager to construct portfolios that can offer redemptions based on investors' demands. Indeed, in less liquid strategies, the differences in redemption decisions of individual investors affects portfolio construction, forces exits, often at sub-optimal levels, or worse still, elicits gates, side-cars or other restrictions. One approach that has been utilised is to put these portfolios in run off mode if there is a redemption request, such as to return the funds to the investor once the investments mature or are realised. However, this structure suffers from the disadvantage of scale and cost efficiencies.

ADM Capital's Typical Credit Transaction



ADM Capital's investments are structured to return consistent, predictable and attractive risk adjusted returns of ~15%+, with elements of income, downside protection and upside addition. Private credit Investments are less liquid than bonds given average 2 year maturities, but more liquid than private equity, suggesting the need for a separate fund structure to address this difference while passing on the income to investors.

Given the disadvantages associated with both traditional private equity or hedge fund structures in the way they accommodate private credit transactions, ADM Capital has used a third "lending platform" structure, or Platform, for its private credit investments. In this structure, the Platform will receive its funding as a loan from investors. Investors will receive regular income in the form of commitment fees on un-invested capital, and a regular cash coupon interest on any invested amount. During the Platform's life, funds are called when new investments are made while those investments that mature are repaid to investors, thus recycling capital efficiently. This was used in ADM Capital's Asia Secured Lending Facility, launched in 2012, and suits the private credit asset class well due to the following reasons:

- It offers a better match between investor and investments, since both are structured as fixed income instruments earning a pre-specified regular coupon;

- A part of the income generated by the investments is passed on regularly to investors as income distribution, thereby making it more liquid than traditional closed-end funds;

- For some investors, such as banks and insurance companies, this structure may allow a lower risk weight or capital charge to be provided against their investment given the debt-like nature of the investment in the Platform;

- Such a structure ensures that some payments are paid to the investor even before the investment manager is paid, thereby effectively providing a 'hurdle' rate before management fees and performance fees are paid to the manager;

- For ADM Capital, the structure benefits our investment strategy in that, unlike a hedge fund structure, we can invest in both short and long maturity papers within the investment period of the Platform, thereby capitalising on the maximum number of investing opportunities to capture true *alpha* for investors. For instance, the duration of our Asian credit investments in the past 5 years has ranged from 0.3 years to 2.8 years, with an average of 1.2 years – all can be accommodated within the same Platform;

- The ability to reinvest principal from exited deals during the investment period allows the Platform to reduce cash drag and more efficiently utilise committed capital to improve returns for the investor. Furthermore, the regular turnover of Platform investments ensures that the investments remain fresh, current and performing;

- The income distribution terms are baked into the contract, leaving limited room for discretion on the part of the fund manager for distribution, and in turn offering higher predictability of income to investors;

- The regular and almost immediate income distribution to investors overcomes the J-curve effect of equity funds, making it therefore an ideal candidate to help diversify investors' portfolios.

Conclusion: ADM Capital manages private credit investments in all three portfolio structures to suit various investors' requirements. There is no change to our investing approach or underlying investments, all of which are structured to return consistent, predictable and attractive risk adjusted returns of ~15%+, with elements of income, downside protection and upside addition. We have achieved average annual investment returns over the past 5 years of 17%, having invested in 33 Asian deals, putting USD 620 million to work, and exited 18 of these deals in this period.