European Direct Lending: Early Innings

NAEL KHATOUN
PORTFOLIO MANAGER,
EUROPEAN PRIVATE DEBT

JENS BAUER
CO-PORTFOLIO MANAGER,
EUROPEAN PRIVATE DEBT

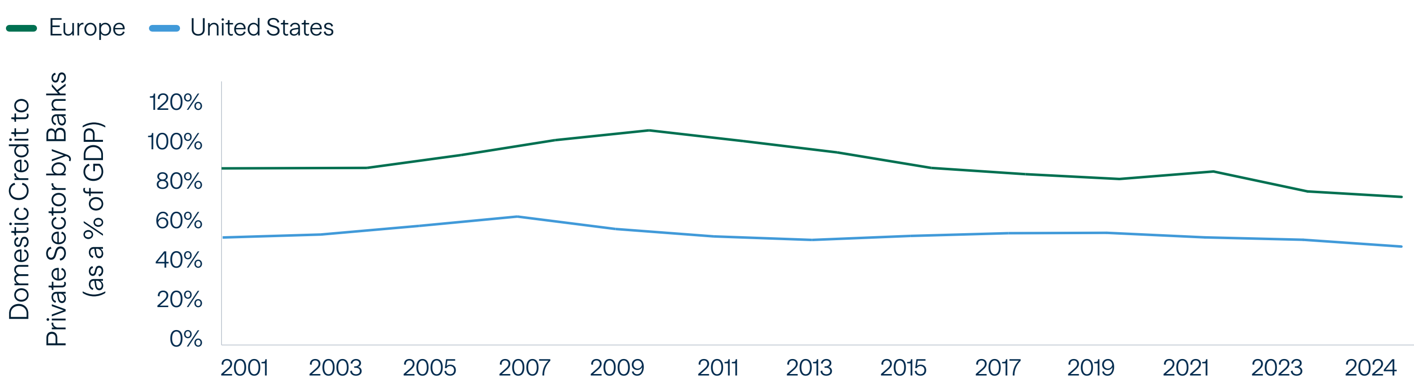
We believe Europe is still early in its private credit journey, with significant growth ahead. Direct lending has risen to become a key financing pillar in Europe, but the region remains overly dependent on banks and it's likely to face significant private capital needs over the coming years. For investors, this may present the opportunity to tap into an inherently diversified and fundamentally solid credit market.

Specifically, growth drivers may include:

- Fading reliance on banks: Traditional banking institutions still dominate European corporate lending. Banks' provision of credit to the private sector constitutes over 75% of GDP in Europe, compared to less than 50% in the U.S. **(See Figure 1.)** At the same time, European banks are dealing with tough regulatory capital requirements, constraining their lending ability and pushing borrowers toward alternative lenders.
- Impending private equity (PE) activity: There's an exceptional volume of PE dry powder in Europe, far beyond current private credit dry powder.[1] This indicates a meaningful leveraged buyout financing gap. The broadly syndicated loan market will likely fill some of the gap but won't provide the flexible solution many borrowers require.
- A supportive economic backdrop: Europe is set to benefit from a prolonged increase in government expenditure. This includes a core focus on bolstering its military and industrial bases following years of underinvestment, with Germany making the seismic decision to release its "debt brake." This will bring a stimulative wave of capital expenditure, providing a handy tailwind to the European economy.

As the market continues to mature, we believe the primary focus is pivoting away from origination volume to sophisticated risk management. This is amplified by signs of cracks in private credit portfolios, with a dramatic rise in borrowers using payment-in-kind interest and some well publicized credit issues. We believe the keys to success in the next phase of European direct lending will be (a) rigorous risk control, (b) experience across multiple market cycles, and (c) localized but broad sourcing networks.

Figure 1: The European Economy Remains Overly Reliant on Bank Lending



Source: World Bank Group.

Endnotes

1. Preqin.

Important Disclosures

All investing involves risk. The value of an investment will fluctuate over time, and an investor may gain or lose money, or the entire investment. **Past performance is no guarantee of future results.**

Asset-backed securities are subject to greater levels of credit risk, call risk and liquidity risks, which may cause their values to decline. Asset-backed securities are complex investments and they are not suitable for all investors.

Brookfield Private Wealth LLC is registered as a broker-dealer with the U.S. Securities and Exchange Commission (SEC) and is a member of FINRA and the Securities Investor Protection Corporation (SIPC). Brookfield Private Wealth LLC is a wholly owned subsidiary of Brookfield.

Statements made reflect the views and opinions of Oaktree. The information contained herein is for educational and informational purposes only and does not constitute, and should not be construed as, an offer to sell, or a solicitation of an offer to buy, any securities or related financial instruments. This commentary discusses broad market, industry or sector trends, or other general economic or market conditions, and it is being provided on a confidential basis.

Forward-Looking Statements

Information herein contains, includes or is based on forward-looking statements within the meaning of the federal securities laws, specifically Section 21E of the Securities Exchange Act of 1934, as amended, and Canadian securities laws. Forward-looking statements include all statements, other than statements of historical fact, that address future activities, events or developments, including, without limitation, business or investment strategy or measures to implement strategy, competitive strengths, goals, expansion and growth of our business, plans, prospects and references to our future success. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe” and other similar words are intended to identify these forward-looking statements. Forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining our actual future results or outcomes. Consequently, no forward-looking statement can be guaranteed. Our actual results or outcomes may vary materially. Given these uncertainties, you should not place undue reliance on these forward-looking statements. This communication is not intended to provide an overview of the terms applicable to any products sponsored by Brookfield Corporation and its affiliates (together, “Brookfield”). Information and views are subject to change without notice. Some of the information provided herein has been prepared based on Brookfield’s internal research, and certain information is based on various assumptions made by Brookfield, any of which may prove to be incorrect. Brookfield may not have verified (and disclaims any obligation to verify) the accuracy or completeness of any information included herein, including information that has been provided by third parties, and you cannot rely on Brookfield as having verified any of the information. The information provided herein reflects Brookfield’s perspectives and beliefs as of the date of this commentary.

ID B875053

Contact Us

privatewealth.brookfield.com

privatewealth@brookfield.com

+1 855-777-8001

Follow us on LinkedIn

Brookfield