KKR

PRIVATE CREDIT

Private Credit in Asia Pacific: A Region on the Rise

For Professional Investors Only

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Executive Summary

Private credit is a nascent asset class in the Asia Pacific (APAC) region, with tremendous growth potential and opportunity for investors.

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There are four key reasons we think the asset class deserves more attention in the coming years:

- The lion's share of future global economic growth is expected to happen in APAC. Though public markets are evolving, we believe private credit is better suited at the moment to capture the dynamism of the region's businesses.
- An allocation to private credit in APAC can diversify exposure to private credit in North America and Europe. The variety of economies, ranging from fast-growing emerging markets to huge developed economies, adds to the diversification potential.
- Multiple demand drivers beyond GDP growth can help sustain the growth of private credit in APAC, in our view, including the maturation of the private equity market and a dearth of flexible, accessible capital.
- We believe lenders with deep, flexible pools of capital and the ability to partner with a range of borrowers in the region will tend to have better negotiating power on protections and terms relative to the United States and Europe, where private credit markets are generally more crowded.

In this paper, we will discuss the supply and demand factors shaping the growth of private credit in APAC, how different types of private credit strategies can help fill in financing gaps for sponsors and companies, how we think about relative value in the market, and the importance of deep local relationships in a complex and diverse region.

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Introduction

The Asia Pacific (APAC) region is home to a rich tapestry of market environments, including two of the world's three largest economies (China and Japan), technological powerhouses, financial hubs, and fast-growing emerging markets that are poised to reap demographic dividends. The region's dynamic economies already account for the bulk of global growth and are poised to grow in magnitude.[1]

Yet, even amid all that growth, companies in the region face a common challenge: a funding environment that does not always provide access to the flexible capital they need to expand, refinance, innovate, and evolve. The credit market in APAC is dominated by traditional and relatively conservative bank capital, while the region's public equity and debt capital markets are on the whole less developed compared to those in the West.

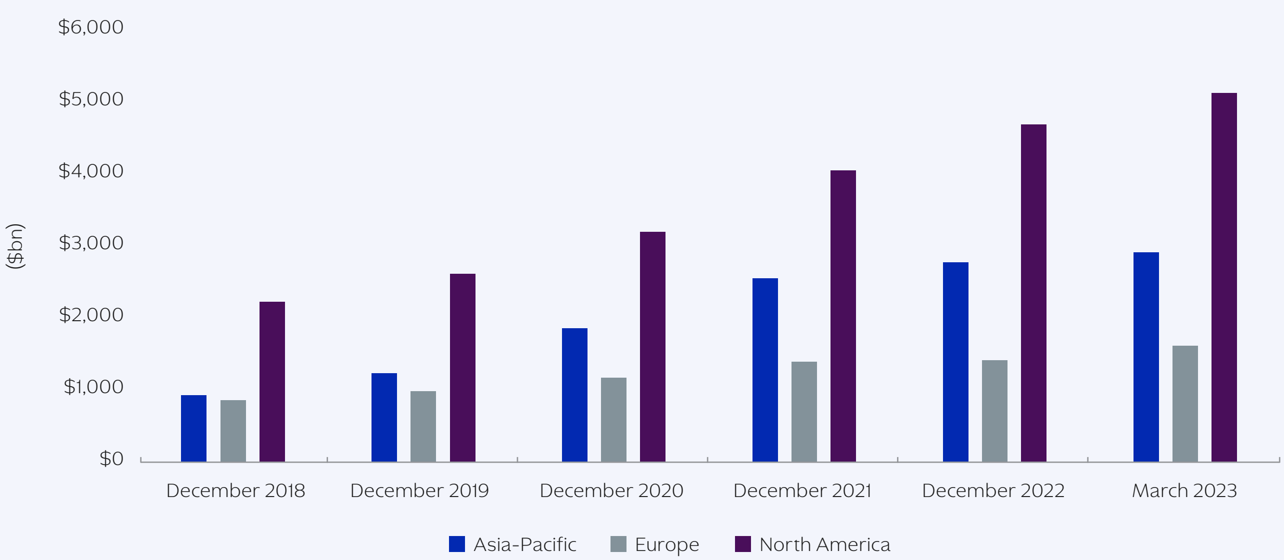
We think private credit is distinctly suited to fill the void. Though the market is still small compared to the private credit markets of the United States and Europe, it has been growing steadily, and we think there are multiple drivers that can help sustain that growth.

The Demand Side: What Is Driving Private Credit in Asia Pacific?

Through our work as a credit investor, we are seeing a growing number of maturing businesses in APAC that could benefit from diversified capital to meet a range of funding needs. Some are growing into global players, while some family-owned companies are trying to figure out how to transition to a more institutional model. Entrepreneur-led companies want to finance growth without diluting their ownership interests prematurely. Public companies are privatizing to unlock value, and large conglomerates in Japan and Korea are spinning off unprofitable or non-core assets. Payment-in-kind (PIK)/HoldCo structures, cross-border funding capabilities, stretching leverage, bullet repayments, and hybrid solutions with features of debt and equity can be very advantageous to businesses in these situations. Unfortunately, this type of credit is rarely available from traditional lenders in APAC, as we'll discuss in the next section.

Additionally, there are compelling opportunities for private credit to support leading private equity sponsors, offering an attractive alternative to traditional bank funding. At more than half the size of the U.S. market and almost double the size of the European market, the APAC private equity market has approximately $2.9 trillion in assets under management that can generate demand for private credit solutions in the region (*Exhibit 1*). Deal value has tripled from $63 billion in 2012 to $198 billion in 2022. The region's buyout market is maturing, with a greater focus on traditional leveraged buyouts, a key driver of demand for private credit financing. At the same time, the APAC private debt market remains significantly undercapitalized both relative to the markets in the United States and Europe and to private equity capital dedicated to the region. The ratio of the private equity to private debt assets under management is 30.8x for APAC compared to 5.2x and 3.5x for the United States and Europe, respectively (Exhibit 2).

EXHIBIT I | Regional Private Equity Assets Under Management Over Time



Source: Preqin as of March 31, 2023. Asia Pacific includes Asia and Australasia.

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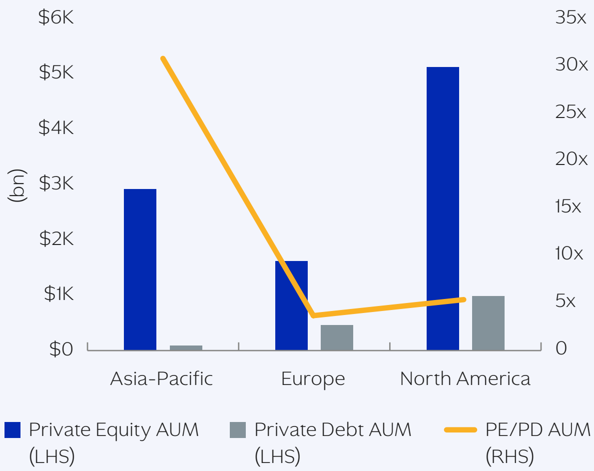
EXHIBIT 2 | **Regional Private Equity to Private Debt Assets Under Management**

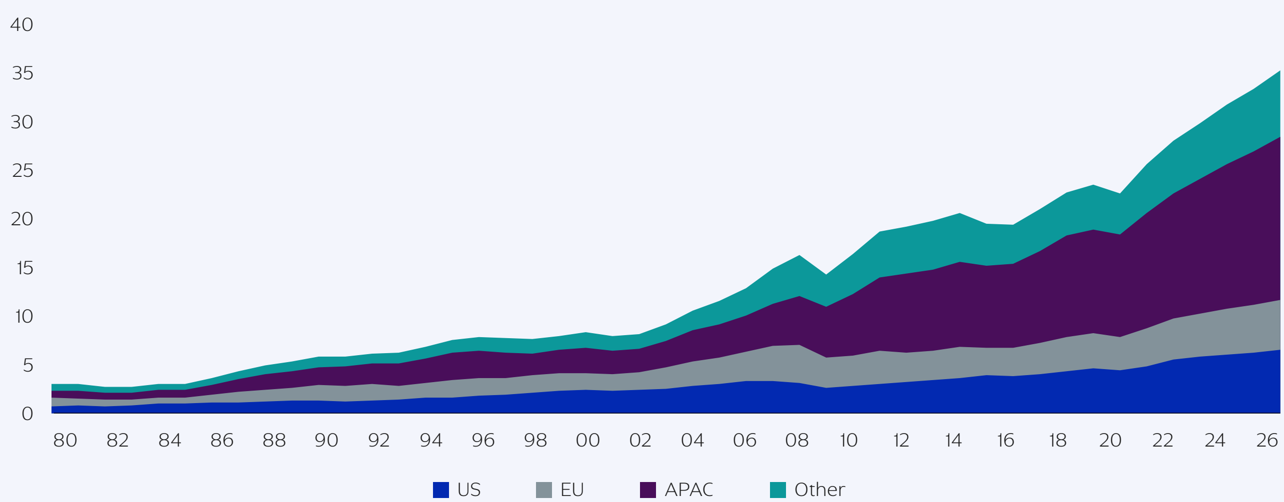


Source: Preqin as of March 31, 2023. Asia Pacific includes Asia and Australasia.

We believe the current state of private credit in APAC is comparable to that of Europe at earlier stages of market development, when banks provided most of the capital for private equity buyouts. Today, it is much more common for American and European private equity sponsors to select private credit, as it can be a more efficient, bespoke form of capital for financing transactions, with the ability to offer terms tailored to the strategic objectives of the transaction (e.g., flexible leverage levels or long-dated maturities), execution speed, and certainty.[2] Private debt, including unitranche structures and first-lien/second-lien debt packages,[3] is funding more buyout transactions in APAC. We expect private debt to gain market share in financing private equity-related transactions in APAC over the next decade as market penetration trends toward the levels in more developed credit markets.

Finally, it is impossible to talk about the increasingly sophisticated financing needs of APAC businesses, or about the development of private equity in the region, without talking about the economic growth that underpins it all. APAC economies account for nearly two-thirds of total global real GDP growth and are expected to drive about 50% of total global capital expenditure investments in the short-term (*Exhibit 3*). Over the next five years, we expect the region's GDP growth to outstrip that of Europe and the United States by more than 2% (*Exhibit 4*).

EXHIBIT 3 | **Contribution to Global Capital Expenditure Investment by Region**



Source: Debtwire as of September 30, 2021

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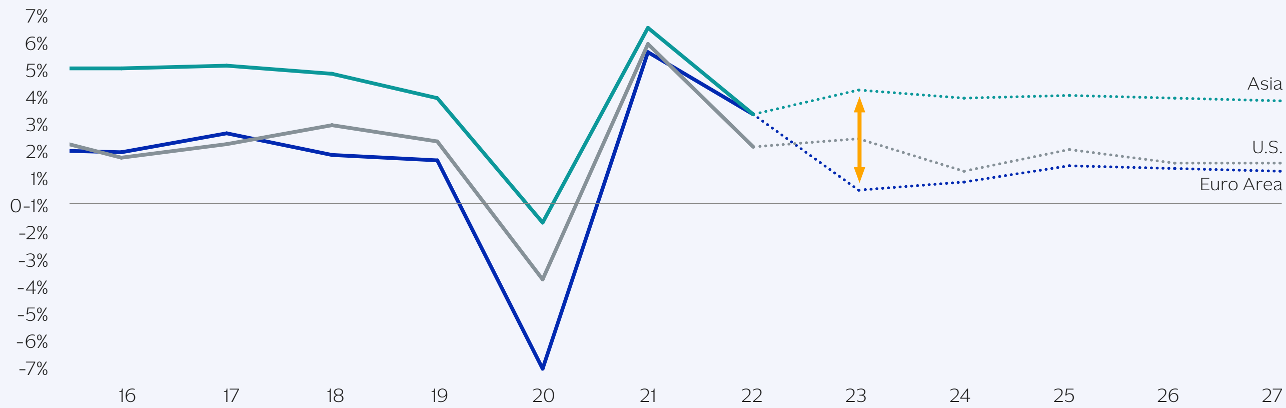
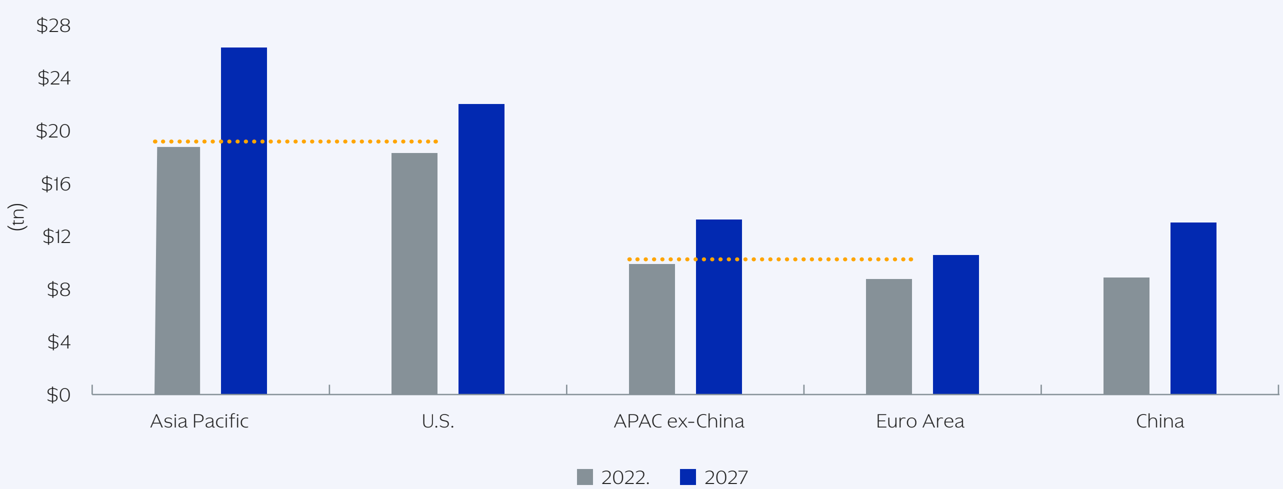
EXHIBIT 4 | **Contribution to Global Growth by Region**



Data retrieved as of November 8, 2023. KKR Global Macro & Asset Allocation (GMAA) estimates for United States, Euro area, and China. IMF estimates for other APAC countries, nominal GDP-weighted. Sources: Haver, IMG, KKR GMAA analysis

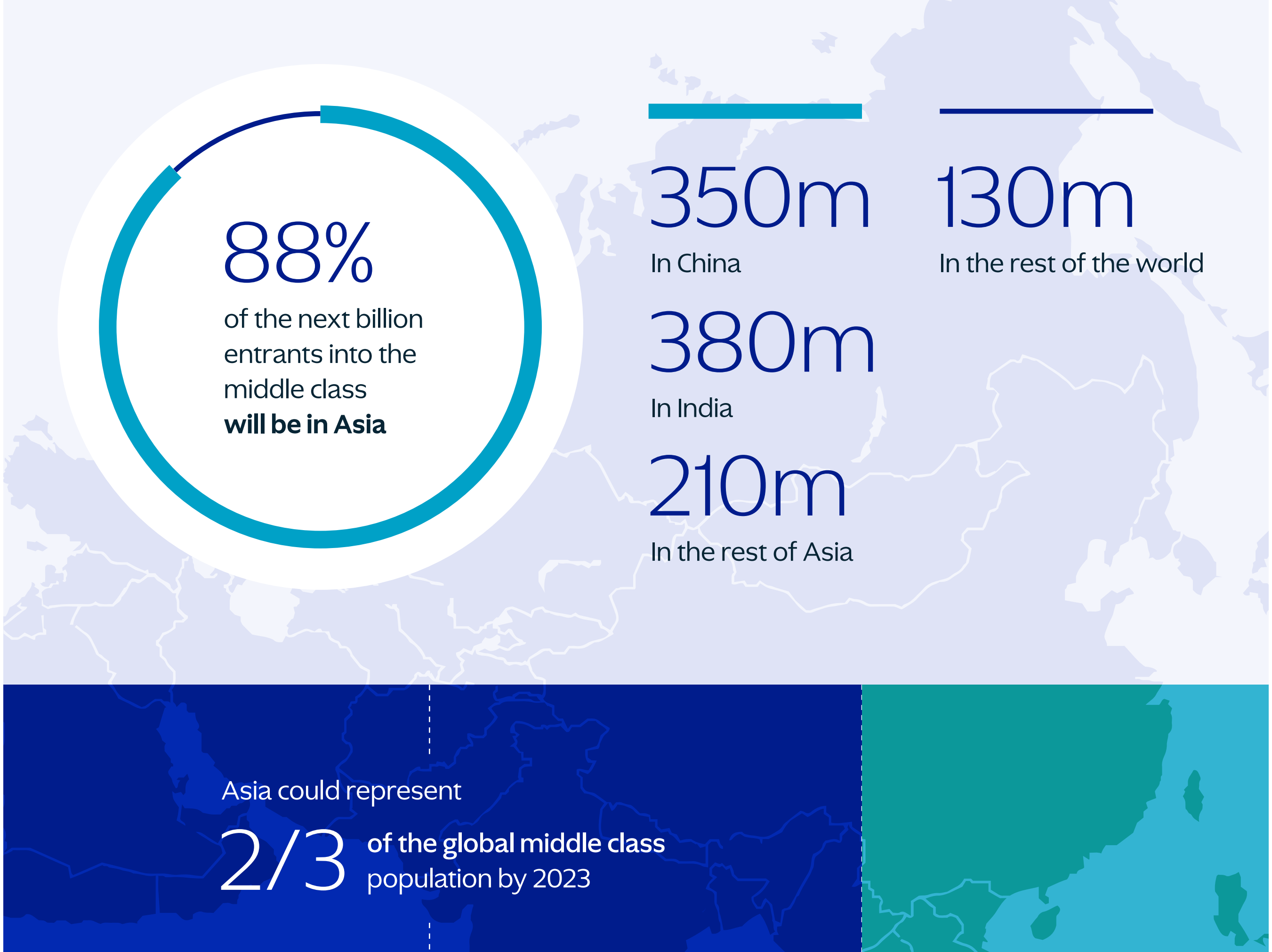
However, it is not just *how much* APAC is growing relative to the rest of the world, it is also *how*. We expect the region to lead the world in global consumption growth as the middle class expands (*Exhibits 5 and 6*). The region's households accounted for nearly 42% of the world's wealth, or $218 trillion, in 2020.[4] According to the Brookings Institution, the region makes up 50 percent of the world's 4-billion-strong consumer class[5] and India and China alone are projected to add 64 million more people to that consumer class this year.[6] Meeting the needs of these new consumers will require new businesses, the expansion of existing businesses, and ultimately, more capital.

EXHIBIT 5 | **Private Consumption by Region**



Data retrieved as of December 12, 2022. Asia Pacific Australia, China, Hong Kong, India, Japan, Korea, New Zealand Taiwan, India, and ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Thailand, Vietnam). Source: IMF, World Bank, National Statistical Agencies, Haver, KKR GMAA analysis.

EXHIBIT 6 | The Future Growth of the Middle Class Will Likely Occur in APAC



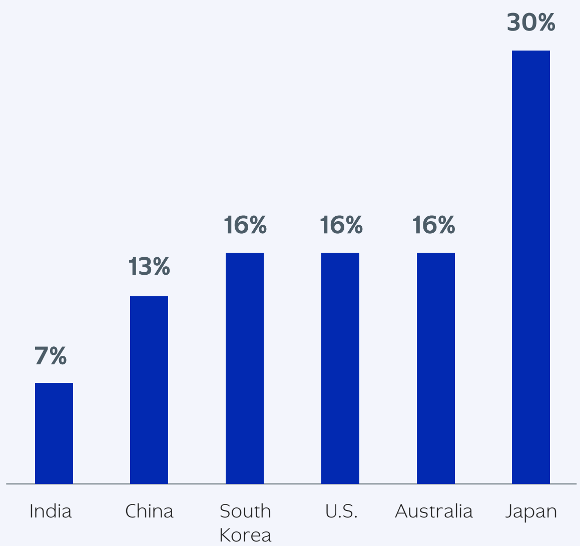
Source: Brookings Institution as of 2020

Demographics also play into the consumption story. Most of the world's societies outside sub-Saharan Africa are aging, but some are further along than others. In Japan, one of the world's oldest societies, some 30% of the population is already over 65. Investments in healthcare, automation, and services will be key to serving older populations and maintaining an adequate workforce.

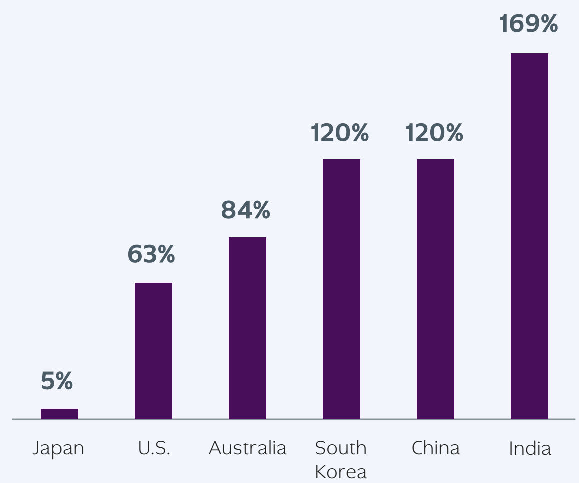
APAC is also home to 60% of the world's young people (between the ages of 15 and 29), and this group makes up 25% of the region's population, concentrated in the developing economies.[7] Countries like Indonesia and Vietnam can still reap a demographic growth dividend, despite the fact that they are aging faster than economies that are already relatively old. Investments in sectors such as education are important in these younger countries.

EXHIBIT 7 | **Developing Countries are Still Young, but Aging Faster than Developed Economies**

Population 65+ in 2020



Estimated Change in 65+ Population, 2020-2050



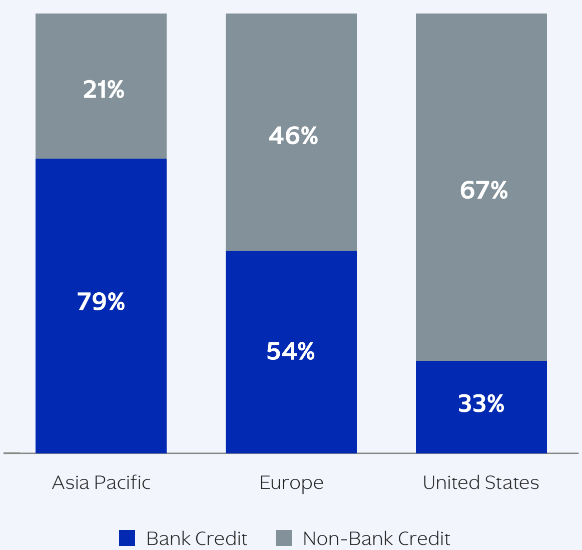
Source: UN World Population Prospects, KKR GMAA analysis as of May 2023

As we will discuss more fully in the next section, the public markets in APAC are heavily weighted toward asset-heavy sectors such as real estate, natural resources and financials. But there is a wide variety of businesses in the performing credit space that have both interesting business models and an urgent need for capital. From an investment perspective, gaining access to credits that more closely mirror APAC's secular growth trends is a challenge for investors given the makeup of today's public markets.

The Supply Side: The Credit Landscape in Asia Pacific

Businesses in APAC generally do not have the same access to diversified debt and hybrid capital alternatives that are available in the U.S. and European credit markets. Banks account for 80% of the credit market, a significantly higher proportion than in either Europe or the United States (*Exhibit 8*). But traditional bank lending is seldom able to serve all the needs of borrowers who may require flexibility or transitional financing. The financial sector is less developed than in the West, and banks in APAC generally have been more conservative lenders.

EXHIBIT 8 | Regional Bank Share of Total Credit



Source: Bank for International Settlements, as of March 31, 2023. Calculated as bank credit divided by total credit to the private non-financial sector. Europe includes Austria, Belgium, Cech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey and United Kingdom. Asia Pacific includes Australia, China, Hong Kong, India, Indonesia, Japan, South Korea, Malaysia, New Zealand, Singapore and Thailand.

Banks in APAC have selectively scaled back on lending in recent years, particularly to smaller businesses, as a result of evolving regulatory rules, anxiety over concentration risks in challenged and cyclical sectors, concerns about the impact of an inflationary environment, and generally a more conservative stance coming out of the pandemic. The result is that the region's banks tend to overemphasize relationships and traditional sectors. The banking system still works well for very large companies, national champions, and state-owned enterprises, but ascendant and middle-market businesses tend to have less access. We see private credit in APAC as a complement to the banking system, expanding the range of capital available to the region's businesses.

Public debt markets are another place that businesses could, in theory, get funding. The public bond markets have started to develop in the past couple of decades, but syndicated institutional lending markets remain relatively less developed in most of APAC compared to Europe or the United States. The public debt markets can be volatile and remain small relative to the region's GDP. This supply dynamic is further exacerbated by the lack of depth in the region's bond markets, which are narrowly constructed from an industry and geographic perspective, and are typically only available to larger companies. As a result, firms that cannot get bank loans have relatively few options beyond issuing equity, which can be expensive and dilutive.

Our research also shows that the public debt markets, specifically the high yield bond markets, do not offer access to the full spectrum of opportunities available in private markets at equivalent rates of return. The benchmark BAML ICE Asia High Yield Index is heavily weighted toward real estate, finance and utilities companies, which together make up nearly 58% of the index (*Exhibit 9*). In our view, this composition reflects an older vision of the region, starkly opposed to the view we express through our thematic investing focus, which leans more heavily toward consumer-driven companies, technological innovation, and healthcare.

EXHIBIT 9 | The Top 5 Components of APAC High Yield vs. KKR Asia Private Credit

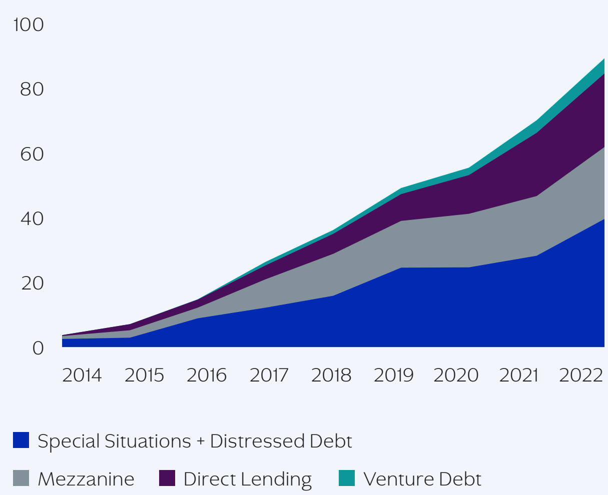
KKR Asia Private Credit		APAC High Yield	
GICS Sector/Sub-Industry		GICS Sector/Sub-Industry	
Education Services	19%	Real Estate Development	20%
Industrials	16%	Financials	17%
Information Technology	14%	Casinos & Gaming	14%
Health Care	14%	Utilities	13%
Specialized Consumer Services	11%	Materials	11%
Other	27%	Other	25%
	100%		100%

GICS Sector, except for Consumer Discretionary and Real Estate, where GICS Sub-Industry is used. Any GICS Sector or Sub-Industry below 10% is aggregated in "Other" for ease of presentation. For KKR Asia Private Credit, Education Services and Specialized Consumer Services are part of the Consumer Discretionary GICS Sector classification. For APAC High Yield, Casinos and Gaming are part of the Consumer Discretionary GICS Sector classification and Real Estate Development is part of the Real Estate GICS Sector classification. "Other" includes 8% in certain other real estate sub-industries.

In the United States and Europe, private debt has increasingly filled the capital gap for companies that may be too small for public bond markets or syndicated loan deals, that need flexibility in terms or structure, or that simply prefer the certainty of execution associated with private lending. The APAC private credit market has grown very quickly (*Exhibit 10*) but is still small compared to other regions. Despite the region being responsible for close to two-thirds of global growth, only 6% of the global private credit assets under management are in APAC, with only a subset of this focused on the performing private credit market.[8]

The private credit market in APAC began with distressed debt, with private lenders offering businesses a means to recapitalize distressed high yield bonds during the Asian Financial Crisis of the late 1990s.[9] Since then, the number of private credit deals and the average size of those deals have steadily increased. However, the region still has a reputation as a market for special situations lending. In fact, roughly half of the private credit capital raised in APAC over the last decade has been for special situations or distressed investments (*Exhibit 11*).

EXHIBIT 10 | The Growth of APAC Private Credit over Time



Source: Preqin as of July 2023

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We strongly believe performing credit is likely to play an increasingly important and outsized role in credit markets. Over time, we have seen a deepening awareness of performing credit toolkits and sophistication on the part of corporates and sponsors in the region. In short, we believe we are in the early innings of an attractive, highly scalable opportunity.

How Performing Private Credit Can Address Asia's Capital Gaps

As the APAC private credit market grows, we think flexible capital and the ability to invest across the debt capital structure are key. We choose to lend only in performing credit across three major strategies: direct lending, capital solutions, and collateral-backed lending.

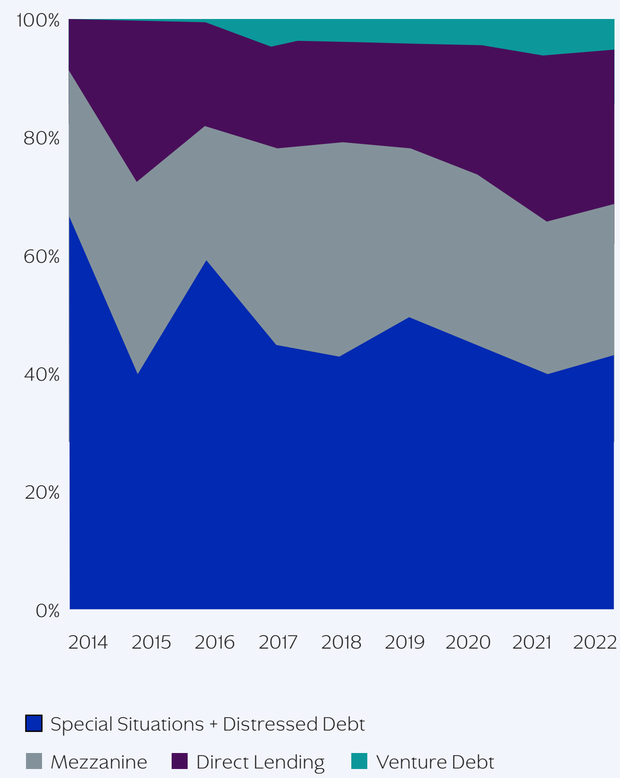
Each of our three preferred types of lending offers access to different markets and different places in the capital structure and allows us to pivot as opportunities ebb and flow.

Direct Lending

As noted earlier, many borrowers in APAC historically have struggled for alternatives beyond traditional senior bank loans, unlike more scaled and developed markets in the United States and Europe, where a broader lender base of insurance capital, business development companies, and CLO platforms delivered liquidity to the syndicated loan markets. This has created a vacuum for direct lending solutions that alternative credit providers have started to fill.

We would typically define direct lending as stretch senior or unitranche financings in excess of where traditional banks would typically lend. As previously discussed, the majority of direct lending in APAC tends to be sponsor-driven. In our own business, about three-quarters of direct lending loans are to back private equity sponsors across a range of situations, including buyouts,

EXHIBIT 11 | **Special Situations and Distressed Debt Dominated the Asia Pacific Private Credit Market**



Source: Preqin as of July 2023

recapitalizations and bolt-on acquisitions. The growth of the private equity market in the region and the shift from minority and growth investments to control leveraged buyouts therefore underpins the growth of direct lending (*Exhibit 12*).

Aside from private equity sponsor-led financings, there is a growing demand for direct lending solutions from underserved corporates that are unable to obtain efficient credit capital from banks, even on a senior secured basis. This constitutes roughly a quarter of our direct lending activity to date.

In more developed markets, increased competition has gradually eroded some standard creditor protections, as evidenced by the advent of covenant-lite loans and extensive EBITDA adjustments. Because the demand for private credit is so strong and the supply is so limited in APAC, we find that we can lend at relatively more conservative leverage levels and obtain more protective terms than in the U.S. or European direct lending markets, even when dealing with large international and local sponsors. We're also seeing the opportunities for larger direct lending deals as the market matures and leading companies expand.

The biggest markets for direct lending are Australia and India, which we estimate make up some 60% and 20% of the current market, respectively. We continue to see unitranche and other stretch senior lending opportunities develop in other parts of APAC.

Australia has strict capital requirements for banks, and we have seen a pullback in leveraged lending to private equity sponsors in recent years, which we think will support demand for private credit going forward. Sponsor lending has typically been a lower priority for local banks in Australia compared to mortgage financing, infrastructure finance, and lending to large corporates. We think these factors will support demand for private credit going forward.

In India, while bank lending has been rising quickly, regulations prohibit local banks from financing the acquisition of shares by foreign parties. We expect these restrictions, coupled with strong economic fundamentals and rapid growth in private equity, to bolster demand for private credit. In fact, a recent survey suggests that 83% of credit fund managers in India are bullish on private credit investments over the next two years.[10]

EXHIBIT 12 | Private Debt-Financed Buyout Deals in APAC

Source: Preqin buyout deals as of October 17, 2023. Asia Pacific includes Asia and Australasia.

Capital Solutions

Some borrowers need different kinds of capital, including junior debt financing, mezzanine debt, or hybrid capital in the form of preferred equity or convertible instruments, to expand, refinance, or access liquidity. Historically, if these borrowers could not get bank capital or syndicated funding, they typically had to turn to raising equity, diluting existing shareholders. We see a compelling opportunity to provide high-quality borrowers with hybrid financing that has credit-like protections, higher contracted rates of return, and upside participation potential in the form of warrants or equity conversion rights. This demand is significant and today we expect capital solutions to represent approximately 40% of the market opportunity in performing private credit.

Unlike the market for direct lending, which is geographically more concentrated, capital solutions opportunities arise in many markets in APAC, driven by idiosyncrasies in local markets or local situational factors. Furthermore, the capital solutions opportunity is much more concentrated on leading corporates than direct lending is, with private equity sponsors accounting for only about 20% of the opportunity set, according to our estimates.

Some of the situations where we believe capital solutions can be helpful for both corporates and sponsor-backed portfolio companies are detailed in *Exhibit 13*.

EXHIBIT 13 | When Are Capital Solutions Useful in APAC?

Effecting a partial return of capital to majority shareholders without raising dilutive equity or ballooning leverage

Bridging a valuation gap during periods of market volatility in M&A or IPO markets

Transitional funding for companies with capital-intensive business models or that are ramping assets

Solving a near-term maturity to bridge toward a longer-term capital structure or facilitate a refinancing

Managing liquidity constraints in the face of higher rates or working capital cycles

Offering preferred equity that (i) functions as pre-IPO validation capital from a reputable institutional investor and (ii) right-sizes the capital structure prior to an IPO

Filling a capital gap for a public company being taken private

Providing more structured capital to help corporates maintain or improve credit ratings

Collateral-Backed Lending

We define collateral-backed opportunities as lending against pools of physical or financial assets. Similar to what is happening in Europe and the United States, we see an attractive growth opportunity as banks facing rising regulatory capital charges increasingly pull back from asset-backed lending and divest non-core loan portfolios.

The collateral in these types of transactions can vary widely. Our team divides the opportunity into four areas: consumer finance (e.g., pools of auto loans, mortgages, and other consumer debt), hard assets (e.g., airplane leasing), small and medium-sized business financing (e.g., accounts receivable, equipment leasing), and contractual

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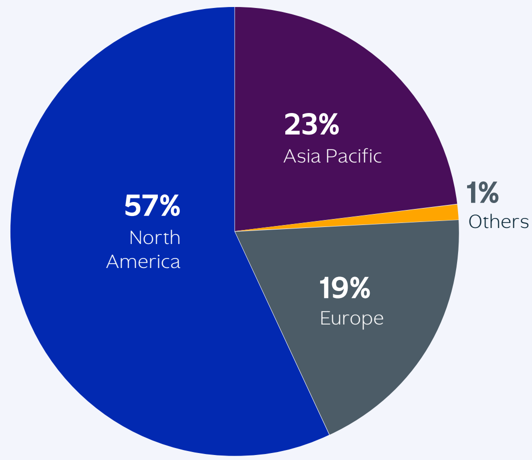
cash flows (e.g., trail commissions, intellectual property, royalty streams, etc.). We estimate that APAC makes up roughly one-fourth of the global market for private asset-backed finance (*Exhibit 14*).

At a portfolio level, collateral-backed opportunities offer non-corporate exposure to hard assets or contractual revenue streams, diversifying portfolios away from the corporate loans of direct lending or capital solutions. Because collateral-backed opportunities group many different loans together, they offer both inherent asset diversification and a potential cushion against capital loss.

For collateral-backed finance to work, lenders need efficient senior financing. For that reason, this sort of lending is more prevalent in APAC's developed markets, such as Australia. While collateral-backed transactions currently account for the smallest portion of our activity, we think the opportunities in this area are poised to increase as regional capital markets grow and mature and banks continue to retreat from select markets.

EXHIBIT 14 | Global Private ABF Market by Region



Source: Integer Advisors and KKR research estimates as of October 31, 2022.

Understanding Relative Value

Private credit in APAC may come with certain risks and challenges that are not present in Western markets. For example, the developing legal systems in some countries make it essential to know how to navigate local systems and stay abreast of potential regulatory changes. Local relationships, sophisticated structuring knowledge, and a deep understanding of insolvency processes in each jurisdiction are critical for diligence, counterparty selection, and protecting capital. The region's diversity can also be an investment challenge, with investors who have an on-the-ground presence, knowledge of local languages and cultures, deep local relationships, and market experience at an advantage over those who do not.

How much reward is there for taking on these risks? The premium for lending in APAC varies considerably depending on the market and the type of loan. We typically see a 50-100 basis-point (bp) premium over the United States and Europe for direct lending deals. However, for capital solutions, the premium is usually a broader range of 300-500 bps compared to subordinated lending deals in the United States or Europe. The exact premium depends on situational dynamics, local borrowing rates, relative complexity and other factors.

However, we think there is another, potentially more important, question to ask about relative returns: How much risk are investors actually taking? Because of the gap between supply and demand for capital in the region, we have seen that there are fewer lenders competing for loan deals. That, in turn, gives lenders much more power to set favorable terms and exercise a degree of control over operations to protect on the downside.

In direct lending, we are seeing tighter documentation more akin to bank lending than the types of private credit terms we might see in the United States or Europe. The vast majority of private equity sponsor-led direct lending deals in APAC have debt maintenance covenants, as opposed to the greater proportion of covenant-lite deals in the West, in addition to more lender-favorable definitions and tighter documentation standards.

In capital solutions, as in direct lending, most deals have covenants. We tend to focus on larger businesses and are typically able to detach at a point more consistent with senior debt in Western markets. Larger businesses tend to be more resilient in difficult economic times, with more options to obtain additional financing or otherwise turn the ship. Private lenders also tend to have more positive and negative controls when providing capital solutions, especially when there is a component of equity-style upside participation that comes with a negotiated shareholders agreement. Protections may include the ability to approve capital expenditures, exit rights, performance milestones, and the ability to take certain actions if leverage increases.

In short, we think investors should consider the holistic risk-adjusted reward of investing in an APAC credit portfolio, taking into account not just an attractive return premium, but also differentiated protections from structure, governance, controls and collateral.

Asia Pacific Private Credit as a Diversifier

Private credit in APAC can offer two major forms of diversification. First, it can be a meaningful diversifier for portfolios comprised primarily of U.S. and European private credit. Moreover, based on our work, we believe there is evidence that adding APAC private credit to a blended portfolio can result in better risk-adjusted returns (For details on these calculations, please see our *Sidebar*.)

Asynchronous global economic growth dynamics can help drive this diversification potential. In the years after the Global Financial Crisis, the world's economies moved more or less in synch. Central banks around the globe drastically and simultaneously reduced interest rates and kept them very low for more than a decade. The pandemic and immediate post-pandemic years, however, are a telling reminder that growth cycles and economic trends can and do diverge. The United States and Europe have tended to follow one set of trends of late, while APAC economies have followed another. For example, Western economies reopened more quickly after the worst of the COVID-19 pandemic, while in many ways, China's recovery from lockdowns has yet to fully materialize. On the other hand, post-pandemic inflation and rising rates have had a more pronounced impact on the United States and Europe than on APAC.

SIDEBAR

Incorporating APAC Private Credit into an Investor's Portfolio of Alternative Credit Can Enhance Risk-Adjusted Returns

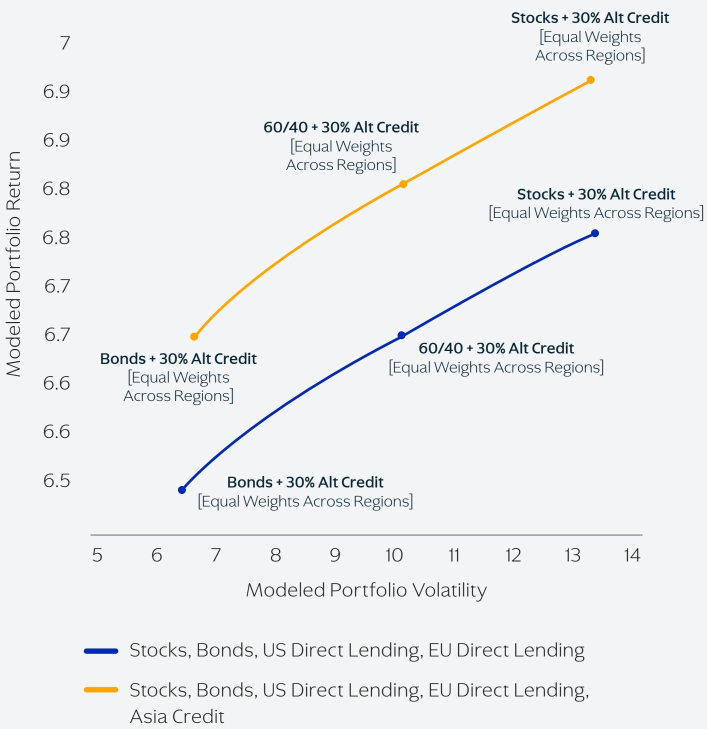
To test how APAC private credit tends to affect a portfolio, we constructed two portfolios of stocks, bonds and private credit.

In the first portfolio, we assumed a portfolio of 30% private credit, split equally between U.S. private credit and Europe private credit, and we plot modeled portfolio return relative to modeled portfolio volatility, assuming the stock/bond portfolio shifts from 0 to 100%.

We then constructed a second portfolio where we assumed a 30% allocation to private credit. But in this portfolio, we introduced APAC private credit such that the 30% allocation was split across U.S. private credit, Europe private credit and APAC private credit. Similar to the first portfolio, we plotted modeled portfolio return relative to modeled portfolio volatility, assuming the stock/bond portfolio shifted from 0 to 100%.

Adding APAC private credit to the portfolio shifted the efficient frontier upwards, which means that it achieved the same level of expected return with lower risk. This is largely due to the higher diversification that Asia private credit offers against the other private and public assets in the portfolio.

APAC Private Credit Improves Risk-Adjusted Returns in a Portfolio



APAC Private Credit Exhibits Lower Correlations to US and Europe Private Credit

	U.S. Credit	Europe Credit	Asia Credit
U.S. Credit	1.00	0.95	0.84
Europe Credit	0.95	1.00	0.80
Asia Credit	0.84	0.80	1.00

Equities refers to the S&P 500, Bonds refers to the Global-Aggregate; correlations and volatilities are estimated using public proxies for Alternative Credit defined as follows: US Direct Lending: Morningstar LSTA US Leveraged Loan TR USD; EU Direct Lending: Morningstar European Leveraged Loan TR EUR; Asia Credit: 35% ICE BofA Australia Corporate Index * 1.25x, 20% ICE BofA High Yield Emerging Markets Corporate Plus India Issuers Index, 22.5% ICE BofA BB Asian Dollar High Yield Index, 22.5% ICE BofA B Asian Dollar High Yield Index. Data from March 31, 2004 to September 30, 2023. Assuming KKR expected returns for S&P 500 and Global-Aggregate, and KKR targeted unlevered returns for Alternative Credit. Source: Bloomberg, KKR GBR Analysis.

EXHIBIT 15 | Some APAC Countries Have Weak Correlations with One Another

	Australia	Singapore	India	China	Japan	Korea	Hong Kong	Indonesia	Malaysia	Vietnam
Australia	1.00	0.90	0.79	0.85	0.97	0.83	0.86	0.85	0.89	0.78
Singapore	0.90	1.00	0.59	0.86	0.93	0.95	0.94	0.78	0.88	0.61
India	0.79	0.59	1.00	0.65	0.76	0.52	0.60	0.84	0.74	0.95
China	0.85	0.86	0.65	1.00	0.86	0.83	0.88	0.78	0.83	0.67
Japan	0.97	0.93	0.76	0.86	1.00	0.89	0.86	0.84	0.89	0.78
Korea	0.83	0.95	0.52	0.83	0.89	1.00	0.90	0.69	0.82	0.58
Hong Kong	0.86	0.94	0.60	0.88	0.86	0.90	1.00	0.77	0.87	0.59
Indonesia	0.85	0.78	0.84	0.78	0.84	0.69	0.77	1.00	0.91	0.83
Malaysia	0.89	0.88	0.74	0.83	0.89	0.82	0.87	0.91	1.00	0.77
Vietnam	0.78	0.61	0.95	0.67	0.78	0.58	0.59	0.83	0.77	1.00

Quarterly JACI APAC indices data from Q4 2012 to Q3 2023. The JACI APAC benchmark index tracks US$ denominated debt issued by Corporate, Sovereign, and Quasi-Sovereign entities from the entire Asia Pacific region spanning Investment Grade and High Yield debt segments. Source: JP Morgan, KKR GBR Analysis as of September 30, 2023.

We tend to group Asia's economies into two categories, developing and developed economies, with plenty of caveats and exceptions. Australia, New Zealand, Japan, South Korea, Hong Kong, and Singapore, fit into the developed bracket; while the developing economies include China, India, Indonesia, Malaysia, the Philippines, and Vietnam. We think that both these groups of developing and developed economies are currently attractive for private credit investing due to a blend of factors such as stable financial or regulatory environments, governments supportive of foreign direct lending, and attractive macroeconomic trends.

Japan and South Korea are among the world's most technologically advanced economies, and the reform of large conglomerates is a powerful trend in both places that may facilitate robust growth in private credit. For example, in South Korea, we are seeing signs that blue-chip Korean borrowers seeking flexible and unconventional capital solutions that local financiers consider too complex.

Hong Kong and Singapore, as well as the cities of Shenzhen and Shanghai, have become global financial centers. Singapore, as an example, has encouraged the development of the private credit market in a bid to become a financial gateway to Asia and a global hub for private markets investments. Notably, the Monetary Authority of Singapore has pledged $1 billion in investment to private credit funds and offered support to fund managers expanding in Asia.

India, one of the region's fastest-growing economies, enjoys strong macroeconomic tailwinds in the form of a growing middle class and the ongoing efforts by international corporations to diversify supply chains. A significant ramp-up in private equity activity over the last four years has led to increasingly scaled leveraged buyouts that require more flexible financing. In addition, structural reforms such as insolvency and bankruptcy code reforms and changes to labor and land laws have made it easier to do business in the country and built confidence in the regulatory regime.

Southeast Asia, on the other hand, is not a deep buyout/control market. The majority of its sponsor activity is in minority or growth deals. There has been limited structural bank retrenchment due to a relatively benign regulatory environment for banks, but that doesn't mean that demand for corporate credit is perfectly fulfilled. Tailored capital solutions are often required for underserved corporates, which are frequently family-owned. Their needs often fall into two broad categories. The first is helping to bridge a gap on valuation and manage dilution by using hybrid capital as a substitute for minority equity. The second is providing transitional capital for companies that are either undergoing generational changes in ownership or that need bridging capital before an asset or business has matured and stabilized.

The relative strength of the legal systems in the various APAC countries can be an important differentiator. On one end of the spectrum, Australia has a very robust bankruptcy code that is arguably even more lender-friendly for secured creditors than most other developed markets. On the other end of that spectrum are some emerging economies where legal outcomes are much less predictable and reliable. In such jurisdictions, we think lenders should consider structuring deals to include enforcement and downside protection, in addition to relying on local relationships built with the borrower and its network of capital providers. Examples of these kinds of protections include collateral escrow accounts, pre-wiring arbitration processes and/or taking security in offshore jurisdictions with more robust creditor protections, as well as other positive controls that give lenders early intervention rights to ensure the borrower is both willing and able to repay.

To take full advantage of the diverse array of APAC private credit opportunities, we believe a pan-Asia approach makes sense. Investing across sub-regions and in different parts of the capital structure allows investors to pursue the best opportunities while also making it possible to pivot when global economic conditions and regional cycles favor one or more sub-regions or financing structures over others.

However, investing in a region as vast and complex as APAC does require specialized expertise. On-the-ground coverage is not only important for sourcing deals, but also for investing. We have structured our own credit team so that it is spread across the region and embedded within our country investment teams to enable us to access the full benefits of a deeply local platform across origination, deal selection, ongoing monitoring and portfolio management, and diligence.

Conclusion

For investors, the private credit opportunity in APAC boils down to a few key points.

First, we think that given the outsized role the region plays and is likely to continue to play in global growth and global consumption, portfolios that are under-allocated to the region are missing a critical opportunity. In thinking about how and where to invest in APAC, we believe private markets offer access to opportunities that are not as readily available in APAC's public debt markets, which are heavily weighted toward utilities, financials, natural resources, and property – an outdated snapshot of the region that does not reflect the strong growth we foresee in consumption, healthcare, automation, and other emerging economic sectors.

In addition, investments in APAC can diversify global credit portfolios that are overly weighted to U.S. or European private credit. A pan-Asia approach that invests across the region allows investors to further diversify and to pivot as strengths and weaknesses emerge in any single economy or sector.

Finally, there is a risk-adjusted return premium over investments in the United States and Europe. However, that premium must be viewed holistically. It's true that specialized local knowledge is imperative, including local languages, a deep understanding of local regulatory systems, and strong relationships on the ground. But because the demand for performing credit capital so far outstrips supply, with the imbalance set to grow considerably in the future, investors have opportunities to lend to large, market-leading companies with covenanted structures, governance rights, and other protective elements that would not be as commonly available in Western markets. Taken as a whole, we think this asset class offers a gateway to a variety of dynamic businesses in a region that increasingly powers the world's growth.

Endnotes

1. Source: Haver Analytics, KKR Global Macro & Asset Allocation analysis as of April 14, 2023.
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