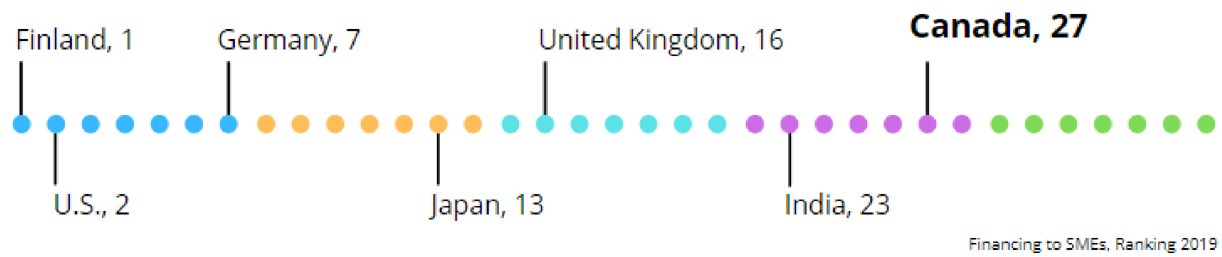
Canada's Underserved Mid-Market Segment of the Economy

Greg Dimmer, April 2021

Canada's lower mid-market sector of the economy remains well underserved in terms of capital formation and access to debt financing. Several factors lead to this, including:

- Bank oligopoly that is very conservative from a lending perspective, with few creative, competitive offerings
- Significant capital (insurance companies, pension funds) that is deployed to large corporations and alternative markets (US, UK, Europe, and Asia)
- Government programs that are partially effective

The inability for mid-market companies to easily access capital in Canada is nothing new and is likely to continue for years. The 2019 Global Competitiveness Report created by the World Economic Forum* ranks Canada in 14th of 141 economies in terms of its Global Competitiveness Index. Canada ranks high in Macro-economic stability (1st), labour market (8th) and overall financial systems (9th) but within financial systems, we do poorly in the following: **Financing of Small and Medium Enterprises (SMEs)** (ranked 27th).



The challenge faced by smaller companies in Canada to raise capital, both equity and debt, has a significant impact on not only our global competitiveness as a nation, but also on the speed and strength in which our economy will recover from the Covid-19-induced downturn. SMEs in Canada account for over 50% of the economic output produced by the business sector and 90% of the employment in the private sector with 10.6 million jobs. Leading industries supported by SMEs include construction, manufacturing, transportation and warehousing, wholesale trade, retail, professional, scientific and technical services, and healthcare.

Innovation, Science and Economic Development Canada's 2019 report listed **financing** as one of the major challenges facing SMEs, along with protection of intellectual property, administrative and border issues, logistics, market knowledge, and insurance.

(continued)

Improving Canadian SMEs' Access to Debt Financing

Private Debt Partners' (PDP's) focus is solely on the mid-market segment of Canadian business. Our Senior Direct Lending Fund will provide long term, patient capital to borrowers requiring $10 million to $50 million of senior secured term debt with longer terms (5 to 10 years) and amortization schedules that meet both the use of capital and life of assets (10+ years). Our Senior Opportunities Fund will likewise provide capital to non-investment grade companies, with strong management teams and clear competitive advantages, that are well positioned for growth.

Other than the traditional banks, there are few alternatives for quality companies to borrow from. Insurance companies that have private credit offerings rarely lend less than $50 million, and larger pension funds with their own internal private credit teams are focused on direct deals that are $50 million or larger, as well as syndicated deals with other lenders.

Given the lack of competition in the mid-market segment, there is an opportunity for enhanced, non-levered returns in the 6%+ range from investment grade opportunities, as well as returns of 8%+ from non-investment grade opportunities. On a risk adjusted return, this segment of the Canadian market offers investors a premium to both the US and European markets, which provide SMEs with significantly more borrowing options.

Most other private debt funds in Canada are focused on higher yielding opportunities with lower risk adjusted returns, while others are focused on opportunities across North America.

Key to accessing high quality loans in the Canadian mid-market segment is direct origination. PDP's underwriting team has a combined 35 years of experience in direct origination in this segment with relationships with advisors, accountants, lawyers, investors, and entrepreneurs from coast to coast. Our advisory board provides insight into regional markets as well as industry verticals.

* World Economic Forum, Insight Report - The Global Competitiveness Report 2019, Klaus Schwab