

# EUROPEAN ROUNDTABLE 2015

From left to right: Christopher Bone, Robert Wagstaff, Jaime Prieto, David Cooper and John Jenkins



PHOTOGRAPHY: JAMES CLARKE

## Cracking the investor code

Not all debt investments are created equal. Four lenders and a trustee spanning the many realms of private debt in Europe today joined **Anna Devine** and **Rachel McGovern** to discuss the tricky yet still promising landscape before them

**T**he main topic engaging our infrastructure, real estate and corporate lending specialists, not to mention the administrator and trustee who manages \$300 billion of illiquid assets? Investors. What they're doing, how they think and where they are investing are all closely dissected topics at *PDI's* annual European roundtable.

Private debt appeals. However, the conversation makes clear that the asset class as a whole – and we have input from most

aspects – is still trying to find its place in pension fund and insurance company portfolios.

On the lending side, the investment environment is constantly evolving. In certain pockets of the market yields are compressing and deployment is slow. In response, private debt practitioners are having to fine-tune their strategies so that they can source deals which pay a premium and keep investors happy.

Despite some trepidation about deployment, our four private lenders and trustee say that the outlook for 2016 looks positive. Continuing demand for less mainstream lending in tandem with a growing awareness of alternative credit are providing managers with the fodder they need. And while our lenders are all

primarily sourcing their own deals, they are not blind to opportunities within secondary deal flow from banks.

One of the secrets to success is the ability of managers to match the supply of capital with borrower demand. Increasing regulation is the backdrop that continues to aid this. And our panellists say there are still rich gaps in the market for customised solutions and in areas where banks can no longer play.

And as you'll see, the discussion makes clear that understanding the needs of investor capital will help private debt practitioners in their quest to get money to work.

#### **Q** What is driving private debt?

**John Jenkins, Omni Partners:** There is a lot of institutional capital seeking yield and a need for alternatives to bank lending. Bringing the two together really is the role of the investment managers, asset managers and hedge fund managers.

**Chris Bone, Partners Group:** It's very much driven by the regulatory environment at this point in time, specifically how banks are being constrained in the US and Europe. [There is also what's happening] in the wider political environment and by that I mean private debt offers a stable source of reliable long-term capital, which borrowers in particular appreciate and like.

#### **Q** According to PDI data, by 30 September \$90.7 billion had been raised for private debt strategies this year, putting the asset class on course for a record-breaking fundraising year. How are you finding the fundraising environment?

**Robert Wagstaff, BNY Mellon:** We're fortunate enough to sit in the middle [of investors and funds]. Private equity firms, particularly, have been able to raise long-term money. Most of the fundraising we're seeing are by the larger insurers and private equity firms that by now have built these platforms and everybody knows that



### **CHRISTOPHER BONE** MANAGING DIRECTOR, PARTNERS GROUP

Based in London, Bone is responsible for the private debt platform in the UK. He has been with the €42 billion asset manager for about six years.

Mid-market private debt is an important part of the business, Bone says. One of the main sources of transactions for the firm is backing private equity-owned companies.

Bone is a member of the private debt investment committee and the private real estate direct investment committee. He has 15 years' industry experience, including stints at AlInvest Partners, Royal Bank of Scotland, PricewaterhouseCoopers and Ernst & Young.

they've got access to the assets. There are very large volumes of money coming to a few players. It does make it difficult for the smaller firms to compete both on fundraising and asset deployment. So now many are going back to their bigger parents and working out a different and better strategy.

**JJ:** We see something similar. The two questions we're asked by investors are, 'Can you deploy this? And what's happening to you?' I think there is nervousness [no matter the asset class] about the scale of fundraising and [whether it can all be deployed].

One of the advantages of having our own platform is that we have constant origination and good deployment visibility. Certainly, in the first fund, which is now in realisation and has already returned most

of investors' capital, that was the case. We're deploying our second fund now and finding more of the same.

[Investors] look at real estate and think it's long money, whereas actually we give them the security that real estate brings with the higher yields specialist debt providers typically earn. We operate in a fairly liquid space within lending, so investors are only sitting on this for 24-36 months. But they still ask the questions.

**CB:** [Private debt is a] maturing industry. There are more managers available to choose from compared with the period immediately following the financial crisis. [Investors] see a lot more research about it. Therefore, they are more comfortable to allocate very small amounts of their overall portfolio to private debt, maybe 1-2 per cent. But, of course, as everyone does that,

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**DAVID COOPER**  
EXECUTIVE DIRECTOR, *IFM INVESTORS*

London-based Cooper joined the Australia-owned asset manager in 2013. The firm's core business is infrastructure investment through both debt and equity. It has invested in private debt since 1999, with the strategy now controlling \$7 billion in assets under management. In Australia, IFM oversees liquid and illiquid strategies. Globally, the firm is a big separately managed account business.

Cooper is responsible for driving the expansion of the firm's infrastructure debt business into the UK and Europe. He has 18 years' experience in banking, focused on project finance, infrastructure debt and structured credit. He joined IFM from Barclays, where he was head of infrastructure and structured project finance. He learned the ropes at UK lenders HBOS and RBS.

it flows into the market and it grows. So, I still believe that there's a lot more money to come, it's just the tip of the iceberg.

**RW:** We see these waves of investors that come in, one geography seems to identify the opportunity in private debt and then about four or five different pension funds or administrators come in. It's the Nordics at the moment. The Germans are still working through regulatory hurdles as to whether they can be direct lending or not direct lending. The UK's always been there.

**Q** Do you have any concern about a mismatch between capital raised and the volume of deals to be had in Europe?

**RW:** There are pockets of the industry,

particularly on the leveraged finance side of things, where the assets are hard to source due to market conditions. And some managers are turning off subscriptions into their credit fund because of this, they're not interested in investing in more exotic stuff. They're staying with the European sponsor-led leverage finance assets which they know will perform through the cycle.

**Jaime Prieto, Kartesia:** Our sense is that most of the capital is being concentrated by very large GPs and as a result most of the capital that's available for private opportunities will be looking to mid-market deals in the region of €75 million-€200 million.

The returns, compared with the risk, even in the mid-market space are still very

interesting but there are a lot more niche opportunities out there and one can avoid that glut of capital. Kartesia focuses on the smaller end of the market and due to its fragmented nature we do see room for more GPs and significantly more capital to be deployed.

**David Cooper, IFM Investors:**

We have been very successful in terms of deployment but one of the things that surprised me recently was how little some of our competitors are managing to deploy.

We are aware of one manager with a mandate virtually identical to one of ours who have only managed to deploy about 20 percent of it compared with our own deployment which is over 50 percent deployed.

We had assumed that a lot of these big insurance companies are deploying for their clients. Some of them are big origination machines. But then there are clearly others who are originating more from their own balance sheet and their third-party clients come in second.

**CB:** We raised over €1 billion in the first half of this year alone. What's important for us as we deploy capital on behalf of our clients is to be able to do it globally and not be too niche. Some of the funds that we raise are multi-asset credit. We can go into real estate and to corporate debt or different geographies. For example, the US at the moment is a little bit more interesting versus Europe. Six months ago, that wasn't the case.

**Q** Do you think investors get a better deal from coming to a manager that has a multifaceted capability to deploy, versus a more linear approach?

**JP:** Some funds are country specific and invest only in Spain or Germany. We feel that it forces them to follow the credit cycle of that country when as a manager what you really need is flexibility to avoid those cycles. Having the trust of the investor is essential

to decide where and how to take advantage of the cycle across Europe.

In Kartesia's case, we didn't invest in Spain until mid-2013. Since then, we've actually deployed around 25 percent of the fund into Spain with very good performance. But today, we find less interesting opportunities in Spain, mainly because of competition driving the prices up. Therefore, we are now looking at other European markets including France and Germany and the secondary market. We definitely benefit from our flexibility as a pan-European platform and our mandate is ample enough to be selective and find the best opportunities.

**JJ:** Our investors like the fact that we are very focused and they come to us because we are a specialist in a very specific market.

**Q** So would you say your individual private debt strategies appeal to different types of investors?

**JJ:** We've had better traction with US and Swiss investors than UK investors because oftentimes they're already in [domestic] real estate [equity] and they look at what we do and say: "Well, that's real estate, right?" So there's an element of reverse-bias on the investor side.

**DC:** They do expect to get a yield pick-up for going overseas and that's something that is quite challenging to achieve. The Australian pension fund industry is getting bigger and bigger because the amount that people have to pay into their pension has increased as a percentage of their salary. I think they're at the stage now where the amount of AUM within the Australian

super funds exceeds the GDP of Australia. So they do need to get their head round the fact that they might have to deploy more outside Australia without necessarily receiving a higher yield for doing so.

**Q** Is it getting more difficult to deploy capital in a way that you'd like to?

**DC:** The bank market in Europe is increasingly dynamic and one that's evolving quite quickly.

To put into context, in the space of six months, there's been one bank – and this is not untypical of the way the bank market tends to operate – but they've gone from being very gung-ho, wanting to write very big tickets for very long-dated debt, to being on the phone three weeks ago, saying: "We need to sell some stuff by the end of the year."

There is a sense that some of those European banks have filled the balance sheets back up almost too quickly. That has created opportunities for us but it does come back to that point about the advantages of having a flexible mandate with the ability to invest in bank loans. In Europe we've found, especially in the last year, some of the best deals we've done, from a relative value perspective, have been secondary deals.

**Q** How does deployment on the corporate side look?

**CB:** The main competition in the segment of the market that we operate [is broadly the same as] three or four years ago. Funds are being deployed but each successive fund size is now increasing. Perhaps we're getting closer in size to the traditional syndicated market, closer to the high-yield market at times.

**Q** How much or little do you deal with banks as fellow lenders? And what about other private debt managers?

**CB:** We don't need to be the sole lender to companies and you will see ourselves and



**JOHN JENKINS**  
CHIEF EXECUTIVE OFFICER, AMICUS  
PARTNER, OMNI PARTNERS

Jenkins heads Amicus, a UK-based origination platform wholly-owned by Omni Partners, a \$1 billion asset manager. Jenkins is also a partner at Omni, which he joined in 2014.

Jenkins has 25 years' experience in senior roles at GE Capital and Lloyds TSB. For eight years prior to his current role he was chief executive of GE Capital in the UK.

Jenkins focuses on running Omni Partners' private debt firm, which specialises in short-term property loans and SME financing. The firm operates in niches that banks are increasingly withdrawing from, he says.

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our friendly competitors, three or four of us in a deal.

**JJ:** The interesting thing is that the banks do try to retain a role.

**JP:** Differentiating yourself from other lenders is essential and although club deals can be interesting they are not differentiating. We feel that to remain relevant in the segment you are in, it's important to have the company's objectives in mind to assist them in getting the best possible deal.

**JJ:** We go one step further again. We're trying to seek out entire markets that no one has really paid too much attention to. We're doing real estate at the moment, and we've just invested in two SME businesses because we think true SME lending [£500,000-£1 million] is going to be another difficult space for the banks to sustain positions in.

If you want to capture more attractive assets you've got to differentiate. We find, in our markets, that we're still having to adapt and make our offer different versus our competitors, otherwise you're not going to get the opportunities you want to win, you're going to get the opportunities that everybody wants and you end up commoditising down. So, where's the added value being an investment manager in that world?

**Q** Leveraged lending guidelines in the US are said to have dampened activity. Do you think that similar regulation could be introduced into Europe? And what regulatory issues concern you?

**RW:** The US market is very hot at the moment. Seventy to 80 percent of the market is in the capital markets and so it's the Fed trying to slow it down. Capital markets are, I believe, approximately 6 percent here, growing to 15 percent. So we're poles apart.

**CB:** I think the environment is going to stay friendly for people like us particularly because of capital adequacy ratios at banks.

The other important regulation for us is on the CLO side.

If the CLO market is not there in size, the banks won't feel comfortable underwriting large amounts of debt and syndicating out. That creates an opportunity for people like us [and] is one of the important determinants of where the leveraged loan market is going over the next 12-24 months.

**RW:** CLO managers are now able to get finance against the vertical strip to cover the risk retention obligations via the sponsor route.

I was talking to a new warehouse provider coming over from the States and they're going to provide the warehouse,

sell the bonds and finance risk retention. The market is changing a lot on the CLO side of things.

**Q** How do borrowers feel about having non-bank private debt investors providing them with capital?

**DC:** On the infrastructure side it's something that people are now used to but there has been an adjustment process, and even now we'll obviously run into particular deals or particular sponsors who aren't used to dealing with institutional investors on the debt side.

**JP:** Issuers are experiencing a learning curve and non-bank private lenders have the responsibility to accompany them in



**JAIME PRIETO**  
CO-FOUNDER & MANAGING PARTNER,  
KARTESIA

Prieto and his three partners set up Kartesia, a pan-European mid-market lender in 2013, building the manager to around €620 million in AUM. Kartesia is focused on direct lending to firms backed by private equity funds. It also acquires assets from banks, CLOs or hedge fund managers. For primary deals, the firm targets the lower mid-market, where there is less competition, Prieto says.

Prior to Kartesia, Prieto co-founded Altercap credit funds at LBO France. He started his career in credit at Intermediate Capital Group (ICG). He also worked at McKinsey & Co advising private equity and corporate clients.



## ROBERT WAGSTAFF MANAGING DIRECTOR, BNY MELLON

Wagstaff heads sales and relationship management for BNY Mellon's corporate trust business. Based in London, he has been with the bank for 12 years, having initially joined in Sydney.

Prior to the financial crisis, the trust's exposure to the private debt market was purely on the CLO side. Since the crisis, it moved into assisting clients to invest in illiquid assets.

Wagstaff is an expert in illiquid asset financing structures. Before his move to London in 2006, his focus was on sales of structured products. Previously, he was the head of securitisation at Perpetual Trustees, a corporate trust provider in Australia.

this process and help them get comfortable with non-banks.

We need to build credibility, individually and collectively. On the corporate side we definitely need to focus on building relationships further. Having only one lender is very important for issuers and it's a big responsibility.

**Q** Is there a danger that private debt lenders could end up loan-to-own investors?

**CB:** I think that's an argument by other players trying to dissuade against direct lending, frankly. I don't see that... maybe one or two examples.

**JP:** There is one important aspect to have in mind which is the size of the counterparty. For example, if you have a small private equity fund with €200

million of assets, you could wonder what will happen if it's financed by a €5 billion fund? It could get a bit scary because for that guy if they need new money at any point in time the credit fund could take control.

**DC:** Certainly, one of the last things that any of our insurance or pension fund clients would want is to take control of some large infrastructure asset which they don't really understand.

**Q** So with 2016 in view, how do you see the year ahead panning out?

**JJ:** 2016 looks good. We've already raised about \$200 million for our second fund vintage since its launch in April. I think we'll raise more than that next year in vintage three, which will follow the same strategy.

There is no shortage of demand and there is a better understanding on the supply side, so I think it looks pretty buoyant.

**CB:** We think that interest rates will stay low for some time, and so default rates will stay low and capital preservation rates high.

**DC:** Generally, we're very positive. There seems to be increasing awareness of bank regulatory capital and liquidity issues, which I think will play favourably for us over the next 12 months, but, perhaps more importantly, at least on the supply side, there is now a view within Europe that infrastructure is one way of getting economic growth back into the economy. We'll see a lot more deals coming to the market in 2016.

**JP:** Kartesia's performance in 2015 was very good across the portfolio. Our deal flow picked up during the second half and we believe that the first half of 2016 will be strong.

On our specific segment there isn't really an increase in competition and there is still a lot of demand for capital from companies. On the fundraising side, we are well positioned to have invested 80-90 percent of our fund by the end of 2016, therefore we might well be on the road by the end of next year.

**RW:** It's all about yield. This is a yield play at the end of day and as people get more comfortable with the risks in the product it becomes a better relative yield place. So, yes, 2015 was better than 2014 and 2016 is going to be better than 2015.

We've got €300 billion under administration on the illiquid side of things across 1,400 portfolios. We'll hope to continue to grow that business. Our focus was traditionally on leveraged finance but it's increasingly more on the real estate and infrastructure debt side. And we're growing with our big insurance clients who are putting more and more money to play in this space. ■