EXPERT Q&A

Navigating a difficult and uncertain market environment requires creative financing solutions, say Partners Group's Oliver Baker and Abhishek Dhayal

Why a flexible strategy is key in 2023

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Q How does Partners Group approach flexibility in its lending strategy globally?

Abhishek Dhayal: We view flexibility as valuable from both the sponsor and the investor perspective. Today's market offers a compelling opportunity for direct lending, especially senior debt, which is attractive from a risk-return perspective. That said, we also see sponsors considering other creative financing solutions in light of higher interest rates, and, in this context, it is even more important to have flexibility in the playbook to identify the best opportunities across different parts of the capital structure and varying regions.

Our mandate and global client base helps. A lot of our capital is in evergreen funds and bespoke mandates that have a broad remit in geography and instrument type, allowing us the flexibility to evaluate opportunities globally with a true relative value mindset, and in turn help clients access differentiated content.

Oliver Baker: Having a highly scaled platform allows us to provide LPs with access to the global private debt landscape, whether that's direct lending content or broadly syndicated loans.

By offering a wide range of funds, LPs can access content ranging from a very specific type of exposure, such as European senior direct lending or junior debt, to a much broader subset of the market, such as global multi-asset credit. We also offer fully bespoke mandates that allow investors to tailor the content; for example, seniority of instrument, sector, geography, ESG requirements, returns or leverage caps.

We are also using innovative structures to facilitate wider access to the asset class, notably evergreen funds, which can accommodate clients that have historically struggled with the illiquidity associated with private markets.

To be an attractive partner to the sponsor community, we believe you need to be relevant across a wide range of situations. That requires being active across different finance structures, geographies and company sizes, from the lower end of the mid-market through to large cap assets. We aim to actively support companies right through their life cycle and potentially through several rounds of private equity ownership. A global presence also allows us to support internationalisation of these assets and finance cross-border opportunities.

Q Why is that so important in the current market?

AD: Direct lending looks very compelling right now, but it's important to be aware that borrowers are navigating a difficult and uncertain market environment. Some of the supply chain issues are normalising, but it remains to be seen how growth rates, inflation and margins will respond.

From an investor perspective, it is important to have a broad funnel of opportunities, flexible capital to play across the capital structure, and a good view of relative value to provide creative financing solutions that will work for borrowers. All of this must be overlaid by good credit selection, which is fundamental, and our ability to dig deep into sectors and identify thematic growth trends is an important part of our strategy. We look for companies in sectors with above-average resilience on the back of transformative trends and then invest with an ownership mentality.

We believe Partners Group is well positioned, with a broad playbook across Europe, the US and Asia-Pacific, and expertise across our broadly syndicated platform that helps us view opportunities more holistically.

Q How do you see private debt crossing over into broadly syndicated loans, and how might that theme play out going forward?

AD: If you look at new issuance supporting leveraged buyouts in 2021 and 2022, direct lending has significantly outpaced the broadly syndicated loan market. We see direct lending taking market share, particularly in the US, where we have seen several unitranche financings of more than $1 billion in value, which speaks to the maturity and

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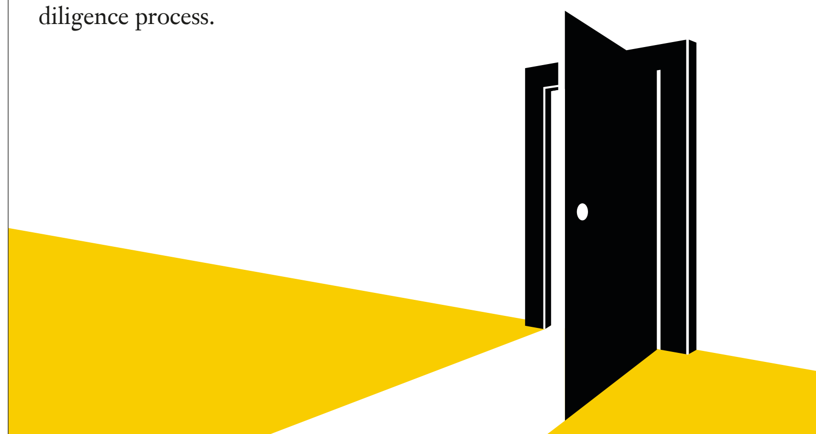
Q How are you responding to the market opportunity around NAV financing?

OB: We have seen a significant increase in interest from both sponsors and direct lenders in NAV financing. The product has existed for a long time in the secondaries space but corporate private equity started to explore NAV options more broadly during covid when facilities were used to support portfolios and finance opportunistic add-ons. The NAV market is still underpenetrated, but it is transitioning into a more mainstream product, and we foresee significant growth there in the next few years.

NAV financing is a synergistic development for Partners Group's debt platform, as we know the asset owners and we know the underlying assets. Some parts of the NAV market are addressed by the banks, such as large secondaries portfolios with low loan-to-value, but we see interesting opportunities where portfolios are a bit more concentrated, so our understanding at the individual asset level can be critical for the due diligence process.



depth of the direct lending market today.

We are seeing companies tapping non-fungible add-ons alongside broadly syndicated structures – given where the syndicated markets have been over the last nine months, this is not surprising. Despite this competitive tension between direct lending and syndicated loans, it will benefit the broader ecosystem if the momentum in the CLO market continues.

The market will continue to ebb and flow between direct lending and the syndicated markets, so lenders have to be able to capitalise on both. We have an active syndicated platform that gives us visibility on high-return hung syndications and non-fungible add-ons that can also be attractive content for direct lending programmes. When markets normalise, direct lending will continue to be a meaningful part of the equation and one can envisage a synergistic market that will benefit both sides.

OB: We see similar trends in Europe, with increasing depth in the market and the ability for direct lenders to service larger companies and therefore compete directly with broadly syndicated loans.

The European direct lending market remains fragmented but has seen some consolidation around larger funds with bigger ticket sizes, which are pushing into large-cap financings. We also see an increasing willingness among direct lenders to club together on financings in order to reduce portfolio exposure risk and provide larger solutions. This trend was particularly clear in the second half of last year and we selectively find attractive relative value in these transactions, with the quid pro quo being reduced control versus a sole or lead lender transaction, where we focus our core mid-market activities.

Q What are you currently observing in terms of borrower demand around flexible financing solutions?

AD: Given where interest rates are right now, we see finance solutions being primarily designed around cashflow coverage and liquidity needs. For new borrowers, sponsors are seeking structures where they have senior capital up to a reasonable leverage point and then are looking for junior capital that provides them with flexibility to PIK, bridging the enterprise value multiples they are having to pay for high-quality businesses.

Existing portfolio companies are looking for ways to access incremental dry powder for acquisitions or to meet upcoming liquidity needs, either in the form of non-fungible add-ons or junior PIK financings. Despite the fact that a lot of lenders are really focused on coverage metrics, sponsors have been able to arrange, at least here in the US, large annual recurring revenue loans to back sizeable public-to-private buyouts in the software space. Lenders view those as good relative value versus where the market was a year ago, and the market has the depth to get those done.

NAV financing is also becoming more common as a tool at portfolio level to access liquidity for LPs when sponsors are not in a rush to sell their crown jewels at discounted multiples. Even though there is sufficient capital in the direct space, structures and terms today are more conservative, and we continue to be in an environment that is favourable to lenders.

Q What lending opportunities do you currently see in Asia?

AD: Similar to the US and Europe, the presence of direct lending continues to gain importance in Asia-Pacific. Historically, the markets relied on bank financing but we see a large financing gap, especially for small to mid-sized companies.

We particularly like businesses based in jurisdictions that have a more developed framework and infrastructure for lending, such as Japan, Korea, Hong Kong, Singapore, Australia and New Zealand.

We see both US and European sponsors increasing their presence in that market and tapping into growth opportunities. The size of APAC-focused AUM has increased significantly, and we often find ourselves backing global sponsors on APAC investments and moving across borders with them.

At the same time, the direct lenders with global presence are bringing over structures from global markets, as was the case with the first unitranche that Partners Group pioneered in APAC in 2017. Still, the documentation and overall structure tends to be more conservative in those markets, and unitranche financings typically have covenants, tighter headroom and better core protections that benefit lenders.

Q Finally, what are the opportunities and challenges around junior debt strategies?

OB: The junior market has really transformed over the last five years and the opportunities we see now are typically more heavily subordinated, higher returning instruments such as PIKs sitting at holdco level, for example.

One of the key drivers of demand for junior capital was historically bridging to high enterprise value multiples, but that is now moderated, with valuations having come down. However, companies are seeing higher interest rate burdens for senior debt so that is a driver, reducing the capability for cash pay at opco level and increasing the attractiveness of doing something with a PIK instrument.

Finally, impending maturities of existing capital structures that will not easily be refinanced because of the shift in interest rates and capacity are another element that could drive appetite for more junior instruments. ■

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