PARTNERS GROUP

The view from the top

With its mandate to seek the best global relative value, Partners Group takes a wide-angle view of credit markets. **Rachel McGovern** and **Anastasia Donde** ask what this shows the Swiss-based firm and what investors think of the combined LP/GP credit platform

Partners Group's private credit group is just that – private. Obsessively so, one could argue.

While alternative investors that court public are the exception, the Swiss-headquartered firm almost never seems comfortable speaking about its achievements. The senior management who sit on the executive committee – most of whom have been with the asset manager for at least 15 years – are not headline-seekers. Aside from some strictly controlled distributions on their investment outlook, the manager rarely discusses deals and remains tight-lipped on fundraising.

When it comes to private debt, though, the firm does things a bit differently from other credit investors. So *PDI* sought out the listed alternative asset manager's credit team to ask how private equity firms view them – as an LP or a lender, and whether their global reach has drawbacks as well as benefits.

Shortly before *PDI* met the three key private credit players for this profile, an internal reshuffle saw René Biner, who set up the credit unit, come back on board as co-head of private debt. Naturally, we sought an interview with him only to find that his co-head of investments role doesn't leave him well placed to discuss the nitty gritty of debt market.

Biner took the co-head of private debt position when Juri Jenkner moved from the credit side of the business to the infrastructure platform. So, operationally, there are three key players who manage Partners Group's credit unit: Scott Essex, Biner's co-head of private debt who is based in New York and leads the firm's office there; London-based Chris Bone, head of credit in Europe; and Edward Tong, based in Singapore and leading the firm's Asia-Pacific lending efforts.

Essex joined in 2007 from GE Capital

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having previously worked at Lazard. Tong is also a former investment banker. He was at ING for almost 10 years on the European leveraged loan desk in London and served in Hong Kong ahead of the financial crisis. Tong, from Singapore, later moved home before joining Partners Group to lead the Asia-Pacific credit effort in 2013. While Bone spent several years at investment bank Royal Bank of Scotland before joining private equity firm AlpInvest.

There are 30 people in Partners Group's credit unit, including 18 in Europe and three in Asia. The rest are in New York, though Essex points out that the team can tap other parts of the business for sourcing support giving it access to a pool of around 110 staff.

The firm has a longer track-record in credit investment than most European-headquartered managers. It first moved into mezzanine investment in 2003 and has raised seven mezzanine vehicles, the latest of which, Partners Group Direct Mezzanine 2013, closed on over €1 billion of LP commitments in late 2014.

The firm had a cautious start in senior lending around 2007, says Bone who joined from Alpinvest in 2010 and heads the London office. "In the period

LOOKING EAST

Though the US currently dominates as the best source of opportunities as judged by Partners Group's global relative value perspective, Asia-Pacific is a comfortable second ahead of Europe.

Tong says the firm has two main sources of deals – both cross-border in nature: international sponsors seeking to expand their portfolio companies into Asia; and Asian-based private equity managers acquiring non-Asian companies with a significant presence in the region.

And both have significant capital reserves that they will need to invest over the coming years, he adds.

"At last count, we've seen seven to eight pan-Asian private equity firms or the Asian arms of global GPs that have at least $3 billion in capital. That dry powder needs a home," says Tong.

Asia-Pacific: key source of deals

Alongside the standard debt fund advantages of flexibility, speed and higher leverage, in Asia being able to offer sponsors financing in local currency to match the cashflows of the underlying portfolio company is a major advantage, says Tong, citing Partners Group's financing of an add-on acquisition for a US sponsor in Australia. The credit line was in Aussie dollars.

Asked about the impact of the slowdown in China, Tong says that Partners Group focuses on the most stable of the Asian economies for deals before noting that, at the moment, concerns mostly just mean opportunity for the lender.

"To the extent that the volatility creates nervousness around underwrites, that generates opportunities for us – either coming in and being a privately pre-placed lender into some of those situations or, indeed, as we see, opening up junior debt opportunities as well, which as we know, the banks don't wish to hold on a long-term basis," he says.

after the global financial crisis, it was quite tough to convince new investors that this [senior debt] asset class made sense. You had to convince them that it wasn't a really quirky asset class, that it was quite an interesting place to be."

The firm has now raised six dedicated senior debt funds with the seventh currently in the market, according to PDI Research & Analytics.

Last year was particularly strong for private debt fundraising, notes Bone, with €1.7 billion raised in total. That's filtered down into the team. The firm prefers to promote from within so with some individuals advanced internally, the London team is adding two financial analysts.

Scale in credit is important in private lending and so the strategy expansion is far from uncommon. Most alternative lenders start in one niche and build outwards. The difference for Partners Group is that it also seeks to build in flexibility – its funds are global.

The last couple of years have seen the firm seek both scale and flexibility in other ways. Partners Group closed its first multi-asset credit fund on $700 million of commitments in June 2015. It was swiftly followed by a second, which is in the market at the moment.

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Chris Bone

Asked whose idea it was, Bone says: "It came almost from the investor side. The opportunity in the debt market is not only corporate debt, it's also real estate and infrastructure debt . . . Investors wanted access to that overall trend in credit."

Investors seeking more diversity and the upside offered by slices of a variety of different instruments mixed with the downside protection of senior debt are attracted by the fund, says Bone. And that is complemented by the security protections offered by assets tied to real estate and infra loans.

HEDGING YOUR BETS

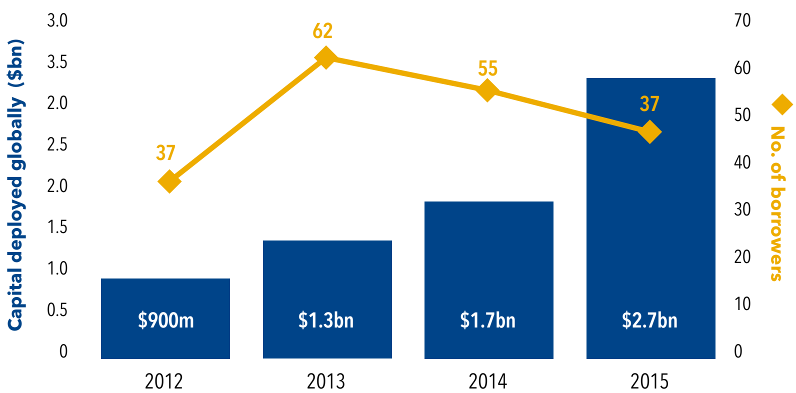
The almost hedging-style approach of the multi-asset fund has perhaps bled across from the firm's primary corporate debt strategy and general investment thesis – execute only where the best deals are to be found.

The global remit enables the debt team to invest in whichever market currently offers the best relative value. For several years that was Europe, but the pendulum has swung back to the US as wider market volatility has seen American lenders push back on terms.

"The relative value of where to invest changes over time," says Bone.

The investment mandate is to seek out

TAKING CARE OF BUSINESS



Source: Partners Group

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the best relative value globally – something that certainly sounds attractive from an investor's point of view.

When fractured and nervous lending conditions in the US offer a 200bps pick-up versus the more competitive European mid-market, having the option to ditch the lower yielding market is all upside for LPs. Add to that a sprinkling of some of Asia-Pacific's best LBOs and you've presumably got a nice portfolio and decent returns.

So that's what Partners Group does.

Asked if the London team are left twiddling their thumbs as the US guys scramble to take advantage of the juicy market, Bone says that the firm moves team members around to support where needed. They can relocate for a few weeks or even longer if necessary, he explains, adding that the London team is currently doing due diligence on a US acquisition by a European sponsor.

"We have a global credit team. They are living with their investments from the beginning to the return of capital, so there isn't a discreet sort of coverage model necessarily. We leverage the platform with regard to that coverage," adds Essex.

Of course, while the broader mandate enables, it also compels. Investment decisions will be made in a global context and one team may find capital redirected away from their deals on that basis.

The issue with that kind of pivoting, though, is that lending is – to repeat a well-worn platitude – a relationship business. What do the sponsors in Europe who approach Partners Group think when the firm turns down a deal because there's a more attractive proposition on the other side of the Atlantic? For many, rejecting a deal that the lender was initially positive about on anything other than fundamentals is at best a faux pas and at worst a reason not to call again.

Asked how they deal with that, Bone says flagging their approach is essential.

"The most important thing is good and swift communication internally, so if you're setting expectations vis-á-vis a sponsor or a borrower, you need to be clear as to what you've promised and are able to deliver and be careful not to promise too much if you think you're not going to be able to get there," says Bone.

BEING THERE

Relationship is clearly key to how Essex works. Before his credit career began, Essex was employed by a telecommunication services company bought by Lightower. His relationship with the firm, plus an invite from sponsor Berkshire Partners, bagged Partners Group one half of a $500 million subordinated debt mandate alongside Highbridge, when Lightower merged with Fibertech last year.

The relationship question has a flip side, they argue. The credit group has found that private equity funds expanding into new markets can be a significant business driver. Bone mentions Arora Capital Group, a US sponsor that had never done a European deal until it came to Europe and bought aluminium tube manufacturer Alltub.

The fund had borrowed from Partners Group in the US and tapped it again for financing when it came to Europe for its debut acquisition.

"Private equity funds are themselves becoming more global. American funds are coming over to Europe and European funds are going over to the US," says Bone.

The dynamic has also gone in the other direction with the US team currently working with a European sponsor introduced by Bone's London team.

The same has also happened in Asia, says Tong. When Ontario Teachers' Pension Plan, which controls UK-based early education and nursery provider BusyBees, was expanding in Asia and needed financing,

Tong: offering financing in local currency is a major advantage

BY THE NUMBERS

30
Investment professionals in the corporate credit team

$2.7bn
Capital deployed in 2015

48
Number of deals done globally in 2015

€250m-plus
Investment capital Partners Group can provide

€2.5bn
AUM in debt as of December 2012 rising to…

€5.7bn
…. in debt AUM as of 31 December 2015

€1.7bn
Third party capital raised for private debt in 2015

the cross-continental introduction was made by the European office.

Knowing the company and having existing institutional exposure, combined with boots on the ground for local due diligence eased the process, says Tong.

INTERPRETING RELATIONSHIPS

Private equity fund relationships are very important for the firm. In corporate lending, it focuses on sponsored deals – not to the exclusion of non-sponsored deals – but the leveraged lending world is where the bulk of its portfolio comes from.

It's also where Partners Group's wider structure complicates its relationship with sponsors. The firm both makes its own private equity investments and invests as an LP into private equity funds on behalf of clients.

That network effect gives it unparalleled coverage of sponsors and through them, potential borrowers. Essex highlights it in the context of doing the Lightower financing.

"There is a relationship nature side to the debt business. We're also investors into private equity funds, as well as secondary investors on behalf of our clients, so the ability to have close relationships with private equity sponsors and see companies is valuable," he says pointing to the cross-pollination within the Lightower deal.

The private equity investor arm of Partners Group invested with Court Square which owned Fibertech, the firm that Berkshire Partners' Lightower acquired.

"Having the ability to know the various underlying assets creates synergies. It has been particularly helpful for us in making decisions on whether to participate in certain investment opportunities," adds Essex.

That blurring of lines between the firm as a lender and as an LP is something several market commentators say is a potential source of conflicts, though Bone says that it's not a problem.

Private equity groups, which are generally acknowledged to be among the most financially driven investors, do not borrow from Partners Group if the terms are not competitive, he argues.

The firm's internal infrastructure is also constructed to head off any issues. "We're very careful to draw strong, high Chinese walls internally. It's about credibility in the market so we're very careful around those topics," he says.

Asked about the issue, Essex responds flatly: "We avoid those conflicts of interests."

RELATIVE VALUE VS RELATIONSHIP

From an investor point of view, accessing the deals with the strongest reward dynamic no matter where they are in the world is ideal. But it doesn't come without trade-offs.

Essex and the rest of the team themselves emphasise the importance of relationships in leveraged lending. And European borrowers certainly prefer to borrow from alternative lenders that are from their country of origin, a survey of borrowers by law firm Allen & Overy showed. Meanwhile, on the sponsor side, having a lender that can pick and choose is not ideal. Of course the firm is likely to move towards where capital is more in demand and markets less liquid, which should mitigate this.

Investors must also consider the fact that the wider Partners Group business includes private equity and fund of funds. Essex notes that the firm's own direct equity investments are never financed by Partners Group.

But he also acknowledges that the firm leverages its relationship as an investor into sponsors to access dealflow. They can't force a sponsor to give them a mandate, but it does open up the possibility of a private equity fund looking ahead to their next fundraise, considering the impact of not borrowing from another part of an institution that is for them, primarily an investor.

A top-down view is never going to be as close to the market as the more intensive, localised approach. That leaves investors with a conundrum: is it better then, to be able to see the wood for the trees? ■

SINKING THEIR TEETH INTO THE RELATIONSHIP

Repeat business from sponsors is important to the firm. Berkshire – also behind Lightower – was the sponsor behind Affordable Care, a US dental services business. Berkshire teamed up with management to buy the company from American Capital Equity in October 2015. Partners Group provided the entire $200 million second lien credit line, as well as taking an equity slice in the deal.

The deal is a good example of the non-cyclical, defensive sectors that the firm likes to focus on, says Essex.

Volatility in global markets has opened up second lien opportunities for Partners Group, says Bone.

The firm is a fan of the instrument, particularly when the banks that seek to intermediate it when things are more settled are forced to pull back by external factors.

"The second lien market can sometimes be intermediated by the banks but that is not the case today. So that's an interesting place to be globally," adds Bone.