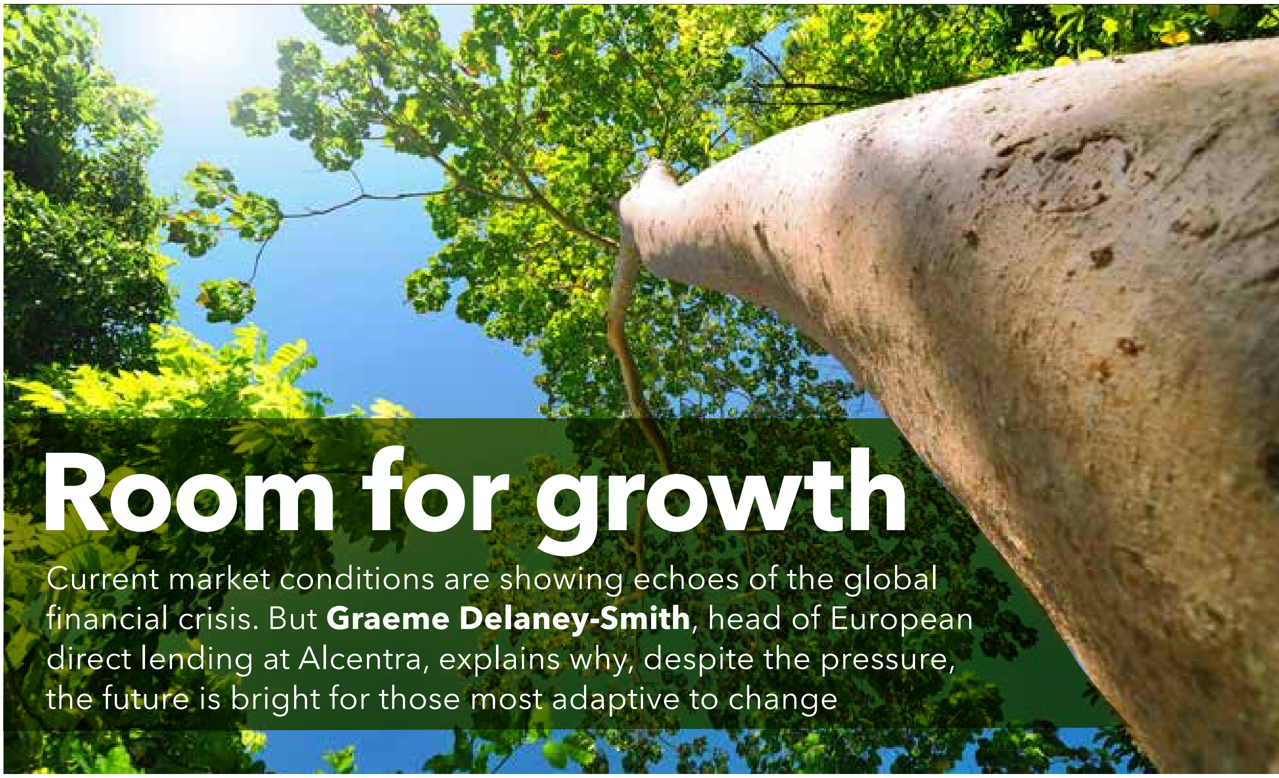


Room for growth

Current market conditions are showing echoes of the global financial crisis. But **Graeme Delaney-Smith**, head of European direct lending at Alcentra, explains why, despite the pressure, the future is bright for those most adaptive to change

Q Do you see parallels between the evolution of private debt in Europe and the US?

Graeme Delaney-Smith: The evolution of the European market is different from the US given the multinational approach in Europe and the lack of bank consolidation that has resulted from the crisis. The homogeneity of the US market, one language and one legal system, has made it simpler. Consolidation and a reduction in the number of local banks has not been seen across Europe. This may occur over time as the reality of the new capital requirements and the over-banked nature of Europe becomes clearer.

The common view is that funds account for 80 percent market share in the US, whereas in Europe we are still in the early stages of market development and funds may only account for 35 percent of market share. The construct of Europe makes it unlikely that 80 percent will be achieved in Europe but 60-65 percent is a good target, leaving a lot of room for growth.

Graeme Delaney-Smith

Q What is driving the demand for debt in Europe, are you seeing more cross-border opportunities, for example?

GDS: The continuing reduction of bank lending is one driver for the market. Awareness of fund capabilities and the flexibility and commerciality of fund capital, however, is a key factor driving demand. This is very often characterised through buy-and-build strategies, where certainty and deliverability is a must-have from an early stage.

The increasing internationalisation of mid-market companies is also driving the need for more flexible and international capital. The Alcentra platform allows us an oversight across all European jurisdictions and sectors in a very focused and precise manner. The focus of our direct lending team to work closely with private equity and interact with the company in delivery of the business plan is a key aspect of our approach. Short lines of communication and relationship continuity assist in this area.

Q Where in the capital stack are European private debt managers investing right now?

GDS: Private debt in Europe is predominately senior debt. I don't think our focus will change in the coming years. Within our fund we can invest across the capital structure but the reality is that in recent years there has been a dearth of good mezzanine product, larger deals have been using second lien to reduce the cost of capital, making mezzanine debt less attractive. Equity co-invest can be interesting but it's used sparingly as it won't be possible nor appropriate in every deal.

Q Where do you see the most competition for deals now?

GDS: Competition has grown in the smaller end of the market where there are more funds and banks with the capability to compete for €50 million-sized deals. New entrants to the market with relatively smaller funds are active here, but so are the more established funds.

The existence of larger transactions is certainly leading to further bifurcation in the market. It enables Alcentra to see more transactions and there is certainly much less competition in the fund market for those sizeable deals. Larger deals may compete with the bottom end of the syndicated loan market, but we won't compete just on price as that's not attractive for returns obviously.

Q We're at the top of the market - do you see echoes of the crisis?

GDS: In the mid-market, not so much, but we're starting to see it through syndicated loans where leverage is going up and documentation has weakened. Some of the excesses that we saw in 2007 and 2008 are coming through, although we would say across the market there is still significant equity underpinning transactions. Sponsors have all raised new funds and they want their money to be invested as well, so I think there is a good balance. The dividend recaps coming through are reminiscent of what was going on back then. A lot of it depends on what happens on the more macro level with the economies of course.

Q What is your outlook in the context of European banking regulation, is the opportunity as strong as it was after the crisis?

GDS: The market outlook remains strong with direct lending funds increasing both the number of deals completed year on year and their deployment of capital. The market volume has grown the further from the crisis years that the market has moved and larger deals are now on the table for larger funds. Our expectation for regulation across the European banking sector remains high, with recent indications of further capital requirements supporting this view. Further regulatory involvement is likely to increase the pressure on banks.

"ANYTIME THAT A PLATFORM HAS MULTIPLE STRATEGIES, THERE'S A NUMBER OF LAYERS OF INFORMATION THAT FIRMS CAN LEVERAGE"

Q What do you think are the main drivers behind the growth of non-sponsor deal activity?

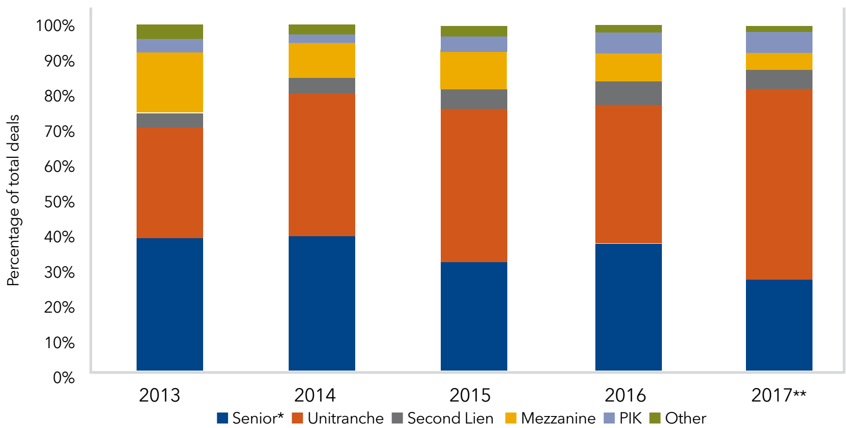
GDS: Non-sponsored deals across Europe will grow as the education of the market continues. Private equity sponsors were very aware of the funds' capabilities having worked with them over the years. This familiarity will only come by increasing the education of the market through advisors, accountants and by word of mouth between private shareholders and management teams. There are many examples of sponsorless deals being completed and I believe that in the right circumstances the appropriate stakeholders are getting more comfortable with private debt funds. This part of the market will likely take some time to develop further, allowing time for comfort to mature without undue pressure.

Q Are you likely to see an increase in opportunities in Europe post-Brexit?

GDS: Across Europe there is more acceptance of what the debt funds are doing. The legal systems are all sensible and able to help the market move forward. Everybody is moving into the twenty first century. Being pan-European is important and it's important to be flexible. ■

SENIOR SEGMENTS

Data from Deloitte's Alternative Lender Deal Tracker show unitranche and senior debt account for the majority of European private debt deals



*Senior only deals with pricing L + 650bps or above classified as unitranche
**First six months

Source: Deloitte