

EUROPE



Breaking down borders

With Europe's private debt markets continuing to mature, fund managers are growing businesses across the region. **Graeme Delaney-Smith**, head of European direct lending at Alcentra, considers the opportunity

"INTERNATIONALISING A BUSINESS MAY BE A BETTER WAY TO CREATE VALUE MORE DYNAMICALLY, IT CAN INCREASE THE VALUE BUT ALSO OPEN UP A BROADER UNIVERSE OF POTENTIAL GROWTH OR EXIT OPTIONS"

Q Looking at the European mid-market today, where do you think the most interesting opportunities are?

We are recognising interesting opportunities across the whole European market. The UK had a bit of a first-mover advantage, but things have picked up in all markets and there is a lot more deal volume. The banks are interested in lending but find it tough because of the restrictions they are under and further regulation is likely to follow. As one of the larger managers, we can look across deal sizes from small to very large and we can commit not just the initial capital but also further capital down the line.

Q How much of an impact do you feel Brexit has had on the types of deals you are doing?

So far, Brexit hasn't resulted in a direct impact. However, we are very conscious of the approaching deadline, as are the sponsors and management teams, and it is an obvious point of discussion in due diligence and consideration when initially looking at new transactions. Some investors have pulled back a little due to the uncertainty, others think the UK will remain a large and active market. We maintain a strong focus on credit fundamentals and a deal-by-deal approach given the wide variety of opportunities we see and the differing company strategies being followed.

Q What is driving the demand for mid-market deals in Europe?

Demand is still largely driven by private equity sponsors that have plenty of capital

to put to work. I think the current environment is conducive to M&A activity, and we have seen a sharp increase in dealflow, although one must be vigilant given market conditions. We have seen deals failing due to poor credit quality, poor due diligence results and unrealistic price expectations. So, sponsors are not just running around desperately trying to spend their money, they are capable of walking away and being reflective of market conditions.

Borrowers see the benefits of working with a fund – certainty of delivery, working with only one lender and the ease of obtaining follow-on capital for the right deal. If it's a hot market and the banks go high on leverage and low on pricing, history shows that may not be good for the market in the long run.

Q Are you seeing more cross-border opportunities and, if so, what kind of support do these portfolio companies need from a private debt investor?

That is definitely something we've seen. Buy-and-build strategies can be cross-border rather than just geographically distinct, especially for larger companies. There are opportunities to grow businesses but they bring with them certain complications. Our experience of cross-border transactions and structuring in these circumstances can be beneficial to our invested companies.

Internationalisation can open up opportunities and it can be trans-continental as well as pan-European. Businesses might want to expand into the US or Asia, and again that's something we can help with. Currently we have a couple of situations like that, one sponsorless transaction which has gone very international in both directions, and another sponsor-driven looking into the US. You can start with a good-sized position in a business with a strong management team



Graeme Delaney-Smith

and then expand it with a strategy that you've really bought into.

Q Are there any particular sectors that are favoured for buy-and-builds?

We have seen them across a number of deals in retail where brands can travel, and we have seen it in technology businesses. Those are two examples, but I'd say it's quite a broad range of sectors where buy-and-build is applicable.

If you've got a mid-sized business in the US or Europe, you can grow it in its own market and create good value. Internationalising a business may be a better way to create value more dynamically, it can increase the value but also open up a broader universe of potential growth and/or exit options.

Q Are there any regulatory hurdles that can make cross-border deals challenging when expanding into the continent?

We as a business are heavily regulated anyway. The portfolio companies will certainly look into the regulatory aspects before embarking on a buy-and-build. I don't think Brexit will change things much, as businesses have always had to

be cognisant of the regulations of a new jurisdiction, it's just about making sure the due diligence is done up-front.

Q How do you view current market conditions?

Positively would be my observation. There is solid economic growth, more dealflow and a good current environment for M&A. We are continuing to see a steady rate of deployment across the European market without terms deteriorating to the point of the more liquid markets. Given our size and reach we have been able to be involved in some of the larger deals across the market, some we have passed on, but there is less competition amongst funds at larger deals sizes.

People worry about the number of funds in Europe and the amount of capital being raised, but we're not at saturation point. There remains a lot of transactions not currently involving funds, so we have a long way to go and market share to take.

We still focus on the first lien part of the structure and, while there are an awful lot of deals, we're being very selective. It's a growing strategy and the team is growing as a result. We find there is no shortage of the right type of candidates to meet our team building aspirations.

As the portfolio grows, the task of monitoring becomes more fundamental, and as we get later into the credit cycle we are looking to identify early signs of stress across the market. With this in mind, we are expanding our internal monitoring team and will continue to do so as the strategy expands.

The market appears to be set fair for a while, but you have to recognise that we're quite a long way into this cycle, given that cycles normally last around 10 years, and there is plenty of talk about issues, each one of which could create a change in outlook. ■