ALCENTRA

Bespoke service

Alcentra's European direct lending team, a long-lived market leader, emphasises bespoke service for its investors and borrowers alike

Longevity is not something that most European direct lenders can boast. The year they were established is something that some managers go to great lengths to avoid mentioning. And while it may seem faintly ridiculous to be so coy about an institution's youth in a still pretty new asset class, it's possible to find managers who will tell you everything but the firm's year of foundation because ultimately – length of service matters.

In the race to become a market leader in an increasingly crowded market, a firm with extensive credit experience, a longstanding team, and a robust infrastructure is at a clear advantage.

So Alcentra, which was set up in 2002 to tap the tradable credit markets before establishing a mezzanine platform under Graeme Delaney-Smith in 2004, has an intrinsic edge and investors have been taking notice. Importantly, it is one of a very small number of European direct lenders that can credibly claim to be more than 10 years old.

"By and large, our current investment activity is an extension of a base the team set pre-crisis. It's very much the same relationships, the same geographical locations, and we feel this is an important aspect of the Alcentra platform," says Graeme Delaney-Smith, Alcentra's head of European direct lending and mezzanine investments.

Graeme Delaney-Smith

But while playground squabbles may be settled by the age trump card, longevity alone won't get you far in this business. Alcentra's team prefers to emphasise their collective experience and strong long-term performance.

FINANCINGS

The team raised €1.5 billion in commitments in a first round of financing between 2013 and 2014 for direct lending investments in Europe and the UK.

The firm is currently in the midst of a second round of financing and is targeting at least €1.5 billion of commitments.

Delaney-Smith declined to comment on fundraising but did agree to answer questions about the European direct lending market.

Pascal Meysson

On deployment in a competitive market, Delaney-Smith says that the team is confident it can continue to deploy at the same pace as their first round of financing given the combination of their strong deal-flow and favourable market position. "The first round of financing was €1.5 billion in total size. That was deployed in an 18-month period and we continue to deploy at that pace so, as we look at the next three-year time horizon, we have the capacity for a larger pool of capital," he notes.

European direct lending is certainly having a moment with investors. Several multi-billion funds have been or are being raised. The immediate effect being an increase in the size of deals that managers like Alcentra can execute.

At the moment the firm makes loans of between €30 million-€150 million to corporates with enterprise values ranging from €50 million-€750 million. Target net returns are in the high single digits – something that has not changed for the new fund.

But that will not necessarily automatically increase the lower-end of the range, he adds. An ideal borrower for Alcentra is one that grows over time, where the firm can develop a relationship and refinance and increase the size of facilities for the company as the business develops.

Writing a large cheque just for the sake of it, is not the aim for Alcentra. "We're seeing tiering amongst the funds able to undertake the larger transactions. You're getting different pricing strategies," explains Delaney-Smith.

"We're sourcing and arranging our own deals and aim to be the sole lender in the vast majority of situations. We can achieve higher returns by tailoring financings to the requirements of a particular borrower. Smaller and newer funds have been more focused on participating in club deals sourced and originated by the banks, and consequently their return targets are going to be lower than what we achieve".

THE TALENT

The European direct lending team is now 16-strong and includes a number of investment specialists who have been with the firm for a number of years. The investment team focuses on specific jurisdictions but all have responsibility for deals from sourcing and credit research, to execution and monitoring.

Pascal Meysson has worked with Delaney-Smith since the latter came on board to lead the mezzanine effort in 2004. He focuses on direct lending opportunities in France, Spain and Italy.

Meysson explains that France, as the second largest market in Europe for alternative lenders, is an important jurisdiction for Alcentra, and one in which it has been very well established for a number of years.

"The French market has been very active since 2010 but with the same deals being passed around rather than new and fresh transactions. We mostly focus on healthcare, business services, and other non-cyclical industries but we are starting to look again at consumers in France, albeit cautiously," says Meysson.

Meysson also adds that "Spain and Italy have recently become increasingly interesting jurisdictions, as the macro economic environments have stabilised. Alcentra arranged direct lending financings in both jurisdictions."

Natalia Tsitoura

In the UK, where alternative finance is well established, Natalia Tsitoura who has been with Alcentra since 2006, points out that the more competitive market has prompted an increased focus on non-sponsored deals, currently 30% of the firm's portfolio. Sponsorless transactions are an important and growing part of Alcentra's direct lending strategy. These transactions are more difficult to source, but generally offer more attractive risk-return and control characteristics versus sponsored transactions.

It would be easy to assume that Patrick Ordynans, who joined Alcentra three years ago and is responsible for DACHS (Germany, Austria and Switzerland) coverage, has the hardest job. The German market is notoriously liquid with willing bank lenders and tight pricing.

But Ordynans points out that the number of deals done by alternative lenders in the region has grown spectacularly in recent years and that the product will continue to be competitive even in a scenario where the banks resume activity.

"You don't need banks to disappear

for alternative lenders to justify their existence," says Ordynans. "There's clear demand for a product that's characterised by flexibility and deliverability, rather than the lengthy, one-size-fits-all approach of the banks historically."

Delaney-Smith agrees: "This isn't a witch hunt against banks. This is a real location of capital across the market in a more efficient manner, similar to the evolution which took place in the US market since the late 90's."

THE PRODUCT

The last few years have seen rapid development in the European direct lending environment. It has moved from being a niche area to a well-established financing option in the continent's largest markets and is growing rapidly across the rest of Europe.

But the number of managers calling themselves direct lenders has proliferated and differentiation between lenders is getting more difficult.

For Alcentra, having hands-on experience through many credit cycles, including a "horrendous downturn", is a clear advantage. As Meysson notes, both investors and sponsors know that Alcentra can manage through difficult situations and have enough experience to make reasonable decisions in tough times.

"It's having people within the platform that you can call on who've been through a number of cycles and downturns, people who have been in difficult negotiations with shareholders and management teams. We've done it already," adds Delaney-Smith.

More important in this growing and ever more competitive market is having an edge on deals, say the team.

"We spend a lot of time with management and private equity houses to truly understand what the needs of the business are and how best we can accommodate them," says Tsitoura. "Everything

Patrick Ordynans

from covenant headroom, to capex, to further facilities they might need. It's genuinely a very bespoke package and people tend to respond well to it."

And that bespoke approach also brings in repeat business. By December 2015, the team had executed three deals in the new fund, two of which were add-on facilities for existing borrowers.

Anesco is an example of the kind of deal that the Alcentra team say makes their approach stand out.

The UK's leading provider of energy efficiency solutions first borrowed from Alcentra around 12 months ago to back the acquisition of CBPE. In December 2015 the deal was refinanced with an upsized unitranche facility to support the company's continued growth in its core energy services as well as to allow it to expand its energy portfolio into new areas. The refinancing also allowed the shareholders to receive a small dividend

Since Alcentra invested in the business, Anesco has continued to perform strongly.

Alcentra view their role as boosting the value of the company, to nearly the same extent as private equity sponsors. Delaney-Smith explains: "What we're trying to do is help the business trying to create equity value. That's obviously true in sponsored deals but it's also the case in non-sponsored deals where perhaps they need a bit more input. Walking them through our thinking and how we end up with a particular structure also helps management think about how they achieve their next five-year business plan."

Asked for the most recent examples of deals where the structuring made a difference for the borrower the team immediately provided a few illustrations.

The firm financed Inflexion's acquisition of Alcumus in October 2015 moving swiftly shortly after to provide an add-on facility to back Alcumus' £47 million purchase of Santia Consulting.

Tentamus, a recently completed transaction in Germany is a good example of why private equity funds would chose a debt fund as a financing partner for an acquisitive growth strategy. Alcentra replaced a banking structure at rather conservative leverage levels but with increased flexibility in order to allow management to pursue an active buy and build strategy.

"Some funds out there will just throw an extra turn at it or reduce the pricing. We will be aggressive when it's merited but we will also spend a lot of time on the business and what's best to keep the balance sheet efficient going forward," says Delaney-Smith.

Through their established institution, deep sourcing network, experienced team and ferocious focus on only executing strong deals, Alcentra's European direct lending team are now looking to a strong second fund and beyond. ■