ALCENTRA

Catering to larger appetites

With the ability to do deals across a broad size range, Alcentra is increasingly seen as an alternative to the syndicated and club deal market. **Graeme Delaney-Smith**, managing director and head of European direct lending, explains why

As evidenced by its recent $245 million unitranche investment in clinical solutions firm Lumenis, Alcentra is increasingly finding itself a favoured choice for larger transactions. In the interview below, Graeme Delaney-Smith reflects on why this is the case as he offers his opinions on current market conditions, competition, and the future of the private debt asset class.

Q How do you perceive the state of the market at the current time?

The market is very busy and there are a large number of projects, although the credit quality of some deals is not as good as it was a couple of years ago. It's a natural working through of the cycle where some poorer companies have come to market and the leverage and price expectations are being pushed. You see it a lot in the syndicated market where there has been a lot of repricing. In the mid-market, there's a bit more discipline and reality. The relationships are very different and pricing is more resilient in the mid-market. The fact is, we're in a cycle and we've seen a number of them before.

Q Do you see many competitive pressures developing?

Not really, you always get people who justify their actions on pricing or leverage – for example, they need to be seen completing deals in order to get a fundraising away. Up to now, that kind of thing has been one-off in nature rather than a trend I would say. Our advantage as a firm is that we are a larger player, which means we can look at a wide range of deal sizes and across the balance sheet.

It's interesting that recently there has been talk about consolidation – we've seen it in the US but only indirectly in Europe where there is more focus on market growth. There could be the odd opportunity here and there in Europe but I don't see it as a large trend. Further down the line it's possible that consolidation could become more of a necessity for some.

We have seen some funds that are flexible in strategy and could move more towards secondary trading if there's a market wobble.

Graeme Delaney-Smith

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Q What level of return is acceptable to investors, and are these expectations likely to be met?

Investors are quite clear about what the different strategies are and acceptable returns depend on which part of their balance sheet they are investing and how they view the risk/return profile. We've been discussing different return strategies with LPs and they generally have parameters around it that reflect the risk/return profile.

Ultimately, though, I guess it's all viewed relative to the returns they can get from other asset classes. Avoiding the volatility you might get with more public investment options makes private debt attractive. The volatility of public markets is a scary prospect and could continue to be so over the next 12 to 24 months given certain developments in the US and Europe.

Q What is the significance of having a certain size and scale?

Our advantage is not just to do with size and scale, it's also the longevity of the team and the sustainability of the business. We also do a bit of education about the market and what's possible.

Over the last 12 to 18 months we've been asked to look at larger companies and bigger debt tranches, where we are seen as an alternative to syndication and large club deals. People can deal with us on a bilateral basis and take comfort from the certainty we offer and the fact that we can move efficiently through the documentation phase.

We will continue to look at the full range of deal sizes and smaller and mid-sized deals, as that's a very important part of the universe, but if it gets easily accessible and the banks push back in, we have the ability to wait until market conditions improve there while still deploying capital somewhere else. Over the last 12 to 18 months we have invested in six to eight deals that have been €100 million-plus.

Q What evidence is there of private debt moving into the mainstream?

When you look at fundraising, a lot of capital has been raised over the past few years but it's indicative of the opportunity, which we think of as a long-term opportunity. We still find some investors looking at the market for the first time. It's attractive because it's private, you get deal origination, the documentation and transparency are good, we provide thorough monitoring of our investments and you take away the concerns around marking to market. You also get cash yield and the returns are competitive.

There's a lot of talk about the liquidity premium versus public markets but that comes with marking to market and I think investors are increasingly seeing private debt as a long-term opportunity because it's less volatile and offers a good relative return compared with other asset classes. We're seeing private debt go more mainstream and in the US the BDC option has been around a long time now for those concerned with liquidity. Europe may also eventually offer that opportunity.

Q There has been talk about the fund/bank relationship becoming more collaborative. How do you see things evolving?

Things have developed well. We have understandings and arrangements with a lot of banks. People wonder how the model will change, but in my view the banks never went away and their business model is still highly relevant in certain areas. We do, however, see a reallocation from banks to funds to provide capital to companies. Those companies need banking services, while we provide the long-term capital – that's where the business models coincide.

But it's true to say the banks may have an issue with pricing risk. In a bull market they will tend to increase leverage and accept lower margins and that's how you end up with credit cycles. They do it to protect their market share but it leads to boom and bust as leverage becomes cheap and when there's a slowdown, the effect gets magnified. ■

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ALCENTRA QUICK FACTS

Formed: 2002

Offices: London, New York, Boston, Singapore, Hong Kong

Targeted investments: Secured loans, high yield bonds, direct lending, mezzanine, special situations, structured credit, multi-strategy

Recent investments include: Lumenis, clinical solutions; Alcumus, technology-enabled risk management; DESK-HLF Group, multi-function printer and copier sales and maintenance