PEMBERTON

Private Debt in Benelux

A LONG-TERM PARTNER FOR COMPANY GROWTH

GEOGRAPHIC SERIES

Introduction

The Benelux region is at the very centre of Europe. Though relatively small in area, it has a dynamic, internationally-minded small and mid-cap (SME) sector that increasingly sees private debt as its funding of choice. As the region bounces back from the Covid pandemic, we expect direct lending opportunities to increase.

July 2021

Why invest in Benelux?

Region punches above its weight

Political and economic stability are the hallmarks of the Benelux region, which comprises Belgium, the Netherlands and Luxembourg. Relatively small geographically – the Netherlands are about twice the size of the US state of New Jersey – these countries have long punched above their weight. Internationally minded by history and necessity, they have had relatively open economies for centuries, and since the 1950s they have been at the centre of moves towards European unity – the EU Commission is based in Brussels.

The total population of the region is approaching 30 million – 17.1 million in the Netherlands, 11.6 million in Belgium and 0.6 million in Luxembourg – but in terms of GDP they are European middle-weights[1]. The Netherlands rank fifth among EU countries by nominal GDP, behind Spain but above countries with much larger populations, such as Poland. Belgium ranks eighth, between Sweden and Austria, while Luxembourg has a higher GDP than European countries with a much larger population such as Bulgaria or Croatia[2]. Unemployment in the Netherlands is low by EU standards at 4.4%, while is Belgium it is a little higher at 5.1%[3].

In the years running up to the Covid pandemic, the Dutch economy had been growing in a range of 1.5-2.5%. During 2020 GDP fell by an estimated 7.4% but the forecast for 2021 is growth of 3%[4]. The Belgian economy was growing by around 1.5% annually before Covid. It shrank by about 8.3% in 2020 and is forecast to grow by 5.4% in 2021[4].

Belgium has been one of the European countries more affected by Covid, with a death rate of 217 per 100K population as of early June 2021[5]. That compares with 103 per 100K in the Netherlands, and 107 per 100K in Germany. But after a slow start, vaccination rates are increasing steadily across the EU. In Belgium 33% of the population had been fully vaccinated as of 25th June, compared with 32% in the Netherlands and 35% in Germany[6].

Service-based and internationally focused

The region was early to industrialise in the 19th century – Belgium was the second European country to do so after the UK – but as elsewhere in Western Europe services now dominate, accounting for about 70% of the economy across the region. That is attractive for private lenders who are typically looking for companies that offer predictable cashflows. Within services, B2B businesses are also generally more attractive than B2C because their cashflows are more predictable.

Dutch companies in particular often have a very international focus. Royal Dutch Shell and Unilever are two genuinely global Dutch companies, but many smaller corporates find it natural to look beyond their local markets, both within the EU and beyond. That attitude is appealing to both private equity and private debt investors looking for companies that can successfully internationalise.

1. https://www.statista.com/statistics/946347/population-of-the-benelux-by-country/
2. IMF World Economic Outlook, October 2020. https://www.imf.org/en/Publications/WEO/weo-database/2020/October
3. Unemployment by sex and age - monthly average. https://ec.europa.eu
4. IMF, World Economic Outlook Database, October 2020. https://www.imf.org/en/Publications/WEO/weo-database/2020/October
5. https://coronavirus.jhu.edu/data/mortality
6. https://coronavirus.jhu.edu/region

In the Netherlands there is a strong and well-developed mid-market corporate sector. SMEs account for a larger proportion of value added than the EU average – 62% compared with 54%[7]. Innovation and digitisation are an important part of the Dutch SME policy-making environment, and the Netherlands ranks well above the EU average in terms of government responsiveness to SME needs.

Belgium is also substantially above the EU average in terms of value added by SMEs, at 63% vs 54%. The Belgian government has launched regular policies to help SMEs but we believe there is still more to be done in boosting entrepreneurship and reducing the administrative burden on SMEs in the country[8].

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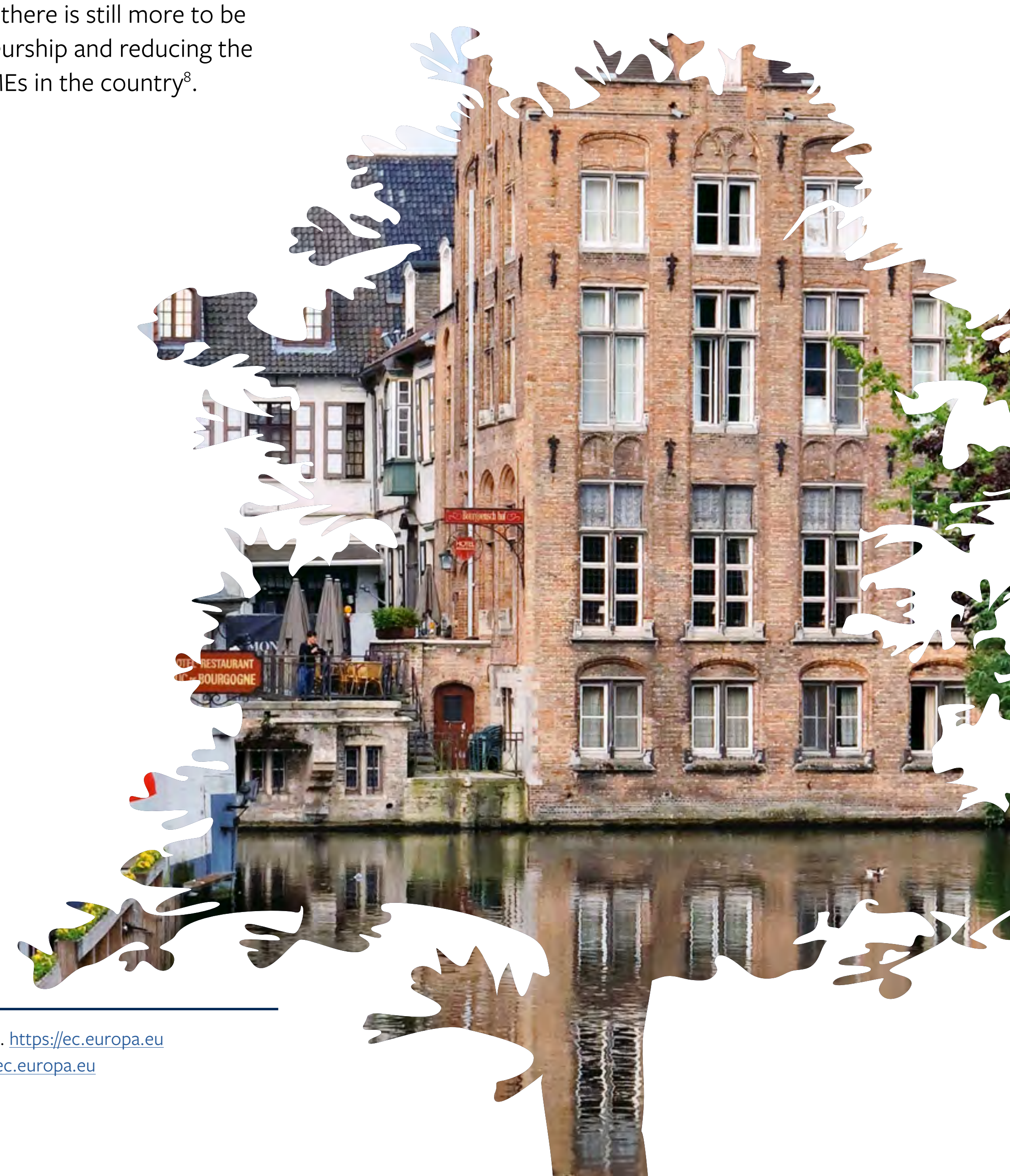


7. 2019 SBA fact sheet – Netherlands. https://ec.europa.eu
8. 2019 fact sheet – Belgium. https://ec.europa.eu

The growth of direct lending in Benelux

As elsewhere, the growth of private equity investment has been the main driver behind the development of private lending in the region. Consolidation by the domestic banking sector has also left growing scope for private lenders, especially in the Netherlands.

Private equity is the driver

Since the beginnings of private debt investment in Europe in 2010 up to the end of 2020 there were 160 direct lending deals in the Netherlands, 51 in Belgium and 25 in Luxembourg, giving a total of 236 for the Benelux region[9]. That represented 8.8% of the European total, and 13.7% of the total ex-UK. There were a further 19 transactions that closed in Q1 2021[10], 60% of them new financings.

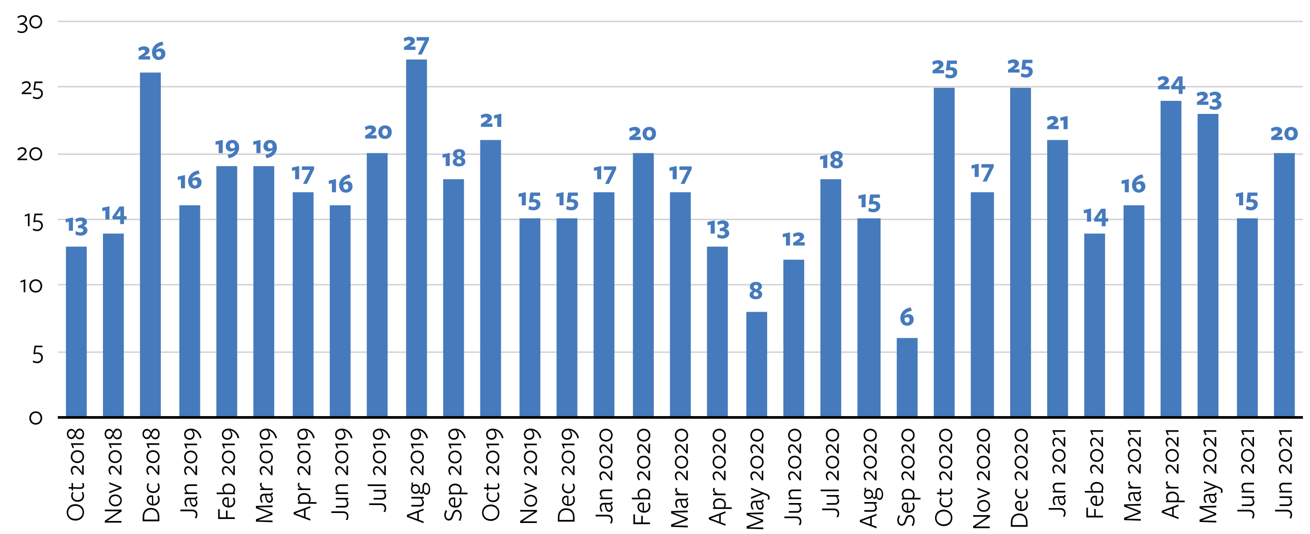
As elsewhere in Europe, the growth of direct lending has been driven by private equity investment and, more broadly, M&A activity.

A relatively large percentage (14%) of Dutch GDP comes from PE-owned companies and over 1,400 Dutch companies have PE or VC owners[11], employing 380,000 people and with a combined annual turnover of €87bn. Dutch family offices developed after the Second World War, and attitudes to private equity and debt have long been much more positive in the Netherlands than, for example, in neighbouring Germany.

There has continued to be a steady stream of PE deals in Benelux during the Covid pandemic in 2020 and YTD 2021. There were quieter months in April and August 2020 (with 8 and 6 deals respectively in the region), but September 2020 saw a return to the highs of 2019 with 25 deals, and the monthly total has been in the range of 14 to 25 since then[12].

There is also every expectation that this will continue. As of June 2021 there was approximately €375bn of PE 'dry powder' that could be deployed in Europe[13].

Figure 1: PE deals in Benelux October 2018 to June 2021



Source: Mergermarket.

9. Deloitte Alternative Lender Deal Tracker – Spring 2021
10. GCA Altium MidCap Monitor Q1 2021
11. https://nvp.nl/en/
12. Mergermarket data
13. Preqin data

Cashflow financing by private lenders is also highly developed in the region, although more so in the Netherlands than in Belgium. The direct lenders active in the region fall into three groups. There are a handful of local players that are generally active in the €10m-20m deal-size range. There are also international lenders that aim to serve the region from a main office, for example in London. But we believe there are no more than four lenders like Pemberton i.e. international players with a local office, in the Dutch Market.

"Despite their openness to external influences, these are markets where local knowledge and presence are surprisingly important for sourcing and securing deals, then managing a portfolio," said Boris Harmsen, head of Pemberton's Benelux office. There is also a strong network of local legal advisors to provide support.

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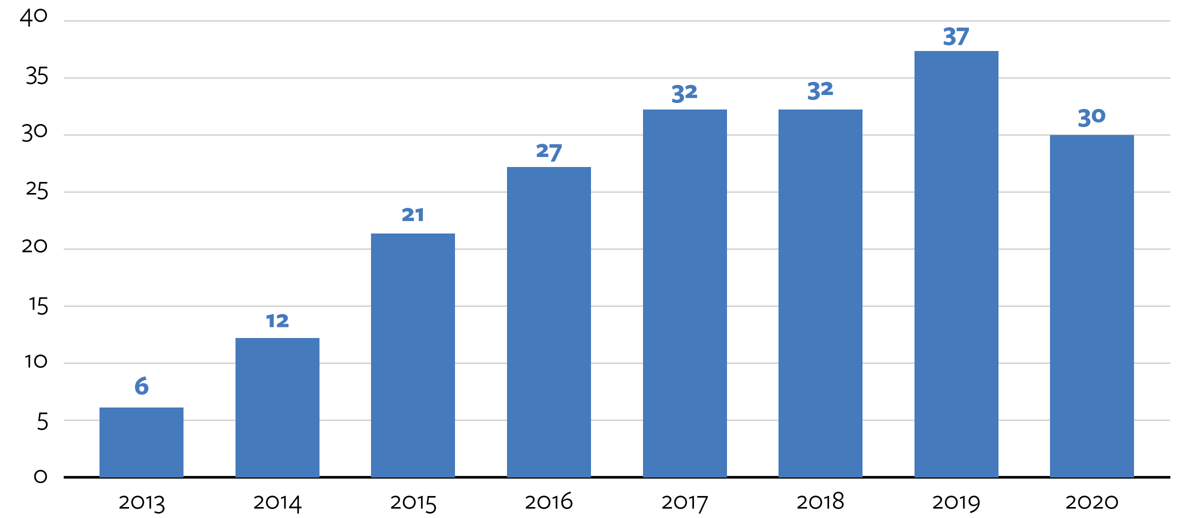
Figure 2: Private Debt deals in Benelux 2013-20

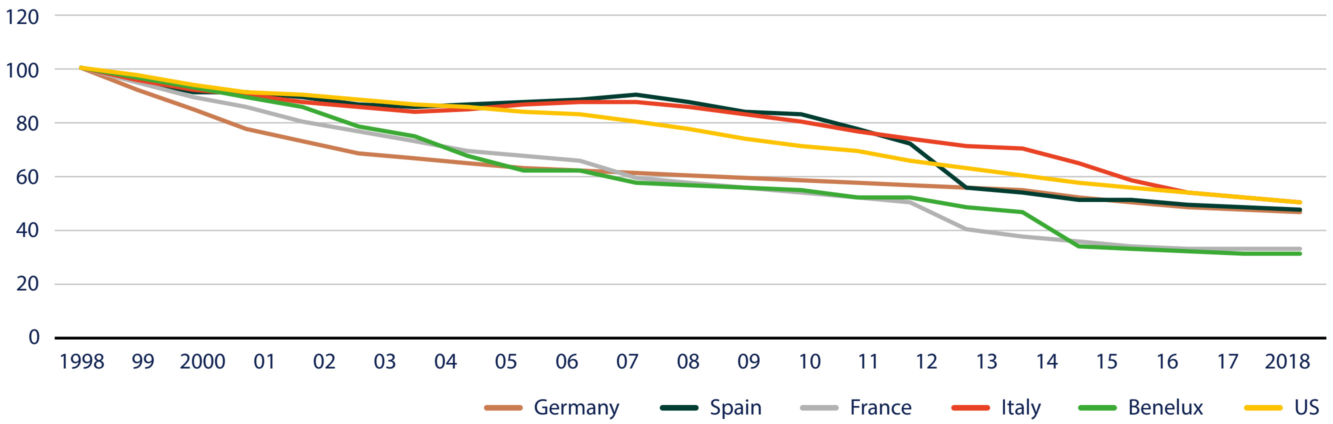


Source: Deloitte ALDT 2020.

Advanced banking sector consolidation

As in other European countries, there has been a steady process of concentration in the domestic banking industry. Overall, the number of credit institutions in Benelux reduced by over 60% from 1998 to 2018, a more significant reduction than in Germany, Spain, France, Italy or the US[14].

Figure 3: Number of credit institutions by country in Europe 1998-2018



Source: European Direct Lending – Review and Outlook, Pemberton and Saïd Business School, University of Oxford, 2021. Number of credit institutions rebased to 100% as of 1998 levels. Data source: European Central Bank and the Federal Reserve Bank of St Louis.

"The local Dutch banks' exposure to certain sectors – such as oil & gas and mortgages – have capital requirement implications that make it hard for them to deploy funds for cash lending. That has meant growing scope for direct lending, which has become the first choice for SMEs in the Netherlands," said Pemberton's Harmsen.

Belgium is a rather different prospect. Traditional banking has been more resilient than in the Netherlands, but increasingly Belgium's banks are looking to cooperate with private lenders. So while private lending is at an earlier stage, the upside potential is very clear. In particular the Flanders region (which shares a very similar language and culture to the Netherlands) has a strong, entrepreneurial business community that is likely to fuel the further growth of direct lending in the country.

Another attraction for private lenders is that the Dutch legal environment is relatively benign for creditors compared with France or Germany, so it is fairly easy for lenders to vest security rights. In recent developments, a Dutch Chapter 11-like structure came into force in January 2021[15].

In Belgium the legal situation is closer to the French model, and lenders often use Luxembourg's capital structures to provide better credit protection.

14. European Direct Lending – Review and Outlook, Pemberton-Saïd Business School, University of Oxford to 2021 – page 4
15. European Direct Lending – Review and Outlook, Pemberton-Saïd Business School, University of Oxford to 2021 - page 39

Pemberton's commitment to Benelux

Pemberton has had a local Benelux office (in Amsterdam) since 2019. Overall, the firm tends to focus on food, business services and pharmaceuticals, which makes the Benelux region a natural area of interest, and the seven investments to date in the region include two large food companies and an IT integrator. As in other markets, Pemberton's ESG considerations exclude from consideration sectors such as weapons manufacturing.

In the year to 30th June 2021, Pemberton was mandated to deploy €509m in Benelux across a number of strategies. This was the fourth highest amount for any country/region after the UK & Ireland, France and Italy.

"We have been able to support local sponsors with LBO financing throughout the Covid pandemic," says Pemberton's Harmsen. "For example, while Europe was in lockdown, we were able to support private equity sponsor Parcom with its buy-out of Project Artisan. Being local helped to maintain dialogue with the local investment team by being able to meet face-to-face." (See box Figure 4 for more on this deal.)

"This is also a good example of Pemberton's thought leadership in the food space. Food is a sector that we know very well and which has shown resilience throughout the various cycles, from the Global Financial Crisis to Covid," Harmsen added.

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Figure 4: Pemberton's Benelux deals to June 2021

Project name	Sector	Sponsors	Notes
Paris	Beverage and food	Pamplona Capital Management	LBO
Artisan	Beverage and food	Parcom	LBO
Falkenstein	High tech industries	Carlyle	LBO
Koda	Hotels and leisure	Triton	LBO
Dune	Durable consumer goods	EQT Partners	LBO
Tiny	Consumer services	HIG Capital	Growth capex
Diamond	Capital equipment	EQT Partners	LBO

Source: Pemberton Asset Management.

CASE STUDY

Funding a Dutch market leader

Founded in Tilburg in 1997, the company has developed into a Dutch market leader in the production of high-quality artisanal meat products, with a focus on sausages and minced meat. It had shown impressive growth in recent years and benefits from a strong market position in the high-quality artisanal meat space.

The company differentiates itself through its high quality standards, smart product marketing, constant innovation in its production and procurement processes, and a keen eye for spotting new trends in the industry, such as American-style BBQ products, gourmet burger restaurants and street food. Its broad range of high-quality meat and sausage products is primarily distributed by leading retail chains in the Netherlands, Belgium and Germany.

In 2020, Dutch investment firm Parcom Private Equity wanted to acquire the company from Equistone Partners Europe. Parcom, a very experienced investor in the food sector, believed that the company had significant potential in the integration of recent acquisitions, through organic growth and by adding new product categories to its portfolio via further add-ons.

Pemberton also has a long track record of investments in the food sector, a sector that had shown resilience during the Covid-19 pandemic. During a time of limited international travel, Pemberton's presence on the ground (thanks to its Amsterdam office) enabled it to work closely with Parcom and the company to ensure a smooth and robust process, benefitting all parties.

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